

2004



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

MARCH

**A Message From
the Auditor General of Canada
Main Points**



Office of the Auditor General of Canada

The March 2004 Report of the Auditor General of Canada comprises seven chapters, and a Message from the Auditor General and Main Points. The main table of contents is found at the end of this publication.

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For copies of the Report or other Office of the Auditor General publications, contact

Office of the Auditor General of Canada
240 Sparks Street, Stop 10-1
Ottawa, Ontario
K1A 0G6

Telephone: (613) 952-0213, ext. 5000, or 1-888-761-5953

Fax: (613) 954-0696

E-mail: distribution@oag-bvg.gc.ca

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Auditor General of Canada
Vérificatrice générale du Canada

To the Honourable Speaker of the House of Commons:

I have the honour to transmit herewith my first Report of 2004 to the House of Commons, which is to be tabled in the House in accordance with the provisions of subsection 7(5) of the *Auditor General Act*.

This Report includes an addendum containing verbatim copies of environmental petitions and ministers' responses, received under the *Auditor General Act* from 19 July 2003 to 21 January 2004.

A handwritten signature in black ink that reads 'Sheila Fraser'.

Sheila Fraser, FCA
Auditor General of Canada

OTTAWA, 30 March 2004



**A Message From
the Auditor General
of Canada**



Sheila Fraser, FCA
Auditor General of Canada

A Message From the Auditor General of Canada

National Security in Canada—The 2001 Anti-Terrorism Initiative

One of the most important areas in which Canadians rely on the federal government to safeguard our well-being is national security. As individuals, we cannot monitor or influence national security on our own—we must look to the government to manage the risks that threaten our security and that of our families.

This report includes my Office's first broad look at national security since the unprecedented terrorist attacks on the United States on September 11, 2001. As Canadians will no doubt recall, the immediate impact on Canada included the shutdown of civil air transport and the grounding of hundreds of international air passengers in locations as far afield as Gander, Newfoundland and Whitehorse, Yukon. These events left many Canadians suddenly feeling vulnerable and insecure.

Soon after the attacks, the government responded with a number of related projects designed to improve Canadian security. It established the Ad Hoc Cabinet Committee on Public Security and Anti-Terrorism and, in the 2001 Budget, allocated \$7.7 billion in new funding to enhance security, emergency preparedness, and infrastructure at our borders. This new funding began in 2001–02 and was to continue for another five years.

Our audit focussed on the overall management of the initiative to enhance national security and the co-ordination of intelligence among departments and agencies—in particular, their ability to provide adequate information to enforcement personnel. It also examined several specific issues: the interoperability of security and intelligence information systems and the sharing of information; fingerprint identification systems; the use of watch lists for border control; and the security clearance of airport workers requiring access to restricted areas.

In December 2003, domestic security agencies were consolidated into a new department, Public Safety and Emergency Preparedness Canada. Our audit assessed the management of national security prior to this reorganization. We found that most proposals submitted by departments for funding under the initiative were directly linked to objectives announced in the Budget. However, we found no evidence that the Privy Council Office, the Department of Finance Canada, and the Treasury Board Secretariat had based their review and approval of departmental projects on a national threat and risk assessment—a tool that could have helped ensure that a project was not given a higher or a lower priority than was warranted. In some cases, projects funded appeared to be related to existing programs of public safety and defence and not a direct response to the threat of terrorism. At the same time, some projects clearly related to combatting terrorism were not fully funded.

Our audit also found deficiencies in the way intelligence is managed across government. A lack of co-ordination has led to some gaps and potential duplications in intelligence coverage. The government as a whole failed to adequately assess intelligence lessons learned from critical incidents such as September 11 and to develop and systematically follow up on needed improvements.

One of the main security challenges the government faces at ports of entry is allowing the free flow of goods and legitimate travellers while keeping terrorists out. Canadians want to know if the interconnected systems that contribute to border security are effective; those who travel want to know if the inconveniences caused by security measures do indeed contribute to greater security.

Up-to-date watch lists can help intercept terrorists and other criminals at our borders. However, we found that watch lists used by departments and agencies to screen visa applicants, refugee claimants, and travellers seeking to enter Canada have significant gaps and errors. Responsibility for watch lists is shared by several departments and agencies. We found an overall lack of quality control of this vital tool: no one is monitoring the accuracy and timeliness of the data across the several agencies involved. Furthermore, the 25,000 Canadian passports lost or stolen each year do not appear on border control watch lists, despite their potential for use by terrorists or other criminals. Missing names reduce the usefulness of watch lists as a security tool, and out-of-date information can inconvenience legitimate travellers unnecessarily.

