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

MAY

Government Decisions Limited  
Parliament's Control of Public Spending



Office of the Auditor General of Canada

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*All of the audit work in this chapter was conducted in accordance with the standards for assurance engagements set by the Canadian Institute of Chartered Accountants. While the Office adopts these standards as the minimum requirement for our audits, we also draw upon the standards and practices of other disciplines.*

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# Government Decisions Limited Parliament's Control of Public Spending

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## Main Points

### What we examined

In the course of auditing the Canada Firearms Centre's 2004–05 expenditures as charged against its voted appropriation, we found that the Centre had not recorded significant costs of the Canadian Firearms Information System (CFIS) II in the correct fiscal year. To determine the origin of this accounting error, we examined the appropriateness of the accounting for the CFIS II costs incurred in 2002–03 and in 2003–04, and we assessed the government's management of the decision not to seek Supplementary Estimates when it became aware of a likely over-expenditure.

We examined the accuracy of the information reported to Parliament by the Canada Firearms Centre in its departmental performance report and in the *Public Accounts of Canada* (Volume II).

We also examined the adequacy of the government's documentation of its decision-making process.

### Why it's important

The essence of parliamentary control of the public purse lies in the ability of the House of Commons to establish an annual cap on the amount of money that the government may spend on each of its identified areas of activity and in holding the government to account for respecting those limits on its spending.

The ability of Parliament to exercise control depends on the government's production of good spending estimates in the first place and, at year-end, on the fair presentation of actual spending in departmental accounts. Only if this is done can Parliament be assured that its authority will not normally be exceeded and, in those rare cases when it is, that Parliament will be in a position to exercise its duty of holding the government to account.

Decisions by the government not to seek authority when required, or not to account fully for expenditures against a vote where an over-expenditure is likely, could be viewed as limiting Parliament's ability to control the public purse.

**What we found**

- Contrary to government accounting policy, the Department of Justice failed to record an expenditure estimated at up to \$39 million incurred in 2002–03 by the Canada Firearms Centre (then part of the Department). It is our opinion that in the *Public Accounts of Canada*, Parliament was misinformed about the Centre's costs for that year. The Centre's actual spending was up to \$17.1 million more than the \$100 million cited by the Minister of Justice in the House of Commons as the limit on the Centre's 2002–03 spending.
- In January 2004, because senior officials advised the Centre to record the \$39 million as an expenditure in 2003–04, and because the Centre believed it would have to record new CFIS II costs that were significantly higher than planned for, the Centre realized it would likely exceed its 2003–04 spending limit authorized by Parliament. Senior officials, however, decided that Supplementary Estimates were not desirable. Secretariat accounting officials were asked to look for an accounting treatment that would, if possible, avoid having to record all the CFIS II costs.
- As the result of a meeting of senior officials in February 2004, the Centre concluded incorrectly that it did not have to record \$21.8 million of CFIS II development and delay costs incurred in 2003–04 as an expenditure that year. In our opinion, this decision was contrary to the government's *Policy on Payables at Year-End (PAYE)* and on accounting for appropriations, as stated in Volume I of the *Public Accounts of Canada*. In their view, not recording the CFIS II costs incurred in 2003–04 eliminated the need to submit Supplementary Estimates for additional funds in 2003–04.
- Had the Centre correctly recorded all CFIS II costs incurred in 2003–04, it would have exceeded its voted appropriation that year unless it had been granted Supplementary Estimates. In our opinion, Parliament was misinformed about the costs the Centre had incurred and, as a result, Parliament's control of government spending was improperly limited.
- In a separate accounting decision in 2005–06, the Centre plans to continue recording costs already incurred as expenditures spread out over the next 15 years, contrary to the Treasury Board's Payables at Year-End policy.
- Key meetings held and decisions taken by the government were documented poorly, if at all. This was not compliant with the Treasury Board's *Policy on Management of Government Information*.



## Introduction

### Foundation of parliamentary control

1. The *Canadian Constitution* established three basic principles for government spending:
  - all Crown funds must be placed in a central fund called the Consolidated Revenue Fund;
  - only Parliament may authorize the spending of those funds; and
  - bills to authorize the spending of public funds must originate in the House of Commons.
2. Based on these three simple principles—in which Parliament's control of the public purse resides—the government tables annually in the House its estimates of the spending plans for each federal department and agency. The Estimates documents support the government's request for Parliament's authority to spend in the upcoming fiscal year. This request is formalized through the tabling of appropriation bills in Parliament. Spending authorities are either voted or statutory. Voted authorities are those for which a department must seek Parliament's approval annually through an appropriation act; statutory authorities represent Parliament's ongoing authorization to spend, granted through its approval of other legislation.
3. In addition, Standing Order 80 (1) of the Standing Orders of the House of Commons further establishes the sole right of the House of Commons to initiate and grant supply, but more particularly to direct and limit spending in the appropriation bills it passes every fiscal year. The Standing Order has been unchanged since Confederation, and the text copies a resolution adopted in the UK in 1678. The House of Commons claims its privilege based on section 53 of the *Constitution Act, 1867*, which has also remained unchanged since Confederation.
4. The Estimates support a set of appropriation bills in which the specific spending authorities of departments and agencies are set out in the form of votes. Once reviewed and approved by the House, the votes establish the maximum amount that the government is permitted to spend during the fiscal year on the matters and activities identified under each Vote. At the end of the fiscal year, if the activities require less than the amount voted, the unspent funds normally lapse along with the authority to spend them. New authority to spend must

be sought in a subsequent year's Estimates. As Robert Marleau and Camille Montpetit state in their book:

Concurrence in the Estimates or in Interim Supply is an order of the House to bring in an appropriation bill or bills giving effect to the spending authority (amounts and their destinations) that the House has approved. Once adopted, the legislation will authorize the government to withdraw from the Consolidated Revenue Fund amounts up to, but not exceeding, the amounts set out in the Estimates for the purposes specified in the Votes. (741)

5. When a department or an agency becomes aware during the year that approved funding is insufficient to deliver its programs, it must seek Parliament's authority to adjust its expenditure plan for that year. The Supplementary Estimates process is used to obtain this additional spending authority; Supplementary Estimates typically are tabled twice each year.

