

Report of the Auditor General to the House of Commons for 1993

Introduction

The principal functions and responsibilities of the Auditor General of Canada are set out in the Auditor General Act. My responsibilities in respect to those Crown corporations for which I have been appointed auditor are set out in the Financial Administration Act. The Auditor General Act is included as Appendix A to this report and the relevant sections of the Financial Administration Act as Appendix B.

The financial statements of the Government of Canada for the fiscal year ended 31 March 1993, which have been prepared by the Receiver General for Canada in accordance with the provisions of section 64 of the Financial Administration Act and appear in Volume I of the Public Accounts of Canada, have been examined by me as required by section 6 of the Auditor General Act.

In compliance with section 7 of the Auditor General Act, my report for 1993 is presented herewith.

As auditor of the accounts of Canada, including those relating to the Consolidated Revenue Fund, I conducted such examinations and inquiries as I considered necessary to enable me to report as required by the Auditor General Act.

With respect to the matters reported, departments, agencies, and the Privy Council Office provided my Office with the information and explanations required to date, including Cabinet documents.

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Chapter 1

Matters of Special Importance and Interest

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Matters of Special Importance and Interest

Main Points

1.1 Chapter 1 focusses on some intractable issues that, if addressed, could help Parliament respond to the challenge of balancing citizens' expectations with reduced fiscal manoeuvrability. Most of these long-standing issues have been well studied and solutions have been proposed. It is time to overcome the resistance in the political and bureaucratic culture to their implementation.

1.2 Opening up the budget process. Very few government documents have the potential to affect the lives of Canadians more profoundly than the budget. There is a compelling need to reconcile the convention of budget secrecy with open consultation and debate, to allow parliamentary input before final decisions are made.

1.3 Information for Parliament. Most of the time Parliament is not provided with adequate information on the results that departments and Crown corporations have achieved with billions of dollars of taxpayers' money.

1.4 Information to support ministerial decision making. Ministers, deputy ministers and senior managers often are not getting the financial and performance information they need for strategic and operational management. To address this situation, strong comptrollership within the government is not just something that would be nice to have, it is something that the government must have and that Canadians have a right to expect.

1.5 Program evaluation. The government will need to ensure that it has in place the requisite analytical capacity to deal with the tough questions on the effectiveness of government programs. The problem is that, based on the Office's government-wide findings, I am forced to report that the present evaluation regime is not working as intended to answer these questions.

1.6 Interdepartmental co-operation. An important challenge for government in the twenty-first century is the effective delivery of services that involve several departments. This could be improved by ensuring that lead departments bring forward clear accountability information on the achievements of all departments involved.

1.7 Administrative reform. Lessons learned from studying reform initiatives in other jurisdictions stress the need for a coherent approach. In Canada, there is a need to revitalize Public Service 2000 and put this important reform initiative in the broader context of any other initiative, such as plans to contain the deficit and to restructure and redefine the role of government in society.

Introduction

Challenges for a New Parliament

1.8 Each successive Parliament faces a new set of challenges and opportunities. Although many of the essential issues remain the same from one Parliament to the next, relative priorities may change, along with the sense of urgency that the government of the day attaches to them. This autumn brought Canadians a new Parliament. The adjustment that Canadians are having to make to new fiscal realities on the eve of the twenty-first century will affect Parliament's concerns and priorities. Canadians are concerned about preserving their standard of living, their quality of life, and their national institutions and values.

1.9 Today it is clearer than ever, to both public servants and parliamentarians, that Canadians expect them to demonstrate sound and prudent management rather than finding new ways to spend borrowed money. There is a growing consensus that the country must confront the deficit to maintain the integrity of our institutions. People are realizing that the more the country spends on servicing the debt, the less it has available to spend on services to the public.

1.10 I believe we are in a new era when it comes to both political behaviour and public expectations: an era when the current economic climate requires timely decisions to maintain our standard of living. Inaction or delay today can limit our choices in the future.

1.11 The government is entrusted with the role of addressing citizens' concerns. It must try to balance what is wanted with what is affordable. This arduous task of weighing the relative priority of national objectives requires proper information, and a proper forum for informed debate and dialogue.

1.12 Parliament's role is to approve or deny expenditures and authorize revenues and borrowings; currently, there are some intractable issues that constrain this role. Some of these issues have been on the agenda for decades. Solutions have been well researched. Addressing them could help Parliament respond to Canadians' uncertainties about the deficit, employment, the environment, international aid and other concerns.

Intractable Issues

1.13 In this context, an intractable issue is one that is not easily dealt with because it is complex and it challenges the status quo. Several such issues are raised, in one form or another, in this Chapter and throughout this Report:

reconciling the need for secrecy with the need to involve Parliament in the budget process;

encouraging departments and agencies to report in clear, global terms that would render a meaningful account of their stewardship by providing Parliament with results-oriented information on significant expenditures;
ensuring that program evaluation asks the tough questions and assesses significant expenditures;
encouraging departments to co-operate in delivering services that cross departmental boundaries;
providing ministers and their deputies with sound information needed to manage departments efficiently and effectively; and
effecting administrative and public service reform.

1.14 What is troubling about these issues is that most have been studied for decades, and recommendations have been made by senior public servants, politicians and outside experts. In many cases there is a broad consensus within the bureaucracy and the political sector on what needs to be fixed. Yet effecting reform in these areas has been elusive.

1.15 The need to open up the budget process is dealt with in the next section of this chapter. The need for better information for Parliament is addressed in sections of the chapter that deal with information on debt and deficit, statutory programs, program evaluation and a case study on the Canadian International Development Agency. These are followed by a section dealing with the need for departments to work together. The important issue of information to support departmental decision making is addressed in my comments on the restructuring of the Office of the Comptroller General, later in the chapter. And finally, the need for political leadership and support of public service reform is dealt with near the end of the chapter.

Producing Relevant Information on the Debt and the Deficit Is Only Half the Battle

"The budget of today is a major event. . . . it is a complex, far-reaching statement . . . with significant bearing on social policy."

The Honourable Michael H. Wilson, Minister of Finance, May 1985

The Importance of the Budget

1.16 A modern budget occupies a central place on a government's agenda. In the early part of this century, the budget served as a routine report of the government's fiscal position and policy, occasioning little public interest and much less excitement. The budget of today is a major event, commanding both national and international attention. The annual budget affects individual Canadians - it sets levels of taxation for the coming year and sometimes signals changes in social programs. Externally, international lenders, investors and other governments have a keen interest in the budget. It can affect the value of the Canadian dollar.

1.17 The importance of an effective budget process is difficult to overstate. It is vital to a government's ability to function efficiently and effectively and to serve the people

responsibly. One of the constraints on parliamentary consideration of the budget is the convention of secrecy. Historically, in the Canadian and British systems, secrecy has been invoked to prevent individuals or specific groups from taking advantage of privileged information about the contents of a budget. This is one element of a broader, long-standing convention that members of Parliament are not privy to classified information routinely available to ministers. In my opinion, there is a compelling need to reconcile the convention of budget secrecy with open consultation and debate, so Parliament can fully play its role in responsible government.

Few opportunities to involve parliamentarians in the budget process

1.18 To understand further why it is difficult for parliamentarians to be involved in the budget process, it is critical to understand the annual budget cycle. An overall fiscal plan, with a forecast of the next and future years' revenues and expenditures, is tabled with the annual budget, usually in February. The timing of the budget is subject to some uncertainty, although in 1986 the government opted for the January-February period. Exhibit 1.1 assumes such timing. To establish the relationship between spending and revenue, an effort has been made to introduce the budget just prior to the tabling of Main Estimates, which is required by the rules of the House to be prior to March 1.

1.19 Today's budget is used to announce significant changes in spending, and in the pre-budget phase, crucial decisions are made on these, as well as on new tax issues and new program initiatives. During this phase, the critical work is done by the Department of Finance in consultation with Cabinet, but given the constraints of secrecy, consultation with Parliament is limited.

1.20 As stated in Chapter 5, "Information for Parliament, Understanding Deficits and Debt", deficits and debt are created when governments respond to demands by society for services. Accordingly, Canadians need to participate in discussions on the debt and deficit with their members of Parliament. Because the fiscal plan is usually not available in the pre-budget consultation phase, there is limited opportunity for parliamentarians to discuss the overall level of debt and the deficit and its components during this phase of the budget process. This is not to imply that parliamentarians do not have an influence under the present system. The government of the day knows that its budget will be challenged. The point is that providing opportunities for greater input earlier in the process, during the pre-budget phase, would enhance the role of parliamentarians.

1.21 The Main Estimates provide a detailed list of the upcoming expenditures for departmental programs. These are referred to the appropriate standing committees for review. There is no longer a single committee - it was once a committee of the whole House sitting together - that reviews the overall picture of expenditures. However, the House of Commons Standing Committee on Finance could be a logical focal point for receiving and discussing these questions by focussing discussion on the government's fiscal plan, the annual financial report and the indicators of affordability described in Chapter 5.

1.22 Next in the budget cycle, from March through May, standing committees have an opportunity to examine the Main Estimates in detail, before reporting them back to the House for concurrence and swift passage in Appropriation Acts. However, committees are spending less and less time on the Estimates. One major reason for this apparent lack of interest lies in the impact of the confidence convention, which, as currently interpreted, makes any motion to change a vote in the Estimates a potential test of the House's confidence in the government. Because failure to win a confidence vote leads to the resignation of the government, no changes can be made in the Estimates, even though committees have the power - at least in theory - to reduce or reject Estimates votes. The last time a voted expenditure was changed was in the minority Parliament of 1972-74.

Reconciling Secrecy with the Need to Involve Parliamentarians

1.23 The need to improve the budget process has been widely recognized for at least 30 years. Successive ministers of Finance have publicly expressed concerns about the budget process and particularly about the constraints that budget secrecy imposes on their preparation. In the 1960s, the Honourable Walter Gordon observed that "the old established tradition - according to which budgets are prepared in the Department of Finance, without consultation or discussion with other officials or outside experts, and without informing the Cabinet of what is going to be proposed until a few hours before presentation to the House - is out of date. . . ."

1.24 In his budget speech of May 1976, the Honourable Donald MacDonald said: "Two aspects of the budgetary process require particular study. The first is the strict rule of secrecy that applies to the budget prior to its introduction. The second is the procedure for consideration of the budget proposals following their introduction in Parliament."

1.25 In 1979 the Royal Commission on Financial Management and Accountability (Lambert Commission) recommended that, each year, the Minister of Finance present to Parliament a five-year fiscal plan that provides estimates of revenues, expenditures and the expected surplus or deficit. The Commission proposed that this be presented in late October, well before the submission of the annual Estimates and the tabling of the budget. This would provide an opportunity for debate focussed on the broad aspects of fiscal planning, which could deal with the government's priorities, how it proposed to fund them, and whether the appropriate balance had been struck between expenditures and revenues. Although fiscal plans have since been presented, none was tabled early enough to allow for the kind of thorough debate the Commission envisioned.

1.26 In 1982, the Honourable Allan J. MacEachen observed that "the extreme interpretation of budget secrecy does not take account of the broad economic and social role which modern budgets must play. . . . In this context, the concept of budget secrecy must be defined in a manner consistent with modern budget realities. . . ." A precondition for more meaningful pre-budget consultations is a redefinition of the tradition of budget secrecy.

1.27 The Honourable Michael H. Wilson stated in 1985 that ". . . it is clear that Canada's system for developing budgetary proposals and implementing budgetary measures has failed to keep pace with the needs of a complex government and a complex economy. . . . The government recommends that the convention of budget secrecy be examined and recommendations developed that will establish a reasonable interpretation of budget secrecy reflecting contemporary budget needs and realities."

1.28 In 1988, the Public Accounts Committee expressed concerns about the adequacy of Parliament's scrutiny of the Estimates. The Committee Chair noted that "the Public Accounts Committee examines government spending after the fact but parliamentary scrutiny before expenditures are made is not effective . . . since estimates of each department are examined separately and by different standing committees there is no overview of total government spending at that stage." The Committee recommended to the House that a new "budget committee" be set up to remedy these deficiencies, and that "the Government not consider a reduction in the Estimates as a matter of non-confidence."

1.29 The 1993 Report of the Liaison Committee on Committee Effectiveness favoured an approach that "would have ministers and senior officials discuss in committee in the early autumn proposed expenditures for the following year so as to make it possible for committees to offer views as to the spending priorities that the government could take into account in preparing its final estimates." The Committee observed in its report that standing committees see "little point in committing precious time to reviewing estimates that will not be modified as long as the government has a majority." The Committee regretted that it is "virtually impossible for members to carry out effectively their responsibility for scrutinizing government expenditure."

1.30 *Making Government Work* (Public Policy Forum, 1993) said that the "government's annual expenditure plan should be made public at a sufficiently early stage in the cycle to permit Parliament and the public to express views before final decisions are made."

1.31 A recommendation in April 1993 by the Standing Committee on House Management dealt with the convention of confidence. It stated that "with few exceptions, motions proposed by the government should be considered as motions of confidence only when clearly identified as such by government." The Committee felt that this, together with deleting some references to confidence in the rules of procedure, could help in opening up the budget process.

The Need for a Parliamentary Forum for Discussion of the Overall Picture of Debt and Deficit

1.32 In August 1993 the Honourable Gilles Loiselle, Minister of Finance, proposed changes to the budget process to make it more open and to permit more public input. These recommendations reaffirm the continued relevance of three decades of comments by ministers of Finance and by parliamentary committees.

1.33 This Office strongly supports any action that encourages members of Parliament to take an active and constructive approach to the financial affairs of our nation. Opening up the budget process and providing Parliament with more complete information in the autumn, including broad-based spending information, would allow for more informed debate and greater input from Parliament and the public. However, better information is only half the battle.

1.34 There needs to be a parliamentary forum for a rational discussion of the national finances and overall questions of debt and deficit. Chapter 5 suggests a framework for developing objective, understandable indicators of the nation's financial health. It notes the need for information on the longer-term implications of today's spending decisions and calls for a forum for discussion of that information.

1.35 To achieve this objective will require a reform of the budget process itself. There is an urgent need to re-think the rules and conventions regarding budget secrecy, what constitute matters of confidence, the need for parliamentary committees to look at the whole picture of revenues and expenditures and a new approach to reviewing statutory programs. The House of Commons Standing Committee on Finance could become an effective focal point for discussion of the overall debt and deficit. This matter is of such importance that it merits early and systematic attention.

Understanding the Impact of Statutory Programs on Fiscal Manoeuvrability

Each New Government Finds a Sizable Portion of Incoming Dollars Already Committed for Future Years, by Past Parliaments

1.36 Of the total net expenditures of approximately \$157 billion for the 1991-92 fiscal year, 70 percent were for ongoing commitments authorized previously through statutes. These statutory expenditures (approximately \$110 billion) include such things as public debt charges (which comprise just over one third of statutory expenditures), unemployment insurance benefits, pensions for seniors, and transfer payments to the provinces. Statutory expenditures are presented in the Estimates "for information only" and are not voted on annually by Parliament.

1.37 As illustrated in Exhibit 1.2, "Statutory and Non-statutory Expenditures as a Percent of Total Net Budgetary Expenditures", statutory expenditures have almost doubled in the past 40 years: from approximately 37 percent of total government expenditures in 1952-53 to 70 percent in 1991-92. The implication for fiscal manoeuvrability is that these statutory payments effectively are seen as immutable and beyond the routine annual scrutiny of Parliament. This is compounded by the fact that Canadians have come to view some statutory payments as "entitlements". Clearly, the review process is incomplete if Parliament does not conduct in-depth cyclical reviews of 70 percent of government spending. Such reviews are essential for ensuring the sustainability of programs and the long-term financial health of the federal government for future generations of Canadians.

1.38 Manoeuvrability may be further reduced by other contractual obligations that reflect past commitments. For example, annual expenditures made under various obligations of the Canada Mortgage and Housing Corporation for Social Housing Programs amount to almost \$2 billion, as reported in the Public Accounts for 1991-92. The Public Accounts for the same year estimate annual payments of approximately \$2 billion for the next five years under these continuing contractual obligations. In addition, they report contingent liabilities of just over \$26 billion to cover guarantees by the federal government for borrowing by Crown corporations or for other explicit guarantees, such as those made for the Hibernia energy megaproject. Obviously, not all of these will come due; however, any that did would further reduce manoeuvrability by reducing the discretionary funds available. Discretionary funds are further reduced by expenditures that reflect the government's past political commitments to aboriginal peoples, environmental protection, regional economic development, and research, to name but a few.

1.39 The government has recognized the need to increase future manoeuvrability by limiting expenditures today. For example, it has introduced the *Spending Control Act*, which has the objective of ensuring that program spending through to the 1995-96 fiscal year will not, with certain exceptions, exceed predefined limits. However, in my view there is a need to find ways to improve the system for Parliament's review of statutory expenditures. As discussed in the next section, the Lambert Commission focussed on methods to improve Parliament's review of these expenditures.

The Need to Support Cyclical Reviews of Statutory Programs

1.40 The Lambert Commission recommended in 1979 that "legislation for all new statutory programs, except those relative to interest on the public debt, require that funding lapse automatically at the end of the fifth year following introduction, and that renewal of such funding be authorized only after parliamentary review of the current and projected costs and benefits of such programs. . . ." The recommendations also called for existing statutory programs to be reviewed on a five-year basis, with a report on all reviews to be tabled in Parliament. These reviews would be referred to the appropriate standing committees for their consideration and recommendations. Chapter 8 in this Report, "The Case for Program Evaluation", recommends that the government do a better job of evaluating large statutory expenditure programs. My concern is that Parliament is not being provided with the information that would enable it to assess the desirability and affordability of sustaining these programs at their present levels, within the context of other commitments.

When parliamentarians see the long-term projections, they are concerned

1.41 Chapter 6 of last year's Report, on information for Parliament, noted the need for a reporting that reflects the broader duties and obligations of government. Parliamentary committees and government departments alike would be better served by cyclical, in-depth reviews of departmental "global stewardship", as part of the current system of annual parliamentary approval of the Estimates. There is an even greater need for this type of information on significant statutory programs, which are not voted through annual expenditure review. Part III of the Estimates currently provides Parliament with only

limited information on a timely basis about, for example, income security for seniors. The current consolidated costs of these programs and their projected future costs, together with information on their effectiveness, are not provided to Parliament in one convenient and accessible document. In using this as an example, the Office's intent is not to suggest the need to alter any of these programs but only to illustrate how the review system could be improved.

1.42 As noted in Chapter 18, "Programs for Seniors", seniors today are one of the fastest-growing segments of Canada's population. The population over 65 years of age in 1991 stood at 3.2 million (12 percent of the Canadian population) and is expected to rise to 18 percent by the year 2021. For 1992-93, the total federal expenditure on programs for seniors was approximately \$30 billion. In addition, tax incentives to those preparing for retirement represent an estimated \$12 billion a year in deferred and partially foregone revenue.

Parliament is not getting information on the future costs and the effects of programs for seniors

1.43 Society is faced with tough decisions on some extremely complex issues. These decisions will have long-term implications for millions of Canadians. Parliamentarians need information that will help them see total costs in the context of the nation's overall fiscal situation. Parliament needs a combination of information - information on intended and unintended effects of programs, and information on present and future costs. For example, future costs of the Old Age Security Program are projected to double by the year 2006, from the present level of approximately \$15 billion. Good financial information is required on an annual basis. However, on a cyclical basis, ideally every five years, Parliament needs analytical information, which would include the results of program effectiveness studies. Only when Parliament is provided with this type of information will it be in a position to assess the long-term implications and sustainability of statutory programs.

Government Needs a Strong Analytical Ability to Manage Intelligently and Humanely

Informed Judgments Combine Political Insight with Independent Assessment of Past Results

1.44 Last year's Report presented the Office's vision of departmental reporting to Parliament. The suggested reporting format addressed the need for stewardship information on the broader duties and obligations of government to preserve, maintain and foster the public enterprise. This stewardship information would be one aspect of the full disclosure necessary to maintain the confidence of Parliament; the other components are financial information and operational information. This year, three chapters in the Report focus on an important part of the content of departmental reporting: Chapter 8, "The Case for Program Evaluation", states the case for measuring results; Chapter 9, "Program Evaluation in Departments", describes the extent to which expectations of early proponents have been realized; Chapter 10, "Program Evaluation - Making It Work",

addresses some fundamental stumbling blocks to providing Parliament with information on results.

1.45 Since the 1960s, the results that program managers have tended to focus on have been outputs, such as the number of cheques issued for income support, rather than the previous input-oriented approach (i.e., the resources used in issuing the cheques). There is now a need for this focus to evolve further, to look at outcomes, such as whether income support may reduce the incentive to save for retirement. Obviously, it is technically more difficult to measure outcomes than outputs. The latter are largely internal numbers and are easy to identify; the former require careful measurement and analysis to draw correct conclusions. Although I recognize that it is intrinsically difficult to measure outcomes, I believe most of these difficulties can be overcome with skill, creativity and commitment. In government, there is predictable resistance to being measured on the basis of outcomes. We have to overcome this resistance, break the logjam, if parliamentarians are to be provided with the information they need to judge the success or failure of programs and policies.

1.46 Today, as government decides how and where to allocate ever scarcer resources, it is expected to make informed judgments that reflect policy commitments. To make these judgments, decision makers need information and independent analysis. This analysis should include reports on results, describing the outcomes achieved against objectives. Were program objectives for such things as unemployment insurance, international aid or income support achieved? Has the program outlived its usefulness? Were there negative side effects that offset the accomplishments? Can objectives be met by replacing existing services with others that are more efficient or effective to operate? Decision makers need a strong analytical capability if they are ever to begin to answer these kinds of questions. Further, this information should also be available to parliamentarians if they are to perform their scrutiny role effectively.

1.47 As summarized by A. W. Johnson in his *Reflections on Administrative Reform in the Government of Canada 1962-1991*, for three decades reformers have been searching for the right analytical tools to support informed judgments. Program evaluation, one such analytical tool, is a disciplined assessment of the results of government programs and activities. It is based on independent, systematic measurement and analysis, carried out to meet expectations set in policy and standards, and publicly reported. The push for program evaluations began in 1962 with the recommendations of the Royal Commission on Government Organization (Glassco Commission). The concern of the Commission was to make programs the focus of all expenditure planning and accountability, rather than the previous focus on line items of expenditure such as travel, payroll and contract costs. In the years following, as this new approach evolved, efforts were made to link program results with program expenditures and to develop objective ways to evaluate those results.

Program evaluation should address tough issues such as unemployment insurance, international aid and income support

1.48 When Canadians go to a doctor, they do not expect that a new treatment will be prescribed before the doctor knows how successful similar treatments have been in the past. In the same way, Chapter 8 provides examples of evaluations that identified savings and supported better decision making. For example, the Department of Finance's evaluation of the Cape Breton Investment Tax Credit reported that much of the investment would have been made without that \$2.1 billion tax credit. The results of the study contributed to the decision to discontinue the tax credit. Members of Parliament need this type of information about results, but most of the time they do not get it.

Program Evaluation Needs to Ask the Tough Questions and Assess Significant Expenditures

1.49 As described in Chapter 9, program evaluations in the federal government are currently directed at fine-tuning existing programs, rather than asking the tough questions about whether the programs are still needed and what they have achieved. The Office found that evaluation studies conducted over a seven-year period covered approximately a quarter of the government's total expenditures (excluding interest on the public debt) for 1991-92. At this rate, it would take almost 30 years to evaluate all programs in government. Generally, program evaluations have focussed on micro-management issues, rather than on the fundamental question of whether large programs are effective at meeting their own objectives as well as national objectives. They tend not to evaluate the issue of continued program relevance, even though this kind of analysis is essential to parliamentarians' scrutiny of expenditures in times of restraint.

1.50 There is also poor evaluation coverage of sectoral programs, programs that involve more than one department. These include search and rescue, immigration, aboriginal economic development, programs for seniors, environmental protection and many others.

1.51 In a 1983 government-wide audit of program evaluation, this Office noted that there was no real capability to evaluate programs involving more than one department. Since then, there has been no substantive progress in this area. For example, to provide parliamentarians with the information they need on the \$30 billion spent annually on seniors' pensions, as well as the billions spent on related tax measures, would require a sectoral analysis of the programs as a whole, addressing such issues as the following:

- whether programs continue to meet identified needs;
- whether the tax measures, such as retirement savings plans, and the public pension programs are working in a complementary, supportive, and cost-effective way;
- whether the programs are significantly increasing, in a cost-effective way, the ability of seniors to live independently; and
- the future cost implications of changing the age at which seniors become eligible to receive pensions, as well as changing the amount of eligible RRSP contributions.

Evaluations have been completed for individual components of public pension programs, but not for all public pensions as a whole.

1.52 Considerable latitude is given to departments to set the scope of inquiry and to conduct program evaluations. The Office reports on whether or not this regime is working as intended to provide Parliament with information on results. Based on the Office's government-wide findings, I am forced to report that it is not. Given the imperative of making intelligent and statesmanlike decisions to preserve the essence of our national institutions, there has never been a more urgent need for the type of analytical information that evaluations of program effectiveness can provide.

1.53 One has to ask why effectiveness evaluation has not lived up to expectations. A. W. Johnson states that a fundamental problem with the effectiveness evaluation regime, as it has developed, is its compatibility with the parliamentary system into which it is implanted. Mr. Johnson concludes that "to ask ministers . . . to table in Parliament rigorous, and rigorously criticized, program evaluations is to ask them to commit a form of political hara-kiri, at least from their point of view." The obvious question is how to overcome this structural resistance. One approach would be to develop evaluation practices that, in addition to answering questions of an operational nature, would address those matters of interest to parliamentarians.

1.54 Another approach would be to consider who should do the strategic evaluations that deal with sectoral issues and issues of continued program relevance. Evaluators need to maintain a high degree of objectivity and independence, which is often difficult now because departments are evaluating their own programs.

Evaluators Should Be Independent of Departmental Operations yet Close to the Decisions that Count

1.55 It is important that evaluators be sufficiently distant from the day-to-day activities of the department (independent of departmental operations) to ask the tough questions, yet close enough to the central decisions to have a stake in ensuring that evaluations are relevant. Whatever group is charged with conducting strategic program evaluations must have the capability to look at the central issues from a broad perspective. Evaluation also needs to be close to where the key decisions are made that allocate resources among competing demands in departments and agencies.

1.56 This is not to say that departments do not have a role to play in program evaluation. Clearly, as demonstrated in several chapters in this Report, program evaluation is important to operational decisions. But there is a need for a distinction between evaluation that is critical to day-to-day management and evaluation that is critical to a strategic overview of broader and sectoral issues. Perhaps those doing the strategic evaluations could include experts from individual departments. They could be organized on an ad hoc basis to evaluate strategic policy issues.

1.57 The point is, the time has come to find workable solutions to resolve this intractable issue. As described in Chapter 6, the government has stated its intent to ask fundamental questions about the nature and role of government and the services it provides during its proposed restructuring. Any government committed to addressing these tough questions will need a strong analytical ability to manage intelligently and humanely. If the present approach to program evaluation cannot be made to work, Parliament may wish to consider the need for more radical solutions to obtain timely, relevant and reliable effectiveness information.

Accounting for Results: The Canadian International Development Agency (CIDA)

How to Put Accountability into Operation

1.58 Last year, Chapter 1 raised the urgent need for government departments to move beyond slogans, to define more precisely their goals and the tangible results the department or agency is accountable for achieving. It discussed the need for departments and agencies to tell their stories in clear and global terms. Since then, I have been asked by ministers, deputy ministers and other officials what I mean, specifically, by "putting accountability into operation".

1.59 What is needed is an accountability model that fits the circumstances of the individual agency or department. The model should reflect whether the department or agency is involved with direct delivery of services and whether there is more than one partner involved. While it is more difficult to establish accountability where there are two or more partners, it is important to do so because responsibilities may be diffused. Whatever program delivery mechanism is used, being accountable means that it is not sufficient to answer only for following the correct process.

1.60 Chapter 12 on the Canadian International Development Agency (CIDA), "Bilateral Economic and Social Development Programs", provides a good example of the opportunities, and challenges, in accounting for results.

Canada Has Been an Active Donor Nation for Over Forty Years

1.61 Canada was one of the founding members of the Colombo Plan, which was launched in the early 1950s. This was Canada's primary response to the demands for international aid in the post-war period. In the mid-1960s, Canada's role in international aid grew and CIDA was established in 1968. CIDA's objectives, which have not changed significantly in the past 25 years, are essentially to help the poorest countries and people in the world to improve their social and economic well-being through self-reliant development. Funding was based on a percentage of Canada's gross national product (GNP). Initially, CIDA focussed on discrete infrastructure projects such as building roads and dams.

1.62 Over time, the number of countries receiving Canadian aid grew to well over a hundred. Significant amounts of Canadian aid also came to be channelled through

multilateral interventions. The scope and nature of CIDA's direct interventions expanded as well, to include human resource development, technical assistance and policy advice, and the increased use of the private sector and of other agencies to deliver projects. As CIDA's activities became more dispersed and complicated, with many different partners, accountability became more diffused. With the growth in the GNP, Canadian aid has grown to about \$3 billion a year. CIDA's prime objective, as articulated in the policy document *Sharing Our Future*, is the alleviation of poverty through development that is sustainable.

1.63 Chapter 12 focusses on the effectiveness of CIDA's programs by examining its activities in a region where a significant portion of the world's poorest people live: Bangladesh, Pakistan and Sri Lanka. CIDA has been operating in these countries for 25 years and has invested upward of \$3.8 billion. Bangladesh was one of the early recipients of Canadian aid under the Colombo Plan. Over time, Bangladesh has emerged as Canada's biggest aid recipient, with more than \$2 billion in aid projects since the early fifties.

1.64 For 25 years, CIDA has sponsored projects in Bangladesh in water, agriculture, population control, health, rail transportation, energy, and food production aimed at alleviating poverty, particularly in rural areas. The Office expected that CIDA would have had a well-defined strategy for each recipient country, given the magnitude of Canadian involvement. A businesslike approach would have identified specific developmental objectives, with measurable results that CIDA wanted to achieve. Such a results-oriented approach unfortunately has not been put in place.

Taxpayers Want to Know whether Billions of Dollars in Aid Have Developed the Potential of the Poor

1.65 A fundamental question addressed in Chapter 12 is whether CIDA is learning from past results when it designs future programs. I recognize that development assistance is a difficult, complex area where results are difficult to evaluate. I have personally visited CIDA projects in other parts of the world to obtain a real appreciation of what Canadians are trying to accomplish. I was moved by the sincerity, dedication and hard work of these Canadians providing drought relief, and trying to alleviate the suffering caused by AIDS. At times the level of help available, compared to the level of human need, seems like a drop in the ocean. I believe that most Canadians are supportive of these efforts but are looking for some assurance that their tax dollars are indeed helping to develop the potential of the world's poor. I believe an analysis of past performance would be an important step to providing that assurance. CIDA should evaluate and report to Parliament whether its interventions have left behind something of significant value that is sustainable and that enables the poorest people to better manage their own development.

1.66 Putting accountability into operation means that CIDA would report to Parliament on the policies and objectives pursued and the results achieved with the more than \$3.8 billion invested in Bangladesh, Pakistan and Sri Lanka over 25 years. Although the

results of many projects will not be evident for many years, a practical first step would be to report on key indicators that are essential for project sustainability. For example, CIDA could measure the extent to which the technical, managerial and financial capability of its partners has been enhanced. It could report what it costs to administer the aid it delivers. In short, CIDA should have information on what works, what has been accomplished and what has been learned from its previous efforts.

1.67 The Office believes that this would be an important first step toward stewardship reporting that provides Parliament with better information on results, such as the extent to which self-reliant development has been achieved. This is what I mean by "putting accountability into operation".

Reconciling Departmental Autonomy with the Delivery of Sectoral Services

1.68 On 25 June 1993, the Prime Minister announced a downsizing and restructuring of government. The announcement stated that the number of departments would be reduced from 32 to 23. She also announced the appointment of a smaller Cabinet, a reduction in the number of Cabinet committees, and related measures aimed at streamlining government decision making. The Prime Minister indicated that the objective of these changes was to provide Canadians with leaner, more accessible and more efficient government.

Why Is It So Difficult for Departments to Work Together?

1.69 Clearly, the restructuring of government activities may permit the government to co-ordinate more effectively issues that, in the past, crossed departmental lines. However, there will still remain significant government issues that continue to cut across departmental lines. For example, implementing a federal water policy involves many different departments with major water interests.

1.70 Traditional department structures are essentially "vertical", conceived in simpler times when fields of activity such as agriculture, forestry, public works or transport could be considered fairly separate domains. Today, however, many of the major issues that affect Canadians involve more than one department. The problem, as past and current audits reveal, is that departments have difficulty working together on sectoral issues that cut across departmental lines.

1.71 In 1990, this Office's audit of the management of the immigration program revealed major challenges in formulating, managing and co-ordinating an integrated immigration program among the seven departments involved in delivering it. The same year, the Office's audit of drug enforcement revealed that the lack of co-ordination between the Royal Canadian Mounted Police and Canada Customs was adversely affecting drug enforcement efforts.

1.72 In this Report, two chapters in particular highlight the need to improve the co-ordination among government departments delivering sectoral programs. Chapter 11 on the Canadian Aboriginal Economic Development Strategy documents the difficulties of the departments of Indian Affairs and Northern Development, Industry, Science and Technology, and Employment and Immigration in implementing a new approach to creating economic opportunities for Canada's aboriginal peoples. Chapter 14, "Control and Clean-up of Freshwater Pollution", describes the difficulties in implementing a federal water policy, in large part caused by the failure of key federal departments to work together. What is particularly disturbing is that, in the latter case, an interdepartmental committee was set up to help resolve issues of common interest, yet it was rarely used.

Departments Need to Work Together to Create Jobs, Protect Inland Waters and Address Other National Issues

1.73 The current reorganization of the government may solve some problems of co-ordination. However, there will always be a need for some form of matrix organization to integrate major sectoral services for Canadians. There is no "perfect" organizational model that will eliminate the need to have senior officials and line managers co-ordinate their efforts to achieve national objectives.

1.74 Clearly, this is a very complex area where there will be few simple solutions. Co-ordination requires a firm commitment from senior management in all organizations to develop a sense of shared purpose and agreement. There is a need for a mutual understanding, and acceptance, of the basic roles and mandates of the agencies and departments involved. There is a need for a shared sense of urgency, political will and commitment. Whatever the structure or organizational arrangements chosen to deliver shared services, there is a critical need for clear accountability. To close the loop, there must be clear responsibility for reporting against this accountability - by departments for individual components and by a lead department for overall results - to facilitate Parliament's scrutiny of these programs.

1.75 The Office recognizes that it is inherently difficult to establish accountability for results in a multidepartmental program. However, if lead departments are given specific responsibilities for reporting meaningful information on their stewardship, Parliament will be better able to hold departments and agencies to account. Improving accountability for interdepartmental co-operation need not be an insurmountable challenge.

Integration of the Office of the Comptroller General into the Treasury Board Secretariat

1.76 As part of the restructuring that the government announced on 25 June 1993, the Office of the Comptroller General has been integrated into the Treasury Board Secretariat. The title and responsibilities of Comptroller General have been added to those of the Secretary of the Treasury Board. Accounting and costing policy, including responsibility for the government's annual financial statements, are now under the Deputy

Secretary (Program Branch), and audit and evaluation have been assigned to the Deputy Secretary (Administrative Policy Branch). The former Comptroller General has been named Chief Informatics Officer within the Secretariat, with responsibility for government-wide information management, systems and technology.

Comptrollership Should Be an Integral Part of Government Decision Making

1.77 I have discussed these changes with the Secretary of the Treasury Board & Comptroller General, and he has assured me that he shares my view that comptrollership and financial management are an integral part of government decision making. I have also consulted with ministers, senior public servants and senior members of the accounting profession. Their consensus - and I think that of taxpayers - is that managing the financial situation we now face will require a strong, effective financial voice at the most senior levels within government.

1.78 My experience with very large business firms reinforces this view. My predecessors expressed strong concerns about the adequacy of financial expertise in the federal government, and recent audits have led me to believe that, although some improvements have been made, decision makers in government often still do not receive adequate information regularly. In addition, decision makers need advice from individuals able to interpret and analyze the ramifications, both short-term and long-term, of complicated financial transactions, which still occur regularly in government, despite trends toward downsizing. These elements are an essential part of comptrollership.

1.79 Comptrollership is a relatively straightforward term. In our personal lives, it means knowing what bills we have and ensuring that they are paid on time and in the right amount. It also means knowing what money we will receive and safeguarding it appropriately when it is received. Personal comptrollership also means assessing the financial implications of some of life's major decisions, such as buying a house, staying in school and getting married. In large and complex organizations such as business firms or governments, however, the practice of comptrollership is anything but straightforward. It is a critical function that must be led by professionals with the requisite background and training.

1.80 Over the first three years of my term as Auditor General, I have been very concerned with assessing the quality of comptrollership throughout the government. The impression I have developed is that, despite certain improvements, ministers and deputy ministers do not yet enjoy the level of support, in terms of expertise and information systems, that chief executive officers of our better-run private sector organizations have at their disposal.

1.81 Successive reports over the past decade have documented serious shortcomings in financial management and control. For example, departments and agencies often do not know what certain activities cost. This Office's 1990 government-wide study on efficiency noted that relevant cost and performance data were, for the most part, either unavailable or underutilized. Other audits have noted the absence of cost information to

support billings or cost recovery by government programs handling hundreds of millions of dollars. There is a lack of information to support an informed analysis of the alternatives to replacing aging government infrastructure, in the form of buildings or other fixed assets. There also seems to be a lack of reliable information to compare costs across programs. And since 1978, the government's audited financial statements have received a clean bill of health from this Office on only two occasions, in 1990 and again last year. Successive Auditors General have questioned how ministers, and deputy ministers, can function without this basic financial information and analysis, and the accompanying expertise, that are an integral part of what I mean by comptrollership.

Successive Governments Have Demonstrated Less than a Full Commitment to the Concept

1.82 From its inception in 1978, the Office of the Comptroller General has never had a clear legislative mandate. The *Financial Administration Act* (FAA) merely established the position. Successive governments have failed to define a clear role and responsibilities. There has been less than a full commitment to the concept.

1.83 Today, the Government of Canada is undergoing the same types of stresses as many business firms, and for the same reasons - concerns about financial condition and the bottom line. Downsizing and restructuring are facts of life in both the private and public sectors. In the business world, strong comptrollership is seen as a key ingredient of managing organizational change. In the government, an effective comptrollership function would:

- prepare, analyze and interpret financial reports used for decision making;
- develop and revise standards for internal control and performance measurement;
- provide objective financial advice to ministers and deputy ministers;
- establish and maintain an integrated operating plan that is consistent with the government's short- and long-term goals; and
- ensure that the comptrollership function is staffed with qualified professionals who possess appropriate expertise and experience.

1.84 It is within this context that I have some serious concerns about the government's decision to integrate the Office of the Comptroller General into the Treasury Board Secretariat. While it would have been the preference of our Office to have seen the Office of the Comptroller General maintained as a separate entity, and, indeed, strengthened along the lines originally advocated, the merger could be made to work. However, it is my view that the actions the government has taken may weaken the comptrollership function. Specifically, I am concerned that departments and agencies may perceive that the government is proposing to:

- fragment the functions of comptrollership;
- assign the various fragments to "part-time" comptrollers at the deputy secretary level who have little time to devote to added responsibilities and who may not have the requisite background or training; and

reconstitute one of these parts (accounting and costing policy) as the only role for the comptroller general function, implicitly under the leadership of an official at least two levels below the Secretary of the Treasury Board & Comptroller General.

Deputy heads may well see this as a reduction in emphasis on the importance of comptrollership and financial management, which may cause them to downgrade this function within their organizations at precisely the time it should be strengthened.

1.85 If the Office of the Comptroller General must be integrated into the Treasury Board Secretariat, there must be a clear focal point for comptrollership within the Secretariat at a high enough level to make a difference, with enough clout to influence important decisions and with sufficient scope to attract and retain top-calibre comptrollership expertise at a very senior level. I also believe that the authority and responsibilities of the Comptroller General should be set out in legislation, as other jurisdictions have done.

1.86 In this age of downsizing and restructuring, with concerns about deficits and debts, strong comptrollership in the Government of Canada is not just something that would be nice to have, it is something that the government must have and that Canadians have a right to expect. In the final analysis it is results that count and I intend to review the activities of the Comptroller General to see whether results are achieved.

Integrating Public Service Reform with the Government's Broader Agenda

The Urgent Need to Revitalize the Renewal Process

1.87 Since I took office in 1991, I have stressed the importance, in this period of economic and fiscal difficulty, of management reform and renewal in the public service. The government introduced an initiative in late 1989 aimed at improving human resource management and streamlining government structures, processes and systems, to make the public service less costly, more productive, more innovative, and more service-oriented. My Office supported the principles and objectives of this initiative, Public Service 2000 (PS 2000), from the outset.

1.88 Administrative reform is not new. Considerable attention has been paid, during the last several decades, to achieving greater cost-effectiveness in the administration of public affairs. A host of inquiries - royal commissions, task forces and internal studies - have been carried out, along with numerous initiatives. What is troubling is that, as noted in my 1991 Report, it has been necessary to revisit some questions over and over again. In part, this has been due to inadequacies in managing change.

1.89 My Office's study of public service reform, reported in Chapter 6, "Canada's Public Service Reform, and Lessons Learned from Selected Jurisdictions", indicates that PS 2000 is in danger of falling short of its potential and that, once again, this is due in significant measure to deficiencies in managing transition.

1.90 In the summer of 1993, the government announced a "restructuring initiative" involving the reorganization and streamlining of government departments and agencies. Subsequently, a re-examination of government programs and services was to be carried out. It is important that this initiative - and indeed, other new initiatives - not undermine PS 2000. The two have objectives in common and need not be in conflict, but focussed effort and clear communications will be required to ensure that they are aligned and mutually reinforcing.

1.91 To ensure that this is the case, and that the problems PS 2000 has sought to address are overcome, there is an urgent need for the government to revitalize the renewal process.

Reconciling the Goals of Public Service Reform with Fiscal Realities

1.92 A second issue also needs to be dealt with. PS 2000 has been plagued by perceptions of inconsistency and lack of coherence between the aims of renewal and other actions and initiatives of the government. Our study suggests that this has been due, in part, to failure to adequately reconcile some of the goals of PS 2000 with the increasing pressures of fiscal restraint.

1.93 Today, persistent deficits and growing debt are among the most important policy issues for government. As mentioned, a review of the affordability of government programs and services was planned as part of the restructuring initiative.

1.94 In this context of fundamental re-examination and change, some of the specific measures that PS 2000 has proposed may no longer be appropriate, or possible to implement. The current government will need to take stock to determine which elements of PS 2000 will take priority. A strategic approach is required: one that will ensure that the government's public service reform and renewal objectives are fully compatible and integrated with its broad policy objectives and its vision of the future role of the public service.

1.95 Regardless of the changes that may be forthcoming, the public service will continue to play a crucial role in advising ministers, delivering government services to Canadians and making our country more competitive. Accordingly, it is imperative that the principles and values that shape the government's approach to managing the public service be compatible with maintaining the ongoing health of this vital institution, while realistically reflecting Canada's changing circumstances.

1.96 Reform and renewal of the public service must succeed. As our study of reform in Canada, Australia, New Zealand and the United Kingdom has shown, for this to occur, visible and ongoing political leadership and commitment are vital. Canada's public service is a valuable asset that must be safeguarded and managed wisely.

Public Accounts and Other Parliamentary Committees

1.97 One of the distinguishing characteristics of this Report is that it will be the first Auditor General's Report to be considered by Canada's 35th Parliament. I am hopeful that the Public Accounts Committee and other standing committees of the House in this new Parliament will bring the same vigor to considering the work of my Office that has been developing over the past two Parliaments.

1.98 A quick look at the number of Public Accounts Committee hearings over the nine years of the 33rd and 34th Parliaments combined shows an increase of about 45 percent in the average annual volume of public hearings between the two Parliaments. At the same time, interest in the annual Report by committees other than Public Accounts has been growing. In fiscal year 1984-85, the first year of the 33rd Parliament, the Office might have been called once or twice by other standing committees of the House. Last year, fiscal year 1992-93, the Office appeared eight times before no less than five standing committees of the House in addition to Public Accounts, as well as one Senate committee. This level of parliamentary interest in the work of the Office is vital to our effectiveness, not because of any enhancement to our public presence but because it often takes a committee hearing, and the consequent public attention to the matter, to get an appropriate level of priority attached to corrective action.

1.99 Revisions to the Standing Orders of the House of Commons since the mid-eighties have paved the way for House standing committees other than Public Accounts to take an interest in, and deal with, the work of this Office. Of equal importance, however, has been the initiative, self-discipline and sense of responsibility demonstrated by the Public Accounts Committee through the latter half of the last Parliament in dealing with the matters raised in my annual Report, in a comprehensive and non-partisan fashion. The Committee's 1992-93 activity level of 27 public and 18 *in camera* meetings places it among the most active of the House standing committees. I am optimistic that this drive, which serves all Canadians well, will not be lost in the transition to a new Parliament.

The Need to Set Priorities to Preserve the Essence of Our Institutions

1.100 Historically, Parliament has had the responsibility of voting expenditures each year. Much of this chapter has examined Parliament's role in the budget process, and has suggested ways of making its involvement more effective. A common thread in this chapter is the need to restore, and improve, Parliament's role in federal finances, particularly at the macro level. A second thread is the need to improve the quality of decisions. The last thread is the need to make operational the accountability of departments to Parliament, without falling into micro- management. Dealing with these issues is essential to ensuring responsible government and the continuation of Canada's values and institutions.

1.101 Clearly, these are challenging times in public administration, as governments struggle to balance citizens' expectations with reduced fiscal manoeuvrability. Every nation is confronted by the challenge of maintaining its traditions and institutions while responding to economic and social change. In times of fiscal restraint the balance can

come under considerable tension, as individuals want the security of existing programs and services along with new initiatives to meet the challenges of the day.

1.102 The Government of Canada has a political commitment to preserving the well-being of its citizens, and an international commitment to humanitarian goals. Sound financial stewardship is essential for Canada to fulfil its commitments. National objectives must acknowledge fiscal realities, but it is essential that policy direct the allocation of resources, rather than the pattern of past expenditures effectively dictating policy. I believe we can preserve the essence of our institutions and values that have been built up over the years, if Canadians are willing to differentiate between what is essential and what is nice to have.

1.103 Canada is ranked among the world's best places to live. However, we must take good care of our country. I believe the Auditor General's role can have a positive influence. This Office is committed to making a difference for the Canadian people by promoting, in all our work for Parliament, answerable, honest and productive government. To the extent that we are successful, this will be our contribution to making sure that Canada continues to be the best place in the world in which to live.

Chapter 2

Follow-up of Recommendations in Previous Reports

Main Points

Introduction

Royal Canadian Mounted Police -

Federal Law Enforcement - 1990, Chapter 26

- Background
- Conclusion
- Observations
 - Improved relations and clearer roles in enforcement
 - Continuing difficulties in implementing the legislation on proceeds of crime
 - Management information systems

Royal Canadian Mounted Police -

Support Services to Canadian Law Enforcement Agencies -

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 - Canadian Police Information Centre
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 - Law Enforcement Services - overall

Innovation within the Parliamentary Control Framework - 1991, Chapter 5

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 - A review of Treasury Board guidance on non-monetary transactions is needed

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Vehicle Fleet Management - 1991, Chapter 7

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Debt Management and Employee Pensions - 1991, Chapter 8

- Background
- Scope
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Financial Management and Control of Non-tax Revenue - 1991, Chapter 9

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Department of External Affairs - Membership Payments to International Organizations - 1991, Chapter 12

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Department of Public Works - Office Accommodation Planning and Leasing - 1991, Chapter 17

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Department of the Secretary of State - Official Languages and Translation - Translation Bureau - 1991, Chapter 20

- Background
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 - Costs
 - Human resource management and translators' performance
 - Client satisfaction and quality of texts translated
 - Management information

Exhibit

2.1 Elements of In-house and Contract Costs

Follow-up of Recommendations in Previous Reports

Main Points

2.1 Departments continue to make progress in correcting deficiencies, but progress is slow in some areas. Some issues have been outstanding for many years.

2.2 Innovation within the Parliamentary Control Framework - Action has been taken to address our concerns about quota monitoring and clarification has been sought on the test fishing matter. The clarification did not fully address our concern. Treasury Board should review the guidance it has provided on non-monetary transactions, to ensure that test fishing is brought into the parliamentary control framework. In addition, authority to carry out test fishing that includes giving access to fish in payment as well as for scientific purposes is still not resolved.

2.3 Debt Management and Employee Pensions - The Department of Finance and the Treasury Board Secretariat have improved information for Parliament on pension accounts, and Finance has completed a study of the implications of the present pension arrangements for its debt management. However, progress has been slow in the main areas of our concern - the long-term implications of alternative financing arrangements for the federal employee pension plans, and fiduciary responsibility.

2.4 Financial Management and Control of Non-tax Revenue - Non-tax revenue management continues to improve and is achieving tangible results. However, we still have some concerns about the financial management and control of this revenue.

2.5 Department of Indian Affairs and Northern Development - The Department has made some progress in addressing our observations and recommendations on specific claims and on Indian Oil and Gas Canada. A timely resolution is necessary for the long-standing issues of strengthening the accountability framework for funds paid to native organizations and resolving the on-reserve housing shortage.

Introduction

2.6 Departments are taking action to correct deficiencies noted in our previous Reports. Progress is slow in some areas. As discussed in Chapter 1, some issues reported in prior years continue to be found in current audits of the same programs and others. It is recognized that some issues are complex, but timely resolution of these deficiencies is desirable so that public funds are used efficiently and effectively.

2.7 Observations and recommendations made in our annual Report are normally followed up and their status reported two years after publication of the original chapter. This year, two follow-ups are reported in separate chapters and three have been deferred. Another was reported last year.

2.8 Issues similar to those in the 1989 chapter, "Federal Regulatory Review Process", are touched on in Chapters 25, 26 and 27, on Regulatory Review.

2.9 The 1991 chapter, "The Accountability Framework for Crown Corporations: Making It Work", is followed up in Chapter 4, "Crown Corporations: Accountability for Performance."

2.10 Follow-up of the 1991 chapter, "Department of Agriculture - Farm Safety Net Programs", has been deferred until 1994.

2.11 The issues raised in the two 1991 chapters on the Department of Supply and Services, "Management of the Government Procurement Service" and "Government Procurement and Industrial Development", will be followed up in 1994. This follow-up will be linked with the follow-up of the 1992 chapter on Department of National Defence, "Major Capital Projects - Industrial Development Initiatives", and with a planned government-wide audit of systems development, which will be a major vehicle for updating procurement approaches.

2.12 The 1991 chapter on the Department of Environment, "Conservation and Protection", was followed up with the 1990 chapter on the Department and the results were reported in the 1992 follow-up chapter.

Royal Canadian Mounted Police - Federal Law Enforcement - 1990, Chapter 26

Background

2.13 In 1990 we reported on the RCMP's federal law enforcement activity, which involves detection and investigation of offences against federal statutes. Our main finding was that the RCMP's responsibilities for enforcing federal statutes were unclear and had remained so despite a number of studies over the years. This led to overlapping jurisdictions and operational problems between the RCMP and other federal departments. We also observed that working relationships between the RCMP and other departments needed significant improvement.

Conclusion

2.14 The Force has taken action on all the issues that we raised in 1990. In some cases the issue has been resolved; in others, action is ongoing.

2.15 We found that the RCMP has addressed the major issue of jurisdictional overlap and that the disputes between the RCMP and Canada Customs have been significantly reduced. The Force has made efforts to improve its management information systems for federal law enforcement.

2.16 At the same time, progress has been slow in implementing the legislation on proceeds of crime.

Observations

Improved relations and clearer roles in enforcement

2.17 In 1990 our recommendations were aimed at improving relations between the RCMP and Canada Customs on two fronts: customs enforcement and drug enforcement.

2.18 The RCMP and Canada Customs signed a memorandum of understanding in June 1991 to clarify the RCMP's role in enforcing the *Customs Act*. Relations between the RCMP and Canada Customs in customs enforcement have improved significantly since then.

2.19 In drug enforcement, the two agencies signed a statement of principles in February 1991 to define their respective roles and responsibilities at ports of entry, inland and internationally, for intelligence gathering and sharing and for public recognition. The situation has significantly improved. There are still some isolated incidents of lack of co-operation, and they are being addressed individually at the local level with the statement of principles as a benchmark.

2.20 In addition, in 1992 the Government of Canada established the Federal Law Enforcement Co-ordination Centre to promote overall co-ordination of all federal law enforcement activities. The overall question of jurisdictional overlap is a concern to the federal government and may be addressed further by the government reorganization announced in June 1993.

Continuing difficulties in implementing the legislation on proceeds of crime

2.21 In 1990 we observed that the various federal departments and agencies concerned with implementing the legislation on proceeds of crime (National Health and Welfare, Justice, the RCMP and the Treasury Board Secretariat) had been slow to resolve a number of issues.

2.22 There has been some progress since then, but we note that it was only in 1992 that pilot units (Integrated Anti-drug Profiteering units) to enforce the legislation were set up in three major centres (Vancouver, Toronto and Montreal) with funding from Phase II of

Canada's Drug Strategy. These units are staffed with RCMP officers, federal Crown counsels, provincial and municipal police officers, forensic accountants and administrative support personnel. In addition, Bill C-123 (*Seized Property Management Act*), an Act concerned with the management of property seized or restrained, received royal assent in June 1993 and came into force in September 1993. This Act is an important element for complementing the legislation on proceeds of crime that came into effect in 1989.

2.23 The ultimate objective of the legislation was to help dismantle criminal organizations by removing both their financial power base and their motivation to remain in business. To date, the use of the legislation has been limited by delays in setting up the supporting infrastructure and in enacting the complementary legislation noted in the previous paragraph.

Management information systems

2.24 In 1990 we recommended that the RCMP improve its management information systems to manage its federal law enforcement activities effectively. Currently, the issues relating to management information systems have yet to be fully resolved but we note that efforts to correct them are ongoing. The Force has initiated corrective action that so far includes:

- the creation of the central Corporate Management Information Branch;
- the implementation of a new management information system in the RCMP's Commercial Crime Directorate;
- a new management information system, currently in its final stages of development, for the Drug Enforcement Directorate; and
- the commencement of an in-depth audit of its information systems.

Royal Canadian Mounted Police - Support Services to Canadian Law Enforcement Agencies - 1990, Chapter 27

Background

2.25 In 1990 we reported on the four main specialized services that the Royal Canadian Mounted Police (RCMP) provides to the Canadian law enforcement community: forensic laboratories, police training, law enforcement information and fingerprint identification. The RCMP identifies these support services as its Law Enforcement Services.

2.26 Our 1990 chapter contained several recommendations and observations, which were concerned primarily with the following: lack of proper analysis of all options for replacing older full-service laboratories; the potential for misuse of the information available from the Canadian Police Information Centre; the need to examine the appropriateness of the Canadian Police College's current curriculum relative to its intended mandate; the RCMP's lack of co-operation and consultation with the law enforcement community about the means of providing fingerprint identification services;

and lack of integration of the individual Law Enforcement Services into a single, more visible entity.

Conclusion

2.27 The RCMP has responded positively to our 1990 recommendations and has initiated corrective action on all of them. Corrective action has yet to be completed in three areas, as explained more fully under "Observations".

Observations

Forensic laboratory services

2.28 The RCMP has reduced the number of its laboratories from eight to six. It carried out studies and assessed other options before deciding to build a new forensic laboratory in Regina to replace its existing laboratory. However, we note that the full costing of options will need to be improved for future studies.

2.29 Further, these future studies will need to take into account the potential impact of significant technological changes that the future will certainly bring, such as the recent introduction of DNA technology.

Canadian Police Information Centre

2.30 Management is fully aware of the sensitivity of the information available from this system. It will consider introducing the use of personal identifiers in a future modernized version, which should enhance the capability to trace inappropriate use of the data. It recently issued a set of rules and a code of ethics stressing that access to the system and dissemination of the related information are for legitimate purposes only. Management will undertake to ensure, through regular audit activities, that all participating agencies in the system conform to the rules and the code of ethics.

2.31 We note that this is an aging system and management has determined that it will need to be modernized to meet user demand in the future. In our opinion, management needs to determine as soon as possible the remaining economic and technological life of this information system, and the role it will play in delivering police services.

Canadian Police College

2.32 The College has re-examined its philosophy and purpose and has developed a mission statement and related core values and guiding principles. These will serve as the basis for its new strategic and action plans and for the ongoing assessment of each course.

2.33 The College is currently reassessing the basic structure, composition and role of its Advisory Committee to include a non-police perspective. It has indicated that it will complete its strategic and action plans and set up its new Advisory Committee in the current year.

Identification services

2.34 The fingerprint identification services have completed the implementation of a state-of-the-art Automated Fingerprint Identification System. The external users of the system whom we contacted expressed a high degree of satisfaction with the quality of service now provided.

Law Enforcement Services - overall

2.35 The RCMP has approved a common mission statement for its Law Enforcement Services and has set up internal committees aimed at ensuring that those operations continue in full partnership with the Canadian police community. As a result of its review of Law Enforcement Services activities, and in conjunction with central agency requirements, the RCMP will be phasing in user fees for some of those services.

2.36 Among other specific corrective actions, we note that the RCMP has improved the consultation process with users of its Law Enforcement Services, especially those outside the RCMP.

Innovation within the Parliamentary Control Framework - 1991, Chapter 5

Background

2.37 The chapter examined the challenge faced by public service managers to reconcile with the parliamentary control framework their program initiatives to improve services while responding to financial constraints. We examined a number of such initiatives by managers in the Department of Fisheries and Oceans. We reported our concern that two of these practices - quota monitoring and test fishing - did not satisfy the requirements for parliamentary control.

2.38 In our opinion, the Department was not at arm's length from the financing arrangements for quota monitoring by the private sector. The process for collecting fees from fishermen for this service was not completely outside of government, and the revenues were not subject to parliamentary controls for collection, spending and accounting.

2.39 In the case of test fishing, we observed an exchange of special fishing rights to some fishermen in return for their services, which, in our opinion, is a non-monetary barter transaction. It was not clear that the Department had the authority under its enabling legislation to take this initiative. The Department reports test fishing in Part III of the Estimates.

Conclusions

2.40 In our follow-up we found that Fisheries and Oceans managers have taken action to address our concerns about quota monitoring. They also sought clarification on how they should proceed in the matter of test fishing. However, the clarifications obtained from the Department of Justice and Treasury Board Secretariat do not fully address our concern

that the intent of Parliament clearly be followed. Parliament may wish to consider reviewing the broad interpretation of the *Fisheries Act* and Regulations that allows the Minister of Fisheries and Oceans to finance fisheries management programs through access to fish. The wording of the Treasury Board policy on non-monetary transactions does not bring significant non-monetary transactions that were identified in Chapter 5 into the parliamentary control framework. Treasury Board should review the guidance it has provided on non-monetary transactions to ensure that test fishing is brought into the parliamentary control framework.

Observations

Guidance from the central agencies

2.41 Prompted by our 1991 chapter, the Office of the Comptroller General held a video conference for government managers on the challenge they face to remain in control of their operations as public service renewal proceeds. Issues raised in the chapter were discussed and the videocassette is available through departmental libraries.

2.42 On 24 June 1993, Treasury Board issued a policy to bring non-monetary transactions within the parliamentary control framework. The policy was made retroactive to 1 April 1993.

Quota monitoring

2.43 Fisheries and Oceans managers have taken corrective action on quota monitoring. The financing of the arrangements for monitoring individual quotas are now at "arm's length" - exclusively provided by the private sector as planned. The nature of these arrangements has been reported to Parliament in Part III of the Estimates.

Test fishing

2.44 Fisheries and Oceans managers have sought a clarification from the Department of Justice of the authority for the test fishing arrangements. Despite the opinion obtained from the Department of Justice, we are not satisfied that the clarification resolves the matter from the broader perspective of parliamentary control over spending and revenue collection.

2.45 The interpretation from the Department of Justice is a technical legal argument based on a broad interpretation of section 7 of the *Fisheries Act*, which gives the Minister "absolute discretion" to issue fishing licences, subject to regulations. However, this opinion does not sufficiently take into account section 4 of the Act, which explicitly provides for the taking of fish for scientific fishing purposes.

2.46 Consequently, the authority to carry out test fishing that includes giving access to fish in payment as well as for scientific purposes is still not resolved.

Parliament may wish to consider reviewing the interpretation

2.47 The consequence of this interpretation means that the Minister of Fisheries and Oceans can use fish, or access to fish, as a means of financing fisheries management and control. Parliament may want to consider reviewing this interpretation of the enabling legislation.

A review of Treasury Board guidance on non-monetary transactions is needed

2.48 In our opinion, allowing some fishermen special access to fish in return for their services is a non-monetary barter transaction. We have seen no evidence to indicate any change in the nature of the transaction described in 1991 Chapter 5 (exhibits 5.3 and 5.4).

2.49 Fisheries and Oceans managers were advised by Treasury Board officials that test fishing is considered a cost-shared project rather than a non-monetary transaction under the policy, and thus the requirements for non-monetary transactions do not apply. There is a sharing of interests between fishermen and the Department; however, this does not change the nature of the barter arrangement. We do not agree that test fishing can be considered a cost-shared project.

2.50 Treasury Board should review its application of this term, since its effect is that a significant exchange - valued at \$4.7 million in 1990 - remains outside the framework of parliamentary control over practices and procedures of the Government of Canada.

Capital Projects - Department of Public Works, Quality in the Constructed Project - 1991, Chapter 6

Background

2.51 The 1991 audit was a pilot audit to test new protocols or audit methodology. Only two buildings were examined, selected by the Department of Public Works from its National Capital Region Portfolio. One was the Crown-owned Phase IV of Place du Portage in Hull; the other was the Lionel Chevrier Building in Cornwall, a lease-purchase.

2.52 Following the audit of the major building elements, services and functions, we reported some 41 consolidated observations of a technical nature. The Department took immediate action on these findings where appropriate, planned other remedial action, and agreed to investigate the remaining findings for possible action or for incorporation into new construction projects.

2.53 Our follow-up focussed on the action taken by the Department in response to all of our pilot audit recommendations and observations. We reviewed the National Capital Region's action report and the documentation in support of action taken, as well as the corporate policies issued since 1991 that addressed our recommendations. Interviews were conducted with Public Works professional staff, Fire Protection Services of the Department of Labour, the Health and Safety committees of both buildings, and the owner and managers of the Chevrier Building.

Observations

2.54 We found that the Department acted promptly and responsibly to investigate all of our observations. It has completed most of the remedial work over the past two years at a cost of approximately \$500,000 for the Place du Portage building, and with an additional capital expenditure of \$900,000 for a direct digital control system to improve the efficiency of the dual-duct heating, ventilating and air-conditioning system, and floor area lighting. The Department has approved further funding for accessibility projects in the building, at a cost of \$975,000, to meet the requirements of the Treasury Board Policy on Accessibility. Cost of remedial work undertaken on the Chevrier Building by the owner was in excess of \$5000 and a further expenditure of \$99,000 is planned to improve accessibility, to be funded by the Department.

2.55 The Department of Labour's Regional Fire Protection Services has monitored the remedial action taken and planned by Public Works with respect to fire safety issues, and is generally satisfied with the results. The major tenant Health and Safety committees of the buildings have expressed satisfaction with the responses by the Department and the management of the Chevrier Building.

2.56 Our recommendation that the Department examine the dual-duct system in Place du Portage, Phase IV, with the objective of modifying the system's operation to achieve greater economy, received considerable attention. The controls for the dual-duct system are being changed from pneumatic to direct digital control. The direct digital control system is expected to improve the operating efficiency of the heating, ventilating and air-conditioning system. More area lighting zones have been added, controlled by the direct digital control system with a view to achieving economy. Nevertheless, because of the design of the dual-duct system, operation outside normal working hours (7 p.m. to 7 a.m. and weekends) is still costly, budgeted at approximately \$337,000 per year. For example, the entire system, serving at least five floors, must be activated to provide services to an average of 150 employees who work during the silent hours (normal Phase IV occupancy is about 4300).

2.57 Our chapter contained five other recommendations of a general nature that were accepted by the Department of Public Works, namely, on the need for life-cycle cost analysis, commissioning services, dispute resolution between design professionals, engagement of acoustics specialists and long-term repair and replacement plans. We are pleased to report that the National Capital Region of the Department has implemented all of these recommendations in works undertaken since 1991.

2.58 We commented on the fact that the Department of Labour had no enclosure testing requirements for existing halon-protected facilities. We have been advised by Labour that some 50 sites in the National Capital Region are presently being investigated by a consultant to determine the need for halon fire protection. Halon, which is a gas used as a fire suppressant, is not considered environmentally friendly. The polychlorinated biphenyls (PCBs) have been removed from the transformers in the vault of Phase IV.

2.59 Due to the diminished inspection service by the Fire Commissioner of Canada, Public Works has established a position of Chief, Fire Prevention and Construction Safety.

2.60 A major benefit from this audit has been that the technical audit methodology developed and field-tested in the pilot project has been modified and expanded by the Institute for Research in Construction, in collaboration with our Office and the Department of Public Works, for use by building owners and managers in the public and private sectors.

2.61 The audit protocols covering fire safety with few exceptions already form part of the Department of Labour's Fire Inspection Guide.

2.62 The Accommodation Branch of the Department of Public Works is the custodian of government general-purpose office buildings, a portfolio of 379 Crown-owned buildings, with a value of \$2.6 billion, nine lease-purchase buildings, and 3068 leases, 4.8 million square meters in total, accommodating some 174,000 employees.

2.63 The cost of remedial work as a result of the audit, particularly on Phase IV, demonstrates that the Department of Public Works - indeed, the federal government - has a significant implicit commitment of future expenditures to repair and modernize its aging stock of buildings, to meet current demands for an adequate working environment and for access by staff and members of the public who are disabled.

2.64 Under Treasury Board Policy on Real Property Management, approximately 50 percent of federally held property is under the custodianship of departments other than Public Works. We urge all custodians of federal government realty to follow our general recommendations accepted by the Department in 1991.

Vehicle Fleet Management - 1991, Chapter 7

Background

2.65 Our 1991 chapter on vehicle fleet management reported significant management deficiencies, such as inadequate attention to transportation planning; the acquisition of vehicles without due regard to life-cycle costs and environmental concerns; the need to standardize fleets; underutilization of vehicles; a lack of established procedures to calculate taxable benefits to employees taking vehicles home; and delays in disposing of surplus vehicles. Moreover, most departments found that the existing vehicle information systems were not useful.

Conclusion

2.66 The government has initiated administrative changes to improve vehicle fleet management in departments and agencies. However, because implementation is at an early stage, it is premature to assess departmental initiatives undertaken to address our concerns.

Observations

2.67 The issues raised by our chapter are being addressed by an Interdepartmental Fleet Management Committee established by the Administrative Policy Branch of Treasury Board in January 1991.

2.68 The Administrative Policy Branch has also conducted workshops on Life Cycle Materiel Management and Fleet Management. In addition, an interdepartmental seminar on life cycle materiel management was held in Ottawa. The Branch also has produced videos on Life Cycle Materiel Management that deal with environmental issues. These videos are used in seminars and training courses offered by central agencies and departments.

2.69 To foster better vehicle management, the Branch has encouraged the use of private sector vehicle management services. Some of the initial advantages departments have reported include:

- improved information for decision making;
- easier identification and use of manufacturers' warranty programs;
- better control of vehicle use, maintenance and repair costs; and
- consolidated billing, resulting in reduced administrative overhead.

2.70 At the time of writing, seven departments had arranged for their vehicles to be managed nationwide by the private sector. According to the Treasury Board, this amounts to about 30 percent of the vehicles owned by government departments.

2.71 Although departments generally have assessed pilot projects as successful, it is too early to judge whether nationwide arrangements will be effective. Generally, it takes a year of experience for a department to resolve start-up problems and to be able to assess reliably the private sector service. The recently announced reorganization of departments and agencies may also slow down implementation.

2.72 The *Surplus Crown Assets Act* was amended in January 1993 to allow departments to dispose of surplus assets, either through the Department of Supply and Services or directly, subject to terms and conditions established by Treasury Board. The Administrative Policy Branch thinks that this amendment provides an incentive for the timely disposal of surplus assets, including vehicles. Six departments have conducted pilot projects involving the direct sales of assets.

Debt Management and Employee Pensions - 1991, Chapter 8

Background

2.73 Chapter 8 of our 1991 Report recommended that the government review the long-term implications of borrowing from federal employee pension accounts, consider establishing clear fiduciary responsibility for the pension plans, and provide better disclosure of employee pensions in the Public Accounts and the Estimates.

2.74 At hearings of the Standing Committee on Public Accounts in February and September 1992, the Deputy Minister of Finance, the Secretary of the Treasury Board and the Comptroller General made commitments to complete a joint study, by the end of summer 1993, on the long-term implications of current and alternative financing arrangements for the public service pension plans. As well, the Department of Finance undertook to perform an internal review of the implications of existing pension plan arrangements for the deficit and debt management. The Comptroller General also agreed to take under consideration the Auditor General's recommendation regarding disclosure of pension information in the Public Accounts.

Scope

2.75 Our follow-up focussed on actions taken by the central agencies involved to address our recommendations. We reviewed the formal responses to the Standing Committee on Public Accounts, and status reports provided by the Department of Finance, the Treasury Board Secretariat and the Office of the Comptroller General explaining what they have done. We also reviewed the Department of Finance's March 1993 internal study report on the implications of the existing pension arrangements for debt management. We interviewed staff of the Department of Finance and the Treasury Board Secretariat and reviewed documentation to substantiate the reported progress.

Conclusion

2.76 The Department of Finance and the Treasury Board Secretariat have improved information for Parliament on pension accounts, and Finance has completed a study of the implications of the present pension arrangements for its debt management. However, progress has been slow in the main areas of our concern - the long-term implications of alternative financing arrangements for the federal employee pension plans, and fiduciary responsibility. Further follow-up needs to be done in 1994.

Observations

Long-term implications of alternative financing arrangements

2.77 We recommended that the government undertake a study of the costs/benefits and long-term implications of alternative financing arrangements for its employee pension plans, including an evaluation of the implications of the current notional investment policy for the deficit, financial requirements and the public debt.

2.78 Department of Finance study. Finance's internal study addressed only the question of whether the existing pension arrangements limit the government's capacity to achieve its current debt strategy and its objective of increasing the fixed or long-term portion of the overall stock of debt. The study concluded that they do not. In fact, they help to achieve the chosen target. Given the assumptions used in the study, we tend to agree with this conclusion.

2.79 However, the study did not report on alternative assumptions of the government's financial requirements and pension debt, as it did for alternative assumptions of interest rate and fixed-floating debt mix. Although the assumptions of future financial

requirements and pension debt growth used in the study were predicated on the government's fiscal and economic projections, one would still expect the study to have considered other plausible alternative assumptions. A sensitivity analysis taking into consideration other financial requirements and pension debt scenarios might also have been helpful, in determining whether pension-related debt will hinder debt management operations if financial requirements do not decline as projected, and/or if pension debt does not increase as anticipated. Continued monitoring and assessment would be prudent.

2.80 The Department indicated that it will continue to assess the impact of the pension account financing as part of its annual debt strategy exercise.

2.81 Joint Treasury Board Secretariat-Department of Finance study. Work has begun on the broader-based joint study on the implications of alternative financing arrangements for public service pensions (including market-based investment approaches). However, progress has been slower than planned.

2.82 An interagency working group was set up to analyze and assess the impact of current and alternative government pension financing arrangements on government expenditures, debt management, capital markets and the economy. The central agencies' plan called for this study to be completed by the end of September 1993. At the time of the follow-up, the study was not completed. We were informed that it will now be completed in early 1994.

2.83 We were also informed that the results of the joint study will be used by the President of the Treasury Board's Advisory Committee on the Public Service Superannuation Act, which has been asked to conduct a fundamental review of the public service pension plans, including such issues as their management, design and financial arrangements. The results of the Advisory Committee review are not expected before early 1994.

Treasury Board Secretariat's response: Unfortunately other priorities have prevented the Treasury Board Secretariat/Finance study from being completed as soon as expected. However, work is well under way and the study should be completed by early 1994.

Fiduciary responsibility

2.84 We recommended in 1991 that the government consider establishing clear fiduciary responsibility for federal employee pension plans.

2.85 No action has been taken in this area. Although it was not covered in the terms of reference of the joint Treasury Board Secretariat - Finance study, officials of the Treasury Board Secretariat informed us that the study will look at the concept of fiduciary responsibility. They also reported that the issue should be dealt with as an outcome of the Advisory Committee's deliberations.

Information for Parliament

2.86 We recommended that the government clearly present pension obligations as public debt in the Public Accounts. We also recommended that adequate information be provided in the Estimates to enable Parliament to review program details, including the present value of long-term obligations arising from government employee pension plans.

2.87 Improvements have been made in this area. In the latest Public Accounts and Estimates, Parliament was provided with additional information on public debt interest charges and the level of liabilities with respect to the Superannuation Accounts. There is an opportunity for further improvement in terms of providing pension information in a more understandable form.

2.88 In that respect, the central agencies indicated that the government is planning to produce an annual report to present its financial position and operating results in summary form. It will consider identifying specifically the key components of public debt, such as employee pensions, and will review the merits of grouping pension liabilities with unmatured debt.

Financial Management and Control of Non-tax Revenue - 1991, Chapter 9

Background

2.89 Our 1991 audit concluded that steps were being taken to improve financial management and control of non-tax revenue. There was a need for effective incentives, better information, and improved control. We reported the following particular matters in need of attention:

- monitoring by central agencies;
- strategic planning and identification of potential revenue sources;
- collecting, controlling and accounting; and
- public disclosure of non-tax revenue activity and performance.

Conclusion

2.90 Non-tax revenue management continues to improve and is achieving tangible results. However, we still have some concerns about financial management and control.

2.91 The Treasury Board Secretariat, including the Office of the Comptroller General, has been influencing non-tax revenue management. User fees are reported to have increased by \$450 million over two years.

2.92 We note progress by the eight departments included in this follow-up. Although gains have been made, the implementation of user fees still faces the ongoing challenge of determining appropriate cost recovery.

2.93 Information for Parliament needs further work to provide meaningful public disclosure.

Observations

Monitoring by central agencies

2.94 Central agencies are monitoring non-tax revenues but could do it more completely. Central agency attention to non-tax revenues is part of the annual multi-year operational planning budget exercise for departments and agencies. We are informed that an annual status report is provided to Treasury Board ministers as part of this process. However, there is yet to be an evaluation of the implementation of the User Fee Policy as Treasury Board originally required by March 1993. We think this commitment should be followed through.

Strategic planning and identification of revenue sources

2.95 Departments have progressed in non-tax revenue management but sustained effort is required. All departments we followed up have taken action on matters reported to them. Although there is progress, departments can still have difficulty sustaining attention to non-tax revenue. The implementation of user fees is not without problems, including differentiating between mandatory and non-mandatory services, determining and allocating costs, and securing acceptance for fees.

2.96 For example, after more than four years and extensive consultation with interested parties, the Department of National Health and Welfare has been unable to meet its 1988 commitment to the Treasury Board for cost recovery in the pre-market evaluation of drugs. The Department informed us that its proposals were opposed by the pharmaceutical industry. In January 1992, the Minister commissioned an external review of the drug approval system. The Department is now engaged in an extensive policy review to design an efficient drug-approval process that includes consideration of various options for cost recovery. Meanwhile, \$182 million has been spent over four years on drug approval activities. In the area of dosimetry services, cost recovery is on hold pending a final decision on privatization. In the operations of the Department's hospitals, the percentage of costs recovered for insured medical services increased from 57 percent to 66 percent over two years.

2.97 The Department of External Affairs took special action and collected more than \$850,000 in overdue rents from over three hundred employees located around the world. The task now being undertaken by the Department is the implementation of a more permanent solution in the system of foreign service management, in order to keep overdue accounts to a minimum and avoid the necessity of special investigations.

Public disclosure

2.98 Information for Parliament needs further work. Although there has been some improvement, the Public Accounts and the Estimates still do not provide information on budgeted revenue that can be compared readily to actual. We also note that there is no analytical information to explain apparent shortfalls in "return on investments".

2.99 Another complex item still not well explained involves the "net revenues" of the Bank of Canada. When money is remitted by the Bank to the Department of Finance, it is

not deducted from public debt charges, even though the money originates from debt securities of Canada. This can affect, by some \$2 billion, the calculation of the government's "operating balance" (annual deficit excluding public debt charges) now used in reporting the budget performance of the government.

2.100 Accounting for the Bank of Canada requires further study because of the unique status and operations of the Bank. The issue of disclosure should be considered as part of the government's study of Crown corporation reporting in the Public Accounts or in a succinct annual financial report. In the meantime, the Department of Finance may wish to consider the treatment of Bank revenues in defining and reporting an operating balance for the Government of Canada.

2.101 We also have some concern that certain money made available to departments will not receive parliamentary scrutiny when annual Estimates are presented. Due to amendments to the *Surplus Crown Assets Act*, departments now have a non-lapsing generic statutory authority to spend additional money generated by the sale of surplus assets. This supplements funding levels previously voted to departments by Parliament. At present, Parliament does not receive information on the amounts involved when reviewing current Estimates.

Treasury Board Secretariat's response: We acknowledge that Bank of Canada profits could be classified in the financial statements either as a reduction in public debt charges or as profits of Crown corporations. We are reviewing the current presentation for this and similar items (such as interest earned in the exchange funds) with a view to improving their presentation in the Public Accounts. We also note that the amounts of the Bank of Canada profits are disclosed in the Public Accounts so that readers may make adjustments to suit their purposes.

Department of External Affairs - Membership Payments to International Organizations - 1991, Chapter 12

Background

2.102 In 1991 we reported on the management practices of the Department of External Affairs pertaining to its accountability for membership payments to international organizations. Recognizing the Department's central role in implementing Canada's foreign policy, we also commented on its arrangements for co-ordinating the involvement of other government departments and agencies in multilateral activities.

Conclusion

2.103 The Department has made progress in implementing certain of our recommendations. It has made an effort to clarify foreign policy objectives and assess the continuing relevance of membership in international organizations, and to strengthen co-ordination with other departments and agencies involved in multilateral activities. However, the Department points out that, in re-examining memberships, it is guided by decisions at the most senior political level. While reform is a continuing goal, the

Department asserts that these memberships bring significant benefits to Canada, such as the development of international health regulations, irrespective of the relative efficiency of the organizations.

2.104 Awareness has been increasing among the Department's staff about the need to be more focussed in efforts to bring about reform of the United Nations system. However, there are two major constraints to achieving substantive results. First, the process of implementing change in the multilateral system is inherently slow. Second, increasing resource constraints and fundamental changes in the role of the UN make it difficult to devote the necessary attention to the UN reform process.

Observations

Relevance and benefits of membership

2.105 In 1991 we recommended that the Department more clearly define its foreign policy objectives with respect to multilateral activities. We recommended that it collect information to assess the benefits accruing from membership in international organizations and the degree to which its multilateral objectives are met, and use the information to decide on the nature and extent of its participation in multilateral co-operation.

2.106 The Department views membership as a given that follows long-established government policy: participation promotes and protects fundamental Canadian interests. The Department has produced a Foreign Policy Framework in which high-level objectives are defined for multilateral activities. These objectives are pursued through participation in individual international organizations whose stated objectives the Department considers to be compatible with, and to contribute to, those of Canada. At the request of External Affairs, other departments and agencies have provided it with documents that set forth their technical objectives and priorities, benefits of membership, and efforts to reform the administrative systems and financial management of the international organizations they are involved with in their spheres of activity and competence.

2.107 Also, the Department has withdrawn from membership in four multilateral trade institutions and did not join a fifth because the benefits of membership were insufficient. During the past year the Department has twice reconsidered the benefits of membership in certain other international organizations. The first review led to a decision to withdraw from the United Nations Industrial Development Organization. However, the second review, of membership in the International Labour Organization, the United Nations Educational, Scientific and Cultural Organization and the Food and Agriculture Organization, was viewed as inconsistent with basic government policy and was therefore discontinued.

Efforts to reform the UN system

2.108 We recommended that, in its efforts to improve the administration of international organizations, the Department set priorities, focus on organizations and programs that are most significant to Canada and pursue co-operation with developing countries.

2.109 The Department has become increasingly aware of the need to be more focussed in its efforts toward administrative reform of the organizations. However, it points out two constraints. First, reform is difficult and extremely slow, given the consensus that must be built among member nations and within organizations. Second, the extent to which Canada can affect the nature and pace of change depends on availability of resources. The Department indicated that government downsizing has forced it to deploy its diminishing resources to only the highest priorities. Reform at the UN, therefore, is becoming a lower priority.

2.110 The Department indicated that it nevertheless has had success in bringing about improvements in certain organizations. Canadians chair expert groups that have launched reform processes at the International Labour Organization (ILO) and the United Nations Educational, Scientific and Cultural Organization (UNESCO). Canada also took the lead at the 1993 World Health Assembly in achieving substantial budget reform, with support from a wide range of countries. The Department has made proposals for major changes to the administrative structure of la Francophonie and is playing a key role in the strategic planning of the Commonwealth Secretariat.

2.111 While recognizing the benefits of increased co-operation with developing countries, the Department has decided, in the face of scarce resources, that a collective effort by like-minded countries to monitor UN organizations is appropriate. It has increased its efforts to make the Geneva Group the focal point for evaluating their performance.

2.112 We note that administrative and management practices of some organizations, for example the UN Organization, the World Health Organization, the ILO, the Food and Agriculture Organization and UNESCO, will require further attention.

Accountability for Canada's performance

2.113 We recommended in 1991 that the Department communicate to other departments and agencies its definition of, and its accountability for, "high-quality Canadian participation in international organizations." The Department has provided a definition with three aspects: 1) projection of Canadian interests and objectives in multilateral forums; 2) co-ordination of Canadian foreign policy; and 3) placement of Canadians in positions of influence in international organizations.

2.114 The Department has also begun the process of concluding memoranda of understanding with other departments and agencies to clarify their respective roles and responsibilities.

Information to Parliament

2.115 In 1991 we recommended that the Department provide better information to Parliament to justify its use of resources in terms of the extent to which Canada is meeting its foreign policy objectives through multilateral channels. During the last two years, the Secretary of State for External Affairs and senior officials appeared before a parliamentary committee more frequently than in previous years to testify on multilateral issues. Because of resource limitations, the Department is asking for guidance from Parliament on its needs for additional information before undertaking to provide significant amounts of new written material.

Department of Fisheries and Oceans - Central and Arctic Operations - 1991, Chapter 13

Background

2.116 In our 1991 chapter, we reported that the Central and Arctic Region of the Department of Fisheries and Oceans was facing a number of significant demands and challenges in delivering its programs. Specifically, we made observations and recommendations in the areas of delegation to provinces, fish habitat management, Arctic fisheries management, science priority setting and small craft harbours. In our follow-up, we asked the Department to update its responses to the more significant observations and recommendations and to report its progress. Then we conducted interviews and reviewed documents to assess the extent of the progress.

Conclusions

2.117 In 1991, we recognized that many of the issues we raised and the demands the Region was facing were of a national or government-wide nature, were complex and difficult to address, and would require considerable time to resolve. Our follow-up confirmed this to be the case in several areas. No significant progress has been made in clarifying fisheries and habitat management roles and responsibilities with the provinces through formal agreements. Only limited progress is reported in efforts to improve information and databases on Arctic fish stocks. Some progress has been made in determining the impact of increasing reliance on outside sources to fund science programs and on options to stabilize such funding. In addition, progress has been satisfactory in promulgating guidelines and reporting progress on fish habitat management initiatives, in further developing co-operative management in the Arctic, in defining and communicating science priorities and plans, and in improving the management of small craft harbours in certain areas.

Observations

Delegation to provinces

2.118 In 1991 we reported a need to clarify fisheries and habitat management responsibilities with the provinces, through formal agreements and sub-agreements. We reported that General Fisheries Agreements were in place in two of the four provinces in the Region, and that there were no formal sub-agreements on specific areas of

responsibility such as habitat and aquaculture. Our follow-up revealed that the situation remains unchanged, although informal mechanisms continue to exist. Such things as the constitution referendum and changes in provincial governments have contributed to making the resolution of these issues difficult and lengthy.

Fish habitat management

2.119 Cabinet has approved a departmental submission to address sustainable development issues and to start negotiations with the provinces on sharing fish habitat responsibilities. Although no formal habitat sub-agreements are in place, the Department hopes that the planned negotiations with the provinces will result in workable sub-agreements.

2.120 The Department has made noticeable progress in addressing our observations and recommendations in three other areas. Specifically, documented "Habitat Conservation and Protection Guidelines" developed from the Policy for the Management of Fish Habitat were recently issued in draft to departmental users. The Central and Arctic Region now has a habitat referral tracking system in place and a national system is being developed. A report to Parliament on the "Administration and Enforcement of the Fish Habitat Protection and Pollution Provisions of the Fisheries Act" was submitted for 1991-92 and will continue to be prepared annually.

Arctic fisheries management

2.121 The 1991 chapter noted that improved data on fish stocks were needed to meet the obligations of native land claim settlements. The settlement of native land claims, and the establishment of wildlife management boards under those claims to co-manage, with the Department, fisheries in the claim areas (among other things), continue to be key priorities for the Department in the Northwest Territories. Since 1991, two additional claims have been settled and it is hoped that agreement on another will soon be reached. The wildlife management boards under these claims are being set up, and include representatives nominated by the Minister, as is the case on existing boards. The extent to which fisheries issues will be addressed will depend on the directions taken and the decisions made by the boards, and on the funding to be made available through them. It is the Department's position that these boards should receive sufficient funding and be responsible for developing the information needed to manage fish stocks. However, funding allocated to the Department and the boards to meet the fisheries obligations under the three claims recently settled has been considerably lower than the amounts requested. This could continue to make the gathering of important fisheries information difficult.

Science priority setting

2.122 Our 1991 chapter observed that, with the increasing reliance on external funding of science projects, there was a risk that research could move away from departmental priorities or that a lack of such funding could put projects or programs in jeopardy. The Experimental Lakes Area program was used as a case example. Since then, the Department has undertaken two initiatives to address these concerns. First, in preparing a "Ten-year DFO Science Perspective", the Science Sector has developed "core business

statements" that identify what it does, and has identified over twenty projects to be undertaken to address the key results it wants to achieve. One such project examined the pros and cons of outside funding. As a second initiative, the Region contracted out an examination of the future of the Experimental Lakes Area program, hoping to identify options to stabilize funding and therefore assure the program's continued operation. The contractor's report provided recommendations and options, and the Region is now actively pursuing these in more detail to determine if they are viable. In the meantime, the Experimental Lakes Area program continues to operate with small "A-base" funding and uncertain external funding.

Small Craft Harbours

2.123 In 1991 we recommended that the delegation levels for approval of projects be increased at the regional levels to improve the timeliness of project initiations and start-ups. This was considered by the Department, but no changes in the delegation levels were made. However, the Small Craft Harbours Branch reports that it is more active in the monitoring and expediting of project plans and proposals, resulting in much earlier project approvals to minimize start-up delays.

2.124 The Department has undertaken initiatives that address our recommendations on the extent of preventive maintenance in the harbours and on the involvement of departmental personnel with the Department of Public Works in inspecting and commissioning major projects.

Department of Indian Affairs and Northern Development - 1991, Chapter 14

Background

2.125 In 1991 we reported on the lack of an accountability framework for the funds administered by Indian bands and tribal councils, the need for a new approach to solve the on-reserve housing backlog and the need to develop and maintain an appropriate Indian population information system for funding purposes.

2.126 We also reported on the settling of specific claims. We recommended that DIAND and the government reassess the fundamental concepts and practices for settling claims. These included the independence of the Specific Claims Branch in DIAND, the roles of other federal departments such as Justice, and the application of claims policies and procedures.

2.127 In addition, our 1991 audit covered Indian Oil and Gas Canada (IOGC). We recommended that it improve its documentation of the production assurance it obtains from several sources relating to oil and gas royalties. In addition, we recommended that it issue reports on all of its oil and gas audits and document the disposition of its audit findings.

Conclusion

2.128 The Department has made some progress in addressing our 1991 observations and recommendations on specific claims and on Indian Oil and Gas Canada. However, the recommendations had not been fully implemented at the time of our follow-up review. Consequently, our review was limited and we were unable to determine the full extent of improvements. We will continue to monitor DIAND's corrective action and a subsequent audit will be considered at an appropriate time.

2.129 The issues pertaining to the accountability framework and housing backlog are complex and have been outstanding for many years. Resolution of these issues requires consultation and action by all the affected parties. The Department has made proposals to those parties for their consideration and is awaiting their decision. A timely resolution of these long-standing issues is necessary.

Observations

Accountability framework

2.130 The Department has taken certain steps to strengthen the accountability framework. A new information system, the Transfer Payment Management System, is currently being implemented to help regional management track the receipt of the necessary information from First Nations. The Department is also in the process of conducting "strategic reviews" to determine the minimum data requirements that will satisfy its accountability to Treasury Board. We believe this process should be accelerated.

Backlog of on-reserve housing

2.131 DIAND has indicated that its proposed on-reserve housing policy will address our recommendation that it resolve the housing shortage. In its fourth report in December 1992, entitled "A Time for Action", the Standing Committee on Aboriginal Affairs recommended that the Government of Canada bring DIAND's review of the on-reserve housing program, begun in 1975, to an immediate conclusion and present recommendations to Cabinet for a new on-reserve housing policy. We agree with this recommendation and encourage remedial action without undue delay.

Membership data

2.132 During 1993, DIAND conducted a pilot project with four bands in the Atlantic Region to collect the necessary data. We have not yet reviewed the results. However, we are concerned that appropriate population statistics are not being collected in the regions west of the Atlantic Region, which contain most of the Indian population in Canada.

Specific claims

2.133 In July 1993, DIAND reported several initiatives to address our 1991 recommendations. They include:

the federal government's creation of an Indian Specific Claims Commission, from whom claimants may seek redress if they are not satisfied with DIAND's decisions on individual claims;
intensified co-ordination between DIAND and Justice to facilitate claims processing;
preparation of an updated claims processing manual and the streamlining of certain claims procedures to facilitate the submission and evaluation of claims;
and
increased co-operation between the federal and provincial governments to share the costs of settling treaty land entitlement claims.

2.134 We believe that these efforts can have a positive impact on the claims process and its results. According to DIAND, they have contributed, together with an increase in resources allocated to the claims process, to a faster disposition of claims. This should address the government's concern and our 1991 observations on the time required in prior years to decide a claim.

2.135 As DIAND continues to act on our 1991 recommendations, we encourage it to ensure that its new procedures contain appropriate safeguards to maintain claims assessment at an acceptable level of quality.

2.136 With respect to funding for claims research, DIAND advised us in August 1993 that it had increased its reviews of recipients' research plans and progress reports. However, DIAND confirms that, under its contribution arrangements, compliance audits of the use of research funds still are not required. Therefore, our 1991 observation still applies: we are concerned that accountability for these funds is weak. DIAND is further considering ways to address this issue effectively.

Indian Oil and Gas, Canada

2.137 In July 1993, IOGC reported several initiatives to address our recommendations. They include:

increased co-ordination of oil and gas production assurance between IOGC and the Alberta Energy Resources Conservation Board;
preparation of an updated program manual for obtaining production assurance related to royalties;
enhanced computer applications for analyzing production data received from oil and gas licensees; and
development of risk assessment criteria for the royalty audit environment, together with improved procedures for audit planning, reporting and disposition of findings.

2.138 We believe that these efforts can have a positive impact on the production assurance that IOGC obtains.

Department of National Revenue - Customs and Excise - Customs Operations - 1991, Chapter 15

Background

2.139 Our 1991 audit reviewed Customs' initiatives to streamline its operations in processing travellers and commercial goods at ports of entry. We also examined two of the many regulatory programs that Customs enforces at ports of entry - those involving illegal drugs and hazardous materials. In addition, we reviewed facilities at land borders as they relate to facilitation of travellers and drug interdiction.

Scope

2.140 Our follow-up consisted of a review of a status report prepared by the Department explaining its actions on our recommendations; interviews with headquarters and regional Customs staff; and a review of documentation.

Conclusion

2.141 The Department has taken action in response to all our recommendations, but work remains in some areas to address our concerns fully. Overall, the Department has made reasonable progress in most areas.

Observations

Travellers at land border crossings

2.142 In 1991 we recommended that the Department determine level-of-service standards for processing travellers at land border crossings. We recommended that it also expedite processing time at major ports, including reviewing the feasibility and applicability of the designated-lanes pilot test, and analyzing travellers' profiles at these ports. In March 1993, the Department completed a study to identify responsiveness indicators for setting standards of service to clients. Customs has planned to conduct surveys of travellers at 24 ports in 1993-94.

2.143 In early 1993 the Department completed an evaluation of a designated-lane pilot to simplify the entry of low-risk, frequent travellers at a major border crossing in British Columbia. The study noted that the pilot had been a success. It also identified certain exceptions, such as increased non-compliance and a need to improve signs. The Department has decided to extend the project, allowing frequent travellers to self-assess duties and taxes using a basket tariff approach, and to implement similar designated lanes at other major entry points. As of July 1993, other options were being pursued at some Customs ports.

Planning for physical facilities

2.144 In 1991 we recommended that the Department integrate port facility planning and management with operational requirements planning, develop and maintain a database of land border facilities and ensure that facilities provide adequate support for current and future operational needs. In response, a facilities working committee has been established

to co-ordinate the collection and dissemination of information on operational initiatives. The Department has launched a multiphased facilities evaluation project based on a detailed analysis of 35 out of a total 107 sites; final results are expected in December 1993.

2.145 In 1991, we observed that approximately 60 percent of all land border crossings owned by Customs had not been subject to a site assessment. As of June 1993, the percentage was reduced to about 30 percent. The Department indicates that it will have complete information on the condition of all its land border facilities by December 1993.

Release of commercial goods

2.146 We recommended that the Department review and determine the level-of-service standard of release time for commercial goods. The Department maintained that implementing a complex measurement system would not be justified; instead, it would conduct surveys from time to time to gauge client satisfaction with release time. We note that regional Customs offices maintain records of average release times at the port level, but release times vary significantly depending on the port and type of transaction. As described in a June 1993 letter from the Secretary of the Treasury Board to department heads, the Department is expected to establish and publish service standards for its major services in 1993-94. In response to this directive, the Department has established a project team to develop client service standards for the commercial process.

Illegal drugs

2.147 In 1991 we recommended that the Department conduct a comprehensive department-wide risk assessment, leading to a more flexible and responsive departmental interdiction plan to counter international drug trafficking. Since then, Customs has established regional intelligence analysis units and flexible response teams. Further, the Customs Enforcement Directorate at headquarters has prepared intelligence threat-assessment reports on specific illegal drugs and has issued periodic intelligence bulletins to describe major problem areas or threats facing Customs. The Department is also expanding the detector dog service and implementing an integrated Customs enforcement system on a pilot basis. As of August 1993, Customs was in the process of drafting a departmental interdiction plan.

Hazardous materials

2.148 Our 1991 audit noted that there was no defined program in place at Customs for dealing with hazardous materials. Since then, the Department has implemented a training program and has made reasonable progress in drafting a directive related to processing shipments of hazardous waste. Also, Customs has had discussions with other departments to co-ordinate the handling of dangerous goods and hazardous products. While training needs related to dangerous goods are being identified, a more active role for Customs and requirements for training in processing hazardous products remain to be decided.

Department of National Revenue-Taxation - Taxpayer Services - 1991, Chapter 16

Background

2.149 In 1991 we audited certain taxpayer services and related products of the Department of National Revenue Taxation. We made recommendations in the areas of understanding and responding to expectations, determining the benefits and costs of services and activities, and reporting to Parliament. This year we followed up on the actions taken by the Department in response to our recommendations and observations. We examined various documents and status reports provided by the Department and reviewed its written statements and explanations.

Conclusion

2.150 The Department has taken action on most of our recommendations but additional work needs to be done in other areas. We note that since our 1991 Report the two programs of the Department - Taxation and Customs and Excise - are being integrated, and many of the client services may have to be reviewed by the Department from the perspective of both the programs.

Observations

Understanding and responding to expectations

2.151 In 1991, we recommended that the Department find ways to obtain ongoing feedback on those of its services that were not being covered by its existing feedback mechanisms (for example, consultative committees, questionnaires and focus groups). The Department has recently begun to collect data regarding who calls the general enquiries service and why they are calling.

2.152 Further, we recommended that the Department ensure that taxpayers are informed about where and how to lodge complaints and that it make the most effective use of complaints as a source of information. Complaints received through the Problem Resolution and Ministerial Correspondence programs are now analyzed, significant trends recorded and information provided to senior management. Feedback on complaints received by other areas of the Department is communicated weekly to senior management through its Service Enhancement Program. In order to make data collection and analysis more manageable, only six field offices participate at a time.

2.153 We recommended that the Department review its existing performance standards. The Department studied clients' acceptance of some of the standards that were in use in 1991 and has either confirmed them or revised them in light of clients' expectations.

Telephone enquiries

2.154 In 1991, we noted that the Department did not have reliable measures of levels of service that could be used throughout the year for its telephone enquiries service; we

recommended that it develop such measures. The Department now has technology in place at local sites that permits the gathering of various level-of-service measurements. From November 1993 to February 1994, it will implement an interim program to roll up local data to provide regional and national measurements. The interim program eventually will be replaced by a more automated system that will make a greater range of data more easily available.

2.155 In 1991, we also observed that the general enquiries surveys conducted during the filing season in 1990 and 1991 were not designed to estimate the accuracy of replies to the general public. A similar survey was done in 1992 but not in 1993. Instead, a pilot survey was completed in the first quarter of 1993 to assist in the future development of a computerized system to measure accuracy.

2.156 In 1991 we reported that a departmental Task Force on Organizational Effectiveness had expressed concern about the use, during the busiest time of the year, of temporary employees with little experience or training as enquiries agents. This use carried with it a high risk that service standards would not be met. We recommended that the Department consider testing whether or not using a higher ratio of permanent to temporary staff, modifying training programs for temporary staff, conducting qualifying technical examinations, or other alternatives would affect accuracy. Budget constraints have caused National Revenue to largely curtail its use of temporary staff as enquiries agents. The Department has taken steps to improve the training program and has developed a selection tool to assess prospective agents' abilities, skills and personal qualities. Knowledge continues to be assessed without the aid of a technical examination.

Counter enquiries

2.157 We recommended that the Department collect information on waiting time at service counters for comparison to existing standards, and also determine whether it was feasible to obtain an objective measurement of the accuracy of replies to counter enquiries. The Department has developed methodology for measurement of counter waiting time, which it will use in the 1994 filing season. At the same time, National Revenue plans to study the effect of publicizing its service standards. However, the Department has stated that action on measuring the accuracy of replies given at the counter will depend on its experience with the accuracy measurement system for telephone enquiries.

Forms and publications

2.158 We recommended that the Department perform a study to estimate the benefits of making its publications easier to read and understand, and to ascertain, from the findings of the study, whether improving publications was being given appropriate priority and adequate resources. The Department recently adopted a process of "full readability review" for all its publications over time, to ensure that they adhere to plain language principles.

Determining the benefit and costs of services and activities

2.159 In 1991 we noted that the Department had not evaluated its various service programs to ascertain whether they were achieving their objectives and contributing to the accomplishment of the Department's mission, and were cost-effective. We recommended that the Department evaluate the costs of its service programs in relation to their contributions to stated objectives, and determine the appropriate allocation of resources. The Department completed a partial review of its Tax Information Phone System (TIPS) program in 1992. National Revenue's internal audit and evaluation unit has tentatively planned to evaluate one aspect of client assistance in 1993-94.

Accountability

2.160 We recommended that the Department develop, and report in Part III of the Estimates, measures of service quality in comparison to the corresponding standards. A review of Part IIIs for 1992-93 and 1993-94 indicates that the Department has made progress in reporting measures of quality for a few of its services. The Department expects that standards for the purpose of comparison will be ready for publication in the 1995-96 Part III.

Department of Public Works - Office Accommodation Planning and Leasing - 1991, Chapter 17

Background

2.161 In 1991 we examined the planning and acquisition of leased office space for accommodation of government employees. The Department of Public Works provides office accommodation to about 110 departments and agencies.

2.162 We concluded that there were long-standing, fundamental accommodation issues to be resolved: the service and control roles of the Department; user pay for accommodation; and long-term planning and investment strategies. Resolution of these issues could facilitate essential reforms in the planning and acquisition of leased office space.

2.163 We also observed that the Department's leasing practices were slow and cumbersome and that lease documents were overly detailed and complex. Our work confirmed what the Department had recognized: that it could and should be more responsive to the accommodation needs of its tenant departments and streamline its leasing operations.

Scope

2.164 Our follow-up consisted of reviewing the Department's June 1992 and 1993 status reports to the Public Accounts Committee on action taken in response to our 1991 recommendations, as well as discussing these reports with departmental officials. We did not examine any additional leasing transactions to determine the current status of leasing practices.

Conclusion

2.165 Officials of the Department of Public Works believe that they have satisfactorily completed the policy groundwork for successfully implementing the new procedures implicit in "shared accommodation leadership". The Department has requested the formal delegation for the authority to develop and enforce office accommodation policies and standards. At the time of writing this report, the Department had just received the delegated authority.

2.166 The Department has undertaken significant initiatives to improve the planning and acquisition of leased office space. Given the fundamental nature of our 1991 observations and recommendations and the recent government reorganization, successful implementation of the Department's accommodation and leasing initiatives is expected to take several years.

Observations

Operational review and government reorganization

2.167 In response to the issues we reported in 1991, the Department undertook a number of initiatives. However, they have been delayed as a result of other departmental priorities.

2.168 In November 1992, a consulting firm completed an operational review of the Department of Public Works. The consultants indicated that the Department could realize annual savings of \$63-68 million by 31 March 1997 through a reduction of 1200-1300 person-years. These would come mainly from business planning and management and support activities.

2.169 On 25 June 1993, the Prime Minister announced a government reorganization. A new Department of Government Services is being created, which combines the former departments of Public Works and Supply and Services. The reorganization affects many tenant departments as well as measures planned in response to our 1991 recommendations. These measures are being continued by the new Department of Government Services.

Service and control roles of Department of Public Works

2.170 In 1991 we noted that Treasury Board was in the process of transferring authority to Public Works to develop and enforce office accommodation policies and standards. The formal delegation to the Department was the third of four phases of this process and was delayed by the government reorganization.

2.171 The Department has been preparing for this responsibility by drafting a new policy framework (called "shared accommodation leadership") for office accommodation and accommodation services. The proposed framework is based on two main concepts: shared accountability between Public Works and the tenant, and flexible departmental standards based on what people do in their jobs (their functional requirements). Public

Works and tenants will share accountability through a Master Occupancy Agreement, which outlines space standards and a framework for accountability. The Department has also developed an office design guide and has established functional standards for individual workplaces. These are available to tenants to help them determine how much space they need and how to use it most effectively.

User pay for accommodation

2.172 The Department plans to evaluate the merit and impact of moving over the long term to a policy of charging tenant departments for office accommodation.

Long-term planning and investment strategies

2.173 Department initiatives to improve long-term accommodation planning are scheduled over several years; these initiatives require the involvement of a number of tenant departments/agencies that are now being redefined, as part of the government's reorganization. That reorganization will have an impact on the current and future office space requirements of departments; on long-term investment strategies; and on leasing strategies for major metropolitan centres.

2.174 Block 56, Vancouver B.C. Our 1991 Report outlined the history of this property since 1982. Block 56 was being used as a parking lot but development proposals were under consideration. In 1992 the property was sold to the City of Vancouver. The Department has entered into a lease-purchase agreement with the City for a major office building to be constructed on a portion of Block 56; the building will house tenants of the Department.

The planning and acquisition of leased office space

2.175 The Department of Public Works is seeking to improve significantly the planning and acquisition of leased office space, through a reorganization of the total process. As the second phase of its operational review, in 1992 the Department established a working group to streamline its processes for acquiring space for tenants by reducing the cycle time substantially and improving service delivery. The project represents part of the remedial action to address our 1991 observations on leasing practices. The working group has completed consultation with Public Works staff, tenants, industry and other government organizations. Senior management review of the working group's proposals is expected to continue into the fall of 1993.

Department of the Secretary of State - Official Languages and Translation - Translation Bureau - 1991, Chapter 20

2.176 Our 1991 audit of the Secretary of State dealt primarily with the management of cost, performance, human resources and contracting out at the Translation Bureau. We also reviewed the results obtained by the Bureau in recent years and analyzed the organization's work climate. It became clear that the Translation Bureau would have to undergo major changes to correct the weaknesses we identified and meet the challenges it was facing.

Background

2.177 Since our audit, several events have happened. In the spring of 1992, a new management team started at the Translation Bureau, and in June 1993 it was announced that the Bureau would join the Department of Government Services. During the same period, it completed two in-house studies aimed at streamlining and redirecting its activities. The government had announced in its April 1993 budget that the Translation Bureau would become a special operating agency by 1 April 1995. Effective on that date, the use of its services by the departments and agencies now dealing with the Bureau would be optional. In April 1994, the Bureau will begin a one-year trial period functioning as a special operating agency.

2.178 This redirection demands significant structural and cultural changes, since the Bureau will be obliged, on the one hand, to compete with the private sector and, on the other, to recover its costs. The Bureau is now in the midst of a complete re-engineering and restructuring process, which is focussed on both its in-house operations and its relations with suppliers and clients. Since February 1993, twelve working groups composed of Bureau staff and consultants have been involved in this undertaking. They are examining, among other things, issues related to new functions for production units, client services, logistics, human resource management and the need for accounting and management information systems. Most of these groups filed reports on 30 July 1993.

Scope

2.179 Our follow-up covered the actions taken by the Bureau in response to our observations and recommendations. In our opinion, our observations and recommendations remain entirely relevant to the requirements associated with the Bureau's status as a special operating agency. We analyzed the available reports and management data and reviewed the studies and other documents, including the working group reports. We also substantiated the progress achieved during discussions with staff and management.

2.180 In August 1993, at the end of our follow-up, management was planning the strategic decisions needed to implement the new operational structure and the special operating agency. Thus we could not verify in what measure these decisions will allow the special operating agency to implement our recommendations. The Bureau must submit its interim business plan for the special operating agency to the Treasury Board by November 1993.

Conclusion

2.181 In deciding the type of organization it wants to become, the Translation Bureau has given priority to resolving a basic issue. We also noted that it has followed up several of our observations and recommendations. Given the environment that has existed since our audit, we think the Bureau has made satisfactory progress so far.

2.182 Despite these efforts, however, we note that significant weaknesses still exist. We are particularly concerned about cost reduction, regular follow-up and analysis of results,

human resource management strategy, performance standards and the comprehensive management information system. These are areas of particular interest that represent key success factors for the Translation Bureau and a special operating agency.

Observations

Costs

2.183 Exhibit 2.1 shows the elements that make up in-house and contract costs.

2.184 As we had recommended, the Translation Bureau has changed its cost determination method, allowing it to now determine the full cost per word translated in-house and contracted out. The Bureau has also decreased its indirect costs by 9.8 percent over the past two years. Moreover, it has eliminated the disparity that existed in 1990-91 between the direct cost per word translated in-house and contracted out. Thus, the direct cost per word is slightly higher for translation contracted out than the direct cost per word translated in-house. This change is a result of the combined effect of a reduction in direct in-house costs and an increase in direct costs of contracting out. Given that the average price paid to contractors has remained quite stable over the past two years, the increase in direct costs of contracting out is explained mainly by the direct costs related to contract management. These costs correspond essentially to the time spent in contract management activities by staff in production units and operations support services. Direct costs related to contract management add 29 percent to the price paid to contractors. This underlines the high cost of contract management for the Translation Bureau.

2.185 At the same time, although the full cost per word translated in-house has decreased by 16 percent since April 1991, it is still higher than the market price. The Bureau must therefore strictly control its costs and even reduce them.

2.186 Currently, the Bureau has a cost accounting system that enables it to determine the direct cost per word for in-house and contracted-out translation. Although management exercises budgetary and operational control, it does not use cost per word as a performance indicator to regularly monitor its direct costs. In September 1993, the Bureau was expecting to receive a proposal from its consultants for a cost accounting system that will meet its future needs and that will be adapted to its products and services.

Human resource management and translators' performance

2.187 In 1991 we recommended that the Bureau, in consultation with employees, develop a human resource management strategy, identify employees' skills, define its needs and monitor the work climate. The Bureau subsequently began to identify its translators' skills and improve certain human resource management practices - in particular, its recruiting and promotion procedures. In addition, the Bureau consulted with employees on numerous occasions, informed them of its decisions and monitored the work climate.

2.188 We also expected that the Bureau would develop a human resource management strategy. We observed that it has started with its working groups to define certain

elements. However, we believe that the human resource management strategy should be part of the strategic decisions that management proposes to make in the near future.

2.189 Translators' performance is the main factor affecting the Translation Bureau's overall productivity and, consequently, its production costs. In 1991 we recommended that quantitative performance standards be established by employee group or by sector, and measures implemented to reward those who achieve or exceed these standards. Since our audit, the Bureau has not adopted performance standards to evaluate its translators' performance objectively and to set an optimum productivity level. Therefore, it is unable to determine whether the performance and production costs have reached an acceptable efficiency level. To compensate, however, management intends to determine expected staff performance levels in conjunction with the cost per word, which will be established in accordance with market price. As part of its redirection, it also began reflecting on incentives to encourage employees to optimize their performance. The Bureau should continue its efforts, together with the Treasury Board Secretariat, to adopt incentives based on the new organization's goals.

Client satisfaction and quality of texts translated

2.190 Client satisfaction and the quality of texts translated are key indicators for the Translation Bureau. To measure them, the Bureau still uses the Continuous Evaluation System. Its objectives and methodology have not been reviewed as we had recommended. Thus, the results of tests provide only general data once a year. For example, the Bureau evaluates the quality of translations without measuring them against the quality expected. Also, client satisfaction with delivery deadlines, the most important factor in client satisfaction, is no longer evaluated. To be effective, the Continuous Evaluation System, or any other mechanism, must help management regularly to make the decisions necessary for achieving established objectives.

Management information

2.191 We found that, in 1992-93, the Bureau improved its performance in terms of costs, productivity and quality of translations. However, it was unable to identify the underlying reasons. Indeed, we noted that management still has only annual general data, which are not subject to sufficient analysis to identify the factors that could explain performance.

2.192 As part of our follow-up, we analyzed the results of the Bureau's tests on the quality of delivered texts. We noted that major changes had been made since 1990-91 to the methodology of evaluating texts. We believe that the changes may explain, in part, the significant improvement in the quality of texts delivered, shown in the test results for the past three years. Moreover, our analysis of the overall productivity of official languages translation showed that close to half the increase in productivity was due to systemic changes in the breakdown of indirect time. Thus, the increase in productivity not related to these changes (1.9 percent per year) corresponds to the increase in productivity of 1.7 percent per year that we identified for the fiscal years 1986-87 to 1989-90.

2.193 During fiscal year 1994-95, the Translation Bureau proposes to acquire a comprehensive management information system to give it real-time access to information it needs to monitor its costs and performance. This should allow it to obtain timely management information and to provide Parliament with more complete information. The Bureau should also ensure that it regularly carries out the necessary analyses to follow up and explain its performance.

Chapter 3

Other Audit Observations

Main Points

Introduction

Observations on Crown Corporations

- Atomic Energy of Canada Limited
 - Failure to record obligations for decommissioning and site remediation in the financial statements of Atomic Energy of Canada Limited for the year ended 31 March 1993

Observations on Departmental Expenditures

- Atlantic Canada Opportunities Agency
 - Failure to adequately evaluate, monitor and control a repayable contribution agreement under the Fisheries Alternatives Program
- Canadian Grain Commission
 - Ex gratia payments made by the Canadian Grain Commission were an inappropriate use of public money and, in some cases, were outside its mandate
- Department of Industry, Science and Technology
 - Investment agreement not structured to adequately protect the interests of taxpayers
- Department of Industry, Science and Technology
 - Unrecorded liabilities result in an understatement of program expenditures
- Investment Canada
 - Duplication of presidential facilities without need
- Department of the Secretary of State
 - Urgent steps required to deal effectively with student loans in excess of the annual loan ceiling provisions of the Canada Student Loans Act

Observations on Tax Revenue

- Departments of Finance and National Revenue
 - A resource allowance income tax provision did not clearly convey the government's intent. This will result in \$636 million in refunds for income tax and interest, and will expose the Crown to at least an additional \$538 million in potential refunds
 - Appendix
 - Background. The Gulf case considered whether certain deductions of scientific research expenditures and capital cost allowance claimed by a taxpayer were required to be deducted in computing the taxpayer's "resource profits".
 - Revenue at risk. The figures used by the Auditor General have been provided by National Revenue officials, who, we understand, are still in the process of refining the figures further. It should be noted that

approximately two thirds of the \$636 million exposure referred to in the audit observation relates to interest and that the government has had use of these funds.

- Departments of National Revenue and Finance
 - A clause in the Government of Canada's tax collection agreements with the provinces and territories needs to be clarified
- Department of National Revenue
 - Overdue goods and services tax continues to rise, and the volume of delinquent registrant accounts remains high

Exhibits

- 3.1 Departments of National Revenue and Finance - Tax Collection Agreements
- 3.2 Overdue GST Accounts
- 3.3 Profile of Compliant versus Delinquent GST Registrants

Other Audit Observations

Main Points

3.1 The *Auditor General Act* requires the Auditor General to include in his annual Report matters of significance that, in his opinion, should be brought to the attention of the House of Commons.

3.2 The "Other Audit Observations" chapter fulfils a special role in the annual Report. 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 is used to report individual matters that have come to our attention during our financial and compliance audits of the Public Accounts of Canada, Crown corporations and other entities. It is also used to report some specific matters that have come to our attention during our comprehensive audits.

3.3 The chapter contains a wide range of observations. One concerns a reservation in the auditor's report on a Crown corporation's financial statements for the year ended 31 March 1993. The others concern departmental expenditures and tax revenues. The issues addressed generally concern failure to comply with authorities, poor cash management practices, inadequate control over revenue, and the expenditure of money without due regard to economy.

3.4 Although the individual audit observations report matters of significance, they should not be used as a basis for drawing wider conclusions about matters we did not examine.

Introduction

3.5 This chapter contains matters of significance not included elsewhere in the annual Report that we believe should be drawn to the attention of the House of Commons. The matters reported have come to our notice during our financial and compliance audits of the Accounts of Canada, Crown corporations and other entities, or during our comprehensive value-for-money audits.

3.6 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; or

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

3.7 Each of the matters of significance reported in this chapter was examined in accordance with generally accepted auditing standards, and 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 Crown corporation or department heading.

3.8 Consistent with Office policy on follow-up of matters in our annual Report, other audit observations included in this chapter are normally followed up two years after initial reporting. In our follow-up of the observations included in our 1991 Report, we found that for ten of the observations, either corrective action had been taken to address the matter or we no longer considered the matter to be an outstanding issue. The other nine observations involve matters that we are continuing to monitor, and corrective action or the lack thereof will be reported as deemed appropriate.

Observations on Crown Corporations

3.9 The Auditor General is appointed auditor of a number of Crown corporations and other entities, under the *Financial Administration Act*, individual Acts incorporating specific corporations, or by orders-in-council. Although our observations have already been raised publicly in our reports on the financial statements of these Crown

corporations and other entities, some are reported in this chapter for emphasis and for consideration by Parliament.

Atomic Energy of Canada Limited

Failure to record obligations for decommissioning and site remediation in the financial statements of Atomic Energy of Canada Limited for the year ended 31 March 1993

The Auditor General included a reservation in his report on the financial statements of Atomic Energy of Canada Limited (AECL) for the year ended 31 March 1993, concluding that the failure to record the total likely liability for costs of decommissioning and site remediation in AECL's financial statements was a departure from generally accepted accounting principles. Although the corporation estimated and reported in notes to its financial statements a range of 200 to 300 million dollars relating to a portion of these costs, it did not determine the overall estimated costs of much of the activities to be carried out over the next four to five decades.

3.10 Background. In common with other entities operating in the nuclear industry, AECL incurs costs for decommissioning its facilities and for site remediation. Decommissioning activities include dismantling, decontamination and storage and disposal of residual waste. Management is responsible for preparing financial statements that fairly present the corporation's financial position and the results of its operations in accordance with generally accepted accounting principles.

3.11 For financial statements relating to years commencing on or after 1 December 1990, generally accepted accounting principles require that, where reasonably determinable, the total obligations related to such future costs for removal and site remediation be established, recorded and amortized over the useful lives of related facilities. Instead, the corporation records these costs as decommissioning activities take place.

3.12 In the Auditor's Report for the year ended 31 March 1992, the Auditor General drew to the attention of the Minister of Energy, Mines and Resources that the corporation is facing significant decommissioning and site remediation expenditures, which, under existing funding arrangements, are financed mainly through parliamentary appropriations. He noted that these costs will continue to be incurred over the long term, and their magnitude is such that there may be a significantly increased demand on government resources.

3.13 The financial statements of the corporation for the year ended 31 March 1993 include note disclosure indicating that the corporation has not recorded any liability for the costs of future decommissioning and site remediation that it will have to incur for nuclear facilities. Management's position is that, historically, these activities have been financed mainly by parliamentary appropriations and that they have not been able to estimate their total likely costs.

3.14 During the past year, the corporation prepared a broad plan of activities to be carried out over the next four to five decades. Although the corporation has estimated a range of 200 to 300 million dollars (in 1993 dollars) as the likely decommissioning costs of part of the program, the corporation has not determined the likely cost of the most significant portion of these activities. Management considers that the estimation of future costs for decommissioning and site remediation depends on the development of detailed plans acceptable to regulatory agencies. This requires a determination of the desired end-state, the technology to be employed and, in some cases, research and development. Industry practice is to prepare estimates based on current technologies, regulations and safety standards, and the cost of using and complying with them in the decommissioning process.

3.15 Issue. Contrary to current generally accepted accounting principles, AECL's policy for the year ended 31 March 1993 has been not to provide for future costs of decommissioning and site remediation in its financial statements. Further, management has not determined an overall estimate of the likely costs of the corporation's decommissioning and site remediation activities. As a consequence, we were unable to determine the magnitude of the impact on AECL's expenses, liabilities and deficit for the year ended 31 March 1993.

3.16 In future, the corporation intends to provide an allowance for the costs of decommissioning and site remediation only to the extent that funding from external sources is realized. For proper decision making, the corporation needs to know the full cost of current activities and the financial obligations they generate for the future. The recording of AECL's liabilities is important in order to fairly reflect the corporation's financial position, and to maintain accountability to Parliament for obligations and conditions known today that will result in claims on public resources.

Observations on Departmental Expenditures

Atlantic Canada Opportunities Agency

Failure to adequately evaluate, monitor and control a repayable contribution agreement under the Fisheries Alternatives Program

In July 1991, the Atlantic Canada Opportunities Agency approved a repayable contribution agreement under the Fisheries Alternatives Program, for a proposed project to establish a metal fabrication facility in Newfoundland. In our view, the Atlantic Canada Opportunities Agency failed to evaluate adequately the project's net economic benefit to Atlantic Canada and did not complete an evaluation of its commercial viability. Furthermore, the Agency disbursed \$1.876 million even though it did not ensure that significant conditions of the repayable contribution agreement had been met by the company. The Agency failed to ensure that the risks associated with the project were shared by the proponents.

3.17 Background. In April 1991, a company applied to the Atlantic Canada Opportunities Agency for assistance to establish a metal fabrication facility in Channel-

Port aux Basques, Newfoundland. The Agency approved a \$2.6 million repayable contribution under the Fisheries Alternatives Program, representing 32.9 percent of the project's estimated eligible capital costs of \$7.9 million. Subsequently, the company applied for and received contributions from the Canada Employment and Immigration Commission and a term loan from the Province of Newfoundland with respect to the same project.

3.18 Issue - evaluation. After an initial review of the company's application and business plan, the Agency rejected the application on 17 July 1991. The review concluded that assisting the project would not provide a net economic benefit to Atlantic Canada. Agency officials noted that the metal fabrication industry in Canada "suffers from excess capacity and declining economic activity" and that, even if the company could access the work it was targeting in the Hibernia offshore oil project, it would likely struggle for work thereafter. The proposed facility would compete for Hibernia work with other metal fabrication facilities, including one in Cow Head, Newfoundland that had already received \$36 million in assistance from the Canada-Newfoundland Offshore Development Fund for an expansion to meet the demands of Hibernia.

3.19 The Agency did not evaluate the commercial viability of the project, as it had already determined that the project would not provide a net economic benefit to Atlantic Canada and the company's application indicated that the proponents did not intend to inject cash equity into the project.

3.20 Subsequently, the Agency made a counter-proposal to the proponents requiring them to invest \$2.5 million in cash equity. No other changes were made to their proposal. The Agency did not complete an evaluation of the project's commercial viability, as required under the terms and conditions of the Fisheries Alternatives Program. Less than eight days after initially rejecting the proposal, the Agency submitted the project to its Minister and recommended, given the proponents' agreement to provide cash equity, that the project be supported. The Agency indicated that the company had the expertise to compete for Hibernia work and eventually for national and international work beyond Hibernia. On 26 July 1991, the Minister approved the \$2.6 million repayable contribution.

3.21 The company accepted the offer of a repayable contribution agreement on 14 November 1991. On 23 December, it requested that \$.9 million of the cash equity requirement of \$2.5 million be met by a loan from a local development agency that was fully funded by the Canada Employment and Immigration Commission. On 21 January 1992, Agency officials approved a reduction in the cash equity requirement to \$1.6 million, if the company obtained the \$.9 million it sought to borrow from the local development agency. The change increased the proportion of project financing provided by government rather than private sources. Ministerial approval was sought for this significant change, as required under the Fisheries Alternatives Program, but was never received.

3.22 Issue - monitoring and control. The repayable contribution agreement between the Agency and the company contained several significant conditions. They included a requirement that the proponents invest \$2.5 million in cash toward the eligible capital costs of the project and that the company submit a copy of its shareholders agreement, which outlined the company's ownership structure, for the Agency's review and approval before commencing the project. The agreement also required the company to submit its audited annual financial statements within 90 days after the end of each fiscal year. The Agency made payments to the company totalling \$1.876 million without assuring itself that these conditions had been met. Agency documentation of the project did not include the following information that we believe is important to project monitoring and control:

evidence that the cash equity requirements had been met, either as approved initially by the Minister responsible for the Atlantic Canada Opportunities Agency or as subsequently reduced by Agency officials;
evidence of the ownership structure of the company and the amount invested by each owner; and
a copy of the company's audited annual financial statements.

3.23 The Agency accepted that the land on which the facility was being constructed could be used to meet the amended equity requirement of \$.9 million to be borrowed from the local development agency, even though Agency officials were aware that the Government of Canada, in fact, owned the land.

3.24 The Agency had concluded that the company would be able to access international markets through the use of patents and technology to be transferred to the company by one of the proponents. Thus, the project would not be reliant solely on the Hibernia offshore oil project for its success. Prior to the disbursement of funds, the Agency failed to confirm the nature of the patents and technology transferred and the conditions of the transfer to the company. The Agency subsequently learned that the company had received the right only to use certain technologies for the North American market. This may limit the company's ability to access international markets as contemplated in the Agency approval documentation.

3.25 Conclusion. The Agency failed to give adequate weight to its own initial negative evaluation of the project, which had noted the excess capacity in Atlantic Canada's metal fabrication industry and the potential for negative effects on existing competitors. In addition, the Agency failed to perform an evaluation of the commercial viability of the project and to obtain ministerial approval for the reduction in the level of cash equity to be supplied by the proponents - both requirements of the Fisheries Alternatives Program.

3.26 The Agency did not ensure that significant conditions of the repayable contribution agreement were met before disbursing funds to the company, thus failing to ensure that the risks associated with the project were shared by the proponents.

3.27 We have made similar observations in recent annual reports on the adequacy of the Agency's procedures for evaluating, monitoring and controlling its projects.

Agency's response: To promote economic development and to allow for new or existing Atlantic Canadian companies to take advantage of opportunities in emerging industrial sectors, the Agency uses flexible and prudent means to provide funding. This approach is necessary for the Agency to respond to the changing circumstances and high risks often associated with such industrial sectors, which allow companies to take advantage of such opportunities before they vanish.

The Agency presented the facts of the case to a board of independent private sector representatives, who subsequently accepted the application.

The comments from the Office of the Auditor General have resulted in improved monitoring procedures and have highlighted the need for the maintenance of comprehensive documentation, supporting decisions.

Further, consistent with the Office of the Auditor General's comments referring to similar observations in recent reports, the Agency implemented an annual Quality Assurance Review, commencing fiscal year 1993-94. This process will assure the compliance of individual project management with the terms and conditions of the Agency funding programs.

Canadian Grain Commission

Ex gratia payments made by the Canadian Grain Commission were an inappropriate use of public money and, in some cases, were outside its mandate

The Canadian Grain Commission (the Commission) made ex gratia payments of approximately \$657,000 to producers as compensation for losses incurred as a result of the bankruptcy of an unlicensed seed cleaning company. There was no legal obligation for these payments. The producers who sold seed to the company should have been aware of the risk of dealing with a company not licensed by the Commission. It is also unclear what public interest was served by these ex gratia payments. Moreover, a portion of the amounts paid was for canary seed, which does not fall within the mandate of the Commission. We also found that procedures used by the Commission to determine amounts to be paid to individual producers were inadequate.

3.28 Background. Under the *Canada Grain Act*, the Commission licenses grain dealers to buy and sell certain grains prescribed in the Act. The Commission also requires licensed grain dealers to post with it sufficient security to compensate producers in the event of the dealer's bankruptcy. Other entities, such as seed cleaning companies, which do not buy and sell grain, are exempt from licensing requirements and the obligation to post security. These entities may use the Commission's inspection services by applying for authorized-user status. Authorized-user status is granted on the condition that the authorized users sign an affidavit stating that they will refrain from buying and selling grain, and advise their clients that they are not a licensed grain dealer by affixing a poster to that effect in a prominent location in their facility.

3.29 In early 1993 the Commission made ex gratia payments of approximately \$657,000 to certain producers to compensate them for losses incurred as a result of the bankruptcy of a seed cleaning company in 1992. The statement of affairs filed by the Trustee in Bankruptcy indicated that there was no grain or seed inventory on hand. The producers, as unsecured creditors, had no claim to any of the other assets of the company. The company had authorized-user status at the time the losses occurred, but was not licensed by the Commission to engage in activities such as buying and selling grain. Commission records indicate that a poster stating that the company was not a licensed dealer was posted on the company's premises. Most of the ex gratia payments were for losses suffered by producers on the sale of grain and canary seed to the seed cleaning company.

3.30 Issues. An ex gratia payment is a payment for which no legal liability is recognized, and which is made as an act of benevolence in the public interest. There was no legal liability on the part of the Commission and thus no legal obligation to pay these amounts. The Commission believed there was a "moral obligation" to compensate these producers, and used the ex gratia mechanism, which was within its legal authority, to make the payments. In our opinion, it is difficult to see how "the public interest" was served in making payments to producers who were aware, or who should have been aware, of the risks of dealing with a company not licensed by the Commission.

3.31 The Commission paid producers approximately \$220,000 for losses related to canary seed. The courts had previously clarified that canary seed is not a prescribed grain covered by the Act. Accordingly, the Commission has denied claims by other producers, arising out of the failure of licensed dealers, for payment for canary seed. Since canary seed is outside the Commission's mandate, we concluded that no payments for canary seed should have been made, even on an ex gratia basis.

3.32 Subsequent to the Commission's decision to make the payments, there has been an increasing number of complaints and inquiries from licensees and producers questioning the decision. Although no formal claims or demands for compensation have been made, there is the risk that this may happen, and that licensed grain dealers may place less value on being licensed if they believe the Commission will cover all producer losses, regardless of the grains involved and whether or not the producer sells to a licensed dealer.

3.33 The Commission decided to pay the producers 75 percent of the amounts they claimed. The Commission was unable to provide us with any rationale or justification for this percentage. We also found that the amounts claimed by producers were not adequately documented. Based on our review, we estimate that only \$390,000 of the \$657,000 paid was supported by proper substantiation of the claims made. Complicating this was the fact that the Commission was advised that the records of the seed cleaning company for 1992 could not be located.

3.34 We noted during our review that one claim was reduced when the claimant remembered receiving a payment from the seed cleaning company. We have no means of verifying whether or not other claimants may have already had seed returned or received

payment from the seed cleaning company, in whole or in part, for the amount claimed. We were unable to determine the amount that the producers may have been overpaid.

3.35 Conclusion. In our opinion, the decision by the Commission to make ex gratia payments of approximately \$657,000 was not wholly within its mandate, was not adequately supported, and was inappropriate from a business perspective.

Canadian Grain Commission's response: The ex gratia policy provided the Commission with the authority to compensate the producers concerned. The decision created no legal precedent. It was the judgment of the Commission that the payments were warranted.

The Commission has undertaken a number of actions to minimize future exposure to liabilities recently identified in the licensing activity:

- Bill C-127, an Act to amend the Canada Grain Act, received first reading after a two-year period of development. The new Act, if passed, would have introduced optional licensing for special crops dealers and clarified producers' responsibilities to deal with licensees to obtain financial protection.

- The Commission's licensing and security policy and procedures have been under internal and external review since March to minimize risks to producers and taxpayers.

- The authorized-user program was cancelled, with Commission services being provided only to licensees or grain producers.

- Advertisements listing licensees and the advantages of dealing only with licensees will be placed in farm papers quarterly (first placed in August 1993).

- Procedures and reports are being enhanced to minimize the possibility of Canada Grain Act infractions.

- Representatives of special crops producers have been requested by the Minister to review the specific needs of the special crops industry, which could include separate legislation.

Department of Industry, Science and Technology

Investment agreement not structured to adequately protect the interests of taxpayers

In October 1986, the government signed a share subscription agreement that provided \$79 million of equity to a publicly held company as part of a two-stage \$260 million plant modernization project. In spite of the government's intent, the agreement was not structured in a way to provide for a reasonable sharing of the risks and returns of the investment and thus did not adequately protect the interests of taxpayers.

3.36 Background. In October 1985, Cabinet authorized the Minister of Finance to provide an equity injection to the Federal Business Development Bank to enable the Bank to purchase a \$69 million special issue of preferred shares (subsequently increased to \$79 million in October 1986) in a publicly held company. The investment in the company was made pursuant to a directive of the Governor in Council and executed by an agreement signed by the Minister of Regional Industrial Expansion (now Industry, Science and Technology), who was responsible for monitoring the transaction. This transaction represented the federal government's share of the project. A similar investment of \$55 million was made by the Province of British Columbia.

3.37 On 22 October 1986, the government signed a share subscription agreement with the company for a two-stage \$260 million plant modernization project. The total capital expenditure for Stage I was estimated at \$171 million, including \$45 million to build an oxygen plant, for which another party was responsible. The company is required to spend a further \$89 million if it proceeds with Stage II of the project. The company received an infusion of \$134 million of equity from federal and provincial sources. Failure to complete Stage I by 31 December 1992 may require the company to repay a portion of the government's investment.

3.38 The information provided to Cabinet for its approval on 7 October 1986 identified a specific Russian technology for the project. This technology was described as the newest and best available in the world.

3.39 Issue. The company decided to switch from the Russian technology to a new German technology, which it purchased in September 1986. Cabinet was not informed of this major change in the project. The Department was unable to provide evidence that it assessed the impact of this change in technology on the viability of the project. The share subscription agreement did not legally oblige the company to use a specific technology.

3.40 The company's new plant, using the German technology, attempted start-up in December 1989 and suspended operations in March 1990. In December 1992, the company advised the Department of Industry, Science and Technology that it could not complete Stage I of the modernization project before 31 December 1992, for "reasons beyond its reasonable control", thereby suspending its obligations under the agreement.

3.41 In the Cabinet approval process, the Department advised Treasury Board of the intention of both the government and the company to share in the project risks and returns. However, in our opinion, the Department's agreement to invest in the special issue of non-marketable preferred shares was not structured to ensure a reasonable sharing of risk and returns.

3.42 The redemption of this investment and payment of dividends are not tied to the project. It is instead determined by a profitability index related to metal prices over the life of the agreement. The agreement provides for a renegotiation of the profitability index, but to date no renegotiation has taken place.

3.43 As early as 1990, the Department estimated that the Federal Business Development Bank was unlikely to recover its investment or earn any dividends. To date, the Bank has received no dividends nor had any of its shares redeemed. In March 1992, based on the advice of the Department, the Federal Business Development Bank "wrote down" the investment to zero. The agreement, however, remains in force until the year 2006.

3.44 The company's audited statement of total capital expenditures for the project at 31 May 1990 indicated that the company had incurred costs of \$161 million. With the \$134 million federal and provincial investment taken into account, the company was out of pocket \$27 million and then only because of cost overruns. Had these cost overruns not occurred, the company's share in the project to that point would have been zero.

3.45 Conclusion. In our opinion, the Government of Canada's agreement to invest in the company did not provide for a reasonable sharing of risks and returns. This did not adequately protect the taxpayers' interests. The Department should also have informed Cabinet of the major change in the project.

Department's response: The agreement between the Minister of Regional Industrial Expansion and the company, designed to facilitate plant modernization, reduce environmental pollution and improve workplace hygiene, was structured to protect the public's interests. The company is bound to complete plant modifications and meet its obligations. The agreement contains specific performance targets that are to be met and adhered to by the company, regardless of the technology used. The Department continues to closely monitor the project.

There were no Cabinet requirements to impose restrictions on the technology to be used by the company.

Department of Industry, Science and Technology

Unrecorded liabilities result in an understatement of program expenditures

In 1992-93, the Department of Industry, Science and Technology had not followed the government's accounting policy requiring the recording of liabilities at the fiscal year end. If the government's accounting policy had been followed, the Department would have reported approximately \$42 million in additional liabilities. If this amount is not recorded, it will result in an understatement of expenditures charged to the Department's parliamentary appropriation for grants and contributions.

3.46 Background. Government accounting policy requires departments to charge expenditures to the period in which they are incurred, rather than when they are paid. Unpaid charges are recorded as liabilities of the government until actually paid. Estimates of these liabilities must be charged to appropriations "even if the charge causes the appropriation to be overexpended".

3.47 Issue. Shared-cost agreements are the primary financial instrument used in Industry, Science and Technology's management of its parliamentary appropriation for grants and

contributions. Many contribution agreements involve multi-year commitments where the government's annual financial obligations are dependent on the rate of progress made by the partners under the agreement. Forecasting the amount of likely expenditures in a particular fiscal year is difficult where such programs have large contribution elements. There is evidence that the Department has managed its appropriation by controlling the amount of payments made in a specific fiscal year, notwithstanding the government's policy that charges to appropriations are to be based on when the expenditure is incurred rather than when the payment is made.

3.48 The accounting implications associated with the management of shared-cost agreements are not new to the Department. In 1991 we reported the Department's practice of changing contribution agreements near year end for cash management purposes. We disagreed with this practice because it resulted in the avoidance of a lapse of \$28 million in the appropriation.

3.49 In 1992, we reported in a management letter to the Department that liabilities for expenditures of \$50 million had not been recorded in fiscal year 1991-92, when the expenditures were incurred. Instead, the Department recorded the expenditures in fiscal year 1992-93, when the payments were actually made. This practice is not in accordance with the government's accounting policy.

3.50 Our audit of the Department's financial records for fiscal year 1992-93 revealed similar problems in unrecorded liabilities. For shared-cost agreements we identified approximately \$42 million in unrecorded liabilities. The impact of these unrecorded liabilities was to understate expenditures by this amount in the Department's appropriation for grants and contributions. At the time of our audit, the government had not formally closed the accounts for 1992-93, and this issue was under discussion by the Department and a central agency.

3.51 In our opinion, the Department is attempting to manage its appropriation by allocating expenditures to fiscal years on the basis of when payments are made. Liabilities associated with multi-year shared-cost agreements, however, should be recognized when costs are incurred by the partners in the agreements. While payments to partners should be structured in accordance with the cash management requirements of the government, liabilities must be recorded in the year in which they are incurred in accordance with the government's accounting policy.

3.52 Conclusion. The Department has not followed the government's accounting policy for the recording of liabilities. If this amount is not recorded, the Department of Industry, Science and Technology will have understated the expenditures charged to its parliamentary appropriation for grants and contributions by \$42 million in the fiscal year 1992-93.

Department's response: As the Office of the Auditor General indicates, there is a genuine difference of opinion between the Department and the OAG on the complex, technical

issue of accounting for annual expenditures when shared-cost, multi-year agreements are being administered.

Investment Canada

Duplication of presidential facilities without need

Investment Canada spent \$132,000 on office renovations, including an office, bathroom and kitchenette for its President, even though similar facilities already existed in the premises of the agency.

3.53 Background. Investment Canada was created in 1985 by an Act of Parliament, with an annual budget of approximately \$10 million and with 120 employees. A new President was appointed by order-in-council in November 1991. The agency began to plan the renovations in December 1991. Investment Canada was merged with other government operations as part of the government's restructuring of operations announced on 25 June 1993.

3.54 Issue. Investment Canada spent \$132,000 on renovations and new facilities that duplicated those already in existence in the agency. The existing facilities included an office, boardroom, bathroom and kitchenette for the President and space for two senior executives and support staff. Despite the existence of these facilities, a new office, kitchenette and bathroom were constructed for the President.

3.55 Investment Canada could not provide evidence that the existing office, bathroom and kitchenette no longer met the standards for the head of an agency. As we stated in our 1992 chapter "Change and Control in the Federal Government", adequate managerial control should require public employees not to "waste public money".

3.56 Conclusion. In our opinion, there was insufficient justification for the expenditure of public funds for these new facilities.

Agency's response: The agency undertook renovations in 1992 to correct several operational and security problems involving three offices and five workstations, as well as to provide a meeting place and facilities for Agency-wide activities and to open up access to boardrooms to all staff. Duplication of facilities was kept to a minimum.

Department of the Secretary of State

Urgent steps required to deal effectively with student loans in excess of the annual loan ceiling provisions of the Canada Student Loans Act

In 1990 and 1992, we reported that the authorized annual monetary ceiling established by the Canada Student Loans Act had been exceeded. For the lending year 1992-93, the annual ceiling was again exceeded, by \$170 million. This represents an additional cost to taxpayers, which we estimate at \$61 million. The Department had proposed corrective measures in 1992 to comply with the Act and Regulations and had formulated other means of controlling program expenditures. However, the remedial process initiated by

the Department to rectify loan issuances in excess of established provincial loan ceilings has not yet been completed.

3.57 Background. The *Canada Student Loans Act* establishes an annual ceiling on the loans that provinces may authorize and for which the federal government is the guarantor. The provincial ceilings are determined by the Minister (the Secretary of State of Canada) pursuant to the *Canada Student Loans Act*. Loan amounts authorized by provinces in excess of their ceilings increase the eventual cost of the program. The ceiling is a mechanism to control the federal government's cost associated with the program.

3.58 In the event that the loans authorized by a province exceed the amounts allocated to the province by the Minister, two remedial options are available under the Act and Regulations:

The first option is for the Minister to reduce the following year's allocation for the province by the excess amount.

The second option requires that, with the approval of the Governor in Council, the Minister enter into an arrangement with each provincial government to increase its allocation for the following year by the excess amount, if the province complies with the terms and conditions of the arrangement. The Act and Regulations do not specify the terms and conditions.

3.59 Issue. Our 1990 and 1992 Reports (paragraphs 29.66 and 3.262 respectively) noted that participating provinces had exceeded their loan allocations. The Department advised us in 1992 that it had initiated corrective measures to comply with the legislation. For the lending year 1992-93, we noted that the authorized ceiling (\$734 million) was again exceeded, by \$170 million. For 1991-92, the ceiling was exceeded by \$142 million.

3.60 Based on the information provided to us by the Department, we estimate that at least 85 percent of the authorized loans are drawn down by the students and are therefore guaranteed. The cost to guarantee one dollar loaned is estimated at 42 cents. Therefore, the additional costs of exceeding the ceilings for 1991-92 and 1992-93 are estimated at \$51 million and \$61 million respectively.

