



**HOUSE OF COMMONS
CANADA**

**CHAPTER 5, FINANCIAL MANAGEMENT AND
CONTROL - NATIONAL DEFENCE OF THE SPRING
2009 REPORT OF THE AUDITOR GENERAL OF
CANADA**

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

**Hon. Shawn Murphy, MP
Chair**

**DECEMBER 2009
40th PARLIAMENT, 2nd SESSION**



Published under the authority of the Speaker of the House of Commons

SPEAKER'S PERMISSION

Reproduction of the proceedings of the House of Commons and its Committees, in whole or in part and in any medium, is hereby permitted provided that the reproduction is accurate and is not presented as official. This permission does not extend to reproduction, distribution or use for commercial purpose of financial gain. Reproduction or use outside this permission or without authorization may be treated as copyright infringement in accordance with the *Copyright Act*. Authorization may be obtained on written application to the Office of the Speaker of the House of Commons.

Reproduction in accordance with this permission does not constitute publication under the authority of the House of Commons. The absolute privilege that applies to the proceedings of the House of Commons does not extend to these permitted reproductions. Where a reproduction includes briefs to a Standing Committee of the House of Commons, authorization for reproduction may be required from the authors in accordance with the *Copyright Act*.

Nothing in this permission abrogates or derogates from the privileges, powers, immunities and rights of the House of Commons and its Committees. For greater certainty, this permission does not affect the prohibition against impeaching or questioning the proceedings of the House of Commons in courts or otherwise. The House of Commons retains the right and privilege to find users in contempt of Parliament if a reproduction or use is not in accordance with this permission.

Additional copies may be obtained from: Publishing and Depository Services
Public Works and Government Services Canada
Ottawa, Ontario K1A 0S5
Telephone: 613-941-5995 or 1-800-635-7943
Fax: 613-954-5779 or 1-800-565-7757
publications@tpsgc-pwgsc.gc.ca
<http://publications.gc.ca>

Also available on the Parliament of Canada Web Site
at the following address: <http://www.parl.gc.ca>

**CHAPTER 5, FINANCIAL MANAGEMENT AND
CONTROL - NATIONAL DEFENCE OF THE SPRING
2009 REPORT OF THE AUDITOR GENERAL OF
CANADA**

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

**Hon. Shawn Murphy, MP
Chair**

**DECEMBER 2009
40th PARLIAMENT, 2nd SESSION**

STANDING COMMITTEE ON PUBLIC ACCOUNTS

CHAIR

Hon. Shawn Murphy

VICE-CHAIRS

David Christopherson

Daryl Kramp

MEMBERS

Bonnie Crombie

Meili Faille

Derek Lee

Pascal-Pierre Paillé

Andrew Saxton

Bev Shipley

John Weston

Terence Young

CLERK OF THE COMMITTEE

Joann Garbig

LIBRARY OF PARLIAMENT

Parliamentary Information and Research Service

Andrew Kitching

Alex Smith

THE STANDING COMMITTEE ON PUBLIC ACCOUNTS

has the honour to present its

TWENTIETH REPORT

Pursuant to its mandate under Standing Order 108(3)(g), the Committee has studied Chapter 5, Financial Management and Control - National Defence of the Spring 2009 Report of the Auditor General of Canada and has agreed to report the following:

INTRODUCTION

Sound financial management is a critical part of effective governance of a large organization. Financial management allows managers to assess the cost of achieving objectives and contributes to managing risks. Managers need to have relevant financial information and control systems in order to make sound decisions on planning, delivering, monitoring, and evaluating programs and activities.

The *Financial Administration Act* provides the framework for financial management within the Government of Canada. Under this legislation, the Treasury Board of Canada sets financial and management policies, assists with the allocation of financial resources, and oversees departments' resource management.

The Department of National Defence (the Department) is one of the largest government departments in terms of expenditures, personnel, and assets. In the fiscal year 2007–2008, it had an annual budget of almost \$19 billion and managed over \$33 billion in equipment, inventory, and real estate. These resources must be carefully managed if the Department is to be successful in meeting its objectives under the government's defence policies. The Department needs to have in place a robust financial framework to plan, manage, monitor, and account for its financial resources.

The Office of the Auditor General of Canada (OAG) conducted an audit of whether National Defence's financial management practices support resource management, strategic planning and decision making, and management of financial risk.¹ The audit examined the key financial management and business processes used by the Department's senior management to control financial and other resources. The audit work was substantially completed on 28 November 2008.

