

CHAPTER II

THE AUDITOR GENERAL'S REPORT OF NOVEMBER 2003

2.1

Genesis in March 2002

In March 2002 the Honourable Don Boudria, who was then the Minister of Public Works and Government Services Canada (PWGSC), asked the Auditor General of Canada to investigate three contracts, totalling \$1.6 million, that had been awarded by PWGSC through its Communication Coordination Services Branch (CCSB) to Groupaction Marketing Inc. in 1996, 1998 and 1999.¹ These contracts had been the subject of many questions in the House of Commons and had attracted considerable media commentary.

On May 6, 2002, the Auditor General reported to the Minister that her audit of these contracts had revealed significant shortcomings at all stages of the contract management process. She advised him that her findings had led her to refer the matter to the RCMP. She also announced that, on the basis of

the facts which she had learned during her investigation of these files, she had decided to undertake a government-wide audit of all of the advertising and sponsorship activities of the Government of Canada since 1997.²

On the basis of this initial Report of the Auditor General, Prime Minister Chrétien, on May 23, 2002, spoke to the House of Commons and announced an eight-point action plan which included changes to the legislation governing the financing of political parties and candidates for office.³ In his speech the Prime Minister acknowledged that “it appears that some mistakes were made.” He did not go into the details of the problems with the House of Commons, because he did not know precisely what they were and because there were ongoing investigations by the police and by the Auditor General.⁴ His intent was to reassure the public that the Government was doing what was necessary to correct the situation and that the matter could be dealt with effectively by the Auditor General and the police.⁵

At the time that the Auditor General announced her intention to conduct a full-scale audit of the Sponsorship Program, she was under the impression that it had been initiated in 1997 at about the time CCSB was created as a branch of PWGSC.⁶ We now know that certain sponsorship initiatives had been undertaken by the Government through the predecessor of CCSB, known as the Advertising and Public Opinion Research Service (APORS), as early as 1995, and that what is now referred to as the Sponsorship Program was commenced in the spring of 1996.⁷

Since the Government’s advertising activities were also being administered by CCSB, the same service that was in charge of the Sponsorship Program, the Auditor General undertook at the same time an audit of the advertising activities of the federal government.⁸ In each case her audit dealt only with the period from November 1997, when CCSB was created, until 2001.

The Auditor General learned in the course of her audit that the Sponsorship Program had been the subject of an internal audit conducted by PWGSC in 2000. That internal audit had revealed serious administrative shortcomings which PWGSC had made attempts to remedy.⁹ Similar problems had been

uncovered in an earlier audit of the Government's advertising activities conducted by outside auditors, Ernst & Young, in 1996.¹⁰ These audits will be discussed in Chapter VII of this Report.

The Auditor General reported that the Sponsorship Program was created as a result of concerns about the visibility of the federal presence across Canada, but particularly in the Province of Quebec. One of the vehicles for promoting the visibility of the federal government was sponsorships. The Government of Canada would agree to provide organizations with financial assistance to support cultural and community events. In exchange, an organization would agree to provide visibility for the federal government by, for example, displaying the Canada wordmark and other symbols, such as the Canadian flag, at its events and on promotional material. Sponsorships were intended to encourage a positive perception of the federal government through its association with popular events in fields such as sports, entertainment and culture.¹¹

2.2

Summary of the Auditor General's Conclusions

The Auditor General's Report of November 2003 is highly critical of the Government's handling of the Sponsorship Program. Under the heading "Overall Main Points," she summarizes her findings in the following paragraphs:¹²

1. We found that the federal government ran the Sponsorship Program in a way that showed little regard for Parliament, the *Financial Administration Act*, contracting rules and regulations, transparency, and value for money. These arrangements—involving multiple transactions with multiple companies, artificial invoices and contracts, or no written contracts at all—appear to have been designed to pay commissions to communications agencies while hiding the source of funding and the true substance of the transactions.
2. We found widespread non-compliance with contracting rules in the management of the federal government's Sponsorship Program, at every stage of the process. Rules for selecting communications agencies, managing contracts, and measuring and reporting results

were broken or ignored. These violations were neither detected, prevented, nor reported for over four years because of the almost total collapse of oversight mechanisms and essential controls. During that period, the program consumed \$250 million of taxpayers' money, over \$100 million of it going to communications agencies as fees and commissions.