3.61 The Department advised us that a new financial control mechanism is being developed, through amendments to the *Canada Student Loans Act*, which will introduce an effective means of controlling program expenditures. The Department also advised us that, pending these amendments, it has requested Governor in Council authority to enter into arrangements with provinces to increase the allocations available under the Act. This will accommodate provincial needs and comply with the current legislation. At the time of our audit, the Department had not yet formalized the agreements with the provinces to receive proper approval from Governor in Council for the excess of the annual loan ceiling for 1992-93 and previous years.

3.62 Conclusion. The annual ceiling has been exceeded by \$312 million for the last two years alone. We have estimated that the resulting additional cost is about \$112 million for those two years.

3.63 The Department needs to continue developing an improved expenditure control mechanism for the program, in the context of its review of the current legislation. However, we are concerned that the Department has not yet entered into an arrangement with provinces to ensure compliance with the current legislation. The additional costs of loans in excess of the annual ceiling imposed by the *Canada Student Loans Act* also need to be properly authorized.

Department's response: In the context of the recent announcement respecting the reform of the Canada Student Loans Program, the Minister-designate of Human Resources and Labour advised provincial ministers responsible for student assistance of the government's intention to enter into agreements with provinces to increase provincial loan allocations as provided for under the Canada Student Loans Act. It is anticipated that these agreements will be concluded in the current student loan year.

Observations on Tax Revenue

Departments of Finance and National Revenue

A resource allowance income tax provision did not clearly convey the government's intent. This will result in \$636 million in refunds for income tax and interest, and will expose the Crown to at least an additional \$538 million in potential refunds

A resource allowance income tax provision introduced in 1974 did not clearly convey the government's intent. This will result in \$636 million in refunds for income tax and interest, and will expose the Crown to at least an additional \$538 million in potential refunds. Recognizing that the Income Tax Act is a high-risk mechanism for delivering incentives, in 1986 the House of Commons Standing Committee on Public Accounts had recommended that the government develop a mechanism to quickly alter tax law when significant problems are encountered. If the government had moved quickly to clarify the regulations, the amount of income tax revenue lost and at risk could have been considerably less than the estimated \$1.2 billion.

3.64 Background. In November 1974, the government introduced a resource allowance income tax provision targeted to the resource sector. We have been advised that the provision was introduced to compensate companies for the non-deductibility of provincial resource royalties. Effective retroactive to 7 May 1974, the provision required petroleum and mining companies to segregate their production income from other income through the computation of "resource profits". The allowance is based on resource profits and has the effect of reducing income taxes otherwise payable.

3.65 In its 1974 and 1975 taxation years, a taxpayer took the position that it could deduct scientific research expenditures and certain capital cost allowances in computing its

income for income tax purposes, but that it did not have to deduct these expenses in computing its resource profits. Because the income tax allowance is based on resource profits, the higher this figure is, the greater the reduction in income tax.

3.66 The departments of National Revenue and Finance disagreed with the taxpayer's interpretation of the law. They argued that the law would require the taxpayer to deduct the expenses in computing its resource profits. The taxpayer was reassessed by National Revenue in August 1979 for its 1974 taxation year, and in September 1980 for its 1975 taxation year. The reassessments were challenged by the taxpayer. Both the Federal Court - Trial Division (October 1990, *Gulf Canada v. The Queen*, 90 DTC 6622) and the Federal Court of Appeal (January 1992, *The Queen v. Gulf Canada*, 92 DTC 6123) found in favour of the taxpayer.

3.67 Because the decision seriously impacts on the government's legislative intent by effectively granting additional income tax reductions to the resource sector, the government sought leave to appeal to the Supreme Court of Canada.

3.68 In its application for leave to appeal, National Revenue informed the Court that the issue in dispute is common to approximately 40 outstanding objections and appeals, and that the amount of tax and interest in respect of petroleum and mining corporations that would be affected by the proposed appeal is approximately \$1.5 billion.

3.69 On 2 July 1992, the government was denied leave to appeal to the Supreme Court of Canada.

3.70 Issues. While there is consensus between National Revenue and the industry about the treatment of expenses specifically dealt with in the decision, it has not been decided how other expenses, now disputed by the industry following the Court's decision, will impact on the calculation of resource profits. After 14 years of dispute, litigation, negotiation and discussion, there is still no consensus on how resource profits for the taxation years 1974 to 1992 should be calculated.

3.71 National Revenue has advised us that it now estimates that the deficient legislation will result in \$227 million in refunds for income tax related to research and development and preproduction expenses, and \$409 million in refunds for interest on that amount. The issues still in dispute represent an additional \$538 million in potential refunds, for a total estimated exposure of \$1.2 billion. National Revenue has also advised us that further litigation may be required to resolve the issues still in dispute.

3.72 For taxation years ending after 23 July 1992, a proposed amendment to the income tax regulations, to clarify the law, was released to the public on that date. The Department of Finance stated that the proposed amendment would override the Court decisions prospectively. As of 30 September 1993, the proposed amendment was still being reviewed and was not in force.

3.73 Conclusions. In a report dated 26 June 1986, the House of Commons Standing Committee on Public Accounts recommended that the government "develop a mechanism to alter quickly a tax expenditure program where significant problems have been encountered." National Revenue has been aware since 1979 that the provision did not clearly convey the legislative intent. If the government had moved quickly in this case to clarify the regulations, the amount of income tax revenue lost and at risk could have been considerably less than National Revenue's estimate of \$1.2 billion.

***Department of National Revenue's response:** The resource allowance provisions are complex. With any complex legislation, there are differing views as to its interpretation. When such differences cannot be settled administratively, taxpayers and the Department have the right to request the Courts to make a determination. Since this is often a lengthy and costly process, it is not invoked unless each party to the appeal feels that its case is meritorious. In the Gulf case, the Courts ultimately disagreed with the Department's interpretation of the law on two of the three issues that were the subject of the appeal. Until the decision of the Federal Court of Appeal, most of the resource industry had been filing their income tax returns in a manner consistent with the Department's interpretation of the law. As they had taken steps to ensure that their income tax returns for prior years were still subject to adjustment, they were able to revise the manner in which they had computed their income for years as far back as 1974.*

***Department of Finance's response:** This audit observation criticizes the Department of Finance for its failure to react quickly to issues considered in the court case of *Gulf Canada v. The Queen* (90 DTC 6622 (F.C); 92 DTC 6123 (F.C.A.)). This criticism is not warranted. In fact, the Supreme Court of Canada refused leave to appeal for the Gulf case on 2 July 1992 and draft regulations were released before the end of that month. Action immediately after the initial Gulf decision would have been inappropriate for two reasons:*

- 1. The Department of National Revenue, the Department of Justice and the Department of Finance all were satisfied that the government's position in the Gulf case had merit.*
- 2. The departments of Justice and National Revenue made strong representations to the Department of Finance that the introduction of clarifying amendments before the termination of the Gulf litigation would create a significant risk of prejudicing the government's case.*

The draft regulations of July 1992 are currently being finalized, together with unrelated amendments to the allowance that are consequential to Bill C-92 (which was given royal assent in June 1993). None of the regulations consequential to Bill C-92 have yet been enacted. Contrary to the suggestion in the audit observation, the period of time for reviewing, finalizing and processing these draft regulations is not excessive and permits concerns on the text of the draft regulations to be fully considered before their enactment. Regardless of the time of their enactment, the amendments relating to the issues raised in the Gulf case will be effective from July 1992.

The Auditor General's criticisms of the Department of Finance in this matter derive from hindsight rather than from a balanced consideration of the management of the relevant issues. Given the facts it knew at the time, the Department's actions with respect to this matter were timely and appropriate.

Furthermore, the audit observation suggests that if action had been taken earlier the exposure to the government could have been eliminated. This is simply not correct unless the government had decided to make retroactive changes to the law. As a matter of long-standing government policy, it has rarely been considered appropriate to introduce tightening changes to the law on a retroactive basis.

The appendix below provides further comments on the audit observation and attempts to put the concerns raised in the observation in what the Department of Finance submits is their proper context.

Appendix

Background. The Gulf case considered whether certain deductions of scientific research expenditures and capital cost allowance claimed by a taxpayer were required to be deducted in computing the taxpayer's "resource profits".

To put these issues in their historical context, the government announced in its 6 May 1974 budget that provincial Crown royalties and mining taxes would no longer be deductible in computing income. Instead, resource corporations would be entitled to a corporate tax abatement known as the "resource profits tax abatement" (referred to below as the "abatement"). The "resource profits tax abatement" was in effect for the 1974 and 1975 taxation years. After considerable discussion with the provinces, the abatement was replaced by a deduction in computing income known as the "resource allowance" (referred to below as the "allowance"). (As a matter of factual clarification, it should be noted that the allowance has been in place from the 1976 and subsequent taxation years, not since November 1974 as stated in the audit observation. In addition, contrary to the assertion in the audit observation, the abatement was effective from the time of its announcement and not on a retroactive basis.)

Both the abatement and the allowance are determined with reference to "resource profits". The Gulf case determined that capital cost allowance relating to non-operating production facilities and scientific research expenditures were not required to be deducted by taxpayers in computing "resource profits". This has the effect of increasing the amount of the abatement or the allowance to which taxpayers are entitled.

Revenue at risk. The figures used by the Auditor General have been provided by National Revenue officials, who, we understand, are still in the process of refining the figures further. It should be noted that approximately two thirds of the \$636 million exposure referred to in the audit observation relates to interest and that the government has had use of these funds.

The remaining potential exposure of \$538 million alleged in the audit observation relates to issues not directly covered by the Gulf case; it is an open question as to how much of this revenue is at risk and whether further litigation will be needed to resolve the extent of the exposure. Approximately one half of this amount also relates to interest.

Nature of the abatement and the allowance. *By referring to a report dated 26 June 1986 by the House of Commons Standing Committee on Public Accounts (referred to below as the PAC Report), the audit observation suggests that the abatement and the allowance are incentives and tax expenditure programs. This is inaccurate. As described above, the abatement and the allowance were to compensate for the non-deductibility of provincial Crown royalties. The overall experience has been that the tax revenue resulting from the non-deductibility of provincial Crown royalties has consistently exceeded the tax revenue reduction resulting from the abatement and the allowance. For example, the Petroleum Monitoring Agency reported that, within the oil and gas industry, the total 1991 allowance was only 87 percent of provincial Crown royalties.*

Income tax rules governing the abatement and the allowance. *In the audit observation, it is stated that the "Resource allowance income tax provision did not convey the government's intent."*

There is, in the Department's view, nothing on the public record or in internal files that can support a definitive statement as to the government's intent in 1974 and 1975 on the issues considered in the Gulf case. The Department of Finance, as well as National Revenue and the Department of Justice, were of the view that the law should and did require the deduction of both scientific research expenditures and capital cost allowance in the computation of "resource profits". The potential weakness of that position was realized only once the Federal Court decision in the Gulf case was given in October 1990. However, the suggestion that the relevant income tax provisions were deficient in any obvious way is unfounded and implies a misunderstanding of the judicial process. While the Courts in the Gulf case provided their interpretation of the relevant legal text, this cannot be taken as an indication that the opposite interpretation was without merit.

Time for resolution of Gulf case. *The Gulf case dealt with the 1974 and 1975 taxation years, but was not ultimately resolved until 1992. From the perspective of the Department of Finance, it would certainly have been preferable for the case to have been resolved much sooner to limit the revenue exposure. However, litigation is typically a lengthy process. The Department of Finance does not have any influence whatever in expediting the process.*

Mechanism to amend income tax law. *By again referring to the PAC Report, the audit observation suggests there is no mechanism to quickly alter the income tax law when problems are identified.*

In fact, there is considerable co-operation among National Revenue and the departments of Finance and Justice with respect to the identification of problems concerning the

interpretation and administration of the income tax rules. For this reason, quick action was possible in the Gulf case following the end of the legal process.

Departments of National Revenue and Finance

A clause in the Government of Canada's tax collection agreements with the provinces and territories needs to be clarified

The Government of Canada's interpretation of a clause in the federal-provincial / territorial tax collection agreements means that the base used to calculate the federal and provincial / territorial sharing of income taxes has not included the income tax portion of certain amounts remitted by employers during the year. For the past six years, the excluded remittances have averaged \$38 million per year, which is slightly less than one-twentieth of one percent of the average payroll deductions remitted by employers over the same time period. Most of the agreements have been in place since 1962.

3.74 Background. The Government of Canada has entered into tax collection agreements with most provinces and the two territories. Under these agreements, the federal government collects individual and corporate income taxes on behalf of the participating provinces and territories; assesses, on their behalf, the income taxes imposed under their income tax Acts; and remits these amounts to the provinces and territories in accordance with the agreements.

3.75 The tax collection agreements are administered jointly by the Department of National Revenue and the Department of Finance. Finance maintains the tax collection agreement accounts and is responsible for the payments to the provinces. National Revenue performs the collection and assessment functions, and provides Finance with the applicable amounts.

3.76 During the year, employers deduct income tax, Canada Pension Plan (CPP) contributions and Unemployment Insurance (UI) premiums from their employees' pay, and remit these amounts to the federal government. The remittances are credited to the employers' accounts maintained by National Revenue.

3.77 At the end of the year, the employer submits T4 slips detailing the breakdown of income tax, CPP and UI for each employee. When employees prepare their income tax returns, they enter on the return the amounts for income tax, CPP and UI shown on their copies of the T4 slips. National Revenue later compares these amounts to those on the employers' copies of the T4 slips.

3.78 Based on the above, there are three key amounts - the total amount remitted by employers to National Revenue during the year, the total of the amounts reported on the employers' copies of the T4 slips, and the total of the amounts reported by individuals on their income tax returns. These three totals are Amounts A, B, and C respectively in [Exhibit 3.1](#).

3.79 In theory, the three amounts should agree. However, in practice this is not the case. Typically, the total amount remitted to National Revenue by the employers (Amount A) exceeds the total amount reported on the employers' copies of the T4 slips (Amount B), which in turn exceeds the total of the amounts claimed by individuals when they file their income tax returns (Amount C).

3.80 National Revenue believes that the excess of Amount A over Amount B may be caused by such factors as mathematical errors by employers, misallocated payments, and the fact that the Department's enforcement actions are geared toward the resolution of potential underpayments rather than overpayments. These enforcement actions primarily involve sending a notice of discrepancy to all employers whose difference exceeds a pre-determined amount. In the case of potential overpayments, if the employer does not adequately respond to the notice of discrepancy, and the excess amount is less than a pre-determined amount, the Government of Canada simply keeps it. Should the excess amount be greater than the pre-determined amount, National Revenue will perform additional reconciliation procedures. Any unreconciled balances are retained by the Government of Canada.

3.81 Most of the tax collection agreements have been in place since 1962. Our review of departmental records for the past fifteen years indicates that the remittances received from employers during the year with respect to income tax, CPP and UI (Amount A) have exceeded the amounts reported by the employers on the T4 slips (Amount B) every year. For the past six years, this excess averaged \$38 million per year, all of which has been retained by the Government of Canada. This amount is slightly less than one twentieth of one percent of the average payroll deductions remitted by employers over the same time period.

3.82 Issue. Section 7(2)(b) of the tax collection agreements requires the federal government to remit to the provinces and territories their share of "amounts, as determined by the Minister, that have been deducted at source from employees in accordance with the provincial act in respect of individual income tax . . . and that have not, because of the failure of such employees to file returns, been applied . . . on account of the tax payable by such employees. . . ." These amounts are referred to as "unapplied taxes".

3.83 The agreements do not define "deducted at source". National Revenue has defined this term as the amounts reflected on the T4 slips filed by employers (Amount B). Using this definition, "unapplied taxes" represent the income tax portion of the difference between Amount B and the total reported by individuals on their income tax returns (Amount C).

3.84 It can be argued, though, that what is actually "deducted at source" is represented by the cash remitted by employers during the year (Amount A). This is essentially the approach mandated by the *Income Tax Act* in the various provisions relating to source deductions (liability of an employer for failure to deduct or withhold amounts as required, the interest charged on amounts that have not been deducted or withheld, the interest and

penalties charged on amounts that have not been remitted, etc.). Generally, these are all enforceable from the date prescribed for remittance of the amount to National Revenue.

3.85 The issue to be clarified is whether amounts "deducted at source" comprise the amounts remitted by employers during the year (Amount A) or amounts reported by employers on their copies of the T4 slips (Amount B).

3.86 Conclusion. Given the magnitude of the amounts involved - for the past six years the excluded remittances have averaged \$38 million per year and most of the agreements have been in place since 1962 - we recommend that the term "deducted at source" be specifically defined when the tax collection agreements are amended.

Department of National Revenue

Overdue goods and services tax continues to rise, and the volume of delinquent registrant accounts remains high

Since the goods and services tax (GST) came into effect, the volume of overdue GST has continued to rise. At the end of March 1993, overdue receivables surpassed \$650 million. In addition, some 576,000 registrants were delinquent in filing returns. The Department has launched a number of initiatives focussing on revenue generation and has allocated additional resources to collections, but overdue receivables are forecast by the Department to reach \$800 million to \$900 million by the end of March 1994. Further, additional information will have to be generated by the automated systems for management to monitor, assess and make changes to the collections function. The support systems also need improvements to enhance the operational effectiveness of collections. In our view, collections is a key enforcement function and, in its initiative to integrate the GST program with that of income tax, the Department needs to ensure that timely actions are taken to address these concerns.

3.87 Background. Registrants who owe tax are those who have sold goods or provided services that are taxable for GST purposes. In general, many of these registrants would have received cash or other consideration before the GST return and liability became due. At the retail level, many consumers have paid for such goods and services, including the GST, in advance of these due dates. Registrants who owe GST and are in this position are, in essence, taking advantage of the GST in using it as a cash advance. This gives them an unfair advantage over registrants who have remitted their GST owing on time. These underlying circumstances and the need to foster a self-assessing tax system require a firm yet fair collections function.

3.88 Collections activities for GST purposes are actions taken against those who are late in filing GST returns or in paying GST owing to the Crown as assessed or filed.

3.89 In 1992 we reported that, although the GST came into effect in January 1991, computer-generated reminder notices had to be withheld until fall 1991. This was a result of the large volume of data initially rejected, which caused long delays in updating the

GST registrant accounts in the automated systems. We also commented that the collections activities still were not fully operational in March 1992.

3.90 In 1993, we followed up on these activities to assess the status of GST collections. Headquarters interviews and field visits were conducted in March, April and May 1993. The following paragraphs raise observations on two essential elements of GST collections - resource deployment, and information and support systems.

3.91 Until November 1992, the Department's emphasis had been on registration and vendor education activities to ensure that registrants were identified and encouraged to file; consequently, less attention had been placed on collections activities. We found that until then, regions and districts had conducted GST collections as they considered appropriate. In November 1992, GST revenue shortfall from budgetary forecast continued; departmental analysis showed \$350 million in overdue GST. In addition, 640,000 registrants, or just over one third of all registrants, were delinquent in filing returns. In this category, some were delinquent in filing one or more returns and others had simply never filed a return since registering for the GST. Although there were no precise estimates of the revenue potential in these accounts, it was the Department's view that this potential would have exceeded the amounts in the overdue accounts recorded at that time.

3.92 Additional resourcing has shown positive results but many accounts remain overdue or delinquent in filing. Concerned with the state of delinquency in collections and the revenue shortfall from budgetary forecast, the Department initiated a number of revenue-focussed projects in November 1992. At the same time, the Department announced a plan proposing an integrated collections program for all National Revenue accounts.

3.93 The initiative in collections called for increasing resources for a four-month period ended 31 March 1993, through the use of temporary employees and the redeployment of other Excise staff to collect GST. This was to be supplemented with overtime, where feasible. The scope of the project included collecting overdue accounts as well as bringing other accounts into compliance by demanding that delinquent returns be filed. It was expected that an additional \$400 million would be collected as a result of this initiative.

3.94 By the end of March 1993, the Department had exceeded its collections target. The collections staff took action on about 330,000 accounts. Preliminary analysis shows that collections for the four-month period included an additional \$480 million of GST receipts that might otherwise not have been received. Their actions also generated new GST assessments totalling over \$700 million.

3.95 However, collections data continue to show a substantial backlog. At the end of March 1993, total overdue receivables stood at \$650 million, and 576,000 registrants remained delinquent in filing. Although the collections initiative generated significant revenues, actions taken on registrants who were delinquent in filing often added to the

number of unpaid assessments and thus to the backlog of overdue accounts. The Department advised us that many of the overdue accounts and delinquent registrants may have little or no revenue potential.

3.96 Despite additional resources for collections, the upward trend in overdue GST is expected to continue, while the volume of delinquent registrant accounts remains high. In early April 1993, field offices were advised to continue the revenue initiative. The temporary resourcing was then confirmed for three additional months, to 30 June 1993.

3.97 In July 1993, the Department advised us that the collections function was allocated additional resources for 1993-94, over and above those deployed at the time of the revenue initiative. The final approved 1993-94 work plan reflects a 32 percent increase in full-time equivalent staff over the 1992-93 actual deployment of staff. The 1993-94 plan forecasts a payback of about 14 times the total direct salaries of collections staff.

3.98 However, despite the increased resources, we noted that the anticipated collections would still fall short of clearing the caseload that existed at the start of the fiscal year. According to the plan, the overdue GST as at 31 March 1994 is estimated to reach \$800 million to \$900 million. The upward trend of overdue GST is shown in [Exhibit 3.2](#). This trend is disturbing in light of the high volume of registrants who are delinquent in filing returns ([Exhibit 3.3](#)).

3.99 The 1993-94 resourcing level for collections, as originally planned, turned out to be highly inadequate. It is encouraging that the Department has taken action to double the collections resources over the original plan. However, the collections function continues to face a workload that is many times higher than the staff can effectively handle. We are concerned about the current level of overdue GST and delinquent registrants. In our view, resource deployment is an essential element of the collections function that needs to be re-examined in terms of the Department's overall collections strategy to meet the workload demands of overdue and delinquent accounts.

***Department's response:** The Department addressed the overall collections strategy within the context of the announcement in October 1992 of the integration of Customs, Excise and Taxation. This will maximize the use of all departmental collections resources according to overall priorities. In addition, systems will be integrated to:*

- improve management of accounts and reporting; and*
- consolidate collection actions where the taxpayer has multiple tax debts.*

3.100 The existing information generated by the Department's automated systems is not sufficient for GST collections. We found that the production reports generated by the GST automated systems did not meet the needs of the collections staff. Production reports, generated systematically and periodically, were developed to provide information on the results of collections actions. However, in 1991 and 1992, management at

headquarters and in field offices felt that they could not rely on these reports. In their view, some reports lacked relevance while others lacked reliability or were difficult to understand.

3.101 We noted that headquarters' staff had to make many ad hoc requests for reports to monitor the state of delinquency. In 1993, almost all collections reports used by the Department have been ad hoc reports; results of the revenue initiative were reported entirely on the basis of ad hoc requests. The ad hoc reports provide collections information upon specific request but they do not offer the comprehensive information that managers need to manage collections.

3.102 In general, the collections cycle involves three stages - computer-generated reminder notices, telephone contacts and direct actions by collections staff. Accounts are assigned from one stage to the next by the automated systems, under parameters set by management. These parameters can be adjusted at the request of the managers. However, the automated systems do not provide adequate information to monitor the appropriateness of the existing cycle, to assess the effectiveness of one stage relative to another and to determine the need for further adjustments. Consequently, decisions and changes are made without the full benefit of such information. The Department advised us that new management information reports are being developed for use in the latter part of 1993-94.

***Department's response:** In 1992, the Department immediately addressed limitations in the reports generated by the GST automated system by creating "alternative" reports. Consequently, the field offices did have the required information, albeit by a different process, to manage the day-to-day workload in the appropriate order of priority. As well, the Department is reviewing its automated reporting process within the context of the integration of Customs, Excise and Taxation.*

3.103 The support systems for GST collections need to be improved. As the collections function was not fully staffed until late 1992, many of the systems' features to aid collections actions were not tested in actual use and at full capacity until then. We noted that many changes to the systems were requested by field offices to improve the support for collections officers and to help expedite their actions.

3.104 The collections staff submitted over 20 requests for changes to be included in a systems update scheduled for July 1993. Half of these requests have been identified by the collections function as high priority. We noted that only two of the requests were acted upon in the July update. The Department advised us that the development of the GST system was affected by a number of competing priorities, and that systems improvements are a high priority.

3.105 In addition, the systems do not have the capability to issue a notice of assessment. In many instances, further collections actions cannot be taken until such a notice is issued by the Department. Since the notices have to be prepared manually, collections actions

are delayed. At the time of our audit, the request for system-generated notices of assessment was still being pursued.

3.106 In our 1992 Report, we noted that many GST return and remittance entries failed to meet the edit requirements of the automated systems, with the result that many registrant accounts were not up-to-date. In 1993, we observed the effect on the collections function.

3.107 Data reliability became questionable as collectors attempted to demand payment and the filing of returns. Collections officers often contacted registrants when their returns or other account information were in the process of being updated. We found that many collections officers were spending their time updating accounts rather than taking collections actions. Approximately one fourth and one third of collections staff time were used to update accounts in 1992-93 and 1991-92 respectively.

3.108 We understand that the Department is taking steps to reduce the account maintenance workload of collections officers. In April 1993, further directions were given to field offices concerning updating registrant accounts. Nevertheless, the 1993-94 work plan calls for, on average, 15 percent of its collections resources to be used to maintain accounts. It is our view that collections resources would be better used in collections actions, and that most of the account maintenance workload could be handled by clerical staff. The Department advised us that these concerns are being addressed by the creation of clerical units and the streamlining of the workload at the interim processing centre.

Department's response: For 1993-94 the reference to 15 percent of the collections resources maintaining accounts reflects the use of clerical staff. Occasionally, a collections officer may change an account when it is more cost-effective; however, the percentage is minimal.

3.109 The collections function needs adequate, appropriate and timely information to monitor its progress, assess its results and make changes as necessary. In our opinion, more comprehensive information reports are required to ensure that the function's needs are met. The weaknesses in the support systems represent opportunities to improve the operational effectiveness of collections. In times of restraint, it is imperative to take advantage of these opportunities.

3.110 Conclusion. The early years of a new tax program are critical in establishing an effective enforcement presence. We understand that the Department has been embarking on many initiatives to integrate the GST program with that of income tax to achieve further administrative efficiency. However, as of 31 March 1993, almost one in three registrants was delinquent in some fashion. In our view, the Department needs to ensure that these initiatives encompass all essential aspects of its collections strategy, including addressing further the issue of resource deployment and taking timely action to improve its information and support systems.

Department's response: While the majority of GST registrants are complying with the law, the dollar amount of receivables has continued to rise. This increase was anticipated because the GST is still a relatively new tax. In addition, the Department's efforts directed toward non-compliant registrants, including those who have now established a liability, as well as the difficult economic times, have contributed to this increase.

The Department has taken and will continue to take action against outstanding receivables through a variety of initiatives. In addition to actively pursuing delinquent registrants, the Department is simplifying procedures to reduce administrative burden and thereby facilitate compliance. This includes reducing filing frequency for seasonal filers and simplifying input tax credits for small businesses. Enhanced programs and procedures arising from the integration of Taxation and Customs and Excise, as well as increased co-operation with the provinces, are also expected to produce beneficial results.

We anticipate that these initiatives, as well as improved systems capabilities, will enhance the collection of GST and will do so without the necessity of a significant additional increase in resources.

Chapter 4

Crown Corporations: Accountability for Performance

Main Points

Introduction and Purpose

Crown Corporations

- Significant changes
- A continuing orientation to public policy and dependency upon appropriations
- Debt held by private sector increasing proportionately
- Management challenges increasing
- Continued importance, requiring governance

Corporate Governance

- The board's role in managing a Crown corporation
- Ensuring that directors understand their responsibilities
- Appointing the best-qualified board members
- Establishing a board member "profile" and seeking board input
- The accountability challenge
- Closing the "accountability loop"

Performance Reporting in Annual Reports

- Accountability through reporting
- Enhancing the usefulness of performance reporting
- Improvements in performance reporting
- Continued efforts required in performance reporting
- Factors inhibiting performance reporting
- Impediments must be overcome

Accounting for Parliamentary Appropriations

- Wide range of accounting practice

Annual Report Award

- Recognition of good annual reports

Conclusion

Exhibits

- 4.1 Number of Parent (or Acting) Crown Corporations
- 4.2 Crown Corporations: Selected Financial Statistics
- 4.3 Crown Corporations: Employment
- 4.4 Characteristics of Useful Performance Information
- 4.5 Crown Corporations: Performance Reporting in Annual Reports Has Improved
- 4.6 Crown Corporations: Performance Reporting in 1992-93 Annual Reports

Crown Corporations:

Accountability for Performance

Assistant Auditor General: Wm. F. Radburn

Responsible Auditor: Grant R. Wilson

Main Points

4.1 Crown corporations are important mechanisms of public policy and largely remain dependent on parliamentary appropriations. As such, they must be fully accountable to Parliament. Because they are under increasing pressure to be more financially self-sufficient, many are re-examining their essential products or services and the methods of providing them.

4.2 The board of directors oversees the management of the affairs of the corporation and is an important link in the chain of accountability. The board is responsible for making major decisions, for monitoring and evaluating performance, and for ensuring that the corporation establishes clear, measurable objectives and reports adequately on results. Because of the importance of their role, board members must fully understand their responsibilities. A competent board requires qualified individuals whose timely appointments should be planned through consultation with the board. In addition, a board membership profile should be developed for each corporation.

4.3 Parliament needs to receive a timely flow of useful information that shows how well corporations are achieving their objectives. Annual reports are the appropriate vehicle for conveying this information.

4.4 Most annual reports do not explicitly state performance information on all approved objectives. Though we noticed considerable improvements in the reporting of performance (with 65 percent of corporations now providing some disclosure of information on objectives), 60 percent of those reporting do not report on all objectives. Furthermore, in those corporations that do report some information, performance reporting still requires improvement.

4.5 Accounting practices used by some Crown corporations vary. As a result, parliamentary appropriations are presented in financial statements in a manner that may lead to inappropriate comparisons and conclusions. This concern has been raised in the past, but the issue has not yet been resolved. Consequently, we intend, in co-operation with the Crown Corporations Directorate of the Department of Finance and Treasury Board Secretariat, to work with the affected Crown corporations to determine how best to disclose parliamentary appropriations in their financial statements.

4.6 We are establishing a Crown Corporation Annual Report Award to recognize those federal Crown corporations whose annual reports best serve as accountability documents.

Introduction and Purpose

4.7 Crown corporations have been used as mechanisms to pursue public policy objectives in Canada since before Confederation. Over the last decade, government management of Crown corporations has stressed the need for productivity gains, expenditure reductions, increased returns to the shareholder and rationalization of operations.

4.8 Crown corporations are distinct legal entities. They have their own boards of directors with major responsibilities, and they enjoy considerable freedom from public sector administrative controls. Crown corporations are assigned their legislative mandates and powers by Parliament and are, thus, ultimately accountable to Parliament through the appropriate minister.

4.9 Revisions to the *Financial Administration Act*, which came into effect on 1 September 1984, aimed to strike a balance for Crown corporations between the need for accountability, which implies adequate information to, and control by, Parliament and government, and the need for an appropriate measure of independence of action. The revisions, as embodied in Part X of the Act, clarified the roles and responsibilities of various players in the corporate governance hierarchy, defined the information that Crown corporations must provide to Parliament to ensure corporate accountability and instituted a comprehensive audit regime.

4.10 This chapter, which builds on a number of earlier chapters relating to Crown corporation accountability, intends:

- to indicate the continuing importance of Crown corporations as a vehicle for implementing public policy and the need for their accountability;
- to outline the importance of the board of directors in the governance of Crown corporations and its role in providing accountability for performance; and
- to comment on the adequacy of information provided to Parliament by Crown corporations, on their performance and on the accounting for, and reporting of parliamentary appropriations.

Crown Corporations

4.11 Information is provided annually to Parliament by the President of the Treasury Board on *Crown Corporations and Other Corporate Interests of Canada*. Based largely on this information, we have highlighted the current characteristics of the sector or portfolio and some of the important changes that have taken place since 1984-85, when the amendments to the *Financial Administration Act* came into force. This information demonstrates the importance of the portfolio and the need for continued emphasis on governance and accountability.

Significant changes

4.12 The number of corporations has fallen from 195 entities in 1984-85 to 112 today, including parents (or acting parents) and wholly owned subsidiaries. In 1984-85, there were 61 parent Crown corporations; by the end of 1991-92, there were 57 parent (or acting parent) corporations. Subsequently, seven parent corporations have been deleted as Crown corporations ([Exhibit 4.1](#)). The fluidity of the sector is evidenced by the 31 additions or deletions of parent corporations since 1984-85. Among the deletions were a few very substantial parent corporations with numerous wholly owned subsidiaries.

4.13 In 1991-92, assets administered by Crown corporations were \$51 billion, expenditures were \$23 billion, and commercial revenues were \$18 billion ([Exhibit 4.2](#)). The number of employees in Crown corporations has decreased from approximately 210,000 in 1984-85 to 120,000 in 1991-92, a decrease of some 90,000 people as a result of divestitures and dissolutions, downsizing and operational efficiencies ([Exhibit 4.3](#)). The privatization of Air Canada and Petro-Canada alone accounted for a reduction of approximately 30,000 employees. Although reduced in size, the Crown corporation work force still represents a significant portion of the government total: 25 percent today compared to 36 percent in 1984.

A continuing orientation to public policy and dependency upon appropriations

4.14 Crown corporations continue to be public policy-oriented and generally dependent upon budgetary appropriations. Certain corporations were privatized because, among other reasons, they no longer served a public policy purpose requiring government ownership. In addition, a number of corporations were downsized by divesting them of business units that had little public policy role. New corporations have tended to be assigned clear public policy roles so that the current portfolio maintains a largely public role.

4.15 While the Crown corporation sector provided over \$2 billion to the government by way of dividends and other payments during the eight-year period from 1984-85 to 1991-92, the sector received \$37 billion in budgetary funding from the federal government. Over this period, though budgetary appropriations have remained relatively constant, they have increased as a percentage of operating expenditures. In 1984-85, Crown corporations received budgetary funding representing 17 percent of expenditures, whereas in 1991-92, budgetary funding represented 24 percent of expenditures.

4.16 Although the Crown corporation sector has experienced an increase in dependency on the public purse to fund expenditures, the main reason is the nature of the entities that now comprise the sector. A few Crown corporations with significant expenditures, which operated independently of government funding, were privatized, while most of the corporations remaining are dependent, to varying degrees, on government funding.

4.17 For the Crown corporations that have operated throughout this eight-year period, operating expenditures and budgetary funding have remained relatively constant. Although 35 of the active Crown corporations, or 65 percent, received some budgetary appropriations to fund their operations, six corporations accounted for almost 85 percent of the \$5.4 billion provided to the sector in 1991-92.

Debt held by private sector increasing proportionately

4.18 Both the number of corporations that borrow from the private sector and the proportion of debt held by the private sector have increased. The total long-term debt of corporations operating throughout the period has remained relatively constant at about \$33 billion. However, the portion of debt borrowed from the private sector has increased from 49 percent to 58 percent of the total, while that borrowed from the government has decreased correspondingly. The government has authorized and encouraged borrowing from the private sector, rather than from the government. This practice is intended to encourage autonomy and a greater commercial orientation for Crown corporations, and reduces the otherwise reported debt of the government in those cases where corporations' debts are not consolidated.

Management challenges increasing

4.19 Crown corporations have become increasingly complex to manage. The management challenges that face Crown corporations have intensified with pressures to do more with less. Fiscal constraints and a taxpayer perception of bureaucratic inefficiency have contributed to a drive for greater productivity. At the same time, the shareholder, interest groups and customers are expecting and demanding more. There is growing insistence that public bodies should address environmental problems, balance the needs of various stakeholders, be more open about performance and adhere to the highest standards of ethical behaviour.

4.20 As a result of these various pressures, a large number of Crown corporations find themselves at a "crossroads" in their existence: in the move toward self-sufficiency and a broader accountability, consideration is being given to identifying the essential products or services and the methods of providing them. In the current situation, perhaps one of the most obvious courses is to downsize; however, this can result in reduced levels of service and, ultimately, in disgruntled employees and frustrated customers. Alternatively, corporations have sought to identify innovative ways to enhance quality and attempt to maintain services at reduced cost.

4.21 Though privatization accounts in large part for the overall decrease in Crown corporation employment, corporations that have continued to exist since 1984 have also reduced their work forces by 30 percent, through downsizing and operational efficiencies. The operating expenditures of these corporations appear to have remained relatively constant over the period but, when adjusted for inflation, they are seen to have fallen by \$7 billion, or 24 percent.

Continued importance, requiring governance

4.22 Our view of the importance of the Crown corporation sector has not changed, nor has our belief that the sector continues to require the strong and sustained attention and active participation of Parliament, government and the various boards of directors. In 1991, we reported that the control and accountability framework established in 1984 represented a vast improvement over the previous situation and provided for greater

vigilance and stability. The framework requires the preparation of corporate plans for government approval and the tabling of related summaries in Parliament, along with an annual report outlining achievements. It allows for flexibility in carrying out mandates, while providing for accountability. It has, in our view, improved the management of Crown corporations as well as the receipt of essential information by Parliament on a more timely basis.

Corporate Governance

4.23 The 1984 amendments to the *Financial Administration Act* include, among other things, an articulation of the roles and responsibilities of Parliament, government, boards of directors, officers and auditors in relation to Crown corporations: this was perceived as a necessary first step in developing an accountability framework. Although each plays a significant and vital role in the chain of corporate governance for Crown corporations, the following comments focus on the functioning of boards of directors. Currently there are over 530 board members, contributing a significant service to the public.

4.24 "Corporate governance" means the provision of strategic leadership that is fully accountable. In the context of Crown corporations, governance is largely the responsibility of the board of directors: in other words, the board is primarily responsible for corporate performance. It follows that one of the government's main objectives in proposing the amendments to the *Financial Administration Act* was to clarify and reaffirm the role of the board as the linchpin of effective management. The government understood the need for an effective board of directors in providing integrity and soundness in: planning the direction of the corporation; managing and safeguarding the corporation's resources; monitoring, evaluating and reporting performance; and supplying guidance on certain operational issues.

The board's role in managing a Crown corporation

4.25 In 1988, to help define the role of the board in managing the affairs of the corporation, the Privy Council Office published a paper, *Governor in Council Appointments in Crown Corporations*, in which it outlined the responsibilities of boards of directors and members of the board. Recently, the Crown Corporations Directorate of the Department of Finance and Treasury Board Secretariat released a guide for directors, *Directors of Crown Corporations: An Introductory Guide to Their Roles and Responsibilities*. We agree with the view that the boards of Crown corporations are crucial to the proper functioning of Crown corporations and to ensuring their ultimate accountability to Parliament.

4.26 The board's purpose is not to manage day-to-day operations, which is clearly the function of senior management, but it is responsible for overseeing the management of operations and for monitoring results to ensure that plans are being carried out successfully. In Crown corporations, a structure for the review and approval of objectives has been established in the form of the corporate planning process. The corporate plan, submitted by the board, approved by government and summarized for public distribution

through its tabling in Parliament, sets out corporate objectives and the strategies for achieving them. Parliament thus has an opportunity to scrutinize plans, objectives, resources and strategies, as do other stakeholders.

4.27 The board is responsible for evaluating strategies for achieving the corporation's objectives. Thereafter, the board works with management to further refine the strategies, helping to modify plans according to its views and insights. Thus, the board shapes a response to various stakeholder needs that can be successfully submitted to government for approval. The board is also responsible for regularly reviewing strategies and challenging their validity in the light of changing circumstances. To do so, it is important that the board receives governance information. This forward-looking information describes where the corporation is going and how it intends to get there.

4.28 Directors are concerned with the future well-being of the corporation consistent with its mandate and government expectations. If objectives are not being met, it is the board's responsibility, through management, to initiate and oversee implementation of corrective action. Directors act as professional trustees independent of company management, but they need to establish a dynamic and challenging relationship with the chief executive officer to promote effective operations.

4.29 A diligent board serves not only as an important source of advice for management, but also as a useful accountability mechanism. Board members who are willing to ask management challenging questions, and who prompt management to prepare thoroughly for board meetings, can encourage sound management practices and ensure that major decisions are not taken without thorough consideration. Boards should be involved in assessing senior management performance and in securing a sound process for succession planning.

Ensuring that directors understand their responsibilities

4.30 It is vital that directors know their individual responsibilities and those of the board. However, in our 1989 Report, we noted that only a few directors had been briefed on their duties. Although individual corporations may brief new directors, and the recent *Introductory Guide* provides valuable information for this purpose, there is still no regular briefing process that we are aware of to ensure that all directors understand their responsibilities.

4.31 At least one provincial jurisdiction has organized seminars for board members to assist them to understand their roles, responsibilities and challenges. In our view, the Crown Corporations Directorate, in concert with other appropriate bodies, could well sponsor similar sessions for Crown corporation board members.

Appointing the best-qualified board members

4.32 Participating on a board of directors is a demanding and challenging responsibility. A good board is composed of people who understand and accept the responsibilities of the position and agree to help make their board function effectively. They should be committed, active and able to approach the job professionally. To meet the demands, members should bring to the board a blend of judgment, skills, specialized knowledge, creativity, attitudes and experience appropriate to the needs of the corporation. Finally, directors should be led by a capable chairperson who is able to mobilize the individual attributes of board members and to structure their efforts by organizing work, sharing power and managing processes effectively. The establishment of committees with clear terms of reference is one way of fulfilling the board's oversight role.

4.33 Although board members are appointed through an order-in-council, parliamentarians have the opportunity to call the appointee before the appropriate standing committee for an examination of qualifications.

Establishing a board member "profile" and seeking board input

4.34 The demands on board members are onerous, and only the appointment of the best-qualified people can ensure the board's proper functioning. To ensure that the best directors are appointed to Crown corporations, planning the board composition, developing director specifications, searching for, screening and selecting candidates, and briefing and training new directors are important steps to consider. Existing boards are in an excellent position to understand current and future needs of the corporation and may be able to identify candidates suitable to meet evolving needs and circumstances.

4.35 For each corporation, the board should establish a membership profile as part of the general planning for the board composition, and input should be sought from the board on the appointment of new members.

4.36 In addition, we encourage the timely replacement of director positions to ensure the continuity, strength and stability of the board. There have been instances where board vacancies have remained unfilled for lengthy periods of time.

4.37 A strong board of directors requires balance. The board may represent a range of social and geographic realities, as well as a broad cross section of skills and experience. Yet competence should be the dominant criterion for board selection. Individuals who have experience unique to the activities of the particular Crown corporation may also contribute to balance.

The accountability challenge

4.38 The board must do what it feels is best for the corporation, within its legislated mandate. Boards should take the initiative to forge ahead and ensure that they and the government have a common understanding of the role and expectations of the corporation.

4.39 The board must clarify the corporation's objectives and approve performance indicators for measuring their achievement. In essence, the role of any board is to ensure that the received mandate is translated into relevant and appropriate objectives and action plans, and that these objectives and plans are met. For Crown corporations, balancing commercial with public policy objectives is a major challenge; measuring and reporting results is an equal or greater challenge.

Closing the "accountability loop"

4.40 To provide for improved accountability, the board must close the "accountability loop". That means ensuring that the corporation reports adequately to Parliament on its performance (specifically, on the extent to which it has achieved government-approved objectives). When Parliament reviews the report, comparing objectives to results and satisfying itself that the corporation has performed satisfactorily, we consider that the accountability loop will be closed.

4.41 In support of improved accountability, boards should ensure that they and Parliament can assess, through their annual reports, the success of Crown corporations in carrying out their mandates.

Performance Reporting in Annual Reports

Accountability through reporting

4.42 A well-functioning accountability framework is based on the premise that Parliament will receive useful information and that it will actively judge corporate performance. If the pertinent information is not provided to Parliament, or if Parliament does not involve itself in judging performance, then the accountability framework will not work as intended.

4.43 The 1984 amendments to the *Financial Administration Act* incorporated, among other things, the following principles:

Parliament will be informed of the objectives of Crown corporations as approved by government; and
Parliament will receive a systematic flow of timely, pertinent information on actual performance so that it can judge how well Crown corporations have achieved their stated objectives for each planning period.

4.44 The practice of reporting performance against established objectives is basic to good management. Certainly, the annual report is the main vehicle by which a Crown corporation accounts for its activity and performance in terms of government-approved goals and objectives. As these reports are the cornerstone of corporate accountability to Parliament, it is important in this context to examine their usefulness.

4.45 The issuing of an annual report does not, by itself, necessarily result in accountability. Indeed, the annual reports of Crown corporations are used for a wide

range of different purposes, such as public relations or marketing, and they may serve a number of "clients", including customers, constituents, the minister, government and Parliament. In our view, however, the first and foremost purpose of the Crown corporation's annual report is to ensure accountability to Parliament.

4.46 In 1991, we reported that, despite the legislated requirement to disclose in their annual reports the extent to which their objectives had been met, the majority of Crown corporations were not meeting this requirement. The Crown Corporations Directorate encouraged Crown corporations, in December 1991 and again in May 1993, to improve their reporting and to fully satisfy this requirement.

4.47 As a follow-up to our 1991 study, we reviewed the 1992-93 annual reports of parent Crown corporations to determine the following:

whether objectives and related performance information were included; and the potential usefulness of the information provided.

Enhancing the usefulness of performance reporting

4.48 A number of recognized bodies have defined and set forth the characteristics of useful information. In particular, a 1991 research study by the Canadian Institute of Chartered Accountants, *Information to Be Included in the Annual Report to Shareholders*, describes the qualitative characteristics that relate to the usefulness of information. These characteristics are generally recognized in the literature as: **relevance, reliability, timeliness, understandability and comparability** (Exhibit 4.4).

Exhibit 4.4

Characteristics of Useful Performance Information

Relevance. Information is relevant if it enables users to evaluate past, present or future events or to confirm or correct previous assessments. There must be a logical relationship between the information provided and the information needs of users (i.e., for accountability purposes, parliamentarians).

The annual report should include the corporate objectives established by the board of directors in keeping with its authorized mandate and approved by the government in the form of a corporate plan. All of the corporation's major activities and undertakings should be consistent with objectives in terms of the expected outcomes. Performance information should relate to a corresponding objective, with each objective reported upon.

The objectives of the corporation should be stated in terms (quantitative or qualitative measures) that permit assessment of the extent to which they are being achieved. Targets should be established against which to compare actual performance. If the objective cannot be measured and reported against, then it is difficult for parliamentarians to assess the performance of the corporation; accountability is, therefore, inhibited. To the extent possible, the quantity, quality and time frame of the relevant activity, service or product should be

reflected in the objectives and related performance information.

Reliability. Information is reliable if it can be depended on by users to represent faithfully what it purports to represent. Objectivity, verifiability and neutrality contribute to the reliability of information. Performance reporting is reliable when it is complete, objective and free of material error.

Timeliness. Information is timely if it is received by parliamentarians while it still has the capacity to influence decisions. The usefulness of information for decision making declines as time elapses. The *Financial Administration Act* requires a Crown corporation to submit its annual report to the responsible minister within three months of its fiscal year-end, and it requires the minister to table the annual report in Parliament within 15 sitting days.

Understandability. The objectives of the corporation and related performance information should be clearly identified and expressed in unambiguous terms. Necessary information about complex matters should not be excluded for the sake of simplicity. The level of detail and extent of technical explanation should be adequate to give parliamentarians sufficient understanding of the information. Charts and graphs, though they can be misused, should be used where they can simplify information without diminishing meaningfulness.

The objectives of the corporation should be significant and central to the business of the corporation, and they should reflect the outcomes that are essential to the corporation's success in delivering its mandate. The report should recognize any conflicting objectives and explain the trade-offs that the corporation will make to accommodate them. Performance indicators should be explained in terms of their limitations, and their significance in terms of the related objective. Performance information should tell parliamentarians the extent to which the objectives were achieved. Performance information should provide a full range of favourable and unfavourable results that fairly and honestly portray the performance of the corporation.

Comparability. The usefulness of information is enhanced when it provides parliamentarians with a basis for making comparisons over time and with other entities. Significant changes in the corporation's objectives should be highlighted. For example, if changes in an entity's environment mean that previously stated objectives are no longer feasible or desirable, appropriate modifications in direction should be discussed in the corporation's annual report. Performance information should be accumulated and reported in a way that, wherever possible, permits comparability over time and among entities.

4.49 Although reliability is an important characteristic of useful information, we have not addressed it in this study. Reliability may be assessed by audit: subsection 132(5) of the *Financial Administration Act* authorizes the Treasury Board to request that any quantitative information included in a corporation's annual report be audited. However, to date, no such audit has been requested. Of course, the board of directors may request its internal audit group or other body to audit this information. Alternatively, the reliability of performance information may be addressed through periodic special examinations. The second round of special examinations of Crown corporations is now under way; the first round identified as common weaknesses a lack of clear objectives along with inadequate measurement and performance reporting.

4.50 Also, for the purposes of this study, we have not assessed the timeliness of the annual reports, as this is audited annually by our Office and reported in the President of the Treasury Board's *Annual Report to Parliament on Crown Corporations and Other Corporate Interests of Canada* . In general, however, annual reports are being provided on a more timely basis now than they were prior to the 1984 amendments to the *Financial Administration Act* . A few corporations report well before the legislated deadline, and timeliness could be further improved if other corporations made the same effort.

4.51 In our current analysis, we reviewed the annual reports of 40 of the 50 parent Crown corporations in existence in 1992-93. We excluded the annual reports of two inactive corporations and two other reports that were not available at the time of our review. In addition, we excluded six of the seven corporations that are exempt from the relevant provisions of the *Financial Administration Act* ; the Canadian Broadcasting Corporation was included, as its enabling Act contains the same legislated requirements for reporting as those of non-exempt corporations.

Improvements in performance reporting

4.52 We noted considerable improvement in the number of Crown corporations that provide some information on performance. Prior to 1984, when there was no legislated requirement to report on the achievement of objectives, few corporations provided performance information, except for annual financial statements and some explanations relating to them. In 1984, only 23 percent of annual reports of corporations that are still operating today provided some indication of objectives and related performance; in 1991, 38 percent did so.

4.53 This year, however, we found that 65 percent of the corporations provided some disclosure in their annual reports of objectives as identified in the corporate plan summary, along with related performance information (Exhibit 4.5). We applaud those corporations that have made an effort to improve their performance reporting since 1991. In fact, a few corporations that did not report any objectives in previous annual reports are now reporting all their objectives, as provided in their corporate plan summaries, with performance information included against each objective. However, most corporations have not achieved that high a level: of those corporations reporting on performance, only ten report performance against all their objectives.

Continued efforts required in performance reporting

4.54 Where corporations failed to report any performance (35 percent, or 14 of the annual reports reviewed), they failed either to state objectives or to report performance information against expressed objectives. Five of these corporations stated generally that "objectives were achieved during the year", but offered no support for such a statement. In our view, this does not constitute adequate performance reporting as envisaged in the *Financial Administration Act* .

4.55 It is interesting to note that 89 percent of the large corporations (defined as those with assets greater than \$200 million and revenues from commercial sources greater than \$50 million) report at least some performance against objectives in their annual reports, whereas only 43 percent of the smaller corporations do so (Exhibit 4.6). Assessing the achievement of established objectives is integral to effective management, regardless of a corporation's size. For Crown corporations, reporting performance information to Parliament not only respects the requirements of the *Financial Administration Act* , but also serves the interests of accountability.

4.56 Those corporations that still do not report performance, or that report performance against only some objectives, should address all corporate objectives in their annual reports.

4.57 For those corporations that do report some performance information in their annual reports (65 percent, or 26 of annual reports reviewed), we determined that, in many cases, the information provided was not as useful as it could be. For example, we found that:

most annual reports include objectives and information limited mainly to inputs, processes and activities, which is insufficient to evaluate performance, rather than to outputs, desired results and actual achievements. As a consequence, it is difficult to determine the extent to which the corporation is successful in delivering its mandate;

in over half the annual reports, some of the objectives provided in the related corporate plan summaries are omitted and, hence, performance information is incomplete;

in some cases, objectives and, hence, performance information do not address key aspects of the corporation's business and therefore do not relate to areas crucial to the success of the corporation;

in some annual reports, objectives are expressed for which no corresponding performance information is reported and, in a few others, it is difficult to associate the information with a specific objective;

objectives often are not stated in terms that lend themselves to measurement (i.e., through performance indicators or measures), so it is difficult for information to demonstrate the extent to which the objective has been achieved; and

although more corporations now devote a separate section of their annual reports to reporting against objectives, about half do not, so it is difficult for the reader to assess the corporation's performance.

4.58 In summary, the significant shortcomings in annual reports stem from objectives that lack potential for measurability and reporting that lacks meaningfulness. Performance reporting could be improved by greater use of performance indicators or measures in describing objectives, and by reporting corresponding information.

Factors inhibiting performance reporting

4.59 Nine years have passed since legislation first required Crown corporations to report on the achievement of objectives, but many still have not complied. Indeed, there are a

number of factors that inhibit corporations from meeting these requirements. First, there are few incentives to comply and few sanctions for not complying. In fact, the criticism that might attend a balanced picture of performance, one that reports failure to achieve a stated objective, may actually be a disincentive.

4.60 Other impediments to reporting performance against objectives include a lack of performance measurement systems, or unwillingness to report because it may place the entity at a competitive disadvantage. Management and the board may be reluctant to be held accountable for failure to meet measurable targets. Also, the use of annual reports as marketing tools may limit willingness to disclose performance information fully and objectively.

Impediments must be overcome

4.61 For some corporate mandates, it may be difficult, though not impossible, to measure and communicate performance. Reporting against objectives is progressively harder as one moves from "activity" type information (i.e., what was done) to "outcome" type (i.e., what was achieved). To assist, a hierarchy of objectives could be constructed such that the more precise and more readily measured objectives serve to define the broader-outcome objectives. Information to Parliament is more useful if it conveys the extent to which a corporation has succeeded in delivering its mandate than if it provides only details of operations, processes and activities.

4.62 The information contained in a corporation's annual report should explicitly address these basic questions: "What must the entity do to be successful?" (i.e., objectives) and "How well did the corporation perform in meeting its objectives?" Objectives should be expressed as the aims or ends of actions; specifying desired results and their effects will set the direction and purpose of the business.

4.63 For annual reporting purposes, objectives should be defined at the corporate level of aggregation: high enough to reflect the business as a whole, and lending themselves to measurement, in either quantitative or qualitative terms. We believe that the characteristics of useful information outlined in [Exhibit 4.4](#) can provide general guidance in addressing these questions and should be considered by Crown corporations in preparing future annual reports.

4.64 Despite the difficulties and impediments, there are many good examples, in both the private and public sectors, of corporations that clearly state objectives in their annual reports and relate them to performance information in measurable and meaningful terms. The Financial Post Annual Report Award recognizes the importance of providing performance information in relation to objectives.

4.65 In the United States, the *Government Performance and Results Act* will eventually require all U.S. federal agencies to submit annual performance reports to the appropriate legislative committees and, in them, to compare what the agency expected to achieve (as set out in performance plans) against what was actually achieved. These annual performance reports will also include a performance evaluation explaining any failure to

achieve goals, and detailing how the agency will deal with such failures. The purpose of the Act is to hold federal agencies accountable for achieving program results.

Accounting for Parliamentary Appropriations

4.66 In addition to reporting against objectives, annual reporting on financial position and results of operations is a fundamental element of accountability. Through financial statements, Crown corporations account for the way in which financial resources have been obtained and used, including parliamentary appropriations.

4.67 Reliable information on the financial resources and obligations of Crown corporations, as well as on the results of operations, is needed to help Parliament assess corporate financial performance and make decisions on the allocation of financial resources. Of course, financial statements of Crown corporations do not "tell the whole story", nor are they intended to. That is why information is also required on objectives and the extent to which they are being achieved.

Wide range of accounting practice

4.68 The *Financial Administration Act* requires that Crown corporations governed by the Act prepare their financial statements in accordance with generally accepted accounting principles, as supplemented or augmented by Treasury Board regulations. During our 1989 review of the implementation of the framework provided under the Act, we noted that, in accounting for parliamentary appropriations, there was a wide range of practice among Crown corporations.

4.69 In our 1991 Report, we stated our concern that different accounting treatments for similar transactions provided unclear and inconsistent information to parliamentarians. For example, some Crown corporations reported operating appropriations in the operating statement, while others reported them as equity on the balance sheet. In addition, Crown corporations that reported operating appropriations in the operating statement did not always report the funds in the same way: in some cases, they were reported as part of revenue; in others, as a reduction of expenses; in still others, they were deducted from the net cost of operations. Appropriations used for capital purposes were applied by some corporations to reduce the cost of assets, while others applied them to increase equity.

4.70 Since 1989, some Crown corporations have improved their reporting of parliamentary appropriations. However, in a number of other cases, problems persist. While the officers and auditors of each affected Crown corporation view their practices as appropriate and permissible within generally accepted accounting principles, in our view, they collectively represent an unacceptable variety of practice. First, it is often difficult to determine the total amount of financing received through parliamentary appropriations in any one set of financial statements. Second, because Crown corporations do not report parliamentary appropriations consistently or explain them

clearly, users of financial statements may well be led to inappropriate comparisons and conclusions.

4.71 It is our present intention, with the co-operation and support of the Crown Corporations Directorate, to communicate with all Crown corporations concerned to enlist their support in addressing these inconsistent practices. The intention is to make financial statements of Crown corporations more useful and readily comparable in the accounting for, and reporting, of parliamentary appropriations.

Annual Report Award

Recognition of good annual reports

4.72 The annual report gives management and boards of directors an opportunity to report to shareholders on how they have fulfilled their responsibilities. The private sector has shown considerable interest in the role of the annual report, and its importance is widely acknowledged. Both the Canadian Institute of Chartered Accountants and the Society of Management Accountants of Canada have issued research reports detailing information that should be included in the annual report, and these are excellent references.

4.73 In 1991, we reported that considerable study was being done on ways to improve the information in private sector annual reports, and we commented on the need for Crown corporations to undertake similar work. To that end, the Crown Corporations Directorate has recently issued a draft discussion paper, *Crown Corporation Annual Reports*, to assist management and boards of directors in the preparation of annual reports.

4.74 We support the Crown Corporations Directorate initiative. Furthermore, we intend to build on the momentum the discussion paper has created by establishing a Crown Corporation Annual Report Award, with annual awards commencing in 1994 and continuing for an initial period of five years. Judges for this award will include knowledgeable and interested parties, as appropriate. This award is intended to recognize those corporations that have prepared suitable annual reports as accountability documents and to provide both an incentive and guidance to Crown corporations in improving annual reports.

Conclusion

4.75 Crown corporations are still important vehicles for the realization of public policy. Society and the economy are in transition, and the changes that affect every part of our system are reflected in the Crown corporation sector. Many Crown corporations have recognized and faced the challenges inherent in managing change: specifically, they have worked to clarify the nature of their business, define their objectives and sharpen their strategic focus.

4.76 A strong board is better able to face the challenges of change. Members of boards, along with certain other key players, have an important role to play in corporate governance. By asking questions, challenging assumptions and being knowledgeable about the corporation and the field in which it works, boards can help their corporations to address uncertainties and constraints. The board of directors can be instrumental in creating a climate in which accountability - that is, the obligation to account for responsibility conferred - becomes one of the corporation's main concerns.

4.77 The practice of reporting on performance in annual reports, though much improved, still has a way to go. The first important steps are: reporting against all objectives; stating objectives in more measurable terms; and reporting performance information that focusses principally on outputs and outcomes. Also, more attention needs to be given to providing more comparable and consistent information on parliamentary funding. The establishment of a Crown Corporation Annual Report Award is intended to recognize those corporations that provide greater accountability to Parliament through good reporting.

Chapter 5

Information for Parliament

Understanding Deficits and Debt

Main Points

Introduction

- What Can the Auditor General of Canada Do?

A Layman's Guide to Deficits and Debt

- The Purpose of the "Guide" Is Educational
- Deficits Versus Financial Requirements
- Gross Debt Versus Net Debt
- What Does a Zero Deficit Mean?
- What Are the Components of a Deficit?
 - Program spending
 - Revenue
 - The cost of borrowing
- Summary

The Need for Simple Indicators

- Why Do We Need Simple Indicators?
- Characteristics of Simple Indicators
- A Set of Indicators
 - Interest bite
 - Program share
 - Expenditure ratio
 - Tax bite
 - Debt-to-GDP ratio
- The Absence of National Indicators
- Summary

Future Trends

- A Need for Longer-term Information
- The Full Cost of Accumulating Annual Deficits
- Longer-term Assessments
- Summary

Forum for Rational Discussion

- Personalizing the Problem
- A Parliamentary Forum

Conclusion

Exhibits

5.1.1 Federal Spending

5.1.2 Federal Tax Revenue

- 5.1.3 Net Debt and Debt-to GDP Ratio
- 5.1.4 Interest Bite
- 5.1.5 Program Share
- 5.1.6 Expenditure Ratio
- 5.2 Tax Bite
- 5.3 Cost of Accumulating Deficits
- 5.4 Forty-Year “What if” Assumptions and Federal Government
Five-Year Budget Targets (1993-98)
- 5.5 “What if” Interest Bite Projections
- 5.6 “What if” Expenditure Ratio Projections
- 5.7 “What if” Debt-to-GDP Ratio Projections

Information for Parliament

Understanding Deficits and Debt

Assistant Auditor General: Ron Thompson

Responsible Auditor: Jeff Greenberg

Main Points

5.1 Persistent deficits and growing debt have been part of the government's financial condition for two decades. Hard choices lie ahead. We hope this chapter will help to explain why.

5.2 Canadians need a better understanding of what deficits and debt mean. Part of this learning process includes understanding the elements that make up the federal deficit and debt. We also explain some of the practical difficulties of deficit reduction plans - both those that scale back expenditures and those that increase revenues.

5.3 In the chapter, we suggest five simple indicators of financial condition and call on the government to report them in a consistent manner from one year to the next. The idea is to help Canadians gain an appreciation of the problem rather than point them toward specific solutions.

5.4 But looking at where we've been is not enough; it is also necessary to see where we're going. For this reason, we propose that three of the simple indicators of financial condition plus a new one, the cost of missing deficit targets, be used as future-oriented indicators. We encourage the government to report this information. And we explain how positive short- to medium-term trends can mask negative long-term problems.

5.5 We conclude by suggesting that governments do not create deficits and debt in isolation from demands by the Canadian people. We point out that Canadians must feel part of any solution to the government's financial woes, and we discuss recent proposals to make the budget process more open.

5.6 In summary, the more informed Canadians become about the implications of deficits and debt, the easier it will be for the government to make the difficult decisions that lie ahead and the easier it will be for the public to accept those decisions.

Introduction

5.7 Two years ago, as part of our concern for the understandability of the government's financial condition, we raised the notion of a financial scorecard. We did this so that Canadians could better assess the success of economic planning and execution by the government, and the reasons for any deviations from its plans. Last year, we suggested the need for simple indicators, for future-oriented information about the government's financial condition, and for a forum for rational discussion. We also indicated that a study should be done on these matters. This chapter is a product of that study.

5.8 Last April, as part of that exercise, we hosted a colloquium on deficits and debt. We asked 35 prominent Canadians representing different areas of the economy to discuss the implications of annual deficits and accumulated debt. We also asked them to comment on appropriate ways to report these numbers and on the role of a legislative auditor. One of the issues discussed was the need for simple but meaningful information; virtually every participant agreed that there was a serious lack of understanding among Canadians about the meaning of deficits and debt, let alone any consensus on solutions.

What Can the Auditor General of Canada Do?

5.9 Public sector deficits and debt are among the most important policy issues we face today because of the concerns they raise about issues related to the financial ability of the government to carry out its economic and social programs.

5.10 First and foremost among these issues is the question of our ability to carry the level of debt we have incurred. The financial experts we consulted say that most countries become aware of a concern about their ability to pay their debts only after a reaction by the financial community. They also say that although it is not appropriate for the Auditor General to comment on the financial viability or the solvency of the federal government, the Auditor General does have a responsibility to comment on important issues like annual deficits and accumulated debt. This means weighing our words very carefully when commenting on the financial condition of the government.

5.11 We believe that we have a responsibility to encourage the federal government to provide enough relevant, reliable and understandable information about its financial condition to allow Canadians and their elected representatives to gain an appreciation of deficits and debt and to draw their own conclusions about their implications.

A Layman's Guide to Deficits and Debt

The Purpose of the "Guide" Is Educational

5.12 In this section, we hope to do two things: first, demystify the meaning of deficits and debt; and second, explain, in financial terms, what it means to reduce the annual deficit and the growth in accumulated debt.

5.13 We do this because many people think that getting rid of the annual deficit means simply eliminating waste and getting rid of a few public servants - a myth that needs dispelling. There are also those who think the annual deficit can be eliminated by getting rid of government programs - not their favoured program, but someone else's program, or by raising taxes - not their taxes, but someone else's taxes. Our objective is to dispel the idea that eliminating the deficit or reducing its relative significance will be easy or painless.

5.14 Experts will, of course, realize that there are complexities we did not touch on, but we hope that they will agree that there are significant barriers to dealing with them until there is a better and more widespread level of understanding.

Deficits Versus Financial Requirements

5.15 The Minister of Finance focusses on two of many measures when presenting a budget. The first is the annual deficit, which measures the shortfall between annual revenues and expenditures. The second is the annual financial requirements, which represent the amount of money the government will have to borrow in open financial markets. The difference between these two measures is made up by other sources of funds, such as borrowing from government employee pension contributions. For 1991-92, the annual deficit was \$34.6 billion, or \$1,260 per capita, while the financial requirements were \$31.8 billion (excluding foreign exchange transactions).

Gross Debt Versus Net Debt

5.16 To calculate the accumulated deficit, or net debt, this annual deficit is added to every annual deficit or surplus since Confederation, arriving at a total of \$423.1 billion, or \$15,440 per capita, by 31 March 1992.

5.17 The gross debt, \$466.7 billion at 31 March 1992, is an alternative number sometimes used for measuring federal indebtedness. This represents the total liabilities of the federal government as reported in its summary financial statements. The difference between gross debt and net debt is the reported value of financial assets held by the federal government.

5.18 These financial assets include investments, loans and advances, and liquid assets such as receivables and cash. Examples include investments in Crown corporations like the Canada Mortgage and Housing Corporation and loans to foreign governments.

5.19 Assets reported by the government, however, do not include any tangible physical assets like buildings and airports, or intangibles like the government's investment in health and education. Whenever items of these kinds are acquired today, their costs are treated as expenditures in the year they were purchased.

5.20 With respect to the tangible physical assets, the Public Sector Accounting and Auditing Board of the Canadian Institute of Chartered Accountants currently has a project under way to develop and propose accounting conventions for reporting them. We support their efforts because we believe that reporting physical assets will contribute to better decision making in the public sector, such as whether to rent or to build office space. We also believe that this will help officials recognize the value of aging infrastructure, and make their decisions about replacing or upgrading it easier. Finally, amortizing the costs of assets over their lifetime will improve our assessment of the true cost of programs.

5.21 Current accounting practices do not take into consideration the impact of inflation on the value of assets or liabilities. They also do not recognize other items, such as the cost of meeting the expectations of Canadians for future pension benefits.

5.22 This is a complex subject and we make these comments because we believe that accounting conventions should be helpful to managers in making decisions about the choices between consumption and capital expenditures. But bear in mind any decisions to report these physical facilities as assets will not reduce our gross debt and therefore our interest charges on that debt.

What Does a Zero Deficit Mean?

5.23 The accumulated debt of an enterprise, whether in the public or private sector, will continue to grow as long as its expenditures exceed its revenues. This is a simple arithmetic reality. The federal government's accumulated deficit of \$423.1 billion will stop growing only if its annual deficit, currently at \$34.6 billion, is reduced to zero. For this to happen, revenues from all sources, like taxes, user fees and return on investments, must equal all expenditures, both the cost of running programs and the cost of servicing the debt.

5.24 Currently the federal government, most provincial governments and many political parties are calling for some form of deficit reduction. Some call for the elimination of annual deficits in a prescribed number of years while others call for a reduction in relation to gross domestic product (GDP). GDP is a measure of the value of goods and services produced in Canada in a given year, sometimes referred to as Canada's annual income.

5.25 Some countries have proposed that limits be set. For example, in the European community, all member countries must strive, under the proposed Maastricht Treaty, to achieve, as a minimum, either a 60 percent debt-to-GDP ratio or a 3 percent deficit-to-GDP ratio.

What Are the Components of a Deficit?

5.26 As the Governor of the Bank of Canada told the House of Commons Standing Committee on Finance during its recent hearings on the national debt, annual deficits arise from the interaction of program spending (i.e., expenditures other than interest costs), revenues, and interest costs.

Program spending

5.27 The Minister of Finance reminded members at these hearings that there are only two ways of bringing down costs in the program area. The first is "reducing those program expenditures" and the second is "finding better ways to administer, distribute, and ensure that these programs are delivered in the manner that gives you good value for the dollar."

5.28 Administrative change . In 1991-92, the federal government spent \$156 billion including debt interest costs of \$41 billion. [Exhibit 5.1](#) gives a broad breakdown of this \$156 billion. Approximately \$17 billion is taken up by expenditures on government operations, the administrative cost of operating programs, excluding the \$11 billion for running the Department of National Defence. Of the \$17 billion, wages and salaries of public servants represent \$13 billion. This means that with the annual deficit running at \$34 billion, even if government salary costs could somehow be reduced to zero, the annual deficit would still be \$21 billion.

5.29 Program reform. Some \$82 billion of total federal spending represents transfers to individuals, provincial governments and others, and an additional \$5 billion in expenditures is provided to Crown corporations. While expenditures on these activities represent a substantial source for scaling back on spending, accomplishing this scaling back would be most difficult. Marcel Côté, the keynote speaker at our colloquium, noted:

Powerful coalitions rapidly mobilized by interest groups can inflict significant political costs on governments who dare to propose radical changes. The political market operates in its perverse way to protect special interests. . . . The "iconization" of government programs has seriously misdirected budget reduction policies. Governments do not abandon programs; they squeeze them.

5.30 The implication of his remarks is not that programs can't be changed or even abandoned, but that bringing about such reform takes considerable effort, which may bring with it a degree of unpopularity.

5.31 The need for evaluation . The entrenchment of programs, particularly those that do not require annual parliamentary authority to spend money, is exacerbated by the limited number of reasonably objective program evaluations to help government decide which programs should be changed or eliminated. In Chapter 1 and in Chapters 8 to 10 of this year's Report we comment on the failure of program evaluation to examine the overall effectiveness of major government initiatives. We discovered that not only is Parliament ill informed about the effectiveness of programs, but the will to make program evaluation happen within government is simply not there.

Revenue

5.32 Revenue is the second component of annual deficits. [Exhibit 5.2](#) shows the value of tax revenue for 1991-92 to be \$113 billion.

5.33 This \$113 billion is a net figure after allowing for income tax deductions, exemptions and credits commonly called "tax expenditures". Since these are netted out at the time of assessment, there is no accurate means of assessing what gross revenue might be.

5.34 When most people think of increasing tax revenue to reduce the annual deficit, they often focus on such areas as reducing the tax loss resulting from unreported economic activity, sometimes called the "underground economy", making changes in tax policy, or stimulating economic activity to increase economic growth.

5.35 Tax loss from the "underground economy". There is the perception today that people are increasingly finding ways of evading taxation - both income tax and excise tax like the GST. Those who do pay their required taxes often feel that they are paying more than their fair share. Increasing efforts on enforcing tax compliance not only would address this concern about fairness, but would have the ancillary effect of increasing revenue. Currently, we have no accurate measure of the value of this tax gap. Department of Finance officials have estimated that the tax loss due to tobacco smuggling alone could be as high as \$600 million annually.

5.36 Tax policy. Tax policy can cover a wide area ranging from the kind of tax employed (e.g. income tax versus consumption tax) to the rate of taxation. Choosing the "right" tax or the "right" rate to increase revenues is not always a straightforward issue. For example, increasing the rate may not lead to an increase in revenue. That is, there may be some threshold above which increases in the rate of taxation have a negative effect on economic activity.

5.37 At the same time, there is a concern that there are a number of loopholes within the existing tax system that make tax avoidance an "art form". This concern stems both from the loss in revenue at a time of increasing debt and from the desire for fair treatment under the tax system.

5.38 In our 1992 Report we commented on the hundreds of millions of dollars lost in tax revenue because of the tax rules on foreign source income and foreign affiliates.

5.39 These are some of the difficult policy questions that make government deficit reduction decisions all the more intractable.

5.40 Changes in economic activity. Improving economic performance is another way of increasing tax revenue. Some Keynesian economists suggest that the principal problem with high annual deficits is not the expenditure side, but the shortfall in revenue due to slow economic growth and underutilized economic capacity. Whether government

priorities for deficit reduction should focus on economic growth through stimulation or on expenditure reduction is a matter of policy and political persuasion. Our concern is that the government demonstrate to Canadians the symptoms and future implications of high deficits and growing debt in order to develop the consensus necessary for dealing with them.

The cost of borrowing

5.41 The cost of borrowing is the third area that affects the annual deficit. In 1991-92, the interest on the debt was \$41 billion. This cost of borrowing and its compounding effect have a significant impact on Canada's annual deficits. From Confederation up to 1991-92, the federal government accumulated a net debt of \$423 billion. Of this, \$37 billion represents the accumulated shortfall in meeting the cost of government programs since Confederation. The remainder, \$386 billion, represents the amount the government has borrowed to service the debt created by previous annual shortfalls.

5.42 We do not take a position on whether budgets should be balanced, or accumulated debt should be reduced. We are simply illustrating the long-term effects of compounding interest charges.

5.43 The amount of debt . The total cost of borrowing is influenced by three factors: the amount of debt, its management, and the rate of interest on the portfolio of debt. [Exhibit 5.3](#) shows that, since Confederation, Canada has consistently used debt financing to cover some of the cost of operations. By the end of World War II, the accumulated debt was at \$13 billion, giving a debt-to-GDP ratio of approximately 108 percent. Most observers of government financing would agree that the high debt-to-GDP ratio at the end of World War II was caused by the need to generate substantial industrial production for the war effort without resorting to taxation to cover its full cost. This meant that immediately after the war, there was considerable room for expenditure reduction through cuts in defence spending.

5.44 Twenty-nine years later, debt had doubled to \$27 billion while output had surged from \$12 billion to \$152 billion, resulting in a debt-to-GDP ratio of 18 percent in 1975. Since then, the debt-to-GDP ratio has risen steadily to its present level of about 62 percent in 1992.

5.45 Managing the debt . An important component of managing the amount of debt is to minimize the interest costs by striking a balance between the short- and long-term bonds that a government issues. In doing so, achieving lowest cost is only one objective; stabilizing the interest costs and minimizing risk are others. Debt portfolio management is carried out to meet many objectives, which may not always be consistent with reducing the current annual deficit.

5.46 Interest on the debt . The most obvious factor affecting the cost of borrowing is the interest rate. The setting of interest rates is commonly thought of as the responsibility of the Bank of Canada.

5.47 The Bank of Canada maintains that while its actions influence the rates, particularly short-term rates, it has even less influence today than it once had. The Governor of the Bank of Canada argues that his current role is to manage the Canadian money supply in a way that encourages investor and saver confidence in the "future value of money"; in other words, price stability. In doing this, the Bank of Canada has to take into consideration the globalization of financial markets.

5.48 During the Finance Committee hearings, the Governor of the Bank of Canada also suggested that such policies do have "some . . . effect on the level of short-term interest rates." But the more fundamental effect on the whole spectrum of long- and short-term nominal interest rates, and hence on the annual deficit, comes from the degree of price stability.

Summary

5.49 In this section, we have provided a layman's guide to the meaning of deficits and debt. We have described some of the various instruments a government has at its disposal to influence the annual deficit. We also showed that reducing the deficit by any one of these is not an easy matter. Institutions, rigidities and conflicting objectives make the business of deficit control very difficult.

5.50 We pointed out that looking for ways to reduce the impact of annual deficits should not be restricted to administrative reform alone. We reminded members of Parliament and all Canadians that only 15 percent of program funding is spent on administering government operations. This should not be interpreted as meaning that because the potential for administrative savings is small, it is not worth achieving. Every dollar saved contributes to deficit reduction.

5.51 In focussing on administrative change, the government is seeking ways of operating more effectively and/or at less cost. This does not, however, draw attention to the choices that governments sometimes have to make among alternative policies and programs as a means of saving money. These choices can have a significant impact on the economic and social wealth of the country. Such decisions to change or eliminate programs are part of the politics of running government.

5.52 In this regard, we note that the Prime Minister indicated that the reform she announced on 25 June 1993 was "the largest reform of the structure of the federal government in Canadian history." The first two phases, departmental restructuring and streamlining, have already begun. The third phase, which is to include a fundamental review of the role of government, is scheduled to begin this fall. This is the kind of review that is necessary if governments and Parliament believe that difficult policy choices are called for to bring deficits and debt under control.

The Need for Simple Indicators

Why Do We Need Simple Indicators?

5.53 In the previous section, we explained the meaning of deficits and debt and some of the public policy choices influencing them. We believe, however, that the public ought to know more than that; they should also know why deficit reduction is important. One member of Parliament made the point well when questioning the Minister of Finance in the recent committee hearings on this matter. He said:

My belief is that we have to move Canadians along with us. In other words, it's incumbent upon us as members of Parliament to spell it out so it's understood. In other words, none of us can be part of the solution unless we really understand what the problem is.

5.54 Last year, we indicated the need for simple indicators in regard to annual deficits and accumulated debt. We felt then, as we do today, that there is a need for Canadians and their elected representatives to be able to make their own assessment about the financial condition of the federal deficit and debt. In a sense we are calling for a set of indicators that would allow parliamentarians and all Canadians to recognize the symptoms of a problem, not the cure: measures that would give them an insight into the consequences of running annual deficits that, between 1945-46 and 1974-75, never exceeded \$2.1 billion, but since then have grown steadily to the current level of \$34.6 billion. (In constant 1992 dollars, this represents an increase from \$6.1 billion in 1974-75 to \$34.6 billion in 1991-92.)

5.55 We believe that to achieve that understanding, Canadians ought to get a sense of the extent of taxation relative to national income, and its use; not in the detailed sense of how the tax dollar is distributed among various economic and social programs, but in terms of the percentages used to pay interest on the debt and the amount remaining to cover programs that contribute to the overall well-being of the country. We also believe that Canadians should have an appreciation of the extent to which the government is relying on deficit financing to meet its revenue needs. Finally, we think that Canadians ought to know whether these growing tax dollars represent a greater or lesser drain on the economy.

Characteristics of Simple Indicators

5.56 At the colloquium, participants indicated that no single indicator about deficits and debt could be sufficient. They pointed out that a set of three to six indicators was needed and that these indicators should:

- be clear and precise;
- be reported at regular intervals on a consistent basis;
- include federal and national (federal plus provincial) deficits/debt information;
- and
- incorporate historical trends and comparative data for other countries.

A Set of Indicators

5.57 We believe that the following five indicators could give Canadians and their elected representatives an insight into what deficits and debt mean to them:

- interest bite;
- program share;
- expenditure ratio;
- tax bite; and
- debt-to-GDP ratio.

These are described below.

Interest bite

5.58 Last year, we referred to a measure of interest payments on the debt expressed as a percentage of revenues, which we called the interest bite. We suggested this measure, which is already used periodically in government documents, because it seemed to us that Canadians were concerned with the amount of money they give to the government in the form of taxes and user charges and what happens to it. [Exhibit 5.4](#) shows this interest bite for the federal government from 1968 to 1992. It shows that it has gone up from 13 to 33 percent over this period. This means that for every dollar collected, 13 cents were used to cover the interest payments on the debt in 1968, while today this has almost tripled to 33 cents.

5.59 We believe that this is a helpful indicator because many Canadians know what it means to pay interest on a debt, particularly debts that are relatively large compared to their income, like a mortgage. The interest bite is a similar concept.

5.60 Whether this interest bite is too high is not really possible to determine with any precision. What is clear is that, over a long period, it has been continually rising, with the result that relatively less is available, without additional taxation or borrowing, for the real business of government - contributing to the well-being of Canadians. Our second indicator, the program share, looks at this aspect.

Program share

5.61 The program share measures the percentage of revenues devoted to program spending.

5.62 When the program share is less than 100 percent it means that the government is running an operating surplus - it is spending less on programs, excluding interest payments on the debt, than it receives in taxes and user charges. When it is greater than 100 percent it means that the government is running an annual operating deficit - spending more on programs than it receives. This means that the government must borrow to meet operating expenditures. A rising interest bite means that a decreasing amount of revenue is available to provide services to citizens. [Exhibit 5.5](#) shows that, for

the federal government, the program share exceeded 100 percent from 1975 to 1987; that is, for 13 years, we were spending more on programs than we collected in revenues. Since then, the program share has fallen below 100 percent; it dropped to 90 percent in 1991 but rose again last year to 95 percent.

5.63 Whether program share should be more, less, or equal to 100 percent is a matter of political choice; that choice is constrained by the size of the debt servicing charges, the rates of taxation, and the political decisions about the size and role of government. However, it is clear that a program share of greater than 100 percent - spending more on programs than collecting in revenues - can lead only to growing debt.

Expenditure ratio

5.64 The question remains as to whether total spending, the combination of program spending and interest payments, is becoming more or less of a burden to Canadians. Our third indicator, the expenditure ratio, sheds some light on this by measuring total expenditures as a percentage of total revenues.

5.65 When the expenditure ratio exceeds 100 percent, it means that the government is relying on deficit financing to meet some of its expenditures. For example, an expenditure ratio of 125 percent means that the government is financing 25 percent of its expenditures by borrowing. An expenditure ratio that exceeds 100 percent and continues to rise means that the government is increasingly using deficit financing to meet its expenditure commitments. [Exhibit 5.6](#) shows that the annual deficit was taking on a growing importance from 1970 to 1985, rising from 98 percent (no deficit) to 154 percent. This meant that, in 1985, the government had to borrow 54 percent more than it received in revenues to meet its expenditure commitments. Over the next eight years, this declined to 126 percent. In the last year, it has edged up again to 128 percent.

Tax bite

5.66 We believe that Canadians also need to know the extent to which the federal government is using Canada's national income to meet its commitments for program spending and debt servicing. The tax bite, which is a measure of tax revenues as a percentage of total national income or gross domestic product (GDP), provides this picture.

5.67 [Exhibit 5.7](#) shows that the tax bite was rising considerably from 1968 to 1975. After the tax reform in 1975, the federal government introduced automatic indexation to both transfer payments and personal income tax. As a result, the tax bite fell from a high of 18 percent in 1975 to about 14 percent in 1980. Since then, the general trend for the tax bite has been progressively upward to about 17 percent today.

5.68 In other words, the federal government, through a combination of different approaches to tax collection and changes in tax policy, has been taking an increasing share of national income to meet its current commitments for interest payments and program spending.

Debt-to-GDP ratio

5.69 Our final indicator is the debt-to-GDP ratio, which measures the total volume of debt in the context of national income. We include this ratio because it is the most commonly used measure of public debt relative to the economy. Over time, the debt-to-GDP ratio reflects the ability of an economy to generate sufficient income to cover its debt. A rising value means that the volume of debt is growing faster than the income base a government draws on to meet its debt obligations.

5.70 Like the interest bite, it may not be possible to determine when the amount of debt a country is carrying is higher than its economic capacity to pay the interest on it. As Marcel Côté indicated at our colloquium, ". . . a debt-to-GDP ratio as high as 150 percent [for all levels of government] by the year 2000 is conceivable, although definitely not recommended." [Exhibit 5.3](#) shows that, for the federal government, the debt-to-GDP ratio currently stands at 62 percent and has been on the upswing since 1975, when it was at 18 percent.

5.71 We think that these five indicators, the interest bite, program share, expenditure ratio, tax bite, and debt-to-GDP ratio, when viewed over time on a consistent basis, would allow the average Canadian to make a fair assessment of the impact of large annual deficits and a growing accumulated debt.

5.72 The first four indicators give Canadians a sense of what is happening to their taxes and the extent to which they have to contribute relative to the national income. They show that since the early 1970s an increasing percentage of their taxes are going to interest on the debt - the interest bite. They also show that a smaller percentage is going to the programs Canadians receive - the program share. Next, they show that an increasing amount of the expenditures of the federal government is coming from borrowing - the expenditure ratio. Finally, they show that in spite of increased deficit financing, the government has been taking a larger amount out of the economy in the form of taxes to meet its commitments - the tax bite.

5.73 The fifth indicator, the debt-to-GDP, illustrates that, on the whole, the federal public debt has been growing faster than the economy.

The Absence of National Indicators

5.74 Canada is a federated nation with multiple levels of government, each of which accumulates debt in some form or another. The indicators we described shed light on the federal financial condition only. Yet, while there are these multiple levels of government, there is only one taxpayer. This means that, for the average taxpayer, the financial condition of the federal government cannot be viewed in isolation from the entire public sector debt in Canada.

5.75 We believe that it is important to present the trends for each of the five indicators we propose, both for the federal government and for the federal and provincial governments

combined, so that Canadians can get a sense of the financial health of all of Canada, not just one level of government.

5.76 In the mid-1980s, the Canadian Institute of Chartered Accountants issued guidelines on general standards of government financial statement presentation in an attempt to standardize government financial reporting across Canada.

5.77 The federal government and the provinces have moved toward implementation of these general standards. However, some have moved more quickly, and further, than others. The result is that there continue to be some inconsistencies in accounting policies among the various jurisdictions. These differences can be significant and, while they can be adjusted for, they seriously hamper the ability to compile consistent, comparable and audited national financial information. In addition, it is difficult to obtain historical data adjusted for these changes in accounting policies.

Summary

5.78 We have suggested, for illustrative purposes, a number of indicators to help Canadians understand public sector deficits and debt. We believe that it is clearly the responsibility of government to define and produce an appropriate set of such indicators. We are aware that the federal government periodically produces indicators, like the interest bite and the debt-to-GDP ratio, in a variety of published reports. We believe, however, that the government should regularly produce a consistent set of indicators consolidated in a single source. In fact, if the government carries through with the Comptroller General's commitment to the Public Accounts Committee to produce a succinct Annual Financial Report of the Government of Canada, this might be an appropriate place to provide them.

5.79 Finally, we believe that the federal and provincial governments should continue to move toward full implementation of the Public Sector Accounting and Auditing Board reporting guidelines. This would make their audited public accounts information consistent. We also believe that the federal government should consolidate and report this information so that Canadians will have the opportunity to understand the symptoms of public sector deficits and debt for all political jurisdictions in Canada. In this regard, we support the initiative that was begun in May 1993, when the federal and provincial ministers of finance met to establish joint objectives for the reduction and elimination of deficits.

Future Trends

A Need for Longer-term Information

5.80 In the "layman's guide" section of this chapter, we indicated that three factors influence annual deficits: expenditures, revenues, and borrowing costs. The corollary of this is that there are only two things causing a large and growing debt - persistent annual deficits incurred over a long period and compounding interest, a point we made in last

year's Report. The consequence of this simple fact is that bringing a growing debt under control cannot happen easily in the short term. Yet by the nature of our political system, governments usually present budgets annually and are held to account for their fiscal management at that time, as well as at elections. The problem is that the outward manifestation of bringing deficits and growing debt under control is not necessarily visible in a one- to five-year time frame.

5.81 We believe that the government ought to provide Parliament and the public with information on the long-range direction it is taking in this area. In this section, we propose four indicators for this purpose. They are:

- debt-to-GDP;
- interest bite;
- expenditure ratio; and
- the full cost of accumulating annual deficits.

5.82 The first three have already been defined in the previous section. The fourth, the "full cost of accumulating annual deficits", is proposed because we think the public ought to get a sense of the true financial cost of accumulating deficits: not just the current cost, but the probable future or downstream costs as well.

The Full Cost of Accumulating Annual Deficits

5.83 When individuals take out loans today, to buy a car for example, a common practice is for lenders to inform them what the total cost of the loan will be when the debt is paid in full. This means calculating the total value of all future payments of the debt, both principal and interest.

5.84 This information is important for public borrowing as well. It would allow Canadians to compare the total cost of annual deficits from one budget to another in order to see the financial implications of missing targets, due either to unexpected economic conditions or to the setting of optimistic assumptions in the hope that this, in itself, might contribute to an improving economy. To illustrate this we compared the 1992 Budget with the 1993 Budget.

5.85 In its 1992 Budget, the government indicated that it expected the 1992-93 deficit to be \$27.5 billion. It also provided medium-term targets for economic variables like inflation, unemployment and interest rates. Based on those assumptions, the government stated that by 1996-97 the annual deficit would fall to \$5.5 billion and the net debt would be \$498 billion. Using these same assumptions, but projecting them a little further, we estimated that by 1997-98 the deficit will be eliminated and the net debt will remain at \$498 billion.

5.86 In its 1993 Budget, the government reported that its annual deficit target for 1992-93 had changed and was now expected to be \$35.5 billion - \$8 billion higher than forecast a year earlier. Based on its new medium-term forecast, the government now expects, that

by 1997-98, the deficit will fall to \$8 billion and the net accumulated debt will be \$563 billion. Using these 1993 assumptions, we estimated that the deficit will be eliminated by 1998-99 and the net debt will stay at \$563 billion.

5.87 [Exhibit 5.8](#) compares the two budgets by showing the forecasts for the annual deficits and the net debt for each year from 1992-93 to 1998-99.

5.88 It shows that in its 1993 Budget, when the government announced revisions to its 1992 economic plan, these seemingly small revisions led to an increase of \$8 billion in the deficit. By 1998-99, the year in which current government plans are expected to yield a balanced budget, this higher 1993 deficit could lead to an increase of \$65 billion in the accumulated net debt. In other words, there is a real cost to missing targets, regardless of the reason.

Longer-term Assessments

5.89 In addition to assessing the total cost of accumulating annual deficits, we should be able to understand the longer-term implications of short- to medium-term plans as set down in budgets. For example, if the five-year economic targets that were announced in the 1993 Budget are met, they will likely lead to a balanced budget by the year 1999. What governments will do if that happens is simply not assessable. Whether they choose to run surpluses or continue to balance the budget is a matter of policy. The only certainty is that, in a growing economy, the impact of the cost of servicing the debt would be lessened.

5.90 Alternatively, if balanced budgets are not in the government's announced medium-term economic plans, or if deviations from current plans occur, both of which appear to generate stability in the medium term, we need a way to assess whether these same plans, if continued, would also lead to long-term stability. To get a sense of this, we developed two "what if" scenarios to illustrate the relationship between medium-term outlooks and the longer term.

5.91 For example, we used our own model to calculate the debt-to-GDP ratio, the interest bite, and the expenditure ratio to the year 2032 using two "what if" scenarios for economic targets that differ from the government's medium-term targets announced in the 1993 Budget. These scenarios, along with the government's 1993 targets, are shown in [Exhibit 5.9](#).

5.92 In our first "what if" scenario, we used the government's medium-term assumptions for inflation of 1.5 percent and interest rates of 6 percent. However, we set a lower growth figure for GDP - 4.5 percent rather than the 6 percent target used in the 1993 Budget. We also set revenues and expenditures growing at the same rate as GDP - 4.5 percent. In our second scenario, we set inflation at 1.5 percent, GDP, expenditures and revenues growing at 4 percent and interest rates at 6.5 percent.

5.93 We did not establish these scenarios because we believe that the government targets will turn out to be incorrect. On the contrary, we hope that the government forecasts do come true and that the annual deficit will be eliminated by 1998-99. However, expectations are not always met; revenues and GDP do not always grow as fast as expected; governments are sometimes forced to move away from expenditure containment programs; and finally, interest rates do not always remain as low as we would hope. If these deviations occur, it is possible for short- to medium-term results to look as if annual deficits and accumulated debt are being controlled, while the longer-term outlook would show signs of economic instability.

5.94 The results based on these "what if" scenarios are displayed in [Exhibits 5.10](#) and [5.11](#). The first scenario shows the interest bite and the expenditure ratio declining very gradually from 1994 to 2003. This would imply that the government would be using a shrinking portion of revenues to meet interest costs and having to borrow a smaller proportion of revenues to meet its expenditures. While this apparent good news is happening, there is the conflicting message of the persistent rise in the debt-to-GDP ratio over the same period, as shown in [Exhibit 5.12](#). After 2003 the interest bite and expenditure ratio stop declining and stabilize for the next few years. Then they begin to rise. All the while, the debt-to-GDP ratio continues to rise.

5.95 In the second scenario, as illustrated in [Exhibits 5.10](#) and [5.11](#), the interest bite and expenditure ratio also decline, but even more gradually than in our first scenario, and level out around 1996. Then they both begin to rise and by 2032 are substantially higher than they are today. All the while, as [Exhibit 5.12](#) shows, the debt-to-GDP ratio rises persistently and more steeply than in the first scenario.

5.96 These two "what if" scenarios illustrate the importance of knowing the long-term implications of short- to medium-term plans. They show that Canadians and their elected representatives need to make sure that governments are aware of these longer-term financial outlooks and report them regularly. Without that vigilance we run the risk of discovering that good financial news is not always what it seems to be, particularly when we look beyond the short- to medium-term signals. In particular we are concerned that people be wary of the argument that says: "We didn't achieve what we set out to do, but at least we are on the right path."

Summary

5.97 Our purpose in focussing on the need for governments to report longer-term trends has been twofold: first, we wanted to illustrate that it costs all of us when governments, on our behalf, persistently accumulate deficits. If governments report that there is a real cost greater than the annual shortfall between expenditures and revenues, just as the total costs of a car loan are greater than the purchase price of the car, we can appreciate the full cost of debt and draw an informed judgment as to whether continuing annual deficits are in our best interest.

5.98 Second, we wanted to illustrate that it is often dangerous to assume that if the short-to medium-term projections lead to acceptable results, the future will also unfold favourably. The point is that we have to be vigilant that governments inform us about the implications of their borrowing, not because they borrow against our wishes but because they borrow on our behalf, and we are not always aware of the implications of that borrowing.

Forum for Rational Discussion

5.99 Last year, Chapter 1 of the Report indicated that, along with the need for simple indicators and future-oriented information, there was a need for a vehicle within our system of government that would allow for rational discussion on this important issue. We continue to believe this is important, but we also believe that part of the problem is with Canadians themselves and their perception of the problem.

Personalizing the Problem

5.100 Canadians need to recognize that annual deficits and accumulated debt are created not just by politicians but by all of us. Political leaders simply meet our demands. We have become all too capable of putting enough pressure on our governments to provide the things we want. We became used to the high rates of real economic growth and low rates of interest in the 1960s and early 1970s and expected them to continue. When they did not, the result was growing deficits for 16 of the last 20 years.

5.101 Even those who believe that the problem with annual deficits is not with excessive expenditures, but with inadequate revenues, would agree that deficits cannot grow relative to GDP in perpetuity. They simply differ with the current government as to where the first priority should be - reducing expenditures versus stimulating job creation and economic growth.

5.102 The problem we have created, with the complicity of government, is in failing to recognize that for every dollar spent, a dollar has to be generated, either by taxation, user charges, or borrowing. Marcel Côté reminded us at the colloquium of the political reality that:

. . . politicians respond to pressures from special interest groups and rely upon the whole population to pay for the resulting costs. Members of special interest groups think that they get a free ride while the rest of society picks up the bill. After a while, everybody belongs to some special interest group, and benefits tend to even out.

5.103 Consistent with this is the mistaken belief that annual deficits and accumulated debt are not our problem but that of the politicians and bureaucrats who created them. Some people think that when governments raise taxes they should do all they can to escape paying. But those who behave in this way also expect to continue to receive their education and health services and the many other social benefits they have become all too accustomed to receiving from their government.

5.104 Deficits and debt are everyone's problem. Until we personalize them and make the numbers and the information behind the numbers more meaningful to individual Canadians, not simply by expressing them in per capita terms, we will live in a way that is consistent with the expression: "Don't tax you, don't tax me, tax the fellow behind the tree."

A Parliamentary Forum

5.105 Taking ownership of the problem is only part of the issue. We also have to feel that we are part of the solution. That means feeling that our concerns about deficits and debt are being listened to and discussed rationally by our elected representatives.

5.106 Concerns about a receptive and responsive parliamentary government are not new. They were raised by the Lambert Commission in 1979, by public accounts committees in the past, by previous ministers of Finance and by the Prime Minister.

5.107 In June 1993, the Public Policy Forum issued a report entitled *Making Government Work*. That report began with the following comment:

Canadians are alienated from the institutions and processes which govern them at precisely the moment when they are being asked to absorb economic body blows. Canadian society has changed rapidly in the past few decades, and government has failed to keep pace.

5.108 That report went on to comment on the need for change that included "relaxing the command and control administration of . . . party caucus." It argued the need for this because it saw "power as being too highly concentrated in the hands of the Prime Minister and Cabinet with a correspondingly limited role for Parliament." We reported these very same problems and constraints in Chapter 6 of last year's Report, when we commented on the frustrations of ordinary members of Parliament in not having any influence on the annual spending of money.

5.109 The Public Policy Forum document calls for an opening up of the budget process so that parliamentary committees can have a meaningful role. It reminded members that:

Governments and opposition parties alike are responsible for this situation: the former by invoking the principle of budget secrecy to justify announcing measures without open consultation . . . the latter by demanding resignation when there is advance disclosure of any budget item, no matter how innocuous. . . .

5.110 The report calls for the tabling of budgetary information and plans sufficiently early to allow parliamentary and public input before final decisions are made. It also suggests that this could be done within our Western style of parliamentary democracy.

5.111 The Lambert Commission proposed 14 years ago that the government provide Parliament with an autumn accounting of its fiscal plans and proposals for the coming five years. We concur with this timing because it would be consistent with the tabling of the Public Accounts and the proposed Annual Financial Report.

5.112 Most recently, the Minister of Finance issued a news release entitled *Opening Up the Budget*, where he indicated that a fall presentation to Parliament ". . . will provide for a more open consultation process by publicly announcing economic, fiscal and other major policy options under consideration and involving parliamentarians and the public more fully."

5.113 All this information could be referred to a standing committee for discussion. This approach could also provide a forum for the government to present its anticipated succinct annual financial report, which might include our suggested indicators on deficits and debt, as well as the indicators of future trends. In this way, the government could make very useful information available to Parliament before the government is committed to a budget that will continue to generate parliamentary confrontation. In this way, members of Parliament could see future plans along with past performance and debate them before government plans are etched in stone.

5.114 Opening up the budget process to allow parliamentarians to participate would certainly contribute to a more meaningful dialogue on deficits, debt and the expectations of the public. However, there would still remain the stumbling block known in our parliamentary institution as the confidence convention: the notion that the party forming the government must be able to demonstrate that it enjoys the support of a majority of the members of the House of Commons on most pieces of financial legislation. The Standing Committee on House Management noted in its April 1993 report on reforming the House that to change this confidence convention does not require amendments to the Standing Orders of the House of Commons. Rather it requires a better understanding of the rights and responsibilities of individual members and a recognition that "Canadians want to feel that their members of Parliament have opportunities to vote freely and they expect them to do it more often."

5.115 The Standing Committee's concerns with the confidence convention, particularly as they relate to the House of Commons' review of the Estimates, are directly related to the lack of respect, or time, that members of the House give to the financial business of the executive. Yet the "power of the purse" is a fundamental responsibility of the House that was won many centuries ago at enormous cost.

5.116 We do not believe that the Auditor General needs to add to the many useful suggestions that are already available publicly on ways to improve the commitment of members of Parliament to the financial affairs of the country. The three reports we have referred to, along with the many past proposals for budget reform by the government, including the most recent one by the Minister of Finance on 10 August 1993 and the speech by the Prime Minister the day before, speak eloquently on this matter. Opening up the budget process, and providing Parliament with more complete information in the autumn, including broad-based spending information, would allow for a more informed debate and greater input from Parliament and the public.

5.117 We recognize that this is a complex business and that we have only touched the surface. There are many other issues that affect the effectiveness of the role of

parliamentarians, like the size and skills of their staff, as well as their access to sensitive information. These matters, as well as others, require much more study than we have given them. But overall, we think that the reforms currently proposed can only make a positive contribution to the financial management of the country. We strongly support any action that encourages members of Parliament to take a more active and constructive approach to the financial affairs of our nation.

Conclusion

5.118 This chapter is about information on deficits and debt. We focussed on a better understanding of the meaning of the federal government's annual deficits and accumulated debt so that members of Parliament and all Canadians could appreciate the difficulty in dealing with the significant gap between expenditures and revenues. We reminded everyone that coming to terms with this financial problem will not be done by reducing expenditures through the elimination of waste or by administrative reform alone. It will also require a rethinking of the services that we, as Canadians, have come to expect of the government. And it will all have to be done in a way that does not inhibit growth in the Canadian economy and the essential investment in our future.

5.119 To enhance the average Canadian's understanding of the financial health of the federal public sector, we proposed a number of simple indicators as an illustration of the kind of information the government should produce to allow Canadians to appreciate the persistence of deficits and growing debt.

5.120 We also illustrated the importance of the need for information about medium- to longer-term trends, so that Canadians would be more critical of claims that we are on the right path even though we have not met our targets. We showed how optimistic short- to medium-term projections may not always lead to a healthy longer-term outlook.

5.121 We reminded all Canadians that persistent annual deficits and growing debt are not the government's problem, but everyone's problem. Governments did not create this debt without our approbation. Solving it will require the willingness of everyone, not at the expense of others but by the combined efforts of all of us.

5.122 Yet, in spite of the growing concern that many people have had about deficits and debt, Parliament has not provided fertile ground for a meaningful dialogue among our elected representatives to address these concerns. Proposals for parliamentary reform to open up the budget process and to encourage parliamentary input in the fiscal plans of government have been made continually over the last decade. A parliamentary forum to debate these issues is necessary if we are to understand and reach a consensus for dealing with these persistent deficits and the growing debt.

5.123 In conclusion, we remind Canadians that public sector deficits and debt are not the sole purview of the federal government. In a federal state with multiple layers of government, persistent annual deficits and growing accumulated debt are everyone's problem. In her background paper for our colloquium, Judith Maxwell pointed out that

there are three governments and only one taxpayer. Donald Savoie reminded us that provincial governments, faced with reduced federal transfers "either cut or reduce their level of service, or increase taxes or their own annual deficits." This means that no one level of government can reduce its deficit and debt burden at the expense of another. Nor can any one level of government solve its financial problem, particularly in the eyes of the investment community, until all governments in Canada do so. We may be in separate cabins, but we are all in the same boat.

5.124 The more informed Canadians become on the subject, the easier it will be for our political leaders to make the difficult decisions.

Chapter 6

Canada's Public Service Reform, and Lessons Learned from Selected Jurisdictions

Main Points

Introduction

Purpose and Scope of the Study

Factors Underlying Reform and Their Impact

- Changing Economic Circumstances
 - In Canada, fiscal restraint was just one of several factors that shaped PS 2000 and the June 1993 restructuring initiative
 - In New Zealand and in the United Kingdom, public service reforms were part of broad changes, notably due to the state of the economy
 - In Australia, economic pressures were an influence whose significance grew as management reforms unfolded during the 1980s
- Increasing and Shifting Public Expectations of Government
 - One effect of changing expectations of government has been an increased emphasis on service to the public
- The Need to Modernize Public Service Management
 - PS 2000 proposes a new management approach - a new management philosophy
 - There were inadequacies in the management of people; there was a need for "renewal"
 - The separation of operational and policy functions figures among the reforms of the last decade

Public Service Reform in the Four Countries: Common Themes

- A Focus on Results and Accountability
 - An increased focus on results, including the costs of attaining them and the related accountability, has been a central theme of the reforms in the four countries
- Delegation and Empowerment
 - Delegation and empowerment are necessary to attain results
- Streamlining and Simplifying Administrative Systems
 - Streamlining administrative systems encourages a focus on service
- A More Businesslike Approach to the Management of Resources
 - Resource constraints are leading to a more businesslike approach

Progress and Problems with the Implementation of Reforms

- PS 2000: Where Progress Has Occurred
 - Some headway has been made
- PS 2000: Problems with Implementation

- There has been a problem of mixed messages from the outset of PS 2000
- Expectations and communications have been poorly managed
- Commitment is not always evident
- Progress in the Selected Jurisdictions
- Implementation of Public Service Reform in the Selected Jurisdictions
 - Visible political leadership and commitment is crucial
 - Sustained leadership from the "centre" is key
 - Public service reforms must be strategically managed

What Can Be Learned?

- A more strategic approach to public management and public service reform is needed
- There must be a sharper focus on the relationship between costs and the results achieved
- Achieving results requires the enhancement of accountability as well as the delegation of authority

Conclusion

- Sustaining reform is essential; political commitment will be the key

Exhibits

- 6.1 Synopsis of Key Events and Reforms in Canada
- 6.2 Synopsis of Key Events and Reforms in Australia
- 6.3 Synopsis of Key Events and Reforms in New Zealand
- 6.4 Synopsis of Key Events and Reforms in the United Kingdom
- 6.5 The Next Steps Initiative in the United Kingdom
- 6.6 The New Zealand Management Model

Canada's Public Service Reform, and Lessons Learned from Selected Jurisdictions

Assistant Auditor General: Robert R. Lalonde

Responsible Auditor: John Holmes

Main Points

6.1 In December 1989, the government announced a public service "renewal" initiative known as Public Service 2000 (PS 2000). It aims to streamline internal administrative regimes and to bring about a change in organizational culture to better serve Canadians. Our study was carried out to provide Parliament with information about the progress of this major initiative, and its relevance and significance in the current context. We also examined PS 2000 in light of reforms in "selected jurisdictions" - Australia, New Zealand, and the United Kingdom.

6.2 Three of the most important common factors underlying reforms in Canada and the selected jurisdictions are:

- changing economic circumstances;
- increasing and shifting public expectations of government; and
- the need to modernize public service management.

The reforms in these countries have much in common; for example, an increased focus on results and accountability.

6.3 PS 2000 has made important progress, particularly in terms of legislative and systemic change. However, we detected serious concerns related, in particular, to how it has been implemented, and noted an atmosphere of scepticism and cynicism surrounding the initiative.

6.4 Several insights have emerged from our study that may have important implications for current and future Canadian public service reforms:

- to be successful, public service reform initiatives need to be integrated with government's broader policy and budgetary agenda;
- a more strategic approach is required; reforms must proceed from a vision developed through a realistic re-examination and determination of what is affordable, and of the future role of the public service;

promoting value for money and performance requires a sharper focus on the outputs and outcomes of public programs and their costs; delegation of authority must be accompanied by a proportional enhancement of accountability; the restructuring initiative announced in the summer of 1993 adds urgency to the need to follow through on the principles of renewal; and sustaining renewal must be a priority; political leadership and support - actions that demonstrate commitment - are critical to successful reform.

Introduction

6.5 In December 1989, the government announced a process of reform and renewal of the federal public service. This initiative, known as Public Service 2000 ("PS 2000"), was described by the Prime Minister as "the policy of the Government of Canada concerning the measures necessary to safeguard and promote the efficiency and professionalism of the Public Service in order that it may serve Canadians effectively into the 21st century."

6.6 In announcing PS 2000, the Prime Minister stated its purpose as:

"to foster and encourage a Public Service that:

is . . . imbued with a mission of service to the public;
recognizes its employees as assets to be valued and developed; and
places as much authority as possible in the hands of front-line employees and managers. . ."

He further stated:

". . . the government's employment and personnel management regime will be made less complicated and burdensome for managers and employees alike; central administrative controls will be reduced so as to give deputy ministers greater freedom to manage their departments and clearer accountability for results;
the roles of central agencies and of systems of personnel and administrative control throughout the government will be clarified and simplified; and
innovative ways to encourage efficiency and improve program delivery will be developed."

6.7 Earlier that year, our annual Report had called for reforms pertaining to how public servants are managed:

"For the federal public service to be able to meet the challenges that the future holds, there is a need for reform of the legislative and administrative structure that governs people. There is a need to bring a creative new outlook to the management of Canada's public servants. . . What is required is a simplifying of the institutional framework; and a streamlining of the ways human resources are managed. . . If the government is serious about achieving more productive management, the time has come to act."

6.8 Because PS 2000 appeared to be based on principles that we have promoted, and to respond to a number of our preoccupations, and because it represented a significant opportunity to bring about much needed change, the Office supported the initiative from the outset.

Purpose and Scope of the Study

6.9 This study was carried out to provide Parliament with information about the progress of PS 2000 - a major government initiative - and about its relevance and significance in

the context of current and emerging issues and in the light of reforms in Australia, New Zealand and the United Kingdom ("selected jurisdictions").

6.10 These jurisdictions were chosen because each has undertaken significant reforms and has a system of government similar in important respects to our own. Exhibits 6.1 to 6.4, appended to this chapter, provide synopses of key events and reforms in Canada and each of the selected jurisdictions. (see Exhibits [6.1](#), [6.2](#), [6.3](#), [6.4](#))

6.11 On 25 June 1993, the government announced a number of changes to the machinery of government, including the reorganization, restructuring and streamlining of departments and agencies (the "restructuring initiative"). Although our study was nearing completion when this initiative was announced, the views we express in this Report take account of the fact that it was under way.

6.12 Though some of the similarities and differences in the public service management regimes of Canada and the selected jurisdictions are identified in this Report, we made no attempt to assess the relative quality of those regimes. Furthermore, nothing in this Report should be construed as indicating or implying a comparison of the performance of the respective public services.

6.13 In carrying out the study, we undertook an extensive review of available literature, including official documents. In addition, our work benefited from:

the views of current and former senior officials and others familiar with the reforms in the selected jurisdictions - about 100 people in total - obtained in most cases through interviews;
the perceptions of about 400 Canadian senior officials, past and present, primarily obtained through focus group discussions conducted during 1993 by the Canadian Centre for Management Development and the Treasury Board Secretariat; and
the views of 16 current and former deputy ministers, obtained through personal interviews conducted, with one exception, before the announcement of the restructuring initiative.

6.14 In this chapter, the "public service" refers to those organizations - normally departments or their equivalents - that are under the direct authority of ministers, to whom they provide support in carrying out their responsibilities; "public sector" includes the public service and other organizations, such as agencies, tribunals or government-owned corporations, which operate more independently of ministers.

Factors Underlying Reform and Their Impact

6.15 A number of common and interrelated factors have influenced reform in Canada and the selected jurisdictions. But there are also pertinent considerations particular to one or another of the countries. For example:

Canada and Australia are federal countries, while the United Kingdom and New Zealand are unitary states; thus, some activities of the national governments in the latter two countries - notably related to services provided - are dealt with by Canadian provincial or Australian state governments.

While all four countries have "Westminster" parliamentary systems, differences among them have an impact on the ease with which reforms can be brought about and therefore on the nature of reforms; for example, New Zealand has a legislature with a single chamber, whereas Australia's Parliament comprises a House of Representatives as well as an elected Senate.

The general climate within which change is being made is also pertinent - for example, the extent to which the public service is positively or negatively viewed by the government of the day and the community at large - as are other considerations, such as the labour relations regime and environment.

6.16 Three of the most important common factors underlying reform are:

changing economic circumstances;
increasing and shifting public expectations of government; and
the need to modernize public service management.

Changing Economic Circumstances

6.17 Canada, New Zealand, Australia and the United Kingdom are four of the 24 members of the Organization for Economic Co-operation and Development ("OECD"). That group of countries, which also includes Japan, the United States and a number of European nations, experienced unprecedented economic growth during the 1960s. However, the 1970s saw the emergence of tensions in the economic environment - the collapse of the fixed exchange rate system, the "oil shock" of 1973, and so on. This gradually led to weakened economic performance among OECD countries and a slowing in the growth of government revenues. But government expenditures generally continued to rise. Budget deficits thus have become a common and persistent feature in many countries since the 1970s.

6.18 Globalization of the economy and increasing competitiveness among nations have added significant pressure for structural adjustment in many economies. The current, prolonged worldwide recession has worsened the fiscal situation. In the face of these economic pressures, governments have begun to examine their role and policies more closely, in line with the view expressed in a 1987 OECD report that

". . . it is only natural that the balance between the public and private sector, and indeed the interplay of public action and private initiative, be adapted to changing circumstances."

In Canada, fiscal restraint was just one of several factors that shaped PS 2000 and the June 1993 restructuring initiative

6.19 By the late 1980s, the federal public service had experienced a decade of cost-cutting measures as part of the fiscal restraint initiatives of government. The cumulative effect of such measures had highlighted concerns about the burden, inflexibility and cost of internal management systems, such as those for classification and staffing.

6.20 It was clear that fiscal restraint would continue. There was, however, growing concern that person-year and cost reductions were adversely affecting the provision of service to the public. Several departments had embarked on their own initiatives to improve management practices. External pressures for change were increasing. It was apparent that fundamental, service-wide change of internal administrative systems and, in particular, of human resource management practices, was required. PS 2000 was the government's response.

6.21 The first two phases of the June 1993 restructuring initiative comprise restructuring and streamlining of departments, and rationalization of service delivery. Senior officials advised us that these changes were aimed primarily at "adapting our organizations to better meet the policy priorities of the 1990s." The third phase is to support eventual decisions, in the context of the policy and budgetary agenda for 1994 and beyond, on the lines of business the federal government ought to be in - or ought not to be in - during the 1990s and in the twenty-first century. This third phase reflects an increased concern about persistent deficits and growing debt, and the affordability of government services.

In New Zealand and in the United Kingdom, public service reforms were part of broad changes, notably due to the state of the economy

6.22 In 1984, New Zealand faced an economic situation that had reached crisis proportions, and radical measures had to be adopted to deal with it. What was called into question was the role of government and the nature and extent of services it provided. Economic and social policies long taken for granted changed. The state apparatus became smaller and less controlling. Several large commercial operations such as banks and insurance companies, part of the public service at the time, were made into state corporations and then privatized; economic activity was less closely regulated, and tariff barriers were lowered. Subsidization of the private sector by the public sector was virtually eliminated. Over the 1984 to 1992 period, the public service was reduced by two-thirds in terms of the number of employees, and major changes were made in its structure and management.

6.23 In the United Kingdom, a major currency crisis in 1976 led to the intervention of the International Monetary Fund. There was a loss of confidence in the government's management of the economy. When a new government was elected in 1979, it sought to reduce the cost of government and lower the burden of taxation. Under the strong leadership of the Prime Minister, the traditional ways of the civil service were called into question, in favour of a more businesslike approach. Overall, the government sought to

minimize the role of the public sector in the economy through privatization and other means.

6.24 Civil service reform in the United Kingdom began with a program to identify savings and improve efficiency: a series of reviews - scrutinies - under the direction of the Prime Minister's Efficiency Unit. These reviews demonstrated the need for better financial management and led to a major initiative to develop the cost and performance information necessary for improved productivity. As financial reforms proceeded, it became clear that the organizational culture in the civil service presented serious obstacles to further progress; consequently, extensive structural change - creation of the Next Steps Agencies - was undertaken (see paragraph 6.46).

In Australia, economic pressures were an influence whose significance grew as management reforms unfolded during the 1980s

6.25 We were told that in Australia public service reform tended initially to be seen as a discrete program, focussing primarily on the efficiency and effectiveness of resource use, and not tightly linked to economic problems. However, in July 1993, the Australian government released an evaluation of reforms over the last decade, which noted that, in official statements concerning objectives "from 1984 onwards, there was an increased emphasis on the constraints on Public Service resources." This was due in large measure to the sharp decline in 1985 in Australia's terms of trade - the prices paid for its commodities in international markets.

Increasing and Shifting Public Expectations of Government

6.26 In spite of a decline in the economic circumstances of many developed nations and the escalating costs of existing government programs, there is demand for more and better public services - such as programs to protect the environment and to improve the social safety net.

6.27 In addition, there are changing societal demands concerning the role of the public sector. One such demand, pertinent to Canada, is the call for strengthened public and private sector co-operation to enhance international competitiveness. Similarly, there are demands from a wide array of lobby groups and other stakeholders for a more direct role in the development of government policies and in the administration of government programs.

6.28 Perceptions that past policies have been flawed, and that governments are having difficulty resolving current social and economic problems, have contributed to the loss of confidence in government institutions and political leaders now evident in many countries.

6.29 In line with an increased focus on service quality in the private sector, there appears to be a public expectation for service of better quality from government. This expectation relates to the responsiveness of government to the needs of particular clients, as well as to

the accessibility of service and to the timeliness, efficiency and courtesy with which service is delivered.

6.30 Other dimensions of changing public expectations are calls for more open and transparent government and for clearer accountability for decisions. What is sought includes increased public disclosure of information and of the reasons for government decisions. As well, there are calls for greater clarity concerning the nature and source of policy advice given to political leaders.

One effect of changing expectations of government has been an increased emphasis on service to the public

6.31 In Canada, PS 2000 and the recent restructuring initiative each have a service dimension. The deputy ministers and public service executives we interviewed generally agreed that the objectives of PS 2000 evolved over time, and that the principal focus shifted from human resource management to service to the public. One deputy minister expressed it this way:

"The initial major focus was on human resource management but this was found to be too inward looking, so service to the public became a second and ultimately the lead theme."

6.32 The White Paper on public service renewal, released one year after the launching of PS 2000, confirms the validity of these perceptions. It not only recognizes the public's increasing insistence on openness, involvement and consultation, it states:

" Improved service to Canada and Canadians is the central theme of Public Service 2000. This means improving service to Ministers, the general public and individual Canadians" (emphasis added).

6.33 The June 1993 restructuring initiative also involves the development of plans for more cost-effective program delivery, making use of innovative technology, joint program delivery by two or more departments or with other levels of government, contracting out or privatization. In addition, it includes plans for possible consolidation of points of service delivery and streamlining of "product lines".

6.34 The United Kingdom's Citizen's Charter initiative is aimed at improving service to the public. This 1991 reform is aimed at responding better to the needs and wishes of citizens. Individual charters are based on key service principles, including standards, openness, choice, consultation, courtesy and redress. Information on service performance is regularly made public, and Charter Mark awards recognize exemplary provision of service. The Prime Minister has indicated that the Citizen's Charter will be at the centre of the government's decision making throughout the 1990s.

6.35 While neither New Zealand nor Australia have had comparable service to the public initiatives, in both of these countries reforms have involved an increased focus on results and, thereby, on service. In New Zealand, because of the severity of the economic crisis, the focus initially was on the affordability of the services provided.

In Australia, service quality and client rights received considerable attention in the 1970s and service is once again recognized as an area requiring increased government-wide emphasis.

The Need to Modernize Public Service Management

6.36 A third prominent underlying pressure for public service reform has been the need to modernize public service management. Public bureaucracies in Western democracies have been governed in accordance with long-established traditions. While new organizations and management systems have often been introduced, attitudes and practices have not changed in fundamental ways over the years.

6.37 The need for change in the way public services are organized and managed arose, in part, from the rapid technological advances that led to the advent of the information age. Computer and other technologies have contributed to many improvements, and make possible many more. In Canada, technology is expected to change service delivery substantially in some of the departments created by the June 1993 restructuring initiative. However, as of completion of our study, none of the four jurisdictions had undertaken, as a major element of its public service reforms, a comprehensive examination of the overall impact of technology.

6.38 The impact of changing lifestyles and higher education levels on workforce habits and expectations also has played a role in reforms. In addition, the private sector's widespread downsizing, de-layering, restructuring and streamlining of recent years have made more apparent the need for the public service to keep pace with new management approaches. Combined with fiscal restraint, this has spurred public service interest in the adoption of more businesslike and more affordable systems and practices.

PS 2000 proposes a new management approach - a new management philosophy

6.39 PS 2000 proposes that increased emphasis be placed on openness and consultation, and on:

- results (rather than process);
- flexibility (rather than conformity);
- judgment (rather than rules);
- innovation (rather than risk aversion);
- accountability (rather than detailed central controls); and
- public servants as assets to be developed (rather than as resources to be used).

There were inadequacies in the management of people; there was a need for "renewal"

6.40 Prior to PS 2000 there had been many unsuccessful attempts at reforming the personnel management regime installed in 1967. The 1974 study "Employer-Employee Relations in the Public Service of Canada" (the Finkelman report) and the 1979 Report of the Special Committee on the Review of Personnel Management and the Merit Principle (the D'Avignon Committee) were among the most prominent.

6.41 The Increased Ministerial Authority and Accountability initiative (IMAA), launched in 1986 and aimed at providing increased authority and flexibility to ministers and senior executives through a reduction in Treasury Board controls, was having limited effect. By 1989, only six of about thirty departments had entered into IMAA agreements with Treasury Board. One reason was that departments sought changes in personnel matters that Treasury Board was either unwilling or unable to grant - in part because the authority rested with the Public Service Commission.

6.42 The results of inaction were increasingly being felt. Morale among the senior managerial ranks of the public service was perceived as being low. A 1986 attitudinal survey (Zussman and Jabes) of executives and managers in the federal public service and in the private sector had revealed that:

private sector managers had a more positive view than their public service counterparts of the management practices of their organizations; and within the public service, "as one moves down the bureaucratic hierarchy, managers are less satisfied and less positive about managerial practices in their organization." No similar effect was noted in the private sector.

6.43 The malaise reflected in these results was consistent with information obtained by this Office during the 1987 audit of the Management Category (now the Executive Group). Another survey, sponsored by the government and conducted in 1988, demonstrated that a deterioration in the attitudes of public service managers had occurred.

6.44 Given these circumstances, it is not surprising that seven of the ten task forces set up at the time of the announcement of PS 2000 dealt with human resource management issues and, except for the Service to the Public Task Force, all of them dealt with internal administrative matters.

6.45 Neither is it surprising that, in addition to "squeezing out" waste and inefficiency and emphasizing service to the public, PS 2000 seeks to simplify personnel, financial and other administrative systems, notably by eliminating unnecessary central controls.

The separation of operational and policy functions figures among the reforms of the last decade

6.46 New Zealand and, to a great extent, the United Kingdom have separated operational and service delivery organizations from the policy function. In New Zealand, the primary rationale for separate departments was the desire to avoid "capture" of policy advice and funding by the large delivery agencies. There had been a serious problem with policy advice tending to serve specific interests rather than the broader public interest. In the United Kingdom, agencies were created, but within the departmental framework. The rationale was to overcome the problems associated with the size and diversity of the "government machine" - seen as too big to be managed well as one unit. These Next Step agencies are headed by a chief executive, often appointed from outside the civil service. Agencies are expected to operate in a businesslike manner with

a framework document reflecting the objectives of the organization, and with significant delegation of authority. [Exhibit 6.5](#) briefly describes the Next Steps Initiative.

Exhibit 6.5

The Next Steps Initiative in the United Kingdom

In February 1988, the Prime Minister of the United Kingdom announced in the House of Commons that the government had accepted the key recommendations of a major report of the Efficiency Unit, entitled "Improving Management In Government: The Next Steps".

The central feature of the Next Steps initiative in the United Kingdom is the separation of policy work from operational activities, with the latter assigned to executive agencies created within departments. These agencies are given greater managerial autonomy, but operate within published policy and resource frameworks that require explicit planning and review procedures to be followed. Next Steps agencies' broad aims and objectives are specified in these frameworks, and the responsible minister annually sets performance targets for each agency to meet.

There has been substantial growth in the Next Steps program. As of April 1993, over 350,000 civil servants, about 60 percent of the total, were working in agencies and other organizations operating along Next Steps lines.

6.47 Canada has also created some new organizational forms designed to improve service delivery and cost effectiveness. One example is the establishment of special operating agencies in several departments since 1989. In principle, these agencies - some of them offering common services to other departments - are to be granted necessary flexibility and authority and, in return, are expected to produce specified results through the application of private sector management techniques, including self-financing.

6.48 Commercialization is a feature of modernization. In Australia and, to a certain extent, in Canada, common services within government have been placed on a commercial footing and opened to competition from the private sector, with the added dimension in Australia of budgetary funding of the user rather than the provider of the service. The Australian evaluation study noted cost savings and improved management practices as a result of these reforms.

Public Service Reform in the Four Countries: Common Themes

6.49 Partly because Canada and the selected jurisdictions have faced a similar set of broad issues, their reform initiatives have much in common.

A Focus on Results and Accountability

An increased focus on results, including the costs of attaining them and the related accountability, has been a central theme of the reforms in the four countries

6.50 PS 2000 aims to increase the emphasis on results. To that end, it proposes a new management philosophy - a change in organizational culture. There is to be an increased focus on consultation with clients and on service to the public. Specific measures

proposed include the requirement for departments and agencies to develop mission statements and to establish clear standards of service, with deputy ministers to be accountable both for the reasonableness of those standards and for the quality of service provided. In addition, performance assessment practices for deputy ministers and other managers are to be improved.

6.51 Significant in this respect is the April 1993 system-wide introduction of the concept of operating budgets - which merge salary, operating and minor capital funds. If costs were known, operating budgets could facilitate more cost-effective decision making than the person-year controls and budgetary allocation mechanisms previously in place.

6.52 In Australia, the move toward a focus on outcomes, plus the cost of achieving them, has led to a major overhaul of the budgetary system. New approaches to budgeting and related financial measures have emphasized objectives, performance information and evaluation. The Australian government's evaluation of its reforms found "improved organizational focus, more structured thinking . . . (and) a greater focus on results" arising out of these reforms. In addition, the evaluation noted that "there is a strong view from both staff and agencies that the reforms have had a positive impact on accountability."

6.53 New Zealand has developed a new model for managing by results. Under this model, defining the desired outputs - the goods and services that government departments are expected to produce - allows for much greater precision in measuring results. Accountability of chief executives to ministers has been redefined. Chief executives, hired on contract, have replaced tenured permanent heads of departments as a measure to increase responsiveness to ministers. They have been given the responsibilities of the employer of departmental staff and a wide range of other authorities, and are responsible for producing outputs for which they are held accountable through annual performance agreements with ministers. Ministers, in turn, are responsible for outcomes, the achievement of broad policy objectives. [Exhibit 6.6](#) describes this model.

Exhibit 6.6

The New Zealand Management Model

The New Zealand management model may be described in terms of the relationship between the chief executive (previously permanent head) of each department and the minister(s) responsible for that department.

The minister has two roles: as purchaser of the department's goods and services (known as "outputs") and as owner of the department's assets.

The chief executive is responsible for the supply of agreed outputs and sound management of all resources. The minister is responsible for the broad social impacts of government activity (or "outcomes").

As purchaser, the minister contracts with the chief executive of the department for the delivery of an agreed quantity and quality of outputs; these agreements are formalized through the parliamentary appropriations process (the Estimates), the chief executive's annual performance agreements, and purchase agreements (a recent development that better specifies the nature of

the outputs). As owner, the minister injects capital into the department through capital appropriations and seeks assurance from the chief executive that the resources of the department are managed with due regard for economy, efficiency and effectiveness.

An important concept is that outputs be offered on a competitive or "contestable" basis by departments. Contestability has two dimensions: an ability to compare outputs among departments, so that ministers may purchase the mix of goods and services from different departments that match the outcomes they seek; and an awareness of cost comparisons with producers of similar outputs in the private sector, so that ministers are free to purchase outputs from the private sector.

The need for cost measurement and control, and for financial information to support the minister's interests as owner and purchaser, has led to the introduction of accrual accounting in all departments. Accrual accounting has thus replaced often rudimentary cash-based accounting systems. Audited departmental financial statements are now issued on an accrual basis in annual reports.

The 1989 legislation that established the outputs and outcomes system also modified the appropriations and budgeting process. The previous line-item system (votes subdivided by program and input category) was replaced by votes for three types of appropriation: classes of outputs; transfer payments (payments on behalf of the Crown); and capital contributions. The Estimates and Budget contain annual appropriations for votes of government departments, including statements of projected performance and projected financial statements. After-the-fact performance information and financial statements are presented in departmental annual reports. These performance statements, together with the financial statements, are audited by the New Zealand Audit Office and tabled in Parliament.

6.54 In the United Kingdom there is also an increased results orientation. Since 1982, the United Kingdom has undertaken financial initiatives that a 1988 government report found had ". . . (begun) to shift the focus of attention from process towards results." In addition, the Next Steps initiative emphasized setting targets for performance - largely in the area of service provision - and meeting those targets.

6.55 An illustration of evolving accountability relationships in the United Kingdom is the role of chief executives of Next Steps agencies. Chief executives have performance agreements with their ministers; those drawn from outside the civil service are hired on a contractual basis. The Efficiency Unit reported in 1991 that "Chief Executives are acutely aware of their visible personal responsibility and accountability for the success of their Agencies."

Delegation and Empowerment

Delegation and empowerment are necessary to attain results

6.56 An important theme of PS 2000 is the increased delegation of authority from central agencies to departments and, within departments, to the lowest levels reasonable. This naturally flows from the focus on results and on service to the public. The push for greater delegation recognizes that managers and front-line employees - most of whom are located in regions - require greater flexibility if they are to provide better service.

6.57 Consequently, to the maximum extent possible, central rules are to be eliminated and to be replaced by guidelines. In the area of common services, wherever possible, services that have been mandatory are being made optional in order to improve cost-effectiveness. Managers are to receive assistance to develop the necessary knowledge and skills to make the best use of their increased authority.

6.58 New Zealand has gone furthest in devolving authority. It has introduced legislative changes that make departmental chief executives largely autonomous and responsible for resource management, within budgetary limits. As a consequence, there has been a move away from a "single" public service, and the personnel central agency has undergone a major restructuring and downsizing.

6.59 In the United Kingdom and Australia, a number of authorities in areas such as financial arrangements, pay and staffing have been delegated to departments and agencies. In the United Kingdom, an increasing number of Next Steps agencies operate as "trading funds"; this allows them to manage their finances more like a commercial company. For the other agencies and departments, the central agencies have, since 1989, developed pay and management "flexibilities" - lists of available delegated authorities - that these entities are encouraged to use. For example, departments and agencies may, with Treasury approval, adopt their own job classification and pay structures. Furthermore, legislation aimed at providing a framework for the delegation of further authorities was passed in 1992. In Australia, the evaluation found that "a substantial amount of devolution of financial management responsibilities to line agencies had occurred." Also, collective bargaining is now being moved to departments under what is known as "enterprise bargaining".

6.60 In these two countries, as in New Zealand, the role and size of central agencies responsible for personnel have been modified substantially. For example, in Australia, the Public Service Commission is much smaller than its predecessor, with most of the operational functions either transferred to other central departments or to departmental management, or discontinued. In the United Kingdom, the Treasury is responsible for matters of personnel policy, such as terms and conditions of employment. The Civil Service Commission, traditionally responsible for recruitment, has seen its role reduced; today it is responsible for overseeing the selection process for certain levels, most notably for "fast stream" graduates, and has been transformed into an Office of Civil Service Commissioners. As such, it remains responsible for policies to protect the merit system, but has little staff support; most operational functions have been transferred to departments and agencies.

6.61 In Canada, some modification to the statutory role of central agencies has been made. The *Public Service Reform Act*, enacted in December 1992, made some noteworthy changes. For example, the role of the Clerk of the Privy Council has been clarified, designating that office-holder as Head of the Public Service. Also, certain powers of the Public Service Commission, such as the power to investigate complaints from employees and to take corrective measures, have been strengthened. The Act also transferred responsibility for the "deployment" of staff from the Commission to

departments, within a policy framework established by Treasury Board. However, the basic division of responsibilities in law between the Treasury Board, as the employer, and the Commission, as the agency responsible for the application of the merit principle in staffing, has not been otherwise changed.

Streamlining and Simplifying Administrative Systems

Streamlining administrative systems encourages a focus on service

6.62 Faced with the difficulty of maintaining service in the context of ongoing fiscal restraint, PS 2000 aims to bring about "wide-ranging changes" in the personnel regime and other administrative functions to reduce costs and administrative burden, and to improve program delivery. The White Paper estimated, for example, that the costs of personnel management, plus the costs of resource management and administrative and common services, were in the order of \$2 billion annually.

6.63 The White Paper called for changes in the legislative framework governing the management of people. The *Public Service Reform Act* contains measures for the simplification of the classification and job evaluation system. It also modifies labour relations mechanisms, notably those related to termination of employment and associated redress and to determination of exclusions from bargaining units.

6.64 In the three other jurisdictions studied, administrative systems and procedures have also been simplified, and rulebooks have been thinned out. For example, New Zealand has made voluminous financial management instructions much briefer and introduced a series of related guideline booklets to aid managers. The service-wide personnel manual has been abolished, and departments' personnel systems and procedures for hiring, classifying, promoting and releasing employees have also generally been simplified.

A More Businesslike Approach to the Management of Resources

Resource constraints are leading to a more businesslike approach

6.65 A number of the reforms already discussed - for example, operating budgets and simplified administrative systems and processes - reflect a shift toward more businesslike methods. So do amendments made to the *Surplus Crown Assets Act* aimed at improving materiel management. Another significant change, resulting from passage of the *Public Service Reform Act*, is the exclusive statutory authority provided to deputy heads to deploy employees in their departments, under certain conditions. PS 2000 also includes proposals relating to productivity gain sharing and other performance rewards for managers and staff. However, these measures have not been implemented due to union opposition or government wage restraints.

6.66 Identifying clients, marketing services and optimizing revenues are among the more businesslike practices increasingly followed in the four countries studied. In the selected jurisdictions, units within departments - or the departments themselves, in New Zealand -

increasingly operate according to business plans, revenue targets, marketing strategies and feedback from client surveys. In some cases, as in Canada, these entities may seek to increase and then retain revenues. They may also be responsible for meeting annual financial performance targets, including revenue targets and a return on public investment. The widespread application of user fees has been a tool for improving financial performance.

6.67 Both the United Kingdom and Australia have had a system of "running costs" budgets for a number of years. Running-costs budgets are similar to Canada's operating budgets. In Australia, there is also a capacity to carry forward from one fiscal year to the next, or to borrow from a future fiscal year, up to six percent of running costs. These provisions exceed the Canadian allowance - for carry overs only - of two percent.

6.68 Accrual accounting is seen as a valuable management tool in New Zealand, Australia and the United Kingdom. The concept of accrual accounting, which is standard practice in the private sector, requires that revenues and expenses be reported in the period in which they occur rather than when the related cash is received or paid. Implicit in this notion is the valuation and depreciation of capital assets and the recognition of liabilities. New Zealand has recently implemented this notion of accrual accounting, as well as an accrual budgeting system, throughout its departments and agencies. The governments of the United Kingdom and Australia have announced plans to progressively implement accrual accounting in departments and agencies.

6.69 Canadian departments and agencies do not operate on a full accrual accounting basis. Expenditures are recorded on an accrual basis, but the full cost of capital assets is charged to expenditure at the time of acquisition or construction. Further, although non-tax revenues are accounted for on an accrual basis, tax revenues are generally recorded in the year in which they are received.

6.70 Canada has been one of the leaders in reporting annual summary-level financial statements in a global and comprehensive manner. However, individual departments and agencies of the Government of Canada do not prepare periodic reports or annual financial statements on a full accrual accounting basis. Consequently, the real cost of carrying out the activities of these departments and agencies is not shown. An exception to this is departmental revolving funds that are accounted for on a full accrual basis.

6.71 Accrual accounting brings with it the ability to account for the real costs of government resource use. Supported by a good cost accounting system, it can provide more complete information about the costs of government activities in departments and agencies - information necessary for better decision making and reporting on the achievement of results. Full accrual accounting could also give public service management a more comprehensive picture of financial operations than the present system; it could help safeguard capital assets by placing them under accounting control and could provide better information to managers facing difficult capital assets maintenance/replacement decisions.

Progress and Problems with the Implementation of Reforms

PS 2000: Where Progress Has Occurred

6.72 An assessment by the Clerk of the Privy Council. The PS 2000 White Paper indicated that the Clerk of the Privy Council ("the Clerk") would be required to report annually to the Prime Minister on:

the state of the public service; and
progress in implementing PS 2000 for the first five years.

6.73 The first such report, which reviewed progress during 1991 and discussed the challenges and priorities for 1992, was dated 30 June 1992. It indicated that "in many places we are seeing the first signs of a real transformation in management culture." It summarized progress in the following terms:

"This is not an easy time to reform institutions or to try to renew a spirit of service and excellence in an institution as large as the public service. Yet despite the obstacles, and despite events such as the 1991 public service strike, I am still able to report genuine progress in reform and renewal across a broad front of activity in all parts of government.
..."

6.74 The *Public Service Reform Act* includes a provision requiring an annual report from the Clerk on the state of the public service. However, it contains no specific requirement to report on the progress of PS 2000.

6.75 As of 1 October 1993, the second annual report on the state of the public service had not been made public.

Some headway has been made

6.76 An update through this study. We obtained the views of deputy ministers and other senior officials and relied on previous and ongoing work of our Office, together with readily available information, to form our views on the progress of PS 2000.

6.77 PS 2000 was described by the former Clerk as "10 percent legislative change, 20 percent change in systems, and 70 percent change in attitudes and practices . . ." If progress is judged against these criteria, it is our view that, in spite of significant problems, important progress has been made, particularly in the areas of legislative and systemic change.

6.78 For example, though it took much longer than originally anticipated, the *Public Service Reform Act* was passed in December 1992. This has permitted changes in the staffing system - notably the introduction of much-needed flexibility in the deployment of staff. In addition, it makes possible the modernization and simplification of the job evaluation and classification system - a key proposal of PS 2000. The latter involves the creation of a new occupational group to cover more than 100,000 public servants. Though this has been under development for more than a year, implementation has been

delayed for several reasons, including the impact on the organization of work in departments arising from actual and potential restructuring.

6.79 Another major systemic change proposed under PS 2000 was the switch to operating budgets. As of 1 April 1993, central person-year controls were abolished, and all departments were authorized to implement operating budgets for each program.

6.80 Other positive signs are reflected in the views of senior officials. For example, the Secretary of the Treasury Board reported to the House of Commons Standing Committee on Public Accounts that the process of Shared Management Agendas - agreements between himself and deputy ministers concerning key issues to be addressed - "has been working well and is an essential element of the overall assessment of deputies carried out by the Privy Council Office."

6.81 Deputy ministers and other senior officials acknowledge that PS 2000 has had positive effects, such as:

increased delegation of authority from Treasury Board;
a changing attitude about training - which departments are now perceiving more often as an investment; and, perhaps most important,
a more positive attitude concerning the possibility of actually bringing about change.

6.82 There is also a perception among deputy ministers and executives that progress has occurred within departments, though this is tempered by the view that it has not been uniform. Although the progress is frequently attributed to the personal leadership of senior departmental officials, PS 2000 is accorded credit for giving legitimacy, momentum and support to departmental initiatives.

PS 2000: Problems with Implementation

6.83 There is a widespread view among deputy ministers and other senior officials that reform is necessary. Nevertheless, some of the executives we met wondered whether PS 2000 was "dead", and we detected an atmosphere of scepticism and cynicism surrounding the renewal initiative. These views are largely based on how PS 2000 has been implemented.

There has been a problem of mixed messages from the outset of PS 2000

6.84 PS 2000 was initially designed and communicated to staff as a "management-driven exercise". Yet its philosophy is one of participative management. Executives at all levels believe that this has been widely interpreted as contradictory and tends to confirm the perceptions of employees that the initiative is aimed mainly at making managers' lives easier. The failure to adequately involve and consult some stakeholders, particularly employees and their representatives, is a significant concern of executives. Despite the notable efforts of some departments to involve staff at all levels, executives point to a

lack of staff involvement and "ownership" of the initiative as a major implementation failing.

6.85 In addition, inconsistency is perceived between some of the principles of PS 2000 and other initiatives or actions. These include: ongoing downsizing and operating budget cuts; the 1991 budget that helped to precipitate a national public service strike and led to wage restraint legislation; the Al-Mashat affair; and the decision to reduce the number of public service executives by ten percent.

Expectations and communications have been poorly managed

6.86 The Standing Senate Committee on National Finance conducted hearings related to PS 2000 during 1991 and 1992. Several witnesses emphasized that the changes envisaged in PS 2000 would be difficult and time-consuming to implement and argued that "it is important . . . that PS 2000 not generate unrealistic expectations of success."

6.87 Deputies and other senior officials interviewed noted that, in retrospect, there should have been better management of expectations. They pointed out that the initial announcement of PS 2000 raised great hopes for quick change, but that it took a long time before even the goals of the initiative became clear, and that real progress on implementation is taking even longer.

6.88 Officials also note the need for a more effective communication process concerning PS 2000 - the need for more dialogue, rather than more paper. They perceive that there is a lack of knowledge about PS 2000, partially due to the fuzziness of the message, conflicting signals and general mistrust. There is a widespread view that insufficient effort has been paid to communicating the message effectively in departments, and that change too often has failed to filter down from senior levels to lower levels in the organization.

