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Auditor General of Canada

to the House of Commons

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Chapter 8

Other Audit Observations

The April 2002 Report of the Auditor General of Canada comprises eight chapters, a Foreword 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

Ce document est également disponible en français.

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Chapter

8

Other Audit Observations

The work that led to the audit observations in this chapter was conducted in accordance with the legislative mandate, policies, and practices of the Office of the Auditor General of Canada. These policies and practices embrace the standards recommended by the Canadian Institute of Chartered Accountants.

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Other Audit Observations

Main Points

8.1 This chapter fulfils a special role in the Report. Other chapters normally report on value-for-money audits or on audits and studies that relate to operations of the government as a whole. Other Audit Observations discusses specific matters that have come to our attention during our financial and compliance audits of the Public Accounts of Canada, Crown corporations, and other entities, or during our value-for-money audits or audit work to follow up on third-party complaints.

8.2 This chapter covers the following:

- Health Canada and Public Works and Government Services Canada—Government contracting rules and regulations were not followed.
- National Defence—Military satellite communication system is unused and placed in storage.
- Canada Customs and Revenue Agency—Process for renewal of duty-free shop licences needs to be improved.
- Treasury Board Secretariat—Departments are paying hundreds of millions of dollars in grants before receiving Parliament's authorization.

8.3 Although audit observations report matters of significance, they should not be used as a basis for drawing conclusions about matters not examined.

Health Canada and Public Works and Government Services Canada

Government contracting rules and regulations were not followed

In brief

Health Canada and Public Works and Government Services Canada (PWGSC) did not follow government contracting rules and regulations when they spent over $25 million on the Canadian Health Network. Although a Web site was developed, there is no assurance that best value was received from this expenditure. Assets purchased were underused and overclaims were made.

Health Canada made commitments and entered into contracts to create a health information Web site without appropriately defining what the Department wanted or needed from the contractors or evaluating options for how best to achieve it.

In awarding these contracts, PWGSC, the contracting authority, failed to follow a number of government contracting rules and regulations. Furthermore, Health Canada transferred its responsibility for managing the initiative to the contractor without ensuring appropriate oversight. Program administration and contracting issues that arose could have been avoided if PWGSC had adhered to sound contracting practices.

Work was begun without a written contract; audits of contracts identified significant overclaims; and Health Canada failed to establish controls over assets purchased on the government's behalf.

Background

8.4 The Canadian Health Network grew out of four small clearing houses for health promotion information, which Health Canada funded prior to 1998. The clearing houses used "old" technology, disseminating information through telephone, fax, and mail.

8.5 After the 1994 Program Review, Health Canada attempted to integrate the four clearing houses into one. Originally service delivery was to be in the form of telephone responses and printed documents and developed into a Web site. The Canadian Health Network brings together expertise and knowledge found in Health Canada, other federal agencies, provinces and territories, non-government organizations, and universities, while maintaining individualized service and telephone access. The intent is to provide Canadians with single-window access to current, accurate, and reliable health information.

8.6 In the February 1997 Budget, the government announced new funding for developing the information highway. The Canadian Health Network was one of three Health Canada initiatives under the Canada Health Infostructure Partnership Program that were designed to give Canadians better access to health information.

8.7 The infostructure initiative involved a major shift from the clearing house concept to a Web-based approach to distributing health promotion information. This approach entailed vastly different requirements for hardware, software, and the capacity to manage more complex activities. For example, the number of affiliate organizations that were to provide health promotion information grew from 4 to 22, with up to 400 links to other organizations. After considering the option of using grants and contributions, Health Canada officials decided that contracting would be the most appropriate way to carry out the work required to put this initiative in place.

8.8 Health Canada hired the same contractors for the Web-based initiative as it had engaged to manage the original, smaller clearing house initiative (the Ontario Prevention Clearinghouse, until April 1998, and OPC–COIP Inc., carrying on business as Innovaction). It also let contracts for surveys and informatics to other contractors.

8.9 PWGSC, as the contracting authority, awarded the first contract we reviewed in January 1998. It continued to contract with suppliers through a series of 44 contracts and 25 amendments until November 2000 (Exhibit 8.1).

Exhibit 8.1 Contracting activity for the Canadian Health Network

Type of contract	Original contract		Amendment		Total
	Number	$ millions	Number	$ millions	$ millions
Survey	17	1.112	4	(0.064)	1.048
Informatics	15	2.600	11	3.980	6.580
Program management	12	10.477	10	7.344	17.821
	44	14.189	25	11.260	25.449*

* Does not include direct Health Canada or PWGSC costs.

Issues

Health Canada's planning and analysis of its contracting needs did not keep pace with initiative requirements

8.10 The major change in the infostructure initiative from a clearing house using a call centre to a more complex Web-based approach resulted in new requirements. Neither Health Canada nor PWGSC provided any evidence to show that they had evaluated the capabilities of the contractors to deliver on those new requirements. They continued to issue contracts for program management and informatics to the same contractors.

8.11 Health Canada did not have an overall plan that contained clear objectives and budgets for contracting out the initiative and that specified in detail the work that the contractors were to carry out. For example, we found no evidence of routine planning tasks such as assessing contractors'

immediate and longer-term needs for computer equipment and software. The Department also purchased a software package to help manage information and made major changes to it. Since 1998, Health Canada has invested more than $6 million in developing and maintaining a document management system. Officials believe that while there was some value in this system, they need to look for a more cost-effective and efficient way to provide this service. At the time of our audit, they were considering alternative software packages.

Health Canada allowed the contractors to work and incur costs without a written contract

8.12 The Treasury Board Secretariat's Contracting Policy states that terms and conditions of any contract issued pursuant to the Government Contracts Regulations and the Treasury Board Contracts Directive should be in writing.

8.13 Starting early in 1997, Health Canada made a number of commitments to the contractors, who by early 1998 became the prime contractors responsible for managing the Canadian Health Network initiative. These commitments promised significant funding to cover future expenditures related to the network. On the strength of these commitments and contrary to the Treasury Board Secretariat's Contracting Policy, the contractors started work without a written contract.

8.14 In a letter to the Department, one of the contractors stated that it had completed the feasibility study and, based on departmental direction, it had proceeded to invest further staff resources and make further commitments to purchase assets and arrangements for physical space.

8.15 This contractor requested, and Health Canada agreed in writing, that all costs it incurred that related to the further development (after 10 January 1997) of the national clearing house pilot would be assumed by Health Canada. In the absence of an appropriate contract, this agreement had no limitation in scope, timing, or amount. Contracts serve to set limits on these factors, thereby protecting the Crown.

8.16 In mid-1997, officials at Health Canada advised senior management that the contractors had incurred many costs that had not been covered by a contract, but they had done so because they assumed that they would receive a contribution of up to $1.3 million to develop, operate, and evaluate the pilot.

8.17 This is contrary to the Treasury Board Secretariat's Contracting Policy, which clearly requires that the terms and conditions of any contract be in writing.

Health Canada gave authority and responsibility for managing the initiative to the contractors

8.18 Health Canada's senior management allowed a management structure to evolve that gave the contractors the authority and responsibility that typically rests with the Department. The contractors were asked to assume many of the functions such as program management and operation and

administrative support. Most important, the contractors were allowed to make decisions about program management and informatics as well as make commitments to subcontractors on behalf of the government.

8.19 From June 1999 to November 2000, at which time the last contract ended, the contractor's representative held the title of Chief Executive Officer of the Integrated Management Structure of the Canadian Health Network. He sat on the Advisory Board of the network. As Chief Executive Officer, he was permitted to control many aspects of the initiative on behalf of the contractor. Under the management structure, he defined the requirements (for example, staff and equipment) and set deadlines and performance measures for what the contractor would deliver to the government. He also determined the level of funding requirements and got the Department's approval, and he chose subcontractors and negotiated their contracts. In effect, he was allowed to set his own terms and to act as if he had full authority to represent the government. This authority was not permitted in the contract.

8.20 In our view, many of the elements common to an employer/employee relationship seemed to be present in this arrangement, although we did not audit whether such a relationship had been created.

8.21 The contracts between Health Canada and the contractors were deficient in a number of key respects. They did not adequately specify the scope of work, milestones, and performance indicators. We also found that the subcontracts, like the prime contracts, were unclear about the scope of work, deliverables, milestones, and deadlines. Therefore, Health Canada had no way of either assessing the outputs or determining whether it had received good value for the money it spent.

8.22 These weaknesses are particularly significant given that most of the $17.8 million that Health Canada paid to the contractors was for subcontracts given to affiliates and regional operations centres.

