Matters of Special Importance – 2000

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Main Points

Each year in this chapter I highlight issues I consider especially significant. In this, my tenth and last such chapter, I concentrate on the question of how we might improve the management of government spending. I discuss four basic principles that should be informing spending decisions and practices in a parliamentary system of government like our own:

- **All government spending should have Parliament's sanction.** Parliamentary control of finance has been described as the bedrock of responsible government. It is based on two central precepts of parliamentary democracy — namely, that the government should not raise money without Parliament's approval, and it should not spend money except for purposes authorized by Parliament. Compliance with parliamentary authority is a minimum requirement that must be met by any disbursement of public funds.

- **Government spending should be managed with probity and efficiency.** This principle recognizes the fact that public money is money held in trust for the benefit of all Canadians. As a consequence, the government has an obligation to ensure that the money is managed prudently in support of the general public interest. It also means that the government must seek to obtain maximum value for the dollars it spends.

- **The value of government spending should be measured by what it achieves.** Historically the tendency has been to justify government programs more by the resources they used than by the results they produced. But governments don't create programs in order to spend money; they establish programs to deliver services that improve the lives of Canadians. That is why they need to manage for results.

- **Government spending programs should remain current.** The resources available to government change over time. So do public needs and preferences. To ensure that public spending is allocated to the uses that are most valued, the government needs to evaluate its programs regularly and assess whether they are still relevant, effective and affordable.

While these principles may appear self-evident, they are nevertheless too frequently breached. I therefore also discuss how a strong framework of values and ethics and appropriately structured incentives can help to ensure that these principles of public spending are observed.

In a supplement to the chapter, I address other matters of ongoing interest:

- reforms in human resource management in the public service;
- financial management capabilities in government departments;
- progress in performance reporting by government departments;
- weaknesses in the education system for Indian children on reserves;
- challenges facing federal health and safety regulatory programs;
- shortcomings in the corporate governance of Crown corporations; and
- opportunities for cost savings identified by our audits.

Background

Despite the retrenchment and cutbacks of the past decade, spending by the federal government remains at historically high levels — roughly $175 billion a year. How well this money is spent is clearly of great interest to the taxpayers, who bear the cost, and to the public at large, on whose behalf the spending takes place.

In my 10 years as Auditor General, I have seen significant improvements in the management of government spending, often made under the pressure of fiscal constraints. But progress has been slow, and there have been relapses as well. Year-end surges in spending, expenditure commitments without adequate planning or control, insufficient effort to recover moneys owed the Crown — these and other indications of a failure to make the best use of resources are still encountered with disquieting frequency in the federal public sector.

Why do these problems seem so intractable? Why do they persist year after year, despite express commitments to set them right? What can be done to close the gap between promise and performance in the way government handles taxpayer money? These are the questions that motivate my discussion in this chapter.

Vision

We are committed to making a difference for the Canadian people by promoting, in all our work for Parliament, answerable, honest and productive government that reflects a commitment to sustainable development.

Mission

The Office of the Auditor General of Canada conducts independent audits and examinations that provide objective information, advice and assurance to Parliament. We promote accountability and best practices in government operations.

Elaboration of Mission

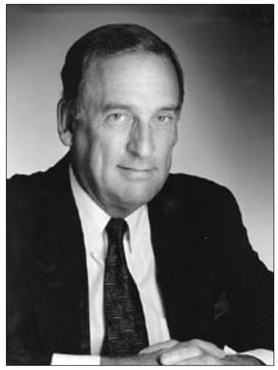
In achieving our mission,
we want to make a difference by promoting:

- *a fair and frank accounting of government's stewardship of financial and other resources;*
- *efficiency and productivity in the public service;*
- *cost effectiveness of government activities; and*
- *collection of revenues owed to the Crown.*

Other effects we want to produce
through our work are:

- *objective assurance on matters found to be satisfactory and unsatisfactory;*
- *compliance with authority; and*
- *deterrence of fraud and dishonesty.*

Improving Performance in Government Spending



Each year in this chapter I highlight issues I consider especially significant. This is my tenth and last such chapter: my 10–year mandate as Auditor General comes to a close at the end of March 2001. In February, I plan to present a "capstone" report to Parliament to coincide with the end of my mandate. That report will provide my perspective on some key management problems facing the federal government, the role of legislative audit and its evolution over the past 10 years, and the efforts my Office has made to identify problems and seek reform in central agencies and in program delivery.

Despite honest efforts and repeated commitments to improvement, expenditure management in the federal public sector is still not as good as it should be and can become.

In this chapter I want to concentrate on a theme that is central to our Office and dear to my heart: how to improve the way **spending** is managed in the public sector. Despite honest efforts and repeated commitments to improvement, expenditure management in the federal public sector is still not as good as it should be and can become. To this end, I set out some basic principles that should be informing spending decisions and practices in a parliamentary system of government like our own, and I draw out some of their implications. I also discuss how a strong framework of values and ethics and appropriately structured incentives can help to ensure that these principles of public spending are observed.

The stewardship of public funds deserves increased attention

Despite the retrenchment and cutbacks of the past decade, spending by the federal government remains at historically high levels — roughly $175 billion a year. How well this money is spent is clearly of great interest to the taxpayers, who bear the cost, and to the public at large, on whose behalf the spending takes place.

