

Chapter

2

Expenditure Management System
in Departments

All of the audit work in this chapter was conducted in accordance with the standards for assurance engagements set by the Canadian Institute of Chartered Accountants. While the Office adopts these standards as the minimum requirement for our audits, we also draw upon the standards and practices of other disciplines.

Table of Contents

Main Points	65
Introduction	67
The role of the departments in the Expenditure Management System	68
Focus of the audit	69
Observations and Recommendations	69
Aligning a program’s funding with its requirements	69
Alignment is important for expenditure management	69
There are significant examples of alignment problems	70
Alignment problems have a significant impact	72
System inflexibility weakens alignment	74
There is a need for more risk assessment	75
Greater attention to alignment is needed	76
Responding to central expenditure review	77
Departments need to build up their capacity to respond to future expenditure reviews	77
Complying with Treasury Board conditions	79
Department practices allow adequate monitoring of conditions	80
Using Supplementary Estimates	81
Guidelines for preparing Supplementary Estimates were clear and departments complied with them	82
Little is being done to limit reliance on Supplementary Estimates	84
Departments are spending existing funds on Supplementary Estimates items	85
Conclusion	87
About the Audit	88
Appendix	
List of recommendations	90



Expenditure Management System in Departments

Main Points

What we examined

In the federal government, departments decide on the mix of resources that is appropriate to deliver programs efficiently and effectively within the amounts voted by Parliament and the policies issued by the Treasury Board.

We examined the Expenditure Management System in three selected departments: Agriculture and Agri-Food Canada, Canadian Heritage, and Public Works and Government Services Canada. We also carried out a survey of officials in ten other departments. We examined selected programs to determine whether the program managers had adequate funding over a long enough timeframe to deliver the program. We examined how departments reallocate resources—specifically, how they respond to central expenditure review—and how they comply with conditions set by the Treasury Board for funding. We also examined whether the Treasury Board Secretariat provides clear guidance on the use of Supplementary Estimates, whether departments follow the guidance, and how departments use the Supplementary Estimates process.

Why it's important

The Expenditure Management System touches everything the government does, since all government activities involve spending. A sound and effective system for managing spending is central to the government's ability to carry out its fiscal responsibilities, fund its programs, control spending, and report financial and performance information to Parliament and the public. A system that works well promotes efficient, responsible, and accountable government. Without a good system, nothing that individual departments and agencies can do will result in sound overall management of government spending.

Departments play a key role in the Expenditure Management System, with primary responsibility for managing the resources allocated to them and achieving the results expected of their programs.

What we found

- In the programs we looked at there were significant examples of funding that was not adequately aligned with what was needed to deliver the programs and achieve their objectives, in terms of the

amounts allocated, timeframes, and funding profiles (the distribution of funding over a period of time). This affected how the programs were delivered, including their ability to recruit and retain staff. Alignment problems and pressures of the annual appropriations process also led departments to rely on cumbersome ad hoc measures to meet spending commitments.

- The capacity to respond to some elements of government-wide reallocation exercises was insufficient in the three departments we examined. In the case of the 2004 Expenditure Review Committee exercise, they responded largely with financial information that was not adequately combined with information on performance. The lack of a systematic government approach to central expenditure reviews is an underlying cause of these problems.
- In recent years, an increasing proportion of spending items has appeared in Supplementary Estimates rather than in Main Estimates. This limits parliamentarians' opportunity to scrutinize the full range of proposed government spending. The Treasury Board Secretariat has recognized the need to consolidate spending items in the Main Estimates. However, little has been done to reduce departments' reliance on Supplementary Estimates. In addition, departments start to spend on items in the Supplementary Estimates using existing authorities but before Parliament has voted on the Estimates. This practice undermines parliamentary control of government spending and exposes program funding to the risk that Parliament might reduce or reject the Supplementary Estimates.

The government has responded. The government considers that the issues raised in the chapter are generally consistent with those that a new Expenditure Management System should address, including the objective of reducing the use of Supplementary Estimates. It is reviewing the issue of alignment in order to identify areas of improvement, and agrees with the need to redesign the process for central expenditure review.

Introduction

2.1 In the Expenditure Management System (EMS), ministers and their departments propose programs, related expenditures, and funding profiles (the distribution of funding over a period of time) to cabinet committees. They request funding approvals from Parliament, and subsequently report back to Parliament on what was achieved with the resources provided. When delivering programs and services, departments must work within their allocated budgets, comply with Treasury Board policies, and meet their legislated mandates.

2.2 This report's Overview of the Federal Government Expenditure Management System provides a description of the roles and responsibilities of the various institutions that are participants and stakeholders in the EMS. Chapter 1, Expenditure Management at the Government Centre, describes the role of the central agencies. The present chapter describes how departments and agencies participate in the Expenditure Management System.

2.3 The *Financial Administration Act* assigns specific responsibilities to Ministers and their deputies for the prudent management of resources. Department statutes assign responsibility to ministers for the "management and direction" of their departments. Treasury Board policy also requires departments to have appropriate management procedures in place to promote efficient and effective use of funds.

2.4 In this audit, we addressed selected key features of the role of departments in the EMS. In deciding on the appropriate mix of resources needed for program delivery, departments set objectives and determine program requirements. We examined the extent to which they align funding with program requirements. We looked at the response to reallocation requests from the centre of government, compliance with conditions set by Treasury Board, and the extent of use of Supplementary as opposed to Main Estimates.

2.5 To examine the role departments play in the Expenditure Management System in greater depth, we selected three departments—Agriculture and Agri-Food Canada, Canadian Heritage, and Public Works and Government Services Canada (Exhibit 2.1). These departments represent a cross-section of the federal government in terms of size and range of functions.

Exhibit 2.1 Audited departments by expenditures, functions, and spending category

Department	Gross expenditures (2004–05 in \$ billions)	Functions	Spending category
Public Works and Government Services Canada	4.6	Supports the daily operations of nearly 140 federal departments and agencies by providing common services to government such as purchasing goods and services and providing office accommodations.	Mainly projects or procurement
Agriculture and Agri-Food Canada	3.4	Supports the security of the food system and the health of the environment, through policies and programs, as well as information, research and technology.	Mainly grants and contributions
Canadian Heritage	1.3	Supports Canadian heritage and culture through national policies and programs.	Mostly grants and contributions

Sources: Public Accounts of Canada 2005 (Volume II) and departments.

