



**HOUSE OF COMMONS  
CANADA**

**CHAPTER 6, "SELECTED CONTRIBUTION  
AGREEMENTS - NATURAL RESOURCES  
CANADA," OF THE SPRING 2009 REPORT OF THE  
AUDITOR GENERAL OF CANADA**

**Report of the Standing Committee on  
Public Accounts**

**Hon. Shawn Murphy, MP  
Chair**

**APRIL 2010**

**40th PARLIAMENT, 3rd SESSION**



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# **STANDING COMMITTEE ON PUBLIC ACCOUNTS**

**40th PARLIAMENT, 3rd SESSION**

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**40th PARLIAMENT, 2nd SESSION**

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# **THE STANDING COMMITTEE ON PUBLIC ACCOUNTS**

has the honour to present its

## **EIGHTH REPORT**

Pursuant to its mandate under Standing Order 108(3)(g), the Committee has studied Chapter 6, “Selected Contribution Agreements – Natural Resources Canada,” of the Spring 2009 Report of the Auditor General of Canada and has agreed to report the following:

## INTRODUCTION

Federal departments and agencies often use grants and contributions as a means of pursuing government objectives. Under a grant or contribution, the government transfers funds to individuals, organizations, or other levels of government to carry out certain activities that support its objectives. Grants are unconditional transfers, and the recipients must meet eligibility criteria to ensure that the government's objectives will be met. Contributions, on the other hand, are conditional in the sense that they are subject to performance conditions specified in a contribution agreement with the recipient, and the government can audit the recipient's compliance with the agreement's performance conditions.

Between 2003 and 2005, the Office of Energy Efficiency at Natural Resources Canada (NRCan) entered into a series of contribution agreements with private sector organizations through the Commercial Transportation Energy Efficiency and Fuels Initiative (CTEEFI). The contribution agreements were for programs related to greenhouse gas emissions in the transportation sector. The total amount disbursed was approximately \$5.9 million. In 2005, at the request of NRCan's senior managers, internal auditors carried out an audit of five contribution agreements involving three organizations.<sup>1</sup> The internal audit assessed NRCan's control and management practices in administering the contributions agreements and found material breaches of the terms and conditions of the agreements.

The Office of the Auditor General of Canada (OAG) was informed of NRCan's internal audit in August 2006. Subsequently, the OAG received a complaint that some issues had not been dealt with in the internal audit, including possible conflicts of interest. The OAG undertook its own audit, examining NRCan's management of the contribution agreements, and the actions NRCan took as a result of the internal audit. The OAG also considered whether the changes NRCan made to its control and

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<sup>1</sup> Natural Resources Canada, Commercial Transportation Energy Efficiency and Fuels Initiative (CTEEFI) - Internal Audit (A06005), September 2006, <http://nrcan.gc.ca/audit/reprap/2006/a06005-eng.php>.



management practices would be adequate to prevent a recurrence of similar problems in the future.

In May 2009, the OAG released its audit.<sup>2</sup> In order to investigate whether NRCan's response to the OAG audit has been satisfactory, the Public Accounts Committee (the Committee) held a meeting on the audit on 28 October 2009.<sup>3</sup> At that meeting, the OAG was represented by Sheila Fraser, Auditor General of Canada; John Wiersema, Deputy Auditor General; and Linda Drainville, Principal. NRCan was represented by Cassie J. Doyle, Deputy Minister; Bill Merklinger, Assistant Deputy Minister and Chief Financial Officer; and Carol Buckley, Director General, Office of Energy Efficiency. As an individual, Richard B. Fadden, the former deputy minister of NRCan from September 2005 to July 2006, attended the meeting.

## **ACTION PLAN**

In response to the audit, NRCan submitted to the Committee a summary of actions it had taken to address the findings and recommendations of the audit. This included adding conflict of interest clauses to contribution agreements, providing training on conflict of interest to employees managing grants and contributions programs, and creating a Centre of Expertise and a Transfer Payment Review Committee. NRCan's Deputy Minister, Cassie J. Doyle, told the Committee that all of NRCan's commitments made in response to the audit had been implemented. She stated, "I am confident that NRCan has a robust system of financial controls in place to ensure that tax dollars are well used and are spent for their intended purpose."<sup>4</sup>

However, the Deputy Minister also told the Committee that NRCan is currently examining a perceived conflict of interest situation. This could indicate that NRCan's new monitoring mechanisms have performed their intended role and identified the problem. On the other hand, it could indicate that NRCan's employee training has not

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<sup>2</sup> Auditor General of Canada, Spring 2009 Report, Chapter 6, *Selected Contribution Agreements- Natural Resources Canada*.

