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Fisheries and Oceans Canada Pêches et Océans Canada

Canada

TABLE OF CONTENTS

1.0 EXECUTIVE SUMMARY

1.1 INTRODUCTION

In 1995, as part of Program Review, Fisheries and Oceans Canada (DFO) committed to increasing revenues rather than compromise delivery of some core programs (such as ice breaking or providing navigational charts for example). Some of the estimates of revenue potential have now proven to be optimistic.

Since Program Review, DFO's annual revenue target has stood at around $105 million. However, the Department has not yet been able to achieve that target, averaging about $13.7 million shortfall annually. This shortfall is factored into annual planning figures. For example planned revenues for 2003/04 amounted to $88.2 million.

The Department has conducted a significant amount of analysis in some areas of revenue management such as commercial fishing licence fees and marine services fees. However, administrative, resourcing and political challenges have slowed progress in achieving needed change.

The Departmental Strategic Plan for 2000 identified a need for a framework to manage the revenue process and ensure a Departmental approach. Senior Management at DFO has endorsed the development of a revenue management framework as part of the Departmental Assessment and Alignment Project (DAAP) Action Framework.

The development of an External Charging Framework for DFO is now moving forward under the aegis of the External Charging Working Group with strong support from most sectors and regions.

The approval on March 30, 2004 of a new *User Fees Act* brings new constraints which will apply to any new or revised fees proposed by the Department.

1.2 SUMMARY OF FINDINGS AND CONCLUSIONS

A corporate view of Departmental revenue generation functions has not yet been achieved. Corporate history of revenue generation remains within individual programs and is often very difficult to reconstruct.

Decisions regarding revenues have generally been made within programs and without full consideration of the overall effects on the Department or on clients who may rely on multiple services of DFO.

Revenue projections introduced during Program Review were sometimes not supported by program decisions made by other parties. For example, it was not possible to increase receipts from wharfage and berthing fees when the Department was being directed to divest of all recreational harbours.

Resistance from industry and individual clients of DFO makes setting and adjusting fees a very difficult process. Costs and market conditions do change over time but the Department has not successfully established automatic mechanisms to adjust fees in response.

Senior management at DFO recognize the need to adopt an integrated Departmental approach to external charging and, in establishing the External Charging Working Group, have made a commitment to do so.

Based on the evidence reviewed, it is apparent that Departmental revenue targets are not achievable under the current charging regimen. An External Charging Working Group is currently conducting a comprehensive, Department-wide study of DFO external charging practices and options. However, the Department will continue to experience an annual revenue shortfall of around $13 to $16 million until such time as significant adjustments are made to fees and to the revenue base.

2.0 INTRODUCTION

2.1 BACKGROUND

DFO is a large, decentralized, federal department of approximately 11,000 employees who deliver services throughout Canada under the direction of six Regional offices and National Headquarters (HQ) in Ottawa. DFO operates under the authority of 15 separate acts and 39 sets of regulations. The departmental budget in the 2003-04 Main Estimates is over $1.4 billion.

DFO collects revenue from a number of its programs, products and services. The revenue sources are diverse and include:

- Marine services fees;
- Maintenance dredging services;
- Employee deductions for employee housing;
- Coast guard radio tolls;
- Icebreaking service fees;
- Rescue, safety and environmental response;
- Canadian Coast Guard College;
- Aids to navigation services;
- Lab tests and analysis;
- Sales of charts and publications;
- Commercial licences;
- Individual vessel quotas;
- Foreign licences;
- Sports fish licences;
- Conservation stamps;
- Rental of land, building, and equipment
- Harbours; and
- Fines.

The department must ensure that all revenue generated from the programs and services are charged, collected and recorded in accordance with Treasury Board policies and guidelines. Planned revenues from the 2001-02 forecast were $91.0 million. In 2003-04 planned revenues had decreased to $88.2 million. Historically, actual revenues have fallen short of planned revenues. Reasons for the declining expectations and the historical shortfall are described with examples in the text of this report and speak to the need for a common, department-wide approach to revenue management.

In June, 2002 a presentation entitled *Revenue Management at DFO –Getting Our House in Order* was prepared for the DFO Departmental Management Committee (DMC). The primary message in the presentation was for DFO "to get our house in order with respect to revenue management by developing a Revenue Management Framework (RMF) to help us manage external charging fairly, consistently, efficiently and in conformity with federal and departmental legislation, policies and procedures."