Government rules and regulations were not followed

8.23 Two complementary principles are central to government contracting—best value and open access to contracting opportunities. The principle of best value is to ensure that in acquiring goods or services for the Crown, the government receives the best combination of value and price. The principle of open access gives all qualifying vendors a fair chance to do business with the Crown without political or bureaucratic favour. An open, competitive bidding process provides the best guarantee that both of these principles will be respected.

8.24 The Treasury Board Secretariat's Contracting Policy states that government contracting must be conducted in a manner that will meet the following requirements:

- stand the test of public scrutiny in matters of prudence and probity, facilitate access, encourage competition, and reflect fairness in the spending of public funds; and
- ensure the pre-eminence of operational requirements.

8.25 The contracting practices of Health Canada and PWGSC (Exhibit 8.2) did not reflect these principles and requirements. PWGSC awarded 27 contracts with 21 amendments for $24.4 million for program management and informatics. This amount excludes $1 million for surveys that were issued using standing offers. PWGSC used two methods to award these contracts. Some were awarded using advance contract award notices (ACANs). Others were awarded in a series of contracts for amounts less than $25,000.

8.26 The rules were broken in the use of ACANs. These are electronic notices to potential suppliers of goods and services advising them that the government intends to award a contract to a particular person or company. Under the Treasury Board Secretariat's Contracting Policy, other potential suppliers can challenge an ACAN. Exhibit 8.3 indicates the four circumstances or "exceptions" that allow a department to award a contract after posting an ACAN.

8.27 None of the contracts awarded using ACANs met any of the four exceptions stated in the Government Contracts Regulations and the Treasury Board Secretariat's Contracting Policy. Since they did not meet any of the allowed exceptions, PWGSC should not have set aside the requirement to solicit bids, and the contracts should have been open to the full competitive process.

8.28 Furthermore, the ACANs stated that the requirement was for "research and development—medical." This was not the case; rather, the services needed were related to managing programs, developing and maintaining a Web site, and identifying sources of health promotion information. Classifying the requirement as medical research and

Exhibit 8.2 **Contracting practices for the Canadian Health Network**

Contracts	Amendments	$ millions	Justification for limited tendering	Contract requirement	Contract method
Program management					
8	1	0.140	Less than $25,000	Commodity	Non-competitive
3	5	12.857	Exclusive rights	R&D—medical	ACAN
1	4	4.824	Government objectives	R&D—medical	ACAN
12	**10**	**17.821**			
Informatics					
8		0.194	Less than $25,000		Non-competitive
7	11	6.386	Exclusive rights	R&D—medical	ACAN
15	**11**	**6.580**			
27	**21**	**24.401**			

R&D—Research and development ACAN—Advance contract award notice

development could have discouraged suppliers who otherwise may have challenged the ACAN.

8.29 Another example of non-compliance with government rules and regulations is an ACAN that PWGSC published on 10 March 1998. This ACAN had a closing date of 20 March 1998 and was for the development, installation, and testing of a pilot telecommunications system—a multimedia call centre with Web integration. All work was to be completed by 31 March 1998. The ACAN did not meet the minimum government guideline of being posted for 15 days; nor did it meet any of the four exceptions. The contract therefore should have been open to the full competitive process.

8.30 On 31 March 1998, this contract for $300,000 was signed. It required that the contractor provide the telecommunications technology and training as contracted by 31 March 1998. PWGSC questioned Health Canada on how it was possible to meet this requirement in one day. Health Canada did not respond. PWGSC went ahead and issued the contract.

8.31 The remaining contracts were awarded for amounts less than $25,000 (contracts below $25,000 may be let without competition). The Treasury Board Secretariat's Contracting Policy states that contracting authorities (in this case PWGSC) must not split contracts or contract amendments to avoid

Exhibit 8.3 Four exceptions to soliciting bids

The Government Contracts Regulations outline four exceptions; the Treasury Board Secretariat's Contracting Policy elaborates on these exceptions.

Government Contracts Regulations	Treasury Board Secretariat's Contracting Policy*
Pressing emergency	Emergencies are normally unavoidable and require immediate action . . . . An emergency may be an actual or imminent life-threatening situation, a disaster that endangers the quality of life or has resulted in the loss of life, or one that may result in significant loss or damage to Crown property.
Value of less than $25,000	Specific dollar limit.
Not in the public interest	Should normally be reserved for dealing with security considerations or to alleviate some significant socio-economic disparity.
Only one person (firm) capable of performing the work	Should be invoked only where patent or copyright requirements, or technical compatibility factors and technological expertise, suggest that only one contractor exists. This exception should not be invoked simply because a proposed contractor is the only one known to management.

*According to the Contracting Policy, any use of the four exceptions should be fully justified on the contract file or, where applicable, in submissions to the Treasury Board.

Source: Government Contracts Regulations (Section 6) and Treasury Board Secretariat's Contracting Policy (Section 10.2.2 to 10.2.5)

Much of the expensive and specialized equipment Health Canada purchased was still in a warehouse.

Battery backup power source

Computer monitors

Computer network communication equipment

obtaining the necessary approvals. The policy describes contract splitting as the practice of unnecessarily dividing an aggregate requirement into a number of smaller contracts.

8.32 We found that a number of contracts for less than $25,000 were issued to the same contractors, for similar requirements and for the same project. Awarding the contracts in this manner allowed PWGSC to avoid the necessity of going through a competitive process.

Health Canada did not control and manage the assets that it provided to the contractor

8.33 Part V, section 62 of the *Financial Administration Act* states that the deputy minister of every department "shall maintain adequate records related to public property for which the department is responsible."

8.34 Health Canada had purchased directly or allowed the contractors to spend more than $2 million on leasehold improvements, computers, office furniture and equipment, and telephone systems. Some of these assets were not needed or used, and some were not used for their intended purposes.

8.35 Health Canada had not maintained a complete inventory listing of items purchased on its behalf. When the contract expired in November 2000, Health Canada took control of the assets that it could identify. In the absence of a complete record of the inventory, the Department was not able to determine whether all assets had been recovered. In addition, more than a year later, much of the expensive and specialized equipment purchased was still in a warehouse. The Department has recently started to identify potential users, with a view to redeploying equipment in the Department wherever possible.

Audits of Canadian Health Network contracts identified significant overclaims

8.36 The contractors submitted claims to Health Canada against the $17.8 million of signed contracts. These claims represented expenses that the contractors and their subcontractors had incurred. Claims covered items such as labour, materials, supplies, and large amounts of software, hardware, and miscellaneous items. PWGSC reviewed the claims and sent them to Health Canada for acceptance and payment.

8.37 Early in 2000, PWGSC decided to audit three contracts representing 98 percent of the total activity ($17.8 million) associated with program management contracts. This decision was a result of the following:

- Health Canada's continuing receipt of claims for progress payments that contained a large number of errors/omissions; and
- Health Canada's proposal to renew the contract for an additional $28 million.

8.38 PWGSC has now audited about $6.5 million in claims and identified more than $800,000 or 12 percent in overclaimed amounts. Audit work is still ongoing. Both departments have informed us that work is under way and that any overclaimed amounts will be dealt with once the PWGSC audits are finalized.

Health Canada has begun to take corrective action

8.39 In May 2000, senior management at Health Canada appointed an Executive Director to take charge of departmental interests related to the Canadian Health Network and deal with the growing number of concerns.

8.40 The Department has changed the management of the initiative in two key respects. First, it is now managing the network in-house, rather than contracting out. Second, it is providing funds to its affiliate organizations (formerly subcontractors) through contributions, not contracts. It is too early to know whether these changes will lower costs or improve the initiative's effectiveness.

8.41 Health Canada provided us with information indicating that it took action in October 2000 to review current departmental policies and procedures and the infrastructure regarding the management and use of government service contracts. The review was precipitated by the findings of the Internal Audit Directorate, our November 1999 Report, and the recommendations of the Standing Committee on Public Accounts.

8.42 In early 2002, Health Canada provided us with its action plan. We were encouraged to see that this plan addresses many aspects of contracting management. Key elements of the plan, including the scope, the role of senior management, and the commitment for an internal audit in 2003–04, will provide the basis upon which Health Canada will improve its contracting practices. We noted that the action plan does not include the need for proper up-front planning, supported by robust analysis. This is important because contracting should be pursued only if it is identified as the best option. The action plan also does not address the requirement to properly control and manage government assets.

8.43 We have shared our views on the action plan with the Department's officials, and they have made commitments to ensure that the final plan will address all of our concerns.