The role of the departments in the Expenditure Management System

2.6 Expenditure management in departments is tied to the annual budget cycle and also reacts to changing priorities throughout the year. The process that sustains it is multi-faceted.

2.7 Departments make a Treasury Board submission each year, asking the Treasury Board to approve their reference levels through the **Annual Reference Level Update** (ARLU) process. Departments provide detailed financial information for this process, which is purely technical. For most new and enriched program funding, the minister presents options to the appropriate Cabinet committee, in a memorandum that the department prepares.

2.8 Funding decisions may be announced in the budget of the Minister of Finance or in a separate government announcement, such as in a news release. These announcements reflect the choice of policy option, and typically do not provide details of program implementation or delivery. When a source of funds has been identified, the department prepares a submission to the Treasury Board.

2.9 The Treasury Board may approve the submission with conditions that departments must meet, including those required to secure continued funding. These conditions cover financial and non-financial matters, as well as approvals of certain spending authorities. The conditions may also involve other departments.

Annual Reference Level Update—A process by which the Treasury Board decides on funding for the ongoing delivery of existing programs. A department reference level is the amount of funding that the Treasury Board has approved for departments and agencies to carry out policies and programs for each year of the planning period.

Business of Supply—The process by which the Government submits its projected annual expenditures for parliamentary approval.

2.10 The process for approval of proposed expenditures culminates in the parliamentary **Business of Supply**, which involves the scrutiny of proposed expenditures in the Main and Supplementary Estimates and the enactment of appropriations.

Focus of the audit

2.11 The objective of this audit was to determine whether the three selected departments—Agriculture and Agri-Food Canada, Canadian Heritage, and Public Works and Government Services Canada—had effective procedures to ensure that spending complied with direction from the centre of government and met program funding requirements.

2.12 Our approach included analyzing various documents (such as policies and the Treasury Board Secretariat's *Guide to Preparing Submissions*), examining files (including a sample of Treasury Board submissions and decisions), and meeting with representatives from the audited entities. We also conducted a survey of officials at ten other departments, in order to reach broader observations and conclusions.

2.13 More details on our audit objective, scope, approach, and criteria are in **About the Audit** at the end of this chapter.

Observations and Recommendations

Aligning a program's funding with its requirements

Alignment is important for expenditure management

2.14 Spending initiatives can involve large or small amounts, an ongoing or a temporary timeframe for funding, and a funding profile of equal or varying amounts each year. Determining the amount, the timeframe, and the funding profile is basic to designing an initiative or a program; all three factors are linked to the nature of the program objectives and how the program will meet its objectives.

2.15 What public programs are expected to do, how they work, and what constraints they face dictate the time and resources needed to meet their objectives. For example, a transfer payment program should reach identified recipients and allow them to use the money productively in line with program objectives. Support for scientific research needs to match the duration and nature of the research program. An information technology project must meet client needs and be responsive to a rapidly evolving technological environment.

2.16 Departments also operate within the constraints of annual appropriations. By determining the amount of funding that will meet program requirements each year, departments can avoid lapsing funds.

2.17 In this chapter, alignment refers to the extent to which the funding amount, timeframe, and profile match what the program requires for its implementation, delivery, and achievement of objectives. While alignment is important for good administration and effective delivery of a program to Canadians, it is not always fully achievable. There is therefore a need to assess the risks associated with a lack of alignment.

2.18 We examined alignment in the three departments through a file review of new spending, and through discussion of cases with the officials responsible for them. In our survey of ten other departments, we asked senior financial officers and program managers about the nature of the funding and alignment issues.

2.19 We expected departments to identify the appropriate timeframe and amount of funding for programs. We also expected that these amounts would be consistent with the requirements for program delivery, enabling the achievement of program objectives.

There are significant examples of alignment problems

2.20 Officials at ten departments—the three we focused on and seven from our survey—recognized the importance of alignment. They identified problems and sought solutions to them. Officials at the other three departments in our survey told us they were generally able to align funding with program requirements, because of stable year-to-year funding.

2.21 We found three types of alignment problems:

- temporary funding for ongoing programs,
- timeframes not set according to program requirements, and
- funding profiles not aligned with planned or actual spending.

2.22 Temporary funding for ongoing programs. We found significant examples in the three departments of ongoing programs with long-term objectives whose funding was either partially or entirely temporary.

2.23 Temporary funding does not in itself lead to a lack of alignment. Spending initiatives announced in budgets typically have three- or five-year timeframes. This does not cause inadequate alignment if

program requirements are temporary in nature. Funding is often approved for shorter periods of time to make it possible to assess a program's progress after a few years. However, temporary funding may not be desirable when programs have objectives that can only be achieved over the long term.

Tomorrow Starts Today—A Department of Canadian Heritage initiative, announced in 2001, that provides support for Canadian arts and culture through a set of programs that help to develop Canada's artists and promote Canadian cultural industries.

2.24 Tomorrow Starts Today is an initiative in the Department of Canadian Heritage currently involving expenditures of \$860 million over five fiscal years, 2005–06 to 2009–10. It contains examples of ongoing programs with short-term funding. It enhanced a number of earlier Heritage programs when it was launched as a three-year initiative in 2001. Tomorrow Starts Today has since been renewed twice: first in 2003, for one year; and then in 2005, for five years (to 2009–10). The Department has sought ongoing funding for these programs. Senior officials have acknowledged that there are problems with sunsetted (time-limited) funding, and have stated that unless programs are truly temporary, not knowing whether the program will be renewed makes it more difficult to achieve the desired results.

2.25 Timeframe not set according to program requirements. In several of the files we examined, we found this alignment problem. In these cases, the government had set timeframes in announcements, but did not necessarily determine timeframes by the requirements of the program.

2.26 We found temporary funding and timeframe problems in Agriculture and Agri-Food Canada's **Agricultural Policy Framework** (APF), which came into force in 2003 as a \$5.2 billion, five-year commitment (fiscal years 2002–03 to 2007–08). The APF, a federal-provincial-territorial cost-shared agreement made up of several new programs, signalled a new national approach to agriculture with long term objectives. By its third year in 2005, APF implementation reflected delays in certain programs and initiatives such as food safety and quality. Delays were caused by a number of factors such as the design and launching of programs and the implementation of delivery mechanisms, including complex delivery by other jurisdictions and lower than expected participation rates. Some of these issues were known when the APF was negotiated; others would have been difficult to predict. Overall, the choice of a five-year framework has not correlated well with a number of program requirements.

