

Notes for an address by

**Ronnie Campbell, CMA
Assistant Auditor General of Canada**

Auditing Transfer Payment Programs

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Ladies and gentlemen, good morning.

It's a privilege to be among representatives of national audit offices from scores of countries. We have a unique opportunity to learn from each other and strengthen legislative auditing throughout the world.

I'm pleased to be here to speak to the community of supreme audit institutions about "better auditing of public aids and subsidies." These terms "aids" and "subsidies" are fairly broad and can have different meanings from one state to another. The term "subsidy," for example, has trade implications in the context of the World Trade Organization. International organizations such as the Organisation for Economic Co-operation and Development use the neutral term "support" to estimate the value of transfers resulting from public policies.

In Canada, we prefer to speak about "support." The government supports individuals or organizations through transfer payments. These payments are a means for the government to pursue its public policy objectives. I will therefore talk to you today about our audits of transfer payment programs.

These programs, covering a wide range of sectors such as agriculture, industry, the environment, and so forth, cost millions of dollars. As the national audit office, we examine whether these government programs are managed with due regard for public funds.

But before I discuss our audits of transfer payment programs, I'll say a few words about our system of government and how our audit office works within that system. I will then explain the types of transfer payments that the government uses to pursue its public policy objectives. I will later discuss our audits of transfer payment programs.

Canadian Audit Model

As you know, Canada is a federation, which means that powers and responsibilities are constitutionally divided between the federal government and the other levels of government. In general, the federal government is responsible for matters that affect all of Canada. These include national defence, foreign policy and citizenship.

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Another point of interest is that Canada's political system is a Westminster-style parliamentary democracy modelled after that of the United Kingdom. The government of

the day must answer for its actions to the people's representatives in Parliament. The people's right to control how public funds are collected and spent is one of the cornerstones of democratically accountable government.

The Parliament of Canada needs reliable and fact-based information in fulfilling its oversight role. As legislative auditors, we provide Parliament with that information. Our national audit office is therefore a critical link in the chain of public accountability.

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In Canada, the Auditor General is an agent of Parliament. Our office is therefore part of the legislative branch. Sheila Fraser, the Auditor General of Canada, was appointed for a ten-year term in 2001.

Role of the Office of the Auditor General of Canada

The role of the Auditor General of Canada is to determine how well the government manages public funds, programs, and services. In our reports to Parliament, we give parliamentarians the information, advice, and assurance they need to hold the government accountable for its stewardship of public funds.

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Parliament granted the Office of the Auditor General of Canada with specific powers and responsibilities, which are spelled out in the *Auditor General Act*, the *Financial Administration Act*, and many other statutes.

Under the *Auditor General Act*, we have the mandate to look at whether government programs are being managed with due regard for economy, efficiency, and environmental impact, and whether measures are in place to determine how effective they are. These audits, known as performance audits, examine a diversity of areas, including the federal government's management of transfer payment programs.

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With a staff of about 640 people and an annual operating budget of about 78 million dollars (about 55 million Euros), we examine most areas of the federal government. This includes about 70 government departments and agencies, as well as 40 Crown corporations, such as the Canadian Broadcasting Corporation, Canada's national public broadcaster.

We audit the Public Accounts of Canada, the government's summary financial statements. It is probably the largest audit in Canada. Besides the federal government, we also audit the governments of Canada's three northern territories.

Our professional staff have post-graduate or bachelor's degrees and professional designations, and many have additional credentials.

Types of transfer payment programs

Let me now turn to the types of transfer payment programs we have in Canada. The federal government pursues some of its public policy objectives through transfer payments to individuals, organizations, and other levels of government. Transfer payments are generally grants or contributions.

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Grants are unconditional transfer payments made to individuals or organizations that have met established eligibility requirements. Once recipients meet the eligibility criteria for a grant, they can usually receive it without meeting further conditions.

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Contributions are conditional transfer payments made to individuals or organizations that are based on a contribution agreement. The recipient of a contribution must meet the monitoring and performance requirements that are specified in the terms and conditions of a contribution agreement in order to be reimbursed for project costs.

The Canadian government currently spends about 17.5 billion dollars (about 12.3 billion Euros) a year on grants and contributions.

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The federal government also uses contracts to pursue public policy objectives. I'll be speaking later on our audit of three government contracts awarded to advertising firms. In addition to this audit of the sponsorship program, I'll also talk about two other audits: our October 2000 audit of management of grants and contributions of the government's human resources department; and our May 2006 government-wide audit of grants and contributions.

Why auditing transfer payment programs is important

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Canadians want to know that the government is making transfer payments with due regard for their hard-earned tax dollars. They want to know that society as a whole is benefiting when the government spends those dollars on programs that may seem to favour some rather than others. Canadians want to see greater transparency in the way government is managing public funds. They want to know why money is being transferred and for what purpose.