6. In essence, Parliament's control of the public purse lies in the House's ability both to cap the government's spending for the year on each identified area of activity and to hold the government to account for respecting those spending caps. As further stated by Marleau and Montpetit:

The financial role of the House of Commons does not end with voting supply or authorizing measures to raise revenue. The House also acts as a "watchdog" to ensure that federal money is spent in the amounts and for the purposes authorized by Parliament. This monitoring function (often described as "closing the loop") is delegated largely to the Standing Committee on Public Accounts, which examines and reports on the *Public Accounts of Canada*, as well as on all reports of the Auditor General of Canada. (762)

7. Parliament's ability to exercise control depends on

- the government's production of good estimates initially;
- assurance that when unanticipated circumstances cause the need for further funds, Parliament's authority will be sought; and
- assurance that the spending attributable to each Vote during the fiscal year will be presented fairly by the government in accordance with its stated basis of accounting for appropriations.

Only in these circumstances can parliamentarians be assured both that the spending they have authorized will not be exceeded (known as "blowing the vote") except in rare cases, and that in those cases, Parliament will be in a position to hold the government to account.

This explanation of the financial role of the House of Commons in paragraphs 4 and 6 is based on Marleau, Robert, and Montpetit, Camille; 2000. *House of Commons Procedure and Practice*. Chenelière/McGraw-Hill, pages 741, 762.

8. Therefore, decisions by the government either not to seek authority when required to do so or not to account fully for expenditures against a Vote could be viewed as limiting Parliament's control of public spending.

### **Financial reporting roles and responsibilities**

9. In the Government of Canada responsibility for accounting is divided, with some responsibilities allocated to the Treasury Board and the Receiver General for Canada and others to individual departments and agencies.

10. The President of the Treasury Board and the Minister of Finance have the authority to prescribe the manner of accounting and the form of the accounts of Canada and those of departments and agencies. Under the *Financial Administration Act* (FAA), the Treasury Board is authorized to establish policies, directives, regulations, standards, and guidelines for the management of public funds. The Treasury Board has placed significant duties and responsibilities for public funds under the control of deputy heads. The Treasury Board authorizes access by ministers to funds that Parliament has appropriated, and the minister delegates spending authority to the deputy minister and other departmental officials.

11. To satisfy the requirements of the FAA, the policies and regulations of the Treasury Board, and the requirements of the Receiver General, departments must establish and maintain adequate systems to account for, control, and report on their financial results. They are also responsible for the accuracy and completeness of the departmental financial results reported in their departmental performance report and in Volume II of the *Public Accounts of Canada*.

12. Senior accounting officials of the Treasury Board Secretariat have told us that a department and its minister are responsible for the accuracy of their financial reporting. In the view of these officials, the Secretariat provides advice only; any financial reporting decision a department makes is the responsibility of that department alone. While we agree with the Secretariat's view, in our opinion its advice is very influential, and departments rarely ignore it.

### **Focus of the audit**

13. As part of our follow-up on a previous audit of the Canadian Firearms Program (see Chapter 4 of our May 2006 Status Report) we audited the Canada Firearms Centre's expenditures of \$92.8 million for the fiscal year ended 31 March 2005, as charged against its voted

appropriation for that year and reported in its *2004–05 Departmental Performance Report*. As noted in Chapter 4, we found the figures to be reasonable except for an accounting error in recording the costs of the Canadian Firearms Information System (CFIS) II. The Centre recorded an expenditure of \$21.8 million in 2004–05 that it should have recorded in 2003–04. We found that this was the second of two accounting errors in the recording of CFIS II development costs. The first error occurred in 2002–03, when the Department of Justice did not record any of the CFIS II costs incurred that year as part of its expenditure charged against the departmental voted appropriation.

14. The objective of our audit was to assess the appropriateness of the government's accounting for the CFIS II costs incurred in 2002–03 and in 2003–04 and the government's management of the decision not to request additional funding through Supplementary Estimates in 2003–04.

15. In addition, as we became aware during our audit that many key decisions lacked documentation, we decided to assess the documentation practices against the Treasury Board *Policy on the Management of Government Information*.

16. It should be noted that our conclusions about management practices and actions refer only to those of public servants. The rules and regulations we refer to are those that apply to public servants; they do not apply to contractors. We did not audit the records of the private sector contractors. Consequently, our conclusions cannot and do not pertain to any practices that contractors followed or to their performance.

17. More information on the objectives, scope, approach, and criteria can be found at the end of this document in **About the Audit**.

## Observations

### Project background

#### **Canadian Firearms Information System II: Unanticipated costs as a result of government delays**

18. The Centre's information on firearms licences and registrations is currently managed by the Canadian Firearms Information System (CFIS I). In July 2002, a contract was signed for the development of CFIS II, a new information system expected to replace the present one. As originally planned, the development phase of CFIS II was to take nine months with a completion or service-effective date of 9 January 2003. In November 2002 the Centre, PWGSC (Public

Works and Government Services Canada, the contracting authority), and the contractor recognized that the project was significantly larger than either the statement of requirements in the 2002 request for proposals or the original contract had anticipated.

**19.** The development of CFIS II was still under way at the time of our follow-up work in 2005. The project had suffered further significant delays when Bill C-10A to amend the *Firearms Act* did not receive royal assent until May 2003, and the related regulations were not enacted until December 2004. The legislative amendments resulted in significantly more changes to the system requirements and the project's scope than the contractor had originally been told. In addition, the number of users increased, and there were new security requirements.