8.44 Health Canada recently began to implement the plan, and it has provided documentation to support what it had accomplished by the end of January 2002. A project manager has been hired and has started work. About 300 of the 1,600 employees who have contracting authority and were targeted for training have attended sessions organized by the Department. A course for members of the Contracting and Requisitioning Control Committee is also being developed.

8.45 The action plan includes an internal audit in 2003–04 to determine the effectiveness of the plan and the management systems, practices, and controls in Health Canada. We look forward to having an opportunity to review the internal audit report.

Conclusion

8.46 Health Canada allowed contractors to begin work without a written contract, on the basis of verbal commitments. PWGSC, as the contracting authority, should have taken steps to ensure that all the contracts issued were in accordance with the government rules and regulations. In the case of contracts that did not meet any of the allowed exceptions to the competitive process, PWGSC should not have set aside the requirement to solicit bids and the contracts should have been open to the full competitive process. In addition, Health Canada failed to maintain appropriate control over Crown-owned assets.

8.47 Health Canada has developed a plan through which it intends to strengthen contract management throughout the Department. The plan includes a commitment by the Department to have its Internal Audit Directorate carry out a review and report on the effectiveness of the plan's implementation. Our Office intends to review the scope of the work and findings once a report becomes available.

Health Canada's response. Health Canada senior management is committed to rigorous contract management practices across the Department. A comprehensive review was completed in April 2001 and an action plan developed. Implementation is well under way, with a Contract Management Framework and mandatory training as key components. The action plan deals with four major themes: responsibility, accountability, oversight and monitoring, and audit.

Audit team

Assistant Auditor General: Shahid Minto
Principal: Ronnie Campbell
Director: Jaak Vanker

Michael Leong
Rosemary Marenger

For information, please contact Communications at (613) 995-3708 or 1-888-761-5953 (toll-free).

National Defence

Military satellite communication system is unused and placed in storage

In brief

In 1991 National Defence contracted for a military very long-range communication system (VLRCS) to provide satellite communications to deployed forces. This system was completed in 1997–98 at a cost of $174 million. While it was being developed, National Defence purchased and leased commercial equipment to satisfy immediate international peacekeeping requirements. By the time the VLRCS was delivered, the Department regarded the commercial system as an alternative to the VLRCS. Furthermore, the VLRCS required an additional 50 people to operate it and an additional $15 million to bring it to current technical standards. National Defence therefore took delivery of the VLRCS but placed it in storage, where it remains. The Department has taken action to address most of the management deficiencies that contributed to the failure to field the VLRCS, but it still needs to ensure effective management oversight of major projects. In 1999 National Defence decided to examine the possibility of combining the two systems in order to meet requirements and obtain some value from its expenditure. A decision is expected in early 2002, but additional expenditures may be required.

Background

8.48 In 1991 National Defence started the Tactical Command, Control and Communication System (TCCCS) project to replace outdated army radio equipment with a secure, highly capable, and fully integrated communication system. The total cost estimated in 1991 was $1.85 billion, increased in 1994 to $1.9 billion. Delivery of equipment began in 1996 and will continue into 2002.

Tactical long-range communication terminal (TLRCT) in the field

Inside the TLRCT equipment shelter

8.49 The very long range communication system—a subcomponent of the TCCCS project—was purchased to modernize and extend the range and capability of communication systems among deployed units by using satellite communications. The system comprised medium- and long-range terminals deployed in the field, and strategic gateways located in Canada that connected Canada with the deployed terminals. It was conceived and designed as a closed military system, capable of battlefield use and meeting the requirements of both departmental strategic communications and the Army; as such, it was protected against nuclear, chemical, and biological agents. It was mobile, transportable, and interoperable within the Canadian Forces and with other allied forces, using both military and commercial satellites. National Defence was to provide manning, maintenance, and training. The Defence Information Services Organization, now the Information Management Group, agreed to man the gateway installations in Canada and to provide life cycle material management support for the complete system.

8.50 The VLRCS was delivered for about $174 million. After several alterations and changes, due to funding constraints and the merging of the Army's and the Information Management Group's strategic requirements, the system included two gateway equipment suites valued at $38 million, 17 tactical long-range communication terminals (TLRCTs) valued at $126 million, and nine high-frequency mobile communication terminals (MCTs) valued at $10 million. All MCTs and four TLRCTs were to be delivered to the Army, while 13 TLRCTs and both gateway suites were to be supplied to the Information Management Group.

8.51 However, with the exception of the MCTs, which are all in use, the Department never fielded the VLRCS. In a series of decisions in 1997, 1998, and 1999, National Defence took delivery of the TLRCT and gateway suites and placed them in storage, where they remain. At this point, the Department has spent $164 million on equipment that has not yet been used, although it was paid for in 1995–96.

Issues

Causal factors

8.52 We have identified a number of causal factors that have led to the situation outlined above.

8.53 **Requirement undefined.** The initial decision to incorporate the VLRCS requirement in the TCCCS project, before a concept of operations was developed and before design and definition were completed, resulted in numerous changes to the requirement and to the concept of employment. Changes continued until 1995. It appears that the Information Management Group never defined the capability it required. This is part of the reason why proof-of-concept studies are still being worked on today.

8.54 **Lack of separate project review and approval.** Managing TCCCS as an umbrella project rather than an omnibus project created a project structure that made departmental oversight and review of individual parts difficult. If TCCCS had been managed as an omnibus project, preliminary approval would have been granted for the overall project; then separate approval would have been required for each major component. Costing almost $200 million, the VLRCS project was large enough to be considered a major Crown project in its own right. Individual management of major components would have allowed more time for definition and would not have locked the project into a fixed-cost solution before definition was completed. It would also have provided more review and control, as each component would have become visible during the approval process.

8.55 **Failure to adjust requirements.** When it became apparent that the commercial system, which was being used to support overseas deployments, was operationally effective and less expensive to operate than the VLRCS, the Department should have revisited the policy requirement for a military system, the rationale for procuring the VLRCS. Conversely, the Department failed to accommodate the policy requirement for a military communications capability when the decision was made not to field the VLRCS.

8.56 **Failure to integrate competing systems.** The Department should have developed a transition plan to integrate the two systems as the VLRCS neared completion, or it should have determined a course of action for the future once it knew there would be two competing capabilities. This should have been undertaken during 1996–97, before the VLRCS was completed. Unwilling to make a decision to cancel the program, the Department waited until delivery before examining its options to redress the problem.

8.57 **Divided responsibility.** A divided responsibility and accountability framework split the requirement between managers and separated the management of the project from the client base and technical expertise. As a result, the Information Management Group developed its own system in isolation to meet urgent requirements, and it did not develop the transition plan required for integrating the two systems. Furthermore, the Army was left in an untenable position for funding when the Group decided not to field the system.

8.58 **Lack of independent management review and oversight.** If an independent review had been conducted at the corporate level, the issue of cancellation or transition might have been raised to senior management for a decision earlier in the process. Although the question of cancellation/termination had been discussed and rejected by the Senior Review Board as early as 1995, it appears that the issue of not fielding the VLRCS was presented to the Program Management Board only in February 1999.

8.59 **External factors.** There were two other causal factors that influenced decision making and over which the Department did not have control. One was the changing strategic environment, which led to overseas deployments in peacekeeping operations as opposed to war fighting, and therefore lessened the demand for mobile, hardened military systems. The other factor was the dramatic cuts in budgets and personnel that occurred throughout the mid-1990s. As a direct result of these cuts, the Information Management Group decided not to field the gateway component of the system because of the requirement for 50 people to operate the equipment. It also decided not to fund the $15 million needed to upgrade the TLRCTs to current technical standards in 1999, and it placed both components in storage.

Lessons learned by National Defence

8.60 The Department learned a number of lessons, especially involving the management of high-technology projects. These lessons relate, in part, to the government process of evolutionary procurement; this is a phased approach that focusses on the end product being acquired to meet a capability deficiency, with off ramps for each phase. The process helps to ensure that definition of each phase is completed before funds are allocated for implementation. It also reduces the likelihood of technology overtaking projects, and it should increase project visibility and managerial responsibility. The Department recently adopted this approach for managing the Canadian Forces Command System Project, and that should help avoid the problems that resulted from the initial departmental decisions in managing the VLRCS project.

8.61 National Defence has also taken steps to reduce risk and improve the efficiency of its acquisition process in general and its information management projects in particular. The Department published an Acquisition Reform Guide in February 1999. Under these reforms, commercial off-the-shelf procurement will become the norm for information management projects. Should development be required for unique military needs, a new procurement concept has been put in place that focusses on allowing industry to provide solutions to a capability deficiency. The Information Management Group has also made a number of conceptual, policy, and organizational changes, which should provide for more visibility and managerial control over information projects and ensure department-wide co-ordination among users. These changes should help prevent a recurrence of the problems in adjusting requirements and in accountability.

