



HOUSE OF COMMONS  
CANADA

**REPORT ON PLANS AND PRIORITIES FOR 2010-  
2011 AND DEPARTMENTAL PERFORMANCE  
REPORT 2008-2009 OF THE OFFICE OF THE  
AUDITOR GENERAL OF CANADA**

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

**Hon. Joseph Volpe, MP  
Chair**

**DECEMBER 2010**

**40th PARLIAMENT, 3rd SESSION**



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# **THE STANDING COMMITTEE ON PUBLIC ACCOUNTS**

has the honour to present its

## **TWENTY-FIRST REPORT**

Pursuant to its mandate under Standing Order 108(3)(g), the Committee has studied Report on Plans and Priorities for 2010-2011 and Departmental Performance Report 2008-2009 of the Office of the Auditor General of Canada and has agreed to report the following:

## **INTRODUCTION**

One of the fundamental roles of parliamentary committees is to hold the government to account by reviewing the government's spending plans for the coming year and its performance in the previous year. This is done through the Estimates process, whereby the government presents in the spring its spending plans in the Main Estimates and departmental priorities and performance objectives in Reports on Plans and Priorities (RPPs). In the fall, the government reports on performance against expected results in Departmental Performance Reports (DPRs).

In contrast to the other House Committees, the Public Accounts Committee does not review the Estimates of government departments, but instead reviews the Estimates of the Office of the Auditor General of Canada (OAG). The Committee has made a regular practice of reviewing and reporting on the OAG's Estimates, including its RPP and DPR, because the Committee has an important role to play in holding the OAG to account on behalf of Parliament and Canadians.

The Committee met on 11 May 2010 to discuss the OAG's 2010-2011 Main Estimates, 2008-09 Departmental Performance Report and the 2010-11 Report on Plans and Priorities. The Committee met with: Sheila Fraser, Auditor General of Canada; John Wiersema, Deputy Auditor General; and Lyn Sachs, Assistant Auditor General. In order to seek clarification about the audit of departmental financial statements, the Committee held two subsequent hearings. On 21 October 2010, the Committee met with John Wiersema, Deputy Auditor General; James Ralston, Comptroller General of Canada; and Bill Matthews, Deputy Assistant General. On 2 November 2010, the Committee met with officials from the OAG: John Wiersema, Deputy Auditor General, and Nancy Cheng, Assistant Auditor General; as well as officials from the Treasury Board of Canada Secretariat: Michelle d'Auray, Secretary of the Treasury Board; James Ralston, Comptroller General of Canada; and Bill Matthews,

Assistant Comptroller General.<sup>1</sup> There were several issues raised during the hearings that merit continued attention, as discussed below.

## **SELECTING A NEW AUDITOR GENERAL**

Under the *Auditor General Act*, the Auditor General, an Officer of Parliament, is appointed for a term of 10 years, and cannot be reappointed.<sup>2</sup> The current Auditor General, Sheila Fraser, was appointed on 31 May 2001. This means that her term expires on 31 May 2011, and a new Auditor General must be appointed. Under the *Act*, the Auditor General is appointed by the Governor in Council, “after consultation with the leader of every recognized party in the Senate and House of Commons and approval of the appointment by resolution of the Senate and House of Commons.”<sup>3</sup> Additionally, under the House of Commons Standing Orders, the Public Accounts Committee will have the opportunity to examine and inquire on the issue, including having a hearing with the proposed appointee, and report back to the House within 30 days of notice of the appointment being given.<sup>4</sup>

The Senior Personnel and Public Service Renewal Secretariat of the Privy Council Office (PCO) assists the Prime Minister and Cabinet in the Governor-in-Council appointment process. A recent audit by the OAG of this process found that there were delays in making appointments and the process was poorly communicated to those involved.<sup>5</sup> The Committee believes that the Auditor General fulfills a fundamental oversight role, and thus the transition to a new Auditor General needs to be as smooth as possible. This process has to be started and completed in a manner that will lead to a seamless transition. The Auditor General expressed hope that, “there would be somebody identified as sort of an AG designate or something and that we could work together for a few months before the end of my term.”<sup>6</sup> As the Committee would like to

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<sup>1</sup> House of Commons Standing Committee on Public Accounts, 40<sup>th</sup> Parliament, 3<sup>rd</sup> Session, Meetings 14, 28, and 30.