2.27 Funding profiles not aligned with planned or actual spending. This major problem was cited by officials at six of the ten departments in our survey. We also found it in three of the files we examined. Respondents to our survey raised the following points:

Agricultural Policy Framework—A federal, provincial, and territorial strategy for prosperity and profitability in the agricultural sector, made up of five elements

- business risk management,
- food safety and quality,
- science and innovation,
- environment, and
- renewal.

- A number of obstacles can delay or impede program implementation, such as negotiations with third party stakeholders because of uncertainty as to the availability and amount of funds that may eventually be released by Treasury Board.
- If the funding profile does not match program requirements, or if delays occur in getting Treasury Board approval, the department normally requests a reprofiling of funds (reprofiling changes the funding profile by moving funds to later years). Since the Department of Finance approves or denies such requests, this causes extra uncertainty for program continuity.
- There is a constant need to change designated funding profiles. Program requirements are continually shifting, often because of factors beyond the department's control.
- Reprofiling of funds is normally requested mid-year, which requires program managers to estimate potential lapse. Most managers find it difficult to estimate these amounts. This eventually leads to the lapsing of large amounts of time-limited funding and restricts the department's ability to meet program objectives.
- Approval processes take longer than anticipated, resulting in delayed program start-up. Treasury Board submissions must reflect funding profiles as presented in policy approvals even though forecasts about cash flows may have changed.
- Even when it is virtually certain that expenditure will ramp up over time, the funding profile for new budget initiatives is typically straight-lined, beginning in the first year of implementation.

Alignment problems have a significant impact

2.28 Alignment problems have had a significant impact on program delivery, and have also led departments to rely on ad hoc measures to meet spending commitments. In the following paragraphs we present examples from the three departments, taken from our file review and other cases we examined. Five other departments responded to our survey with examples related to human resources management and program effectiveness.

2.29 One example of effects on delivery to Canadians was found in contribution programs intended to support multi-year projects. Because it was uncertain whether the **Cultural Spaces Canada** program (part of the Tomorrow Starts Today initiative) would be

Cultural Spaces Canada—This program focuses on repairing and upgrading arts and heritage facilities across Canada.

renewed on a long-term basis, Canadian Heritage was unable to commit funding for multi-year projects in the last two years of the initial five-year program. The Budget 2005 announcement of funding for Tomorrow Starts Today and Cultural Spaces Canada until the end of 2009–10 should rectify the situation.

2.30 Uncertainty also led to a number of administrative problems, such as the need to continually reassess program priorities and funding. On an ongoing basis, more than half of the funding for some of the Tomorrow Starts Today programs was not secure. For example, Canadian Heritage applied a funding ratio (50 percent temporary and 50 percent permanent) to the **Canadian Memory Fund** for the years in which that program's funding was not assured. If temporary funding were interrupted or significantly reduced, individual programs would not be dropped. Instead, the funding for the entire Tomorrow Starts Today initiative would be reviewed. This created additional planning and administrative burdens on program management staff, and also required complex projects to be completed in one year. In the **National Water Supply Expansion** program (Agriculture and Agri-Food Canada), funds were moved into the final two years of the program so that multi-year projects could be completed by that time. The program involved expenditures of \$60 million over four fiscal years, 2002–03 to 2005–06, as part of the Agricultural Policy Framework.

2.31 We found examples of alignment problems affecting human resources management. At Canadian Heritage, Tomorrow Starts Today programs have hired specialized staff on a temporary basis. It has proven difficult to recruit and retain staff. The problem is more acute in the regions, where there is limited ability to reassign indeterminate staff when temporary programs end. We found comparable problems in Public Works and Government Services Canada, where the **Exhibitions** program had a 30 percent annual turnover in staff, and the **Industrial Security** program also had recruitment and retention problems.

2.32 **Secure Channel** is a Public Works and Government Services Canada initiative that provides a major example of reliance on “cash managing” as a result of alignment problems. Secure Channel cost \$400 million to build and was put into production in 2004. Over five fiscal years, beginning in 2000–01, the department has been cash managing Secure Channel's ongoing operational funding until the funding is eventually recovered through the Treasury Board submission process. For example, in 2005–06, cash management amounted to \$126 million. Over a sustained period, cash managing can cause

The **Canadian Memory Fund** makes available on the Internet, in both official languages and free of charge, key Canadian cultural collections held by federal institutions.

The **National Water Supply Expansion** program is administered by the federal government, in agreement with, and with additional contributions by, provincial governments across Canada. The program helps the agriculture community develop and enhance agricultural water supplies.

Exhibitions—A Public Works and Government Services Canada (PWGSC) program that coordinates federal participation in fairs and exhibitions. PWGSC develops, manages, and adjusts the Exhibitions program in consultation with institutions and various stakeholders. It oversees the program's planning, logistics, media and public relations, database management, and evaluation activities.

Industrial Security—A program established by the Government of Canada to safeguard classified and protected Canadian, NATO and foreign information and assets entrusted to private sector organizations as a result of participation in contractual and/or project program requirements.

Secure Channel—An Internet pathway with a high level of security through which individuals and businesses communicate with the government.

distortions, since the funds must come from other sources within the department. It is an ad hoc approach to program funding.

System inflexibility weakens alignment

2.33 We asked what causes weak alignment of funding with program requirements. Officials in the three departments, as well as those responding to our survey, told us that a major cause of alignment problems is inflexibility in the Expenditure Management System.

2.34 Chapter 1 of this Report discusses problems created when funding allocations from the government centre do not appropriately align with program requirements. What we heard from the three departments that we audited raises the same issues.

2.35 It is difficult to change key approved policy options at the time of the program implementation, even when there is good reason to do so. In the files we examined, and in the interviews we conducted, it was clear that most decisions on the amount, the timeframe, and the funding profile were taken at the stage of the Memorandum to Cabinet. However, issues of program design were often unclear at that early stage. When circumstances changed, including cost increases and unforeseen delays, the Treasury Board Secretariat generally did not allow departments to use the Treasury Board submission process to change the amount, the timeframe, or the funding profile.

2.36 The Secretariat and the Department of Finance require adjustments to funding profiles to be made through an Annual Reference Level Update submission for reprofiling. This provides an opportunity to balance increases and decreases in program funding across government, as a way of managing the fiscal framework.