A *Proposed Guide for the Revenue Management Framework for External Charging at DFO* was in development at the time this audit began and was in a very preliminary state but viewed as an important priority. Work on this has now been subsumed by the Working Group on External Charging and significant progress is being made.

2.2 ORIGINAL OBJECTIVES

- To assess the management control framework(s) for the identification, generation, collection and reporting of existing external revenues;
- To assess the process to amend external revenue streams; and
- To assess the forecast methodology and identify why forecast and actual results vary.

2.3 SCOPE

The review was limited to the following revenue streams:
- Icebreaking service fees;
- Sales of charts and publications;
- Commercial licenses (including fisher and vessel registration); and
- Small Craft Harbour fees.

This engagement included selected regions and HQ. As much as possible, work was conducted in or from National Headquarters. Within individual Regions, some revenue streams either did not exist or were not sufficiently material to warrant detailed examination.

The scope included interviews with managers in DFO Headquarters (HQ) supported by teleconferences with selected regional managers and staff. Procedures, guidelines and practices used to establish revenue targets were examined in light of program decisions that support or undermine achievement of those targets.

The review examined:

- Authority to Generate Revenue – the adequacy of the existing framework under which new fees may be introduced or existing fees amended;
- Determination of Fee Structures – the appropriateness of mechanisms in place that determine fee structures; and
- Forecasting – the adequacy of the mechanisms in place that calculate forecasts and address variances

2.4 RESCOPING

This project began as an audit. During the conduct of the audit DMC established an External Charging Working Group. This fulfilled what was to be the major recommendation of the audit. Therefore, detailed audit work was suspended and the project was revised into a consulting engagement which would provide information and advice to the working group. This participation is ongoing.

2.5 FORMAT FOR REPORT

This report outlines our methodology, our summary of conclusions and then discusses the results of the consultancy, organized by program.

2.6 METHODOLOGY

The audit/consultancy was conducted in three phases: Planning, Conduct and Reporting.

Planning Phase

- Review applicable departmental and central agency policies and guidelines;
- Determine audit scope and methodology;
- Develop draft program outline;
- Draft a Terms of Reference document; and
- Develop a detailed work plan.

Conduct Phase - Preliminary Survey

- Determine whether Departmental policies are consistent with central agency policies;
- Identify and validate key audit and program-related issues with Departmental stakeholders;
- Identify and validate initial observations through assessment of documents at HQ and in two regions;
- Rescope based on reduced resources; and
- Finalize the program based on initial findings.

Conduct Phase – Detailed Examination

- Examine practices and documents in NHQ, supported with teleconferences with regional managers and staff;
- Debrief relevant departmental officials;
- Complete working papers; and
- Produce an Initial Statement of Findings.

Reporting Phase

- Validate Initial Statement of Findings;
- Produce a Draft Consulting Report;
- Debrief key stakeholders on the Draft Report; and
- Finalize the Report.

3.0 FINDINGS AND CONCLUSIONS

3.1 ICEBREAKING SERVICES FEE (ISF)

Introduction

The authority for DFO to charge fees for icebreaking is provided in Section 47 of the *Oceans Act*. The current departmental target for Icebreaking Services Fee (ISF) is $13,824,000 of which the Department generated about $4.4 million in 2003-04. This represents a revenue shortfall of about $9.4 million or 68%. The majority of ISF revenue comes from fees levied on shipping operations in the Province of Quebec.

Targets

The ISF was implemented in 1998 as part of Program Review where DFO agreed to recover $41.5M in revenue from marine services to avoid cuts to programs. In 1996 DFO implemented the first of the two Marine Services Fees - the Marine Navigation Services Fee (MNSF) - with a target of $27.7M. Accordingly, the $13.8M target for the ISF was set to increase revenues to meet the $41.5M target. It should be noted that $1.5M of the target is comprised of the administration costs to bill and collect fees.

Fee Cuts and Reduced Revenue Base

Early in 1998, the Department completed what was intended to be a final approach on the Marine Services Fees. The approach would be balanced against a recognition of the still controversial nature of the fees, and the need to deliberately advance the implementation of the Marine Services Fees program by proceeding with measures to achieve the $41.5M target set by Program Review. Key elements included:

- Implementation of an icebreaking fee to generate $13.8M annually;
- Renewing the Marine Navigation Services Fee to collect $27.7M; and

- Freeze rates for three years to allow industry time to adjust to the fees.

Based on industry opposition, the proposals were scaled back as follows:

- A cumulative study into the impact of all federal fees on the marine sector would be undertaken by Treasury Board Secretariat;
- The study was to be completed in time for changes to the fees to be implemented at the end of the three year fee freeze; and
- To avoid the imposition of higher fees, the new icebreaking fee was implemented at half its intended rate.