<sup>3</sup> House of Commons Standing Committee on Public Accounts, 40<sup>th</sup> Parliament, 2<sup>nd</sup> Session, Meeting 36.

<sup>4</sup> *Ibid.*, 15:35.

been adequate to ensure that these situations do not arise. Additionally, some of NRCan's actions, such as creating the Centre of Expertise and the Transfer Payment Review Committee, were completed well before the OAG conducted its audit between June and November 2008. Yet, in its audit report the OAG expressed concerns about NRCan's management of contribution agreements. Thus, the Committee is not as confident as NRCan's Deputy Minister and recommends:

### **RECOMMENDATION 1**

**That NRCan review its response to the audits to determine whether it has the right mix of policies, procedures, and practices in place to appropriately manage grants and contributions programs and to ensure that this type of problem does not recur.**

### **CONFLICTS OF INTEREST**

In 2005, NRCan senior management became aware that one of the contribution recipients, Canadian Energy Efficiency Alliance Transport (CEEA-T), was not complying with some of the terms and conditions of the contribution agreement. Senior management subsequently requested an internal audit of five contribution agreements. The internal audit identified serious problems in NRCan's management of, and control framework for, contribution agreements, as well as the approval of payments that were not in compliance with the terms and conditions of the contribution agreement.

The OAG decided to undertake its own audit after a whistleblower sent an anonymous letter to the OAG stating that the internal audit had not dealt with a conflict of interest. In her testimony before the Committee the Auditor General explained that the internal audit "highlighted several problems, including serious compliance issues with the claims submitted for payment and with the control framework in place at the time. We subsequently became aware that the department may not have addressed all the issues and we therefore undertook this audit."<sup>5</sup>

The OAG's audit determined that a consultant, who had helped NRCan develop two contribution programs, subsequently worked for the organizations that received

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<sup>5</sup> Ibid., 15:30.

funding under the same programs. The department paid at least \$110,000 to the consultant. The consultant then signed a contribution agreement with NRCan as president of a recipient organization, CEEA-T. CEEA-T entered into a contract with the consultant, which included provisions to pay up to \$712,000 for professional services. The OAG concluded that NRCan knew of these circumstances and permitted the conflict of interest to occur by the way that it managed the contracts and contribution agreements. According to the Auditor General, “I would just add that while the department was aware of the facts, it did not itself identify this as a conflict of interest.”<sup>6</sup>

The Committee was surprised that the conflict of interest was not identified in the internal audit, given its significance. However, the Deputy Minister of NRCan stated that, “at the time we initiated the internal audit, the focus was very much on our management control framework and ensuring that we had adequate controls in place to govern adherence to terms and conditions and to ensure value for money.”<sup>7</sup> The Auditor General told the Committee that the internal audit “focused on the management framework” and that the “scope of the audit was quite narrow and quite specific.”<sup>8</sup>

While NRCan implemented a number of new practices and processes in response to the internal audit, which were designed to improve management controls with respect to contribution agreements, the OAG noted that the Office of Energy Efficiency continued to perform most of the monitoring of its contribution agreements, and was responsible for deciding which recipients would be audited. In addition, the OAG reported that NRCan’s policy on transfer payments and its values and ethics framework were silent on conflict of interest situations for private sector consultants and for contribution agreements.

The Deputy Minister stated that the conflict of interest was dealt with independently:

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<sup>6</sup> Ibid., 16:35.

<sup>7</sup> Ibid., 16:00.

<sup>8</sup> Ibid., 16:35.

All of the findings of the internal audit were provided to the RCMP. After its review, the RCMP noted that there was no evidence of wrongdoing warranting either further review or initiation of a criminal investigation.<sup>9</sup>

She later went on to say:

At the time this situation was under review with the internal audit, there was a recognition that there was a potential for conflict of interest, so one thing that was driving us in the department was to assess whether there had been wrongdoing, first of all from a criminal perspective. That's why the matter was referred to the RCMP on two separate occasions: to formally ask the RCMP to investigate. I've mentioned their response. We also followed up the aspect of mismanagement from a labour relations perspective, and so there was a specific focus on the individual who had responsibility for generating the conflict of interest situation.