2.37 Departments also face the constraints of annual appropriations. With the exception of limited carry-over provisions, unspent funds lapse at the end of a fiscal year and are no longer available to meet program needs in a subsequent year.

2.38 We noted significant lapsing of funds in fiscal years 2003–04 and 2004–05 in connection with the Agricultural Policy Framework (APF). In the case of the APF, the lapsed funds were reprofiled to later years based on special arrangements with central agencies, but this took more than a year to arrange.

2.39 The existing process for changing these decisions is cumbersome and unresponsive to varying circumstances. We noted a number of cases where changes in the funding profile were required due to

circumstances beyond the departments' control. The reprofiling process was time-consuming and tied to a fixed schedule, often making it difficult to get the changes when needed, prior to program implementation.

Surplus Federal Real Property for Homelessness compensates federal departments and agencies at market value for surplus properties, and transfers them at a nominal cost to community organizations, the not-for-profit sector and other orders of government for projects to help alleviate and prevent homelessness.

Launched in April 2004 as a successor to the Canadian Adaptation and Rural Development Fund, the **Advancing Canadian Agriculture and Agri-Food** program will continue its predecessor's approach to funding projects at the national, multi-regional, and regional level.

2.40 For example, funding for **Surplus Federal Real Property for Homelessness** (a Public Works and Government Services Canada initiative), was distributed equally over the three years of the program (\$3 million each year). However, that funding profile did not match program requirements, which led to a reprofiling of all the funding to the last year. The department attempted without success to change the funding profile at the Treasury Board submission stage. Similar inflexibility arose in the case of the funding profile for the **Advancing Canadian Agriculture and Agri-Food** program. The funding for this program was \$240 million over five fiscal years, from 2004–05 to 2008–09.

There is a need for more risk assessment

2.41 There are significant risks to the amount and timing of funding when there is a failure to adequately align program funding with program requirements. For example, Agriculture and Agri-Food Canada must assess such risks when it estimates the amount of funding needed for farm income support programs under the Agricultural Policy Framework, particularly if it does not know how much demand there is for the program.

2.42 We expected departments to identify potential risks to the amount and timing of funding that may affect the achievement of program objectives.

2.43 For Treasury Board submissions, the Secretariat's *Guide* calls upon departments to provide specific funding details and a clear rationale for the resources to be spent each year. Among the questions that the Secretariat's analysts ask is whether departments have assessed the risks to the amount and timing of their funding, and whether they have a plan to manage them. The risk profile for Treasury Board submissions identifies financial risks, including expenditures that are likely to exceed funding.

2.44 We noted that the Secretariat and corporate services in the three departments provided program managers with guidance on high-level risk assessment. However, in the majority of the files we reviewed, there was no indication that departments considered risks related to the amount and timing of funding in the Treasury Board submission

process. In many of the cases, the treatment of risks was at a broader level, lacking specific analysis of program-level risks with respect to the funding amount, timeframe, and profile. Such assessments were not a requirement in a submission.

2.45 Departments told us that these risks are generally assessed at the Memorandum to Cabinet stage, when the Cabinet committee decides whether to approve the funding. In view of the extent of alignment problems, there is a need to continuously assess financial risk as program details become more clearly defined, as an integral part of the Treasury Board submission process.

2.46 Recommendation. The Treasury Board Secretariat should assess risks related to alignment issues in the Treasury Board submission process.

The government's response. As stated in the response to the recommendation of paragraph 1.64 of Chapter 1, the issue of alignment is being reviewed in order to identify areas for improvement.

Greater attention to alignment is needed

2.47 In the three departments, officials emphasized the role of the central agency approval processes in ensuring alignment. However, the officials consider it essential that program funding meet program requirements. They want to find ways to ensure greater alignment. In particular, all three departments have improved their capacity to know where the money goes. For example, at the start of fiscal year 2006–07, Agriculture and Agri-Food Canada established a baseline for tracking expenditures to sources of funds.

2.48 Officials responding to our survey of ten departments suggested a number of other actions that would help to ensure greater alignment. These included better costing procedures, improvements in cash management and reprofiling practices, as well as more involvement by the senior financial officer.

2.49 In announcing a review of the Expenditure Management System in Budget 2006, the government sought to ensure that all programs were aligned with its priorities and responsibilities. Our findings underscore the need for greater attention to alignment to meet responsibilities for program delivery.

2.50 Recommendation. The central agencies (Treasury Board Secretariat, Department of Finance, and Privy Council Office), in consultation with senior financial officers, should

- investigate the causes of lack of alignment of program funding, timeframe, and funding profile with program requirements; and
- develop an action plan for remediation of these problems, to be carried out along with the government review of the Expenditure Management System.

The government's response. As stated in the response to the recommendation of paragraph 1.64 of Chapter 1, the issue of alignment is being reviewed in order to identify areas for improvement.

Responding to central expenditure review

2.51 The capacity of departments to allocate and reallocate resources based on changing priorities is a major part of the Expenditure Management System. In order to examine this capacity in the three departments, we focused on the 2004 Expenditure Review Committee exercise.

2.52 We expected the departments to have effective processes and procedures to review their existing spending in order to adequately respond to requests for reallocation from central agencies.

2.53 The Expenditure Review Committee of Cabinet, which was created in 2003 as part of an undertaking to review all government programs, launched an exercise in September 2004 that required departments to identify low priority items that could be curtailed or eliminated to generate permanent savings. It was tied to Budget 2005 and carried out under budget secrecy. It required departments to work under tight deadlines, preparing proposals that had to meet criteria based on both financial and non-financial information.

2.54 Through the Expenditure Review Committee exercise, Budget 2005 identified \$11 billion in savings, to be achieved over five years. The government also committed itself to an annual spending review as part of the yearly budget cycle, intended to make the reallocation process an ongoing part of the Expenditure Management System.

Departments need to build up their capacity to respond to future expenditure reviews

2.55 We examined the way the three departments responded to the Expenditure Review Committee tests related to value-for-money, achieving results, and efficiency. We did not look at more subjective tests, such as opportunities for realignment of programs to the provinces, or at horizontal ones, such as those involving other departments.

2.56 The departments faced a challenging need for secrecy and tight deadlines, which limited their ability to respond. Each department had established an ad hoc coordination body, made up of senior officials, which led the department response.