We also concluded that applicants for clearance to restricted airport areas are not being checked against available intelligence databases. As a result, many individuals whose reliability is questionable have access to restricted areas. We asked the RCMP to review the files of a sample group that had been issued clearances by Transport Canada; 5.5 percent of those with access to restricted areas at five Canadian airports were found to have possible criminal associations that warrant further investigation and possibly withdrawal of their security clearances. If these results were generalized to the total number of people holding clearances at the five airports, the number warranting further investigation would amount to some 4,500 individuals. Spending on passenger and cargo security will be of limited value unless air transportation workers with access to aircraft are trustworthy.

On 12 December 2003, after we had completed most of our examination, the Prime Minister announced significant changes to departments and agencies involved in national security. These include the creation of Public Safety and Emergency Preparedness Canada, the Canada Border Services Agency, and the new position of National Security Advisor to the Prime Minister.

Overall, should Canadians be indignant about the government's management of national security in light of the specific deficiencies we found? Or should they be reassured that the federal government acted quickly and is on the

right track in its efforts to solve problems that became obvious only following September 11, 2001?

Clearly, the deficiencies we've noted are serious and need to be addressed on an urgent basis. At the same time, many things changed on September 11, 2001—our perception of risk, our feeling of vulnerability, our definition of national security and the amount of inconvenience we are prepared to tolerate in order to attain it—and Canada, like other governments around the world, must now adjust to new realities. It is worth noting that Canada's performance in managing national security in the past two and a half years is consistent with that of our international peers. Other countries, including the United States, have examined similar areas and have reported findings comparable with those of our audit.

National security is one of several areas of federal government responsibility considered in this Report that contribute directly to the well-being of Canadians. Other chapters focus on the regulation of medical devices, the regulation of plant biotechnology products, and the conduct of leading-edge scientific research.

Health Canada—Regulation of Medical Devices

Modern health care relies more and more on using medical devices—blood test kits, diagnostic imaging equipment, and heart valves, for example—to diagnose, treat, mitigate, and prevent diseases and medical conditions.

Along with the benefits they provide, medical devices carry some level of potential risk: their quality and safety can never be guaranteed absolutely. The public has limited control over those risks and must trust health care professionals and the manufacturers of medical devices to provide safe and effective products and services.

Under the *Food and Drug Act*, Health Canada is responsible for protecting the public from undue risks to health and safety. Thus, it must weigh the benefits of using medical devices against the associated risks to determine whether or not particular devices should be available to Canadians.

Our audit found that Health Canada has made good progress in managing risks before medical devices are made available for sale but needs to better manage risks after the products are on the market. It needs to adopt a more proactive inspection program to verify that industry is complying with regulations, and it needs to better manage the risks related to the sale of unlicensed medical devices.

An improved surveillance system is also required to provide timely, accurate, and complete information about adverse events after devices are in use. And once safety concerns are identified, there must be better communication with those who need this information.

Ultimately, we are concerned that Health Canada still does not have a comprehensive program in place to protect the health and safety of Canadians from the risks related to medical devices, even though it

committed to such a program over a decade ago. The failure to deliver such a program could translate into growing risks—of both injury to Canadians and liability to the Department.

Canadian Food Inspection Agency—Regulation of Plants with Novel Traits

In the past few years, Canada's biotechnology sector has seen rapid growth in the number of companies and in the number of their products and processes on the market. The federal government has identified biotechnology as key to the country's economic growth and international competitiveness and has invested heavily in its research, promotion, and regulation.

Biotechnology has been broadly defined as the use of biological processes, especially genetic manipulation, for industrial and other purposes. It can refer to traditional as well as modern processes. Modern biotechnology enables scientists to transfer specific genetic traits directly from one organism to another, including species that would not naturally interbreed. Concerns have been expressed about the potential social, ethical, and economic risks of modern biotechnology. There are also concerns about the potential impacts on the environment and the potential health effects of new products developed through biotechnology.

A strong regulatory framework is essential if Canada is to capitalize on the potential benefits of modern biotechnology while appropriately managing the potential risks. Our audit examined how the Canadian Food Inspection Agency regulates the environmental release of plants developed through modern biotechnology, which are included in a broad category called plants with novel traits. Approval of a plant with a novel trait that harms the environment or human health could undermine public confidence in the regulatory system.

Our audit identified weaknesses in how the Agency identifies and manages risks posed by the environmental release of plants with novel traits. For example, there is a risk that undeclared and undetected plants with novel traits are being imported into Canada and may therefore be escaping Canada's regulatory system. Our findings also suggest there is a risk that unapproved ornamental plants with novel traits could be present in Canada. Moreover, the Agency did not have complete documentary evidence to show how it evaluates the long-term harmful effects on the environment, as it is legally required to do, before authorizing the unconfined release of plants with novel traits.

Our findings provide an early warning signal that the Agency's regulatory processes for plants with novel traits need strengthening. This is especially important given that the Agency expects the next generation of plants with novel traits to pose new and more complex environmental risks.