<sup>2</sup> See *Auditor General Act* (R.S., 1985, C. A-17), Sections 3 (1.1) and 3 (3).

<sup>3</sup> *Ibid.*, Section 3.(1).

<sup>4</sup> *Standing Orders of the House of Commons*, Standing Order 111.1. See also Audrey O'Brien and Marc Bosc, eds., *House of Commons Procedure and Practice*, 2<sup>nd</sup> Edition, 2009, Chapter 20.

<sup>5</sup> Auditor General of Canada, 2009 Status Report, *Chapter 2, Governor in Council Appointment Process*.

<sup>6</sup> Meeting 14, 10:10.



monitor this issue to ensure that a new Auditor General is appointed in a timely manner, it recommends:

### **RECOMMENDATION 1**

**That the Privy Council Office provide to the Public Accounts Committee by 31 January 2011 a timeline of the steps to be taken to appoint a new Auditor General and an update on progress made.**

### **FUNDING**

During the 2008-2009 fiscal year, the OAG used \$84.4 million of the \$87.9 million in appropriations available, and employed the equivalent of 628 full-time employees. The net cost of operations—taking into account services provided without charge by other departments and other smaller adjustments—was \$100.1 million. The planned spending for 2010-2011 is \$98.0 million.

In her opening statement, the Auditor General noted that Budget 2010 committed to freezing departmental operating budgets, including the budget of the OAG, for the next three years. This means that the mandated economic increase of 1.5% in salary compensation for 2010-2011 must be funded through internal reallocations. In the case of the OAG, this will mean finding \$860,000 to reallocate in 2010-2011. The OAG has also faced funding pressures in other ways. The OAG's mandate has been expanded; for example, in some instances where the OAG was formerly the joint auditor, it is now the sole auditor. Also, the move to new international accounting standards will lead to approximately \$3 million in costs for updating audit manuals, tools, and checklists and providing training over the next two years.

In its report on the OAG's 2009-2010 RPP, the Committee noted that the OAG had intended to seek an additional \$3 million to \$4 million in 2009-2010 in order to meet additional audit responsibilities.<sup>7</sup> However, the OAG decided not to request additional

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<sup>7</sup> House of Commons Standing Committee on Public Accounts, *Report on Plans and Priorities for 2009-2010 and Departmental Performance Report for 2007-2008 of the Office of the Auditor General of Canada*, Report 16, 40<sup>th</sup> Parliament, 2<sup>nd</sup> Session, June 2009.

funds at that time due to the country's economic circumstances. The OAG showed leadership by managing its new responsibilities through reductions in some activities and efficiencies in other areas. Beginning in 2010, the OAG will reduce the number of performance audits conducted from approximately 30 to about 25 a year. The OAG has also reduced the use of auditors on a contract basis and reviewed all corporate service, travel, and other non-fixed costs to identify possible savings.<sup>8</sup> Another possible source of savings could be in the use of contracts, as the OAG spent almost \$10 million on 619 contracts in 2008-2009.<sup>9</sup> The Auditor General noted that they had reduced training, but this was not sustainable in the long term. The Auditor General concluded, "I think we will be all right for the next year. Obviously, as this goes forward in the three years, these reductions compound. If it becomes very problematic, we will obviously have to come back to the committee."<sup>10</sup>

In addition to a reduced number of performance audits, the budgetary pressures will have other impacts on the OAG. The Auditor General indicated in her opening statement that her office will not be auditing departmental financial statements, which is discussed in more detail below. The Auditor General also said, "The other area that I think will be challenging for us is, as I mentioned, the market for financial accountants. This is a very competitive market, and with the salary caps that we have, I am concerned that we are going to be quickly non-competitive in that market and have difficulty getting experienced people. For the moment we are managing the situation. We have the staff that we need, but we will have to pay close attention to this going forward."<sup>11</sup> While the OAG has been recognized as one of Canada's top 100 employers and one of Canada's top 20 family-friendly employers, the OAG has a turnover rate of about 12% and must attract 60-65 new staff every year. However, the market for financial accountants is very competitive. The OAG was at the point of negotiating a new salary structure with its audit staff when the mandated salary levels came into effect. The Auditor General said, "I think our challenge over time will be to try to remain

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<sup>8</sup> Office of the Auditor General of Canada, *2010-2011 Report on Plans and Priorities*, page 10.