**20.** In March 2003 (fiscal year 2002–03), the contractor informed the government that it was ready to begin testing the system as originally designed. However, the legislative amendments had not yet been approved, and the Centre expected that the system as developed would not meet its needs, given the new legislative requirements. It therefore put the project on hold and asked the contractor to maintain the system in a state of readiness. The next fiscal year, in July 2003, the Centre, PWGSC, and the contractor reached an “agreement in principle” under which the contractor agreed to incur, and the Centre agreed to pay, the costs of maintaining the system in a state of readiness, subject to Treasury Board ministers’ ratification of the agreement and to approval of related amendments to the CFIS II contract.

**21.** Later in 2003–04, the Centre started to question the wisdom of continuing the development of CFIS II because of the significant additional work and associated costs and because reviews of CFIS I concluded that it could continue to meet the Centre’s needs for the next two to three years. Because of the uncertain future of CFIS II, the ratification of the “agreement in principle” and the approval of the related contract amendments were delayed well into the 2004–05 fiscal year. As a result, at the Centre’s request to put the development on hold, the contractor incurred additional development and delay costs of \$21.8 million during 2003–04, which were not covered at the time by the original CFIS II contract then in effect.

**22.** A more detailed analysis of the reasons for project delays is presented in Chapter 4 of our May 2006 Status Report.

## The first accounting error **Failure to record costs in 2002–03**

**23. Chronology and actions.** In order to understand how all of the key decisions with respect to expenditure reporting were made, we looked back to 2002. In December of that year, the Department of Justice requested Parliament's approval for Supplementary Estimates to bring the planned spending of the Canada Firearms Centre (then reporting to the Minister of Justice) to \$113 million for 2002–03. However, on the motion of two members, the House of Commons gave unanimous consent to reducing the Supplementary Estimates for the Department of Justice by \$72 million (the additional amount requested for the Centre). In February 2003 the government tabled its final Supplementary Estimates for the year, in which the Minister of Justice requested \$59 million in additional spending authority for the Centre. During discussions about these Supplementary Estimates, the Minister of Justice committed to Parliament that the Centre's spending for 2002–03 would not exceed \$100 million. In March 2003 Parliament then approved Supplementary Estimates that would bring the Centre's total planned spending to \$100 million.

**24.** Later, the Department of Justice reported in the 2002–03 *Public Accounts of Canada* the Centre's actual spending for 2002–03 at \$78.3 million. However, this amount did not include the CFIS II development costs incurred that year, estimated at up to \$39 million.

**25.** Department of Justice officials did not record the CFIS II costs in 2002–03. They were unable to provide us with any documents showing any analysis or process by which the decision was made on how to deal that year with the CFIS II liability.

**26.** During 2003–04, when the Centre became aware of the 2002–03 unrecorded CFIS II costs, it sought advice from the Treasury Board Secretariat on the proper accounting treatment for these costs. The Treasury Board Secretariat concluded that an accounting error had been made and that CFIS II costs incurred to date should have been recorded with the Department of Justice's 2002–03 expenditures. The Secretariat further concluded that this error should be corrected by recording the 2002–03 CFIS II costs in the current fiscal year, 2003–04.

### **Analysis of government's rationale and our opinion**

**27.** In leaving the \$39 million unrecorded the Department of Justice did not, in our opinion, comply with the Treasury Board's *Policy on Payables at Year-End (PAYE)*. The PAYE policy states that costs for the

development of large systems are to be recorded as expenditures against a departmental appropriation in the year when they are incurred, rather than when they become due and payable under a contract.

**28.** While the Department of Justice's total spending would have remained within its voted appropriation had it recorded the \$39 million in its 2002–03 expenditures, actual spending of the Canada Firearms Centre would have been \$117.3 million, \$17.1 million more than the maximum amount the Minister had said the Centre would spend that year.

**29.** In our opinion, it would likely have been of significant interest to Parliament that a major expenditure was not recorded in the correct fiscal year, and that recording it properly would have resulted in the Centre's exceeding the spending limit that the Minister of Justice communicated to the House. In our view, this should have been reported at the time.

## The second accounting error

### Failure to record costs in 2003–04

**30. Chronology and actions.** The Canada Firearms Centre was established as a separate department in April 2003, reporting to the Minister of Public Safety and Emergency Preparedness. With the decision to record the 2002–03 CFIS II costs in 2003–04, the Centre inherited the problem caused by the Department of Justice's accounting error. Because of this, and because CFIS II costs continued to rise unexpectedly, the Centre became concerned that if it recorded all of the CFIS II costs incurred in 2003–04, it would exceed its voted appropriation.

**31.** The Centre sought advice from the Treasury Board Secretariat in January 2004 on the appropriate accounting treatment for the 2003–04 CFIS II costs. On 30 January 2004, the Centre's Commissioner wrote to the Minister of Public Safety and Emergency Preparedness Canada (PSEPC) saying that the Treasury Board Secretariat had advised him that all costs incurred to date on the CFIS II project, including those incurred in 2002–03 and those incurred outside the original contract, would have to be charged to the Centre's 2003–04 voted appropriation in order to comply with the *Policy on Payables at Year-End (PAYE)*. The Commissioner further wrote that doing so would result in exceeding that year's voted appropriation unless Supplementary Estimates were granted, and that a submission to the Treasury Board for Supplementary Estimates would be prepared and forwarded to the Minister.

**32.** In February 2004, as the deadline for Supplementary Estimates was approaching, senior officials briefed ministers. It was decided that Supplementary Estimates were not desirable. At the same time, Secretariat accounting officials were asked to look for an accounting treatment that would avoid having to record all of the CFIS II costs incurred in 2003–04 and therefore avoid, if possible, the need to submit Supplementary Estimates.