Earlier this year, the disclosure of serious shortcomings in the management of grants and contributions at Human Resources Development Canada (HRDC) created a major stir. Public reaction was strong because the amounts involved were large and also, I believe, because years of rising taxes and shrinking or stagnating household budgets have made the public even more sensitive than usual to lax spending practices in government. The issue received wide publicity in the news media and was intensely debated in the House of Commons. But shortcomings of the sort revealed at HRDC — vague and inconsistently applied eligibility criteria, breaches of authority, absence of an appropriate control and accountability framework — are by no means exclusive to one program or one department. We observed shortcomings of a similar nature (though of a lesser magnitude) in our 1996 audit of the Canada Infrastructure Works program, our 1997 audit of The Atlantic Groundfish Strategy and our 1998 audit of grant and contribution programs in Industry Canada and the Department of Canadian Heritage. I can cite other examples over the years, but these will suffice to make my point that spending in government is not always conducted with the care and prudence that taxpayers have a right to expect.

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Canadians are justifiably upset by such disclosures. They may agree with Justice Oliver Wendell Holmes that taxes are the price we pay for civilization, and not begrudge the high taxes they pay to finance necessary public services. But they get upset and angry when they see their tax dollars squandered or used with less care and prudence than they must use to make ends meet in their household budgets. Frankly, I share their frustration. It is discouraging to witness new incidents of waste and mismanagement crop up hydra-like after older ones have been discovered and dispatched.

In my 10 years as Auditor General, I have seen significant improvements in the management of government spending, often made under the pressure of fiscal constraints. But progress has been slow, and there have been relapses as well. Year-end surges in spending, expenditure commitments without adequate planning or control, insufficient effort to recover moneys owed to the Crown — these and other indications of a failure to make the best use of resources are still encountered with disquieting frequency in the federal public sector.

Why do these problems seem so intractable? Why do they persist year after year, despite express commitments to set them right? What can be done to close the gap between promise and performance in the way government handles taxpayer money?

If these questions were easy to answer, we would not need to revisit them so often. But after 10 years of looking close up at government spending, I believe we can do better and should resolve to do so. The core of this chapter discusses how this might be done. The section that follows sets out a number of principles that ought to guide spending decisions in government.

Subsequent sections of the chapter discuss means of reinforcing the principles through appropriate structures of incentives and ethics. As in previous years, issues that are not directly related to the theme of the chapter (in this case, ensuring prudent spending in the public sector) but that I consider important are reported in a supplement to the chapter.

Four Basic Principles of Public Spending

Public administration at the federal level in Canada has undergone huge changes over the past decade. As in many other countries in the developed world, there has been a marked shift away from the traditional bureaucratic emphasis on detailed control from the centre and preoccupation with process toward more autonomy for departments and a focus on results. The shift to results-oriented management has been driven by a desire to harness the enterprise and judgment of public sector employees and empower them to improve performance. At the same time, however, the weakening of traditional controls can increase the risk of error, misjudgment or abuse.

The downside risks of empowerment can be minimized if some key principles are applied to help guide action and set limits on the exercise of discretion.

Reverting to the old rule-bound systems is not an answer to this dilemma. In today’s information age, top-down, command-and-control approaches do not work — if they ever did. The downside risks of empowerment can be minimized if some key principles are applied to help guide action and set limits on the exercise of discretion in the new, decentralized environment of the public sector.

My 1992 Report stressed the need for appropriate safeguards to accompany the devolution of authority in the public sector. Drawing on parallels with private sector firms, the Report suggested that a set of fundamental rules be instituted to frame the boundaries of decision making by public servants. A clear set of ground rules within which discretion can be exercised, the Report contended, can help to minimize unwanted risks while encouraging innovation by providing more certainty about what employees may do.

The rules my 1992 Report suggested are shown in Exhibit 1. The list is not exhaustive; other examples can be added. To work, the rules would have to be well understood. They should therefore be codified and communicated throughout the public service. I still believe that this would help to minimize unwanted risks in government activities.

These rules, and others like them, can be captured in a small number of principles rooted in our parliamentary system of government and in the government's fiduciary obligation to Canadians for the management of public funds. I discuss four such principles here:

Exhibit 1 — Some Fundamental Rules for the Public Service

- Do nothing illegal. Uphold the spirit and letter of laws and regulations.
- Act within your delegated authority.
- Act in a politically neutral manner.
- Act impartially, honestly and fairly.
- Don't waste public money.
- Safeguard assets.
- Respect the core values of your organization.
- Make service standards visible.
- Realize the productive potential of all resources entrusted, especially people.
- Don't make decisions that commit significant public resources without proper authority.
- Document risk acceptance.
- Account for the discharge of responsibilities and achievement of agreed performance.
- Get authority for waiving a fundamental rule.

Source: Report of the Auditor General of Canada, Chapter 4, 1992.

- All government spending should have Parliament's sanction.
- Government spending should be managed with probity and efficiency.
- The value of government spending should be measured by what it achieves.
- Government spending programs should remain current.

While these principles may seem self-evident, they are apparently not clear enough to have prevented breaches of each one of them, as I note below. I believe that further emphasis on guiding principles and fundamental rules would reduce the incidence of such breaches in the future.

I also discuss procedures and practices that flow from these principles. The procedures and practices may vary over time; the principles themselves remain constant. They can give direction to specific processes and inform appropriate conduct.