<sup>9</sup> Office of the Auditor General of Canada, *2008-2009 Departmental Performance Report*, page 42.

<sup>10</sup> Meeting 14, 9:25.

<sup>11</sup> *Ibid.*

competitive with a market where clearly the salary increases are going to be more than 1.5%.”<sup>12</sup>

Notwithstanding the fact that the government has frozen the operating budgets of all departments and agencies, some members of the Committee are concerned with the effects of freezing the OAG’s funding at its 2010-2011 level. This has meant that some audit activities have been curtailed, such as fewer performance audits and no annual audits of departmental financial statements, and it may inhibit the OAG’s ability to attract and retain audit professionals. Parliamentarians and Canadians rely on the work of the OAG to provide assurance that government activities are undertaken with due regard to economy and efficiency and measures are in place to assess effectiveness. In order to do this work effectively, the OAG must have an appropriate level of funding. The Auditor General stated that the OAG will be able to function for the next year, but the Committee is concerned that funding may become a more serious issue for the OAG in the coming years, and the Committee will monitor this matter accordingly.

## **DEPARTMENTAL FINANCIAL STATEMENTS**

Currently, the OAG audits the Government of Canada’s consolidated financial statements, as found in the *Public Accounts of Canada, Volume I*. The OAG follows guidelines put forward by the Canadian Institute of Chartered Accountants (CICA) and reviews the consolidated financial statements with a materiality of 0.5% on about \$240 billion in annual expenditures (for 2008-2009), which works out to approximately \$1 billion.<sup>13</sup> As some departments are too small to have an accounting error or misstatement of plus or minus \$1 billion, the OAG audits the financial records and internal controls of these departments on a cyclical basis rather than annually.

As part of its initiative to strengthen public sector management, the federal government announced in 2004 that all annual financial statements of departments and agencies would be audited. The Comptroller General decided to take a tiered approach

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<sup>12</sup> Ibid, 9:50.

<sup>13</sup> “Materiality” is the term used to describe the significance of financial statement information to decision-makers.

to this initiative, and focused on the financial statements of the 22 largest departments, which represent approximately 90% of total government expenses. The Committee has strongly supported this initiative, as it would provide greater assurance about the financial management of all departments. The Committee has made recommendations or commented on this issue in its reports on the *Public Accounts of Canada* of 2006, 2007, 2008, and 2009.<sup>14</sup> This initiative was also supported by the Senior Committee on the Review of the Financial Management Framework in its March 2007 report.<sup>15</sup>

In her observations on the 2008-2009 *Public Accounts of Canada*, the Auditor General indicated that her office had completed an audit of the financial statements of the Department of Justice and would be undertaking a readiness assessment of Industry Canada and possibly one other department. Another six departments indicated their readiness for 2010-2011. The Auditor General stated, "Having the first of the 22 large departments undergo an external audit of their financial statements is an important step toward the objective of improving internal controls and providing credible financial information."<sup>16</sup>

The Committee learned at its May 11 hearing that the Auditor General does not plan to proceed with auditing departmental financial statements. She said,

We have recently communicated to the Comptroller General that we will not audit departmental-level financial statements. In addition to the issue of funding, we reached this decision after considering the delays in the readiness of the largest government departments to have their financial statements audited, as well as a lack of a formal government policy on audited departmental financial statements.<sup>17</sup>

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<sup>14</sup> House of Commons Standing Committee on Public Accounts, *Public Accounts of Canada 2006*, 12th Report, 39<sup>th</sup> Parliament, 1<sup>st</sup> Session, December 2006; 11<sup>th</sup> Report, *Public Accounts of Canada 2007*, 39<sup>th</sup> Parliament, 2<sup>nd</sup> Session, March 2008; 6<sup>th</sup> Report, *Public Accounts of Canada 2008*, 40<sup>th</sup> Parliament, 2<sup>nd</sup> Session, March 2009; 10<sup>th</sup> Report, *Public Accounts of Canada 2009*, 40<sup>th</sup> Parliament, 3<sup>rd</sup> Session, April 2010.