**33.** On 3 February 2004, senior officials at the Secretariat sought legal advice. In early February 2004, senior officials of PSEPC obtained their own separate legal opinion on how FAA subsection 37.1(1) applied to this situation. While we reviewed the opinions, we are unable to discuss the former because officials of the Secretariat chose, as was their right, not to waive the solicitor/client privilege.

**34.** Senior accounting officials of the Treasury Board Secretariat continued to maintain that all CFIS II costs and other estimable liabilities incurred in 2003–04 should be recorded and charged against the Centre's voted appropriation that year. They held that this was consistent with the requirements of transparency, full disclosure, and good accounting practices—as well as the PAYE policy, which had been applied by all other government departments since it was established in 1991. These officials also stated that legal advice should not determine the correct accounting treatment. According to the Accounting Standards Board of the Canadian Institute of Chartered Accountants' Standard 1000.21(a), the correct accounting treatment should reflect the economic substance of the transaction over its legal form:

Representational faithfulness is achieved when transactions and events affecting the entity are presented in financial statements in a manner that is in agreement with the actual underlying transactions and events. Thus, transactions and events are accounted for and presented in a manner that conveys their substance rather than necessarily their legal or other form. . . .

**35.** In mid-February 2004, a meeting took place to discuss whether the Centre needed to record all of the CFIS II costs incurred that year and whether, as a result, it should recommend that its Minister submit Supplementary Estimates. We were told that attending this meeting were senior officials from the Centre, PSEPC, PWGSC, and the Treasury Board Secretariat. We were also told that there are no written records of this meeting or the decisions taken during the meeting. Ultimately, it is the responsibility of the Centre's Commissioner to decide whether or not to recommend that the PSEPC Minister submit Supplementary Estimates, and the Commissioner told us that based on



discussions held at that meeting he had decided there was no need for such a recommendation. However, in our interviews we found that senior officials differed significantly in their recollection of the level of concurrence at the meeting or of whether there had been any decision taken at all at the meeting.

**36.** In March 2004, after the deadline for Supplementary Estimates had passed, Treasury Board Secretariat accounting officials continued to evaluate alternative accounting treatments for the CFIS II costs. At the time, they still appeared to hold the view that the proper accounting treatment was to book all CFIS II costs against the Centre's voted appropriation and report an over-expenditure.

**37.** In May 2004, as a result of an April 2004 meeting with the Treasury Board Secretariat, the Centre reported the CFIS II unrecorded costs of \$21.8 million as an "unrecorded liability" in the annual confirmation letter on "Valuation of Assets and Liabilities" that departments must provide to the Secretariat, and not as a charge to its own appropriation. The Centre also disclosed the existence of the unrecorded liability in its 2003–04 and 2004–05 departmental performance reports (see excerpts 1–3). The Centre's Commissioner told us that, in his opinion, he had performed proper due diligence in determining the proper accounting treatment for CFIS II costs by consulting extensively with the Treasury Board Secretariat, informing his Minister, and ultimately relying on the legal opinion sought by senior officials of PSEPC.

**Full accrual basis of accounting**—The full accrual accounting basis refers to a method of accounting that records an entity's financial transactions and other economic events when they occur, rather than when the entity receives or pays cash or its equivalent. It records expenses as goods or services are consumed, and it records revenues in the period to which they pertain. It recognizes the life-cycle costs associated with long-lived assets.

**38.** The Secretariat recognized that under the **full accrual basis of accounting**, a liability of \$21.8 million existed at the end of 2003–04. It recorded this liability as part of the central allowance amount included in the summary financial statements of the *Public Accounts of Canada*.

**Excerpt 1 Canada Firearms Centre 2003–04 Departmental Performance Report**

**Table 7: Unrecorded Liabilities**

Unrecorded Liabilities	
	Amount
Claims pending	\$21.8M
<b>Total Unrecorded Liabilities</b>	<b>\$21.8M</b>

*Note: Section 6.5 Detail Project Spending identifies \$32M in delay costs that is included within the current estimated total cost of the CFIS Renewal Project. Of this amount, \$18.2M is related to 2003-2004 and has been reported as an unrecorded liability together with a further \$3.6M for other system development related scope items for a total of \$21.8M.*

**Excerpt 2 Canada Firearms Centre 2003–04 Departmental Performance Report**

**[Section] 6.5 Details on Project Spending**

**Canadian Firearms Information System**

(\$Millions)	Original Estimated Cost	Current Estimated Total Cost	Forecast Spending to March 31, 2004
<b>Canadian Firearms Information System (CFIS) Renewal</b>			
<i>a) Solution Realization Development – Phase I</i>			
	\$32.3	\$70.0	\$39.6
<i>b) Ongoing Operations (15 years) – Phase II</i>			
	\$231.9	\$360.0	
<i>c) Solution Enhancements (15 years)</i>			
	\$26.6	\$81.0	
<i>d) Delay Costs</i>			
	\$0.0	\$32.0	

*Note: As a result of uncertainties, and a changing legislative and regulatory environment under which this project has proceeded, there have been significant scope changes and implementation delays. The contractor has incurred costs outside of the formally approved contract. Discussions are underway to determine additional costs and the most appropriate approach to regularize the situation and account for the resulting liability. Included in the current estimated total cost, \$21.8M has been listed as an unrecorded liability in the government of Canada's financial statements; \$18.2M related to delay costs and \$3.6M related to Solution Realization Development scope changes.*

**Excerpt 3 Canada Firearms Centre 2004–05 Departmental Performance Report**

**Table 5: Contingent Liabilities**

Contingent Liabilities	March 31, 2004	March 31, 2005
Claims pending	\$21.8 million	\$0
<b>Total Contingent Liabilities</b>	<b>\$21.8 million</b>	<b>\$0</b>