Commitment is not always evident

6.89 Senior officials mention that where there has been commitment to the initiative and its principles, it has translated into results. The departments with deputy ministers of the right temperament and values have made major efforts at reform and have achieved real progress. However, they identify a need for more visible commitment from both the senior-most public servants and from the political level.

6.90 It is suggested that some deputy ministers are either not sympathetic to, or not adept at coping with, some of the ideas associated with PS 2000 and, as a result, little progress has occurred in their departments. Some officials express the view that there do not seem to be any sanctions for departments or senior managers who fail to adhere to PS 2000 principles. There are also perceptions that there seems to be a tolerance for officials in senior positions who conduct themselves in ways inconsistent with the proclaimed principles of reform. As a deputy minister said:

"PS 2000 was not terribly successful as a common or across-the-board exercise. People could not see . . . (some key officials) as `walking the talk'. There were no sanctions for non-performance."

6.91 A number of senior officials also question whether, as a rule, politicians have much interest in the public service, or much sympathy for it as an institution. From their perspective, with a few exceptions, there has been neither interest in nor active support at the political level for the PS 2000 initiative as a whole, in spite of the White Paper and passage of the *Public Service Reform Act* . It is also suggested that there is no real support for ideas such as empowerment and risk taking.

Progress in the Selected Jurisdictions

6.92 Some of the reforms in the selected jurisdictions have been in place or under way for a decade or more. Canada's PS 2000 was announced in December 1989, and the essence of the initiative - bringing about a change in organizational culture - will take time. This needs to be borne in mind in comparing reform efforts in Canada and the three other countries.

6.93 It is our perception that there are significant differences in how officials in each of the selected jurisdictions and their Canadian counterparts feel about public service reforms. Officials in the other countries seem to be clearer about the goals of their reform initiatives. They are generally positive in their perceptions about the achievement of progress, the coherence of reforms and the consistency of direction. Studies carried out in each jurisdiction lend some support to these perceptions.

6.94 In Australia, the evaluation found that "there is a general view by agencies and staff that the reforms have had a positive impact on agency management and performance." It suggested that:

"the direction of the reforms has been correct; they have been well accepted and have had many positive effects, as well as some costs (especially in implementation); and more needs to be done, especially to extend them across the Australian Public Service, and to incorporate them into the culture of the entire administration."

6.95 In New Zealand, a 1991 review was carried out on behalf of a newly elected government, and identified several problems - for example, there was confusion about the roles and responsibilities in facilitating reform - but concluded that the framework of the reforms was perceived as sound. According to ministers, public servants and observers, performance had improved in most key activities.

6.96 Government evaluative studies in the United Kingdom have tended to focus on particular reform initiatives, rather than on the impact of the whole body of reforms. Their findings have been generally positive. For example, a 1991 Efficiency Unit report found that ". . . the Next Steps has generated renewed enthusiasm and increased commitment to improving value for money and quality of service."

Implementation of Public Service Reform in the Selected Jurisdictions

6.97 Given the purpose of our study, we were not able to ascertain directly how well public service reforms were being implemented in the selected jurisdictions. We were nevertheless able to form an overall impression that can help to put into perspective the process of implementation of public service renewal in Canada, and the views of Canadian executives in that regard.

Visible political leadership and commitment is crucial

6.98 Senior officials who had been closely associated with the implementation of reforms in other jurisdictions emphasized that visible political leadership and commitment to reforms is key to their successful implementation. The more significant the planned changes, the more likely they would fail without clear backing from the political leadership. The United Kingdom presents a striking example of prime ministerial spearheading of reform. With respect to both the financial and structural reforms of the 1980s and the more recent Citizen's Charter initiative, prime ministers have demonstrated leadership and determination that created circumstances where change could occur.

Sustained leadership from the "centre" is key

6.99 In the United Kingdom, small groups of senior officials - reporting to the Prime Minister - have worked with top private sector executives to co-ordinate reform initiatives. In New Zealand, a central agency, the Treasury, was instrumental in developing a systematic and coherent approach to reform, and then followed through with strong leadership for implementation.

Public service reforms must be strategically managed

6.100 In the United Kingdom and New Zealand, the reform initiatives appear to have been implemented with greater consistency with their underpinning principles than is perceived to have been the case with PS 2000. The Next Steps initiative is exactly that; it flowed from the Financial Management Initiative, which in turn flowed from the scrutinies undertaken by the Efficiency Unit. In New Zealand, a series of incentives was designed to make the new management model work as intended. For example, a financial incentive, known as the "capital charge", requires departments to take account of the cost of capital in pricing their goods and services. Other incentives include those tied to the contractual, performance-based nature of senior officials' employment.

6.101 Australia has developed a gradual but persistent approach to reform. Since 1987, the involvement of all the players - in central agencies and departments - has been facilitated through a Management Advisory Board (MAB). The Board, chaired by the Secretary of the Prime Minister and Cabinet Department (equivalent to the Clerk of the Privy Council in Canada) is a statutory agency, "advis(ing) the government on significant issues relating to the management of the public service, and (acting as) a forum for the consideration of (such) issues". As of June 1993, the Management Advisory Board's eight other members were the heads of three central agencies and three line departments, plus

one union and one private sector representative. A Management Improvement Advisory Committee was set up in 1989 as the Management Advisory Board's operational arm; its role is "to prepare discussion papers and advice on issues referred to it by MAB or which it considers important." The Management Improvement Advisory Committee is composed of senior officials from central agencies and line departments, including regional representatives, and its Chair comes from a line agency. As of June 1993, it had ten members, six of whom were from line departments.

6.102 An example of the consistency with which the principles of reform have been applied in Australia is provided by the central idea of running costs - giving managers "a pot of money" that they are responsible for - and not weakening this concept by arbitrary and unpredicted across-the-board cuts. Although there is a rollback feature, known as the efficiency dividend (1.25 percent), it is known in advance and thus forms part of managers' running-costs budgets. Officials told us that, since its inception in 1987, this running-costs system has been free of across-the-board or directed cuts, aside from the efficiency dividend. Running costs are one component of budget reforms that is seen to be linked to improved efficiency and effectiveness.

6.103 Periodic evaluations. There have been periodic evaluations or reviews in each of the selected jurisdictions. These were carried out at various stages of the reform, either by the government - a newly elected government in the case of New Zealand - or by parliamentary committees. Australia's evaluation stands out as the most comprehensive. We think it is of significant interest, both from a methodological perspective and for its findings.

6.104 The evaluation of the Australian public service reforms: a notable initiative. The evaluation report, entitled "The Australian Public Service Reformed, An Evaluation of a Decade of Management Reform", was released by the Prime Minister of Australia in July 1993, and contains the results of an evaluation of the whole range of their public service reform initiatives since 1983.

6.105 The basis for the evaluation was the need to know whether, and to what extent, reforms were attaining their stated objectives; and then, to propose direction for further reforms in light of this knowledge. The evaluation was based on extensive surveys of staff and clients, submissions, case studies and research reports. For example, some 10,000 public servants, about one out of every 15, were included in the sample for the employee survey; 63 percent responded.

6.106 The evaluation covered six areas of reform: structural; industrial relations; human resource management; financial management and budgeting; commercial; and planning and reporting. Each area was examined in terms of specific initiatives, covering implementation, impact and, finally, an analysis of results.

6.107 A second part of the evaluation examined the relevance of reform objectives to the 1990s and the question of whether or not there were better ways to meet the objectives.

Among the topics covered were: service to the public; improving agency and staff performance; and the need for co-ordination of continuous reform from the centre.

What Can Be Learned?

6.108 Several insights have emerged from our study that may have important implications for current and future reforms.

6.109 To be successful, public service reform initiatives need to be integrated with the government's broader policy and budgetary agenda. For example, the typical response to changing economic circumstances has involved measures for both deficit reduction and public management modernization: the former can undermine the latter if not handled carefully but, with care, they can be mutually reinforcing. From that perspective, PS 2000 is clearly perceived as having been undermined by parallel initiatives, such as expenditure reductions.

6.110 Also, although led by governments of different political persuasions, and having significant differences in their political structures and economic environments, public service reforms in Canada and the selected jurisdictions are based on some common themes. These themes, discussed earlier, have not emerged in the reforms of each country from a complex theoretical design, except perhaps in New Zealand, where a new management model is in place. In each case, including New Zealand, a good deal of organizational learning has occurred. There has also been an international learning dimension, with all four jurisdictions aware of changes in the others.

6.111 What appears to be significantly different is the way the countries have used the common themes to reinforce the strategic direction of the reforms, such as the redefinition of the role of government or of the relationship between ministers and public servants. There are also significant differences in the priority or the emphasis given to each theme. For example, although in Australia measures have been taken to improve client services over the last decade, service has only recently been identified as a high-priority service-wide target for the future. In Canada, *improving* service to the public became a key theme of PS 2000 even though expenditure reduction and downsizing were ongoing.

6.112 In Australia, New Zealand and the United Kingdom, progress has been made by building on experience with successive reform measures. Nonetheless, we formed the opinion that reforms have had a more strategic focus and greater coherence and consistency in the selected jurisdictions than in Canada. We believe that reforms in the Canadian federal public service could benefit from the adoption of a more strategic approach to public management and public service reform.

A more strategic approach to public management and public service reform is needed

6.113 Strategic management involves the positioning of an organization in relation to the challenges and opportunities it faces. From that perspective, one of the most significant

challenges faced by Canada is the persistent deficit and the growing debt. There appears to be an emerging consensus that the question of affordability of government services must now be addressed.

6.114 Reforms in the Canadian public service reflect a "ratcheting" approach with respect to the importance placed on the deficit and debt issue. PS 2000 has sought to "squeeze out" inefficiencies, to improve internal systems and practices, and to enhance the focus on service. The June 1993 restructuring initiative aims to further streamline administrative overhead and service delivery and to improve government responsiveness. The plan is to follow this with a re-examination of the affordability of government programs and services to determine future "lines of business."

6.115 The problem with such a "ratcheting" approach is that, even if these successive reforms and other government measures were managed carefully, each new initiative could call into question the validity or appropriateness of the preceding ones, potentially reducing their beneficial effects and obstructing their implementation, if not actually reversing their direction.

6.116 A case in point is the Work Force Adjustment Directive. Signed in 1991, it guarantees at least one reasonable job offer to public servants declared surplus. Some executives question how this could have been reconciled with departmental budget cuts and downsizing. In April 1993, less than two years later, the government indicated that it would seek basic changes to the Directive. Some union leaders have made it clear that they intend to oppose changes that would eliminate the guarantee of a job offer.

6.117 There are other examples of apparent conflicts that suggest the need to take stock - to reconsider actions planned or under way in the light of new and emerging realities.

6.118 Australia's experience with its 1987 restructuring changes - similar in nature, scope and purpose to those announced in Canada in June 1993 - is relevant. In Australia, the number of departments was reduced from 28 to 18.

6.119 The Australian evaluation of reforms found that restructuring had generated greater organizational stability and had improved both program delivery and the effectiveness of the policy and decision-making process. At the same time, the evaluation concluded that the extent of the disruptive effects had been underestimated. It pointed out that attention at the time of the restructuring had been focussed on the desired state to be achieved, rather than on the strategies required to assist people across the public service to put the changes into effect. As a result, "many agencies and staff believed that the machinery changes (had) diverted effort from management improvement rather than achieving the reverse."

6.120 The Australian experience points to the need to ensure that public service renewal is not undermined by the June 1993 restructuring initiative or other measures. PS 2000 and the restructuring initiative have objectives in common and need not be in conflict, but focussed effort will be required to ensure that they are aligned and mutually reinforcing.

6.121 In a sense there is nothing new in this, but today governments are being forced by the challenges they face to revisit basic questions about what they do and how they do it. Strategic direction is required in streamlining administration. It cannot be taken for granted that the delivery of public services by government departments and agencies is the most effective approach to achieving desired outcomes.

6.122 It is imperative that public service reforms proceed from a vision developed through a realistic re-examination and determination of what is affordable and what role the public service is to play in the years ahead.

6.123 Once that vision is agreed on:

it should provide the basis for developing management principles, organizational arrangements and administrative systems; mechanisms should be developed, and roles and responsibilities clarified, to ensure that decisions - such as budget measures, or other government initiatives affecting public service reforms - are assessed against the vision, to optimize relevance, coherence, consistency and the efficient use of resources; public servants and other stakeholders should be kept informed of the purposes and direction of reforms, including how they relate to previous reforms and to the overall strategic direction, and should participate to the maximum extent feasible in their development and implementation; periodic assessments of progress should be carried out to determine if specific reform objectives are being met, to identify problems and lessons learned, and to point to new directions; timely reports should be provided to Parliament, and these should be considered by a parliamentary committee; and at the appropriate time, serious consideration should be given to undertaking a full evaluation of the impact of the reform and renewal initiatives now under way.

There must be a sharper focus on the relationship between costs and the results achieved

6.124 Inputs, outputs and outcomes. Canada and the selected jurisdictions recognize that, with increased fiscal restraint and increased public demand for effectiveness, there must be a sharper focus on the outputs and outcomes of public programs and their costs. Both the productivity and the quality of public services have assumed increased importance. The result has been an enhanced recognition of the need to use the inputs of government - both public money and public employees - in ways that promote value for money and improved public service performance.

6.125 The four countries have approached the implementation of this principle in significantly different ways and with different degrees of vigor. There is, however, general agreement that the achievement of value for money and the improvement of public service performance requires:

explicit linkages, in both management and public reporting systems, of the overall level of the inputs deployed, the outputs produced and their cost, and the effects of outputs on desired outcomes; and agreed and known measures and standards against which performance can be assessed.

6.126 In this regard, the New Zealand management model is innovative, particularly in its clear definition of the relationship between ministers and chief executives, which provides the potential for clearer accountability.

Achieving results requires the enhancement of accountability as well as the delegation of authority

6.127 Centralized authority in such large, complex organizations as the governments of the four countries studied simply cannot respond efficiently or effectively to the myriad decisions that must be made to produce value for money and deliver high-quality service. Some delegation must take place. Delegation is also essential to enhancing cost-consciousness, cost-effectiveness and quality in the design and delivery of public services. If individual ministers and public managers do not have sufficient control over inputs, cost-consciousness will not be achieved, let alone cost-effectiveness.

6.128 However, delegation is a means to an end, not an end in itself. It is not meant to release either ministers or public managers from their obligations to adhere to government policy, or to reduce their accountability for actions and decisions. Indeed, if delegation is to take place without abdication of authority, accountability must be enhanced proportionally.

6.129 To enhance the accountability of chief executives - heading departments in New Zealand and Next Steps agencies in the United Kingdom - formal performance agreements with ministers have been developed. These countries have also established clear links between expectations and performance information. Furthermore, there are rewards and sanctions implicit, if not explicit - such as performance pay - in the nature of the "contractual" arrangements between heads of agencies or departments and their ministers. It is within this tight "playing field" that delegation takes place.

6.130 In separating policy making from operational or service delivery functions, the United Kingdom, like New Zealand, has changed the nature of accountability to ministers concerning the attainment of operational objectives. When the accountabilities of ministers and heads of agencies are defined clearly, accountability to elected representatives, and through them to the taxpayers, is also likely to be enhanced.

6.131 A long-standing concern of this Office is the failure of successive reform initiatives to adequately address accountability. In our view, PS 2000 has not remedied this problem. While the initiative proposes measures to enhance the accountability of deputy ministers and other managers for the quality of their management performance, in our opinion the necessary changes have yet to occur. Furthermore, much remains to be done to enhance the accountability of government to Parliament.

Conclusion

Sustaining reform is essential; political commitment will be the key

6.132 There can be no doubt that a high-quality public service is essential to high-quality governance. Public servants play a crucial role in gathering and developing advice for ministers on a wide range of complex issues and in managing the delivery to Canadians of government programs and services.

6.133 Significant changes may be made to the size, role and functions of the public service in the months and years ahead. However, this will not diminish its importance as a vital element of our system of government.

6.134 Canada's renewal initiative proposes changes that are imperative in the current context - fundamental changes in how public servants are managed, and other changes essential to a modern and service-oriented public service. But as this report reveals, for a variety of reasons, scepticism and cynicism surround PS 2000. Much is being done. However, it is not clear that the momentum for change in attitudes - the essence of PS 2000 - is being maintained. This remains a major challenge. The complexity of the task must not be underestimated.

6.135 The restructuring initiative announced in the summer of 1993 reflects the increasing priority of fiscal considerations, and further widens the scope of change. It also adds a sense of importance and urgency to the need to follow through on the basic principles of public service renewal.

6.136 Sustaining reform and renewal must be a priority. Political leadership and support - actions that demonstrate commitment - are critical to ensuring that reform initiatives are successful, and that Canada's public service is a vibrant, efficient and effective organization, capable of meeting the challenges that lie ahead. Consistency in trying times, and over the long haul, is the ultimate test of that commitment.

Chapter 7

Internal Audit

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Internal Audit

Assistant Auditor General: David Roth

Responsible Auditor: John K. Prokaska

Main Points

7.1 Our study of the best internal auditing practices in 40 organizations outside the Canadian government clearly indicated that, particularly in times of restraint, internal audit can contribute greatly to improving management practices.

7.2 Three major stakeholders - the Comptroller General, senior management and internal audit - have key roles in ensuring that internal audit operates effectively.

7.3 Thirty years of effort to establish effective internal auditing have not resulted in a uniformly high standard of internal audit throughout the government. All the major stakeholders - central agencies, departmental management and departmental internal audit units - need to change their views on internal audit and to look for more innovative and effective ways of using the resources associated with it before the full benefits of internal auditing can be realized.

7.4 Changes in management culture resulting from efforts to reform the public service, and rapid changes in computer technology, are creating major challenges for internal audit in the 1990s.

7.5 Good people are critical to the success of any internal audit organization. Major changes in the practices for staffing internal audit are needed if people with top potential are to be attracted to work in internal auditing.

Introduction

7.6 The purpose of internal audit is to review and assess, independently, management practices, including controls, in major financial, administrative and operating areas and to recommend improvements wherever beneficial. These reviews are designed to help managers achieve their business objectives by identifying weaknesses or opportunities to improve the overall economy, efficiency and effectiveness of departmental management practices.

Objectives

7.7 The audit was designed to determine:

whether internal audit in departments and agencies is concentrating its efforts on significant and high-risk areas; whether the quality of audits meets professional standards; whether internal audit information and advice are valuable and contribute to improving the management of programs; whether the Office of the Comptroller General has instituted a high standard of internal auditing across the government; and whether the government internal audit community is well positioned to meet the challenges arising from public service renewal.

Scope

7.8 We reviewed internal audit activities in ten departments and agencies. Our review accounted for about 65 percent of person-years working in internal audit and approximately 57 percent of the 1992-93 internal audit budget across the government. The review covered the following areas:

management support;
staffing, training and development;
audit planning and coverage;
quality of work;
audit reports; and
the measurement of audit performance.

7.9 We considered the results of other reviews of internal audit work carried out in recent years by several of our audit teams in departments. We also reviewed activities of the Office of the Comptroller General in fulfilling its role and responsibilities for internal auditing across the government.

Criteria and Approach

7.10 The Treasury Board internal audit policy and the standards for the professional practice of internal auditing issued by the Office of the Comptroller General provided the basis for our review of internal audit in departments and agencies. Where appropriate, we

took into account other papers or documents issued by the Office of the Comptroller General and other central agencies.

7.11 In view of certain key initiatives to revitalize government, we recognized, before we started this audit, that it would not be productive to assess internal auditing solely against current practices. We felt that some of these practices, if not outmoded at the time of the audit, would become so as the government's management reform initiatives took effect. Therefore, we looked at internal audit in terms of what it needs to become in the new management culture in government.

7.12 To identify "best practices" in the internal auditing profession, we conducted a study of 40 organizations in the public and private sectors. Many of the organizations that we visited had gone through, or were undertaking, management and organizational changes similar to those proposed in the government. The study resulted in a publication entitled *Internal Auditing in a Changing Management Culture*. We highlighted some of the "best practices" used by internal auditing units that we believe the Government of Canada should adopt or adapt. The study also confirmed that internal audit in the federal government can be improved and that it needs to play an important role in improving government management practices in a time of transition.

Background

7.13 In 1962, the Royal Commission on Government Organization (Glassco) highlighted the importance of internal audit as a management tool in the Government of Canada. Four years later, in 1966, the Treasury Board issued its first policy recommending that departments and agencies establish internal auditing units. The policy was revised significantly in 1973, 1978, 1982, and 1991. Before the Office of the Comptroller General was established in 1978, the Treasury Board Secretariat had staff dedicated to supporting the implementation of internal auditing. When created, the Office of the Comptroller General had a mandate to provide leadership, direction, guidance and advice to the internal audit community.

Previous Audits and Reviews of the Internal Audit Function

7.14 Since the mid-1970s, several audits by the Office of the Auditor General and reviews by the government itself found that internal audit had not lived up to the expectations that had been established for it. The 1979 Royal Commission on Financial Management and Accountability (Lambert) also expressed concerns about internal audit.

7.15 The studies and audits tried to determine why internal audit had not met expectations. They cited the following reasons (among others):

Some senior managers have not understood the role of an effective internal audit function and the benefits to be derived from it, and therefore have not given it the support and direction it requires.

Strong leadership and technically proficient audit staff have been lacking.

Many internal auditors have failed to understand fully the business of their departments, which has weakened their ability to focus on matters of greatest importance and risk.

A lack of management support - or, in some cases, the auditors' inability to deal with technology and complex higher-level issues - have restricted audit scope. Often internal audit reports have not been timely, have dealt with secondary issues, and have not clearly identified the significance of the issues being reported. Many reports have not been considered constructive vehicles for positive change.

Follow-up of audit reports has been inadequate.

7.16 After each of these audits and studies, the central agencies have renewed their commitment and effort to improve the quality of internal auditing.

7.17 In 1984, we reported that the basic infrastructure for internal audit was in place. Professional standards had been issued; all departments had resources for audit; and material on methodology was available. We also noted, however, that most departments still needed to make improvements. More specifically, improvements were needed in the level and nature of audit coverage, focussing audit resources on areas of significance and highest risk; in the timeliness and quality of audit reports; and in the follow-up and implementation of audit findings. More effective means were needed to evaluate internal audit's performance. The government agreed in general with the audit findings and stated that the Office of the Comptroller General would continue to remedy these weaknesses.

Internal Audit and Public Service Renewal

7.18 In our 1984 Report we noted that, to be effective, internal audit must focus on those issues that are significant for government. These include providing better service, using resources more effectively, reducing cost and increasing revenues, deterring fraud, detecting waste and abuse, and ensuring compliance with laws, policies and directives.

7.19 Subsequently, in 1989, the government announced its public service renewal initiative, which was intended to introduce new, dynamic approaches to managing in government. The new approaches included focussing more on the quality of service, using public resources more productively and effectively, and establishing an accountability regime based on results rather than on inputs. They also called for introducing participatory management with more decentralization and teamwork, thus encouraging employees to be more entrepreneurial and less averse to taking reasonable and appropriate risks.

7.20 A certain similarity exists between the focus of the current renewal process and the needed improvements that we pointed out in our 1984 Report as being important in government organizations - areas where we thought effective internal audit could play an important role.

7.21 Although the initial government documents issued in 1989 on the Public Service 2000 initiative discussed the negative effects that auditing had on the system, they did not suggest that internal audit itself be reformed so that it could make a positive contribution to the proposed new model for managing in the government. It seems that those outlining the framework for Public Service 2000 did not feel that internal audit was an important aspect of management reform. In 1991 the government issued a document entitled "PS 2000 & Auditing", outlining the role internal audit could play in a Public Service 2000 environment.

Current Overall Assessment

7.22 The present audit shows that the quality of internal auditing still varies considerably from department to department. On the basis of our audit work and other information available to us, we believe that in several of the departments the problems are so significant that management cannot appreciate the benefits available from effective internal auditing. In others, varying degrees of improvement are still required. Many of the suggestions for improvement noted in our 1984 Report are still applicable today. Some internal audit groups still require improvement to meet Treasury Board standards covering the professional practice of internal auditing. All internal audit groups need improvement to meet the best private sector standards of practice. Although some internal audit groups have improved, we are concerned that certain internal audit groups whom we previously rated among the leaders have fallen back in their performance.

7.23 Although it is difficult to measure progress precisely, and the goal of what constitutes good internal audit is constantly evolving, it is our view that, when compared to outside organizations in our study, internal audit in the Canadian government may not be gaining ground in closing the gap between what can reasonably be expected from internal audit and its actual performance.

7.24 Since 1973, Treasury Board policy has required departments to have internal audit units and has established, maintained and revised standards for the professional practice of internal audit in government. Our present audit and our knowledge of departments not included in our sample indicate that some internal audit groups are still operating below current standards. Achieving uniformly high standards across all departments and agencies has been an elusive goal. We also believe that few of the government's internal audit groups are currently well positioned to operate effectively in this time of organizational renewal.

7.25 Within the last two years there have been a number of initiatives, by both the Office of the Comptroller General and the internal audit groups, that focus on the areas of concern we have identified in this chapter. We believe that these initiatives are an important first step and, if carried through to fruition, should improve departmental internal audit groups and provide better service to senior management. However, at the time of publication of this Report, it is too early to assess the impact and sustainability of these initiatives. The commitment and support of senior management, the Comptroller

General, and the internal audit community are essential to ensure the success of these initiatives. We intend to monitor their progress closely.

Potential Benefits from a Strong Internal Audit Function

7.26 Our study of best practices demonstrated that the following factors are essential to the success of an effective internal audit group:

- visible and substantive support by senior management;
- qualified, competent internal audit staff;
- a high level of adherence to professional standards; and
- a corporate culture emphasizing continuous improvement.

7.27 Our study of best practices clearly showed that an internal audit group can both be a leader in the drive toward renewal of government and act as an important catalyst for good management. To assume this leadership role, the group must be working with management; keeping up-to-date on developments in the department, the government and the internal audit profession; and continually analyzing risks and adapting to changing circumstances.

Outside the Government of Canada, Internal Audit Is Widely Accepted as an Important Management Tool

7.28 Internal audit has attained wide acceptance as an important management tool in many major organizations outside the Government of Canada, in both the private and public sectors. Our study of internal auditing practices in 40 of these organizations indicated that most place a high value on the role of internal audit in providing assurance that "the business" is being conducted in a disciplined and efficient manner. Many private sector organizations included in the study either have gone through or are undergoing major changes to stay competitive in the global marketplace. The changes include significant downsizing, redesigning control processes and eliminating non-productive activities. Unlike the federal government, many of these organizations have recognized the importance of internal audit in both providing objective appraisals of the control environment and generally helping the organization achieve its objectives. The study also indicated that, despite widespread downsizing within organizations, resources allocated to internal audit either had not been reduced or had been reduced proportionately less than in other parts of the organization. This continuing support strongly indicates the value that management of these organizations places on the internal audit function.

Examples to Illustrate the Benefits Available from Internal Audit

7.29 Although the quality of internal audit work across the government is inconsistent, some internal audit groups have identified important opportunities that have resulted in improved management processes or have saved money or prevented losses to their organizations. Two cases illustrate the positive contributions that internal audit can make to an organization ([Exhibits 7.1](#) , [7.2](#)). The third case illustrates where all but one

internal audit group failed to identify and prevent a situation that ultimately resulted in loss and substantial embarrassment to the government ([Exhibit 7.3](#)).

Exhibit 7.1

Case Study 1: Internal Audit Leads to a Streamlining of Controls and Increased Client Service

The objective of the internal audit was to assess the adequacy of the management of trust funds administered by a department. A critical component of the audit was to recognize that senior management was attempting to migrate from a traditional control-oriented approach to one that encouraged participating teamwork and empowerment of their employees.

The results of the audit were presented in terms of the opportunities for re-engineering some of the policy and control framework of the department. Specific findings included instances where the level and cost of controls outweighed the risks that they were intended to manage. The audit identified situations where there was excessive effort on paperwork and administrative tasks.

This audit illustrates the importance of internal audit aligning its approaches and activities to parallel the changes taking place in the department. By doing so, the audit focussed on improving and streamlining the department's program delivery, which ultimately led to improved client service and a reduction in administrative costs.

Exhibit 7.2

Case Study 2: Internal Audit Results in Significant Savings

The objective of the audit was to assess the economy, efficiency and effectiveness of the acquisition, operation and use of a department's telecommunication facilities. The annual cost of these facilities is approximately \$11 million.

The audit concluded that the department could realize significant savings through improving the management of its telecommunication activities. Savings were conservatively estimated to be \$6.8 million over five years. Subsequent follow-up of this audit revealed that savings have been even higher than originally estimated.

In addition to showing where potential savings could be made, the audit pointed out opportunities to improve telecommunication services. It also revealed the department's exposure to serious security threats through its data networks.

Exhibit 7.3

Case Study 3: Effective Internal Audit Could Have Prevented a Significant Problem

An issue reported in the Auditor General's 1992 Report illustrates the potential benefits of internal audit. The audit of payments to employees under the Work Force Adjustment Policy noted that, based on a sample, 35 percent of payments were judged to be without foundation, and an additional 29 percent of the payments were questionable.

Departments are responsible for managing the implementation of the Work Force Adjustment Policy. The Report noted that there had been gradual deterioration in the administration of the program. Such deterioration opened the door to the questionable use of taxpayers' dollars and increased public scepticism concerning the reduction in the size of the public service.

The 1992 Report raised some interesting questions: "Who is responsible for ensuring that control mechanisms are in place and working?" and "Why were problems in the administration of the policy not identified and promptly corrected?"

Further questions could have been added: "Where was internal audit? Why was internal audit not advising senior management of the misuse of the policy and the potential for embarrassment?"

In one department, internal audit had reviewed the program in progress and had recommended corrective action. The department acted on the recommendations, and we had only minor comments in that case.

The timely review of controls is clearly an internal audit responsibility and yet, to our knowledge, none of the internal audit groups in the problem departments had provided timely advice to management.

Conclusion

7.30 The government is spending a significant amount of money on internal audit services. The internal audit community is made up of 694 staff and costs the Canadian taxpayer \$56.6 million in direct costs per year. We believe, and other organizations we studied stated, that an objective and effective internal audit group, which is listened to and which has the support of management, can produce savings that far exceed the cost of providing the internal audit services.

What Needs to Change?

7.31 The federal government has invested 30 years of effort to establish effective and uniform internal auditing across all government departments. During this period, the internal audit function has evolved in many departments, moving from a focus on financial auditing to comprehensive operational and system auditing. Internal audit has been slow, however, to respond to the accelerated pace of change, and has failed to live up to expectations and to be a vibrant function. To achieve its potential, internal audit needs improved direction and support from departmental management, more effective direction and support from central agencies, and a more innovative and flexible internal audit community.

7.32 All the major stakeholders - the central agencies, departmental management, and departmental internal audit - need to change their views on internal audit and to look for more innovative and effective ways of using the resources associated with it. In the paragraphs that follow, we discuss the changes that we believe are required.

Internal Audit and the Comptroller General

7.33 The Comptroller General has been responsible for providing leadership, direction, guidance and advice to the internal audit community. One of the Comptroller General's objectives has been to promote cost-effective and accountable management in departments and agencies by ensuring that they establish and maintain sound internal

auditing. (In June 1993, as part of a reorganization of the government, the activities of the Comptroller General were amalgamated into the operations of the Treasury Board. The Secretary of the Treasury Board also became the Comptroller General of Canada.)

7.34 Over the years, the Comptroller General has had staff dedicated to carrying out this role. They have developed the government's policy on internal audit, issued internal audit standards, provided guidance, counsel and advice to the audit community, co-ordinated the development of the Government Internal Audit Plan, provided input to internal audit training, monitored the performance of internal audit and carried out many other related activities. The Office's emphasis in some areas has changed, and certain tasks have been added or dropped, most notably, in the scaling back of its monitoring activities. However, the fundamental approach to carrying out its responsibilities for internal audit in the government has remained constant over the years.

7.35 A recent operational review of the Office of the Comptroller General, including the Evaluation and Audit Branch, was commissioned by the President of the Treasury Board. This review was part of an overall review of common-service departments and central agencies. The primary objective of the review was to identify immediate and longer-term opportunities for reducing the operating costs of the Office of the Comptroller General without reducing its effectiveness. Accordingly, our audit did not look at the efficiency of operations in the Office of the Comptroller General.

7.36 However, our review did identify major concerns with the operations of the Office of the Comptroller General related to its internal audit activities:

The results of our interviews with departmental internal auditors, and the findings of the operational review, indicate that the internal audit community is expecting more leadership from central agencies in the form of support, assistance and professional guidance.

A number of years ago, the Office of the Comptroller General significantly scaled back its monitoring activities. In recent years it has taken a more reactive role.

The Office has established liaison officers, but their monitoring activities are mainly limited to discussions with heads of departmental internal audit units. This type of review does not provide enough information to enable the liaison officers to recognize situations where internal audit in departments needs help to improve its work. We noted that there was only limited communication between the Office and senior departmental managers. In our view, one of its primary responsibilities is to work with senior management to develop effective internal auditing.

The Office of the Comptroller General has either issued, or is in the process of issuing, a number of papers that define the expectations for internal audit. It must now develop plans that outline the steps necessary to help ensure that the internal audit community meets the expectations set out in policy, standards and other documents.

Training for the audit community and Comptroller General staff involved with internal auditing is not adequate to keep up with public service reform initiatives and changes in the practice of internal auditing.

The Office of the Comptroller General develops and co-ordinates the preparation of the Government Internal Audit Plan. The plan sets out the central agencies' audit priorities. However, the planning process does not include a sound, effective methodology for identifying government-wide risks. The Comptroller General should also have an effective process for carrying out or co-ordinating audits of these risks and monitoring the results of those audits.

The Office of the Comptroller General does not have an effective way to measure the success of its efforts to institute effective internal auditing.

7.37 We note that the operational review report of the Treasury Board confirms several of the above findings.

7.38 Over the past 15 years, the Office of the Comptroller General has expended considerable effort in trying to institute effective internal auditing in departments and agencies. As noted earlier in this Report, progress has been made in developing the infrastructure for internal audit. However, in recent years the rate of progress in improving the quality of internal audit in departments and agencies has not kept pace with the changes that have taken place in leading organizations in our study.

7.39 We believe that the Comptroller General needs to play a key role if internal audit is to succeed. In order to play this role effectively, the Office of the Comptroller General needs sound information on the performance of the various internal audit groups. In our view, the only way to obtain this information and to bring about positive change in the internal audit community is to carry out periodic quality assurance reviews. Various options are available for carrying out these reviews, such as the approach followed by the Institute of Internal Auditors. Under this approach, the Comptroller General would co-ordinate and direct quality assurance reviews by a team of leading internal auditors in the federal government's internal audit community.

Internal Audit and Departmental Management

7.40 During our interviews, several senior departmental managers indicated that they would not have an internal audit group in their organizations if the Treasury Board did not require them to do so. The reasons for this vary, but in many cases are based on bad experiences with the function, or on a lack of familiarity with the role and the potential benefits of an effective internal audit function. We believe that in an environment where management does not appreciate the role of internal audit or is not committed to making it work, internal audit cannot achieve the level of excellence necessary to help senior managers improve their organizations in the 1990s. Management also must create a culture that encourages suggestions for improving the organization. Internal audit could contribute a large proportion of these suggestions.

7.41 Deputy heads and senior departmental management must understand the potential benefits of effective internal auditing. If they do not, they will not be able to either hold internal audit to account or provide the required support for the function. According to our study findings and the results of our audit, and our knowledge of the departments,

until managers understand and support internal audit there is little prospect that many of the senior managers will be able to realize the benefits of internal audit that their colleagues outside the federal government enjoy.

7.42 We noted that the deputy head's personal involvement and commitment to internal audit can make a difference. For example, we found one department in which the deputy head's involvement was a contributing factor to its being among the best departmental audit groups we reviewed ([Exhibit 7.4](#)).

Exhibit 7.4

Case Study 4: A Good Example of Management Support

In this case a deputy head's direct actions demonstrated strong support for the internal audit function.

He involved himself personally in developing a vision and establishing a mission for internal audit.

He described at general staff assemblies the significance of internal auditing and its importance as a tool for managers.

He appointed a top-level management person to head up internal audit. This person knew the business, was respected within the organization, and had high standards of integrity and the strength to defend them. He also had the potential for higher-level positions in the department.

Based on the superior performance of the internal audit group, the deputy head awarded it the "Award of Merit". This prestigious award in the department is given only for exceptional performance.

He personally participated in internal audit workshops -- discussing personal views on internal auditing and the importance of the contribution internal audit can make.

He personally held internal audit to account for its performance.

Internal Auditing in Departments

7.43 Our review of the internal audit function indicated that there are almost as many different levels of performance as there are audit groups. Several departments whose internal audit groups have been extremely weak in the past have tried to strengthen the function. We acknowledge that some improvement has taken place in these departments. However, in view of the history of internal audit in these organizations and their limited audit coverage to date, it is too early to speculate on whether the improvements will translate to more effective auditing. Some groups have attained a reasonable level of performance. Others that were ranked highly by earlier studies and audits have fallen back in their performance. Generally, on a government-wide basis we found little overall improvement since our last government-wide audit in 1984. Although the community is slowly changing and is aware that more change is required, the pace of change has to be accelerated. The following is an overview of improvements needed.

Audit coverage

7.44 Our audit revealed that improvement in audit coverage is still needed. Very little ongoing work to identify and monitor risks is carried out, and the list of key components in the audit universe often is not kept current. We found that major operational systems, and systems under development in several departments included in our audit, were not adequately covered by departmental internal audit groups. In some departments the scope of audit coverage was limited to only those areas that management had asked to be reviewed. While such an approach provides responsiveness to management's expressed needs, it deprives it of a major internal audit service - an independent review and assessment of the risks and exposures that the organization faces. Such information is essential to management's understanding of internal audit coverage of all critical areas of the department's operations.

7.45 Our study outside of the Government of Canada indicated that the leaders in internal audit place considerable emphasis on identifying the nature, scope and potential effects of risks facing their organizations. As a result, they are often in a position to identify deteriorating control situations before major loss or embarrassment to the organization occurs. We also noted that the leading internal audit units carry out considerable experimentation and research work to develop audit tools for ongoing monitoring and analysis of risk. These units also become involved in the early stages of developing systems and programs. We believe that, if adopted, these practices and activities could significantly improve the quality and productivity of internal auditing in the Government of Canada. In our view, the internal audit community should direct more resources to developing methodology and tools for monitoring and analyzing risk.

7.46 Because of the size and complexity of government operations, it is usually uneconomical for internal auditors to audit all aspects of departmental operations on a timely, in-depth basis. Consequently, internal auditors must find ways to focus on matters of significance and areas of greatest risk, in order to get the most benefit from their resources. Internal auditors should:

- identify the most important business processes in their organizations to ensure that matters of importance are not overlooked;
- carry out ongoing analysis of risks and find opportunities for improvements to help ensure that audits are carried out in a timely manner and provide the greatest benefit; and
- develop an effective working relationship with operational managers to help ensure that their concerns are taken into account in the audit planning process.

7.47 The resources necessary to audit every activity in a department are not going to be available. To obtain the maximum benefit from increasingly scarce audit resources, internal auditors will need to find ways to monitor the activities of their organizations on a continuous basis, focussing on areas where the most significant risks lie. Internal auditors will need to make informed judgments about where risk is highest and, therefore, where audit resources should be directed to best advantage. They must also accept the

fact that resources will not be available to audit lower-risk areas, and must be able to tell management which areas of significant risk will not be audited.

Staffing and training

7.48 Our study of best practices showed that many organizations view an assignment with the internal audit group as an ideal training and developmental experience. Internal auditing involves carrying out reviews in all parts of the organization. It thus provides an opportunity to give employees with high potential a broad exposure to the organization's activities, culture, risk-management practices, and accountability and control environments. This type of broad knowledge of an organization is highly useful to those aspiring to higher-level management positions. Many internal audit groups we spoke to during our study of outside organizations told us that they recruited only promising, high-potential people. The average length of assignment ranged from two to four years. In several organizations, good people view internal audit as an important step in their career development, and management expects the function to develop future leaders for the organization.

7.49 Although our review showed that there are highly skilled, innovative and motivated professional auditors in departments, internal audit too often has been used as a place to relocate people without potential for advancement in other areas. At the same time, there has been a tendency to leave some people with potential in an internal audit unit for too long. In many instances, this practice has meant that people's skills have eroded and they have reached a point where they are of limited use in other parts of the department. Many consider that the bureaucratic processes for classifying and staffing positions in the government are one reason why internal audit has not been used effectively as a training and career-development mechanism. Although significant staff changes have occurred recently in internal audit, the staffing practices of the federal government are far behind those of leading organizations in the private sector. To staff internal audit with the types of people and the skills necessary to carry out the function effectively in the 1990s, change is required. It must be seen to be an area that provides career opportunities through training, career development, mentoring and on-the-job training.

7.50 Over time, a new approach to staffing that uses the training and development potential of internal audit will likely result in staff who bring a different mix of skills to their work. Staff with only technical audit skills will become less prevalent. By contrast, those with program-related knowledge, a broad management perspective and specialized skills such as information management and technology will become more common.

7.51 Training to provide staff who do not have an audit background with a knowledge of audit standards, principles and ethics and with the requisite technical audit skills will be essential.

7.52 We trust that with public service reform, ways can be found to build the career-development opportunities offered by internal audit directly into departmental management-development programs.

Responding to the challenges of computer technology

7.53 The rapid changes caused by the continuous introduction of new computer technology have made the internal auditor's job more complex. Typical computerized applications of the 1990s incorporate, and are developed using, advanced methodologies and techniques. These applications may be decentralized and may have distributed databases. Telecommunications is becoming an integral part of computerized applications and many of these will be designed in conjunction with the use of innovative technology.

7.54 In our study of best practices in internal audit, we saw examples of how developments in technology have increasingly affected internal audit. Most internal audit groups feel that, in order to fulfil their responsibilities in the information systems environment of the 1990s, they will have to change their audit approaches and use technology more and more to improve both their productivity and the quality of their audits. Internal audit in the federal government (as in outside organizations) has to understand information technology and be technically proficient in this area in order to review information systems, explore control issues and make meaningful recommendations.

7.55 Several departments operate large EDP systems that control the payment and receipt of billions of dollars, and they invest large amounts in systems development. We expected to find the internal audit function in these departments equal to the best in our study in terms of its knowledge of auditing in an EDP environment, because of the risks associated with the massive expenditures flowing through their EDP systems. However, we found that internal audit in the federal government has not met the challenge of playing an effective role in auditing these systems. In reaching this conclusion, we looked at the scope of audits of information systems, the staff qualifications for auditing these systems and the extent to which computer technology is being used as an audit tool in actually performing the audits.

7.56 We found that, in several departments, internal audit:

- did not provide adequate audit coverage of EDP systems;
- did not audit at the systems development stage;
- did not effectively use computers to improve audit productivity; and
- did not have the internal computer audit skills either to carry out major computer audits or to supervise the work of EDP audit consultants.

7.57 Significant improvement is needed to eliminate these weaknesses. Specifically, internal audit must acquire and maintain EDP audit skills and develop and use methodology for auditing computer systems. It must also learn to use technological tools to increase the productivity of its audits.

Reporting the results of audits

7.58 The standards for internal audit require that the audit report be concise, timely and complete, include only significant observations and make recommendations for improvement.

7.59 Our audit noted that the audit reports of most departments included in our sample contained numerous observations of little significance, were often issued long after the audit work had been completed and, on occasion, were not followed up to determine whether corrective action had been taken.

7.60 In contrast, the leading organizations in our study of best practices have a more constructive reporting strategy. The critical elements of such a strategy are:

reports that focus on solutions rather than elaborating on causes;
reports that are issued as soon as the audit is finished rather than months later; and
detailed reports that are directed only to those who have responsibility for the controls, systems or operations in question and who are in a position to make improvements.

7.61 Most departments can substantially improve the quality and timing of their reporting process. We believe that reporting practices need to be re-examined to ensure that they will be appropriate.

Measuring internal audit performance

7.62 The leading audit groups in our study of best practices have developed procedures and indicators for measuring their audit performance. They believe that both are essential to achieving continuous improvements in their own operations, and to carrying out audits that help to improve management practices in their organizations. Specific procedures and practices include obtaining feedback from managers being audited, setting performance targets and measuring and monitoring actual performance over time. Leading audit groups also compare their practices with those of other audit groups to identify "best practices" that can be adopted or adapted to improve their own operations. They also measure their employees' satisfaction.

7.63 Our present audit showed that government internal audit groups need to do a great deal of work to develop and apply appropriate indicators for measuring their performance. Virtually no internal audit group in government had a mechanism for measuring its performance on a continuing basis. Most groups did not even have an adequate time-reporting system. Few, if any, could demonstrate that they were improving their organization in any significant way. As a result, most departments cannot effectively hold internal audit accountable for the results achieved and for the way it uses its resources.

7.64 If internal audit groups are to strive for continuous improvement - both in using their audit resources to best advantage in their organizations and in assessing their own performance - they must have good performance information. Only with such information will they be able to demonstrate that they are contributing positively to the management of their departments.

Summary Comments

7.65 The Canadian government, like other governments throughout the world and major organizations in the private sector, is going through a period of restructuring and downsizing. The government efforts, such as the announcement of the Prime Minister on 25 June 1993 and earlier initiatives like Public Service 2000, are aimed at streamlining government structures, processes and systems. They are designed to make the public service less costly, more productive, more innovative and more service-oriented, while maintaining probity and prudence and strengthening accountability.

7.66 There is a need for a strong internal auditing capability. Internal audit can play an important role in helping to achieve these goals by independently reviewing management processes and information for decision making. It can provide assurance to senior management that "the business" is being conducted in a disciplined and efficient manner, that downsizing and the redesign of control processes and the elimination of non-productive activities are proceeding as planned. The reform process to date has not sufficiently emphasized the role internal audit can play in changing the way the public service is managed. This is a missed opportunity that has been seized by leading private sector companies, as well as by governments other than the federal government.

7.67 We believe that the three stakeholders, together, should move quickly to improve internal auditing. It is clear that the continuing relevance of internal audit is directly related to its ability to adapt to cultural change and to broaden its horizons. Successful internal audit units have to align their own philosophies and activities to parallel the changes taking place in their organizations. In our view, the necessary changes to internal audit are slowly happening. However, we are concerned with the rate of progress to date. We intend to closely monitor the government's progress in developing effective internal audit groups.

Comptroller General's response: *The expectations of and policy on internal audit in the federal government have changed substantially in recent years. However, to meet contemporary management needs and the challenges created by new ways of delivering programs and by the informatics revolution, further and rapid changes in internal audit practices are required.*

The work conducted by the Office of the Auditor General, in both identifying and communicating leading internal audit practices in private and public organizations, and challenging the government's current capacity to meet such practices, is welcome. Particularly important is its observation that effective, mainstream internal audit is a

product of teamwork involving commitment and leadership from departmental management, internal audit practitioners and central agencies.

While accepting that weaknesses must be addressed by departments and the Treasury Board Secretariat, we note that there are internal audit functions that meet departmental expectations consistent with the federal internal auditing standards. In addressing the weaknesses we will draw on the many excellent practices and innovations in a number of departments, those disclosed through the Office of the Auditor General's studies as well as those of central governments in other countries.

Internal audit in the federal government will continue to play a vital role both in its more traditional capacity of providing assurance on management systems and practices and in addressing re-engineering, productivity and governance issues. Canadian federal audit practice, in many areas, compares favourably with those of other national governments. Accordingly, we have a solid base upon which to build.

Chapter 8

Program Evaluation in the Federal Government

The Case for Program Evaluation

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Program Evaluation

Assistant Auditor General: Paul Ward

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Main Points

Program Evaluation in the Federal Government: The Case for Program Evaluation

8.1 The results from program evaluation provide an important measure of the value obtained from government programs and expenditures. The Government of Canada has formally required the evaluation of the effectiveness of its programs and policies for the past 16 years. By 1983 the system was in place. Development of the function over the past ten years has fallen short of expectations set for it, at a time when information on the effectiveness of government activities could prove to be particularly useful.

8.2 The function's potential to provide reliable analytic information has been recognized by many managers in government, and by Cabinet and Parliament. Evaluation of program results not only can provide information to improve management but also should provide essential accountability information within the public service and outside, to Parliament and the public.

8.3 Program evaluation was expected to meet needs for information: to support decision making about resource allocation; to help Canadians determine the value obtained with their tax dollars; and to enable public servants to take responsibility for results rather than process. Such information is urgently needed if decisions to deal with ineffective program expenditures are going to be made.

8.4 Our audit found that the story of program evaluation in the Government of Canada is one of high expectations and great potential that have been only partly fulfilled.

8.5 The system's results are often disappointing. Program evaluations frequently are not timely or relevant. Many large-expenditure programs have not been evaluated under the policy. Despite policy requirements for evaluating all regulatory measures, half have been evaluated, although other reviews have taken place in many departments.

8.6 The development of program evaluation over the last ten years has been primarily in departments' evaluation units. More progress is required in developing program evaluation systems that respond effectively to the interest in effectiveness information shown by Cabinet, Parliament and the public.

The Case for Program Evaluation

Introduction

8.7 Program evaluation is a disciplined assessment of government programs and activities. It is based on independent, systematic measurement and analysis, carried out to meet expectations set in policy and standards, and publicly reported. The first government policy requiring program evaluation was issued in 1977. It followed in a tradition of administrative reforms that attempted to link the systematic collection and analysis of information to improved public sector management. Six years after the first evaluation policy, our 1983 audit found program evaluation in place in most departments in the federal government. Over the next ten years, the development of the function took place largely in these departments rather than in the central agencies.

8.8 There were high expectations for program evaluation. It was expected to support key functions of government - allocation of resources, efficient and effective operations, and accountability reporting. In addition, program evaluation was expected to serve many different information needs, including those of managers of government programs, managers in central agencies, Parliament and the public.

8.9 Program evaluation is intended to have a strategic focus that periodically assesses the performance of policies and programs, providing results that can be used reliably by decision makers. Program evaluation involves applying systematic research methods drawn from many different disciplines to assess performance, particularly effectiveness. The evaluation results are presented in a report. By answering questions about what has been accomplished, program evaluation can provide an important measure of the value obtained from government programs and expenditures.

8.10 The government established program evaluation to identify whether its initiatives have been successful, whether they should be continued, or whether there are more cost-effective alternatives. The federal government is responsible for large expenditures on programs - with a budget of \$161 billion for 1993-94. The expenditures involve over 1500 components, each with its own objectives. In addition, the government has in place a large number of tax expenditures and selective tax measures that also have specific purposes. Program evaluation can be the source of objective information on the complex operations of government, and can provide a measure of the value being obtained.

Audit Scope and Approach

8.11 Our audit examined program evaluation in the Government of Canada. The purpose was to assess the government's success in implementing its program evaluation policy and to ascertain its progress since our last government-wide audit of program evaluation in 1983.

8.12 The audit included four areas.

We looked at effectiveness measurement in 11 major government program activities. Ten of these activities were examined as part of value-for-money audits carried out in the past three years. [Exhibit 8.1](#) lists the program activities, the departments and the years when our value-for-money audits were reported. Four of these activities involved shared responsibilities among departments (paragraphs 8.100 and 8.101). While representing a range of government programs, this is not a statistically drawn sample. In addition to the value-for-money audits, we examined the Department of Finance's revised approach to evaluating tax measures.

We audited the functioning and the evaluation output of 42 program evaluation units in departments across government that had reported completing at least one program evaluation from 1985-86 to 1991-92. The 42 units include all the larger federal departments except Treasury Board Secretariat, and a number of smaller agencies, departmental corporations and commissions. These organizations were responsible for almost all government program expenditures and major tax expenditures in fiscal year 1991-92.

We examined the management and operational activities related to program evaluation that the Evaluation and Audit Branch of the Office of the Comptroller General of Canada had carried out up to 31 March 1993.

We also reviewed reports and analyses describing program evaluation in other government jurisdictions outside Canada, to provide a comparative assessment of how evaluation has evolved in some other advanced industrialized countries.

8.13 Assessment of effectiveness can be both formal and informal. Informal effectiveness assessment occurs intermittently in the course of implementing a program, by way of operational trial and error and administrative problem solving. It is a partial assessment and usually is not recorded in any systematic way. It is frequently based on particular incidents or developments that have occurred, rather than on the overall operation of a program.

8.14 Effectiveness measurement in government can be found in various forms, including policy analysis, special studies, organizational reviews, and royal commissions. However, program evaluation is the instrument that the government has put in place and defined in policy that sets out standards and methodology for formal effectiveness measurement. This formalization can ensure that adequate attention is given to systematic measurement, that standards are maintained and that the results are used throughout government and made publicly available. While recognizing that program review can take several forms, government policy identifies program evaluation as the key form of disciplined review of program performance.

8.15 Program evaluation is the focus of the present audit. Evaluation takes a systematic approach to measuring the results of a program, with the objective of producing relevant and reliable information.

8.16 Since the program evaluation policy does not apply to Crown corporations, this audit does not include the evaluation of the effectiveness of these organizations. Chapter 4 describes how Crown corporations report on their own effectiveness.

8.17 The results of this audit examination are reported in three chapters. Chapter 8 assesses the potential that program evaluation holds for examining questions of effectiveness in the federal government. Chapter 9 examines the implementation of program evaluation in departments and the types of results produced. Chapter 10 examines progress in putting in place a system for program evaluation in the federal government, and some lessons from the experience of other governments.

Audit Criteria

8.18 The detailed audit criteria are set out in our audit guide on **Auditing of Effectiveness Measurement, Reporting and Use** . They are summarized in three main criteria contained in the guide:

Departments and agencies should measure and report effectiveness and these procedures should reflect the state of the art and be cost-justified.

The results of program effectiveness measurement should be considered for use in making decisions.

Departments and agencies should have an organizational capability and management practices to measure program effectiveness in an ongoing and/or periodic way.

8.19 Government has put program evaluation in place as the key form of disciplined review of a program's performance. The government's program evaluation policy is consistent with our audit criteria and sets out more specific requirements for government. For our examination we added a fourth criterion:

Government practice should conform to its policy for program evaluation.

Audit Observations

8.20 Our examination of the government's program evaluation function and the implementation of its evaluation policy produced the findings that follow.

Program Evaluation as an Essential Part of Government Management

8.21 Program evaluation has the potential to answer three pressing needs for information: first, to help make the decisions about resource allocation that could contribute to controlling the deficit; second, to help Canadians determine the value obtained with their tax dollars; and third, to enable public servants to take responsibility for results rather than process.

Program evaluation findings as a key tool in resource allocation decisions

8.22 The need for good effectiveness information is more urgent now than ever. In the 1990s, program evaluation should be seen as crucial to the management of government expenditures, because it can help to arrive at informed decisions aimed at controlling growth of the public debt. In addition, program evaluation provides useful information to Canadians about the effects of programs and what has been achieved with tax dollars at a time when taxes are taking a greater proportion of national income.

8.23 Canada has had large deficits for most of the last 20 years, resulting in a federal net debt of \$423 billion as of March 1992. There is widespread concern over this growing debt. Chapter 5 provides the results of a study by this Office on debt and deficit.

8.24 For more than a decade, the government has been concerned about restraining its spending. In successive years it has imposed reductions in the person-year and operating budgets of many departments. However, the reductions have not yet reduced the annual deficit significantly or slowed the growth in debt. At the same time, the government is under pressure to spend more on both domestic and international programs in response to issues like unemployment, environmental protection, increasing numbers of seniors, more expensive health care, and demands like peacekeeping and humanitarian aid. Reducing the deficit in the face of such demands calls for difficult choices about which programs should be funded and to what extent.

8.25 Many factors affect the decisions that ministers must ultimately make about programs. However, program evaluation can aid their decision making by providing objective and reliable information that will enable decision makers to identify programs that:

work well.

are no longer needed because of changed conditions.

do not make the desired difference because they are not reaching their objectives.

This may be because the programs do not accomplish what was expected, or because they have negative side effects that counterbalance the desired accomplishments.

can be replaced by other programs that will achieve the objectives more cost-effectively.

8.26 In some cases a program will be considered so important that it cannot be cut, even if its objectives have not yet been achieved. In such cases, evaluation can help by indicating elements of the program that should be carried over into the design of new measures. It can also indicate potential options that would be more effective at the same or lower cost.

8.27 In the present climate of restraint, the public wants better information on the achievements of government programs. Canadians see their taxes going up, and the proportion spent on actual government services has generally been declining. They are concerned about the way continually high annual deficits and growing debt will affect their standard of living and that of future generations. Program evaluation can inform the

public and Parliament about whether programs achieve the expected results, and thus help them judge the value obtained from government activities.

Evaluation findings as a necessary tool for managing results

8.28 Like the private sector, the public sector is seeking new ways to improve its operations by placing more emphasis on quality and on meeting the needs of its client groups. Cabinet is changing its structure and organization. Ministers and public service managers are also seeking to renew management as part of the reform initiative. To make organizational change effective, managers must be clear about what they are trying to achieve; learn from past experience; and make improvements.

8.29 An essential part of change is assessing what has been achieved, what has not been achieved, and what other, unanticipated, things have happened. Managers have to be committed to measuring results against a basis for comparison, such as objectives, and be prepared to identify what is not working and take corrective action.

8.30 The information produced and used by managers to bring about effective renewal can provide information for Parliament on the results of government operations. Such information supports Parliament's scrutiny of government operations.

8.31 Program evaluation is not the only form of results-based measurement available to managers. It is often used in conjunction with such measures of performance as resources used, efficiency of operations, and output produced. These measures can be useful but, alone, provide only a partial reading of success. It is evaluation that can bring all the relevant factors together to conclude whether accomplishments were adequate and cost-effective, and what changes are needed for significant improvement.

8.32 Program evaluation is an established tool that allows managers to study the strengths and weaknesses of their programs, how well they meet expectations and their cost-effectiveness. It requires a management culture that values the assessment that program evaluation provides, and that learns from it by making necessary changes and adjustments.

8.33 Government renewal initiatives aim to shift the emphasis in government activities from administration and control systems to achieving results in delivering programs and services. As part of this, authority for the day-to-day running of programs is to be deregulated and decentralized to managers who are then accountable for delivering results that meet established goals.

8.34 Instead of following prescribed procedures, managers will be expected to judge their best course of action, within the parliamentary control framework. This approach to management relies on measuring performance to ensure that the right things are being delivered in the right way. Managers will be expected to make these changes in a time of reduced budgets and increasing demand for services.

8.35 A management culture that evaluates programs and activities with the objective of improving efficiency and effectiveness is needed more than ever, at all levels of government management - in departments that deliver programs and services directly, in central agencies, and in the Cabinet itself. Such evaluations not only would improve management but also could provide essential accountability information within the public service and outside, to Parliament and the public.

Evaluation findings as a necessary tool for accountability

8.36 Government ministers are given responsibility for a wide range of diverse activities. They are obliged to report to Parliament on the way they have exercised their stewardship. Chapter 6 of our 1992 Report outlined principles for this stewardship reporting: an important component is accounting for the effectiveness of policies, programs and activities.

8.37 In the private sector, objectives are measured essentially in terms of profit, market share and return on equity. These are mostly reported in financial terms. They constitute the benchmarks against which a business's performance is measured.

8.38 In the public sector, financial accounts are also prepared. However, the nature and complex array of government activities do not lend themselves to the same profit-oriented measures of effectiveness used in the private sector, given that the goals of government programs are frequently stated in non-financial terms. Since effectiveness information is critical for managing these activities, other forms of measurement and reporting are needed.

8.39 Without such information, program managers, taxpayers and Parliament cannot know whether programs are achieving what was intended and what, if anything, has been changed as a result of implementing the program. Program evaluation can provide information and analysis to address these issues.

8.40 Under public service renewal, accountability for the use of public funds should focus on results, not simply on compliance with systems and procedures. Results will need to be measured - and program evaluation will be a necessary measurement tool.

8.41 Program evaluation's potential to provide reliable analytic information has been recognized by many managers in government, and by Cabinet and Parliament. However, our audit found that the story of program evaluation in the Government of Canada is one of high expectations and great potential that have been only partly fulfilled.

The Program Evaluation System in the Government of Canada

8.42 Since 1977, government policy has required the establishment of a capacity in federal departments to conduct program evaluation, and has required them to evaluate their programs. [Exhibit 8.2](#) provides an outline of the evolution of the government's evaluation system.

8.43 The federal government's requirements for program evaluation are set out in a central policy by the Treasury Board. The policy follows a two-pronged approach: self-evaluation by the departments responsible for implementing the programs; and a centrally led process that includes a framework for evaluation planning and priorities, technical assistance to departments in implementing studies, monitoring of the quality of evaluations undertaken by departments, and overseeing centrally requested evaluations.

8.44 Program evaluation studies are produced almost exclusively in departments. As described in Chapter 9, these studies are oriented to meeting the interests of departmental management. The central leadership of program evaluation, as described in Chapter 10, needs strengthening.

8.45 Departments expended a total of \$28.5 million on the program evaluation function in 1991-92, which included expenditures on 263 person-years. The expenditures also included contract budgets; operational and management expenses; and resources transferred to departmental evaluation units for specified evaluations. In a limited number of instances, program evaluations are also undertaken outside of the formal evaluation function. For example, the Canadian International Development Agency spends, through its geographic branches, approximately \$4.0 million annually in conducting evaluations of its projects, as described in Chapter 12.

8.46 The Evaluation and Audit Branch, reporting to the Comptroller General, is responsible for centrally led responsibilities. Approximately one half of the Branch's 32 person-years and \$2.9 million budget are committed, as of April 1993, to program evaluation-related duties. This amount is 33 percent lower than in 1991-92.

The policy requirements

8.47 In 1991, Treasury Board revised and reissued its policy on program evaluation. The revised policy calls for a more strategic approach, focussing the limited resources for evaluation on priority areas, where the need for information on the results that programs are achieving clearly justifies the cost of evaluating them.

8.48 Deputy heads of departments are accountable for implementing the program evaluation policy in their organizations. The policy requires that all programs or program instruments be considered for evaluation and that evaluations be carried out where they are material and cost-effective. It also requires that a senior manager, independent from line management, be assigned the responsibility for the day-to-day managing of evaluation.

8.49 The purpose of program evaluation, as set out in the policy, is to provide information on three basic evaluation issues, determining whether a program is:

Relevant: continues to be consistent with department and government-wide priorities and to address realistically an actual need.

Successful: is effective in meeting its objectives, within budget and without significant unwanted outcomes.

Cost-effective: is the most appropriate and efficient means for achieving the objectives, relative to alternative design and delivery approaches.

8.50 Program evaluation is meant to be used to confirm, improve or discontinue programs or program instruments. Management can use it to improve operations, make programming and budgeting changes, and provide accountability information. The policy expects the results of program evaluations to be available to Treasury Board Secretariat, Cabinet committees and Parliament.

8.51 The program evaluation policy is intended to apply government-wide, reflecting the need for reliable information to determine the "bottom line" results across the government's program activities. For evaluation purposes, a departmental program is any set of departmental activities directed to achieving common programming objectives. Departmental programs may involve one or more program instruments. [Exhibit 8.3](#) shows the list of instruments to which the government's program evaluation requirements apply. The policy also applies to the full range of departments, departmental corporations and other agencies as defined in section 2 of the *Financial Administration Act* .

Exhibit 8.3

Program Instruments

Types of program instruments that can be used for program delivery.

- direct services
- major Crown projects
- special operating agencies
- policies
- legislative provisions and regulation
- user charges
- selective tax measures

8.52 An important but frequently unused feature of the policy, as described in the Program Evaluation Policy Guidelines, is the requirement to develop evaluation frameworks. An evaluation framework sets out the plan to collect performance data as an activity is being implemented. Such data would provide ongoing measures of performance and much of the necessary information for planned evaluations.

8.53 In addition, the government's program evaluation policy specifies how the function is to be organized within the current structure of government - indicating the roles and responsibilities of both individual departments and the Treasury Board, including the Office of the Comptroller General, which has been merged into the Treasury Board Secretariat since July 1993.

8.54 The central agency functions located in the Comptroller General's Evaluation and Audit Branch include monitoring and providing quality assurance on departments'

evaluations of their own programs so that users may have confidence in evaluation findings for decision-making purposes. The Comptroller General is also required to report to deputy ministers and the President of the Treasury Board on program evaluation performance across government. In addition, the Evaluation and Audit Branch is responsible for co-ordinating departmental evaluation planning with the needs of Treasury Board and other Cabinet committees for information on program performance, and for overseeing any evaluations undertaken for Cabinet committees.

Examples of the issues examined by evaluation

8.55 The results from program evaluations should provide information on whether the programs are achieving their objectives. Some objectives are stated in terms of meeting the needs of clients, for example, in programs established for seniors, farm safety nets, and worker retraining. Other objectives are stated in terms of desired program effects on industries, regions, communities, groups and individuals.

8.56 Examples of the types of information that can be provided by program evaluation are presented in Exhibits 8.4 and 8.5. [Exhibit 8.4](#) illustrates examples of issues that can be addressed in evaluating energy megaprojects. In response to the recommendation in our 1992 Report (Chapter 14, paragraph 14.78) that the Department of Energy, Mines and Resources evaluate the effects of the energy megaprojects, the Department is considering these issues in planning the evaluation.

Exhibit 8.4

Energy Megaprojects

Examples of Effectiveness Indicators - Energy Megaprojects (EMR).

Megaprojects Objectives: Official statements of intended results include: regional development; technology transfer; economic diversification; increased oil supplies; financial returns to Canada.

Examples of Related Effectiveness Indicators

Number of jobs created

Cost per job created by megaprojects versus other regional development assistance measures

Cost-effectiveness of megaprojects in developing additional oil reserves

Reduced dependence on federal-provincial equalization payments

Number of jobs created as a result of technology transfer

8.57 [Exhibit 8.5](#) shows the kinds of issues addressed in a program evaluation of the Cape Breton Investment Tax Credit.

Exhibit 8.5

Cape Breton Investment Tax Credit (CBITC)

Examples of Effectiveness Indicators - Cape Breton Investment Tax Credit (Finance).

CBITC Objective: To promote productive durable employment in Cape Breton by encouraging new investment in the region.

Examples of Related Effectiveness Indicators

Additional number of jobs created in the region as a result of CBITC

Cost per job created vs cost of other regional development measures

Reduction in regional unemployment disparities

Value of new investment by private industry as a result of program

Reduced employment benefits because firms use program's capital assistance to pay for new machinery to replace workers

8.58 As the examples indicate, there is a wide range of possible effects - both direct and indirect - where information is needed. This entails measuring not only positive effects but also any negative and unintended effects. For example, programs aimed at encouraging additional investment activity (such as the Cape Breton Investment Tax Credit) may end up supporting firms that would have undertaken the activity anyway, without government assistance. Such effects would be unintended but must be taken into account in arriving at an overall net assessment of the program's results.

Stakeholder Interest

8.59 The main responsibility for the operations of the Canadian government's program evaluation system is with deputy heads. They are responsible for ensuring that program evaluation is conducted in their departments. Since few program evaluations have been carried out by the central agencies of government, it is essentially the line departments that are concerned with evaluating whether government program expenditures are achieving their objectives. Yet our audit found that there are interests beyond the immediate concerns of line departments that are not consistently being met by program evaluation.

Cabinet interest in program evaluation

8.60 Based on information made available to us by the staff of the Comptroller General, Cabinet has maintained an ongoing interest in program evaluation information for more than ten years. On average, requests for evaluation studies were identified about ten to twenty times a year. The Comptroller General's staff did not have available a measure of compliance with these requests.

8.61 Aside from requests for special studies, Cabinet has also turned to program evaluation from time to time with broader requests to assess the effectiveness of programs. For example, in 1985 the Ministerial Task Force on Program Review referred

to program evaluation as a source of information to make extensive recommendations on government programs.

8.62 The Task Force examined a wide range of existing government programs and had two major objectives - better service to the public and improved management of government programs. Among the areas where it sought advice were cases of duplication among programs, programs that might be eliminated, and programs whose scope could be reduced. The Task Force indicated that it had made significant attempts to assess programs based on the findings in program evaluation reports from departments. However, as a user of program evaluation information, the Task Force found the material provided to them by government evaluators did not satisfy their needs.

8.63 Cabinet also turned to program evaluation to provide feedback on the results of regulatory programs. The government's comprehensive statement of federal regulatory policy in its 1986 Regulatory Process Action Plan placed priority on reforming ineffective or economically counterproductive regulations. To achieve this goal, all regulatory programs were to be evaluated for efficiency and effectiveness at least once every seven years.

8.64 Based on estimates of the total regulatory activities in government, our audit of the evaluations produced by departmental program evaluation units (Chapter 9) estimated that only about 53 percent of regulatory activities had been evaluated during the period 1985-86 to 1991-92. Government has turned to other review mechanisms to assess the effectiveness of many of its regulatory programs (see Chapters 25, 26, 27) despite the policy obligations placed on program evaluation.

Growth in parliamentary committee interest in program evaluation

8.65 In parallel with a growing interest among the Canadian public in the results of government expenditures, parliamentary committees have shown increasing interest in using evaluations in their scrutiny of government budgets and programs.

8.66 In its 1991 Report on the Program Evaluation System in the Government of Canada, the Senate Standing Committee on National Finance said that "a more systematic use of program evaluation findings could provide the National Finance Committee with a powerful approach to its reviews of the Estimates and, in particular, could enable it to make concrete proposals for improvements to government programs." However, the current system did not adequately provide the information the Committee felt was required.

8.67 Since 1986, the Public Accounts Committee (PAC) has also demonstrated a strong interest in evaluation as a way of obtaining specific information on the effectiveness of expenditures, particularly of tax expenditures. In its 26 June 1986 Report to the House, the Committee recommended that the Department of Finance develop a comprehensive program evaluation capability and ensure that all tax expenditures be subject to program evaluation.

8.68 More recently, the PAC stepped up its interest in program evaluation by requesting a range of evaluation studies on issues that it considered of pressing importance. For instance, in 1991 the Committee directed the Department of Finance to evaluate specific tax measures, including the Goods and Services Tax and the new tax treatment of retirement savings. The Department modified its evaluation plans to take into account the Committee's request. In 1993 the Committee asked the Department of Employment and Immigration to submit a detailed calendar of its evaluation work program.

8.69 Finally, in 1993 the Sub-committee on Regulations and Competitiveness of the House of Commons Standing Committee on Finance proposed changes aimed at giving Parliament a greater role in evaluating regulatory measures. Program evaluation under the Treasury Board policy was viewed largely as an aid to top managers in departments rather than an aid to Parliament. The Sub-committee recommended that standing committees in each subject area undertake reviews of regulatory programs. It said that one of the ways these reviews could be triggered was by the completion of a program evaluation. The committee felt that systematic program evaluations are a necessary step in moving toward improved accountability and more rational decision making about regulations.

Central agency interest in program evaluation

8.70 The formal responsibilities of the Secretary of the Treasury Board and the Comptroller General are set out in the policy on program evaluation. The approach they have taken to implementing evaluation is to focus on issues at the departmental level and to rely on initiatives in the departments to meet the interests of the various stakeholders in evaluation.

8.71 The Comptroller General approached his responsibilities for program evaluation by developing and communicating an evaluation policy, providing advice on plans and providing guidance on evaluation methods, procedures and standards. The policy and supporting standards and methodologies provide a sound basis for the conduct of program evaluation in government. We used them as criteria in our audit. The concerns that we identify in Chapters 9 and 10 are related, in large part, to how these policies and standards have been implemented.

8.72 The Comptroller General provided professional development for the program evaluation community and actively promoted program evaluation throughout government. However, his staff acted primarily as a facilitator and co-ordinator, relying on persuasion rather than specific direction. We found no examples of program evaluations conducted or led by Treasury Board Secretariat and/or the staff of the Comptroller General since our last audit in 1983.

8.73 We also found that Treasury Board decisions seldom provided departments with the impetus to undertake program evaluations. In 1989-90, for example, Treasury Board issued a total of 2243 decisions, many of which relate to strictly administrative matters. In only 18 cases did it request program evaluations or approve resources in support of evaluation.

8.74 By 1993, departments had complied with ten of the 18 requests. In three of the eight cases where no evaluations had been produced, evaluations were no longer considered by departments to be required. In the remaining five, evaluations either were under way or were to be undertaken later.

Demonstrated Potential for Providing Good Effectiveness Information

8.75 The findings of some individual program evaluation studies demonstrate the system's potential to provide sound effectiveness information on both strategic and operational issues. Our audit of the evaluations of selected programs found some well-supported findings contained in evaluation studies, which identified savings, led to informed management decision making and supported accountability. The following paragraphs give some examples of what evaluations have achieved.

8.76 Identified potential cost savings and increased cost-effectiveness. The Department of Transport completed an evaluation of its Canadian Coast Guard Search and Rescue activity in 1993. The evaluation looked at, among other things, the costs and benefits of the more than 70 vessels that the Coast Guard devotes primarily to search and rescue. These range from small inshore rescue boats to large cutters. The evaluation found that the costs of the six largest vessels more than equalled the costs for the entire remaining fleet (\$35.6 million compared to \$32.2 million). Yet these large vessels accounted for fewer than ten percent of the lives saved by the primary fleet from 1988 to 1990. On 1 March 1993, the Deputy Minister of Transport approved a recommendation that the Coast Guard consider decommissioning these 600-class vessels, or give them assignments apart from search and rescue to contribute to their cost-effectiveness.

8.77 Found initiative not cost-effective. The Department of Finance's evaluation of the Cape Breton Investment Tax Credit estimated that the amount of investment qualifying for the tax credit was \$2.1 billion. Of this amount, however, the evaluation assessed that only 19 percent at most (or about \$400 million) was incremental - that is, would not have been invested in Cape Breton without the 60 percent tax credit. The results of the study contributed to the decision to discontinue the tax credit.

8.78 Helped improve cost-effectiveness and service to clients. The Department of Employment and Immigration's Job Development Program is designed to assist workers who are experiencing employment difficulties, by providing a combination of formal training and direct job experience. It has a number of options to which applicants may be assigned. The evaluation found that the relatively inexpensive Job Finding Club is a cost-effective initiative. It also found that the program has helped social assistance recipients, particularly males in the Severely Employment-Disadvantaged option, to find jobs. These and other related findings on the relative effectiveness of various options for specific types of clients will enable program officers to make better judgments when assigning clients to projects. Another finding was that projects with private sponsors are more effective than those with public sector sponsors. New program directives will emphasize the use of private sector sponsors where appropriate.

8.79 Identified consequences of change in policy. The Department of Finance's evaluation of tobacco taxes indicated that, in the short run, a ten percent increase in the real price of cigarettes would lead to a nine percent decline in their consumption. However, consumption would later climb back, to some extent. The evaluation also developed a technique to measure unintended side effects of the impact of taxes on smuggling: a ten percent increase in tobacco taxes would lead to at least a ten percent increase in the amount of tobacco exported - an amount apparently destined to be smuggled back into the Canadian market. For instance, the evaluation concluded that the market for smuggled tobacco cost the federal government between \$555 million and \$695 million in foregone revenues in 1991.

8.80 Assessed savings resulting from a project initiative. An evaluation of the Locomotive Rehabilitation Program (Pakistan Railways), conducted by the Canadian International Development Agency, found that the total savings from the rehabilitation of 42 locomotives of Pakistan Railways was about \$21.6 million. This figure was based on a comparison with the alternative of purchasing new locomotives, and took into account the shorter working life of the rehabilitated engines.

8.81 These specific examples demonstrate the potential of evaluation for providing reliable information to serve a range of information needs. Unfortunately, the quality demonstrated in these evaluations is not found consistently across the system.

Unfulfilled Expectations

Inconsistent delivery of essential information

8.82 Program evaluation is oriented primarily to meeting the needs of departmental managers. As Chapter 9 shows, much of this evaluation effort is directed to smaller activities and toward operational questions, with the result that reliable evaluation findings on major government programs and activities are not always available in a timely manner.

8.83 In the 11 major programs where we examined effectiveness measurement, we found that evaluation did not consistently produce timely and relevant studies important to support decision making in program development or to provide ministers and Parliament with accountability information on major expenditures.

8.84 For example, in the case of the Agricultural Safety Net Programs (Department of Agriculture), there was a lack of timely evaluation findings available when major program redesign was under way. There were also problems with late timing in the evaluations of the Petroleum Incentives Program and the Canadian Exploration and Development Incentives Program (Department of Energy, Mines and Resources), and the Canada Pension Plan Retirement Benefits (Department of National Health and Welfare). In the case of the Specific Claims Program in the Department of Indian Affairs and Northern Development, at the time of our audit little evaluation had been undertaken although the program had been in operation since the early 1970s. The Department has since indicated that it is proceeding to evaluate this program.

Need to turn to other sources of effectiveness evaluation

8.85 Program evaluation is described in policy as "the key form of disciplined review of the performance of programs." Effectiveness studies outside of program evaluation do not fall under the requirements of the established policy and the standards for quality and reliability.

8.86 In the 11 programs we examined, we asked program managers how they determined the program's effectiveness. We found that program evaluation was the most commonly used form of effectiveness study. In five of the 11 programs, however, managers turned to select special studies for input to policy development.

8.87 Special studies were undertaken instead of program evaluation (or instead of updating out-of-date program evaluations) to arrive at important program decisions, in such cases as the redesign of the Agricultural Safety Net Programs by the Department of Agriculture and the phase-out of the Petroleum Incentives Program by the Department of Energy, Mines and Resources. Managers also turned to Service Line Reviews in the Department of Supply and Services; and to the Royal Commission on the Ocean Ranger Marine Disaster, conducted in 1986, which examined search and rescue activities.

8.88 Given the policy requirement to evaluate regulatory programs, we expected major programs in these areas to be evaluated on a priority basis. The government's Regulatory Process Action Plan called for all regulatory programs to be evaluated for efficiency and effectiveness at least once every seven years, a requirement that was partially met (see paragraph 8.64).

8.89 A number of significant areas in regulatory activities, such as medical devices, atomic reactor regulation, atomic fuel facilities and material, and frontier oil and gas lands administration were not evaluated under the policy but were reviewed, in whole or in part, by other mechanisms that do not provide the same assurance on consistency of approach. The government may wish to consider including these reviews as part of the evaluation process. As noted in paragraph 8.69, the House of Commons Sub-committee on Regulations and Competitiveness indicated in 1993 that program evaluations should be playing an important role as part of any wider review process to be undertaken.

Often incomplete coverage of tough evaluation questions

8.90 We examined how well evaluations of the 11 government programs addressed each of the issues of cost-effectiveness, program success and program relevance.

8.91 Consistent with findings reported for all program evaluations (See Chapter 9, paragraph 9.63), in only about half of the programs did evaluations deal with program relevance and cost-effectiveness. Even then, the evaluations often did not examine key questions about the programs' relevance. In most of the programs, evaluations examined program success. However, even when evaluation addressed all three issues, the treatment, in our opinion, often was incomplete. Evaluation issues important to providing

a balanced assessment of the program were not included. These are often tough questions, but essential to challenging whether a program should continue.

Uneven quality of analysis reduces credibility and usefulness

8.92 Evaluators are expected to develop and apply methodologies appropriate to the evaluation issues included in the scope of their studies. This enables them to produce valid and reliable findings to support their conclusions. Inconsistency in the reliability of the data reduces confidence in the usefulness of evaluation measurements. We examined the quality of evaluation in the 11 programs we audited and found it to be uneven. Even within a given study, the reliability of the findings was not consistent. We identified only two programs that had been evaluated consistent with standards of quality.

8.93 We have already noted that we found certain aspects of evaluation measurement that were well done and that provided important information on program results. Such findings provide a demonstrated potential for what the evaluation function can achieve when it produces work of quality.

8.94 However, we also found instances of studies that produced results of questionable reliability. Inconsistent quality reduces users' confidence in even reliable results.

8.95 For example, the evaluation of the 1987 Special Canadian Grains Program, in conjunction with the *Western Grain Stabilization Act*, by the Department of Agriculture (see our 1991 Report) concluded that the program had proven to be very effective because total payments from both safety net programs to farmers resulted in 75 percent of them having an income greater than they would have had in 1985 (pre-trade war). However, these data also raise the possibility that the cost to the government may well have been significantly higher than necessary. The Department did not attempt to assess this possibility.

8.96 Elsewhere, in the evaluations of Selective Tax Measures undertaken by the Department of Finance, the conclusions of the evaluation study of the Disability Tax Credit concerning the average out-of-pocket expenses covered by the tax credit are, in our opinion, of questionable reliability. This is particularly with respect to measuring the tax credit's effects in compensating severely disabled individuals. A full description of the assessment of the evaluation and the Department's response was provided to the Public Accounts Committee in April 1993.

8.97 Further, in National Health and Welfare's evaluation of the New Horizons program for seniors, we found shortcomings in sampling and in information collection. This program provides many small grants to seniors to alleviate loneliness and promote social activities. Part of the evaluation methodology involved a survey of a sample of project directors rather than typical participants, who were not surveyed. As a result, the methodology used in the program evaluation cannot support the evaluation's conclusion that the initiative had a positive effect on the lives of seniors.

Lack of systematic approach to multidepartment evaluations

8.98 In our 1983 government-wide audit of program evaluation, we noted that no procedure was specified for conducting evaluations of programs that involve more than one department. Heads of evaluation, at the time, were uncertain about how to proceed and what their responsibilities were. The result was that multidepartment programs were not subject to the same systematic evaluation scrutiny as programs administered wholly within single departments. We recommended that the government improve procedures to ensure that these multidepartment programs are identified and periodically evaluated, where reasonable and appropriate to do so.

8.99 Our present audit found that, ten years later, the government has not yet implemented a systematic approach to multidepartment evaluations. In four of the 11 programs we examined, the issue of multidepartment evaluations was considered important. In all four cases, partial evaluations had been undertaken; there was still no adequate government procedure in place to provide an overall assessment of the effectiveness of the programs.

8.100 In the case of government measures to support public and private pension provisions, the Department of Finance and the Department of National Health and Welfare undertook separate evaluations. The National Health and Welfare study considered the anti-poverty effectiveness of Old Age Security and the Guaranteed Income Supplement, whereas the Finance study analyzed the distributional effects of the pension system. In the case of the Department of Supply and Services Acquisition program (government procurement), the Department recognizes that it evaluates only a portion of the program's effects in achieving national objectives such as regional development. Treasury Board's Procurement Review Policy co-ordinates evaluation responsibilities for the achievement of national objectives through procurement. In particular, the Department of Industry, Science and Technology has the lead responsibility for evaluating industrial and regional development objectives. No overall evaluation of the program's national objectives has been done to date, although evaluation is planned.

8.101 Elsewhere, in the case of the *Special Import Measures Act (SIMA)*, National Revenue - Customs and Excise evaluated the operational aspects of the program. The Department of Finance is responsible for the policy of the program. At the time of our audit, due to ongoing trade negotiations, which will have policy implications, the Department of Finance had not yet completed an effectiveness study. The Department indicated that it will intensify its work toward this end as the outcome of the negotiations becomes clear. Similarly, for search and rescue activities the main departments involved, such as National Defence and Transport, individually have undertaken evaluations focussing on their own activities. However, there has been no comprehensive evaluation of the overall effectiveness and cost-effectiveness of the government's search and rescue activities over the past ten years.

8.102 The division of responsibilities among departments for a single program places special requirements on the government to ensure that there is an approach in place to identify multidepartment programs and periodically evaluate them in a comprehensive

way. Such a requirement needs to be taken into account as part of an improved approach to planning, as described in Chapter 10.

Lack of priority given to evaluating large-expenditure programs

8.103 With increasing concern about the level of debt and deficit, and Parliament's expressed interest in having effectiveness information on government programs to assist it in the scrutiny of budgets, it would be expected that larger program expenditures would be of particular concern for evaluation. This has not been the case.

8.104 We reviewed continuing government programs with expenditures in excess of one billion dollars. These are the kinds of programs that we expected would receive priority attention for evaluation. In 1991-92, there were 16 programs whose expenditures totalled \$124.5 billion (see [Exhibit 8.6](#)). Only two of the programs had been evaluated fully. We considered a program to have sizeable evaluation coverage if a sizeable number of its significant components were assessed or if, in our opinion, some important evaluation questions, but not all, had been addressed. We determined that about one third of the programs had sizeable evaluation coverage. The remainder had received limited or no evaluation.

8.105 For the Maritime Forces program, the Department of National Defence evaluation plans showed limited evaluation for the period under review, while more evaluation was done for Land Forces. However, the Department indicates that, since the Canadian Forces are unified and there is an integrated Canadian Forces/DND organization, the common service activities of the major programs (Maritime, Land and Air) are assessed through all the evaluations undertaken.

8.106 [Exhibit 8.6](#) presents the coverage by program evaluations under the Treasury Board Policy. Not included are other studies or reviews such as the 1986 Commission of Enquiry on Unemployment Insurance.

8.107 Of the six programs that had sizeable evaluation coverage, the evaluations of three, in our view, included a sufficient share of components to be considered sizeable evaluations. The evaluations of the remaining three programs considered to have sizeable evaluation coverage addressed some important program issues but not all. For example, in the Employment activities, evaluations of most of the elements were undertaken but did not provide an assessment of their contributions to the objective of the whole program: to promote the effective and efficient functioning of the labour market.

8.108 Some action is being taken to fill some of these gaps. The Department of Finance has started an evaluation of its debt management program. In October 1992, it completed the first year's report on the debt management evaluation (the first phase of a series of planned reports) and submitted it to the Public Accounts Committee in December 1992. This was in response to our recommendation in 1988 and subsequent requests from the Public Accounts Committee. It is also undertaking a review, jointly with provinces, of programs such as Fiscal Equalization and Stabilization Payments arrangements, as part of the formal review process announced in the 1991 Budget to examine the need for reform

of the system of major transfers to the provinces. The Department of Employment and Immigration is undertaking an evaluation of Unemployment Insurance Benefits.

8.109 Further, the Department of National Health and Welfare has indicated that it is now conducting an evaluation of a portion of the Health Insurance Contributions program and the Canada Pension Plan. The Department of Finance has begun an evaluation of the reform of tax assistance for retirement savings. In addition to completing an evaluation of the Bureau of Pension Advocates, the Veterans Affairs Portfolio approved an evaluation assessment (a plan for the evaluation) of the Pension Program in 1991 and is in the process of completing this evaluation report.

8.110 With programs such as Post-secondary Education, Fiscal Equalization and Stabilization, and Health Insurance Contributions, new mechanisms involving close consultation and co-operation with provincial governments may need to be developed to ensure that the gaps in evaluation coverage are filled. The Department of Finance is of the opinion that existing consultative mechanisms are sufficient for evaluation purposes.

Government approach to planning evaluations

8.111 We found significant shortcomings in the overall approach to planning (see Chapter 10). The shortcomings result from not clearly identifying priority areas for evaluation, and not following through to ensure that the capacity to respond is in place and that quality studies are produced on a government-wide basis. Further, the overall requirements are expected to be met by individually developed plans, as described in Chapter 9.

Conclusions

8.112 At the time of our 1983 government-wide audit, essential features of the system of program evaluation were found to have been put in place. The development of evaluation has been largely in departments. As a result, the system is oriented more to meeting the requirements of departmental managers than those of government central agencies, ministers or Parliament. Little progress has been made in providing information to these important stakeholders, at a time when information on the effectiveness of government activities could prove to be particularly useful.

8.113 The program evaluation policies, standards and methodologies were designed to provide effectiveness information to departmental program managers as well as to Parliament, ministers and central agency managers. However, the focus has remained almost exclusively on the departmental units. The shortcomings in the system are not in the policy and supporting guidance, but in the approach to implementing them. The will to make the system work more broadly appears to be lacking.

8.114 The commitment to effective program evaluation requires collecting and analyzing information on the performance of programs, and making decisions in light of this information. Program evaluation provides the capacity to bring together information

gathered as part of program management with information from other sources, to present a complete picture of the continuing effectiveness of a program.

8.115 Government is faced with difficult questions about the effectiveness of its programs and expenditures. Great urgency is attached to many of these questions. Program evaluation can provide sound information to help find the answers to these questions, but considerable improvement needs to be made to increase the usefulness of evaluation. We have made specific recommendations in Chapter 9 to improve the operation of departmental evaluation units. Other recommendations are directed to the Treasury Board Secretariat and staff of the Comptroller General in Chapter 10.

Chapter 9

Program Evaluation in Departments

The Operation of Program Evaluation Units

Main Points

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Audit Scope and Objectives

Audit Observations

- Evaluation Infrastructure
 - The resources allocated to program evaluation are declining
 - Evaluation managers emphasize supporting departmental management
 - Not all departments plan systematically
- Evaluation Outputs
 - The number of program evaluations is declining
 - Low evaluation coverage of program expenditures
 - Program evaluations focus on smaller units of government activities or programs
 - Program evaluations focus on matters related to operational effectiveness
 - Evaluation studies are less likely to evaluate questions of the relevance and cost-effectiveness of programs
- The Use of Evaluation Studies
 - Findings from program evaluations are relevant mostly to the operational effectiveness of programs
 - The use of program evaluation frequently cannot be demonstrated
 - Where used, evaluations contribute most often to operational decisions or improving program understanding
 - Use of evaluations increases with senior management involvement
- Savings Resulting from the Use of Evaluation Studies
 - Limited savings from evaluation studies confirm potential
- The Management of Program Evaluation Units
 - Quality of evaluation studies needs improvement
 - Need to improve management practices

Conclusion

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- 9.1 A Common Form of Organization for Program Evaluation
- 9.2 Expenditures on Program Evaluation – All Departments 1989-90 – 1991-92
- 9.3 Expenditures on Program Evaluation in 19 Departments, 1982-83 – 1991-92
- 9.4 Program Evaluation Planning Criteria Used by the Department of Finance
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Program Evaluation

The Operation of Program Evaluation Units

Assistant Auditor General: Paul Ward

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Main Points

Program Evaluation in Departments: The Operation of Program Evaluation Units

9.1 In 1991-92, only \$28.5 million was spent on program evaluation across all federal government departments. Yet program evaluation is charged with considering for evaluation all the programs and activities of government. It evaluated about one quarter of government expenditures from 1985-86 to 1991-92, far short of original expectations that all programs would be evaluated over five years. Regulatory programs were all to be evaluated over seven years, but about 53 percent actually were. The program evaluation capability established by the federal government in the early 1980s is still in place, but its strength is declining. Fewer resources tend to produce fewer studies.

9.2 Program evaluation is located in departments and is the responsibility of the deputy heads. Priority has been given to meeting the needs of departmental managers. As a result, evaluations examine smaller program units or lower-budget activities and focus on operational performance. They are less likely to challenge the existence of a program or to evaluate its cost-effectiveness.

9.3 The government's use of program evaluation studies often is difficult to demonstrate. Although the savings from program evaluation have been small overall, a few individual studies have led to significant savings. However, deputy heads seldom have used evaluation to carry out studies that could lead to significant savings.

9.4 Management of individual units in a number of departments should be improved and be better integrated into the management of the department. Some units demonstrate good practices. These units are integrated into the management of their departments and support the operational interests of deputy heads.

Introduction

9.5 The government system of program evaluation relies almost exclusively on the units in departments to provide evaluation studies. The Comptroller General and the Secretary of the Treasury Board set out policy and methodology to guide and support the work of these units.

9.6 The policy requires departments to carry out program evaluations. The deputy heads are accountable for the planning, conduct, and reporting of program evaluation studies. In placing the responsibility with deputy heads, Treasury Board expected evaluation results to be produced for, and used by, senior managers.

9.7 The 1991 Treasury Board policy on program evaluation requires that departments establish an infrastructure headed by a senior manager who is independent from program operations and responsible for the conduct of evaluations for the department. Conducting high-quality evaluation studies requires an adequate budget and appropriate professional evaluation resources. Decisions on the strength of the evaluation function, the programs to be evaluated and the evaluation questions to be addressed are made in departments, under the direction of the deputy head.

9.8 In addition to developing the evaluation policy, the Comptroller General has provided *Working Standards for the Evaluation of Programs in Federal Departments and Agencies*, and other guidance on conducting evaluations. The Comptroller General publishes newsletters and occasional papers discussing innovations in evaluation methods and practice.

9.9 Our Office carried out government-wide examinations of program evaluation in 1978 and 1983. The 1978 study found few successful attempts at program evaluation. By 1983, we found that departments had made considerable progress in establishing an infrastructure and building the capacity to carry out evaluations. Deputy ministers found evaluations useful but felt it was too early to assess their cost-effectiveness.

9.10 Our 1983 audit identified a number of areas for improvement. We observed that the government initially encouraged the use of study findings in the ongoing management of programs, in order to develop experience and enhance the credibility of program evaluation with management. In response to the audit, the government confirmed its aim to ensure the production of relevant and reliable information on the performance and relative cost-effectiveness of programs. Its main approach would be to integrate program evaluation into the improving management practices in each department.

Audit Scope and Objectives

9.11 The overall objectives of our government-wide audit of program evaluation are described in Chapter 8, paragraph 8.11. This chapter examines the operation of program

evaluation in departments. Our purpose was to assess the implementation, products and use of program evaluation in departments and the progress made since 1983. Specifically, we examined:

- evaluation infrastructure - the resources dedicated to evaluation and the way it is organized;
- the products of evaluation units - the scope and quality of evaluation studies;
- the uses made of evaluation studies, and the associated savings; and
- the management of program evaluation units.

9.12 The Comptroller General's staff monitors the performance of program evaluation units and maintains a database of performance information, including information on program evaluation resources, products, use and contribution to cost savings. In January 1992 they surveyed evaluation units to update their performance information. After consultation with our Office, they designed the survey to meet their own data requirements and to support the information needs of our audit.

9.13 We contacted each program evaluation unit included in the survey, to confirm and supplement the information we obtained from the Office of the Comptroller General. Based on this work, we constructed an expanded database that provides the basis for our audit observations and conclusions. Included were 42 evaluation units that are responsible for evaluating most of the program expenditures and tax measures of government.

9.14 In conducting our examination, we:

- interviewed the heads of evaluation units about the structure, role, planning and management of program evaluation;
- obtained documentation to confirm data from the Office of the Comptroller General on program evaluation resources, the uses made of evaluations and the cost savings resulting from program evaluation;
- reviewed program evaluation reports completed between 1 April 1985 and 31 March 1992 to assess the scope of the studies and the format of the reports; and
- obtained additional information on the activity structure and expenditures in the departments concerned.

9.15 Statistical analyses were used to identify patterns in the data as a basis for our conclusions. These analyses were conducted on the data for all departments combined. The conclusions and recommendations therefore apply to program evaluation units overall. Estimates of savings and use of evaluations reflect our judgment based on material provided to us during the audit. In one department we did not obtain final concurrence on the estimate of savings to be entered into the aggregate analysis. However, this would not have changed our conclusions.

9.16 Our 1983 government-wide audit of program evaluation examined the organization and management of program evaluation units and the planning, conduct, reporting and

use of program evaluation studies in 19 departments. We compared our 1983 findings with information about the same 19 departments obtained during the present audit, to assess how the function has changed over time.

Audit Observations

Evaluation Infrastructure

9.17 There were 42 active program evaluation units that made up the system of federal program evaluation and that were monitored under the Treasury Board policy. These units spent \$28.5 million on program evaluation in 1991-92 and included all major departments, with the exception of Treasury Board Secretariat. There was little change in the number of evaluation units between 1983, when 41 departments and agencies had established a basic structure for program evaluation, and 1991-92.

9.18 Most evaluation managers report to directors general or assistant deputy ministers who are also responsible for internal audit or some other management function, such as corporate planning.

9.19 Program evaluation and internal audit increasingly are managed jointly. A common arrangement is to have a director general managing an audit and evaluation division with separate audit and evaluation units, as is the case in the Department of Agriculture (see [Exhibit 9.1](#)). Approximately half of the program evaluation units have adopted some form of this arrangement since 1989-90.

Exhibit 9.1

A Common Form of Organization for Program Evaluation

The Program Evaluation Division, Department of Agriculture

In fiscal year 1991-92, the Program Evaluation Division used just over nine person-years on evaluation activities and expended \$197,700 dollars on contracts for program evaluation.

Since April 1993, the Director, Program Evaluation reports to the Director General, Audit and Evaluation, who in turn reports to the Deputy Minister of Agriculture through the Associate Deputy Minister. Although the Division co-ordinates its activities with internal audit by way of a common planning document, the two functions are resourced separately and rarely undertake joint studies.

Between 1985-86 and 1991-92, the Division produced 36 program evaluation studies. Evaluation activities are based on a three-year plan and a separate, more detailed annual plan. Plans and evaluation studies are approved by the Departmental Management Committee - Policy, a committee of senior departmental officials chaired by the Deputy Minister.

9.20 Even though program evaluation and internal audit often are jointly managed, their work remains distinct. The two groups operate under independent standards and policies of Treasury Board. (Additional detail on internal audit can be found in Chapter 7.) Only a few studies are carried out jointly by internal audit and program evaluation units.

9.21 Consistent with Treasury Board policy, program evaluation managers are independent of program responsibility centres and report to the deputy head, often through senior managers with other administrative responsibilities.

9.22 The Department of Finance has implemented an organizational approach where the management responsibility for evaluation is independent of policy development but evaluators can be drawn from the policy areas. The Department undertook this reorganization in an effort to deploy its resources in the most efficient and effective way.

9.23 The Department of Finance was the only major department in 1983 without an evaluation unit. The Tax Measures Evaluation Division was established in 1987, in response to concerns of the House of Commons Standing Committee on Public Accounts and this Office about the need for effectiveness information on tax expenditures. When the Department of Finance subsequently announced its new approach to evaluation in 1991, there was concern that it would not maintain its capacity to evaluate tax measures.

9.24 However, we found that the Department has maintained a capability to carry out evaluations, although it dedicates fewer resources to them and places greater reliance on contracting. The Department has confirmed its commitment to evaluate tax measures in a systematic way. Because the new organizational arrangement has been in place for only a short time, our audit conclusions on the efficacy of the new approach are preliminary. The evaluation function under the new approach is being closely monitored by the Public Accounts Committee and this Office.

The resources allocated to program evaluation are declining

9.25 The ability to carry out program evaluations depends on the availability of professional evaluators and staff, supplemented by contract resources. Treasury Board guidance suggests that departments take full advantage of the benefits of professional evaluation resources outside the government, such as those in private sector consulting firms, university-based institutes and consulting groups, and public policy advisory groups.

9.26 Overall, there has been a loss of resources allocated to program evaluation. Based on the 19 departments audited in 1983, in-house staff has been reduced, initially offset by increased contracting resources. Later there was a reduction in contract dollars.

9.27 Expenditures on contracts for program evaluations in all departments decreased significantly from 1989-90 to 1991-92, by 28 percent. In-house staff levels were unchanged over the same period (see [Exhibit 9.2](#)). However, total program expenditures have not decreased over this period. Thus, the work to be accomplished has not decreased, but the ability to carry out evaluations using contract resources has declined.

Exhibit 9.2
Expenditures on Program
Evaluation - All Departments
1989-90 - 1991-92

	1989-90	1991-92	Reduction	% Change
Person-Years	263	263	0	0.0%
Contract \$(millions)	11.8	8.5	3.3	-28.0%

Exhibit 9.3
Expenditures on Program
Evaluation in 19 Departments
1982-83 - 1991-92

	1982-83	1989-90	1991-92
Person-Years	168	152	154
Contract \$ (millions)	3.3	6.5	4.0

9.28 A reduced ability to carry out evaluations results from the reduction in contracting resources and from changes over the past ten years in the expertise required of the function. In 1983, we noted the need for uniquely trained professionals who are knowledgeable about government and trained in evaluation. We had found a number of program evaluation units where the number of staff with program evaluation knowledge and skills was insufficient.

9.29 In the 1980s, program evaluation managers came to rely more on outside consultants than on in-house staff to carry out evaluations. In our comparison group of departments from the 1983 audit, in-house evaluation staff declined from 1982-83 to 1989-90 by ten percent. At the same time, expenditures on contracting nearly doubled, from \$3.3 million to \$6.5 million. Between 1989-90 and 1991-92, however, contract resources decreased without a compensating increase in staff resources. Contracting levels in 1991-92 for these 19 departments were closer to 1982-83 levels (see [Exhibit 9.3](#)). Greater reliance was placed on contractors in the 1980s. The need is changing from contract management to conducting in-house evaluations, with fewer people.

Evaluation managers emphasize supporting departmental management

9.30 Locating program evaluation units in departments and agencies gives more immediacy to the needs of departmental managers than to broader government or public interest in evaluations. We discussed the role of program evaluation with all 42 heads of program evaluation units.

9.31 Evaluation managers attached the greatest importance to helping management resolve operational issues and improve programs. They placed a much lower priority on the role of evaluation in challenging existing programs to support resource allocation decisions, and on evaluating large program units to support accountability to Parliament.

9.32 Consistent with their desire to assist program managers, many evaluation managers viewed non-evaluation work as important to establishing the credibility of the function and fostering the use of evaluation findings. Evaluators can contribute usefully to other departmental management processes. Because of the pressure on evaluation resources, we asked evaluation managers to estimate the amount of their resources that were used in other management activity. A quarter of evaluation managers had difficulty distinguishing between evaluation and non-evaluation work and documenting the effort devoted to non-evaluation activities.

9.33 Managers of 33 program evaluation units indicated that evaluation resources were sometimes allocated to a variety of work whose focus was not effectiveness measurement. Such work included reviewing program management and operations, participating in policy and program development and analyses, and providing technical support such as statistical analysis.

9.34 Less than ten percent of total expenditures for program evaluation in 1991-92 went to non-evaluation work. The estimate includes departments where program evaluation resources were combined with resources for other functions, such as audit and corporate review. As an average figure this should not be a concern, but in individual cases it can be as high as one third of evaluation resources, which would mean that far fewer evaluations could be carried out.

Not all departments plan systematically

9.35 Almost all managers responsible for evaluation in departments prepare evaluation plans for the deputy head. However, not all prepare multi-year plans and only 17 do multi-year plans along with a separate annual plan. The program evaluation policy calls for multi-year plans to be submitted to the Comptroller General for his information. Plans are generally respected.

9.36 Program evaluation is to address priority concerns where it can make the greatest contribution. Evaluation plans are vital in allocating scarce resources to a range of potential evaluation projects that can involve lead times of up to two years.

9.37 In the 11 major program activities where we examined effectiveness measurement (described in Chapter 8, paragraph 8.12), we found that departments do not always undertake a systematic analysis of the full array of their programs to select the most suitable candidates for effectiveness measurement. Planning considerations might include a concern with activities involving large amounts of money (expenditures, revenues, or tax expenditures), requests from Parliament and Cabinet, or major policy and program initiatives.

9.38 An example of a reasonable attempt at systematic planning was that of the Department of Finance in its first three-year evaluation plan. Although the second three-year plan did not follow the same rigorous approach, the Department subsequently reaffirmed its commitment to evaluate tax measures systematically. The Department is

sharing its plans with the Public Accounts Committee and has made changes in the plans at the Committee's request.

9.39 The Department of Finance's first plan developed a basic list of program components and undertook a systematic analysis for selection purposes, based on a set of seven criteria (see [Exhibit 9.4](#)). By this means the Department was able to establish a planning process that took into account a range of competing considerations when allocating scarce evaluation resources among programs. Applying criteria of this type can provide a risk analysis of the consequences of not evaluating particular programs.

Exhibit 9.4

Program Evaluation Planning Criteria Used by the Department of Finance

Tax Evaluation, Department of Finance

Planning Criteria:

1. Sunset clauses and the issue of program termination
2. Potential controversial issues (including requests from Parliament)
3. The budgetary level involved
4. The availability of other effectiveness studies and analysis in the program area
5. The potential usefulness of the evaluation for developing future studies
6. Potential replacement programs
7. The need for information on lessons learned for future programs.

9.40 Three of the other departments we examined also have developed their own criteria for selecting and/or scheduling program components to be evaluated (National Defence, Employment and Immigration, and National Health and Welfare).

9.41 Improvements can be made in a number of departments in planning to allocate scarce evaluation resources to areas of greatest priority. Although the basis for establishing priorities can vary by department, specifying the basis for selecting areas to evaluate makes choices and priorities explicit.

9.42 The decisions on the areas to be evaluated and the types of studies to be undertaken are made in each department under the direction of the deputy head, with limited central direction. Major changes in the operation of the evaluation function in departments cannot be made without the support of the deputy head. Evaluators and evaluation managers are responsible for implementing the plans and producing the evaluation studies.

Evaluation Outputs

The number of program evaluations is declining

9.43 Program evaluation units provide a number of different outputs, including advice to managers, evaluation frameworks, evaluation assessments and evaluation reports. The evaluation reports are one of the most visible outputs, since they are to be used outside departments as well as inside. Treasury Board requires that these reports be written and presented clearly, in anticipation of an external readership.

9.44 Evaluation reports can vary widely with respect to such factors as complexity of the issues evaluated and methodologies used. Often they are written too technically to be easily understood by the general reader. As a measure of output, the number of reports produced does not take into account the variation in their content or quality, but does indicate the volume of the primary product being produced by decreasing program evaluation resources. Even if other evaluation products were to increase, it is important that the flow of reports be maintained, as they reflect the completion of evaluation studies and the reporting of their findings. Evaluation managers were asked to show us the studies they had completed. Our estimates are based on the sum of the studies we were shown in the course of our audit.

9.45 The number of program evaluations completed each year has been declining since 1987-88, as contracting resources have declined. In 1987-88, program evaluation units produced 99 reports, compared with 80 in 1991-92. (see [Exhibit 9.5](#))

Low evaluation coverage of program expenditures

9.46 The decision on what and how much to evaluate in each department is the responsibility of the deputy head. The 1977 Treasury Board policy suggested that departments evaluate each program at least once every three to five years, so that 100 percent of program expenditures would be evaluated over five years. This proved to be an unachievable target. The revised 1991 policy suggested that all programs be considered for evaluation within six years. It would be reasonable to expect a level of evaluation across government that demonstrated a clear commitment to implementing the intent of the policy.

9.47 The revised policy requires that all programs be considered for evaluation, although evaluations should be carried out only where material and cost-effective. There are requirements for evaluation associated with Treasury Board decisions, Increased Ministerial Authority and Accountability (IMAA) memoranda of understanding with Treasury Board, and other policies such as the Regulatory Process Action Plan, as described in Chapter 8. That policy, for example, required that all regulatory programs be evaluated every seven years.

9.48 We found that evaluation studies conducted over a seven-year period covered approximately 24 percent of the government's program expenditures in 1991-92. If expenditures on servicing the national debt are included, only 18 percent of expenditures

were covered in seven years. Evaluation coverage can be estimated in different ways. Our estimates are based on best estimates, agreed by managers, of expenditures evaluated as a proportion of budgetary expenditures reported in the Public Accounts.

9.49 As a test of responsiveness to the 1986 general regulatory policy requirement, we examined the evaluation coverage of regulatory activities. We estimate that 53 percent of regulatory program expenditures have been evaluated over seven years. Although this estimate is higher than the overall rate of coverage of 18 percent to 24 percent, it falls far short of the policy requirement that all regulatory programs be evaluated. Revised 1992 Treasury Board policy restates the requirement to determine the effectiveness of regulatory programs, but is less specific in its requirements for coverage.

9.50 Program evaluation studies have examined a comparatively small proportion of government expenditures. The extent of coverage of other significant areas, such as the regulatory programs, did not meet policy requirements. Government has frequently turned to other review mechanisms, such as special studies, regulatory reviews or royal commissions, rather than to program evaluation. These mechanisms often have other objectives in addition to measuring program or policy effectiveness, as illustrated in Chapter 13 on the implementation of the Agri-Food Policy Review.

Program evaluations focus on smaller units of government activities or programs

9.51 In 1983 we found that, in drafting evaluation plans, departments focussed on smaller programs or less difficult aspects of larger ones. In some cases, the evaluation of larger and more complex programs was deferred. We found in the present audit that the focus continues to be on smaller program units.

9.52 Government programs are organized into activities and sub-divisions of activities for planning, budgeting and reporting purposes. The same activity structure is reflected in aggregate form in the Estimates submitted to Parliament and in the accompanying Part III accountability reports. The smallest program unit reported is typically the sub-activity.

9.53 Program evaluation results could support parliamentary scrutiny of the Estimates. However, ideally those results would need to relate to the reporting units in the activity structure. Of the 610 program evaluations completed from 1985-86 to 1991-92, 533 evaluated a portion of the activity structure. The remaining evaluations examined departmental operations or other matters that could not be attributed to a part of the activity structure, such as evaluations of governing legislation. We found that 75 percent of evaluations looked at program components much smaller than the sub-activity. As a result, the conclusions of these specifically focussed studies would be of only limited use for broader-based accountability reporting to Parliament.

9.54 Even when evaluations cover all the sub-units of an activity, the understanding of the total program that they provide can be incomplete, as illustrated by the evaluations of Employment activities in the Department of Employment and Immigration, described in [Exhibit 9.6](#). These evaluations responded to the needs of departmental management but not to parliamentary interest in the overall effectiveness of the program. Program

evaluations at the sub-activity level or below provide only a partial assessment of the total activity's effectiveness.

Exhibit 9.6

Evaluation Coverage of Sub-activities at Employment and Immigration

Employment and Immigration - Employment Activities

In 1992, we reported on performance monitoring of Employment activities at the Department of Employment and Immigration, with expenditures of \$3.25 billion. We observed that evaluations were generally restricted to components within sub-activities, although the 40 evaluation reports covered most of the Employment activity. The studies did not provide a comprehensive basis for considering their overall contribution to the program objective of promoting the effective and efficient functioning of the labor market.

9.55 Another measure of a program's size is expenditure. We found that programs and activities with larger expenditures receive less evaluation attention than those with smaller expenditures. The rate of coverage of programs with expenditures of over \$250 million is less than half that of programs spending \$250 million or less (see [Exhibit 9.7](#)). Yet programs with expenditures of over \$250 million account for 78 percent of total federal government program expenditures. Because of its focus on smaller program expenditures, program evaluation is not addressing the effectiveness of the bulk of government expenditures.

Program Size (1991-92)	Percentage of Program Budgets Evaluated (1985-86 - 1991-92)	Number of Completed Evaluations*
Over \$250 million	18.2%	18
\$0 - \$250 million	46.9%	480

Exhibit 9.7
Proportion of Program
Expenditures Evaluated

* Includes only those evaluations that addressed a portion of the department activity structure and for which the required resource information was available.

Program evaluations focus on matters related to operational effectiveness

9.56 The policy statements and guidance on the conduct of evaluations set out the basic issues that program evaluation studies are expected to address. These issues, set out in 1981, were simplified and redefined in the 1991 revised policy as follows:

- Relevance (formerly Program Rationale): Does the program make sense?
- Success (formerly Impacts and Effects and Objectives Achievement):
What happened as a result of the program? Has the program achieved what was expected?
- Cost-effectiveness (formerly Alternatives): Are there better ways of achieving the results?

9.57 Not all program evaluations are required to address all these issues. The selection of the issues examined is determined in the planning stage, and should be strongly influenced by the nature of the program or activity being evaluated and by the expected use of the evaluation results.

9.58 We reviewed all program evaluation reports completed from 1985-86 to 1991-92, to determine whether operational issues had been addressed and which basic evaluation issues had been evaluated. Operational issues would include the suitability and efficiency of the program's day-to-day operations, rather than the program's results.

9.59 Operational issues are a major focus of program evaluations. We found that over three quarters of evaluations addressed operational issues as part of the evaluation.

Evaluation studies are less likely to evaluate questions of the relevance and cost-effectiveness of programs

9.60 We would expect the focus on particular evaluation issues to vary, depending on the anticipated use of the evaluation. If the use was to challenge the future of a program, the focus would tend to be on questions of relevance (does the program make sense?) and cost-effectiveness (are there better ways of achieving the same results?) However, if the intended use was to provide program understanding and accountability information, the focus would tend to be on questions of success (what has happened as a result of the program and has it achieved what was expected?)

9.61 We identified the basic evaluation issues that appeared in the terms of reference for each evaluation, or that appeared to be reported in the evaluation conclusions or recommendations.

9.62 Attention to questions of program relevance has decreased since 1983. Three quarters of the studies we examined in 1983 addressed relevance, while the same departments addressed this issue in just over half of the studies they completed from 1985-86 to 1991-92. This trend is consistent with the focus on operational issues and is away from challenging policy effectiveness.

9.63 Overall, of the three basic evaluation issues, evaluation studies were most likely to address questions of success. Close to 80 percent examined issues of success to some extent, while about half the evaluations sought to determine whether there were cost-effective alternatives and just over half whether the program was still relevant (see [Exhibit 9.8](#)). Program evaluations in departments are directed even less than in 1983 to challenging the future direction of programs rather than examining past performance.

The Use of Evaluation Studies

Findings from program evaluations are relevant mostly to the operational effectiveness of programs

9.64 The results of program evaluation are expected to serve different stakeholders who have different information requirements (see Chapter 8). Affected by technical feasibility

and limits of time and budgets, evaluations inevitably are selective in the questions they address and the topics selected for examination. The type of information produced by evaluation studies indicates which of the potential uses described in the evaluation policy they can serve. We would expect evaluations to provide information to support:

accountability, by examining questions of program success;
program and policy decision making, by examining questions of continued relevance and cost-effectiveness; or
operational effectiveness, by examining questions of program delivery, such as quality of service to clients and their assessment of programs.

9.65 We examined the program evaluations for the 11 programs we audited to assess whether the information provided was relevant to program/policy decision making, accountability to Parliament and operational effectiveness, and whether the studies provide reasonable, partial or adequate information. To provide useful information, not only do the relevant evaluation issues need to be covered but the information presented needs to be reasonably complete.

9.66 We found that evaluation is less likely to be an important source of information in support of program and policy decisions addressing questions of continued relevance and cost-effectiveness. Evaluations are more likely to provide information for accountability purposes but it is often partial.

9.67 The most complete information available is related to operational effectiveness, the way a program is working. This information is useful for administering programs and supporting government initiatives to reduce red tape and streamline regulations. It also can assist in refocussing the day-to-day management of programs to achieve results. The program evaluation of the *Special Import Measures Act* demonstrates the usefulness of this type of program evaluation. Yet the impacts and effects of the program have not been measured (see [Exhibit 9.9](#)).

Exhibit 9.9

Example of Operational Modifications Resulting from Program Evaluation

Special Import Measures Act

The *Special Import Measures Act (SIMA)* is Canada's codification of anti-dumping and countervail rules. As of March 1992, existing anti-dumping and countervail cases involved approximately \$2 billion of domestic goods and affected over 10,000 jobs.

The Department of National Revenue - Customs and Excise evaluated the administration of *SIMA* in 1988. The study examined operational issues, and the Department used the results to improve program administration. The Department has, among other actions, implemented a public information strategy and streamlined enforcement efforts between headquarters and the regions. At the time of our audit, due to ongoing trade negotiations, which will have policy implications, the Department of Finance had not yet completed an effectiveness study. The Department indicated that it will intensify its work to this end as the outcome of the negotiations becomes clear.

The use of program evaluation frequently cannot be demonstrated

9.68 Deputy heads are responsible for having evaluations conducted and using the resulting information to confirm, modify or recommend major reforms of programs or to discontinue them. We would expect to find evidence that program evaluations are used by senior managers for any of these three purposes.

9.69 We examined 168 studies where uses had been identified in the January 1992 survey by the Comptroller General, or by departments during our examination.

9.70 We asked departments to provide documentary evidence in support of the evaluations' primary uses, and we sought to confirm whether the evaluations had contributed to program termination, reform or modification, or had led to improved understanding of the programs. Departments at times found it difficult to provide documentation at the standard we required within the time frame of the audit. [Exhibit 9.10](#) sets out our criteria for use. Documentation was still being provided as long as 11 months after our initial request.

Exhibit 9.10

Criteria for Demonstrating Evaluation Use

Confirming Evaluation Use

To confirm use we asked for one or more of the following:

Specific recommendations

Management's response in:

- action plans
- audit and evaluation committee decisions
- program proposals
- organization charts
- departmental budget documents

Reference to the evaluation in:

- Main Estimates - Part III
- interviews or correspondence with program managers

9.71 Applying the requirement to provide evidence demonstrating the use of studies, we were able to confirm the uses identified by the departments or by the Comptroller General's staff for 53 percent of the evaluations. This figure underestimates the overall use, in that we did not seek confirmation of uses other than those suggested by the Comptroller General or departments. Neither were we able to recognize the informal sharing of information that occurs as part of the evaluation process, and the input of evaluators into management decision making after a formal evaluation is completed. Still, when so much of the value gained appears to be shared informally, it is difficult to be

certain how useful the evaluations are for providing information to others outside the departments.

Where used, evaluations contribute most often to operational decisions or improving program understanding

9.72 Program evaluations for which we found documented confirmation of use contributed most frequently to improved understanding of the programs and to program modifications (see [Exhibit 9.11](#)). In 20 percent of the evaluations we examined, departments provided evidence of operational changes made to improve program delivery, often in ways not visible to program clients. To confirm the use of the evaluation, we sought evidence that the program evaluation had clearly recommended or identified program changes, that it was a factor considered by management in changing the program and that the changes had actually occurred.

Type of Use	% of Studies
Program Termination	1
Program Reform	9
Program Modification	20
Program Understanding	23
<hr/>	
Total Confirmed Use	53 %
Total Number of Studies Examined	168

Exhibit 9.11
Primary Use of Evaluations
 1989-90 - 1990-91

9.73 For another 23 percent, we obtained documents confirming that the departments had used the evaluation findings to promote better understanding of the programs, by reporting findings in Main Estimates Part III or by some other mechanism. No specific changes were made to these programs as a result of the evaluations, but program evaluation resulted in a better understanding of the programs and their rationale among line managers and clientele, and in better information for reporting on program performance. We did not attempt to identify any further benefits associated with improved understanding.

9.74 A much smaller proportion of the studies we examined were confirmed as having contributed to significant reforms, producing major changes to program delivery. These changes were visible to program clients and reoriented the programs. Few evaluations resulted in program termination.

Use of evaluations increases with senior management involvement

9.75 We examined further the evaluations that clearly had been used, to determine what factors were associated with greater use. Evaluations that dealt with operational questions were the most likely to have a demonstrated use. We observed that 62 percent of studies that addressed operational issues had a demonstrated use, compared to 34.5 percent of studies that addressed only other issues.

9.76 Long-range planning for program evaluation allows a department to look ahead and make strategic choices about the focus and timing of evaluations. Adequate follow-up procedures help ensure that appropriate actions are taken on any decisions the deputy head makes as a result of the evaluation. Evaluations are more likely to have a demonstrated use if there is a multi-year plan for program evaluation in place ([Exhibit 9.12](#)).

9.77 We also found indications that evaluations were more likely to have a demonstrated use in departments where a senior-level committee, such as an audit and evaluation committee or an executive committee, monitored the implementation of evaluation findings. All departments have some form of follow-up procedure. However, 14 departments do not have follow-up by a committee of senior managers. Follow-up that includes a senior committee, such as an audit and evaluation committee, provides the basis for closing the loop with senior managers who are also responsible for approving evaluation plans. Closer integration of program evaluation into the senior management process in the department was associated with demonstrable use of evaluation.

Savings Resulting from the Use of Evaluation Studies

9.78 Program evaluations are used at times to modify programs or, in a few cases, to reform them in ways that result in savings. Program evaluation can also be used to confirm the value of programs. Although program evaluations are not necessarily designed to result in savings, they can produce findings that can result in significant savings. Program evaluation managers were asked to provide confirmation of cost savings identified by the Comptroller General as a result of evaluations completed during the period 1986-87 to 1991-92. Some program managers identified additional examples. We sought to confirm the cost-savings estimates with supporting evidence that would link an evaluation study with management action that resulted in savings. Most program evaluation managers do not attempt to maintain information systematically on savings resulting from evaluation studies. The estimates included both savings resulting from program terminations and the reallocation of resources from one program to another or within a program.

Limited savings from evaluation studies confirm potential

9.79 Because of the lack of documentation on savings and on the results of evaluation studies in many departments, we were able to confirm in only 17 of the 39 examples provided that evaluations contributed to savings. Most of these savings were under \$5 million. Total savings for the period 1986-87 to 1991-92 were estimated at \$212 million. However, a large proportion of this figure was accounted for by one classified study, at the Department of National Defence. In some instances, including the single study associated with larger savings, the studies were only one factor contributing to a decision that resulted in cost savings. The one study demonstrates the contribution that program evaluation can make to large program savings.

9.80 Our audit of effectiveness measurement in 11 government programs identified another form of saving not included by the Comptroller General. The Department of

Finance's 1990 evaluation of the effects of the Cape Breton Investment Tax Credit was instrumental in the decision not to renew this measure, which involved more than \$500 million in tax revenue foregone during the period it was in effect.

The Management of Program Evaluation Units

Quality of evaluation studies needs improvement

9.81 The 1983 audit found that a substantial number of the evaluation studies had significant weaknesses in the methods used to carry out planned work, particularly with respect to measuring program effectiveness. As reported in Chapter 8, we continue to identify weaknesses in the methods used to conduct evaluations. We examined the quality of evaluations in the 11 programs we audited and found it to be uneven. Even within a given study, the reliability of the findings was not consistent.

9.82 Evaluators are expected to develop and apply methodologies appropriate to the evaluation issues included in the scope of their studies. This enables them to produce valid and reliable findings to support their conclusions. Inconsistency in the reliability of the data reduces confidence in the usefulness of the evaluation.

9.83 Decisions affecting the quality of individual studies are made in the departments. It is increasingly accepted that the most cost-effective approach to achieving quality is to build it into the product instead of relying primarily on after-the-fact quality assurance. We found that insufficient attention has been paid to building quality into evaluation products.

9.84 In addition, Treasury Board guidelines made the Comptroller General responsible for quality assessment across the evaluation system. His staff is required to assess the quality of key evaluations and the quality of departmental evaluation practice against standards. We also found that, in carrying out his quality assurance responsibilities, the Comptroller General has not clearly identified and reported difficulties in meeting standards of quality.

9.85 Staff of the Comptroller General did not assess the quality of key evaluations against the working standards. Rather, they produced summaries. These summaries were a source of information for liaison officers' assessments of departments and for their database on the program evaluation function. Staff of the Comptroller General feel that, through their participation in steering and advisory committees for key evaluations, they provide regular input on evaluation quality. Given the difficulties we identified with a number of evaluations, we believe a more systematic approach to quality assurance should be taken by the staff of the Comptroller General, as described in Chapter 10. This approach would be consistent with the requirements of the policy.

Need to improve management practices

9.86 In many departments, steps are needed to improve management practices with respect to program evaluation. Some evaluation units are stronger than others. All

program evaluation managers and deputy heads responsible for program evaluation need to be sure that their units maximize their contribution to meeting departmental needs and, as noted in Chapters 8 and 10, to government-wide initiatives.

9.87 With limited evaluation resources, only a select number of evaluations can be carried out. Criteria need to be established that set out the basis for selecting evaluation topics and areas for examination as part of other strategic and performance planning. If departmental units are to contribute to government-wide concerns, in developing plans they should give greater attention to evaluating programs with larger expenditures and evaluating larger program units. As part of departmental planning, the link should be made between the government's strategic requirements and the interests of the evaluation managers. Programs should be selected for evaluation so that evaluations add value to departmental and overall government effectiveness.

9.88 Deputy heads should ensure in planning that all activities are considered for evaluation and that criteria for selecting areas for evaluation are clearly set out and followed. They should also ensure that evaluations address the more significant departmental issues, as well as government priority areas, in a timely manner.

9.89 The Comptroller General has provided guidance on integrating evaluations into senior management decision making in departments. Guidance, rather than policy direction, offers suggestions on past practices that have proven beneficial. In particular, our audit supports the importance of senior management commitment, demonstrated by involvement in the systematic planning of evaluations on a multi-year basis, in monitoring the implementation of evaluation recommendations and in following up on corrective action. Regular departmental audit and evaluation committee meetings, chaired by the deputy heads, can ensure that priority issues are evaluated and findings acted on. The departments that implemented these practices were better able to demonstrate greater use of evaluation studies.

9.90 Deputy heads should be involved in approving and ensuring the use of multi-year evaluation plans, monitoring the implementation of evaluation recommendations and following up on corrective action.

9.91 We had difficulty confirming the uses and cost savings claimed for program evaluation studies. Managers of program evaluation in many instances were not able to provide clear evidence to demonstrate the effectiveness of their outputs. Monitoring by a central group of the Comptroller General's staff cannot be expected to serve as a substitute for this individual management responsibility. We found few systematic approaches in place to provide a basis for evaluation managers to assess the performance of their units, both to improve their management and to account for their own responsibilities.

9.92 Program evaluation managers should put in place mechanisms for objectively assessing and demonstrating the value obtained from the evaluation efforts of their units.

9.93 All users of evaluation results want to be assured that they can rely on the evaluation findings. It is the responsibility of evaluation managers to take appropriate steps to build quality into their evaluations. Some managers have used advisory committees, others have used specialists on contract, and others have used peer review. The Comptroller General has a role in quality assurance for a limited number of key evaluations, but evaluation managers ultimately are responsible for the quality of their products.

9.94 Program evaluation managers should ensure that they have the required management processes in place to build quality into their evaluation products.

9.95 The infrastructure to carry out evaluations has been in place since the early 1980s. Over time, the function is evolving. The ability to produce high-quality evaluation studies depends, to a great extent, on the skills of professional evaluators - either on staff or on contract. For a time, reliance was placed on outside contractors to carry out evaluations. Now, increasingly, in-house staff will be required to conduct the evaluations themselves. This represents a significant change in their responsibilities and raises a question of whether the required professional skills are available.

9.96 Deputy heads and program evaluation managers should assess the skill requirements of their evaluation units against existing staff skills to ensure that the required professional capacity is in place, and take appropriate steps to fill identified gaps.

Conclusion

9.97 Questions are being raised about the cost-effectiveness of many support functions in government. Program evaluation has demonstrated that its studies can contribute to the review, modification and reform of government programs, and can contribute to savings. However, deputy heads have not fully exploited the potential of the function.

9.98 The resources dedicated to program evaluation are relatively small - both staff and contract resources - in proportion to the expenditures they are to evaluate. Further, these comparatively modest resources are dispersed across government departments. The outputs from the investment also are comparatively modest. The units in departments are primarily directed to supporting the evaluation interests of deputy heads and senior departmental officials. These units are not working equally well. Although a few strong units in government produce quality studies that respond to the interests of the deputy head, others need to improve.

9.99 The program evaluation system at present relies on results from program evaluation units in departments. Yet in meeting departmental requirements, the interests of other stakeholders have not been met well, as shown in Chapter 8. With its focus on operational issues and informal process, the contribution of evaluation in departments has not been sufficiently impressive to prevent the loss in evaluation capacity over the past seven years.

9.100 There are limits to how much can be accomplished, with the current resources, by changing the practice of evaluation in departments. The challenge is to respond to other stakeholders' needs for improved effectiveness information, as shown in Chapter 8. Evaluation units in departments can play an important part but will require additional interest and support, as described in Chapter 10.

Chapter 10

The Program Evaluation System

Making it Work

Main Points

Introduction

Audit Scope and Approach

Audit Observations

- Strengths to Build on
 - A system in place
 - The standards to be achieved are in place
 - Experience of other countries with program evaluation
- Strengthening Evaluations through External Review
 - Different approaches to external evaluation or review
 - Need to improve external review in the Canadian federal government evaluation system
- Being Part of the Mainstream
 - Proximity to major government initiatives in other countries
 - Need to strengthen the link to expenditure decisions in Canada
 - Need to establish government-wide planning of program evaluation
- Strengthening the Leadership of the Function
 - The need for a strong focal point
 - Building demand among stakeholders
 - Responsiveness to specific parliamentary requests
 - Responsiveness to recommendations for improvements in the evaluation of specific programs

Conclusion

Exhibits

10.1 The Evaluation System in the Commonwealth of Australia

10.2 The Evaluation System in the United States of America

10.3 The Evaluation System in the United Kingdom

Program Evaluation

Making it Work

Assistant Auditor General: Paul Ward

Responsible Auditor: Maria Barrados

Main Points

The Program Evaluation System: Making It Work

10.1 Program evaluation is at a crucial stage. Although there are examples of success, it has not developed fully into an effective government-wide system. Strong leadership and greater effort are needed to improve the quality and relevance of evaluations, to meet information requirements outside of departments and to change the management culture toward insisting on the availability and use of broad-based effectiveness information.

10.2 The essential components of a program evaluation system are in place. But improvements need to be made in the coverage, relevance and reliability of program evaluations.

10.3 For the evaluation system to work effectively, key evaluations carried out by evaluation groups in their own departments need formal outside review and assessment, to ensure objectivity.

10.4 The relevance and timeliness of evaluations are enhanced if they are linked into the major decisions and initiatives of government related to resource allocation, program and policy reviews and accountability reporting. These links need to be strengthened.

10.5 Improvement is needed in monitoring and quality assurance by the Comptroller General. Improvement is also needed in the information provided to parliamentarians on the results of evaluations.

10.6 Although the program evaluation system has not responded well to the general requirements, evaluation units have responded to departmental needs and to specific requests by the Public Accounts Committee. Evaluation managers have also taken corrective action in response to specific audit recommendations.

10.7 If the present approach cannot be made to work through reform, Parliament may wish to consider more radical solutions to obtaining timely, relevant and reliable effectiveness information.

Introduction

10.8 Program evaluation is at a crucial stage in its development. Although there are examples of success, in the main it has not lived up to its potential, particularly in meeting expectations beyond those of operational management in departments. In addition, the government is gradually losing the capacity to do evaluation because of reductions in the resources available for it. These reductions come at a time when the effectiveness of current expenditures is becoming a major concern: there is a shift toward a more results-oriented public service and a growing public interest in holding government accountable for its performance.

10.9 In Chapter 9 we identified a number of areas for improvement in the operation of departmental program evaluation units. Action in these areas would significantly improve the functioning of part of the program evaluation system. The changes would not address other aspects of the overall system that can make an important difference to its effectiveness.

10.10 A number of recent examinations of the government program evaluation system have noted the need for corrective action and have identified specific factors that can make an important contribution to its success. Successful change can take place only by addressing how the system can be organized to provide relevant, timely and reliable information for all major stakeholders, as described in Chapter 8.

10.11 The Senate Committee on National Finance held hearings in 1990 with the major participants in the Canadian government system of program evaluation. They included senior managers responsible for evaluation in departments, and representatives of Treasury Board Secretariat, the Office of the Comptroller General and the Office of the Auditor General. In its report analyzing the current evaluation system (tabled in January 1991), the Committee identified a number of considerations that are important to successful evaluation.

10.12 The Committee was concerned about the objectivity of program evaluation, particularly as a source of reliable information for ministers. However, it recognized that there is a trade-off between the objectivity and independence that may be characteristic of evaluators from outside departments and the knowledge and access to information found among department personnel. Further, a balance needs to be struck between the desire to decentralize authority and the need for central control of an activity like program evaluation. The Committee believed that, in a rational world, program evaluation could support assessing government programs by measures of priority, and the lowest-priority items could be cut when the budgetary situation demanded.

10.13 A January 1993 report of the Sub-committee on Regulation and Competitiveness of the House of Commons Standing Committee on Finance argued that program evaluation conducted under the Treasury Board evaluation policy is largely an aid to serve top

management in departments. Evaluations were not seen as a means by which "outsiders" (Parliament or citizens) would gain the kind of insight into the performance of regulatory programs that would enable them to hold to account those responsible (notably the ministers).

10.14 The Committee thought that systematic program evaluations were a necessary step toward improved accountability and more rational decision making about regulation, but that external review or audit of evaluation reports was essential. External review could be carried out by publishing program evaluation reports for public scrutiny, by auditing selected evaluation reports, or by general parliamentary review.

10.15 In his study of administrative reform from 1962 to 1991, commissioned by our Office, A. W. Johnson observed that it was generally accepted that departmental accountability to Parliament be based, in part, on the department's own evaluations of program effectiveness, and on the Auditor General's audit of the quality of those evaluations. The success of this approach would depend on the technical capacity to solve difficult analytical problems; the ability to carry out objective, independent evaluations of politically sensitive issues; and the willingness of ministers to have criticisms of their programs made public. He concluded that the evaluation system had not succeeded in meeting these challenges.

10.16 In the larger context of Parliament and government, there are potential constraints for program evaluation. The constraints often are inherent in our system of government and set limits on change. Within these limits, there is stakeholder interest and a number of opportunities for improving the current system.

Audit Scope and Approach

10.17 The overall objectives of our government-wide audit of program evaluation are described in Chapter 8, paragraph 8.11. As part of this government-wide audit, reported in Chapters 8, 9 and 10, we reviewed other studies, particularly recent parliamentary reviews, and experience with program evaluation in other countries. The purpose of the review was to identify, in light of the findings from the audit examination, approaches that have been suggested or used elsewhere to improve the effectiveness of government program evaluation.

10.18 Specifically, we sought to identify practices and procedures that would support improvement in the objectivity, relevance, timeliness, and use of evaluations. However, such practices and procedures must be feasible and practical in an environment of fiscal restraint, and must build on existing experience and infrastructure.

Audit Observations

Strengths to Build on

A system in place

10.19 The essential components of a program evaluation system are in place. Departments have established program evaluation units, as described in Chapter 9, paragraph 9.17. Central responsibility is in place with the Secretary of the Treasury Board and the Comptroller General. The Auditor General provides an external review of the systems and procedures for measuring the effectiveness of programs, where measurement could appropriately and reasonably be done.

The standards to be achieved are in place

10.20 The government has published a set of working standards for evaluation of programs in federal departments and agencies, in support of the program evaluation policy. The policy requires that "relevant, credible and objective" information be available from program evaluation.

10.21 Responsibility for meeting the standards lies with deputy heads and the responsible managers. Among other requirements, the standards call for evaluation of programs by departments, using techniques that produce credible and objective findings based on valid and reliable data collection. For an evaluation to be objective, others must be able to derive the findings using the same data and analysis; to be credible, the results usually should be based on multiple lines of evidence. A further step to protect objectivity is the requirement that responsibility for the "day-to-day" management of evaluation be independent from line management, as discussed in Chapter 9, paragraph 9.21.

Experience of other countries with program evaluation

10.22 We examined the approaches that other countries have taken to evaluation. Although there are differences in the structuring and development of evaluation functions, evaluation is a tool increasingly used throughout the world. Governments are turning to program evaluation as a way to improve financial management and accountability. Legislative audit offices, within their mandates, are using program evaluation methodologies to assess the effectiveness of government expenditures. It is also being used by international financial institutions to assess the effectiveness of their performance.

10.23 Some countries, although interested in the practice of evaluation, are first focussing their efforts on putting in place sound financial accounting procedures and systems, including, in some cases, the ability to assign expenditures to programs. We looked in greater detail at program evaluation in three countries where the practice is established: the United States, Australia, and the United Kingdom. A description of each of the systems is presented in Exhibits 10.1 to 10.3. (see [Exhibit 10.1](#), [10.2](#), [10.3](#))

Exhibit 10.1

The Evaluation System in the Commonwealth of Australia

Purposes of Evaluation

During the 1980s, Australia initiated a sweeping reform of the budgetary, regulatory and administrative frameworks and restructuring of personnel and financial management practices, with a focus on effective programming. Among other things, the changes were intended to enhance the systematic use of program evaluation, including strengthening its links to the central budgetary process.

Responsibilities

Australia has a parliamentary system. Government is structured into portfolios, which consist of all departments and agencies that report to ministers. The Australian evaluation strategy assigns prime responsibility for evaluation to individual portfolios. There is considerable variation among portfolios in the way senior managers organize the function. Unit evaluation plans, if there are any, are rolled up into portfolio evaluation plans, which are submitted to the Department of Finance. The portfolio plans identify those evaluations that have major resource or policy implications.

The portfolio evaluation plans are centrally monitored by the Department of Finance to ensure that evaluation activity accords with government-wide priorities. The Department of Finance also plays an important role in directing the focus of these major evaluations. Its representatives are often invited to serve on steering committees, or are directed to do so by Cabinet, to ensure that information is pertinent and available when allocation decisions are being made. The Department of Finance monitors and reviews these evaluations.

As part of an external audit role, the Auditor General reviews the operation and effectiveness of evaluation's contribution to government management and accountability. The Auditor General has reported to Parliament on the use of evaluation in preparation of the federal budget.

Exhibit 10.2

The Evaluation System in the United States of America

Purposes of Evaluation

Departments and agencies in the United States started developing the capacity to carry out evaluations in the 1960s. Evaluations are to provide oversight and judgment of program and policy effectiveness, to provide input to management practices and sometimes to respond to legislative requirements. The Congress also has the capacity to conduct evaluation to support its legislative work.

Responsibilities

The congressional form of government is characterized by a division of powers and responsibilities between the executive branch and the legislative branch. Program evaluations are carried out by both branches. In the executive branch, the responsibilities for conducting evaluation rest with the departments and agencies. They are required to consult with the Office of Management and Budget in the development of their multi-year evaluation plans and agendas, listing major current activities and upcoming plans for evaluation activities. The

administration of the executive branch strongly supports the production of sound, timely and relevant information on program results to make informed major policy decisions and to improve program management. There are also a number of legislated requirements for effectiveness information. The *Government Performance and Results Act* of 1993 requires as part of strategic plans a description of the program evaluations used in establishing or revising general goals and objectives, with a schedule for future program evaluations.

As early as 1967, Congress recognized the importance of evaluations that responded to the needs of the legislative branch. It extended the mandate of its auditor, the General Accounting Office (GAO), in 1974 to include evaluation. The General Accounting Office both conducts evaluations itself and reviews evaluations done by departments and agencies.

Exhibit 10.3

The Evaluation System in the United Kingdom

Purposes of Evaluation

The policy on evaluation followed on from the Financial Management Initiative of the early 1980s, which emphasized the importance of performance measures and, in particular, indicators of operational achievements and their costs.

Responsibilities

In 1988 the United Kingdom's department of finance, the Treasury, issued guidance on the UK government's policy on program evaluation, termed "policy" evaluation. Each government department has been given primary responsibility for evaluating its programs, with central advice and guidance supplied by the Treasury. Within departments, those responsible for commissioning and carrying out evaluations include line management, central units with specialized staff, central finance or policy divisions, or some combination of these. There is no separate agency responsible for monitoring the implementation of program evaluation.

The National Audit Office can examine evaluations as part of its responsibility for auditing the performance of departments. It can also conduct effectiveness audits, looking at the extent to which policy objectives have been achieved, provided it does not question the merits of the policy objectives themselves.

10.24 Our aim was to identify management practices and procedures put in place by these governments to increase the objectivity, relevance and timeliness of program evaluations. We also examined the steps taken to change the culture and approach to evaluation as a means of increasing its acceptance and use. A range of approaches is identified and contrasted with the experience in the Canadian federal government. Our objective was to identify suggestions that could be used to strengthen the Canadian federal system of program evaluation.

10.25 Evaluation practice is the most clearly established in the United States of America, with program evaluation supporting government and legislative decisions. The development of program evaluation in Australia and the United Kingdom is more recent and is linked to government initiatives to improve financial management. Analysts have identified areas for improvement in each system. Despite interest in program evaluation

in the United Kingdom, it is the least developed there, as a formal system, of the countries we examined. Our analysis identified as factors of particular importance the use of quality assessment or external review, the linking of program evaluation to significant decision making, and strong leadership.

Strengthening Evaluations through External Review

10.26 The Canadian system, as designed, is oriented to the concerns of departmental management and, as shown in Chapters 8 and 9, responds mostly to management concerns. Yet there is the expectation that the department will provide performance information from its evaluation units to Treasury Board Secretariat, Cabinet committees and Parliament. Can this expectation reasonably be met?

10.27 In any evaluation, many choices need to be made. Some relate to the part of a program or activity to be evaluated and the evaluation questions to be addressed, as discussed in Chapters 8 and 9. There are additional choices about aspects that are important, specific tests, strategies for data collection, methods of analysis and the interpretation and presentation of findings.

10.28 Each choice requires professional judgment and has the potential to compromise objectivity and credibility. We are concerned about the selectivity in evaluations that has given them more focus on operations and smaller activities. This type of evaluation is generally viewed as less useful to interested stakeholders outside departments. The result has often been the perception that program evaluations are "tailored" or that their findings are "dampened down". The dilemma is whether a system of departmental evaluations oriented to meeting departmental requirements can also meet external needs. What type of external evaluative capacity would complement the internal focus of the present system?