2.57 We found some positive elements in department responses to the Expenditure Review Committee. Departments were able to identify savings, and responded to the government centre with an analysis and rationale for them. They used some performance information, including benchmarking information and program evaluations. For example, Canadian Heritage reviewed program initiatives to verify their link to the core mission and strategic objectives of the department. Their response to the Expenditure Review Committee included the review of recent internal audits and program evaluations.

2.58 However, we found that the departments were not well prepared to carry out the Expenditure Review Committee tests. They had not developed the capacity necessary to make permanent cuts in programs. Overall, the analysis was largely based on financial information. While in some cases, departments did make use of non-financial information to substantiate their decisions on value-for-money, achieving results, and efficiency, they did not generally do this.

2.59 What departments needed for these tests was partially available. Just prior to the launching of the Expenditure Review Committee exercise, Public Works and Government Services Canada implemented improvements in costing, based on a review of departmental expenditures. The development of the Agricultural Policy Framework in 2002 provided Agriculture and Agri-Food Canada with program information that was useful in the Expenditure Review Committee exercise. Canadian Heritage and Agriculture and Agri-Food Canada made use of program evaluations.

2.60 Although all three departments made major reallocation and reduction commitments, they did not adequately document what had been learned from the Expenditure Review Committee exercise. This could reduce the departments' capacity to effectively respond to future government spending reviews.

2.61 In our view, the lack of a systematic approach is an underlying cause of the problems with central expenditure reviews. There is a need to better understand the issues, and how they relate to program performance. This requires encouragement and support from central agencies.

2.62 In Budget 2006, the government announced that the President of the Treasury Board will identify savings of \$1 billion in 2006–07 and

in 2007–08. This, together with the review of the Expenditure Management System, provides an opportunity to redesign the process for central expenditure review and develop department capacity to respond to it more effectively.

2.63 Recommendation. The central agencies (Treasury Board Secretariat, Department of Finance, and Privy Council Office), in consultation with senior financial officers, should

- redesign the process for central expenditure review, in conjunction with the government review of the Expenditure Management System; and
- ensure that departments improve their capacity to respond to future central expenditure reviews.

The government's response. Agreed. The implementation of systematic reviews of ongoing programs will address this.

Complying with Treasury Board conditions

2.64 Departments and agencies are subject to two broad levels of control over the funds that form part of their approved budgets. Parliament exercises control through appropriations, and the Treasury Board exercises control on behalf of the executive, through a variety of mechanisms. These include controlling departments' approved funding levels by means of specific conditions attached to individual Treasury Board decisions. Treasury Board has four options when considering a submission: approve; not approve; approve with conditions; or defer to another meeting. Treasury Board can impose different types of conditions on Treasury Board submissions (Exhibit 2.2). For example, a portion of a payment from a contribution program may not be released to a department until it meets the reporting requirements.

Exhibit 2.2 Examples of Treasury Board conditions for departments

Submission # 1	Submission # 2
<ul style="list-style-type: none"> • Provide a revised trust agreement to the Treasury Board on time, otherwise they will establish frozen allotments. • Provide the Business Plan to Treasury Board by a set deadline. • Finalize an umbrella Results-based Management and Accountability Framework and Risk-Based Audit Framework. 	<ul style="list-style-type: none"> • Undertake a study to decide the full cost of accommodating staff. • Evaluate both the benefit and feasibility of purchasing the building and report back to Treasury Board Secretariat before a set deadline. • Accommodate all administrative staff across the government in a consistent manner.

Source: Treasury Board Secretariat

2.65 Once the Treasury Board approves a submission with a condition, departments are responsible for fulfilling that condition. A condition may take months to fulfill. We expected that the departments would ensure they respect and fulfill funding conditions by

- tracking conditions and related requirements,
- monitoring the fulfillment of the conditions, and
- taking appropriate steps to address compliance issues as they arise.

Department practices allow adequate monitoring of conditions

2.66 Although there are variations among them, all three departments have a centralized process for monitoring and tracking conditions (Exhibit 2.3). Typically, there is a unit under corporate finance that has a coordinating role in tracking and monitoring conditions. The unit is responsible for updating the database with new information and reporting to senior department officials on the status of compliance. They work with program managers to monitor conditions. They can also challenge the adequacy of the department’s response to those conditions, to ensure that the Treasury Board Secretariat is satisfied with the responses related to conditions requiring follow-up.

2.67 We selected a sample of Treasury Board decisions that had attached conditions for our three departments. We found that all three departments have adequate procedures allowing them to comply with funding conditions.

Exhibit 2.3 How departments monitor funding conditions

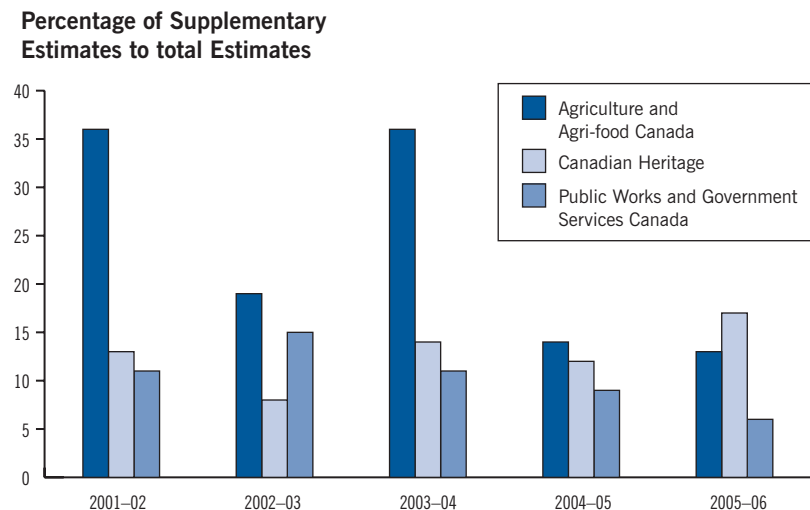
Monitoring systems	Information tracked	Monitoring process
<ul style="list-style-type: none"> • Registry database • Condition reporting database/file system 	<ul style="list-style-type: none"> • Date and Treasury Board number • Treasury Board submission title • Programs and branches • Recap or edit of conditions • Status and follow-ups 	<ul style="list-style-type: none"> • Department registers the conditions centrally. • Responsible unit updates compliance with conditions frequently. • Department follows up on outstanding conditions with programs and branches by informing responsible senior managers. • Department updates senior officials on status, consulting with Treasury Board Secretariat program sector analysts and reviewing and coordinating documents, sending them to Treasury Board Secretariat to fulfill conditions. • Department registers responses and reports to senior officials.