8.62 The issue of transition planning is also being addressed. The Department is currently completing a proposal to develop a hybrid system, incorporating the best aspects of both systems it acquired. It completed engineering studies, trials, and assessments during 2001, along with technical feasibility studies, implementation studies, and operations and maintenance cost studies. The Information Management Group is finalizing the options analysis package, which will include the costs of integrating this hybrid system into its strategic structure. While this initiative is four or five years late, it may lead to most of the TLRCTs being used.

8.63 This project raises questions about the structure of senior review boards and their effectiveness. The senior review boards are meant to provide oversight of major projects, but they are chaired by senior officials with management responsibility for the same projects they are overseeing. Board members may therefore be hesitant to formally identify problems. The Vice Chief of the Defence Staff has already expressed the need for senior review boards to provide rigorous examination of projects. He also stated that they are to deal with all project issues and to provide full and open departmental review of projects.

8.64 The Department has strengthened corporate review. By the late 1990s, the Director General, Strategic Planning and the Chief, Review Services had filled the vacuum left by the closing of the Program Branch in 1992. For example, in 1999 at a Senior Review Board meeting, the Director General, concerned about the Information Management Group's decision not to field the VLRCS, called for an audit of the decision. This was the first time this review mechanism had been used. The Department needs to ensure that senior analytical and audit staff continue to be involved in senior review boards. In addition, the Department needs to consider the composition of senior review boards to ensure that they are sufficiently independent from the management of the projects they oversee.

Conclusion

8.65 In the late 1990s, National Defence acquired the VLRCS, a satellite communication system for $174 million. Although one component is in service—the mobile communication terminals, which cost a total of $10 million—the rest of the system has never been fielded and currently sits in storage. National Defence later decided to examine the possibility of defining a hybrid system, essentially combining both the VLRCS and the commercial system that the Department acquired and is using. Such a system would respond to increased communication requirements resulting from new operational deployments and increased demand. A decision on the hybrid system is expected in 2002.

8.66 National Defence paid $164 million for components of a military satellite communication system and has yet to receive any value for this expenditure. Changes already made to the acquisition process and to the organization and management of information services should address a number of the systemic causes that produced this situation. The Department now needs to continue with the recommendations made by the Vice Chief of the Defence Staff to strengthen the independence and functioning of senior review boards.

Audit team

Assistant Auditor General: Hugh McRoberts
Principal: Peter Kasurak

For information, please contact Communications at (613) 995-3708 or 1-888-761-5953 (toll-free).

Canada Customs and Revenue Agency

Process for renewal of duty-free shop licences needs to be improved

In brief

The Canada Customs and Revenue Agency did not award a future duty-free shop licence through an open, competitive process upon expiration of the existing licence, despite a commitment in response to our 1997 Report. In 2000, the Agency advised us that at the end of a one-year extension, the licence would be tendered unless the results of the regulatory review dictated otherwise or the Minister decided at that time, for other reasons, that a tendering action was not appropriate. The Agency has now determined that tendering was not in the public interest and was no longer considered appropriate because the licensee was eligible for licence renewal, having met the regulatory requirements.

The initial award of most licences by the Canada Customs and Revenue Agency to operate duty-free shops has been consistent with the Agency's standards and practices. However, when these licences are renewed, the Agency does not always ensure that the shops continue to meet program requirements; nor is it consistent in ensuring the control of duty-free goods at the shops. Furthermore, not having carried out a formal program review or evaluation, the Agency does not know the extent to which the program is meeting its objectives.

Background

8.67 The Canada Customs and Revenue Agency is responsible for issuing and renewing licences to operate duty-free shops and for monitoring their ongoing operation. Currently, duty-free shops operate at 35 land border crossings and at 19 airports. Gross revenue for the shops is about $370 million annually.

8.68 The duty-free shop program is administered under the *Customs Act* and the Duty Free Shop Regulations. The Agency has also established policies and procedures for carrying out this responsibility.

8.69 In December 1997, we reported that in awarding duty-free shop licences at one location in 1995 and 1997, the Canada Customs and Revenue Agency (at that time Revenue Canada) had departed from its own standards and practices.

8.70 The Agency's position was that the applicants for the licences in question satisfied all requirements under the law and regulations as they pertain to the operation of duty-free shops at land border crossings. The Agency said that the decision to award the licences without recourse to an open tendering process complied fully with the law; however, it undertook to conduct a full review of the Duty Free Shop Regulations. The Agency also indicated that after the current licence expired, it would award any future licence at that site through an open, competitive process, notwithstanding any position the owners of the land might take in advance.

8.71 In 2000 we followed up on our December 1997 Report and the Agency advised us, "At the end of the one-year extension, the licence will be tendered unless the results of the regulatory review dictated otherwise or the Minister decided at that time, for other reasons, that a tendering action is not appropriate."

8.72 As a result of our observations in 1997, we reviewed the duty-free shop program to determine the Agency's practices in awarding licences and its ongoing controls and administration of the program. We reviewed files related to 36 of the 54 duty-free shops. In addition, we followed up on the Agency's actions in response to our 1997 audit.

Issues

Licences awarded at land border crossings were consistent with the Regulations and policies, but for licences at airports, assurance of meeting financial regulatory requirements is needed

8.73 The Duty Free Shop Regulations require that applicants to operate a licensed facility at a land border crossing be Canadian citizens or permanent residents of Canada. A corporation must be incorporated in Canada and all shares must be beneficially owned by Canadian citizens or permanent residents of Canada. The Agency's policies and procedures require that applications for establishing duty-free shops at land border crossings be invited by national advertisements. Successful applicants are selected on the basis of an evaluation and ranking of individual proposals. The proposals must provide detailed information in seven areas, as identified in the Regulations and policies. We found that all licences for duty-free shops at land border crossings, with the exception of awards discussed in our 1997 Report, met these requirements and were awarded in a manner consistent with the Agency's standards and practices.

8.74 The operators of duty-free shops at airports are selected by the local airport authorities, or by Transport Canada where the federal government operates the airport. The Canada Customs and Revenue Agency is responsible for issuing the licences to operate the shops. The Duty Free Shop Regulations require that applicants have "sufficient financial resources." This requirement is for both land border and airport shops. The Agency informed us that for airport shops it accepts proof of a lease as a demonstration of an applicant's ability to satisfy financial requirements under one part of the Regulations. It also stated that under the other part, the requirement for sufficient financial resources is minimal in an airport environment and thus there is no requirement to conduct a separate review of financial resources. We believe that the Agency needs to obtain assurance from the individual airport operators that their review of applicants' financial resources is sufficient to satisfy the regulatory requirements.

The Agency does not always ensure that all program requirements are met when renewing licences

8.75 The Agency's policies and procedures require that a performance evaluation be conducted when a licence comes up for renewal. The performance evaluation is to determine if the shop carried out its

undertakings and met program requirements. However, over time, the Agency has reduced the information requested from land border shops and no longer conducts the performance evaluation prior to renewing a licence. Further, the Agency does not conduct the required performance evaluations for airport shops and does not request that airport operators conduct the performance evaluations.

8.76 When a licence is to be renewed, a memorandum is prepared for the Minister with a recommendation for renewal. While regulatory requirements are verified, the Agency's policies and procedures for renewal of a licence require that audits be conducted annually. In three renewals we examined, the Minister had been informed that audits supported the decision to renew; in fact, no audits had been conducted in the previous two years or more prior to the renewals.

Audits of duty-free shops not conducted annually

8.77 The Agency has established reporting and control policies and procedures to ensure that products sold at duty-free shops are exported and do not avoid government taxes or harm the domestic market. The policies require that the Agency conduct an audit of each shop at least once a year.

8.78 We noted that the Agency did not conduct annual audits of the shops at 10 of the 28 border crossings we examined. We found no audit plan or risk assessment supporting the Agency's decision to deviate from its established policy and procedures. Nor is there a central control to ensure that audits are conducted and results reported.

The Agency has not measured the extent to which program objectives are being met

8.79 Section 26 of the *Customs Act* requires that "the operator of a duty-free shop shall ensure that the prices of goods offered for sale at the duty-free shop reflect the extent to which the goods have not been subject to duties and taxes." For the shops at land border crossings, the program objectives are as follows:

- to ensure that the operation of duty-free shops meets customs requirements and conforms generally with sound business practices;
- to provide economic benefits to Canada by promoting the sale of Canadian goods;
- to offer a popular service to the travelling public with significant levels of savings;
- to encourage small business private sector ownership of these shops; and
- to ensure a federal presence and create a positive image of Canadian identity.