Different approaches to external evaluation or review

10.29 There is some capacity for external evaluation or external review in all three countries we looked at. The strongest system for external review is found in the United States. Independence is achieved through a system of evaluation in which the executive branch and the legislative branch have separate agencies for evaluation, each responding to its own needs. The executive branch evaluations are carried out in departments and agencies.

10.30 The General Accounting Office responds to requests by Congress for evaluation, initiates some evaluation on its own, and comments on the quality of evaluations done by the executive branch. The General Accounting Office also prepares reports on the state of the evaluation system. About 80 percent of its work is at the request of Congress.

10.31 Australia, Canada and the United Kingdom do not have external evaluation as is found in the United States. Nor do their legislative audit offices have a broad mandate to conduct program evaluations. These countries rely on their audit offices to provide limited assurance that the evaluation function is working as it should. The extent and type

of work done varies among them with their mandates and approaches to value-for-money auditing. The Auditor General in Australia, for example, has issued a number of reports with recommendations for improving the operations of the program evaluation system, and specific reports in a number of portfolio sectors.

10.32 In Australia, as in Canada, program evaluation is expected to serve not only departmental needs but also the needs of central agencies, Cabinet and thereby Parliament. This is achieved by giving responsibility for program evaluation to departments (portfolios in Australia), with some co-ordination and review by a central agency. Central agencies provide some independence from specific departmental concerns.

10.33 This balance of interests is needed if the concerns about maintaining credibility and objectivity are to be understood clearly and supported actively by departmental management. The Australian Audit Office concluded that, if evaluation is to make an effective contribution to improving public sector performance, it is vital that the Department of Finance accept fully an oversight responsibility for monitoring, reporting, and insisting on adherence to the framework.

10.34 Another form of review is public scrutiny of published reports. In the United States almost all evaluations are public documents, often provided directly to Congress in response to its requests. In the United Kingdom the results of evaluations often are internal to the department, but an increasing number are being published, and summaries included in departmental annual reports. In Australia as in Canada, there is a formal requirement for public reporting and accountability. In Australia, departments' annual reports and portfolio program performance statements, which are tabled annually in Parliament, are intended to become major vehicles for providing summary information on program evaluation. In addition there is a requirement that the full report on major portfolio evaluations normally be made public.

Need to improve external review in the Canadian federal government evaluation system

10.35 As we noted in Chapter 9, the Comptroller General was assigned responsibility for assessing evaluation practice and monitoring the performance of departments in meeting the requirements of the policy. He was to provide deputy heads with his assessment of the quality of their evaluation practice and to report on government-wide evaluation performance to the President of the Treasury Board. We found that the Comptroller General has carried out only a part of these responsibilities.

10.36 The Comptroller General did not report formally to deputy heads or to the President of the Treasury Board. Instead, he raised matters of importance with them on an exception basis. As a result, this mechanism does not, in our opinion, provide sufficient assurance of the objectivity and reliability of evaluation through independent review from outside the departments.

10.37 In addition to being responsible for reviewing the quality of individual evaluations, the Comptroller General is responsible for assessing the overall performance of

departmental evaluation practice. The assessments were part of the annual Departmental Management Assessment process managed by the Treasury Board Secretariat. On an exception basis, assessments were provided to appropriate managers. Where specific undertakings with management were identified, they were monitored by staff. As a result, assessment coverage was selective.

10.38 For improvements to be made, it is important to identify shortcomings clearly. The assessments we examined were general and not very analytical or critical. For nine of the 11 programs whose effectiveness measurement we examined, we compared our assessment of departmental evaluation performance to the assessments by the Comptroller General. We found that the assessments by the Comptroller General did not clearly identify the important areas for improvement that we identified as the result of our audit work.

10.39 The Public Accounts Committee reviewed the Auditor General's 1978 Report, and recommended to the House that all effectiveness evaluations be tabled in the House of Commons within 60 days of their completion. The government responded that it was committed to making program evaluations publicly available. However, by 1983 only one program evaluation report had been tabled.

10.40 Since that time, the *Access to Information Act* was proclaimed and Part IIIs of the Estimates were put in place. The Senate Committee on National Finance, as part of its inquiry on program evaluation in 1990, still found that the information provided on evaluations was inadequate.

10.41 In 1991 the Committee found that the list of completed program evaluations given to the Public Accounts Committee was not enough, since it provided only a list of titles and did not provide information about specific evaluations. Similarly, the Committee found that the Estimates did not provide enough information on program evaluation. As a result, it solicited information directly from departments that had completed evaluations. The Comptroller General subsequently published portions of the information collected. There has been little progress in making available to Parliament the results of program evaluation in a way that is useful to parliamentarians and the public.

10.42 In our 1992 Report we recommended changes to the Part IIIs of the Estimates to improve reporting on global stewardship of duties and obligations. Stewardship reporting would include a report on how a department did in meeting its objectives - information available from program evaluation. As we reported in 1992, there is considerable room for more openness by management about its global stewardship role.

10.43 The January 1993 Report of the Sub-committee on Regulation and Competitiveness of the Standing Committee on Finance concluded that it was essential to create procedures for an external review or audit of evaluation reports. One such mechanism would involve the publication and public scrutiny of the government's evaluation reports. Another mechanism would be to have all evaluations tabled in

Parliament and referred automatically to the appropriate subject-area standing committees.

10.44 A system of evaluation by departmental evaluation units requires some form of check on the objectivity and credibility of its output. In Canada, we rely on external review by Parliament, on public disclosure, and on review by the external auditor. These mechanisms are in addition to a requirement for commitment among evaluators and evaluation managers to maintain established standards.

10.45 For the system to function effectively, all parts have to be working. In Chapter 9, we identified improvements that deputy heads and evaluation managers need to make. Improvements are also needed in monitoring, quality assurance and reporting by the Comptroller General, and in making information on the results of evaluations available to Parliament.

10.46 The government should ensure that the responsibilities of the Comptroller General for monitoring, quality assurance and reporting are carried out, as set out in the policy on program evaluation.

10.47 The government should ensure that Parliament is provided with the results of program evaluation in a form that Members find useful.

Being Part of the Mainstream

10.48 Evaluation offers the potential to improve management operations, identify areas of savings and ineffective expenditure, and support accountability. To meet this potential, evaluation needs to be an integral part of the management practices and culture of government. Its role should be well defined and clearly integrated into new initiatives and established management systems such as planning. The government approach to planning evaluation needs to establish a means of linking the requirements of individual units with those across government and those of other interested stakeholders outside government.

Proximity to major government initiatives in other countries

10.49 In reviewing the experience of other countries, we examined how evaluation is integrated into government. In the United States the General Accounting Office responds to requests from, and reports to, Congress. Recently enacted requirements for performance reporting include a definition of program evaluation, and a requirement that evaluation plans be included in strategic plans and their results included in performance reports. The Office of Management and Budget uses evaluation results to support decisions to continue, increase, or reduce proposed program funding during budget formulation.

10.50 In the United Kingdom, the reforms of public sector management make managers accountable for the achievement of performance targets. The scope of those performance assessment regimes was recently broadened by the introduction of customer service

targets under the Citizens' Charters. Program evaluation, while not neglected, has received less emphasis than the more managerial and routine instruments associated with service planning and annual reporting.

10.51 In Australia, evaluation is an important part of rationalizing program budgeting procedures. The Australian Department of Finance, through its contribution to the evaluation planning process and through its advice to Cabinet during the budgetary process, requests evaluations that will contribute to future budget rounds in a timely manner. The Australian National Audit Office found, in an audit of evaluation's contribution to the budgetary process, a "reasonable level of overall usage at that stage of development of evaluation." Not as many evaluations were available as expected, but there were some notable uses of evaluation in budget deliberations. The Audit Office observed that systematic and vigorous linkages between evaluation and the central budget process have not been widely applied by administrations abroad or in Australian states. It concluded that it is crucial that the approach be carefully balanced, communicated and consistently applied.

10.52 Evaluations of the effectiveness of program expenditures can be a requirement built into all new expenditures. In the United Kingdom, the evaluation policy requires that program evaluation be built into all new policy initiatives and all proposals arising from policy reviews. So far, audit and academic work shows an uneven pattern of achievement.

10.53 In Australia, all proposals for major expansion or new programs are expected to be accompanied by an evaluation plan. In this way, evaluation is to provide information for subsequent scrutiny of budget expenditures. The Australian Audit Office found, in looking at the process over 1990-92, examples of "evaluation's use as a pointer to the need for significant changes, redirection and better targeting in the distribution of resources."

Need to strengthen the link to expenditure decisions in Canada

10.54 In Canada, some effort has been made to link evaluation to the government's planning and budgeting process that has resulted in limited success, as described in Chapters 8 and 9. Program evaluation was to be linked to an operational plan framework prepared by each department. This framework sets out objectives, statements of intended results, performance indicators and planned use of resources for each planning element or part of a program. The findings of evaluations were one piece of information to be included in the assessments of proposed policy and program changes. In practice, we found that these linkages are weak because of the focus of evaluation on small program units and on operational issues.

10.55 Other government initiatives setting out the accountability agreements between deputy heads and the Treasury Board, in the form of memoranda of understanding under Increased Ministerial Authority and Accountability (IMAA) or the Shared Management Agenda, also implied a need for evaluations. However, our findings in Chapter 9 show a decline in the capacity for evaluation.

10.56 In Canada, for most new or substantially modified programs, there has been a requirement in submissions to Treasury Board that an evaluation framework be developed as early as possible in a program's design or implementation. This requirement was spelled out in the 1981 *Guide on the Evaluation Function* .

10.57 An evaluation framework sets out a plan to collect and interpret baseline data, ongoing program performance indicators and a tentative plan for future evaluation of the program. We found that departments are not consistently meeting the requirements set out twelve years ago for frameworks. For example, we note in Chapter 11 that the Canadian Aboriginal Economic Development Strategy program agreed on a framework only after the start of the initiative.

10.58 Treasury Board should ensure that evaluation frameworks are developed and included as part of submissions to Treasury Board and that procedures to follow up on their implementation are established.

Need to establish government-wide planning of program evaluation

10.59 Evaluation has great potential. It cannot be marginal to the major concerns of government. For evaluation to contribute, it needs to be linked to key government processes. All programs cannot be evaluated simultaneously, and considerable lead times can be involved in conducting evaluations (as much as two years for more complex evaluations). Program evaluation, like other functions of government, is under budgetary pressure; scarce evaluation resources must be used in the most efficient and effective way. Program evaluation is expected to meet the needs of managers in their departments as well as the strategic requirements of government and Parliament, with timely and good-quality program evaluation studies. Evaluation effort needs to be turned to the priority concerns of government.

10.60 As shown in Chapter 9, the operation of evaluation units is oriented primarily to meeting the requirements of departmental managers. To meet government-wide evaluation needs and those of other stakeholders, requirements have to be clearly identified and steps taken to ensure that priority needs for effectiveness information are met. As Chapters 8 and 9 have shown, quality and quantity of evaluations need to be improved, to assess many of the activities of government in order to meet key stakeholders' needs for information.

10.61 We expected the Comptroller General to set out the government's priority needs for program evaluation. Further, we expected that, if individual departmental plans did not address those needs, steps would be taken to have the evaluations done. A well-functioning system of program evaluation would be expected to provide otherwise unavailable information on the results of priority programs and policies.

10.62 We found that the Comptroller General's staff do not have a systematic approach to planning for government-wide or central evaluations. They keep track of central requests for evaluations and, on an ongoing basis, communicate those requests to departments.

However, they do not use the information to establish government-wide plans for responding to the needs.

10.63 The Government Program Evaluation Plan is not considered to be an instrument for conveying particular evaluation demands, nor is it a mechanism to sort out specific evaluation priorities. Rather, it is a vehicle for setting out general expectations for the function and assessing the overall capacity of departmental evaluation to respond. As a result, it does not serve as a mechanism for co-ordinating departmental evaluation plans with central needs and with the needs of other departments.

10.64 The Comptroller General has not ensured that government needs for information from program evaluation are addressed by departments in their individual plans. Departments have not consistently submitted plans. Rather, Comptroller General staff have relied on ongoing liaison with departments. In addition, they have not played a leadership role in identifying areas for multidepartment evaluations. Rather, they have relied on the planning processes of individual departments, contributing to poor evaluation coverage of major government-wide programs and initiatives.

10.65 Comptroller General staff have, on occasion, organized briefing meetings between a departmental evaluation unit and the central agencies to discuss the planning of evaluations. They have also participated in 12 interdepartmental evaluations in recent years. However, these initiatives were not part of a systematic planned approach. They have encouraged the inclusion of evaluation requirements in IMAA agreements. However, we found that these practices resulted in uneven success. For example, in six of the seven IMAA agreements that included evaluation plans, the evaluation plans had not been fully implemented.

10.66 An approach by government is needed to ensure that priority areas and government-wide concerns are covered in individual departments' evaluation plans. If they are not, a centrally led approach will be needed to ensure that high-quality, timely evaluations are done.

10.67 **The Office of the Secretary of the Treasury Board and Comptroller General should develop the capacity to identify systematically the government priorities for evaluation. It should review individual departments' evaluation plans to identify gaps in the coverage of the identified priorities. At the same time, it should identify gaps in the evaluation coverage of multidepartment programs. Where there are significant gaps it should establish a mechanism to ensure that high-quality evaluations are conducted in a timely manner.**

Strengthening the Leadership of the Function

10.68 From 1977 to 1983, progress was made in establishing the infrastructure to carry out evaluations and putting in place supporting policies, methodologies and guidance. However, the function has not developed into an effective government-wide system. Our audit identified a number of areas where the intent of the evaluation policy, directions

and guidance were not followed. Strong leadership is needed to improve the operations of the program evaluation system, and to strengthen the commitment to making sound effectiveness information an integral part of government decision making.

The need for a strong focal point

10.69 The program evaluation policy assigned formal responsibility for leadership and support of the evaluation function to the Comptroller General. In our opinion, the Comptroller General placed greater emphasis on supporting the function than on leading it.

10.70 A strong central focus is necessary in a system that is decentralized and oriented toward serving departments, but that is also intended to serve the needs of those outside the departmental structure. Such a focus would set central requirements for evaluation, provide quality assurance and champion the cause of evaluation. Evaluation managers need strong support to meet these requirements both inside and outside of their management structure.

10.71 Evaluation managers do not feel that they have been receiving such support. In 1990 focus group discussions, program evaluation managers were generally supportive of the Office of the Comptroller General. However, they felt that the support they received was often indecisive and could not be counted on to defend the function "in a crunch with senior managers to reduce function staffing and resources." Many expressed the view that the Office of the Comptroller General's strength in "getting the function going" did not carry over into "helping ongoing functions."

10.72 Subsequent focus groups two years later, as part of an internal operational review, were more critical. These focus groups were held with heads of audit and evaluation because, increasingly, the two functions are being managed jointly. Heads of audit and evaluation said they were uncertain whether they could get assistance from the Office of the Comptroller General because of the varying quality and experience of its staff responsible for liaison with practitioners. The merger of liaison responsibilities for audit and evaluation at the Office of the Comptroller General has contributed to this situation. At the time of our audit, only one of the 22 branch officers had experience in both audit and evaluation.

10.73 In our opinion, the Comptroller General did not fully exercise the leadership described in the policy. Such leadership would develop the function by building on its strengths, identifying areas for improvement and initiating corrective action.

10.74 We found little evidence of self-evaluation or of performance measurement systems by evaluation managers, as described in Chapter 9. The staff of the Comptroller General put in place a database containing measures of departmental evaluation performance based on data provided by managers of evaluation units. As part of the audit work reported in Chapter 9, we verified the database measures for 1985 to 1991. We found a number of weaknesses in the data.

10.75 The Secretary of the Treasury Board and the Comptroller General should ensure that information on evaluation activity and performance is valid and reliable.

10.76 If properly implemented, the recommendation in 10.46 to ensure monitoring, quality assurance and reporting, and the recommendation in 10.67 to put in place system-wide evaluation planning, will support the leadership role of the Comptroller General in program evaluation. On 25 June 1993, the Prime Minister announced that the responsibilities and functions of the Office of the Comptroller General, including the Evaluation and Audit Branch, would be integrated into the Treasury Board. As a result, the evaluation function is being re-examined. This presents an opportunity for the Office of the Secretary of the Treasury Board and Comptroller General to re-establish its leadership of program evaluation.

Building demand among stakeholders

10.77 Essential to a process of successful evaluation is an interest in receiving evaluation results and finding the results credible and relevant to the questions being addressed. In addition, information should be presented in a clear, readable style.

10.78 In a parliamentary system, the political will of the majority sets the agenda. It has been argued that this results in an unwillingness on the part of ministers to present negative findings on the effectiveness of their own policies and programs. Yet this inherent constraint may not be as great as some have argued. Parliamentarians, including Cabinet ministers, have demonstrated an interest in obtaining the results of sound evaluations, as shown in Chapter 8.

Responsiveness to specific parliamentary requests

10.79 Departmental managers are constrained by limited resources and, often, by conflicting priorities. The program evaluation system has not responded well to the general requirement for program evaluation to provide information for scrutinizing budget estimates or regulatory programs, as shown in Chapter 8. However, departments have been responsive to providing evaluations when specific requests have been made by Parliament or suggestions made as part of our audits.

10.80 For example, following a series of hearings on tax measure evaluation, the House of Commons Standing Committee on Public Accounts prepared a report to the House listing five tax measures that it wished to see evaluated: the Goods and Services Tax (GST), the new tax treatment of retirement savings, the tax treatment of capital gains, the tax treatment of flow-through shares and the Canadian Exploration Incentives Program.

10.81 In December 1991, the Department of Finance responded by submitting a work plan setting out the tax measures that it would evaluate in the coming years, including possible methods of evaluating the GST and the treatment of retirement savings. In addition, the evaluation of flow-through shares was to be undertaken in 1993. The capital gains tax would begin with an evaluation of the lifetime capital gains exemption in 1993

and 1994. The Department of Finance indicated that the Canadian Exploration Incentives Program was the responsibility of the Department of Energy, Mines and Resources and its evaluation was already under way. In early 1993, the Department of Finance submitted a framework to the Committee for evaluating the different GST components.

Responsiveness to recommendations for improvements in the evaluation of specific programs

10.82 Our audit also found that the government's evaluation system responded to audit recommendations for improvements in the evaluation of specific programs. Some of the steps taken in response to recommendations follow.

10.83 Improve timing and range of questions addressed. In response to concerns raised in our 1991 audit of the Department of Agriculture regarding the evaluation of Farm Safety Net Programs, the Department produced timely evaluation frameworks for the new generation of government measures under the recently enacted *Farm Income Protection Act*. Although the evaluation framework for the Gross Revenue Insurance Program and the Net Income Stabilization Account requires further work by the Department, the evaluation framework prepared for the Farm Support and Adjustment Measures (FSAM) represents a significant improvement over the Department's earlier evaluation activities in this area. In the framework, the Department is indicating that it intends to address comprehensively the program's effects on the agricultural sector. The Department has indicated that the evaluation is under way.

10.84 Increase emphasis on reliability of findings and indicators. In the Department of Supply and Services, we identified problems with the quality of earlier evaluations of the Department's Acquisition and Major Crown Projects programs (government procurement), particularly with respect to reliability of findings and of evaluation indicators used. The Department has recognized these problems and has started to take corrective action. Its evaluation of its Electronic Catalogue and Order-taking System, and the framework it has developed to evaluate its Open Bidding Service, though partial in nature, represent a significant improvement over earlier activities.

10.85 Start the evaluation of a complex and technically difficult area. The Department of Finance's program activities related to the management of the national debt cover a large component of the federal expenditure. The Auditor General's reports of 1988 and 1991 recommended evaluation of this complex borrowing program. These concerns were supported by the Public Accounts Committee. In response to our recommendations, the Department agreed to carry out the evaluation over three to five years. In October 1992, it produced a first report on its approach to debt management evaluation and submitted it to the Committee in December 1992.

Conclusion

10.86 The need for sound effectiveness information is greater than ever. Yet the system is not meeting this need. There is potential in the current approach to evaluation that has not been exploited. Throughout the three chapters on our audit of program evaluation, we

have identified where corrective action should be taken in managing departmental evaluation units and in managing the entire evaluation system.

10.87 Greater effort is needed to make the existing program evaluation policy work. More effort needs to be directed at improving the quality and relevance of evaluation products, at changing the management culture to seek effectiveness information and to use it in making decisions, and at developing a system that meets the needs of stakeholders inside and outside of government, as well as those of departmental managers.

10.88 If the present approach cannot be made to work, Parliament may wish to consider more radical solutions to obtain more timely, relevant and reliable effectiveness information.

10.89 The reorganization of the Office of the Comptroller General and its integration into the Treasury Board Secretariat present the government with the opportunity to renew and revitalize its program evaluation efforts.

Chapter 11

Canadian Aboriginal Economic Development Strategy

Main Points

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Canadian Aboriginal Economic Development Strategy

Assistant Auditor General: Elwyn Dickson

Responsible Auditors: Larry Ting, Louis Lalonde, Raymond Foote

Main Points

11.1 The Canadian Aboriginal Economic Development Strategy (CAED Strategy) was initiated by the Government of Canada in 1989 to address the economic disparities between aboriginal peoples and other Canadians. The overall objective of the CAED Strategy is to help the aboriginal peoples achieve economic self-reliance. It replaces and seeks to improve on previous aboriginal economic development programs.

11.2 The departments of Indian Affairs and Northern Development, Employment and Immigration, and Industry, Science and Technology were given the responsibility to implement this initiative, at an estimated cost of approximately \$1 billion for the first five years of its operation. Certain other federal departments have a role to play, although they are not directly accountable for the Strategy.

11.3 Visible leadership for implementing the Strategy as a whole needs to be better established. For example, leadership to manage the development of strategic partnerships across participating federal departments, and with private and aboriginal stakeholders, could be strengthened through the development and application of a comprehensive implementation plan.

11.4 The three departments responsible for implementing the CAED Strategy could not demonstrate that the variety of funding methods and amounts provided under the Strategy were appropriate in the circumstances. In addition, despite some positive examples of aboriginal economic development, they could not demonstrate that, after spending at least \$900 million from the beginning of its implementation in 1989 to early 1993, they were meeting the Strategy's objectives.

11.5 The lack of appropriate performance and evaluation information impedes the necessary accountability within the aboriginal communities and between the government and Parliament.

11.6 Aboriginal community economic development organizations, local aboriginal management boards, and aboriginal capital corporations were established as intended opportunities to increase aboriginal participation toward economic self-reliance. In our view, they have a responsibility to co-operate with each other by sharing economic development information, such as potential business opportunities, and to co-ordinate their efforts in areas such as job training.

Background

11.7 Aboriginal Canadians are a diverse group with many cultures and languages. They inhabit all parts of Canada, from remote to urban areas. Their access to resources and their mobility, expectations and capabilities vary widely.

11.8 Aboriginal peoples include status and non-status Indians, Metis, Inuit and Innu. Responsibilities pertaining to status Indians living on reserves (approximately one third of the total aboriginal population of one million) and to the Inuit and the Innu generally belong to the Department of Indian Affairs and Northern Development (DIAND). Other federal departments and provincial and territorial governments provide a variety of services and assistance to all eligible aboriginal Canadians.

11.9 The Canadian Aboriginal Economic Development Strategy (CAED Strategy) was established by the federal government in 1989 to help develop and support the economic self-reliance of aboriginal people by providing them with the means to take advantage of economic development opportunities to achieve long-term employment and develop their own businesses. The CAED Strategy is implemented in partnership with aboriginal Canadians by three federal departments, each with its own primary area of responsibility ([see Exhibit 11.1](#)).

DEPARTMENT	RESPONSIBILITY	FINANCIAL VEHICLE
Indian Affairs and Northern Development	Community economic development	Contributions
	Resource development	Contributions
	Commercial development	Loans and guarantees
Employment and Immigration	Skills development and urban employment	Contributions and services
Industry, Science and Technology	Business development and joint ventures	Contributions and guarantees
	Aboriginal capital corporations	Contributions
All three departments	Research and advocacy	Contributions

Exhibit 11.1
CAED Strategy Responsibilities of the Three Federal Partners

11.10 The Department of Indian Affairs and Northern Development has responsibility for community economic and resource development; the Department of Employment and Immigration is responsible for skills development and urban employment; and the Department of Industry, Science and Technology is responsible for business development and the establishment of aboriginal capital corporations. The three departments share the responsibility for research and advocacy in the promotion of aboriginal economic self-reliance.

11.11 The CAED Strategy implementation focusses on:

greater aboriginal participation in the national economy;

increased opportunities for ownership and management of business enterprises and economic institutions;
access to continuing jobs;
aboriginal participation in the design and delivery of programs;
unrestricted access to federal economic development initiatives;
increased aboriginal involvement with Canadian business and investment interests; and
active participation and support from provincial and territorial governments.

11.12 The federal government expects the CAED Strategy to achieve, among other things:

greater employment and higher income levels for aboriginal people;
a broadened business base and improved aboriginal management and entrepreneurial skills;
a decrease in dependency on social welfare; and
an increase in the capacity of aboriginal communities to manage their affairs.

Financial Resources

11.13 To support more effective participation by aboriginal people in Canada's growing economy, the federal government dedicated funds, on a continuing basis, to the departments responsible for implementing the CAED Strategy. Funds were to be allocated yearly, and the initial five-year total was \$873.7 million. These moneys enabled the departments of Indian Affairs and Northern Development and Industry, Science and Technology to put the Strategy into action. In addition, aboriginal participation and expenditures in programs offered by the Canada Employment and Immigration Commission were to continue to be targeted at no less than the 1988-89 level (approximately \$120 million).

Responsibilities of the Department of Indian Affairs and Northern Development

11.14 DIAND has full responsibility for four programs under the CAED Strategy. Its main program is the Community Economic Development Program.

11.15 The purpose of this program is to assist status Indians and Inuit and Innu communities to establish and control community economic development organizations both on reserves and in the North.

11.16 The Department's main approach is to devolve delivery of program services to community-controlled economic development organizations. Under contribution arrangements with DIAND, these organizations use federal funding to provide direct services to their constituents. Based on criteria determined by the organizations, these services may include:

preparing community economic development strategies;

initiating business and resource development projects;
taking equity positions in private or community enterprises; and
supporting job-related training and employment programs.

11.17 Under the CAED Strategy, DIAND's financial assistance to the community economic development organizations has exceeded \$50 million annually, which constitutes 70 percent of the Department's total CAED Strategy expenditures. According to DIAND, which retains responsibility for monitoring them, community economic development organizations are investing about 50 percent of their funding as equity or seed money in employment, business and resource development projects.

11.18 The other DIAND components under the CAED Strategy are the Commercial Development Program, the Resource Access Negotiations Program, the Regional Opportunities Program and, in conjunction with the departments of Employment and Immigration and Industry, Science and Technology, the research and advocacy component.

Responsibilities of the Department of Employment and Immigration

11.19 The Department of Employment and Immigration perceives its role in the CAED Strategy as one of administration and co-ordination with its federal partners. It uses Pathways to Success, a separate employment and training strategy for aboriginals, to meet its CAED Strategy responsibilities for skills development and urban employment. This allows the Department to commit to a number of related objectives: involving aboriginal people in local planning strategies; maintaining flexibility in programming; encouraging the development of aboriginal institutions to deliver employment programs and services; and complementing local and provincial programs and services.

11.20 Pathways to Success is a partnership between the Department and aboriginal groups, organizations and communities to invest in and develop a trained aboriginal labour force for participation in the unique aboriginal labour markets as well as in the broader Canadian labour market. The Pathways approach is based on decision making within the communities, which enables aboriginals at the local level to influence program changes at the national level.

11.21 Through Pathways, boards were created at the local, regional and national levels that represent all aboriginal communities in Canada, whether on or off reserves. The key element in this new partnership is the establishment of local aboriginal management boards. Eighty-six of the planned 110 boards were established. They are spread across the country and are responsible for defining training and employment priorities for their respective areas and for recommending project proposals. The boards and the Canada Employment Centres are jointly responsible for monitoring the effectiveness of local initiatives.

11.22 Canada Employment Centres are responsible for providing labour market information and preparing local planning strategies. In consultation with their community

partners in the public and private sectors, the Centres determine local labour market needs and, where intervention is deemed appropriate, plan the most effective program and/or service responses. They also provide administrative and technical support to the local aboriginal management boards.

Responsibilities of the Department of Industry, Science and Technology

11.23 Industry, Science and Technology fulfils its CAED Strategy responsibilities through the Aboriginal Economic Program. The two main components are described below.

11.24 Aboriginal Business Development and Joint Ventures Program. This is the largest of the Department's CAED Strategy programs in terms of funding. It is designed to provide financial and developmental assistance to all eligible aboriginal individuals or groups for the establishment, expansion, modernization or acquisition of businesses. Industry, Science and Technology delivers this program through its offices located across Canada and makes contributions to aboriginals on and off reserves on the basis of applications it has received and approved. The Department has established external delivery organizations to build aboriginal business capacity and to deliver aboriginal programs in areas where access to its development offices is limited. These organizations are operated by aboriginal institutions such as the aboriginal capital corporations.

11.25 The aboriginal economic development boards form part of the management structure of Aboriginal Economic Program. One national and two regional aboriginal economic development boards have been set up to make recommendations to the Minister of Industry, Science and Technology on projects funded under the Department's programs. Board members are order-in-council appointees, and the majority of them are aboriginal. The boards assist Industry, Science and Technology in the implementation of its assigned CAED Strategy components and may advise the ministers of DIAND and Employment and Immigration, where appropriate, on co-ordinating their programs with the regulations respecting aboriginal economic development. These boards are also authorized to recommend to the Minister of Industry, Science and Technology the establishment of policies, procedures and guidelines necessary for the efficient operation and administration of the Department's programs.

11.26 Aboriginal Capital Corporations Program. Industry, Science and Technology provides contributions to aboriginal capital corporations, which in turn make commercial loans to businesses owned by aboriginal individuals or organizations. These aboriginal capital corporations are incorporated and are locally or regionally based. They tend to be owned by provincial aboriginal institutions, groups of tribal councils, a number of bands or sometimes entire aboriginal communities. The aim of aboriginal capital corporations is not to make a profit, but to help develop businesses, while maintaining their capital over time. The corporations are designed to break even on operations and be self-sustaining at the end of five years.

Achievements Demonstrate Potential for Success

11.27 We believe that the activities of the three departments can become a catalyst for establishing successful organizations in aboriginal communities.

11.28 We observed cases where aboriginal individuals and organizations have achieved positive results by participating in federally sponsored economic development programs. The example in [Exhibit 11.2](#) describes a partnership between the federal government and the aboriginal people for making decisions in regard to training programs and community and business development. This case illustrates the co-operative approach that can contribute greatly to the achievement of aboriginal economic development.

Exhibit 11.2

An Example of Successful Federal-Aboriginal Partnership

A First Nation band set up a community economic development organization, which opened a shopping and office complex. The investment came from the band and a contribution of CAED Strategy money from the community economic development organization. The band also received external financing for the building complex from the Department of Industry, Science and Technology. The training component was provided by the Department of Employment and Immigration.

11.29 The projects described in [Exhibit 11.3](#) show that partnerships with the private sector can also contribute to aboriginal economic development.

Exhibit 11.3

Two Projects Involving the Private Sector

Our examination of projects at the local level revealed two instances in which a chartered bank and the Department of Employment and Immigration, together with aboriginal community groups, were involved in a joint effort to train aboriginal individuals in the field of customer service in the banking and financial services sector.

These projects, which took place during fiscal year 1992-93, were very similar in nature. Their overall objective was to provide community members who had been out of work or school for some time with the necessary training to re-enter the labour force by accessing available opportunities in a viable sector of the economy.

The projects lasted approximately six months. Both instances required in-class training and job experience. The curriculum was developed jointly by the bank, community colleges, and representatives from aboriginal community groups. The classroom component comprised subjects ranging from life skills to computer operations. The job experience component was provided by various branches of the bank.

These initiatives were the result of a co-ordinated effort in which each partner contributed time, facilities or funds.

For the two projects combined, 38 participants were selected. Seventeen of them were social assistance recipients; 12 were unemployment assistance recipients. Thirty graduated from the course at an average out-of-pocket cost of \$9200 per graduate. As of June 1993, 25 of the graduates were employed, 18 of them in the field for which they had been trained.

11.30 Nevertheless, effectiveness evaluation is needed to determine to what extent these projects have been successful in increasing employment and expanding the aboriginal business base as intended.

Audit Objectives and Scope

11.31 Our audit objectives were to assess the adequacy of management practices for the implementation of and accountability for the CAED Strategy, disclosure of results, and compliance with authorities. We considered, among other things, the extent of participation of aboriginal peoples, provincial governments and the private sector.

11.32 Accordingly, we reviewed DIAND's involvement in community development, and Employment and Immigration's skills development and urban employment initiatives. We also audited a sample of Industry, Science and Technology's projects relating to business development and aboriginal capital corporations. We did not review the less significant CAED Strategy activities within these areas.

Management Practices for Success

11.33 In our review of CAED Strategy implementation, we expected to find, collectively for the three departments, certain management practices that would provide a reasonable chance for success ([see Exhibit 11.4](#)).

Exhibit 11.4

Management Practices for Success

- a) Demonstrated leadership to effectively exercise overall responsibility for the success of the CAED Strategy and to ensure accountability for results.
- b) Co-ordinated procedures to appropriately identify and respond to the priorities, needs, opportunities and constraints of aboriginal clients.
- c) Implementation procedures that comply with all applicable authorities.
- d) A valid and reliable performance evaluation and management information system that contains, as a minimum: total costs incurred under the CAED Strategy, a clear statement of its overall objectives, the quantity and quality of services provided, and the results obtained. Such information would be used to monitor progress, assess results and modify CAED Strategy principles and funding, where appropriate.
- e) Annual disclosure to Parliament of useful and reliable performance information on the results of CAED Strategy activities and the cost of achieving them compared to planned results and costs.

Observations and Recommendations

Need for an Overall Implementation Plan - Leadership and Accountability

11.34 The CAED Strategy calls for comprehensive, integrated federal government action to enhance the economic self-reliance of aboriginal people. Three principal departments - Indian Affairs and Northern Development, Industry, Science and Technology, and Employment and Immigration - were mandated to provide joint direction for the design and delivery of program components under the Strategy.

11.35 The Strategy acknowledges that co-ordination of effort among federal departments is an important factor for success. We therefore expected to find, among other things, that the three principal departments were co-ordinating their efforts with a full and continual exchange of information on their priorities, activities, results, and issues to be resolved. In our view, this approach would help reduce any potential for duplicated activities and missed opportunities.

11.36 The published Strategy assigns responsibility for its implementation to a CAED Management Committee to ensure co-ordinated field delivery. This Committee comprises senior officials from all three federal partners and includes representation from the aboriginal community. The Committee established working groups in early 1990 to facilitate co-ordination and communication among the three departments.

11.37 We found that the CAED Management Committee and its successor committees met occasionally to help co-ordinate implementation of the Strategy. The selected approach was for each department to operate separately its respective programs under the CAED Strategy. In their opinion, this would prevent a duplication of effort while streamlining implementation.

11.38 We noted that DIAND and Industry, Science and Technology entered into an implementation agreement in July 1990, approximately one year after the Strategy was announced. The primary purpose of the agreement was to achieve full co-operation and co-ordination between the two departments in delivery of their respective mandates for aboriginal business financing. However, Employment and Immigration was not a party to the agreement, even though it is a principal partner in the Strategy.

11.39 We noted from departmental files that, some four years after the Strategy had been announced, certain basic and significant issues remained unresolved. These included the need to develop CAED Strategy agreements among federal, provincial and territorial governments and to establish an evaluation framework for the Strategy. The three principal federal departments agreed to a framework only in May 1993.

11.40 We further noted that there was no overall implementation plan. Such a plan could include goals leading toward aboriginal economic self-reliance against which their achievement and the related planned and actual expenditures would be monitored on an ongoing basis. In our view, notwithstanding the involvement of CAED committees, the

absence of an appropriate plan means that leadership and accountability for the CAED Strategy as a whole need to be better established.

11.41 However, the departments recently indicated their belief that the aboriginal community should assume even greater responsibility for their own economic development than envisaged under the original Strategy. Given this approach, the federal government should reassess the appropriateness of the Strategy. If it continues to endorse the Strategy as currently set out, it will need to develop an implementation plan, as indicated below.

11.42 The federal CAED Strategy partners, in collaboration with aboriginal and other partners, should develop an appropriate CAED Strategy implementation plan. The plan should then be communicated, implemented and monitored with the co-operation of provincial/territorial governments and aboriginal organizations.

11.43 The plan should, as a minimum:

designate accountability for implementation of the Strategy;
provide for appropriate aboriginal representation in decision making;
address how effective interaction among all participant groups can be obtained to maximize the exploitation of opportunities and minimize unnecessary overlap; and
call for a monitoring regime to assess progress against goals so that remedial action can be taken where necessary.

DIAND's response: The Department can demonstrate that the Strategy has achieved one of its primary objectives, that of transferring real decision making and accountability to our clients. It would therefore be inappropriate to establish an implementation plan that could have the impact of centralizing decision making with the federal departments. The Department agrees that it is appropriate to review the current strategy of implementation in conjunction with aboriginal advisory boards and the other federal partners, through a regionally based process supported by Headquarters to redefine the Strategy based on our clients' priorities and to exchange the reporting of the results achieved.

EIC's response: An implementation plan, by centralizing the decision-making process within the federal departments, could adversely affect aboriginal institutions' and communities' control and direction over their own economic development. The Department agrees that its role in the CAED Strategy must be determined by the aboriginal management boards.

ISTC's response: Instead of providing a response to the specific observations and recommendations, ISTC has elected to provide an overall response concerning its role. It follows paragraph 11.88.

Inadequate Co-ordination Between Federal and Provincial/Territorial Governments

11.44 Natural resources are often under provincial and territorial jurisdiction. Thus, support and co-operation from those levels of government are needed when aboriginal communities wish to pursue economic development projects involving these resources.

11.45 Further, in both urban and rural settings, the co-operation of provincial and territorial governments is needed to help aboriginal people access business opportunities, training and jobs.

11.46 The ministers for Industry, Science and Technology and Indian Affairs and Northern Development were authorized to secure the active participation of provincial and territorial governments and to seek matching financial commitments for off-reserve aboriginals. Employment and Immigration was not required, under the CAED Strategy, to join its federal partners in this regard. However, it acknowledged the importance of federal/provincial and territorial participation and elected to rely on its existing (non-CAED Strategy) agreements with the provinces that cover training and related matters for the general population.

11.47 We could not find any documented national procedures that would require the CAED Strategy partners to identify those matters where provincial and territorial government support is needed and to pursue their active participation. According to DIAND, with the exception of specific agreements under the Resource Access Negotiations Program and some business projects, provincial and territorial participation under the CAED Strategy has not been obtained as intended.

11.48 The Minister for Industry, Science and Technology was required to report to Cabinet on the implementation of federal-provincial aboriginal economic development agreements by December 1990. This was not done.

11.49 **The three federal CAED Strategy partners, in consultation with aboriginal representatives, should identify the areas where provincial and territorial support is needed and seek active participation from the governments concerned.**

DIAND's response: The Department agrees that the provincial and territorial governments have an important role to play in expanding the economic base available to aboriginal people, and will continue to pursue opportunities in this regard under the direction of its respective aboriginal boards, advisory bodies and communities.

EIC's response: The Department agrees that provincial and territorial governments have an important role to play in expanding the economic base available to aboriginal people, and will continue to pursue opportunities in this regard through the aboriginal management boards.

11.50 **The Department of Industry, Science and Technology should comply with Cabinet's directive to report on the implementation of federal-provincial aboriginal economic development agreements.**

Concerns over Funding

11.51 Aboriginal communities are not homogeneous. They have different needs and opportunities, different governing structures and different access to natural and other resources. Some of them place more emphasis on environmentally and culturally sound economic development than others. In some communities, it could be more advantageous to upgrade the basic education of unemployed persons than to provide them with specific job skills.

11.52 Efficient and effective use of public funds requires that funding be appropriately planned and directed to activities that would be most beneficial to aboriginal communities as well as to aboriginal individuals living among the general population.

The basis for funding in the Department of Indian Affairs and Northern Development is questionable

11.53 Under the CAED Strategy, aboriginal communities are expected to identify their own needs, opportunities and priorities and to submit related strategic or operational plans. DIAND's policy is to release funds to the community upon receipt of these plans. However, the plans received are not used to determine the funding levels to be provided.

11.54 Instead, DIAND's contributions are provided primarily by the application of a formula based on population size. However, certain communities in remote areas have few employment or business opportunities. They are more concerned about their immediate needs, such as adequate housing and health care.

11.55 Conversely, some bands located near major urban centres or with access to developed natural resources have made progress toward achieving economic self-reliance. They may have a lesser need for economic development assistance. Yet, they continue to receive assistance for economic development primarily on the basis of population.

11.56 We further noted that DIAND continues to fund, on this basis, community economic development organizations that it has classified as being fully developed. According to the Department, in 1992, 73 fully developed organizations received \$20 million from DIAND and 296 less-developed organizations received \$33 million.

11.57 In addition, we could not find consistent evidence that DIAND had performed adequate reviews of the plans submitted by aboriginals. In our opinion, such reviews should be appropriately documented and they should be used in determining the level of funding provided, over time and within budgetary constraints.

Labour market information is insufficient for funding decisions by the Department of Employment and Immigration

11.58 The Department of Employment and Immigration shares with its aboriginal partners the responsibility for identifying training needs. These needs, which take into account labour market information, should influence how funds are allocated. The

Pathways allocation process is done in consultation between the Department and its aboriginal partners. Several factors are used in allocating resources, including demographic data, unemployment levels, remoteness from urban centres and the historical level of expenditures.

11.59 Skills development for aboriginal people includes pre-vocational, vocational and management training. At the time of our audit, many local aboriginal management boards had not analyzed training needs for their areas to determine what training to provide, and to whom. Thus, funding for job and skill training through the Pathways strategy may not necessarily be targeted to identified aboriginal training needs.

11.60 The Department is responsible for providing appropriate labour market information to the local aboriginal management boards; based on that information, the boards could be expected to develop training needs analyses for their territories. However, Employment and Immigration does not always have sufficient information on the local labour market to enable the boards to determine the training opportunities that would eventually provide employment to aboriginals. For example, very little information is provided on occupations for which there is a shortage of skilled workers, or occupations where employment growth is projected.

11.61 Consequently, these boards are faced with the task of searching for other sources of labour market information and are not yet in a position to address the question of what training to provide.

11.62 The Internal Audit Bureau of Employment and Immigration recently completed an audit of the progress made by the Department in implementing its Labour Market Information Action Plan. This plan is intended to provide a general framework for promoting the systematic development and refinement of the labour market information function. According to the Internal Audit Bureau, the implementation of the action plan is progressing, but the process is very slow in several areas. The report, dated April 1993, states that ". . . the data bases developed locally do not always represent the total local labour market in a current and accurate manner." The report adds, "Presently, there is no formalized or commonly applied mechanism to clearly identify the needs of present and potential users."

11.63 The availability of reliable labour market information is essential to ensure that the training recommended by the local aboriginal management boards is appropriate. We recognize that aggregating labour market information at all levels is difficult as well as costly, and that the needs and expectations of users are constantly evolving. Since program funds are limited, we are concerned that the Department's funding allocation may not be targeted to areas with the most pressing needs and with the best job opportunities. We urge the Department to obtain and use complete and reliable data on the labour market.

Project funding by the Department of Industry, Science and Technology does not adequately consider the socio-economic circumstances of applicants

11.64 To apply for Aboriginal Business Development and Joint Ventures Program funding, potential applicants are required to demonstrate the commercial viability of their proposed projects using standard business criteria, such as return on investment, debt-equity ratios and gross profit. The terms and conditions of the program do not require consideration of the socio-economic circumstances of applicants as a criterion for assistance.

11.65 Approximately 76 percent of the aboriginal population have not completed high school. The letter of offer of assistance, which constitutes the principal document between the applicant and the Department, is too complex for the majority of applicants, as it is directed at individuals with schooling at the university graduate level.

11.66 In our examination of this program, we found projects that, in our view, would have been implemented even without financial assistance.

Funding decisions by the Department of Industry, Science and Technology do not depend on performance

11.67 The intent of the Aboriginal Capital Corporations Program is to provide contributions for the establishment of self-sustaining capital corporations owned and controlled by aboriginals. There are currently 33 such corporations with a total approved capital base of approximately \$200 million. In the assessment of proposals for the creation of new aboriginal capital corporations or diversification of existing ones, the program terms and conditions require assessment of each corporation's potential to break even within five years. Our examination of Industry, Science and Technology's monitoring files for 11 corporations revealed that seven of them had 25 percent or more of their loans in arrears, and that two of the seven had eroded part of their capital base.

11.68 We found that the Department approved funding for four of the 11 aboriginal capital corporations without assurance that they were in compliance with the terms and conditions of the program. Three corporations had not demonstrated the required favourable record of operating performance and managerial capacity, and a fourth had not supplied a required third-party quality assessment of existing loan portfolios. We also noted that certain proposals were not adequately supported by a business plan, and that sensitivity analyses in support of the funding decisions were not maintained on file.

11.69 The three departments, in co-operation with other CAED Strategy partners, should adopt funding methods based on identified needs, priorities, constraints and opportunities.

DIAND's response: The Department considers that existing funding methods and mechanisms are designed to meet needs, constraints, priorities and opportunities of aboriginal individuals and communities who access CAED Strategy programs. These mechanisms recognize the importance of client control over program delivery and decision making.

EIC's response: The Department believes that funding methods are designed to meet needs, constraints, priorities and opportunities of aboriginal individuals and communities who access the CAED Strategy programs. These mechanisms recognize the importance of client control over program delivery and decision making.

11.70 The Department of Indian Affairs and Northern Development should document its review of the progress of community economic development organizations and the plans they submit and use this information as a basis for funding within budgetary constraints.

DIAND's response: The Department feels the funding was distributed in a fair and equitable way based upon the on-reserve population. The terms and conditions for each community economic development organization (CEDO) provided the maximum flexibility for them to develop their ability to deliver economic programs and advisory services and, at the same time, to respond quickly to local needs and economic opportunities.

DIAND agrees to undertake a review of the funding mechanism in conjunction with CEDOs and to explore the practicality of using the regional reviews of CEDO operating plans as a basis for future funding within budgetary constraints.

11.71 The Department of Employment and Immigration should provide, at all levels, labour market information that would enable aboriginal management boards to appropriately plan their training interventions.

EIC's response: Labour market information based on official census data are often not appropriate when disaggregated to the level useful for local boards and its credibility is questioned by the aboriginal partnership. With the recent release of the Aboriginal Peoples Survey data, and as the aboriginal management boards become operational and begin to input into the planning cycles, Human Resources and Labour Canada and Aboriginal people in partnership through the boards are determining the information needed and how it will best be obtained.

11.72 The Department of Industry, Science and Technology should:

develop and apply a criterion respecting the socio-economic circumstances of applicants when assessing eligibility for project funding through the Aboriginal Business Development and Joint Ventures Program; and enforce the terms and conditions required by the Aboriginal Capital Corporations Program for funding the corporations.

Observations on the Monitoring Practices of the Department of Industry, Science and Technology

Monitoring practices are inadequate

11.73 In our examination of 84 projects, a representative sample from the Aboriginal Business Development and Joint Ventures Program, we found that 14 were no longer operating. Despite the fact that the program's short-term success rate is better than that achieved under previous programs, ongoing monitoring is essential in evaluating the program's ability to achieve its goals, particularly since the contributions are usually non-repayable.

11.74 We found documented evidence of monitoring for only 17 of the projects examined. Furthermore, in these cases, there was no evidence on file to indicate that the information submitted by applicants had been analyzed, for example, by comparing actual results to the business plan estimates. In addition, the first required monitoring is 13 to 16 months into the life of a project. In our opinion, progress reports and financial information gathered from monitoring a project would be more useful if they were more timely.

11.75 The Department of Industry, Science and Technology should strengthen its monitoring procedures to ensure that all projects in the Aboriginal Business Development and Joint Ventures Program are appropriately reviewed within a reasonable period of time, and that the results of such reviews are documented and considered when determining whether to provide ongoing support for a particular project.

External delivery organizations

11.76 We found, as in the case of the Aboriginal Business Development and Joint Ventures Program, that the Department of Industry, Science and Technology was not adequately monitoring the performance of external delivery organizations. In particular, the required reports to the Department from these organizations were not always provided, and when they were, they did not include performance data such as jobs created or other indicators of project success.

11.77 The Department of Industry, Science and Technology should take steps to ensure that external delivery organizations provide reports as required and that such reports include appropriate performance information.

Results Measurement Framework

11.78 When the CAED Strategy was initiated in 1989, the Government of Canada committed itself to obtaining measurable results over the next five years.

11.79 At the time of our audit, the three departments had made only limited efforts to assess how well the CAED Strategy was working. They did not have the information necessary to measure results. Although some quantitative data exist, such as the number of projects funded, data on results and quality of services provided are incomplete or non-existent.

11.80 In addition, although a draft framework for measurement was proposed by DIAND in December 1991, the departments (at the time of our audit in the spring of 1993) had yet to decide collectively on key evaluation matters, such as the type and accuracy of required data on results.

11.81 In our view, these matters should have been addressed when the CAED Strategy was designed, so that the implementation focus and accountability for results could have been determined right from the outset and then refined on a continuing basis.

11.82 We noted that, in May 1993, the CAED Strategy Management Committee approved a "CAEDS Results Measurement Framework" to be implemented at a later date.

11.83 In our opinion, the lack of appropriate performance and evaluation information impedes the necessary accountability within the aboriginal communities and between the government and Parliament. It makes effective implementation of the CAED Strategy more difficult.

11.84 The three federal departments involved in the CAED Strategy should obtain and use appropriate data to evaluate and report on the results of the Strategy.

DIAND's response: All CAED Strategy partners have determined an assessment framework that is employing various and appropriate sources of data and information to report on the results of the Strategy. In addition to significant performance monitoring to date, the Department is undertaking evaluation initiatives as outlined below, which will more fully address evaluation requirements.

The Department of Indian Affairs and Northern Development made a commitment to Treasury Board in 1990 to begin a series of evaluations and results gathering initiatives commencing in 1991:

A CAED Strategy assessment conducted by aboriginal people as recipient clients - to be completed this fiscal year;
Economic Development Strategic Review - to be completed this fiscal year;
Program evaluation of DIAND-CAEDS components - to be completed this fiscal year;
Statistics Canada post-census survey - aboriginal people - completed and data results are now being released;
CEDO operating plan results reporting data annexes - completed and reporting annually; and
Publication of status reports for the DIAND-CAEDS components - Community Economic Development, Research and Advocacy and Resource Access Negotiations - completed and published.

EIC's response: All CAED Strategy partners have determined an assessment framework that is employing various, appropriate sources of data and information to report on the

results of the Strategy. In addition to significant performance monitoring to date, the partner departments are undertaking additional evaluation initiatives that will more fully address all evaluation requirements.

Questions That Need to Be Answered

11.85 The following questions, among others, need to be answered by both the government and non-government CAED Strategy partners in order to conclude on the success of the Strategy.

What actual benefits have resulted from CAED Strategy activities, and have these activities achieved value for money?

Did CAED Strategy expenditures take into account priorities of aboriginal people, or could the funds have been used differently to generate greater benefit?

Is there a more cost-effective way to achieve the same results?

What is meant by "economic self-reliance", and what criteria will be used to determine whether it has been achieved?

Inadequate Information to Parliament

11.86 Information on CAED Strategy costs and performance should, in our opinion, be reported to Parliament annually. Such information should be relevant, complete, and reliable. The only consolidated report on CAED Strategy activities that was provided to Parliament was a March 1991 joint status report. It describes the CAED Strategy components that are assigned to each of the participating partners and contains selected statistics such as costs and the number of projects approved, rejected or withdrawn. However, it does not provide performance information. In our view, the absence of this information impedes accountability.

11.87 The federal CAED Strategy partners should provide, in a comprehensive annual report to Parliament, information on costs and performance that is relevant, complete and reliable. This information should clearly indicate the total costs incurred and the progress made in relation to the stated objectives.

DIAND's response: The Department currently reports on DIAND components of the CAED Strategy through Part III of the Estimates. DIAND agrees with the need for results reporting. A CAED Strategy results measurement framework was agreed to and implemented by the Department and its partners in May 1993. It is expected that this new measurement framework will satisfy the informational needs outlined by the Auditor General's findings. These reports will be available as public documents on a periodic basis.

EIC's response: The Department agrees with the need to report to Parliament on an annual basis, but believes the appropriate reporting mechanisms on CAED and/or supporting programs are already in place through Part III of the Main Estimates.

11.88 ISTC, succeeded by Industry and Science Canada, has provided the following overall response regarding its role under the CAED Strategy. We are concerned that this response does not address the specific audit observations and recommendations.

ISTC's response: Industry and Science Canada believes that the audit of the CAED Strategy obscures the significant accomplishments of aboriginal Canadians and of the Department's Aboriginal Economic Program (AEP) business development initiatives. There is much to demonstrate that we are progressing well toward meeting the Strategy's objectives.

The Department is proud that since the autumn of 1989 to 31 March 1993, AEP has approved support for over 3100 proposals from clients. This financing totals \$207 million and has resulted in investments, from all sources, of almost half a billion dollars in the aboriginal business sector. The effort toward increasing aboriginal participation in the national economy has clearly taken hold. Moreover, the direct involvement of aboriginal business leadership in the decision-making process through the Department's aboriginal economic development boards has made our investments responsive to the needs, constraints, priorities and opportunities of aboriginal individuals and communities.

Recently, the Department conducted a business performance review of the 337 aboriginal businesses with more than two years of operating experience that had received assistance early in the mandate of the Aboriginal Business Development Program. Ninety percent were still in operation, and sixty percent were operating with a profit or a small loss. This compares favourably with the Canadian average for new small businesses. A full review of all AEP activities, planned for 1994-95, will be based on an evaluation framework established by the Department in 1991. Meanwhile, the Department continues to report on specific achievements through studies, annual and progress reports, and by reporting both to Parliament and to aboriginal client groups.

The Department agrees with the importance of monitoring projects and of following up on the performance of its client businesses. It continues to make improvements in client monitoring and reporting practices.

Equally important, the Department has pioneered innovative approaches to the delivery of programs to aboriginal businesses through the establishment of aboriginal capital corporations, which provide loans to small businesses, and through external delivery organizations that substantially improve access to the program in rural and remote areas. These achievements have been critical to increasing the level of business management skills in communities across the country.

In summary, the Department's Aboriginal Economic Program effectively provides support to the growing aboriginal private sector - in collaboration with aboriginal people. Our programming is co-ordinated with other federal CAED Strategy partners by a common mission, and co-ordinated mandates and delivery mechanisms.

Additional Matters for Consideration

11.89 CAED Strategy funding to DIAND and Industry, Science and Technology was initially provided for five years ending in 1994. With respect to proposed funding renewals, we believe the federal CAED Strategy partners should take into account the following matters in addition to the observations and recommendations already discussed.

Employment Equity

11.90 As part of the federal government's 1990 Native Agenda, and in response to the recommendation of the Fourth Report of the Standing Committee on Aboriginal Affairs, DIAND and the Treasury Board sponsored the Aboriginal Workforce Participation Initiative in 1991. Its major goal is to increase aboriginal employment in the public service of the federal, provincial and territorial governments, as well as in the private sector.

11.91 This initiative gave federal departments and agencies specific duties, such as the development of aboriginal employment strategies, including the establishment of targets for recruitment, promotion and retention.

11.92 The Aboriginal Workforce Participation Initiative acknowledges that aboriginal people continue to be under-represented in the federal public service. Further, with respect to the private sector, a 1992 Employment and Immigration report on the application of the *Employment Equity Act* indicated that, although aboriginal representation in the work force had improved over a five-year period, aboriginal people remained substantially under-represented.

Basic Education

11.93 Studies conducted by DIAND and by an Indian community identified barriers to labour market participation, including low education levels and a lack of access to adult basic education programs.

11.94 A 1989 policy paper, "Success in the Works", published by Employment and Immigration, estimated that most new jobs will require more than five years of combined education and training beyond the completion of high school. Community entrepreneurs must compete in a changing business world, which demands frequent updating of sophisticated management and marketing skills. Even traditional occupations, such as resource development, are being influenced by technological change.

Investment Capital

11.95 The federal government has acknowledged that the *Indian Act* can impede economic development. For example, restrictions relating to on-reserve land use and other aboriginal assets make it more difficult for aboriginal peoples to obtain financing

for development projects. Although these restrictions are not necessarily insurmountable, they do not facilitate exploitation of development opportunities.

The Role of Aboriginal Institutions

11.96 As a result of CAED and Pathways strategies, specific aboriginal institutions were established to assist the aboriginal people to obtain greater control over their economic destiny. The community economic development organizations, the local aboriginal management boards and the aboriginal capital corporations are examples of intended opportunities to increase aboriginal participation. At the same time, however, these institutions have a responsibility to co-operate with each other by sharing economic development information and co-ordinating their efforts to lead their constituents toward achieving their goals.

Chapter 12

Canadian International Development Agency

Bilateral Economic and Social Development Programs

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Canadian International Development Agency

Bilateral Economic and Social Development Programs

Assistant Auditor General: Richard B. Fadden

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Main Points

12.1 Official Development Assistance is a significant aspect of Canada's foreign policy. For 25 years CIDA has been the main conduit for delivering development assistance. Annual expenditures for bilateral economic and social development assistance exceed one billion dollars.

12.2 We conducted this audit taking into account the increasing international awareness that continued investment in development projects that are not likely to be sustained beyond donors' financial assistance represents a questionable use of scarce resources.

12.3 In its ability to meet development needs of the nineties, the Agency has been losing ground. Current performance has not maximized the use of resources and has not led sufficiently to self-reliant development. There is considerable scope to improve CIDA's performance in promoting enduring benefits from its investments.

12.4 CIDA's bilateral programs need to concentrate more on those countries and activities where there is the greatest potential.

12.5 Lessons learned from 25 years' experience show a need to resolve conflicts among multiple objectives and to establish a more results-oriented, focussed, businesslike and accountable style of operation. They also call for dedication to the basic objectives - such as fighting poverty and helping people help themselves - that Canada has affirmed repeatedly over many years.

12.6 None of these changes will be easy to make, since they will require a change in mindset, skills and culture, and strong ministerial support. Their successful implementation will depend on the will to reform, not only among management and staff of the Agency but also among those who act as its development partners, in Canada and in the developing countries where CIDA operates.

Introduction

12.7 CIDA has been the main Canadian conduit for administering Official Development Assistance since 1968. In recent years its annual expenditures on bilateral economic and social development assistance have exceeded one billion dollars - over half of its share of Official Development Assistance (ODA) to developing countries. The rest is delivered mainly through funding to multilateral institutions such as United Nations programs, to international financial institutions such as the regional development banks, and to the multitude of non-governmental organizations such as CARE and the Canadian Comprehensive Auditing Foundation. ([see Exhibit 12.1](#))

12.8 Chapter 11 of our 1992 Report dealt with the way CIDA manages Canada's participation in the regional development banks. We audited certain other aspects of CIDA's operations in 1988, including contributions to non-governmental organizations.

12.9 The past decade has been particularly turbulent, with events that have challenged earlier assumptions about development aid and about what works. The link between development and the degradation of the environment has become more visible. The challenge ahead will be to articulate a clear strategic direction and priorities for Canada's overall co-operation in international development. This will have to be done during a period of large federal deficits, increased emphasis on domestic needs, demands for economic assistance from emerging nations in Eastern Europe and the related pressure for better fiscal planning and control. A new policy direction for Canada's overall international co-operation may become necessary.

12.10 CIDA provides assistance to about 115 countries; however, 70 percent of its bilateral expenditures are directed to a core group of 35 countries in Asia, Africa and the Americas.

12.11 Few Canadian organizations, private or public, attempt the complex and high-risk task that CIDA undertakes: making large annual expenditures in a wide variety of ambitious projects in a great many countries and in a multitude of economic and social sectors, often in uncertain political and economic conditions. CIDA in the field has a reputation for integrity and co-operation.

Official Development Assistance is a significant part of Canada's foreign policy

12.12 In 1987, after a comprehensive review of Canada's Official Development Assistance, the House of Commons Standing Committee on External Affairs and International Trade published a report entitled "For Whose Benefit?" The Committee report and the government response to it led to a comprehensive strategy for development assistance. The document entitled *Sharing Our Future* became Canada's foreign policy on Official Development Assistance. It reaffirms earlier strategic policy directions - fighting poverty and promoting self-reliant development. CIDA has pointed out that there

is no other official source of Canadian policy on Official Development Assistance. ([see Special Insert](#))

Principles and Priorities of Canada's Official Development Assistance (ODA)

Canada's ODA Charter underlines four guiding principles:

Putting poverty first: The primary purpose of Canadian Official Development Assistance is to help the poorest countries and people of the world.

Helping people to help themselves: Canadian development assistance aims to strengthen the ability of people and institutions in developing countries to solve their own problems in harmony with the natural environment.

Development priorities must prevail in setting objectives for the aid program. So long as these priorities are met, aid objectives may take into account other foreign policy goals.

Partnership is the key to fostering and strengthening the links between Canada's people and institutions and those of the Third World.

In the context of these guiding principles, six development priorities have been identified. They are poverty alleviation; structural adjustment; increased participation of women; environmentally sound development; food security; and energy availability.

Human resource development will become the central programming thrust of all country programs.

Source: Sharing Our Future

12.13 Thinking has evolved over the past two decades on how best to alleviate poverty. In the 1960s, general economic growth was seen as the key. As the "trickle down" theory proved unrealistic, emphasis in the seventies shifted to social and economic interventions intended to redistribute income. The results of that policy were mixed at best. In the 1980s, the focus changed to the interrelationship among population growth, poverty, environmental degradation and the policy environment. It became clear that translating economic growth into human development and reduction of poverty requires effective policy management. Today, CIDA points out that a combination of factors contributes to alleviating poverty: policy reform in key sectors, structural adjustment leading to improved macro-economic planning and emphasis on human resource development. Fighting global poverty through economic and social development is recognized as an investment in the future.

12.14 The importance of development aid to Canada's foreign policy has been reaffirmed in the recent document "Foreign Policy Themes and Priorities" (1991-92 update) issued by the Department of External Affairs.

CIDA's mandate

12.15 There is no specific enabling legislation that sets out CIDA's mandate and accountability for Official Development Assistance, although the House of Commons Standing Committee on External Affairs and International Trade recommended such

legislation in 1987. The ODA charter in the strategy document *Sharing Our Future* sets out the basis for its mandate. The *Department of External Affairs Act* makes the Secretary of State for External Affairs the Minister responsible for CIDA, thereby bringing the actions of the Agency under that Act's broad authority. Its spending is authorized by the annual appropriation Acts. ([see Special Insert](#))

Constraints to Good Management Identified by CIDA

Our discussions with a variety of observers, CIDA management, and other officials pointed to several factors over which CIDA has limited control but that affect the implementation and results of its programs and activities.

Pre-conditions for effective delivery are often missing. Frequently in recipient countries there are government policies, limited institutional capacity, political instability and administrative constraints that are not conducive to achieving value for money from development projects. In addition, there are difficulties in enforcing bilateral agreements.

Fiscal uncertainty in Canada is making it harder for CIDA to plan for the long term. The early 1980s were a period of continued growth in Official Development Assistance; there was pressure to spend and to find ways to spend faster. The trend in the late 1980s and in the 1990s has been just the opposite.

The political will to concentrate CIDA's efforts on a limited number of objectives is not consistently apparent. Pursuing multiple objectives, not always complementary and sometimes unwritten, in response to multiple constituencies makes the program complex, increases its cost, and adds to confusion of purpose.

Over time, political and commercial objectives have encouraged CIDA to spread its limited human and financial resources widely. CIDA's broad geographic spread and range of interventions add to complexity in management.

There was a perception within CIDA that it was subject to too many Treasury Board rules that limited its flexibility . These included a five-year planning cycle, the number of people CIDA could deploy overseas and the contracting-out policy that limited its staff strength unduly.

There is often tension between CIDA and the Department of External Affairs over how much money is to be committed, in which country, for what purpose, and when. Foreign policy, including development assistance, is based primarily on long-term interests and objectives. The need to be flexible in responding to global changes that affect Canada's interests and objectives is sometimes at odds with the longer-term perspective CIDA adopts in development goals, strategies and funding commitments.

12.16 Program objective. Part III of CIDA's 1993-94 Estimates states: "The objective of the CIDA program is to facilitate the effort of the peoples of developing countries to achieve self-sustainable economic and social development in accordance with their needs and environment by co-operating with them in development activities; and to provide humanitarian assistance." Two percent of total Official Development Assistance was to be allocated to international humanitarian assistance.

Audit Objective, Scope and Approach

12.17 We planned this audit taking into account the increasing international awareness that many development projects are having problems, although reportedly fewer in some regions than others. There is cause for concern. The World Bank stated, in a 1992 report, that the number of its projects facing "major problems" has gone up significantly. Management in this institution was reportedly more preoccupied with approving new loans than with pursuing the successful implementation of development projects. Now, however, as an indicator of effectiveness, successful implementation of approved projects is taking priority over new annual commitments. Similar difficulties have been voiced by other development agencies, such as US A.I.D. It has been pointed out that continued investment in development projects that are not likely to be sustained beyond donors' financial assistance represents a major waste of scarce resources.

12.18 Objective . We conducted this audit with a view to:

providing objective information, advice and assurance to help Parliament scrutinize CIDA's use of resources and the management of its results;
promoting accountability and good practices in CIDA in managing for results;
and
highlighting areas for improving the Agency's management of its country programs and projects.

12.19 Scope . We examined CIDA's management of bilateral economic and social development assistance by asking whether:

CIDA implements the principles and priorities set forth in the Official Development Assistance strategy *Sharing Our Future* , and whether there are other relevant considerations;
CIDA defines, plans, implements and accounts for the results of its programs and activities;
the Agency, in cases where it entrusts other parties with the disbursement of Canadian funds on its behalf, obtains independent assurance that moneys have been spent for the purposes intended, and have been accounted for fully; and
management identifies lessons learned and applies them to future policy, programming and implementation at the Agency, country and activity levels.

12.20 Approach . We examined CIDA's stewardship of the funds entrusted by Parliament, in the context of the principles and priorities of Canada's policy on Official Development Assistance. We took into account the fact that Canada has a choice of various channels for delivering aid. We also recognized the reality of current financial restraints and Canada's overall international commitments.

12.21 We used a combined country- and project-based approach to conduct this audit. CIDA funds its bilateral programs and activities on a country basis. This allows it to consult with the Department of External Affairs on foreign policy and related funding

considerations. It also allows for dialogue with the recipient country and with other donors. This helps in developing a framework for matching the needs of the recipient country with Canadian capabilities, while taking into account foreign policy and fiscal considerations. At the same time, CIDA's discrete activities are carried out on a project basis.

12.22 We focussed our attention on three country programs, selected in consultation with CIDA management, and examined in depth 18 development projects in the field. The countries - Bangladesh, Pakistan, and Sri Lanka - are situated in a region where a significant portion of the world's poorest people live and where CIDA has been operating for over 25 years. Understanding the political, economic and cultural environment and the development needs of these countries was a key consideration in planning this audit. We do not assume that these three countries and 18 projects reflect all the kinds of programs and projects CIDA undertakes around the world, but CIDA agrees with us that our findings on its management are representative. No one CIDA country is "typical", but CIDA's management of bilateral development aid projects is reasonably well represented by its approach in the three countries.

12.23 Emphasis . We paid special attention to understanding CIDA's accountability in relation to managing for results. Accountability at its simplest calls for holding public officials answerable for their actions, including the provision of appropriate information to Parliament. The objective is not so much to attach blame when something goes wrong as to find out why it went wrong, and what can be done to rectify it and guard against a recurrence in the future. As well, we explored what kinds of yardsticks could be used to monitor the progress and results of CIDA's development projects. ([see Special Insert](#))

Managing for Results

In referring to the accountability of CIDA managers with respect to managing for results, we mean:

- actively pursuing well-defined policy and specific strategic objectives;
- assessing and managing the risks associated with the programs and activities undertaken;
- obtaining and using relevant information on performance;
- understanding and evaluating to what extent programs and activities are meeting the Agency's performance expectations;
- continually learning from their experience and redirecting resources more productively among programs and projects;
- reporting on costs and accomplishments in terms of results; and
- creating an action-oriented organizational environment that promotes learning by doing, an innovative style of management and an openness to differing viewpoints.

12.24 The Minister without question is accountable to Parliament for measuring and reporting on the results of CIDA's programs. The Minister's accountability must take into account that, in practice, CIDA cannot be expected to be successful in every activity it undertakes. CIDA's operating environment is such that control over the ultimate result of its efforts is often limited by the fact that it works in partnership with other sovereign states.

12.25 At the time of our audit, CIDA had completed a major Strategic Management Review. This review was comprehensive: it covered the organizational status of the Agency, its major management processes and its various delivery methods. We took the review's findings into account in shaping our audit and developing our observations and conclusions. ([see Special Insert](#))

Challenges Facing CIDA

CIDA is in the process of strengthening its management capacity for decision making. In our view, there are at least five major challenges facing the Agency:

To develop a consensus among all the key players involved in international development activities, including politicians, on how to build an overall aid program for Canada. Consensus is needed on the primary purpose of Official Development Assistance, the key countries in which CIDA should operate and the best ways to achieve the government's policy objectives and priorities.

To spell out more clearly CIDA's accountability in managing for results within the Agency, and the Minister's accountability to Parliament.

To design and implement a more innovative management system. There is a need for a more strategic and results-oriented management culture and contracting regime in the Agency.

To concentrate its resources and efforts on specific countries and activities in order to maximize results. Given resource limitations, it would be preferable, for example, to reduce the number of Canadian aid priorities, recipient countries and the objectives pursued in any one country.

To become more transparent. This means being open with Parliament and with CIDA's partners in development about the policy objectives being pursued, the programming decisions being made, the costs involved and the results achieved.

12.26 We consulted with CIDA's Audit and Evaluation Division. It had seldom carried out significant examinations of the Agency's overall management of the bilateral programs, in terms of results or the effectiveness of its programs in each country. Consequently, the Division had not systematically addressed country-related or other obstacles to successful implementation of the Agency's mandate. Accordingly, in our audit we could place only limited reliance on its work. A study the Division had commissioned on the quality of project evaluations by CIDA's geographic branches was helpful to our understanding of the Agency's operating environment. We used the results of the study in formulating our views on what improvements are needed in project evaluations. We discussed our audit approach with the Auditors General of each of the

three countries covered in our examination and with members of their staffs who had received training in Canada through the Canadian Comprehensive Auditing Foundation.

Audit Observations

12.27 Our observations are organized into several sections. First, we discuss some of the challenges that CIDA faces. Second, we outline the lessons that CIDA itself identified in its recent Strategic Management Review, and that we have confirmed in our audit. Third, we describe the actions CIDA is taking to respond to the observations of its Strategic Management Review. Fourth, we set out some additional findings that we believe are crucial to CIDA's achieving value in its bilateral country programs.

Our Findings on Lessons Identified by CIDA's Strategic Management Review

12.28 CIDA has reflected recently on the lessons it has learned in two and a half decades of operation. The main vehicle for this reflection was the Strategic Management Review, one objective of which was to assess CIDA's ability to meet the challenges of the nineties and recommend ways to improve its management practices and philosophy. In our view, this was a timely and valuable re-examination of the fundamentals of the Agency's operations.

12.29 The consultants who conducted the main examination at CIDA's request identified many problems that call for early remedial action, and formulated three key recommendations:

- improve the Agency's "development" knowledge base;
- increase the relevance of the aid program through better dialogue with its stakeholders; and
- reduce its delivery costs.

12.30 CIDA took these recommendations into consideration before concluding its review. Its overall conclusion was that, in terms of its ability to meet development needs of the nineties, the Agency was indeed losing ground. Our audit confirmed the significance of the lessons learned, their interdependency and the need to take corrective action.

CIDA's Lesson #1 There remains considerable confusion in the minds of many about the sometimes conflicting objectives of the Official Development Assistance program and about how to resolve these conflicts on a daily basis.

Our view: Conflicts among objectives need to be resolved

12.31 The Agency, in practice, has been tasked with multiple objectives: while charged with pursuing one primary objective, CIDA has others that can often conflict with it. It is difficult for CIDA to concentrate on putting poverty first and encouraging self-reliance while, at the same time, it has commercial and political objectives that do not always lend

themselves to dealing with poverty in a direct way and that encourage external dependency. We appreciate that government programs seldom operate in sole pursuit of a single overriding objective. Nevertheless, competing or conflicting objectives should be pursued only consciously and in full realization of their effect on the primary objective.

12.32 The way development is to be implemented is, at present, very broadly defined. Often the link between the activities undertaken and CIDA's primary purpose of "putting poverty first", as defined in the ODA Charter, appears to be indirect.

12.33 In Bangladesh, the site of CIDA's largest bilateral program, Canadian bilateral aid to date has been over \$2 billion. Food and commodity aid accounted for two thirds of the almost \$1.1 billion total aid between 1981 and 1990. Even now, food and commodity aid account for 40 percent of annual bilateral aid to this country. This is notwithstanding CIDA's stated priority for South Asia: to direct a considerable portion of the funds in the country programs toward improving the productive capacity of the poor. Although we recognize that humanitarian food aid to bridge a food gap is sometimes necessary, CIDA agrees that it should not act as a disincentive to local production. Aid in this form given over extended periods raises questions about the country's dependency on foreign aid. We do not expect that the Agency can or should discontinue food aid. However, it is recognized that the effects of such aid - however beneficial - are necessarily short-term if the agricultural productive capacity of the recipient country is not improved in a sustainable way in the long run.

12.34 CIDA points out that the many structural weaknesses in Bangladesh make self-reliant development very difficult. For example, the state institutions that CIDA must deal with are weak and there is a lack of local financial resources for operating and maintaining development projects. Given these shortcomings, it has been argued that it is preferable to continue funding economic and social development projects, with emphasis on improving the policy environment, even if the result is more external dependency. It was pointed out that the consequences could be political, social and economic chaos if donors withdrew their support. In such a case, the costs of peacekeeping and/or emergency humanitarian assistance could dwarf the present cost of bilateral aid. Although these arguments cannot be dismissed, we believe that they do not sufficiently emphasize CIDA's primary purpose for using funds earmarked for self-reliant development.

12.35 In Pakistan, where Canada has invested over \$1.3 billion to date, Canadian commercial and other interests appear to have shaped CIDA's activities as much as the objective of helping the poorest people become more self-reliant. For example, in the 1980s a large share of project aid was devoted to funding state-owned infrastructure projects in rail transportation and energy, which were delivered by the Canadian private sector. These do not appear to be the most direct ways for helping Pakistan's poorest people improve their human development and earning capacity. Direct involvement in areas such as population control, education, health and the productive capacity of the poorest people was not prominent in the portfolio of projects we examined.

12.36 Many factors have contributed to the difficulty of producing with dispatch a coherent plan of work that would put approved development objectives first. CIDA is subject to many competing interests, and Pakistan, like many other developing countries, is plagued by chronic poverty and, reportedly, by administrative complexities and weak state institutions, which have traditionally delivered aid projects. It was explained to us that without a functioning system of financial accountability, government efficiency in the recipient country is reduced, and the probability of corruption increases. An effective network of non-governmental organizations as an alternative vehicle for aid has yet to evolve. This is the inherently difficult situation in which CIDA must work.

12.37 In Pakistan we encountered an extraordinary range of views among CIDA officials on the strategic thrust the Agency should be taking, and we observed a lack of coherence in programming. For example, opinions on what the country program should include range across such diverse approaches as working in small grass-roots projects (a small contribution to a girls' school; helping villagers build their own bridge over a stream); helping the country reform its judicial system to minimize administrative constraints and inefficiencies; encouraging Canadian private business to increase trade; and deregulating and opening the economy along the lines of a model that, to some, appears to have been successful in Indonesia. Moreover, recipient government officials have lobbied for megaprojects in the power and oil and gas sectors, and have been supported by some Canadian private interests. Each of these views may have merit, but a sense of coherent direction has not developed. Some argue that CIDA's ability to deal more directly with poverty may, in the future, require placing a higher priority on the social sector - which reportedly the Government of Pakistan has not supported sufficiently in the past. ([see photograph](#))

12.38 In Sri Lanka, we found CIDA's projects and programs driven primarily by Canada's political concerns about social justice, peace and human rights in a situation where civil order had broken down. CIDA's budget for this country has gone down from a peak of \$43 million in 1982-83 to less than \$10 million today. Some donors point out that, unless human rights are restored and the root causes of ethnic conflict satisfactorily resolved, traditional economic and social development objectives are bound to be thwarted. This may well be true, but should CIDA continue to provide Official Development Assistance funds in a country where it believes that its traditional development activities, emphasizing human resource development, have become impossible to implement? If CIDA believes that funding should continue, it should publicly explain the basis for the shift in emphasis, the criteria applied to make this decision, and the nature of the program's reorientation.

12.39 In summary , the issue of conflicting objectives raised in 1987 by the House of Commons Standing Committee on External Affairs and International Trade remains unresolved. At stake is CIDA's ability to pursue its development mandate effectively.

CIDA's Lesson #2 CIDA is an over-extended Agency. Activities are dispersed over numbers of countries, projects, delivery channels and funded institutions. A lack of

strategic focus leads to reduced program impact. Furthermore, Canada's influence with recipient governments is diluted, given our relatively low ranking among donors in terms of volume of aid to any given country.

Our view: CIDA needs to concentrate its efforts

12.40 CIDA would benefit from concentrating on its primary objectives and priorities and reducing the dispersion of its programs. There has been, in the past, little Agency-wide incentive or pressure to do so. CIDA needs to be more selective, by focussing on key countries and more productive activities where there is the greatest potential for benefit in terms of development.

12.41 Despite recent efforts by CIDA to reduce dispersion, particularly in Asia, we found that the mix of existing projects and programs covered a wide range of sectors, types of CIDA support, channels of delivery and funding mechanisms, as shown in [Exhibit 12.2](#). There was a general lack of focus, especially evident in two of the three country programs we examined.

12.42 Although in the last few years CIDA has reviewed its strategic objectives for many of its "core" countries, and although the plans (Country Policy Frameworks) do represent, in cases like Pakistan, some narrowing of focus, the objectives typically remain broad and the measures of success undefined. Over time, dispersion may be reduced, aided by shrinking budgets. In the meantime, however, CIDA in some respects has extended its scope over the past few years. In addition to servicing capital infrastructure projects and undertaking economic and social programs and projects, which have been the traditional focus of its attention, CIDA has greatly increased its emphasis on the broad themes of human rights, good governance and the environment. "Policy dialogue" with recipient governments has received more emphasis and CIDA has co-operated with other agencies, such as the International Monetary Fund and the World Bank, in "structural adjustment" negotiations and funding.

12.43 In Sri Lanka adversity had, in fact, led to a concentration and simplification of aid strategy. In light of serious ethnic violence and human rights abuses in that country, CIDA decided to focus primarily on aiding non-governmental organizations to research policy issues related to good governance and to assist small entrepreneurs, instead of the traditional mix of infrastructure and institutional development projects in a multitude of sectors. ([see photograph](#))

12.44 Undoubtedly, CIDA could do valuable work in many fields and in many countries. But adding to an already large and complex workload could detract from CIDA's ability to deliver a core program focussed on its primary objectives. The proliferation of programs, and the experience of many years that saw CIDA staff transferred too frequently from one country to another and from one program to another, have moulded the Agency in ways that might be difficult to change in the short term.

12.45 Lack of focus makes it difficult to achieve the desired impact or build enduring partnerships. It also increases the cost of program delivery. Lack of focus hinders an emphasis on a clear strategy for building the strength of institutions and for promoting equitable distribution of wealth. It increases the administrative burden on CIDA staff. It strains CIDA's monitoring, audit and evaluation capability and increases the difficulty of measuring results. Moreover, it limits in-depth learning and development of the "core competence" of CIDA staff.

12.46 In summary, this is an issue of productivity. Given increasing resource constraints, CIDA needs a clear and specific strategy for each country, focussed on the Agency's primary objectives. At stake is the quality of CIDA's programs and projects in relation to its mandate.

CIDA's Lesson #3 CIDA is an over-regulated Agency. Too much focus is placed, and time spent, on managing the bureaucratic processes and on minimizing risk, to the detriment of development content. This leads to higher administration costs, delays, and efficiency losses. Contracting processes are too complex and cumbersome.

Our view: There is a need for CIDA to streamline the way it runs its business, including its existing controls, to be more efficient and effective

12.47 We share the view of CIDA's Strategic Management Review that CIDA staff have been devoting more attention to process than to the substance of development. On the one hand, CIDA had resisted being held accountable for managing results rather than process alone, but on the other, it objected to the proliferation of process-oriented controls. This presents a dilemma. It is unlikely that controls agreed to with the Treasury Board can be discontinued before CIDA demonstrates its ability to achieve value for money with development results. There is a need to incorporate flexibility while retaining essential controls. If CIDA could demonstrate that the benefits that accrued from the investments in developing countries were greater than the costs it incurred, one might expect that the pressure for controls on its processes would be lessened, and its ability to innovate would be less constrained.

12.48 One aspect of the dominance of desk administration is the limited contact that CIDA officers have in the field with the recipients of their projects. CIDA project team leaders' site visits, or other visits to the field, tend to be far too superficial to be effective. The Agency's general decentralization in the late 1980s was supposed to address this problem, but to CIDA that effort proved to be too costly and has since been reversed.

12.49 CIDA staff have few opportunities to develop, through direct experience, their "core competence" in social and economic development. The Strategic Management Review pointed this out, noting that management processes have grown in complexity over the years and that CIDA staff have devoted their time increasingly to managing the paper flow. "Hands off" management has become the order of the day, without adequate recognition of either the consequent limitations on learning or the increase in operating

costs. For example, all six projects we examined in Pakistan contracted out all phases of the work: project design, implementation, monitoring and evaluation. In some cases, contractors were engaged to manage other contractors. There is nothing inherently wrong with contracting out, particularly where specialized expertise is needed and where it is cost-effective. However, CIDA needs to recognize that, like all government departments and agencies, it is answerable for the cost and performance of its contractors.

12.50 Another factor that limits the "core competence" of the Agency is the frequent rotation of staff without apparent concern for loss of expertise. CIDA's officers are shifted from one country to another frequently, and can find themselves managing projects in entirely unfamiliar economic sectors in a country where the culture and language are also unfamiliar. Excessive rotation can severely limit their contribution to the Agency's performance. Some way must be found to enable CIDA staff to remain working for longer periods in regions where they have developed in-depth knowledge and understanding over a number of years, and in types of projects where they have expertise as well. If CIDA's staff remain generalist administrators, who may be managing a women-in-development rural credit project in Indonesia one year and a geological survey project in Nepal the next, they inevitably will be focussed on desk administration and buried in paper rather than substantially involved in generating development results in a particular country.

12.51 Short posting tenures of two or three years also limit knowledge and lead to a disassociation of individual CIDA staff members from the results of projects and programs. The projects we examined had life cycles varying from three to fourteen years. Longer tenures, say four to six years, and greater delegation to local staff could be considered, as could the identification of milestones within projects to facilitate the staff's accountability. US A.I.D., for instance, posts its staff in countries like Pakistan and Sri Lanka for four years. The life of most projects we looked at was much longer than the typical tenure of a CIDA officer in a particular post. For example, CIDA's involvement in land reclamation projects generally requires at least a ten-year commitment. In a project we examined in Pakistan, there had been a succession of four different project team leaders, four different field officers, and three different monitors. When one considers that the project is often continued through a number of phases, it is clear that the total number of staff responsible at some time for some part of the project over its life is very large. A long-term commitment by a stable CIDA management team with particular knowledge in the project is rare. An approach that links staff assignment lengths with evaluable results is needed.

12.52 In summary, this lesson from CIDA's Strategic Management Review and our views thereon point toward the need for a new control structure for the Agency. There is a need to simplify its management process and make individual staff much more answerable for managing results of clearly identifiable activities assigned to them. To do this, CIDA needs to modify its administrative policies, systems and practices. It also needs to link changes in administrative practices to improvements in staff capability to manage for results, become more adaptive and assume more personal responsibility. At stake is the Agency's ability to manage efficiently and effectively.

CIDA's Lesson #4 The existing project management approach needs significant modification.

Our view: CIDA's approach to project management needs to be revised. More innovative project management skills and practices are needed

12.53 CIDA's approach to project management was designed mainly to deliver replicable and highly structured capital projects, such as roads and bridges. This engineering "blueprint" for funding, staffing and managing CIDA's activities cannot be applied in a mechanical way to many of the newer types of CIDA projects, such as human resource development, policy advice, structural adjustment or balance-of-payment support. These are much "softer" in nature, where results can be demonstrated only over a longer period of time. The added complexity of such projects demands higher levels of project management skills and cost consciousness throughout the Agency. The nature of the risk associated with human resource development and policy influence calls for a much greater understanding of the cultural, political and social implications involved. A good understanding of local culture and values becomes critical to assessing the appropriateness of expertise and technology provided by Canada. The environment in many respects is more demanding. For example, professionals in recipient countries are more inclined to challenge the appropriateness of donors' advice and proposals. The CIDA officer now needs to have more expertise in development planning, as well as more expertise in the country and the nature of the project than was previously the case.

12.54 CIDA needs to develop the capacity to deal with the new kind of risk and uncertainty without abandoning traditional project management disciplines. More flexible project management and funding arrangements may be needed. However, they must be accompanied by a wider set of skills and knowledge of development priorities, more rigorous planning and better answerability of individual staff for achieving the results CIDA wants, on time and within budget. The nature of control may change but not the need for it. For example, if CIDA is going to continue to fund projects, say, to train nurses or to help a country develop and implement a national environmental strategy, it will need very careful and continual thinking through of all the tasks, steps, and performance indicators needed over an extended period to monitor progress and eventually to obtain meaningful results. If the new direction in CIDA is to enhance the long-term capacity for policy development in the recipient country, a stronger commitment on the part of CIDA and its counterparts in developing countries is also needed. Continuity of staff needs to be ensured in order to build longer-term relations with local officials. These are prerequisites for effective project management. It is not simply a matter of completing a technical task according to a blueprint, funding the activity and assuming that the desired results will follow.

12.55 In summary, CIDA's growing involvement in a wide range of "softer" projects requires that its staff maintain traditional project management skills while systematically developing the mindset, knowledge and skills necessary for the new types of projects. At stake is the Agency's ability to demonstrate achievement of results.

CIDA's Lesson # 5 CIDA has not appropriately acknowledged its accountability to Parliament for the management of development results.

Our view: Accountability needs to be clarified

12.56 We feel strongly that CIDA's accountability to Parliament with respect to managing for results needs to be clarified. There are varying types of delivery mechanisms and financial arrangements that CIDA enters into with its partners. There is a need to clarify the respective accountability of CIDA's staff and its partners for obtaining results, as illustrated in [Exhibit 12.3](#). This would have a beneficial effect on the Agency's performance and the motivation of its personnel.

12.57 Until recently CIDA did not fully acknowledge its accountability to Parliament for managing in a way that would produce desired results - that is, for obtaining value for money. Its reluctance arose from a keen awareness of the uncertainties and risks that are common in the general environment of development projects and the multiple jurisdictions involved.

12.58 Agreements with partners in development are not enforceable in practice. CIDA has not focussed on the results that are to be achieved or that have been achieved. The "audit trail" often ends with intermediate organizations funded by CIDA.

12.59 The general memorandum of understanding usually signed with recipient governments does not spell out specific development objectives or results that are to be pursued, or how accountability will be served.

12.60 At the project level, memoranda of understanding with the appointed bodies of recipient governments - usually government institutions - are vague about development results.

12.61 One consequence is that costs become disassociated from development benefits. Projects are budgeted, and budgets extended, often without explicit comparison of costs and benefits. A project that goes smoothly and has some benefits can, when no explicit comparison of costs and benefits is visible, seem a success. We do not expect CIDA to adopt a simplistic "rate of return" criterion for project funding, but it needs some systematic method of assessing a project's potential for meeting the Agency's development objectives. We refer to one such method in paragraphs 12.90 to 12.95.

12.62 CIDA's external accountability for the stewardship of funds entrusted to it would be better served if internal accountabilities also were made more explicit. Within the Agency, we visualize CIDA's intervention in a country as requiring at least five levels of management accountability. In such a case, the Vice-President would be accountable to the President for managing the overall geographic Branch performance in terms of both the quality of country-specific strategies and objectives and the extent to which they are met in the Branch. Second, the Country Program Director logically would be responsible

for managing the operational plan for his/her country and would be held to account for managing in a way that would produce results in that country. Third, the Project Team Leader would be responsible for specific projects and be held to account for achieving results at this level, particularly self-sustainability. Fourth, a specific role would have to be clearly established in the field for providing on-site monitoring of progress toward results, in some cost-effective way. Fifth, the President would be accountable for maintaining an organizational environment that promotes an action-oriented, learning culture throughout the Agency.

12.63 In summary, increasing budget constraints and a greater emphasis on results make it crucial that CIDA clarify the parameters of its accountability for achieving results. It also needs to come to clearer understandings with recipient governments about what specific objectives can be realistically pursued, what the Agency can reasonably be held answerable for, and those aspects for which the recipient government or others will be held to account. At stake is CIDA's ability to obtain worthwhile development results.

CIDA's Lesson #6 CIDA needs to be more open and transparent about its policy objectives, programming decisions, and the related outcomes.

Our view: CIDA needs to be more transparent about what it is trying to achieve and how well it is doing

12.64 We stress the need for open discussion of CIDA's policies, programs and accomplishments. When multiple objectives are pursued, parliamentarians need to be informed about the relative significance of the objectives and how they impact on the overall outcomes or results to be achieved. CIDA's policies, plans and the extent of its accomplishments should be open to anyone with a legitimate interest; as well, CIDA needs to make a greater effort to communicate with Parliament and with people and organizations in recipient countries. Reporting to Parliament should focus less on inputs and more on accomplishments and lessons learned.

12.65 The purpose of CIDA's aid and the cost of delivery needs to be made clear in the vote structure of the Estimates. If the primary purpose is humanitarian or motivated by trade or political considerations, as opposed to economic and social development assistance, this should be reflected clearly in the expenditure structure; the cost of delivering programs should also be truly reflected. We note, for example, that the United Kingdom's Overseas Development Administration in its budget papers shows its provision for Aid and Trade as a separate allocation within the bilateral aid program.

12.66 CIDA also needs to use plain language to communicate within the Agency and to stakeholders outside. For example, it needs to explain in simple words exactly what it means when it uses all-encompassing terms such as development, sustainable development, and partnerships to describe its objectives and operating environment.

12.67 To assist the Minister in fulfilling his or her accountability to Parliament, Agency management needs to make available information on the achievement of results, on a periodic basis.

12.68 In summary , CIDA needs to be more forthcoming with full and frank information to the public in Canada and the recipient countries on what it is trying to achieve and how well it is doing. At stake is the credibility of the Agency, both with the people of Canada and in the developing countries with which it works.

Meeting the Challenges Ahead

CIDA recognizes the need for reform and has outlined a sequential approach to meeting the challenges ahead

12.69 The Strategic Management Review of the Agency that was carried out during the period 1991 to 1993 has come to a close. A three-part action plan to implement its recommendations has been drawn up by the President of the Agency, and individuals responsible for undertaking the specific tasks involved have been identified. A timetable for implementation has also been established. Actions that are within CIDA's control will be implemented forthwith. In due course, CIDA also proposes to consult actively with its partners about changes that more directly affect their operations and relations with the Agency. A logical step will be a review of issues facing the Government of Canada on Official Development Assistance policy and CIDA's mandate.

12.70 CIDA anticipates that most, if not all, aspects of the first part of the action plan will be implemented before the end of the 1993-94 fiscal year. It expects that implementing them will:

- improve the Agency's corporate planning function, its accountability framework and its capacity for performance assessment. The objective is to introduce centralized planning and put in place a results-oriented management approach in lieu of the present emphasis on process and inputs.
- strengthen its policy-making capacity. The intention is to establish a broadly mandated Corporate Management Branch and rationalize the corporate committee structure, with the objective of achieving greater direction, coherence and efficiencies in overhead management activities.
- provide Program Branch managers with the delegated authorities, organization and resources required for more effective management. This will include planning, programming and delivery of the various programs consistent with Agency policies and intended results.

Need to Manage for Results

12.71 In addition to the lessons CIDA has identified in its Strategic Management Review, there are areas in the management of the Official Development Assistance program that we believe need to be improved in the immediate future. The intent is not to add more processes and controls, but to redefine the existing administrative process while

strengthening certain controls that are critical to achieving value for money, thereby enhancing CIDA's ability to manage for results. At issue is the lasting value of CIDA's interventions.

A better focus on what results realistically can be expected in each country

12.72 The recipient country is an appropriate level at which the question of results can be addressed because it is the level where bilateral funding allocations are made by the Minister, where the strategy for results can be determined, where CIDA can focus attention in its planning and programming, where goals are set and where bilateral agreements are signed for programs and projects and the attendant commitments are made.

12.73 The first critical area for improvement is to bridge the present gap between the very general policy framework that CIDA has developed to guide its country programs and the specific individual projects within the country project "portfolio". Problems in different countries and regions call for different strategies: what works in Pakistan may not work in Sri Lanka, a country in the same region. It is important to be specific about strategies and objectives that can be pursued in a particular sector and to be clear about the results that reasonably can be expected.

12.74 As we have noted, CIDA programming is often influenced by a number of interest groups with diverse agendas. The choice and mix of projects delivered must be linked to the strategic development objectives for a country or sector to achieve meaningful results. Weak linkages can lead to a diffusion of activities, confusion among CIDA staff and a loss of impact, as we saw in CIDA's Bangladesh and Pakistan country programs.

12.75 CIDA's approach to planning so far has been to develop a broad policy framework for each of its major recipient countries but no operating plan to accompany it. The framework for Bangladesh, for instance, outlines economic, social, cultural and other policy issues as a basis for identifying the country's stage of development and the sectors where Canada has the capacity to respond to the need. The constraints in the policy environment that CIDA will face are listed. But because the framework does not include specific operating objectives and results to be achieved, its use as an accountability document is limited.

12.76 We expected to find in each country policy framework a statement of strategy that outlined specifically what CIDA expected to achieve over time and was willing to be held accountable for. We also expected to find an operating plan outlining the specific objectives and results - whether at the sector or other level - that CIDA wanted to achieve in each country, and how the mix of projects would accomplish this.

12.77 We observed that the country policy framework does not outline specifically and realistically what CIDA expects to achieve over time. The framework as currently structured can be interpreted too broadly. It is not at all clear how the collection of diverse projects undertaken in a country or sector will lead to a definitive result in relation to CIDA's mandate and its purpose for being in the country.

12.78 In our view, there is a gap between CIDA's broad policy framework for a country and its projects in that country. To bridge the gap it needs a policy framework that clearly articulates its specific strategy for the country, and an operating plan that links that strategy to specific objectives and intended results. This link could provide the discipline CIDA needs to target its efforts and reorient resources and staff in the most effective and productive directions. It would also allow it to direct its future activities in any given country to what Canada wants to achieve there over time, on its own or with other donors and with its partners.

12.79 In summary, a country-specific strategy linked to an operating plan would enable CIDA to focus on specific and measurable results, country by country. It would also allow CIDA to discuss its operations in a more practical way with its partners and host country officials.

Promoting enduring benefits through more self-reliant development

12.80 In order to understand whether the programs and projects funded by the Agency were meeting Canada's expectations for development results, we asked three questions:

How does CIDA define overall results at the project, country and Agency levels?
What indicators does CIDA use to measure the potential for development results?
What reporting system does CIDA use to communicate the achievement of development results up the line?

12.81 At the Agency level, CIDA has not systematically defined and monitored results of its bilateral assistance programs. The World Bank, for instance, has recently undertaken to use the performance of its portfolio of projects as an indicator of development results.

12.82 At the country level, lacking the kind of operating plan we have suggested, the Agency has not defined indicators to measure its performance in each country. It is thus difficult to report whether Canada is getting benefits commensurate with its investment in that country.

12.83 At the project level, CIDA generally monitors its performance by assessing whether the inputs agreed to have been delivered. It does not measure development results. Consequently, knowledge about the quality of individual projects is not gathered and assessed.

12.84 Development requires that, after the termination of aid funding, something of value be left behind that can be sustained and that enables countries to better manage their own development. This is fundamental to achieving the goal of "helping people help themselves", i.e. to become more self-reliant. Our review of best practices suggests that one indicator of results that can be applied is whether the project has the potential to promote enduring self-sustainable benefits, namely "the ability to deliver an appropriate level of benefits for an extended period of time after major financial, managerial and technical assistance from the donor is terminated." As acknowledged in this statement by

the Development Assistance Committee of the Organization of Economic Co-operation and Development, sustainability is an appropriate indicator for judging a project.

12.85 In this regard, the experience of some donor agencies suggests that monitoring certain indicators of project self-sustainability ([see Exhibit 12.4](#)) at appropriate milestones can provide an early warning system, to help managers identify and correct problems related to sustainability before they become unmanageable. We used these indicators to assess the potential of 18 CIDA projects to become self-sustainable and thereby promote more self-reliant development. Such indicators are particularly important in many of the new kinds of projects CIDA is undertaking in social sectors, where results are softer in nature, and in the policy advice area, where development results can be proven only in the long run.

Exhibit 12.4

Key Indicators of Project Self-sustainability

1. **Technical and managerial capability** or readiness of the recipients (recipient country or "inheritor" institution) to sustain the project.
2. **Commitment of the "inheritor"** to assume ownership and responsibility for sustaining the project.
3. **Target group involvement** in project design and evaluation, and the value it places on the development benefits.
4. **Availability of sustaining resources** - cash and other resources - to operate and maintain the project over its life cycle.

12.86 We have two main observations at the project level.

(a) **In our analysis, we applied indicators of self-sustainability that are relevant to CIDA and practical to use.** We believe these indicators to be reasonable measures of a project's potential to promote enduring self-sustainable benefits, although others may exist. Such an approach would provide knowledge on the extent to which development results are likely to be achieved. It would also show the degree to which CIDA has been able to strengthen the capacity of its partners to deliver its projects. How best to use such indicators in a variety of circumstances may require ongoing refinement.

(b) **Promoting enduring benefits through greater self-sustainability warrants more attention from management.** The availability of financial and other resources to sustain CIDA's projects after the Agency's withdrawal was not assured in a large number of the cases we examined. Current performance has not adequately maximized the use of resources and has not led sufficiently to self-reliant development.

12.87 Overall, our analysis shows that the potential for enduring benefits is less than was anticipated when the projects were first approved.

12.88 Specifically, among the 18 projects we examined:

The technical and managerial capability in the recipient country after CIDA's withdrawal ranged from satisfactory in some cases to weak and unsatisfactory in most others, depending on the country, the sector and the type of project.

The commitment of the "inheritor" was generally satisfactory in the initial stages. It grew weaker over time in many cases, and was absent in some after CIDA's withdrawal from the project.

The involvement of the target group of people in project design and evaluation varied considerably - from high in a few cases to low in most.

Although the first three indicators are important in themselves, the fourth - the availability of sustaining resources to operate and maintain the project over its life cycle after CIDA withdraws - is critical in determining whether the project will be self-sustainable. It merits serious and ongoing attention. At the time of our audit, a few projects were clearly sustainable; the majority will require continued host government or donor support; and some are unlikely to be financially self-sustainable.

12.89 Project sustainability needs to be considered in all forms of appraisal. This is as critical to the quality of the investments CIDA makes as technical feasibility and project design. CIDA has placed far too little emphasis on the clarity of objectives in contractual arrangements - including project sustainability and continuation of benefits after it has withdrawn - and too much on the details associated with completing a specified set of activities in compliance with technical requirements during the assistance phase.

Improvements needed in the way CIDA manages its operating risks

12.90 Quality control at entry . Factors, whether qualitative or quantitative, that could eventually impact on the Agency's ability to achieve the results it expects need to be rigorously assessed, before funding is approved and at appropriate subsequent milestones. Management of risk is required at both the country and the project levels. CIDA would benefit from a more objective review of a project's potential to promote self-sustainability before approving the funding. In making this point, we are not implying that CIDA does not scrutinize projects before approval, nor are we proposing that it set up a new system of review or add more paper and process. We are pointing out that CIDA needs to obtain some assurance up front that the risks associated with an activity it is prepared to fund are commensurate with the benefits expected. There are at least three specific areas where further improvement is needed.

12.91 First, CIDA needs to examine thoroughly the capacity of the recipient country and its main public institutions to absorb development assistance effectively. We found this factor to be paramount particularly in Bangladesh. That country could not possibly absorb and use in a cost-effective way all the development assistance it was already getting from multiple donors. This point has been acknowledged as a matter of great concern by many prominent Bangladeshi economists. The World Bank has identified effective use of aid as a key prerequisite for increasing economic growth and making lasting progress in alleviating poverty. Most projects we looked at suffered because the host government or its parastatal body was unable to deliver on its commitments. Often

projects were funded simply because funds were available from donors, irrespective of past difficulties in obtaining the necessary support from the host country.

12.92 Second, there must be testing by CIDA of the assumptions it makes to support the recipient country's commitment, and increased participation of the targeted beneficiaries in the identification and preparation stages of the project. Commitment of the recipient country stems from a better understanding of the project's potential for enduring benefits. As well, ownership of the project is tied to meaningful early and ongoing participation by the beneficiaries. ([see photograph](#))

12.93 Third, the quality of risk assessment at the project level needs to be improved. All projects do not have the same level of risk associated with them; therefore CIDA's project management approach needs to be tailored to the type of project being undertaken and to the host country's institutional capabilities. High-risk projects warrant more monitoring than others, with appropriately placed milestones for additional funding.

12.94 The experience of the World Bank and other donors suggests that both the number of project components and the number of co-funders increases the risk of unsatisfactory performance. However, there may be a bias among donors toward complexity, partly because of the urge to include as many novel features as possible to increase a project's chance of acceptance, or because often it is the only way to "buy in" to a multi-donor project. This kind of bias needs to be addressed in the early stages of project approval.

12.95 The right questions have to be asked, such as how will the indicators of self-sustainability ([Exhibit 12.4](#)) be satisfied, and what is the risk that they will not? CIDA project documentation identifies critical assumptions on which the long-term success of the project will depend. However, by and large these qualitative assumptions are stated but not sufficiently analyzed. Risks often are not seriously taken into account. Even when assumptions subsequently are proven unrealistic, we found that corresponding adjustments are not made on a timely basis in subsequent phases of the same project. The Small Scale Water Control project in Bangladesh is an illustration: in the third phase of this project CIDA continued to make the same assumptions about the Bangladesh Water Control Board's commitment and ability to provide technical and managerial capability and sustaining financial resources, despite indications that those assumptions were proving to be too optimistic. ([see photograph](#))

12.96 An early warning system to track potential for results . At present CIDA does not have a reporting system, even for its riskiest projects, that provides results-oriented and timely information on whether its projects are performing as well as expected. For instance, there is no monitoring of indicators of self-sustainability. At CIDA we note a serious lack of incentives to ensure that benefits will accrue after assistance ends. Information on projects is provided to CIDA managers periodically by executing agents, monitors and/or evaluators. The information is generally routine and deals with process. This falls considerably short of what is needed, namely, an early-warning system that will provide explicit data periodically up the line on what projects are in difficulty, and why. Solutions for alleviating difficulties could then be explored more selectively. If CIDA

were to concentrate its efforts, as we have suggested, on fewer projects in fewer countries and with fewer "agents", the cost of introducing such a reporting system that highlights management's effectiveness would not be excessive.

Institutionalizing lessons learned

12.97 Generally, learning organizations display four important characteristics: an organizational culture that stresses learning, places value on it, encourages it and rewards it; an institutionalized but simple and clearly understood mechanism that allows lessons learned to be captured and accessed; an environment that actively encourages learning by doing; and finally, a requirement and a responsibility to use lessons learned as part of the normal management process.

12.98 We observed that the Agency does not have an organizational "learning culture". Staff often are less than open in responding to questions about what problems were encountered in the implementation of their projects. Heads of Aid located in the field often are not fully aware of how their projects are progressing in terms of promoting self-reliant development. Because the Agency does not formally stress learning, it is difficult to determine how much and what kind of learning is taking place. As we have already noted, staff rotation policies and the contracting regime also inhibit learning.

12.99 We found that lessons learned are not incorporated in a systematic and timely way into operations. Internal audits, project termination reports and end-of-project evaluations are used very unevenly to guide future activities or to highlight what works to achieve results and what does not.

12.100 CIDA has acknowledged that there is no formal mechanism or requirement to capture lessons learned or to use them. CIDA's learning culture, we were told, is oral and staff will consult with each other informally as and when necessary.

12.101 For CIDA to transform itself into an action-oriented learning organization, it needs to institutionalize lessons learned at the project and country levels. It is important to understand why programs and projects are meeting or not meeting the Agency's expectations.

Upgrading CIDA's internal audit and project evaluations

12.102 Internal audit and evaluation of development projects can play a critical role in ensuring the credibility of aid agencies, legitimizing development assistance to various constituencies, and improving the performance of the Agency. We observed, based on our review of the 18 projects in Bangladesh, Pakistan and Sri Lanka, that at present this is not the case. The benefit of audit and evaluation as a tool for wider learning in the Agency is not being maximized. Greater interaction, outreach and sharing of examination results are needed.

12.103 Internal audit: an emphasis on significance. There is a need to be more selective in identifying issues for audit. If internal audit is to play its role in the new

accountability regime at CIDA, it needs to be focussed systematically on the issues most significant to achieving results.

12.104 The Audit and Evaluation Division has seldom undertaken significant internal audits of CIDA's country programs. Most internal audits tend to focus on the Agency's administrative and project management procedures rather than managing to achieve development results; such examinations can be useful if the objective is to assess whether major systems are working. There has been no specific requirement for internal audit to present its overall findings on the significant economy and efficiency issues that have been facing the Agency. Many of the significant lessons identified by the Strategic Management Review, for instance, had not been highlighted by internal audit.

12.105 The Agency could improve the value of its audit work and the significance of its audit findings by adopting a more selective approach: for example, determining whether appropriate mechanisms are in place (and are working) for monitoring results in high-risk situations could replace the routine examination of project management procedures. Also, delegation of audit to the host country could be explored, where appropriate.

12.106 Project evaluations . Bilateral Branches spend about \$4 million each year on project evaluations. We reviewed those that related to the 18 projects we examined in depth. Most project evaluations were commissioned by the country program staff, not by the central Audit and Evaluation Division. We noted differing standards and terms of reference in the project evaluations we encountered. Also, most project evaluations were not focussed on the potential of the project to become self-sustainable. Nor are the results of evaluations systematically fed into future project appraisals - standard practice in the World Bank.

12.107 An increased emphasis on quality. There is a need to improve the quality of project evaluations undertaken by the operating branches in the Agency. Project evaluations normally are conducted on an *ex post* basis. The ability to monitor and evaluate the potential for results more selectively, so that changes in the environment are discerned and activities suitably adapted, needs to be strengthened if evaluations are to contribute to CIDA's strategic management capacity. An internal review of project evaluations conducted in 1991 showed that, while one third were fully satisfactory in methodology and implementation, the others were not. The principal weaknesses pointed out were: unstructured data collection; insufficient time spent in host countries, including in particular a lack of intensive on-site consultations with project beneficiaries; and a lack of explicit comparisons of the costs and benefits associated with CIDA's investments. Yet we noted that, at times, even when the quality of the project was not assured, conclusions were drawn that were used to justify more funding.

12.108 There is no ongoing quality assurance function in CIDA that examines whether minimum evaluation standards have been met. CIDA contracts out most project evaluations to the private sector. We believe that, in at least some of these examinations, CIDA could consider using "mixed teams" of CIDA staff and Canadian or local

contractors, where appropriate, as a way to ensure more consistent quality and reduce costs.

12.109 Emphasis on sharing project evaluation results. Results of examinations are not widely shared with others, for example, recipient governments and other partners involved in development projects. Thus, the benefits of project evaluations as a tool for learning are not being maximized. It is difficult to tell how useful project evaluations are for judging their contribution to the learning process in the Agency.

12.110 There is also a need to guard against a perceived lack of objectivity. Best practices would suggest re-examining how this function should be done and located in the organization. Some organizations, like the World Bank and US A.I.D., assure quality by separating the evaluation function from line management. Others use independent reviewers.

Better internal control over contributions involving counterpart funds

12.111 CIDA provides bilateral funds to other organizations to spend for development purposes in accordance with conditions specified in contribution agreements. Certain contributions are donations of food and commodities, which are converted into "counterpart funds" at an agreed value and set aside in local currency by recipient governments for use in development activities. Other contributions are advance cash payments to Canadian, international or recipient country non-governmental organizations.

12.112 We examined three counterpart funds in Bangladesh and Sri Lanka totalling \$200 million over a four- to five-year period. We found that CIDA did not have adequate assurance that all moneys had been spent for the intended purposes and had been accounted for fully. CIDA relied on unaudited statements of account submitted by the recipient governments, some of which were not complete or submitted on a timely basis. This is contrary to CIDA's policy on the management of counterpart funds. CIDA's policy notes that independent audits are one way to gain assurance on whether conditions associated with the counterpart funds have been complied with. ([see photograph](#))

12.113 We brought this issue to CIDA's attention with specific examples to illustrate our main concerns. The Agency has recently undertaken to re-examine its practices and to implement new procedures by January 1994. It has also decided to consult with our Office to explore the possibility of engaging the services of the national audit offices in developing countries, where appropriate, as a way to strengthen the accountability of its partners.

12.114 Auditing is not absolutely necessary to achieve accountability for counterpart funds. There may be other ways. But auditing is one of the more effective ways to strengthen accountability in situations where the risk of non-compliance with conditions can be high.

Conclusion

12.115 Principles to guide the delivery of Official Development Assistance have been defined by the government without ambiguity: addressing poverty comes first. The problem is in implementation. The Agency continues to face pressures that divert it from its primary objectives, and certain constraints, both political and bureaucratic, that add to its difficulties and operating risks.

12.116 Our audit coincided with a Strategic Management Review conducted by the Agency at the request of the Minister. Both examinations identified some important lessons from CIDA's twenty-five years of experience. Generally, these lessons point to a need for attention to self-reliant development and a more results-oriented, focussed, businesslike and accountable style of operation. Most important, they also call for dedication to the basic objectives - fighting poverty and promoting enduring benefits through an increased emphasis on helping people to help themselves - that Canadians have affirmed repeatedly over many years.

12.117 There needs to be more concentration, in the bilateral country programs, on those countries and activities where Canada can have the greatest impact. At present there is too much dispersion. As well, there is a need to pay more attention to the quality of aid provided, and a need for an environment within the Agency that will encourage the development of an action-oriented learning organization. None of these changes will be easy to make, since they require a new mindset, skills and culture, and strong ministerial support. Their successful implementation will depend on the will to reform, not only among the management and staff of the Agency but also among those who act as its development partners, in Canada and in the developing countries where CIDA operates.

CIDA's response and commitment

1. The Agency agrees:

with the Auditor General's findings and with the thrust of the recommendations aimed at improving the Agency's accountability and strengthening its management effectiveness.

that CIDA's ability to do this will require not only the support of the government but also the support of its development partners both in Canada and in recipient countries.

2. CIDA is committed to taking action to address the concerns raised in the Report, in particular, the need for introducing management of results as a central feature in its reforms.

3. The Auditor General is invited to monitor the implementation of the Agency's reforms with a follow-up Report to Parliament in 1995.

Chapter 13

Department of Agriculture

Agri-Food Policy Review

Main Points

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- Background
- Overall Scope of the Audit
- Criteria

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 - Market information/intelligence
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 - Market strategies
 - Agreed-to next steps include the following:
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 - Rewarding change
 - Agreed-to next steps include the following:
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 - Agreed-to next steps include the following:
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- 13.1 Pillars of Agricultural Reform
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- 13.5 Lessons Learned from the Regulatory Review Process

Department of Agriculture

Agri-Food Policy Review

Assistant Auditor General: Paul Ward

Responsible Auditor: Hugh McRoberts

Main Points

13.1 The Agri-Food Policy Review left the Department of Agriculture with a formidable agenda of policy changes that it and its partners are now in the process of translating into action. Expectations arising from the review were high; but there are many stakeholders and, often, these stakeholders have divergent views on the complex issues involved.

13.2 Although the Department has been active and much of the early work has been accomplished in response to the Agri-Food Policy Review, in many areas the changes have been to departmental infrastructure; for example, the Agri-Food Competitiveness Division was created and studies such as the continued development of a competitiveness framework were undertaken. Consequently, change is not always visible to external observers.

13.3 The Department believes that the successful implementation of the Agri-Food Policy Review depends in part on a series of changes in culture affecting the relationships and expectations of all of the partners in the agri-food sector. There is an important dimension to this change in culture that must occur in the Department, as well. This will be particularly important in developing a working partnership as the Department balances priorities and demands among its economic, social, regional and environmental responsibilities.

13.4 Because the effects of change are not yet appropriately measured in many of the action areas of the Agri-Food Policy Review, such as environmental sustainability, it is difficult for managers to know the effects of their actions, and hence to manage the change.

13.5 There is now a need for the Department to define common concepts and terms for the key areas of policy change, for example "value-added", "market-oriented versus production-oriented" and "marketing strategy". This will affect how the Department communicates with its partners, and its reporting and accountability to Parliament.

13.6 There is a clear expectation that the Department will process and disseminate market information/intelligence that is useful to government and industry, and do so in a manner that ensures a cost-effective use of public funds. Data will need to be analyzed and the results disseminated to interested parties without risk of gaps and duplication. Ensuring

that it has the right data, as well as good analytical and dissemination capabilities, is a key challenge facing the Department.

Introduction

13.7 For the Department of Agriculture, 1989 to 1991 was a period of intense policy review. This review occupied much of the time and energy of the partners in the Canadian agri-food sector, including the federal and provincial governments, producers, suppliers, distributors and processors. The objectives of the review were to develop policies and programs that would lead to a more market-oriented, self-reliant and environmentally sustainable agri-food industry in Canada; in so doing, the aim was to develop truly national policies and programs that recognize and respond to regional diversity.

13.8 By 1991, an array of recommendations touching on virtually every aspect of the agri-food sector's infrastructure had been reviewed, and many had been accepted both by the federal ministers of Agriculture and by their provincial counterparts. The challenge then facing the Department of Agriculture and its partners was to develop programs to implement the policy directions established by the ministers, at the same time preserving and enhancing what they considered to be the rich consultative process and sense of partnership they saw as the hallmark of the Agri-Food Policy Review.

13.9 The purpose of this chapter is to report on the progress the Department has made in a number of key areas.

Background

13.10 In the spring of 1989, at a time of continuing national and international crisis in agriculture, the ministers of Agriculture announced that there would be a major review of Canadian agri-food policy. Its objective was to encourage industry responsiveness to domestic and export markets, and self-reliance; at the same time, the review would look at how to preserve the environment and ensure a safe supply of food.

13.11 In November 1989, Canada's three federal ministers of Agriculture published *Growing Together: A Vision for Canada's Agri-Food Industry*. In this document the ministers established four pillars for agricultural reform, to guide the direction of future programs and as a test against which past and future programs could be assessed. ([see Exhibit 13.1](#))

More Market Responsiveness
Greater Self-reliance in the Agri-Food Sector
A National Policy That Recognizes Regional Diversity
Increased Environmental Sustainability

Exhibit 13.1
Pillars of Agricultural Reform

13.12 In December 1989, the Department brought together over 1800 representatives from federal and provincial governments, producers, processors, suppliers and distributors at a national conference in Ottawa. Following two and a half days of discussions, ministers announced a second stage to the policy review process - the formation of 11 task forces or committees comprising representatives from industry, government, academia and farm associations to develop options for policy change for each of the major policy areas.

13.13 For the next 18 months the task forces met, debated and wrote. By 1991, they had completed their work. Their reports had been presented, sometimes more than once, at meetings of federal-provincial ministers; in most cases, their recommendations had been accepted. The Department and its partners then faced the challenge of implementation.

Overall Scope of the Audit

13.14 The purpose of this audit was to examine and report on the Department's progress in implementing the recommendations of the Agri-Food Policy Review. We focussed on those action areas related to:

market and trade development,
research and technology transfer,
environmental sustainability,
farm management skills,
regulatory review, and
pesticides registration review.

13.15 The other directions for change coming out of the Agri-Food Policy Review are also important and contain elements that affect the areas subject to audit. However, we have excluded them as a primary focus of this audit for various reasons: Safety Nets is an area we reported on in 1991 and which we will follow up in 1994; Food Safety and Quality was examined in 1988 and will be the subject of a separate 1994 audit report; and the remaining areas represent subjects where the mandate of the Office and/or the mandate of the Department is less direct, such as Western Grain Transportation. Excluding safety nets, food safety and quality, and western grain transportation activities, the Department of Agriculture's annual expenditures were about \$700 million and 6000 person-years during the period under review.

13.16 In addition to auditing progress in each of the action areas cited here, we have developed a number of overall observations on how the Department has responded to the challenge of change presented by the Agri-Food Policy Review.

13.17 We then present our progress reports for each of the action areas. These follow a common format. They begin with a brief presentation of the Agri-Food Policy Review's directives; this is followed by a discussion of the progress that we have observed. Each report concludes with a section headed "Agreed-to next steps". This is in keeping with the nature of our report as a progress audit, and represents an agenda of actions to continue the change that has begun, jointly developed by management and by us, and to which management is prepared to commit. This agenda will be the basis for audit follow-up by our Office and for Parliament in future years.

Criteria

13.18 In this audit we elaborated on our traditional general audit criteria, which are focussed on the need for management with due regard to economy, efficiency and effectiveness, to include specific criteria based on the accepted recommendations of the Agri-Food Policy Review. In each of the action areas, we identified the recommendations that had been made and presented to federal and provincial ministers of Agriculture. We supplemented these with related recommendations arising from other authoritative sources, such as parliamentary committees and the budget. We reviewed these with management to arrive at a list of recommendations that management agreed represented government policy direction. The recommendations used to shape our audit are presented in Annex A.

Overall Observations

The Visibility of Change

13.19 The Agri-Food Policy Review left the Department of Agriculture with a formidable agenda of policy changes that it and its partners are now in the process of translating into action. Within the agri-food sector, the expectations for change arising from the review were high; however, there are many stakeholders and, often, these stakeholders have divergent views on the complex issues involved. The urgent need to maintain the momentum for change will remain a priority throughout this decade.

13.20 When we began our audit we were aware of a growing impatience on the part of many of the individuals and organizations who had played a part in the Agri-Food Policy Review. The impatience was centred around what many felt was the lack of action on the part of the Department following extensive consultations that had taken place over the previous three years. We found that these perceptions were both true and false. We found them to be reasonable observations - notwithstanding the accomplishments of the Department - because many who were consulted could see little public evidence of action on some of the issues on which they had given their advice. We found them to be false in that, in the course of our audit and as reported here, much has changed and is changing,

particularly within the Department of Agriculture. Much of this change - such as the creation of the Agri-Food Competitiveness Division and the continued development of a competitiveness framework - is in the departmental infrastructure and is a necessary platform for the more visible changes to come.

13.21 The situation is not unlike that of a large ship that must change course and speed in an emergency. The outside observer may perceive a long lapse between the time the situation becomes apparent and the time something is seen to be happening. This is not because those on the ship are unaware of the problem and doing nothing about it. Far from it. Activity inside the ship is likely to be quite hectic. It just takes a while for that activity to show an externally visible result.

The Challenge of Change in Culture

13.22 "Both levels of government understand that they alone cannot solve the problems and lay the foundation for a solid tomorrow. To make a plan for the next century, a working partnership is needed, a partnership covering all the players: farmers, food processors and distributors, input suppliers and consumers, as well as governments. Together, we can help the industry to grow even stronger.

We believe that we must act now to develop this partnership and to address the problems in our system. If we wait, those problems will prevent us from meeting the challenges and realizing the opportunities for growth in the 1990s and beyond." *Growing Together* , 1989

13.23 From the inception of the review in 1989, the Department was clear that a significant change - in essence, a change in culture - would have to be made, away from old behaviours, expectations and attitudes to agriculture and agri-food policy. This change in culture would have to march hand in hand with substantive programmatic changes if the Agri-Food Policy Review was to succeed. There were two components to this change in culture: internal and external.

13.24 The external component focussed on the relationship between the Department and the other stakeholders in the agri-food industry. In a very summary way, that change can be seen as proceeding in stages, as the circle of involvement and inclusion is successively broadened. It began with the essentially unilateral policy culture of the post-war decades, in which the two levels of government exercised their concurrent jurisdictions on behalf of producers more or less independently. Then there emerged in the late 1980s a trilateral approach to programs, which brought together the two orders of government and producers in the co-development and management of safety-net programs. This culminated in the development of the *Farm Income Protection Act* . Next came an extension from trilateralism to multilateralism as the stakeholder base was broadened from agriculture to agri-food to draw in processors, distributors and consumers. The most recent recognition of this element of change is to be found in the new and much broadened range of responsibilities assigned to the Department in the most recent government restructuring.

13.25 A less visible but equally important dimension of change in culture is the need to couple these external changes with an equally profound change in the corporate culture of the Department. For example, the change from a unilateral to a multilateral policy/program environment requires that the departmental officials involved change in very fundamental ways their understanding of their roles and accountabilities. What was appropriate in one environment may be unacceptable in another. Such change is difficult and can take time, particularly when the same people must continue to administer programs and policies.

13.26 As part of this internal change in culture, officials must learn to think more broadly. In the past, the departmental culture has been built around very strong vertically structured branches, each focussing on its own business. Often entire careers would be served out within a single branch. While the professionalism and loyalty in these vertical organizations will continue to be important, responding to the challenges of the Agri-Food Policy Review will increasingly require a more holistic and integrated approach to problems and issues. Concepts such as sustainability and competitiveness cannot succeed if they are seen as the concern of only one or two branches. Rather, they must become pervasive concepts integral to the thinking in all branches. This will be particularly important as the Department balances demands arising out of the economic, social, regional and environmental responsibilities inherent in its new mandate.

13.27 We have observed in the course of our audit that, while the Department has started down the path of change in culture, it has a long journey ahead. At the same time, it is not alone on this path; the industry and the other levels of government must be part of this change and, to some extent, the rate at which they change affects the rate at which the Department can change.

The Measurement of Change

13.28 At the core of *Growing Together* and the Agri-Food Policy Review was a desire for change - for a more market-oriented, self-reliant, sustainable and competitive agri-food sector. The magnitude of this change is such that it will extend over many years and involve many parties. Generally accepted management practices, in the area of change management, stress the importance of measurement (particularly quantitative measurement). In particular, these practices emphasize the need to develop yardsticks to measure the initial state, and to repeat those measurements at regular intervals in order to track the extent to which programs will effect the desired change.

13.29 During our audit, management repeatedly challenged us to judge them on results rather than on systems. Unfortunately, we were only partially able to do so. We found that management had a lot of information on their inputs to the various areas of desired change, i.e., new calls for workplans related to changed objectives, and setting up new organizations such as the Bureau for Environmental Sustainability and the Agri-Food Competitiveness Council. We found that management was also able to supply us with a lot of information on the outputs of their efforts, for example, new programs such as National Farm Business Management, marketing strategies, regulatory review and *Green*

Plan activities. We also found in most areas that management had not developed the indicators or measurement procedures necessary to determine the precise nature and magnitude of the problems in their areas of responsibility, or to permit them to track the outcomes of their interventions in relation to the objectives of the Agri-Food Policy Review. We observed, however, that in most areas management had action plans in place to develop indicators of effectiveness and to gather the data necessary to measure them. The pursuit of these initiatives to their successful conclusion will be vital to the success of the Agri-Food Policy Review.

The Need for a Common Understanding

13.30 Clear concepts and a shared understanding of what they entail are the building blocks of culture and cultural change. Without such shared understanding by the Department of Agriculture and its partners, it is very difficult to reach consensus on where the culture is going and to let those involved focus their energies on common goals. In the course of our audit we found that there were important differences in how terms such as "value-added", "market-oriented versus production-oriented" and "market strategy" were used in different branches, and sometimes within branches as well. Such a lack of shared meaning on key concepts will, at the very least, impede the pace of change in culture in the Department. Further, if the effectiveness measurement procedures discussed here are to be developed successfully, it will be essential to have clear concepts from which to construct the measures and indicators. At an early stage in the process of the Agri-Food Policy Review, an element of conceptual "fuzziness" may have been necessary to encourage buy-in and to facilitate participation. However, based on our discussions with industry representatives and our observations within the Department, some conceptual sharpening is now necessary. This will also be important to facilitate working with other branches, and with the other partners in the sector, and to communicate plans and progress clearly to Parliament.

Information: A Key Business for the Department of Agriculture

13.31 In addition to the need to develop effectiveness information for internal management, the other partners in the agri-food sector require information and market intelligence from the Department of Agriculture.

13.32 It is clear that one of the unique roles identified for the Department is to serve as a central point for gathering, analyzing, organizing and disseminating market information/intelligence to the other partners in the agri-food sector on agri-food related matters. This ranges from the demand on the part of the provinces and industry that the Department play a strong role in providing market information/intelligence, to the need expressed in the Agri-Food Policy Review on Research and Technology Transfer for an inventory of transferable technologies. However, in the course of our discussions with experts in the agri-food sector, we found that, while the expectation of more and better market information/intelligence from the Department is strongly felt, the demands are also diffuse and unspecific. This situation poses a challenge to the Department. Information systems can be very expensive to develop and maintain. It will be essential

that the Department work closely with the potential consumers to ensure that the information in the system, and the ways in which it can be accessed, are consistent with user needs if these expenditures are to be cost-beneficial.

Action Area Reports

Market and Trade Development

13.33 *Growing Together* identified marketing and trade development as an area in which change was needed. Among the issues raised in this context were the need to identify roles, responsibilities and priorities more clearly, and the need for governments to gather, analyze and disseminate market information/intelligence better.

13.34 The Department has done a number of things to increase trade: for example, federal and provincial ministers have set a target of increasing annual agri-food exports from \$13 billion to \$20 billion by the year 2000. To this end, the Department has announced the implementation of the Trade Opportunities Strategy to support the sector in improving its trade performance. To encourage market and scientific research, Parliament recently passed legislation permitting industry-wide sales levies to generate the funds to support this work. No industry associations have yet applied to develop such an arrangement under this new program, as no federal-provincial agreements have been signed.

Roles, responsibilities and co-ordination

13.35 The Agri-Food Policy Review began the process of defining roles. Industry was to be the backbone of market development. The Department of Agriculture's role was to help producers organize to solve marketing problems themselves, to become more market-responsive and self-reliant. Specifically this meant promoting ways to improve the export readiness of firms, developing marketing strategies with industry, developing a better market analysis and intelligence capability, and continuing trade negotiations for improved market access.

13.36 Several federal entities play a role in market and trade development for the agri-food sector, as do many provincial departments. Their roles in this area are not clearly defined. The Department is studying federal and provincial roles in export market development. Taking into account both federal and provincial programs, it will identify opportunities for domestic and export market development, and develop options and mechanisms for federal-provincial co-ordination. It will also examine the willingness of provincial agriculture and trade ministries to develop a co-ordinated federal-provincial agri-food trade development program. A final report was expected in late summer 1993.

13.37 The Federal-Provincial Market Development Council, made up of federal and provincial officials responsible for agri-food market development, is to "provide leadership and co-ordination in fostering a competitive oriented Canadian agri-food sector."

13.38 While progress is being made in addressing federal-provincial co-ordination, management cannot be assured there is no overlap, duplication or gap of activity in market and trade development among governments.

13.39 Farm leaders told us they were concerned that insufficient attention had been paid to domestic market development issues. The Department concurs.

Market information/intelligence

13.40 "Collecting market intelligence for use by government and industry often appears wasteful because it is unclear how or whether it is used. Sometimes governments spend considerable resources obtaining information which appears only marginally useful. There are strong indications that the tremendous amount of market information which is currently available needs to be further analyzed and made more relevant to its users. This can be a key role for governments as industry is often unable to undertake the analysis necessary to effectively use market data." *Growing Together*, 1989

13.41 Information on domestic and export markets is needed by the agri-food sector to make informed production and marketing decisions, and by governments to allow them to make policy and program decisions.

13.42 To make market information/ intelligence relevant and useful, and to ensure a cost-effective application of public funds, it is necessary to determine users' needs before systems are designed and implemented. This should include an analysis of who needs what, for what purposes, how often, via which media, and what cost should be recovered. While a recent program evaluation included a client survey to assess satisfaction with market information/intelligence, a complete assessment of client needs has yet to be done.

13.43 Several federal and provincial departments and agencies, including the Department of Agriculture, provide market information/intelligence. Their sources of information include on-site direct data collection, Statistics Canada, Canadian embassies and trade missions, a variety of domestic and international electronic databases, and direct contact with members of the agri-food sector.

13.44 Once an analysis of user needs is completed it will be necessary to match those market information/intelligence needs with the market information/ intelligence being gathered by the various federal and provincial agencies, to identify where the needed information is being gathered, where gaps exist and where there is duplication. Currently the information necessary to do this is not available.

13.45 Indications are that gaps and duplication exist. There is a gap with respect to data for the processing and distribution elements of the agri-food sector. Leaders in this sector told us that such data are vital to dispelling myths and misconceptions respecting the sector's performance. On the duplication side, for example, beef export data are provided by both the Department of Agriculture and Statistics Canada. Departmental studies have noted significant inconsistencies between them.

13.46 Recently, the Department completed some studies of specific aspects of market information/intelligence, including a program evaluation of the gathering and compilation of statistical reports on market information by the Agri-Food Development Branch and the Food Production and Inspection Branch, and a study of public market opportunity information for agri-food products in export markets. Both reported their findings in the spring of 1993. Here are some of their key findings:

Although some analytical work is done, market information/intelligence provided to industry is usually a compilation of statistics on production and prices.

Analysis, repackaging and synthesizing of data are not always performed; nor are conclusions, forecasts and market opportunities always identified.

Dissemination of market information/intelligence is too slow and fails to meet the industry's needs for timeliness.

Problems continue to exist with the quality of market information/intelligence provided to users.

Sources of market information/intelligence are fragmented and difficult to access.

These findings echo the concerns raised in 1989.

Measuring performance and establishing priorities

13.47 At present, there are no criteria for allocating resources for market and trade development activities effectively among commodities within the agri-food sector. The sector is characterized by differences in interests among commodities as well as between producer and processor interests. It is critical that the Department identify priorities and measure its progress in these priority areas.

13.48 The importance of shifting resources from lower-priority to higher-priority areas is clearly articulated in Agri-Food Development Branch's Statement of Priorities for 1993-1994. The preliminary results of an ongoing internal audit of Agri-Food Development Branch show the absence of indicators to reallocate resources effectively. Branch officials have informed us that by 1995, mechanisms will be in place to assist them in better determining priorities.

13.49 A framework for analyzing the agri-food sector's competitiveness continues to be developed and applied to several commodity sectors. A holistic approach is being adopted that takes into account the needs of producers, processors, distributors and consumers. Considerable consultation with government and industry is taking place to ensure an accurate understanding of the dynamics of each sector.

13.50 Extensive data exist for analytical purposes for bulk commodities such as grains and cattle. Some of these data come from the recently developed Farm Level Data Base. However, problems exist in measuring the competitiveness of the processing and distributor elements of the agri-food sector. At present, processing-sector measurement data are too aggregated and out-of-date to be of much value for policy analysis and decision making. A preliminary needs analysis undertaken by the Department points to these limitations and has resulted in departmental officials meeting with Statistics Canada

officials to develop new data sources. Without timely and disaggregated data, it will be difficult - if not impossible - to conduct useful and relevant assessments of competitiveness.

Market strategies

13.51 Subsequent to *Growing Together*, the Department of Agriculture has developed a variety of marketing strategies that provide analytical data along commodity and geographic lines. Generally speaking, they are prepared in consultation with the affected industry groups and other government departments, and take into account both domestic and export considerations. They include commodity strategies, industry strategies, agri-food export market strategies, trade missions and regional development strategies. In our view, the links among these strategies are not clear. There is the expectation that strategies, by definition, provide guidance for action. Given the wide variety, timing and availability of strategies, as illustrated in [Exhibit 13.2](#), it is hard to see how the Department can act in unison internally or with its partners.

Agreed-to next steps include the following:

13.52 *A formal assessment of all market and trade development programs and activities will be undertaken.*

13.53 *The Department of Agriculture will continue to define more clearly its role and responsibilities vis-à-vis other federal departments/agencies and provincial governments, and to identify possible gaps and areas of overlap.*

13.54 *The Department recognizes that a gap in its focus on market and trade development exists in the area of domestic market development, and will extend its planning to take this into account.*

13.55 *The Department will continue to develop mechanisms in order to establish priorities among programs and activities, to develop short- and medium-term goals to meet objectives, and to permit tracking of their progress.*

13.56 *The Department acknowledges that improvements to the availability, timeliness and quality of data for the processing and distribution elements of the agri-food sector are required. A more comprehensive client-needs assessment of the market information/intelligence required by the agri-food sector and by governments to enhance market and trade development will be done.*

13.57 *As part of the needs assessment, continuing problems in the usefulness and accessibility of market information/intelligence will be addressed. An action plan with assigned accountabilities will then be developed.*

13.58 *The Department will define more fully "market strategies"; it will then review its and its partners' future market strategies with respect to completeness of commodities*

covered, clarification of objectives, establishing priorities, and ensuring co-ordination and consistency of format.

Research and Technology Transfer

13.59 *Growing Together* identified research and technology transfer as critical to the successful marketing of agri-food products, and to increasing the amount of value-added production in the agri-food industry. The report indicated three areas where greater emphasis was needed:

targeting research to place a greater emphasis on market-oriented research as distinct from farm production-oriented research;
encouraging industry to adopt new technologies at a quicker pace and to conduct more of its own research and development; and
engaging in more research in support of value-added production.

13.60 In 1991-92, Research Branch expenditures approximated \$270 million and 3100 person-years.

Targeting research to enhance competitiveness

13.61 Early in the Agri-Food Policy Review the Research Branch defined its mission this way:

"To improve the long-term competitiveness of the Canadian agri-food sector through the development and transfer of innovative technologies."

13.62 One of the key challenges facing Branch management is to reshape the research portfolio in line with its mission and to place a greater emphasis on the types of research noted above.

13.63 Beginning in the fall of 1991, Research Branch gave its scientists clear direction to target research efforts to foster competitiveness and to establish research priorities that will lead to competitiveness. The intent is to screen out research proposals that do not meet these Branch priorities.

13.64 We looked at how the Research Branch would determine how its research program had been affected as a result of this directive. In the Branch, the substantive decision to continue existing research and, more important in this context, to initiate new research is delegated to the regional directors general of research. They in turn delegate approval authority to the directors of the 25 research stations. The delegation at each level is subject to review and override at the higher levels.

13.65 In its 1993-94 Business Plan, the Branch states that in its overall research portfolio "...accountability is reflected through three processes: audits and evaluations, station reviews, and annual reports." Site visits to the research stations by Branch management and periodic variance reports supplement these processes. In our view, while these are valuable sources of information for management, they are - with the exception of site

visits - periodic in nature and, in the case of evaluations and reviews, will take many years to complete. They need to be supplemented by an improved management information system that comprises the elements described below.

13.66 We also looked at the Department's scientific management information system. In a Branch with such a highly decentralized decision-making system, we would have expected a strong information system to enable Branch management to monitor the composition of the research portfolio in terms of the extent to which it reflects existing and new priorities. Such information is essential if Branch managers are to be accountable for using the decision-making authority delegated to them.

13.67 The Research Study Data Base has information on over 800 active research projects. While the database contains extensive information on individual research projects, it is difficult to determine from this information how projects support the objectives of the Department and foster competitiveness in the agri-food sector. In our view, this is likely due to the definition and usage of key terms in the database, which was designed to describe what a project does rather than how it contributes to competitiveness. The Branch plans to add the data necessary to assess how projects contribute to competitiveness, and a new benefit/cost model is being developed. This will become part of the new Executive Management Information System that, according to the Department, is being developed to ensure that its research enhances competitiveness and ensures managerial accountability.

Encouraging the involvement of industry

13.68 Encouraging significantly greater industry investment in agri-food research was an important objective identified in the Agri-Food Policy Review. The Department has pursued two directions to that end.

13.69 First, Research Branch has defined its role as focussing on research that has economic or environmental significance for the sector, but that likely has less potential for an early return on investment. The Branch hopes that the private sector will support more of the shorter-term, adaptive, problem-solving research.

13.70 Second, the Branch has decided to encourage private sector involvement by entering into more joint research ventures with industry. According to the Branch, there were constraints on the extent to which the private sector could participate in the fruits of collaboration. The Department therefore negotiated an agreement with Treasury Board to increase the profit-sharing potential.

13.71 Branch officials believe that the number of joint ventures with the private sector and its total investment in such ventures have increased substantially since 1989. Due to changing reporting methods used by the Branch in the last four years, it is difficult to precisely quantify the actual amount of change.

Technology transfer

13.72 *Growing Together* stated that technological advances will be critical if the agri-food industry is to compete effectively at home and abroad. In 1991, Research Branch asserted that, "in a more market-driven climate, the Branch's ability to transfer knowledge and technology to the private sector will become the yardstick by which its performance is measured."

13.73 The Department is only one player in the technology transfer game. The successful movement of technology requires the co-operation of others, including the provinces and the agri-food industry. Because the Department is possibly the largest single generator of transferable agri-food technology in Canada, there are certain tasks that it must perform particularly well.

13.74 First, the Department must be able to recognize, capture and protect its transferable technologies. To do this requires a clear understanding of the priorities and needs of the potential users.

13.75 Second, during the planning phase of new research, the potential for the creation of transferable technology must be assessed and, where the potential exists, a transfer plan must be developed as part of the proposal.

13.76 Third, a database of technology that can be transferred to the agri-food sector needs to be developed. This is important for several reasons:

With respect to planning, technology transfer priorities must be set. This is particularly important in three areas:

- the identification of potentially transferable technologies that need further development work "on the bench" before they are transferable or protectable;
- the early identification of transferable technologies that should be protected both to ensure that the Crown's interests are safeguarded and to enhance their attractiveness to industry; and
- the targeting of those transferable technologies that require management's attention to market their potential to industry or other users.

The expressed needs of the Department's technology transfer partners must be met to achieve a common technical base and a means of sharing, modifying and updating that knowledge as required.

13.77 Since the Agri-Food Policy Review the Branch has taken a number of steps to enhance its technology transfer capability, and it continues to be the centre of considerable technology transfer activity. For example, in response to the perception held by the agri-food community that there is research sitting on the shelf that could be used to achieve greater competitiveness, the Department began:

a review "to take a broad look at technology transfer by province, looking at approaches, costs and quality of services, and the relationship with the research centres as well as with the other branches of Agriculture Canada";

a study to identify alternative approaches to the transfer of technology; and a study of the dairy and spring wheat sectors to determine how successful technology transfers have occurred.

13.78 The Department does not have in place a system to monitor the use of the technologies it has developed and transferred, with the exception of tracking the usage of new seed varieties. Without an effective monitoring system, it is not possible to determine how successful the Department has been in improving the adoption of technology by Canadian producers and processors.

Rewarding change

13.79 We examined how the Branch rewards personnel who respond to the changes in direction called for in *Growing Together*. Matching rewards with expected change is critical for the Department in demonstrating the commitment of senior management to change.

13.80 We reviewed the Branch's most recent promotions for the research scientist group. Our examination of the criteria for promotion showed that changes in research focus, encouraging private sector investment, and performing technology transfer activities have been used as bases for promotion. However, in keeping with government selection standards, scientific publications and international recognition continue to be the primary criteria for promotion.