Using Supplementary Estimates

2.68 The government cannot proceed with its spending plans without parliamentary approval. Supplementary Estimates directly support supply bills. They identify the spending authorities (votes) and amounts to be included in subsequent appropriation acts. Supplementary Estimates are normally tabled twice a year, the first in November (Supplementary Estimates A) and the second in March (Supplementary Estimates B). Appropriation acts are passed in December and March, respectively. Exhibit 2.4 shows the extent to which the three departments used Supplementary Estimates between 2001 and 2006.

2.69 As described in the Overview and Chapter 1, across the government in recent years a rising proportion of spending items has appeared in Supplementary rather than Main Estimates (Chapter 1, Exhibit 1.1). We found that the process for Supplementary Estimates was technical and that the main reason for including items was timing. Reliance on Supplementary Estimates means that Main Estimates have become less meaningful because they no longer show the complete picture of planned spending. In our view, more complete Main Estimates would provide an opportunity for parliamentarians to scrutinize the full range of government expenditure.

Exhibit 2.4 Reliance on Supplementary Estimates varies by year and by department



Supplementary Estimates (A) 2005-06 were tabled but not approved by Parliament.

2.70 According to the Treasury Board Secretariat, the purpose of Supplementary Estimates is to seek parliamentary approval of

- changes (usually increases) to existing appropriations or for new appropriations;
- new or modified vote wording;
- increases to existing grants or the establishment of new grants when these require specific parliamentary approval;
- transfers of funds from one vote to another, either within an organization or between organizations; and
- specific spending authorities such as loan guarantees, debt write-offs, or revolving fund write-offs.

Supplementary Estimates also inform Parliament of significant changes to statutory spending, for example, public debt costs and federal-provincial transfers.

2.71 Accordingly, we expected that

- Treasury Board Secretariat rules and guidelines governing the use of Supplementary Estimates would be clearly established, communicated, and understood by department officials;
- the Treasury Board Secretariat would have in place effective processes and procedures to monitor compliance with the rules governing the use of Supplementary Estimates;
- departments would have processes and procedures in place to ensure that they comply with the rules and guidelines governing the use of Supplementary Estimates.

Guidelines for preparing Supplementary Estimates were clear and departments complied with them

2.72 Exhibit 2.5 describes the process followed to prepare Supplementary Estimates.

2.73 Although the Secretariat and departments each have a role to play in getting the Supplementary Estimates approved by Parliament, all stages of the process require ongoing consultations between the Treasury Board Secretariat and the departments.

2.74 For all Supplementary Estimates that are going to be published, the Secretariat prepares detailed instructions listing eligible items and items to be excluded. Over the past years, some changes have been

made to the instructions to reflect, for example, new requirements for reporting Supplementary Estimates to Parliament. We reviewed the guidelines and concluded that they were adequate.

Exhibit 2.5 Typical process of preparing Supplementary Estimates (A)

Date	Departments	Treasury Board Secretariat
Early August		Secretariat mails call letters for Supplementary Estimates and expenditure status reports to departments' Senior Financial Officers. These documents list the items eligible for inclusion in the Supplementary Estimates and those that may still require Treasury Board approval.
	Detailed instructions list the eligible items to be included in the Supplementary Estimates. The instructions also list the items that should be excluded. A template worksheet is available to departments to help them prepare the Supplementary Estimates.	
	Finance branches in departments contact the other branches about completing the template worksheet. The branches decide whether to request additional funding in the Supplementary Estimates, or to "cash manage" instead. An explanation of the requirement must also be provided. In addition to the items listed, the departments can request Treasury Board approval for other non-controversial items to be included in the Supplementary Estimates.	Secretariat analysts are available to help the departments complete this work.
Early September	Deadline for sending Supplementary Estimates submissions and worksheets to the Secretariat.	
		Secretariat analysts review the departments' Supplementary Estimates submissions and worksheets. They verify the accuracy of the items included. They ensure that amounts requested on the spreadsheet match the amount approved in the Treasury Board decision and are in the correct vote. If the item has not been approved, they have to determine what changes will increase its chances for approval.
Mid-September		Deadline in this period for Treasury Board analysts to submit the information required to get approval for items not already approved.
Early October		Last Treasury Board meeting to get items approved for inclusion in the Supplementary Estimate.
		Secretariat analysts ensure that the departments have the required spending authorities including transfers between departments. They finalize page proofs and prepare briefing notes for the President of the Treasury Board.
Mid- to end October	Departments must have the proofs that are sent by the Secretariat signed by their Minister.	Secretariat sends the proofs to the departments.

2.75 We examined the processes and procedures used by the three departments to ensure that they comply with the rules and guidelines set by the Secretariat, and we concluded that these were adequate.

Little is being done to limit reliance on Supplementary Estimates

2.76 The Treasury Board Secretariat recognizes the need to consolidate spending items in the Main Estimates and to minimize the repetitive use of items in the Supplementary Estimates.

2.77 However, we did not find anything related to this in their call letter forms, or in their guidelines for preparing the Annual Reference Level Update, the Main Estimates, and the Supplementary Estimates.

2.78 We have also reviewed the training material on Supplementary Estimates for Secretariat program analysts. However, the training material did not offer instruction as to when they must question whether an item belongs in the Main Estimates, instead of in the Supplementary Estimates.

2.79 Items that will appear in the Supplementary Estimates must first have been approved by the Treasury Board (Exhibit 2.5). We noted that the timing of Treasury Board approval and the need for the money within the current fiscal year dictate whether parliamentary approval will be sought through the Supplementary Estimates. Secretariat officials told us that after challenging submissions in the approval process, they do not challenge the inclusion of items in the Supplementary Estimates.

2.80 The timing of the Budget and the Main Estimates is a key factor in the use of Supplementary Estimates. The deadline for inclusion of items in the Main Estimates is usually months in advance of the Budget. For example, new announcements in Budget 2005, for spending in fiscal year 2005–06, meant that the only way to get parliamentary approval for spending in that fiscal year is through the Supplementary Estimates, the deadline for inclusion of items in Main Estimates having passed. Although a Treasury Board submission may be approved in October—just before the deadline for inclusion of items in the Main Estimates—that does not mean it will be included in the Main Estimates. If a department needs funding for the current fiscal year, it can only get parliamentary approval through Supplementary Estimates.