3. Public servants also broke the rules in selecting communications agencies for the government's advertising activities. Most agencies were selected in a manner that did not meet the requirements of the government's contracting policy. In some cases, we could find no evidence that a selection process was conducted at all.

Chapter 4 of the Auditor General's Report deals with the advertising activities of the Government of Canada. In it, critical observations are made concerning deficient management practices by public servants; the Auditor General takes care to specify that her comments and criticisms do not apply to the persons with whom the Government contracted for advertising services.¹³

In her testimony at the hearings of the Commission, the Auditor General and her colleagues on her panel described their audit objectives as follows:¹⁴

- whether the Government had exercised adequate control over the Sponsorship Program, public opinion research, and advertising activities;
- whether the program and activities were duly reported to Parliament; and
- to what extent the Government had taken corrective action as a result of previous audits and reviews.

The entities audited were CCSB and its successor, Communication Canada, which were believed to be the two main agencies responsible for the management of the Sponsorship Program, as well as the two central agencies with oversight responsibility, the Treasury Board Secretariat and the Privy Council Office. Included in the audit were the Government agencies and Crown

Corporations that had received money from the Government through the Sponsorship Program.¹⁵

The Auditor General comes to eight principal conclusions, which may be summarized as follows:

1. *Parliament's role was not respected* in that Parliament was not informed of the Sponsorship Program's existence and objectives.¹⁶ There had been no advice or direction from the Government as to how the Program was to be implemented, and no strategic plan. In fact, the Auditor General had been unable to determine how the decision to create the Program had been made, or by whom. None of PWGSC's performance reports to Parliament mentioned the Sponsorship Program prior to 2001. The Auditor General was of the opinion that in such performance reports there should have been specific mention of the Sponsorship Program, given its importance.¹⁷
2. *There was a breakdown in internal controls*, due in part to the fact that the contracting and payment procedures followed at CCSB violated basic principles of segregation of duties and oversight. Essentially a deputy head is obliged, by reason of section 32 of the *Financial Administration Act* and related Treasury Board policies, to ensure that procurement, requisitions for payment, and certification for payment according to section 34 of the *Financial Administration Act* are kept separate and performed by different persons. This did not occur.¹⁸

Personnel at CCSB told the representatives of the Office of the Auditor General that Mr. Guité, the Executive Director of CCSB, decided, without their involvement, on events to be sponsored, amounts to be allocated and the selection of agencies. He held discussions with the Minister's office or representatives of the Prime Minister's Office at various times, and then instructed them to prepare contract requisitions and to forward them to procurement staff for the completion of contracts. The Executive Director then approved payments to the contracted communication agencies. The

concentration of all these functions in the hands of one public servant constituted a serious irregularity. The Auditor General also found that the Sponsorship Program operated without written guidelines, and that events and the amounts of money granted to them by way of sponsorships appeared to be decided arbitrarily and on an *ad hoc* basis.¹⁹

3. *There were problems related to the selection of agencies.* According to the Government Contracting Policy and particularly Appendix Q,²⁰ which governs the selection of advertising agencies, suppliers should have been selected competitively²¹ according to procedures that were frequently not followed.²²

Until 2001, for sponsorship contracts, PWGSC used communication agencies from three lists of pre-qualified suppliers that were approved for another purpose. Two of the lists had been created in 1995, and one in 1997. None of the agencies on the three lists of pre-qualified suppliers had been selected in conformity with the required competitive process. In every case there were serious irregularities.²³

4. *Files were poorly documented.* Section I2.3.I of the Contracting Policy of the Government provides that:²⁴

Procurement files shall be established and structured to facilitate management oversight with a complete audit trail that contains contracting details related to relevant communications and decisions including the identification of involved officials and contracting approval authorities.