All Government Spending Should Have Parliament's Sanction

Parliamentary control of finance has been described as the bedrock of responsible government. It is based on two central precepts of parliamentary democracy — namely, that the government should not raise money without Parliament's approval, and it should not spend money except for purposes authorized by Parliament. These precepts, the achievement of centuries of struggle between the Crown and the Commons in England, were already well established at the time of our Confederation in 1867. When the original provinces got together to establish a form of government "similar in Principle to that of the United Kingdom," they incorporated these precepts in the *Constitution Act, 1867*. The principle that Parliament is the custodian of the public purse has thus been part of Canada's constitutional landscape since the country's inception.

Over time, a number of specific practices were developed to put this principle into effect. Since 1951, those practices have been brought together under a single act of Parliament, the *Financial Administration Act* (*FAA*). The Act makes the Treasury Board responsible for overall control of public spending and each minister responsible for the legality and probity of spending in his or her department. It also sets precise conditions that govern payments out of the Consolidated Revenue Fund — the account into which, by law, all government revenues are credited. Specifically, the payments must:

The principle that Parliament is the custodian of the public purse has been part of Canada's constitutional landscape since the country's inception.

- be authorized by a warrant signed by the Governor General (*FAA*, section 28);
- conform to a plan approved by the Treasury Board (section 31);
- not exceed funds appropriated for the purpose by Parliament (section 32); and
- be requisitioned by a minister or authorized officer in a form prescribed by the Treasury Board (section 33).

Where payments are for services or goods received, the responsible departmental officer must certify before payment is made that the performance conditions were met. For grants and contributions, the officer must certify that the recipient is entitled to the payment (section 34).

These provisions of the *FAA* establish minimum requirements for the disbursement of public funds — there are no short-cuts around them. Yet breaches of these provisions, while infrequent, still occur. In our audit of HRDC earlier this year, we found instances of payments made without required approvals or before project commitments had been met. The audit found that payments had been approved by staff who lacked the delegated authority to do so and who often did not review whether claims for payment were supported by the requisite information. The point of the *FAA* provisions is to ensure that government spending is in compliance with parliamentary authority and consistent with enunciated government policies. Failure to adhere to them normally signals further weaknesses in the way a program is managed and run.

For related Auditor General work, see: 2000 Chapter 11 Human Resources Development Canada — Grants and Contributions; 2000 Chapter 17 Other Audit Observations — Parc Downsview Park Incorporated and Public Works and Government Services Canada; 1998 Chapter 27 Grants and Contributions: Selected

Programs in Industry Canada and Department of Canadian Heritage; 1997 Chapter 13 Health Canada — First Nations Health; 1996 Chapter 26 Canada Infrastructure Works Program — Lessons Learned; 1994 Chapter 12 Aspects of Federal Real Property Management; 1993 Chapter 25 Parliamentary Control over the Raising of Revenues by Fees.

Government Spending Should Be Managed With Probity and Efficiency

This principle recognizes the fact that public money is money held in trust for the benefit of all Canadians. As a consequence, the government has an obligation to ensure that the money is managed prudently in support of the general public interest. It also means that the government must seek to obtain maximum value for the dollars it spends. Common sense and good management practices suggest a number of conditions that need to be in place if these fiduciary obligations of the government are to be met. They include appropriate program design, adequate capacity to run each program, and effective systems of internal control.

Public money is money held in trust for the benefit of all Canadians.

Appropriate design. Legislation normally provides only general direction and outlines of spending plans. Departmental managers are then responsible for designing specific programs to achieve the legislation's intent. They need to define clearly the desired outcomes and set priorities; choose appropriate mechanisms and instruments to deliver the program; and identify potential risks and means to manage them.

Haste makes waste. The Northern Cod Adjustment and Recovery Program offers a good example. Established in 1992 to provide relief to fishers and plant workers affected by the moratorium on cod fishing, the program was rushed into operation before proper eligibility criteria and appropriate financial controls had been established. As a result, payments were made to many people who were not affected by the moratorium; and contrary to the program's intent, people who had left the fishery were drawn back to it. Spending the time and the resources it takes to establish a workable, effective plan for running a program is an investment worth making.

Adequate capacity to run the program. Does the program have enough resources to achieve the desired results efficiently? Are they allocated optimally across the tasks involved in running the program? Having adequate capacity in place is a manifestly basic ingredient of program success, but one not always present in government departments. As we reported in October, inadequate capacities for financial management and control at HRDC in the wake of the cutbacks and reorganizations of the mid–1990s were factors that contributed to the mismanagement of several programs in that department.

Establishing huge spending programs and then, in effect, putting them on auto-pilot is clearly not consistent with the principle of seeking to maximize value for the taxpayer's dollar.

Similarly, our 1996 audit of the Canada Pension Plan (CPP) disability program concluded that the sharp increases in CPP disability payments during the previous decade had occurred in the absence of sufficient capacity to analyze trends in benefit payments, manage eligibility assessments, and review files systematically to identify ineligible beneficiaries. Establishing huge spending programs and then in effect putting them on auto-pilot is clearly not consistent with the principle of seeking to maximize value for the taxpayer's dollar. A program worth doing is worth doing well. Inadequate resources or resources poorly deployed can undermine the effectiveness of the program and lead to waste, loss of trust and erosion of support for the program.