The airport duty-free shops do not have similar objectives.

8.80 While the Agency has some information on program objectives, it has not conducted a formal program review or evaluation to determine the extent to which the requirement of the *Customs Act* and the objectives of the land border shops are being met.

The regulatory review did not clarify the issues discussed in our 1997 audit

8.81 As mentioned earlier, we followed up on the commitments the Agency made in 1997. In 1997 it said, "In light of the issues raised by the Auditor General with respect to conflicting interpretations of the regulations and the intent of the law, the Department has undertaken to pursue a full review of the Duty Free Regulations."

8.82 The Agency completed its review of the Duty Free Shop Regulations in May 2001. However, it did not clarify the issues of concern in our 1997 audit. It did not specify what constitutes beneficial ownership of a duty-free shop licence; nor did it clarify the requirement for a competitive tendering process and a clear and consistent approach to evaluating applications for new licences. While the review resulted in some changes to the program, the Agency did not take advantage of the opportunity to use its review to clarify the issues in our 1997 Report, which are important to the consistent, transparent, and effective administration of the program.

The Agency did not follow an open, competitive process in renewing the licence discussed in our 1997 report

8.83 In our 1997 Report, we noted that there were no national tender calls in awarding duty-free shop licences for one location in 1995 and 1997. An open and competitive process adds transparency to what is, in effect, the awarding of a licence to operate a monopoly at a site. In response to our 1997 audit, the Agency noted our concerns about the transparency and credibility of the process for awarding duty-free shop licences. It stated that upon expiration of the current licences, it intended to award any future duty-free licence at that site through an open, competitive process, notwithstanding any position the owners of the land might take in advance.

8.84 In 2000 we followed up on progress and reported our findings in our December 2000 Report to Parliament. In that report, we noted that the Agency had adopted the practice of renewing duty-free shop licences for a maximum one-year term when they expired prior to completion of the review of the Duty Free Shop Regulations. Therefore, the licence at the land border crossing referred to in our 1997 Report was to be renewed for a one-year term, in keeping with the adopted practice. At the end of the one-year extension, the licence was to be tendered unless the results of the regulatory review dictated otherwise or the Minister decided at that time, for other reasons, that a tendering action was not appropriate. The one-year extension expired in July 2001.

8.85 In June 2001, the Agency renewed this licence for five years to the same licensee without an open and competitive process. At the time of the renewal, in June 2001, the Minister of National Revenue advised the Auditor General, "As the licensee continued to meet all regulatory requirements, it is my view that there is no need to tender this site." The Minister also added that it was not in the public interest to undertake a time-consuming and costly tendering action. Further, the Agency's view now is that competitive

tendering was not appropriate for this licence because the licensee was eligible for licence renewal, having met the regulatory requirements.

Conclusion

8.86 With the exception of the two licences for a location discussed in our 1997 Report, the Agency awarded duty-free shop licences at land border crossings in a manner consistent with the Duty Free Shop Regulations and its own policies and procedures.

8.87 For airport shop licences, the Agency does not have an agreement or review process with the airport operators to confirm that the financial review conducted for purposes of granting the lease meets the regulatory requirement to ensure that shop operators have "sufficient financial resources." The Agency has stopped conducting performance evaluations prior to renewing a licence, and it is not consistent in auditing the control of duty-free goods at the shops. Furthermore, since the beginning of the program, about 15 years ago, the Agency has not determined the extent to which the requirement of section 26 of the *Customs Act* and the program's objectives are being met. Also, the Agency did not clarify the Regulations and the policies related to the issues raised in our 1997 audit, which are important to meeting the stated program objectives.

8.88 The Agency did not follow through on its commitment made in 1997 that on expiration of the current licence it would use an open, competitive process to award any future duty-free shop licence at that site. The reasons cited for not following an open, competitive process were that the licensee, having met the regulatory requirements, was eligible to request a renewal; and that it was not in the public interest to undertake tendering for this site.

Canada Customs and Revenue Agency's response. It is the position of the CCRA that as the licensee in question was eligible for the renewal of its duty-free shop licence, and as tendering was not in the public interest, the Minister of National Revenue acted within his rights to renew the licence as he did. This renewal reflected appropriate judgment in light of the unique circumstances of this case, and in no manner compromised the integrity of the Duty Free Shop Program. Furthermore, it should be clear that the CCRA's update in response to the Auditor General's December 2000 Report stressed that the tendering of the licence was subject to the results of the regulatory review or a decision by the Minister that tendering would not be appropriate for other reasons.

The Minister subsequently informed the Office of the Auditor General in a letter dated June 8, 2001 that, given the fact that the only suitable land for the shop would not be available to other potential bidders, the selection of the current operator was essentially predetermined; therefore, it would not be in the public interest to undertake a time-consuming and costly tendering action. Upon receipt and verification of the required renewal application against the regulatory requirements of the Duty Free Shop Program, the Minister decided not to follow a competitive process as committed to in 1997 and exercised his option to renew the licence for a five-year term.

The CCRA believes that it obtains adequate assurance of the ability of airport operators to meet financial regulatory requirements. Paragraph 3 (6) (*c*) of the Duty Free Shop Regulations states that the Minister will not issue a licence to an applicant unless "the applicant has sufficient financial resources to enable him to lease or purchase the place proposed to be operated as a duty-free shop." The CCRA accepts a copy of the lease itself as proof that this financial requirement has been met by an airport applicant.

Paragraph 3 (6) (*d*) states that the Minister will not issue a licence to an applicant unless "the applicant has sufficient financial resources to enable him to provide the facilities, equipment and personnel required under these regulations." The Regulations specify that a licensee shall provide public washrooms with disabled access and public telephones with disabled access. In the case of shops operating at airports, both these requirements are provided by the airport itself. The Regulations do not specify any requirements related to personnel or equipment. Therefore, the requirements of paragraph 3 (6) (*d*) do not apply in a meaningful way for airport applicants.

As financial requirements are minimal in an airport environment, and licensees are required to provide security to the CCRA before a licence will be issued, it is therefore the position of the CCRA that a more in-depth review of financial resources is not required.

The CCRA acknowledges that, since the inception of the Duty Free Shop Program, it has reduced the information it requests from land border shops and has adopted a less formal approach to evaluating performance prior to renewing a licence. The CCRA is satisfied that the information it currently obtains meets regulatory requirements and is sufficient to determine whether a licensee's performance has been acceptable. We have begun to update our policies, procedures, and internal form letters to reflect more accurately our current methods for assessing the eligibility of licencees for renewal.

The CCRA does not audit every shop on an annual basis. The Agency's policies will be reviewed to ensure that its audit program is providing appropriate coverage and that compliance verification is conducted on an effective risk management basis. Our policy and procedures will be adjusted to reflect the results of this review.

As part of its review of Duty Free Shop Regulations, the CCRA completed a thorough consultation process involving key private and public sector stakeholders, including information sessions to ensure that key issues were identified and addressed. Information gathered was analyzed, and a series of program models were developed in an effort to determine how the program could be enhanced to better achieve program goals. As a result of the regulatory review, a number of enhancements have been introduced in order to secure the best possible future for this program. The CCRA believes that, through the regulatory review, the Program has been closely scrutinized and opportunities to achieve program and administrative enhancements have been identified and are being put into practice. Therefore, the CCRA has no plans to undertake a further review of the Program at this time.

Audit team

Assistant Auditor General: Douglas Timmins
Principal: Ronnie Campbell
Director: Abid Raza

For information, please contact Communications at (613) 995-3708 or 1-888-761-5953 (toll-free).

Treasury Board Secretariat

Departments are paying hundreds of millions of dollars in grants before receiving Parliament's authorization

In brief

In accordance with the laws of Canada, all disbursements of public money must be authorized by Parliament through annual appropriation acts and other statutes. For decades, however, with the explicit approval of the Treasury Board, departments have been making grant payments before parliamentary authority has been granted. The Treasury Board has based its approval on Parliament's annual authorization of funds to supplement departmental appropriations and to provide for "miscellaneous minor and unforeseen expenses not otherwise provided for." This parliamentary authority is Vote 5, the Government Contingencies Vote, administered by the Treasury Board Secretariat.

At various times over the past 30 years, both this Office and several parliamentary committees have questioned the use of Vote 5 for grants. The Secretariat itself has acknowledged that the use of this Vote for grant payments is a grey area, yet it has done little to resolve the issue. The guidelines it has prepared for the use of its staff in reviewing departmental requests for access to the Vote do not mention grants; nor do they define "miscellaneous minor and unforeseen expenses."