The $40M Program Review target was, however, maintained, but with anticipation that financial relief would be provided to DFO to offset the reduction in the new icebreaking fee. This relief would be for a three year period (eventually extended to four years) to allow the impact study to report and a revenue level be set that based on that study. The end of the annual icebreaking fees relief is now what constitutes the largest portion of the revenue shortfalls. The impact study concluded prematurely in October 2002 as it was not able to assess the impact.

Current Situation

The fee freeze essentially remains in effect because the two preconditions to its conclusion – the impact study, and then a decision on a final fee revenue level – have not been met. Program officials advise that a decision is pending, although no timing associated with that decision has been set.

Departmental officials see two likely options to correct the shortfall issue. Either the ISF rates must increase to meet the target, or the target assigned to these fees must be adjusted. Treasury Board Secretariat officials recently advised that relief will not be forthcoming. Consequently, two options remain: 1) Fees can be increased; or 2) The Department can continue to absorb the shortfall indefinitely.

Conclusions, Icebreaking Service Fees

- Revenue targets were established during Program Review as a means to reduce cuts to programs;

- Direction to the Department prevented the implementation of departmental proposals to meet revenue targets;

- $6.65M of the deficit in ISF revenues is directly attributed to a 50% reduction in the fee, and no extension of annual TBS relief when it expired;

- Revenue shortfall is compounded by over optimistic traffic projections used in 1998 to calculate expected revenues, and no immediate recourse to adjust rates;

- Proposals developed by the Department to initiate changes to the Marine Services Fees may have benefited from being part of a larger departmental approach; and,

- DFO is unable to correct the revenue shortfall until a decision is taken on a future direction for the Marine Services Fees.

3.2 SALES OF HYDROGRAPHIC CHARTS AND PUBLICATIONS

Introduction

The Charts and Nautical Publications Regulation of the Canada Shipping Act require all vessels to carry on board, for each area in which the vessel is to be navigated, the most recent editions of the charts, and designated documents and publications, except in the case of vessels under 100 tons when the person in charge of navigation has sufficient knowledge of the area such that safe and efficient navigation is not compromised. The authority for DFO to charge fees for hydrographic charts and other publications is provided in paragraph 47 (1) of the *Oceans Act* 1996 c.31. The Canadian Hydrographic Service (CHS) sells approximately 250,000 charts and publications annually. Recreational boaters are responsible for about 80% of sales with the balance being purchased by commercial mariners.

Targets

As part of Program Review, in 1995, the Departmental Management Committee (DMC) assigned an additional $ 1.25 M target to the CHS program for a total revenue target of $2.84 million based on an increase to then-existing revenues. This additional target was made without any analysis of market conditions. Revenue targets have never been achieved since they were established in 1996-97. In 1996, in order to meet revenue targets, CHS raised the price of its main products by some 54%. While this resulted in an 11% increase in revenue, CHS management now attribute a 30% reduction in sales to the price increase. In short, raising prices did provide a marginal increase in revenues but the subsequent drop in sales created a potential risk to marine safety. Future decisions regarding revenue generating activities should be based on more thorough analysis.

The revenue shortfall has ranged from approximately $ 300K to $500K. CHS expects to collect $2.38 million this fiscal year leaving a projected deficit of $457.8 K or roughly 20%.

The revenue target for CHS is $2.84 million. CHS revenues, which are not respendable, accrue to the Consolidated Revenue Fund (CRF) of the federal government. Following Program Review, DFO’s total departmental target (including Program Review) for CRF revenues became subject to a frozen allotment. As such, any shortfall is withheld from DFO by Treasury Board. As a result, CHS revenue shortfalls were clawed back from the CHS O&M budget until 2002-03. Since 2003-04 shortfalls are absorbed at the departmental level and not passed on to CHS. CHS management has stated that if they had to cover any of the revenue shortfall, that it would have a dramatic impact on their operations.

Resource Pressures

CHS management has addressed budget reductions and financial strategies and the continuing requirement to meet revenues targets through efficiency improvements such as print on demand and by increasing prices for products. CHS has used a risk-based approach based on traffic, navigation conditions and state of charts to identify an estimated 220 high priority charts which they try to maintain current. However, CHS management stated they have resources to maintain only 15 to 20% of the high priority charts or 3 to 5% of all charts each year based on a 5 year edition cycle. CHS management advised that budgets are so tight that money is not available when needed to print some basic (e.g. Chart # 1) and lucrative publications (e.g. Cruising Atlas).