I want to assure the committee that it wasn't as though we were not aware. It was just not specified as a specific reference. There was certainly cause for seeing a failure of management, and there was a complete review in terms of any kind of criminal negligence on the part of either of the parties to the contribution agreement.<sup>10</sup>

However, it is only subsequent to the OAG's audit that NRCan clearly acknowledged that the possibility of conflicts of interest was a problem and took action to prevent them from recurring in the future. In response to the OAG's recommendation that NRCan develop policies and guidance to identify and address conflict of interest situations, NRCan has added clauses to its contribution agreements to avoid conflict of interest situations involving employees and recipients, as well as incorporating conflict of interest requirements into transfer payment training. In other words, if not for the anonymous letter sent to the OAG and the OAG's subsequent audit, it is unlikely that

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<sup>9</sup> Ibid., 1625.

<sup>10</sup> Ibid., 16:35.

NRCan would have made changes to its policies, guidance, and training on conflict of interest.

What is more troubling is that this may not be an isolated incident and conflict of interest in the management of contracts and grants and contributions programs may be prevalent elsewhere in the government. As noted earlier, NRCan is currently reviewing another potential conflict of interest related to one of its contribution agreements, and the Auditor General told the Committee that her office has “identified other cases of conflict of interest through recent audits. It seems obvious to us that this is not well understood. There seems to be a gap, generally, in the training of public servants and in their understanding of conflicts of interest.”<sup>11</sup>

While it is difficult to know how extensive conflict of interest problems are within the federal government, some departments, including Public Works and Government Services Canada, report wrongdoing on the proactive disclosure section of their website.<sup>12</sup> In fact, under section 11(c) of the *Public Servants Disclosure Protection Act*, the deputy head of a federal government organization must provide public access to information on founded wrongdoing. As of the preparation of this report, NRCan had not yet developed a system for including information on founded wrongdoing on the proactive disclosure section of its website, as other departments have done. As the Committee believes that the disclosure of wrongdoing in a readily accessible manner is important, it recommends:

## **RECOMMENDATION 2**

**That Natural Resources Canada establish a sub-section on the proactive disclosure section of its website to disclose any and all cases of founded wrongdoing.**

Officials from NRCan told the Committee that the primary government policy on the avoidance of conflict of interest is contained in the *Values and Ethics Code for the Public Service*, which is published by the Treasury Board of Canada Secretariat.

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<sup>11</sup> Ibid., 15:55.

<sup>12</sup> A list of proactive disclosure websites can be found at: <http://www.tbs-sct.gc.ca/pd-dp/gr-rg/index-eng.asp>.

Chapter 2 of that document contains sections on measures to prevent conflicts of interest, and methods of compliance. However, this Code directs public servants to avoid conflicts of interest and is silent on whether public servants should act in order to avoid conflicts of interests by contractors and recipients of grants and contributions.

In the Committee's view, the *Values and Ethics Code for the Public Service* provides general guidance to public servants, but it is not sufficient to prevent the kinds of conflict of interest situations under consideration. Also, the Treasury Board of Canada Secretariat's *Policy on Transfer Payments*, which outlines the duties and responsibilities of public servants administering grants and contributions, is silent on the potential for conflicts of interest. The Committee believes that contractors and recipients of grants and contributions should abide by the same conflict of interest rules as public servants. Additionally, if it is appropriate for NRCan to add conflict of interest clauses to its contribution agreements, then it would be appropriate for all departments to do likewise. Therefore, the Committee recommends:

### **RECOMMENDATION 3**

**That the Treasury Board of Canada Secretariat provide clear rules and guidance, including draft contractual provisions, to departments and agencies to assist them in identifying and avoiding conflicts of interest by contractors and the recipients of transfer payments.**

### **PAYMENTS TO AN INSOLVENT COMPANY**

In 2005, NRCan became aware that CEEA-T had not made payments to some of its contractors before submitting claims to NRCan for payment, as required by the contribution agreement. While NRCan had sufficient evidence of CEEA-T's insolvency, it continued to provide funding to CEEA-T. Motivated by its desire to ensure that CEEA-T's subcontractors were compensated, and to avoid the potential for litigation, NRCan issued additional payments to CEEA-T, totalling around \$1.1 million, with the expectation that the money would be used to pay amounts claimed by CEEA-T's subcontractors. According to the OAG, \$3.2 million in payments were not made in accordance with the terms and conditions of the contribution agreement, and this

approach led to a risk that the funds would not be used as intended. As the Auditor General told the Committee:

...obviously [the] government was trying to do the right thing and ensure that the subcontractors were paid for the work that was done, but we believe that \$3.2 million was put at risk because payments were made to an insolvent company and there was, as far as we could determine, no guarantee that the payment would actually go to the subcontractors.<sup>13</sup>

The OAG concluded that NRCan did not satisfy its obligations under section 34 of the *Financial Administration Act*, which requires certification that the recipient is eligible for or entitled to the payment. The OAG noted that such certifications are an essential control over the expenditure of public money. According to the OAG, this certification was not satisfied because the payments were not made in accordance with the terms and conditions of the contribution agreement.