A healthy scepticism on the part of Canadians regarding the government's management of funds stems from our audit of grants and contributions in October 2000. Our findings gave Canadians reason for concern.

October 2000 audit at HRDC

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Our audit of the management of grants and contributions at Human Resources Development Canada assessed about 40 transfer payment programs. These represent about 560 million dollars (about 394 million Euros) in transfer payments.

We found serious weaknesses in project selection and approval, and in the financial management and control of approved projects. Many of the practices we reviewed were unacceptable, including breaches of authority, payments made improperly, and approvals that were not based on established processes. In addition, we found weaknesses in the design of these programs and in the measurement and reporting of program results.

Because transfer payments involve large amounts of public funds, it is important that we carry out periodic government-wide audits of these programs. It is equally important that we conduct follow-up audits to assess the government's progress in improving its management of transfer payment programs. We conducted such an audit in May of this year and are planning to carry out more of these.

May 2006 audit of grants and contributions

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The objective of our May 2006 audit was to determine the extent to which the federal government has ensured effective government-wide management and control of the spending of public money through transfer payments.

Our audit of grants and contributions in the spring assessed the application of the government's Policy on Transfer Payments. The policy aims to promote a results-based approach to designing and managing transfer payment programs. It requires that federal government departments develop a framework that integrates risk concepts into transfer payment management and audit planning procedures.

To comply with the policy, government departments are also required to develop a framework that takes into account performance measurement and evaluation strategies in the delivery of its programs.

We reported that the government has made satisfactory progress in responding to our past concerns of its management of transfer payments. We found that the Policy on Transfer Payments and the guidelines on applying the policy provide a basis for effective control over the use of grants and contributions. Four of the five departments we audited had satisfactory controls to ensure that recipients of grants and contributions were eligible and were monitored according to risk.

Finally, we recommended that departments streamline their management of transfer payments and maintain an appropriate balance between risk and control. In cases where individuals or organizations were receiving transfer payments from multiple federal government programs, we recommended that the government implement a single audit process.

Sponsorship audit in November 2003

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I'll now talk about our audit of the government's sponsorship program in November 2003, which examined three large government contracts awarded to advertising firms. The federal government spent more than 250 million dollars (about 176 million Euros) from 1997 to March 2003 in a program without clearly stated objectives.

The audit of the sponsorship program was very complex. Parliament had not been informed of the program's objectives or the results it achieved and was misinformed as to how the program was being managed. Those responsible for managing the program broke the government's own rules in the way they selected advertising firms and awarded contracts to them.

Sheila Fraser said that in its management of the sponsorship program, the government “broke every rule in the book.”

In her statement to the Parliament of Canada, the Auditor General said, and I quote: “I am troubled by the appalling lack of regard for rules and regulations that we saw in the way these three contracts were managed. Equally disturbing is that it happened in the very department that is supposed to ensure prudence, probity, and fairness in contract management throughout the government.”

We found that the government had run 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. Controls and oversight mechanisms that should have been in place had collapsed.

Since documentation was very poor, there was little evidence of analysis to support the expenditure of more than 250 million dollars (about 176 million Euros). Some sponsorship funds were transferred to Crown corporations using unusual methods that appear to have been designed to provide significant commissions to advertising firms, while hiding the source of funds and the true nature of the transactions.

Our audit revealed significant shortcomings at all stages of the contract management process: the decision to contract the work; developing the contract specifications, selecting the contractor; and ensuring that the government got what it had contracted for before the contractor was paid. In short, contracts were given to advertising firms that had connections to a political party.

Having found extensive non-compliance with the law that applies to the government's financial transactions and with government policies and regulations, the Auditor General referred the matter to the Royal Canadian Mounted Police, our national police service. Although it happens rarely, the Auditor General can refer matters to the Royal Canadian Mounted Police's commercial crime unit in cases of suspected fraud.

Our audit of the sponsorship program led to a public inquiry in February 2004. The Gomery inquiry was asked to investigate and report on questions that we raised in our November 2003 Report.

All of our working papers were subpoenaed, and an affidavit provided us with an opportunity to explain our audit methodology. But our meticulous adherence to methodology and professional standards stood us in very good stead throughout the events. And the Gomery inquiry concluded its hearings without any serious challenge to the credibility of our report.

As a result of its investigations, the Royal Canadian Mounted Police laid charges of fraud against the senior bureaucrat who managed the program and against three advertising executives. The government has since hired a special counsel for the recovery of funds that may have been improperly received through the sponsorship program.

We learned several lessons from our audit of this program. We know that there is a risk of litigation and that we need to be prepared in the event that we are called to be witnesses in a court of law or at an inquiry. We can no longer assume that our working

papers will remain confidential given that an audit can lead to a public inquiry or criminal investigation.