Agreed-to next steps include the following:

13.81 *The Department is taking steps to strengthen the accountability process between scientific decision-makers and senior management with respect to making project-initiation decisions and changing the nature of the research portfolio.*

13.82 *The Department will continue to strengthen the scientific management information system, focussing on adding competitiveness information to support the accountability process.*

13.83 *The Department will implement a technology database as a platform for supporting both management's needs for planning and monitoring information, and industry's needs for current and comprehensive information on the availability of new knowledge.*

13.84 *The Department will require that research proposals include a technology transfer plan.*

13.85 *The Department will evaluate key technology transfer activities - including industry infrastructure - by commodity sector to target the most effective methods of technology transfer; the evaluations will include an analysis of technologies that have already been transferred and those not yet transferred.*

13.86 *The Department will conduct a periodic review of technologies to determine whether commercial interest has evolved and could be exploited.*

13.87 *The Department will continue to emphasize rewards that reflect changed priorities.*

Environmental Sustainability

13.88 In keeping with the general concern about environmental issues in the 1980s, *Growing Together* identified environmental sustainability as one of the four pillars of policy reform.

13.89 As part of the Agri-Food Policy Review, a Federal-Provincial Agriculture Committee on Environmental Sustainability was set up to develop an action plan to address the environmental issues facing the agri-food sector. The Committee's report was adopted in its entirety by the federal and provincial ministers of Agriculture in August 1990.

13.90 In May 1992 the Standing Committee on Agriculture issued a report to the House of Commons called *The Path to Sustainable Agriculture*. Several of the Committee's recommendations reinforce those of the Agri-Food Policy Review. The report is also a strong indication of parliamentary interest in, and support for, the need for action on environmental sustainability issues, particularly as they relate to agriculture.

13.91 The Agri-Food Policy Review and the parliamentary report both identify four key activities the Department must pursue:

- develop indicators that measure the state of key resources such as soil and water, and the extent of key farming practices;
- use these indicators to monitor the changes in the state of key resources and the prevalence of environmentally desirable farming practices, and the effects on the environment of those changes;
- implement new environmental programs that encourage environmental sustainability; and
- review and, where necessary, reform all existing and planned programs and policies to ensure that they do not or will not adversely affect the environment or act at cross-purposes to each other.

Progress in implementation

13.92 Following the adoption of the *Report of the Federal-Provincial Agriculture Committee on Environmental Sustainability*, the Department did several things:

A Bureau for Environmental Sustainability was created to provide departmental leadership for - and co-ordination of - environmental issues. Initially the Bureau, with a budget of \$1.3 million, was led by a director general reporting to an associate deputy minister. It is now led by a director reporting to a director

general and has a budget of \$833,000 for 1993-94, a reduction of 34 percent over two years.

A process for complying with the *Environmental Assessment Review Process Guidelines Order* was put in place.

The agriculture component of the *Green Plan* was developed to address the issues and to implement changes identified in the report. Initial funding of \$170 million was later reduced to \$155 million in the Government's Economic Statement of December 1992.

Pamphlets on environmental sustainability and on the *Green Plan* were published and widely distributed.

The priority of environmental indicators

13.93 Over the years, the Department has gathered a lot of detailed data on the state of agricultural resources and land management practices. However, there is a gap between these detailed data and the creation of environmental indicators that can be used to monitor changes in the agricultural environment.

13.94 In January 1993, the Department launched a project to develop indicators of environmentally related trends in agriculture. While the primary purpose of these indicators is to support decision makers and policy makers and to facilitate analyses of issues, such indicators must also serve the accountability needs of Parliament.

13.95 The first phase of the project is to develop, by December 1993, a set of indicators based on existing data. The second phase is to refine the initial set of indicators, and identify those areas where new data-gathering procedures will have to be set up. The plan has yet to address a reporting strategy indicating where, to whom and when these indicators will be reported.

13.96 Developing environmental indicators that are meaningful to end-users is not an easy task. As attempts to develop indicators in other fields have shown, it is critical to develop either a reference value or, where that is not possible, a desired direction for change. This kind of interpretive framework is necessary if data are to become useful information for policy-making, planning and accountability purposes.

13.97 For example, one key problem is soil erosion. This is an environmental concern with air and water implications, and an economic concern because of the effect on the soil's productivity. The statistic "number of farms reporting erosion control practices" presents the frequency of use of several practices intended to reduce soil erosion (see [Exhibit 13.3](#)). The Department plans to use simple statistics like these, based on available data, refining them into more meaningful information later. The basic statistic can be made into an indicator by relating the use of erosion control practices to some measure of the need for their use - for example, the ratio of the number of farms that use erosion control measures to the number that require erosion control.

Green Plan implementation

13.98 There are high expectations for the agriculture component of the *Green Plan* . It addresses the issues defined in the *Report of the Federal-Provincial Agriculture Committee on Environmental Sustainability* and is intended to have a significant effect on each. This is to happen through a combination of national initiatives and federal-provincial agreements. As of July 1993, agreements had been signed with nine provinces and one territory, and work had begun on the national initiatives.

13.99 The agriculture component of the *Green Plan* was designed based on a "review" of previous programs, consisting largely of a subjective assessment of what should continue and what should not. At the agreement level, personal knowledge of related programs, a formal or informal consultation process with stakeholders, and reviews of previous agreements and programs, as available, were used to develop agreements, to determine priorities for action and to define work plans. Little formal quantitative or qualitative analysis was used.

13.100 Lacking reliable information on the extent of agricultural environmental problems, the allocation of *Green Plan* money among provinces was made on the basis of share of agricultural gross domestic product.

13.101 The measurement of effectiveness. The national objectives for the agriculture component of the *Green Plan* are presented in [Exhibit 13.4](#) . However, the Department states that, as the development of indicators was not sufficiently advanced, it has not established operational goals for each of the objectives and has not set targets for the extent to which the *Green Plan* is expected to move matters in the direction of these goals.

Exhibit 13.4

National Objectives for the Agriculture Component of the *Green Plan*

The following have been adopted by the Department as a statement of national objectives for the agriculture component of the *Green Plan* .

A secure and well-managed resource base of agricultural land and soil to support the long-term productivity and competitiveness of the Canadian agri-food industry.

An agri-food sector that contributes to improved surface and groundwater quality through the use of environmentally sustainable production and processing practices.

An agri-food sector that has adapted itself to, and manages on a sustainable basis, the surface and groundwater resources available to it.

Canada's agri-food sector and wildlife resources to be managed for sustainability and long-term mutual benefits.

An agri-food sector that is able to respond to air and climate change, and which does not itself contribute to air and climate problems.

An agri-food sector that is more energy-efficient, less polluting and less

dependent on non-renewable energy sources.

A major reduction in the impact of pollution on air, soil and water resources used by the agri-food sector. An agri-food sector that has minimized its contribution to air, soil and water degradation and pollution.

Canada to have an accessible and sufficiently diversified genetic resource base that can be effectively utilized to assure the sustainability of agriculture for future generations.

13.102 According to the Department, the program was designed to have the management committee for each federal-provincial agreement set its own goals and targets. However, operational goals for the national objectives were not established at the provincial level either. Work plans were developed and include statements of goals such as encouraging adoption of new, more environmentally sustainable farming practices, but these are not further defined. Nor are performance targets set for these goals.

13.103 An evaluation framework is the basis on which the future assessment of a program's effectiveness is built. It is a way to ensure that it will be possible to measure the achievement of objectives at the end of a program, and to test the soundness of the program logic. Government policy requires that an evaluation framework be developed during the planning stages of new programs.

13.104 An evaluation framework for the agriculture component of the *Green Plan* is only now being prepared. Evaluation frameworks are also being prepared for individual agreements. These were not completed within the timeframe required in the agreements. There is a need for a better articulation of the relationships between national and agreement-level evaluation frameworks.

13.105 Overall, much has been done in developing *Green Plan* agreements and work plans for each province. The analysis of the effectiveness and efficiency of the program, however, will have to rely heavily on judgmental assessments and consultation with advisory committees. The Department agrees that these should be complemented with quantitative assessments for future programs. This will be possible only if the indicators and measurement tools are developed.

Review of existing policies and programs

13.106 In addition to direct action on environmental issues through new long-term programming, for example the agriculture component of the *Green Plan*, the *Report of the Federal-Provincial Agriculture Committee on Environmental Sustainability* identified the need for an immediate reform of existing policies and programs. One of its recommendations called for accelerated reform of policies and programs that contribute to resource-base and environmental degradation. A similar recommendation - to set a timeframe to meet the urgent need to convert existing agri-food policies and programs into an environmentally sustainable food system - was made by the Standing Committee on Agriculture and was endorsed by the government.

13.107 Shortly after the publication of the *Report of the Federal-Provincial Agriculture Committee on Environmental Sustainability*, a Federal-Provincial Working Group on Program Review was put in place to develop an action plan for addressing environmental concerns within the existing set of policies and programs. This Group was to develop methodology and criteria to assess programs, to test them during the review of the Gross Revenue Insurance Program (GRIP) and the Net Income Stabilization Account (NISA), and to develop a timeframe to conduct reviews of other programs. Although a report was produced by the Working Group, it has never been presented to the federal and provincial ministers.

13.108 Environmental reviews of some programs are in progress. The reviews of programs pursuant to the *Farm Income Protection Act*, Gross Revenue Insurance Program, Net Income Stabilization Account and Crop Insurance, were scheduled for completion by the end of July 1993. A review of options to the *Western Grains Transportation Act* was also conducted.

13.109 The Department intends to conduct policy and program reviews when one of the following three factors apply: the policy or program is being changed, there are compelling environmental reasons, or sufficient public concern is demonstrated. In addition, when initiating any program evaluation, its impact on environmental sustainability is to be considered and, if deemed important, will be examined further. While this reactive approach may serve the policy process, it may also leave programs that have a significant impact on environmental sustainability untouched. The Department does not intend to use a structured analysis of the potential risk of environmental impacts of its programs as a basis for setting priorities for its policy and program reviews.

13.110 The *Report of the Federal-Provincial Agriculture Committee on Environmental Sustainability* included preliminary criteria to assess policies and programs. The Committee did not consider the preliminary criteria as definitive, and recommended that these be developed further and expanded. This has not been done. The Department intends to develop the methodology and criteria to conduct environmental reviews of policies and programs.

Cross-compliance

13.111 *Growing Together* asserts that all government programs and policies must take environmental sustainability into account in their design and delivery. "Compliance with environmental requirements may have to be encouraged." The Federal-Provincial Agriculture Committee on Environmental Sustainability recommended an immediate detailed examination of the feasibility and acceptability of implementing suitable cross-compliance measures, i.e., measures used to effect compliance or harmony between two or more policies or programs.

13.112 Work has been ongoing in this area. A departmental discussion paper is planned for 1993-94. This work emphasizes cross-compliance as an instrument, among others, to encourage environmental sustainability or to speed up its pace. A typical example would

require that farmers have in place approved farm plans demonstrating that they are using environmentally sustainable practices before being eligible for government assistance.

13.113 The *Farm Income Protection Act* requires that all agreements provide for circumstances under which insurance may be withheld, restricted or enhanced for the purpose of protecting the environment. These circumstances were not clearly identified in the agreements because the Department, in its view, lacked sufficient information on the environmental effects of the programs and on good farming practices. Environmental reviews of the Gross Revenue Insurance Program, the Net Income Stabilization Account and Crop Insurance are now being conducted.

13.114 Examples where some form of cross-compliance could be used, through restrictions or enhancements, are being investigated in the Gross Revenue Insurance Plan review. One would restrict program benefits for annual crops grown on lands classified 4, 5 or 6 under the Canada Land Inventory System. These are "marginal lands", generally considered unsuitable for annual crop production and often highly susceptible to soil erosion and degradation. The Permanent Cover Programs were designed specifically to stop annual crop production on these lands. Departmental estimates indicate that 11.8 million acres of marginal lands are actually used for annual crop production in the Prairies, and that \$107 million in federal contributions to ongoing income support programs are spent annually on these lands. The reviews of the Gross Revenue Insurance Program, the Net Income Stabilization Account and Crop Insurance will identify circumstances under which insurance may be withheld, restricted or enhanced to protect the environment. The federal-provincial management committees for these programs will then assess the options and recommend amendments to the agreements to the ministers.

Agreed-to next steps include the following:

13.115 *The Department will continue to develop environmental indicators for the agricultural resource sector, including the establishment of reference levels to interpret the indicators. The Department will monitor and report on changes in the state of the resources and their effect on the environment to assist at all levels of decision making.*

13.116 *The Department will monitor and report the results of the Green Plan in relation to its national objectives. Furthermore, it is committed to ensuring that it has the data to assess quantitatively the efficiency and effectiveness of future programs.*

13.117 *The Department will continue to examine cross-compliance issues and, where feasible, will provide for the circumstances under which payments can be withheld, restricted or enhanced for the purpose of protecting the environment.*

Farm Management Skills

13.118 *Growing Together* pointed to the adoption of new technology and better production and financial management skills as critical if producers are to respond more effectively to changing consumer demands for new and different products. Improved management skills and increased use of new technology will help farmers to identify

additional ways of reducing input costs, and/or increasing revenue, to achieve an improved net farm income.

13.119 The Task Force on Farm Finance and Management recommended establishing a national program for farm management training, services and information.

A new program

13.120 In July 1991, a proposal for the National Farm Business Management Program was accepted by the federal and provincial ministers of Agriculture. Co-ordination of farm business management programming across provincial boundaries was viewed as the primary function of the national program. Approval for the National Farm Business Management Program to run from April 1992 to March 1995, at a total federal cost of \$30 million, was given in April 1992.

13.121 In each province, the National Farm Business Management Program has been characterized by a separate federal-provincial agreement. For the most part, the program builds on farm business management activities that existed prior to its launch at both the national and provincial levels. According to departmental reports, provincial contributions to the Program - with the exception of one province - represent ongoing farm management programming.

13.122 At the national level, projects and courses under the National Farm Business Management Program were delivered in 1992-93, with the exception of two provinces. All federal-provincial agreements had been signed by April 1993.

Program administration

13.123 The Department of Agriculture created the Canadian Farm Business Management Council to monitor and guide the implementation of the National Farm Business Management Program and to co-ordinate farm business management activities undertaken at the national level.

13.124 An important aspect of developing national programs is establishing consistent approaches and national standards. The importance of these can be seen in the results of projects such as the *Farm Accounting Standardization Manual*. The weakness in not having national standards is apparent in the results of the provincial training-needs assessments, where there was no national standard or model to ensure that common standards were followed. The lack of a national standard or model in conducting the training-needs assessments may have resulted in some training needs being overlooked. It will also make sharing information among the provinces more difficult.

Program effects

13.125 While studies completed by the Department have shown that management ability positively affects net farm income, there was no analysis completed to determine the optimal level of financing for the National Farm Business Management Program.

Without an economic impact analysis of the program, it is not known what the impact of \$30 million over three years may be on farm profitability in Canada. Such a study should be completed and presented to decision makers as part of any program renewal efforts.

13.126 The first year of the program has been productive. However, only two years are left in which to achieve its founding objective: to improve the financial viability of farm operations across Canada. It is not clear how the benefits derived from improved farm management skills, generally recognized to be long-term, can be achieved in this time.

Agreed-to next steps include the following:

13.127 *The Department will ask the Canadian Farm Business Management Council to continue to perform needed research, monitor the results of training and use this information to conduct an economic impact analysis. For example, it may be useful to track the impact of the program on the farm profitability of selected participants.*

13.128 *The Department will develop common approaches and national standards to be incorporated in any future federal-provincial agreements, to ensure maximum co-ordination and co-operation among stakeholders.*

13.129 *The Department will assess and make recommendations respecting the three-year time frame of the National Farm Business Management Program against the long-term objective of farm profitability.*

Regulatory Review

Background

13.130 *Growing Together* urged the removal of regulatory obstacles to competitiveness. In June 1990 the Task Force on Competitiveness also recommended improving the regulatory environment for the agri-food industry.

13.131 The government's 1992 budget required a full review of federal regulations and the regulatory process, including areas of potential deregulation or re-regulation. The reasons for the review include the need to improve competitiveness, use government resources more effectively, reduce cost to industry and consumers, and ensure an appropriate relationship between the costs and benefits of the regulatory regime. According to the government, "this review should require a public rejustification of existing regulations that are to be retained to ensure that those which stifle the creativity and efficiency required by Canadian business to compete and grow in today's modern world, or which serve no public good, are removed."

13.132 The Standing Committee on Finance was mandated to examine the review process and report on 30 September 1992. Ministers of Agriculture felt that the Department should report by the same date. The Department accomplished a great deal in a short period of time. Following its review, the Standing Committee on Finance reported

that, "of the three departments (Agriculture Canada, Transport Canada and Consumer and Corporate Affairs) undertaking reviews, Agriculture Canada was the most advanced."

13.133 Although the regulatory review was directly mandated by the 1992 budget, the need for a review and much of the thinking behind it were, according to the Department, an integral part of the Agri-Food Policy Review, and it asked us to include the regulatory review as part of our audit.

The review process in the Department of Agriculture

13.134 The review covered regulations with respect to Grains and Oilseeds and Food Production and Inspection. These reviews were conducted in parallel, using common departmental structures.

13.135 An advisory panel was established to challenge and guide both components of the review, ensure that the views of external stakeholders were considered, and review the criteria used to assess the regulations. A secretariat was established to link the panel, branches and other departments.

13.136 The Grains and Oilseeds review dealt mainly with regulations administered by the Canadian Wheat Board and the Canadian Grain Commission. A review of regulations pertaining to the Livestock Feed Bureau was undertaken concurrently.

13.137 Food Production and Inspection Branch reviewed all regulations in its Acts, except those related to pesticides and racetrack supervision. The Food Production and Inspection regulations were reviewed in four groups: Horticulture, Animal Products, Animal and Plant Health, and Inputs (i.e., fertilizers and seeds).

13.138 The Department developed criteria to provide a consistent base for evaluating the regulations. They included a competitiveness test based on one developed by the Agri-Food Competitiveness Council.

13.139 Sets of tailored questions were developed as a guide to stakeholders in formulating their comments on the regulations. They were also used to structure discussions and follow-up interviews with stakeholders.

13.140 To ensure a thorough review of the regulations, the Department involved both departmental staff and a wide spectrum of stakeholders in assessing regulations that directly affected them. In light of the limited time, this process presented challenges to the Department in terms of identifying and contacting a broader spectrum of stakeholders, designing a consultation protocol, and analyzing the responses.

13.141 The results of the review have already been substantial in terms of the numbers of regulations that have been modified or deleted. However, further results will be seen as the subsequent reviews of the many regulatory sets identified for additional study are completed.

Lessons learned

13.142 As a result of our examination of the regulatory review process at the Department of Agriculture, we have identified several "lessons learned" that fall under the headings of Consultation, Criteria, Co-ordination and Control ([see Exhibit 13.5](#)). We and the Department agree that these could serve as a guide for other departments embarking on the process of regulatory review, and for the Department in subsequent reviews. These "lessons learned" represent a mix of what worked, what could have worked better and what could have been done to improve the process.

Exhibit 13.5

Lessons Learned from the Regulatory Review Process

These "lessons learned" represent a mix of what worked, what could have worked better and what could have been done to improve the process.

Consultation

The public consultation process was one of the most important features of this review and it is important that such a process be meaningful. A consultation process should have the following characteristics:

A comprehensive set of stakeholders needs to be properly defined and identified. First, it is necessary to determine who constitutes a stakeholder. Specific stakeholders should then be identified and sought out for their input.

The information provided to stakeholders should fully explain the process of regulatory review, the regulations in question and the criteria to be used, to enable them to prepare thorough and meaningful responses.

The stakeholders should be given adequate time to review the information provided, conduct research and prepare their response.

Individuals, organizations representing provincial and regional interests, and the general public should be invited to participate in the consultation process.

Criteria

Criteria should be clearly understood, consistently applied and comprehensive. In addition, for regulations to be assessed consistently, the criteria need to be applied to each regulation in the same manner. This includes ensuring that all regulations are tested against all criteria.

Benefit-cost analysis should be one of the methods used to evaluate regulations, if the impact of the regulation involved is sufficiently material. The costs should include not only the cost of compliance, but also the cost of administering and enforcing the regulation and the cost to consumers. Benefits should also be examined from both the industry's and consumers' perspectives.

Each regulation should be subjected to public rationalization. The general public is an important stakeholder and should be consulted as part of the process, and informed of the results.

Co-ordination

Reviews of regulations should be co-ordinated across departments, and regulations should be reviewed in light of other existing regulations legislated by other bodies of government. Regulations need to be harmonized within departments, among departments and with the provinces. There is a cost associated with complying with a variety of related regulations, even more if the regulations contradict each other.

Regulatory review should be an integral part of the departmental management function. A plan should be in place to ensure that all regulations are reviewed on a periodic basis. The plan should ensure that:

related regulations are reviewed together; and

the review is co-ordinated with other departments, and all regulations are included in the plan.

Control

A senior manager should be appointed to guide the regulatory review, facilitate the process among the various groups and ensure that the planned path is followed.

Adequate time should be allotted for the regulatory review. A plan that allows for sufficient time to conduct all the steps in the process must be in place.

Resources need to be properly planned and allocated to the process.

The regulatory review process should include a challenge function to reduce any bias inherent in the process. The challenge role is more effective when given to an individual or group not involved in the creation of the regulations being reviewed.

The review teams should have access to legal, economic and other expertise.

Agreed-to next steps include the following:

13.143 *The Department will develop an ongoing review process to schedule the review of all regulations on a cyclical basis. This will also help stakeholders to better plan their participation in the reviews.*

13.144 *The Department will continue to develop ways to ensure that the invitation to participate in the review process is extended to all interested stakeholders. In particular it is working to find ways to better capture the views of the provinces, consumers and the general public.*

Pesticides Registration Review

Background

13.145 The *Pest Control Products Act* has not been amended significantly since 1969. Our 1988 Report raised a number of concerns about the operation of the registration process. In 1989, as a result of this and a number of other widely held concerns, the Minister of Agriculture launched a comprehensive review of the pesticide registration

system. These concerns included: the lack of transparency in the registration system; the knowledge that older, more commonly used pesticides would not meet current registration standards; and the fact that certain products were not available to Canadian producers or were much more expensive than in other jurisdictions.

13.146 The review team issued its final report in December 1990. In October 1991, the government accepted the thrust of the review team's 27 recommendations and indicated it would proceed with the implementation of a revised regulatory system based on these recommendations.

Progress in developing a new system

13.147 The government has stated that the *Pest Control Products Act* and Pest Control Products Regulations administered by the Department of Agriculture will be amended, to entrench the revised roles and responsibilities of the departments of Health and Welfare, Environment and Forestry and to incorporate several new initiatives.

13.148 It has established an Interdepartmental Executive Committee to manage the pesticides registration process and to meet operational standards for on-time performance. A Pest Management Secretariat was established to support the Executive Committee.

13.149 The government has approved the expenditure of around 257 person-years and \$81 million over six years to implement the recommendations of the review team and to facilitate the ongoing registration process.

13.150 Progress has been made in a number of areas, for example, the expansion of the minor use program, the price monitoring program and the product import program.

Agreed-to next steps include the following:

13.151 *The Interdepartmental Executive Committee is continuing efforts to better integrate the various registration responsibilities and activities now carried out by the departments of Agriculture, Health and Welfare, Environment and Forestry, and to ensure the timely approval of products during the transition.*

13.152 *The government recognizes the need to enact the new legislation in order to provide a foundation of stability, predictability and accountability for a revised system.*

ANNEX A

Recommendations Arising from the Agri--Food Policy Review Used as Audit Criteria

Market and Trade Development

A market development strategy (both domestically and internationally) should be developed.

Market information for producers and processors should be more useful and accessible.

There is a need for better co-ordination among federal and provincial governments and industry in market development.

There is a need for better co-ordination among federal and provincial governments and industry in the provision of market information.

Research and Technology Transfer

Research efforts should be targeted in order to achieve competitiveness.

Adoption of the best available technology by producers and processors to gain and maintain market access, including technology developed outside Canada, is a critical step to the achievement of competitiveness.

There should be more joint ventures between government and the private sector to meet competition, and greater private sector involvement in research.

Environmental Sustainability

Develop indicators to monitor and assess the state of natural resources and environmental quality in relation to agriculture.

Develop and implement long-term, cost-shared environmental sustainability agreements to provide additional resources for measures such as technical and financial assistance, monitoring, research, education and awareness activities, to encourage adoption of sound resource management practices.

Review programs and activities related to environmental sustainability issues so that long-term support is both adequate and responsive to regional conditions and needs.

Accelerate reform of policies and programs that contribute to resource-base and environmental degradation, and reallocate resources to support environmental sustainability.

Adopt consistent criteria for assessing the environmental sustainability of agricultural policies and programs.

Immediately initiate a detailed examination of the feasibility and acceptability of implementing suitable cross-compliance measures in federal and provincial agricultural programs.

Farm Management Skills

Research what farm management training and advisory services are needed.

Establish a national program for farm management training, services and information.

Regulatory Review

Review existing regulations to ascertain whether they comply with the objective of greatest prosperity for Canadians. Part of this review should require public "rejustification" of existing regulations.

Pesticide Registration Review

The *Pest Control Products Act* and Regulations will be rewritten and entitled the *Pest Management Act* and Regulations. Subject to constitutional constraints, the legislation will incorporate a comprehensive approach (cradle-to-grave) to pesticide regulation.

Chapter 14

Department of the Environment

The Control and Clean-up of Freshwater Pollution

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Department of the Environment

The Control and Clean-up of Freshwater Pollution

Assistant Auditor General: Elwyn Dickson

Responsible Auditor: Wayne Cluskey

Main Points

14.1 The federal government is implementing action plans to improve water quality in several areas, including the Great Lakes, the St. Lawrence and Fraser rivers and along the Atlantic Coast. The audit of the St. Lawrence and Fraser River action plans indicates that they are producing some positive results, while providing lessons to be learned and applied in future programs.

14.2 In view of the many interested parties involved in water management and use, the successful delivery of individual action plans depends on partnerships between governments, and among governments, industry and other stakeholders.

14.3 The Department of the Environment should be providing strong leadership, through the Interdepartmental Committee on Water, for the effective co-ordination and implementation of the action plan process.

14.4 While the St. Lawrence and Fraser River action plans are being managed satisfactorily at the regional level, there is a need for long-term strategic planning at the national level to achieve desired water quality objectives. This would involve the development of a federal framework of water quality objectives for major individual ecosystems, based on user needs, that can help to ensure the best allocation of limited resources. The present Canadian Water Quality Guidelines provide the scientific basis for such objectives.

14.5 Action plans should be subject to timely and comprehensive program evaluation to determine the degree of success in achieving objectives and in efficient use of resources.

14.6 Parliament and the public need information to help them determine the extent of progress of clean-up activities and assess the use of resources to achieve improvements in water quality.

Introduction

Importance of Fresh Water

14.7 Fresh water is one of Canada's most valuable natural resources. As a former Minister of the Environment said in the introduction to the Federal Water Policy released in 1987:

Water is a remarkable substance...It is the genesis of and the continuing source of life. Without water, humankind - indeed, all forms of life on Earth - would perish.

14.8 A significant portion of the world's fresh water is found in Canada. Much of this water drains toward the north, whereas approximately 90 percent of our population lives near the southern border. The availability of water in the most densely populated part of Canada is limited, and water is used extensively for a variety of purposes, including drinking water and agricultural and industrial processes. As a result, where water is in greatest demand it is also more susceptible to heavy pollution from a variety of sources, such as sewage disposal, agricultural run-off and industrial effluents. If the impacts of this pollution on human health and on fish and wildlife are to be avoided, all stakeholders must contribute to controlling the sources of pollution and enhancing water quality. The fact that pollution and water quality problems cross many jurisdictions leads one to conclude that there is a need for strategic planning to develop a national approach to water quality improvement. The approach should have the support of major stakeholders and accommodate the user demands on different ecosystems across the country. The Canadian Water Quality Guidelines, prepared by the Canadian Council of Ministers of the Environment, are now being used to establish water quality objectives at the regional action plan level. However, these need to be viewed in a national context to guide governments in planning programs and assigning limited resources on an ecosystem basis.

Background

Previous Observations on Clean-up Programs

Jurisdictional complexities

14.9 Our 1990 Report on the Department of the Environment included the observation that "the general public believe that governments at all levels must take immediate, co-ordinated and decisive action to halt further deterioration of the environment." Furthermore, we noted that the "consequence of these federal-provincial and interdepartmental divisions in responsibility for environmental matters is a patchwork that makes it almost impossible to assign public accountability for safeguarding Canada's environment." There is some evidence of improvement since then. However, the need for improved co-ordination and co-operation among federal departments, among different levels of government and with industry and environmental interest groups is still evident.

Collective action by stakeholders is essential for the successful implementation of environmental programs.

Lack of a Great Lakes strategic plan

14.10 In 1991 we reviewed one of Canada's water quality control and clean-up initiatives in action - the Great Lakes Action Plan. Although this action plan was being managed adequately at the regional level, there was no strategic planning at that level to guide Canada in meeting its overall commitments to the Canada-USA Great Lakes Water Quality Agreement. A Canada-Ontario strategy was drafted, but as of 30 April 1993 had not been finalized. After conducting a follow-up to our audit, in 1992, we remained concerned about co-ordination of clean-up initiatives, and the lack of action by the federal Interdepartmental Committee on Water to address this particular problem at the national level. Subsequent to our follow-up, an ad hoc sub-committee was formed in late 1992 to prepare a strategic framework for the proposed second phase of the Great Lakes Action Plan. It should be noted that Cabinet made the parent Committee responsible for co-ordinating the federal components of that Action Plan.

The Action Plan Approach to Water Quality

14.11 In 1987, the Minister of the Environment released the Federal Water Policy developed under the *Canada Water Act*. This, together with the *Canadian Environmental Protection Act*, forms the legislative base and the federal policy framework for developing and implementing the federal components of action plans. The Federal Water Policy names the Interdepartmental Committee on Water as "the focal point for co-ordinating the policy among federal departments and agencies." It is chaired by the Department of the Environment. The policy also provides the strategic link between federal and provincial responsibilities for water quality. Thus, the Committee has a key role to play in co-ordinating federal-provincial action plans.

14.12 The action plan approach addresses the ecosystem itself, in that it focusses on such items as the restoration and protection of wildlife habitat, protection of endangered species, and improvements in water quality and in overall ecosystem productivity. A variety of water quality programs are currently being implemented by the federal and provincial governments in most major ecosystems across Canada. Major efforts are being directed toward specific polluted ecosystems in the most densely populated areas of the country. Examples of these are the action plans operating for the St. Lawrence River (1988), the Great Lakes (1989), the Fraser River (1991) and the Atlantic Coast (1991). Together, the areas covered by these four plans comprise a significant portion of Canada's land mass (see [Exhibit 14.1](#)). Federal input to these action plans is entrusted to regional managers of participating departments who, with their provincial counterparts, are responsible for clean-up and related activities, such as the restoration and protection of wildlife habitat.

General Audit Scope

14.13 To assess the management of water quality improvement in the current action plan process, we examined both policy and operational elements. We looked at the Federal Water Policy as the source of direction for federal input to action plans, and at the role of the Interdepartmental Committee on Water in implementing this policy. We also examined the five-year St. Lawrence Action Plan begun in 1988, and the six-year Fraser River Action Plan introduced in 1991 as one of the *Green Plan* initiatives. This gave us an appreciation of an action plan whose first phase was close to completion at the time of our audit (St. Lawrence) and another that was in the early stages of implementation (Fraser River). We examined the implementation of the Federal Water Policy, and related strategic and operational issues. These issues are particularly important because water quality clean-up programs are complex, costly and difficult to implement. As progress may occur only over long periods, clear objectives and long-term resource commitments to individual plans by all parties are essential to ensure optimum value from expenditures. Examples of this are seen in the Great Lakes, where water quality clean-up has been going on for over twenty years, and in the St. Lawrence Action Plan, where the federal government has already announced a second phase to the program.

14.14 The audit focussed on the Department of the Environment's responsibilities for, and activities under, the water quality aspects of these action plans. However, we also interviewed other federal and provincial government officials and private sector participants involved in the clean-up, to gain an appreciation of the Department's role and those of others.

The Interdepartmental Committee on Water

Audit Criteria

14.15 In keeping with its mandate, we expected to find that the Interdepartmental Committee on Water was monitoring and reporting on how the Federal Water Policy is applied to the action plan process, and how the process is linked to such federal-provincial co-ordinating bodies as the Canadian Council of Ministers of the Environment. We expected that, in carrying out its review and reporting role, the Interdepartmental Committee on Water would provide a focus for the development of a federal strategy to guide decision makers in the implementation of federal water quality improvements across Canada. In addition, we expected that the Committee would serve as the focal point for developing federal advice to the Minister of the Environment for federal-provincial discussions on this subject. Furthermore, we expected to find that the various federal components of action plans were co-ordinated effectively and that the means were in place to handle interdepartmental conflicts over policy, planning and funding as action plans are implemented.

Observations and Recommendations

Leadership opportunity

14.16 The Department of the Environment provides both the chairperson for the Interdepartmental Committee on Water and the Committee's Secretariat. It is also responsible for the Committee's agenda and for reporting to the Minister of the Environment on the Committee's work. The Committee has a wide range of water-related responsibilities, including water quality, one of the main components of action plans.

14.17 The Federal Water Policy and the Terms of Reference of the Interdepartmental Committee on Water clearly give the Committee the authority to deal with all federal aspects of action plans, from strategic planning through to implementation of individual plans. In addition to the Department of the Environment, eight other departments with major water-related responsibilities are members of the Committee. Representatives from central agencies attend as observers. Its breadth of expertise, along with the government's intent to apply the policy through both federal-provincial and international co-ordinating mechanisms, give the Committee the status necessary to provide advice on water policy issues to federal departments and to federal-provincial bodies, such as the Canadian Council of Ministers of the Environment.

14.18 Given its strong terms of reference, its responsibilities under the Federal Water Policy and its membership of key departments, the Interdepartmental Committee on Water would be expected to provide federal leadership with respect to action plans. Activities could include developing a federal position on the need for the establishment of water quality objectives for each major ecosystem; and offering information and advice on water quality issues to the federal Minister of the Environment.

14.19 The *Green Plan* reaffirmed the goals and strategies of the Federal Water Policy, thereby recognizing its application to the government's movement toward sustainable development. In effect, the *Green Plan* broadened the Committee's area of responsibility, giving it the opportunity to advise on environmental issues that involve any aspect of water management or use under federal jurisdiction - including action plans.

14.20 The Committee has the responsibility and authority, the expertise and, with its major role in the Great Lakes Action Plan, the precedent to provide leadership for the action plan process. By virtue of its requirement to report to the Minister of the Environment, it can have action plan issues placed on the joint agenda of the federal and provincial governments through the Canadian Council of Ministers of the Environment.

Need for advice on action plans

14.21 Since receiving its new mandate in 1987, the Committee has not taken an active role, except for the Great Lakes Action Plan, in guiding the action plan process. There is little evidence that it has advised the Minister of the Environment on federal strategic planning for the action plan process, on related long-term implications, or on federal requirements under the Federal Water Policy to implement such a strategy. For example, no formal positions have been taken on any of these matters that could be useful to regional managers responsible for strategic and operational planning at the local level.

Need for improved monitoring and reporting

14.22 The Interdepartmental Committee on Water has recognized the need for more involvement in monitoring the implementation of the Federal Water Policy. The Committee recommended in its first Report, in 1990, that it "be used as a forum for improving integrated decision making at the federal level for policies and programs that may affect water." However, a review of Committee minutes and other documentation showed no evidence of any change in the Committee's functioning since then.

14.23 In the draft of its second Report, covering the period 1991 to 1992, the Committee indicates that it intends to develop, on a priority basis, a report on the need for and timing of a comprehensive review and, if necessary, revision of the Federal Water Policy in light of current and emerging water-related issues subject to federal jurisdiction. This would provide an opportunity to examine the Committee's role in guiding the action plan process and in advising on the implementation of individual plans. The report is expected to be completed toward the end of 1993.

Need for federal strategic planning on water quality

14.24 Although initially conceived as a response to a specific pollution problem, e.g., in the Great Lakes, federal-provincial action plans now appear to be the preferred management approach to clean up polluted ecosystems across the country. However, Canada has no federal strategic plan for the water quality action plan process, to guide the development and implementation of its component individual action plans. Such a strategic plan could incorporate a federal framework of water quality objectives for each major ecosystem, developed in co-operation with major stakeholders. The framework could provide valuable benchmarks for future federal-provincial agreements on water quality control and clean-up, and could form the basis for setting priorities and allocating resources.

14.25 In our opinion, the absence of a federal strategic plan hampers the development of links among action plans. For example, there is an obvious connection between the Great Lakes and St. Lawrence action plans: water quality in the St. Lawrence is significantly influenced by conditions prevailing in the Great Lakes and both have international impacts. However, we saw little evidence that decisions on program priorities and funding for either action plan recognize this relationship and take it into account. The lack of a federal strategic plan may also contribute to problems in funding, co-ordinating, evaluating and reporting on federal input to action plans. ([see Special Insert](#))

14.26 The Department of the Environment should, through the Interdepartmental Committee on Water or some similar mechanism, ensure that there is appropriate:

discussion of the need for, and feasibility of, a federal framework of water quality objectives for major ecosystems across the country, based on user requirements; and
discussion of the need for a federal strategic plan for the action plan process, which would incorporate such a framework as the guide for setting priorities, allocating resources and evaluating and reporting progress toward objectives for individual action plans.

The St. Lawrence and Fraser River Action Plans

14.27 The quality of water in the St. Lawrence and Fraser rivers is important to the health and economic well-being of approximately seven million Canadians. To improve and protect these two ecosystems, various departments of the federal government, with provincial, municipal and private sector co-operation, are acting to control pollution, clean up contaminated areas and enhance the productivity of these waters. Our audit focussed mainly on the contribution of the Department of the Environment to improving water quality under the St. Lawrence and Fraser River action plans.

Audit Criteria

14.28 We expected to find that: 1) partnership agreements or memoranda of understanding were in place and that they clearly spelled out the roles and responsibilities of major players; 2) action plan objectives were clearly defined and documented; 3) an appropriate action plan management structure was in place; 4) progress toward stated objectives was measured; and 5) results of action plan activities were appropriately reported to Parliament and the public.

14.29 We applied all five audit criteria to the first phase of the St. Lawrence Action Plan, which concluded in March 1993. However, we excluded the reporting criterion from our review of the Fraser River Action Plan, because it was still in an early stage.

The St. Lawrence Action Plan

Background

14.30 The St. Lawrence River basin is the most heavily populated (five million people) and most highly industrialized area of Quebec. The river is the economic hub of the province, a major source of drinking water and a vital transportation link between the Atlantic Ocean and the Great Lakes. With its freshwater, brackish and saltwater ecosystems, the St. Lawrence River provides essential habitat for numerous species of fish, animals and birds.

14.31 The federal and provincial governments have conducted a number of studies in the St. Lawrence River basin since 1970. However, it was not until 1988 that the federal government focussed its efforts on the river's water quality, through the St. Lawrence Action Plan. The Plan had a budget of \$110 million spread over the five-year period ending 31 March 1993. Responsibility for financing and implementing the Plan is shared by three federal departments - Environment; Industry, Science and Technology; and Fisheries and Oceans: their total contributions are \$84 million, \$20 million and \$6 million respectively. The Department of the Environment is the co-ordinator of the Plan ([see Exhibit 14.2](#)).

14.32 The general objectives of the St. Lawrence Action Plan are threefold: to co-ordinate federal activities and encourage the participation of other levels of government,

industry and the general public; to reduce pollution sources; and to update and increase environmental information about the St. Lawrence River ecosystem.

14.33 In June 1989, Canada and Quebec signed a *"harmonization and co-ordination agreement for the depollution, the protection, the restoration and the conservation of the St. Lawrence River."* Under this agreement, the parties agreed to harmonize more than \$60 million of the Province's portion of its total St. Lawrence River pollution control and abatement activities with the federal action plan.

Observations and Recommendations

Lack of interdepartmental co-ordination

14.34 The St. Lawrence Action Plan requires that the departments of Environment, Fisheries and Oceans, and Industry, Science and Technology co-ordinate their activities to achieve common goals. We conducted a limited review of the co-ordination between Environment and Fisheries and Oceans and found no evidence of problems. Our examination focussed primarily on the co-ordination between Environment and Industry, Science and Technology, due to the latter's \$20 million contribution to the \$37 million technological development thrust of the plan. This overall thrust is aimed at developing, adapting and applying advanced environmental technologies to the clean-up of the St. Lawrence River.

14.35 However, the focusses of the two departments are different. Environment's program focusses on the demonstration and application of technologies that meet the immediate needs of the 50 industries directly involved in the clean-up. Industry, Science and Technology's program focusses on the development and application of new and improved technology that can be marketed nationally and internationally, while being applicable eventually to St. Lawrence industries.

14.36 This difference in departmental objectives and program funding mechanisms led to co-ordination problems. Although an agreement was concluded between the two departments to provide for a management structure to co-ordinate their respective programs, it proved to be ineffective. An ad hoc arrangement between the two departments at the regional level improved co-ordination temporarily but did not fully resolve problems.

Co-ordination of federal and provincial activities

14.37 The Canada-Quebec Agreement is comprehensive and specific about the objectives, the activities to be conducted jointly or independently, and the financial obligations of each party. It provides an appropriate management structure and mechanisms to co-ordinate federal and provincial initiatives. Co-ordination mechanisms are simple and are oriented to the Agreement's objectives. The administration of the Agreement is assigned to a Management Committee, assisted by four harmonization committees corresponding to the four components of the Action Plan, namely, protection,

conservation, restoration and state of the environment. The functions and responsibilities of these committees are clearly defined.

14.38 All of the mechanisms generally operate as described in the Agreement. Based on interviews with federal and provincial officials and reviews of relevant documentation, the Management Committee appears, in general, to have performed its co-ordination function. However, the federal and provincial partners also recognize that not all of the harmonization committees have been equally effective.

14.39 The stakeholders we interviewed told us that the joint federal-provincial St. Lawrence action team, created to deal with industry, proved to be an innovative and positive approach to achieving co-operation in the first phase of the Plan.

Clarity of objectives

14.40 The three general objectives of the St. Lawrence Action Plan (paragraph 14.32) were translated into five operational objectives ([see Exhibit 14.3](#)). These objectives are clearly defined and have served to guide subsequent decision making, to focus activities and to measure progress. Action Plan reports indicate that progress in achieving the objectives is being made. However, there is a need for explicit benchmarks against which existing water quality can be assessed, progress toward desirable water quality objectives can be measured and improvements reported to Parliament and the public. This would provide a basis for relating results at any given time to the current and future use of the water for drinking, swimming and fishing purposes and the impact on human health.

Need for strategic planning

14.41 The St. Lawrence Action Plan is the first step in what is now widely recognized as a long-term initiative. The first phase of the plan, which ended on 31 March 1993, developed a mechanism for co-ordinating federal-provincial clean-up activities while establishing the necessary environmental database on which to plan future activities. However, a federal-provincial long-term strategic plan for future clean-up activities in the St. Lawrence has not been developed. The lack of a strategic plan may have contributed to the delay in federal-provincial approval of the second phase of the St. Lawrence Action Plan. When approval of the federal component of the second phase was announced in April 1993, a formal commitment from Quebec to continue to co-ordinate its clean-up activities with the federal plan was not in place. Such a delay could lead to a loss of momentum, resulting in a slowdown of activities and a reduction in the commitment of key participants. In our opinion, this situation could lead to inefficient use of limited resources and could impede progress in the clean-up of the St. Lawrence River.

14.42 The Department of the Environment, in collaboration with the other federal departments concerned and the Province of Quebec, should develop a long-term strategic plan for the clean-up of the St. Lawrence River.

Mobilization of non-governmental stakeholders

14.43 The government states in the *Green Plan* that it is committed to building productive partnerships with all environmental stakeholders. This implies that the federal government will work closely with the targeted industries and environmental groups in implementing the St. Lawrence Action Plan.

14.44 Although there is no formal consultation process, the non-government stakeholders we interviewed were generally satisfied with the objectives of the Action Plan. However, environmental groups felt that such a process would be needed if they were to contribute more effectively to future phases of the Plan.

14.45 A group of non-government organizations took the initiative of creating committees at the community level to participate in developing remedial action plans for their respective areas of the St. Lawrence - "zones of priority action". The first local committee met in 1992. The Department of the Environment participates in this process. The consultation process may be continued in the second phase of the Action Plan.

14.46 The Department of the Environment, in collaboration with other stakeholders, should ensure that there is an appropriate process for public consultation and participation in the second phase of the St. Lawrence Action Plan.

Action plan management

14.47 St. Lawrence Action Plan management mechanisms were, on the whole, effective in the first phase. The project management approach provided for regular monitoring of work progress and for measuring results against operational objectives.

14.48 Working groups were created and given responsibility for attaining major objectives. The roles and responsibilities of each working group were clearly defined and deadlines were established. In addition, a system was set up that allowed all working group members to identify their own contributions toward achieving operational objectives. Appropriate tools were developed and are being used for monitoring and controlling activities.

Program evaluation

14.49 The purpose of program evaluation is to ensure that federal departments have relevant, credible and objective information available on the performance of their programs and that they use that information to manage their programs in a cost-effective way. That is, the federal government should be able to determine the relevance of a program and the degree of success or failure in relation to objectives and resources used. This information should then be used in making decisions about the future direction and resourcing of programs. In addition, program evaluation should provide important information for Parliament and the Canadian public.

14.50 An important early step in the evaluation process is the development of a comprehensive evaluation framework. The framework outlines what the evaluation is

likely to entail and, more critical, describes the program profile and the information and data that are to be collected prior to and during the evaluation.

Program evaluation must be timely

14.51 Cabinet gave approval to the second phase of the St. Lawrence Action Plan in 1993, without the benefit of formal evaluation of the effectiveness of the first phase by the departments involved, i.e., Environment, Fisheries and Oceans, and Industry, Science and Technology. The Department of the Environment is of the opinion that it had sufficient information about results achieved in the first phase and about the state of the St. Lawrence ecosystem to know that there was a need for a second phase. However, without a timely evaluation, the government, Parliament and the public cannot judge if the Department has selected appropriate objectives for the second phase.

Evaluation must address the strategic goal of the program

14.52 In early 1993 the Department of the Environment began an evaluation of the first phase of the Action Plan. The Department recognized that the evaluation framework prepared in 1990 did not cover the full scope of issues that the evaluation should have included. It focussed on whether the program objectives were realistic in terms of timing and the resources allocated, but not whether they were the most appropriate to address the environmental problems. In particular, the evaluation framework did not fully address the strategic goal of the St. Lawrence Action Plan, which is the "clean-up, protection, restoration and conservation of the biological, physical and chemical integrity of the St. Lawrence River and the development of an environmental technology for the sustainable development of its resources."

Evaluation findings can be used to improve programs

14.53 Even though the decision to pursue the second phase of the Action Plan has already been taken, the Department still has the opportunity to use the results of the evaluation of the first phase to modify and improve the design of its program for the second phase. The evaluation of the first phase can also help identify any lessons learned to be used in preparing for the program evaluation of the second phase.

14.54 The Department should conduct timely program evaluations that cover the full scope of evaluation issues, and use findings from the evaluations to improve or modify the programs evaluated or to confirm the continuing need for them.

Accountability reporting

14.55 Accountability to Parliament and the public depends on adequate information on the resources expended, the activities carried out and the planned outcomes and actual results achieved. Our examination focussed on the St. Lawrence Action Plan annual reports for 1988-89 to 1991-92, and Environment's Part III of the Estimates for 1991-92 to 1993-94.

Incomplete information could be misleading

14.56 We found that, although the reports provide information on the achievement of operational objectives of the St. Lawrence Action Plan, there is little explanation of their relationship to the overall health of the ecosystem, including water quality. For example, one of the Plan's principal objectives is a 90 percent reduction in discharges of industrial liquid toxic wastes. The reports provide the actual percentage reduction but no analysis of the likely impact on water quality. Furthermore, these reports do not address the impact of external factors such as plant closures and reduced production levels due to the recession or other circumstances, which may have contributed to the reduction in discharge of toxic wastes.

14.57 Some environmental data have been accumulated over the five years of the plan, and a report on the state of the environment of the St. Lawrence ecosystem, including water quality, is planned for release before the end of 1993. This should enable the Department of the Environment, in collaboration with the Province and other stakeholders, to establish a set of water quality benchmarks against which future improvements can be measured. Such improvements need to be expressed in terms of actual water quality and the suitability of the water for the various user demands being placed on it.

14.58 We found no information on the obstacles, limits and uncertainties affecting the achievement of the Plan's general objectives, namely, to co-ordinate federal activities and encourage the participation of other levels of government, industry and the general public to reduce pollution sources; and to update and increase environmental information on the St. Lawrence River ecosystem. The initial five-year plan with a budget of \$110 million is only the beginning of a long-term effort to repair environmental damage in this river system. Parliament and the public should be fully informed about the Plan's limitations and the estimated long-term costs that will have to be incurred to fully rehabilitate the St. Lawrence River basin.

14.59 The Department of the Environment should provide relevant, reliable and understandable information to Parliament and the public on the nature and magnitude of the problems being addressed by the St. Lawrence Action Plan, the scope and costs of the measures that are being taken to solve these problems and the results expected and achieved.

Fraser River Action Plan

Background

14.60 The Fraser River basin covers a quarter of British Columbia and is home to almost two million people. It is the fifth-largest river in Canada and produces more salmon than any other river in the world. It is a vital feeding and resting stop for migratory birds and an over-wintering habitat for several hundred thousand waterfowl. ([see Special Insert](#))

14.61 In June 1991 the federal government announced the Fraser River Action Plan, a six-year, \$100 million initiative under the *Green Plan*. The departments of the Environment and Fisheries and Oceans were each responsible for \$50 million in program funding ([see Exhibit 14.4](#)). The objectives of the Plan are threefold: to clean up pollution; to restore the productivity of the natural environment; and to develop, through partnerships with stakeholders, a sustainable management program for the Fraser River basin (one that integrates socio-economic and environmental concerns into planning and decision making).

14.62 As a consequence of a \$5 million reduction in Environment's funding for the Fraser River Action Plan for 1992-93 to 1994-95, and in anticipation of further budget cuts, the Department completed a review of its component of the Plan. This included a review of partnership commitments, and has led to a reallocation of resources and a change in expected results. Adjustments to the program were achieved by eliminating some components (demonstration watersheds) and severely curtailing others (land acquisition to secure critical habitat). The objectives of the original program, however, were retained.

14.63 Although Environment and Fisheries and Oceans are equal partners in the Plan, our audit focussed on Environment's activities with respect to water quality.

Contribution to the sustainable development of the basin

14.64 The Fraser Basin Management Program was developed from the Fraser River Action Plan. This program focusses on sustainable development and incorporates federal, provincial, municipal and other stakeholder interests ([see Exhibit 14.5](#)). A federal/provincial/ municipal agreement providing for the establishment of the Fraser Basin Management Program was signed in May 1992. The agreement calls for a Management Board, comprising government and non-government members, to influence and guide the co-ordination and integration of all stakeholders' ongoing activities, including those of the Fraser River Action Plan, toward achieving sustainable development in the Basin. The Board was established in August 1992 but does not yet include any representatives from non-government environmental organizations.

14.65 We did not audit the Fraser Basin Management Program as a whole. The focus of our audit was mainly on the role of the Department of the Environment in the Fraser River Action Plan and its input to the Fraser Basin Management Program.

Observations and Recommendations

Lack of interdepartmental co-ordination

14.66 The Department of the Environment and the Department of Fisheries and Oceans are partners in the Fraser River Action Plan. Although each department focusses on its own responsibilities, co-ordination is critical to the Plan's success. For example, the rehabilitation of salmon stocks and the restoration of fish habitat - mainly a responsibility of the Department of Fisheries and Oceans - is very much dependent on the quality of the water - a responsibility of the Department of the Environment.

14.67 There is evidence of a lack of co-ordination between the two federal departments in implementing the Action Plan. Attempts were made in the first year of the program to form interdepartmental work groups to co-ordinate the activities of the two departments. Some work groups seldom met and others no longer exist. In view of the departments' co-responsibility for the delivery of the Action Plan, a high degree of co-ordination would assist in the efficient achievement of objectives.

Stakeholder involvement

14.68 When the Fraser River Action Plan was announced in June 1991, there had been little, if any, consultation with the Province of British Columbia, despite the fact that the Province is an essential partner in the efforts to clean up and restore the river. Such a lack of early consultation can inhibit timely action and program development by potential partners.

14.69 The agreement respecting the Fraser Basin Management Program provides the foundation for all stakeholders to participate. Public information, education and involvement are to be accomplished through the Management Program. By 30 April 1993, the federal Fraser River Action Plan was entering the third year of the six-year program. However, the Fraser Basin Management Program was just beginning the process of obtaining the participation of local communities and the general public. Furthermore, little information has been provided to the public. If the public is to be involved and to give its support to the Management Program, it is critical that it be fully informed and educated about the relevant environmental issues. The public should also be involved in developing objectives and plans that guide decisions on funding, through an appropriate participatory process extending to the community level.

14.70 The departments of the Environment and Fisheries and Oceans, in co-operation with other stakeholders, should request the Fraser Basin Management Board to develop and implement an appropriate public information, education and participation process.

Cleaning up pollution

14.71 The Fraser River Action Plan provides for the abatement and clean-up of contamination of the Fraser River ecosystem. Activities planned to meet the clean-up objective consist of identifying sources and amounts of pollution, developing abatement plans, monitoring the implementation of these plans by the polluter, increasing enforcement activities, monitoring the condition of the basin, setting objectives for water quality, and conducting water quality research.

14.72 The water quality objectives for this Action Plan are clearly defined. The Department has put in place appropriate program management procedures and structures to implement and monitor activities under this part of the Plan. As we have already noted for the St. Lawrence Action Plan, however, there is also a need for specific benchmarks against which existing water quality can be assessed and progress measured in the Fraser River Action Plan.

14.73 The Department of the Environment is making a significant investment in the improvement of water quality. However, the activities of the Department alone will not clean up the river. Responsibility for activities that impact on water quality is shared among several federal departments and with provincial and local governments and the private sector. Co-ordination of stakeholder contributions is therefore required to ensure cost-effective implementation of clean-up programs.

Renewing the productivity of the environment

14.74 The Department of Fisheries and Oceans is largely responsible for the second objective of the Fraser River Action Plan - restoring the productivity of the natural environment. It has defined this as restoring the salmon populations to historic levels and maintaining them. As appropriate, we may examine that Department's contribution (approximately \$39 million) to this component of the Action Plan together with that of the Department of the Environment (approximately \$12 million) at some future date.

A management program for sustainable development

14.75 The third objective of the Fraser River Action Plan is to develop a management program that will provide for the sustainable development of the Fraser River basin. This will be done through the Fraser Basin Management Program. This challenging task is primarily the responsibility of the Fraser Basin Management Board. It is not clear how the current design of the program will provide for sustainable development. It is essential that the intended scope and meaning of sustainable development, as applied to the Fraser basin, be defined to the satisfaction of all stakeholders. This would then provide direction for program development and implementation.

14.76 The Fraser Basin Management Program does, however, include elements for co-ordinating the activities of stakeholders, improving institutional relationships and management processes, fostering sustainable development, developing and applying a process for public education and involvement, and improving scientific data and knowledge. The multi-stakeholder Management Board established by the agreement has developed "A Strategic Plan for the Fraser Basin Management Program for 1993-98". This Plan, published in May 1993, should help guide the co-ordination and integration of the stakeholders' ongoing activities. One priority will be its co-ordination with the Fraser River Action Plan to ensure progress toward the achievement of sustainable development objectives.

14.77 The departments of the Environment and Fisheries and Oceans should encourage the other members of the Fraser Basin Management Board to indicate, in the context of the strategic planning process now being implemented, how the Fraser River Action Plan will be co-ordinated with the Management Program to achieve sustainable development objectives.

Program evaluation

14.78 The Department of the Environment has prepared an evaluation framework, comprising a program profile and an evaluation strategy for its portion of the Fraser River Action Plan. We found the strategy, which proposes to look at both program implementation and achievement of objectives, to be appropriate for a program such as the Fraser River Action Plan. We noted, however, that the collaboration of all parties to the Plan will be required so that all of the necessary data will be available for the evaluation.

14.79 The federal/provincial/municipal agreement on the Fraser Basin Management Program does not include a formal requirement for program evaluation. However, the Fraser Basin Management Board has stated its intention to conduct annual audits of the state of the basin's environmental, economic and social systems; the state of the basin's management institutions; and the performance of the Management Program and Board. These audits, along with the program evaluations of the Action Plan that the Department of the Environment proposes to conduct, are essential to provide needed information for informed decision making.

Conclusions and Lessons Learned

14.80 The St. Lawrence and Fraser River action plans differ significantly in their development and implementation. They are not directly comparable. Both differ, in turn, from the Great Lakes Action Plan, although the physical link between the Great Lakes and the St. Lawrence River requires some degree of co-ordination in managing these plans. However, there are still enough common features among the action plans that lessons learned from one can be applied to the others.

Need for a Federal Framework of Water Quality Objectives

14.81 One thing shared by all three action plans that we audited is a common goal - water quality control and improvement. Furthermore, this goal is to be achieved within the bounds of the *Green Plan*, which stresses movement toward sustainable development through the use of partnerships among governments and other stakeholders. In our opinion, there is a need for a federal framework of desirable water quality objectives for the major ecosystems across Canada, as part of long-term strategic planning and to assist in setting priorities and allocating resources. This would provide a set of benchmarks against which local water quality and corresponding beneficial water uses could be established and measured. Such an approach would entail developing a federal proposal and placing it, as an important item, on the agenda of the Canadian Council of Ministers of the Environment for federal-provincial resolution.

Need for Federal Long-term Strategic Planning

14.82 There is a marked absence of strategic planning to guide decision makers. However, some planning has been done at the regional level, in that a draft strategic plan has been developed for the Great Lakes and recently a strategic plan for the Fraser River was published by the Fraser Basin Management Board. However, the lack of a federal

strategic plan to provide a framework within which the individual action plans can be developed has led to problems in both communication and co-ordination. The federal government needs to know where it is going and how it is going to get there if it is to use its limited resources efficiently and effectively. The Department of the Environment has the major federal responsibility for water quality management. It should, therefore, take a lead role among federal departments with water interests to address the problem, thereby putting into practice the words of the *Green Plan* : "first and foremost, the federal government must lead by doing." A long-term strategic plan would provide a context for the federal framework of water quality objectives and would indicate when and how water quality improvements are to be attained. Such a document would, therefore, help decision makers to assign priorities to individual action plans and to allocate limited resources. It would also form the basis for evaluating and reporting on progress.

Key Criteria for Successful Partnerships

14.83 Partnerships are important and necessary to achieve results in a complex multi-jurisdictional environment. Although they will differ in structure and application, they need to meet certain requirements if they are to succeed. Partnerships should be put in place as early as possible in the planning stage to ensure that the participants are involved in setting objectives and designing program delivery mechanisms. Participants must be well informed and their roles and responsibilities clearly stated and documented, together with expectations and commitments.

14.84 Partnerships operate at three levels: among federal departments, between federal and provincial governments, and between governments and other stakeholders. The Interdepartmental Committee on Water provides a structure for the co-ordination of federal action. However, until the Department of the Environment provides leadership and makes better use of the Committee, which in turn will encourage other participating departments to commit to the partnership, the present problems are likely to continue.

14.85 These conclusions also apply to public involvement. If participation rather than consultation is intended, action must be taken early in the process to ensure that the public is well informed. The St. Lawrence Action Plan provided a good public information program with respect to reporting on government activities, but with a view to obtaining the public's support more than its participation. The Great Lakes Action Plan has involved the public in remedial action plans. The Fraser River Action Plan has begun to involve the public directly, but rather late in the process. Governments must provide leadership and the public must be involved early if its participation is to be effective.

Evaluating and Reporting on Action Plans

14.86 The reporting of results provides accountability to Parliament and the public for resources expended. Annual reports give information on individual plans. State of the environment reports provide some general information on the health of major water ecosystems, but insufficient data for assessing the effectiveness of individual action plans. Only rigorous and timely program evaluation can determine if the action plans are

achieving their intended objectives in the most cost-effective way, and if limited dollars are being spent where they have the most impact.

14.87 Current government reporting does not provide consolidated information on the costs and achievements of the efforts to improve water quality. Parliament thus does not have access to important information to assist in its review and approval of the total funds, timeframes and approaches proposed for the rehabilitation of these major ecosystems.

14.88 There is no doubt that such rehabilitation is a prerequisite if Canada is to achieve its goal of sustainable development while providing clean water for future generations. However, as we have noted throughout the Chapter, all stakeholders must be involved and their activities co-ordinated if significant improvements in water quality are to be achieved and reported within a reasonable timeframe.

Department's response: One of the Green Plan's principles for environmental action is to "think, plan and act in terms of ecosystems", which implies the need for an integrated approach to making informed decisions for today's complex environmental issues. The regional action plans are being implemented through an ecosystem management approach. The framework for management of ecosystem-based water action plans includes the development of ecosystem-specific objectives and indicators and national water quality guidelines. Ecosystem objectives, which are being developed in consultation with a wide range of partners and stakeholders, define the longer-term state of the environment, while ecosystem indicators, based on new scientific information, measure the achievement of progress. Ecosystem indicators are a relatively new concept and the Interdepartmental Committee on Water has recently reviewed a draft process document entitled "National Framework for Developing Indicators for Evaluating and Reporting Ecosystem Health", developed by the Department of the Environment. The Canadian Council of Ministers of the Environment will be asked to review the document and, if they approve of the proposal, it could be published in early 1994 as the national framework and form the basis through which a national perspective on water quality objectives would be addressed.

Canadian Water Quality Guidelines are developed co-operatively by the federal government, the provinces and territories under the auspices of the Canadian Council of Ministers of the Environment (CCME). These guidelines are used as benchmarks to assess water quality problems and concerns in Canada and are used in conjunction with local water quality information to establish water quality objectives for specific sites. This is a sound approach for maintaining and restoring water quality impacted by toxic chemicals. However, water is only one important component of the ecosystem. Our experience with regional action plans has demonstrated that the long-term protection of the physical, chemical and biological integrity of an ecosystem requires an ecosystem approach, of which water quality guidelines are a part.

The Interdepartmental Committee on Water recognizes the value of pursuing a strategic orientation to its work and has encouraged regular attendance of observers from key

federal departments. In developing its agenda for the coming few years, the Committee will examine the means by which it could contribute to enhancing co-ordination between the various current basin and coastal action plans.

As well as the Interdepartmental Committee on Water, there are a number of other formal and informal mechanisms in place for strategic planning purposes, such as: business planning and annual management contracts as an element of the departmental planning process; federal meetings and workshops between the responsible region to share experiences; the Canadian Council of Ministers of the Environment; and co-operative mechanisms in the area of planning and issue management among communities in the specific action plan areas.

Chapter 15

Department of Fisheries and Oceans

Northern Cod Adjustment and Recovery Program

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Department of Fisheries and Oceans

Northern Cod Adjustment and Recovery Program

Assistant Auditor General: Paul Ward

Responsible Auditor: Hugh McRoberts

Main Points

15.1 On 2 July 1992, the government announced a moratorium on fishing cod in the Northern cod zone of the North Atlantic. The Department estimated that over 25,000 people would be affected by the moratorium and that 19,000 would require income assistance. To meet this need, the government established the Northern Cod Adjustment and Recovery Program to provide immediate income relief to the fishermen, plant workers, and trawlermen affected, and to prepare for a much reduced fishery in the future.

15.2 Although it was faced with a difficult policy challenge in a new field, the Department met the government's objectives in terms of getting the new program in place and getting the cheques out in a timely fashion, and has been able to continue doing so. The program was rushed, as the Department had not considered the potential effects of a stock decline of this magnitude. As a result, compromises in program design were made that would have significant effects later.

15.3 The Department cites as its authority for this program the *Atlantic Fisheries Restructuring Act* that was passed in the mid-eighties to permit the government to implement certain recommendations of the Task Force on Atlantic Fisheries (the Kirby Commission). In our opinion, this Act does not provide a clear authority for the program, and hence, the Department is operating a \$587 million program without a clear legislative authority.

15.4 Although the program was intended to benefit only those who fished or processed Northern cod and who were affected by the moratorium, the design compromises made in the interest of initial responsiveness meant that many who were not affected by the moratorium or did not fish Northern cod become eligible for the program under the established terms and conditions. We found a number of examples of this. However, because of the lack of information in departmental files, we and the Department were unable to quantify the extent of these problems. The Department is working to identify further instances of this type and to deal with them.

15.5 Another area compromised in the initial drive for responsiveness was the financial management and control of the program. In February 1993 a review team identified a list of significant weaknesses covering most important areas of financial management and

control, and made some 68 recommendations to remedy them. The Department's figures indicate that 54 of these recommendations are, in its view, fully implemented.

15.6 An important objective of the program is to achieve a significant and permanent reduction in both the fishing and processing capacity in the Northern cod fishery by the end of the moratorium. To this end, the program has offered options including training, licence retirement and early retirement to assist those who wish to leave the fishery. These will be complemented by significantly higher standards for re-entry to the fishery at the end of the moratorium. Although it is early in the program, data on the choices being made by program recipients indicate that exits from the fishery are occurring at a lower rate than anticipated by the Department.

Introduction

15.7 On 2 July 1992, the Minister of Fisheries and Oceans announced that there would be a two-year moratorium on fishing Northern cod. He also stated that, over the next ten weeks, emergency assistance payments would be made to affected fishermen and plant workers. Details of a longer-term program were to be announced by the end of that period.

15.8 Prior to the announcement, the Department had considered a range of options to keep the inshore fishery open. The option of closing the inshore fishery was not considered until very late, leaving the Department little time to prepare for the consequences.

15.9 Once it had been decided that the state of the Northern cod stocks warranted a moratorium, the government was faced with how it was to respond. As the lead department for this issue, Fisheries and Oceans was responsible for developing and delivering the program. Doing this would have been a formidable challenge for a department experienced in developing social support programs, had it been given the ten weeks allotted to do the job. Neither was true in this case. The Department had little past experience or expertise in developing and delivering programs of this type. Further, the government had decided that speed in delivery was of the essence, and it committed to have cheques in the hands of affected fishermen and plant workers within two weeks. Originally, the Department was to have had ten weeks in which to develop the long-term program. However, difficulties with the public reaction to the emergency program led to significant pressures to announce the long-term program sooner. The Department believes that it has succeeded in responding quickly. The initial cheques did go out to recipients just over two weeks after the program was announced. The long-term program was begun just four weeks after the initial announcement. However, the Department believes that some of the problems that we discuss in this chapter have resulted from the Department's need to respond swiftly to the challenges that it faced.

Scope and Objectives

15.10 The purpose of this audit was to report on how the Department responded to the decline in the Northern cod fishery and delivered the Northern Cod Adjustment and Recovery Program.

15.11 Government often has to respond quickly to changing circumstances. This can require creating new programs or modifying existing ones in response to changing needs. In turn, consideration must be given not only to the specific content of programs, but also to the authority for expenditures and to the need for proper financial management and control of funds. In this audit we examined the Department's implementation of the Northern Cod Adjustment and Recovery Program, to determine whether funds have been expended only with proper authority, the program has been delivered with due regard to

economy, efficiency, and effectiveness, and there has been a proper regard for financial management and control.

Background

15.12 The Northern cod fishery is a major contributor to the economy of the Province of Newfoundland. However, it is a fishery unable to support fully many of those who depend on it. A 1988 income survey done by the Department found that Unemployment Insurance accounts for 34 percent of an average Newfoundland fisherman's total income. As a result, most fishermen and plant workers depend upon the fishery not only for the income it provides, but also as the mechanism to qualify for Unemployment Insurance. To qualify for Fisherman's Unemployment Insurance, an individual must work at least ten weeks, of which six must be worked within the fishery. In a bad year in the fishery, even this can be hard to do.

15.13 According to the Department, the Northern cod fishery has been viewed for some time as an "employer of last resort". It is a fishery that the Department sees as having at least 50 percent more harvesting and processing capacity than is justified by the size of the resource. Many in its work force lack skills that can be transferred to other sectors of the economy. Finally, for many in this fishery there are no alternative sources of income available. The result of this is a population whose economic fate is tied to the health of the fishery in much the same way as the residents of a remote mining town have their fate tied to the amount of mineable ore.

15.14 Fortunately, for most of the 500-year history of the Northern cod fishery, the stock has proved to be a robust and forgiving resource. Indeed, the Department's scientists have had to search back in historical records to 1713 to find evidence of a collapse of the Northern cod stock on the scale that has occurred beginning in 1991.

Observations

The Program Was Rushed, as the Department Had Not Considered the Potential Effects of a Stock Decline of This Magnitude

15.15 Late fall 1991. In the fall of 1991 the Department was preparing to confirm a decision to proceed with the second year of a three-year plan to manage the Northern cod stock. However, there was a growing sense of unease concerning the abundance of this key Atlantic stock. The offshore fishery was experiencing one of the worst years since it had been established in 1977, and the inshore had experienced a very lean season, with a catch of just under 60,000 tonnes. Overall, the total catch was down by more than 64 percent compared to three years earlier. Perhaps more ominous than the sharply declining tonnages, however, was the very large proportion of small fish in the catches. Increasingly, the question being asked was, Where have the cod gone?

15.16 During that fall, the ships of the Department's Science Branch were at sea carrying out their annual survey of the Northern cod stock. This survey, combined with an analysis

of commercial landings, forms the basis for the annual scientific advice to the Department on the state of the stock. As the reports from sea came in, and as the new year approached, it became increasingly clear that survey results would show a sharp decline in stock from previous years. The survey results showed that the stock was 52 percent lower by weight than in the previous year and 33 percent lower by count. Not only did this point to a dramatic decline in the size of the stock, it indicated that the surviving fish were significantly smaller than in the previous year.

15.17 February 1992. An interim assessment of the state of the stock was presented in February 1992. It confirmed a serious decline in the Northern cod stock. The scientists advised that average weights at age were lower than average, that the winter fishery had decreased substantially, and that research vessel indices of abundance were among the lowest since data had begun to be compiled. They recommended that catches be restricted to the lowest possible level for the first half of the year. They also stated that they were carrying out additional confirmatory procedures but added that they did not expect the final July assessment to differ substantially from the interim assessment. In March, the results of a hydroacoustic survey confirmed that there was no significant concentration of cod in the Northern cod area (2J3KL). ([See Exhibit 15.1](#))

15.18 On 24 February, the Minister instituted a "conservation ceiling" that effectively closed the offshore cod fishery. He expressed his expectation that the inshore fishery would continue to operate without limits on catches when it opened in May. Finally, he created a task force on incomes and adjustment in the fishery.

15.19 March 1992. By early March, the Department had begun an assessment of the economic impacts of the catch reductions. However, there was no analysis of the possible impacts of a catch failure in the inshore fishery. Although catch failures had been experienced in the past, and indices of abundance were near to the lowest on record, the Department's economic impact analyses were based on the assumption that "the inshore catch will remain at the 1991 level of 75,000 tonnes, but the actual catch could be higher."

15.20 April and May 1992. The Northern cod stock is what is called a trans-boundary stock, one that has international waters as part of its range. Because of this, Canada attempts to work with the other nations fishing this stock to manage it. This is done through the North Atlantic Fisheries Organization (NAFO). By early April, European Economic Community scientists had also concluded that there was a possibility of biological problems in the Northern cod stock. Two weeks later, Canada asked NAFO scientists to review the state of the Northern cod stocks.

15.21 June 1992. On 4 June 1992, NAFO confirmed that the stock had declined rapidly to a level at, or close to, the lowest ever observed, that the small size of the spawning stock was cause for concern, and that the causes for this decline were not clear. NAFO suggested a total allowable catch for Northern cod of 50,000 tonnes, much of which had already been caught. The Department began monitoring the inshore fishery on a daily basis.

15.22 By mid-June, the possibility that the range of responses to the scientific advice might include a moratorium began to be considered. Within the next two weeks, an interdepartmental committee began meeting to discuss possible courses of action.

15.23 Moratorium. On 2 July 1992 the Minister announced a two-year moratorium on the Northern cod fishery.

15.24 Between January and June, no consideration had been given to the possibility that a sudden, unexplained decline in biomass to the lowest level ever recorded might have an impact on the inshore fishery. Indeed, we have been told by the Department that the notion of a restricted inshore fishery (let alone a moratorium) was so foreign to the Department's corporate culture that it was raised as a possibility only quite late and, even then, with great reluctance. Rather than develop its economic impact analysis based on a range of possible fishing volumes (including a small or nil fishery), all of the Department's economic analysis was based on the assumption that the inshore fishery would somehow be unaffected. As a result, the Department was unprepared to deal with the consequences of the moratorium.

15.25 In 1988 we wrote that the Department's objectives in managing the fish stocks encompass both conservation and economic matters. Setting the total allowable catches has very significant impacts directly affecting the economic circumstances of those involved in the fishery. We were concerned then about the need to formalize the economic analysis and link it more closely to the scientific advice. At the time, the Department agreed.

15.26 For all of the major stocks, the Department should prepare annual economic assessments of the economic effects of the possible stock management decisions.

Department's response: As part of its mandate, the newly created Fisheries Resource Conservation Council (FRCC) will undertake a full economic analysis of significant quota changes in conjunction with the Department. This information is meant to be used as part of the FRCC's public consultation process and as input into the advice to the Minister for the setting of total allowable catches.

Currently, the FRCC is limited to examining groundfish stocks on the east coast. However, its mandate includes expanding its areas of responsibility to both coasts and to other species.

15.27 The response - July 1992. The government's response was to provide emergency support immediately while it developed a comprehensive plan to provide assistance to meet the Northern cod crisis through income replacement, adjustment and industry restructuring over the two years of the moratorium. The plan was to be consistent with the goal of a sustainable Northern cod fishery. The projected cost of this program was \$920 million, of which \$587 million was to be spent by the Department.

15.28 In attempting to respond to the moratorium, the Department was faced with a formidable task. The moratorium, in the Department's estimation, caused the largest layoff in Canadian history. Geographically it affected a large area including the East coasts of Newfoundland and Labrador and the lower north shore of Quebec. Over 25,000 people scattered over 400 largely remote fishing communities throughout this area were thought to be affected by the closure of the fishery. Of these, the Department estimated that some 19,000 would require income assistance.

15.29 In a very short time, a program had to be designed and the eligible population defined and identified. Before cheques could be issued, necessary resources - both human and financial - had to be found. In dealing with these issues, the Department had to ensure that the necessary authorities, and financial management and accountability regimes, were in place.

15.30 In issuing the initial cheques within ten days, management was certainly successful in meeting its objective of responding in a timely fashion. In other aspects, we have observed significant weaknesses in the Department's response, many of which were caused or exacerbated by time constraints.

Lack of a Clear Legislative Authority for a \$587 Million Program

15.31 The government may not spend money from the Consolidated Revenue Fund without the explicit authority of Parliament. This authority comes in two forms: first, through substantive legislation, Parliament gives the government authority to act in a certain way and to spend money to achieve the objectives specified in the legislation; second, through the voting of appropriations, Parliament annually controls the amount of money to be spent for each approved purpose.

15.32 In our opinion, departmental expenditures on the Northern Cod Adjustment and Recovery Program have been made without clear legislative authority. The government has cited the *Atlantic Fisheries Restructuring Act* as the authority for its expenditures on the Northern Cod Adjustment and Recovery Program. However, this Act is questionable as an authority on two grounds. The income replacement component of the program is paid to the recipients in the form of grants. However, the Act contains no specific authority to pay grants for any purpose. The Department paid grants in the amount of \$183 million for this purpose in 1992-93 and plans to spend a further \$238 million for the remainder of the program. In addition, the Act is a questionable authority for some of the program's adjustment options. The Department estimates that it will spend \$147 million on these.

15.33 The *Atlantic Fisheries Restructuring Act* was passed by Parliament in 1983 specifically to give authority to the government of the day to effect some of the recommendations arising from the Task Force on Atlantic Fisheries (the Kirby Commission). The relevant sections of that Act empower the Minister of Fisheries and Oceans to make a loan or contribution to a fishery enterprise to facilitate the development of viable Atlantic Fisheries that are competitive and privately owned, through the

restructuring of fishery enterprises. The Act in turn defines the "restructuring" of an enterprise as including the reorganization, refinancing, modernization, rationalization and expansion of the enterprise, and any similar activity directed toward improving the economic performance of the enterprise.

15.34 The Northern Cod Adjustment and Recovery Program has two components - income replacement and adjustment. The purpose of the income replacement component has been clearly set out as the replacement, in whole or in part, of income that was lost as the result of the closure of the fishery. The replacement is effected through grants paid bi-weekly, subject to continuing eligibility.

The payments are grants, not contributions. The Act contains no clear authority to make a grant for any purpose.

The purpose of the payments is to compensate for lost income. This purpose is not specifically included in any definition of restructuring as set out in the Act, nor is any restructuring in that sense accomplished.

15.35 The Department of Fisheries and Oceans is responsible for funding two parts of the adjustment component of the program. These two parts are: retirement of licences and, for those who qualify, an early retirement option involving the purchase of an annuity to provide income replacement until age 65.

The retirement of licences and the provision of retirement annuities arguably does not achieve enterprise restructuring objectives as defined in the Act and hence no clear authority to spend for these purposes exists in the Act.

The Department received cautionary advice from its lawyers

15.36 Advice was sought and received from the Department of Justice on whether authority for this program could be found in this Act. The first legal advice was received on 6 July 1992 and concluded that there was no clear and satisfactory authority for these assistance programs, and that a solution to obtaining such authority was to seek legislative approval. The advice went on to explore other options available to the Department, such as making the payments as *ex gratia* payments, seeking program authority by way of an *Appropriation Act* or using the *Atlantic Fisheries Restructuring Act* to pay contributions (although there would be a risk of challenge). However, these options were not pursued by the Department, which made the payments in the form of grants.

15.37 In a subsequent legal opinion provided on 31 July 1992, the Department of Justice advised that the *Atlantic Fisheries Restructuring Act* does not provide authority for making grants. Counsel also advised that the fact that the Act was used as the authority for the payments for the first ten weeks (the emergency period) does not automatically confirm that its use is legally correct. It was noted that, as the Department had used the Act as an authority before without being challenged, it might choose to try it again. Again, another option (*ex gratia* payments) was discussed as being legally more defensible but was not pursued by the Department.

15.38 The government, quite properly and at the appropriate times, went to Parliament by way of Supplementary Estimates and, for the 1993-94 fiscal year, by way of Estimates for the funds to pay for the Northern Cod Adjustment and Recovery Program. However, as explained in paragraph 15.31, these appropriation Acts provide funding, not substantive program approval.

15.39 The government implemented a program - the Northern Cod Adjustment and Recovery Program - for which, in our view, no clear and satisfactory authority existed. At no time did it go to Parliament to seek proper substantive authority for its actions. Parliament was denied thereby the proper opportunity to review and debate the government's proposed program as part of the normal legislative process, to decide on its objectives and to approve expenditures to achieve those objectives.

15.40 The government should present to Parliament legislation that will provide a proper authority for this program and for any future programs of a similar nature.

Department's response: The Department of Fisheries and Oceans continues to maintain that, given the nature of the crisis and the fact that the program was intended to be interim in nature, there was legislative authority for the program both pursuant to the Atlantic Fisheries Restructuring Act and the requisite appropriation Acts that authorized spending for the program.

The Department Had Difficulty in Targeting Payments to Those Clearly Affected by the Moratorium

15.41 In announcing the moratorium on 2 July 1992, the government stated that by the end of an initial ten-week period it would introduce a program to last through the moratorium. After only four weeks, the income replacement component of the Northern Cod Adjustment and Recovery Program was implemented on 1 August 1992. In responding so rapidly, the Department was faced with two very different challenges. First, it had to transform the direction from the government into a set of operational eligibility criteria to determine who would receive payments. Second, it had to put in place the infrastructure, including appropriate financial controls, to ensure that the cheques were issued on time, in the right amount and to the right people. We will discuss the response to the latter challenge in a later section.

15.42 The government stated that assistance was only for those who fish or process Northern cod and whose livelihood was affected by the moratorium. Subsequent appropriation Acts identified the target population as those fishermen, plant workers and trawlermen affected by the Northern cod moratorium. The information booklet presented to recipients as part of the declaration process (see paragraph 15.64) states that:

"The Emergency Assistance and Income Replacement Programs are meant to provide compensation to fisherpersons, plant workers, and trawlermen whose livelihoods depend directly on fishing or processing Northern cod."

15.43 Once approval has been given by the government for a grant program, it is necessary to prepare a set of terms and conditions and to have these approved by Treasury Board. This was done. However, the Department wished to expedite payment by eliminating the need to have prospective recipients apply for the program. To achieve this, it sought to define eligibility, as much as possible, in terms of membership on existing government lists that could be easily obtained and merged. This decision was to have a number of consequences. Most immediately, a set of terms and conditions were established that have broadened the program well beyond that contemplated by the government.

15.44 There are two broad classes of persons eligible for the program - plant workers and fishermen. In establishing the eligibility of plant workers, the key concept in the terms and conditions is the definition of a "designated Northern cod processing plant" as a plant whose throughput in 1990 or 1991 consisted of ten percent or more Northern cod. We asked the Department for its analysis of the relationship between throughput level and effect of the moratorium on the number of person-weeks of work available in the plant. It did not provide us with any analysis of this type and accordingly we cannot determine the basis on which the ten percent level was chosen, or whether that was a reasonable basis on which to decide that all of the plant's employees had been affected by the moratorium.

15.45 We are also concerned that, by extending eligibility back to 1990, the Department may be including plants where the level of employment was affected by factors other than those that the program is intended to compensate, such as bankruptcy or corporate restructuring.

15.46 In view of the broad sweep of the plant worker eligibility criteria, it is perhaps not surprising to find that the current number of plant worker recipients exceeds the Department's original estimate by over 60 percent.

15.47 The terms and conditions define a resident "Northern cod fisherman" as a fisherman resident in the Northern cod area with a 1992 commercial fishing registration. This represents over 90 percent of all eligible fishermen ([see Exhibit 15.2](#)). In these cases, the concept of "effect" resulting from the moratorium has been dropped entirely. It is possible, as our examples show, for a person who did not fish Northern cod (and hence who was not affected by the moratorium) to be eligible for the program.

15.48 The eligibility criteria for resident fishermen establish eligibility based on their Unemployment Insurance history for 1991 and 1990, or on their participation in the 1991 Ice Compensation Program. While the participants in these programs may have included many who participated in the Northern cod fishery, those programs also included many who did not. Hence, the use of participation in these programs to define eligibility in the terms and conditions again broadened eligibility to persons who were not affected by the moratorium.

15.49 Departmental data show that over 70 percent of all resident fishermen were placed in the program because they had earlier been placed in the Ice Compensation Program, a

program that was directed much more broadly than solely to those who fished Northern cod.

15.50 Although the government approved a program intended to be restricted to those who were directly affected by the moratorium, the terms and conditions fail to establish a clear requirement to demonstrate injury caused by the moratorium as an essential requirement for eligibility. Indeed, those outside the Northern cod fishery and those who have suffered loss from causes other than the moratorium can benefit from the program on the same basis as those who suffered injury.

15.51 In the examples that follow we present instances of such cases based on our examination of individual case files. However, we attempted to go further and to quantify the extent of these problems in the recipient population. We asked for information on an individual's level of activity in the Northern cod fishery and also on his or her level of dependence upon Northern cod. The Department does not maintain this information and was unable to otherwise obtain it. *Therefore, neither we nor the Department are able to determine to what extent the population receiving Northern Cod Adjustment and Recovery Program benefits accurately reflects the intent of the program with respect to who should receive benefits .*

15.52 In our examination of the files, we have identified the following instances where the terms and conditions have enabled payments to be made to individuals not affected by the closure of the Northern cod fishery. Because of the information limitations discussed above, we are unable to determine how many other cases like these exist.

Income Replacement payments were made to unregistered fishermen. We are aware of over 20 instances in which individuals who applied for Northern Cod Adjustment and Recovery Program benefits had been participating in the Northern cod fishery without a valid fishing registration. As such, they were fishing illegally. If the individuals could prove, however, that they had fished commercially (albeit illegally) prior to the moratorium, the Department then issued fishing registrations and made the individuals eligible for Northern Cod Adjustment and Recovery Program payments. Payments were made retroactively. Individuals who fished species other than Northern cod are eligible for Northern Cod Adjustment and Recovery Program payments. Resident fishermen need not substantiate their dependence on the Northern cod fishery; they need only have a valid commercial fishing registration, a minimum condition to fish any species. Thus, resident fishermen in the Northern cod zone who hold a valid commercial registration are eligible for income replacement payments, regardless of the type of fishery they pursue. For example, a fisherman who had fished only in the crab fishery in 1991 was eligible for the program because he had the necessary 20 insurable weeks of fishery activity in 1990 and 1991.

The extension of eligibility for plant workers to include those who had worked at designated plants in the years prior to the moratorium resulted in persons being eligible who had left the fishery well before the moratorium and for other reasons.

This included people whose employment had terminated up to 18 months prior to the moratorium.

In addition, six plants that were closed prior to the moratorium (i.e., affected by factors other than the Northern cod moratorium) were designated as Northern cod plants under the terms and conditions (plants operating in either 1990 or 1991 can receive departmental designation). However, when a plant has been closed for a year before the moratorium, the employees cannot be considered to have been affected by the moratorium by virtue of their past employment at these plants.

Workers who were being trained for employment outside the fishery were made eligible for payments. In 1990, a Northern cod plant announced its intention to permanently cease operations. Several employees were offered skills training under the Atlantic Fisheries Adjustment Program. This training was designed to lead to employment outside the fishery. The Department deemed the employees eligible for the Northern Cod Adjustment and Recovery Program.

The terms and conditions for plant workers state that, to be eligible, they must have worked for a number of weeks in a designated plant in 1990 and 1991 combined. The Department qualified several individuals who did not meet this requirement. It developed a policy, using extenuating circumstances as permitted by the terms and conditions, whereby weeks worked in 1989 were used in conjunction with weeks worked in 1990 or 1991 to qualify people. This policy makes people eligible who, although they were available for work in 1992, were affected by declines in the fishery prior to 1992, rather than by the moratorium itself.

Individuals whose income had come mostly from work outside the fishery qualified for payments. These people were made eligible despite their employment histories' indicating that the majority of insurable weeks were earned outside the fishery in 1990 or 1991.

In one situation, an individual had worked 25 weeks outside the fishery in 1990 and 1991 and only nine weeks inside the fishery. The Department accepted that this person was a "victim of working circumstance, in that [they] worked too many weeks [outside the fishery]...to qualify for this program". The Department indicates that, if the individual had simply worked a few weeks less outside the fishery, he or she would have qualified for the program. Nonetheless, the Department qualified this individual.

Another situation involved an individual who had accepted a full-time job outside the fishery in 1990, had later been laid off and yet was approved for payment by the Department.

15.53 In summary, individuals were qualified who had fished species other than Northern cod, who had retired from active participation in the fishery, who had left the province during the qualifying years of 1990 and 1991, or who had been out of the country during that period - in short, individuals who were not affected by the moratorium.

15.54 Despite the fact that the Northern Cod Adjustment and Recovery Program aimed to encourage participants to leave the fishery, the income replacement component brought back some who had already left.

The Department has recognized the difficulty of targeting the intended population

15.55 Several months into the income replacement program, departmental officials became concerned about the Department's ability to restrict eligibility to the program, as the client population was some 6000 larger than originally forecast. In fact, departmental officials recognized that:

"... the terms and conditions of the program introduced criteria which were very broad incorporating more workers than the previous forecast considered as being dependent on Northern cod. The 10% criteria for plant designation caused the number of plants to rise above the number previously considered as Northern cod plants.

However, more significantly the eligibility requirements for plant workers resulted in peak and/or marginally dependent workers in the plants being able to meet the eligibility criteria... The criteria have in effect defined [as] full[y] dependent (in terms of workforce numbers) all individuals involved in the harvesting and/or processing of Northern cod, whereas, the original budget projections reflected a more stringent estimate of hard core employees."

15.56 One of the key difficulties is that the terms and conditions have made the Department dependent on the Unemployment Insurance database for evidence of participation in the Northern cod fishery. However, the Fisherman's Unemployment Insurance program only requires that the qualifying work be done in any of the many fisheries. Because they do not need this type of information, the Unemployment Insurance records do not necessarily contain evidence as to which of the specific fisheries recipients were engaged in to get their qualifying weeks. The Department has concluded that, because of its dependence on Unemployment Insurance data, it is now very difficult to identify the size of the population that was part of the Northern cod fishery and hence at risk of being affected by the moratorium.

Payments were made to individuals who did not meet the eligibility criteria

15.57 Despite the broad terms and conditions of the program and the significant degree of latitude afforded to management, individuals who were ineligible under the terms and conditions were also issued payments.

15.58 Many of these payments occurred because the Department used data not suitable for identifying individuals who met the various eligibility criteria. These data were not verified before payments were made.

15.59 Individuals who did not have sufficient insurable weeks in the fishery were made eligible under the Northern Cod Adjustment and Recovery Program. This happened because the unemployment information first obtained identified only whether a person had received unemployment benefits in a particular period and the total number of qualifying weeks. The database did not specify the source of each of those weeks - just the last week worked.

15.60 In addition to the fact that the Ice Compensation data did not indicate if the person had fished Northern cod, information from the Ice Compensation file was found to be unreliable in identifying eligible participants for the Northern Cod Adjustment and Recovery Program. Many individuals included on the database have been found to have received Ice Compensation payments in error. The Department has, thus far, identified 712 individuals not eligible for Ice Compensation and has eliminated 318 of those individuals from the Northern Cod Adjustment and Recovery Program eligibility list.

15.61 Information received from the various plants identified only former employees, not whether an individual was available for work and therefore an eligible plant worker under the Northern Cod Adjustment and Recovery Program.

15.62 Because "throughput", as used to designate plants, was not adequately defined in the terms and conditions, the Department designated two processing plants that were later determined not to have processed sufficient Northern cod and hence were ineligible. The affected individuals owe the Crown approximately \$290,000.

Corrective action taken by the Department

15.63 The decision to use existing databases to qualify automatically the vast majority of Northern Cod Adjustment and Recovery Program recipients had two consequences that the Department has had to try to deal with: the extension of the terms and conditions beyond those approved by Treasury Board, and the lack of any agreement between the government and the program recipients. For four months, the Department was issuing cheques every other week without any written agreement between it and the majority of recipients as to the terms under which they were paid or the conditions attached to their receipt.

15.64 The Department attempted to address both issues by preparing a declaration form. This form and an information booklet attempted to explain the terms and conditions of the program, and to require recipients to provide the information on their involvement in the Northern cod fishery that the Department could not obtain from the data used to qualify them. The forms also required that recipients certify that they had received and understood the information booklet on the program. This booklet provides a detailed description of the program, its objectives and the eligibility criteria. The forms were to be signed by the recipients and returned to the Department by the end of October 1992.

15.65 In explaining the program to the recipients, the Department placed considerable emphasis on the concept of "dependence on the fishery" as a necessary condition for access to the program, and attempted to gather some information that would allow it to better conclude on the involvement of recipients in the fishery. However, the Department failed to gather sufficient information to allow it to reach such conclusions. For example, fishermen were asked what percentage of their fishing income came from the Northern cod fishery. However, by not asking about the amount of that income and the amount of income from all other sources, the Department was little further ahead. This is reflected in the very limited use to which the information has been put. According to the Department, only those who reported that they derived none of their fishing income from

the Northern cod fishery were investigated. Further, although the Department introduced the concept of "dependence on the fishery" in the declaration form, by failing to define the concept for recipients, by failing to establish clear operational indicators for itself, and by failing to amend the original terms and conditions, the Department has left itself with little basis to retrench from the initial expansive terms and conditions that remain in force.

15.66 The Department has conducted further reviews of the Unemployment Insurance data. As a result, a number of recipients have been declared ineligible. In addition, overpayments to eligible recipients were identified. As of 31 March 1993, the total recoverable was \$10.13 million. The Department continues to identify ineligible applicants through third-party complaints, inconsistencies reported on subsequent income reporting forms it received and other investigation activities.

15.67 In addition, on 11 August 1993, payments to 20 percent of the recipients were 'on hold' while information was being reviewed. The Department did not know at that time the total amount of potential overpayment.

Authority is also needed to manage

15.68 Securing clear authority is necessary, not only to ensure that the fundamental rights of Parliament are respected but also to ensure that the fundamental features of the program, such as its scope and intent, are made clear, so that program managers have the practical mechanisms to make reasonable program decisions. The absence of clear authority and guidance has left program managers with limited authority to take action to safeguard public funds. The operational problems arising from the lack of clear and satisfactory authority are summarized below.

The Department wishes to establish an 'Investigations Unit' to determine where eligibility may have been granted as a result of misleading or fraudulent information. Legal counsel, however, has informed the Department that the *Atlantic Fisheries Restructuring Act* provides no authority for audit, review, or investigations or for any remedies where a wrong has been detected. Counsel advised that the only authority available to the Department would flow from the declaration form, signed by most Northern Cod Adjustment and Recovery Program recipients several months after payments were first issued. As a result, the powers and duties of investigators are limited to inspecting documents and asking questions of the recipient. No authority exists to require any other party to disclose information to investigators without the express permission of the recipient under investigation. In other similar government programs, the necessary authorities are frequently included in the program legislation. Another avenue not legally available to the Department is that of putting payments 'on hold'. In spite of this, more than 5300 individuals are currently 'on hold'. That is, they are still deemed eligible; however, their eligibility, entitlement, or the information provided is in doubt to such an extent that program managers have deemed it prudent to suspend payments until the issue is resolved. Legal advice, obtained in July 1993, states that there is no legal authority for these 'on

hold' procedures. In the absence of legislation, legal counsel looked to both the terms and conditions and the declaration form, and found no mention of these procedures.

The Northern Cod Adjustment and Recovery Program terms and conditions state that recipients will be disqualified from receiving any future payments if they refuse work within the fishing industry. Legal counsel has advised that this may be subject to legal challenge unless the Department informs recipients of the guidelines under which these decisions will be made. These guidelines were mailed to recipients on 4 August 1993 - more than halfway through the program. As a result, none of the some 80 refusal-to-work files as of that date has been resolved.

Action to recover payments made in error prior to the introduction of the declaration forms has been delayed while the Department attempts to confirm its legal right to collect these amounts. It is the absence of any written agreement between the Department and the recipients that has placed the recovery of these amounts in doubt.

15.69 While the Department was aware that no clear and satisfactory authority existed for the Northern Cod Adjustment and Recovery Program, it proceeded to implement the various components, citing the *Atlantic Fisheries Restructuring Act*. Many of the difficulties encountered in managing the program flow from the absence of the authority and guidance that appropriate legislation would have provided.

15.70 **Once a satisfactory legislative foundation for this program has been established, the Department should amend the terms and conditions and its administrative procedures to correspond to the legislation.**

Department's response: The Department would amend terms and conditions as a matter of course if new legislation were passed.

Weaknesses in the Financial Management and Control of the Income Replacement Component

15.71 As noted previously, severe time pressures affected management's ability to deal adequately with issues related to both program design and authority. Another victim of this haste was financial management and control. In the rush to implement the program, management acknowledged that the risk of error was high. In order to react quickly, implementation of the income replacement component was delegated completely to the Newfoundland region. Responsibility for program design was shared between the region and a planning group at headquarters.

15.72 We would have expected, in a program of this size and complexity, that the Senior Financial Officer would have been given leadership on financial management and control matters. We would have expected that, in exercising this leadership, the Senior Financial Officer would have directed the design and maintenance of systems of financial administration.

15.73 However, because implementation of the program and the related financial authorities were delegated directly to the region, bypassing the Senior Financial Officer, there was no involvement on the part of senior information or finance personnel in the program's design or implementation. In fact, neither the Senior Financial Officer nor any of his staff had any involvement in the design of financial or systems controls.

15.74 Those to whom program responsibility was delegated focussed from the outset on the need to issue cheques as quickly as possible. Little attention was paid to establishing an appropriate management control framework.

15.75 As the program was implemented, it became clear to management that a number of key information and financial issues had been overlooked in the design of the program. For example, management had failed to understand the data requirements for the program. Recipients were identified using a combination of various databases that were not well adapted for this purpose. Payments were automatically made to individuals, using only third-party information.

15.76 Following implementation of the program, cheques started coming back, either voluntarily returned by recipients or marked undeliverable. It took several months before the Department began to analyze the reasons for these returns. By December 1992, over 4600 cheques had been returned. In addition, concerns were raised about the adequacy of the income support budget. When it was realized that additional funds would be required before the end of the fiscal year, management had difficulty in projecting financial requirements.

15.77 As early as October 1992, the Department's Internal Audit Group had offered to conduct a review of the implementation of the Northern Cod Adjustment and Recovery Program components. This proposal was rejected. In December, concerns were raised in headquarters about the region's ability to control program costs, and about the lack of a reliable accounting system to track expenditures. Finally, in February 1993 a team began to review and make recommendations concerning quality control, system integrity and procedural compliance with respect to the Northern Cod Adjustment and Recovery Program.

15.78 The review was completed in March 1993 and, among the 68 recommendations, the review raised concerns regarding:

the lack of documentation on the computer programs used to determine the eligibility of claimants and to calculate payments.
weaknesses in security, including the observation that the system allowed unauthorized access. For example, changes could be made to recipients' files, without anyone being able to identify the person making the changes. This included access that would allow for the unauthorized addition, deletion or amendment of client status, data or rate of pay. Because of the lack of adequate paper files, this finding was particularly worrisome.
inadequate controls over data input.

no procedures manuals developed for assessing or reviewing recipient files.
no plans developed by the Department to collect the more than \$4 million in overpayments that were deemed to be recoverable.

In addition to an absence of basic systems documentation, regional staff had limited experience with both the system and the programming language used to implement it.

15.79 Following receipt of this report, the Department established a second team to implement many of the 68 recommendations. This team, which includes headquarters finance and informatics staff, has begun to address many of them. The Department states that it has fully implemented 54 of the recommendations and rejected five, and work on nine is still in progress.

Preliminary Results from the Adjustment Components of the Northern Cod Adjustment and Recovery Program Show that Capacity and Dependence on the Fishery Remain High

15.80 Even before the moratorium, the Department believed that significant overcapacity existed in the fishery. At the beginning of the moratorium the Department estimated that there was 50 percent overcapacity in both the harvesting and processing sectors.

15.81 The objective of the Northern Cod Adjustment and Recovery Program comprehensive plan was to provide assistance to meet the crisis through income replacement, adjustment and industry restructuring. This was to be done in a manner consistent with the goal of a sustainable Northern cod fishery in balance with the potential of the resource. The government saw the moratorium as an opportunity to achieve a significant and permanent reduction in capacity.

15.82 The Department has targeted adjustment in two ways. It has attempted to decrease the number of people dependent on the fishery through a variety of initiatives, and has attempted to reduce fishing capacity by reducing the number of licences.

Reducing the number of people dependent on the fishery

15.83 Northern Cod Adjustment and Recovery Program participants were required to select one of five program options: training within the fishery, approved fisheries-related work, training outside the fishery, early retirement for those over 55, and minimum payment (by choosing none of the above). Originally, recipients were to have considered their options and made their choices by 31 December 1992. However, the options took longer than expected to develop and the date was moved to 1 March 1993.

15.84 The Department expected that, of the 19,000 anticipated program participants, 33 percent of the fishermen (3000) and 50 percent of the plant workers (5000) would leave the fishery. ([see Exhibit 15.3](#))

Lower than expected reduction in number of individuals dependent on the fishery

15.85 As of August 1993, of the 26,338 actual program participants, only 20 percent of the fishermen (1933) and 30 percent of the plant workers (5010) were enrolled in components leading to a possible exit from the fishery.

15.86 Conversely, 74 percent of Northern Cod Adjustment and Recovery Program participants (19,395 participants) have not enrolled in components leading to a possible exit from the fishery.

15.87 There is no assurance that those enrolled in components leading to a possible exit from the fishery will actually leave. While 5213 participants were enrolled in skills training for potential employment outside the fishery in August 1993, they are under no obligation to actually leave the fishery. Therefore, the real adjustment will occur only when these people find other employment and are no longer on the Northern Cod Adjustment and Recovery Program payroll. In addition, the early retirement option (chosen by 1730 participants) is not binding until such time as the Department and the individual agree on the amount of the annuity. All of these are included in the figures in paragraph 15.85 as potential exits from the fishery. However, as of October 1993, payments have been approved for only three recipients and the number of people who are expected to retire using this component is not known.

15.88 This means that a large proportion of Northern Cod Adjustment and Recovery Program participants will not have been adjusted out by the end of the moratorium.

15.89 The Department believes that the Northern Cod Adjustment and Recovery Program could eventually remove from the fishery approximately 32 percent of eligible fishermen and 36 percent of eligible plant workers. To arrive at these numbers, it is assuming, although only three monetary agreements had been reached as of October 1993, that all of the 1730 participants who expressed an interest in early retirement will actually retire. It is also assuming that the 5213 participants enrolled in skills training for potential employment outside the fishery in August 1993 will all find other employment and be removed from the fishery. In addition, it estimates that 1200 participants will enrol in skills training in September 1993 and will also be removed from the fishery. Finally, it assumes that a number of crew members will exit the fishery as a result of licence retirements.

Reducing capacity

15.90 Overcapacity exists in both the harvesting and processing sectors. The processing sector is under provincial jurisdiction and, accordingly, plants are licensed by the province. The Department was unsuccessful in negotiations with the Province of Newfoundland, aimed at reducing processing capacity in Newfoundland. The Province has stated, however, that it will permit no further increase in processing capacity.

15.91 The federal government is responsible for licensing the harvesting sector. The Department intended to reduce capacity through licence retirement and cancellation of inactive licences.

15.92 When the adjustment components were designed, the Department estimated that there were approximately 6000 Northern cod licence holders, and that one third of these were inactive. It expected to remove 800 (or 20 percent) of the active licences through the licence retirement component (i.e., through providing compensation for licence retirement) and to remove all of the inactive ones without compensation. This would have left available a core of 3200 licences to fish.

Although licenses are being retired, significant overcapacity continues to exist

15.93 Although licences are being retired, it appears that there will be approximately 5300 licences available to fish Northern cod at the end of the moratorium, as opposed to the departmental target of 3200.

15.94 Cancellation of inactive licences has not proceeded as expected. Rather than removing inactive licences, the Department later decided to freeze inactive licences until 1994. At that time, active and inactive licence holders will be allowed to reactivate their licences as long as they meet certain criteria. These criteria have not yet been established. In addition, the Department is uncertain as to how many licences are actually inactive.

15.95 The Department now considers that there are approximately 6100 licences available to fish Northern cod. Although 1112 licence holders selected the licence retirement option, the actual number of licences that will be retired is not known, as the selection of this option is not binding until an agreement on the payment for the licence is reached. As of July 1993, only six monetary agreements had been reached. Assuming that 800 licences will be retired as originally planned, and given the uncertainty surrounding inactive licences, a core of at least 5300 licences could still exist at the end of the moratorium and only a 13 percent reduction would have been achieved.

15.96 Although funds are being spent to achieve a sustainable fishery, capacity and dependence on the fishery remain high. In the design of the Northern Cod Adjustment and Recovery Program adjustment components, the Department did not assess the potential of the resource in terms of fish biomass and amount of fish that can be captured while maintaining an ecologically sustainable fishery. Furthermore, it did not attempt to assess the number and nature of fishermen, plant workers, vessels, and licences that can be sustained, in order to target its adjustment programs. Rather, it has focussed on reducing the number of people involved in the fishery, and the number of licences, on a voluntary basis without linking these to what the resource can sustain.

15.97 The Department informs us that adjustment is a process that takes place over time and is the result of hundreds of individual decisions. The Department believes that the number of signed agreements to date is not indicative of eventual take-up rates. Early retirement and licence retirement programs involve a lengthy and time-consuming process before final agreements can be reached.

There are limits to what the Department can be expected to achieve

15.98 In attempting to develop the adjustment components, the Department has faced some very real constraints. First, because the majority of Northern Cod Adjustment and Recovery Program recipients are plant workers, the federal government has little direct influence on their participation in the fishery. Any attempt to influence directly the number of plants, the employment practices of plant owners, or the future decisions of individuals to work in a fish plant would intrude directly into provincial jurisdiction.

15.99 In the case of fishermen, the Department, in theory, has more ability to intervene directly. The Minister has the authority to determine both who shall participate in the fishery and how they shall do it. However, as a practical matter the Department is quite limited in what it can do with respect to those already in the fishery. The Department has attempted to withdraw registrations (the personal right to fish) but has found that, apart from voluntary surrenders of registrations, this is very difficult to do. Licences (the right to fish in a particular way) have proved even more vexing. As we noted in our 1988 Chapter on the Atlantic Fishery, it is the Department's practice to allow the capitalized value of a licence to accrue to the holder. When it wishes to withdraw a licence, it has, on occasion, paid much or all of this accrued value to the licensee. In doing this, the Department has placed a significant fiscal restraint on its ability to act.

15.100 Overall, the Department has little choice in dealing with those already in the fishery but to attempt to persuade them of the futility of remaining in the fishery and to facilitate their voluntary withdrawal. However, as the data indicate, the rate of even potential withdrawals is nearly 50 percent short of the minimum that the Department believes is needed.

15.101 With respect to the future, the Department has a greater ability to influence gradually the size of the fishery by limiting the number of new licences that it will allow. In the area of fishermen's registration, it can attempt to control numbers through its planned professionalization program. This program represents an effort to improve the quality of fishing effort and to limit entry into the fishery through a program that would require a period of formal education in fishery skills, followed by a certification of competence, as a prerequisite to getting a personal fisherman's registration.

15.102 All of this begs, of course, the crucial question: What, in a fishery reduced to 50 percent of its current size, will the displaced workers do?

Chapter 16

Department of Forestry

Main Points

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- Mandate and Mission of the Department
- Programs
- Resources
- Constitutional Roles
- Sustainable Development
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Audit Objective and Conclusion

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- 16.10 Canada's Network of Model Forest

Department of Forestry

Assistant Auditor General: Paul Ward

Responsible Auditor: John Wiersema

Main Points

16.1 While forest management on provincial lands is the responsibility of provincial governments, the federal government can also affect forest management through its responsibility for, among other things, trade, scientific research, the environment, and federal lands. Some of the federal responsibilities are carried out, at least in part, by the Department of Forestry. The objective of our audit was to determine whether the Department can be reasonably confident that it is successfully carrying out its mission to promote the sustainable development and competitiveness of the forest sector.

16.2 In general, we found that the Department has successfully influenced forest stewardship nationally and internationally. However, the Department has not sufficiently clarified the objectives of its research programs and its forest sector development activities so that its success in promoting sustainable development and competitiveness can be assessed. As a result, it is not sufficiently clear what the Department is accountable for achieving through these programs and activities. Accordingly, we have concluded that, during the period covered by our audit, the Department could be reasonably confident that certain programs and activities successfully promoted sustainable development and competitiveness, but it could not be reasonably confident that others did.

16.3 Specifically, we found that the Department positively influenced forest stewardship at the national level by assisting forest sector stakeholders in establishing a framework for the sustainable development of forest resources - the *Canada Forest Accord* and the *National Forest Strategy*. It helped focus international attention on the wise use of global forest resources and the need for a multilateral convention on forestry practices. In addition, the establishment of the Model Forest Network by the Department has already served an important purpose by providing a mechanism whereby various forest sector stakeholders can work together in managing forest resources.

16.4 The Department has not yet completed its assessment of the role of its research activities in support of sustainable development by identifying the most appropriate research issues for it to address. In this context, the Department has not articulated clear research goals and priorities. A new strategic plan for its research program, explaining how the Department will promote sustainable development through research, is urgently needed.

16.5 For its forest sector development activities, the Department has re-oriented the general aim of its individual development agreements with provinces and territories to support sustainable development. However, the Department:

explains that, historically, it has not been responsible for the allocation of forest sector development funds among agreements and that other priorities, such as regional development, took precedence over sustainable development and competitiveness in these decisions;
did not conduct a rigorous analysis of the sustainable development and competitiveness needs within provinces as a basis for the allocation of funds among the specific programs the agreements support; and
did not ensure that clear objectives were set for these agreements.

16.6 Finally, the Department needs to improve the performance information it provides to Parliament on the success of its research and its forest sector development activities.

Background

Mandate and Mission of the Department

16.7 The principal statutes authorizing the activities of the Department of Forestry are the *Forestry Act* and the *Department of Forestry Act* (1989). Consistent with these Acts, the Department's mission is "to promote the sustainable development and competitiveness of the Canadian forest sector for the well-being of present and future generations of Canadians."

Programs

16.8 As described in Part III of the Estimates, most activities of the Department fall into one of three areas: forest research and technical services (including scientific inquiry into areas such as forest environment, forest production, forest protection from insects, diseases and fires and the dissemination of research findings); forestry development (encouraging sustainable forest sector development through forestry development programs and federal-provincial/territorial forest resource development agreements - FRDAs); and, finally, administration (including work on forestry issues related to industry and trade, international relations, statistics and economic analysis, as well as public information on forests and forestry). The Department also supports national and international efforts to improve forest stewardship.

Resources

16.9 According to its Estimates for 1992-93, the Department delivers its programs with the following resources:

	\$ Thousands	Employees (Full-time Equivalents)
Forest Research and Technical Services	87,547	842
Forestry Development	117,135	217
Administration	<u>35,143</u>	<u>387</u>
	<u>\$239,825</u>	<u>1446</u>

Constitutional Roles

16.10 The Constitution establishes forest management on provincial land as a responsibility of provincial governments. Each province has its own forestry legislation, regulations, standards and programs through which it controls harvesting rights and resource management responsibilities. The federal government can also affect forest management and the forest sector in that it has direct or shared responsibility for industrial and regional development, trade, international relations, taxation, science and

technology, the environment, federal lands, Indian affairs, employment and training, pesticide regulation, national statistics, national parks and fisheries.

16.11 The Department of Forestry directs most of its program efforts and the majority of its research and FRDA resources to support forest stewardship. In other words, the Department's main programs are intended to help forest managers (principally provincial and territorial governments, but also private woodlot owners, federal departments, Indian bands and industry) in the sustainable development of forests.

Sustainable Development

16.12 The major part of the Department of Forestry's mission is the promotion of sustainable forest sector development. While this mission reflects the present concern that the impact of human activities must respect the tolerance limits of forest ecosystems, the interest is not new: in North America, it is the latest expression of a long conservationist tradition. The idea of environmentally sustainable economic development in its present form received worldwide attention in 1987 through the report of the World Commission on Environment and Development, titled *Our Common Future*. The Commission defined sustainable development as "development that meets the needs of the present without compromising the ability of future generations to meet their own needs."

16.13 The 1990 report of the Standing Committee on Forestry and Fisheries emphasized that stewardship of forest resources was the essence of sustainable development. The Committee wrote that "stewardship is the principle by which sustainable development is achieved."

16.14 The 1992 *National Forest Strategy*, which arose from a consensus among government, industry and other organizations to deal with common problems in co-ordinated ways, also adopts stewardship as one of its central values. Through the *Strategy*, forest management agencies are working toward a shared vision for Canada's forests. A guiding principle of the *Strategy* is that "sustainable forest management recognizes a forest's potential to sustain a range of values and establishes targets for an optimal mix of uses." In that context, a shared vision means articulating the desired future state of the forests by specifying clear goals for the economic, environmental and social values inherent in forest resources. The *Strategy* describes sustainable development as an expansion of the principle of sustained timber yield by including other values such as wildlife and fish habitats, watersheds and hydrological cycles, as well as species diversity.

16.15 Sustainable development is a broad concept, and operational application is now the challenge for forestry managers. This means that the term "sustainable development" by itself does not provide a self-evident set of associated objectives and responsibilities for a government agency wishing to promote it. To provide a sound basis for accountability, the Department of Forestry would need to clearly define its goals, priorities and intended actions in the context of promoting sustainable development.

Competitiveness

16.16 The forests of Canada support a large industrial sector, and part of the Department of Forestry's mission is to promote sectoral competitiveness. In 1991, according to the Department, 299,000 people worked directly in the forest industries, and they produced \$20.6 billion in exports. Overall, the forest sector directly contributed 2.9 percent of Canada's gross domestic product.

16.17 The *National Forest Strategy* recognizes the obvious importance of the forest sector to the national economy. According to the *Strategy*, the competitiveness of Canada's forest industries "depends on the development and application of advanced technology, access to markets, a favourable investment climate, a reliable wood supply and a skilled and adaptable workforce." The *Strategy* goes on to note that environmentally sound forest management practices and manufacturing processes contribute to the country's ability to sell its goods and services in foreign markets.

16.18 Similarly, the Department's report to Parliament, *The State of Canada's Forests 1991*, explains that "the position of Canadian forest products in international markets is generally determined by:

- the costs of inputs (timber, energy, labour and capital) to manufacturing and distribution processes;
- the efficiency of manufacturing and distribution processes in using these inputs (i.e., their productivity);
- the currency exchange rates between Canada and its competitors; and
- the competitive quality of Canadian products."

16.19 Competitiveness is a multidimensional issue; a stable supply of wood fibre is important, but by itself will not improve manufacturing efficiency or marketing effectiveness. The Department of Forestry has worked with other departments on various aspects of competitiveness and on other trade-related issues, such as the softwood lumber and the pinewood nematode trade disputes. It has partnership arrangements with the Forest Engineering Research Institute of Canada and with Forintek Canada Corporation, which address aspects of competitiveness. Generally speaking, however, the Department directs most of its resources to forest stewardship, and thereby affects competitiveness through the supply of wood fibre.

Audit Objective and Conclusion

16.20 The objective of our audit was to determine whether the Department of Forestry can be reasonably confident that it is successfully carrying out its mission to promote the sustainable development and competitiveness of the forest sector. We reviewed the Department's efforts in this regard from its creation in 1989 to April 1993. We did not examine its financial control practices, as we were satisfied that they were being adequately reviewed by the Department's internal audit function.

16.21 We audited the following aspects of the Department:

its efforts to influence forest stewardship nationally and internationally and to provide leadership for federal forestry initiatives;
its research and development programs;
its forest resource development agreements with British Columbia, Alberta, Saskatchewan, Manitoba and New Brunswick; and
its reporting to Parliament on these activities and on the condition of Canada's forest resources.

16.22 To be accountable for fulfilling its mission, we expected that the Department would:

clarify its mandate and mission by identifying the sustainable development and competitiveness issues that are within its mandate to address, setting its priorities and goals opposite these issues, and developing or modifying programs to achieve its goals;
practice good management by safeguarding public property and maintaining appropriate financial controls, delivering its programs with due regard to economy, efficiency and effectiveness, and following government policies; and
report to Parliament on how successfully it is carrying out its mission, the use of resources, and operational performance.

16.23 By defining its responsibilities clearly, carrying them out properly and reporting on the results, the Department can accomplish two important things: it can be reasonably confident that it is fulfilling its mission; and it will have created a sound basis for accountability both within the Department and to Parliament.

16.24 In general, we found that the Department has successfully influenced forest stewardship nationally and internationally. However, the Department has not sufficiently clarified the objectives of its research programs and its forest sector development activities so that its success in promoting sustainable development and competitiveness could be assessed. As a result, it is not sufficiently clear what the Department is accountable for achieving through these programs and activities. Accordingly, we have concluded that, during the period covered by our audit, the Department could be reasonably confident that certain programs and activities successfully promoted sustainable development and competitiveness, but it could not be reasonably confident that others did.

Observations and Recommendations

Creating a Shared Vision: Influencing Forest Stewardship

16.25 In its response to the 1990 report of the Standing Committee on Forestry and Fisheries, the government stated that it established the Department of Forestry as a separate department with an important element of its mandate being to "co-ordinate the

development and implementation of federal forestry policies and programs and to provide leadership in bringing all forestry stakeholders together to find consensus on satisfactory solutions on the sustainable management and use of Canada's forests." There are three forums within which the Department can influence forest stewardship: in national discussions of common principles of forest stewardship; in federal government forest sector initiatives; and in international discussions of sustainable forest resource development.

16.26 In order to carry out its responsibilities in these three areas, we expected that the Department would work with other federal departments and agencies, provincial and territorial governments, industry and other interested parties, to help:

- clarify and address national problems of sustainability and competitiveness in the forest sector;
- develop and implement a co-ordinated federal response to sustainability and competitiveness issues in the forests and forest sector, and to help manage forests on federal lands; and
- advance Canada's interests abroad on forest-related issues.

Stewardship of forests in Canada: the Department's role

16.27 Since the turn of the century, there have been repeated calls for a national policy on forest stewardship ([Exhibit 16.1](#)). A "national" policy in this sense refers to a country-wide consensus on similar approaches to common problems and opportunities rather than to a policy of the federal government. The long-standing rationale for a national policy is that forest stewardship is a responsibility shared by the federal and provincial governments, by industry and by other users of forest resources.

Exhibit 16.1

Calls for a National Policy on Forest Stewardship: A History

A long history of unsuccessful appeals for a national forest policy preceded the signing of the *National Forest Strategy* and the *Canada Forest Accord* in 1992. Although the present *Strategy* seems to show progress toward setting a national agenda for sustainable forest resource development, many similar efforts have dissipated in the past. For example:

- 1906 Concern over the future of Canada's forests resulted in the country's first national forest congress, presided over by Sir Wilfrid Laurier. The congress resolved that "the time is now ripe for a general forest policy" and that the federal government be asked to inaugurate the same." However, the policy was not forthcoming.
- 1924 The Royal Commission on Pulpwood recommended that the federal government co-operate with the provinces to establish a national forest policy and program of "Dominion-wide application." This recommendation was not accepted.
- 1945 The subcommittee on natural resources of the Advisory Committee on Reconstruction recommended the creation of a national development board to manage all resources including forests. This recommendation was not accepted.
- 1966 The federal forestry Minister promised a national forest policy to representatives of the forest sector gathered in Montebello, Quebec. No policy was forthcoming.
- 1979 The Canadian Council of Resource and Environment Ministers proposed 11 principles for a national forest policy - one that would ensure that Canada's forests are managed and used so as to meet the present and future economic and social needs of Canadians. The principles were not adopted as a national policy.
- 1987 The Canadian Council of Forest Ministers adopted *A National Forest Sector Strategy for Canada*. The paper was viewed as "a guide for government, industry, labour, and other Canadians with a stake in the forest resources to undertake actions to meet several strategic national aims within the next 5 years." The *Strategy* was not acted on.
- 1992 The Canadian Council of Forest Ministers produced a document called *Sustainable Forests: A Canadian Commitment*, which, along with the *Canada Forest Accord*, became the revised *National Forest Strategy*. As called for by the *Strategy*, action plans and a public evaluation process were subsequently established.

16.28 The 1980 Canadian Forest Congress, jointly sponsored by forest industry and labour groups, considered national forest sector management issues and economic development concerns. In the mid-1980s, the Canadian Council of Forest Ministers sponsored four discussions on the forest sector leading up to the Canadian Forest Conference of 1986. The results of these meetings formed the basis for the development of *A National Forest Sector Strategy* in 1987. However, public attitudes toward the uses of forest resources continued to change, and in 1990 the Council set out once again to achieve a national consensus on new directions for forest management. This process culminated in the signing of the *Canada Forest Accord* and adoption of the *National Forest Strategy* in 1992 ([Exhibit 16.2](#)).

16.29 The Department of Forestry has actively participated in the Canadian Council of Forest Ministers since its creation in 1985, and was instrumental in facilitating the work and discussions that produced the *Accord*. This agreement commits the federal government, along with the other signatories, to a series of actions in support of sustainable forest development. In addition, the Council agreed to create a coalition among all signatories to the *Accord* to oversee the implementation of the *Strategy* .

16.30 To respond to federal commitments under the *Strategy* , the Department of Forestry has formed both an intradepartmental task force and an interdepartmental committee and has identified federal goals and objectives in relation to the *Strategy* . Work schedules and action plans have been provided to the Department by the other departments involved.

16.31 The Department of Forestry, by co-ordinating the development of the *Canada Forest Accord* and the *National Forest Strategy* , has assisted provincial and territorial governments, industry and other non-government organizations in establishing a national framework for the sustainable development of forest resources. The *Accord* and *Strategy* constitute an important starting point for sustainable forest resource development.

Federal forestry initiatives: the Department's role

16.32 Many federal government programs affect the forests and the various constituencies that make up the forest sector. The 1990 report of the Standing Committee on Forestry and Fisheries identified 15 federal departments and agencies involved in forest-related matters. In its 1990 strategic plan, the Department of Forestry set out two roles for itself in ensuring an appropriate mix of federal policies and programs: first, the Department planned to co-ordinate the development and implementation of federal forestry policies and programs by formulating an integrated and comprehensive federal forest policy by the spring of 1992; second, the Department made a commitment to provide other departments and agencies with policy and technical advice on industry and trade matters and on forest management on federally owned lands. In response to the Standing Committee's report, the government restated the Department's responsibility to co-ordinate the development and implementation of federal forestry policies and to strengthen co-operation on forest issues at the federal level.

16.33 We found that the Department has worked with other departments to ensure that forestry issues are reflected in broader federal initiatives such as the *Green Plan*, the federal government's action plan on the environment, and the Prosperity Initiative, a consultation process focussing on competitiveness issues in the major sectors of the economy. The Department has provided technical advice to other departments on forestry-related matters such as the softwood lumber trade dispute and newsprint recycling. The Department has also provided forestry services to other departments managing forest lands. However, despite the government's intention that interdepartmental agreements would be reviewed in the context of the Department's mission, the Department has not yet updated most of its memoranda of understanding with other departments to reflect the goals of sustainable development.

16.34 With regard to the Department of Forestry's role in overall federal co-ordination, it has not yet established an integrated and comprehensive federal forestry policy. However, the Department has been involved in two interdepartmental policy planning processes dealing with forestry: the Prosperity Initiative, in particular the federal response to the report of the Forest Sector Advisory Committee; and the implementation of federal commitments under the *National Forest Strategy*. In our view, the Department needs to assess the scope of the policy implications of these two initiatives and report to the government on whether a separate, integrated federal forest policy is still needed.

Stewardship of forests internationally: the Department's role

16.35 The *National Forest Strategy* and the *Green Plan* recognize the importance of the world's forests to the health of the planet and acknowledge the significant role played by Canada as the steward of a substantial portion of those forests. In support of sustainable forest development worldwide, the Department of Forestry is working with international bodies, such as the United Nations Food and Agriculture Organization and its Committee on Forestry, the Organization for Economic Co-operation and Development and the International Tropical Timber Organization.

16.36 The Department of Forestry made a significant contribution to the United Nations Conference on Environment and Development in June 1992. In particular, the Department helped expand the pre-conference debate from a narrow focus on tropical deforestation to include the broader issues of conservation, management and sustainable development of forest resources. The Department was also deeply involved in the process leading to the adoption of the non-legally binding statement of forestry principles by the Conference.

16.37 The Department has helped focus international attention on certain worldwide forest problems and the need for a multilateral convention on the conservation and sustainable development of global forests. An international convention on global forests could help to protect forest environments worldwide. It could also serve Canadian interests by helping to preserve access to traditional export markets through the establishment of internationally accepted norms for sustainable forestry.

Understanding Forests: The Department's Research Programs

Forest research in Canada

16.38 The *National Forest Strategy* identifies two main areas of forest research: forest management and forest products, processing and equipment. The *Strategy* observes that, through the Department of Forestry and its predecessors, the federal government has focussed principally on forest management research, and the Department is the country's largest forest management research organization ([Exhibit 16.3](#)). Provincial forestry ministries also support forest research, and the Department advises that Quebec, Ontario, and British Columbia carry out their own research programs in specific fields. In addition, industry and universities engage in research into forest management and products.

16.39 Forest management research, whether it is directed at creating new knowledge or developing management applications, supports forest stewardship. In 1992, the Science Council of Canada commented that "in the new era of sustainable forestry development, if there is any real hope of maintaining and expanding present uses of the forests, as well as their environmental values and capabilities, forest research must not only reflect these goals, but it must also lead the way toward them."

Defining the Department's research goals and priorities

16.40 The Department's strategic plan (1990) commits it to reassessing and clarifying its research role and to developing a national research agenda and priorities in the context of promoting sustainable development. We expected that the Department would have identified the most appropriate research areas for it to pursue, by undertaking a broad assessment of the new knowledge and management applications needed to develop forest resources sustainably. Such an assessment would have identified which research and development agencies were already working on relevant lines of enquiry, and how respective efforts would be co-ordinated. In this context, the Department would have defined its role in addressing these research issues by defining clear goals for its research programs.

16.41 We found that over the past few years the Department has undertaken an ongoing series of strategic analyses and assessments, each with a different scope, which generally outline some aspects of its research directions and intentions. These various analyses are meant to guide the selection of individual projects by departmental research managers. However, the Department has not specified the role that it would play in pursuing these directions by setting clear, attainable goals for its research efforts. We noted that the most recent strategic plan, setting out the medium- to long-term directions and priorities for all the Department's research activities, was prepared in 1987. It makes no reference to the idea of sustainable development and little or no reference to many of the more recent issues, such as climate change, biodiversity and the non-consumptive use of forest resources, that have emerged in the context of sustainable development.

16.42 In late 1991, the Department undertook a "national forestry science and technology agenda" initiative. Its purpose was to recommend ways to enhance the country's forestry research and development efforts by reassessing the roles, responsibilities and

interrelationships of Canada's researchers and research users. However, the initiative was not intended to address the question of future research needs and relative priorities for the Department; this was to be the subject of future work.

16.43 In our view, a new strategic plan for the Department's research program is urgently needed to explain how the Department intends to manage its research efforts to promote sustainable development.

Results-oriented research

16.44 A recurring theme among reviews of government research and development programs is that research activities should be closely tied to mission-driven goals, with expected results, timing and impact established in advance. While recognizing the inherent difficulty of the task for scientific programs, we expected the Department to have clearly defined its individual research and development programs in terms of expected results toward specific research goals, so that the success of these programs could be determined and accountability would be evident.

16.45 As previously noted, the Department has several strategic plans for research: the 1987 plan for all its research and development programs; the 1990 departmental strategic plan, which touches on research; a plan for each of the eight research establishments; and several plans for individual fields of study, such as climate change and bioenergy. However, none of these plans clarifies the results needed to attain clear research goals. Instead, the plans are activity-oriented, with research goals expressed as actions, such as "studying the effects of" or "monitoring the health of", which set the direction that research will follow, rather than the expected outcomes. Targets are established for individual research projects, but we found they are frequently not time-bound, or specific.

16.46 Without a clear set of expected results linking the Department's research activities nationally, management of each establishment interprets for itself how best to carry out the Department's research intentions. While departmental co-ordinating committees are in place and departmental researchers co-operate and collaborate on projects, they lack clear goals on which to focus and therefore their efforts are process-oriented. In our opinion, departmental research programs can be described, to a greater or lesser extent, as the sum of individual projects in the same area of scientific inquiry, rather than as a co-ordinated set of related research activities aimed at resolving a specific forest stewardship issue or problem.

Selecting research projects

16.47 We expected to find a clear and rigorous selection framework for the Department's research projects. Within such a framework, project selection criteria would support research program results and goals.

16.48 As discussed above, the Department has not articulated clear goals for its research and development programs. Consequently, we were unable to assess meaningfully whether those projects that were selected supported departmental goals. Instead, we could

look only at the process used by the Department to review and select projects, and we found that it varies with the source of research funding. For *Green Plan*, FRDA and interdepartmental projects, a co-ordinating committee reviews and approves research proposals. The selected projects represent the research to be carried out during the time frame of the program plan, usually five years. However, the expected results from this research are not aggregated and incorporated into the strategic plans as a basis for program-level accountability.

16.49 The remainder of the Department's research projects are selected by regional management. Regional managers receive advice from provincial forest research advisory committees. When evaluating research proposals, management considers factors such as scientific merit and suitability; however, the reasons why certain projects were selected over others were not documented.

16.50 It is possible for the Department to link all of its research projects to its mission to promote sustainable development. However, without clear program goals supported by rigorous project selection criteria, the Department can have little confidence that it is systematically addressing the research issues most relevant to sustainable development with well-selected research projects and studies.

Management of research quality

16.51 The National Advisory Board on Science and Technology, which reported to the Prime Minister in 1990, reviewed the key characteristics of successful government research and development programs. Among other things, the Board recommended that management conduct periodic evaluations of research quality and relevance and that it strongly commit to rigorous planning and budgeting.

16.52 The Department uses periodic peer reviews by internal and external experts to evaluate the scientific quality of its in-house research projects. However, only those recommendations agreed to by regional management are incorporated into the subsequent year's work plans; and there is no review of a decision not to accept certain recommendations. Follow-up, to ensure that management has acted on the recommendations to which it agreed, is delayed until the next peer review, three years later. Furthermore, the Department advised us that it is at least one year behind schedule on peer reviews. These limitations lessen the value of the peer reviews in helping to ensure research quality.

16.53 In addition to evaluating research quality, we expected management to monitor research projects against plans and budgets. In our 1988 audit of the Canadian Forestry Service (the predecessor of the Department of Forestry), we recommended that monitoring include cumulative cost information for each research project and assessment of the potential costs and benefits of research devoted to specific lines of enquiry. We found that annual status reports are prepared for projects funded from the *Green Plan*, FRDAs, or through collaboration with external partners. For projects funded from the Department's ongoing established funding base, however, the only status reports are abbreviated versions in the Department's computerized work planning system. This

system is new and does not yet capture cumulative or projected costs. While management also conducts informal reviews of these projects as part of the annual planning process, we found no formal record of findings or of approved changes to plans resulting from these reviews.

16.54 The Department has established a reasonable framework to ensure the scientific quality of individual research projects. However, to ensure the continued relevance and cost-justification of all research projects, improvements are needed in the way certain measures are carried out.

Communicating research results to users

16.55 Research results, if they are to have any practical relevance, must be communicated effectively. As one measure of this, we expected to find that scientists and project managers were accountable for knowledge transfer; as another measure, we expected that evaluations of research projects would include an objective assessment of the success of knowledge or technology transfer.

16.56 We found that performance evaluations for scientists and project managers do take into account various forms of knowledge transfer, such as journal articles or field demonstrations. However, the success of such transfers is assessed through informal client contacts. Although the Department's program evaluation function has started to look at this issue, the Department has no ongoing, objective way of evaluating how well it has communicated research results. As a consequence, the Department has limited information on whether its research results are reaching the people who could use them.

Reporting to Parliament on the Department's research results

16.57 To assess the quality of information reported to Parliament on research results, we examined the relevant sections of Part III of the Department's Estimates for 1992-93 and 1993-94.

16.58 The Department's reporting in Part III consists mainly of information on activities, rather than achievements. Many of the same activities were reported under the heading of "accomplishments" in both years. Without clear statements of goals, Parliament has little information on which to judge the success of the Department's research program.

16.59 While the Department uses financial and other resources from external sources and FRDA funding for its research programs, these resources are not reported to Parliament as part of the cost of its research. Resources from external sources are not reported at all, and the funding through the forest resource development agreements of research carried out by the Department is not reported as such. We estimate that the Department and its external partners spent \$12 million more on departmental research than is reported in the 1992-93 Estimates Part III. Therefore, Parliament has not been informed of the full amount of resources used by the Department's research and development program, or of the Department's success in leveraging resources from outside the federal government for its research.

16.60 The Department should address how its research program will promote sustainable development by:

**identifying the new knowledge and management applications needed to develop forest resources sustainably; and
ensuring that expected results for research programs are clearly defined at the outset and that they support attainable goals.**

Department's response: Sustainable development is a key focus of the Department's research program and is recognized in its departmental strategic plan and Green Plan program documentation. However, the Department recognizes the need to develop a new strategic plan for research that is integrated with the various subject-specific plans, and which is more precisely linked to sustainable development needs and identifies as clearly as possible expected research results. The Department has put in place a process and is working toward developing such a strategic plan over the course of the next fiscal year.

16.61 The Department should also ensure that:

**all research projects are regularly reviewed for relevance and cost-justification;
it assesses, on an ongoing basis, how well it is communicating its research results to clients; and
research results and related costs are reported fully and accurately to Parliament.**

Department's response:

The Department agrees with the importance of regular reviews of its research projects and will be re-examining all of the components of the existing system to improve it over the course of the next fiscal year.

The Department acknowledges the importance of effectively communicating research results to clients, and is continually working with them to develop better and more cost-effective ways of ensuring successful technology transfer.

Accordingly, the Department will be reviewing its mechanisms for monitoring technology transfer over the course of the next fiscal year.

The Department agrees with the need to further improve its reporting of research results to Parliament. The Department will present its research expenditures and accomplishments as fully and accurately as possible.

Improving Forest Management Practices: Forest Resource Development Agreements

Introduction

16.62 Forest resource development agreements (FRDAs) are an important means by which the Department can influence the direction of forest stewardship and applied forestry research in Canada to support sustainable forest development.

16.63 FRDAs, which are signed and jointly funded by the federal and provincial/territorial governments, are subsidiary agreements to federal-provincial economic and regional development agreements. The Department's regional research establishments negotiated the agreements with the provinces and participate in program administration through joint management committees.

16.64 These agreements "are designed to stimulate increased levels of forest management by the provinces, industry, woodlot owners, Indian bands, and federal departments and to provide a program of research and development, and technology transfer in support of forest management planning and silviculture." Increasing the supply of wood fibre is a primary objective of the agreements, receiving 71 percent of the funding ([Exhibit 16.4](#)).

16.65 Federal contributions over the five-year life of the current round of agreements will total approximately \$500 million. We examined the agreements negotiated with New Brunswick, Manitoba, Saskatchewan, Alberta and British Columbia, which represent approximately 38 percent (\$195 million) of the total federal funding provided for the current round of agreements ([Exhibits 16.7](#) , [16.8](#) , [16.9](#)).

Exhibit 16.7

The Canada/New Brunswick Co-operation Agreement

The primary objective of this agreement is to "increase the sustainable supply of softwood to an average 7.47 million m³ annually to help ensure the continued viability and competitiveness of the present wood-based industry." This supply objective includes 7.07 million m³ of the major softwood species of spruce, balsam fir and jack pine.

However, analysis in the agreement itself states that current annual industrial demand for these major species is 7.356 million m³ annually. Supplying this volume on a sustainable basis would require a larger silviculture program than is provided for in the agreement. The Department's analysis prior to negotiations with New Brunswick argued that to maintain current production levels, an agreement of \$150 million (\$75 million federal share) would be required, and that an agreement of \$85 million (\$42.5 million federal share) could jeopardize the competitive position of the industry and the future of individual mills and associated communities. Further, a number of assumptions incorporated in the agreement's projection of increased wood volume may overstate what can be achieved. Although a \$91 million agreement was eventually signed (\$50 million federal share), the efforts it funds fall short of industrial requirements, according to information available to the Department.

We are concerned that the agreement gives the impression that the continued viability

and competitiveness of the present industry will be ensured, when the Department's own analysis suggests that this is not the case. The Department responds that average annual industrial demand between 1986 and 1991 for the major softwood species was 7.13 million m³, and whether the 7.07 million m³ is sufficient to meet the industrial requirements is an issue that goes beyond the scope of the agreement.

Exhibit 16.8

The Partnership Agreements with Alberta, Saskatchewan and Manitoba

Despite apparent differences among these provinces in terms of the nature and size of their forests and industrial sectors, the agreements each receive identical federal contributions of \$15 million. The Department explains that it has not historically been responsible for the allocation of forest sector development funds among federal-provincial agreements. The funding is determined through the existing federal-provincial economic and regional development agreements, which address economic development goals for a number of industrial sectors within each province. The Department was unable to explain fully why the objectives and goals were virtually identical for each agreement.

We found that a formal needs analysis was not completed for each of these three agreements. The Department states that it determined provincial needs from staff knowledge, personal contacts in industry, government and universities, a client survey conducted several years previously and from other similar information. This process was less rigorous than that followed in other agreements we audited, and its results were not consolidated into comprehensive, province-specific analyses.

We are concerned about apparent anomalies in the allocation of funds among programs in the individual agreements. For example, we noted that Saskatchewan has the greatest number of Indian bands, and the most reserves, with the largest productive forest area among the three provinces. However, we found that the "Aboriginal Lands" forestry program in the Saskatchewan agreement was smaller than that of either Alberta or Manitoba.

Exhibit 16.9

The Canada/British Columbia Partnership Agreement

This agreement is the largest in Canada (\$100 million federal share) and supports a wide range of sustainable development issues in British Columbia. The agreement's programs constitute a collective and comprehensive attempt to address the guiding principles of the Forest Resource Development Agreements. We found that the linkage

between the agreement's programs and its goals and objectives needs to be improved, and that the objectives were worded very generally. We are also concerned that the Department could not demonstrate that the best use was made of the funds available to it for the Partnership Agreement. Our specific concerns follow.

We found that prior to negotiations with the province, the Department had consulted widely with stakeholders, but that this process had not led to development by the Department of a comprehensive priority list of specific problem areas and corresponding actions to be taken under the agreement. The Department has advised that a recently formed public advisory committee and a planned mid-term evaluation will both be used to consider changes in agreement priorities.

Of the total federal contribution of \$100 million, \$52 million was allocated to a program of intensive silviculture. This program is intended to help offset reductions ("falldown") in the allowable harvest that will occur over the longer term as some of the province's "old growth" is replaced by second growth forests. However, we found that the basis for allocating \$52 million to this program was unclear. The four-year plan for the agreement states that a 1.4 million m³ increase in the calculation of wood supply available for harvest could be expected from this investment, although information available to the Department when the agreement was negotiated indicated that this increase in wood supply could be achieved by spending only \$36 million. The Department advises that this information was only one factor in the decision, and there were concerns about its reliability. The Department explains that the additional investment was made to further improve wood quality and value and to create jobs. However, no additional analysis was developed by the Department in deciding how much to invest in silviculture or whether the additional \$16 million could have been better spent on other programs under the agreement.

Guiding principles

16.66 FRDAs have evolved over time as successive rounds of agreements addressed changing priorities. For the current round, the Department developed "eight guiding principles" to redirect the agreements in line with its new mandate to promote sustainable development and competitiveness. The Department successfully negotiated agreements with all of the provinces and territories, incorporating these principles.

16.67 The first of the eight principles stipulates that provinces must elaborate long-term forest management plans consistent with sustainable development. Three of the five agreements we audited included a provincial commitment to develop, within one year of signing, a long-range plan outlining forest strategies (including non-timber forest values) over a full rotation and addressing key forest development issues. These commitments have not yet been met ([Exhibit 16.5](#)), although the Department advises that all the plans are being developed. The British Columbia agreement committed the Province to continue developing a long-term plan, not to complete one within the time frame of the

agreement; the Alberta agreement commits the Province to complete a plan by 1995. The preparation of these plans is a complex undertaking requiring co-ordination among different provincial agencies, public reviews and multisector consultations.

16.68 According to the Department, federal expenditures under the new agreements have shifted away from areas of provincial jurisdiction. The agreements contribute to advancing basic forest management by successfully embedding an "incrementality" principle into the current round. This principle states that the responsibility for protection, harvest planning and prompt renewal of harvested lands ("basic forest management") belongs to the landowner, for both Crown and industrial freehold lands.

Funding of agreements

16.69 The *Department of Forestry Act* instructs the Minister to have regard to the integrated management and sustainable development of Canada's forest resources, and to seek to enhance the utilization of Canada's forest resources and the competitiveness of Canada's forest sector. The Department's mission also emphasizes this responsibility for promoting sustainable development and competitiveness.

16.70 In accordance with its legislation and mission, Part III of the Department's Estimates for 1992-93 notes that the principle of sustainable development guides its programs and its dealings with other agencies. It states that the FRDAs are designed to stimulate better forest management by governments and the private sector so as to help ensure the long-term economic viability and international competitiveness of the forest sector and the health of Canada's forests. The agreements generate regional economic and employment benefits. They also provide the federal government with an important instrument to promote increased forest sector activity in support of integrated resource management and sustainable development.

16.71 Given this context, we asked the Department to explain the allocation of funds among FRDAs in relation to its mission. The Department explained that, historically, it has not been responsible for the allocation of these funds and that other priorities, such as regional development, took precedence over sustainable development and competitiveness in these decisions. Through the existing federal-provincial framework of economic and regional development agreements administered by the federal government's regional development agencies, the money for each FRDA was allocated as part of addressing economic development goals for a number of industrial sectors within each province. In the context of promoting sustainable development and competitiveness, we noted anomalies in the relative funding of the FRDAs, particularly when the amount of funding is compared to the relative sizes of the provincial forest sectors (as measured by value of shipments or the amounts of forested lands - see [Exhibit 16.6](#)).