The Auditor General found that there was a general lack of documentation in the files, which usually did not contain any assessment of a project's merits (indeed, there were no criteria in existence for assessing merit) or a documented rationale supporting the level of funding approved. There was a general lack of visibility plans and post-mortem reports that would permit evaluation of value received for money spent.²⁵

5. *Amendments were made irregularly.* The Auditor General found that 21% of the audited files had been amended without any explanation of the reasons for the amendments or of how such amendments were in the best interests of the Government.²⁶
6. *There were serious problems relating to section 34 certification and payment.* Although sponsorship files invariably included a signature certifying that the requirements of section 34 of the *Financial Administration Act* had been satisfied, in many instances the Auditor General saw insufficient evidence in the file supporting that signature. Some payments were made on the basis of lump-sum invoices, with no supporting documentation; or there was no record of who had performed the work, and no post-mortem report showing that the sponsored event had taken place and that the Government had received the visibility for which it had paid. In many cases, the file contained only a contract and an invoice.²⁷
7. *Commissions and production costs were excessive.* The Auditor General found that of about \$250 million spent in Sponsorship Program expenditures, over \$100 million was paid to communication agencies as production fees and commissions. The latter sum could be roughly broken down into \$16.9 million in agency commissions, calculated at 12% of sponsorship values; \$4.3 million in Agency of Record commissions, calculated at 3% of sponsorship values; and \$85.4 million in production costs. It was the \$85.4 million in production costs that was of particular concern to the Auditor General. They included sums expended through subcontracting, and she could not be sure from the documentation in the files if further commissions had been charged in the subcontracts. Although there must have been some value received for the commissions and fees spent, there was little evidence to justify this.²⁸

In her testimony, the Auditor General agreed that the problem was not with commissions as such. The Program had been established in such a way that communication agencies would do most of the management of the Program, giving advice on what to sponsor, taking care of administrative details and ensuring that the requested visibility was received. Her quarrel was with the amounts charged as production costs that would normally be covered by the commission of 12%. Her view was that the commission should have been a management fee paid to manage the whole activity, and that additional production costs should have been charged only on an exceptional basis.²⁹

8. *The Government's Transfer Payments Policy was not observed.* The final area of criticism was related to sponsorship of Crown Corporations and agencies, such as Via Rail, Canada Post, the Business Development Bank and the RCMP. In the course of the audit, the Office of the Auditor General learned of arrangements between PWGSC and communication agencies to transfer sponsorship funds to these corporations and agencies. PWGSC did not enter into contracts directly with the Crown Corporations to which it was transferring money; rather it contracted with communication agencies, to which it paid commissions to transfer money to the Crown Corporation or agency concerned.³⁰ The Auditor General takes the position that these transfers violate the intent of the Transfer Payments Policy, which aims to ensure that grants, contributions and other transfer payments are not used as a substitute for financing a Crown Corporation's operating or capital requirements.³¹

The Auditor General expressed the view that if a Crown Corporation or agency requires additional funds, it must go to Parliament to seek additional funds through supplemental appropriations. To do otherwise amounts to a bypass of parliamentary controls and oversights.³²

In addition, there was little or no value for the money paid as commissions to transfer these funds from PWGSC to the Crown Corporation or agency concerned.³³

The Report of the Auditor General includes a number of case studies which serve to illustrate the above findings most eloquently.³⁴

With respect to the Auditor General's audit of the advertising activities of the Government of Canada, the audit objective was to determine whether in contracting for advertising services the federal government ensured that it obtained the best value for the Crown in a process that was transparent and gave equitable access to suppliers of advertising services. The objective was also to determine whether departments ensured that their advertising campaigns were designed to achieve the expected results and whether there was a corporate approach to advertising activities and their coordination.³⁵

As a general conclusion, the Auditor General found that the Government of Canada failed to meet its obligation to allow suppliers equitable access to government business and obtain best value in selecting advertising agencies. She also found that most of the advertising agencies chosen to supply advertising services to the various departments of government that needed their assistance were selected in a manner that did not comply with the Government Contracting Policy.³⁶ All of the evidence presented to the Commission relating to advertising contracts, including the report submitted by Kroll Lindquist Avey (the "Kroll Report," which is reproduced as a separate volume of this Report—Forensic Audit), is consistent with the Auditor General's findings.

The Report of the Auditor General disclosed serious shortcomings relating mostly to the Sponsorship Program, but also to the general advertising activities of the Government of Canada. She made her findings on the basis of an audit of the books and records of the Government of Canada supported by interviews with public servants. However, there were limits on how far she could go in her investigation.