*In the 2003-2004 Departmental Performance Report, \$21.8 million was shown as an amount of unrecorded liability. The amount was related to work accomplished by Team CENTRA in the development of a business solution for the redesign of the Canadian Firearms Information System CFIS II and its operation of the solution under an Alternative Service Delivery (ASD) model. The original contract with Team CENTRA did not call for any payments until the Service Effective Date. It was recognized however that the contractor, due to a number of circumstances, had incurred costs outside of the formally approved signed contract. Ongoing negotiations were aimed at regularizing the issues, but no formal resolution had been arrived at before year-end (2003-2004). A legal opinion obtained from the Department of Justice concluded that only work accomplished by Team CENTRA that was approved by TB and covered by the contract or amendments, should be charged to the 2003-2004 year and that the remaining work should not be charged to the 2003-2004 appropriation. In February 2005, TB Ministers granted effective project approval for the redesign of the Canadian Firearms Information System CFIS II and a related contract amendment. The amendment led to the elimination of the unrecorded liability. For further information, see Table 10 - Details on Project Spending.*

### Analysis of government's rationale and our opinion

39. It is subsection 37.1(1) of the *Financial Administration Act* (FAA) that governs amounts to be charged against voted appropriations:

**Subsection 37.1(1) of the FAA**—Subject to such directions as the Treasury Board may make, a debt incurred by Her Majesty for work performed, goods received or services rendered before the end of a fiscal year, and any amount due or owing under a contract, contribution or other similar arrangement entered into before the end of the fiscal year that remains unpaid at the end of the fiscal year, shall be recorded as a charge against the appropriation to which it relates.

40. To justify their decision not to record the \$21.8 million as an expenditure against the Centre's 2003–04 voted appropriation, certain government officials made the following arguments based on the two main components of FAA subsection 37.1(1):

- No amount was due or owing under a contract, contribution, or other similar arrangement.
- No debt had been incurred for services rendered before the end of a fiscal year.

41. We do not accept these arguments. In our opinion, the Centre should have recorded the \$21.8 million as an expenditure against its 2003–04 voted appropriation. As a result, it would have exceeded the limit of its appropriation that year. Our opinion is supported by our analysis of the government's arguments in the following paragraphs.

42. **“No amount due under a contract or other arrangement.”** In the summer of 2003, the Centre, PWGSC, and the contractor agreed in principle that

- the delays in delivering the system were the result of delays in passing the legislation and subsequent regulations, and
- the scope of work was significantly greater than had been specified in the request for proposals for the original contract.

43. As a result, the contractor agreed that on the instructions of the Centre and of PWGSC, the contracting authority, it would carry out extra work on CFIS II and incur delay costs. The agreement was subject to ratification by Treasury Board ministers and to the signing of a proper contract amendment. The agreement in principle was reached verbally at a meeting held on 3 July 2003. A PWGSC representative documented the verbal agreement in a Record of Decision, which was distributed to all those who had attended the meeting as representatives of the government and the contractor.

44. Officials of the Treasury Board Secretariat told us they did not believe the agreement in principle was a legally binding agreement because it was evidenced only by a Record of Decision, signed by PWGSC alone and by neither of the other parties—the Centre and the contractor. We do not believe this argument is valid, because records of decision are normally prepared by one party attending a meeting and are distributed to all others. Furthermore, subsequent correspondence between the contractor, the Centre, and PWGSC provides written evidence of the parties' concurrence with the agreement in principle set out in the Record of Decision.

45. In addition, the preamble to amendment no. 2 of the CFIS II contract, signed on 23 December 2003 (see Excerpt 4), clearly recognized the agreement in principle. Canada's intent to honour the agreement in principle is clear in contract amendment no. 2, and we therefore conclude that a legally binding agreement existed at the end of 2003–04.

**Excerpt 4 Canadian Firearms Information System II contract, amendment no. 2**

WHEREAS Canada and the Service Provider have negotiated additional work and increased costs relating to the Work, as documented in a Record of Decision dated July [3], 2003;

WHEREAS Canada intends to incorporate such additional work and increased costs, as mutually agreed to in principle, into the contract via an amendment, subject to Canada receiving the necessary contract approval;

. . .

WHEREAS Canada and the Service Provider have agreed to postpone to a later date such amendments as are necessary, in order to reflect past and future agreements with respect to price, schedule and performance adjustments. . . .

46. Government officials also argued that because the agreement in principle was subject to Treasury Board ministers' approval and the signing of a formal contract amendment, and because these two conditions were not met prior to 31 March 2004, the agreement in principle was not a legally binding agreement. However, in our view the senior government officials from the Centre and PWGSC who asked the contractor to start incurring the additional development and delay costs had sufficient authority to enter into an agreement that bound the Government of Canada to a contract, even without the approval of Treasury Board ministers. In this case, the government was seeking the Treasury Board's ratification for a liability that had already been incurred in accordance with subsection 4.1.11 of the Treasury Board *Contracting Policy* (see Excerpt 5).

**Excerpt 5 Contracting Policy**

4.1.11 If a contracting authority enters into a contract without Treasury Board approval when such approval should have been obtained, ratification by the Treasury Board must be sought as soon as possible.

[www.tbs-sct.gc.ca/pubs\\_pol/dcgpubs/Contracting/contractingpol\\_2\\_e.asp#4-1](http://www.tbs-sct.gc.ca/pubs_pol/dcgpubs/Contracting/contractingpol_2_e.asp#4-1)

47. From an accounting perspective, we would be very concerned if the government could move the recording of expenditures from one year to the next based only on the timing of their approval by the Treasury Board. We believe that under FAA subsection 37.1(1) and the PAYE policy, costs must be charged as expenditures against a voted appropriation in the year when they are incurred.