2.81 We noted that a few items in the Supplementary Estimates (B) 2004–05 reappeared in the Supplementary Estimates (A) 2005–06. The departments wanted to obtain funding for those items during the

2004–05 and 2005–06 fiscal years. Because the deadline for inclusion of items in the 2005–06 Main Estimates had passed, the items were included in the next year’s Supplementary Estimates.

2.82 Timing might explain why some items appear in the Supplementary Estimates in a given year, but we also wanted to know whether timing could explain their regular reappearance year after year in the Supplementary Estimates. Our review shows that items reappear for different reasons such as for ongoing programs without a permanent source of funding, and for different projects submitted each year under the same title.

2.83 Our audit work indicates that unless government brings about changes to the Expenditure Management System, many items will still be included in Supplementary Estimates because of the system’s timing and the necessity of obtaining funding in the current fiscal year. We also found that the Treasury Board Secretariat does not perform regular and thorough reviews of items included in the Supplementary Estimates. In our view, effectively challenging the reliance on Supplementary Estimates would improve the Expenditure Management System.

Departments are spending existing funds on Supplementary Estimates items

2.84 Supplementary Estimates seek authority for spending initiatives that are announced in the Budget, or that are announced subsequently, outside the Budget cycle, and that Parliament will be asked to approve in an appropriation act. In many instances, several months elapse between the initial approval of the funds requested in a Treasury Board submission and the subsequent approval by Parliament. Departments then face two choices: they can wait for parliamentary approval before spending or they can start spending if they think they can manage the risk that parliamentary approval may not come. The latter practice is a form of cash management. While waiting for parliamentary approval, the latter departments can use existing approvals to fund a program or activity, if the wording of that existing spending authority is broad enough. In a regular year, with Supplementary Estimates (B) approved late in March, most of the spending occurs before year-end (March 31). Departments are told by the Treasury Board Secretariat that they are accountable for their spending.

2.85 In the three departments, and in eight others covered by our survey, officials cited instances where spending started after Treasury Board approval and a risk assessment, but before appropriations for Supplementary Estimates had been passed by Parliament, in order to provide programs and services for Canadians.

2.86 If earlier appropriation acts have provided sufficient authority for program spending, then further spending before the approval of a Supplementary Estimate is not a compliance problem. It does raise two concerns, however. First, Parliament has the right to examine proposed expenditures before departments make them, which cannot be done if departments spend prior to approval. Second, the Treasury Board has indicated to departments that they face a supply risk, a risk of having insufficient funds, should Parliament exercise its power to reduce or “negative” (not approve) a vote (an Estimate). In such cases, departments will have used money allocated to other requirements for spending items that they listed in their Supplementary Estimates. Existing programs may suffer.

2.87 We expected the rules governing Supplementary Estimates to be clear and to be followed by departments. The Treasury Board Secretariat sends a call letter warning the departments of a funding supply risk if they start spending on Supplementary Estimates items before parliamentary approval. In the three departments, officials told us that there was pressure to implement programs in a timely way, following budget or government announcements and Treasury Board approval. Because of those mixed messages, they faced a dilemma: to spend before parliamentary approval or delay program delivery. In a number of cases, they proceeded with program delivery and managed the associated risks. This course of action undermines parliamentary control over public spending, particularly for Supplementary Estimates (B).

2.88 Recommendation. In relation to the Supplementary Estimates

- the central agencies (Treasury Board Secretariat, Department of Finance, and Privy Council Office) should develop an action plan for consolidating spending items in the Main Estimates, in order to limit the use of Supplementary Estimates;
- the Treasury Board Secretariat should ensure that departments respect the parliamentary control framework; and
- these measures should be taken along with the government review of the Expenditure Management System.

The government’s response. Main Estimates remain the primary vehicle for setting out government spending for review by Parliament. Reducing the use of Supplementary Estimates is one of the objectives in the new Expenditure Management System.

The Treasury Board Secretariat is very clear in its guidance to departments as well as Treasury Board decision letters that Treasury Board approval does not mean authority to spend since Parliament has

not provided spending authority. Treasury Board Secretariat has, particularly in recent years, been very pro-active in cautioning departments. The call letter sent to departments for Supplementary Estimates states,

“While the Treasury Board, as part of the executive arm of government, has authority to approve departmental spending proposals, such approval does not constitute the authority to spend, but only to seek spending authority through the Estimates. Departments face a supply risk if they start to spend in advance of parliamentary approval. Parliament can reduce the amounts contained in the supply bills, and has done so in the recent past. If departments do elect to start spending in advance of parliamentary approval of Supplementary Estimates supply, even for initiatives announced in the Budget, they must manage this risk by being prepared to reallocate funds from existing programs to make up the potential shortfall.”

Conclusion

2.89 In this audit we examined the role of departments in the Expenditure Management System. We selected for detailed audit three departments that represent a cross-section of the federal government. We also carried out a survey among officials at ten other departments.

2.90 Some parts of the system are working well in the three departments we examined. For example, the departments are able to track and monitor their compliance with conditions imposed by Treasury Board in funding decisions. However, there are notable weaknesses. In particular, there were significant examples of funding that was not adequately aligned with program requirements, which had a negative effect on program delivery. This problematic lack of alignment was primarily due to inflexibility in the system. Other such problems were the lack of a systematic approach to central expenditure review exercises, and the increasing proportion of spending items appearing in Supplementary Estimates rather than Main Estimates.

2.91 Although departments can take remedial measures in several areas, our conclusion is that there is a need for improvements to be carried out across the system, along with the government review of the Expenditure Management System, and led by the Treasury Board Secretariat and the other central agencies.

About the Audit

Objectives

Our general objective was to determine whether departments have effective procedures to ensure that spending complies with direction from the government centre and meets program funding requirements.

We examined whether program funding aligns with program requirements, looking specifically at

- the extent to which department requests for funding adequately reflect the financial requirements and timing of the program, and
- the impact of the timeframe of funding on departments' abilities to effectively manage department programs and to achieve program objectives.

We also examined

- allocation and reallocation issues, looking specifically at whether departments adequately respond to expenditure review exercises;
- the funding conditions under which allocation and reallocation occur; and
- the use of Supplementary Estimates, looking specifically at the adequacy of Treasury Board Secretariat oversight concerning the use of Supplementary Estimates, and the extent to which departments comply with the rules and guidance governing the use of Supplementary Estimates.