Effective internal control systems. Internal control refers to the methods and procedures used by management to ensure that decisions are carried out properly, risks are managed, transactions recorded, performance monitored and results reported: in short, everything it takes to ensure that the program is running as it should.

An integral part of an effective internal control system is a strong audit function, one that tests the credibility of performance measurements and provides assurance that the management framework for achieving program objectives is operating as intended. In government-wide audits completed in 1993 and 1996, we found weaknesses in the internal audit functions of many departments. Since then, disproportionate cutbacks in the government's internal audit, evaluation and review functions have eroded them further. In HRDC, for example, the internal audit staff was reduced from 54 in 1994–95 to 33 in 1999–2000. As Treasury Board standards recognize, internal audit is a fundamental tool of effective management. Treating it as a frill or an afterthought can put an organization at risk.

For related Auditor General work, see: 2000 Chapter 3 Citizenship and Immigration Canada — The Economic Component of the Canadian Immigration Program; 2000 Chapter 13 Assessment of Financial Management Capabilities in Departments; 2000 Chapter 14 Canadian International Development Agency — Managing Contracts and Contribution Agreements; 2000 Chapter 18 Governance of Crown Corporations; 1996 Chapter 4 Internal Audit in Departments and Agencies; 1996 Chapter 17 Human Resources Development Canada — Canada Pension Plan: Disability; 1993 Chapter 7 Internal Audit; 1993 Chapter 15 Department of Fisheries and Oceans — Northern Cod Adjustment and Recovery Program.

The Value of Government Spending Should Be Measured By What It Achieves

Defining clearly the results of a program is a difficult task — especially in the public sector, where the policy aims are often intrinsically broad — but a task that is necessary. Historically the tendency has been to justify government programs more by the resources they used than by the results they produced. But governments don't create programs in order to spend money; they establish programs to deliver services that improve the lives of Canadians. What is a program expected to achieve? How will we know if it does? These questions need to be answered as clearly as the circumstances of each program will permit. That is why government needs to manage for results.

Historically the tendency has been to justify government programs more by the resources they used than by the results they produced.

As noted in Chapter 20 of this Report, managing for results in an organization requires the following elements:

- Fostering an organizational climate that encourages managing for results, including leadership from senior management and appropriate incentives.
- Agreeing on a strategic framework for results, making clear what the organization intends to accomplish and how.
- Agreeing on the expected results and strategies of programs, establishing clear objectives and performance indicators up front.
- Measuring performance results and using that information to improve the design and operation of the program.
- Reporting performance effectively, that is, in a way that allows Parliament and stakeholders to see how well the program is doing.

Establishing clear objectives and performance indicators up front and regular monitoring and reporting of results are useful on several counts. They encourage program improvements by helping management know how well a program works. They enhance Parliament's ability to hold the government to account for the use of public funds. And they nourish public trust in government, by enabling the public to know what they get for their tax dollars and whether it represents the best value for the money.

The government does recognize the importance of managing for results. In a November 1995 paper entitled *Strengthening Government Review,* it announced an explicit commitment to establish "a results-based management

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culture," embracing the expectation that "programs and services will identify intended results, measure progress and then report on achievements." As we report in Chapter 20, the government has introduced several important initiatives in support of that commitment, and a focus on results is now common in government departments. However, it is proving very difficult to complete certain critical steps, such as measuring results and using that information to improve performance.

For related Auditor General work, see: 2000 Chapter 20 Managing Departments for Results and Managing Horizontal Issues for Results; 2000 Chapter 29 Treasury Board Secretariat — the Government's Annual Contracting Activity Report — 1998; 1999 Chapter 19 Industry Portfolio — Investing in Innovation; 1997 Chapter 5 Reporting Performance in the Expenditure Management System; 1997 Chapter 11 Moving Toward Managing for Results; 1997 Chapter 22 Crown Corporations: Making Performance Measurement Work.

Government Spending Programs Should Remain Current

The resources available to government change over time. So do public needs and preferences. To ensure that public spending is allocated to the uses that are most valued, government needs to evaluate its programs regularly and assess whether they are still relevant, effective and efficient. Questions that evaluations should address include the following:

- Does the program still serve a clearly defined public purpose that matters to Canadians?
- Would we establish the program today if it did not already exist?
- Is it desirable to maintain it at the current level?
- Can it be delivered more effectively or efficiently? Have there been changes (in the service environment infrastructure, technology, etc.) since the program's inception that would now permit an alternative means of achieving its objectives with greater economy, efficiency, or effectiveness?

These questions are similar to those asked during the government's Program Review that preceded the deficit-cutting measures announced in the February 1995 Budget. The government claims that Program Review was instrumental in establishing the priorities that should be supported and in identifying where spending could be cut with the least pain to the system and fewest adverse consequences for Canadians. These are, of course, precisely the purposes that program evaluation can serve. But evaluations should not be sporadic, or byproducts of financial crisis. Systematic, ongoing evaluation of programs is an essential part of good public management.

High deficits and the need to rein them in provided strong incentive during the 1990s to review government programs closely for savings opportunities and to evaluate new spending proposals carefully. Indeed, under the government's Expenditure Management System published in early 1995, all new spending had to be financed through reallocations from existing programs. In the current post-deficit environment, the demand for fiscal discipline may appear less pressing. The need for ongoing review of government programs remains, however, for we still need to ensure that they continue to serve a useful public purpose and that they remain efficient, effective and affordable.