**48. No debt incurred for services rendered before the fiscal year-end.** The government uses the full accrual method of accounting to prepare its annual financial statements. However, the spending authorities voted by Parliament remain on an expenditure basis, which uses only a partial accrual method of accounting. Under that method, departments record their expenditures against their voted appropriations on a cash flow basis during the fiscal year, as payments are made. Then, at the fiscal year-end, annual expenditures must be adjusted to record transactions related to goods received or services rendered before the fiscal year-end but for which no payment will be made until the next fiscal year. Some of these year-end adjustments are made in accordance with the Treasury Board *Policy on Payables at Year-End (PAYE)*. For long-term system development projects like CFIS II, the PAYE policy clearly requires that when a project is still under way at a fiscal year-end, a liability must be estimated and charged against that year's appropriation based on the percentage of work completed. Under the PAYE policy and consistent with full accrual accounting concepts, costs are recorded and charged to the Vote as expenditures when they are incurred rather than when they are paid (see Excerpt 6).

49. Although there are a number of material differences between the full and the partial accrual bases of accounting, these differences lie in specific areas outside the limits of the situation addressed here. (Some examples of these areas are certain employee benefits, vacation pay, prepaid expenditures, and acquisitions of capital assets.) We therefore conclude that although the partial accrual basis of accounting differs materially from the full accrual basis of accounting, both bases of accounting require identical treatment of costs incurred for services rendered under a long-term contract, the situation discussed here.

**Excerpt 6 Policy on Payables at Year-End (PAYE)****Policy Statement**

. . . It is the policy of the Government of Canada to record liabilities to outside organizations and individuals incurred up to and including March 31st in each fiscal year and to charge them to existing appropriations or provide for them through a central provision for valuation.

**Policy Requirements**

. . . In the absence of certainty, estimates must be used to determine the amounts of liabilities, as long as reasonably accurate values can be assigned. . . .

**Appendix A—Technical Requirements for Identifying, Quantifying, Recording and Reporting Liabilities**

These definitions are in general accordance with accounting and reporting principles recommended for governments by the Public Sector Accounting and Auditing Committee of the Canadian Institute of Chartered Accountants. However, the Government's appropriation, accounting, and reporting policies and practices impose some special criteria for defining and recording liabilities.

**Special items**

In the case of large, long term contracts for supply of works, buildings, major systems or equipment where physical ownership has not been transferred, calculation of liabilities should be based on the percentage of work completed which has not been paid. Acceptance or non acceptance of work or product completed should be taken into account in determining the amount to be recorded, but only significant or total rejection of the product or performance should be considered as cause for not recording a liability. Otherwise, the best estimate available should be used.

[www.tbs-sct.gc.ca/pubs\\_pol/dcgpubs/TBM\\_142/5-5-1\\_e.asp](http://www.tbs-sct.gc.ca/pubs_pol/dcgpubs/TBM_142/5-5-1_e.asp)

50. Certain government officials argued, along the lines set out in the Centre's 2004–05 *Departmental Performance Report*, Table 5, (see Excerpt 3), that the meaning of debt in the context of FAA subsection 37.1(1) is much more restrictive than the meaning of a financial liability under accrual accounting. They argued that since no legally binding agreement existed to cover the additional development and delay costs, there was no debt to be charged against the Centre's voted appropriation. We disagree with this argument because it disregarded the existence of, and contradicted the requirements of the Treasury Board PAYE policy.

51. The Treasury Board approved the PAYE policy under the authority provided by FAA subsection 37.1(1)—“Subject to such direction as the Treasury Board may make. . . .” The policy provides the government with detailed guidance on how to interpret and apply FAA subsection 37.1(1); it clarifies that the word “debt” used in the subsection has the meaning of a financial liability under accrual

accounting. We therefore conclude that any interpretation of subsection 37.1(1) that does not consider the requirements of the PAYE policy is incomplete and inaccurate.

**52.** Furthermore, if the accounting treatment decided on was appropriate despite its contradicting the PAYE policy, we fail to understand why the PAYE policy has not been amended and its application changed across the government. In our opinion, such a significant change in the interpretation of the FAA and a Treasury Board policy should have been reflected immediately in the government's practices.

**53.** The PAYE policy allows a liability to be recorded as a central accrual instead of a charge to the departmental appropriation if—and only if—no relevant appropriation exists. Treasury Board Secretariat officials relied on that section of the PAYE policy to justify the recording of the \$21.8 million liability as a central allowance in the summary financial statements of the *Public Accounts of Canada*, prepared on the full accrual basis of accounting, rather than against the Centre's appropriation. We disagree with this: In our view, the Centre had a relevant appropriation against which the liability for costs incurred outside the formal CFIS II contract ought to have been charged.

**54. Government also considered terminating the contract.** Treasury Board Secretariat officials also told us that at the time, termination of the CFIS II contract for default was seriously contemplated. Termination of a contract for default means that one of the parties has the ability to terminate the contract because the other party is not doing what it has agreed to do. Had that been the case, the government's conclusion not to record all CFIS II costs in 2003–04 might have been appropriate. However, we found no evidence to support a termination for default. We found that by late spring of 2004, in an effort to contain the rising costs of CFIS II, the Centre had requested authority to terminate the contract given that the current system (CFIS I) was working well and its operating costs were predictable. Nowhere in the documents that we saw was there any suggestion that the contractor was not meeting performance expectations. Therefore, the liability continued to exist.

**55.** In fact, what we found was clear evidence of discussions about terminating the contract “for convenience.” The evidence we reviewed showed that the Centre was concerned because CFIS II was a long way from completion due to changing government requirements and was going to cost much more than had been estimated. Moreover, the Centre believed that CFIS I was meeting its requirements.

A termination for convenience would have meant further acknowledging the work performed and the costs incurred, which would represent a liability to be recorded as an expenditure against the voted appropriation.

### Poor practice continues

#### The Canada Firearms Centre plans to record costs already incurred as future years' expenditures

56. The current CFIS II contract as amended provides for monthly and annual payments to the contractor to operate and maintain the system over 15 years, starting after the system's effective date. In addition to these service charges, the amended contract provides for the payment of a separate \$15 million over 15 years. That amount was for the remaining development and delay costs the project was expected to incur in 2005–06 before December 2005, the expected completion at that time. The Centre plans to record these development and delay costs as expenditures against annual appropriations over the 15 years as they are paid, rather than in 2005–06 when they were incurred.