2.3

Additional Scope of a Commission of Inquiry

The present Commission of Inquiry has had many advantages which the Auditor General did not have. It has been able to subpoena records from third parties and to compel witnesses from within and outside the Government to testify under oath, whether they were inclined to cooperate with counsel for the Commission or not. In this way, a fuller and more complete examination of the shortcomings described in the Auditor General's Report has been possible. As already indicated, everything that the present Inquiry learned tends to validate the conclusions of the Auditor General's Report on the Sponsorship Program and government advertising activities, except that in many cases the irregularities and mismanagement that she described were clearly worse and more widespread than the Auditor General had learned or imagined, particularly with respect to sponsorship.

It is not necessary for the present Report to repeat what is disclosed in the Report of the Auditor General, especially since Chapters 3 and 4 are available to the interested reader as Appendix B to this Report. However, it should be noted that the objectives of an audit are to verify if the books and records of an organization have been properly maintained and accurately represent its financial results and situation. It also seeks to discover if the management of the organization which is being audited is conforming to established laws, regulations and policies, and whether there has been maladministration. In extreme cases, the audit may reveal the commission of criminal acts. Audits would not be required if the owners of the organization were correct to presume that every one of its employees was perfectly competent and honest and had not committed any errors. In other words, the function of an auditor is necessary because sometimes people are in error, incompetent or dishonest. Good management requires that these possibilities be anticipated, envisaged and discouraged.

But before launching into a description of what went wrong, it is important first to examine the structure, organization and operation of the Canadian government and how "good government" is supposed to function. That will be the subject of the next chapter.

Endnotes to Chapter II

-
- ¹ Testimony of Ms. Fraser, Transcripts vol. I, p. 43 (OE), p. 46 (F); Exhibit P-I(A), pp. I0-I1.
- ² Exhibit P-I(A), p. I0.
- ³ Exhibit P-2I0(D), p. 754.
- ⁴ Testimony of Mr. Chrétien, Transcripts vol. 72, p. I264I (OF), pp. I2625-I2626 (E), Exhibit P-2I0(D), pp. 754-759.
- ⁵ Testimony of Mr. Chrétien, Transcripts vol. 72, pp. I264I-I2645 (OF), pp. I2626-I2629 (E).
- ⁶ Office of the Auditor General of Canada, *Report of the Auditor General to the House of Commons: Government-Wide Audit of Sponsorship, Advertising, and Public Opinion Research* (Minister of Public Works and Government Services Canada 2003), chapter 3, para. 3.6.
- ⁷ The recent history of sponsorships initiatives is discussed more fully in Chapter IV of this report.
- ⁸ Exhibit JC-I0, tab 3.
- ⁹ Office of the Auditor General of Canada, *Report of the Auditor General to the House of Commons: Government-Wide Audit of Sponsorship, Advertising, and Public Opinion Research* (Minister of Public Works and Government Services Canada 2003), chapter 3, para. 3.95.
- ¹⁰ Exhibit P-3(A), tab 3.
- ¹¹ Office of the Auditor General of Canada, *Report of the Auditor General to the House of Commons: Government-Wide Audit of Sponsorship, Advertising, and Public Opinion Research* (Minister of Public Works and Government Services Canada 2003), chapter 3, paras. 3.5-3.7, 3.I4.
- ¹² Office of the Auditor General of Canada, *Report of the Auditor General to the House of Commons: Government-Wide Audit of Sponsorship, Advertising, and Public Opinion Research* (Minister of Public Works and Government Services Canada 2003), chapter 3, para. 3.I.
- ¹³ Office of the Auditor General of Canada, *Report of the Auditor General to the House of Commons: Government-Wide Audit of Sponsorship, Advertising, and Public Opinion Research* (Minister of Public Works and Government Services Canada 2003), chapter 4, paras. 4.I, 4.6.
- ¹⁴ Testimony of Ms. Fraser, Transcripts vol. I, p. 58 (OE), p. 62 (F); Exhibit P-I(A), p. I4.
- ¹⁵ Testimony of Mr. Campbell, Transcripts vol. I, pp. 6I-62 (OE), pp. 66-67 (F); Exhibit P-I(A), pp. I5-I6.
- ¹⁶ Office of the Auditor General of Canada, *Report of the Auditor General to the House of Commons: Government-Wide Audit of Sponsorship, Advertising, and Public Opinion Research* (Minister of Public Works and Government Services Canada 2003), chapter 3, para. 3.I00.
- ¹⁷ Testimony of Ms. Fraser, Transcripts vol. I, pp. 95-I02 (OE), pp. I0I-I08 (F).
- ¹⁸ Exhibit P-I(A), p. 26.
- ¹⁹ Office of the Auditor General of Canada, *Report of the Auditor General to the House of Commons: Government-Wide Audit of Sponsorship, Advertising, and Public Opinion Research* (Minister of Public Works and Government Services Canada 2003), chapter 3, paras. 3.20-3.23, 3.I20-3.I22; Exhibit P-I(A), p. 27.
- ²⁰ See Chapter V, Section 5.3, for a fuller description of Appendix Q and the circumstances of its adoption.
- ²¹ Testimony of Mr. Minto, Transcripts vol. I, pp. I16-I17 (OE), pp. I23-I24 (F); Exhibit P-I(A), pp. 28-29.