Systematic, ongoing evaluation of programs is an essential part of good public management.

For related Auditor General work, see: 1996 Chapter 3 Evaluation in the Federal Government; 1993 Chapter 8 Program Evaluation in the Federal Government — The Case for Program Evaluation; 1993 Chapter 9 Program Evaluation in Departments — The Operation of Program Evaluation Units; 1993 Chapter 10 The Program Evaluation System — Making It Work.

Recent government pronouncements on spending practices are commendable, but follow-through is key

I was encouraged to see the government's clear commitment to "responsible spending" in the Treasury Board publication, *Results for Canadians: A Management Framework for the Government of Canada*, released earlier this year. Specific parts of that commitment coincide with several of the prerequisites for sound management of public spending I have been discussing here, including a focus on results, a proper environment of control, and continuous examination of expenditures to ensure that value is obtained for the taxpayer's dollar.

I was also pleased at the revised policy for transfer payments announced last May by the Treasury Board President. Key components of that new policy — clear eligibility criteria, due diligence in approving entitlement and making payments, a results-based accountability framework, enhanced reporting to Parliament, ongoing monitoring and evaluation — are consistent with recommendations we have made in past reports on audits of grant and contribution programs. Appropriately implemented, the revised policy should result in much better management of government transfer payments.

Effective implementation is key of course. In the rest of this chapter, I discuss how a sound framework of values and ethics and the right incentives can help convert principle into practice.

A Strong Foundation of Values and Ethics Can Support Prudent Spending

Government is increasingly relying on values and ethics, rather than on prescriptive controls, to maintain probity and prudence in the public sector. A strong foundation of values and ethics helps to ensure that sound judgments are made in deciding how to spend money and implement programs. There is such a foundation in the federal public service at present, but it should not be taken for granted.

Exhibit 2 — Components of an Ethical Framework

- Statement of principles.
- Leadership by ministers and senior officials.
- Empowerment of public servants to carry out their duties in the public interest.
- Increased transparency in decision making.
- Provision of ethics–related training.
- Effective and trustworthy recourses for voicing ethical concerns.

Source: Reports of the Auditor General of Canada, 1995 and 2000.

As we note in Chapter 12 of this year's Report, major changes in government, such as the relaxation of central controls and the diffusion of decision-making authority, could undermine the existing strong foundation of values and ethics. We have proposed a framework to help maintain that foundation. This framework focusses on leadership, transparency in decision-making and the provision of guidance and training (see Exhibit 2).

The government has taken a number of important steps in recent years to maintain a strong foundation of values and ethics in the federal public sector. The 1996 report of the Task Force on Public Service Values and Ethics (the Tait report) helped forge a consensus on the current state of values and ethics in the federal public service and on areas for action. As well, the government is trying to reinvigorate a discussion of values and ethics in the public service. A number of departments are in the process of implementing sophisticated programs of values and ethics. For the most part, however, work to implement needed reforms in this area is only at a preliminary stage.

In its efforts to sustain sound values and ethics in the public sector, the government faces several major challenges. A set of principles to guide the public sector has to be developed. This cannot be imposed. It needs to be developed with the full participation of members of the public service and those who do business with the government. If the principles are to have credibility, leadership by example throughout the public sector will be critical.

In its efforts to sustain sound values and ethics in the public sector, the government faces several major challenges.

The government is telling public servants that ethics involve “a commitment to do the right thing.” It is also advising them that in deciding how to act, they should consider their obligation and authority to act, choose the best option, and accept responsibility for the actions taken. To help public servants act on this advice, the government needs to clarify the responsibilities of ministers and officials so there is a better understanding of who is accountable for what.

There is also a need to provide public servants with effective means to intervene in good faith and voice ethical concerns. Public servants should not be put in the position of believing that their only recourse is to express their concerns publicly. It should be possible to address matters of ethical concern effectively within an organization. To make it possible, the recourse mechanisms must be clear and trustworthy.

Finally, organizations and individuals doing business with the government or receiving government funds must play a supportive role. They need to understand that they are expected to respect the values and ethics that underpin sound public administration. The government will need to provide appropriate guidance on this.

A strong foundation of sound values and ethics is an essential part of good governance. It deserves more vigorous and systematic support than it has received to date. The government need to show greater determination on this front, develop a plan to address the issues involved, and act decisively to implement it.

For related Auditor General work, see: 2000 Chapter 12 Values and Ethics in the Federal Public Sector; 1999 Chapter 26 National Defence — The Proper Conduct of Public Business; 1998 Chapter 15 Promoting Integrity in Revenue Canada; 1995 Chapter 1 Ethics and Fraud Awareness in Government.

Incentives Should Be Harnessed to Pull in the Right Direction

A strong commitment to the values of professionalism, integrity and service reduces the risk that office holders will behave improperly or abuse the power of their office. But virtue alone is not enough to produce good results. As the famous British economist Alfred Marshall once observed, "Progress chiefly depends on the extent to which the *strongest* and not merely the *highest* forces of human nature can be utilized for the increase in social good." An altruist will give more to charity than a miser, but each is likely to give less when the cost of giving rises (through a reduction in the tax subsidy afforded charitable donations, for instance). Incentives matter. How to make them work in the administration of the public sector is a question of the first importance. Regrettably, it has not always received the attention it deserves.