Scope and Approach

We selected three departments for our audit work: Agriculture and Agri-Food Canada, Canadian Heritage, and Public Works and Government Services Canada. These departments represent a cross-section of the federal government, in terms of size and range of functions. Treasury Board Secretariat was also part of our audit.

Our approach included analyzing various documents (such as policies and guidelines), examining files (including a sample of Treasury Board submissions and decisions), and meeting with representatives from the audited entities. We also conducted a survey of ten other departments and agencies in order to reach broader observations and conclusions. These departments and agencies are: Canadian International Development Agency, Canada Revenue Agency, Environment Canada, Fisheries and Oceans Canada, Indian and Northern Affairs Canada, Industry Canada, Natural Resources Canada, Human Resources and Social Development Canada (Service Canada only), Transport Canada, and Veterans Affairs Canada. We did not audit the responses to our survey.

Criteria

We expected that departments

- would identify an appropriate timeframe and amount of program funding that is consistent with requirements for program delivery, and that will enable the achievement of program objectives;

- would identify potential risks related to the amount and timing of funding that could affect the achievement of program objectives;
- would have effective processes and procedures for reviewing their existing spending, enabling them to respond adequately to requests for reallocation from central agencies; and
- would respect and fulfill funding conditions by being aware of all conditions and related requirements, monitoring the fulfillment of the conditions, and taking appropriate steps to comply whenever required.

We also expected that

- Treasury Board Secretariat rules and guidance governing the use of Supplementary Estimates would be clearly established, communicated, and understood by department officials;
- the Treasury Board Secretariat would have in place effective processes and procedures to monitor compliance with the rules governing the use of Supplementary Estimates; and
- departments would have processes and procedures in place to ensure that they comply with the rules and guidelines governing the use of Supplementary Estimates.

Audit work completed

Audit work for this chapter was substantially completed in June 2006.

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Appendix List of recommendations

The following is a list of recommendations found in Chapter 2. The number in front of the recommendation indicates the paragraph where it appears in the chapter. The numbers in parentheses indicate the paragraphs where the topic is discussed.

Recommendation	Government's response
Aligning a program's funding with its requirements	
<p>2.46 The Treasury Board Secretariat should assess risks related to alignment issues in the Treasury Board submission process. (2.14–2.45)</p>	<p>As stated in the response to the recommendation of paragraph 1.64 of Chapter 1, the issue of alignment is being reviewed in order to identify areas for improvement.</p>
<p>2.50 The central agencies (Treasury Board Secretariat, Department of Finance, and Privy Council Office), in consultation with senior financial officers should</p> <ul style="list-style-type: none"> • investigate the causes of lack of alignment of program funding, timeframe, and funding profile with program requirements; and • develop an action plan for remediation of these problems, to be carried out along with the government review of the Expenditure Management System. (2.14–2.49) 	<p>As stated in the response to the recommendation of paragraph 1.64 of Chapter 1, the issue of alignment is being reviewed in order to identify areas for improvement.</p>

Recommendation	Government's response
<p>Responding to central expenditure review</p> <p>2.63 The central agencies (Treasury Board Secretariat, Department of Finance, and Privy Council Office), in consultation with senior financial officers, should</p> <ul style="list-style-type: none"> • redesign the process for central expenditure review, in conjunction with the government review of the Expenditure Management System; and • ensure that departments improve their capacity to respond to future central expenditure reviews. <p>(2.51–2.62)</p>	<p>Agreed. The implementation of systematic reviews of ongoing programs will address this.</p>
<p>Using Supplementary Estimates</p> <p>2.88 In relation to the Supplementary Estimates</p> <ul style="list-style-type: none"> • the central agencies (Treasury Board Secretariat, Department of Finance, and Privy Council Office) should develop an action plan for consolidating spending items in the Main Estimates, in order to limit the use of Supplementary Estimates; • the Treasury Board Secretariat should ensure that departments respect the parliamentary control framework; and • these measures should be taken along with the government review of the Expenditure Management System. <p>(2.68–2.87)</p>	<p>Main Estimates remain the primary vehicle for setting out government spending for review by Parliament. Reducing the use of Supplementary Estimates is one of the objectives in the new Expenditure Management System.</p> <p>The Treasury Board Secretariat is very clear in its guidance to departments as well as Treasury Board decision letters that Treasury Board approval does not mean authority to spend since Parliament has not provided spending authority. Treasury Board Secretariat has, particularly in recent years, been very pro-active in cautioning departments. The call letter sent to departments for Supplementary Estimates states,</p> <p>“While the Treasury Board, as part of the executive arm of government, has authority to approve departmental spending proposals, such approval does not constitute the authority to spend, but only to seek spending authority through the Estimates. Departments face a supply risk if they start to spend in advance of parliamentary approval. Parliament can reduce the amounts contained in the supply bills, and has done so in the recent past. If departments do elect to start spending in advance of parliamentary approval of Supplementary Estimates supply, even for initiatives announced in the Budget, they must manage this risk by being prepared to reallocate funds from existing programs to make up the potential shortfall.”</p>

Report of the Auditor General of Canada to the House of Commons—November 2006

Main Table of Contents

Matters of Special Importance—2006
Main Points—Chapters 1 to 12
Appendices

An Overview of the Federal Government's Expenditure Management System

- Chapter 1** Expenditure Management System at the Government Centre
- Chapter 2** Expenditure Management System in Departments
- Chapter 3** Large Information Technology Projects
- Chapter 4** Proper Conduct of Public Business—Public Safety and Emergency Preparedness Agencies
- Chapter 5** Relocating Members of the Canadian Forces, RCMP, and Federal Public Service
- Chapter 6** Old Age Security—Human Resources and Social Development Canada and Service Canada
- Chapter 7** Federal Participation in the British Columbia Treaty Process—
Indian and Northern Affairs Canada
- Chapter 8** Allocating Funds to Regulatory Programs—Health Canada
- Chapter 9** Pension and Insurance Administration—Royal Canadian Mounted Police
- Chapter 10** Award and Management of a Health Benefits Contract—Public Works and Government
Services Canada and Health Canada
- Chapter 11** Protection of Public Assets—Office of the Correctional Investigator
- Chapter 12** Role of Federally Appointed Board Members—Sustainable Development Technology Canada