For example, unanticipated brisk sales of a new edition of a Lake of the Woods chart caused an estimated 5-year supply to be exhausted in less than two years. While this contributed more than expected to the CHS revenues, it had a negative effect on CHS programs as O&M had to be re-directed from higher priority items to pay for re-printing the chart three years earlier than budgeted for.

Some best-selling charts may remain out of print for a year or longer. These products have good return on investment. For example, an investment of $100,000 in reprinting a Cruising Atlas will generate revenues of about $200,000 per year for five years. Ensuring these products remain in print would contribute to maintaining the revenue position of the Department by compensating for declining revenue related to other CHS products.

Declining Revenue Base

Developing trends such as the increased use of electronic navigation are expected, over time, to reduce the sales of paper charts from which the major part of CHS revenues are being generated. CHS management is aware of this and entered into a licensing agreement with a private firm over 10 years ago to distribute CHS digital products and license others to provide electronic products using CHS data. However, CHS does not have sufficient market information on virtually any aspect of the market, nor do they appear to have the capacity to ask fundamental marketing questions. For example they are unaware of future trends in recreational boat ownership, although this information is likely available through boating industry associations. CHS also lack information on the downward trend in paper chart sales and increase in digital product sales to develop projections which could lead to strategies to maintain revenues or have targets adjusted.

Higher prices for charts and other publications have created an incentive for the private sector to enter the market with products that meet market demand. CHS is not resourced to monitor current private sector activity effectively. Not all private sector companies have a formal agreement. As a result, potential royalty revenues are lost through copyright infringements. DFO needs to assess its business of producing and selling charts when the private sector is willing and able to print and distribute them at competitive prices. On the other hand, turning the sales of charts and maps over to the private sector would likely further erode DFO revenues and the Department would still need to produce and distribute products for which the demand is insufficient to interest the private sector and to ensure chart coverage should a private sector producer cease to operate. Having private charts recognized as meeting the carriage requirements of the Charts and Nautical Publications Regulations of the Canada Shipping Act is also an issue.

CHS is aware that a more detailed analysis of revenue generation is now occurring as part of preparing a business case for CHS to be considered as an SOA, respond to the requirements of the new “User Fees Act”, and assess implementation of DAAP initiatives related to “Risk Based Level of Services” and “Commercialization of Charts Distribution.”

Conclusions, Canadian Hydrographic Service, Sales of Charts and Publications

- CHS is not meeting its full revenue target of $ 2.84 M and the current trend of decreasing paper chart sales leads us to conclude that the shortfall will only increase in the future.

- The additional $ 1.25 M revenue target established for CHS was not linked to conditions in the marketplace.

- Some decisions were made about CHS revenue generation activities without adequate analysis, leading to unanticipated negative results.

- Increasing involvement of private enterprise in producing and distributing charts and other publications or products appears inevitable, and will result in greater reduction of revenue opportunities for DFO.

- CHS must identify realistic expected results, based on appropriate analyses before implementing program changes and technology development.

- With resource constraints, CHS finds itself having to choose between assigning resources to revenue generation activities or implementing some of its high- priority mandated tasks that will enable the department to provide essential service to the public and mitigate potential crown liability.

3.3 COMMERCIAL FISHING LICENCES

Introduction

The authority for DFO to charge fees for commercial fishing licences, fisher registration and vessel registration is provided in the *Fisheries Act* and the *Coastal Fisheries Protection Act* (for foreign vessels). Charging a fee for a fishing licence is based on the principle that those who benefit from access to a public resource should pay a fee that reflects the value of the privilege. Fees are set out in regulations under the *Fisheries Act* and the *Coastal Fisheries Protection Act*. DFO expects to collect approximately $15.2 million this fiscal year from sale of commercial fishing licences and another $21.5 million for individual vessel quotas.

Targets

Following Program Review, Fisheries Management was given a revenue target based on historical data. Since then there have been important changes including an erosion of the commercial licence base and changing landed values in various fisheries. This suggests adjustments to targets are needed.

Declining Revenue Base

The Canadian Fisheries Adjustment and Restructuring Program (CFAR) was intended to reduce the number of commercial fishing licences. Following the Marshall decision, additional licences were retired and reissued without fee to First Nations. Professionalisation of fishers in Quebec and Newfoundland led to a reduction in the number of licensed fishers. The Department's success in implementing these programs and others has reduced the size of the base from which DFO can generate revenues. Treasury Board provided partial relief of $1.7M/year to cover revenues lost due to the Marshall decision, but only for 3 years. In the interim, neither revenue targets nor licence fees have been adjusted leaving the Department to cover the shortfall from other sources once again.