Both carrot and stick can be used for the purpose. Deliberate abuse of power must invite appropriately corrective consequences. Good performance — performance above and beyond the call of duty — should be rewarded accordingly. Opportunities to tie rewards to performance may not be as prevalent in the public sector as in the private sector, but they do exist. Bonuses, promotions and reassignments are some available means. Programs of public recognition for a job well done or recognition from colleagues can also motivate a greater effort to improve performance and are often easier to implement than monetary incentives.

The question of the right incentives extends beyond individual rewards and sanctions to broader rules in government.

The question of the right incentives extends beyond individual rewards and sanctions to broader rules in government. To illustrate, until 1993 all savings achieved by departments — any unspent balances by year-end — would be returned to the government's general coffers. Where was the incentive to save in such a system? In 1993, the supply process was amended to allow departments to carry forward a portion of their unspent funds to the following fiscal year. As a result of that change, year-end spending sprees by departments are now less common than they used to be.

Unfortunately, they have recently been replaced by a similar practice at a more aggregate level. With the elimination of the deficit three years ago, the government has adopted the practice of announcing significant new spending toward year-end so the estimated surplus is reduced to a level no higher than the $3 billion "contingency reserve" included in the Budget forecast. Largely as a result of this practice, cumulative spending in excess of Budget projections has amounted to $10.5 billion over the past three years.

Poorly structured incentives also appear to have played a role in the mismanagement of job creation programs at HRDC. According to testimony before the House of Commons Standing Committee on Human Resources Development and the Status of Persons with Disabilities, HRDC front-line employees were under pressure to approve projects quickly and spend the available funds. Employees who exercised prudence might have been assessed poorly for failing to disburse enough funds.

There is a tendency in government at times to move cautiously in ferreting out error and to respond slowly when it is found.

Mistakes can occur in any organization. When they occur in the private sector, there are strong incentives to correct them quickly and move on: financial markets and the bottom line are powerful enforcers.

In the public sector, rectifying mistakes often appears less pressing. To set a failure right, it is necessary to own up to the failure first. But where are the benefits to ministers and senior management of acknowledging error? The fallout can often be severe. Cover the mistake up, on the other hand, and life chugs along normally: none is the worse off but taxpayers. There is therefore a tendency in government at times to move cautiously in ferreting out error and to respond slowly when it is found.

A number of lessons emerge from this experience:

- It takes courage for public officials to bring administrative abuses and mistakes to light. When they do, they deserve protection against possible retribution from their bureaucratic or political masters for the discomfort they may have caused. As the Task Force on Public Service Values and Ethics concluded, appropriate mechanisms are needed to permit public servants to express dissent and raise ethical concerns without suffering for their efforts.

Enhanced transparency and accountability lead to stronger institutions and more effective government.

- Accountability requires that people accept responsibility for their mistakes — that goes without saying. Excessive emphasis on laying blame, however, can be counterproductive. If we wish to empower employees and encourage them to innovate, then we must be prepared to accept the risk that, at times, mistakes and wrong decisions will be made. When that happens, we should focus on learning from the experience rather than assigning blame.

- Parliament and the public should encourage more openness in government. Sunlight, it has been said, is the best antiseptic. Clear, timely information on money spent, where it went and what it achieved makes it easier for those outside the organization to monitor the disbursement of funds for consistency with policy intentions, probity and prudence. The knowledge that their operations are visible encourages public servants and their political masters to exhibit behaviour that can withstand scrutiny. **Overall, enhanced transparency and accountability lead to stronger institutions and more effective government.**

For related Auditor General work, see: 1999 Chapter 11 Agriculture Portfolio — User Charges; 1994 Chapter 32 Department of Finance and Revenue Canada — Income Tax Incentives for Research and Development; 1992 Chapter 5 The Learning Organization.

Conclusion

The past decade has seen a strong movement toward a less bureaucratic, more flexible approach to management in the federal public sector. The relaxation of central controls, increased managerial discretion, a focus on results over process — these are all elements in this trend. This is a trend that I very much favour and have strongly supported, but it has a downside. As recent disclosures of some lax spending practices in government suggest, when controls are reduced and more discretion is allowed, there is some risk that discretion will be misused and things may go wrong.

To minimize that risk, devolution of authority must be matched with some basic principles to guide spending decisions and to place appropriate bounds on the use of discretion. In broad terms, these principles require acting within authority and acting with prudence while maintaining a focus on results that matter to Canadians. Reinforced with appropriate incentives, values and ethics, they can help produce government that is both frugal and effective.

The Canadian economy has been on a strong upward trajectory over the past few years, and government coffers are flush with cash. Good times are not normally conducive to intensive efforts to achieve economy and efficiency. All the more reason, therefore, for parliamentarians and the public to remain vigilant, and to insist that government spending take place within a framework that respects the supremacy of Parliament and fosters value for the taxpayer’s dollar.

Supplement: Other Matters

Reforms in human resource management have not met expectations

Public management in Canada has changed significantly in the last decade, becoming less reliant on detailed central controls and more focussed on results. As part of this change, departments and their employees have received broader authority and discretion to find innovative ways of meeting objectives. These changes have highlighted the importance of improving the way government employees are managed in order to attain desirable results. As I have stressed on previous occasions, success on this front is key to successful public sector reform generally, for it is people who must implement the reforms, deliver the services and provide feedback for improved performance.