<sup>15</sup> Senior Committee on the Review of the Financial Management Framework, *Report of the Senior Committee on the Review of the Financial Management Framework*, March 2007.

<sup>16</sup> Government of Canada, *Public Accounts of Canada, 2008-2009*, page 2.35.

<sup>17</sup> Meeting 14, 9:10.

She went on to explain:

Quite frankly, the government does not seem to view this as a priority at the current time. So we asked why we would continue to work on something when obviously we would have to probably reduce our performance audits even more to do this work. We have clearly indicated to government that should they decide that this is a priority, and if there is a policy, then we would be quite pleased, of course, to reconsider our position on it. Unless we get an indication from them, we don't think we should be doing it.<sup>18</sup>

The Comptroller General, James Ralston, explained the government's position at a later hearing. He said that the environment of 2010 is different from that of 2004, which has led the government to re-evaluate its position. Treasury Board has recently adopted a number of policies to improve financial management in the federal government, such as the "Policy on Internal Control," the "Policy on Financial Management Governance," and the "Policy on Financial Reporting, Information and Resource Management." This latter policy requires departments to be capable of sustaining a controls-based audit of their financial statements, and departments are also required to publicly disclose the state of their internal controls, including an action plan of how they intend to address any deficiencies.

The Comptroller General told the Committee that these policies were not a change in goals, just a change in means. He said, "The goal before, in 2004, and the goal today, at both times, has not changed: better financial statements, better financial management, and better controls."<sup>19</sup> The Comptroller General also told the Committee that Treasury Board policies can achieve these ends, and a level of assurance is provided by the OAG's current audit of the government's consolidated financial statements, there is no need to move to an audit of departmental financial statements. The Comptroller General noted that an auditor's report does not provide direct assurances on internal controls, and it would be more costly, both for departments and for the OAG, to have departmental financial statements audited on a controls basis.<sup>20</sup>

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<sup>18</sup> Ibid., 9:45.

<sup>19</sup> Meeting 28, 11:35.

<sup>20</sup> It would be still more expensive to undertake substantive audits, and would probably require more foundational work and costs for departments.

The issue was raised regarding the costs for departments to undergo audits of their financial statements. When the question of how much it would cost was first posed, the Committee was told that the 22 largest departments provided an overall rough estimate of \$300 million. Upon further discussion, the Committee learned that this amount is a foundation cost to improve internal controls and accounting systems in order to achieve readiness for a controls-based audit. This cost would need to be incurred regardless of whether or not the financial statements would be in fact audited. Instead, the incremental cost of auditing departmental financial statements would be an annual, recurring cost to the OAG and departments for undertaking the audits. The witnesses were not able to confirm what the costs would be. The additional costs were concerning to some of the Committee members.

For his part, the Deputy Auditor General, John Wiersema, said that his office had supported the original decision in 2004 and was ready to play its part. According to the Deputy Auditor General, the benefits of an annual audit of departmental financial statements include improvements in internal controls in order to be ready for an audit and more reliable financial information both for internal management purposes and external review by Parliament. Auditing the financial statement of the Government of Canada is quite different from auditing departmental financial statements because the level of materiality goes down and more scrutiny is required. He explained what would be lost by not auditing departmental financial statements, "What we have been pointing out to this committee in our discussions is what you will not be receiving, as a result of not auditing those financial statements, is some form of independent validation that the controls are there at the departmental level, relative to the department, to sustain a controls-based audit. You will not be getting that independent validation from the Office of the Auditor General."<sup>21</sup> The Deputy Auditor General noted that this issue is for the government, and ultimately Parliament, to decide, and his office would work with whatever decision is made.