The OAG found that the Department considered, but did not implement, other available options. This included the possibility of entering into new contribution agreements, amending the existing contribution agreements, or making payments that would be consistent with the policy on claims and *ex gratia* payments. NRCan's Deputy Minister told the Committee that while the department had a range of options to deal with the situation, its actions were consistent with the legal advice it received. Carol Buckley, Director General of the Office of Energy Efficiency, explained to the Committee that:

The entity with whom we had a legal agreement would not have been likely to want to stand back from that agreement; they wanted to continue to be the entity delivering the work under the contribution agreement. In addition, there were some 40 or more subcontractors, so the administrative difficulty of moving a contract of many millions of dollars to tens and tens of subcontractors would have been very difficult...So we had

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<sup>13</sup> Ibid., 16:15

advice that there were options we could undertake, and we felt confident in the option we chose.<sup>14</sup>

The Committee cannot fault NRCan for following the legal advice they were provided, and there may have been sound legal and administrative reasons for making the payments and avoiding costly litigation. However, the OAG rightly notes that making payments to an insolvent company put public funds at risk because NRCan had no guarantee that the payments would be made to the subcontractors. As the possibility of amending the contribution agreement does not seem to have been viable, it appears that NRCan was in a bind between the legal requirements of the *Financial Administration Act*, its contractual obligations under the contribution agreement, and the administrative difficulty of providing payments to 40 or more subcontractors.

It is not clear whether this was a unique circumstance faced by NRCan's Office of Energy Efficiency, or whether this type of difficulty occurs from time to time within the federal government. If it is a periodic occurrence, then departments likely need more guidance on how to deal with these types of situations and to ensure that they meet their responsibilities under Section 34 of the *Financial Administration Act*. As the Committee believes that this issue should be examined further, it recommends:

#### **RECOMMENDATION 4**

**That the Comptroller General of Canada examine whether departments need more guidance on how to reconcile possible conflicting contractual obligations arising from contribution agreements and statutory requirements outlined in the *Financial Administration Act*.**

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<sup>14</sup> Ibid., at 16:20



## **CONCLUSION**

The Committee is very troubled by the events that took place within NRCan's Office of Energy Efficiency. However, when NRCan senior management recognized that there were compliance issues related to certain contribution agreements, they appropriately ordered an internal audit. While the internal audit highlighted problems with NRCan's management of contribution agreements and the department's control framework, the internal audit failed to identify the conflict of interest. It was only after the OAG conducted its audit that NRCan acknowledged that the conflict of interest was a problem and took action to prevent it from recurring. As the Committee believes that this situation may arise in other departments, it is necessary for all departments to take action to prevent conflicts of interest. Thus, the Committee believes that the Treasury Board of Canada Secretariat should provide all departments with additional guidance on avoiding of conflicts of interest when managing grants and contributions.

# APPENDIX A LIST OF WITNESSES

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Organizations and Individuals	Date	Meeting
<b><u>40th Parliament, 2nd Session</u></b>		
<b>Department of Natural Resources</b>	2009/10/28	36
Carol Buckley, Director General Office of Energy Efficiency CassieJ. Doyle, Deputy Minister Bill Merklinger, Assistant Deputy Minister and Chief Financial Officer		
<b>Office of the Auditor General of Canada</b>		
Linda Drainville, Principal Sheila Fraser, Auditor General of Canada John Wiersema, Deputy Auditor General		
<b>As an individual</b>		
Richard B. Fadden, Former Deputy Minister Department of Natural Resources		

# REQUEST FOR GOVERNMENT RESPONSE

Pursuant to Standing Order 109, the Committee requests that the government table a comprehensive response to this Report.

A copy of the relevant Minutes of Proceedings (40th Parliament, 3rd Session: [Meetings Nos. 3 and 5](#); 40th Parliament, 2nd Session: [Meeting No. 36](#)) is tabled.

Respectfully submitted,

Hon. Shawn Murphy, MP

Chair