Identifying sustainable development and competitiveness needs

16.72 We expected that the Department would approach the negotiations of FRDAs by assessing the sustainable development and competitiveness needs within each province. As the basis for the federal position, these analyses would draw on views of the various

stakeholders, and would identify and assess local problems, opportunities and other issues within the scope of the agreement. Federal priorities would have been set among issues, and solutions proposed by assessing relative costs and benefits. We also expected the Department to address only those needs consistent with the eight principles guiding federal involvement in FRDAs.

16.73 Managers at the Department's regional establishments indicated that they have good working relationships with colleagues from the respective provincial forestry communities, including the provincial ministries, university forestry faculties, industry, relevant advisory committees and producer associations. However, while the Department's regional staff may be well aware of provincial forestry issues and their significance, this knowledge was not captured in the form of a rigorous analysis of sustainable development and competitiveness needs within the province, nor was one required by senior management of the Department.

16.74 The programs included in the FRDAs we audited were consistent with the eight guiding principles. However, the needs analyses underlying the program structure in these agreements should have been documented and reviewed by senior management of the Department to ensure that the most effective use was made of available funding.

The objectives of the agreements

16.75 Each agreement we examined included a section describing objectives and goals. We expected these objectives to have the following attributes:

- they would clearly identify intended results;
- the intended results would be outcome-oriented (i.e., end-product/result) and not input-oriented (i.e., action taken);
- the intended results would be measurable; and
- the objectives would be linked to the "needs analysis" for the province.

16.76 In the agreements we audited, objectives were typically expressed in terms of "promote", "contribute to", "strengthen" or "enhance". Such phrasing conveys a general intention but does not specify intended results. In some provinces, we found objectives like "increasing timber supply", but, except for New Brunswick, no quantitative goal was specified. The Department also has not defined the specific results necessary to achieve these objectives.

16.77 We expected that the Department would have undertaken sufficient analysis to be confident that funding allocations to the programs supported by the agreements would maximize potential benefits. However, without clear objectives, it is difficult to know exactly what the individual programs were intended to achieve or how the anticipated benefits compare with the identified needs. It is also difficult to establish definitive links between programs carried out under the FRDAs and the identified sustainable development and competitiveness needs within the province. For three of the five agreements we audited, the Department could not provide us with an analysis showing that it had allocated funding among the programs to maximize the potential benefits.

While analyses were done for New Brunswick and British Columbia, they covered only spending on silviculture and had other important limitations ([Exhibits 16.7](#) and [16.9](#)).

16.78 As a consequence, it is difficult for the Department to know the extent to which the objectives of the individual agreements are being achieved. It is also difficult to establish exactly what the Department is accountable for achieving toward promoting sustainable development and competitiveness with the funds it is spending over the five-year life of the current agreements.

Administration of agreement projects

16.79 Our examination of the day-to-day administrative practices of five FRDAs indicates that the programs delivered by the Department of Forestry are well administered. Appropriate program guidelines, policies and procedures have been developed and documented. Existing management information systems are capturing and reporting basic data needed to administer the program. Departmental officials are taking appropriate steps to ensure that work paid for under the agreements is of acceptable quality and that project milestones are adhered to. Annual plans with goals are developed and approved by a management committee, which also reviews operational results.

Reporting to Parliament on agreement achievements

16.80 To assess the quality of information reported to Parliament on the FRDAs, we examined relevant sections of Part III of the Department's Estimates for 1992-93 and 1993-94.

16.81 An appropriate amount of information is included in Part III to describe, in general terms, the nature of the agreements, the significance of the eight principles underlying the agreements, and important basic information for individual agreements, such as the total size, the size of the federal contribution, the date signed and the period covered.

16.82 However, performance-related information needs to be improved. For example, the information provided on "Forest Renewal and Intensive Forest Management", which represents the largest area of expenditures under the agreements (71 percent of the funding), describes the funded activities but does not indicate the resulting effects on volume, quality and cost of the wood supply. Further, statistics that are unrelated to performance are used as performance measures: for example, the number of trees planted (which is not an objective in any of the agreements we audited) or the number of hectares under intensive silviculture treatment (which, by itself, does not provide information useful to measure performance). The report merges performance information from both the current and previous rounds of agreements but says little about the Department's performance in light of its current goals.

16.83 Reporting to Parliament on the FRDAs needs to be improved. Information on results and achievements would be more valuable if it were more outcome-oriented, and if the reporting segregated performance information for the current round of agreements from that of the previous round.

16.84 In its 26 April 1993 budget, the government announced that it would not be renewing the present FRDAs. Nevertheless, during the remaining life of the agreements, the Department should encourage the provinces to develop long-term plans outlining sustainable forest strategies over several decades, as required under the agreements. Also, the Department should provide Parliament with better information on FRDA achievements.

Department's response:

(1) Long-term Plans

The Department is committed to the establishment of long-term forestry plans. As provided for in the Department's guiding forest development principles and individual agreements we will be encouraging the provinces to finalize these plans.

(2) Improved reporting to Parliament

The Department recognizes the need to improve reporting on FRDA impacts and results. Improving forestry data was one of the guiding principles under which the agreements were negotiated. The Department, in co-operation with the provinces and territories, will continue to improve the information available on the forest resource, allowing us to enhance our assessment of FRDA results. As technologies such as Geographic Information Systems (GIS) are enhanced, over time, our reporting will also improve.

16.85 For future forest sector development programs, the Department should:

ensure that the programs are based on a rigorous analysis of the relevant needs;
set clear and attainable objectives; and
ensure that available funding is allocated in a way that maximizes the benefits achievable.

Department's response: The current round of Forest Resource Development Agreements was based on input from a number of sources: assessments of the previous round of agreements; consultations with industry, the provinces, and other stakeholders; and an analysis of various related data and reports. We do, however, recognize the value of a more systematic needs analysis and more precise objectives in order to maximize benefits within each of the agreements. Accordingly, the Department will work toward this end in any future development programs.

Measuring Progress: National Database and Indicators of Sustainable Development

16.86 The *National Forest Strategy* states that the public has an important role to play in setting objectives, policies and plans for forest management; and to participate properly, the public has to be knowledgeable. The Department of Forestry seeks to inform the public in two ways: first, through the National Forestry Database Program, by which the

Department collects and reports information on forests and forest management; and second, through its indicators of sustainable development, reported in the annual *State of Canada's Forests* reports, which attempt to chart progress toward sustainable forest management.

Establishing a baseline: the National Forestry Database

16.87 The need to capture timely, accurate and comprehensive information on a full range of forest resources has been discussed for at least two decades. More recently, this need has been recognized in the Department's strategic plan, in the *Green Plan*, in the *National Forest Strategy* and as one of the eight policy principles that underpin the FRDAs. The *Green Plan*, in particular, noted that informed debate and wise decisions depended on authoritative information. The National Forestry Database Program, developed under the auspices of the Canadian Council of Forestry Ministers and managed by the Department of Forestry, is intended to address this demand for more complete information. The government, in its response to the 1990 report of the Standing Committee, stated that the database would account for all forest resources in order to mark progress toward sustainable development.

16.88 The Department has not yet significantly expanded or advanced the non-timber information, such as information on wildlife and forest health, collected and reported through the database program. It has, however, focussed on establishing working relationships with the provinces and on resolving accuracy and consistency problems with existing data on timber values. The Department has agreed with the provinces on an initial set of timber-related data, but not on what non-timber information to collect and eventually report. Without this additional information, the database cannot mark progress toward sustainable development.

Measuring progress: indicators of sustainable development

16.89 *The State of Canada's Forests 1991* includes a chapter on environmental, economic and social indicators. In order to measure the health and viability of Canada's forests and progress in achieving sustainable development, the Department developed a set of 12 themes that addressed environmental, economic and social values. For each theme, an indicator was selected to represent Canada's performance. According to the Department, "these indicators were based on the best available data, and efforts to enhance and refine definitions and data are continuing." The Department points out that, as a result of this work, Canada has been asked by the Organization for Economic Co-operation and Development to develop some initial forestry indicators for international use.

16.90 We reviewed the process followed by the Department in arriving at the indicators reported in *The State of Canada's Forests 1991*, and we examined a sample of these indicators for relevance, accuracy and timeliness. We concluded that the process followed was reasonable inasmuch as it included the establishment of a task force to consult with a variety of stakeholders and experts and to review similar work done by other organizations.

16.91 However, we found that the conclusions reached in the report are not always supported by these indicators. For example, one indicator looks at whether human intervention has changed the forests. It shows that in the Great Lakes-St. Lawrence Region, where white pine used to make up 30 percent of the forest, it now represents only 10 percent: a decline of 67 percent. Similarly, in the Boreal Forest Region, spruce has been reduced by 25 percent, and pine by 50 percent. Yet the report concludes that "the fundamental nature of the forests does not appear to have changed when considered on a regional basis." The report does not explain why sharp declines in important species are not significant.

16.92 A second indicator looks at whether Canada's forests will continue to supply sufficient fibre to sustain the long-term economic needs of Canadians. The indicator uses annual allowable cuts, which are the maximum amounts of wood that may be harvested in a province, to show sustainability of the wood supply. Allowable cuts, which are set by provincial governments, are based on a consideration of biological, social and economic factors. The indicator combines the allowable cuts for hardwoods and softwoods and compares them to the combined actual harvest rates, pointing out that the sum is still 17 percent less than the combined allowable cuts. However, industry relies primarily on softwoods (88 percent of the harvest), and hardwoods and softwoods are not, for the most part, interchangeable. By adding hardwoods and softwood supplies together, the indicator obscures the fact that softwood harvest rates are at the maximum set by provincial governments, and that industry is experiencing shortages of quality raw material (almost entirely softwood) in nearly every producing region. As a result, this indicator is not a good measure of the sustainability of the economic benefits that Canadians derive from their forests.

16.93 *The State of Canada's Forests 1991* summarizes information at a regional or national level, making it difficult to discern problems within provinces or forest regions. For example, the national forest account shows national changes in area and volume of the commercial (harvestable) forest. However, the lack of a regional or provincial breakdown obscures the significance of changes over time. The account shows a decrease of 5.3 million hectares in the stocked forest from 1986 to 1989; this is a large area, roughly the size of Nova Scotia. Yet the report, because it presents only large-scale summaries, gives little indication of the significance of the decline. If the intent of the report is to make Parliament aware of forest development problems and issues, it should present information at the level at which problems can be discerned.

16.94 **The Department should expand the National Database Program to include non-timber values in order to mark progress toward sustainable development.**

Department's response: In working with the provincial and territorial governments to establish the national forestry data base, the first priority was to improve the timeliness and accuracy of the available information, much of which related to timber production. The Department recognizes the importance of improving the information available on non-timber values. To this end, the Department is preparing, with other members of the Canadian Council of Forest Ministers, a strategy for the National Database Program,

which will include an assessment of non-timber data. However, the present financial limitations of governments at all levels may slow progress in this area.

16.95 The Department should ensure that conclusions in its report to Parliament, *The State of Canada's Forests* , are supported by the indicators of sustainable development presented in it.

Department's response: The indicators developed and presented in the Report to Parliament were the first developed by any major forest nation in the world. We remain committed to improving both the indicators and the data required to support them. The Department also remains strongly committed to the principle of providing Canadians with the best information available, and not delaying their access to information as improvements are made.

The Department's intent in the State of Forests report is to provide a national picture of Canada's forests. The Department will make every effort to present information at an appropriate level of detail and to ensure that the conclusions in the report are supported by the information presented. The 1993 report to Parliament provides more detail on annual allowable cuts, and this information is published at a provincial level in other departmental publications.

Making Sustainable Development Operative: The Model Forest Network

Background

16.96 Under the *Green Plan* , the Department of Forestry has played a leading role in the creation in Canada of the Model Forest Network, made up of working models of sustainable forest management ([Exhibit 16.10](#)). These models are designed to expand the range of forest uses and benefits in keeping with sustainable development. *The National Forest Strategy* states that the model forests should be:

based on the management of forest ecosystems;
managed to achieve a full range of forest values;
open to public participation within a consultative framework; and
capable of demonstrating and evaluating new and ecologically sound forest management practices.

16.97 The establishment of the Model Forest Network by the Department of Forestry through five-year contribution agreements has already served an important purpose by providing a mechanism for various groups and agencies to work together in managing forest resources. The participants also see numerous scientific, educational and forest management benefits to come from the model forests.

Planning and financing model forests

16.98 In our review of individual model forest agreements and plans, we expected to find either clear and quantifiable management goals for the sustainable development of a full

range of forest values, or at least the commitment to have developed such goals by the end of the five-year contribution agreements. However, we found no explicit recognition of the need to work toward forest management goals, although we did find a commitment in the five-year plans to work toward baseline inventories and indicators of sustainable development, covering timber and other forest values.

16.99 The Model Forest Network was approved by Cabinet with the clear expectation that it would be implemented through formal, contractual, cost-shared partnership arrangements. We found that there are indications that the model forest partners are providing substantial financial and other support. However, the responsibility of the partners to share model forest costs with the Department is not clearly set out in the majority of the agreements signed as of 30 April 1993.

16.100 The Department should encourage the model forest partners to develop and manage toward clear and quantifiable goals for sustainable development of the model forests.

Department's response: All model forest partners, as part of the competition process, were required to demonstrate how their proposals would accelerate the implementation of sustainable development in the practice of forestry. In addition, the Department is assisting its partners in developing and managing toward clear and quantifiable goals for sustainable development of the model forests. To this end, the Department is organizing workshops to develop indicators for inclusion in the annual workplans and reports against which progress can be assessed.

16.101 The Department should clarify the responsibility of its partners to share the costs of the model forests.

Department's response: The Department will strengthen cost-sharing arrangements and encourage all model forest partners to identify in their annual work plans and annual reports all in-kind and financial contributions made toward their respective model forest.

Chapter 17

Department of Justice

Legal Advisory and Litigation Services

Main Points

Introduction

Background

- The Department develops and implements policy, drafts laws, provides legal advice and represents the government in court
- The Department spends nearly \$500 million a year and employs over 2000 people
- The Charter and other developments have profoundly changed the Department's environment

Audit Scope

Observations and Recommendations

- Legal Advisory Services
 - Basic management control information on workload and costs is lacking
 - Clients are generally satisfied with the quality of service
 - There are insufficient systematic processes to manage or measure timeliness of service
 - Responsibility and accountability for resources are divided
 - More attention is needed to formalizing partnerships with client departments and agencies
- Litigation Services
 - The Department has systems and practices to help ensure that it protects Crown interests and acts in accordance with consistent policy positions
 - The Department's control over Crown agents needs to be strengthened
 - Basic management control information is lacking
 - There is insufficient incentive to manage the cost of litigation services
- Information Technology Management
 - The Department will have invested about \$78 million in information systems in the eight-year period ending in 1996-97
 - Information technology plans are ambitious; it will be important to get key things right
- Corporate Issues
 - The Department has started to respond to the challenges it faces
 - A corporate planning process is being implemented
 - The Department will have difficulty getting full benefit from Operating Budgets
 - Accountability to Parliament needs strengthening

- There is urgency about the matters we have raised

Exhibits

- 17.1 1992-93 Full-time Equivalents by Activity; 1992-93 Expenditure by Activity
- 17.2 Department of Justice: Organization
- 17.3 Department of Justice: Legal Services Person-years 1983-84 to 1992-93
- 17.4 Department of Justice: Litigation Person-years 1983-84 to 1992-93
- 17.5 Strategic Plan for Information Management – Total Projected Costs 1989-90 to 1996-97
- 17.6 Department of Justice – Mission Statement

Department of Justice

Legal Advisory and Litigation Services

Assistant Auditor General: Richard B. Fadden

Responsible Auditor: Henno Moenting

Main Points

17.1 The legal services that government requires are extensive and important. The Department of Justice provides those services to the federal government. In doing so, it develops and implements policy, drafts laws, provides legal advice and represents the government in court.

17.2 Our audit focussed on legal advisory and litigation services. These services are important to Canadians, to Parliament and to the government inasmuch as they:

- affect individual rights and freedoms;
- help ensure that public affairs are administered in accordance with the law;
- inform government departments and agencies of the legal implications of policy and program decisions;
- defend the government against claims and help recover moneys owing to it; and
- help prevent disputes or help resolve them if they occur.

Ultimately, they help maintain the government's ability to govern.

17.3 Despite increased resources allocated to the Department in recent years, client demands are starting to exceed the Department's ability to respond to them fully and effectively. As a result, unless there are significant changes in the way the Department manages its activities, we believe its capacity to do what Parliament has mandated it to do - to protect and promote the legal interests of the Crown - will be undermined.

17.4 At the time of our audit, the Department did not have a corporate plan. In order to plan and to undertake other essential management functions, the Department will need to develop systems to collect basic information about workload, costs and performance.

17.5 Client departments and agencies pay for, or provide, about 30 percent of the total resources used by the Department to deliver litigation and legal services. This arrangement undermines responsibility and accountability, and reduces the Department's incentive to use the most cost-effective means of delivering services.

17.6 The government spends more than \$40 million a year on Crown agents - private sector lawyers working under contract to help do the Department's work. Mechanisms in

place to appoint agents and oversee their work should be improved to ensure the protection of the Crown's interests.

17.7 The Department recognizes information technology's potential to help deal with the challenges it faces. Ambitious plans foresee the investment of \$78 million over an eight-year period to 1996-97. The Department will need to get key things right in managing this investment if the opportunities are to be realized.

17.8 Parliament receives little information on workload or performance, and only partial information on the cost of delivering litigation and legal advisory services. Because information is provided to Parliament on a departmental basis, and not on an activity basis that cuts across departments and agencies, the Department's Part III of the Estimates does not report all resources used to deliver these activities.

Introduction

17.9 Like any large organization, the federal government needs legal services to carry out many of its day-to-day operations. These services can relate to contracting, buying or selling property, employing people and many other matters.

17.10 But the government's activities go much further than those of large private sector organizations. For instance, the government proposes legislation, regulates, enforces laws, prosecutes offenders, negotiates and administers treaties and agreements, conducts international relations and promotes national unity. Its activities may affect society as a whole or fundamental issues of individual rights and freedoms.

17.11 Because the government operates largely through the use of legal powers, the legal services it requires are both extensive and important. The Department of Justice (the Department) has a virtual monopoly on providing those services to the federal government. As a result, its influence on Canadian society is important and pervasive.

Background

The Department develops and implements policy, drafts laws, provides legal advice and represents the government in court

17.12 The Department of Justice was created in May 1868 through the *Department of Justice Act* (the Act), enacted by the First Session of Parliament of the Dominion of Canada. The Act sets out separately the powers, duties and functions of the Attorney General of Canada and those of the Minister of Justice. Traditionally, however, they are carried out by the same person. In supporting both roles, the Department:

- plans, develops and implements government policies and programs related to the administration of justice within federal jurisdiction; the Department has a lead policy role in areas such as the *Criminal Code* and criminal procedure, family and youth law, human rights and aboriginal justice;

- drafts legislation and regulations, and prepares legal documents for federal departments and agencies;

- reviews all proposed legislation and regulations to ensure their consistency with the Constitution and the *Canadian Bill of Rights* ;

- negotiates treaties, implements treaty obligations, participates in international fora and represents foreign states in court;

- sees that the affairs of government are administered in accordance with the law;

- provides legal advice to the government and to client departments and agencies;

- and

- conducts all litigation for or against the Crown or any department at all levels of provincial and federal courts and before various administrative bodies, in both the civil and common law systems.

The Department spends nearly \$500 million a year and employs over 2000 people

17.13 All of the Department's work is encompassed by the Administration of Justice Program. The program comprises five activities: Legal Services, Litigation Services, Legislative Services, Legal Policy and Program Development, and Administration. The Department forecasts that in 1992-93 it will have spent \$482.5 million - \$279 million for grants and contributions - and used 2126 "full-time equivalent" employees. [Exhibit 17.1](#) shows forecasted gross expenditures (excluding grants and contributions) and full-time equivalents by activity in 1992-93.

17.14 The Department has its headquarters in Ottawa. At the time of our audit there were 47 legal services units in client departments and agencies (mainly in the National Capital Region), nine regional offices and two sub-offices.

Departmental Legal Services Units are located on the premises of client departments and agencies, where staff deliver services broadly analogous to those provided by corporate counsel in the private sector.

Regional offices and sub-offices undertake all forms of litigation and prosecutions. Regional offices also provide legal advisory services to local offices of client departments and agencies, and most undertake property and commercial transactions.

Headquarters staff conduct litigation of national importance, provide advice, co-ordination and functional direction to regional offices and Departmental Legal Services Units, develop legal policy, and draft legislation. Headquarters also functions as a "regional office" responsible for criminal prosecutions and litigation in the National Capital Region, and provides central management and administrative services.

17.15 The Department has eight main organizational components (Sectors); the heads of these report directly to the Deputy Minister/Deputy Attorney General (see [Exhibit 17.2](#)). About half the Department's staff are lawyers.

The Charter and other developments have profoundly changed the Department's environment

17.16 Although by no means the only factor, the introduction of the *Canadian Charter of Rights and Freedoms* (the Charter) in 1982 was perhaps the single most profound change in the Department's environment in its 125-year history. The Chief Justice of Canada, Antonio Lamer, has stated that the introduction of the Charter "...has been nothing less than a revolution on the scale of the metric system, the great medical discoveries of Louis Pasteur and the invention of penicillin and the laser."

17.17 The Charter, together with social forces that supported it and have been reinforced by it, has affected the nature and extent of the Department's work:

Canada is becoming an increasingly litigious society as individuals and interest groups assert their rights.

Canadians expect more of the justice system, including its accessibility and responsiveness.

The Charter has led to a greater role for the judiciary in public policy. Laws, policies and programs are open to challenge, and the potential policy and financial implications of court decisions can be significant.

The law is evolving more quickly than in the past. In addition, the sheer volume of legislation and regulations is growing.

17.18 Recent government initiatives in areas such as the Constitution, taxation, the environment, aboriginal issues, refugee determination and free trade have also created increased demands for the Department's services.

17.19 Largely because of the factors outlined above, the Department faces a critical challenge: it needs to respond to a revolution in the law and in society at a time when there are increasing constraints on resources.

Audit Scope

17.20 We audited the delivery of litigation and legal advisory services. These services are the Department's main operational responsibilities and they share many common issues. These services accounted for over 65 percent of the Department's operating expenditures in 1992-93 (excluding grants and contributions) and used 70 percent of the staff resources ([Exhibit 17.1](#)). The potential impact of these activities on society is large.

17.21 We also audited the Department's policies and practices in managing and accounting for resources used in litigation and legal advisory services, because of the growing volume and complexity of work at a time of resource constraint. This combination of forces has increased pressure on the Department to make the most effective and efficient use of available resources. At issue is not just the rapidly increasing cost of litigation and legal advisory services, but the risk that the quality of the Department's legal services to the government could be compromised.

17.22 The Department has made, and plans to make, significant investments in information technology over the next few years. We reviewed the management of information technology because of its potentially important role in supporting the Department's service delivery and management responsibilities.

Observations and Recommendations

Legal Advisory Services

17.23 The Department provides a wide variety of legal advisory services to client departments and agencies (clients). These services include, for example: advising on the legal implications of policy and program decisions; interpreting statutes and regulations; assessing legal options when enforcing legislation and regulations; and helping prepare instructions for litigation counsel.

17.24 The Department has a responsibility to see that public affairs are administered in accordance with the law. Legal advice to client departments and agencies is designed to help them achieve their policy and program objectives, consistent with broader legal interests. In giving advice, counsel must take account of government-wide legal interests and the objectives and policies of the Minister of Justice. Sound legal advice on proposed courses of action can reduce the possibility of subsequent disputes and litigation, and their attendant costs.

17.25 [Exhibit 17.3](#) shows person-years allocated by the Department to the delivery of legal advisory services over the last 10 years. The increase of 22 percent in the last two years of that period, from 367 in 1990-91 to a forecasted 451 in 1992-93, is particularly striking. Without adjusting for inflation, corresponding expenditures by the Department increased 110 percent over the 10-year period, from \$19.2 million in 1983-84 to a forecasted \$40.4 million in 1992-93.

Basic management control information on workload and costs is lacking

17.26 We expected the Department to have basic management control information on legal advisory services' workload volumes and costs. Moreover, we expected staff to use this information to monitor trends, plan, set priorities, manage resources, analyze service delivery options and identify opportunities for controlling costs. The Department does not have this information. However, it is aware of the need and is taking steps to gather more information.

17.27 At the time of our audit, Departmental Legal Services Units, Headquarters and regional offices had few systems to track legal advisory services workload and costs. As a result, the Department cannot clearly demonstrate to Treasury Board or to clients the growing demand for legal advisory services, the resource consequences, or the Department's productivity. Nor can changes in the nature and cost of services be tracked. It is difficult for the Department to justify resource requirements or to know whether resources are allocated fairly among Departmental Legal Services Units and other units. Similarly, the Department is ill-equipped to analyze and choose among service delivery options, such as changes in resource mix, or cost recovery.

17.28 The Department has recently developed a "work profiling" system to capture time spent by Departmental Legal Services Unit lawyers by project and category of work. This system was being implemented during our audit. Its aim is to gather information needed to set priorities, to obtain required resources and to allocate them to priority uses. We believe the development of this system is an important step toward overcoming a chronic lack of basic information.

Department's response: The work profiling system is now producing information essential for the effective allocation of resources to priority areas served by the Department's Legal Services Sector. Information needed to show the impact of our work is being defined by our Department's "Service to The Client Task Force".

Clients are generally satisfied with the quality of service

17.29 The Department sees client satisfaction as the key indicator of service quality, including the quality and timeliness of advice. We agree. The Department surveyed client satisfaction in 1990, and carried out another survey during our audit. We understand that senior managers of the Legal Services Sector meet regularly with deputy heads of client departments and agencies to discuss service, and noted that heads of Departmental Legal Services Units maintain close contact with client managers.

17.30 The Department has formal and informal systems and practices to help ensure useful, clear and consistent advice, which reflects the broader legal interests of the government and the Crown. Perhaps the most important of these is a staff of legal professionals. Others include the co-ordination and leadership provided by specialized functional groups at Headquarters, informal communications among Departmental Legal Services Units and other units delivering advice, peer and supervisory review of opinions in some cases, and reasonable access to legal and other research materials.

17.31 We interviewed about 40 individual clients of legal advisory services. Most were satisfied with the quality of the advice they received. These findings were similar to the results of the Department's 1990 and 1993 client satisfaction surveys.

17.32 We found, and many client managers confirmed, that delivery of legal advisory services has become more client-oriented in recent years. For example, heads of Departmental Legal Services Units usually participate as full members of clients' management committees. This allows them to provide early advice on the legal implications of policy and program options being considered as well as to monitor client satisfaction. The Department has also sought to increase clients' awareness of legal matters and trends through publications such as the *Justice Echo* and by training under the Legal Awareness Program.

There are insufficient systematic processes to manage or measure timeliness of service

17.33 Part of Legal Services' objective is to provide timely service. Timely service avoids the risks that government operations will proceed without adequate legal advice, that operations will be delayed, or that departments will seek advice from sources other than the Department of Justice. Nevertheless, the Department has few systematic, ongoing processes to manage or measure the timeliness of the delivery of even the most routine services. Most Departmental Legal Services Units we visited did not have performance standards relating to timeliness; nor did they have tracking systems to record requests for service and to monitor turnaround times. Consequently, performance against standards could not be measured or reported to clients.

17.34 Despite the perceived increase in service orientation, our interviews with client managers and the 1990 and 1993 client satisfaction surveys indicated that some were concerned about timeliness of service. Client managers told us that they expected a timely answer to their queries or, failing that, a projected response date and a contact name. However, these expectations were not always met. Some would like to see mutually accepted service standards established.

Department's response: In conformity with Treasury Board Policy, the Department is pursuing a phased approach to the development of service standards. In partnership with our clients, we continually refine mechanisms to increase the frequency with which we meet client expectations. While we are pleased with the overall results of the most recent client satisfaction survey in which 83 percent of clients indicate that the services we provided over the last year were "very good" or better, we will continue to take every opportunity to improve performance.

Responsibility and accountability for resources are divided

17.35 The cost of delivering legal advisory services is subsidized significantly by client departments and agencies. The Department uses about 240 support staff in Departmental Legal Services Units who are employed by clients; it uses funds provided by clients to pay the salaries of more than 70 lawyers; it depends on clients for most Departmental Legal Services Unit operating and maintenance funds, including funds for information technology; and it uses private sector lawyers on contract (Crown agents) whose fees are paid by clients. In addition to the Department's expenditure of \$40.4 million, we estimate conservatively that client departments and agencies provided about \$26 million toward costs associated with Crown agents, salaries, and operating and maintenance budgets in 1992-93. In our view, these arrangements affect the quality, quantity and cost of legal advisory services.

17.36 Responding to priorities. When workloads and priorities change, the Department cannot readily reallocate resources because borrowed resources usually come with the condition that they must remain dedicated to the client. One possible outcome is that resources may not be allocated according to priorities but, rather, according to the ability of clients to provide resources.

17.37 Incentives. As well as reducing managerial flexibility, the current resource arrangements reduce incentives for managing legal advisory services in the most cost-effective manner. For example, they reduce the need for the Department to justify total resource requirements to Treasury Board. In addition, there is less incentive for the Department to explore alternative resource mixes, such as different ratios among Justice lawyers, Crown agents, paralegal staff and support staff, as possible means to improve service or to reduce costs.

17.38 Client attitudes. Some client managers we interviewed resented the existing arrangements. They believe that without information on workload volumes and costs, the Department finds it easier to justify resource requirements to clients than to Treasury Board. They stated that they feel compelled to provide resources to the Department in order to get the services they need. They believe the Department's mandate is to provide legal advisory services to departments and agencies, and that it should have the resources to fulfil that mandate.

17.39 Managing people. Reviews by the Department and our own observations point to problems in people management. These include: the failure of either the clients or the Department to take full responsibility for career planning and training of borrowed

employees; difficulties in establishing long-term human resource plans; widely varying ratios of support staff to lawyers among Departmental Legal Services Units; and the isolation of borrowed support staff who have no clear sense of belonging either to the Department of Justice or to the department or agency that employs them.

17.40 Information technology. At the time of our audit, the responsibility for planning and implementing information technology was not clear. Client departments usually provided equipment, software and support. The Department also contributed some software. The results were a lack of consistency in hardware, software and support among Departmental Legal Services Units, and between them and the rest of the Department, as well as a failure to harmonize the use of information technology. For example, the importance of rapid communications in a department as decentralized as the Department of Justice cannot be overemphasized. Staff in the Departmental Units must be able to communicate readily not only with their clients, but also with other units of the Department of Justice, including Headquarters, other Departmental Legal Services Units and regional offices. However, despite efforts by the Department to install an appropriate system, many officers in Departmental Legal Services Units told us they could not communicate with other units in the Department by electronic mail.

Department's response: Some of the costs of providing legal services to departments and agencies are shared with our clients. The Auditor General has raised a number of issues relating to the nature and consequences of this partnership in legal services. The Department will undertake a study of those and the matters related to resourcing of legal services. This study will be designed to identify systematically the positive and negative features of current arrangements and options to them.

More attention is needed to formalizing partnerships with client departments and agencies

17.41 In many respects, the Department and its clients are partners when it comes to legal advisory services. As described above, the delivery of legal advisory services is supported heavily by client departments and agencies. In a climate of government-wide restraint, it is likely that these arrangements, and other aspects of the relationship, will come increasingly under review. A withdrawal of a significant proportion of client resources could cause difficulty for the Department.

17.42 In most cases, arrangements or understandings concerning the Department's relationship with clients have not been documented. We believe it is important for the Department to have clear understandings on resource issues as well as the nature and extent of services to be provided. Agreements could also cover items such as service standards, performance information to be reported to the client, arrangements for requesting legal advisory services, accommodation, information technology, and training for client staff.

Litigation Services

17.43 Litigation consumes a significant part of the Department's resources. The Department spent approximately \$95 million on litigation in 1992-93, including salary

costs for more than 1000 people. [Exhibit 17.4](#) shows that person-years allocated to litigation by the Department grew from 465 in 1983-84 to a forecasted 1045 in 1992-93, an increase of nearly 125 percent. Most of that increase has occurred in the last few years in response to increasing workloads in such areas as refugee determination and litigation related to the Charter and environmental issues. The Department's expenditures on litigation (not adjusted for inflation) increased 256 percent over the same 10-year period.

17.44 The Department is involved in three broad types of litigation - civil litigation, criminal prosecutions and tax litigation. We excluded tax litigation from our audit because much of the Department's work in that regard was covered in Chapter 21 of our 1992 Report.

17.45 Civil litigation cases involve a wide range of issues, from damage claims to contract disputes and public law issues such as native land claims, refugee determination and "Charter challenges" to federal legislation. Criminal law and procedure are within the exclusive legislative authority of the Parliament of Canada. However, provincial attorneys general prosecute most offences under the *Criminal Code*. The Department prosecutes offences under a variety of other federal statutes - offences such as drug trafficking and income tax evasion. The Department is also responsible for all criminal prosecutions in the Yukon and the Northwest Territories.

17.46 Although most litigation is handled in regional offices, Headquarters is responsible for litigation of national importance. In that capacity, it both advises and directs regional offices and conducts litigation related to criminal, tax and civil law, including such areas as constitutional, human rights, official language rights, international and environmental law. It also prosecutes war crimes and crimes against humanity.

17.47 The Department has a Litigation Committee, composed of Headquarters' senior litigation managers and certain other staff. This committee has ultimate, not immediate, responsibility for supervising all litigation. The committee monitors important cases to which the Attorney General is a party, reviews recommendations to appeal important cases, reviews proposals for the Attorney General to intervene in cases, and selects counsel to appear before the Supreme Court of Canada.

The Department has systems and practices to help ensure that it protects Crown interests and acts in accordance with consistent policy positions

17.48 We expected the Department to have systems and practices in place to provide reasonable assurance that, in conducting litigation, it protects the Crown's interests and acts in accordance with consistent policy positions. We found that the Department has a number of formal and informal systems and practices that provide this assurance:

The Department specifies the types of litigation that must be carried out by departmental counsel and those that should or could be carried out by Crown agents.

The Department has recently published the Crown Counsel Policy Manual that provides, among other things, direction on the exercise of prosecutorial discretion.

The Department has Litigation and Charter committees and a Native Advisory Group to provide direction on significant litigation and policy issues.

The Department has national co-ordinators for Charter, environmental and native litigation, and an Office of National Strategy for Drug Prosecutions.

Litigation reports summarizing important cases are distributed throughout the Department.

A large proportion of the professional staff are senior practitioners. Further, our interviews indicated considerable informal networking among departmental litigators.

We did note one area where, in our view, the Department does not have adequate assurance that it is protecting the interests of the Crown and acting in accordance with consistent policy positions - the management of Crown agents.

The Department's control over Crown agents needs to be strengthened

17.49 The Department uses "standing agents" to carry out prosecutions in areas where the Department does not have a regional office or where travel costs would be prohibitive. In addition, the Department uses standing agents in Toronto, Vancouver and Montreal for routine cases. The Department also uses "ad hoc agents" on a case-by-case basis in criminal and civil litigation. Ad hoc agents may be used for many reasons - specific expertise is required, a standing agent is not available, or a departmental counsel or standing agent has a conflict of interest.

17.50 Like departmental counsel, Crown agents have broad discretionary powers when prosecuting cases on behalf of the Attorney General. For example, agents have the power to stay proceedings and to negotiate pleas and sentences. Their decisions can affect the liberty of individuals and the effective enforcement of the law. Because of the significance of their work, it is important for the Department to have adequate control over Crown agents. We found that the Department does not have this control.

17.51 Selecting, appointing and dismissing agents. Contracts for the performance of legal services may be entered into only by or under the authority of the Minister of Justice. These contracts are not subject to the Government Contracts Regulations, which provide for some transparency by outlining the circumstances and manner in which bids are to be solicited. Although there is a mechanism for consultation between managers in the Department and the Minister's office concerning the selection, appointment and dismissal of agents, these matters are ultimately the responsibility of the Minister of Justice. Therefore, the Minister, rather than departmental managers, has primary responsibility and accountability for agents' performance.

17.52 Supervising agents. According to its 1993-94 Estimates (Part III), the Department retained 3200 Crown agents in 1992. Beyond monitoring what agents are doing, supervision extends to providing the support and guidance they need - responding to their requests and ensuring they are informed of, and acting in accordance with, the Department's positions.

17.53 The Department has concluded that, other than in exceptional cases, Crown agents lack the orientation, the specialized expertise and the national connections and presence required for some particularly important, complex and sensitive types of litigation. As a result, it has specified the classes of work that must be done by departmental counsel and those that should or could be contracted to Crown agents. However, we were told that because of resource shortages in the Department, agents sometimes litigate cases that the Department's policy requires to be handled by in-house counsel. There is no information on how frequently this happens or on what the consequences are.

17.54 Departmental documents and our interviews with staff indicate that in most cases standing agents receive little supervision. We recognize that for the majority of routine cases little supervision is required; it would not be cost-effective to scrutinize each and every case being handled by a Crown agent. Nevertheless, the Department needs, and recognizes the need, to have at least some systematic information on what agents are doing and how they are performing. Some lawyers in regional offices indicated that they may not even be aware of cases in their regions being handled by standing agents unless and until they get a request for advice.

17.55 The Department should strengthen its management of Crown agents.

Department's response: We have had many of the matters relating to the use of crown agents reported by the Auditor General under review for many years. About two years ago, the Department struck a senior level Steering Committee to develop and direct a program to improve our management, control, payment and supervision of agents. As a result of the work of that Committee, we have identified the substantive and managerial areas in need of change, developed plans to address them and are pursuing them as a priority activity.

Basic management control information is lacking

17.56 As is the case with legal advisory services, an overriding problem in managing litigation services is the lack of basic management control information. Information on workload, costs and performance is needed to plan for the future, to set priorities, to determine and justify resource requirements, to allocate resources, to analyze service delivery alternatives and to manage and account for performance. The lack of information limits the Department's ability to discharge these fundamental management responsibilities effectively.

17.57 The Department has been aware of this problem for some time. A 1987 evaluation of litigation services revealed that the Department had no way of counting the number of cases handled by its staff and agents. Consequently, it could not begin to assess its workload. With respect to civil and criminal litigation, the situation remains much the same today.

17.58 Information for planning and resource allocation. The 1987 evaluation of litigation services concluded that it was essential for the Department to make reasonable planning projections about future workloads and to "develop the means to allocate

resources more rationally" among and within offices. The Department still does not have the means to do this.

17.59 To forecast future resource requirements, an organization must know its workload, as well as the resources expended on past and present workloads. The Department has only limited information on its litigation workload and does not have any information on the resources required to handle various types of litigation.

17.60 Regional offices request resources as part of the Department's multi-year operational planning process. But there are no standard data to support these requests. We recognize that quantitative workload indicators cannot perfectly reflect the actual workload of regional offices. However, the Department's ability to manage its workload and fairly allocate resources at the corporate and local-office levels is impaired by the absence of standard data on the number and types of matters handled and their cost.

17.61 Information for analysis. The Department recognizes the need to seek alternatives to litigation and to the way it delivers services. To that end, it has undertaken some relevant studies. However, lack of information makes analysis difficult. For example, the Department recently completed a comparative analysis of costs for in-house counsel and Crown agents in respect of certain types of cases. The major difficulty in carrying out this study was that the quantity and quality of management information was, according to the authors, "extremely poor". The authors noted:

"... it is clear that better record-keeping and data collection will be needed. Without more detailed data... the Department will never be in a position to assess the cost-effectiveness of its work in a satisfactorily definitive manner."

17.62 This comment could also apply when considering other service delivery options. We note that the Department has begun to examine alternatives, including: cost recovery; greater use of paralegal staff; the use of alternative means of dispute resolution; more formal arrangements for sharing drug prosecution responsibilities with the provinces; and the "Director of Public Prosecutions" model used in some jurisdictions to enhance the independence of the Attorney General. The Department recognizes that a thorough analysis of alternatives, and decisions about them, will require reliable information.

17.63 Information for accountability. Departmental managers at all levels lack systematic, quantitative performance information with regard to litigation. This limits their ability to manage for improved performance and to account for results. We recognize that it is intrinsically difficult to measure performance in litigation, but note that experience in some other jurisdictions indicates that the difficulties are not always insurmountable. We note, too, that the Department has developed a draft Operational Plan Framework that identifies potential performance indicators such as the cost of cases litigated, the number of cases litigated per lawyer (by level of complexity), client satisfaction and case outcomes. However, the Department does not yet have the information required to make effective use of these kinds of performance indicators.

Department's response: The Auditor General has recognized that " ...It is intrinsically difficult to measure performance in litigation." Quantification gives some appreciation of the work being done, but in order to give a complete picture, qualitative assessments will continue to be important.

It must be noted that, in general, both legal services and litigation provided by the Department are in response to a specific need of the client at a given time. Experience shows that it is extremely difficult to forecast specific resource requirements that fluctuate substantially from year to year depending on factors often out of our control. We will develop a plan to secure the historical information relating to workload, costs, and performance that is useful and necessary.

There is insufficient incentive to manage the cost of litigation services

17.64 The Department has little control over the volume or nature of its litigation workload. Any reduction in the cost of providing litigation services, therefore, will have to come mostly from the way the Department uses its resources. However, under the present system, the Department's incentive to control the costs of providing litigation services is limited. Workload pressures on the Department's counsel can be relieved by using Crown agents; moreover, the costs of this safety valve are usually borne by client departments and agencies. For example, agents who conduct drug prosecutions under the *Narcotic Control Act* or the *Food and Drugs Act* are paid by the Department of National Health and Welfare. In 1992-93, clients paid an estimated \$31 million in Crown agents' fees for litigation.

17.65 In addition to paying for Crown agents, some client departments provide funds for the Department to hire lawyers who will work exclusively on litigation involving the client. There are approximately 40 of these positions. We estimate that expenditures by clients on Crown agents and on lawyers' salaries added approximately \$34 million to the \$95 million spent by the Department on litigation in 1992-93.

17.66 As we noted in assessing similar arrangements for legal advisory services, the divided responsibility for costs does not promote accountability. Nor does it ensure an adequate incentive to seek the most cost-effective means of delivering service.

17.67 We noted earlier that resource pressures sometimes force the Department to use Crown agents to litigate cases that the Department's own policies require to be handled by in-house counsel. With control of the funds that clients now spend on agents, the Department would have greater flexibility in using agents or in-house counsel, as appropriate. If the profile of litigation work required more in-house counsel and fewer agents, or if in some areas of the country it would be more cost-effective to use in-house counsel, the Department could use funds otherwise spent on agents to hire additional counsel. However, even with increased flexibility, reliable information would be a prerequisite for making decisions that lead to the most cost-effective use of resources.

Information Technology Management

17.68 The Department recognizes that effective use of information technology can help it meet growing and costly demands for its services in a period of continuing resource restraint. Accordingly, the Department sees the implementation of what it has described as an "automated information environment" by 1996-97 as a key element in improving its management capability and productivity, and in maintaining the quality of the services it provides to government.

The Department will have invested about \$78 million in information systems in the eight-year period ending in 1996-97

17.69 The Department's Executive Committee approved an Information Management Strategy in 1989. In 1990, the Department requested funding from Treasury Board to implement the strategy. Treasury Board provided \$8.5 million for the period 1989-90 to 1991-92 to allow the Department to design and implement several pilot projects in Phase I of its Strategic Plan for Information Management. In 1992, the Department received approval for a further \$33.7 million from Treasury Board to implement systems in Phase II. The Department plans to seek an additional \$6.8 million from Treasury Board to replace and enhance existing program administration and resource management systems by 1996-97. This would bring Treasury Board's total investment in the Department's Information Management Strategy to \$49 million.

17.70 The Department anticipates that, in addition to the new funding approved by Treasury Board, it will invest a total of \$29 million from its own budget by 1996-97, principally for managing the strategy. Therefore, by the time the Information Management Strategy is scheduled to be implemented in 1997, the Department will have spent a total of about \$78 million.

17.71 [Exhibit 17.5](#) shows how the \$78 million will be used. It shows the funds allocated to Phase I, to the main "business areas" and applications in Phase II, and to project management and support.

17.72 The Department has agreed to repay Treasury Board's Phase II investment of \$33.7 million by 2005-06 out of anticipated productivity gains, by cutting \$4.5 million annually from its budget, starting in 1997-98. We note that with such a long payback period, the technology and applications will likely be obsolete before their cost has been repaid.

Information technology plans are ambitious; it will be important to get key things right

17.73 The Department plans to launch about 20 systems development projects over the next four years. These will affect virtually every staff member. In the course of our audit we were unable to identify any comparable organizations in the private or public sectors that had applied information technology and information management systems to the practice of law on the scale proposed.

17.74 This does not mean that it cannot be done. It does mean, however, that there are no successful models to emulate and very little experience available. The strategy as a

whole, and individual projects, will have to be managed carefully to achieve the objectives of the strategy. Several aspects deserve close attention.

17.75 Senior management commitment and attention. Private- and public-sector experience in developing successful systems consistently shows that ongoing commitment and attention by senior management is essential. The Department has recently taken steps to demonstrate senior management's commitment.

17.76 The Assistant Deputy Minister, Corporate Management, Policy and Programs has been designated Project Leader for the Information Management Strategy. The Project Leader is accountable directly to the Deputy Minister for the overall management and success of the strategy. In August 1992, the Department established an Information Management Advisory Committee, composed of senior managers from each of the sectors; the committee gives advice to the Project Leader in setting priorities and allocating resources.

17.77 The responsibility, authority and accountability for the Information Management Strategy are therefore clear. However, we are concerned that the Project Leader, who is charged with the overall management and success of the strategy, has many other responsibilities - personnel and financial management, internal audit and evaluation, security services, administration and corporate planning. In early 1993, the Project Leader assumed additional responsibility for a variety of activities and major expenditures when the Corporate Policy and Programs group was amalgamated with the Corporate Management Sector. The Project Leader's wide range of diverse and important responsibilities calls into question the amount of attention that he can reasonably be expected to give to managing the Information Management Strategy.

17.78 Integration of information technology plans with the plans for litigation and legal services. At the time of our audit, the Department did not have comprehensive plans for litigation and legal services. As a result, it has not been possible to integrate plans. The Department has recently decided to implement a corporate planning process that will include developing plans for the Litigation and Legal Services Sectors.

17.79 When these Sector plans are prepared, it will be important to integrate information technology plans with them to ensure that the plans will reinforce each other. For example, plans for specific operational applications of information technology must ensure the capture of information needed for corporate management purposes. However, the Department is still identifying its management information needs.

17.80 Analyzing and simplifying work. Many organizations are starting to recognize that simply automating existing processes rarely produces significant gains. Much of the real and continuing benefit from information technology is realized when work processes are closely analyzed. Such analysis can lead to unproductive processes being eliminated or changed, or completely new ways of service delivery being identified that make optimum use of information technology.

17.81 The Department is currently involved in a major effort to put in place an automated case management system for litigation at an estimated cost of \$10 million. The Department expects this system to improve efficiency significantly. But the Department has not analyzed existing litigation practices to determine whether these could be streamlined before selecting an automated case management system.

17.82 The role of "systems owners". "Systems owners" are responsible for ensuring that information technology delivers what front-line legal professionals need to cope with work demands. The Department expects key systems users to assume the role of systems owners, with ultimate responsibility for the success of specific systems development initiatives.

17.83 However, at the time of our audit, the management framework identified in planning documents extended only to technical support resources provided by the Information Management and Technology Division in the Corporate Management, Policy and Programs Sector. The systems owners had not been identified, and their pivotal role, which will require freeing them from some of their regular professional work, had yet to be articulated or planned in detail.

17.84 Impact on people. The literature and our own interviews in the Department show that many lawyers are conservative and sceptical about using information technology. This underlines the importance of accompanying a systems development effort that could fundamentally alter the work of the Department's staff with a thorough analysis of potential impacts on people and with plans for managing the change.

17.85 For managing the change, some of the questions that need to be answered are - how will work change? what new skills will be required? how will new skills be acquired? will the resource mix have to change? who will need to be trained, and when? what support arrangements will be needed? We found that the Department has not yet undertaken such analyses in most key areas that will be affected by planned projects.

***Department's response:** The Department's Information Technology plans cover the next five years. A comprehensive approach to their development was taken so that we would be able to chart and take account of the full range of what we were to do and accomplish. As a result, the plan is necessarily general on the systems development process we will follow, including the modelling that will be done in order to identify work that can be simplified or eliminated. The projects and activities in that plan interrelate. In order to ensure they will be managed in an integrated, fully effective way, a new directorate has been created reporting to the Assistant Deputy Minister, Corporate Management, Policy and Programs. The Director General, Information Management and Technology and the organization and people supporting her have been assigned important responsibilities in managing the Information Management Strategy. The Assistant Deputy Minister, however, will continue to be the project leader and in this role to chair the Information Management Advisory Committee so as to ensure that senior managers are aware of the responsibilities they must discharge, as systems owners, as the Information Technology Plan's implementation evolves.*

Corporate Issues

The Department has started to respond to the challenges it faces

17.86 The Department issued a mission statement in 1990. This indicates, in broad terms, what the Department wants to achieve (see [Exhibit 17.6](#)). A set of "Strategic Directions", established in 1991, focussed on how to attain the goals that are implicit or explicit in that statement.

Exhibit 17.6

Department of Justice

Mission Statement

MISSION

The mission of the Department of Justice is to:

- support the Minister of Justice in working to ensure that Canada is a just and law-abiding society with an accessible, efficient and fair system of justice;
- provide high quality legal services and counsel to the government and to client departments and agencies; and
- promote respect for rights and freedoms, the law and the Constitution.

Source: Department of Justice

17.87 A series of improvement initiatives is being undertaken within the context of the "Justice in the 1990s" program. This program comprises a number of projects in three priority areas: managing the law, managing resources and managing people. Other elements of the Department's response focus on a Shared Management Agenda with Treasury Board and the results of a review of the justice and legal system carried out jointly by the Department of Justice, the Treasury Board Secretariat and the Office of the Comptroller General in 1992.

17.88 Under the Shared Management Agenda, the Department has agreed to work toward establishing processes for setting priorities, managing workload and allocating resources. In December 1992, Treasury Board approved recommendations arising from the first phase of the joint review of the justice and legal system, many of which deal with matters we addressed in our audit. The recommendations call on the Department to: review alternative dispute resolution mechanisms; examine and adjust its resource mix; examine the use of market-based incentives to rationalize demand for service; develop a management framework for assessing priorities and allocating resources; and seek ways to increase efficiency through automation. Work on these and other recommendations of the joint study is under way in the Department.

A corporate planning process is being implemented

17.89 In an organization with diverse and complex professional responsibilities, and an external environment as challenging as that of the Department, a corporate planning process provides a framework to assess and set priorities, and to allocate resources accordingly. As well, it provides a basis for co-ordinating various action plans - such as Sector plans, human resource plans and information technology plans - to move the organization toward common goals.

17.90 At the time of our audit the Department had neither a corporate plan nor equivalent plans at the Sector level. However, in January 1993 the Department's Executive Committee decided to implement a priority-setting and planning process. The key elements of this process are the development of the first corporate plan for 1994-95, Sector plans consistent with the corporate plan, and operational plans at other management levels, as determined by Sector Heads.

17.91 In earlier sections dealing with legal advisory services and litigation, we identified a serious lack of basic management information on workload, costs and performance. Such management information will be critical in setting priorities and allocating resources in the context of the proposed corporate planning process.

The Department will have difficulty getting full benefit from Operating Budgets

17.92 Operating Budgets are part of a new budgeting system commencing in 1993-94. Under this system, there is no central control over "person-years". Each program has a single operating budget covering salary, operating and minor capital funds; managers can shift funds between salaries, for example, and other budget items. This gives departments flexibility to deploy the mix of resources that can accomplish objectives at least cost.

17.93 However, the lack of management information severely limits the Department's ability to make decisions about the most appropriate resource mix. Further, the funding arrangements for the delivery of litigation and legal advisory services described earlier, under which client departments and agencies control about 30 percent of total resources, reduce the Department's flexibility to change the resource mix. We are concerned that this combination of circumstances will impede the flexible resource management that Operating Budgets are meant to facilitate.

Accountability to Parliament needs strengthening

17.94 Parliament votes funds for specific purposes. The Estimates should provide parliamentarians with the information they need - information on what departments are doing with the funds provided and what results they achieve.

17.95 Our review of the Department's Part III of the Estimates shows that Parliament receives little information on the Department's workload or performance. With respect to legal advisory services, the 1993-94 Part III reports only the finding from the 1990 client satisfaction survey: that 85 percent of respondents were very satisfied with the services received. For litigation, Part III presents some information on the number of cases handled - for example: the number of appeals heard by the Supreme Court of Canada and

the Federal Court of Appeal in which the Crown was represented; the number of income tax appeals and tax evasion cases; and the number of extradition and rendition requests. However, these cases represent only a portion of the litigation workload.

17.96 Parliament is not aware of the full cost of delivering litigation and legal advisory services. As described earlier, significant proportions of the costs of these services are borne by client departments and agencies. The Department is not obliged to report in its Part IIIs the costs borne by client departments and agencies - and does not do so. Therefore, Parliament does not know these costs. We estimate conservatively that information available to Parliament for 1992-93, for example, understated the costs of delivering litigation services by 26 percent and legal advisory services by 40 percent.

Department's response: We have already noted our work on defining and meeting our current needs for information on workload, costs and performance. Once those are identified and systems have been put in place to meet them, we will be making significant changes to what we report in Part III of the Estimates. In the meantime, we will be reviewing the desirability of reporting total governmental expenditures on legal agents.

17.97 The Department should:

define its minimum information needs for managing litigation and legal advisory services, and develop the means for collecting and reporting that information;
seek full responsibility for the resources it uses to deliver litigation and legal advisory services; and
improve its accountability to Parliament for delivering litigation and legal advisory services by providing Parliament with broad-based indicators of workload and performance.

There is urgency about the matters we have raised

17.98 Increasing workload and resource restraints have brought the Department to a point where it has no alternative but to set priorities, search actively for alternative ways to deliver services, and identify and implement means to get more out of available resources. The Department has started to do these things, but it needs to continue strengthening its basic management tools if it is to succeed. These include sound management information on workload and costs, meaningful measures of performance and control over resources. In our opinion, failure to move urgently on these matters will put at risk the responsiveness and quality of the Department's litigation and legal advisory services.

Chapter 18

Department of National Health and Welfare

Programs for Seniors

Main Points

Introduction

- Background
- Audit Objective and Scope

Observations and Recommendations

- General Matters
 - Seniors programs lack co-ordination
 - Service standards have not been implemented
 - The quality of program reviews varies
 - Accountability documents are not doing the job
- Pension Programs
 - Pension program costs will rise significantly in future years
 - Little information is produced to improve public understanding of the Canada Pension Plan
 - The management framework for the Canada Pension Plan is unstructured
 - Serious deficiencies exist in the management of pension overpayments
 - Two program areas generate the majority of overpayments
 - The Canada Pension Plan appeals process is severely backlogged and inefficient
 - A major redesign of pension program delivery is under way
- Seniors Strategy
 - The 1988 Seniors Strategy was poorly planned and organized
 - Contribution arrangements for seniors programs were well managed
 - The Seniors Strategy was renewed without a full accounting for the results of the first five years

Exhibits

- 18.1 Canadian Population over 65
- 18.2 Program Expenditures for Seniors Programs, 1992-93
- 18.3 Scope of the Audit
- 18.4 Programs for Seniors – Organization Chart
- 18.5 Seniors' Sources of Income
- 18.6 Percentage of Seniors below Statistics Canada low-income Cutoff
- 18.7 Forecast of Basic Old Age Security Pension Expenditures

- 18.8 The Canada Pension Plan
- 18.9 Projected Annual Pension Overpayments
- 18.10 Income Security Programs Redesign Project
- 18.11 Income Security Programs Redesign Cost Breakdown
- 18.12 Components of the Seniors Strategy

Department of National Health and Welfare

Programs for Seniors

Assistant Auditor General: Elwyn Dickson

Responsible Auditor: Bill Rafuse

Main Points

18.1 Seniors are one of the fastest-growing population segments in Canada. Expenditures for seniors programs administered by the Department of National Health and Welfare were \$30 billion in 1992-93. Benefits paid under the Old Age Security, Guaranteed Income Supplement and Canada Pension Plan programs accounted for 99 percent of the total.

18.2 Within the Department, the development of seniors policy and programs is uncoordinated and fragmented; some duplication and overlap result. The Department plans to develop a federal policy on aging by 1995, in part to encourage departments and agencies to act collaboratively.

18.3 Service standards for seniors programs have yet to be developed in accordance with government policy. The Estimates Part III and annual reports are not fulfilling their role as accountability documents for these programs. Commitments to the Public Accounts Committee concerning tabling of statutory annual reports for the pension programs were not met.

18.4 The Old Age Security and Canada Pension Plan programs have been successful in partially replacing income lost on retirement and have contributed in large part to the reduction of poverty among seniors. The cost of these pension programs will increase rapidly in step with the aging of the Canadian population. More and better information on the operations of these programs, including their future costs, is necessary for informed consideration of their effectiveness and affordability.

18.5 We observed significant deficiencies in the management of the Canada Pension Plan program. Overpayments in the Canada Pension Plan and Old Age Security programs range from \$120 million to \$220 million each year. Existing systems and procedures are inadequate to identify, control and collect these overpayments.

18.6 The quality and level of service for Canada Pension Plan disability appeals and pensions telephone service is unacceptable to both departmental managers and the public. A major project to improve the administration and delivery of the pension programs by

1997 is well under way. It is too soon to know if the deficiencies we identified will be addressed and rectified.

18.7 The \$200 million Seniors Strategy was established in 1988 without a needs assessment and with little planning for implementation. Accountability for the results of the Strategy was not specified, and the overall effectiveness of this initiative is unknown. The Strategy was renewed in 1993 without reliable, complete and timely information on the results of the first five years of spending.

18.8 The Department ensures that agreements are properly established for projects funded under New Horizons and the Seniors Independence Program and that program recipients comply with the terms and conditions of the arrangements. The administration costs associated with these programs, however, are high.

Introduction

18.9 In Canada, the term seniors generally refers to persons who are 65 years of age and older. This age-related definition has developed from old-age security pension legislation and from customary retirement practice.

18.10 Certain programs delivered by the Department of National Health and Welfare are designed to promote and strengthen the income security of Canada's seniors. The Department also supports the development of a broad range of services to meet the changing needs of seniors, with particular attention paid to health and social integration.

18.11 Seniors are one of the fastest-growing population segments in Canada. Projections by Statistics Canada indicate that the number of seniors will increase until the early part of the next century (see [Exhibit 18.1](#)). The population over 65 years of age was 3.2 million (11.6 percent of the Canadian population) in 1991 and is projected to rise to 6.6 million (18.1 percent) by 2021.

18.12 In our 1985 Report, the chapter on public pension management focussed on the pension programs - Old Age Security and the Canada Pension Plan - administered by the Department of National Health and Welfare. The audit assessed the adequacy and accuracy of financial information provided to Parliament and evaluated the systems and procedures in place for managing these programs. Prior to that, in 1982, we reported on the administration of the Department's New Horizons program.

Background

18.13 The *Constitution Act* does not specify either federal or provincial responsibility for seniors programs. Consequently, many departments and agencies at all levels of government share the responsibility for policy setting and program delivery for publicly funded programs for Canada's seniors. The federal government has jurisdiction over and delivers health and social programs to classes of individuals as defined in section 91 of the Act, such as veterans and Indians, including the seniors in these groups. Generally speaking, however, the provinces and territories are primarily responsible under the Constitution for providing health and social programs to Canadians of all ages.

18.14 National Health and Welfare's involvement in health and social programs for seniors originates mainly from the broad provisions of the *Department of National Health and Welfare Act*. The application of these provisions to income support programs required amendments to the *Constitution Act*. The first, in 1951, provided for federal participation in old-age security pensions. The second, in 1964, related to the Canada Pension Plan and the decision to include survivors and disability benefits irrespective of age.

18.15 The Department's programs for seniors reflect this broad mandate. The principal programs and their expenditures are presented in [Exhibit 18.2](#).

Audit Objective and Scope

18.16 Objective. The objective of the audit was to determine whether the programs for seniors administered by the Department of National Health and Welfare were managed in compliance with legislation and other authorities and with due regard to economy and efficiency, and whether the effectiveness of programs was measured and reported. This included determining whether reporting and accountability obligations to Parliament, central agencies, seniors and the public were being fulfilled.

18.17 Scope. The scope of the audit included all National Health and Welfare seniors programs (see [Exhibit 18.3](#)). Certain benefits payable under the Canada Pension Plan are not directed toward seniors. These include disability and orphans benefits, as well as survivors pensions paid to those under 65 years of age. We reviewed the administration of the Canada Pension Plan in general and did not focus on these non-seniors programs. However, in the areas of pension overpayments and appeals, we found that disability cases were a major concern. Therefore, to provide a complete picture of the issues in those two areas, we have included these findings in this chapter.

18.18 This year's Report of the Auditor General of Canada includes chapters on the government-wide audits of internal audit and program evaluation. National Health and Welfare was one of several departments examined in these audits. The internal audit and program evaluation functions at National Health and Welfare were reviewed in general, with particular attention to recent work on seniors programs. Our findings specific to these programs are reported in this chapter.

18.19 During the planning phase of the audit, we found that there was no "elder care" program in place for First Nations communities. Although certain services are provided when necessary, the Department has not allocated resources, developed policies, defined services or set standards for home nursing. However, a consultation process with First Nations communities is under way to determine the health care portion of home care needs for seniors on reserves. In the absence of a specific program and in light of this current initiative, we did not include First Nations elder care in our audit scope.

18.20 The Canada Assistance Plan was also not included in the scope of the audit. Under this program, the federal government shares with the provinces and territories the cost of providing social assistance and welfare services to persons in need. A small portion of these payments represents cost sharing for seniors in long-term care institutions. We reported on the Department of National Health and Welfare's administration of the Canada Assistance Plan in 1989 and conducted a follow-up in 1991.

Observations and Recommendations

18.21 The significant findings of our audit are described in this section. The observations present first the issues that are common to all seniors programs, then those that address the pension programs, and finally those that deal with the community-based contribution programs.

General Matters

Seniors programs lack co-ordination

18.22 We examined the co-ordination of policy and program development for seniors programs within the Department of National Health and Welfare (see [Exhibit 18.4](#)) and in relation to other federal initiatives for seniors. Also, since the provinces have jurisdiction for health and social services, we examined federal-provincial consultation mechanisms.

18.23 We concluded that within the Department of National Health and Welfare there was a lack of central co-ordination for seniors policy and program development and communications.

18.24 Several program changes introduced in 1988 through the Seniors Strategy have resulted in a diffusion of responsibility within National Health and Welfare. The creation of the position of Minister of State for Seniors in 1987 resulted in increased communications and programming activity related to seniors. The Seniors Secretariat was established to increase the level of communication with seniors and to provide services to the new Minister of State. Two new seniors programs were created, and the funding level of a third was expanded. Funding was also increased for the National Advisory Council on Aging and the Department's Policy, Planning and Information Branch.

18.25 An important thrust of the 1988 Seniors Strategy was to improve communications with seniors. The Seniors Secretariat and the National Advisory Council on Aging were each given responsibilities in this regard, and funds were allocated to improve telephone service for the pension programs. The number of publications directed to and about seniors increased significantly during the five-year period of the 1988 Seniors Strategy. Foremost among them is the Seniors Guide. It provides information on the various federal programs and services available to seniors and lists addresses and telephone numbers of departments and agencies.

18.26 Since 1988, two million copies of the Seniors Guide have been distributed, and every month it is mailed to some 19,000 new Old Age Security pension recipients. In addition, the Seniors Secretariat produces newsletters on a regular basis, and information pamphlets are produced for each of the seniors programs. One objective of these communication activities is to make seniors more aware of programs and their requirements and benefits. However, the Department does not have current information on its success in achieving this objective.

18.27 More recent initiatives have also affected the administration and delivery of seniors programs. Examples are the merger of the Social Services Branch and the Health

Services and Promotion Branch, and the shift of responsibility for program delivery to the regions. The result has been a consolidation of some activities related to seniors programs, with further fragmentation of responsibility for others. Several key activities remain unco-ordinated, and there is some duplication of effort.

18.28 For example, policy development related to seniors issues is carried out independently in several different areas of the Department. Liaison with other departments and jurisdictions also is not co-ordinated. The roles and activities of the National Advisory Council on Aging and the Seniors Secretariat overlap in critical areas, particularly in liaison with national, provincial and local associations, institutions and groups involved in aging or representing the aged, and in the research and communication of information on issues relevant to seniors. Communication with seniors has been given high priority in recent years. However, co-ordination between the communications related to income security programs and those directed toward other seniors programs could be improved.

18.29 We also found a lack of co-operative program planning with the provincial governments, particularly related to New Horizons and the Seniors Independence Program. The Seniors Secretariat and National Health and Welfare's regional offices carry out similar roles in priority setting and planning for seniors programs.

18.30 The Department has acknowledged that current program planning and delivery take place in an unco-ordinated and fragmented fashion. The National Advisory Council on Aging has called since 1991 for "a national multi-sectoral (income security, health, social services and housing) aging policy that involves all levels of government." The 1993 Seniors Strategy, "Aging Together", includes the development of a federal policy on aging to enable parties to act responsively and collaboratively. The intended approach is to prepare a federal discussion paper for public consultation leading to a policy framework, guiding principles and action plans by the spring of 1995.

Service standards have not been implemented

18.31 The level and quality of service is an important issue for seniors and for the managers of programs for seniors. Public service reform, with its emphasis on a more client-centred approach to business, is leading to changes in traditional management practices and controls. The Department's own reform initiative, "Excellence and Renewal", calls for managers to be accountable for establishing service standards, for monitoring program delivery against these standards and for ensuring that the results are communicated to clients and staff.

18.32 The 1992 federal Budget specifically called for departments to develop and publish standards for service, based on consultation with clients, that clearly spell out service levels and costs. The Treasury Board defines these standards as performance objectives for the delivery of government products or services to the public. Good service standards are client-oriented and might address, for example, delivery dimensions such as timeliness, accessibility and accuracy.

18.33 The Department set up a service standard committee in 1992 to ensure that all branches and regions develop and implement service standards in keeping with the federal service standard initiative. In phase one, the committee was to focus on service standards that impact on individual Canadians. Some work has been undertaken by the Income Security Programs Branch, but the committee itself has been inactive, and little of substance has been accomplished. The latest Estimates planning document identifies the development of an accountability framework, with service standards and performance indicators, as a new initiative for 1993-94.

18.34 We concluded that in the area of service standards, the Department has suffered from a lack of sustained focus and of continuity of leadership. The development and publication of service standards and the reporting of performance against these standards would help to focus management and client attention on the quality and level of service being offered.

18.35 Currently, the Department is providing a poor quality of service to its clients in the areas of Canada Pension Plan medical appeals and telephone calls regarding pensions. In fact, client service for Canada Pension Plan appeals has been declining for many years (see paragraphs 18.83 to 18.88). We were advised that service standards for appeals will not be implemented until the current backlogs have been eliminated.

18.36 For seniors who are dealing with the Department on pension matters, most of the contact is with the 69 full-time and 208 part-time client service centres by phone, by letter, or in person. No doubt the greatest frustration is with the telephone service. This is not a new problem. We commented on the poor level of telephone service in our 1985 Report, noting that the Department had identified the problem in 1977 and that it was getting worse. That trend has continued.

18.37 The Department's client service centres and regional offices handle four million telephone calls a year, but another seven million are dropped or are abandoned by callers. The Department's 1993-94 operational plan reported that "ongoing monitoring of the delivery of telephone service to clients indicates that the level and quality of service are continuing to decline." The plan stated that technological and organizational change would provide marginal improvement only. The solution may lie in reducing the need to phone the Department.

18.38 We found that the Department had not determined why so many seniors try to contact the Department by telephone. Some of the reasons lie in ineffective communications and inefficient administrative practices such as those described in this chapter. One such problem is related to forms design. There are fourteen Old Age Security and Canada Pension Plan forms that seniors may be required to complete. Only one of these, the Old Age Security application form, conforms with the Department's own guidelines for communicating in print with seniors.

18.39 The lack of service standards and of regular measurement of service levels contributes to a lack of accountability for program performance. Seniors, the public and

parliamentarians are unable to determine what reasonable service expectations are for these programs and how well the Department is meeting them.

18.40 Under the heading of service standards, the Estimates Part III for 1993-94 presents accountability information on the level and quality of telephone service for income security programs. We found this information to be incomplete. It does not state what the service standard is, or indicate that the level and quality of service is declining. Clearly, in this case, the Estimates are not providing the accountability called for by the government's service standards initiative or the Department's own client service action plan.

The quality of program reviews varies

18.41 Government policy requires that departments periodically conduct a systematic review and appraisal of management policies, practices and controls and evaluate the efficiency and effectiveness of their programs. The Department of National Health and Welfare has both an internal audit group and a program evaluation group to fulfil these requirements.

18.42 This year we conducted government-wide reviews of these two functions (Chapters 7, 8, 9 and 10), and National Health and Welfare was included in both of these reviews. To link these reviews with our audit of seniors programs, we examined recent audit and evaluation reports on both pension and contribution programs for seniors.

18.43 We examined three audits of seniors programs conducted by the Department's Internal Audit Division and concluded that, in each case, the assignment was adequately planned and there was sufficient documentation to support the audit findings. We did identify opportunities to improve the risk assessment conducted in support of the annual internal audit plan.

18.44 We examined planning, coverage, quality, findings and use of results from evaluation studies of seniors programs. We found that the respective 1989 and 1992 evaluation studies of New Horizons and the Seniors Independence Program did not meet our criteria in those areas. Some of our findings with respect to these studies are presented in paragraphs 18.106 to 18.108.

18.45 We found that the 1992 Old Age Security evaluation appropriately covered the expected effects of the program. We concluded that the evaluation findings were reliable. The evaluation study was completed only recently, however, which limited our ability to assess its use by the Department.

Accountability documents are not doing the job

18.46 The Department does not have a process in place to independently validate the information contained in the Estimates Part III and departmental annual reports. We found that management is signing the Part III representation letter without assurance from

any independent review. Although the internal audit group identified this risk and has proposed such a review for several years, it has never been carried out.

18.47 The management representation is a statement confirming the quality of the Part III process and product. The Department, however, views the management representation primarily as a transmittal letter for the Part III submission. We see the representation as having the much more important role of attesting to the integrity of the Department's Estimates submission.

18.48 In the course of our audit, a number of deficiencies in the Part III information related to seniors programs came to our attention. For example, the reporting of program evaluation findings was unsatisfactory in terms of both timing and content. Several other deficiencies are described in this chapter.

18.49 The Department has a long history of being late in tabling its annual reports. Delays in tabling the annual reports required for the Canada Pension Plan and the Old Age Security programs diminish accountability for the seniors programs. The Public Accounts Committee, in its Eighth Report, in September 1992, commented, "Annual reports on major programs such as Old Age Security, the Canada Pension Plan and Family Allowance are all late. Your Committee wonders whether Health and Welfare Canada has demonstrated the will to produce its statutory reports on time by putting in place the appropriate mechanisms." Based on our review of the situation, the answer appears to be no.

18.50 The Department made a commitment to the Public Accounts Committee to table the 1989-90 and 1990-91 annual reports for Old Age Security and the Canada Pension Plan in October 1992. This commitment was not met. The Department now plans to table these reports before the end of December 1993. We believe that reports tabled up to three years late are of little value to parliamentarians or others.

18.51 To improve the overall planning for seniors programs and the reporting of results, the Department should:

in developing the federal policy on aging, ensure the co-ordination of planning, delivery and communications for pension programs and other seniors programs;
establish service standards in accordance with government policy and report performance against these standards to Parliament and the public; and
ensure that the information on seniors programs contained in the Estimates Part III is accurate, complete and presented in a meaningful way, and that statutory annual reports are tabled on a timely basis.

Department's response: The need for better co-ordination has been recognized by Health Canada and Human Resources and Labour Canada. In fact, two processes are already under way which examine how activities are co-ordinated. Both departments are collaborating on an aging/seniors policy review and Health Canada has initiated another

strategic review that will include an assessment of experimental and developmental programming, including seniors programs.

Health Canada agrees that a great deal of developmental work is still required regarding service standards and is committed to making significant progress in the next year.

Health Canada will review this recommendation, in the context of government restructuring, to determine what changes are needed in the Estimates. A post-tabling, independent review will also be considered; it would lead to changes, if required, one year in arrears. In addition, the need for improvement in the timeliness of submitting statutory annual reports is recognized.

Pension Programs

Pension program costs will rise significantly in future years

18.52 Public pensions are the most important source of income for the majority of Canada's seniors ([Exhibit 18.5](#)). Almost one third of their incomes in 1991 came from Old Age Security and Guaranteed Income Supplement benefits. As the Canada Pension Plan and the Quebec Pension Plan, both introduced in 1966, have matured, they have provided an increasing percentage of seniors' income. These plans accounted for approximately 17 percent of seniors' income in 1991.

18.53 It is generally accepted that the pension programs have been effective in meeting their objectives of partially replacing income that is lost on retirement and reducing the level of poverty among the elderly. The Economic Council of Canada, in its 1992 report entitled *The New Face of Poverty* , stated, "Today, senior citizens are much better off than were their parents when *they* retired. . . . Most of this lessening in the overall presence of poverty reflects a major reduction in its incidence and depth among the elderly population, thanks to better income security programs for those aged 65 and older."

18.54 A recent evaluation of the Old Age Security program carried out by the Department reached similar conclusions. The 1992 evaluation report concluded that, in terms of adequacy and earnings replacement, the program was generally fulfilling its role within the retirement income system. A program evaluation of the Canada Pension Plan is now under way. [Exhibit 18.6](#) shows the improvement in seniors' income status over the ten-year period from 1981 to 1991.

18.55 Benefits paid under the Old Age Security and Guaranteed Income Supplement programs in 1992-93 totalled \$19.1 billion. Canada Pension Plan benefits, excluding disability and orphans payments, were \$10.7 billion in the same year. Over the last five years, these benefits have grown from a total of \$22 billion to \$30 billion. The rapid increase is the result of inflation (both programs are fully indexed to the consumer price index) and the greater number of seniors, who are also living longer.

18.56 Like the Canada Pension Plan, Old Age Security is a pay-as-you-go pension program - in fact, even more so, as Old Age Security does not have a contingency reserve such as the Canada Pension Plan has. Old Age Security benefits are paid on a current basis from general revenues of the government. The aging of the Canadian population (that is, the increasing percentage of the population over age 65) will have doubled the real (constant dollar) cost of the Old Age Security program by 2021 (see [Exhibit 18.7](#)).

18.57 The same demographics will also double the cost of the Canada Pension Plan program over roughly the same period. In this case, however, the increased cost will be borne by the contributors to the Plan. As a result, today's combined (employer and employee) contribution rate of 5 percent will double by 2016 and climb to 13 percent by 2030. The payment of future Old Age Security benefits, like Canada Pension Plan benefits, is dependent on future generations being willing and able to pay the contributions required. Information on future costs should be readily available for both programs.

Little information is produced to improve public understanding of the Canada Pension Plan

18.58 Although the Canada Pension Plan has been an integral part of the social security system in Canada for over 25 years, there is still little understanding of how it operates. The reporting of information on the operations of the Plan was of special interest to us because of the regular appearance of articles on its financial soundness. Recent articles have questioned the Plan's continuing existence and its future affordability.

18.59 Recent surveys show that confidence in public pension plans has been eroded and attitudes toward overall pensions and retirement planning have been affected. According to a survey conducted for the Department, 98 percent of Canadians have heard of the Canada Pension Plan. However, only 13 percent of Canadians believe it will be available to all Canadians in the future; 50 percent of the respondents believe it will be limited at some point and 28 percent believe it will not exist at all.

18.60 The Department of National Health and Welfare, as administrator of the Canada Pension Plan, publishes information on the Plan in the Estimates and annual reports. However, it produces very little information on the unique features of the Plan or how it is financed, or other information designed to improve public understanding of the Plan. The Minister of Finance, who has specific responsibilities under the *Canada Pension Plan (Act)*, has produced some good information on the Plan's financing, but this was not widely distributed.

18.61 It is important that people know what their benefits and the cost of providing them will be. The public should be provided with complete and timely information on the administration and affordability of the Canada Pension Plan. For the benefit of parliamentarians and other readers, we present some basic information on the Plan gathered from a variety of sources in [Exhibit 18.8](#).

The management framework for the Canada Pension Plan is unstructured

18.62 Our audit focus was on the management of the Canada Pension Plan, Old Age Security and Guaranteed Income Supplement programs. Our conclusion was that certain aspects of these programs are not being managed in a cost-effective manner. In the case of the Canada Pension Plan, the Department has specific and special responsibilities as administrator. Administration of the Plan is a business, and the Department should manage it in a cost-effective manner to the benefit of its contributors and beneficiaries. We found instances where this was not done.

18.63 The key point is that the Canada Pension Plan, unlike Old Age Security, is financed by contributors, rather than from the government's general revenues. The principle, therefore, should be that decisions are taken after due consideration of service to the Plan's clients and of the bottom-line impact on the fund. Bottom line means that both administrative and benefit costs must be considered together; for example, spending one administration dollar to save four benefit dollars would be a sound decision. Decisions have not always been based on such considerations.

18.64 Although plans exist at the Income Security Programs Branch level, no single plan exists to guide the overall management of the Canada Pension Plan. Such a plan would help to ensure that benefits are paid to the right person, at the right time, in the right amount, in compliance with the legislation and in a cost-effective manner. Responsibility for achieving the plan would be clearly assigned.

18.65 A number of the Canada Pension Plan initiatives presently under way would be part of the plan. These include the communications strategy, the disability reassessment project and the record-of-earnings project. Through these projects, the plan would answer such questions as: What do we want to achieve? Where are we now? What are the targets? How will we measure our progress? Who is accountable for achieving results? Problem areas such as overpayments and telephone service would also be addressed through this plan.

18.66 The Canada Pension Plan communications strategy is one initiative that could benefit from the discipline of a plan. The strategy was costed at \$8 million to \$10 million over a five-year period to 1997-98. Year-one (1993-94) activities and expenditures have begun with some preparatory work, including the development of a business plan. However, the strategy was not justified on a benefit-cost basis, and there has been no senior management approval of either the strategy or the budget as a whole.

18.67 The question of decision making and approvals for Canada Pension Plan initiatives such as this is an important one. Does the Minister receive the necessary information to ensure that his/her responsibilities as Plan administrator are being properly exercised? A clear decision-making and accountability structure is required.

18.68 The principles and practices of good management discussed for the Canada Pension Plan would also apply to the Old Age Security program. The following section on overpayments outlines the weaknesses in both programs. The high losses occurring

through overpayments increase program costs and compromise the integrity of the programs.

Serious deficiencies exist in the management of pension overpayments

18.69 The *Old Age Security Act* and *Canada Pension Plan (Act)* both state that the receipt of a benefit to which one is not entitled represents a debt to the Crown and must be repaid. Debts arising from pension benefit overpayments are occurring in the range of \$120 million to \$220 million each year. The total administrative cost of delivering the pension programs is \$260 million. Although these overpayments represent only 0.5 percent of total payments, they effectively increase the administrative cost of program delivery by more than 50 percent.

18.70 We reviewed the systems that existed and the practices that were being followed in the Department with respect to pension benefit overpayments. We concluded that the detection, recording and recovery of overpayments were not being managed in a cost-effective manner. We found that most overpayments could be related to deficiencies in two key program activities - Canada Pension Plan disability reassessment and Guaranteed Income Supplement renewal. The systems and procedures in place for the recording, control and collection of overpayments fell far short of meeting minimum standards for such accounts.

18.71 Overpayments result when payments are made to individuals who are either not eligible for the benefit at all or not entitled to as high a benefit as they are receiving. Past efforts to prevent and detect overpayments have been minimal and largely ineffective. A new overpayment policy introduced in 1991 helped in the write-off of overpayments, but not in identification and recovery activities. In 1992, the Department wrote to the Treasury Board proposing that recoveries of overpayments should be reinvested in recovery/control-type activities relating to the statutory programs. It was suggested that ". . . such an approach would achieve significant savings for the Canadian taxpayer." No decision has been taken on this proposal.

18.72 National Health and Welfare does not maintain information on the extent of overpayments. We developed an estimate of the total figure by combining information from several sources in the Department (see [Exhibit 18.9](#)).

18.73 In February 1993, in a report on overpayments in the Old Age Security and Canada Pension Plan programs, the Department projected a conservative figure of \$70 million with an upper limit of \$108 million. These figures do not include projected overpayments related to Canada Pension Plan disability reassessment and Guaranteed Income Supplement renewal activities.

Two program areas generate the majority of overpayments

18.74 In the Canada Pension Plan, the greatest loss results from the lack of an effective disability reassessment process. In our 1992 Report chapter entitled Other Audit Observations, we noted that insufficient attention was directed to the reassessment of

eligibility for the Plan's disability benefits. The Department's policies and procedures did not ensure that disability benefits were paid only to those who continue to be eligible due to a severe and prolonged disability. We concluded that annual overpayments of up to \$65 million would continue until the reassessment process was improved and the required resources were allocated to this activity.

18.75 The Department confirmed our findings early in 1993. Its report concluded that reassessments based on evidence of employment earnings need to be carried out on a regular basis. "Not doing so has resulted in extremely high overpayments which may never be completely recovered. Failure to carry out this task ensures substantial losses to the Plan." This conclusion was based on the results of a 1991-92 pilot project. It reviewed 320 cases where income tax records indicated substantial earnings in years when the individual was receiving disability benefits. With 170 cases still under investigation, 46 reassessments have been finalized and overpayments of \$1.2 million recorded.

18.76 In the spring of 1993, a disability reassessment project was launched to address deficiencies over the short and long terms. The first priority was reassessment of the high-risk group of disability pension recipients who have reported earnings to the Department of National Revenue. Lists of these recipients are received quarterly but are from 1 to 1½ years in arrears. Persons receiving disability benefits can have earnings from employment for several years before the situation is discovered and recovery action is begun. Over the long term, the disability reassessment activity will be incorporated into the new client service delivery network scheduled for completion in 1997. Although return on investment is a project consideration, the Department has not specified the amount of overpayments it expects to identify and recover during the course of the reassessment project.

18.77 The Guaranteed Income Supplement renewal process is another major cause of overpayments. In the Audit Notes chapter of our 1991 Report, we noted that significant overpayments and underpayments of Guaranteed Income Supplement benefits were occurring every year.

18.78 In August 1992, the Department informed the Public Accounts Committee that the procedures had been rewritten to achieve a uniform and more rigorous review of Guaranteed Income Supplement renewal applications. These new procedures were to be in place for the processing of 1993 renewals. Our audit found that some new procedures had been developed but were not applied consistently. For the most part, corrective actions did not prevent mispayments from occurring in the first place. Many eligible Canadians still do not receive the pension supplement to which they are entitled.

18.79 The process for determining entitlement to Guaranteed Income Supplement benefits is inherently inefficient. Benefit entitlement is based on the applicant's estimate of prior year's income and is later adjusted, if necessary, to reflect the actual income as determined by National Revenue's income tax assessment. The direct administrative costs alone associated with the annual renewal process are roughly \$4 million. The Department's most recent projection indicates annual Guaranteed Income Supplement

benefit overpayments of up to \$40 million. We were informed that the Department is contemplating income data transfers to verify income as tax returns are processed, thereby eliminating a major portion of the overpayments.

18.80 The systems and procedures in place for recording and collecting overpayments are completely inadequate. Benefit clerks are responsible for account maintenance, including the recording and recovery of overpayments, but the Department does not monitor the process on a regular basis to ensure that appropriate action is taken. Amounts collected are not regularly aggregated by individual office or region. On a national basis, overpayment information is aggregated only at year-end for reporting in the Public Accounts. The figure for recorded overpayments (Old Age Security and Canada Pension Plan accounts receivable) at 31 March 1993 was \$70 million.

18.81 The Department could not provide us with complete or reliable data even for the overpayments that were recorded. Year-over-year changes in the overpayment figures could not be accounted for.

18.82 In short, the Department does not have proper control of the overpayment situation. Benefits are paid to those not entitled to receive them. Existing systems do not allow managers to quantify the amounts involved or to manage their collection efficiently. Moreover, the Department is not organized for enforcement activities such as the recovery of overpayments.

The Canada Pension Plan appeals process is severely backlogged and inefficient

18.83 The *Canada Pension Plan (Act)* and *Old Age Security Act* contain provisions that permit applicants to appeal benefit adjudication decisions. We found that since our last audit eight years ago, the Department had made few improvements in the Canada Pension Plan appeals area. In fact, the observations in our 1985 Report still hold today. There are virtually no written policies or procedures; it is difficult for client service centres to get information on the status of clients' cases; there are large backlogs in appeals processing; and no service standards or performance measures exist.

18.84 For Old Age Security, an applicant can request reconsideration of his/her application for a pension and, if not satisfied with the decision, can appeal to an Old Age Security Review Tribunal. We found that the two-level appeals process for the program works well for the relatively few cases that are received. The process is simple, quick and informal, and cases are heard in the area where the appellant lives.

18.85 Under the *Canada Pension Plan (Act)*, there are three levels of appeal. The first, to the Minister, is administered by the Department; the second is to an independent Canada Pension Plan Review Tribunal; and the third is to the Pension Appeals Board.

18.86 Over 90 percent of appeals relate to claims for Canada Pension Plan disability benefits. Here, the statistics are alarming. Over the past five years, the percentage of disability claims denied rose steadily and now stands at 44 percent. Over the same period, the percentage of those denials that were appealed also increased, from 36 percent in

1988-89 to 60 percent in 1992-93. Prior-year statistics indicate that the majority of these appeals will be successful.

18.87 Past strategies to deal with the backlog of first-level appeals were unsuccessful. At the end of March 1993, the backlog exceeded 17,000 cases. The waiting time for a Canada Pension Plan first-level appeal is now almost a year. Taking a case through the three levels of appeal takes, on average, two to three years. Current efforts to clear the backlog of cases at first level will likely move the backlog to the Review Tribunals.

18.88 The first level of the appeals process is severely backlogged and inefficient. The situation - old systems, poor communications, insufficient resources - has reached the point of being unacceptable to both managers and clients. The cost of correcting this situation is significant and will be borne by the Canada Pension Plan. Late in 1992, the Department started action to clear the first-level backlog, using contract and term staff. As a result of this initiative, the cost of the appeals process will increase by more than \$3 million in 1993-94. The total cost of the process will be \$8 million to \$10 million in that year.

A major redesign of pension program delivery is under way

18.89 For several years now, the Department has looked to the income security programs redesign project to improve administration and delivery of the pension programs. This project is a joint undertaking by the departments of National Health and Welfare and Supply and Services to provide an integrated client service delivery network for the Old Age Security, Canada Pension Plan and Child Tax Benefit programs. The delivery network is intended to improve the level of service to clients, within existing budgets, while managing a client population workload increase.

18.90 The redesign project will extend to 1997 at a cost of over \$250 million and is expected to address and resolve many specific program problems. Several of these involve areas where the level of service to clients is unacceptable, such as telephone service and the appeals process. Others are areas where hundreds of millions of dollars of benefits are being paid improperly. [Exhibit 18.10](#) shows estimated expenditures over the life of the project.

18.91 These problems are not new ones; in fact, as we noted earlier, many have existed for years. Several previous initiatives to upgrade income security programs systems and practices were planned. Some, such as improvements to the former Family Allowances program, were completed, while others were not. Meanwhile, the workload related to the Old Age Security and Canada Pension Plan programs continued to increase due to demographic factors. At the same time, resources were constrained and the limitations of the existing computer systems - developed 25 years earlier - became clearer. The situation finally reached the point in 1991 where a \$250-million solution was considered necessary.

18.92 We reviewed the redesign project to determine whether there was compliance with generally accepted criteria for large systems development projects, including those with

significant information technology components. We also audited for compliance with Treasury Board policies and guidelines for major Crown projects. We found that the management structure and process for the project complied in all material respects with these criteria.

18.93 We had a particular interest in the accountability framework for the income security programs redesign project. Although planning began four years ago, the project will have few quantifiable benefits until implementation is well under way in 1995. Some \$30 million had been spent as of 31 March 1993 (see [Exhibit 18.11](#)).

18.94 The primary means of reporting to Parliament on the redesign project is through the major Crown projects addendum to the Estimates Part III. We reviewed the addendum and other related information in the 1993-94 Part III and found that it met the reporting criteria set by the Office of the Comptroller General. We did note that two 1993-94 project cost figures that differed by \$3.5 million were presented in the document without explanation. Periodic reporting of project results to the Treasury Board is also required, and we reviewed the first such report submitted in January 1993. That report also met the stipulated reporting requirements.

18.95 The high costs associated with present problems - in terms of both overpayments and poor service - will continue until solutions are implemented. Delays in the implementation of solutions are very costly. By the Department's estimate, benefit overpayments of \$1 billion could occur and remain undetected until implementation is completed in 1997. At this stage of the redesign project, however, it is not possible to determine the extent to which program delivery deficiencies, such as overpayments, will be addressed and rectified.

18.96 The Department should seek to improve public understanding of the pension programs by:

**presenting information on projected future costs of the Old Age Security and Canada Pension Plan programs in the Estimates Part III and annual reports; and
communicating more and better information to Canada Pension Plan contributors and beneficiaries on the Plan's benefits, financing arrangements and present and future costs.**

18.97 To improve the overall management of the pension programs, the Department should:

for the Canada Pension Plan, develop a management framework that incorporates a clear decision-making structure and an annual plan to help ensure that administrative responsibilities are appropriately discharged; implement measures for the prevention, prompt identification and recovery of overpayments using, to the fullest extent possible, information available from the Department of National Revenue; and

develop improved systems and procedures for the control and collection of known overpayments.

Department's response: The Department is in the process of identifying how best to include information on projected future costs for OAS and CPP in its Estimates Part III document and annual reports.

In the case of the Canada Pension Plan, information such as projected rates of contributions, currently contained in the actuarial report of the Office of the Superintendent of Financial Institutions, could be included. A CPP communications team has recently begun to implement a strategy to provide Canadians with increased information. Communications are a key concern of the Canada Pension Plan Advisory Board which has set up a sub-committee to help the Department address some of the misconceptions which exist.

As the Auditor General has noted, many organizations are involved in the administration of the Canada Pension Plan. Given this administrative structure, work began in June 1993 focussing on the types of effectiveness information needed to better manage the Canada Pension Plan from a corporate perspective and to better report on the performance of the CPP as a corporate entity. This work was recently presented to a sub-committee of the Canada Pension Plan Advisory Board and will be discussed at the next full meeting of the Board at the end of September 1993.

The Branch is actively discussing with Revenue Canada two areas where the use of earnings information will prevent and detect overpayments.

A formal operational review of the application of the policy dealing with overpayments was completed in March 1993. This review showed that the policy was generally well applied, but some weaknesses do exist. As a follow-up, a working group was established in April 1993 to identify and recommend ways to strengthen the identification of Canada Pension Plan overpayments, the recovery and the control of known overpayments. The working group has also been tasked with identifying means to prevent overpayments.

In addition, the Branch is currently conducting two projects to identify, as early as possible, beneficiaries of disability benefits who return to gainful employment so the disability benefits under the Canada Pension Plan may be stopped as soon as possible after eligibility ceases. These projects are also aimed at automating the process of identification of ineligible beneficiaries to prevent the accumulation of overpayments while minimizing the resources required to maintain control of statutory costs.

Seniors Strategy

The 1988 Seniors Strategy was poorly planned and organized

18.98 In 1988 the federal government approved a five-year initiative, the Seniors Strategy, targeting Canada's seniors population. The Strategy was to be implemented by

the Department of National Health and Welfare, which, as a result, expanded its existing activities and established new programs and organizations. For example, a new program, the Seniors Independence Program, was created to support the provision and development of services that enhance the quality of life and independence of seniors. Funding for the New Horizons program, which supports seniors groups, was expanded. Funds were also allocated for research on diseases related to seniors, through another new program, the Seniors Independence Research Program. As well, the Strategy set out to improve communications with seniors and to establish administrative support for the Minister of State for Seniors.

18.99 The original five-year budget of \$197 million was later reduced to \$183 million by government-wide expenditure reductions. Only \$144 million was actually spent. The Strategy was renewed in 1993 with \$170 million to be provided over the next five years (see [Exhibit 18.12](#)).

18.100 The Department made little effort at consultation and needs analysis prior to the launching of the 1988 Seniors Strategy. Without this analysis, it is difficult to know if the Strategy was focussed on the most important issues affecting seniors and to assess the appropriateness of the Strategy components in addressing these needs.

18.101 Objectives were not set for the Strategy as a whole or for any of the new program components. Funds were allocated to the different branches within the Department, but no mechanism was put in place to capture and report overall financial performance. The lack of organization and clear objectives at the Strategy level may have contributed to a lack of focus at the program level.

18.102 We also found a lack of planning with respect to implementation of the Strategy. For example, the Seniors Independence Program suffered organizational and start-up problems, and just 20 percent of the first year's budget was actually spent. Only after two years of operation did the program managers set out a framework to provide direction for implementation and a basis for setting priorities, improving public information and training staff.

Contribution arrangements for seniors programs were well managed

18.103 New Horizons and the Seniors Independence Program provide funds to seniors organizations and the volunteer sector. We examined the delivery of these two programs and found that the contribution arrangements were well managed; that is, the Department ensured that projects were properly established and that program recipients complied with the terms and conditions of the agreements.

18.104 We did note that delivering the New Horizons program costs significantly more than the Seniors Independence Program. In 1992-93, roughly 25 cents of every New Horizons program dollar went to administrative activities. This was because New Horizons contributions are allocated on the basis of federal electoral districts, requiring staff to travel to each district and assist seniors in preparing submissions for funds. The

Treasury Board has asked the Department to review these programs with a view to reducing the level of resources needed for program administration.

The Seniors Strategy was renewed without a full accounting for the results of the first five years

18.105 We found that consultation with the provinces consisted of working arrangements at the project level and an annual meeting with provincial officials responsible for seniors issues. Documentation in support of the renewal of the Strategy in 1993 revealed that better program results could be achieved by strengthened collaboration with community stakeholders and provincial and territorial jurisdictions. It is not yet clear how the Department intends to achieve this.

18.106 In general, we found that management had neither reviewed the purposes and results of seniors programs to assist in planning for the renewal nor evaluated the 1988 Strategy as a whole to determine if it was successful. New Horizons was last evaluated in 1989, one year after a decision was taken to increase the program funding level by 50 percent. Recent evaluation activity has focussed principally on the Seniors Independence Program.

18.107 We found that the evaluation findings cited in the 1993 Strategy renewal documentation were misleading with respect to the effectiveness of both programs. The findings of the 1989 New Horizons evaluation were referred to, even though no attempt had been made to update them. Based on our review of the evaluation study, we concluded that the Department's findings with respect to program results were not valid.

18.108 A 1992 study of the Seniors Independence Program did not gather data on the results of expenditures, nor did it evaluate the program against its goals of increased independence and quality of life for seniors. Nevertheless, the study report concluded that program funds were well spent toward the intended accomplishments and that the program had already made some important and positive differences to seniors.

18.109 The lack of an accountability framework for the Seniors Strategy is a significant deficiency. The Department's Estimates do not describe the Strategy, reveal its expenditures or report on its achievements. For example, in the 1993-94 Estimates Part III, although the Strategy is mentioned several times, the programs that comprise it are not identified. Nor are the expiry of the 1988 Strategy and the impact on program funding levels explained. Because the Strategy was not established as a distinct initiative, it is also difficult to determine who is answerable for its success or failure.

18.110 Overall, we concluded that information available for decision making with respect to the Seniors Strategy renewal was inadequate. Implementation of the renewed Strategy has begun without the benefit of reliable, complete and timely information on the results of the initial Strategy.

18.111 To improve accountability for Seniors Strategy program results, the Department should:

carry out an assessment of the 1988 Seniors Strategy and use the results to improve implementation of the strategy renewal; and identify the Seniors Strategy as a distinct initiative in the Estimates, presenting current and future financial data as well as information on the performance and effectiveness of the Strategy programs and components.

Department's response: Health Canada intends to do an evaluation of the Seniors Strategy and its components, which will be completed by 1996-97. Various assessments are already under way as part of Health Canada's policy review and strategic planning exercises.

Health Canada will review the recommendation concerning Estimates presentation, in the context of government restructuring, to determine what changes are appropriate and possible, given the structure of the Estimates.

Chapter 19

Department of National Health and Welfare

Non-Insured Health Benefits

Main Points

Introduction

- Background
- Audit Objective and Scope

Observations

- Program Mandate
 - The provision of Indian health services has evolved gradually
 - The non-insured health benefits program authority and mandate are unclear
- Program Management and Delivery
 - Deficiencies exist in expenditure control processes
 - Development and implementation of the health information and claims processing system have incurred numerous problems
- Public Disclosure of Program Information
 - The Department has been aware since 1987 that non-insured health benefits information in the Estimates Part III is inadequate
 - The effectiveness of disclosure on non-insured health benefits in the Estimates Part III is greatly reduced because the program is not a distinct expenditure component
 - Financial information on non-insured health benefits in the Estimates Part III remains unacceptable

Conclusion and Recommendations

- An unclear mandate and poor disclosure practices have resulted in a lack of accountability for this major program
- The joint audit report contains a number of important recommendations

Exhibits

- 19.1 Status Indian and Inuit Population
- 19.2 Non-Insured Health Benefits Expenditures by Benefit Type, 1992-93
- 19.3 Total Expenditures for Non-Insured Health Benefits, 1984 to 1992
- 19.4 Non-Insured Health Benefits Expenditures – Actual vs Main Estimates

Department of National Health and Welfare

Non-Insured Health Benefits

Assistant Auditor General: Elwyn Dickson
Responsible Auditor: Bill Rafuse

Main Points

19.1 In 1992-93, Canada's status Indians and Inuit received non-insured health benefits totalling \$422 million. These benefits are administered by the Medical Services Branch of the Department of National Health and Welfare.

19.2 The non-insured health benefits program is not recognized in any legislation. The lack of clarity in the authority and mandate for the provision of these benefits detracts from the efficient and cost-effective delivery of the program.

19.3 The Department of National Health and Welfare is administering this program without agreement on its exact nature, without complete information on its costs, and without an effective management control framework. In the absence of specific direction from the government, the Department established national Program Directives setting out the terms and conditions for the provision of non-insured health benefits.

19.4 The cost of the program in 1992-93 would have been reduced by \$85 million, or 20 percent of the total, if the benefits had been provided in accordance with the national Program Directives and principles.

19.5 The Estimates Part III is the only public record of information on the non-insured health benefits program. Information presented in the Estimates continues to fall far short of reasonable and adequate disclosure. This reporting practice, along with management inadequacies, resulted in insufficient accountability for program results.

Non-Insured Health Benefits

Introduction

19.6 This chapter presents highlights from a report on the audit, undertaken jointly by the Office of the Auditor General and the Program Audit and Review Directorate of the Department of National Health and Welfare, of the non-insured health benefits program.

19.7 An audit of this program by the Auditor General in 1987 found planning and evaluation processes to be poor and performance measures to be lacking. The audit also found that the respective roles and responsibilities of the provinces and the federal government required clarification, and that improvement was needed in the information reported to Parliament. A follow-up audit in 1990 reported that little progress had been made in these areas.

19.8 Subsequent work carried out by both our Office and the Program Audit and Review Directorate led to a proposal to conduct a joint audit of the non-insured health benefits program that would satisfy the audit objectives of both organizations. Late in 1992, the Deputy Minister of National Health and Welfare and the Auditor General approved the proposal for a joint audit.

19.9 The auditors recognized that non-insured health benefits do not constitute a program or activity as defined in the Estimates Part III. However, for ease of reference throughout the chapter, the term "program" is used.

Background

19.10 Non-insured health benefits are health-related goods and services provided to Canada's status Indian and Inuit population (see [Exhibit 19.1](#)). The benefits fall into six categories: medical insurance premiums; other health care services; drugs, medical supplies and equipment; dental care; vision care; and medical transportation. [Exhibit 19.2](#) shows the 1992-93 expenditures for each of the benefit categories. The program is administered by the Department's Medical Services Branch.

19.11 [Exhibit 19.3](#) shows program expenditures in both current and constant dollars (adjusted for the effects of inflation). Program expenditures increased significantly over the period 1984-85 to 1992-93. This increase, after inflation had been taken into account, was due largely to the natural growth of the eligible population and the effects of Bill C-31 (April 1985), an amendment to the *Indian Act* that granted status to, or reinstated the status of, a large number of Indians. The growth of program expenditures in constant dollars on a per capita basis has averaged seven percent over the last eight years.

19.12 Greater awareness by eligible recipients and health professionals of the range of benefits available was another factor causing expenditure growth. The auditors were concerned that deficiencies in management practices, particularly those related to

eligibility and entitlement controls, may also have contributed to increases in expenditures.

Audit Objective and Scope

19.13 The objective of the audit was to determine whether the non-insured health benefits program is managed in accordance with all related authorities and with due regard to economy and efficiency, and that the effectiveness of the program is measured and reported. Specific criteria were developed prior to the audit and were agreed to by the departmental managers responsible for the program.

19.14 The scope of the audit included an examination of the authorities, management practices and operational controls at headquarters, as well as in regional offices and selected zone offices. In addition, contacts were made with other federal and provincial departments.

Observations

Program Mandate

The provision of Indian health services has evolved gradually

19.15 The Department clarified its position on Indian health services in 1975, stating that it was "a matter of policy rather than statutory or treaty obligation that the federal government has provided certain health services to Indians. Parliament is asked each year through appropriation acts for the authority and resources to provide these services. The policy has been, and is, for the federal government to do what is necessary to ensure that Indians have access to adequate health services in order to achieve a standard of health comparable to that of other Canadians."

19.16 Three years later, the federal government introduced Guidelines for Uninsured Medical and Dental Benefits to the Indian and Inuit peoples to standardize practices across the country and set limits on benefits. The 1978 Guidelines proposed restricting eligibility to those who live on reserves and who meet the criteria of a financial means test. In 1979, in the face of intense opposition from the Indian community, the Minister of National Health and Welfare declared a six-month moratorium on the Guidelines. The government drew up a new Indian Health Policy that authorized the Minister of National Health and Welfare to:

- withdraw the Guidelines for Uninsured Medical and Dental Benefits and establish the level of service during the moratorium as the norm for budgetary purposes;
- establish professional medical or dental judgment or other fair and comparable Canadian standards as the criteria for health service delivery;
- reaffirm the historical role of the federal government and the provinces in the provision of health services; and

promote consultation and participation in the administration and delivery of health programs.

19.17 The 1979 policy re-established non-insured health benefits as an open-ended program: requirements for a means test and on-reserve residency were dropped. The program still operates within the general framework established by this policy, with expenditures authorized through annual appropriation acts. Management improvement efforts since that time have focussed on defining and limiting the benefits available. For example, national Program Directives that set out the terms and conditions for provision of the various benefits available under the program were completed in 1989. Also, to improve control and efficiency, the Department contracted with a third party for automated claims processing services (see paragraphs 19.29 to 19.33).

The non-insured health benefits program authority and mandate are unclear

19.18 The Department of National Health and Welfare has historically been involved in delivering health services to Canada's status Indian and Inuit population. The 1979 Indian Health Policy states that the federal government's "legal and traditional responsibilities to Indians" flow from "constitutional and statutory provisions, treaties and customary practice." In spite of this historic relationship between the government and Canada's native population, there is no specific federal legislation recognizing non-insured health benefits.

19.19 The absence of specific enabling legislation has left a gap in the definitions of purpose, expected results and outcomes of the non-insured health benefits program. With no legislative starting point for policy and program development, there is still, after almost fifteen years, no consensus in the Department as to the exact nature of the program.

19.20 A clear understanding of the purpose of non-insured health benefits is essential for the efficient and effective delivery of the program. The Department's national Program Directive 1/1 defined non-insured health benefits in these terms: "MSB (Medical Services Branch) provides or arranges for the provision of non-insured health benefits for eligible beneficiaries who require medical services for the purposes of maintaining health, preventing disease, diagnosing or treating an illness, injury or disability. Non-insured health benefits are a limited number of health-related goods and services not provided to Inuit and registered Indians by other agencies."

19.21 The principles of the program, also contained in national Program Directive 1/1, are more consistent with a health insurance plan than a health program. Whereas a health program might have objectives defined in terms of improving health status, a health insurance plan would have as its objective to provide coverage, up to pre-determined limits, for specified medically required services and products. The auditors concluded that the description of non-insured health benefits in Directive 1/1 does not clearly define the program as either a health program or a health insurance plan. Interviews with managers confirmed this lack of clarity of the nature of the program.

19.22 The auditors found that, in practice, the program is managed more as an insurance plan. As such, it covers the cost of providing supplementary health benefits to qualified individuals. Program performance is judged on whether the specified benefits were provided within the set limits. Although the premiums, deductibles and co-payment provisions commonly found in health insurance plans are absent in this program, this is consistent with the general direction of the 1979 Indian Health Policy.

19.23 Practices for the administration and delivery of the program have developed over the years without the discipline imposed by a clear program authority, mandate and policy. Accountability for financial and other program results has also been hindered by the lack of clear direction. Deficiencies in this area are reported in paragraphs 19.34 to 19.40.

Program Management and Delivery

Deficiencies exist in expenditure control processes

19.24 Some program managers tend to view non-insured health benefits as quasi-statutory or uncontrollable expenditures because they are authorized by health professionals and accessed directly by the eligible population. As a result, the delivery of these benefits is often not subject to the same rigorous review as other expenditures. The auditors found that lines of responsibility and accountability for program management functions were unclear. One example relates to arrangements with third parties to deliver certain non-insured health benefits. Some of these arrangements did not include provisions to ensure that delivery was in accordance with program principles and the national Program Directives and was, in general, efficient and cost-effective. Further, the management of these agreements did not always include adequate monitoring and evaluation.

19.25 The auditors estimated that failure to effectively implement the principle of last resort as defined in the Directives resulted in annual expenditures of \$45 million that would not otherwise have been incurred. This principle states that health services will not be provided or paid for when they are available to provincial or territorial residents under provincial or territorial health plans or other programs. The specific instances identified were where status Indians and Inuit did not fully use some or all of the supplementary health benefits available from provincial and territorial social assistance, health care insurance plans and employer group insurance plans.

19.26 The auditors also found that the 1992-93 expenditures of the non-insured health benefits program included \$40 million for goods and services not specified as benefits in the national Program Directives and related policies. These related to such things as salaries for nurses, training of dental therapists, charges for residence and treatment at alcohol and substance abuse treatment centres, and payments to contractors for systems development and administration.

19.27 The program lacks the information systems and capabilities necessary to analyze expenditure patterns at the national and regional levels. Financial planning, forecasting

and reporting practices have resulted in Estimates figures that are consistently below actual expenditures (paragraphs 19.37 to 19.40).

19.28 The administration costs of the program are not identified and segregated. Some administration costs - for example, those included in contracts for the delivery of benefits or payment of suppliers - are in fact charged as benefits, even though the Program Directives do not allow for this. The total cost of administering the program is unknown. As a result, the costs of managing and delivering the program cannot be compared from region to region, or in total, with possible alternatives. For example, the contract for claims processing and payment of supplier accounts was entered into without the information necessary to evaluate the cost-effectiveness of this alternative. This contract provides for administration fees of \$42 million over its five-year term. The auditors identified several deficiencies in this contract, which are outlined below.

Development and implementation of the health information and claims processing system have incurred numerous problems

19.29 In July 1987, the federal government entered into a two-year contract, with an option to renew, with a private sector firm for the development and operation of a claims processing system for dental accounts. In December 1988, following the implementation of the system, the Department decided to tender for the development and operation of a similar automated claims processing system for all benefits.

19.30 In March 1990, a second five-year contract was awarded, on a competitive basis, to the same firm for \$42 million, and work on the development of the pharmacy claims portion of the contract was initiated.

19.31 The auditors found that the Department had developed only general system specifications prior to awarding the second contract. As a consequence, implementation of the system was delayed for one year while the Department finalized the specifications. Further delays were encountered while the contractor responded to the Department's detailed systems requirements. Original plans called for the entire system to be implemented by December 1992. However, it was not until July 1993 that pharmacy accounts were processed in all regions. The system is not expected to be fully operational for all benefits before December 1994. As of September 1993, the Department had not prepared detailed systems requirements for vision care and medical transportation benefits.

19.32 Other deficiencies were also identified in the contract. For example, most large-scale systems contracts contain provisions for penalties for delays. This contract did include penalty provisions for inadequate systems availability, but did not address clearly either the contractor's or the Crown's liabilities with respect to delays in systems development or implementation. A 1992 amendment to the original contract specified that the charges associated with processing pharmacy transactions would be discounted in the event of system implementation delays or failure to meet the specifications. However, the specific criteria necessary to apply this discount are currently being negotiated with the contractor.

19.33 The auditors found that the Department's systems and procedures to monitor and control advance benefit claim payments to the contractor were inadequate. For example, there are no safeguards to protect the value of advance payments outstanding. In addition, the 1992 contract amendment was primarily intended to clarify the contractual terms and conditions. The amendment, however, did not include a description of the work to be performed, and negotiations are also under way to more clearly define this requirement.

Public Disclosure of Program Information

The Department has been aware since 1987 that non-insured health benefits information in the Estimates Part III is inadequate

19.34 The Estimates Part III is the Department's fundamental planning and accountability vehicle for reporting to Parliament. It is intended to provide program information primarily in terms of the results expected for the money that will be spent. It should also provide information for assessing financial performance over the past year. In the case of non-insured health benefits, the Estimates Part III is the only document that provides timely financial information that is publicly available.

19.35 We reported in 1987 and 1990 that information in the Estimates Part III did not disclose sufficient information on the program for members of Parliament and others to evaluate its financial and program performance.

The effectiveness of disclosure on non-insured health benefits in the Estimates Part III is greatly reduced because the program is not a distinct expenditure component

19.36 The auditors' review of the Estimates Part III for 1993-94 found that a number of deficiencies persisted in the disclosure of information on the program. Non-insured health benefits, with estimated expenditures of \$470 million, will represent 56 percent of total spending for the Indian and Northern Health Services program activity. These benefits, however, are not identified in the Estimates as a distinct program activity or sub-activity, but are included in the Community Health Services sub-activity. The Part III information is also deficient in that it:

- does not explain why these health benefits are provided to status Indians and Inuit, nor does it describe the basis for payment;
- presents four pages of information on status Indian and Inuit mortality but does not link this directly to the effectiveness of non-insured health benefits; and
- does not disclose the costs of administering the program.

Financial information on non-insured health benefits in the Estimates Part III remains unacceptable

19.37 Only a very careful and informed reader of the Estimates Part III could learn anything about the financial performance of the non-insured health benefits program. The Estimates document does present trend data for several benefit categories, but it does not provide other useful information, such as constant dollar costs, per capita costs or

comparative financial data to provide a basis for assessing past and future performance of the program.

19.38 Estimates figures for the program have been consistently low, with actual expenditures exceeding the budget in eight of the last nine fiscal years (see [Exhibit 19.4](#)).

19.39 Although the actual expenditures have exceeded the Estimates by only nine percent on average over the past nine years, the information has existed for the Department to make much more accurate projections. In 1987, for example, we reported that, based on departmental information, the Estimates figure for that year was likely understated by \$30 million.

19.40 Moreover, the explanations of changes, for both year-over-year and budget-to-actual expenditures, are generally insufficient and at times misleading. For example, in the 1993-94 Estimates Part III, the increase in non-insured health benefits costs over the previous year of \$39.4 million is explained as "due to normal and Bill C-31 generated increases to the Indian population, and price increases." For years, this has been the standard explanation of program cost increases presented to Parliament in the Main Estimates. However, when Supplementary Estimates are requested from Parliament to cover budget shortfalls, the reason given is "extraordinary cost increases related to the non-insured health benefits program." The distinction between normal and extraordinary increases has not been clarified and is not supported by an analysis of costs. In fact, management has not undertaken the analysis required to determine and quantify the factors that are causing the increase in the costs of non-insured health benefits.

Conclusion and Recommendations

An unclear mandate and poor disclosure practices have resulted in a lack of accountability for this major program

19.41 The terms and conditions for the provision of non-insured health benefits and the nature and extent of these benefits have been established by the Department with very little direction from the government. The non-insured health benefits program is not recognized in any legislation, direction from Cabinet is general and outdated, and direction from the Treasury Board has focussed almost exclusively on cost containment. With scant political guidance over the past fifteen years, the program has grown significantly in terms of benefits provided, population served and funds expended. Policy and management practices have evolved largely in response to program growth, Treasury Board concerns about rapidly rising costs and criticisms from the Auditor General and others.

The joint audit report contains a number of important recommendations

19.42 The joint audit report contains recommendations for all of the major observations raised in the report. These recommendations are presented below in a condensed form. The issues that they address are reported in a summary fashion in this chapter.

19.43 Recognizing the need for appropriate consultation with the parties concerned, the Department should seek from the government a renewed mandate for the non-insured health benefits program to clarify the authority base, purpose and objective of the program.

Department's response: Health Canada agrees and intends to integrate the key points, in consultation with First Nations, to review the program and policy content to culminate in a Cabinet submission.

19.44 As intermediate measures, or as appropriate when formulating a renewed program mandate, the Department should:

establish clear lines of responsibility and accountability and improve financial planning and reporting practices and information systems at the regional and national levels;
pursue cost savings available from implementation of the principle of last resort and ensure that only the costs of benefits specified in the Program Directives are charged as non-insured health benefits;
strengthen the capability to manage the implementation of the health information and claims processing system.

Department's response: Health Canada has already enhanced the policy and management capacity of the program and introduced costing procedures and containment mechanisms. The Department will act further on findings in the joint audit report, where cost-effective measures can be implemented within its resource base, authorities and legislative limitations.

19.45 To improve the public disclosure of program information, the Department should establish the non-insured health benefits program as a distinct expenditure sub-component in the Main Estimates. Program information in the Estimates Part III should be complete and accurate.

Department's response: Health Canada agrees and will present the non-insured health benefits program as a distinct sub-activity in the 1994-95 Part III of the Estimates.

Chapter 20

Department of National Revenue

Main Points

ADVANCE INCOME TAX RULINGS

Background

Audit Objective and Scope

Observations and Recommendations

- The rulings process requires expert analysis of tax law and policy
- The rulings process generates information that is of interest to other taxpayers
- Published advance income tax rulings are not timely

GOODS AND SERVICES TAX RULINGS AND INTERPRETATIONS

Background

Audit Objective and Scope

Observations and Recommendations

- The risk of issuing inaccurate and/or inconsistent GST rulings and interpretations is high in a new system
- There is a need to enhance current training efforts
- Sections of the Canada-Quebec agreement on GST rulings and interpretations issued by the Province of Quebec are not fully implemented
- Communicating more information on rulings and interpretations to the public would increase equity among GST registrants

Exhibits

20.1 Advance Income Tax Rulings Issued

20.2 Users of Advance Income Tax Rulings – October 1991 to June 1993

Department of National Revenue

Assistant Auditor General: Shahid Minto

Responsible Auditor: Barry Elkin

Main Points

ADVANCE INCOME TAX RULINGS

20.1 The Department of National Revenue provides an advance income tax rulings service to facilitate voluntary compliance with the *Income Tax Act*, uniformity of application and self-assessment by taxpayers.

20.2 Advance income tax rulings provide certainty to a taxpayer by guaranteeing the income tax effect of specific transactions contemplated by the taxpayer. They involve some of the most complex tax issues, and their tax revenue implications can be significant.

20.3 The processing of requests for advance rulings requires expert analysis of tax law and policy. At times, it also requires clarification of tax policy intent from the Department of Finance.

20.4 One of the main outcomes of the ruling process is the clarification or development of National Revenue's interpretation of the law. These interpretations are critical to facilitate compliance with the Act. In that sense, the ruling process generates information that may be of interest to other taxpayers.

20.5 The Department publishes selected advance income tax rulings that it considers to be of particular interest to taxpayers. However, since 1985, it has published only 58 advance rulings out of an estimated 4300 issued. Recent rulings have been published with a delay of about two years.

20.6 Making more advance income tax rulings available would increase certainty among taxpayers and improve the transparency of the tax system. Consequently, equity among taxpayers would be enhanced and compliance with the *Income Tax Act* facilitated.

GOODS AND SERVICES TAX RULINGS AND INTERPRETATIONS

20.7 National Revenue also provides an advance rulings service for Goods and Services Tax (GST) registrants. The rulings service is decentralized among 34 district offices and involves about 400 interpretation officers across the country. In the Province of Quebec, the issuance of GST rulings and interpretations has been the responsibility of the Quebec Ministry of Revenue since 1 July 1992.

20.8 The legislation is new and was substantially modified in 1993. As a result, the Department has limited experience in interpreting and applying the GST. The fact that the system has not matured, as well as the decentralization of interpretation services, increase the risk of issuing inconsistent and inaccurate rulings and interpretations.

20.9 Inconsistent and inaccurate rulings and interpretations may create situations where registrants producing and selling similar goods or services are treated differently. Such unfair treatment could also affect the public's perception of the GST and reduce its motivation to comply with the tax.

20.10 To mitigate the risk of inconsistent and inaccurate rulings, National Revenue provides training for its interpretation officers and has developed an automated database to facilitate research before issuing GST rulings. It also established a formalized Quality Assurance Program in January 1993.

20.11 Initial data from the new Quality Assurance Program reveal a global error rate of 15 percent in rulings and interpretations issued between February and June 1993. About 6 percent were technically inaccurate and 9 percent were unclear or incomplete. This shows a need to enhance current training efforts, including the provision of additional training in legislative interpretation.

20.12 Progress was made in implementing the sections of the Canada-Quebec GST agreement relative to rulings and interpretations. However, the Department has not yet received the results of the Province's quality assurance activities and copies of interpretation and information letters issued by Quebec field offices.

20.13 National Revenue makes available to the public the policy content of its rulings and interpretations. However, we believe there is a need to release more information on rulings and interpretations, in order to provide greater certainty and equity to all registrants who collect the GST on behalf of the government.

ADVANCE INCOME TAX RULINGS

Background

20.14 An advance ruling is a written statement given by the Department to a taxpayer; it outlines how the Department will interpret specific provisions of existing Canadian income tax law as it applies to a specific proposed transaction or transactions to be carried out by the taxpayer.

20.15 National Revenue issues on average about 600 rulings a year. An additional 200 rulings are issued to supplement previously issued rulings. An advance ruling may be either favourable or unfavourable. Where an unfavourable ruling is to be issued, the taxpayer is given the opportunity to withdraw the advance ruling request (see [Exhibit 20.1](#)).

20.16 The provision of advance rulings is an administrative service. Although the Department is not legally required to issue them, it considers itself bound by advance rulings, provided that the statement of relevant facts or proposed transactions submitted by the taxpayer contains no material omissions or misrepresentations and that these facts and transactions do not change after the issuance of the ruling. An advance ruling applies only to the taxpayer who requested it. Tax accountants and tax lawyers are the main users of the ruling service (see [Exhibit 20.2](#)).

20.17 The Department charges a fee for time spent in connection with advance ruling requests. The fee is set by order-in-council and is currently \$90 for each hour or part thereof. As the aim here is to recover costs, the Department will review the fee periodically to make sure that it is appropriate.

20.18 The purpose of the advance rulings service is to promote voluntary compliance, uniformity and self-assessment by providing certainty with respect to the income tax implications of proposed business transactions. By removing doubt as to the tax consequences of a particular transaction, advance rulings provide certainty for business and facilitate commercial transactions.

20.19 Advance rulings often deal with the most complex tax issues or can have significant tax revenue implications. Many Canadian corporations consider it necessary to refer their more significant proposed reorganizations and other complex transactions for an advance ruling before going ahead with them. A large number of corporate reorganizations involving the tax-free transfer of assets worth several billion dollars have been the subject of an advance ruling.

20.20 The Department publishes selected advance rulings that it considers to be of particular interest to taxpayers. It takes care to preserve confidentiality by deleting ("severing") details that would identify the taxpayer concerned. The taxpayer or representative who requested the ruling is informed in advance of the intention to publish.

Since 1985, only 58 advance rulings have been published out of an estimated 4300 issued.

Audit Objective and Scope

20.21 The objective of our audit was to assess the appropriateness of procedures put in place by the advance rulings service of the Department of National Revenue to maximize certainty, as well as voluntary compliance and self-assessment.

20.22 Our audit was limited to the advance income tax rulings service, and included a review of advance rulings and supporting documentation. We conducted interviews at head office and certain district offices; we also interviewed private sector tax experts.

Observations and Recommendations

The rulings process requires expert analysis of tax law and policy

20.23 Reviewing an advance ruling request and issuing an advance ruling is not a mechanical process. It requires judgment and in-depth knowledge and understanding of the *Income Tax Act* .

20.24 The review of the ruling request is undertaken by one of the four specialized divisions within the rulings group. All rulings are reviewed by a supervisor and director and signed by the supervisor. Contentious rulings and those involving new issues are referred to an internal review committee of directors and the Director General. The contentious issues that cannot be resolved at this level are referred to the departmental policy committee. The Department may also refuse to rule on a proposed transaction, though this is rare.

20.25 When the legislative provision is vague or ambiguous, the Department seeks clarification of the underlying policy intent from the Department of Finance. In 1992-93, this happened about 50 times. The review of the ruling request may result in the Department of National Revenue recommending technical amendments to the *Income Tax Act*. National Revenue advised us that, of the technical amendments released in December 1992, 56 of the 180 proposed amendments arose as a result of issues they had raised. These data also show that the advance ruling service constitutes an early warning system for tax policy and administration.

The rulings process generates information that is of interest to other taxpayers

20.26 As well as providing certainty to the specific taxpayer, the rulings process may clarify or develop the Department's position on specific technical matters of interest to other taxpayers. Departmental positions are an agreed-upon way of treating similar situations in the same manner or on a consistent basis. They are critical in determining what the taxpayer needs to do to comply with the *Income Tax Act* .

20.27 One example is the interpretation of the reorganization rules, commonly called "butterfly" rules, where the Department developed complex positions on such matters as types of property, net equity method, etc., through a series of rulings decisions. Another example is the definition of "financial difficulty" that was likewise expanded through rulings decisions, allowing more flexibility in refinancing troubled companies through the issue of preferred shares.

20.28 Newly developed positions or changes in existing positions have also been noted by tax professionals at various tax conferences and in tax journals. Many practitioners have analyzed and commented on the evolution of "butterfly" reorganization rules and related positions developed as a result of rulings.

20.29 The importance of positions and changes in positions for taxpayers and tax advisors is reflected in the fact that each year National Revenue is invited to answer tax practitioners' questions at various tax conferences, such as those of the Canadian Tax Foundation.

Published advance income tax rulings are not timely

20.30 The Department has endeavoured to communicate to some extent the positions taken in rulings. It publishes severed versions of selected advance rulings considered to be of particular interest to taxpayers. However, it publishes only one percent of all rulings issued, and the information is not timely. For example, each of the five published rulings we examined came out at least two years after it had been issued.

20.31 We believe that making more advance income tax rulings available would result in a more consistent and uniform application of the law among taxpayers and would improve the transparency of the tax system. All taxpayers, not only those who are issued advance rulings, would have access to sources of law and to knowledge of how the law is applied. This in turn would facilitate compliance.

Department's comment: We publish all rulings that we believe will be of general interest. However, it is not clear that publishing more rulings, containing information already available, will improve compliance. Making publications more timely is a continuing priority of the Department.

20.32 Other options exist to communicate, on a more timely basis, advance rulings to taxpayers or their tax representatives. The Department could simply release the rulings and let tax practitioners, who are its clients, analyze them and draw their own conclusions.

20.33 The Department currently releases severed versions of all 3000 written technical interpretations it gives each year. These severed documents are released under contract with commercial publishers, who obtain, for a fee, the copyright to the information. They then distribute it to taxpayers in electronic and in printed format. This appears to be an efficient way of releasing important information to taxpayers and improves the timeliness

of the information provided. We believe the Department should consider adopting this process for releasing the advance income tax rulings, as well.

20.34 Severed versions of advance income tax rulings could also be released accompanied by the technical discussion sheet prepared by the ruling officer who processed the ruling request.

20.35 The Internal Revenue Service in the U.S. has been using this severing and release process since 1977. The release of the ruling is a condition under which it is issued. The publisher selects and comments on the rulings.

20.36 It is important for National Revenue to instil in its public three important characteristics of the tax administration process: integrity, equity and fairness.

(a) Integrity - the tax administration process operates with the basic expectation that everyone must and does pay his or her fair share of taxes due under the law.

(b) Equity - the tax enforcement process is applied impartially to all citizens.

(c) Fairness - the tax collector does not act capriciously or unreasonably in enforcing the law.

20.37 We believe that the tax administration process would be well served by making more advance income tax rulings available. Its transparency would be improved.

20.38 The Department of National Revenue should release to taxpayers, in severed form, issued advance rulings.

Department's response: The Department is committed to ensuring that its administration is not only fair and transparent but also responsive to clients' needs and responsible with government funds. In this respect, our research to date has indicated that taxpayers do not want to receive copies of all advance rulings if they are repetitive. If, after further consultation with the tax community, it is determined that a service similar to that provided by the American Internal Revenue Service is desired, the Department will provide such service to the extent that resources permit.

GOODS AND SERVICES TAX RULINGS AND INTERPRETATIONS

Background

20.39 The Goods and Services Tax (GST) was introduced in January 1991 and substantially amended in June 1993. As part of its efforts to promote voluntary compliance and self-assessment, National Revenue introduced a formal ruling procedure for administering the GST in November 1991. Prior to that date, written advice was given to registrants in the form of interpretations.

20.40 The ruling procedure is similar to the one used in the area of income taxation except that it defines an additional type of ruling, called an application ruling. Summarized below are the definitions of the types of rulings covered under the GST procedure.

20.41 Advance GST rulings are written statements issued by the Department to a registrant or other person, stating how specific provisions of the *Excise Tax Act* will be interpreted with respect to a specific proposed transaction that the person intends to carry out. **GST application rulings** involve the application of the GST to certain supplies of goods or services, to the status of persons as registrants, and to the determination of commercial activities; they relate to the person to whom they are given and to a specific, factual situation. Both types of rulings are considered binding on the Department.

20.42 The Department provides **interpretations** in response to requests for general explanations of how the Act would apply in clearly defined circumstances. These are not binding.

20.43 It is important to keep in mind that GST registrants, not taxpayers as is the case with the *Income Tax Act*, are the prime users of GST rulings. As agents of the Crown, registrants are required to collect GST on behalf of the government. Their interest in requesting a ruling is to be certain whether the goods and services they produce and sell are either taxable or not. If they do not collect taxes on taxable goods and services, they risk having to reimburse the government in the amount that should have been collected, and having to pay penalties and interest.

20.44 As of January 1993, the Department had issued only six advance rulings and 295 application rulings, and had replied to about 48,000 interpretations and information requests. The low volume of advance and application rulings may reflect the limited experience of registrants and tax advisors with the GST's application. It may also reflect the policy of the Department, which is to not issue rulings when there are pending amendments to the legislation; instead, interpretations are issued.

20.45 The delivery of GST rulings is more decentralized than that of advance income tax rulings. Thirty-four district offices and about 400 interpretation officers across the country issue application rulings and interpretations. Headquarters issues GST advance rulings, application rulings and interpretations. Since 1 July 1992, the Quebec Ministry of Revenue has been responsible for administering the GST in the Province of Quebec.

Audit Objective and Scope

20.46 The objective of our audit was to assess the appropriateness of procedures put in place by the Department to ensure the consistency and accuracy of GST rulings and interpretations.

20.47 Our audit was limited to GST rulings and interpretations. It included a review of GST rulings and interpretations and supporting documentation. We conducted interviews

at head office and in certain regional and district offices; we also interviewed private sector tax experts.

Observations and Recommendations

The risk of issuing inaccurate and/or inconsistent GST rulings and interpretations is high in a new system

20.48 Experience in interpreting and applying the GST is fairly recent and therefore limited. Administrative guidelines or positions, which facilitate the interpretation of the GST legislation by district office staff, do not always exist and must be developed before staff can respond to ruling and interpretation requests. The necessary technical expertise, which is acquired mainly through experience in dealing with ruling and interpretation requests and through formal training, is not fully developed. In an unmaturing system such as GST, the risk of issuing inconsistent or inaccurate rulings and interpretations is relatively high. The decentralization of interpretation services - along with other GST administration - to 34 district offices and about 400 interpretation officers increases the risk of inconsistencies and inaccuracies in rulings and interpretations.

***Department's comment:** The appropriate tools and processes are in place or in the process of being put in place to ensure that the risk is minimized. These include improved training, the availability of expanded research tools for the field offices, and an ongoing quality control process. The Department considers that, given the state of maturity of the GST system, the incidence of inaccurate rulings or interpretations has been minimal.*

20.49 Inconsistent and inaccurate rulings and interpretations may create situations where registrants producing and selling similar goods or services are treated differently. Such unfair treatment could also affect the public's perception of the GST and reduce compliance with the tax legislation.

20.50 In January 1993, the Department implemented a standardized Quality Assurance Program to ensure accuracy, consistency and uniformity in providing interpretations and application rulings across Canada. Prior to 1993, rulings and interpretations were reviewed in regions and at headquarters on an ad hoc basis.

20.51 Initial data from the new Quality Assurance Program revealed a global error rate of 15 percent in rulings and interpretations issued between February and June 1993. About six percent of issued rulings and interpretations were technically inaccurate, and nine percent were unclear or incomplete.

20.52 Both types of errors can be serious. Incomplete or unclear interpretations will be relied upon by other registrants and can lead to further errors in the future. It is also possible that the registrant requesting the interpretation will be misled by the incomplete or unclear response and will thus handle the response incorrectly.

***Department's comment:** The purpose of having a decentralized ruling system is to make registrant-specific advice at the local district office very accessible, with the view to*

eliminating the need to rely on a non-specific interpretation that might have been provided to another registrant.

20.53 Our interviews with staff in district offices and our review of application rulings and interpretations also revealed inconsistency about when to issue an application ruling versus an interpretation. In some instances, interpretations were issued, as requested by registrants, even though application rulings could have been provided. In other instances, interpretations were issued, even though an application ruling was requested and all relevant facts were provided. Also, due to the numerous changes proposed to the legislation, there were many instances where interpretations should have been given instead of application rulings. Specific training is being given to district offices with respect to when application rulings and interpretations are to be given.

20.54 Registrants issued an interpretation do not receive a binding commitment from the Department that it will not change its position when it audits them. As a result, an inequity exists, that is to say, registrants issued an interpretation do not enjoy the same benefit as registrants issued a ruling.

***Department's comment:** The right to obtain a ruling is not restricted and, in part, depends on the degree of detailed fact the registrant is willing to provide. If all of the facts are provided, a ruling will be given. In many cases, interpretations are issued because changes to the law have not been adopted by Parliament. In this situation, rulings would not be issued to any registrant, so the perceived inequity would not be relevant.*

20.55 The Department has advised us that, in the case of an interpretation error, it would maintain its interpretation until the error was found and the registrant advised; that way, the registrant would not suffer any hardship. The Crown would bear the cost of the error.

20.56 While the registrant would not suffer any harm in such a case, competitors and customers may well be affected. Competitors charging the GST may lose customers to registrants not charging the GST as a result of an interpretation or ruling error. If the tax is collected erroneously, remitting the tax to customers who paid it may be a problem because they cannot be identified.

There is a need to enhance current training efforts

20.57 The Department recognizes that there is a need to increase the technical expertise of its staff in regional and district offices. It has developed tools to enhance staff expertise in applying the GST legislation. An automated database that contains advance and application rulings, precedent-setting rulings and interpretations, and policy statements issued by headquarters was developed to facilitate research in processing ruling and interpretation requests. These documents are made available electronically to regional and district offices. Training manuals in the areas that present major interpretation difficulties - real property and financial institutions - have been and are being developed. Seminars have also been given by head office personnel in these specialized areas.

20.58 The Department also provides various types of training, ranging from formal training courses such as "Basic GST Legislation" to seminars and videos on the impact of GST amendments. However, during our interviews with staff from district offices, interpretation officers expressed a need for more training in how to interpret GST legislation. Although the Department has included such training in its 1993-94 training plan, no training course has been developed yet.

20.59 National Revenue should ensure that all relevant training is provided to its staff on a timely basis.

Department's response: The Department recognizes the importance of training in maintaining a consistent, timely and accurate rulings and interpretation service. Various training tools have been produced for use by staff dealing with rulings and interpretations. These range from videos on specific topics to in-depth seminars on difficult technical areas and timely training materials on the amendments package related to Bill C-112.

Furthermore, a course on how to interpret GST legislation is now being developed as is a project to update the Basic GST Legislation course. National Revenue is committed to providing up-to-date technical training.

Sections of the Canada-Quebec agreement on GST rulings and interpretations issued by the Province of Quebec are not fully implemented

20.60 Under the Canada-Quebec agreement on the administration of the GST, the Province has agreed to process all requests for interpretations or advance rulings relating to the GST; this is to be done in accordance with interpretations already issued in similar matters or with Canada's tax policy. Quebec has also agreed to provide Canada with a copy of all rulings and interpretations issued. And it has agreed that, before informing the applicant, it will submit all precedent-setting interpretations or advance rulings to Canada for approval.

20.61 Our examination revealed that Canada and Quebec have taken actions to implement the sections of the agreement related to GST rulings and interpretations issued by Quebec.

Department's comment: The basic rules regarding the exchange of information and statistics necessary to perform effective quality control with respect to rulings and interpretations in the Province of Quebec are provided for in the agreement. Revenue Quebec has been very co-operative in providing any information requested, and full implementation of required processes and procedures is expected to be attained in the near future.

20.62 Quebec has provided Canada with a description of the quality control procedures it has established to ensure that its rulings and interpretations are consistent and accurate. However, quality control reports have not yet been provided to Canada.

20.63 Canada receives precedent-setting interpretations on a regular basis and has requested that interpretations and information letters issued by Quebec field offices be forwarded to it. At the time of our audit, Canada had not yet received the information requested.

Communicating more information on rulings and interpretations to the public would increase equity among GST registrants

20.64 In its GST Memorandum of Rulings, the Department of National Revenue indicates that it has no plans to publish specific GST rulings. Rather, the policy content of any GST ruling that sets a precedent will ultimately be incorporated into other departmental publications, such as GST memoranda.

20.65 The Department makes policy statements available to the public and to commercial tax publishers. Indeed, 37 policy statements have been released since 1 June 1993. It is the intention of the Department to use the policy database to isolate and clarify the main policy content of rulings and interpretations given.

20.66 Regional offices have access to specific GST rulings and interpretations. We believe that, since it is important for the Crown to have access to these documents in issuing rulings and interpretations, it is equally important that registrants, who are agents of the Crown, have access to them.

Department's comment: Rulings that are accessible at the regional office level for research purposes are limited to those issued by head office and the database is appropriately caveated with respect to possible changes in law and position, etc. It is intended that the Policy Issues database, the Question and Answer database, and other relevant research material that is available to the public will be the basic research tools used in providing interpretations at the district offices.

20.67 National Revenue should make available to registrants and other interested members of the public all issued GST rulings and technical interpretations.

Department's response: Releasing more rulings and interpretations to the public may not achieve the desired results of providing greater certainty and equity to all registrants. The application of GST is very often fact-specific. To encourage registrants to determine their GST liability by referring to decisions based on others' fact situations may cause misapplication of the tax, with subsequent problems of assessment and enforcement. The approach we have followed is to publish policy guidelines with examples of their application and to provide individual, fact-specific rulings where registrants want specific guidance.

The decentralized rulings structure whereby the District Offices issue rulings is meant to facilitate client service. Further, there is a substantial amount of public information available that outlines the Department's policies and positions. In addition to memoranda and technical information bulletins, there is a Question and Answer database and a Policy Issues database that set out departmental policy positions that, in effect, distil and

condense the main issues that arise from ruling requests. Specific sectors have also been targeted with published information pamphlets.

Nevertheless, we will explore the benefits of publishing all GST rulings and interpretations in the course of integration of Revenue Canada's Excise and Taxation rulings and interpretation service. If publication is considered beneficial by the tax community, we will provide this service to the extent that our resources permit.

Chapter 21

Department of National Revenue

Electronic Filing of Individual Income Tax Returns

Main Points

Introduction

- Electronic filing is central to National Revenue's vision of efficient tax administration
- Taxpayer acceptance of electronic returns has exceeded National Revenue's expectations

Audit Objectives and Scope

Observations and Recommendations

- New Returns-processing Regime
 - Using a phased-in approach, National Revenue put EFILE in place nationwide a year ahead of schedule
 - Absence of timely cost-benefit analysis weakens accountability for EFILE
- Impact on Voluntary Compliance
 - Introduction of EFILE may have an impact on voluntary compliance
 - The Department needs to expand its efforts to monitor changes in voluntary compliance caused by introducing paperless returns
- Legal Matters
 - Legal advice was sought on a regular and timely basis
 - EFILE requires a new way of linking a taxpayer with a return
- Control Environment
 - Screening of tax preparers and transmitters is a first line of defence
 - Our audit focussed on three sets of controls over EFILE returns
 - The Department has appropriate, automated front-end edit checks built into the EFILE system
 - Some limited checks are done on electronic returns as part of initial assessing
 - Processing review can be used to improve the Department's ability to identify erroneous or fraudulent EFILE returns
 - Earlier matching would reduce risks related to paperless filing
- Information for Parliament
 - Information to Parliament can be improved

Summary and Conclusion

Exhibits

21.1 Relationship of Participants in the EFILE Program

21.2 Manual Processing Steps Replaced by EFILE

21.3 EFILE Statistics

- 21.4 Audit Criteria
- 21.5 Items Targeted for Monitoring
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- 21.7 National Revenue's EFILE Control Environment
 - 21.7.1 Front-end Edits
 - 21.7.2 Pre-assessment Verification
 - 21.7.3 Post Assessment Verification

Department of National Revenue

Electronic Filing of Individual Income Tax Returns

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Main Points

21.1 In an effort to enhance productivity and improve service to taxpayers, the Department of National Revenue instituted a program for electronic filing of personal income tax returns, which was launched nationwide this year. This program is known as EFILE. With EFILE, the Department has demonstrated a continued commitment to pursue and develop new, innovative tax administration technologies.

21.2 Departmental statistics reveal good initial acceptance of the program. About 2.1 million taxpayers filed their 1992 returns using EFILE, surpassing by a considerable margin National Revenue's own predictions.

21.3 The Department tested the data capture and transmission systems on which EFILE is based through a phased-in implementation. This proved successful.

21.4 EFILE is also paperless. Taxpayers using EFILE are not required to submit any supporting documentation unless the Department asks for it. The Department made this decision based on limited knowledge and assessment of the impact that such a move would have on voluntary compliance. The potential for revenue loss if taxpayers' voluntary compliance deteriorates could be significant. The Department needs to expand and improve its efforts to monitor changes in voluntary compliance.

21.5 New verification programs related to the introduction of EFILE are evolving. Most of the work of those programs takes place after refund cheques or initial assessments are issued. To mitigate the risks of revenue loss associated with paperless electronic returns, National Revenue should conduct its present document matching program earlier, at the time that tax returns are filed.

Introduction

Electronic filing is central to National Revenue's vision of efficient tax administration

21.6 The Department of National Revenue is positioning itself to meet the demands of the next decade. It is using technology to simplify tax administration practices and improve service to taxpayers. It also seeks to reduce costs by improving productivity. Over the past few years, the Department has demonstrated a strong commitment to pursue and develop new, innovative tax administration technologies.

21.7 The electronic filing of personal income tax returns is one such initiative. Launched nationwide this year, electronic filing has caused profound changes to tax administration practices. The implications are far-reaching, since electronic filing is the forerunner of changes that will also affect the processing of paper income tax returns. Departmental officials have indicated that returns processing is undergoing the most significant restructuring of the last 30 years.

21.8 Electronic filing (EFILE) provides taxpayers with an alternative to paper tax returns. With EFILE, personal income tax information is sent electronically to National Revenue, using communication lines. EFILE is paperless - taxpayers who use it are not required to submit any supporting documentation unless the Department asks for it. However, taxpayers are expected to retain the information for a period of six years.