Despite major initiatives during the 1990s, human resource management reforms have not met expectations. Further, the challenges have taken on increased urgency. One reason is that measures to cope with difficult fiscal circumstances exacerbated poor labour-management relations and led many public servants to question the wisdom of a career in the public service. A second is that the public service faces new or heightened concerns. These include an impending “retirement bulge”, which raises the spectre of a future leadership crisis, and increasing competition from other employers for “knowledge workers.”

There is a need for a real breakthrough in human resource management if the public service is to meet the challenges before it. Key to achieving this breakthrough is the resolution of three long-standing issues. The administrative framework governing the public service is cumbersome, costly and ill-suited to the demands of modern management. Responsibility is fragmented to an extent that clear leadership is lacking and accountability for reforms is unclear. And the increasing autonomy of departments demands major changes in the roles played by departmental managers. Deputy ministers, traditionally seen as primarily responsible for administering a centrally prescribed framework, must instead assume pivotal responsibility for the way their people are managed and for maintaining a healthy work environment in their departments.

For related Auditor General work see: 2000 Chapter 9 Streamlining the Human Resource Management Regime: A Study of Changing Roles and Responsibilities; 2000 Chapter 21 Post-Secondary Recruitment Program of the Federal Public Service; 2000 Chapter 22 Development of the Universal Classification Standard: A Follow-up.

Financial management capabilities in departments fall short of what is needed

Encouraging better financial management in government has been a long-standing strategic priority of my Office. As part of this effort, in April 1999 we published the Financial Management Capability Model, a framework describing the essential elements of financial management in government departments and agencies. The Model sets out the Office’s expectations for financial management and is the basis on which future audits in this area will be conducted.

In Chapter 13 of this year’s Report, we presented the results of an audit of the financial management capabilities in five government departments. The audit found that none of these departments meets the requirements of important current government initiatives, such as the Modernization of Comptrollership and the Financial Information Strategy. These initiatives aim to modernize the way government manages resources, by strengthening internal controls and providing better information to support planning, decision making and reporting.

One of the most common weaknesses we found was the limited ability to integrate financial and non-financial information. Without integrated information, departments cannot determine accurately how much it costs to produce a particular result or to deliver a service at a given level. They need such information to make sound decisions, manage risks well and account properly for the use of resources.

It will be difficult to modernize government operations without strong financial management capabilities. The development of these capabilities throughout government will require the sustained support and concerted effort of the Treasury Board Secretariat, the Privy Council Office and deputy ministers. With important government initiatives hinging on capabilities that do not currently exist, there is no time to spare.

For related Auditor General work, see: 2000 Chapter 13 Assessment of Financial Management Capabilities in Departments; April 1999 Financial Management Capability Model; 1999 Chapter 21 Financial Information Strategy: Departmental Readiness; 1998 Chapter 18 The Financial Information Strategy: A Key Ingredient in Getting Government Right.

Performance reporting has improved but progress has been slow

In Chapter 19 of this Report, we examine the reporting of departmental performance to Parliament. Some improvement has been made since our 1997 audit of this matter, but I am disappointed at the slow pace of progress. While today's performance reports are better than the information that was available to parliamentarians in the previous Part III Estimates, they are still too much a report of activities rather than an accounting of the results achieved compared with what was planned. Too often the planned results are vague about what the departments actually expect to achieve, and the reporting of performance does not link achievements to the longer-term benefits for Canadians.

Members of Parliament and the public need good performance information to be able to hold the government to account. Parliamentarians need this information in their committee reviews of departmental programs and in their scrutiny of the budgetary process. Parliament may want to consider legislation to ensure that it is provided. But other changes are also needed in the reporting regime. Agreement on principles of reporting, more incentives for good reporting, and stronger oversight and challenge by the Treasury Board Secretariat are all required. Departments also need performance information to improve programs and services.

I am pleased to note that a general focus on results seems to have taken hold in the culture of departmental management and performance reporting. But effective implementation requires that the next steps — measuring results, using that information to improve programs and credible reporting on results to Parliament — be taken with some urgency.

For related Auditor General work, see: 2000 Chapter 19 Reporting Performance to Parliament: Progress Too Slow; 2000 Chapter 20 Managing Departments for Results and Managing Horizontal Issues for Results; 1997 Chapter 5 Reporting Performance in the Expenditure Management System.

Education system fails to meet the needs of Indian children on reserves

In April of this year, we reported on our audit of elementary and secondary education for Indian children who live on reserves. Indian and Northern Affairs Canada (INAC) allocates about $1 billion each year for this purpose, in addition to funding school construction and maintenance.

The audit found serious gaps in the academic achievement of First Nations students compared with other Canadians. The dropout rate of these students before grade nine is six times higher than that of the general Canadian population. The proportion of the on-reserve population with a high school education is significantly lower than in the general population. Moreover, it is questionable whether the education received by Indian students meets their cultural needs.

This poor record reflects deficiencies in the education programs funded by INAC that have existed for a very long time. For one, the Department has not articulated its role in education. Clarification of the role is essential both for accountability purposes and for the Department to know whether its existing capacity and resources are sufficient to fulfil that role.

The Department also needs to address several operational issues, including how education funds are administered. As a result of program devolution and delegation of authorities, the Department has come to rely on First Nations and the provinces for the delivery of education services. The Department needs to take the measures necessary to ensure that these services — for which it provides funding — are effective and efficient.