In the 2001–02 fiscal year alone, departments used temporary authority from the Government Contingencies Vote to pay, for example, $95 million in grants to the airline industry and $50 million in grants for sustainable development technology. In our view, these were not miscellaneous minor and unforeseen expenses. Moreover, at the time the departments made the payments, Parliament had not authorized them to do so—a view we believe is supported by Speakers' rulings on this issue.

Background

8.89 The Canadian Constitution establishes the Consolidated Revenue Fund and provides for the balance in the fund to be appropriated by Parliament to give the government authority to spend. It does this in two ways: through statutes with spending authority that continues from year to year; and through annual appropriation acts with authority that lapses at the end of each fiscal year. Itemized in schedules to an appropriation act are "votes" that stipulate the maximum amounts the departments can spend and for what purposes.

8.90 Parliament has approved only two exceptions to this fundamental principle. One permits payments that the government considers are urgently needed for the public good. When Parliament is not in session and there is no other appropriation that would authorize such a payment, the *Financial Administration Act* allows for the government to prepare a special warrant for the Governor General's signature, authorizing the payment.

8.91 The other option open to the government is Treasury Board Vote 5, the Government Contingencies Vote:

> Government contingencies—Subject to the approval of the Treasury Board, to supplement other appropriations for paylist and other requirements and to provide for miscellaneous minor and unforeseen expenses not otherwise provided for, including awards under the *Public Servants Inventions Act* and authority to re-use any sums allotted for non-paylist requirements and repaid to this appropriation from other appropriations.

The wording of this Vote recognizes that it is impossible to provide specific spending authority for every type of expenditure and that the government needs some flexibility to cover unforeseen expenses.

8.92 This Vote is a source of temporary funds to supplement a department's existing vote. It also permits a department to pay miscellaneous minor and unforeseen expenses for which no other spending authority exists. An amount is transferred from Vote 5 to the appropriate vote of the department to cover the unanticipated shortfall in the vote. Later in the fiscal year, Parliament approves the Supplementary Estimates, which include the amount the department received from Vote 5 as an amount the department is seeking. Parliament's approval of the Supplementary Estimates gives the department the authority to spend that amount. Since the department has already spent it using funds from Treasury Board Vote 5, the amount is then transferred back to Vote 5.

Issues

8.93 To shed light on the issues that concern us, we trace the evolution of the Government Contingencies Vote and the Treasury Board Secretariat's interpretation of this spending authority. We also present previous Auditor General comments on the use of this Vote (see page 28, "A history of the use of Treasury Board Vote 5 for grant payments").

Lack of clarity about the authority Vote 5 provides to make grant payments that Parliament has not yet authorized

8.94 Three grants that we discuss in Exhibit 8.4 raise certain issues that go to the essence of the principle that all spending must be authorized by Parliament. They illustrate our concerns with the Treasury Board Secretariat's interpretation of the authority that Vote 5 provides.

8.95 As we have noted, Vote 5 provides temporary spending authority in part for miscellaneous minor and unforeseen expenses. Normally such authority is transferred to other grants and contributions votes and not charged directly to Vote 5. However, the Treasury Board considers that where there is an urgent need for grant payments, the wording of Vote 5 gives departments the legislative authority to make them—in other words, to pay grants that Parliament has not yet authorized either individually or as a class.

Exhibit 8.4 Grants paid using the authority of Vote 5

We reviewed three grants, focussing on whether the Treasury Board Secretariat had followed its eight guidelines.

Canada Foundation for Sustainable Development Technology. In the 2001 *Public Accounts of Canada*, the Auditor General's Observations examined the use of Vote 5 to transfer $50 million to a not-for-profit corporation that would use the money for sustainable development technology in Canada. Given the government's practice of providing for retroactive spending authority in the appropriation act accompanying the next supplementary estimates, we had concluded that it would be difficult to challenge the payment of the $50 million on the basis of lack of authority. However, we suggested that due to the nature and size of the grant, it would be appropriate to review the use of temporary authority from Vote 5 to make significant grants. We said that if Parliament did not approve the next supplementary estimates and thereby provide retroactive authority for the $50 million payment to the Foundation, the grants would have been made without authority. In that event, we believed the grants could not be charged to Vote 10 of Environment Canada and Natural Resources Canada because when the departments made the payments, the grants did not fit in any of the classes of grants described in those votes.

Later, Supplementary Estimates (A) 2001–02 were tabled in Parliament. The two departments each listed a grant of $50 million to the Canada Foundation for Sustainable Development Technology, noting also that $25 million had been provided to each temporarily from Vote 5 to pay for part of the grant.

On 1 November 2001, a member of Parliament raised a point of order on these Supplementary Estimates. In ruling on the point of order, the Speaker noted that the items in the Supplementary Estimates referred to a sustainable development technology fund and that the two departments had already paid the fund $50 million using temporary funding from Vote 5.

The Speaker then asked what link there was between the $100 million requested for the fund in the Supplementary Estimates and the $50 million already paid to the not-for-profit corporation in April 2001. The Speaker noted a further complication: another act of Parliament had established the Canada Foundation for Sustainable Development Technology. He said, "Simply put, the $100 million now being sought cannot be used both to fund the foundation and to refund the Treasury Board contingencies vote for $50 million paid out earlier to the corporation."

The Speaker concluded that no authority had ever been sought from Parliament for the $50 million in grants already paid to the not-for-profit corporation. He said the note in the Supplementary Estimates on the disbursement of these funds from Vote 5 was not sufficient to be considered a request for approval of those grants.

Finally, the Speaker voiced concern over the lack of clarity and transparency in this case. He noted that the departments had the legislative authority under the *Energy Efficiency Act* and the *Department of the Environment Act* to make the grants, but they had never sought the corresponding authority under the supply process to make the actual payments. He ruled that the government therefore had to make an appropriate request of Parliament through the supplementary estimates process, before the end of 2001–02.

The table illustrates the magnitude and extent of the use of Vote 5 for grants, including the three we reviewed. It shows the total annual amounts in grants of over $10 million for which temporary funding was provided in the last 10 years from Treasury Board Vote 5.

Fiscal Year	Grants with over $10 million provided through Vote 5	Limit of Vote 5
	($ millions)	
1992–93	206	450
1993–94	178	450
1994–95	245	450
1995–96	182	450
1996–97	200	450
1997–98	45	450
1998–99	43	450
1999–2000	96	550
2000–01[1]	266	550
2001–02[2]	202	750

[1] An election was called that prevented departments from obtaining spending authority through the normal supplementary estimates process.

[2] Excludes Supplementary Estimates (B), which Parliament had not approved when we finalized this audit observation.

Exhibit 8.4 Grants paid using the authority of Vote 5 (continued)

Although Supplementary Estimates (B), 2001–02 had been tabled in Parliament, seeking authority for the $50 million in payments made in April 2001 to the not-for-profit corporation, when we finalized this audit observation in early March 2002 there was still no parliamentary authority for the payments.

Officials of the Treasury Board Secretariat followed the eight guidelines when they reviewed the departments' request for access to Vote 5 to make the payments to the not-for-profit corporation. They told us the "sense of urgency" was that in waiting for the next supplementary estimates, this important government initiative would have lost momentum.

Airline compensation package. Grants of $152 million to Canadian airlines and specialty air operators were temporarily funded from Vote 5 to cushion losses caused by the temporary closing of Canadian air space in September 2001. The amount was later included in Supplementary Estimates (A), 2001–02.

Before Parliament approved those Supplementary Estimates, Transport Canada had made payments totalling $95 million; payment authority was provided retroactively by *Appropriation Act No. 3, 2001–02*. After the Supplementary Estimates were approved, payment of the rest of the grants continued.

Officials informed us that Vote 5 was used because of the emergency arising from 11 September 2001. They also indicated that although Transport Canada had the legal mandate to make the payments in fall 2001, it lacked the funds. Staff of the Secretariat followed the eight guidelines when they reviewed Transport Canada's request for access to Vote 5. They told us that waiting for the supplementary estimates had not been an option, because some of the airline companies might have gone bankrupt had the payments been delayed.

Clayoquot Sound biosphere reserve. In its February 1999 Budget, the government announced that it was setting aside up to $12 million to support the establishment of a UNESCO biosphere reserve in Clayoquot Sound. The funds were transferred from Treasury Board Vote 5 to Environment Canada's Vote 10 and paid to the Clayoquot Sound biosphere reserve on 5 May 2000. On 30 March 2001, the authority to spend the $12 million was provided retroactively by *Appropriation Act No. 3, 2000–01*, which approved Supplementary Estimates (A), 2000–01. The Supplementary Estimates clearly mentioned that the grant to the Clayoquot Sound biosphere reserve under Environment Canada's Vote 10 had received temporary funding from Treasury Board Vote 5.