- ²² *Office of the Auditor General of Canada, Report of the Auditor General to the House of Commons: Government-Wide Audit of Sponsorship, Advertising, and Public Opinion Research* (Minister of Public Works and Government Services Canada 2003), chapter 3, paras. 3.49-3.54; chapter 4, paras. 4.20-4.31.
- ²³ Testimony of Mr. Minto, Transcripts vol. I, pp. 124-126 (OE), pp. 130-132 (F); Exhibit P-I(A), pp. 29-30.
- ²⁴ Testimony of Mr. Minto, Transcripts vol. I, pp. 133-134 (OE), pp. 139-140 (F).
- ²⁵ Testimony of Mr. Minto, Transcripts vol. I, pp. 134-136 (OE), pp. 140-142 (F); Exhibit P-I(A), p. 31.
- ²⁶ Testimony of Mr. Minto, Transcripts vol. I, pp. 150-151 (OE), pp. 156-157 (F); Exhibit P-I(A), p. 31.
- ²⁷ Testimony of Mr. Minto, Transcripts vol. I, pp. 137-138 (OE), pp. 143-144 (F); Exhibit P-I(A), pp. 35-37.
- ²⁸ Testimony of Mr. Minto, Transcripts vol. I, pp. 152-157 (OE), pp. 158-164 (F); Testimony of Ms. Fraser, Transcripts vol. 2, p. 294 (OE), p. 313 (F); Exhibit P-I(A), pp. 31-37.
- ²⁹ Testimony of Ms. Fraser, Transcripts vol. 2, pp. 329-331 (OE), pp. 332-334 (F).
- ³⁰ *Office of the Auditor General of Canada, Report of the Auditor General to the House of Commons: Government-Wide Audit of Sponsorship, Advertising, and Public Opinion Research* (Minister of Public Works and Government Services Canada 2003), chapter 3, para. 3.43.
- ³¹ Testimony of Mr. Minto, Transcripts vol. I, pp. 163-166 (OE), pp. 170-174 (F); Testimony of Ms. Fraser and Mr. Minto, Transcripts vol. I, pp. 67-76 (OE), pp. 73-82 (F); Exhibit P-I(A), pp. 37-41; Exhibit P-2(A), tab 17; *Office of the Auditor General of Canada, Report of the Auditor General to the House of Commons: Government-Wide Audit of Sponsorship, Advertising, and Public Opinion Research* (Minister of Public Works and Government Services Canada 2003), chapter 3, para. 3.43.
- ³² Testimony of Ms. Fraser, Transcripts vol. I, pp. 108-111 (OE), pp. 115-117 (F).
- ³³ *Office of the Auditor General of Canada, Report of the Auditor General to the House of Commons: Government-Wide Audit of Sponsorship, Advertising, and Public Opinion Research* (Minister of Public Works and Government Services Canada 2003), chapter 3, para. 3.35.
- ³⁴ *Office of the Auditor General of Canada, Report of the Auditor General to the House of Commons: Government-Wide Audit of Sponsorship, Advertising, and Public Opinion Research* (Minister of Public Works and Government Services Canada 2003), chapter 3, pp. 10-20.
- ³⁵ Exhibit P-I(A), p. 66.
- ³⁶ *Office of the Auditor General of Canada, Report of the Auditor General to the House of Commons: Government-Wide Audit of Sponsorship, Advertising, and Public Opinion Research* (Minister of Public Works and Government Services Canada 2003), chapter 4, paras. 4.24-4.31.