The formula used to calculate commercial fishing licence fees creates inequities among fleets and fisheries as it no longer reflects landed values adequately. In December 1995, new fees were introduced using a national formula based on average landed values for 1990-1993. Globally, landed values in 2002 were about 50% higher than those used to establish licence fees. While some fisheries have increased in value, others have declined but licence fees have not been adjusted. Fishers in some less lucrative fisheries now pay proportionally more for their licences while in other fisheries average landed values per licence have increased by as much as 300% without an adjustment to licence fees.

In 2002, DFO proposed a licence reform intended to restore equity among fleets. The proposal included an option to mitigate the impact of the fee adjustment on more lucrative fisheries and a process to update licence fees every 2 years to prevent recurrence of inequities. The total revenue generated from the commercial licence fees would have increased from $29M to approximately $35M. The reform was not approved.

New Review in Progress

A detailed review of the revenue situation with respect to commercial licences and vessel registration is currently underway by program authorities as part of their support for the External Charging Working Group.

Conclusion

Revenue targets established for commercial fishing licences are not supported by decisions, made independently, to reduce the number of fee-generating licences and not to adjust fees despite changing landed values. This leaves the department in a position of being unable to meet its revenue commitments.

3.4 SMALL CRAFT HARBOUR FEES

Introduction

The authority for DFO to charge fees for use of small craft harbours is provided in The *Fishing and Recreational Harbours Act*. In 95/96, Small Craft Harbours (SCH) was assigned a revenue target of $5.1M, exactly $1M above the revenues that were expected that year. Following an Annual Reference Level Update (ARLU) adjustment the following year, the annual revenue target was set at $4.7M and has remained at that level ever since. SCH has never met this target. Current planned Departmental revenues for Small Craft Harbours amount to $1.2 million annually over the next three years.

Declining Revenue Base

In the late 1980's, the Neilson Task Force recommended that the federal Government divest of recreational harbours and reduce the SCH budget by $10M. The Department did not implement the recommendation to divest but did move forward on reducing the SCH budget by $10M. As such when Program Review came in 1995, efficiencies and cuts had already been made leaving room for only marginal savings from a new decision to divest. At that time SCH budget was cut again by $2M/year for 4 years.

However, because SCH is divesting of revenue generating recreational harbours, and an increasing number of fishing harbours are being managed by Harbour Authorities, the likelihood of meeting revenue targets grows more and more remote. Monies collected by Harbour Authorities are re-invested by the Harbour Authorities in the harbours themselves and do not contribute to Departmental revenues.

In 1995 DFO had 2137 harbours. The intent was and remains to divest (mainly to municipalities) all the recreational harbours and keep only those fishing harbours which are active and deemed essential (currently about 750, but this total is being reviewed). DFO is to retain ownership of these fishing harbours but lease the facilities to local administrations. In April 2004, 1265 (244 recreational and 1021 fishing) harbours still remained with DFO.

Conflicting Objectives

Senior Management at DFO is aware of conflicting objectives (divesting & generating revenues) and understands that revenues will go down as SCH divests further and more commercial fishing harbours are managed by Harbour Authorities. As such, the expected shortfall for 2003/04 was added to the list of pressures presented to Senior Management at the beginning of the fiscal year. SCH is no longer expected to cover their shortfall; however, decisions to divest made independently of revenue target setting leave DFO in the position of likely not ever achieving revenue targets and thus having to cover shortfalls from other resources. Small Craft Harbours is undertaking a more detailed analysis of its revenue situation as part of its support for the External Charging Working Group and as it builds a business case for an SOA.

Conclusion

Revenues for Small Craft Harbours will continue to decline as DFO divests of harbours. Targets should be adjusted to reflect reasonable expectations based on program and policy changes implemented since targets were set during Program Review. This might best be done working within a Departmental revenue management framework.

4.0 OVERALL CONCLUSION

Based on the evidence reviewed, it is apparent that Departmental revenue targets are not achievable under the current charging regimen. An External Charging Working Group is currently conducting a comprehensive, Department-wide study of DFO external charging practices and options. However, the Department will continue to experience an annual revenue shortfall of around $13 to $16 million until such time as significant adjustments are made to fees and to the revenue base.