¹ Auditor General of Canada, Spring 2009 Report, Chapter 5, *Financial Management and Control—National Defence*.

As the Public Accounts Committee recognizes the importance of financial management and control at the Department of National Defence, it held a hearing on this audit on 28 September 2009.² From the Office of the Auditor General of Canada, the Committee heard from Sheila Fraser, Auditor General; Jerome Berthelette, Assistant Auditor General; and Dale MacMillan, Principal. From the Department of National Defence, the Committee heard from Robert Fonberg, Deputy Minister; William F. Pentney, Associate Deputy Minister; Kevin Lindsey, Assistant Deputy Minister, Finance and Corporate Services; and VAdm Denis Rouleau, Vice Chief of the Defence Staff.

STATUS REPORT

The Department of National Defence has identified financial management as a priority for many years. Previous audits by the OAG have found that financial management and controls needed further attention at the Department. These audits found that corporate-level planning was not adequate to guide resource allocation, information was often not available to decision makers, and the Department lacked results and performance data.

The 2009 audit found that National Defence has some elements of good financial control. For example, the department complies with legislative and government requirements for financial reporting and has kept its annual spending within authorized funding limits.

On the other hand, the audit found that the Department has no overall corporate plan; senior managers in the department do not have timely and accurate information for decision-making; integrated risk management has not been applied consistently in financial and resource management activities; the senior management committees responsible for providing strategic and operational oversight and advice were not sufficiently focused on financial management; and the responsibilities and accountabilities of a Chief Financial Officer had not been identified.

² House of Commons Standing Committee on Public Accounts, 40th Parliament, 2nd Session, Meeting 30.

In his opening statement, the Deputy Minister of National Defence, Robert Fonberg, told the Committee that the Department had four broad objectives when responding to the audit. They are:

Firstly, to strengthen our governance structure and improve our capacity to ensure sound financial management on a continuing basis; secondly, to establish a simplified process to clearly identify corporate priorities; thirdly, to make corporate planning across Defence more rigorous; and, fourthly, to better incorporate risk and performance management into defence planning and governance. We have already begun to implement measures to help us achieve these objectives.³

The Deputy Minister has also formed a new Defence Finance Committee to make allocation decisions and to review strategic financial information, as well as a new Defence Strategic Executive committee that will set strategic direction for the Department and ensure alignment with government priorities. The Assistant Deputy Minister of Finance and Corporate Services has been designated as the Department's Chief Financial Officer.

The Auditor General told the Committee that she was pleased with the Department's response to the audit, and made the following comment on the Department's action plan: "We believe this plan represents a reasonable approach to addressing the concerns raised, and we are pleased to see the target dates for completing the main objectives have been included in the plan."⁴ She also noted that the Defence Finance Committee may be the only committee of its kind in the federal government.

The Committee is satisfied that the Department of National Defence has prepared a detailed action plan with clearly stated expected outcomes, milestones, completion dates, and points of contact. However, the Committee is concerned that it has taken so long for National Defence to put into place the elements of a complete financial framework to support the financial management of resources, corporate

³ Meeting 30, 15:35.

⁴ Ibid., 15:35.

planning, and decision making. The action plan is a good starting point, but it must be fully implemented in order to be effective. The Deputy Minister acknowledged that putting into place the action plan will take persistence, determination, and time. As the Committee would like to ensure that the Department of National Defence continues to make progress in developing a robust financial framework, the Committee recommends:

RECOMMENDATION 1

That the Department of National Defence provide the Public Accounts Committee with a report by 31 December 2010 on progress in implementing the recommendations made in Chapter 5 of the Auditor General's Spring 2009 Report.

DEPARTMENTAL CARRY-FORWARD

Each year, Parliament provides authority to federal government departments to spend funds. Departments cannot spend more than has been authorized. If they spend less, the funds are said to have "lapsed" and are no longer available to be spent by the department. In order to limit the extent to which departments rush to try to spend all of their authorized funds by the end of the fiscal year, most government departments are permitted to "carry-forward" up to five percent of their operating budget into the following fiscal year. This takes place through the Supplementary Estimates process with a Treasury Board central vote.