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<sup>21</sup> Meeting 30, 12:25.

The Committee is concerned that this initiative appears to have stalled. Time and effort has been put in by departments to get to this point, and it is important to complete this work. The Committee notes that the United Kingdom, the United States, Australia, and New Zealand have already implemented the audit of departmental financial statements. However, the Committee also learned from the witnesses that other countries have not always received clean audits. Canada, on the other hand, has received a clean audit for 11 years, which is quite an accomplishment. Additionally, the government had clearly indicated its commitment to proceed with this initiative, including acknowledging the possibility that the OAG may need additional funding for the work. In response to a Committee report, the government stated:

It is the intent of the government to have departmental financial statements, audited by the Office of the Auditor General of Canada. ... It is also recognized that increasing the number of departmental financial statements audited by the Office of the Auditor General of Canada may require an increased budget for the Office of the Auditor General of Canada.<sup>22</sup>

The Committee continues to believe that it is important for departments to achieve a state of readiness to have their financial statements audited annually. Indeed, the “Policy on Financial Resource Management, Information and Reporting” requires departments to be capable of sustaining a controls-based audit. Thus it recommends:

## **RECOMMENDATION 2**

**That the Comptroller General and the Treasury Board of Canada Secretariat work to implement the “Policy on Financial Resource Management, Information and Reporting” and assist the largest 22 departments in having their financial statements ready for a controls-based audit by the Office of the Auditor General.**

And

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<sup>22</sup> Government of Canada, *Government Response to the Ninth Report of the Standing Committee on Public Accounts: Government Decisions Limited Parliament’s Control of Public Spending of the 2006 Report of the Auditor General of Canada*, February 2007.

### **RECOMMENDATION 3**

**That the Office of the Auditor General audit the financial statements of the largest 22 departments that will be ready for a controls-based audit.**

### **CONCLUSION**

The Auditor General and her office conduct very valuable work that assists Parliament in holding the government to account for efficient and economical administration. The current Auditor General, Sheila Fraser, has done outstanding work, and it will be difficult to replace her. However, her term will come to an end in May 2011, and it is vital that the government act to ensure that a suitable candidate is chosen in a timely manner, which will enable a smooth transition between Auditors General.

Notwithstanding the fact that the government has frozen the operating budgets of all departments and agencies, some members of the Committee are concerned with the effects of freezing the OAG's funding at its 2010-2011 level. This has meant that some audit activities have been curtailed.

In 2004, the government committed to have the financial statements of all departments and agencies audited. The Committee was told that the government now intends to move forward with policies to improve financial management and internal controls. The Committee believes that the largest 22 departments should work to be ready for a controls-based audit of their financial statements and, in order to provide objective and independent assurance about the reliability of financial information, that the OAG should conduct audits of these financial statements.



# APPENDIX A LIST OF WITNESSES

Organizations and Individuals	Date	Meeting
<b><u>40th Parliament, 3rd Session</u></b>		
<b>Office of the Auditor General of Canada</b> Sheila Fraser, Auditor General of Canada John Wiersema, Deputy Auditor General Lyn Sachs, Assistant Auditor General	2010/05/11	14
<b>Office of the Auditor General of Canada</b> John Wiersema, Deputy Auditor General <b>Treasury Board Secretariat</b> Bill Matthews, Assistant Comptroller General James Ralston, Comptroller General of Canada	2010/10/21	28
<b>Office of the Auditor General of Canada</b> Nancy Cheng, Assistant Auditor General John Wiersema, Deputy Auditor General <b>Treasury Board Secretariat</b> Michelle d'Auray, Secretary of the Treasury Board of Canada Bill Matthews, Assistant Comptroller General James Ralston, Comptroller General of Canada	2010/11/02	30

# 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. 14, 28, 30, 33, 34 and 35](#)) is tabled.

Respectfully submitted,

Hon. Joseph Volpe, M.P.

Chair