Officials of the Secretariat followed the eight guidelines when they reviewed Environment Canada's request for access to Vote 5. They told us that in their view, the urgency of the grant lay in the fact that the government had to be seen to be acting on its Budget decision to establish and fund the biosphere reserve.

A history of the use of Treasury Board Vote 5 for grant payments

Wording of Treasury Board Vote 5 has evolved. The government has provided for contingencies in appropriation acts since 1876–77. The current form of the Government Contingencies Vote reflects an amalgamation in 1964–65 of two Department of Finance votes. The Main Estimates for that year showed Vote 15 of the Department of Finance as follows:

> Contingencies—Subject to the approval of the Treasury Board, to supplement the paylist provisions of other votes; for miscellaneous minor or unforeseen expenses; and for awards under the *Public Servants Inventions Act*; including authority to re-use any sums repaid to this appropriation from other appropriations.

The 1966–67 Main Estimates changed "to supplement the paylist provisions of other votes" to read "to supplement other votes" and restricted miscellaneous minor or unforeseen expenses to those "not otherwise provided for."

The Vote first appeared as Treasury Board Vote 5 in the 1967–68 Main Estimates. It carried additional authority to supplement other votes for "other requirements" and to reuse any amounts reimbursed to the Vote that had been allotted for non-paylist requirements. Although the Vote's current limit is $750 million, the provision for reusing reimbursed amounts means that the Vote is a revolving authority.

The Treasury Board Secretariat has used the Introduction to the Main Estimates to keep Parliament informed of the changes to Vote 5. The 1978–79 Main Estimates described it as follows:

> This vote provides funds to meet relatively small expenditures of a miscellaneous character that cannot be foreseen when the Estimates are drawn up and to meet the salary costs arising out of collective bargaining agreements that come into effect in the New Year and that exceed the provision that departments made in their own votes for these costs.

The next year, "relatively small expenditures of a miscellaneous

A history of the use of Treasury Board Vote 5 for grant payments (continued)

character" became "urgent expenditures of a miscellaneous character." The 1987–88 Main Estimates dropped the mention of "urgency." In the 2001–02 Main Estimates, the description reads:

> This Vote supplements other appropriations to provide the Government **with the flexibility to meet unforeseen expenditures until Parliamentary approval can be obtained** and to meet additional paylist costs such as severance pay and maternity benefits which are not provided for in departmental estimates. [emphasis added]

Long-standing concerns of auditors general. The 1968, 1969, and 1970 reports of the Auditor General questioned the Treasury Board's use of Vote 5 to fund grants without first having Parliament's approval. In 1968, we noted that the Treasury Board had authorized eight grants without Parliament's prior sanction. In 1969 we noted the payment of seven grants from Vote 5 that had later been included in supplementary estimates; we reported in 1971 that the House of Commons had been told the grants had been "allocated" or "allotted" but not that they had already been paid. We raised similar issues in 1972, and in 1973 we asked the House to look at the related policies of the Treasury Board Secretariat.

On 26 June 1975, the Secretary of the Treasury Board told the House of Commons Standing Committee on Public Accounts that all grants paid initially from the contingencies vote were later included as a matter of course in supplementary estimates, for Parliament's consideration, with the notation that the funds were provided from Treasury Board Vote 5. Therefore, in his view, no other action was necessary.

Speakers' rulings. Over the years, Speakers of the House of Commons have made a number of rulings concerning estimates. In our view the thrust of those rulings, as they touch on the transfer of temporary authority from Vote 5 to pay for grants, is as follows:

- The government cannot establish a program through the estimates process; that process provides money only for programs already authorized by statute. The grants to airlines were funded out of Vote 5 (Exhibit 8.4) but in our view, Parliament had not authorized this spending.
- The principles of parliamentary control are simple: through legislation, the government establishes a program that is subject to Parliament's scrutiny; then it seeks Parliament's authority to spend money on that program through an appropriation act.

On 21 March 1983, the Speaker made the following ruling on a case that involved a payment of funds while the authorizing legislation was still before the House:

> The Hon. Member for Calgary Centre also objected to Vote 10c under Industry, Trade and Commerce. I agree with the Hon. Member that here the real issue is not the method used to transfer money from the Treasury Board Contingencies Vote to Vote 10c, but rather the purpose of the program for which the grant is intended. As outlined in the Estimates, the grant is to provide payments under the *Small Business Investment Grant Act* which is now before the House in the form of Bill C–136.
>
> I can only repeat what I said in my ruling of June 12, 1981, that "the Appropriation Act should only seek authority to spend the money for a program that has been previously authorized by a statute." Vote 10c clearly anticipates legislation, and, in that sense, seeks to establish a new program in the absence of other legislative authority and seeks also the funds to put it into operation. In accordance with rulings by my two predecessors and myself, I must agree with the Hon. Member for Calgary Centre that Vote 10c is also out of order. Accordingly, Vote L11c under Fisheries and Oceans and Vote 10c under Industry, Trade and Commerce, being improperly before the House, shall be deleted from the Supplementary Estimates (C) for the fiscal year ending March 31, 1983, and I so order.

Senate Standing Committee on National Finance. Over the years, this Committee has expressed an interest in the government's use of the contingencies vote. In its Third Report dated 16 December 1986, the Committee noted a discrepancy between the statement of the purpose of the Vote in Part III of the Estimates—for "urgent expenditures of a miscellaneous nature which cannot be foreseen when the Estimates are drawn up"—and the Vote's actual wording in the proposed schedule to the appropriation act, "to provide for miscellaneous minor and unforeseen expenses." The Committee recommended that TBS examine the use of Vote 5, clarify its purpose, and redraft parts II and III of future Estimates to ensure consistency between them.

The Committee also commented on the growth in the Vote's component covering "urgent or unforeseen expenditures." In the view of Secretariat officials, this was a matter of policy and the responsibility of ministers. However, in testimony before the Committee they stated:

> The very vagueness . . . in the wording of the Vote where we refer to miscellaneous, minor and unforeseen expenditure is open to all kinds of interpretation . . . in summary . . . there is a tremendous grey area in the wording of the Vote. That means there is a lot of latitude for government to decide how they would like to use this particular Vote and the circumstances under which they can do so.

The Committee concluded that the ambiguous wording on the use of this allotment and the absence of any guidelines left Vote 5 susceptible to abuse. It recommended that the Treasury Board Secretariat draw up guidelines on the use of the Vote in "urgent and unforeseen" circumstances so that Parliament could give it closer scrutiny.

8.96 In our view, when amounts are transferred to a departmental vote they may be spent only in accordance with the wording of that vote. For most operational votes, this is not a problem. However, for grant payments the sums are transferred to departmental votes worded, "The grants listed in the Estimates." At the time that many of the grants funded temporarily from Vote 5 are paid by departments, they are not yet listed in the Estimates. These grants are not listed until Supplementary Estimates are prepared. Parliament's approval of the Supplementary Estimates provides retroactive authority for this spending. This means that in the fullness of time, the grants are authorized by Parliament but they have not been authorized on the day the payments are made.

8.97 Although the Treasury Board has transferred the funds to departmental votes, it relies on the phrase "to provide for miscellaneous minor and unforeseen expenses" as the legislative authority for the grant payments. In our view, this language is sufficiently broad that arguably it establishes authority for practically any payment if the funds are paid directly from the Vote without first being transferred to a departmental vote. We question whether this lack of clarity is appropriate given the increasing use of the Vote to temporarily fund grant payments.

8.98 The Treasury Board Secretariat maintains that this use of the Vote has been more restrictive than uses authorized by Parliament. In considering requests from departments for access to Vote 5, the Treasury Board requires that a department have legislative authority to make the desired payment; that is, the type or purpose of the payment must clearly fall within the department's statutory authorities or mandate. However, program authority—the authority to make payments of a particular nature—must be distinguished from spending authority—authority to spend in advancing program objectives. Program objectives are found in substantive legislation. The related spending authority is provided through appropriation acts.

8.99 We recognize that the government must ensure that it has enough flexibility to deal with unforeseen events. However, we are concerned that the Secretariat's views on the use of Vote 5 allow for large amounts of public money to be spent before receiving Parliament's authorization. The grant for sustainable development technology described in Exhibit 8.4, for example, raised a significant question that we first outlined in the Auditor General's Observations in the 2001 *Public Accounts of Canada*: the authority for Environment Canada and Natural Resources Canada to pay out the funds upon being notified of the transfer of authority from Vote 5.