Unlike other departments, the Department of National Defence is only permitted to carry-forward \$200 million in unused funds from one year to the next, which is approximately one percent of its operating budget. This is likely due to the large size of the Department's budget, which was almost \$19 billion in 2007-2008. If the Department's carry-forward limit was increased to five percent, this would mean that the Department could potentially carry-forward \$1 billion into the next fiscal year. Thus, the government's overall expenditures in the following year could unexpectedly increase by \$1 billion, which could make it more difficult for the Department of Finance to manage the federal government's fiscal framework.

In its audit, the OAG was not concerned with the nature of the Department of National Defence's carry-forward limit per se, but the ability of the Department to manage within it. As the Department could only carry-forward \$200 million in surplus funds, it needs to have a higher level of financial control than most departments. The audit found that in fiscal year 2007-2008, the Department had a surplus of \$500 million, which was in addition to over \$700 million that was re-profiled to future years. Consequently, the Department lapsed \$300 million in 2007-2008.⁵ The OAG attributed this to a lack of timely and accurate information for senior managers, as they were only fully aware of the large surplus too late in the year to make effective use of the funds. Additionally, the Department has a large number of independent systems that are designed to support operational requirements and not financial management.

The Deputy Minister told the Committee how difficult it is to ensure that the Department of National Defence not only stays within its appropriation, but also fully utilizes the funds available. He said:

[W]e work as effectively as we can to essentially land a very large organization on a very small dot in financial terms. Two hundred million dollars, 1% of a \$20 billion budget, is pretty tough. We can't go the other way, so we're not ever going to be in a position to move over our appropriation. We manage in a risk-averse way in terms of the appropriation. If we have to go one way or the other, we clearly will end up lapsing money as opposed to moving into a world where we're above our appropriation.⁶

The Department spends a lot of time and effort trying to manage its activities to stay at most one percent below its annual appropriation. The Deputy Minister noted that this is neither efficient nor effective for planning, and if the Department had more fiscal flexibility, it could probably allocate resources to other priorities. The Deputy Minister told the Committee that they had decided not to spend the funds at the end of 2007-2008 as it would not have been a responsible use of taxpayer's money.

⁵ Chapter 5, paragraph 5.37.

⁶ Meeting 30, 15:45.

While the Committee understands the Department of Finance's concern with regard to reliably predicting the government's overall spending, the Committee believes that the recent growth in the Department of National Defence's annual budget has meant that the \$200 million carry-forward limit makes financial management at National Defence unduly difficult. The Committee believes that the Department's carry-forward should be set at a level that provides senior managers with sufficient flexibility to manage financial resources in a given fiscal year without forcing them to be preoccupied with "landing the organization on a dot." It will nonetheless be important for senior managers to have sufficient financial information to make appropriate decisions, but the Department has committed in its action plan to a number of changes to address this issue. The Committee recommends:

RECOMMENDATION 2

That the Treasury Board, in consultation with the Department of Finance, consider raising the limit on the amount that the Department of National Defence can carry-forward from one fiscal year to another.

CONCLUSION

As one of the largest organizations in the federal government, the Department of National Defence must take special care to ensure that public funds are managed prudently and economically. The Office of the Auditor General found that the Department had some elements of good financial control; however, the Department did not have an overall corporate plan, senior managers did not have timely and accurate financial information, and integrated risk management had not been fully implemented. Financial management has long been identified as an issue at National Defence, and the Committee hopes that the Department's commitments as laid out in its action plan will help to fix the weaknesses in its financial management systems and controls. The Committee also believes that the Department could use additional flexibility in its operating budget carry-forward, as the current limit causes senior managers to spend too much time managing the Department's budget within a one percent margin.

APPENDIX A LIST OF WITNESSES

| Organizations and Individuals | Date | Meeting |
|---|-------------|----------------|
| Department of National Defence | 2009/09/28 | 30 |
| Robert Fonberg, Deputy Minister | | |
| Kevin Lindsey, Assistant Deputy Minister, Finance and Corporate Services | | |
| William F. Pentney, Associate Deputy Minister | | |
| VAdm D. Rouleau, Vice-Chief of the Defence Staff | | |
| Office of the Auditor General of Canada | | |
| Jerome Berthelette, Assistant Auditor General | | |
| Sheila Fraser, Auditor General of Canada | | |
| Dale MacMillan, Principal | | |

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 ([Meetings Nos. 30 and 40](#)) is tabled.

Respectfully submitted,

Hon. Shawn Murphy, MP

Chair