21.9 EFILE offers substantial opportunities for National Revenue to streamline its operations. The Department believes that EFILE will reduce the cost of entering information from tax returns into its computer files. EFILE means less paper to handle, fewer keying errors and fewer arithmetical errors on tax returns as originally submitted. It also means reducing the Department's storage facility requirements. Other benefits made possible with EFILE include providing a new vehicle for the Department to communicate with the tax preparation and software industries. ([see photograph](#))

Taxpayer acceptance of electronic returns has exceeded National Revenue's expectations

21.10 Taxpayers who wish to file their returns electronically must submit their returns to National Revenue through an authorized EFILE tax preparer and transmitter (see [Exhibit 21.1](#)). Taxpayers have several options when choosing to use EFILE. They may:

- have the return completed by the tax preparer, who will also electronically file the return;
- complete the return on paper and then have a tax preparer convert it to an EFILE format; or
- use EFILE microcomputer software to complete the return and then provide the tax preparer with an electronic copy of it.

Once the return is in EFILE format, the tax preparer sends it to a tax transmitter. The transmitter batches the return with other returns and transmits them to National Revenue over dedicated communication lines. The fee for transmission services usually ranges from \$5 to \$15. Tax preparers may offer transmission services free of charge or include the services in the preparation fee.

21.11 For taxpayers, electronic filing means that they receive their assessments and tax refunds in less time. Electronic returns bypass various manual processing steps - such as sorting, batching and data transcription - that are necessary for paper returns (see [Exhibit 21.2](#)). Those processing steps, which the Department estimates can take as long as three weeks if done manually, are automated for electronically filed returns.

21.12 Assessments for electronic returns are processed within about 14 days, compared to the usual three to eight weeks for paper returns. Where taxpayers have asked to have refund cheques deposited directly to their bank accounts, the wait under EFILE can be as brief as eight days. The system also provides authorized transmitters with National Revenue's acknowledgment of receipt of transmission within hours.

21.13 National Revenue statistics show the program's appeal (see [Exhibit 21.3](#)). In its first year of nationwide operation, about 2.1 million taxpayers used EFILE (about 11 percent of personal tax return filers), surpassing by a considerable margin the Department's own predictions. In the United States, it has taken the Internal Revenue Service three years to reach this percentage. The Department estimates that individuals who used EFILE were assessed \$6.4 billion in federal tax revenues for 1992, representing approximately 12 percent of the total for the year. Currently, about 95 percent of personal tax returns are eligible to be filed electronically. Generally, all but the more complex returns (such as those involving deceased taxpayers, or non-residents) are eligible.

21.14 Statistics show that individuals using EFILE are mostly those expecting larger tax refunds. For 1992 returns, 78 percent of taxpayers who used EFILE received refunds averaging \$1272, compared to a \$987 average for paper and electronic returns combined. Over the last three years the average refund for EFILE returns has consistently been higher - by at least 20 percent - than the average refund overall.

21.15 National Revenue anticipates that EFILE volume will double next year, reaching four million returns, or roughly 20 percent of all personal income tax returns. In the future, the Department intends to make EFILE more widely accessible to individuals at the lowest cost possible while maintaining high security. As a long-term objective, the Department wants to expand the scope of electronic filing to include corporate and trust tax returns.

Audit Objectives and Scope

21.16 Our audit focussed on the control environment in place for 1992 EFILE returns. In particular, we looked at components of the system designed to ensure its overall integrity and security, and at systems development activities undertaken by the Department prior

to nationwide implementation. Our ultimate objective was to seek reasonable assurance that EFILE was operating as designed and that the overall system design was sound. We also examined the legal considerations related to EFILE as well as the financial risks surrounding paperless returns. Finally, we looked at the extent to which Parliament has been kept informed on the progress of EFILE, including information on associated costs, risks and expected performance. [Exhibit 21.4](#) lists the criteria we used during the examination.

Exhibit 21.4

Audit Criteria

In deciding to proceed with new systems development projects, the technical feasibility, related costs, benefits and risks and other factors, including impact on voluntary compliance, should be taken into consideration.

The Department should have in place a comprehensive implementation strategy and sound project management techniques for new systems development projects.

There should be an adequate system of internal control for all projects and sufficient, appropriate and timely verification programs to compensate for any reduction in existing controls.

For new projects, the necessary legal authorities should be in place before moving on to each new stage of a project, and appropriate procedures established to satisfy legal proof issues.

There should be in place a framework for monitoring and evaluating the EFILE program, procedures for collecting the necessary performance information and procedures for reporting thereon.

For programs designed to improve service to taxpayers, performance compared to service standards should be reported on periodically.

21.17 We conducted our audit work in National Revenue's head office, six taxation centres, and eight district offices.

Observations and Recommendations

New Returns-processing Regime

Using a phased-in approach, National Revenue put EFILE in place nationwide a year ahead of schedule

21.18 EFILE was implemented over a four-year period, becoming available to all Canadians in February 1993, at least one year ahead of schedule.

21.19 The Department proceeded in a systematic way to develop the data capture and transmission systems on which EFILE is based. It tested the technology and public acceptance of EFILE through phased-in operations in western Canada, the Northwest

Territories, the Yukon and Quebec. Gradual implementation proved successful on other fronts as well. It enabled the Department to check the computer and telecommunications systems supporting EFILE for capacity and response time at different volume levels, and provided a good test for built-in systems controls, including the production of acknowledgments.

21.20 During the phase-in period, the Department surveyed Canadians on their receptiveness to EFILE as a filing alternative and kept pace with legal considerations affecting electronic paperless returns. It also consulted with representatives of the tax preparer, transmitter and software industries.

Absence of timely cost-benefit analysis weakens accountability for EFILE

21.21 After the 1989 pilot, the Department proceeded with the phased-in implementation of EFILE. At the time this decision was taken, the Department had not conducted a cost-benefit analysis of EFILE. In 1991, in an effort to get Treasury Board approval for increased resources for EFILE and other activities, the Department prepared an analysis of the costs and benefits of EFILE. This analysis covered a ten-year period but, given its purpose, did not look back to costs incurred prior to 1991. The Department estimated that after ten years the cumulative savings would offset the cumulative operating and capital costs of the initiative.

21.22 The absence of an analysis of expected costs and benefits at the time the decision was taken weakens the accountability for the EFILE project. The fact that an analysis was done later, albeit for a purpose other than supporting the decision and establishing a basis for accountability, mitigates our concern somewhat.

21.23 Also required for adequate accountability is an appropriate mechanism to monitor costs and to verify that planned benefits are achieved. The Department indicates that, although it monitors the costs of various activities and components of its operations, it does not think it feasible, practical or meaningful to track costs specific to initiatives such as EFILE. We appreciate the Department's concern that an elaborate accounting system may not be worth the effort needed to maintain it for some projects. However, we think it possible, given today's technology and software, to find a suitable, economical accounting system in most circumstances.

21.24 With respect to benefits, the Department most recently estimated, in May 1993, that it will save 62.5 person-years or \$1.8 million in front-end mailroom, keying, storage and error correction activities for every one million EFILE returns processed. The Department has begun to redeploy staff savings to other areas. ([see photograph](#))

21.25 The Department should perform a cost-benefit analysis on a timely basis for projects such as EFILE and should put in place appropriate systems for monitoring costs.

Department's response: The Department agrees that a cost-benefit analysis is normally a basic ingredient when recommending an initiative. As noted, EFILE offers substantial

opportunities to streamline operations. The Department already has appropriate systems in place to accurately cost various activities and components of overall operations; but it considers tracking costs specific to initiatives such as EFILE to be neither practical nor meaningful, until they become support tools for the new lines of business.

Impact on Voluntary Compliance

Introduction of EFILE may have an impact on voluntary compliance

21.26 Paperless filing means that information slips and receipts such as T4s, T5s and charitable donations receipts do not accompany electronic tax returns when they are sent to National Revenue. The move to paperless filing affects the nature and timing of verification that the Department can do of information contained in tax returns. Perhaps more important, it could affect the care exercised by taxpayers in preparing their returns.

21.27 In a paperless environment, information slips and receipts are not available immediately to National Revenue to check the legitimacy and accuracy of income and deduction amounts reported by taxpayers. With paper returns, information slips and receipts are available at the time of initial assessment and are subject to some checking. If National Revenue finds an error, or suspects an intentional misstatement, it can correct it or follow it up immediately to keep the error or misstatement from entering the assessment. The absence of this information would seem to increase chances that assessments based on incorrect information may be issued. Incorrect assessments can, in turn, lead to incorrect social benefit entitlements where benefits received by taxpayers are tied to tax return information.

21.28 Also, it seems likely that taxpayers who are required to file information slips and receipts will be more careful to ensure that the amounts they record on tax returns agree with the supporting documentation. In a paperless system, taxpayers might be less diligent about keeping and using supporting documents and thus more likely to make errors or misstatements. Granted, the information should still be available and taxpayers will still have to present it if National Revenue asks them to.

21.29 Finally, there may be taxpayers who see the elimination of the requirement to file information slips and receipts as an opportunity to cheat on their tax returns. Some may be individuals who would deliberately try to evade taxes in any case; others may simply find that an innocent error one year goes undetected, and then try the next year to slip a not-so-innocent error past National Revenue. Our concern is further heightened by recent literature on the Canadian underground economy, which seems to suggest that an increasing number of Canadians are turning outside of the formal economy to evade paying taxes.

21.30 We are concerned that National Revenue's paperless EFILE initiative may ultimately lead to a reduced level of voluntary compliance by taxpayers, an increased enforcement problem, and a significant loss of tax revenue for the government. We recognize that the Department generally has three years to reassess personal tax returns and that it intends to devote increasing resources to post assessment verification

programs. Lost tax revenue could be recovered. But the Department does not have the resources to ensure that every erroneous tax return is reassessed. Moreover, even for those that are reassessed, collection is not guaranteed. However, we note that the Department can offset refunds in any one year against taxes owing from prior years.

21.31 In 1991 the Department reported on a qualitative threat-risk assessment of paperless EFILE, after which it removed most of the paper filing requirements for EFILE returns for that year. The Department considered it crucial to review the 1991 returns for impacts prior to nationwide implementation. However, in the end it decided to eliminate the requirement to file supporting documentation, without first having seen the results of the test (see paragraphs 21.35 and 21.36).

21.32 The United States and Australia both have systems for electronic filing of personal tax returns. In the United States, the Internal Revenue Service still requires taxpayers who file their returns electronically to send in third-party information slips on employment earnings and income tax withholdings. In Australia, the same type of information slip as well as third-party information slips supporting pension contributions are required either to be sent to the Australian Taxation Office or to be presented to a tax preparer, who will retain them on the Taxation Office's behalf.

21.33 It is significant that neither Australia nor the United States has removed completely the requirement to provide supporting documentation for income tax withholding amounts at the time of filing. Income tax refunds represent mainly the repayment of excess amounts of tax withheld from employees at source. An error that overstates tax withholdings can cause an overstated refund to be issued. In not requiring evidence of income tax withholdings before issuing refunds, Canada is clearly accepting a greater level of risk of incorrect refunds than has been accepted by the United States and Australia.

21.34 The Department has put in place new verification programs to compensate for the change in the control environment related to the introduction of EFILE. However, these were developed only recently and are still evolving, and some aspects were untested prior to nationwide implementation. As well, the resulting verification activities largely take place after the refund cheques are issued. Given these circumstances, National Revenue's ability to contain the risks associated with paperless EFILE returns has not been proven, particularly in this first year of nationwide implementation and in view of the unexpectedly high volume.

The Department needs to expand its efforts to monitor changes in voluntary compliance caused by introducing paperless returns

21.35 Given that the Department has undertaken this bold initiative, in the ensuing years it needs to monitor the effects of paperless electronic filing on voluntary compliance. A monitoring program was instituted for the 1991 EFILE return, which was mostly paperless. The program compares, for particular items on the tax return, the compliance rate of taxpayers who filed paper returns with that of taxpayers who filed electronically. The compliance rate is based on the number of adjustments the Department identified for

the particular items after verifying amounts reported by taxpayers. Preliminary results for the 1991 tax year revealed that going paperless had no significant impact on compliance.

21.36 In our opinion, however, the preliminary results are far from conclusive. First, they are based on a comparison of only five items (the EFILE program looked at 13 items but comparative data for paper returns were obtained for only five). Second, the five items did not include information on income and income tax withholdings, which often are claimed by people filing electronic returns and which U.S. experience shows are frequently implicated in frauds involving electronic returns. Third, there may be differences in the characteristics of the EFILE and paper return filing populations that render the respective samples incomparable. Fourth, the data from only one year are incapable of revealing trends. Changes in voluntary compliance may vary substantially from one year to the next and may be cumulative over time.

21.37 It might be argued that the exclusion of information on income and income tax withholdings from the Department's monitoring program is not significant, since these items are covered in its matching program (which compares information on T4 slips filed by employers with information on personal tax returns). But at present, the matching program is not set up to compare the incidence of discrepancies between EFILE and paper returns. We understand that, subsequent to our audit, the Department requested that this information be captured from its systems.

21.38 We also observed that the Department is changing the composition of items targeted for monitoring of taxpayers' voluntary compliance. As shown in [Exhibit 21.5](#), for 1992 the Department has selected 16 items to monitor on the EFILE tax return. But only about half of these are in common with the 13 items selected for monitoring from the EFILE returns for the program in the previous year. Moreover, to compare the compliance rates between EFILE and paper returns for 1992, the Department will have data for ten items. However, only four of these items are in common with the five reported on in the previous EFILE-to-paper comparison. This will limit the Department's ability to evaluate changes in voluntary compliance over time as the EFILE program expands and evolves.

21.39 In monitoring taxpayers' voluntary compliance, the Department should increase the scope of items covered, ensure that the most significant items are included, and ensure the year-to-year comparability of sample characteristics.

Department's response: The Department agrees that it is essential to monitor the level of voluntary compliance and make periodic comparisons. To that end, the Department will continue to use current compliance monitoring methods and pursue any further improvements in compliance monitoring techniques, as they become available.

Legal Matters

Legal advice was sought on a regular and timely basis

21.40 The Department devoted a lot of effort to the legal issues that the EFILE initiative raised. On the whole, we found that it sought legal advice regularly on a broad range of issues. The legal advice was requested and received in time to modify project plans when necessary.

21.41 The Department was required to seek amendments to the *Income Tax Act* to accommodate changes brought about by the EFILE initiative. The required amendments were tabled in the House of Commons in June 1992 and received royal assent in June 1993. The amendments provide a legal basis for EFILE returns and define the weight that will be given to EFILE data in a court of law.

21.42 We noted that the Department proceeded with full implementation of the initiative nationwide in advance of the necessary legislative changes. Although legislation was passed in June of 1993 with retroactive application to 1992, the Department had completed its processing of the 2.1 million EFILE returns for the 1992 tax year, the first year of nationwide implementation, while legislation was still pending.

EFILE requires a new way of linking a taxpayer with a return

21.43 One legal issue was that the advent of EFILE required new methods to establish the origin of a tax return, and to link a return with an individual. The method chosen to link a taxpayer with a return is a paper form T183 (Authorization and Declaration for Electronic Filing). On this form, taxpayers declare specific financial information from their electronic returns. The form has other purposes as well. With it, the taxpayer also authorizes the electronic filing of a tax return; acknowledges that the Department is liable for the confidentiality of the data only upon its receipt of the electronic return; and authorizes the EFILE tax preparer, within limits, to correct and retransmit the return if the original is not accepted by National Revenue.

21.44 Taxpayers wishing to use EFILE are required to sign the form and to retain a copy; the Department may ask to examine it at a later time. EFILE tax preparers are also required to keep copies of their clients' T183 forms for a period of six years. Failure to do so may result in a tax preparer's rejection from the EFILE program.

21.45 The Department checks that tax preparers are maintaining their copies of the T183 form. For the 1992 returns, the Department contacted 75 percent of its authorized EFILE tax preparers and asked them to provide the forms for 22,500 EFILE tax returns. It found that 95 percent of the T183 forms were completed in accordance with the Department's requirements. The sampling method was not designed to ensure a specific degree of confidence that preparers were complying with the requirement as designed. For 1993, the Department plans to use a statistically based monitoring process to select returns for T183 monitoring. This should provide it with greater confidence that EFILE tax preparers are in compliance.

21.46 Although we are unable to determine the risk of loss associated with having this potentially important document kept outside the custody of National Revenue, we are concerned that the evidentiary link between tax returns and taxpayers may be broken. Our

concern is heightened by the fact that the Department is silent on security and confidentiality standards for the safekeeping of T183 forms at EFILE tax preparer premises. As well, the Department has no procedures to follow with respect to the forms in the event of sale or closure of an EFILE tax preparer's business.

21.47 The Department has indicated that the lodging of taxpayer authorization forms processed off-site is an interim position. It is pursuing new cost-effective technologies to receive electronic transmissions of taxpayer authorizations and signatures at the time of filing.

21.48 The Department should specify standards for security and confidentiality of the T183 forms lodged at tax preparer premises, as well as procedures to follow in the event of sale or closure of a tax preparer's business.

Department's response: Ongoing monitoring of form T183 has not revealed any problems associated with the security and confidentiality of these forms. We are also investigating voice recognition and electronic signature technology that should render this form obsolete.

Control Environment

Screening of tax preparers and transmitters is a first line of defence

21.49 To become an authorized EFILE tax preparer or transmitter, interested individuals or businesses must pass a screening test for suitability. Screening is a first line of defence to prevent unsuitable participants from entering the program. EFILE co-ordinators in the Department's district offices are responsible for deciding whether to accept or reject an applicant on the basis of established and public criteria. The co-ordinators check the Department's tax records for such items as failure to file tax returns and failure to pay tax liabilities, as well as for any convictions under the *Income Tax Act*. There are a number of other screening criteria that the Department has established but it leaves it to the district office co-ordinators to judge which ones to follow up. Despite this screening process, it must be stressed that there is no obligation on the part of tax preparers (whether preparing EFILE or paper returns for clients) to ensure that amounts reported by taxpayers are reasonable and substantiated. The obligation to declare income and claim only those deductions that are appropriate rests with the taxpayer.

21.50 We noted that the application form asks potential tax preparers and transmitters for only limited information. For instance, unlike the Internal Revenue Service (IRS), the Department does not require disclosure of associates, and does not require applicants to state if they have been assessed penalties in the past, if they have been convicted of a monetary crime, if they have unpaid tax liabilities, or if they have ever been convicted of a criminal offense under the *Income Tax Act*. Disclosure of such information on National Revenue forms would provide useful data for the screening process. We also observed that, unlike the IRS, the Department has no authority to invoke penalties against applicants who submit false or erroneous information.

21.51 EFILE tax preparers and transmitters must apply for authorized status each year, but they might undergo suitability screening only once every three years. In the intervening period, the Department may accept them on the basis of their performance in the program in the prior year(s). For the 1992 tax year, the Department rejected 15 applicants and accepted a total of 7100 into the EFILE program. Of these, 4520 were preparers, 75 were transmitters and 675 were both transmitters and preparers. The remainder were inactive. EFILE has expanded considerably over the past few years and the Department foresees significant growth in the number of EFILE applicants. It is critical that the Department have sufficient resources in its district offices to ensure proper screening for suitability, and to monitor EFILE tax preparers and transmitters in the years between their suitability screenings. [Exhibit 21.6](#) provides statistics on tax preparer volume for the 1992 EFILE returns.

21.52 The Department should improve the design of its application form to facilitate the screening of applicants for EFILE tax preparers and transmitters. The Department should assess the extent to which established criteria for suitability screening are being followed up. Criteria that are not being followed up should be reviewed by the Department and removed from the established list if found to be invalid. The Department should also consider seeking legislative authority to invoke penalties against applicants submitting false or erroneous information.

Department's response: The Department is in the process of redesigning the application form to facilitate screening of potential applicants. Suitability screening criteria, and procedures associated with their application, are in the process of being revised. National Revenue presently has the authority to deny an applicant entry into, or revoke participation in, the EFILE program if false or erroneous information is submitted, thus seriously impacting the economic livelihood of the applicant. A tax preparer penalty is under consideration to provide a less draconian alternative.

Our audit focussed on three sets of controls over EFILE returns

21.53 Controls over EFILE returns (see [Exhibit 21.7](#)) are of three broad types. Two of these types either operate or are triggered prior to an assessment or before a refund is issued. The third type operates after an assessment or after a refund is issued.

21.54 In the first category are computer-based controls over the transmission of data from preparers or transmitters to National Revenue. The objective here is primarily to ensure that the information received by the Department has been transmitted by authorized third parties, is complete and is in a usable format. We refer to controls of this type as front-end edit checks.

21.55 The second category consists of controls meant to highlight returns that may not comply with the tax law. These controls can be partly computerized and partly manual. Returns are highlighted before an assessment or before a refund is issued but may not be followed up until afterward. The controls of this type include confidence validities, error clues and the fraudulent refund detection program.

21.56 The third category of controls differs from the first two in that the controls operate only after assessments have been completed and refunds issued, but their purpose is the same - to detect possible noncompliance. The processing review and matching programs fall into this category.

The Department has appropriate, automated front-end edit checks built into the EFILE system

21.57 With EFILE returns, transmitters send taxpayer information to National Revenue over secure dedicated communication lines. Before the Department will accept an electronic transmission, it verifies the format and ensures that the transmitter has been approved to file electronically (see [Exhibit 21.7.1](#)). Transmissions that do not pass this initial acceptance test will be rejected by the system. After acceptance, EFILE returns undergo a number of systems checks and balances using computer logic before they are acknowledged. For some discrepancies, the returns will be sent back to EFILE tax preparers for correction through their authorized transmitters. In this way, the acknowledgment process tries to ensure greater accuracy at the beginning of the process and eliminates the need for the Department to perform some corrections.

21.58 During our audit, we tested the automated edit checks built into the EFILE system, which are designed to ensure that the data as initially submitted are arithmetically correct, the tax preparer's and transmitter's numbers are valid and the EFILE transmissions that the Department accepts for subsequent processing, including the generation of corresponding acknowledgments, are complete. The results of our tests confirmed that appropriate controls exist and that these controls are effective in meeting their design objectives. Further, the Department asked the Royal Canadian Mounted Police to conduct a security review of EFILE front-end systems prior to nationwide implementation. The Department has made changes to the EFILE systems as a result of this review and has contacted the RCMP to assess the adequacy of these security improvements.

Some limited checks are done on electronic returns as part of initial assessing

21.59 Once EFILE returns have passed the acknowledgment process, they undergo other systems checks designed to identify unusual amounts and potentially excessive claims prior to initial assessments and the issuing of refund cheques (see [Exhibit 21.7.2](#)). Suspicious returns are selected automatically by the system, based on pre-determined criteria known as confidence validities. Examiners following up on confidence validities perform a number of procedures to satisfy themselves about the amounts claimed. In some instances, the taxpayer is contacted and asked to submit receipts.

21.60 Departmental statistics reveal that the number of electronic returns subjected to follow-up activity for confidence validities was small - about 6 of every 1000 returns filed this year. Selection criteria for confidence validities and the volume of transactions the Department reviewed were based in part on availability of staff and on the need to achieve a balance between the objectives of enforcement and maintaining taxpayer acceptance of the program.

21.61 At the time of initial assessment, electronic returns are also subjected to the same automated systems checks for reasonableness that are in place for paper returns. These checks are known as error clues. When error clues are combined with confidence validities, the volume of EFILE returns requiring follow-up action increases to about three percent of electronic returns filed for 1992.

21.62 If following up on unusual amounts and potentially excessive claims raises a suspicion of fraud in an electronic return, it will be examined in the fraudulent refund detection program. Paperless electronic tax returns may necessitate the development of new procedures to identify fraud, since examiners' procedures for detecting fraud on paper returns may not be appropriate for electronic tax returns. In the U.S., the IRS is developing better ways to identify fraudulent electronic returns. We note that National Revenue's detection program has not been modified for electronic returns. The Department has indicated that enhancements to the program are in the planning stage.

21.63 Although confidence validities, error clues and the fraudulent refund detection program are applied at the front end, the combined rate at which EFILE returns are examined is less than for paper returns during initial assessment.

Department's response: The Department considers that the controls, i.e., confidence validities, on-line error clues and the risk assessment profiling, will contain the risks associated with EFILE. In addition the Department continues to work actively on enhancements to these controls as well as investigating other compliance mechanisms.

Processing review can be used to improve the Department's ability to identify erroneous or fraudulent EFILE returns

21.64 To compensate for the reduction in front-end verification, the Department has put in place a new back-end verification program (see [Exhibit 21.7.3](#)).

21.65 In 1991 the Department reported a study, based on 1989 taxpayer return information, to assess the benefits of manual up-front verification and follow-up of automated systems reasonableness checks prior to initial assessments or the issuance of refund cheques. The study indicated that those procedures had resulted in the collection of approximately \$119 million in additional tax revenue by the Department. Of that amount, \$61 million was the result of manual up-front verification of documents supporting income and deduction amounts.

21.66 From the Department's perspective, returns processing would be more cost-effective if effort were focussed on examining returns that have the most potential for additional revenue. In its view, the key would be to ensure that any enhanced back-end review process would generate at least as much revenue as would have been generated by the up-front verification steps that were eliminated.

21.67 To implement this strategy, the Department created a new verification program called processing review, which addresses paper and EFILE returns separately. The program is run several months after returns are first processed and refund cheques issued.

For EFILE returns, the Department verifies information by asking taxpayers to submit supporting documents. Its overall goal is to maintain the integrity of the tax system by ensuring that tax returns are properly assessed.

21.68 One objective of processing review is to provide information that can be used to update the criteria used by National Revenue to identify potential areas of abuse for further investigation. Part of the processing review program involves verification of a random sample of returns, and another part involves verification of a non-random "compliance" sample of returns that are considered most likely to contain errors. These samples will cover 22 items on the 1992 return.

21.69 The compliance or non-random sample currently is selected using criteria that are plausible but arbitrary, and that have not been empirically tested prior to implementation. The random sample is intended to identify and test such criteria. If proven effective, they can be incorporated into the routine for selecting subsequent compliance samples.

21.70 We wanted to find out whether the new back-end review process (processing review) had generated as much revenue as would have been generated by the up-front verification steps that were eliminated. We found that the Department had not collected the information necessary to answer this specific question. As an alternative, we looked at information that the Department had gathered for other purposes to see whether it could shed light on the question.

21.71 We found that, in 1993, the Department estimated the maximum additional revenue that might have been found in a sample of certain types of unverified items on 1991 paper returns if the returns had still been subjected to manual up-front verification for these types of items. The amount was estimated at \$39 million but, due to the fact that taxpayers were not contacted to provide explanations or other supporting documents, the Department feels that this figure overstates the maximum revenue foregone (possibly by as much as 50 percent). By way of contrast, we note that the actual reassessments resulting from the new back-end review of the paper returns for the same types of items amounted to only \$1.2 million.

21.72 The significant variation suggests that the focus on enhanced back-end verification may not be as effective in generating additional revenue as was anticipated. We assume that the experience with respect to the same types of items on electronically filed returns would be similar to the above results relating to paper returns.

21.73 This also illustrates the need for the Department to establish appropriate, reliable measures for evaluating the effectiveness of the back-end verification process. The proxy measures that we made use of are adequate for our purpose but we would expect the Department to have better information for its own monitoring requirements.

21.74 The verification of both the random and compliance samples is meant to fulfil yet another objective of the processing review program - to heighten taxpayers' awareness of the Department's enforcement activities. However, the Department is conscious that

pursuing this objective for EFILE returns would impact on another departmental objective: to make using EFILE attractive to taxpayers. In establishing the extent of contact with taxpayers for processing review of the 1991 EFILE returns, the Department balanced those objectives and decided on a combined random and compliance sample of 43,000 returns. For the 1992 returns, the sample will increase to 104,000 although, due to growth in the EFILE population and the availability of resources, the percentage coverage will decline.

21.75 The Department should establish appropriate, reliable measures for evaluating the effectiveness of the back-end verification process.

Department's response: The Department's processing restructuring plans are a multi-year process. The Report indicates that the audit focussed on the control environment in place for the 1992 EFILE returns. Consequently, this "snapshot" review does not take into consideration the significant enhancements to the processing system that have been implemented for 1993 returns and the further enhancements scheduled for implementation in subsequent years.

Earlier matching would reduce risks related to paperless filing

21.76 In our view, removing the requirement to file supporting information for EFILE tax returns, and limiting their up-front verification, have increased the risk that fraudulent or erroneous returns will be filed and will go undetected. At the same time, processing review does not cover the items most often reported by taxpayers. Matching is one program that does cover some of those items.

21.77 Matching is a long-established enforcement program performed on virtually all returns. It involves the verification of income and deductions reported by taxpayers against information slips with valid social insurance numbers received from third parties, for example, T4 slips from employers and T5 slips from financial institutions. Matching generated over \$194 million in reassessments in 1992-93.

21.78 Currently, matching is done in the fall, after returns have been assessed and refunds issued. The main reason is that, even though the Department receives the information from third parties in the spring, a significant proportion is received on paper and has to be converted to electronic format so that the computer can do the matching.

21.79 In our 1990 Report, we recommended that the Department take steps to increase the proportion of T4 and T5 slips filed in magnetic format by employers and financial institutions. Since then, the proportion of T5 slips filed in magnetic format has increased from 38 percent to about 90 percent, but for T4 slips the proportion has increased only from 20 percent to 27 percent. The Department is committed to reviewing the need for mandatory filing of T4 slips on magnetic media at the end of 1993.

21.80 In our opinion, elimination of the requirement for supporting documentation for EFILE returns, the increased speed in processing these returns and the Department's focus on back-end compensating verification procedures significantly increase the overall

risk that fraudulent or erroneous tax returns will go undetected at initial assessing. Because of this, we believe it is more important than ever to perform matching as early as possible - at the time returns are first assessed and before refunds are paid. Having third-party information to match with taxpayer returns at the time the returns are filed would enhance significantly the Department's control environment over initial assessing and payment of tax refunds. To this end, we think the Department should be exploring ways to implement early third-party matching as soon as possible. As a first step, we again urge the Department to take measures to substantially increase the percentage of T4 slips filed on magnetic format. For those T4 slips that are not filed on magnetic format, we note that the Department is considering the use of electronic scanners for data conversion. It has recently started using this technology for T5 slips. In addition, the Department is exploring the feasibility of electronic transmission of third-party information slips over communication lines.

21.81 To mitigate potential risks associated with paperless returns, the Department should perform matching at the time of initial assessing.

Department's response: The Department confirms that this is consistent with its plans for the Matching Program. Indeed, the Department's T1 Simplification Initiative for 1993 returns will result in the pre-printing of selected third-party information for a selected number of taxpayers on customized returns. Additionally, significant progress has been achieved in obtaining information slips in magnetic or scannable format. The Department is committed to using third-party data in our on-line processing of individual returns both to simplify the filing process and to enable automatic verification during assessment.

Information for Parliament

Information to Parliament can be improved

21.82 In our view, two very significant issues related to EFILE are the impact that it may have on voluntary compliance and the changes in the control environment that accompany its introduction. The Department's Part III of the Estimates has contained no mention of EFILE's possible impact on voluntary compliance and the associated risk of revenue loss. The 1993-94 Part III did make reference to the new control environment for EFILE, but the reference came in the context of a discussion of another, future initiative. We feel that this manner of disclosure obscured the significance of the new control environment as it is currently operating with respect to EFILE.

21.83 Other information about EFILE has appeared in Part III of the Estimates each year, starting with 1990-91. Disclosure has included information on human resources costs and other expenditures, and discussion of expected benefits such as faster refunds and assessments, more accurate returns and streamlined operations. Part III does not indicate standards of service for EFILE, nor does it report on performance.

Summary and Conclusion

21.84 We found that the Department proceeded in a systematic way to develop, through phased-in implementation, the systems for data capture and transmission on which EFILE is based. Gradual implementation enabled the Department to test new front-end systems for capacity, response time and effectiveness of controls prior to nationwide implementation.

21.85 Regarding the paperless aspect of EFILE, we found that the Department acted on very limited information about the risks involved, and with only a qualitative assessment of the effect this may have on voluntary compliance by taxpayers. Although National Revenue has identified and put in place important compensating verification and monitoring programs, we are concerned, given the newness of these programs in the year of nationwide implementation, that their likely effectiveness in achieving desired results is unknown. At this stage, it is unclear what the overall impact on tax revenues will be.

21.86 The Department has focussed primarily on achieving gains in operational efficiency. In contrast, we found that it has not placed the same emphasis on assessing the effect of the new program on taxpayers' voluntary compliance or on the performance of the new verification programs. The Department could mitigate many of the risks associated with paperless filing by having third-party information matched with taxpayer returns at the time of initial assessing.

***Department's response:** The Department has a strong commitment to pursue and develop new, innovative tax administration technologies. Electronic filing (EFILE) is a clear example of an innovative use of technology that is improving client service and enhancing productivity.*

This success story provides a simple, cost-effective way for Canadians to have their income tax returns processed. At the same time, the Department continues to invest in and enhance complementary compliance mechanisms. This not only increases compliance, but also strengthens the Canadian self-assessment income tax system.

Chapter 22

Department of Transport

Airport Transfers

Main Points

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Exhibits

22.1 Comparison of Actual Revenue to Departmental Forecasts

22.2 Comparison of Impact on Net Cash Flows and Capital Expenditures

Department of Transport

Airport Transfers

Assistant Auditor General: Shahid Minto

Responsible Auditor: Doug Timmins

Main Points

22.1 The *Aeronautics Act* gives the Minister of Transport broad powers with respect to airports, but it does not require the Minister to own or operate airports. The Department of Transport does not operate most of the licensed airports in Canada, although it used to operate all the major airports. In 1992, the international airports in Vancouver, Calgary, Edmonton and Montreal (Dorval and Mirabel) were leased to Local Airport Authorities. Departmentally operated airports in other cities may be leased or sold in the near future. The Department continues to be responsible for aviation matters, such as air navigation and air traffic control, for all airports, including those leased to Local Airport Authorities.

22.2 The transfer of the airports shifts responsibility for airport operations and maintenance from the Department of Transport to Local Airport Authorities, relies on local involvement and accountability and fixes minimum capital expenditure amounts to be spent on these airports for the next 18 years.

22.3 We noted in our 1990 and 1992 Reports that there was a shortfall between capital needs and funding from traditional sources. The lease agreements increase capital expenditure commitments over historical levels for the next 15 years by \$326 million. The expectation is that over the long term these capital commitments would be funded from increased revenues. However, revenues are significantly lower than the original forecasts that were used as a basis for negotiating the leases. Future revenue increases will have to be significant to achieve the optimistic forecasts and avoid a permanent shortfall between revenue and net cash that would have been generated under departmental operations. This shortfall results from the increase in capital expenditures for the transferred airports. There is also a risk of a permanent shortfall in lease revenue for future transfers if capital expenditure commitments exceed historical departmental budget levels.

22.4 The capital projects that are undertaken at the transferred airports are no longer subject to approval by the Department or Treasury Board or to scrutiny by Parliament. The Department also no longer has the flexibility to defer capital expenditures at these airports as it has done in the past.

Introduction

22.5 In October 1985, the Minister of Transport established a Task Force on Airports to examine alternatives to the existing federal airport system. The following September, the task force recommended the establishment of Local Airport Authorities (LAAs) that would have the support of their provincial and municipal governments. The broad objectives of the airport transfer initiative are to permit airports to better serve local community interests, to enhance regional economic development and to allow airports to operate in a more cost-efficient and commercial manner.

22.6 In 1992, international airports owned and operated by the Department of Transport in Vancouver, Calgary, Edmonton and Montreal (Dorval and Mirabel) were leased to Local Airport Authorities. Each Authority is a not-for-profit corporation headed by a board of directors, whose members are nominated by local municipalities and other representative local groups and cannot be elected politicians or civil servants. The LAAs are responsible for the management, operation and maintenance, as well as the capital projects, for the airports they lease, including runways, terminal buildings, industrial properties, parking, ground transportation, emergency response services, and financial, personnel and administrative functions.

22.7 The Department is now preparing to transfer airport operations in some other cities through long-term leases and is also in the process of selling a number of small airports. In our 1990 Report chapter on airports, we observed that the Department owned 135 of the country's 466 licensed/certified airports. The Department operated only 76 of those it owned and had various arrangements with other parties to operate the others on its behalf. While it is not unusual that other parties operate smaller airports, the airports transferred handle a substantial number of interprovincial and international travellers each year. Previously, major airports were operated only by the Department.

Background

22.8 The *Aeronautics Act* gives the Minister of Transport broad powers with respect to airports, but it does not include a statutory obligation requiring the Minister to continue to own, operate, maintain or finance airports. Based on a Cabinet decision, the Minister announced a new policy in 1987 that encouraged discussions on airport ownership or operation by other interested parties. Under the policy, the federal government would remain responsible for safety and security, including air navigation services, air traffic control, and airport certification. The policy contained eight guiding principles to be used as the basis for any transfer of airports to local groups. These principles included such items as no increase in federal long-term funding requirements, an equitable package for transferred employees, and federal retention of all taxes, such as the Air Transportation Tax.

22.9 In developing this new policy, several options were considered. These options included airports being:

- owned or operated by private sector enterprises;
- operated within a departmental structure with an enhanced commercial mandate and operating authority;
- owned and operated by a parent Crown corporation with several wholly owned subsidiaries; and
- owned, operated and financed by an autonomous local entity, a Local Airport Authority.

22.10 In 1988, the Minister established the Airport Transfer Advisory Board, headed by the Deputy Minister and composed of eight members from the private sector from across the country, to advise the Minister on airport transfer proposals. The Department also formed a task force that would support the Board and manage the daily analyses, negotiations and policy development related to airport transfers. Treasury Board approval was obtained in late 1989 to engage a consulting firm to provide financial advice on the initial four transfers.

22.11 In 1989, Cabinet approved 36 supplementary principles for airport transfers to provide more specific guidance than the original guiding principles. These supplementary principles included such items as the initiation of the transfers on the basis of a long-term lease with consideration of other options, the valuation of each airport at "fair market value" with appropriate consideration of the airport's future earning potential, and the financing of operating and capital requirements by Local Airport Authorities without recourse to the federal government.

22.12 The four parties that were interested in the transfers, and that were supported by the affected municipalities and provincial governments, submitted proposals for the airports. Attached to the proposals were feasibility studies undertaken by the local groups with financial assistance from the Department and, in some cases, from other levels of government as well as other federal organizations. The Department analyzed the proposals, and when the local groups incorporated, negotiations commenced. In November 1990, Cabinet approved a financial formula for the lease of the Vancouver International Airport, which was also intended to serve as the basis for similar financial arrangements with the other LAAs, subject to adjustment for local conditions.

22.13 In March 1992, the *Airport Transfer (Miscellaneous Matters) Act* received royal assent. The Act required the *Official Languages Act* and the Canada Labour Code to apply to transferred airports and employees. The Act was later amended to exempt Local Airport Authorities from income tax on airport-related businesses and give them powers to seize aircraft for unpaid airport charges. It also deemed the rights and interests acquired by the Authorities under the transfer agreements as assets and therefore as qualified investments for banks, insurance companies and pension funds for debt instrument purposes.

22.14 Each Local Airport Authority has signed a transfer agreement and a lease. The transfer agreements outline the general transfer provisions and the leases specify the detailed operational and financial requirements. The agreements were approved by Governor in Council in 1992. Treasury Board instructed the Department to manage the transfers within its existing budget levels and to prepare a plan on how to reduce administrative overhead to reflect the transfers. The LAAs have been operating the airports since July 1992 at Vancouver and Calgary and since August 1992 at Montreal and Edmonton.

22.15 The Department of Transport has retained control over aviation matters such as air navigation and air traffic control. Local Airport Authorities are subject to inspections by the Department for the purpose of retaining their aerodrome certificates. For each of these airports, there are, along with the transfer agreement, ancillary agreements for air traffic control and air navigation services and facilities, Canadian Inspection Services and police and security. The Department pays for the cost of utilities and services provided by the LAAs for air navigation. The Royal Canadian Mounted Police continue to provide policing services to the airports at no cost to the LAAs. A Memorandum of Agreement on Employment outlines the responsibilities of the Authorities for employees transferred from the federal government. Although the leases do not require the Department, as the landlord, to pay for any direct operating costs, in some cases a negative lease payment (a payment to the LAA) can arise. The term of the leases is 60 years with a 20-year renewal option.

22.16 The Department has agreed to consider proposals from Local Airport Authorities regarding the purchase of the transferred airports after five years. The transfer agreements also require the LAAs to assume the operation of specific satellite airports within five years.

22.17 The Department has yet to agree with three Local Airport Authorities on how progress payments on the lease rent will be adjusted based on actual revenues and capital expenditures at the end of the year.

Audit Scope

22.18 This audit focussed on the financial aspects of the transfer process in relation to the transfer principles approved by Cabinet. Although the majority of our work was directed toward analysis of matters for the airports already transferred, we also looked at whether the Department had defined its role with regard to transferred airports and the effect of these transfers and possible future transfers on the operations of the Department. We did not review the transfer agreements, leases and associated legal documents for completeness or from a technical point of view. We also did not attempt to determine whether the documents were being complied with; nor did we, in any way, audit the Local Airport Authorities.

22.19 Financial information available for our analysis was for the first five or six months of operation under the LAAs. This information may not be indicative of financial results over the long term.

Observations and Recommendations

Results of Transfers to Date

22.20 We reported in our 1990 and 1992 Reports that the Department had not defined its role in regard to airports. We stated that it needed to develop criteria for providing federal funding to airports and to formulate a plan to rationalize federal asset holdings and financial involvement in airports. While this role has still not been formalized, the transfer initiative is clearly a step toward reducing the Department's operational control of airports. There are several areas where the impact of the transfer of airports is positive and others where the impact is not yet clear.

Financial arrangements provided for in the lease agreements

22.21 The guiding and supplementary principles endorsed by Cabinet and issued publicly provide only general indications of what the government envisioned in terms of rent from Local Airport Authorities. The Department took the approach that each Authority should provide the government with at least the same cash flow, on a net present-value basis, as the Department would have generated if it had continued to operate the airports. The Department engaged consultants to prepare financial forecasts for each of the airports that showed net cash flows to the Department under three possible traffic scenarios for continued departmental operations.

22.22 We found many similarities among the lease arrangements, such as insurance requirements, terms of the leases, costs to be paid by LAAs, default clauses and environmental provisions. While the financial format was generally the same, the specific rental clauses differ in several respects from those contained in the Vancouver lease, which was approved by Cabinet as the model for the other leases.

22.23 Vancouver International Airport was expected to be able to generate sufficient revenue on airside and general terminal operations (fees to airlines for use of runways, terminals, etc.) to recover its costs, and as a result, an annual minimum rent payment of \$10 million is required in the lease. For the other Authorities, the net airside and general terminal rent revenue was not expected to be sufficient to cover airside and general terminal operating and capital costs for the early years of LAA operation of the airports. The resulting shortfall is deducted from the other rent revenues of the airport (concessions and property rentals). For one airport, this has resulted in negative rent payments, or payments from the Department to the Local Airport Authorities, at least in the short term. Another airport has produced a negative rent payment for at least the first year of the lease. The Department has indicated that these modifications to the rent formula were not considered to be significant and therefore did not warrant specific Cabinet approval of the subsequent leases.

22.24 For three of the leases, as requested by the LAAs concerned, deferred rent is permitted. Deferred rent allows the Authority to retain a portion of rent from any of the first five years of the lease to be payable, with compound interest, from the eleventh to the fifteenth years of the lease. Two LAAs have opted for deferred rent and the third has indicated that it intends to do so. The Department advised us that the deferred rent option, as approved by Cabinet, was provided to finance early operations of LAAs because financial institutions were unfamiliar with them. The Department also stated that it does not see a need to offer deferred rent in future transfers.

Leases were designed to protect the Crown's interests

22.25 While the Local Airport Authorities are responsible for the operation, maintenance and administration of the airport, the airports remain assets of the Crown. The leases protect this interest by prohibiting Authorities from pledging capital assets as collateral. Although the rights and interests in the lease can be pledged, the rent payable to the Department cannot be subordinated to other LAA debts. As a result, financing obtained by an Authority must stand on its own merits, and the government assumes no legal liability. LAA by-laws or provincial legislation require that upon dissolution of an Authority, after payment of all liabilities, its assets and property shall be distributed to the Government of Canada. Distribution of any assets or property of the LAA among the members is not permitted. With regard to land use, the LAA is to consult with local municipalities, and any changes to the approved land use plan for each airport must be approved by the Minister of Transport.

Local involvement and accountability are increased

22.26 In the past, many important decisions on an airport were made by politicians or bureaucrats often situated far from the airport and, as a result, somewhat insulated from local concerns. The members of each Local Airport Authority are, on the other hand, nominated by municipalities and other representative local groups and are intended to represent the interests of the regional community. The process for nominating members to the board of directors of a Local Airport Authority was approved by the Minister and the local governments, and changes to this process would require approval by the Minister. Each Authority must hold an annual public meeting to present its audited financial statements. The Department has the right to examine any and all LAA records and to cause an audit to be done, with the result being binding on both parties. Every five years, each LAA is obliged to have an independent review of its management, operational and financial performance conducted, which shall be made public upon request. The Department does not have a say in determining the scope and nature of this review.

22.27 Not only can a Local Airport Authority promote the use of its airport as a key part of the local economy, but virtually all decisions concerning a transferred airport are made locally. For example, the Authorities decide on service levels to be provided, on which capital projects should proceed and in what order, on rates for user fees, rents and concessions, and on marketing of the airports. They are also accountable for environmental matters relating to the operations for which they are responsible at

transferred airports. In addition, because of their commitment to the community and their legal liability, they have the potential to be more proactive and responsive to environmental matters than the Department.

22.28 The Department stated that the Minister of Transport has responsibilities as the landlord and is still accountable to Parliament for air navigation services at these airports. However, the Minister is no longer responsible for airport operations. The Department must rely on the aerodrome certification procedures, the default provisions in the lease and its position as landlord to hold Local Airport Authorities accountable for airport operations. Nevertheless, under the terms of the lease, the Department does not hold the Authorities accountable for many aspects of airport operations. For example, there is no requirement for them to report information on levels of service provided, rates for user fees, environmental matters or, as discussed earlier, capital expenditures.

Most departmental employees were retained

22.29 There were 1,025 permanent positions at the transferred airports on 31 March 1991. A total of 881 employees were transferred from the Department to the Local Airport Authorities. Only 110 employees had to be placed in other jobs within the federal government. As a result, potential service disruptions resulting from large-scale staff changes at transferred airports were avoided. The agreements stipulate that for the first two years of operation of each Authority, all transferred positions must be kept. Subsequent to the transfer date, the LAAs and their employees are to bargain collectively for new agreements that will cover all aspects of wages and benefits, including pensions. We have been advised that reciprocal transfer agreements relating to pensions are expected to be completed in 1993.

User fees increased by Local Airport Authorities

22.30 In previous annual Reports, we reported that the Department was making little progress on cost recovery through fee increases. Generally, it takes six months for the Department to make any changes to its rate structure, and its user fees to airlines have not increased since 1989. We have been told that the Local Airport Authorities have all made some increase in their user fees during their first year of operation, and the Department gets a share of this increase. Vancouver International Airport has instituted an airport improvement fee that no departmentally operated airport charges. The Department will receive a portion of the revenues from this airport improvement fee. Consequently, transferred airports are now generating more revenues than they would if the Department were still operating them because the fees charged at airports that the Department operates have not been increased.

22.31 Local Airport Authorities also have the flexibility to change their rates to respond to market conditions without going through the government regulatory approval process. In this regard, there is no independent third party that reviews the rates charged by the LAAs. A share of revenue for the Department is assured in two of the leases, since they contain minimum airside and general terminal revenue amounts to protect the Crown from traffic declines and reductions in fees charged by the LAAs. However, users have

put pressure on the Authorities to explain why they have raised fees while departmentally operated airports have not.

Some funding reductions have resulted

22.32 By transferring airports, some funding requirements have been reduced for the government. For example, no working capital - or at least a reduced amount - is required from the government at the transferred airports, since it is provided by the Local Airport Authorities. Also, the Authorities are required to secure appropriate insurance, whereas the government did not insure; the costs of any losses are no longer borne by the government. The government also sold chattels and inventories such as fuel supplies and mobile and office equipment to the LAAs at net book value, which will result in payments to the Department of about \$22 million, although the amounts have not been finalized.

Future viability of Edmonton International Airport is at risk

22.33 Even before the transfer in August 1992, Edmonton International Airport was in competition with the Edmonton Municipal Airport, which is owned and operated by the City of Edmonton. In December 1991, the Edmonton Regional Airports Authority issued a discussion paper that identified options for airline service in Edmonton. Closure of either airport was not considered a feasible option and was not pursued. In March 1992, the Authority published a report concluding that consolidation of scheduled service must occur at the International Airport. In response to the report, it was proposed that the Municipal Airport be transferred to the Authority, with the eventual consolidation of scheduled service at the International Airport. In October 1992, this proposal was overturned in a plebiscite forced by a petition initiated by a local group. The result of the plebiscite led to the decision to continue scheduled service at the Municipal Airport for the next five years. We noted that in 1993, scheduled flights to Vancouver started from the Edmonton Municipal Airport, while scheduled flights at Edmonton International Airport were reduced. The Authority has stated that the future viability of the International Airport is at risk if the current trend continues.

Clarifications Needed for Future Transfers

Capital funding needs to be addressed

22.34 In our 1990 and 1992 Reports, we reported that the Department had determined that a large "backlog" existed between capital expenditures that were required at airports and capital expenditures that were being made. What this meant was that previous capital funding levels at airports were inadequate to meet the demands of the airport infrastructure. The Department's capital budget and the portion allocated to airports have declined over the past few years. In 1988-89, \$246 million was spent on capital expenditures for airports, while only \$119 million was forecast for 1992-93.

22.35 The transfer of airports to Local Airport Authorities provides a new way of addressing the capital requirements. Each Authority has the ability to borrow from

external sources for capital projects. This permits them to undertake capital projects that would not likely be carried out by the Department, particularly given current budget constraints.

22.36 The Vancouver International Airport Authority is building a third runway while maintaining its rent payment to the federal government. Had the airport not been transferred, the Department would have had to obtain additional funds either from the government or from external sources in order to carry out this capital project. The Authority is also planning to construct a new terminal building at an estimated cost of \$250 million, which will be funded by external financing and the recently introduced airport improvement fee charged to travellers departing from the airport.

22.37 The leases specify a minimum amount that must be spent on capital expenditures by the LAAs. If the minimum amount in the lease is not spent over a specific period, the difference is payable to the Department as additional rent. The lease for the Vancouver Airport Authority in effect requires it to generate additional revenues to fund the increase in capital expenditures over amounts previously spent by the Department. For the other airports, the government is effectively funding the increase in capital expenditures up to the minimum specified in the lease through the offset of such expenditures against rent revenues. The Department states that the amounts specified for capital expenditures were based upon its assessment of what should be spent to maintain and rehabilitate the present infrastructure at the airports. This has resulted in a significant increase in commitments for future capital expenditures at some of the transferred airports. It could also result in the situation where an Authority is unable to generate sufficient revenues over the long term to offset the increased level of capital expenditures. If this were to occur, then lease revenues paid to the Department would not equal the net cash that would have been generated had the Department continued to operate the airport. The Department would then have to absorb the impact of any shortfall in lease revenue in its own budget or request additional funds from the government.

22.38 The capital projects to be undertaken at the airports are no longer subject to approval by the Department or Treasury Board or to scrutiny by Parliament, even though they will result in new assets or enhanced assets owned by the Crown. Decisions on the extent, nature and timing of specific capital expenditures are solely within the mandate of the Local Airport Authority. Further, the provision of minimum amounts for capital expenditures in the leases means that the Department no longer has the flexibility to defer capital expenditures at the transferred airports. It had this ability prior to transfer. The Department has stated that the commitment of minimum amounts for capital expenditures ensures an adequate level of capital for maintenance of the existing infrastructure. It has also stated that safety and security projects are not subject to a rate-of-return requirement. While not all capital expenditures can be deferred indefinitely, the Department may wish to have the ability to defer some if traffic does not meet expected levels or if funds are needed to meet departmental or other government priorities. The Department needs to explore other options, including whether some portion of the capital funding for future airport transfers could be linked to revenues to deal with cases where traffic is not

increasing, and whether it could be linked to other capital funding criteria, such as a specific rate of return.

22.39 The Treasury Board submission approved in March 1992 for the four transfers estimated that the Crown would be better off by \$4 million as a result of the transfers over the first 15 years of the leases. This included forecast shortfalls of \$2 million in 1993-94 and surpluses of \$5 million and \$39 million for the next two years. The estimate was based on the assumption that the increase in capital expenditures over historical departmental levels would also be spent by the Department if it had continued to operate the airports and that overhead costs would be reduced. Later that year, the Department advised Treasury Board that the Department's budget had been adversely affected by the transfer to the extent of \$44 million for 1993-94, and that \$49 million and \$52 million were forecast for the following two years. Much of the difference in the two sets of estimates results from the effect on the Department's budget of capital expenditures being increased and overhead costs not being reduced.

22.40 The Department indicated to Treasury Board in March 1992 that, under the transfer agreements, \$326 million of capital in excess of currently approved and projected levels would be spent by the Local Airport Authorities over the next 15 years. In the short term, the Department would subsidize this shortfall from its parliamentary appropriations by changing priorities and delaying other departmental capital programs. In the long term, increased revenues to be generated by the Authorities would be expected to fund the increased capital commitments. We note that the originally forecasted revenues, used as the basis for the negotiation of the transfer, are not currently being achieved at three of the airports (see [Exhibit 22.1](#)). The Department has stated that forecasted traffic increases were not met due to unforeseen events, including the recession, the Gulf War and airline flight rationalization. In addition, the Department did not increase its fees as forecasted. However, the revenue forecasts were not revised as negotiations proceeded with the LAAs or when approval from Treasury Board was obtained.

22.41 Over the long term, future revenues will have to increase significantly to reach the original optimistic forecasts and avoid a permanent shortfall in lease revenue due to the increased commitment in capital expenditures at the airports. Further, the risk of such shortfalls in lease revenue will increase as the Department continues to transfer airports, if it commits to minimum capital expenditures in excess of current departmental budget levels.

22.42 To illustrate what has happened since the transfers occurred, we compared LAA 1992 rent payments (projected on a yearly basis) to the net cash from the airports under departmental operations for the 1990-91 fiscal year (see [Exhibit 22.2](#)). The combined effect of the first four transfers shows that net cash provided to the Department from airport operations has gone down by approximately \$15 million. The increase in capital expenditures committed in the lease for Montreal International Airport of \$13 million per year accounts for a substantial portion of the reduction in the net cash provided to the Department. The capital funding at this airport had averaged \$14 million for the four years ending 31 March 1991. The lease, however, provides for funding of \$27 million

annually for the next 15 years. This increased capital funding was to be offset by increased revenues. Original departmental forecasts predicted total airport revenues of \$142 million for Montreal International Airport in 1993-94, while current predictions are for total airport revenues of only \$108 million.

22.43 The Exhibit also shows that capital expenditures for the four airports have increased by about \$35 million. Of this amount, \$22 million is the increase in capital expenditures that Vancouver International Airport will have to offset by generating additional revenues.

22.44 The principles endorsed by Cabinet and the financial formula used to arrive at the lease payments for Vancouver International Airport were approved with large airports in mind. The Department is now in the process of negotiating the transfer of a number of other airports of various sizes. These transfers may include both sales of airports to municipalities and transfers of operations with continued departmental funding. The Department has methodology approved by the Minister for the transfers of both small and medium-sized airports. Some of the small airports will have a more limited revenue potential than the large airports already transferred. As a result, capital requirements are less likely to be offset by increases in future revenues.

22.45 The Department should ensure that revenue forecasts used for future transfers are kept current throughout negotiations. The Department should consider whether funding of minimum capital expenditure amounts in future leases is appropriate, or whether capital funding should be linked to revenues and/or to other capital funding criteria.

Department's response: The Department plans to use the most current forecasts during negotiations. Linking capital funding to revenues and to other capital funding criteria was considered and rejected for a number of reasons not the least of which was that it would involve the Department in Local Airport Authority decision making and this is counter to the objectives of the transfer policy.

The Department must leave the Authority enough working capital to maintain its asset base. The amounts of capital expenditures in the leases are for basic maintenance and replacement and do not include a provision for expansion.

The Department will remain vigilant in determining the most appropriate method of funding, and will alter its approach if warranted.

Cost savings are not being realized

22.46 Prior to the transfer of the four airports, the Department recorded overhead costs, based on a percentage of direct operating and maintenance expenses, that amounted to \$17.2 million for the year ended 31 March 1991 for these four airports. Subsequently, the Department indicated to Treasury Board that it would be able to avoid only about one third of these costs in 1992-93. The Department also stated that these costs could be further reduced by 10 percent annually to a maximum reduction of 70 percent. In its

approval of the transfers, Treasury Board requested that the Department bring forward a plan as to how it would reduce its administrative overhead to reflect the transfers. In response, the Department reported that it could now identify only \$2 million of overhead costs as avoidable. However, the Department has stated that Department-wide budget cuts have been made to offset, among other things, revenue shortfalls resulting from airport transfers.

22.47 We noted that during the transition period provided for each airport for the transfer of control to the Local Airport Authority, the Department encountered a number of problems, such as a loss of control over receivables, improper cutoff and breakdown of controls. An additional problem was that staff transferred to the LAAs had to now also respond to departmental concerns. The Department has commenced audits of the transition periods at three of the airports. Once the audits are completed, the recommendations may influence plans for future transfers.

Changes may be needed to facilitate land development

22.48 Because airports are key to the transportation infrastructure and economy of a community, one of the objectives of the transfer initiative is to enhance regional economic development. Local Airport Authorities claim that the attainment of this objective is impeded by the lease provisions relating to land development at airports. Departmentally operated airports are subject to many of the same restrictions on property development.

22.49 Three leases require that 85 percent of the fair market value of the land, valued at the transfer date, will go to the Department as land rent for developed land. Land rents paid by the LAAs to the Department are to be based on market values and updated every five years to ensure that the Crown receives current rental rates. This leaves the LAAs uncertain as to what their future costs will be. Furthermore, any structure built by a tenant on the leased property will vest to, or become property of, the Crown at the end of the lease term.

22.50 The Department indicates that common commercial leasing practices provide for regular rent increases and that the LAAs do not have to pass on these increases to their tenants based on the updates every five years. The Department needs to determine the extent to which it wants to increase land development at airports and whether changes to the present lease conditions would be required to facilitate such development.

22.51 The Department should review the lease provisions to determine whether changes are required to facilitate the development of airport lands.

Department's response: The Department has invited Local Airport Authorities to submit any proposed changes that would facilitate land development but that do not leave the government worse off.

Future leases could be simplified

22.52 The Department has described its role in transferred airports as a "hands-off" or "arm's-length" relationship. The Department has attempted to establish a balance between giving the Local Airport Authorities freedom to operate the airports and maintaining control of the airports as both landlord and regulator. Yet the leases and other legal documents are lengthy and complex. The rent articles in the leases are extensive and broken down into different categories and also have participation factors for increased revenues. A simpler approach would have been, for example, to use a percentage of gross revenue on a reduced number of rent categories.

22.53 The lease provisions should be reviewed to see if the leases for future transfers could be simplified.

Department's response: The lease provisions have already been reviewed in detail and a significant number of simplifications have already been identified for incorporation in the next group of leases. The priorities are the protection of the Crown's interests and the provision of flexibility to Local Airport Authorities so they can manage. While we endorse any means to make the leases simpler, we must ensure that the objectives of these complex leases are met.

A different approach is being taken for Pearson International Airport

22.54 We observed in our 1990 Report that Pearson International Airport not only was the nation's busiest airport, but also had many problems that the Department needed to address. The Department contracted with a private sector developer to construct and operate Terminal 3. It has reached an agreement with another company to renovate and operate the other two terminals at the airport in partnership with the operator of Terminal 3. In addition, it has issued a request for proposals for the construction of additional runways at the airport. As a final ingredient in this mix of external players, a Local Airport Authority has been established, but it has not yet been endorsed by the Minister of Transport.

22.55 We support the Department's initiative in seeking Local Airport Authority involvement in the management of airports, but it is not clear what the advantage is in proceeding with external financing for these large capital commitments before transferring the airport to a Local Airport Authority instead of proceeding with an approach similar to that taken for the Vancouver International Airport. If a significant portion of airport revenues is committed to these projects before the LAA is operating the airport, it may limit the ability of the Authority to generate revenue and funding for other capital projects.

22.56 In addition, the Department will have to resolve the issue of what level of capital expenditure is to be provided for in any lease with a Local Airport Authority and how any private sector involvement will be co-ordinated and factored into the lease. Once these issues are clarified, it will be possible to determine the rent payments that the Department could receive or the funding that it could be required to provide.

Department's response: Given passenger forecasts, proceeding with the runways and terminals maintains a good level of service to the public and avoids lengthy delays and serious congestion while the terms and conditions are negotiated over the coming years and an LAA is eventually put in place. The funding of these projects will not limit the LAA's ability to fund other capital projects.

Chapter 23

Merchandise Trade Statistics

Main Points

Introduction

Audit Scope

Observations and Recommendations

- Trade Data: Administrative Arrangements
- Customs Collection of Documentation
 - Satisfactory controls are in place for the collection of import documents
 - Usefulness of sending copies of import documents to Statistics Canada needs to be reviewed
- Customs Verification Procedures
 - Often, required manual verification work is not performed
 - Summary information on results of Customs review is not provided to Statistics Canada
- Customs Compliance Verification and Audit
 - The cumulative effect of errors detected by Customs compliance verification and audit work has not been determined
- Customs Physical Examination of Commercial Shipments
 - Physical inspection confirms only the narrative description of goods provided on import documents
- Statistics Canada Data Verification and Imputation
 - Statistics Canada verification and imputation procedures do not always improve data quality
 - Many transactions with invalid codes or missing information are not analyzed or are incorrectly imputed
- Data Transmission to the United States
 - Satisfactory controls exist for the transfer of data to the United States
- Operating Relationships: Customs and Statistics Canada
 - Extending direct communications at the operational level would promote timely resolution of problems
 - Some duplication of effort between Customs and Statistics Canada
- Measurement and Definitional Issues in Import Data
- Postal Imports
 - Non-commercial postal imports are based on estimates
- Casual Imports
 - Casual imports are not considered a component of merchandise trade data
- Merchandise Trade Data on Exports
 - Under-reporting of exports to countries other than the United States is an ongoing problem

- Future Initiatives: Impact on Trade Statistics
- Electronic Release and Data Interchange
 - Customs plans to release commercial shipments by transferring information electronically
- Auditing Importers
 - Emphasis in verification is shifting to auditing of importers
- Statistics Canada: Alternative Data Sources
 - As systems for data collection change, new and broader sources of data are needed

Conclusion

- Continuing vigilance is required to maintain high-quality merchandise trade data

Exhibits

- 23.1 Balance of Payments (Current Account)
- 23.2 Merchandise Trade Data Process - Imports

Merchandise Trade Statistics

Assistant Auditor General: Elwyn Dickson

Responsible Auditor: Raymond Foote

Main Points

23.1 Merchandise trade is a key component of Canada's current account. This information is used by governments in making economic policy decisions and international trade agreements. Merchandise trade data are also used at the detailed level by governments and business to make decisions on markets and products.

23.2 Statistics Canada relies largely on administrative data collected by the Department of National Revenue (Customs) in compiling merchandise import trade data. Under a Memorandum of Understanding with the United States Bureau of the Census, data on merchandise imports are exchanged between Canada and the United States. This information is used to determine exports to each other.

23.3 Satisfactory controls are in place for the collection of import documentation and the electronic transmittal of data from Customs to Statistics Canada, and from Canada to the United States. The usefulness of sending copies of import documents to Statistics Canada needs to be reviewed.

23.4 Customs manual verification of commercial entries often is not performed and summary results are not reported to Statistics Canada. Deficiencies also exist in Statistics Canada verification and imputation procedures. The impact of these deficiencies on the overall quality of merchandise trade data has not been determined.

23.5 Improvements in communications and co-ordination between Customs and Statistics Canada are needed to resolve current and emerging data quality issues.

23.6 Difficulties exist in measuring illegal, non-commercial postal and casual imports, and in defining their relationship to merchandise trade data.

23.7 Current Customs procedures do not ensure complete collection of export declarations, and there is ongoing under-reporting of merchandise exports to countries other than the United States.

23.8 Recent Customs initiatives to streamline operations, and changing technology and patterns of trade, will require Customs and Statistics Canada to review their working relationship in the collection, verification and analysis of merchandise trade data to ensure an uninterrupted flow of high-quality data.

23.9 Internationally, Canada is considered to have high-quality merchandise trade statistics but the maintenance of the system for collection and verification will require continuing vigilance and co-operation.

23.10 The findings of the United States General Accounting Office review of United States merchandise trade data are consistent with those of our audit of Canadian trade statistics.

Introduction

23.11 Canada's trade with the world consists of imports and exports of merchandise and services. Net changes in the level of imports and exports of merchandise and services are collectively recorded in Canada's current account. This account also includes financial flows such as dividends and interest paid to and received from foreign sources.

23.12 Accurate and timely statistics on trade are an important source of information about the pattern and pace of economic activity. The current account is a key indicator of how well the economy is performing in relation to those of its international trading partners. Such information is essential to private sector decision makers, as well as to government. In addition to supporting fiscal and monetary policy decisions, governments use trade data to support the negotiation of international trade agreements, such as the General Agreement on Tariffs and Trade, the Free Trade Agreement between Canada and the United States and the pending North American Free Trade Agreement.

23.13 Merchandise trade data, the largest component of the current account, are derived from the administrative records of goods imported and exported by Canada. Records are mainly collected by National Revenue (Customs) at all points where goods enter or leave the country legally. This information is transmitted to Statistics Canada for analysis and reporting of merchandise trade statistics.

23.14 Neither Canada nor the United States collects data on merchandise exports to the other. Instead, since one country's exports are another country's imports, they merely translate each other's import data into statistics on exports. In January 1990, Canada and the United States implemented a Memorandum of Understanding to govern the collection and exchange of merchandise trade data.

23.15 Our report focusses on the data used to report on Canadian merchandise imports, which in 1992 amounted to \$148.0 billion, whereas Canadian merchandise exports to the world were reported as \$157.5 billion. Historically, Canada has maintained a surplus in its merchandise trade with the world. In recent years this surplus has fallen as deficits in services and financial transactions have increased.

23.16 In 1992, Canada's surplus of \$9.5 billion in merchandise trade could not compensate for a deficit of \$38.0 billion in non-merchandise transactions, and a net deficit of approximately \$29 billion was left in Canada's overall trade with the world. Net balances on trade in goods and services are an important factor in Canada's ability to service international liabilities over the long term. (see [Exhibit 23.1](#))

23.17 To address each country's interest in the quality of import and export data, the United States General Accounting Office and the Office of the Auditor General agreed to examine the systems, procedures and practices in place for the collection and reporting of merchandise import data in their respective countries.

Audit Scope

23.18 In Canada, Statistics Canada is responsible for the reporting of merchandise trade statistics. Responsibility for the collection and verification of data is shared by Customs and Statistics Canada. Customs is required to collect import documentation for all goods entering Canada, except for data transmitted directly to Statistics Canada by Canada's National Energy Board, and data on imports of fully assembled vehicles provided by the major North American automobile companies. Our audit examined:

- the reliability of Customs systems, procedures and practices in the collection of all merchandise import documentation, along with some export data, at border and merchandise transshipment points within Canada;
- the accuracy achieved by Customs procedures and practices in the processing and verification of trade data, and the transmission of electronic and paper documentation to Statistics Canada;
- the reliability and accuracy achieved by Statistics Canada systems, procedures and practices for the verification, analysis and reporting of merchandise trade data; and
- the appropriateness of actions taken by Statistics Canada and Customs to address changes in technology and other initiatives that could affect the collection and reporting of merchandise trade data.

23.19 The methodology of our audit was developed in conjunction with a parallel review of United States trade data conducted by the General Accounting Office. Methods included a literature review on the compilation and interpretation of trade statistics, interviews with employees of Customs and Statistics Canada, and site visits to four Customs regional offices and a number of border crossings between Canada and the United States. Work included the detailed charting of the trade data system to identify and assess controls on computer access, data completeness, and accuracy in the recording of transactions and verification procedures. Our examination of controls included the review of a representative sample of transactions used in the verification and imputation of import data.

Observations and Recommendations

Trade Data: Administrative Arrangements

23.20 Customs is responsible to ensure that all duties and taxes are assessed and collected on commercial goods entering Canada. It is also responsible for controlling the movement of people and goods to achieve compliance with legislation. Statistics Canada is responsible for defining the concepts of trade statistics and for the conversion of administrative data into trade statistics.

23.21 The *Statistics Act* requires the Minister of National Revenue to provide the Chief Statistician with the administrative data on Canadian imports and exports collected by Customs. The arrangement by which data are transmitted was agreed upon in a 1984 memorandum of understanding between the two departments. (see [Exhibit 23.2](#))

23.22 In January 1988, Customs implemented the Customs Commercial System, an automated system to process all commercial goods entering Canada. At the same time, Canada adopted the international convention on the Harmonized Commodity Description and Coding System based on a six-digit code to classify goods. However, Canada and the United States expanded the code to 10 digits. The first six digits are the Harmonized System Code for the commodity. The next two digits are to identify a particular tariff item and the last two digits are for statistical detail on the commodity. A revised memorandum of understanding between Customs and Statistics Canada was signed in 1993 to incorporate these changes and the data exchange agreement between the two countries.

Customs Collection of Documentation

Satisfactory controls are in place for the collection of import documents

23.23 In 1992, Customs processed over 40 million commercial documents, including cargo control documents, commercial invoices and import accounting coding forms. Most transactions are processed via the Customs Automated Data Exchange (CADEX). In our view, satisfactory controls are in place to ensure that import documents are collected for shipments released and electronic records of transactions are transmitted to Statistics Canada. ([see photograph](#))

Usefulness of sending copies of import documents to Statistics Canada needs to be reviewed

23.24 Customs keeps a copy of the commercial invoice and other documentation for all commercial entries processed and sends Statistics Canada copies for transactions of over \$1200. Customs keeps the documentation for six years and Statistics Canada for two. Brokers and importers keep their own records. Current procedures for the storage and transport of commercial import documents involve manual collecting, sorting, dispatching, filing, storing and retrieving of documents. Statistics Canada estimates that approximately seven percent of the 750,000 documents sent to the agency each month cannot be retrieved. In testing the system to retrieve import documents for data verification, we noted that, while the electronic records of transactions were complete, a high proportion of the paper documents at Statistics Canada could not be found within the test period.

Statistics Canada response: The Agency's present quality assurance and verification procedures for imports depend upon direct access to the paper documents and the estimated non-retrieval rate of seven percent under the regular search program is acceptable. This is likely to become a moot issue, however, as Customs moves toward a paperless environment. Statistics Canada is prepared to work with Customs in developing on-line access to information as well as new quality assurance procedures.

Customs Verification Procedures

Often, required manual verification work is not performed

23.25 One Customs procedure involves manual review and adjustment of commercial entries to ensure the correct application of duty and taxes on imported goods. Such procedures also improve the reliability of data transmitted to Statistics Canada.

23.26 Merchandise import transaction data, input into the Customs Commercial System by Customs staff at ports or by brokers or importers via CADEX, are electronically validated. Only commercial entries without validation errors are accepted. A selection of validated commercial entries is subsequently reviewed by Customs commodity specialists. In 1992, approximately 1.8 million transactions, or eight percent of all transactions, were selected for review by approximately 263 commodity specialists. Commodity specialists verify details of selected transactions such as commodity classification, value, quantity and country of origin.

23.27 We noted that Customs commodity specialists made data adjustments in approximately six percent of the transactions selected for review. The remaining transactions not adjusted by a commodity specialist are supposed to be subject to a quarterly spot check, but often these checks are not performed, and error rates are not reported.

23.28 Our audit also noted that often transactions selected for manual review by commodity specialists are not reviewed; perhaps because of inadequate human resources to handle the volume of transactions selected. In other cases, the commodity specialist may decide on the basis of experience that a review is not necessary.

23.29 Customs uses electronic verification tests (called edits) designed by Statistics Canada to review all transactions with a value of more than \$25,000. Transactions of more than \$25,000 that do not fall within a predetermined unit value range are selected for detailed review since they are considered to be inaccurate; these account for approximately one quarter of all data entries selected for verification. Unit value ranges refer to the range of normal or expected values established by Statistics Canada for each type of merchandise. If these ranges are to serve their purpose, which is to identify imports where unit values fall outside these ranges and then to subject these transactions to further review, they must be both appropriate and current. Our audit noted that, in fact, unit values often are not updated on a timely basis, and many of the value ranges are too wide to allow the enforcement of meaningful standards. Unit values, which allow the computer to target these transactions for manual review, are necessary to validate data for commodity classification groups, for example, electronic goods and pharmaceutical products, that are subject to wide variation over time. About 4000, or 23 percent, of the 16,000 classification codes involving commodities without standardized units of measure do not have the unit value ranges needed to do electronic verification. Statistics Canada is attempting to reduce this percentage over a period of time.

Summary information on results of Customs review is not provided to Statistics Canada

23.30 Statistics Canada estimates that if Customs performs the verification procedures required by the memorandum of understanding between Customs and Statistics Canada, 75 percent of the value of each commodity class entering Canada will be verified. In fact,

there is insufficient information on the frequency of verifications carried out by Customs to know whether this level of verification is appropriate and is actually achieved.

23.31 Customs, in selecting samples for verification, also applies selection criteria based on target groups and perceived risk. In addition, it makes random selections of transactions based on the commodity specialist workload. However, the random selection procedure, which accounts for approximately 25 percent of all transactions selected for verification, is not intended to provide a statistically valid sample or to be used to assess overall data quality.

23.32 Customs does not provide Statistics Canada with summary information on verification results relating to transactions selected for verification. Lacking an analysis of results, it is impossible to evaluate the effectiveness of Customs verification procedures and the usefulness of Statistics Canada's computer verification tests. In our view, Customs and Statistics Canada need to determine whether these edits are a cost-effective method of ensuring the accuracy of trade data.

23.33 Customs and Statistics Canada should develop appropriate performance indicators and review the effectiveness and workload implications of the procedures used to verify merchandise trade data.

Customs response: Agreed. We will, in consultation with Statistics Canada, work toward developing appropriate indicators within the context of current activities related to government restructuring and the implementation of the Customs new business re-engineering initiatives. Both of these can be expected to have a substantial impact on the collection and verification procedures for trade data.

Statistics Canada response: The Agency fully supports the recommendation that the two departments should develop appropriate performance indicators, and management information tools, to determine the cost-effectiveness of data verification procedures. However, joint consideration must be given to whether the investment required to undertake the task at this time is warranted, when Customs' re-engineering initiatives, such as audit verification and electronic release, will change the way in which Customs and Statistics Canada will control the quality of the data in the future.

Customs Compliance Verification and Audit

The cumulative effect of errors detected by Customs compliance verification and audit work has not been determined

23.34 In 1992, Customs set up compliance verification units in its regional offices to perform post-importation reviews of commodity declarations. These focussed on commodity classification, valuation and country-of-origin data. While this work resulted in additional revenue, a lack of summary information on adjustments made to the import data means that the impact of the reviews on merchandise trade statistics is unknown.

23.35 During the same period, Customs implemented a pilot program to audit importers' activities rather than focus on specific transactions. Pilot audits of two large companies were conducted in 1992-93, the purpose being to evaluate audits as a cost-effective way of verifying compliance with Customs accounting requirements. Both pilot audits revealed classification errors in the reporting of merchandise trade data. In our view, these errors would not have been detected by commodity specialists performing desk verifications.

23.36 Customs and Statistics Canada jointly should analyze the statistical implications of Customs compliance verification activities and audits in relation to merchandise trade data.

Customs response: Agreed. We will, in consultation with Statistics Canada, develop the means to do so within the context of departmental efforts in business re-engineering.

Statistics Canada response: The Agency concurs. A joint effort to analyze the statistical implications of Customs' initiatives to streamline operations is especially critical if Statistics Canada is to ensure an uninterrupted flow of high-quality merchandise trade data.

Customs Physical Examination of Commercial Shipments

Physical inspection confirms only the narrative description of goods provided on import documents

23.37 One aspect of Customs commercial enforcement is the physical examination of goods. Mandatory examinations involve the physical inspection of all shipments of a particular commodity. Selective referrals depend on the inspector's judgment as to whether a shipment should be examined or not. For random referrals, the Customs Commercial System identifies for examination a specified percentage of all imported shipments.

23.38 A physical examination is performed to check information on the cargo control document and commercial invoice - including a description of the goods, country of origin and quantity - against the actual shipment. Unfortunately, these documents do not indicate commodity classification codes. Therefore, a physical examination can only confirm the general narrative description of goods provided on the import documents, but cannot be used to verify the commodity classification. Customs indicates that the most effective way of physically verifying the commodity classification would be through post-audits at the importers' premises.

23.39 Customs and Statistics Canada, in their reliance on electronic and paper documentation, assume that the nature of trade merchandise entering Canada is reasonably reflected in the information on file. We believe that the verification of commodity classification, whether by physical inspection of goods at the time of release or through on-site inspections at importers' premises, is important to improving trade data.

Statistics Canada Data Verification and Imputation

23.40 To improve data quality, Statistics Canada conducts a variety of electronic verification tests, manually reviews selected transaction documentation, imputes data values where information is not available and, where warranted, makes various adjustments to the data. In attempting to enhance data quality, Statistics Canada risks the introduction of inaccurate adjustments and imputations; in terms of value for money, it may be that the cost of adjustments is not justified by improvements in data quality.

23.41 Statistics Canada has an ongoing concern with the quality of trade data. Its publications usually define the limitations of their data, though quantitative indicators can be given only in relation to appropriate assessment measures. Statistics Canada maintains that there are no simple and efficient ways to determine accurate measures of quality: "Attempts made in the past to obtain error rates for the coding of commodities have yielded inconclusive results primarily because the task of commodity coding can be quite subjective since the Harmonized System of Commodity Description and Coding (HS) has over 16,000 codes. Furthermore, the quality of trade data has more dimensions (due to the large number of variables involved) than the accuracy of commodity coding and this quality cannot be captured in a single quantitative measure." *The Quality of Canadian Imports Data*, Statistics Canada Catalogue, no. 65-001, September 1991

23.42 While the above problems are inherent in the system of collecting and analyzing trade data, our audit identified a number of less integral deficiencies that also affect data quality. These deficiencies were identified through testing the accuracy of computer verification and imputation procedures, updating a 1991 data quality analysis, and reviewing results with senior staff at Statistics Canada.

23.43 Statistics Canada conducts three types of tests: one test detects inadmissible values (for example, non-existent unit of measure); the second test cross-references two pieces of data (for example, country of origin and classification code, as in "oil from Switzerland"); the third test checks that the value of a commodity lies within an acceptable range. Where specific transactions do not pass the computer's checks, adjustments are imputed automatically by the computer for transactions of less than \$50,000. Rejected transactions of more than \$50,000 are manually reviewed by a commodity officer.

Statistics Canada verification and imputation procedures do not always improve data quality

23.44 Our test of Statistics Canada's verification and imputation system included a representative sample of 520 transactions selected from current trade data. While our test sample is too small to allow us to estimate total error, the results raise questions about the ability of the system to optimize data quality.

23.45 Of the 520 transactions in the sample, documents for only 233 transactions were retrieved from the Statistics Canada records room; this retrieval rate was less than Statistics Canada estimates of documents not received or misfiled. Many transactions

rejected by the edits are not analyzed and may be incorrectly imputed because copies of documents cannot be found in Statistics Canada.

Many transactions with invalid codes or missing information are not analyzed or are incorrectly imputed

23.46 In comparing the computer records against the physical records of transactions in documents we did obtain and examine, we noted that where the transaction's commodity classification code cannot be matched to a table of valid codes or imputed, the computer allocates an "unassigned" code to the transaction. The total value of unassigned transactions, which mainly includes low-value items under \$1200, is approximately \$1.5 billion annually; but these transactions are not analyzed.

23.47 In comparing the commodity classification code with the country of origin, the computer incorrectly imputed the data in 32 out of 35 cases: the effect is to overstate the number of imports from the United States, our largest trading partner, and to understate the number of imports from Canada's smaller trading partners.

23.48 We noted that some of the unit values in our sample had been recently updated. We also found that the commodity officers were well informed of current developments in their areas of expertise although, because of the increasing volume of international trade, they were not able to review and adjust all selected transactions. Our review also indicated that errors in unit of measure (for example, imperial instead of metric) for specific commodity groups could be more easily detected by Customs at the data input stage.

23.49 Information on the mode of transportation for imports from countries other than the United States is derived from the cargo control document for the transaction. Our audit found that in 31 of the 46 transactions we examined the mode of transport was incorrectly derived. In fact, since imports from countries other than the United States tend to involve more than one mode of transport, it has been difficult to assign a single appropriate mode. However, as of 1 April 1993, it became mandatory for the importer to provide information on the principal mode of transport, so those data will no longer be derived. This will improve the quality of information required for the data exchange with the United States.

23.50 The size of the sample of transactions selected for review is too small to allow us to estimate the effect of these deficiencies on Statistics Canada's verification and imputation procedures. However, the results obtained do raise questions about the effect of current imputation procedures on improving data quality.

23.51 Statistics Canada verification and imputation procedures should be reviewed to determine their effectiveness in improving data quality. The review should include an assessment of opportunities to apply better, possibly automated, quality control techniques to update the unit values used to verify trade data.

Statistics Canada response: The Agency recognizes that its verification and imputation procedures require review and revision. Even more important, the changes taking place in the international trading environment and the implementation of the "New Business Relationship" initiatives at Customs will require revisions to the concepts and methodologies underlying the present trade statistics program.

In reference to the specific data quality issues related to unit value ranges, Statistics Canada and the U.S. Bureau of the Census are in the process of reviewing and harmonizing their editing strategies to alleviate inconsistencies and improve the effectiveness of these edit parameters. This harmonization process is being carried out under the direction of the Heads of Agencies who meet annually to review the status of the Canada-U.S. Memorandum of Understanding on the Exchange of Import Data. In addition, the recent recommendations of the Customs Co-operation Council in Brussels to internationally standardize units of quantity may facilitate the alignment process.

Data Transmission to the United States

Satisfactory controls exist for the transfer of data to the United States

23.52 Once verification and adjustments are complete, Statistics Canada transmits data on merchandise imports from the United States to the United States Bureau of the Census. This is done twice a month through a communications link-up to the Canadian Embassy in Washington. The Bureau reviews the data and, if questions are raised or changes are required, contacts Statistics Canada directly. Statistics Canada reconciles its monthly merchandise trade statistics with those of the United States Bureau of the Census.

Operating Relationships: Customs and Statistics Canada

23.53 Differences in the strategic objectives of Customs and Statistics Canada affect the collection and verification of merchandise trade data. While Customs is responsible for the initial collection of merchandise trade data, its primary objectives are to collect revenue and to control the movement of goods and people as required to achieve compliance with legislation. Statistics Canada is responsible for the analysis of data and reporting of statistics. Electronic verification procedures designed by Statistics Canada can increase the workload of Customs. For example, out-of-date unit values used in electronic verifications increase the number of selected transactions that require manual review by Customs commodity specialists. This practice can leave commodity specialists unable to perform the required verifications or reduce the time available for them to do other required work, such as examining high-risk commercial entries.

Extending direct communications at the operational level would promote timely resolution of problems

23.54 Maintaining good data quality depends on good communication between Customs and Statistics Canada. In fact, current operating procedures do not encourage direct

communication between Statistics Canada and Customs regional offices on specific data quality issues.

23.55 Statistics Canada usually communicates directly with Customs headquarters rather than with regional offices, where at least some data inquiries could be answered directly. This increases the time required by both organizations to respond to data quality improvement initiatives. The lack of prompt action taken in response to "problem reports" and "case studies" is evidence of the communication problems between Customs and Statistics Canada.

23.56 "Problem reports", which are filed by Customs when regional commodity specialists note that a particular Statistics Canada validity check is out-of-date, are forwarded to Statistics Canada for review and update. "Problem reports" are relayed through Customs headquarters, which reviews and then transmits them to Statistics Canada: this transmission does not always occur in a timely manner. Most Customs commodity specialists, seeing little action result from their reports, do not bother to prepare reports when unit value problems are detected.

23.57 Statistics Canada case studies, which deal with specific data quality issues such as commodity classifications, value ranges or country of origin, also experience delays when they are forwarded to Customs headquarters for review and appropriate action. The inability of Statistics Canada to communicate directly with Customs regional offices to resolve regional data problems hinders the timeliness of data quality improvements. Both Customs and Statistics Canada have advised us that procedures are being developed to allow more flexibility and direct communication at the operational level.

Some duplication of effort between Customs and Statistics Canada

23.58 Current verification procedures sometimes result in a duplication of verification work by Customs and Statistics Canada. For example, transactions of more than \$50,000 that fail the unit value verification edits are selected for review at Customs; if they are not adjusted at Customs, the transactions will undergo a similar review at Statistics Canada. As mentioned earlier, Statistics Canada is not informed of the summary results of Customs verification adjustments made as a result of Statistics Canada's edits. Hence, Statistics Canada is not able to analyze the effectiveness of its verification edits and the usefulness of the review procedures used to ensure data quality.

23.59 Customs and Statistics Canada should continue to improve communications with a view to achieving prompt action and enhancing data quality.

Customs response: We agree with the importance placed by the OAG on this activity. There has already been a marked improvement in communication between the two departments in the recent past. Customs and Statistics Canada have established a close working relationship and efforts have been ongoing to ensure that a high level of communication and co-ordination between the departments continues. Measures taken include the signing of a memorandum of understanding by the departments and the establishment of formal communication mechanisms such as the Data

Quality/Classification Committee and the quarterly Working Committee for the memorandum of understanding on the exchange of import data. Statistics Canada is being consulted in the development of new departmental initiatives that may have an impact on statistical data collection, and is making direct contact with local Customs offices more frequently in order to promote the timely resolution of problems. Efforts in this regard will continue to be made under the terms of the memorandum of understanding between the departments.

Statistics Canada response: *The Agency fully endorses this recommendation and believes it is especially critical at this time. The Agency is working with Customs to establish a closer working relationship and to effect the timely resolution of current and emerging data quality issues.*

Measurement and Definitional Issues in Import Data

23.60 An accurate knowledge of what goods are included or omitted from the data collection process is an important element in the interpretation of international trade statistics. Transactions are often complex, and information on quantities, value or composition of shipments can be difficult to obtain. Knowledge of data limitations improves the usefulness of trade statistics.

23.61 In some cases, international conventions define trade categories and thus affect the classification of goods. For example, goods imported by travellers (such as used automobiles) are counted as services, whereas value added by services in the manufacture of goods and intellectual properties may be included in the price: for instance, royalties on any patented goods if the royalty payment is a condition of the sale.

23.62 Illegal imports, which are not included in the trade statistics, are difficult to measure. Any time there is an incentive to avoid taxes or duties, there is the possibility of under-reporting. With Canada's major trading partner, the United States, the incentive for misclassification of trade data is now diminishing as duties are lowered or eliminated under the Free Trade Agreement; however, it is not known if this decline will translate into increased accuracy in the value of trade reported in import documents.

23.63 In other cases, there may be an incentive for international firms to reduce taxes through "transfer pricing". This practice places an unrealistic value on exported or imported products transferred between two divisions of the same corporation, so that profits of the corporation are minimized in countries with high tax rates and maximized in countries with low tax rates. Another way to reduce the dutiable value of goods is to bill separately for services such as licensing, marketing, financial advice or data processing. Pricing issues are complex, and their full impact on trade statistics is unknown. These nuances in trade patterns and practices represent an ongoing challenge to producers and users of merchandise trade statistics.

Postal Imports

Non-commercial postal imports are based on estimates

23.64 Information on non-commercial postal imports is based on estimates. The estimated value of these transactions has increased from \$541 million in 1988 to \$1.5 billion in 1992. In July 1992, Customs implemented a Postal Import Control System to collect duties and taxes on postal imports with a value for duty over \$20.

23.65 However, due to limitations in the Postal Import Control System, Customs is unable to provide specific information on postal items imported into Canada, though it estimated that postal imports accounted for approximately 2.5 million items in 1992-93. With the full implementation of the system, Statistics Canada expects to have better estimates of non-commercial postal imports to be included in the "Customs basis" merchandise trade data.

Casual Imports

Casual imports are not considered a component of merchandise trade data

23.66 In March 1991, Customs implemented the Travellers Entry Processing System, which by March 1993 was operating in 90 of Canada's 350 ports of entry. During 1992, Customs processed over 123 million travellers entering Canada and approximately 4.2 million casual import documents. However, because the system is not operational at all ports and is not designed to provide summary data, the total value of casual imports by travellers into Canada continues to be based on estimates.

23.67 To complement this system, Customs officers at ports collect data on the number of cars, residents and non-residents entering Canada. Statistics Canada has used this information, as well as quarterly samples collected in collaboration with Customs, to estimate the total value of casual imports at around \$3 billion in 1992, though that value is not included in Statistics Canada merchandise trade data. Casual imports by travellers are defined by international convention as a component of the "service account" in Canada's balance of payments.

Merchandise Trade Data on Exports

Under-reporting of exports to countries other than the United States is an ongoing problem

23.68 Under the memorandum of understanding with the United States Bureau of the Census, Statistics Canada relies on U.S. import data to determine Canada's exports to the United States: these account for about 70 percent of Canada's merchandise exports worldwide.

23.69 For exports to countries other than the United States, Customs is responsible for the collection, sorting and forwarding of export documentation to Statistics Canada. In addition, Statistics Canada receives about 50 percent of the export declarations from Customs-approved exporters, in the form of monthly summary reports. Statistics Canada is responsible for compiling export data and for developing, implementing and monitoring data verification procedures.

23.70 In fact, the collection of export forms is erratic. There is no penalty to exporters for not submitting the export forms and there are inadequate controls on the collection of export declarations at Customs border points. For example, marine carriers present bills of lading or equivalent printouts to Customs within five days after leaving a Canadian port. Customs then checks the bill of lading to determine if the export form is required, and if it has been submitted. If the form is missing, a tracing letter is sent to the exporter. After a month, if no export form has been received, there is no further administrative recourse and the file is closed. In one region, Customs estimates that approximately seven percent of the data on marine export trade, representing approximately \$100 million annually, goes unreported to Statistics Canada.

23.71 As a result of the data exchange between Canada and the United States, Customs no longer requires Canadian exporters to complete an export declaration for goods entering the United States. However, goods entering the United States from Canada that are destined for other countries do require an export form to be completed; exporters often assume otherwise, since such forms are not required for goods destined for the United States, and do not comply.

23.72 Also, if Canadian goods are purchased by a company in the United States for eventual sale to a third country, such as Mexico, the Canadian exports are recorded as a sale to the United States and not to the final country of destination. Such practices in the international recording of data affect the interpretation of trade statistics by overstating exports to the United States and under-reporting exports to, for example, Mexico.

23.73 Customs and Statistics Canada recognize the problem of under-reporting of exports to countries other than the United States and have undertaken a number of studies to estimate the impact on trade data, specifically: seeking to assess trade by different modes of transportation; attempting to reconcile Canadian merchandise export trade data with the data of other countries; and establishing a joint Statistics Canada and Customs data committee to monitor the quality of data on Canadian exports. Customs has also taken steps to encourage exporters to participate in monthly summary reporting to Statistics Canada. The importance of good quality data on Canada's world trade patterns warrants increased efforts to improve current methods of collecting data on Canadian exports to other countries via the United States.

23.74 Customs and Statistics Canada should work with United States agencies to review current practices in the recording of trade data involving exports from Canada to other countries through the United States.

Customs response: Both Customs and Statistics Canada have been working with the United States agencies for some time to improve our trade data with respect to in-transit trade statistics. These efforts will continue as a result of the memorandum of understanding between the United States and Canada, which provides and sets out the terms and conditions for the exchange of import data.

Statistics Canada response: The under-coverage of Canadian exports to countries outside the United States, for shipments directly to those countries and in transit through the United States, is a critical issue in Statistics Canada's measurement of export trade. The Agency is working with both Customs and the U.S. agencies to quantify this under-coverage and to increase the accurate filing of export data. Nevertheless, in the absence of Customs border controls and compliance sanctions, there is no definitive solution to the problem. The registration of new exporters, however, under the Single Business Registration Number initiative, will help to develop a statistical solution to the under-coverage problem.

Future Initiatives: Impact on Trade Statistics

23.75 In 1992, National Revenue announced a number of initiatives intended to streamline Customs operations. Two Customs initiatives in particular will have a major impact on the collection, verification and reporting of merchandise trade statistics. The primary objective of these initiatives, which are described below, is to increase the efficiency of Customs operations and to allow a speedy "no hassle" transfer of goods across Canada's borders.

Electronic Release and Data Interchange

Customs plans to release commercial shipments by transferring information electronically

23.76 The purpose of this initiative is to increase the use of electronic data interchange in effecting import clearances, and to move toward a paperless system of reporting on, and accounting for, imports. Under the new system, release information is electronically transmitted to Customs by the importer or broker. There it is reviewed, and the transporter is informed through electronic data interchange when the goods are cleared for import into Canada.

23.77 This initiative is directed to the 70 percent of the importing community already transmitting accounting information via CADEX. The program eliminates the need for importers to physically deliver paper documents to Customs, although hard copy documentation would be retained by the importers and could be forwarded to Customs on demand. Other government departments, including Statistics Canada, would receive information through access to the Customs Commercial System.

23.78 In March 1993, Customs began the process of identifying user requirements for electronic release, and announced in June 1993 that the automotive industry will be the first to use the new system to process the import of auto parts and supplies. The program will also be extended to other industries. As yet, there is no agreement between Customs and Statistics Canada on the best ways to maintain data quality.

Auditing Importers

Emphasis in verification is shifting to auditing of importers

23.79 In the streamlining of its operations, Customs indicated that in future it would turn toward a greater use of importer audits. To that end, Customs is now developing procedures that will eliminate "hard copy" invoice requirements for shipment clearance; instead, import business will be verified through audits of importers after the goods have entered Canada. This initiative will have a significant impact on Statistics Canada's merchandise data verification requirements since the data format will differ from that of the current import system.

23.80 The implementation of periodic verifications or audits could have a significant impact on the quality of merchandise trade data being reported: for example, commodity classification errors may not be detected in a timely manner. Depending on Customs capability and the number of audits to be carried out, a large number of importers may not be audited. In our view, continuing consultation between Customs and Statistics Canada is needed to assess how this initiative will affect the collection and reporting of merchandise trade data.

Statistics Canada: Alternative Data Sources

As systems for data collection change, new and broader sources of data are needed

23.81 In view of potential changes in the way import trade data are collected, Statistics Canada has been working since April 1991 to identify alternative data sources. Officials in Customs and Statistics Canada have met periodically to discuss matters of mutual interest in this area.

23.82 The primary focus of the project is to identify the best methods for surveying importers, exporters and carriers so as to obtain high-quality import data. To begin with, such a survey requires an up-to-date inventory of Canadian importers and exporters.

23.83 While it has been concluded that much of the required trade data is available from Canadian importers, there are many concerns about the effects of using survey techniques in the collection of trade data, specifically: the response burden on Canadian business; whether data gathered by means of surveys would meet the requirements of Statistics Canada's data exchange agreement with the United States; and, finally, the role of the 350 Canadian customs brokers, as opposed to that of some 150,000 importers, in the retention of documentation required for data verification. Under the Free Trade Agreement, duties and tariffs between Canada and the United States will be gradually eliminated, but the complexities of compliance with international trade rules, particularly with regard to country of origin, will increase. A new role for customs brokers in serving these needs and in assisting the data collection process has not yet been established.

23.84 **Statistics Canada and Customs, in consultation with other users of trade data, should take steps to ensure that, as new data collection and verification techniques are implemented, the quality of Canadian merchandise trade statistics is maintained.**

Customs response: Both National Revenue and Statistics Canada are committed to the maintenance of quality statistics and will take appropriate steps to ensure that the quality of merchandise trade statistics is maintained when any new data collection or verification techniques are implemented.

Statistics Canada response: The Agency is pleased with the acknowledgment given to the high quality of its merchandise trade statistics and to the importance of accurate and timely trade statistics, to decision makers in both government and the private sector. As Customs proceeds with the implementation of its initiatives to streamline operations, the requirement for a joint consultative process becomes especially critical if Statistics Canada is to ensure an uninterrupted flow of high-quality merchandise trade data.

Conclusion

Continuing vigilance is required to maintain high-quality merchandise trade data

23.85 Statistics Canada generates merchandise trade statistics from collecting data on millions of individual transactions. Simply adding the results of all import transactions should, in theory, produce a precise statement of exactly what entered the country. In practice, however, there are bound to be inaccuracies.

23.86 Several factors contribute to the reporting of inaccurate merchandise trade data: human error, incomplete documentation, under- or over-reporting of imports to avoid taxes, deliberate or accidental misclassification to avoid duties, or wrong indication of country of origin to gain preferential duty treatment. In addition, there are legitimate differences of opinion on the interpretation of the commodity classification, country of origin and mode of transportation. Also, there are illegal imports. The challenge is to understand the limitations of the data, measure their impact and, whenever possible, take steps to overcome them.

23.87 Internationally, Canada is considered to have high-quality merchandise trade data and, indeed, the current system of collecting data is working well. However, to maintain that system in light of changing patterns of trade and technology will require continuing vigilance and responsiveness. Measurement issues and questionable categories of trade, when added together, substantially affect the interpretation of Canada's reported 1992 merchandise trade surplus of \$10 billion: for example, an estimated \$3 billion in casual imports by travellers, currently classified as services, is not included in the amount of merchandise imported into Canada; furthermore, trade data do not include estimates of illegal imports. At a more detailed level, \$1.5 billion worth of goods that fall in the unassigned commodity code could, if assigned codes, substantially affect trade data for specific commodity groups, as could the estimated \$1.5 billion in non-commercial postal imports. While small in relation to Canada's total trade with the world, these amounts could affect the picture for particular sectors of the Canadian economy.

23.88 Improving the accuracy of statistical measurements, or even maintaining it, will continue to be challenged by changes in technology, transnational transactions and

budgetary restraint. Nevertheless, the demand for high-quality, detailed trade statistics will continue. Administrative records may still be the primary source of information, but methods of collection and verification will change. In managing this change, Customs and Statistics Canada must work together to ensure that there is an uninterrupted flow of data, and to implement improvements that meet the needs of governments and other users of trade data for accurate and timely statistics.

Appendix

United States General Accounting Office Report to Congress

NOVEMBER 1993 MEASURING U.S.-CANADA TRADE

**Shifting Trade Winds May Threaten Recent Progress
(GAO/GGD - 94-4)**

EXECUTIVE SUMMARY

PURPOSE

The United States and Canada are the world's top trading partners. The free trade agreement between the two countries, which began in 1989 and is gradually phasing out duties on bilateral trade, is expected to further enhance their trade relationship. Considering the importance of this relationship to the economies of the two nations, accurate data on its nature and extent are vital. For this reason GAO and the Office of the Auditor General of Canada reviewed the capacity of the statistical systems of their respective countries to produce accurate and complete trade data for both the present and the future. This report focusses primarily on merchandise trade data, but also recognizes the importance of data on international transactions of services, investment income and capital.

BACKGROUND

Trade data have many uses. The balance of trade, the difference in the value of a country's imports and exports, has become an increasingly important economic measure because of the emerging global economy as represented by growth in both exports and imports. Trade data are indicators of the effect of a nation's trade policies and play a significant role in the negotiation of trade agreements, such as the U.S.-Canada Free Trade Agreement and the North American Free Trade Agreement. Because the U.S. and Canadian economies are so intertwined, an accurate measurement of their bilateral trade is important for understanding each country's economy.

Although there are many aspects of U.S. international trade, data on merchandise trade are the most closely watched. Data on every declared import and export of merchandise

are to be collected by the U.S. Customs Service at ports of entry as part of its trade administration efforts. The U.S. Bureau of the Census then compiles this information and publishes it on a monthly basis. Merchandise trade data are also used by the Bureau of Economic Analysis in constructing the balance of payments accounts. These accounts are the statistical summary of all of the United States' international transactions and include information on transfers of services, interest income and capital.

RESULTS IN BRIEF

The United States and Canada have made great strides in improving the collection of the data on merchandise trade. For years, U.S. and Canadian government officials were aware of a serious undercount of U.S. exports to Canada mainly because of the failure of exporters to file export documents with U.S. Customs. To alleviate this problem, the United States and Canada agreed to develop a program to exchange their more accurate administrative records on imports and use this information to determine each country's exports to the other. This data exchange program has significantly improved the quality of U.S.-Canada merchandise trade data, although some issues concerning data collection and import classification still must be resolved.

Despite the success of the data exchange program, problems with collecting and processing import data could adversely affect to an unknown extent the accuracy of U.S. data on merchandise trade with Canada. Some of these problems, such as the lack of control of import documents sent from Customs to Census, will be corrected by the automation of Customs processes. Another problem is Customs' lack of assurance that its cargo examination and import document review procedures are effective in uncovering violations of Customs laws. Such violations, if undetected, could affect the accuracy of trade data. Customs, however, is making substantial efforts to improve its trade enforcement programs.

Even with their shortcomings, merchandise import data are still considered some of the most accurate trade data produced in the United States. Unlike data on other forms of trade, such as service transactions, which are collected through sample surveys that are limited in coverage, Customs attempts to collect data on all imports.

Changes in the international trade environment, however, could significantly affect the quality of merchandise import data. For example, when free trade with Canada is fully implemented in 1998, there will be little need for Customs' entry documentation beyond the collection of trade data. These changes may require developing new methods for collecting these data. Alternative methods for the United States to consider include the use of surveys and the direct reporting of merchandise trade data by businesses to Census. However, these methods have potential drawbacks, such as a loss of detailed product information and diminished statistical accuracy, that would have to be addressed.

GAO's ANALYSIS

U.S.-Canada Trade Data Exchange Successful, but Problems Remain

The federal government has long suspected that U.S. exports have been undercounted. In 1986, a reconciliation of U.S.-Canada merchandise trade data indicated that reported U.S. exports were 20 percent lower than Canada's recorded imports from the United States. The undercount was primarily due to the failure of exporters to report exports to Customs. To deal with the export undercount, the United States and Canada decided to exchange their more accurate administrative records on imports and use them to determine each country's exports to the other. U.S. and Canadian officials agree that the exchange, which began in 1990, has reconciled most of the differences in U.S.-Canada merchandise trade data. However, the countries are still working to resolve some problems, such as the undercounting of exports to third countries that go through the United States or Canada, and the failure of one country's import data to adequately capture some data elements previously available in the other's export data, such as the methods used to transport imports.

Although import data are generally considered to be more accurate than export data, they too are flawed. Recent evaluations by the National Research Council and GAO revealed that flaws in compliance and quality control procedures could affect the accuracy of import as well as export data. One problem, the lack of control over manually filed import documents, is diminishing as Customs continues to implement an electronic filing system. A problem that is potentially more serious is that Customs' cargo examinations and import document reviews lack effectiveness in identifying violations of Customs laws. The extent to which trade data have been affected by importer noncompliance is unknown. Since a September 1992 GAO study that identified these problems, Customs has been working to improve its trade enforcement efforts.

Changing Trade Environment Will Challenge Merchandise Trade Data System

Simply improving the current systems and procedures may not be enough to ensure the long-term quality of merchandise trade data, particularly that of import data. One reason is that Customs may end up giving less emphasis to traditional Customs documentation as the free trade agreement between the United States and Canada and other potential free trade agreements eliminate duties on imports. Customs also plans to further automate its cargo processing to deal more efficiently with the increasing trade volume. This planned automation could limit the amount of information provided by businesses to monthly summaries instead of single-transaction entries. These changes could significantly affect the quality of import data.

Problems With Service Transaction and Investment Income Information Limits Trade Data Quality

The monthly merchandise trade balance reports issued by Census are a closely watched indicator of the country's international economic competitiveness. However, merchandise trade accounts for only a part of United States' international economic activity. Service transactions, such as international long distance telephone calls, and interest paid on investments by foreign citizens constitute an important and growing part of the United States trade relationship with Canada and other countries. In fact, when service

transactions and investment income are included with merchandise trade, the U.S. trade balance improves. For example, in 1992, this country had a merchandise trade deficit with Canada of \$8.0 billion. However, when services and investment income are factored in, the balance with Canada became a \$4.5 billion surplus.

Data for the service and investment income components of this balance are collected mainly through surveys that are limited in frequency, level of detail and coverage. Therefore the level of quality of the data on services and investment income are lower than that for merchandise trade. Initiatives have been proposed by the current and previous administrations to improve these data, but Congress has approved limited funding for these initiatives.

RECOMMENDATIONS

GAO recommends that Census and Customs form an interagency task force to study how U.S.-Canada merchandise trade data should be collected in the future trade environment. (The study should be expanded to include U.S.-Mexico trade data in the event that the North American Free Trade Agreement is ratified and implemented. Note: Congress may decide on NAFTA before report is issued). Census should consider joining Customs with their Canadian counterparts to form a bilateral task force to address these issues cooperatively. GAO further recommends that the work of the interagency task force be done in the context of broader efforts to improve the measurement of all forms of U.S. international trade.

Chapter 24

Disclosure of the Cost of Using the Administrative Flight Service (VIP Fleet)

Main Points

Introduction

Audit Scope

Observations and Recommendations

- Incomplete and Inaccurate Information
 - Why does the Administrative Flight Service exist?
 - Costs were greater than reported
- Reasons for Differences between the Department's and Our Estimates of Costs
 - Incremental and total costs
 - Training and maintenance flying-hour costs
 - Indirect and overhead costs
 - Inaccurate cost factors
 - Depreciation and attrition
 - Cost of interest on capital
 - Unreported flights
- Comparison with Private Sector
- Recommendations

Disclosure of the Cost of Using the Administrative Flight Service (VIP Fleet)

Assistant Auditor General: Richard B. Fadden

Responsible Auditor: Alan Gilmore

Main Points

24.1 In 1989, we reported to the House of Commons on our attempt to audit ministers' travel expenses, including the Administrative Flight Service (VIP Challenger Fleet) of the Department of National Defence. We could not conduct an audit because we were denied access to certain information.

24.2 In October/November 1989, the House of Commons Standing Committee on Public Accounts reviewed our report. With respect to the Service, the Committee concluded that it was "not adequately assured that such costs are accurately disclosed to Parliament."

24.3 This year we reviewed the accuracy of the information on the cost of the use of the Service for 1990-91. We found that the information provided to Parliament on the cost to transport ministers and other VIPs was inaccurate and incomplete.

24.4 For 1990-91, we estimate that the total cost of operating the Service was about \$54 million. The Department reported in Part III of its Estimates that the total was about \$27.5 million. We estimate that the total cost per flying hour for 1990-91 was about \$19,650. The Department reported an incremental figure of \$3440 and a standard total estimate of \$6735.

24.5 For 1990-91, we estimate that the total cost for transporting ministers was at least \$24.5 million. The Department's Part III Estimates reported a total cost of about \$9.6 million and a total incremental cost of \$4.9 million. The Department's monthly reports show the total incremental cost as \$4.1 million.

24.6 We recommend that the Department provide complete and accurate information to Parliament on the full cost of using government aircraft to transport users such as the Prime Minister, ministers, and other VIPs.

24.7 Further, the Department, in co-operation with other appropriate departments, should conduct a review of the economy, efficiency and effectiveness of providing government aircraft to transport such users.

Introduction

24.8 In 1989, we reported to the House of Commons on our attempt to audit ministers' travel expenses, including the use of the Challenger aircraft of the Department of National Defence Administrative Flight Service, commonly known as the VIP fleet. We indicated that we were not able to conduct an audit because the government would not provide us with receipts and specific reasons given by ministers for their use of the VIP fleet.

24.9 In October/November 1989, our report was reviewed by the House of Commons Standing Committee on Public Accounts. With respect to the costs of the Administrative Flight Service, the Committee concluded that it was "not adequately assured that such costs are accurately disclosed to Parliament."

24.10 The Eighth Report of the Standing Committee (December 1990) recommended that the Auditor General conduct a comprehensive audit of the Administrative Flight Service of the Department of National Defence (DND).

Audit Scope

24.11 In response to this recommendation, and in the absence of information on specific reasons for the use of the aircraft, we decided to review the accuracy of the travel cost information for 1990-91 reported by the Department in the following documents:

"Use of Administrative Flight Service Challenger Aircraft" (issued monthly);
Part III of the Department's Estimates.

24.12 The monthly reports on the use of the Administrative Flight Service Challengers were initiated in 1990. The reports provide details on each trip and the cost of the use of the Service's Challenger aircraft. The Department does not report, and is not required by Treasury Board to report, on the use of its other aircraft by ministers and other VIPS. In addition, other departments are not required to report on the use of their own aircraft for similar purposes.

24.13 The first report, in October 1990, covered the months of April to September 1990. These monthly reports, along with a semi-annual report on ministerial travel, were part of the government's response to our 1989 Report.

24.14 The reports contain certain information on costs and passengers for each trip, but only two generic descriptions of the purposes for the trips: government or departmental business. The Department uses these descriptions because they are specified as the ones to be used, in the Treasury Board's Administrative Practices - Guidelines for Ministers' Offices.

24.15 The reported costs of operating the Administrative Flight Service are based on estimates developed by the Department from historical cost information, which is updated every two to three years as part of the Department's overall costing system.

24.16 Where practical, we verified the accuracy of the cost information reported by the Department, by identifying and costing the Challenger passenger transport activities and the activities that exist to support this function. Where it was not practical to use actual costs, we used departmental estimates. We used this information to calculate the total cost per flying hour for ministerial travel.

24.17 We did not review the cost of the use of other Department of National Defence aircraft to transport VIPs. As stated above, the Department is not required by Treasury Board to report on ministers' use of its other aircraft. However, these costs could be significant. For example, reports are not published on the use of Boeing 707s to transport VIPs. The Boeing 707s have been replaced with five used A-310 Airbus aircraft. According to the Department, one of the aircraft has been permanently configured for both VIP use and regular passenger use.

24.18 However, the Department did conduct a special survey to provide us with information on the use of its other aircraft to transport VIPs. The information provided indicated, for example, that four ministerial flights were made using Cosmopolitan aircraft stationed at Canadian Forces Base Ottawa (412 Squadron).

24.19 We tested the accuracy of the information on the use of the Cosmopolitan aircraft stationed at Canadian Forces Base Ottawa. We found that other departmental records showed that there had been nine ministerial flights using these aircraft. As a result of this test, we decided we could not rely on the information provided to us on the use of other departmental aircraft. To verify the use and the associated costs of other departmental aircraft for ministerial travel would require a check of the records of all aircraft. We did not consider this to be practical.

24.20 We also could not readily identify trips taken by ministers in aircraft owned by other government departments.

24.21 Further, we did not review whether expenditures on the Service have been made with due regard to economy and efficiency. We also did not review whether the Service was used in compliance with legislative and government authorities. These examinations could not be done for the flights subsequent to January 1991. As of January 1991, ministers are no longer required by Treasury Board to provide the Minister of National Defence with specific reasons for using the Service. They simply note that it is for either departmental or government business.

24.22 The matters reported in this chapter have been thoroughly discussed with officials of the Department of National Defence over a lengthy period of time.

Observations and Recommendations

Incomplete and Inaccurate Information

24.23 The information provided to Parliament by the Department of National Defence, on the cost of the use of the Department's Administrative Flight Service aircraft to transport ministers and other VIPs, is inaccurate and incomplete.

24.24 We think that parliamentarians and Canadian taxpayers should be able to understand easily how much it is costing to operate the Administrative Flight Service as a whole and to transport specific users. One of the ways of achieving this is to report the full annual costs of operating the Service, the full costs per flying hour, and the full costs per trip by individual users.

Why does the Administrative Flight Service exist?

24.25 A June 1990 report to the President of Treasury Board on the Service, subsequently provided to the House of Commons, stated that the Service ". . . was established first and foremost, as a national and international air transport service for the Royal Family, the Governor General and the Prime Minister." It also stated that "a secondary use was for ministerial purposes", and that the Department uses the aircraft for VIP transport, medical evacuations and demonstrations. Part III of the Department's Estimates contains a similar statement of the objective of the Service.

24.26 The Department of National Defence has a fleet of 16 Challenger aircraft, 12 of which are passenger aircraft. Seven of the 12 aircraft normally are used by the Administrative Flight Service.

Costs were greater than reported

24.27 We estimated that the total cost of operating the Service in 1990-91 was about \$54 million. The Department of National Defence reported in Part III of its Estimates that the total for 1990-91 was about \$27.5 million.

24.28 The incremental and standard total costs per flying hour for the Service as reported by the Department for 1990-91 were \$3440 and \$6735, respectively. Based on our estimate of total operating costs and hours of use, the total cost per flying hour for 1990-91 was about \$19,650.

24.29 We found that the flying hours in 1990-91 for each user and for training and maintenance purposes were as follows:

	1991 Flying Hours	
	No.	Percent
Royal Family	69	1.6
Governor General	232	5.3
Prime Minister	206	4.7
VIPs	583	13.4
Ministers	1245	28.6
National Defence	440	10.1
Subtotal	2775	63.7
Training and Maintenance		
For Service Users	1388	31.8
Other	196	4.5
Subtotal	1584	36.3
Total	4359	100.0

24.30 Travel by ministers was the single largest passenger use of the Challenger aircraft assigned to the Service. During 1990-91, National Defence records indicate that travel by ministers constituted about 29 percent of the use. The next largest group of users were VIPs, for example, heads of foreign countries and provincial premiers. They accounted for about 13 percent of the use. About 32 percent of the hours flown were for training and maintenance purposes related to users of the Service.

24.31 Using our cost data, the total cost for transporting ministers in 1990-91 was at least \$24.5 million. This amount is much higher than the total of about \$9.6 million reported by the Department in Part III of its Estimates. It is also much higher than the total incremental costs of \$4.1 million shown for ministers' trips in monthly reports for 1990-91, or the \$4.9 million shown in Part III of the Department's Estimates.

24.32 In part, our cost estimate is higher than the Department's because the Department's figure does not include a number of costs. For example, the Department shows costs of training and maintenance flights as a separate operational category. We allocated these types of costs to the users of the Service on the basis that the costs are incurred to enable the Department to provide the service for them.

Reasons for Differences between the Department's and Our Estimates of Costs

24.33 The reasons for the difference between our estimates and the Department's include: the Department's use of incremental costing; its non-allocation to users of training and maintenance flying costs; its exclusion of certain costs such as the cost of training courses and the cost of capital; its use of inaccurate cost factors; different estimates of depreciation; and unreported flights.

Incremental and total costs

24.34 On a monthly basis, the Department reports the incremental costs but not the total cost of flights. According to the Department, incremental costs are defined as the costs that would not have been incurred had the goods and services not been provided. These include the costs of petrol, oil, lubrications, spares, repairs and overhaul, food, incidentals, ground handling fees and air crew temporary duty. In 1991, the incremental cost figure used by the Department was \$3440 per flying hour.

24.35 Although the Department does not report total costs by user on a monthly basis, Part III of its Estimates does allocate costs to users. However, even this amount does not include all costs. The Department defines total flight costs as including incremental costs, direct labour costs of servicing and minor maintenance, capital costs (depreciation and attrition), air crew costs (air crew salary and benefits only) and base support costs (air crew only). In 1991, the total cost reported by Department was \$6735 per flying hour.

24.36 The Department's definition of total costs excludes certain costs, such as those of maintenance-related flying hours, training, air operations, passenger and baggage handling, and the cost of capital.

24.37 The Department does report training and maintenance flying-hour costs of the fleet's Challengers under the category "Others" in Part III of its Estimates. However, we note that the meaning of this category is not explained in Part III and the costs are not allocated to users.

24.38 Review of non-incremental costs and the primary purpose for the service. The major costs the Department classifies as non-incremental include: air crew, in-service maintenance, base support, and depreciation. We reviewed the relationship between these costs and the primary purpose for having the Service.

24.39 As stated in paragraph 24.25, the Service exists primarily to transport the Royal Family, the Governor General and the Prime Minister. The Department could not provide us with an analysis supporting the need for the number of aircraft used by the Service.

24.40 We found that the Service Challenger personnel and aircraft resource levels at the 412 Squadron are well in excess of what would be reasonable for transporting the Royal Family, the Governor General and the Prime Minister. For example:

Crew costs : During 1990-91 there were approximately 11 Challenger crews assigned to the Service at Canadian Forces Base Ottawa. If crews were there to service the Royal Family, the Governor General and the Prime Minister on 87 flights, the personnel levels would have been one air crew for every eight flights.

In-service maintenance : During 1990-91, approximately 88 person-years at the Ottawa base were used to provide service and minor maintenance to the Challenger aircraft. If these resources were there to service the Royal Family, the Governor General and the Prime Minister on 87 flights during 1990-91, the resource levels would have been about one person-year of maintenance for each flight.

This analysis underscores the fact that the resources dedicated to this service are in excess of what is really needed to transport the primary users and that the costs are also incurred, consciously, to transport ministers, who are the largest single user group. Therefore, it seems logical to us to allocate to ministers their proportionate share of the full cost and report these rather than what the Department defines as incremental costs.

Training and maintenance flying-hour costs

24.41 We found that the training and maintenance flying-hour costs are significant. The training program focusses on training air crews to transport passengers on 9- to 12-seat Challenger aircraft and to fly in and out of commercial airports. We found that the total cost of the 1203 training flying-hours for users of the Service in 1990-91 was \$14.7 million. Further, about one third of the training hours involved flights to foreign countries.

24.42 The maintenance of Administrative Flight Service planes involves flights to transport crews to repair the aircraft, to test aircraft after repairs and to ferry aircraft for major repair and overhaul work. In 1990-91, the number of hours used for these purposes was 214. This cost was about \$2.7 million.

Indirect and overhead costs

24.43 The Department does not include the cost of purchased and departmental training courses provided to flight crews in its calculation of total costs. In 1990-91 this cost was \$548 per flying hour.

24.44 It also does not include such indirect and overhead costs as passenger and baggage handling, the operation of the ministerial terminal, base air operations staff and contract management. The Department's explanation "for excluding these costs is that they are not part of the standard costs that it develops in support of its normal operations."

24.45 We reviewed the costs and, although we did not calculate all of them, we found that indirect and overhead costs were significant - at least \$1000 per passenger flying-hour. For example, the per flying-hour cost of passenger and baggage handling and the operation of the ministerial terminal was \$831.

Inaccurate cost factors

24.46 The use of inaccurate cost factors by the Department also accounts for some of the differences between its costing calculations and ours. The Department uses cost factors based on projecting historic cost information adjusted by inflation factors. We do not disagree with the use of inflation factors.

24.47 The Department's costing system makes use of multi-year averages of actual expenditures, which are updated every two to three years. Certain costs are not reflected in the cost factor until after the factor is updated. Thus, significant additional and increased costs associated with the aging of the aircraft, especially repair and overhaul

costs, are not included in the cost factors until they are updated. For example, a requirement for overhauling engines commenced in 1990-91, costing \$2.5 million annually. This cost was not included in the Department's cost factors until the factors were updated for 1992-93.

24.48 In addition, the cost factors are based on bulk purchases of fuel and in-flight meals. However, a significant percentage of these items are retail purchases. For example, over 60 percent of the fuel used by the Service is from primarily retail sources, rather than bulk purchase. We estimate the average per-litre fuel cost to be 40 cents rather than the Department's bulk price of 29 cents.

Depreciation and attrition

24.49 The Department's standard total cost includes the cost of depreciation and attrition. Depreciation is the allowance made for the loss in value of the Service's aircraft due to use. Attrition is the allowance for aircraft lost prior to the end of their normal useful life. Part III of the Department's Estimates reported that in 1990-91 these costs totalled \$5.1 million.

24.50 To calculate depreciation and attrition, the Department uses replacement cost rather than the historic costs. In our opinion, the use of historic costs is preferable since they relate to current users, whereas replacement costs relate to future users. Historic costs identify the cost of the consumption of an asset, while replacement costs identify the funding that will be required to replace the portion of the asset being consumed. Using replacement costs rather than historic costs, our estimate of the hourly cost of flying the Challenger would be \$20,354 rather than \$19,650.

Cost of interest on capital

24.51 The Department told us that it cost \$96.3 million to buy six aircraft for the Administrative Flight Service. However, the Department does not include the cost of interest on capital in calculations of total standard costs, and it does not report it in Part III of its Estimates. In addition, we note that there are seven aircraft normally used by the Service, rather than six.

24.52 Our estimate of the cost of interest on capital for the Service in 1990-91 is \$9.7 million.

Unreported flights

24.53 We found that some Challenger flights were not reported. Our review of 412 Squadron records indicates that seven flights in support of the Prime Minister and twelve other ministerial trips had not been included in the Challenger report.

Comparison with Private Sector

24.54 For 1990-91, we compared the costs of using the Department's aircraft to transport ministers with the costs of private sector aircraft. We compared departmental costs of completing a return flight from Ottawa to Vancouver with the costs of three charter airplane companies that use a similar-size passenger aircraft and have similar flying hours.

24.55 Using our approach to estimating costs, in 1990-91 the cost of using a Department of National Defence Challenger for such a flight was about \$197,000. If the Department had reported the costs using its method of calculation, it would have reported a total cost of about \$67,000 and an incremental cost of about \$34,000.

24.56 The use of a private sector aircraft to transport ministers would be much less expensive. The high estimate in 1993 for such a flight, from the three companies we contacted, was about \$38,500, including GST; the lowest was about \$24,000.

Recommendations

24.57 The Department should provide complete and accurate information to Parliament on the full cost of using government-owned aircraft to transport users such as the Prime Minister, ministers, and other VIPs.

24.58 The Department, in co-operation with other appropriate departments, should conduct a review of the economy, efficiency and effectiveness of providing government aircraft to transport users such as the Prime Minister, ministers, and other VIPs. Such a review would address questions such as these:

What government-owned and commercial aircraft are being used to transport the Royal Family, the Governor General, the Prime Minister, heads of states, ministers and other VIPs?

What are the full costs of providing these services?

What types of planes and levels of service are required to transport specific users?

Are the standards of availability, maintenance and security for such flights appropriate?

Do ministers need to use the Administrative Flight Service and other government aircraft or can they use regular commercial or charter aircraft?

To what extent do ministers already use regular commercial or charter aircraft?

Why is the cost of contracting out maintenance for the Administrative Flight Service aircraft so high, and why does it take so long to perform the maintenance?

Why is 28 percent of the Administrative Flight Service flying time used for Service training purposes?

Why are the costs so high for pre-flight and post-flight servicing of the Administrative Flight Service aircraft?

Department's response:

(24.23) The Department agrees that its use of standard costs does not capture and allocate all of the costs in the same manner as identified in this audit. The Department is

prepared to make an exception in its cost accounting practices by reviewing the full range of cost elements that comprise the direct and indirect, or overhead, costs of operating the Administrative Flight Service and building a revised cost-allocation model. This will bring the DND annual cost of fleet operations much closer to the OAG calculations. It should be noted, however, that many of these additional costs would be incurred whether or not there is an Administrative Flight Service.

(24.24) The Department agrees that the costs incurred in the provision of the Administrative Flight Service should be complete and easily understood. The Department therefore agrees to expand and clarify the information on the annual operations and costs of the Service in its Part III of Main Estimates. However, the Department believes that the fixed costs that have been incurred because of the decision to operate the Service cannot be meaningfully allocated to users and should be categorized as annual fleet costs. Therefore, for the flying hours of individual flights in the monthly report and user categories in the Part III Estimates, DND considers it appropriate to use the incremental costs.

(24.25) As specified in Treasury Board Guidelines, the Department of National Defence operates an Administrative Flight Service for members of the Royal Family, the Governor General, the Prime Minister, former prime ministers travelling for purposes relating to their former office, Cabinet ministers, foreign dignitaries visiting Canada, parliamentary committees or delegates on official business and, when authorized by a minister, senior federal officers on government business. Priority on the use of the Service is given to the Royal Family, the Governor General and the Prime Minister, but the Service exists and is resourced to support all user categories.

(24.26) Only six Challenger aircraft are on the establishment of 412 Squadron and dedicated to the Administrative Flight Service. The seventh aircraft was made available to the Service pending its refitment and has been returned to its home squadron for use in the Electronic Support and Training role.

(24.27) Based on its review of cost allocations, the Department estimates that the annual cost of providing the Service in 1993-94 is \$38.2 million.

(24.28) In paragraph 24.27, the auditors indicate that the total annual cost of operating the service was about double the amount reported by DND. In paragraph 24.28, the auditors indicate that the total hourly cost was about three times the amount reported by DND. The reason for this apparent anomaly is that the auditors, in fact, calculated the total cost per flying hour at \$13,640. When they reallocated costs of training and maintenance hours to other users, the cost increased to \$19,650 per hour flown with users of the fleet actually aboard. The Department believes that the hourly costs for training and maintenance should be identified and reported as a component of the annual fixed or overhead costs and not reallocated to users on an hourly basis.

(24.31) The Department estimates, using its modified costing methodology, that of the \$38.2 million annual cost to operate the fleet, the fixed costs are \$27.4 million. Since

these fixed costs have been incurred because of the decision to operate the Service and do not vary with the level of user activity, the Department believes they should be categorized only as annual fixed fleet costs. In addition to the fixed costs, the annual incremental costs of fleet operations are estimated at \$10.8 million for all users of which \$5.1 million are for ministers' trips.

(24.32) This matter is addressed in our response to paragraphs 24.28 and 24.31.

(24.34) Based on its revised costing approach, the Department estimates that the incremental cost in 1993-94 is \$4,639 per hour.

(24.35) Based on its new costing approach, the Department believes that it would be misleading to report a total cost per user flying hour since the fixed costs will be incurred whether or not user flights occur.

(24.36) Comments on this observation are provided in the related paragraphs below.

(24.37) The Department will clarify the reporting of annual training and maintenance hours in its Part III of Estimates. As stated in our response to paragraph 24.28, the Department disagrees with the practice of allocating these costs to users on an individual flying-hour basis.

(24.39) The Service's approved establishment of aircraft is the result of the government's decision in 1989 to reduce the fleet from eight to six aircraft. With these resources, the Service is mandated to operate throughout the year seven days a week, 24 hours a day. The AFS will normally provide up to four aircraft per day for government use. On days when air crew operational training is required, the AFS will provide three aircraft. Depending on maintenance schedules, additional aircraft may be available.

(24.40) The Department notes the observation that the personnel and resource levels are in excess of what would be reasonable for transporting only the Royal Family, the Governor General and the Prime Minister. However, as explained in the response to paragraph 24.25, the Service is mandated for other users as well who, as indicated in paragraph 24.29, account for almost 82 percent of user flying hours. The Department can see no logical basis for allocating the total Service costs to the Royal Family, the Governor General and the Prime Minister. The Department does not believe that the hypothetical cost accounting in paragraph 24.40 contributes to the audit in a meaningful way.

(24.43) The costs of purchased and departmental training courses have been included in the revised annual costs of the Service.

(24.44) While these costs are not a part of DND standard costs, they have been included in our redevelopment of the annual costs of the Service.

(24.45) The Department acknowledges that the allocated indirect and overhead costs are significant and as indicated in the response to the two previous paragraphs, these costs have been included in the revised annual costs of the Service. It is important to note, however, that the Department would incur many of these costs even if the Administrative Flight Service did not exist.

(24.47) The Department maintains thousands of standard costs for its personnel, equipment and facilities and cannot possibly update all of them on an annual basis. For this reason, it updates them periodically, uses multi-year averages of historical spending and applies inflation factors to estimate costs in the current year. The Department believes this is a reasonable approach.

(24.48) Agreed. In the Department's revised methodology, the cost of fuel includes retail purchases.

(24.49) The Department has traditionally based its depreciation and attrition calculations on replacement cost because this was considered more appropriate for use in circumstances where full costs were being recovered from users of Departmental services. However, depreciation and attrition are imputed costs for which there are no expenditures until the equipment is replaced. Since the purpose of Part III of Estimates is to explain how the Department will use its annual appropriation of funds, depreciation and attrition costs will be excluded from the annual cost of fleet operations. In order to ensure full disclosure of costs related to the Service, the Department plans to identify the original procurement cost of the fleet aircraft in Part III Estimates.

(24.51) As indicated in the response to paragraph 24.26, the seventh aircraft was on interim assignment with the Service pending its refitment for use in the Electronic Support and Training role. This aircraft has been returned to its home squadron.

(24.52) The Department does not include imputed interest on capital in any of its cost estimates and believes that it would be inappropriate to make an exception for the Administrative Flight Service. The government displays its debt servicing costs separately in Estimates under the Department of Finance.

(24.53) The Department has issued instructions that will serve to ensure that reports on Challenger flights will be accurate.

(24.56) The Department believes that, compared to a charter airline, the Administrative Flight Service provides a higher level of responsiveness, flexibility, security and dependability and that these factors contribute to the differential in cost between the two. Furthermore, a significant portion of the total cost calculated by the auditors comprises imputed costs (as opposed to expenditures) and allocated overheads that would largely be incurred even if the Service did not exist. Therefore, for the purposes of comparing costs for a given flight, the Department believes that only its incremental costs would be relevant because only those costs would be saved if a user were to fly by charter instead of by Service Challenger.

(24.57) This recommendation deals with matters that are outside the authority of DND. As such, the Department's response will be confined to the reporting of the Administrative Flight Service, which was the subject of this audit.

The Department fully agrees that complete and accurate information should be provided to Parliament on the cost and use of the Administrative Flight Service. To that end, the Department reports monthly on ministers' use of the Service and annually on fleet operations in Part III of Main Estimates.

To ensure that the information provided is both clear and comprehensive, the Department is conducting a thorough review of the contents of its annual report on the Administrative Flight Service in Part III of Estimates.

In the spirit of trying to link resources to activities for the purposes of comprehensive cost reporting, the Department agrees that all departmental expenditures incurred in the provision of the Administrative Flight Service should be identified.

Since existing DND standard costs for the Administrative Flight Service do not include all overhead costs, the Department is prepared to tailor its cost accounting practices taking into account many of the suggestions and observations made during the audit. The Department will review the full range of cost elements which make up the total cost of operating the Administrative Flight Service.

However, the Department believes that the fixed costs that have been incurred because of the decision to operate the Service cannot be meaningfully allocated to users and should be categorized as annual fleet costs. Therefore, for the flying hours of individual users in the monthly report and user categories in the Part III Estimates, DND considers it appropriate to continue to report incremental costs.

Recognizing that the use of incremental costs does not provide visibility on the fixed costs of the Administrative Flight Service, the Department will recommend that the monthly report be amended to include an appropriate extract from the revised annual report in Part III Estimates.

(24.58) The Department is prepared to participate in any review carried out to address the first six of the suggested questions, but believes that such a review should be initiated and led from outside the Department. The Department agrees to a review of the last three questions, which relate specifically to the cost and efficiency of the Administrative Flight Service operated by DND.

Chapter 25

Parliamentary Control over the Raising of Revenues by Fees

Main Points

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[Audit Scope and Objectives](#)

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Parliamentary Control over the Raising of Revenues by Fees

Assistant Auditor General: Richard B. Fadden

Responsible Auditor: Alan Gilmore

Main Points

25.1 In 1992, Treasury Board estimated that revenues from user fees would exceed \$3 billion and were expected to increase. Individuals, companies and other jurisdictions are charged fees for the use of government facilities, services, and goods. For example, fees are charged for passports, books and maps, and making photocopies.

25.2 User fees are established pursuant to departmental legislation and the *Financial Administration Act*, and by contracts with users. Fees established by contracts and other non-regulatory means are not subject to the regulatory process. The process seeks to ensure adherence to such principles as providing a full opportunity for public consultation and an assessment of proposals to ensure that benefits clearly exceed costs.

25.3 We are concerned that Parliament cannot readily scrutinize the user fees established by contracts and other non-regulatory means. There does not exist a government-wide summary of the fees being charged, the revenues raised and the authorities under which they are established.

25.4 The use of contracts on a broad scale to establish fees needs to include careful consideration of such issues as:

How would affected parties be consulted?

How would Parliament be given the opportunity to review fees established by contracts?

How would users be assured that they are being charged the same price for identical services or uses?

25.5 In certain instances, departments are using technical legal reasons to avoid the regulatory process or are using general regulatory powers to raise revenues to cover the costs of their regulatory activities.

25.6 We have recommended that the Treasury Board review and report to Parliament on the adequacy of the current legislative and administrative framework for establishing user fees, and provide Parliament with government-wide summary information on fees being charged.

Introduction

25.7 In 1992, Treasury Board estimated that federal revenues from user fees exceeded \$3 billion and were expected to increase. User fees are charges to individuals, companies and other jurisdictions for the use of government facilities, services and goods. For example, the government charges fees for passports, operating motor vehicles in national parks, making photocopies, licences for non-broadcasting radio communication equipment, and books and maps.

25.8 Parliamentary control over the raising of revenues by government is based on a constitutional and statutory framework dating back to the origins of parliamentary democracy, and codified at the time of Confederation in the *Constitution Act, 1867*.

25.9 The *Constitution Act* requires that legislation for imposing any tax or charge shall originate in the House of Commons. Parliament has granted the government legislative authority to establish and amend user fees through:

specific legislation that established the department or agency concerned, for example, the *Department of Transport Act* , or legislation establishing a particular program or activity, for example, the *Aeronautics Act* ; and section 19 of the *Financial Administration Act* , subject to any other Act, which provides the Governor in Council with authority to set fees or to authorize ministers to set fees by order.

25.10 Fee orders authorized under either of these mechanisms normally are considered to be statutory instruments and, as such, must follow the government's regulatory process before taking effect. The regulatory process seeks to ensure adherence to the following principles:

clear accountability of ministers and officials;
full opportunity for public consultation and participation in the regulatory process;
an assessment of proposed regulations to ensure that benefits clearly exceed costs;
clear and reliable public information on the need for regulations;
an evaluation of the effectiveness of regulatory programs; and
a secure foundation in law for actions of regulatory authorities.

25.11 In October 1988, the Department of Justice concluded that, as an alternative to obtaining authority pursuant to the *Financial Administration Act* , departments and agencies could use contracts to set fees for services, for use of facilities, and for rights and privileges conferred by Her Majesty by means of licences, permits or other regulations. In other words, departments could establish fees without specific statutory authority, by entering into contracts with users of a service or product. One consequence of using contracts is that it is not necessary to obtain approval for fees by proposing a regulation and following the regulatory process.

25.12 In December 1989, Treasury Board approved a new policy on charges to external users, which requires departments and agencies to identify opportunities to establish user fees. Guidelines on the policy state that "in a limited number of cases, primarily those for special services, it may be possible to charge on the basis of a negotiated contract entered into voluntarily by a willing purchaser. Otherwise, an Act of Parliament must provide specific authority to establish user charges."

25.13 In May 1991, section 19 of the *Financial Administration Act* was amended to clarify the cost-recovery authority for user fees and to ensure greater fairness and uniformity. According to Treasury Board documents, one of the key objectives of the new section 19 was to make it a statutory requirement, rather than just policy, that the fees be subject to the regulatory process and published in the Canada Gazette.

25.14 In July 1991 Treasury Board circulated a draft discussion paper, entitled "User Fees: Getting Away from the Regulatory Process". According to Treasury Board officials, the paper was developed because departments were already using contracts to establish user fees and there was concern that no appropriate framework and controls existed for this alternative to the *Financial Administration Act*.

25.15 According to Treasury Board officials, the main reason for seeking an alternative to the *Financial Administration Act* to set user fees is that the regulatory process is lengthy, expensive and frustrating.

Audit Scope and Objectives

25.16 We reviewed a variety of authorities and procedures used by departments and agencies to charge user and licensing fees. Since the government has not summarized them, we used existing information from our Office's audit work to select departments and agencies for review.

25.17 The objective of our review was to assess whether there was authority for, and adequate parliamentary control over, the raising of revenues by user fees.

25.18 We focussed on the disclosure of information to Parliament and the public on the basis that, in a democratic country, individuals, groups, and companies have the right to be fully informed about, and to participate in, government decisions that limit their freedom or affect their lives. This places an obligation on the government to disclose information fully rather than choosing when and what information to disclose. Although equal access to information is not alone a sufficient condition for a reasonable outcome, it is a necessary condition. These principles are recognized and accepted by the government in its Citizens' Code of Regulatory Fairness.

Parliament Cannot Readily Scrutinize the User Fees Established by Contracts and Other Non-regulatory Means

25.19 Departments are establishing user fees for government services and facilities pursuant to provisions in departmental legislation, section 19 of the *Financial Administration Act* , and by contracts with users.

25.20 There is no government-wide summary of fees charged, revenues raised and authorities under which they are established. For example, while departments and agencies are using contracts to establish user fees, the Treasury Board does not have information on the extent to which they are doing so. Without such information, Parliament cannot easily scrutinize the raising of revenues by fees.

25.21 We are also concerned that the application of section 19 of the *Financial Administration Act* is unclear. In May 1991, the section of the *Financial Administration Act* covering user fees was amended. The December 1990 President of Treasury Board statement to the House of Commons committee reviewing amendments to the Act indicated that the amendments related to section 19 would strengthen parliamentary control by:

enshrining in statute the current administrative requirement that fees prescribed by ministers be established by a statutory order; and
ensuring that all fees are subject to the regulatory process, are published in the Canada Gazette, and stand referred to the Standing Joint Committee for the Scrutiny of Regulations.

25.22 Departments and agencies are establishing user fees by including them in the terms of contracts, rather than by obtaining orders-in-council as per section 19 of the *Financial Administration Act* . This method is not subject to the regulatory process and principles described above.

25.23 The alternative of using contracts on a broad scale needs careful consideration. Among the factors to be considered are the following:

Should contracts be used rather than section 19 of the *Financial Administration Act* or another statutory authority?

How would affected parties be consulted?

How would Parliament be given the opportunity to review fees established by contracts?

Who would set the price for each of the individual services and uses? The advantage of using an order is that the price is not subject to bureaucratic discretion. In the absence of a fees order, a price would have to be set for each contract.

How would uniformity or consistency of price be maintained? How would users be assured that they are being charged the same price for identical services or uses? Would a price list for the services or uses be created? How would it be kept current? How would it be communicated adequately to employees and customers and be administered and enforced? Why would it be difficult to transform such a list into a fees order pursuant to section 19 of the *Financial Administration Act* ?

Are more internal control mechanisms needed if contracts are used? The use of an order tells employees and customers alike that there is no legal discretion in the matter of price.

Is the establishment of fees by order less open to abuse? If the regulatory process is followed, there is a degree of transparency in how a price is established. If fees are established by contracts, the process could be subject unduly to political and administrative considerations.

Many of the above matters have been raised by the Department of Justice in its advice to departments.

25.24 In addition, in certain instances departments are using technical legal reasons to avoid the regulatory process or are using general regulatory powers to raise revenues to cover the costs of their regulatory activities.

Examples of departments using or considering the use of contracts to establish user fees

25.25 Statistics Canada. In 1993-94, Statistics Canada expects to receive about \$26.6 million from the sale of publications and CANSIM retrievals, the sale of special products and services, and for work done under cost-recovery arrangements.

25.26 With respect to publishing information, Statistics Canada has received legal advice that the *Statistics Act* in conjunction with the *Supply and Services Act* give the agency the authority to publish information concerning statistics. Its approach to setting prices for publications requires the approval of Treasury Board. The Board approves an overall approach rather than specific prices. Statistics Canada has received such approval. Prices set pursuant to these statutes and approvals are not subject to the regulatory process.

25.27 In earlier years, Statistics Canada set fees for special products and services through an order-in-council. Since 1989, on the basis of a legal opinion from the Department of Justice and guidance from the Administrative Policy Branch of Treasury Board, Statistics Canada has been using contracts to charge fees to users. This procedure is not subject to the regulatory process.

25.28 Statistics Canada is now seeking formal revocation of the order-in-council on the basis of the legal opinion from the Department of Justice. The agency has estimated that "exemptions from the regulatory policy will have a beneficial impact resulting in annual cost avoidance of in excess of \$150,000 in regulation preparation and publication fees."