National Research Council Canada—Management of Leading-Edge Research

The National Research Council (NRC) has earned international recognition in a broad diversity of scientific disciplines. It has a long history of scientific discoveries that contribute to the well-being of Canadians and others worldwide.

While most of the NRC's research is well-managed, our audit found that the leading-edge research funded predominantly by parliamentary appropriations is not subjected to a rigorous priority-setting framework at all the institutes under its umbrella. The NRC needs to review its corporate mechanisms for setting priorities to avoid an imbalance between its research activities and the funding it has available. Although it has had no increase in its core budget, it is currently launching several long-term initiatives that call for major increases in infrastructure and staff. At the same time, funding most of its existing activities is proving to be a challenge.

Strengthening governance and accountability would improve the NRC's ability to set priorities and manage its resources accordingly. Our audit found that the Governing Council is not fulfilling its duty to control and direct the work of the organization through the President as required under the *National Research Council Act*. The Governing Council's responsibilities are not defined clearly or well understood by Council members.

To be a leading research and development organization, the NRC must be able to continue recruiting and retaining highly qualified researchers. Yet a shortage of researchers is anticipated. The NRC has not yet assessed the risks or the opportunities in its human resources management in order to address future key challenges in research institutes. Further, the NRC needs a coherent and comprehensive action plan to implement its strategic direction.

After seven years of collecting and reporting data on its corporate performance, the NRC is continuing to improve its performance measurement and reporting through a new corporate framework. It now needs to strengthen and implement that framework and to address weaknesses in its performance report.

Managing Government: Using Financial Information

Programs and services that improve the well-being of Canadians need to be managed prudently if Canadians are to receive value for the money spent. Complete financial information and strong internal controls are vital components of the effective management and good stewardship of public funds.

After facing many challenges, and with considerable effort, the government prepared its 2003 summary financial statements on a full accrual basis of accounting. This achievement has made Canada a world leader among national governments in financial reporting.

This new basis for preparing financial information provides a more complete picture of the full financial scope of government activities and enables

legislators to hold the government more accountable for the stewardship of its assets, the full costs of its programs, and its ability to meet short-term and long-term financial obligations. Accrual financial information can also help improve decision making in departments and agencies by showing managers the full costs of providing programs and services.

The adoption of accrual accounting at the summary level was never intended as an end in itself but as part of a wider initiative to improve financial management and control in the federal government. We urge the government to take the next steps and incorporate financial information on an accrual basis in its daily decision making and its management and reporting practices. Departments must also strengthen their internal control systems. Integrated and comprehensive internal control systems play a significant role in ensuring that high-quality financial information is available.

In our view, it is time for the government to finally implement accrual appropriations and budgeting at the departmental level. Until government-wide and departmental budgeting, financial reporting, and appropriations are put on a common basis, effective use of financial management information in the government will not be achieved.

Canada Revenue Agency—Audits of Small and Medium Enterprises

As the trend to self-employment increases, small and medium-sized enterprises represent a growing segment of the economy—one that is most at risk of participation in the underground economy. The Canada Revenue Agency conducts audits of businesses in this sector to improve compliance with tax legislation, thus helping to protect the tax base for the benefit of all Canadians.

To carry out this important role adequately, the Agency needs to make several improvements. It needs an overall analysis of all threats to the tax base to determine whether its current resourcing decisions are the most appropriate for each of its compliance activities, including its audits of small and medium enterprises. An audit strategy that better reflects risk would allow the Agency to allocate its resources to the areas of highest risk and to intervene, where necessary, while reducing the burden on compliant taxpayers. Currently in the tax services offices, staffing for audits of small and medium enterprises is based on the gross revenue reported by the taxpayers served rather than on the level of risk and complexity of their tax files. The Agency's own studies indicate that many of the small and medium enterprises it has audited represented little or no risk.

The Agency does not have the information it needs to measure compliance over time and thereby assess the effectiveness of its activities. It has not yet tested the results of initiatives undertaken to strengthen compliance by small and medium enterprises with the goods and services tax and harmonized sales tax.

Although it has not yet completed a review to determine if the penalties provided for in tax legislation are improving compliance and increasing public confidence, the Agency has reduced the penalties on employers who are late

in remitting income taxes withheld from employee salaries. We also noted that the Agency did not have the legislative authority to reduce these penalties.

Managing Government: A Study of the Role of the Treasury Board and its Secretariat

The government has launched an ambitious agenda for strengthening management across the federal public sector—one that stresses managing in a manner that preserves public trust; enhances economy, efficiency, and effectiveness; and ensures accountability. The Treasury Board of Canada and its Secretariat play an important role in developing and overseeing the implementation of this agenda across departments.

To provide Parliament with information on the key challenges the government faces in translating this agenda into tangible improvements in management, we carried out the study included in this Report. It is the first step toward a longer-term audit plan for our Office, which will report in the coming years on how well the federal government's management agenda is being implemented.