8.100 We noted that when they made the payments in April 2001, the wording of Vote 10 for each of the departments—the votes through which the funds were channeled—did not contemplate grants of this kind or magnitude. We also noted, however, that subsequently Parliament's approval of the specific items through the Supplementary Estimates would provide the spending authority retroactively. At the time of this writing, the $50 million in grants paid almost one year earlier still had not been authorized, although

the request for authority through Supplementary Estimates (B) 2001–02 was then before Parliament.

8.101 The Treasury Board Secretariat contends that the phrase "to provide for miscellaneous minor and unforeseen expenses not otherwise provided for" constitutes the required authority. By this interpretation any payment could be made under Vote 5, but the Secretariat's eight guidelines (Exhibit 8.5) do place some restrictions on this spending power. The Secretariat will not recommend access to Vote 5 unless the Treasury Board can be shown that the department has a legal mandate to make the expenditure. In addition, the Treasury Board must be assured that terms and conditions or funding agreements for the grants have been approved.

Exhibit 8.5 The Treasury Board Secretariat's eight guidelines

The Secretary of the Treasury Board in 1989 reported to the Senate Standing Committee on National Finance on the Secretariat's approach to reviewing departmental requests for access to the Government Contingencies Vote. The following are some of the guidelines set out in that report, as approved by Treasury Board:

1. As the authority for payments out of the contingencies fund is contained in the Vote 5 wording, all such payments must be fully consistent with that wording itself (if necessary, they could be legitimate charges to Vote 5).
2. As a general rule, permanent charges will not be made to the Vote for requirements other than paylist shortfalls or awards under the *Public Service Inventions Act*. All other advances from the Contingencies Vote should be considered temporary advances to be covered by items included in subsequent Supplementary Estimates and reimbursed when the associated appropriation act is passed.
3. When cash advances are requested to meet a financial requirement, the Treasury Board must be assured that the payment is within the legal mandate of the department and that there is a valid cash requirement that must be met before Supplementary Estimates are approved.
4. When making a transfer to provide authority for a payment, the Treasury Board must be satisfied that there is valid and sufficient reason why the payment must be made before normal parliamentary approval is received. If the payment could reasonably be deferred until Supplementary Estimates are tabled and Parliamentary authority granted via an appropriation act, the contingency funding should not be provided to grant such authority.

In 1996, the Secretariat added the following guidelines:

5. Sufficient funds must be available within Treasury Board Vote 5.
6. The department's existing appropriated authority must be insufficient to cover existing requirements and those of the new initiative (excluding grant items) until the end of the current Supply period.
7. There must be a sense of urgency related to the initiative such that the expenditure must be made prior to Parliament's approval of the item in an appropriation act.

And, more recently:

8. There must be a valid, legally incorporated recipient in existence to whom the grant is to be paid.

These guidelines remain in effect today, and the Secretariat uses them to assess each departmental request for access to Vote 5. It then submits the request to the Treasury Board with its recommendations. Of the eight guidelines used by Treasury Board Secretariat staff, only the first four above have been approved by Treasury Board ministers as formal Treasury Board policy.

8.102 However, in his ruling of 22 November 2001, the Speaker of the House of Commons distinguished between the legislative authority in principle to provide grants and the related authority under the Supply process to make the grant payments. We, too, consider this a fundamentally important distinction. We do not question that Environment Canada and Natural Resources Canada are the appropriate departments to make a grant for sustainable development technology, given the activities within their legislative mandates. However, the authority to spend public money on such a grant is not provided in their mandates. It is Parliament that provides the authority, through an appropriation act.

8.103 The government's practice of temporarily transferring grant amounts to departmental votes that do not include payment authority weakens Parliament's control over government spending.

No definition of "miscellaneous minor and unforeseen expenses not otherwise provided for"

8.104 The Treasury Board Secretariat has no guidelines or criteria that indicate what expenses could be considered "miscellaneous minor and unforeseen expenses." This has permitted the Treasury Board to use the contingencies vote to fund items not provided for in the Main Estimates but whose inclusion in future supplementary estimates it has approved.

8.105 While it is clear that the Secretariat has developed no definition or policy guidance on the interpretation of this phrase, "miscellaneous minor and unforeseen expenses" is not without ordinary meaning. In our view, it is not clear whether several grant payments made with the authority of Vote 5, including the three grants described in Exhibit 8.4, were "miscellaneous minor and unforeseen expenses," as intended by Parliament.

8.106 It is difficult to characterize the Canada Foundation for Sustainable Development Technology and Clayoquot Sound grants as unforeseen. The Foundation initiative was announced in the February 2000 Budget, over a year before the funds were paid. The Clayoquot Sound initiative was announced in the February 1999 Budget; the grant was paid on 5 May 2000, the day the Prime Minister attended the official commemoration of the designation of Clayoquot Sound as a UNESCO biosphere reserve. It is thus apparent that neither of these grants was unforeseen.

8.107 Were they minor? The officials we interviewed at the Treasury Board Secretariat gave different answers for what "minor" meant.

8.108 The airline compensation package was announced by the Minister of Transport on 2 October 2001. The need for a compensation package as a result of the closure of Canadian air space following the terrorist attacks of September 11 was certainly unforeseen; further, the situation was clearly urgent. But was the amount "minor"? If not, it is our view that the government had other means available to make these payments.

8.109 There was a precedent, for example, in Supplementary Estimates (B) 1986–87, which requested additional funds for a special program of financial

assistance to cushion the impact of the global subsidy trade war on Canadian farmers. All parties agreed to consider the appropriation bill in the House of Commons the next day. The program was discussed during review of the bill by the Committee of the Whole. The bill was passed by the House of Commons, was referred immediately to the Senate for approval, and received royal assent within hours. This exercise was a departure from the established convention and set a precedent whereby Parliament was asked, as a result of special circumstances, to debate an issue even though the Minister of Agriculture had sufficient program authority to deliver such an initiative.

8.110 The government could have used this precedent, in our view, for the grants to airlines. Legislation could likely have been prepared, tabled, passed, and given royal assent when Parliament was in session between 17 September and 5 October 2001, in time to avoid airline bankruptcies.

Conclusion

8.111 The use of the Government Contingencies Vote to make large grant payments continues despite concerns expressed over the past 30 years by this Office and by Parliament. As a result, hundreds of millions of dollars are being paid before receiving Parliament's authorization. Members of Parliament and Speakers of the House of Commons have questioned this use of the Vote by the government; and even within the Treasury Board Secretariat itself, officials differ on the meaning of the Vote's wording.

8.112 **Recommendation.** Given the evolution of the use of Vote 5, Parliament, through the Senate Standing Committee on National Finance and the House of Commons Standing Committee on Public Accounts, may wish to consider examining the wording of the Government Contingencies Vote to ensure that the use of the Vote for grants reflects Parliament's intent. The Treasury Board Secretariat should respond to the committees' recommendations in accordance with parliamentary procedures.

8.113 **Recommendation.** The Treasury Board Secretariat should submit to the Treasury Board for its approval a formal policy or guidelines on the use of the Government Contingencies Vote for grants. The policy or guidelines should clarify the interpretation of "miscellaneous minor and unforeseen expenses" in relation to grants. The Secretariat should communicate the policy or guidelines to its analysts.

8.114 **Recommendation.** The Treasury Board should report to Parliament in the Supplementary Estimates any exceptions to its policies or guidelines governing access to Vote 5 for grants, and the reasons for the exceptions.

Treasury Board Secretariat's response. It is the position of the Treasury Board Secretariat that the use of Treasury Board Vote 5 as a source of interim authority to make payments for urgent and unforeseen expenditures, including grants, is both essential to the maintenance of good government and within the law. Moreover, it is consistent with previous Speakers' rulings on the subject as well as parliamentary precedent and tradition, as evidenced by its many years of use for this purpose. All grant items initially paid from Vote 5 are later included in supplementary estimates and, in response to

previous questions raised by the Auditor General and Parliament, are clearly flagged for Parliament's attention.

The Treasury Board, as outlined in the audit observation, has approved guidelines for analysts on recommending access to Vote 5. These have evolved over the years. As indicated in the three case studies, the Secretariat followed these guidelines in each of the cases.

The Secretariat will update these guidelines and present them to Treasury Board ministers for approval. The guidelines will be communicated to all Treasury Board Secretariat analysts to ensure their consistent application to departmental submissions.

Audit team

Assistant Auditor General: John Wiersema
Principals: John Hodgins and Anne-Marie Smith

Rose Pelletier
Beth Stewart

For information, please contact Communications at (613) 995-3708 or 1-888-761-5953 (toll-free).

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