Action to meet the education needs of Indian children is urgently needed. In the absence of satisfactory progress, there will be high financial cost in social programs, an increased waste of human capital, and degradation of the relationship between the government and First Nations peoples.

For related Auditor General work, see: 2000 Chapter 4 Indian and Northern Affairs Canada — Elementary and Secondary Education.

Health and safety regulatory programs face difficult challenges

Health and safety regulatory programs deal with issues ranging from food inspection and nuclear power regulation to environmental pollution and air safety. Their basic purpose is to protect Canadians from risks to health and safety. This task is becoming increasingly complex, requiring a correspondingly sophisticated approach to accomplish it.

Federal health and safety regulatory programs have experienced profound changes over the past decade. They were restructured to streamline delivery, and they shifted orientation away from direct regulation (designed and imposed by government) toward greater reliance on standards developed by third parties, such as voluntary industry codes. They were also subjected to funding reductions, which have been partly reinstated recently.

Some of these changes have had an adverse impact on public confidence in the effectiveness and credibility of health and safety regulatory programs. Restoring public confidence is one of several serious challenges facing these programs today. Other challenges include a significant exposure to legal claims for regulatory negligence, arising from court decisions over the past decade; the need to co-ordinate operations across departments and jurisdictions, since many health and safety issues cut across departmental mandates and political borders; and the need for large-scale recruitment of expert staff, in light of the high proportion of employees who will be eligible for retirement in the near future.

In Chapter 24 of this Report, we make a number of recommendations that can help government respond to these challenges.

For related Auditor General work, see: 2000 Chapter 24 Federal Health and Safety Regulatory Programs; 2000 Chapter 25 Canadian Food Inspection Agency — Food Inspection Programs; 2000 Chapter 26 Health Canada — Regulatory Regime of Biologics; 2000 Chapter 27 Canadian Nuclear Safety Commission — Power Reactor Regulation; 2000 Chapter 28 Follow-up of Previous Recommendations on Health and Safety Regulatory Programs.

Governance of Crown corporations has improved but can be made better

Corporate governance refers to the process and structures for overseeing the direction and management of a corporation so that it effectively carries out its mandate and objectives. It is critical that a Crown corporation be well governed if taxpayers' money is to be well spent. Based on our general experience in auditing Crown corporations and a more specific review of 15 corporations, we see shortcomings in three areas important to the way Crown corporations are governed.

First, boards of directors need strengthening. Currently, they lack key skills and capacities to oversee effectively the management of Crown corporations. Corporations need to define better their requirements in this area, and government needs to act on them. Boards of directors also need to be more engaged in selecting the corporation's chief executive officer (CEO). Without meaningful involvement by the board in the process, accountability of the CEO to the board is weakened and corporate governance as a whole suffers.

Second, the audit committees of Crown corporation boards often fall short of recognized best practices. The audit committee plays a crucial role in financial reporting, risk management and internal control. Of the committees we examined, half were considered ineffective or only marginally effective.

Finally, the government has a limited capacity to review and challenge Crown corporation corporate plans. The government needs to strengthen this capacity, since these plans are the basis for holding Crown corporations accountable for their conformance to government policy and their performance overall.

For related Auditor General work, see: 2000 Chapter 18 Governance of Crown Corporations; 1995 Chapter 10 Crown Corporations: Fulfilling Responsibilities for Governance.

Opportunities for cost savings

Improving the efficiency and effectiveness of government activities and cultivating a healthy regard for economy are objectives central to our mandate and to the work that we do at the Office. The impact of our work is not easily quantifiable in most cases, but often in the course of our audits we find opportunities for cost savings to which a price tag can be attached. The following are examples taken from audits reported this year:

Management of health benefits to First Nations. In a 1997 audit of health programs delivered to First Nations communities, we noted the need for a point-of-service system to control the administration of benefits. We also recommended that Health Canada take appropriate steps to improve claims-processing system controls and edits. In a follow-up audit this year, we found that $8.4 million was saved in 1999 through identification and rejection of improper claims, but further improvements are still possible.

Non-recovery of expenditures by Indian and Northern Affairs Canada. The Department has spent approximately $151 million since 1977 to ensure a continuous supply of drinking water to Cree communities that were adversely affected by hydro-electric development by Manitoba Hydro. Under an agreement signed in 1977, Manitoba Hydro is required to reimburse the Department for 50 percent of the expenditures attributable to the adverse effects of the hydro projects. We note in Chapter 17 that the Department has not made any recoveries to date.

Debt servicing costs. In order to limit its exposure to unexpected increases in interest rates, the government increased the fixed-rate share of federal debt from 55 percent of gross debt in 1995 to 67 percent in 1998, where it remains today. In Chapter 8 we recommended that in light of its improved fiscal condition the government review its debt structure target to determine whether it is still appropriate. The chapter noted that based on the historical difference between long- and short-term rates, a five-percentage-point shift from fixed-rate to floating-rate debt could generate an annual saving of some $250 million.

For related Auditor General work, see: 2000 Chapter 8 Department of Finance — Managing Canada's Debt: Facing New Challenges; 2000 Chapter 15 Health Canada — First Nations Health: Follow-up; 2000 Chapter 17 Other Audit Observations.