57. In our opinion, this accounting treatment does not comply with the Treasury Board's *Policy on Payables at Year-End (PAYE)*, which requires that the development and delay costs incurred in 2005–06 be recorded as expenditures in that year.

### Lack of documentary evidence

58. Our analysis and opinion are based on documents made available to us. Key meetings held and decisions made in relation to certain matters discussed here were not documented. We obtained information about these key meetings and decisions through interviews with government officials. Specifically, we note the failure by government officials to record the decision-making process and the conclusion reached at the mid-February 2004 meeting. The importance of this failure to document becomes clear in the face of a specific disagreement among those present about what transpired at the meeting. The written records we gathered reveal a serious gap in documenting what we believe were important decisions made by the government—a gap that reflects non-compliance with the Treasury Board's *Policy on the Management of Government Information*, which states the following:

. . . [government] institutions must. . . document decisions and decision-making processes to account for government operations, reconstruct the evolution of policies and programs, support the continuity of government and its decision-making, and allow for independent audit and review. . . .



Responsibilities of Deputy heads include: ensuring implementation of this policy and related standards and guidelines. . . .

Responsibilities of senior executives accountable for this policy include: championing information management. . . .

All public service employees are responsible for. . . documenting their activities and decisions. . . .

## Conclusion

**59.** In our opinion, the Department of Justice failed to record CFIS II development costs incurred in 2002–03 as required by the Payables at Year-End (PAYE) policy. While its total spending would have remained within its voted appropriation, had the Department recorded the CFIS II costs in accordance with the PAYE policy, the Canada Firearms Centre's actual spending would have exceeded (by up to \$17.1 million) the spending limit set by the Minister. In our opinion, Parliament was misinformed about the costs the Centre incurred for CFIS II that year.

**60.** In our opinion, the Centre's decision to not record \$21.8 million of CFIS II development and delay costs incurred in 2003–04 as an expenditure that year was contrary to the government's *Policy on Payables at Year-End (PAYE)* and on accounting for appropriations, as stated in Volume I of the *Public Accounts of Canada*. Not recording the CFIS II costs incurred in 2003–04 eliminated the need, in their view, to submit Supplementary Estimates for additional funds in 2003–04.

**61.** Had the Centre correctly recorded all CFIS II costs incurred in 2003–04, it would have exceeded its voted appropriation that year unless it had been granted Supplementary Estimates. In our opinion, Parliament was misinformed about the costs the Centre had incurred and, as a result, Parliament's control of government spending was improperly limited.

**62.** Correcting these two accounting errors would result in a reallocation of expenditures between fiscal years. The cumulative CFIS II project costs of \$74.3 million reported to date at 31 March 2005 remain accurate.

**63.** The Centre plans to continue recording costs already incurred as expenditures spread out over the next 15 years, contrary to the Treasury Board's PAYE policy.

64. Not seeking proper authority for supplementary funds where there is a reasonable likelihood that an appropriation will be exceeded could be interpreted as a breach of the Standing Orders of the House of Commons. Failure to fully account to Parliament for expenditures against a Vote could also be viewed as an infringement of the privileges of the House of Commons. However, only the House itself can determine whether such a breach has occurred. The Standing Committee on Public Accounts may wish to pursue this matter further if it considers that to be appropriate.

65. In addition, key meetings held and decisions taken by the government were documented poorly, if at all. This serious lack of documentary evidence is inconsistent with the Treasury Board's *Policy on Management of Government Information*.

**Treasury Board of Canada Secretariat's response.** The focus of this audit has been on technical, legal and accounting interpretations that were applied to a complex and dynamic management environment. Throughout the period in question, Treasury Board of Canada Secretariat staff, including those of the Office of the Comptroller General, worked closely with officials from the Canada Firearms Centre and the Department of Justice. This cooperation was required to ensure a good understanding of the facts and applicable legislative and policy requirements to make informed recommendations and decisions. The extent of the discussion and review reflected the overriding imperative to ensure that all legislative authorities were fully respected.

We acknowledge the Auditor General's understanding of the facts and legislative and policy requirements. For greater clarity, the Secretariat confirms its full agreement with the Auditor General's finding with respect to the first accounting error in 2002–03. Furthermore, the Secretariat accepts the conclusions related to the second accounting error in 2003–04 and the ongoing accounting for the CFIS II contract. However, the Secretariat does wish to note the steps and considerations that were taken into account that led to a different interpretation of the legislative and policy requirements on this matter.

These were as follows:

- The Centre sought the advice of the Treasury Board Secretariat on the appropriate accounting for the CFIS II contract in January 2004. Time was of the essence given the deadline for Supplementary Estimates;

- The Secretariat worked with the Centre over a number of weeks to confirm the facts surrounding the CFIS II contract and an agreement in principle that had not been approved by the Treasury Board nor subject to a contract amendment;
- Accounting policy advice was provided on the application of the *TB Policy on Payables at Year-end (PAYE)* based on assumptions of actions to be taken by March 31<sup>st</sup> (i.e. a likely contract amendment);
- Legal advice was sought to confirm *Financial Administration Act* Section 37.1 requirements for charging appropriations;
- Based on the policy and legal advice obtained, and the assumed actions to be taken, it was concluded that there was no requirement to charge appropriations for the costs incurred outside of the contract under the agreement in principle and therefore there was no purpose to seek Supplementary Estimates;
- As the books of the Government were being closed, the contract management situation was monitored to determine if there were any changing circumstances requiring a different accounting treatment relative to appropriations; there were none;
- The Centre reported the unrecorded liability to the Treasury Board Secretariat as required under the *TB Policy on Allowances for Valuation of Assets and Liabilities*. The Secretariat assessed these costs as a contingent liability and recorded the liability and expense in the Government's financial statements;
- To ensure transparency, the Secretariat advised the Centre to fully disclose the contingent liability in its Departmental Performance Reports to Parliament; which it did in 2003–04 and 2004–05; and,
- The Comptroller General met with officials from the Office of the Auditor General, as part of the audit of Public Accounts 2004, to discuss the accounting treatment of the CFIS II contingent liability. The Office of the Auditor General subsequently advised verbally that it had no issues with the accounting for this matter.