We have since developed guidance for dealing with audits that have the potential of leading to public inquiries or cases of litigation. One step we have taken is to involve senior management and Communications at the advisory committee stage, which occurs early in the process.

We have also taken steps to strengthen our audit evidence to ensure that it can withstand a public inquiry. For example, we have decided that interview notes should be signed by interviewees when the contents are evidentiary in nature.

And we are working to improve our access to the information we need from auditees by acting sooner when it appears that someone is stalling. When auditees refuse to provide documents, we have ways of dealing with it. The problem is when entities promise documents but fail to deliver, or deliver very late in the process.

We developed guidance that requires teams to keep track of the steps they have taken to acquire documents and the failure to deliver so that we can take action sooner in the process rather than risk not getting important evidence, or getting it too late in the process.

I will now talk about our approach to auditing transfer payment programs. I'll then explain how we ensure the quality of our audits. Finally, I'll discuss whether our audits make a difference.

Our approach to auditing transfer payment programs

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When we conduct an audit of a transfer payment program, we determine whether the government is following its own rules and whether the recipient is meeting the requirements of the program. We examine compliance and eligibility and whether the program has met its objectives.

Our audits of these programs examine whether transfer payments comply with the government's Policy on Transfer Payments. We also look at whether payments comply with the *Financial Administration Act* and whether delegations of authority are respected. And we examine whether the approval of recipients is clearly documented to support the eligibility requirements.

We also look at the way the program is promoted to ensure that all potential applicants have equal access to public funding. We examine whether eligibility criteria are linked to program objectives. As well, we determine whether payments are made only to eligible recipients for eligible expenses.

Because consistency of appraisal is critical to ensuring fairness and equity, we examine whether guidelines have been developed to assist managers to consistently apply program terms and conditions. Furthermore, we look at whether there is a system in place to analyze the cost of running the transfer payment program compared to the total value of the program.

In essence, we determine whether all the rules have been followed. We use a statistical approach in assessing the level of error of the transactions that we examine. This ensures that we have an appropriate level of assurance that the program is properly managed.

How we ensure the quality of our audits

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As auditors, however, we realize that no set of rules or controls can cover every circumstance that arises. A key challenge has been to provide the right balance between required control steps and professional judgement. In response to changing perceptions of risks and the increasing diversity of our audits, we continuously seek to improve the quality of our audit reports.

We ensure the quality of our audits by following professional auditing standards. In Canada, these standards are set by the Auditing and Assurance Standards Board of the Canadian Institute of Chartered Accountants. They are considered minimum requirements for all our audits. Our audits therefore conform to rigorous professional standards.

Our audits also conform to our quality management framework. This framework aims at ensuring that we deliver quality audit work by building quality into the production process rather than relying on post-production audits.

Our quality management systems are based on a number of principles, such as clearly defining and properly communicating the responsibilities of each person in the control process. We review our quality management systems on an ongoing basis and make adjustments where necessary.

Our audits make a difference

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In response to our audits of transfer payment programs, the government has taken a number of steps to strengthen controls on the use of grants and contributions. For example, the government acted on our recommendation that it co-ordinate and implement a single-audit process for recipients of transfer payments from multiple programs.

Some departments have simplified their application forms and have more clearly explained how the recipients' performance will be measured and what information they must provide for evaluations. This reduces uncertainty and helps to ensure that recipients will provide the right performance information.

The government has agreed with our recommendation to streamline the application, reporting, and audit requirements for grants and contributions in ways that would reduce the administrative burden on recipients, while balancing risk, control, and accountability for results.

Reporting to Parliament

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You may be interested to know how we report our findings and recommendations to Parliament. We communicate these through the Speaker of the House of Commons, the lower Chamber of Parliament.

Once tabled in the House of Commons, our reports are automatically referred to the Public Accounts Committee for further review. Since this committee bases much of its work on our reports, we are often asked to appear before the committee to answer questions about our findings and recommendations.

The Public Accounts Committee tables its own reports in the House of Commons that sometimes include our recommendations. Without the support that Parliament can offer through its attention to our findings, we are not nearly as effective as we might otherwise be.

As legislative auditors, we need to be sure that the things we bring to Parliament's attention are significant and relevant and that our audit reports are clear and understandable.

Conclusion

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In closing, not only is it important that we report on the government's progress in improving its management of public programs, but it is just as important that we inform parliamentarians and Canadians when government does exercise sound stewardship of public funds.

Our national audit office feels privileged to carry on a tradition that contributes to good governance and accountability on behalf of all Canadians.

I believe that good governance not only strengthens accountability, it also builds credibility and public confidence in our democratic institutions.

Thank you for your attention and for your interest in the work that we do in Canada. I would be happy to respond to your questions.