25.29 By way of explanation for setting fees by contract, Statistics Canada told us that using an order-in-council to set fees "is highly impractical because the unique nature of each of the thousands of requests does not lend itself to approving pre-established fees." The agency also told us that "fees were charged on the basis of costs incurred."

25.30 The Canadian Parks Service. Up to the present time the Canadian Parks Service has used the regulatory process to control fee setting. In 1992, the Canadian Parks

Service generated about \$34.6 million in user fees. These fees currently are dealt with in 26 separate regulations promulgated under a number of different Acts.

25.31 In response to the government's February 1992 call for individual departmental review of regulations, the Canadian Parks Service carried out a review of its regulatory regime. As a result of this review, it was estimated that approximately \$300,000 to \$500,000 of revenue was lost due to delays caused by the existing regulatory process.

25.32 The review highlighted difficulties, inefficiencies and loss of revenue involved in managing fees under the regulatory process. This led the Canadian Parks Service to seek legal advice, which indicates that it can consider other mechanisms for the control of user fees, including contracts or new legislation.

25.33 National Archives of Canada. The National Archives has been charging user fees for a number of years. In 1992 it charged clients about \$120,000 for reprographic and other copying services and archival training services.

25.34 In August 1989, pursuant to the *Financial Administration Act*, the Governor in Council authorized the Minister of the Department of Communications to prescribe fees by order. The Minister has not issued such an order. Thus, in our opinion, the Archives has been charging fees without ministerial authority. The Archives states that it did not obtain the ministerial order because it is seeking to have its order-in-council revised to reflect the December 1989 Treasury Board user fee policy.

25.35 In June 1992, the Archives began the process of obtaining a new order-in-council and the required ministerial fee order. The revised fees were scheduled to be effective 1 April 1993.

25.36 In August 1992, the Regulatory Affairs Division, Treasury Board questioned why the National Archives was following the regulatory process to obtain the necessary authority to charge fees when it could use a contract. The Archives then sought legal confirmation that it could proceed using contracts.

25.37 In January 1993, the Archives was advised to revise its fee order in accordance with the requirements of the *Financial Administration Act*. It was believed that a contract could be used but, in the absence of a Treasury Board policy, the Archives received legal advice to follow the regulatory process.

25.38 The National Archives has advised us that the required order-in-council is expected to be approved by the end of fiscal year 1993-94, one year later than originally planned.

25.39 Department of National Defence. According to the Department, approximately \$350 million in revenues were derived in 1991-92 from user fees. Examples include:

	(\$ millions)
• provision of services from sales to or on behalf of NATO and foreign governments, including military assistance and training programs	125.0
• rentals — married quarters	85.3

25.40 A 1973 order-in-council is the main authority that National Defence relies on to prescribe fees and charges for a wide range of services undertaken on behalf of non-defence agencies. The order-in-council authorizes the Minister of Defence to prescribe fees or charges.

25.41 In April 1992, the Standing Joint Committee of the Senate and the House of Commons for the Scrutiny of Regulations informed the Minister that the Department was not in compliance with the government's 1986 directive that all authorizing orders-in-council issued pursuant to section 19 of the *Financial Administration Act* should be revoked and replaced by new orders-in-council. The new orders-in-council would authorize the Minister to prescribe fees by means of an order of the Minister, which is then registered and published in the Canada Gazette.

25.42 In the fall of 1992, the Department wrote the Joint Committee and informed it that, after completing a study, the Department had concluded that it was not necessary to use ministerial orders to impose fees. The Department further stated that it planned to seek approval from Treasury Board and the Governor in Council to revoke the 1973 order-in-council, but would not be requesting a new order-in-council. According to National Defence officials, the Department is using contracts and memoranda of understanding to establish fees.

25.43 Department officials state that obtaining the required orders would lead to a proliferation of such orders and create an unmanageable administrative burden, because the types of services provided by the Canadian Forces and the Department are so diverse that it would be impractical to set fees in advance.

Use of technical legal reasons for not following the regulatory process

25.44 Department of Energy, Mines and Resources. The Department of Energy, Mines and Resources charges fees (estimated at \$6.4 million for 1993-94) for maps, charts, aerial photographs and survey plans. These fees are set under the authority of a 1972 order-in-council issued pursuant to the *Financial Administration Act*. The Department also plans to generate about \$9 million in 1993-94, primarily from a combination of established charges and contracting of scientific services and testing activities. These fees are set under the authority of a 1974 order-in-council.

25.45 The Department has obtained several legal opinions from the Department of Justice. These state that, because neither of the above orders-in-council contains the words "by order", the documents used by the Minister to prescribe fees under those orders-in-council are not statutory instruments and are not subject to the regulatory process. As a result, the Department believes that, so long as it complies with the terms and conditions of the orders, there is no legal requirement to obtain new authorities. Thus, ". . . for technical reasons, the older orders-in-council escape the regulatory review process."

25.46 In its Sixth Report to Parliament in June 1984, the Standing Joint Committee for the Scrutiny of Regulations concluded that this approach was unacceptable and that it should be remedied. It recommended that every authorizing order-in-council adopted pursuant to the *Financial Administration Act* contain the words "by order". This would ensure that a minister's prescription of fees to be charged for a service or for the use of a facility would always be treated as a statutory instrument, and would be subject to the regulatory process.

25.47 In April 1986, in response to the Joint Committee's report, the President of the Treasury Board agreed that fees prescribed under the *Financial Administration Act* should be open to public scrutiny; subsequently, in December 1988, the Treasury Board's Guide on Financial Administration was so amended. However, he noted that, of the 36 "Authority to Prescribe Fees and Charges" orders known to be in effect on 31 December 1985, ten did not contain the phrase "by order". Neither of the Energy, Mines and Resources orders-in-council that did not contain the phrase "by order" was included on the list.

Questionable use of a general regulatory authority

25.48 The Atomic Energy Control Board. Authority granted by Parliament for the specific purpose of regulating an economic sector is also being used as an authority to raise revenues.

25.49 The Atomic Energy Control Board (AECB) regulates the Canadian nuclear industry. In 1990, in response to the government's cost-recovery initiative, the Board began charging fees for licensing. It issued "cost-recovery fee regulations" pursuant to its general regulatory power in section 9 of the *Atomic Energy Control Act*. The regulatory process was followed.

25.50 The Standing Joint Committee considered these regulations in February 1991. The Committee concluded that the *Atomic Energy Control Act* does not expressly authorize the imposition of fees, and recommended that the Board request specific legislative approval from Parliament.

25.51 The Board believes, based on the advice of the Department of Justice, that it has the power to make cost-recovery fee regulations.

25.52 In December 1992, Cabinet agreed to proceed with the Board's proposal to seek new legislation for nuclear safety. The proposed legislation would, among other things, make explicit provision for the recovery of the costs of regulation from the users of nuclear energy. The legislation has not yet been tabled in Parliament.

25.53 In our opinion, the Board's establishment of fees by way of the general regulatory power is questionable. It converts a general regulatory power intended to ensure a safe and viable nuclear industry to one that can also be used to generate revenues for the government. This could pose a threat to Parliament's control over the government's raising of revenues.

Recommendations

25.54 The Treasury Board should fully review and report to Parliament on:

the adequacy of the legislative framework governing the establishment of user fees, particularly where fees are to cover the cost of requirements that the government imposes or where the government has a monopoly or quasi-monopoly on the service or facility;
the application of section 19 of the *Financial Administration Act* ;
the specific problems, if any, that lead to undue delays in the establishment of fees under the current regulatory process; and
the advantages and disadvantages of using contracts to establish user fees.

25.55 The Treasury Board also should fully review and report to Parliament on alternative procedures that could be established to ensure that Parliament has appropriate opportunity and information to decide which user fees to review, regardless of how they are established. On a selective basis, such a review could involve the examination of fees to determine whether:

the minister has the authority to establish such fees;
the fees should have been established by regulation;
affected users have been adequately consulted;
the cost and benefits of imposing the fees were assessed; and
users of services and facilities are being treated equitably.

25.56 Departments and agencies should ensure that they have a clear legislative authority to charge user fees.

25.57 The Treasury Board should provide Parliament with a summary of fees being charged, the revenues raised, and the authorities under which they are established.

25.58 If other than statutory authority is being used to establish fees, the Treasury Board should ensure that the fees are developed in accordance with the principles of the regulatory process.

Department of Energy, Mines and Resources (NRCan) response: *Further to the examination of the proposed regulatory reviews report, we concur with the facts presented in paragraphs 25.44 to 25.47.*

The situation has been discussed with Treasury Board Secretariat's officials and the appropriate actions will be initiated by NRCan upon resolution of the two orders-in-council status.

Treasury Board Secretariat's response: *The government has had a comprehensive user fee policy in place since 1989. It clearly sets out the legislative and accountability frameworks for establishing fees.*

The policy states that the usual course for implementing fees is the regulatory process based on the legal authority conferred through departmental legislation or, in its absence, the Financial Administration Act (FAA). The application and use of the FAA was clarified when it was amended in 1991. In the user fee policy, it is recognized explicitly that in some limited circumstances, ministerial authority to enter into contracts with clients to implement fees is appropriate, but that clients must still be consulted, their feedback considered, and the impact of fees on them assessed and deemed to be acceptable.

We acknowledge there is always room for improvements to ensure the transparency of the mechanism used to establish fees, and openness to Parliamentary scrutiny. There may be some merit in reviewing the regulatory process pertaining to user fees and to consider opportunities for change.

We will remain vigilant in ensuring that departments respect the principles of the regulatory and user fee policies when using contracts, and that they report openly to Parliament on the revenues collected from contracts. We acknowledge that reiterating the precepts of the user fee policy and providing more precise directions to departments may be appropriate.

Chapter 26

Pulp and Paper Regulations

Main Points

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[Audit Scope](#)

[Description of Regulations](#)

- [Pulp and Paper Effluent Regulations](#)
- [Pulp and Paper Mill Effluent Chlorinated Dioxins and Furans Regulations](#)
- [Adsorbable Organic Halogens \(AOX\)](#)
- [Pulp and Paper Mill Defoamer and Wood Chip Regulations](#)

[Observations and Recommendations](#)

- [Incomplete Information Provided on Effectiveness and Cost](#)
 - [A key reason for enacting the 1992 effluent regulations was not clearly stated](#)
 - [Expected improvements to the environment or human health were not explained](#)
 - [The basis for pollution control standards was not clearly explained](#)
 - [Potential overlaps with provincial pulp and paper regulations were not fully explained](#)
 - [How the regulatory overlap problems will be resolved is unclear](#)
 - [Impact of tax deductions on cost to industry was not explained](#)
 - [Significant uncertainty in the cost estimates was not explained](#)
 - [Comparability of Canada's regulations to those of our competitors is difficult to assess](#)
 - [Responses to industry concerns were not clearly explained](#)
- [Assessment of Regulatory Alternatives and Options Was Not Adequate](#)
 - [There was inadequate consideration of not regulating pulp and paper defoamers and wood chips](#)
 - [The potential of using economic instruments was not examined](#)
 - [Site-specific pollution controls were not explained](#)
 - [Information provided on testing for chronic effects was inadequate](#)
 - [The reason for not regulating other types of dioxin and furan was not explained](#)
- [Consultation Is Satisfactory for the Development of Regulations, but Not for Their Implementation](#)

[Conclusions](#)

Pulp and Paper Regulations

Assistant Auditor General: Richard B. Fadden

Responsible Auditor: Alan Gilmore

Main Points

26.1 The pulp and paper industry is a major contributor to Canada's economy and our trade balance. The industry is the largest industrial user of water in Canada and a major source of pollution. This makes it a focus of both government and environmentalist concern.

26.2 We examined the information provided to Parliament and the public on three sets of regulations intended to control pollutants from pulp and paper mills.

26.3 We found that parliamentarians and stakeholders were not comprehensively and equally informed about key issues affecting the effectiveness and cost of the pulp and paper regulations, for example:

- industry and environmentalist concerns about the effectiveness of the effluent regulations;
- potential overlaps with provincial pulp and paper regulations;
- tax deductions that could substantially reduce the cost to industry of implementation and that could reduce taxes paid to the federal and provincial governments;
- alternative and possibly more efficient or more environmentally sensitive solutions;
- why the government did not regulate, as did Quebec, dioxins and furans by their total toxicity; and
- the advantages and disadvantages of using site-specific pollution control standards based on the assimilative capacity of a watershed.

26.4 We recommend that the Department of the Environment more comprehensively and equally inform Parliament and stakeholders about its regulatory initiatives and that its Regulatory Impact Analysis Statements contain full information on proposed regulations.

Introduction

26.5 The pulp and paper industry is a major contributor to Canada's economy and our trade balance. About 2.8 percent of total employment in 1989 was forestry-related, and pulp and paper mills accounted for almost one in three of these jobs. The forestry sector's 1992 contribution to the balance of trade was \$19.5 billion. This was larger than any other sector, and roughly one third was from wood pulp exports. In 1989, wood pulp net exports alone contributed about \$6.8 billion to the balance of Canadian commodity trade.

26.6 Canada produced over 15 percent of the world's pulp in 1989, second only to the United States, which produced 37 percent. Canada's principal export markets are the United States, the European Economic Community, and Japan. Domestically and internationally, Canada is the world's largest trader in market pulp, with 28 percent of the global free market. The United States follows with 23 percent, and Scandinavia is the third-largest trader with 20 percent. Although countries other than these export market pulp, none has a share exceeding 5 percent.

26.7 The pulp and paper industry is the largest industrial user of water in Canada, and a major source of pollution. This makes it a focus of both government and environmentalist concern. In the context of its *Green Plan* and the concept of "sustainable development", the government has developed what it believes is a sound regulatory program to control pollution from the industry. The pulp and paper regulations were among the early government measures under the *Green Plan*.

Audit Scope

26.8 We examined the Pulp and Paper Effluent Regulations, the Pulp and Paper Mill Effluent Chlorinated Dioxins and Furans Regulations, and the Pulp and Paper Mill Defoamer and Wood Chip Regulations.

26.9 We reviewed the economic and scientific analyses supporting the need for the regulations; alternatives examined by the government; and cost-benefit analyses. We also reviewed the process of consultation with stakeholders, and information in the Regulatory Impact Analysis Statements.

26.10 We examined material from the departments of the Environment, Fisheries and Oceans, National Health and Welfare, Industry, Science and Technology, and Forestry.

26.11 We focussed on the extent to which the pulp and paper regulations were developed in accordance with the principles of the government's regulatory policy. These principles include:

- clear accountability of ministers and officials;
- full opportunity for public consultation and participation in the regulatory process;
- an assessment of proposed regulations to ensure that benefits clearly exceed costs;
- clear and reliable public information on the need for regulations;

an evaluation of the effectiveness of regulatory programs;
a secure foundation in law for the actions of regulatory authorities.

26.12 Of particular concern was the accuracy and completeness of the information provided in the Regulatory Impact Analysis Statement. The function of the Regulatory Impact Analysis Statement, one of the basic elements of the regulatory policy, has not changed. It remains the essential means of disclosing information to Cabinet, Parliament and the public.

26.13 The Regulatory Impact Analysis Statement is intended to provide decision makers with the following information:

the purpose and content of the proposal, and the current situation or conditions that the regulation is expected to improve;
the alternative means that were considered to meet the proposal's objectives, and the reasons why these alternatives were rejected;
explanations of any departures from the government's regulatory policy;
a clear assessment of the impact of the proposed initiative on Canada's economy and society, including its costs and benefits;
a summary of the intergovernmental and private sector consultation that has taken place, and a description of any change between the original and final proposals and the basis for the change; and
the strategy being adopted to ensure and monitor compliance, and a description of the enforcement mechanism in place or anticipated.

26.14 Our focus on the disclosure of information to Parliament and the public is based on the principle that individuals, groups, and companies have the right, in a democratic country, to be fully informed about, and to participate in, government decisions that limit their freedom or affect their lives. This places an obligation on the government to disclose information fully rather than choosing when and what information to disclose. Our emphasis on disclosure was also in recognition that most regulatory decisions are, in the end, judgments involving a balancing of individual, group, business and community interests. Although equal access to information is not alone a sufficient condition for a reasonable outcome, it is a necessary condition. These principles are recognized and accepted by the government in its Citizens' Code of Regulatory Fairness.

Description of Regulations

Pulp and Paper Effluent Regulations

26.15 The Pulp and Paper Effluent Regulations were passed 7 May 1992 under the authority of the *Fisheries Act*, replacing the 1971 Pulp and Paper Effluent Regulations. They are intended primarily to control conventional pollutants from pulp and paper mills in order to protect fish and their habitat. Pollutants of concern are suspended solids, biochemical oxygen-demanding matter and effluent that is acutely lethal to fish.

26.16 Although the legal responsibility for the *Fisheries Act* rests with the Department of Fisheries and Oceans, administrative responsibility for sections related to pollution control have been the responsibility of the Department of the Environment since 1978.

26.17 An assessment of the effluent's potential harm to human health was not conducted because the regulations were passed under the authority of the *Fisheries Act*. That Act, unlike the *Canadian Environmental Protection Act*, does not require a human health assessment. However, the Department has done work on assessing the damage to fish and fish habitat.

26.18 The regulations define effluent as waste water from a variety of sources in the production process. The effluent regulations set limits on total suspended solids that can be present in the effluent, on the extent of biological oxygen demand caused by the effluent and on the acute lethality, as defined by tests on trout.

26.19 The regulatory limits on total suspended solids and biological oxygen demand are related to the production rate of a mill. The limits are not absolute, but are linked to the quantity of finished product. Higher production could allow more pollution. There is no specific limit on the quantities of effluent that can be discharged, except as defined by the historical production capacity of a mill. Permissible deposits as a result of increased capacity can be raised with the approval of the Department. Finally, the regulatory limits apply to the effluent coming out at the end of the pipe. The regulations do not directly address pulp and paper sludge, or air emissions from pulp and paper plants, as these are not within the scope of the *Fisheries Act*.

26.20 The regulations also require that the industry establish an Environmental Effects Monitoring program. On a three-year cycle, each mill is required to provide local information on whether deposits of deleterious substances in waters frequented by fish have altered, disrupted or destroyed fish habitat. The program is intended to provide information to evaluate the need for further control measures, by evaluating the effectiveness of existing control measures and by assessing changes in the receiving environment.

26.21 The 1992 regulations update the regulations passed in 1971. According to the Department, the main changes are the following:

- new effluent quality requirements are established, with limits and conditions prescribed for the deposit of effluent;
- the regulations are binding on all mills that deposit effluent in receiving waters, whereas the 1971 regulations applied only to mills built after their promulgation, and covered less than ten percent of mills;
- procedures are established for the routine monitoring and reporting of deposits;
- and
- an Environmental Effects Monitoring program is included in the regulation.

Pulp and Paper Mill Effluent Chlorinated Dioxins and Furans Regulations

26.22 The Pulp and Paper Mill Effluent Chlorinated Dioxins and Furans Regulations were passed on 7 May 1992 under the authority of the *Canadian Environmental Protection Act*. They took effect on 1 July 1992. The regulations control two members of the family of chlorinated dioxins and furans. Chlorinated dioxins and furans, as a group, were the first substances on the Priority Substance List to be assessed for their toxicity, as defined in part 2 of the Act.

26.23 The assessment concluded that the compounds are highly toxic, that they may enter the environment in quantities that have immediate and long-term harmful effects on the environment, and that they constitute a danger to human health in Canada.

26.24 Under the *Canadian Environmental Protection Act*, the definition of a toxic substance is broad and may include any substances considered harmful to the environment and/or human health. The ministers of Environment and Health and Welfare each are responsible for activities under this legislation and may act jointly or separately. Assessing toxicity and recommending regulations are areas where the ministers have equal responsibility and must act together.

26.25 The Dioxin and Furan Regulations specify that no mill may release into the environment final effluent that contains **any** measurable concentration of 2,3,7,8 TCDD (a particularly toxic dioxin compound) or of 2,3,7,8 TCDF (a particularly toxic furan). This regulation is directed solely at chlorine bleaching plants.

26.26 The regulations also authorize the government to require that mills provide data on dioxins and furans in the intermediate effluent flows and in the pulp and paper sludge at the mill.

Adsorbable Organic Halogens (AOX)

26.27 The regulations for dioxins and furans were based on an assessment report under the *Canadian Environmental Protection Act*. A second assessment report addressed all organochlorines in components of effluent from pulp and paper mills. This second assessment included an evaluation of the use of the test parameter "AOX", or Adsorbable Organic Halogens, as a potential federal pollution control limit. The report concluded that AOX as a measure does not provide estimates of the potential toxicity, persistence, or bio-accumulation in the aquatic environment. Its use as a regulatory parameter was therefore rejected by the Department. Subsequent studies by the Department support this conclusion.

26.28 Several provinces are proceeding to regulate AOX. They believe that AOX is an indicator for a large number of organochlorines, some of which may be highly toxic. They also believe that the most appropriate and responsible action would be to adopt a precautionary approach and regulate AOX.

Pulp and Paper Mill Defoamer and Wood Chip Regulations

26.29 The Pulp and Paper Mill Defoamer and Wood Chip Regulations also were passed on 7 May 1992 under the *Canadian Environmental Protection Act*. Their purpose is to reduce possible precursors to toxic dioxin and furan.

26.30 Pulp and paper mills use defoamer additives that, in the presence of a chlorine bleaching process, could be a source of dioxins and furans in mill products and in their effluents. To manufacture these defoamers, oils and polymers are used that can contain dibenzo-para-dioxins and dibenzofurans. These can react with chlorine to form toxic dioxin and toxic furan.

26.31 Polychlorinated phenols, which can contain dioxins and furans, are used as fungicides to preserve and protect wood. When a mill uses chips from wood treated in this way, dioxins and furans could be released both in the final products and in the waste water from the mills.

26.32 The Pulp and Paper Mill Defoamer and Wood Chips Regulations limit the potential sources of dioxins and furans from defoamers and wood chips.

Observations and Recommendations

Incomplete Information Provided on Effectiveness and Cost

Parliamentarians and stakeholders were not comprehensively and equally informed about key issues affecting the effectiveness and cost of the pulp and paper regulations.

26.33 The Department used press releases, public discussions, telephone conversations and parliamentary committee hearings to provide information on the Pulp and Paper Regulations. The Department also provided information to interested parties on request. However, we found that, where one part of the public was fully informed about a particular part of the regulations and its impacts, another part of the public received little information.

26.34 We found that there was a lack of comprehensive and equally available information on a number of issues, including:

- industry and environmentalist concerns about the effectiveness of the effluent regulations;
- potential overlaps with provincial pulp and paper regulations;
- tax deductions that could substantially reduce the cost to industry of implementation and that could reduce taxes paid to the federal and provincial governments;
- alternative and possibly more efficient or more environmentally sensitive solutions;
- why the government did not regulate, as did Quebec, dioxins and furans by their total toxicity; and
- the advantages and disadvantages of using site-specific pollution control standards based on the assimilative capacity of a watershed.

A key reason for enacting the 1992 effluent regulations was not clearly stated

26.35 The *Green Plan* states that the pulp and paper effluent regulations are necessary to provide a national framework for the protection of fish and fish habitat to ensure sustainable fisheries. However, the Department of the Environment did not explain to Parliament and stakeholders that, without regulations, the industry was subject to prosecution under section 36(3) of the *Fisheries Act* for depositing substances deleterious to fish, and that the Department had not taken full action. Without the new regulations, 90 percent of pulp and paper mills could have been subject to a potential threat of prosecution. Departmental officials told us that "there have been very few convictions under the *Fisheries Act* ." Nevertheless, implementing the regulations afforded mills who met the regulatory requirements with some protection, by allowing the discharge of prescribed amounts under specified conditions.

Expected improvements to the environment or human health were not explained

26.36 The regulations that deal with conventional pollutants under the *Fisheries Act* pertain only to fish and fish habitat. Therefore, because there was no legislative obligation to do so, little information was provided on the impact of conventional pollutants on the environment in general, or on human health.

26.37 The January 1993 report of the Sub-committee on Regulations and Competitiveness of the House of Commons Standing Committee on Finance criticized the Department for not assessing the benefits of the regulations. The report stated that a commitment of \$4.1 billion in resources, with no apparent sense of the magnitude of the benefits, was not reasonable.

26.38 The data to assess the effectiveness of the regulations, including long-term impacts, are expected to come eventually from the Environmental Effects Monitoring program. The program is an important component of the pulp and paper effluent regulations and all mills must comply. The program is under the *Fisheries Act* and therefore does not assess the effects on the environment in general, or on human health.

26.39 The monitoring program is intended to evaluate the need for future control measures, but is not itself a pollution control. The details of the program, including the scientific methodologies, have been left to the administrative discretion of the Department of the Environment. This is because there has been no legislative authorization to do otherwise. The Environmental Effects Monitoring guidelines and program continued to be developed after the regulations were passed. In early 1993, the industry expressed concern that the program was still evolving and that its final scope and costs to all were not yet defined fully.

The basis for pollution control standards was not clearly explained

26.40 The Regulatory Impact Analysis Statement stated that "the regulatory limits have been set to take into consideration the available technologies." The statement did not explain that the limits were not set based on best available technology. Rather,

departmental officials told us that "the limits were crafted as a national baseline and to be consistent with those of competitor countries."

Potential overlaps with provincial pulp and paper regulations were not fully explained

26.41 The pulp and paper regulations were put in place under Acts that control both fisheries and the environment. These are legislative areas in which both federal and provincial levels of government have exercised jurisdiction.

26.42 At the same time as the federal pulp and paper regulations were being introduced, Quebec, Ontario, Alberta and British Columbia were proposing similar or more stringent general effluent regulations. Given the overlapping regulatory plans, the federal regulations could be redundant in four key provinces. In addition, the costs and benefits of implementation could be attributed to the provincial regulatory actions rather than to the federal initiative.

26.43 The Department of the Environment recognized the consequences of the regulatory overlaps. For the Pulp and Paper Effluent Regulations, the Department estimated that the incremental capital cost due to federal regulations might be about \$347 million, not \$2.3 billion as reported in the Regulatory Impact Analysis Statement, assuming that the regulatory initiatives of the provinces would be introduced as planned. Similarly, the Department's estimate that it needed 78 person-years to enforce the regulations did not take into account the resources that the provinces would be providing.

How the regulatory overlap problems will be resolved is unclear

26.44 Both the industry and the provinces have expressed the desire that the regulations be implemented as efficiently as possible. They have proposed that the federal and provincial governments agree on a consistent pollution prevention approach, and one administration and inspection system. This would reduce the need for parallel federal and provincial regulatory offices and would reduce the costs to industry of regulatory compliance. To date, how this will be done remains unresolved.

Impact of tax deductions on cost to industry was not explained

26.45 When regulations are introduced that require a business to spend money to meet new standards, the business may reduce its taxable income by deducting capital cost allowances and operating expenses. These deductions can reduce substantially the taxes paid to the federal and provincial governments. Depending on profitability, a loss of up to \$1.4 billion in direct federal and provincial tax revenue could result from the Pulp and Paper Effluent Regulations, and \$180 million from the Chlorinated Dioxin and Furan Regulations.

Significant uncertainty in the cost estimates was not explained

26.46 The cost estimates in the impact analyses of the regulations are based on expert opinion on the current state of the mills in Canada and on what individual mills might do

to meet regulation requirements. The Department did not explain that its estimates were accurate to plus or minus 25 percent, or \$1.2 billion.

Comparability of Canada's regulations to those of our competitors is difficult to assess

26.47 The Regulatory Impact Analysis Statement stated that Canada's pulp and paper mill regulatory program was one of the most comprehensive of regulatory frameworks, and comparable to those of other pulp and paper producing countries. This statement was based on a comparison of Canada's legal framework with those of other countries. The Department did not explain that there are few simple standards and that regulatory regimes vary considerably among countries. Scientific methodologies for testing differ, different product lines or production techniques can have different standards, and in many countries the effluent standard is negotiated individually on a mill-by-mill basis.

26.48 The best test of the comparability of Canada's regulations is the resulting quality of the effluent, as determined by effects on the environment and on human health. The Department, as mentioned previously, has yet to express clearly the expected benefits of these regulations. Until these expected benefits are stated, or measured, comparability of the pulp and paper regulations is tenuous.

Responses to industry concerns were not clearly explained

26.49 Industry was concerned that it might not have sufficient time to find financing and to construct the necessary pollution controls. The Department did not clearly explain that, in response, the government included a provision in the regulations to allow it to authorize, up to 31 December 1995, the continued discharging of effluents at pre-regulation levels.

26.50 The effluent regulations allow the government to grant two types of authority to companies to continue polluting at pre-regulation levels. A transitional authorization may be granted to mills from December 1992 until 31 December 1993, and "under extraordinary circumstances" a transitional authorization extension to 31 December 1995 may be granted. The authorizations also require mills to submit plans for installing pollution controls and they permit the Department to monitor the mills' performance against these plans. Departmental officials told us that "the authorization process was a workable solution as it sets interim targets and milestones with monitoring during the extension period to ensure final compliance."

26.51 The effluent regulations came into force in December 1992. Of the 97 mills that were not already in compliance, 91 have been granted authority to continue polluting at pre-regulation levels until the end of 1993. The number of mills that would apply for this authority was not known at the time the regulation was passed. However, it was anticipated that a significant number might apply. This was not explained in the Regulatory Impact Analysis Statement.

26.52 In addition to the authorizations to the end of 1993, about 70 of the 97 mills have applied for further extensions to the end of 1995. If these are granted, the medium-term effectiveness of the regulations may be questionable.

26.53 An extension also is allowed for dioxins and furans. However, the life span of that extension is more limited. If a mill meets certain requirements, it may be authorized to pollute at pre-regulation levels until January 1994. The regulations do not provide for an extension beyond that date. After passage of the regulations, 26 mills were granted the extension to the January 1994 deadline. Another 21 mills were directly affected by the regulation but, according to the Department of the Environment, they were already in compliance.

26.54 Amendments were also made to respond to industry concerns that its water conservation initiatives may make it difficult to meet the water-concentration-based limits on pollution. The Department did not explain clearly that amendments to the regulations allow it to authorize mills to combine treated and untreated effluents within certain limits to reduce the acute lethality of the final effluent.

Assessment of Regulatory Alternatives and Options Was Not Adequate

26.55 We are concerned that more efficient or more environmentally sensitive solutions may not have been adequately considered.

26.56 Policies of the Department of the Environment and Treasury Board require a proper assessment and analysis of options, including socio-economic implications, before making a decision to regulate. However, in the case of the pulp and paper regulations, an options report with associated costs and benefits was not prepared in advance of the decision.

There was inadequate consideration of not regulating pulp and paper defoamers and wood chips

26.57 The objective of the regulations is to reduce specific chemicals in defoamers and wood chips that are linked to the production of toxic dioxin and furan in paper mills. However, industry had already acted, without regulations, to reduce precursor chemicals prior to passage of the regulations. According to the Department of the Environment, the industry had reduced the use of treated wood chips by 90 percent. There have been no violations since the regulations were passed. The alternative of not having regulations was not assessed.

26.58 The Department's draft Regulatory Review Report recommends the retention of the regulations, but also recommends the development of a national standard and certification program for defoamers and a code of practice for the use of PCP-treated chips, in preparation for the withdrawal of the regulations.

The potential of using economic instruments was not examined

26.59 Regulatory approaches that include requiring industry to consider the cost of using the environment, previously free, are called market or economic instruments. In practice, they involve charging companies for effluent discharges, or creating market permits or quotas. For example, an effluent charge (a form of tax) requires those who discharge a pollutant into the environment to pay the government a specified amount for every kilogram discharged.

26.60 Economic instruments, particularly effluent charges, in conjunction with traditional regulations have been implemented in some jurisdictions to control effluent. We commented in our 1989 Report that such instruments for controlling ozone-depleting chemicals had not been considered. The advantages and disadvantages of using economic instruments in Canada were discussed in a Department of the Environment discussion paper published in 1992.

26.61 The paper, entitled "Economic Instruments for Environmental Protection", concluded that economic instruments alone, or in conjunction with regulations, could be a viable alternative to traditional regulation. It recommended that economic instruments be considered for specific environmental problems. However, the Department did not consider and explain to decision makers the pros and cons of using economic instruments to control pulp and paper effluents.

26.62 The Department indicates that, although the use of economic instruments could be successful in reducing pollution, it would not meet the requirements of the *Fisheries Act* that prohibit any deposition of any deleterious substance. Thus, the use of economic instruments would require a change in legislation. In the case of toxic dioxin and furan, we agree that an outright ban of these highly toxic substances is required.

Site-specific pollution controls were not explained

26.63 The current regulations set the same pollution control standards for all mills in Canada. In a site-specific approach, the performance standards that apply at each mill would vary with the characteristics of the waterway receiving the effluent, and its ability to absorb the harmful effects caused by the effluent. The Regulatory Impact Analysis Statement should have explained this approach and the reasons for rejecting it, because:

the regulations do not place a limit on the total amount of pollutants that can be discharged into a specific watershed, and it may have been more effective to set limits based on the receiving capacity of the water body;
the advantages of site specific regulations based on local assimilative capacity had long been known in the Department of the Environment;
it was an issue in the public consultations. This public concern was not reported in the Regulatory Impact Analysis Statement; and
it has been implemented in several jurisdictions. Several countries, notably Sweden, Finland and, to some extent, the U.S., have adopted some type of site-specific strategy. The federal government has developed site-specific regulations for the Port Alberni mill in B.C, which is situated in a particularly sensitive ecosystem.

Information provided on testing for chronic effects was inadequate

26.64 The Regulatory Impact Analysis Statement did not report that stakeholders were concerned over the lack of control measures for chronic effects of pollution. They were concerned that acute effect controls were insufficient for proper regulation. Acute effect controls regulate water quality by assessing the short-term survival rates of fish and insects in mill effluent. For example, if no more than 50 percent of the fish are dead after 96 hours of exposure, the effluent passes the pollution standard.

26.65 Chronic effect controls are believed to reflect more accurately the impacts of effluents on the environment and living organisms because of the cumulative effects of exposure over time. Controls for chronic effects were recommended to the Department of the Environment as long ago as 1980. They are already required in some jurisdictions, for example, by some permits in the United States. Tests similar to what might become chronic effect controls are contained in the Department's Environmental Effects Monitoring program. The first results of these tests are not expected until 1996.

The reason for not regulating other types of dioxin and furan was not explained

26.66 The current regulations address one of many toxic forms of chlorinated dioxin and chlorinated furan, which normally account for 90 percent of the total toxicity. However, this is not always the case. Departmental studies show that in sediments near coastal mills, non-controlled forms are found in much larger proportions. The Department did not explain why it did not regulate dioxins and furans according to their total toxicity, as Quebec did.

26.67 The Department believes that its regulatory approach will address the situation that gave rise to the contaminated sediments. Further, it states that its monitoring program will allow it to eliminate the sources of other forms of dioxin and furan if significant levels are found.

Consultation Is Satisfactory for the Development of Regulations, but Not for Their Implementation

26.68 Our 1989 Report noted that there was room for major improvement in consulting with stakeholders, particularly environmentalists. We have found that the consultation process leading to the development of regulations is now satisfactory. However, environmentalists and other interest groups indicate that consultation while the regulations were being implemented was inadequate, particularly in developing the guidance documents for the Environmental Effects Monitoring program.

Conclusions

26.69 This chapter reports on an audit of the 1992 pulp and paper regulations. Major improvements are needed to provide comprehensive information equally to Parliament and stakeholders, on such matters as the reasons for enacting the regulations, the concerns of the public, the reasons behind regulatory limits, potential overlaps with

provincial regulation, regulatory costs, and possible regulatory options. The provision of information on options, and the evaluation of options, continue to need improvement.

26.70 The Department of the Environment should more comprehensively and equally inform Parliament and stakeholders about its regulatory initiatives. In particular, its Regulatory Impact Analysis Statements should contain full information on:

reasons for the regulations;
reasons for the regulatory limits, and comparisons with other jurisdictions, especially where international competitiveness is an issue;
the concerns of stakeholders and why these concerns should or should not be taken into account in formulating the regulation;
overlaps and potential overlaps with provincial regulations, and how they will be reconciled; and
the costs and benefits of regulations, taking into account federal-provincial overlaps and tax deductions.

26.71 The Department of the Environment should improve its identification and evaluation of regulatory and non-regulatory options.

26.72 The Department of the Environment should seek to improve its consultation process further by providing more opportunities for public participation during the implementation of regulations.

Department's response: The Auditor General's observations on the comprehensiveness of the Regulatory Impact Analysis Statement (RIAS) for the pulp and paper regulations provide valuable advice in considering development of future regulations. The Department is, in fact, proceeding to address concerns raised in the audit.

Administrative agreements are currently under negotiation with provinces on the pulp and paper regulations to provide a single regulatory window for industry that meets the obligations of both levels of government. Through information transfer and work-sharing between governments, the agreements will reduce overlap of federal and provincial regulatory requirements to industry. The federal government recognizes that provincial governments may put in place more stringent requirements to address site-specific concerns. Equivalency agreements are also under discussion under which a Canadian Environmental Protection Act regulation would not apply in a province where an equivalent provincial or territorial regulation is in force.

The Department is actively exploring alternatives to regulation and is formally incorporating benefit analysis and assessment of alternatives in the environmental measures development process. Some alternatives are: SO₂ emission trading; study of management options for HCFC's and methyl bromide; and the use of economic instruments to encourage less waste generation. Benefit valuation activities initiated by the Department include the development of a policy proposal for Treasury Board on the

role of discount rates in environmental benefit analysis, an annotated benefit analysis inventory that would facilitate the use of results from one study for alternative applications and a survey on the importance to Canadians of achieving a cleaner ecosystem.

In addition to the above general comments, there are three particular points to which the Department wishes to respond. These are: industry's concern that the final scope and cost of the Environmental Effects Monitoring program is not yet fully defined; the uncertainty of cost estimates for mills to implement the regulations; and the nature of transitional authorizations.

The Environmental Effects Monitoring program is indeed evolutionary and is intended to take advantage of advances in science and methodology. At the end of each three-year cycle, monitoring requirements are reviewed and evaluated for their effectiveness.

Cost estimates, as noted by the Auditor General, were based on expert opinion of the current situation of mills in Canada. They were pre-design estimates across the whole industry and a variance on the scale of plus or minus 25 percent was within recognized industry practice.

A key benefit of the transitional authorization process, as provided for in the regulations, is an effective, legally binding mechanism to ensure that the necessary planning, design and investments are made so that the regulations are fully implemented in a predictable manner.

Chapter 27

Gun Control Program

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Gun Control Program

Assistant Auditor General: Richard B. Fadden

Responsible Auditor: Alan Gilmore

Main Points

27.1 Canada's gun control program seeks to reduce accidental, intentional and criminal misuse of firearms, to keep guns out of the hands of those who should not have them and to encourage and ensure responsible gun ownership and use. The framework for the current regime was instituted in 1978 and refined in 1991.

27.2 Canada's gun control program is controversial and complex. Evaluation of the program is therefore essential to give the Canadian public and members of Parliament the assurance that its objectives are being met. The program has been evaluated once, but we found weaknesses in the methodology that significantly reduce the extent to which the government, members of Parliament and the Canadian public can rely on the evaluation to feel assured that the gun control program is effective.

27.3 As well, our review of the new regulations indicated that important data, needed to assess the potential benefits and future effectiveness of the regulations, were not available at the time the regulations were drafted. Because of this, we believe it is important that the measures chosen by the government be evaluated at the earliest opportunity.

27.4 We reviewed with law enforcement authorities the issue of a potential firearms smuggling problem. We found that major police forces are concerned that a serious firearms smuggling problem may exist and could be increasing. We recommend that the issue be comprehensively reviewed, as previously recommended by parliamentary committees.

27.5 The gun control program is administered by the federal and provincial/territorial governments. In July 1993 the Department of Justice informed the Treasury Board that implementation and co-operation could be in jeopardy unless funding concerns are resolved.

Introduction

27.6 Available data indicate that there are about one million legally registered restricted weapons in Canada, and suggest that there are about five million legally held unrestricted firearms. The *Criminal Code* defines restricted weapons and requires that they be registered to be held legally. Handguns are the most common type of restricted weapon. The *Criminal Code* also defines prohibited weapons, which cannot be held legally. Machine guns are an example of a prohibited weapon. All other firearms, such as hunting rifles and shotguns, are considered unrestricted and do not need to be registered.

27.7 Canada's gun control program seeks to reduce accidental, intentional and criminal misuse of firearms, to keep guns out of the hands of those who should not have them, and to encourage and ensure responsible gun ownership and use. The program is authorized by the *Criminal Code* (sections 84 to 117) and by several regulations.

Specifically, the program is intended to:

- make it more difficult for persons who should not have firearms to acquire them legally, by screening individuals who wish to acquire firearms and training them in firearms safety;
- reduce the possibility of accidents, intentional misuse and theft through requirements for storage, display, handling and transportation of firearms;
- reduce the risk to public safety by restricting or prohibiting ownership of specific types of firearms and other weapons, including parts, components and accessories;
- prohibit potentially dangerous gun users from legally owning or using firearms, through court orders; and
- deter the criminal use of firearms, by sentencing provisions.

27.8 The screening and firearms safety training requirements apply only to individuals who acquire firearms in the future. Those who already own firearms do not have to meet these requirements unless they wish to renew their firearms acquisition certificates. As well, the legislation provides for grandfathering certain firearms that are now prohibited weapons. For example, automatic firearms that have been converted to fire as semi-automatics are now prohibited. Individuals who owned these firearms on 1 October 1992 are permitted to keep them, so long as the firearms were registered as restricted weapons by that date.

27.9 The program is administered by the federal and provincial/territorial governments, generally through the Chief Provincial/Territorial Firearms Officers and provincial/territorial and local police agencies. Costs paid by the federal government are governed by federal-provincial financial agreements negotiated under the authority of section 111 of the *Criminal Code* .

27.10 The Department of Justice has overall responsibility for the gun control program.

Audit Scope

Focus on recent amendments to legislation and new regulations

27.11 Canada has had gun control in one form or another for many years. The framework for the current regime was instituted in 1978 and refined in 1991. As part of our Regulatory Review audit, we examined how the amendments to the legislation and several new regulations were developed. We reviewed the information provided to ministers, members of Parliament and the public.

27.12 The most recent round of amendments to the *Criminal Code* started in 1990, when Bill C-80 was tabled in Parliament. The subject matter of this bill was referred to a special committee chaired by MP John Reimer, who conducted a wide investigation into the subject of gun control. The results of the committee's review were published in February 1991 and included 32 recommendations. The committee recommended that the federal government table, and Parliament enact, the legislation necessary to implement the committee's recommendations as soon as possible.

27.13 Bill C-80 died on the order paper and was followed in 1991 by Bill C-17, which incorporated many of the recommendations of the Reimer Committee. Bill C-17 was referred to a legislative committee chaired by MP Blaine Thacker. Bill C-17 was given royal assent in 1991 and most sections have now been proclaimed into law.

27.14 In addition to the amendments to the *Criminal Code*, several new regulations authorized by Bill C-17 have been approved to implement parts of the gun control program. The *Criminal Code* now requires that all regulations made under section 116(1) be laid before Parliament for review "at least thirty sitting days" before their effective date. Appropriate committee reviews are authorized, but not required. The Reimer Committee recommended that this be done in order to make the regulation-making process as transparent as possible and to ensure that the interests and expertise of firearms owners are duly taken into account when regulations are both made and amended.

27.15 The regulations were tabled in March 1992 and were reviewed by the Standing Committee on Justice and the Solicitor General, chaired by MP Bob Horner. The Committee reported the results of its review in June 1992 and made 37 recommendations, most of which suggested changes to the proposed regulations. Many of these recommendations were accepted by the government.

27.16 The regulations we focussed on are the following:

- the Storage, Display, Handling and Transportation of Certain Firearms Regulations (SOR/92-459);
- the Firearms Acquisition Certificate Regulations (SOR/92-461);
- the Cartridge Magazine Control Regulations (SOR/92-460, amended by SOR/93-366); and
- the Genuine Gun Collector Regulations (SOR 92-435).

27.17 Implementing the changes to the gun control program brought about by Bill C-17 is a complex task. It requires the co-operation of the provinces and territories. According to the Department, the program has been phased in to reduce the possibility of public confusion, to maximize public information efforts and to ease the administrative effort. The approach was announced by the Minister in July 1992.

27.18 We did not examine other regulations, such as orders-in-council specifying prohibited and restricted weapons.

27.19 In recognition of the wide scope of the gun control legislation and regulations, we reviewed material provided by the departments of Justice, National Revenue and External Affairs, the Ministry of the Solicitor General and the Royal Canadian Mounted Police. We also sought the views of several provinces and specialists in the area.

Observations and Recommendations

27.20 Canada's gun control program is controversial and complex. Evaluation of the program is therefore essential to give the Canadian public and members of Parliament the assurance that its objectives are being met. A more up-to-date evaluation of the program is essential.

27.21 Testimony before parliamentary committees, and our own review, indicate that there may be a serious firearms smuggling problem. If this were the case, it would significantly weaken the effectiveness of the government's gun control program, particularly with respect to keeping firearms from being used in criminal activity. Thus, we are concerned that the government has not responded to parliamentary recommendations to undertake a comprehensive review of the matter.

27.22 The Department of Justice has not concluded financial agreements with the provinces and territories. Given the importance of co-operation with the provinces and territories to the effective administration of this program, we question why these agreements have not been renegotiated on a timely basis.

It Is Essential to Know whether the Gun Control Program Is Effective

27.23 The current gun control regime was instituted in 1978. An initial evaluation of the impact of the program was conducted over a three-year period starting in 1979. The evaluation's final report was published in 1983. The objective of the evaluation was to assess the impact of the 1978 legislation by comparing pre- and post-legislation data on firearms and by conducting trend analyses to observe changes that had occurred since the legislation was implemented. The evaluation concluded that the 1978 legislation had had a moderate impact on the use of firearms.

27.24 The Department of Justice used the evaluation, supplemented by updated statistical reports on firearms-related offences and deaths, to demonstrate that the 1978 gun control legislation had had a major effect in reducing criminal activity involving firearms and in

reducing the number of accidental deaths. It noted, however, that the number of suicides involving firearms had not changed.

Weaknesses in evaluation methodology

27.25 The evaluation tried to address many of the key program effectiveness issues. However, we found several weaknesses in the methodology, which significantly reduce the extent to which the government, members of Parliament and the Canadian public can rely on the evaluation to be assured that the gun control program is effective.

27.26 For example, we are concerned that no tests of statistical significance were calculated for any of the report's observations. Tests of statistical significance are necessary because they indicate whether the results could have happened by chance or whether there is a reasonable basis for concluding why they happened.

27.27 We calculated tests of significance on much of the data found in the evaluation. These data included such things as the percentage of firearms-related homicides before the introduction of the legislation in 1978 and the percentage after. We found that many of the observed differences in the data before 1978 and after could have occurred by chance. More and different testing would be necessary before these differences could be attributed to the 1978 legislation.

27.28 We also are concerned that most of the evaluation's conclusions on changes in firearms incidents over time may have been premature. The evaluation included only four post-legislation years, so the comparisons with the pre-legislation situation may be unreliable. The differences noted could be due to random fluctuations occurring over the time period or to other factors, such as economic ones. Many pre- and post-legislation observations are needed for a reliable estimation of trends over time.

Evaluation of new regulations needed

27.29 Our review of the new regulations indicated that important data, needed to assess the potential benefits and future effectiveness of the regulations, were not available at the time the regulations were drafted. The government proceeded with new regulations for reasons of public policy.

27.30 Because the data were not available when the regulations were drafted, we believe it is important that the measures chosen by the government be evaluated at the earliest opportunity. This should help Parliament, the government and stakeholders determine whether these measures have been effective in meeting policy objectives, and should indicate whether any adjustments are needed. Particular issues that should be addressed in the evaluation are the extent of reduction in accidents, suicides and criminal activity involving firearms that resulted from the regulations, possible alternative means to achieve the objectives of the regulations and the effectiveness of the enforcement measures in place.

27.31 Example: storage, display, handling and transportation of certain firearms.

These regulations address concerns that accidents and thefts occur because of poor storage. The Reimer Committee recommended that the gun control program deal with safe storage requirements for all firearms owners.

27.32 However, there is currently insufficient information on the number of accidents and shootings related to poor storage conditions to allow an assessment of the potential benefits of the regulations. Also, enforcement of these regulations will depend heavily on provincial and local resources and priorities. Insufficient enforcement could impair the effectiveness of the regulations in achieving their objectives.

27.33 Example: cartridge magazine control. These regulations are designed to place limits on the firepower of certain automatic and semi-automatic firearms. Again, there is insufficient information on the number of criminal offences typically committed with high-firepower firearms and who commits them.

27.34 As well, the government considered several alternatives to achieving the objectives of these regulations, including setting a single limit for all types of firearms and limiting the capacity for rimfire firearms. An evaluation would help determine whether the alternative chosen by the government was the best one under the circumstances.

27.35 Finally, concerns about enforcement of the Cartridge Magazine Control Regulations were raised by key stakeholders. Furthermore, the Regulatory Impact Analysis Statement for the regulations did not describe how enforcement officials would go about detecting an offence prior to laying a charge. It is important to know how effectively these regulations are being enforced.

Insufficient information on the administration of the firearms acquisition certificate screening system

27.36 As we note elsewhere in this Report, the gun control program is administered by the federal and provincial/territorial governments. The Reimer Committee heard testimony that the administration of the program, particularly the firearms acquisition certificate (FAC) provisions, was not uniform across the country. The Committee expressed concern about this issue and recommended uniform screening of FAC applicants. The government has taken steps to improve the uniformity of the screening procedures.

27.37 Lack of uniformity in administration could have detrimental effects on the overall effectiveness of the program. For example, an ineffective investigation of FAC applications in one province could weaken the screening system nationally. The last evaluation touched on the issue of provincial administration but did not explore it in any depth. Therefore, we believe this issue needs to be evaluated in depth.

Conclusion

27.38 We believe it is essential that the Department of Justice evaluate the effectiveness of the program again. Members of Parliament and the Canadian public need to know

whether the means the government has chosen to achieve the program's objectives are working.

Potential Smuggling Problem

A comprehensive review of the extent of smuggling of firearms into Canada has not been undertaken, as recommended by parliamentary committees

27.39 Canada's gun control program seeks to make it more difficult for persons who should not have firearms to acquire them legally. It also restricts or prohibits the legal possession of certain firearms. However, if these firearms could be easily smuggled into the country, then the objectives of the gun control program would be undermined.

27.40 There are several factors that increase the potential for a serious firearms smuggling problem in Canada. Many firearms that are either restricted or prohibited in Canada are easily available in the United States. Canada's long border with the United States is difficult to protect. The restrictions on acquiring firearms legally in Canada can make smuggling financially attractive.

27.41 During their review of the amendments to the *Criminal Code* and the new regulations, the Reimer and Horner committees heard testimony that there is a serious firearms smuggling problem in Canada. The Reimer Committee recommended that the federal government undertake a comprehensive review of all issues relating to the illegal entry of firearms into Canada. The Horner Committee recommended that the government take all possible steps to strengthen the border controls necessary to keep illegal firearms and firearms accessories from being smuggled into Canada.

27.42 In response, the Minister of Justice proposed amendments to the *Criminal Code* to increase the maximum term of imprisonment for importing a prohibited weapon, or parts designed exclusively for manufacturing a prohibited weapon, from five years to ten years. The maximum imprisonment for importing a restricted weapon without a permit remains at five years.

27.43 However, the government has not undertaken a study to determine the extent of the problem and whether, in the light of other priorities, resources should be allocated to deal with the problem.

27.44 We tried to develop an estimate of the size of the firearms smuggling problem in Canada. We were unable to do so because of a lack of readily accessible information on offences involving firearms, the types of firearms used and the origin of firearms that were seized.

27.45 In the absence of such data, we reviewed the issue with law enforcement authorities. We found that major police forces are concerned that a serious firearms smuggling problem may exist and that the problem could be increasing.

27.46 Given the concerns raised, we believe that the issue should be comprehensively reviewed to determine whether a serious firearms smuggling problem exists in Canada. This type of review is what the Reimer Committee called for in 1991.

Financial Agreements with the Provinces and Territories

Delays in concluding financial agreements with the provinces and territories may weaken the gun control program

27.47 The gun control program is administered by the federal and provincial/territorial governments. Co-operation among these governments is essential if the program is to be administered effectively. One of the more contentious issues in the administration of the program is who will bear the cost. Section 111 of the *Criminal Code* allows the Governor in Council to enter into agreements with the provinces and territories to reimburse them for certain costs actually incurred in administering the program.

27.48 Financial agreements have existed since 1979. They were extended several times and expired on 31 March 1993. The federal government is in the process of renegotiating the agreements with the provinces and territories. The Department of Justice completed a framework for the agreements in December 1992, and Treasury Board approval to proceed with the negotiations was received in August 1993.

27.49 The Department informed Treasury Board in July 1993 that successful implementation of the program, particularly the important Safety Education program, depends on provincial and territorial government co-operation. The Department also indicated that implementation and co-operation could be in jeopardy unless funding concerns are resolved. The implementation date for the Safety Education program has already been deferred at the request of the provinces and territories. If the financial agreements are not concluded by the deferral date of 1 January 1994, further delays may be encountered.

Recommendations

27.50 **The Department of Justice should undertake a rigorous evaluation of the gun control program.**

Department's response: The current gun control initiative made only limited use of the 1983 evaluation. More reliance was placed on the statistics available since the seventies on homicides, suicides, accidental deaths and robberies. In any event, the legislation and regulations were driven by clear public interest considerations, which needed to be acted upon despite the absence of precise data.

The Department monitors the gun control program on an ongoing basis. In order to supplement this, the Department had always intended to undertake an evaluation of this initiative. Evaluation plans have been under development for some time but any new evaluable issues raised by the Auditor General and not included in our plans will be added.

27.51 The government should undertake a comprehensive review to determine the extent of the firearms smuggling problem.

Department's response: The Department of Justice, in consultation with other concerned federal, provincial and territorial departments and agencies, will examine the extent of firearms smuggling and what additional measures need to be taken to control the problem.

27.52 The Department of Justice should inform Parliament about the status of negotiations on the financial agreements with the provinces and territories and the impact of any delays on the implementation of the program.

Department's response: It is unlikely that negotiation of the new financial agreements will be completed before May 1994. However, we believe that implementation of the gun control program has not been adversely affected by the timing of the renegotiation process. Indeed, parts of the program, including the firearms safety courses, could not have been developed earlier, even if the agreements had been in place. The provinces and territories have been kept informed of our progress with respect to renegotiation and have proceeded in good faith to implement the new gun control measures.

The existing mechanisms for reporting to Parliament, we believe, offer parliamentarians opportunities to seek information, including that relating to negotiations of financial agreements.

Chapter 28

Background on the Audit Process

[Introduction](#)

[Selecting an Area for Audit](#)

[Ensuring Audit Quality](#)

[Costs of Crown Corporation Audits](#)

Exhibits

- 28.1 Organization of the Office of the Auditor General
- 28.2 Costs of Preparing Annual Audit Report for Fiscal Years Ending on or before 31 March 1993

Introduction

28.1 The preceding chapters of this Report describe the results of audit work and studies completed by the Office during the past year.

28.2 The purpose of this chapter is to provide some background on a few key features of the audit process, including what the Office considers when deciding what programs or activities to audit. Information on the cost of audit work in Crown corporations is also included.

28.3 A description of the activities and costs of the Office, and its organization and staff, is shown in its Part III of the Estimates for 1993-94. This chapter contains a summary organization chart shown in [Exhibit 28.1](#).

Selecting an Area for Audit

28.4 A long-range audit plan is prepared for all departments, multidepartmental programs, and a number of functions that are common across government, such as internal audit and program evaluation. This plan normally covers a five-year period and identifies the proposed approach to completing the annual financial attest, compliance with authority, and value-for-money audit work required for a comprehensive audit of the entity.

28.5 The plan lays out a proposed cycle for audit work for each entity. These proposed cycles vary according to the nature of the entity, its level of expenditure and importance in government operations, and the resources available to carry out the audit. The Office's approach does not call for all operations of an entity to be audited within a fixed audit cycle. The principles of audit worthiness and auditability are fundamental in deciding what to audit.

28.6 Some issues are such that they are included in all entity audits. For example, in every audit, the Office considers the quality of reporting by a department or agency on its stewardship of the resources voted by Parliament, and on the results achieved with these resources. There are other issues where the Office exercises its judgment as to what it believes is important to Canadians at a given time. An example is the Office's concern that Canadians receive better information about the deficit and accumulated debt (Chapter 5, "Information for Parliament - Understanding Deficits and Debt").

28.7 In assessing whether something is worth auditing, the Office looks at the significance of an entity or activity, including both its impact on government spending and revenue and the social, economic, environmental, safety or equity issues involved. The risk factor is another important consideration in assessing audit worthiness. The Office assesses the possibility that an undesirable result might occur, and what its consequences might be.

28.8 A further point when judging audit worthiness is sensitivity to the general political and managerial climate. The Office wants its work to be as timely and relevant as possible. For example, it must consider whether the area under consideration is the subject of current public attention. If it is, then the Office would determine whether an audit at that time could produce additional independent information to Parliament. If not, the audit would probably be delayed. The Office must at all times remain - and be seen to remain - independent and objective.

28.9 Another fundamental consideration is auditability, or whether a particular audit is possible. This involves consideration of such questions as:

Does the proposed area fall within the Office's audit mandate?

Can the Office obtain sufficient evidence to reach an objective conclusion on the audit area?

Can the Office assemble the expertise needed to carry out the audit successfully?

Does the Office have the resources needed to conduct the audit in accordance with generally accepted auditing standards?

28.10 A proposed audit area must meet the tests of being both audit worthy and auditable to be selected for audit.

Ensuring Audit Quality

28.11 Once an area has been selected for audit, the Office establishes an advisory committee to provide advice throughout the course of the audit. These committees usually have advisors from outside the Office and the public service, as well as from inside the Office.

28.12 Advisors are chosen to bring the perspectives and experiences of managers or auditors of similar entities, or of persons knowledgeable in the area under audit, or others affected by the operations of the entity. External advisors have included former members of Parliament and deputy ministers, business executives, academics, representatives of client groups, and recognized subject matter experts.

28.13 The purpose of these advisory committees is to provide advice and guidance on matters such as audit scope, criteria, methodology, the reasonableness of observations and recommendations, and the overall presentation of the report. In short, these committees guide, review and challenge the work of audit teams over the life of an audit.

28.14 For this year's Report, the Office used 62 outside advisors, including:

14 university professors

12 former deputy ministers and assistant deputy ministers in federal and provincial governments

6 management consultants

6 officials from non-profit corporations and research institutions

5 officials from audit offices in the public and private sectors
4 lawyers
4 economists
3 accountants
3 current and former business executives
2 officials from industry associations
1 environmental scientist
1 parliamentary officer
1 medical doctor

28.15 Observations, conclusions and recommendations are presented to entity management before an audit chapter is finalized. This permits the Office to obtain confirmation of audit facts, and management reaction to the chapter. Management responses are included in the final report. This process serves to highlight any areas of agreement or disagreement on any conclusions or recommendations emerging from an audit.

28.16 This process is applied to all audits and reports to create an end product of the highest quality possible, in terms of both the way an audit is conducted and how it is reported. It also permits the Public Accounts Committee to focus on the issues raised in a chapter.

Costs of Crown Corporation Audits

28.17 Section 147 of the *Financial Administration Act* requires that the Office disclose the costs of preparing audit reports on all Crown corporations other than those exempted under section 85 of the Act (see [Exhibit 28.2](#)). An audit report includes an opinion on a corporation's financial statements and on its compliance with specified authorities. It may also include reporting on any other matter deemed significant.

28.18 The Office is also required by section 68 of the *Broadcasting Act* to report the cost of any audit report on the Canadian Broadcasting Corporation. For the fiscal year ended 31 March 1993, the full cost of the annual audit report was \$687,620.

28.19 Section 138 of the *Financial Administration Act* requires that, at least once every five years, each parent Crown corporation named in Schedule III of the Act undergo a special examination. This is distinct from the requirement for the annual audit of financial statements.

28.20 The objective of a special examination is to determine whether a corporation's financial and management control and information systems and its management practices provide reasonable assurance that:

assets have been safeguarded and controlled;
financial, human and physical resources have been managed economically and efficiently; and
operations have been carried out effectively.

28.21 In 1992-93 the Office completed the special examination of three Crown corporations. The costs were:

Atlantic Pilotage Authority	\$ 254,230
Cape Breton Development Corporation	1,194,600
Great Lakes Pilotage Authority	198,650

Appendix A

Auditor General Act

R.S., c. A-17

An Act respecting the office of the Auditor General of Canada and matters related or incidental thereto

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,

Auditor General

“auditor General” means the Auditor General of Canada appointed pursuant to subsection 3(1);

Crown corporation

“rown corporation” has the meaning assigned 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* . 1976-77, c. 34, s.2, 1984, c. 31, s.14.

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.

Report to the House of Commons

7. (1) The Auditor General shall report annually to the House of Commons

(a) on the work of his office; and,

(b) on whether, in carrying on the work of his office, he received all the information and explanations he required.

Idem

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

(a) accounts have not been faithfully and properly maintained or public money has not been fully accounted for or paid, where so required by law, into the Consolidated Revenue Fund;

(b) essential records have not been maintained or the rules and procedures applied have been insufficient to safeguard and control public property, to secure an effective check on the assessment, collection and proper allocation of the revenue and to ensure that expenditures have been made only as authorized;

(c) money has been expended other than for purposes for which it was appropriated by Parliament;

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

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

Submission of report to Speaker and tabling in the House of Commons

(3) Each annual report by the Auditor General to the House of Commons shall be submitted to the Speaker of the House of Commons on or before the 31st day of December in the year to which the report relates and the Speaker of the House of Commons shall lay each such report before the House of Commons forthwith after receipt thereof by him or, if that House is not then sitting, on the first day next thereafter that the House of Commons is sitting. 1976-77, c. 34, s.7.

Special report

8. (1) The Auditor General may make a special report to the House of Commons on any matter of pressing importance or urgency that, in his opinion, should not be deferred until the presentation of his annual report.

Submission of reports to Speaker and tabling in the House of Commons

(2) Each special report of the Auditor General to the House of Commons made under subsection (1) or 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.

Idem

9. The Auditor General shall

(a) make such examination of the accounts and records of each registrar as he deems necessary, and such other examinations of a registrar's transactions as the Minister of Finance may require, and;

(b) when and to the extent required by the Minister of Finance, participate in the destruction of any redeemed or cancelled securities or unissued reserves of securities authorized to be destroyed under the *Financial Administration Act* ;

and he may, by arrangement with a registrar, maintain custody and control, jointly with that registrar, of cancelled and unissued securities. 1976-77, c. 34, s.9.

Improper retention of public money

10. Whenever it appears to the Auditor General that any public money has been improperly retained by any person, he shall forthwith report the circumstances of the case to the President of the Treasury Board. 1976-77, c. 34, s.10.

Inquiry and report

11. The Auditor General may, if in his opinion such an assignment does not interfere with his primary responsibilities, whenever the Governor in Council so requests, inquire into and report on any matter relating to the financial affairs of Canada or to public property or inquire into and report on any person or organization that has received financial aid from the Government of Canada or in respect of which financial aid from the Government of Canada is sought. 1976-77, c. 34, s.11.

Advisory powers

12. The Auditor General may advise appropriate officers and employees in the public service of Canada of matters discovered in his examinations and, in particular, may draw any such matter to the attention of officers and employees engaged in the conduct of the business of the Treasury Board. 1976-77, c. 34, s.12.

ACCESS TO INFORMATION

Access to information

13. (1) Except as provided by any other Act of Parliament that expressly refers to this subsection, the Auditor General is entitled to free access at all convenient times to information that relates to the fulfilment of his responsibilities and he is also entitled to require and receive from members of the public service of Canada such information, reports and explanations as he deems necessary for that purpose.

Stationing of officers in departments

(2) In order to carry out his duties more effectively, the Auditor General may station in any department any person employed in his office, and the department shall provide the necessary office accommodation for any person so stationed.

Oath of secrecy

(3) The Auditor General shall require every person employed in his office who is to examine the accounts of a department or of a Crown corporation pursuant to this Act to comply with any security requirements applicable to, and to take any oath of secrecy required to be taken by, persons employed in that department or Crown corporation.

Inquiries

(4) The Auditor General may examine any person on oath on any matter pertaining to any account subject to audit by him and for the purposes of any such examination the Auditor General may exercise all the powers of a commissioner under Part I of the *Inquiries Act* . 1976-77, c. 34, s.13.

Reliance on audit reports of Crown corporations

14. (1) Notwithstanding subsections (2) and (3), in order to fulfil his responsibilities as the auditor of the accounts of Canada, the Auditor General may rely on the report of the duly appointed auditor of a Crown corporation or of any subsidiary of a Crown corporation.

Auditor General may request information

(2) The Auditor General may request a Crown corporation to obtain and furnish to him such information and explanations from its present or former directors, officers, employees, agents and auditors or those of any of its subsidiaries as are, in his opinion, necessary to enable him to fulfil his responsibilities as the auditor of the accounts of Canada.

Direction of the Governor in Council

(3) If, in the opinion of the Auditor General, a Crown corporation, in response to a request made under subsection (2), fails to provide any or sufficient information or explanations, he may so advise the Governor in Council, who may thereupon direct the officers of the corporation to furnish the Auditor General with such information and explanations and to give him access to those records, documents, books, accounts and vouchers of the corporation or any of its subsidiaries access to which is, in the opinion of the Auditor General, necessary for him to fulfil his responsibilities as the auditor of the accounts of Canada. 1976-77, c. 34, s.14.

STAFF OF THE AUDITOR GENERAL

Officers, etc.

15. (1) Such officers and employees as are necessary to enable the Auditor General to perform his duties shall be appointed in accordance with the *Public Service Employment Act* .

Contract for professional services

(2) Subject to any other Act of Parliament or regulations made thereunder, but without the approval of the Treasury Board, the Auditor General may, within the total dollar limitations established for his office in appropriation Acts, contract for professional services.

Delegation to Auditor General

(3) The Auditor General may exercise and perform, in such manner and subject to such terms and conditions as the Public Service Commission directs, the powers, duties and functions of the Public Service Commission under the *Public Service Employment Act*, other than the powers, duties and functions of the Commission in relation to appeals under sections 21 and 31 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.

Responsibility for personnel management

16. In respect of persons employed in his office, the Auditor General is authorized to exercise the powers and perform the duties and functions of the Treasury Board under the *Financial Administration Act* that relate to personnel management including the determination of terms and conditions of employment and the responsibility for employer and employee relations, within the meaning of paragraph (1)(e) and sections 11 to 13 of that Act. 1976-77, c. 34, s.16.

Classification standards

17. Classification standards may be prepared for persons employed in the office of the Auditor General to conform with the classifications that the Auditor General recognizes for the purposes of that office. 1976-77, c. 34, s.18.

Delegation

18. The Auditor General may designate a senior member of his staff to sign on his behalf any opinion that he is required to give and any report, other than his annual report on the financial statements of Canada made pursuant to section 64 of the *Financial Administration Act* and his reports to the House of Commons under this Act and any member so signing an opinion or report shall indicate beneath his signature his position in the office of the Auditor General and the fact that he is signing on behalf of the Auditor General. 1976-77, c. 34, s.19.

ESTIMATES

Estimates

19. (1) The Auditor General shall annually prepare an estimate of the sums that will be required to be provided by Parliament for the payment of the salaries, allowances and expenses of his office during the next ensuing fiscal year.

Special report

(2) The Auditor General may make a special report to the House of Commons in the event that amounts provided for his office in the estimates submitted to Parliament are, in his opinion, inadequate to enable him to fulfil the responsibilities of his office. 1976-77, c. 34, s.20.

Appropriation allotments

20. The provisions of the *Financial Administration Act* with respect to the division of appropriations into allotments do not apply in respect of appropriations for the office of the Auditor General. 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.

Appendix B

Financial Administration Act - Extracts from Part X

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 appointment

(5) The Governor in Council may make regulations prescribing the criteria to be 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,

(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

(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.

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

(a) information and explanations, and

(b) access to records, documents, books, accounts and vouchers of the corporation or any of its subsidiaries

as the auditor or examiner considers necessary to enable him to prepare any report as required by this Division and that the directors, officers, employees or agents are reasonably able to furnish.

Idem

(2) On the demand of the auditor or examiner of a Crown corporation, the directors of the corporation shall

(a) obtain from the present or former directors, officers, employees or agents of any subsidiary of the corporation such information and explanations as the auditor or examiner considers necessary to enable him to prepare any report as required by this Division and that the present or former directors, officers, employees or agents are reasonably able to furnish; and

(b) furnish the auditor or examiner with the information and explanations so obtained.

Reliance on reports

(3) An auditor or examiner of a Crown corporation may reasonably rely on any report of any other auditor or examiner. 1984, c. 31, s. 11.

Policy

Restriction

145. Nothing in this Part or the regulations shall be construed as authorizing the auditor or examiner of a Crown corporation to express any opinion on the merits of matters of policy, including the merits of

(a) the objects or purposes for which the corporation is incorporated, or the restrictions on the businesses or activities that it may carry on, as set out in its charter;

(b) the objectives of the corporation; and

(c) any business or policy decision of the corporation or of the Government of Canada. 1984, c. 31, s. 11.

Qualified Privilege

Qualified privilege

146. Any oral or written statement or report made under this Part or the regulations by the auditor or a former auditor, or the examiner or a former examiner, of a parent Crown corporation or a wholly-owned subsidiary has qualified privilege. 1991, c. 24, s. 43.

Costs

Cost of audit and examination

147. (1) The amounts paid to an auditor or examiner of a Crown corporation for preparing any report under section 132, 139, 140 or 141 shall be reported to the President of the Treasury Board.

Idem

(2) Where the Auditor General of Canada is the auditor or examiner of a Crown corporation, the costs incurred by him in preparing any report under section 132, 139, 140 or 141 shall be disclosed in the next annual report of the Auditor General and be paid out of the moneys appropriated for his office. 1984, c. 31, s. 11.

Audit Committee

Audit committee

148. (1) Each parent Crown corporation that has four or more directors shall establish an audit committee composed of not less than three directors of the corporation, the majority of whom are not officers or employees of the corporation or any of its affiliates.

Idem

(2) In the case of a parent Crown corporation that has less than four directors, the board of directors of the corporation constitutes the audit committee of the corporation and shall perform the duties and functions assigned to an audit committee by any provision of this Part and the provision shall be construed accordingly.

Duties

(3) The audit committee of a parent Crown corporation shall

(a) review, and advise the board of directors with respect to, the financial statements that are to be included in the annual report of the corporation;

(b) oversee any internal audit of the corporation that is conducted pursuant to subsection 131(3);

(c) review, and advise the board of directors with respect to, the annual auditor's report of the corporation referred to in subsection 132(1);

(d) in the case of a corporation undergoing a special examination, review, and advise the board of directors with respect to, the plan and reports referred to in sections 138 to 141; and

(e) perform such other functions as are assigned to it by the board of directors or the charter or by-laws of the corporation.

Auditor's or examiner's attendance

(4) The auditor and any examiner of a parent Crown corporation are entitled to receive notice of every meeting of the audit committee and, at the expense of the corporation, to attend and be heard at each meeting; and, if so requested by a member of the audit committee, the auditor or examiner shall attend any or every meeting of the committee held during his term of office.

Calling meeting

(5) The auditor or examiner of a parent Crown corporation or a member of the audit committee may call a meeting of the committee.

Wholly-owned subsidiary

(6) Where the report referred to in subsection 132(1) is to be prepared in respect of a wholly-owned subsidiary separately, subsections (1) to (5) apply, with such modifications as the circumstances require, in respect of the subsidiary as though

(a) the references in subsections (1) to (5) to a parent Crown corporation were references to the subsidiary; and

(b) the reference in paragraph (3)(a) to the annual report of the corporation were a reference to the annual report of the parent Crown corporation that wholly owns the subsidiary. 1984, c. 31, s. 11.

Reports

Accounts, etc. to Treasury Board or appropriate Minister

149. (1) A parent Crown corporation shall provide the Treasury Board or the appropriate Minister with such accounts, budgets, returns, statements, documents, records, books, reports or other information as the Board or appropriate Minister may require.

Reports on material developments

(2) The chief executive officer of a parent Crown corporation shall, as soon as reasonably practicable, notify the appropriate Minister, the President of the Treasury Board and any director of the corporation not already aware thereof of any financial or other developments that, in the chief executive officer's opinion, are likely to have a material effect on the performance of the corporation, including its wholly-owned subsidiaries, if any, relative to the corporation's objectives or on the corporation's requirements for funding.

Reports on wholly-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

150. (1) Each parent Crown corporation shall, as soon as possible, but in any case within three months, after the termination of each financial year submit an annual report on the operations of the corporation in that year concurrently to the appropriate Minister and the President of the Treasury Board, and the appropriate Minister shall cause a copy of the report to be laid before each House of Parliament on any of the first fifteen days on which that House is sitting after he receives it.

Reference to committee

(2) An annual report laid before Parliament pursuant to subsection (1) stands permanently referred to such committee of Parliament as may be designated or established to review matters relating to the businesses and activities of the corporation submitting the report.

Form and contents

(3) The annual report of a parent Crown corporation shall include

(a) the financial statements of the corporation referred to in section 131,

(b) the annual auditor's report referred to in subsection 132(1),

(c) a statement on the extent to which the corporation has met its objectives for the financial year,

(d) such quantitative information respecting the performance of the corporation, including its wholly-owned subsidiaries, if any, relative to the corporation's objectives as the Treasury Board may require to be included in the annual report, and

(e) such other information as is required by this or any other Act of Parliament, or by the appropriate Minister, the President of the Treasury Board or the Minister of Finance, to be included in the annual report,

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.

Idem

(4) In addition to any other requirements under this Act or any other Act of Parliament, the Treasury Board may, by regulation, prescribe the information to be included in annual reports and the form in which such information is to be prepared. 1991, c. 24, s. 49.

Annual consolidated report

151. (1) The President of the Treasury Board shall, not later than December 31 of each year, cause a copy of an annual consolidated report on the businesses and activities of all parent Crown corporations for their financial years ending on or before the previous July 31 to be laid before each House of Parliament.

Reference to committee

(2) An annual consolidated report laid before Parliament pursuant to subsection (1) stands permanently referred to such committee of Parliament as may be designated or established to review matters relating to Crown corporations.

Contents

(3) The annual consolidated report referred to in subsection (1) shall include

(a) a list naming, as of a specified date, all Crown corporations and all corporations of which any shares are held by, on behalf of or in trust for the Crown or any Crown corporation;

(b) employment and financial data, including aggregate borrowings of parent Crown corporations; and

(c) such other information as the President of the Treasury Board may determine. 1984, c. 31, s. 11.

Annual report

152. (1) The President of the Treasury Board shall, not later than December 31 of each year, cause to be laid before each House of Parliament a copy of a report indicating the summaries and annual reports that under this Part were to be laid before that House by July 31 in that year, the time at, before or within which they were to be laid and the time they were laid before that House.

Attest

(2) The accuracy of the information contained in the report referred to in subsection (1) shall be attested by the Auditor General of Canada in the Auditor General's report to the House of Commons. 1991, c. 24, s. 44.

Appendix C

Reports of the Standing Committee on Public Accounts to the House of Commons

REPORT TO THE HOUSE

Wednesday, September 16, 1992

The Standing Committee on Public Accounts has the honour to present its

EIGHTH REPORT

Pursuant to Standing Order 108(3)(e), your Committee examined paragraphs 3.131 to 3.139 of Chapter 3 of the Auditor General's Report for 1991 - Department of National Health and Welfare - Canada Assistance Plan - 1989, Chapter 15.

It is generally agreed that parliamentarians and Canadians have the right to require the federal government to publish, at such time as prescribed by law, information on the expenditures, objectives, effectiveness and efficiency of government programs. This information, which shall be concise as well as exhaustive, must be published regularly, at the appropriate time, and in accordance with the laws of Parliament.

It is up to Parliament to make decisions on behalf of all Canadians. For instance, it is incumbent on Parliament to pass and amend legislation, to vote on appropriations, to decide how they should be spent and to set certain limits on funding for various programs. Under this system, accountability and the obligation to inform Parliament are fundamental.

Background

In his annual report for 1991, as in his report for 1989, the Auditor General pointed out that the Department of National Health and Welfare had fallen short in meeting its obligations. The Department had failed to provide Parliament with several annual reports on the Canada Assistance Plan (CAP). Furthermore, because of the lack of information on program evaluation in the Estimates, Members of Parliament and interested parties were unable to obtain data on CAP results, for instance.

The lack of information on CAP is not a new development. In fact, it has been going on for some time. In 1978, the Breaux report, *Fiscal federalism in Canada*, recommended improving the statistical and financial information available on CAP. In 1985, the Study Team Report to the Task Force on Program Review (the Nielsen Task Force) mentioned a number of shortcomings with respect to the collection of CAP data. More recently, in 1987, the National Welfare Council recommended that statistical information be published on a more regular basis.

CAP annual reports

CAP annual reports for fiscal years 1986-87, 1987-88 and 1988-89 were published simultaneously as one document in June 1991. The annual reports for 1989-90, 1990-91 and now 1991-92 have yet to be released and will probably take several months.

After discussing the problem with senior officials from Health and Welfare Canada invited to appear before your Committee, members were puzzled about the current practice of not publishing information on CAP within a reasonable timeframe. The federal government spends \$6 billion on CAP without reporting to Parliament. This means the government is violating the *Canada Assistance Plan*, which is an Act of Parliament. Since these are statutory expenditures which Parliament does not have to approve, it is your Committee's opinion that this is one more reason why the Department should follow the letter of the law by publishing on time its annual report on CAP, so that parliamentarians and Canadians be well informed.

Considering its broad financial responsibility and the size of this assistance program designed for Canadians who are most in need, the Public Accounts Committee considers that CAP management should improve its reporting on the billions of dollars for which it is responsible.

The time has come to correct a situation that has gone on far too long already. The delays in publishing CAP annual reports are not an isolated incident. Annual reports on major programs such as Old Age Security, the Canada Pension Plan and family allowances are all late. Your Committee wonders whether Health and Welfare Canada has demonstrated the will to produce its statutory reports on time by putting in place the appropriate mechanisms.

The Public Accounts Committee therefore recommends:

that the Department of National Health and Welfare table its annual report on time, as required under section 18 of the *Canada Assistance Plan*. If the Department is unable to table a complete report, it should provide an interim report, pending final compilation of information provided by the provinces.

Your Committee realizes that the Department is, to a certain extent, dependent on the provinces and that it is not easy to reconcile statistical information based on definitions that vary. After the federal government has given the provinces \$20 million to help them update their equipment and simplify data collection, the Committee wondered whether

Canadians have gotten their money's worth. In fact, it is your Committee's opinion that the Department is being somewhat lax by not requiring the provinces to submit their information on time.

Your Committee therefore recommends:

that, if the situation does not improve significantly within the next year, the Department of National Health and Welfare should seriously consider imposing monetary sanctions on provinces whose timeframes are unacceptable and which persist in late reporting of the information required to prepare the CAP annual report. Those sanctions could be effected by holding back transfer payments provided for under the CAP.

Estimates Part III

The Public Accounts Committee believes that the Department's Estimates Part III is incomplete. Although the relevance of the information reported is an important consideration, your Committee is of the opinion that the quality of CAP-related information should be improved.

The Estimates for 1992-93 do not mention the impact of the current economic recession on the number of welfare recipients in Canada in future years. Nor do the Estimates indicate the effects of the *Government Expenditures Restraint Plan Act* on CAP (Bill C-69, which received royal assent in February 1991).

The Department should also be more specific in its analysis of CAP financial requirements. It should avoid the use of vague statements and should include an analysis of past and future trends, for instance. The Department should also provide in the Estimates better disclosure of key findings of program evaluations, including CAP.

Your Committee therefore recommends:

that the Department of National Health and Welfare improve the reporting of CAP information in the Estimates, so that parliamentarians and all Canadians be well informed.

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 and Evidence* (Issues No. 28 and No. 33 which includes this Report) is tabled.

Respectfully submitted,

JEAN-ROBERT GAUTHIER

Chairman.

REPORT TO THE HOUSE

Wednesday, September 16, 1992

The Standing Committee on Public Accounts has the honour to present its

NINTH REPORT

Pursuant to Standing Order 108(3)(e), your Committee examined paragraphs 2.67 and 2.68 of the Report of the Auditor General for 1991 concerning the letters of comfort on income tax issued by the Department of Finance.

The Department of Finance decides from time to time to amend the *Income Tax Act* pursuant to explanations requested by taxpayers. The latter, seeking a technical interpretation of tax matters in unusual circumstances for which no provision is made in the Act, wish to ensure that their interpretation of the Act is clearly consistent with Parliament's intention. In response to their requests, these taxpayers receive a letter of comfort informing them that the Department will recommend amendments to the *Income Tax Act*.

In 1990, the Department issued 20 comfort letters to taxpayers or their representatives. By confirming the application of certain future legislative provisions, these letters facilitate interpretation of the *Income Tax Act*. It has not been the practice of the Department of Finance to make a public announcement when it sends a letter of comfort to a taxpayer.

According to the Auditor General, this practice enables some taxpayers to manage their business affairs with greater certainty, but places those who are unable to examine the letters of comfort at a disadvantage. Some taxpayers are thus placed in a privileged position since the information contained in those letters is not forwarded to other taxpayers in similar situations. According to the Auditor General, many of the latter would adjust their tax planning if they knew the content of those letters. The Auditor General goes even further to say that this practice constitutes a breach of one of the Department of National Revenue's commitments in its Declaration of Taxpayer Rights, according to which the government must make every reasonable effort to transmit tax information to taxpayers. When the Committee examined this question, the Auditor General's representative expressed the hope that the government would ensure all taxpayers have access to complete and accurate information concerning the *Income Tax Act*. According to him, the Department of Finance should "amend its practice... and at the time it issues a letter of comfort, it will advise the public of its intention to recommend

amendments to the *Income Tax Act* " (*Minutes of Proceedings and Evidence, Issue No. 23, p. 6*) .

Furthermore, the Department of Finance claims that the letters of comfort merely confirm Parliament's well-known intention to amend the Act in response to a particular situation. They thus enable taxpayers to avoid being trapped by an improper literal interpretation of the existing Act. The Senior Assistant Deputy Minister contended before the Committee that it was not the overall policy that was in question, but rather the Act's application to specific situations. In his view, the letters of comfort "deal with very narrow technical interpretations of the law in the context of a specific fact situation". (*Minutes of Proceedings and Evidence, Issue No. 23, p. 17*) Lastly, the Department of Finance also believes that the letters of comfort are so specific and technical that it is highly unlikely any other taxpayer could use the information they contain.

To help clarify the entire question, the Committee invited a number of accounting firms to express their views. The firms Peat Marwick Thorne and Ernst & Young appeared before the Committee, and the firm Samson Bélair Deloitte & Touche submitted a brief in which it stated, "If the purpose of such amendments is to change the Act to do away with certain irregularities or consequences that the legislator may not have foreseen initially, then all taxpayers should be informed." The representative of Peat Marwick Thorne, for his part, said he was convinced that "these comfort letters rarely, if ever, grant any advantage to the taxpayer receiving them". (*Minutes of Proceedings and Evidence, Issue No. 30, p. 5*) Consequently, he saw little need to make them public immediately on their issuance. In any case, as he emphasized further on, "Rarely are other taxpayers as interested in a Department of Finance comfort letter, because the facts they deal with are typically so technical and so narrow that they often only affect one company". (*Minutes of Proceedings and Evidence, Issue No. 30, p. 8*) Lastly, the accountants believe that the letters of comfort are necessary since certain major business transactions would otherwise not be conducted for lack of certainty. Without these letters, taxpayers would be obliged to request remission orders or retroactive tax relief. These consultations also show that the accountants agree with the Auditor General's view that all taxpayers should be treated equally and notified of Parliament's intention to amend the Act.

It is the Committee's view that economic decisions that have tax effects are necessarily influenced when certain taxpayers are in exclusive possession of information. Furthermore, in any business, tax information is a key factor in every major decision and is supremely useful if it is also exclusive. Since information plays a fundamental role in the competitiveness of businesses, it is essential that the government ensure that this information is made public in an equitable manner.

The Committee is of the view that, by virtue of the principle of fairness, these letters of comfort should be made public in order to assist all taxpayers in better managing their affairs. However, it recognizes the existence of three problems associated with the publication of such letters. The Committee admits that there is some danger in publishing, on a broad scale, information based solely on the Department's interpretation,

but which does not yet have force of law. Furthermore, publication of these letters could prove costly. Considerable human resources would thus have to be allocated in order to respond to taxpayers' requests. Lastly, the Committee believes that increasing the frequency and distribution of letters of comfort could reduce their number, something that goes against the opinions of the accounting firms. The representative of Peat Marwick Thorne stated that it "would be regrettable if any mandatory form of publication caused the Department of Finance to curtail the activity. I can see many officials concluding that we cannot proceed; we simply will not be able to issue the comfort letter at this point in time" (*Minutes of Proceedings and Evidence, Issue No. 30, p. 19*) The Committee would find this situation regrettable because it is of the view that these letters are undeniably useful in certain cases.

The Department of Finance proposes to publish a set of technical amendments associated with the letters of comfort once a year, but the Committee believes that this would still provide a certain benefit to the recipients of those letters.

The Committee therefore recommends:

A) that the Department of Finance publish copies of the letters of comfort sent to taxpayers in the Canada Gazette every three months (taking care to protect the identity of their recipients);

B) that, for each letter of comfort, the Department append a brief technical paper explaining the context and objectives of the amendments which it intends to make to the Income Tax Act.

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 and Evidence (Issues Nos. 23, 30 and 33 which includes this Report)* is tabled.

Respectfully submitted,

JEAN-ROBERT GAUTHIER

Chairman.

REPORT TO THE HOUSE

Thursday, November 26, 1992

The Standing Committee on Public Accounts has the honour to present its

TENTH REPORT

Pursuant to Standing Order 108(3)(e), your Committee examined the Report of the Auditor General for 1992 and recommends

that the Department of Finance and the Auditor General meet as soon as possible in order to clarify their positions and seek common ground on the nature and extent of the issue of tax arrangements for foreign affiliates of Canadian companies that may result in considerable erosion of the tax base.

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 and Evidence (Issue No. 35* which includes this Report) is tabled.

Respectfully submitted,

JEAN-ROBERT GAUTHIER

Chairman.

REPORT TO THE HOUSE

Wednesday, February 24, 1993

The Standing Committee on Public Accounts has the honour to present its

ELEVENTH REPORT

Pursuant to a motion adopted by the House of Commons on Friday, June 19, 1992, authorizing the Standing Committee on Public Accounts to travel, a delegation made up of four members of the Committee, and accompanied by the Auditor General of Canada, met in London from November 1 to 5, 1992.

In travelling to London, the Committee had a number of objectives, one of which was to obtain a better understanding of the reform of the British civil service and to learn from it. The Committee also wanted to discuss such issues as information for Parliament, program evaluation, tax measures and financial control in connection with aid to developing countries. The Committee also wanted to find out more about the Public Accounts Committee, the Public Accounts Commission, the Comptroller and Auditor General of the United Kingdom, and about relations between these groups. Finally, the

Committee considered it important to discuss the particular role of the Accounting Officer and its potential relevance to the Canadian context.

A. The Reform of the Civil Service in the United Kingdom

A number of Western countries are currently endeavouring to revitalize their civil service; the governments of the United Kingdom, Sweden, France and Japan have all put forward civil service reform proposals. Canada has not escaped the trend; the first Canadian attempt at reorganization was the Glassco Commission in 1962.

In December 1990, in an attempt to reduce the costs of the public service and at the same time breathe new life into it, the Canadian government announced a new reform package. Called "Public Service 2000", its aim is to stimulate creativity among public employees. The government is moving towards partial deregulation of the bureaucratic environment, in the hope of promoting excellence among public employees.

The Canadian Standing Committee on Public Accounts has pointed out on a number of occasions that it will be difficult for managers to report to Parliament, once Public Service 2000 has been implemented. In his opening remarks to the Standing Committee on Public Accounts on May 14, 1992, the Chairman of the Committee and Member of Parliament for Ottawa-Vanier clearly summarized this concern:

There is a problem, however. Public Service 2000 fails to provide an accountability system for public employees and does not indicate how Parliament and members of Parliament would exercise control over public employees' innovative ideas on behalf of Canadians. In fact, the two major elements still lacking in Public Service 2000 are an efficient accountability system and parliamentary control mechanisms. (*Minutes of Proceedings and Evidence, Issue No. 27, p. 5*)

In order to find out more about how the British government overhauled its civil service and, in particular, how it managed to reconcile an extraordinary delegation of authority with the requirement to report to Parliament, the Standing Committee on Public Accounts met with British managers involved in implementing the reforms, public employees working within the framework of the new management model, and a union of professionals. Since 1982, the British government has made three attempts at reorganizing the civil service.

The Financial Management Initiative

In its Financial Management Initiative announced in 1982, the British government asked each department to review its managerial responsibilities and its financial and accounting control mechanisms. It also asked the departments to develop mechanisms that would allow managers to manage according to objectives, results and performance. This initiative gave managers considerably more responsibility. In 1983 and 1984, the government submitted evaluation reports on this issue, noting that, although there had been improvements in civil service management, more efforts were needed if managers were to become more motivated and better organized. Today, it is believed that the Next

Steps Initiative has made managers aware of the costs of the delivery of service to the public.

The Next Steps Initiative

On February 18, 1988, the British government announced that it accepted the key recommendations of the report "Improving Management in Government: The Next Steps", drafted by the Efficiency Unit for the Prime Minister's Office. The report found that many managers wanted to see further changes so as to achieve more room and flexibility for the exercise of personal responsibility. In a statement to the House of Commons, Prime Minister Thatcher summarized the main findings of the report:

...first, that... the executive functions of Government... should be carried out by units clearly designated within Departments, referred to in the report as "agencies". Responsibility for the day-to-day operations of each agency should be delegated to a chief executive. He would be responsible for management within a framework of policy objectives and resources set by the responsible Minister, in consultation with the Treasury... secondly, that the Government should commit themselves to a progressive programme for attaining this objective; thirdly, that staff should be properly trained and prepared for management of the delivery of services... and, fourthly, that a "project manager" at a senior level should ensure that the programme of change takes place. (House of Commons Debates, February 18, 1988)

Delegation of Broader Authority and Flexibility

The main objectives of this reform were, on the one hand, to improve the efficiency and effectiveness of the machinery of government without increasing its cost, and on the other hand to increase the satisfaction of taxpayers, clients and civil servants. To this end, the British delegated considerable discretionary powers to agency managers so as to make management more flexible. Rather than using a standardizing formula, the style, functions and decision-making powers of the agency were tailored to its corporate objectives and needs. It was recognized that agencies required various operational and hierarchical structures that matched their specific roles and purposes. The more complex an agency is to manage, the more delegated authority it has.

At the outset, the agency and the responsible department sign a framework document which defines the agency's objectives, determines the means of measuring its achievements, describes anticipated performance, outlines the duties and responsibilities of the Chief Executive Officer, and sets out the obligation and the method of reporting, the financial and accounting structure, the degree of delegated authority and personnel management. Furthermore, the framework document clearly establishes the line between the responsibilities of the department, charged as it is with policy development, and those of the agency, which is responsible solely for the delivery of public goods or services.

Usually funded out of the votes allocated to the department, the agency negotiates with the department a package of powers and financial regulations that are tailored to its

needs. It has total control over its budget and may use its funds as it sees fit. Finances are therefore managed with the sole aim of improving the agency's performance.

Agencies that generate sufficient income through the sale of public goods or services are authorized to use "trading funds". There are currently eight agencies which have received such authorization. This financial framework, which has existed since 1973 and whose use has now been extended to the agencies, allows greater flexibility and permits agencies to be self-financing. For instance, operations, capital expenditures and loans can be financed with trading funds and surplus funds from one year may be carried over to the next. Agencies are not required to turn their income or budget surpluses over to the British government's Consolidated Revenue Fund. The corporate discipline imposed by trading funds means that the agencies are more aware of their performance, which is measured not only in terms of costs, but also in terms of expenditures and the quality of services rendered. In fact, the use of trading funds must be seen as one of the cornerstones of the reform of the British civil service, since they increase managers' financial responsibilities considerably.

Accountability

According to British officials, authority has been delegated without undermining the accountability to Parliament. In fact, the government claims that the agency concept, in clarifying responsibilities and expectations, has enhanced accountability. The agencies are headed by Chief Executive Officers who are personally accountable for the agencies to ministers and who work according to the roles and responsibilities assigned to them in the framework documents. Even though the Minister is accountable to Parliament, it is the Chief Executive Officer who must appear before the Public Accounts Committee, for example; yet according to the British government, this system takes away none of the Minister's responsibility.

The framework document described above is the key and the guarantee that the accountability system will be effective, since it sets out explicitly the expectations, the objectives, and the desired level of performance, as negotiated with the Department, including performance indicators. With regard to accountability, the document also sets out control mechanisms and the structure linking the agency, the Minister responsible and Parliament. According to officials, it increases the openness of the accountability requirement, which is supposed to make the financial management of the agencies and the quality of performance information all the more accessible. It is likely that this will have repercussions throughout the entire machinery of government. On January 8, 1990, the Minister for the Civil Service said in the House of Commons:

There will be much more scope for Parliament to scrutinize the activities of the agencies than there has been hitherto... Agencies' objectives and performance will be more open to scrutiny than ever before, by Parliament and by others with an interest, including their customers. (Debates of the House of Commons, January 8, 1990)

Agencies are also required to prepare annual corporate accounts which must be audited by the Comptroller and Auditor General. These reports must not only contain information

of a general and financial nature, but must also describe performance, measured in terms of the objectives. It is interesting to note that the agencies are not required to follow a pre-established format. Even though the Treasury has the authority to impose the content, the principles to be followed and the format of accounts, it is the minister responsible and the Chief Executive Officer who decide what is appropriate in light of the agency's objectives. It is interesting to note that Price Waterhouse recently set up a jury that awarded a short time ago the first annual prize for the best agency report.

The Citizen's Charter

As a logical consequence of the Next Steps Initiative, the Citizen's Charter, published in July 1991, encourages agency managers to improve the delivery of service by guaranteeing high quality services to the client, the enforcement of standards and frequent performance reports. The desire to excel is produced by a variety of mechanisms such as privatization and contracting out, rigorous inspections, the publication of performance levels, both anticipated and actual, increased competition, a performance pay system, and a complaint redress mechanism.

In January 1991, Prime Minister Major announced the creation of the Charter Mark Award for agencies that have had excellent performance and met the commitments made in the Citizen's Charter. The assumption is that the winning agencies will have found ways of innovating without increasing costs.

In May 1991, the Efficiency Unit published a report entitled "Making the Most of Next Steps: the Management of Ministers' Departments and their Executive Agencies" (the Fraser Report). Prime Minister Major accepted the recommendations of this report aiming at enhancing even further the agencies' freedom of movement and managerial flexibility. One of the recommendations was for eliminating various limitations so that agencies could "shop around" to obtain services from the private sector at a better price; it was also proposed that Chief Executive Officers should have greater authority and responsibility for performance and that agency employees should have vocational training to acquire the tools to deliver services of higher quality.

In November 1991, in a report entitled "Competing for Quality", the government announced its intention of using market testing, that is, including the private sector in tendering to compete with the public sector in the delivery of services. It is already anticipated that public services with a total worth of about a quarter of a billion pounds sterling will have been tested by next year. Some Whitehall officials are even aiming at the figure of 1 billion pounds sterling.

The Next Steps Initiative and the Citizen's Charter have changed the British civil service considerably. At first glance, it appears that there is still a major challenge to reconcile delegation of authority with the need for control. According to officials we met in London, now that managers are aware of the clients' needs, they have managed to improve the quality of service provided and to excel, without undermining the accountability requirement. In July 1992, almost half of all public employees (nearly 300,000 people) were working in 81 government agencies as diverse as the Weather

Office, the Motor Vehicle Office and the Passport Office. The largest of these, the Social Security Benefits Agency, employs more than 63,000 people, while the smallest, the Wilton Park Conference Agency, has 30 employees. Fifty-four of the 81 Chief Executive Officers had been recruited through an open competition process and, of these fifty-four, 30 came from outside the civil service. The government has identified 28 other services that are likely to become agencies, adding an additional 68,000 public employees, and plans to have nearly three-quarters of its public employees working in agencies by 1995. This achievement can be attributed to the deep-rooted political will to reform the bureaucracy that has been evident over the past ten years, but were preceded by 20 years of vain attempts at reform and fruitless discussions.

Observations

The Public Accounts Committee is convinced that there is a need to redesign the senior levels of the Canadian federal public service with a view to heightening and defining more clearly the responsibilities of senior managers in terms of accountability, and to promote the desire for constant improvements in performance. To this end, expected results must be stated more explicitly, and more attention must be paid to inputs and results. In other words, rather than managing within a framework of restrictions and control, a way must be found to bring in a management model that is results-oriented—that is, based on performance and the quality of service provided to the clients. In this regard, Canadian political authorities can certainly find inspiration in the British experience.

According to a representative of the National Audit Office, the British government has in fact managed to improve the quality of service while at the same time paying more attention to the clients. In addition to delegating considerable authority to officials, the British government implemented a pay system based on performance and attainment of objectives, and made hiring and dismissal of personnel more flexible. The Canadian delegation was shown concrete examples of success, such as the Driver and Vehicle Licensing Agency and the United Kingdom Passport Agency, and met with an official of the Social Security Office—an office made up of five agencies which had considerable success in reducing the time required to process ever greater numbers of files. This improved performance, according to government representatives, could only be to the benefit of taxpayers and clients. Thanks to significant changes in attitude, public employees now understand the importance of providing high quality services to the clients. Although the Public Accounts Committee saw a number of changes in London that would be desirable in Canada, we are unable to rate the overall success of the British initiative. While a number of encouraging signs were brought out in our discussions, it is too early to assess the impact of the Citizen's Charter on clients, managers and taxpayers. We can, however, draw up a list of observations and lessons learned that will surely be useful in the reform of the Canadian public service.

1) The Public Accounts Committee observed that the unions had not been adequately consulted in the British reform. It is not surprising that the unions would oppose market testing, for example, since they felt that the Next Steps Initiative was the last stage before privatization. A representative from the First Division Civil Service Association told the Committee that private sector tenderers would always have an advantage over their

public sector counterparts because of their lower fixed costs. This association of professionals also pointed out that pay and benefits would probably be reduced, that stability and the continuity required for certain functions would suffer, that long-term planning would be very difficult, that there would be conflicts of interest with the tenderers, and that the security of certain information would be endangered. Even though the union admitted that the Next Steps Initiative worked in terms of making public employees more aware of operating costs, it felt that market testing would prove to be a disaster.

The Public Accounts Committee does not want to pass judgment on the ever-increasing use of the private sector by the British government. We would, however, like to issue a warning and stress the importance of consultations with unions and professional associations before embarking on the process of reform. It would probably be worthwhile developing a new type of partnership between public employees, senior managers and politicians before even thinking of undertaking such far-reaching reforms in Canada.

2) The Public Accounts Committee would also like to point out that market testing carried out too aggressively entails considerable risks for management. First, if the private sector is to be called on more and more, we should try to ensure the neutrality of "private" public employees and that the tendering process is managed fairly and without interference. Second, since the position of those in senior agency positions (such as Chief Executive Officers) will be continually jeopardized by market testing, one might wonder whether they might not be tempted to make unacceptable innovations (for instance, by reducing the quality of the service their agency provides). We might also ask how qualified employees will be recruited to fill senior level positions if managerial positions are constantly being called into question.

3) Since the senior executive of an agency has close relations with the Minister responsible, there is a danger that, when the time comes to report to Parliament, the Minister may hide behind the Chief Executive Officer. Moreover, the proliferation of administrative units will make it more difficult to verify that maximum benefit has been derived from resources. Finally, more contracting out and privatization will gradually make accountability the responsibility of the private sector. Accountability and openness may not be guaranteed as fully as those in London believe them to be; only time and experience will tell.

4) In order to make such significant changes to a bureaucracy, it is necessary to have powerful political support and a firm commitment to change. It cannot be left up to senior officials to implement drastic changes to the public service in which they themselves work. Without the support of the last two British Prime Ministers, the successes seen in various quarters would probably not have been as marked. It might be asked whether the reform would have been possible without major shock treatment. If the new organizational culture based on client satisfaction and performance had not been imposed so forcefully, the British civil service would very likely have resisted any attempt at reform. If the reforms had not been so well structured, without the delegation of authority and responsibilities, and without the major innovations resulting in freedom to make

decisions, change would probably have been impossible and the British government would have been unable to counter the normal tendency towards centralization. The Next Steps Initiative can therefore be seen as the catalyst that brought about change.

5) In conclusion, the Committee wishes to stress that we must be careful that we do not produce a public service which is overly concerned with financial results and employment security and pays scant attention to the needs of its clients.

B. Information for Parliament

Over the current session, the Public Accounts Committee has frequently criticized the quality of information made available to Parliament. The Committee members find that parliamentarians receive information that is generally of poor quality. Members of Parliament and Senators are too often dissatisfied with the information provided by departments and public organizations, as it is often irrelevant and presented in an indigestible format. Canadian parliamentarians need information not only on inputs, but also on results and program performance. In a context of budgetary restraint, they must be able to find out about the repercussions of budget cutbacks, not only on program cost but also on performance. A close look must be taken at information for Parliament while increasing its quality, if the machinery of government is to become more open. Information for Parliament must be relevant, credible, reliable, understandable and accessible.

In order to find out British views on this issue, the Public Accounts Committee discussed information to Parliament with a number of senior officials, politicians and a professor from the London Business School. For departments, government information is not as uniform as it is in Canada; within the guidelines issued by the Treasury Office, the departments are more or less free to choose the format. The 81 government agencies, as mentioned above, have even more flexibility. The subject of information for Parliament arouses little interest in the United Kingdom, but parliamentarians do not seem to complain about it. The Chairman of Britain's Public Accounts Committee said that the members are quite indifferent to the information submitted to them. Estimates are concurred in as tabled, without the possibility of any amendments. The House Select Committees review neither the reports nor the expenditure plans. It is not surprising, since they have so little influence, that members are not interested in the information they receive. In any case, at the London Business School, the Canadian delegation was told that, although the volume of information has increased exponentially over the last few years, it is not understood, being all too often too technical and irrelevant. The British government has no electronic method of transmitting information. The situation is strangely similar to the Canadian experience, where parliamentarians do not need more information, but rather information that is more accurate and more relevant. Unless this change comes about, they will continue to be uninterested in the information they are given.

Observations

In light of what we saw in the United Kingdom, the Public Accounts Committee believes that it is important to improve the quality of information delivered to the Canadian Parliament as soon as possible. If additional authority is to be delegated to senior officials and if accountability is to be enhanced, parliamentarians must be better informed. Parliamentarians must, however, make their needs known. Apart from providing general guidelines, it might be worthwhile to allow departments to select the format and information most suitable for their objectives and performance measurement systems, as well as the needs of the users. Improved information must include objectives and performance indicators. Departments must periodically review the relevance of the information presented. Finally, in order to make the information more accessible, serious thought should be given to the use of electronic equipment.

C. Program Evaluation

A number of meetings of the Canadian Public Accounts Committee have dealt directly or indirectly with the periodic evaluation of all government programs and with the publication of those evaluations. The Committee clearly summarized its views in the Second Report to the House, stating:

Whoever wishes to optimize resource use must be accurately informed about the way programs perform. Program evaluation makes it possible to know whether the *raison d'être*, goals, anticipated and actual results and program design are satisfactory. When such evaluations... are made public, they increase the accountability of the government and its officials... Program evaluation is all the more important in the current context of budgetary restraint... The government must continually improve the allocation of ever-scarcer resources. (*Minutes of Proceedings and Evidence, Issue No. 9, p. 4*)

In order to find out more about the United Kingdom's policy on program evaluation, the Public Accounts Committee met with managers in the Treasury Office. To its great surprise, the Committee learned that the British government has no clear and specific orders requiring regular and independent program evaluation; only new large-scale programs are evaluated the year following their implementation. There is no official evaluation of tax measures, nor does the government publish accounts of fiscal expenditures. There was a clear interest in the issue, but nothing more. In fact, one manager told us that the current state of affairs was "patchy". Those at more senior levels appeared to rely on audits by the Comptroller and Auditor General for the evaluation of program performance.

Our discussions in London convinced the Committee of the importance of program evaluation. With reform of the public service, the Canadian government is preparing to delegate further decision-making authority to its managers. The many *raisons d'être* and degree to which objectives were attained must be reviewed and evaluated periodically, and adapted when necessary; fiscal measures must not escape this fundamental rule.

Consequently, the Public Accounts Committee recommends

that all programs be evaluated regularly and independently.

D. Management of Financial Aid to Developing Countries

On December 11, 1991, the Canadian Public Accounts Committee presented its Fourth Report to the House. The report examined the way in which the Canadian International Development Agency (CIDA) had managed the construction of a coal-washing plant in Pakistan in 1975, and the fact that CIDA denied any responsibility for the failure of the project. CIDA claimed that, since the project in Pakistan was financed through a "line of credit", it has assumed that the beneficiary country took responsibility for the feasibility, management and control of the sums invested. CIDA claims that its responsibility is limited exclusively to ensuring that the payment process is effectively managed. In its report, the Committee stated that:

The Agency claims that, if full feasibility studies had to be conducted for all transactions of this type, their administrative cost would be high and they would monopolize scarce resources. (*Minutes of Proceedings and Evidence, Issue No. 13, p. 4*)

The Committee recommended:

that CIDA undertake, as required by Treasury Board, full risk assessments of all projects... The extent of these assessments should obviously be directly proportional to the level of CIDA funding. (*Minutes of Proceedings and Evidence, Issue No. 13, p.6*)

In order to find out how the British government manages risk and shares responsibility for financial aid to developing countries, the Public Accounts Committee visited the Overseas Development Administration (ODA) which is part of the Foreign and Commonwealth Office and is responsible for managing and supervising financial aid to developing countries. In 1991-92, British aid to developing countries amounted to approximately 1.8 billion pounds sterling. In light of our discussions with an ODA manager, the Committee feels it would be in CIDA's interests to emulate the ODA's management practices. In fact, while the ODA's role is essentially that of money-lender, it ensures that the risks and feasibility of all the projects in which it participates have been properly assessed *ex ante*, regardless of the method of financing and the amount involved. Beneficiary countries are responsible for conducting feasibility studies and risk assessments, and the ODA provides the resources to do the analyses if the need arises. The ODA representative mentioned that this was not ODA's preferred option, and that it hoped to see beneficiary countries developing their own expertise in project evaluation. The ODA also prepares, **independently** and systematically, *ex post* evaluation reports five to ten years after the start-up of each project, in which its performance is assessed in light of its initial objectives. These assessments make it possible to learn from the errors made. All aid is credited in the form of partnerships and the ODA expects that the beneficiary country will manage the project effectively. Like CIDA, however, it operates in a high risk environment. Unlike the situation in Canada, the ODA's accountability is shared in the event of failure, since the participants sign an agreement in principle covering the division of responsibilities. Furthermore, ODA managers oversee the interests of the British government and the beneficiary country in the field. While helping

to ensure that the project runs smoothly, these managers can also warn the British authorities should difficulties arise.

It should be noted that, while ODA funds projects in more than 150 countries, its aid goes primarily to only about 30, thus making the risks easier to manage. One of the comments the Committee made in the Fourth Report to the House was that "CIDA should perhaps do less, but do it better". (*Minutes of Proceedings and Evidence, Issue No. 13, p. 6*)

Observations

The Public Accounts Committee concluded that CIDA should review, among other issues, its current management practices and carry out, systematically and regardless of the financing mechanism, a *ex ante* risk evaluation (as recommended in the Committee's Fourth Report to the House) and an independent *ex post* evaluation for projects. The Committee considers that the risk of failure of a number of projects would be significantly lower if these management practices were implemented. We would also like to see CIDA emulate the ODA's approach to sharing accountability.

E. Operating Relationships between the National Audit Office, the Public Accounts Committee and the Public Accounts Commission

In order to obtain a clearer picture of the unique relationship between the National Audit Office, the Public Accounts Committee and the Public Accounts Commission, the Canadian delegation met with a number of officials.

The National Audit Office

As in Canada, the British Auditor General is a servant of the House of Commons appointed by the Crown. In Britain, however, the Auditor General is also the Comptroller General. While Canada's Auditor General is appointed for a ten-year term, the Comptroller and Auditor General is appointed for life and can be removed only by the Queen. It is important to note that the Chairman of the Public Accounts Committee recommends a person for the appointment, after consultation with the Chairman of the Commission.

Observations

In the United Kingdom, the Comptroller and Auditor General has two functions. First, as Comptroller, he authorizes movements of funds from the Exchequer to departments and other government organizations, a role clearly portrayed in the official title--Comptroller General of the Receipt and Issue of Her Majesty's Exchequer and Auditor General of Public Accounts. As Auditor General, this official must certify the financial statements of departments, agencies and other public organizations, the Consolidated Revenue Fund transactions account, and the appropriation accounts. It should be noted that there is no consolidated public accounts to be audited, as there are in Canada. The Comptroller and Auditor General must also report to Parliament on the financial audits and is also responsible for carrying out comprehensive audits that look into value for money

according to such criteria as effectiveness, efficiency and economy. Furthermore, the Comptroller and Auditor General cannot cast doubt on a program's merits or justification; the office considers requests from the Public Accounts Committee or its members in preparing its audit plan for future value for money audits. Each year, the incumbent submits to the Committee a list of audits to be carried out over the next two years. In Canada, the Auditor General is required by section 7 of the *Auditor General Act* to present an annual report to Parliament. The Comptroller and Auditor General tables value for money audits as they are completed and thus produces some fifty such audits annually. Approximately three times a year, the incumbent informs the Public Accounts Committee of the value for money audits to be tabled in the near future, so that the Committee is able to plan its activities well in advance.

In light of the British experience, the Public Accounts Committee believes that the future Auditor General of Canada should be appointed following consultations with the Chairman of the Public Accounts Committee. This procedure would enhance the independence of the Auditor General.

The Committee is of the view that the Office of the Auditor General of Canada should be able to table reports as soon as they are completed or as it considers appropriate. The British experience has confirmed to the Public Accounts Committee that regular tabling of reports and the constant media attention would encourage senior managers to manage public funds more efficiently and to react more rapidly to the observations of the Auditor General and the Committee.

Consequently, the Public Accounts Committee recommends

that Canada's *Auditor General Act* be amended to allow the Auditor General's comprehensive audits to be tabled, on a timely and appropriate basis, rather than waiting for their publication in the form of chapters in an annual report.

The Public Accounts Committee

This Committee studies about 40 of the 50 reports put out by the National Audit Office as these are presented to Parliament and publishes a report on almost every subject reviewed. These Committee reports are drafted by the same people who carried out the comprehensive audit.

Observations

The Canadian Public Accounts Committee finds this situation (sometimes described as ``incestuous") potentially dangerous, since it undermines the Committee's independence. The Public Accounts Committee is of the view that it is necessary to maintain current procedures, whereby research staff are independent of the Office of the Auditor General. Emulating the British government in this regard would turn the Public Accounts Committee into the parliamentary branch of the Office of the Auditor General of Canada.

The Public Accounts Commission

The Public Accounts Commission has no Canadian equivalent. Composed of nine members who meet on occasion, its primary role is to examine the estimates of the National Audit Office, and to report to the House of Commons in consultation with the Public Accounts Committee and the Treasury Office. The National Audit Office presents a five-year corporate plan to the Commission. The officials and politicians that we met in London considered it normal that Parliament alone, through the Commission, should decide on the resources required for the smooth operation of the Office, since the Comptroller and Auditor General is a servant of the British Parliament. Moreover, its budget requirements are set by the organization itself. The British Treasury has no control over the preparation of the operating budget. Among other important functions, the Public Accounts Commission is involved in the process of appointing and setting the salary of the Comptroller and Auditor General. It also prepares an annual report in which it assesses the work of the Office and selects the firm that will be in charge of auditing it. The Chairman of the Commission is also responsible for responding in the House to questions addressed to the Comptroller and Auditor General.

Observations

The Canadian Public Accounts Committee feels that the Public Accounts Commission ensures a certain degree of independence that would be healthy in the Canadian context. In fact, the Committee is of the view that serious thought should be given to setting up such a parliamentary commission that would be charged with evaluating-independently and far from any political interference-the budget requirements of the Office of the Auditor General, rather than leaving this task up to the government. The Commission would evaluate the performance of the Office of the Auditor General of Canada and would participate in the selection of the Auditor General.

The Role of the Accounting Officer

The functions of Accounting Officer are usually performed by a department's Permanent Secretary or the Second Permanent Secretary, or, in the case of an agency, by the Chief Executive Officer whose primary responsibility is to ensure that expenditures are carried out according to the wishes of Parliament, avoiding waste and with due regard for prudence and economy. The Officer reports to the minister, who is ultimately responsible to Parliament for government's policies and the management of the organization. The Officer's duties boil down to signing appropriation accounts and other accounts assigned and tabling them in Parliament as required, to ensure that sound financial practices are followed and that books are kept correctly. The Officer must also ensure that the public funds and capital for which he is responsible are correctly managed. To carry out these functions, the Accounting Officer must have a clear view of the organization's objectives, performance measurement tools, and, in particular, information about costs. The Accounting Officer must also have clearly defined objectives and responsibilities in order to optimize the use of resources; he must also ensure that the financial impact of any new policy is appropriately measured according to value for money criteria with financial considerations being brought to the attention of the minister responsible. The Officer may even go so far as recording, in writing, his objections to a project; these objections must also be sent to the Comptroller and Auditor General. Responsible for resource

optimization and effective management, the Accounting Officer is a key witness to the Public Accounts Committee and responds on behalf of the department or agency, except in cases where he has put his objections to a specific project in writing.

Observations

These discussions highlighted the importance of making senior officials accountable for the management of public funds in accordance with established rules and with the obligation to report to Parliament. The Public Accounts Committee feels there would be no advantage in having an accounting officer in Canada, as long as the deputy ministers comply absolutely with the policies and standards established by the central agencies.

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 and Evidence (Issue No. 41 which includes this Report)* is tabled.

Respectfully submitted,

JEAN-ROBERT GAUTHIER

Chairman.

REPORT TO THE HOUSE

Friday, April 23, 1993

The Standing Committee on Public Accounts has the honour to present its

TWELFTH REPORT

Pursuant to Standing Order 108(3)(e), the Committee has examined paragraphs 2.28 to 2.61 of the Report of the Auditor General for 1992, which deal with tax arrangements for foreign affiliates.

Introduction

The *Auditor General Act* clearly defines the mandate of the Auditor General of Canada concerning any threat to the integrity of the tax base. Under section 7, the Auditor General of Canada must, in his annual report, "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 ... the rules and procedures applied have been insufficient to ... secure an effective check on the

assessment, collection and proper allocation of the revenue". According to the Auditor General, the tax avoidance measures used by certain corporations that operate subsidiaries abroad in order to minimize the tax payable are undermining the integrity of the tax system.

On the strength of this mandate, the Auditor General considered it important to call attention to the fact that, because of the tax arrangements for foreign affiliates, Canada has likely lost hundreds of millions of dollars in tax revenue.

The ingenuity of the several hundred taxpayers involved seems limitless, and the Committee is concerned that a number of businesses are succeeding in obtaining undue tax benefits.

It is also important to point out that it is not so much the Auditor General's observations, which are disturbing to say the least, that led the Committee to study this question in greater depth, but rather the tone of the long commentary by the Department of Finance in response to the Report of the Auditor General. The almost arrogant self-assurance with which the Department of Finance rejected the Auditor General's comments encouraged the Committee to fully explore the question of the taxing of foreign subsidiaries and consult some expert witnesses.

Background

The Auditor General raised a number of concerns about the tax arrangements for foreign affiliates. In his view, the resulting loss of revenue could well be considerable.

In his annual report, he shows that Canadian corporations have received nearly \$600 million in the form of tax-exempt dividends from Barbados, Cyprus, Ireland, Liberia, the Netherlands and Switzerland. These observations are based on Revenue Canada's T106 data base. According to the Auditor General, that represents a loss of about \$240 million in tax revenue for Canada, since the other countries have not collected any tax on those amounts. On March 11, 1993, the Department of Finance sent the Committee a letter pointing out an error in the T106 data base. This correction affects only the estimate of dividends received from the designated countries where tax is collected at rates similar to Canadian rates. The estimate of dividends received from certain designated countries where the tax rates are low therefore remains unchanged. Discovery of this error in the Revenue Canada data does not change the substance of the Auditor General's comments. Actually, the error seems to increase his concerns, since the dividends received from certain designated countries that have low tax rates now represent 23 per cent of total dividends received rather than 14 per cent.

There is no doubt that the system for taxing foreign subsidiaries is essentially equitable and appropriate. Brian Arnold, of the University of Western Ontario, stated that "... I think the fundamental structure of our tax system for taxing foreign source income of Canadian multinationals is correct, fundamentally sound." (*Minutes of Proceedings and Evidence, Issue No. 40, p. 22*) He had previously stated that the "... current system for taxing foreign affiliates... is satisfactory and working reasonably well." (*ibid.*, p. 6) The

Committee also admits that many international transactions involving foreign subsidiaries do not undermine the current provisions of the *Income Tax Act* .

In the Committee's view, however, the fact that many of these transactions comply with the provisions of the Act, and hence are completely legal, does not mean that the rules should not be changed. Brian Arnold added that, even though the tax system was working well, that "does not mean that there aren't some things that can be done to improve it." (*ibid* ., p. 6) The Committee feels that a number of tax avoidance schemes are not justifiable and run counter to Parliament's intention and the objectives of the *Income Tax Act* . In this report, the Committee therefore recommends certain amendments with respect to the taxing of foreign subsidiaries that would make the Act consistent with the intention of Parliament and would in all likelihood put an end to much of the fiscal erosion.

Significance of the tax losses

Since the Department of Finance rejected the Auditor General's conclusions in their entirety, and since the parties concerned disagree on the significance of the amounts involved, the Committee on Public Accounts recommended in its tenth report to the House that the two parties attempt to reach agreement on the nature and scope of the problem of these fiscal arrangements.

In response to the Committee's request, the Auditor General indicated on December 8, 1992, that his Office and the Department of Finance had agreed that the tax arrangements for foreign affiliates could erode the tax base. He did mention that they still could not agree on the amount of tax revenue already lost.

According to the Department of Finance, in a dynamic universe, any change to the tax regime would result in significant changes in the behaviour of taxpayers, who would find other ways of avoiding tax. As a result, there would not be any additional income to tax.

A number of witnesses said that we should not expect to collect any additional revenue from taxing the foreign activities of Canadian multinationals.

First, the Committee considers that the integrity of Canada's tax base must be protected. Brian Arnold said: "It is ... protecting the domestic tax base. It is not trying to raise revenue from these foreign-source activities of Canadian-based multinationals, because you will have enormous difficulty in collecting any significant revenue from that activity." (*ibid* ., p. 9)

Second, the Committee thinks that care must also be taken to keep the tax system fair and equitable, and that there is no reason, in our tax regime, why income earned in a tax haven should be given preferential treatment over income earned in Canada and subject to Canadian tax. The Department of Finance has pointed out several times that the tax system must protect the competitiveness of Canadian firms. However, the Committee considers that offering Canadian multinationals a double deduction of interest costs, in order to maintain a degree of competitiveness, makes the tax system unfair. Offering

multinationals a subsidy disguised as preferential tax treatment, without doing the same for other Canadian firms that do not have operations abroad, makes the tax system unfair.

List of designated countries and tax havens

Canadian multinationals must remain viable and competitive, retaining the power to bring back to Canada, tax-free, active income earned by foreign subsidiaries that are actively carrying on business in a country with which Canada has signed a tax treaty.

However, the Auditor General points out that it often happens that certain multinationals abuse the rules that permit a Canadian firm to repatriate, on a tax-exempt basis, income from an active business, by using the tax havens mentioned in the list of designated countries. This means that we are allowing into Canada earned income that is not taxed or is taxed at a lower rate.

The Deputy Minister of Finance, David Dodge, told the Committee: "All countries with which Canada has concluded tax treaties impose corporate taxes at significant rates." (*Minutes of Proceedings and Evidence, Issue No. 37, p. 13*) However, an exception is made in the case of developing countries: "Canada, as a matter of policy, has long maintained the habit of accommodating such concessions provided by Third World countries and not frustrating them by taxing income that has benefited from their fiscal incentives." (*ibid*, p. 13) The Deputy Minister continued by stating:

As part of our general policy toward economic development in lesser developed countries, ... we have undertaken, along with most OECD countries, to not offset through our tax system fiscal incentives they provide to try to increase incomes in very low-income economies. (*ibid*, p. 23)

The Committee does not accept the words of the Department of Finance when it questions the good faith of a number of foreign subsidiaries of Canadian corporations working in these developing countries that are considered tax havens. Brian Arnold contradicted the Department of Finance when he told the Committee the following:

There is no real business being done in most of these tax havens... generally... we are talking about banking services. The banks and the local professional community will benefit to a certain extent, but for the most part there are not real activities. These companies are conduits. The money is actually being invested elsewhere. (*Minutes of Proceedings and Evidence, Issue No. 40, p. 20*)

Thus the list of designated countries must be reviewed regularly. Brian Arnold suggested removing all countries that do not have tax treaties. Even the Department of Finance seems to agree with this proposal: one of its representatives told the Committee: "When it becomes obvious that we will not be in a position to conclude negotiations [with those countries], clearly consideration should be given to taking them off the list." (*Minutes of Proceedings and Evidence, Issue No. 38, p. 35*) Robert Brown of Price Waterhouse supported the view of Brian Arnold when he said: "[The list] is not quite meeting that challenge, and it would be appropriate to review it and to consider whether some of the

countries on it should be on it." (*Minutes of Proceedings and Evidence, Issue No. 43, p. 10*) This review of the list of designated countries would have little effect on the competitiveness of Canadian multinationals. In this connection Robert Brown said: "So while taking a few islands off the list might be something that could be considered, it will not alter the position of Canadian corporations, and it will also not change the fact that there are differences between the Canadian tax system and other systems". (*ibid* . p. 10)

The Public Accounts Committee accordingly recommends

A) that the Department of Finance immediately, and regularly thereafter, review the list of designated countries given in Regulation 5907(11) made under the Income Tax Act to remove all countries with which Canada has not signed a tax treaty or with which the negotiations will likely be impossible to conclude;

B) that the Department of Finance assess the merits of being able to bring back to Canada tax-exempt all income from subsidiaries operating in these tax havens.

Foreign Accrual Property Income (FAPI) and active foreign business income

The foreign accrual property income (FAPI) rules are an anti-avoidance measure. However, these rules are currently being used to divert abroad income of Canadian corporations, to convert income from Canadian businesses into tax-exempt income, or to transfer foreign subsidiary losses to Canadian parent corporations.

The difficulty in administering these rules lies in the fact that the Department of Finance has not yet defined the term "active business income". However, Revenue Canada has pointed the problem out to the Department of Finance a number of times.

The lack of a precise definition is a matter for concern. The Committee wonders how the General Anti-Avoidance Rule can be applied when the term "active income" has never been defined. The Committee considers that something that is implicitly permitted by the *Income Tax Act* cannot be prohibited. Amending the Act to clarify what is meant by active income would not weaken the rule of taxing income from foreign sources, and it would put an end to the tax avoidance schemes that are eroding the Canadian tax base. Brian Arnold also stated on this subject that "those rules [FAPI] need to be modified, strengthened, expanded in order to make them work more effectively. I think those changes would mean you would raise more revenue or you would not lose as much revenue elsewhere in your system." (*Minutes of Proceedings and Evidence, Issue No. 40, p. 10*)

Contrary to what some witnesses have said, the Committee also considers that the responsibility for finding the right definition should not be left to the courts. It is time to act. Since there is no question of changing the basic structure of the rules, the Committee thinks that definitions can be developed. Even the Department of Finance agrees on the nature of the problem, since it stated: "the essential problem is one of finding out what the definition should be." (*Minutes of Proceedings and Evidence, Issue No. 37, p. 28*)

The Committee accordingly recommends

A) that the Department of Finance immediately clarify what constitutes active business income in the context of the rules on foreign accrual property income;

B) that the necessary amendments be made to the *Income Tax Act* to protect the integrity of Canada's tax base.

The FAPI rules and transferring foreign losses to Canada

One of the provisions in the FAPI rules permits corporations to deduct, from the passive investment income of subsidiaries operating abroad, losses that are not incurred in Canada. The Committee considers that it is not this type of transaction that Parliament wanted to promote in adopting the FAPI rules.

Besides, Brian Arnold said the following on this subject: "I know of no other country that permits active business losses in a foreign affiliate to be offset against passive investment income of the foreign affiliate." (*Minutes of Proceedings and Evidence, Issue No. 40, p. 11*) Robert Brown also stated that "there would certainly be some questions about the appropriateness [of such measures]." (*Minutes of Proceedings and Evidence, Issue No. 43, p. 6*) He also indicated that this change would not harm Canada's competitive position or encourage Canadian firms to leave the country. He did not think that "it would lead to any massive outflow of Canadian corporations." (*ibid.*, p. 16) According to Allan R. Lanthier of the Canadian Institute of Chartered Accountants, the General Anti-Avoidance Rule could not prevent the transfer of foreign losses to Canada.

The Committee considers that amending the *Income Tax Act* would protect our tax base without affecting the competitiveness of Canadian corporations in any way.

The Committee accordingly recommends

that the *Income Tax Act* be amended to prevent Canadian corporations operating subsidiaries abroad from using the tax losses of those subsidiaries to reduce their taxable income in Canada.

Interest deductibility and transfer prices

The Act permits Canadian businesses to deduct interest charges on amounts borrowed and invested in foreign subsidiaries. Concerning these interest charges, which are deductible for tax purposes without the need to take into account the relative income of the foreign subsidiaries, the Committee thinks that we should move cautiously. The situation certainly gives cause for concern, because some taxpayers are successfully using it to obtain several interest deductions for the same transaction. As Robert Brown pointed out: "the question of interest deductibility is a huge interrelated problem. You cannot deal successfully with the foreign aspects unless you take a view of the Canadian aspects, and that is an area in which I would certainly urge you to go slowly." (*ibid.*, p. 7)

The Committee accordingly recommends

A) that the Department of Finance study in depth the problem of interest deductibility before making changes to the *Income Tax Act*

B) that the Department send the Committee on Public Accounts the results of this study.

The question of interest deductibility is closely linked to that of transfer pricing. Capital is "property" with a price, for which the costs may be deducted for income tax purposes. The Department of Finance and Revenue Canada should therefore study in greater depth the question of transfer pricing (fair selling price for goods and services, including capital invested, to Canadian businesses by foreign affiliates). On this subject, Robert Brown stated: "Developments now occurring in other countries relating to transfer prices could undermine the Canadian revenue base if not successfully resisted by Canadian authorities." (*ibid.*, p. 6)

The Committee accordingly recommends

A) that the Department of Finance carefully study the problems associated with setting transfer prices;

B) that Revenue Canada strengthen its efforts on monitoring transfer prices.

Problems of communication between Revenue Canada and the Department of Finance

In paragraph 2.34 of his Annual Report for 1992, the Auditor General notes the following:

Tax arrangements for foreign affiliates are a concern for the Department of National Revenue-Taxation (NRT). On a number of occasions, NRT has advised the Department of Finance about concerns it has with existing legislation.

In its evidence before the Committee, Revenue Canada indicated that it had become more interested in this question, and the officials of the Department said they had reported some of their concerns to the Department of Finance.

Apparently, Revenue Canada several times made suggestions to the Department of Finance for amendments to the *Income Tax Act* in the area of foreign-source income. Also, on January 25, 1993, the senior advisor to the Deputy Minister of National Revenue, Robert Beith, sent the Committee a list of the changes that had been suggested to the Department of Finance.

The first recommendation reads as follows:

Consider interim budget amendments to the foreign affiliate rules, before reactivating and completing their in-depth study and review, to address the more obviously abusive tax practices in this area...

The Department of Finance seems to be simply ignoring the alarm when it is sounded. Obviously, there are communication problems between the two departments. If Revenue Canada is to be stricter in applying the foreign accrual property income rules, for example, the Department of Finance will have to be more receptive to its comments and give it the necessary tools.

In this respect Robert Brown said it was necessary to

[strengthen]... the communication between the Department of Finance and Revenue Canada on avoidance issues or issues which appear to result in anomalies or unfairnesses in the taxation of foreign-source income. I think it's important that this communication should be as direct and as continuous as possible. (*ibid* . p. 5)

Alan M. Schwartz, of the Canadian Bar Association, said that "there would be that internal tension between a tax collector and somebody who is standing back and looking at it from the point of view of the overall scheme." (*ibid* ., p. 30)

Also, Revenue Canada should have more and better qualified resources in order to be stricter in applying the *Income Tax Act* . Allan R. Lanthier said the following in that connection: "I fully endorse strong assessing policies on the part of Revenue Canada". (*ibid.*, p. 31). As Robert Brown pointed out: "You have to have effective legislation and you have to have an effective enforcement effort. The two of those will produce results". (*ibid* . p. 18)

The Committee therefore recommends:

A) that the Department of Finance and Revenue Canada jointly develop a specific policy for better communication and to fully take into account the observations and comments by Revenue Canada. The Committee on Public Accounts will request Revenue Canada to advise the Committee on any occasions on which observations or suggestions are rejected arbitrarily by the Department of Finance.

B) that Revenue Canada apply more aggressively the provisions of the *Income Tax Act* and its regulations (like the General Anti-Avoidance Rule). If necessary, the Department should hire additional qualified and experienced staff.

The General Anti-Avoidance Rule

In its evidence to the Committee in response to the remarks of the Auditor General, the Department of Finance congratulated itself on introducing the General Anti-Avoidance Rule (GAAR) in 1988, to protect the tax system from abuses. The Deputy Minister, David Dodge, stated the following in this connection:

to the extent the rules in the foreign affiliate area are abused by taxpayers, we believe the general anti-avoidance rule, introduced in 1988, will assist Revenue Canada in protecting against abusive transactions in the future. (*Minutes of Proceedings and Evidence, Issue No. 37, p. 15*)

However, the Auditor General, some expert witnesses and a number of tax experts doubt that this rule can in fact curb the abuses raised in the audit note. Brian Arnold had this to say on the subject: "I don't think the general anti-avoidance rule is a panacea for Revenue Canada in terms of dealing with abusive tax avoidance arrangements." (*Minutes of Proceedings and Evidence, Issue No. 40, p. 28*) Robert Brown supported Brian Arnold's statement in a way when he said: "I think in the general foreign affiliate area the GAAR rule would have only limited application ... I think in some areas it could have application, but it requires an aggressive enforcement action by Revenue Canada and some interpretation by the courts." (*Minutes of Proceedings and Evidence, Issue No. 43, p. 17*) It is important to note that the GAAR has never been applied.

The Committee therefore recommends

that the Department of Finance and Revenue Canada annually submit to the Committee on Public Accounts a report on the effectiveness of the General Anti-Avoidance Rule in thwarting the tax avoidance schemes used in connection with foreign affiliates.

Conclusion

The Committee on Public Accounts admits that it is very hard to reconcile incompatible policy objectives, but agrees that there is some logic in the present rules. Because of the globalization of trade and the capital market, international taxation is necessarily becoming more complex, and Canada has no choice but to adopt a competitive tax policy. It is therefore necessary constantly to ensure that the tax system is comparable to what exists in other OECD countries, if we do not want to hamper capital formation. Canadian corporations operating foreign subsidiaries must be able to take advantage of tax rules similar to those applying to other foreign corporations. As the Deputy Minister of Finance pointed out, "it would not make sense to impose on our companies the necessity to pay more taxes abroad than their competitors." (*Minutes of Proceedings and Evidence, Issue No. 38, p. 18*) The tax rules must strengthen the competitive position of Canadian businesses worldwide if we want to create high-value-added jobs in Canada.

As Robert Brown said: "It is important that the Canadian system for taxing international income should be fair, that it should provide a competitive environment for Canadian corporations to operate abroad, and that it should not create opportunities for the avoidance of Canadian tax on Canadian-source income." (*Minutes of Proceedings and Evidence, Issue No. 43, p. 5*) For example, we must avoid double taxation and facilitate the return of the income to Canada.

However, the Committee does not believe that the competitive position of Canadian businesses should be based on an unfair tax system that threatens to undermine Canada's tax base, as is the case now. On this subject, Brian Arnold stated the following:

We also want to have rules in place that stop Canadian-based multinationals, Canadian taxpayers generally, from trying to abuse that fundamental proposition, which is sound. But there needs to be limits on it. What we are really talking about here is how we should frame those limits. Right now there are some instances where the limits aren't working as well as they should, and we should fix those things up. (*Minutes of Proceedings and Evidence, Issue No. 40, p. 22*)

The Committee on Public Accounts is convinced that Parliament's intention was not to promote the international competitiveness of Canadian corporations through abusive or inappropriate tax avoidance practices. A number of tax arrangements for foreign corporations, which are currently tolerated, run counter to that intention.

The Department of Finance must therefore undertake to eliminate the abusive tax arrangements for foreign affiliates so as to protect the government's revenues and ensure that certain taxpayers will not be disadvantaged.

Though they are provisional in nature, these major amendments would finally give Revenue Canada the tools it needs to have Parliament's intention respected and protect the tax base. This is all the more important in a context of budget constraints and rationalization of public finances like the present one. The Committee on Public Accounts does not think that amendments to the current rules to stop the erosion of the tax base will cause a large number of Canadian businesses to move abroad, as the Department of Finance claims. According to the experts consulted, the necessary changes, with the exception of interest deductibility and transfer pricing, are relatively simple and will have no negative consequences. Brian Arnold said that it is not easy for a company to move its operations to another jurisdiction. The Committee also thinks that the changes suggested in this report would put an end to much of the erosion of the tax base without hampering the legal trade operations carried on abroad by Canadian taxpayers.

The Committee accordingly recommends

A) that the Department of Finance, even before completing the studies begun in 1987, undertake to amend the *Income Tax Act* provisionally to end the tax avoidance schemes used by Canadian corporations operating foreign subsidiaries, as recommended in this report;

B) that once the provisional measures are in place, the Department of Finance undertake to complete the studies begun in 1987 in order to develop specific amendments to the *Income Tax Act* designed to protect the integrity of the tax base in the long term;

C) that the Department of Finance continue to revise the legislative and regulatory measures, on an ongoing basis, to ensure that they are always adapted to the circumstances, to the evolution of tax laws in other countries and to the interpretations by the courts.

Finally, the government should ensure that all taxpayers and tax consultants have access to clear, complete, precise and accurate information concerning the taxation of foreign affiliates.

The Committee therefore recommends

that the Department of Finance commit itself to clarify the legal language relative to the *Income Tax Act* and to the taxation of foreign affiliates.

APPENDIX

April 22, 1993

Hon. Donald Frank Mazankowski
Minister of Finance
Room 209-S
Centre Block

Dear Minister:

In accordance with its mandate, the Standing Committee on Public Accounts examined paragraphs 2.28 to 2.61 of the Report of the Auditor General for 1992. At the meeting held on March 9, 1993, I asked the witnesses, Mr. Lanthier, Mr. Schwartz and Mr. Brown, whether they had had conversations or exchanges of views with your Department about their appearance before the Committee. In particular, I sought to know whether your Department had tried to influence the testimony of these experts in any way.

Although the witnesses stated that they had conversations with some officials in your Department, they all declared that they did not feel that the Department was trying to influence them. The Committee is concerned about this practice of communicating with witnesses before they appear at a Committee meeting.

Since much effort has been invested in its work, the Committee has no wish to see doubt cast on the relevance of the conclusions contained in its report because of such an intervention. In conclusion, the Committee would like to know what is the justification for this practice and how you explain proceeding in this manner.

I look forward to a prompt response.

Yours truly,

Jean-Robert Gauthier, M.P. Ottawa-Vanier

c.c.: Mr. David Dodge, Deputy Minister

Pursuant to Standing Order 109, the Committee requests the government to table an overall response to this report. However, given the extraordinary nature of the problem and the likelihood that Parliament will be dissolved before the expiry of the 150-day time limit prescribed in the Standing Orders, the Committee on Public Accounts would appreciate receiving a response from the government within 40 days of presentation of this report.

A copy of the relevant *Minutes of Proceedings and Evidence (Issues Nos. 37, 38, 40, 43 and 48 which includes this report)* is tabled.

Respectfully submitted,

JEAN-ROBERT GAUTHIER

Chairman.

REPORT TO THE HOUSE

Friday, April 23, 1993

The Standing Committee on Public Accounts has the honour to present its

THIRTEENTH REPORT

In accordance with the Order of Reference of Thursday, February 25, 1993, your Committee has considered Vote 35 under FINANCE in the Main Estimates for the fiscal year ending March 31, 1994, and reports the same.

A copy of the relevant Minutes of Proceedings and Evidence (*Issues No. 45 and No. 48 which includes this Report*) is tabled.

Respectfully submitted,

JEAN-ROBERT GAUTHIER

Chairman

REPORT TO THE HOUSE

Wednesday, June 9, 1993

The Standing Committee on Public Accounts has the honour to present its

FOURTEENTH REPORT

Pursuant to Standing Order 108(3)(e), the Committee has reviewed Chapter 9 of the 1992 Report of the Auditor General - Employment and Immigration Canada - Employment Monitoring Performance Against Expectations.

The Committee considers that the resources allocated to employment should, because of the pressures on today's labour market, increasingly be used for worker adjustment. In 1991-92, the Department of Employment and Immigration allocated \$2.858 billion to its Employment Activity Programs. These have an impact on the employment rate and thus on the economy, and interest in how they are managed is intensifying accordingly. It was with this in mind that the Committee focused on the question of the effectiveness of the Department's employment programs and its ability to promote the efficient and effective functioning of the Canadian labour market.

The Committee was pleased with the commitments made by the Department of Employment and Immigration according to the statement by Mr. François Pouliot, Associate Deputy Minister, of the Department's intention of expanding the scope of its program evaluations.

To ensure that evaluation of the interdependency of program components will be undertaken within a reasonable period of time, the Committee recommends

that the Department of Employment and Immigration submit a detailed calendar of its work plan within 60 days.

The Committee is not, however, entirely convinced that the Department is in a position to carry out this program evaluation successfully, as it does not seem to have all the tools required for the exercise.

In the Committee's view, in order to carry out appropriate performance monitoring, the Department must have reliable information on the results of its efforts. The Auditor General notes that the Department has had longstanding difficulty in developing and selecting performance indicators for its employment programs and services.

The Committee realizes that in a constantly evolving labour market the Department must frequently rethink its performance indicators. Nevertheless, the Committee considers that the Department should ensure that it has the means to meet this challenge.

Therefore, with a view to making possible better project monitoring, the Committee recommends

that the Department of Employment and Immigration improve program performance measurement

- by making available in a timely manner the necessary data already on hand for establishing performance indicators; and

- by developing new performance indicators corresponding to the various objectives for different programs, as these are initiated or modified.

A copy of the relevant *Minutes of Proceedings and Evidence (Issues No 53 and No 54 which includes this Report)* is tabled.

Respectfully submitted,

JEAN-ROBERT GAUTHIER

Chairman.

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

Introduction. 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 included in the President of the Treasury Board's annual report to Parliament, *Crown Corporations and Other Corporate Interests of Canada* .

Scope . In my annual Report to the House of Commons, I am required by subsection 152(2) of the *Financial Administration Act* to attest to the accuracy of the information contained in the President of the Treasury Board's report on tablings. Accordingly, I have examined the report for the year ended 31 July 1993, to be tabled not later than 31 December 1993*.

My examination included a review of the systems and procedures used by Treasury Board to monitor the tabling of the summaries and annual reports in each House of Parliament, a verification of the information contained in the report, and such other tests and procedures as I considered necessary in the circumstances.

Conclusion. I have concluded that the report on tablings contains all the required information about the timing of tabling, by the appropriate ministers, of Crown corporations' annual reports and summaries (and amendments to them) of corporate plans, capital budgets and operating budgets, and in my opinion, the information contained in the report is accurate in all significant respects.

L. Denis Desautels, FCA
Auditor General of Canada

OTTAWA, 13 October 1993

* Not tabled at time of going to press