Based on the above, the Secretariat was led to believe that it had come to a reasonable interpretation and conclusion regarding the accounting treatment. The Secretariat does recognize and accept the Auditor General's different interpretation.

It should be noted that the specific circumstances in the case of the Centre were different than that of the Department of Justice in the previous year and therefore required a different accounting treatment. In the case of the Department of Justice, a contract existed and work

had been performed. It was therefore the conclusion that a charge to appropriation should have been made in 2002–03. Regarding the Centre's situation, there had been work performed by the supplier with respect to an agreement in principle drafted after a meeting between the supplier and Public Works and Government Services Canada and Centre officials. The parties clearly acknowledged that this was conditional on obtaining Treasury Board approval and signing a formal contract amendment. However, this was not done until well into 2004–05.

Concerning the on-going accounting of development costs, we will review the matter with the Centre and the Office of the Auditor General to ensure proper accounting treatment in the Public Accounts for the year-end March 31, 2006.

As already indicated to the Auditor General, lessons have been learned by the Treasury Board Secretariat and corrective actions taken, including;

- First, about the miscommunication that happened during the audit of the Public Accounts. The Comptroller General has implemented a protocol with the Office of the Auditor General for “advance audit opinion ruling” whereby the written confirmation of the Office of the Auditor General is sought for complex and significant accounting transactions prior to the actual transaction taking place.
- Second, to provide a timely forum for discussion of areas of possible differences of opinion in the accounting treatment of certain transactions. The coming into force of the new *Policy on Internal Audit* on April 1, 2006 will provide a timely venue for the Office of the Auditor General and departments to discuss complex accounting matters with an independent audit committee.
- Third, to clarify possible differences of interpretation of legislation, policies and directives. The Comptroller General has launched a full-scale review of all financial management policies and related directives in mid 2005. Many of these policies are 10 to 20-years old and do not reflect the changes in terminology, nor the adoption of the full accrual basis of accounting for the Financial Statements of Government of Canada. The Federal Accountability Action Plan calls for the results of the review to be submitted to the President of the Treasury Board by the end of calendar year 2006.

- Fourth, to bring a greater degree of precision and transparency in the accounts of the Government. The Comptroller General has launched a 3-year initiative to have all financial statements of the largest departments and agencies audited annually starting no later than March 31, 2009. Those entities represent in excess of 90% of all government spending. In addition, starting in fiscal year 2005–06, all departments will start reporting their financial statements in their Departmental Performance Reports.

In conclusion, the Secretariat acknowledges and accepts the position of the Auditor General on these errors and is taking appropriate and far-reaching actions to minimize a repeat of these circumstances. Given the differing interpretations of legislation and Treasury Board policy, it is apparent to the Secretariat that further work will be required to determine, with the Auditor General and others, what legislative and policy changes are required to provide the necessary clarity in this area.

## About the Audit

### Objectives

The main objective of this audit was to assess the government's management of the decision not to seek Supplementary Estimates for the Canada Firearms Centre in 2003–04 and the accounting treatment it used for the related transactions.

We wanted to determine whether the government should have sought approval for Supplementary Estimates when it became aware of a likely over-expenditure.

We also wanted to determine whether the government had adequately documented the process and the rationale by which it arrived at the decisions it made in these cases.

### Scope and approach

As part of our follow-up on a previous audit of the Canadian Firearms Program (see Chapter 4 of our May 2006 Status Report) we audited the total expenditures incurred by the Canada Firearms Centre and charged against its voted appropriation for the year ended 31 March 2005. In addition, although we did not audit total expenditures reported by the Centre in prior fiscal years, we reviewed all CFIS II costs incurred during the period from 1 July 2002 to 31 March 2005.

We interviewed senior managers and staff of the Centre, Justice Canada, PSEPC, PWGSC, and the Treasury Board Secretariat. We reviewed extensive documentation including relevant submissions to the Treasury Board.

During the course of our work we kept senior management informed on our progress and our preliminary findings. The period of our audit was from April 2005 to March 2006.

### Conflict-of-interest disclosure

The current Deputy Auditor General was the Acting Comptroller General of Canada during part of the period in which the decisions about the 2003–04 accounts were made—that is, late January 2004 to early March 2004. He resigned his position in mid-February 2004 and left the employment of the government in early March 2004. Shortly thereafter, he was named Deputy Auditor General of Canada.

When the commencement of this audit was announced, he immediately disclosed that he had been involved in matters that might arise in the course of our audit and recused himself from all involvement in the audit. He was interviewed by the audit team in his capacity as the former Acting Comptroller General of Canada.

### Criteria

We expected that the Centre's annual expenditures for the year ending 31 March 2005, reported in its 2004–05 *Departmental Performance Report* and charged against its voted appropriations, would be presented fairly in all material respects, in accordance with requirements of the Receiver General and the Treasury Board.

We expected that if a reasonable possibility existed that expenditures incurred in pursuit of the objects of a Vote would exceed the appropriated limit, the government would seek Supplementary Estimates in accordance with the principle of parliamentary control of the public purse.

We expected that all significant decisions taken and key meetings held by government officials would be properly documented in written records, in accordance with the Treasury Board *Policy on the Management of Government Information*.

**Audit work completed**

Audit work for this chapter was substantially completed in March 2006.

**Team**

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