

SPEECH TO THE CANADIAN CLUB OF OTTAWA

BY

ARTHUR KROEGER

DECEMBER 12, 2000

THE HRD AFFAIR: REFLECTIONS ON ACCOUNTABILITY IN GOVERNMENT

The controversy over the Department of Human Resources' grants and contributions programs has now been going on for nearly a year. It has been the subject of continuous media reports and is one of the longest running Parliamentary controversies in memory. We could all feel that we don't want to hear any more, because we know all about it.

Or do we?

In my view, there are some important aspects of the affair that have received far less attention than they deserve, with the result that a seriously distorted picture is now firmly established in the public's mind. Too much of what has been written and said about this subject has been characterized by misinformation about the amount of money involved and what it was spent on, which has then been run together with criticism about partisan influence on decisions about specific expenditures, thus conveying an overall impression of a vast scandal.

In dealing with this subject, I want to make it clear that I am not setting out to defend the Government. They have all the means they need to defend themselves. My concern is with the effects that the prolonged and acrimonious public debate has had on governance, by which I mean the week-in-and-week-out conduct of public business, including the delivery of services to the public - not just by the department of Human Resources Development (HRD) but across the entire government system.

Let's begin with a brief review of events. In March of 1998, the department initiated an audit of selected grants and contributions. Staff had been cut by 20% following the government's 1995 budget, and senior officials had become concerned about the possible impact on the management of the department's programs.

The findings began to emerge in the latter part of 1999, and the full audit was made public last January. It found a wide range of deficiencies: projects undertaken without applications on file, inadequate evidence of project monitoring by officials, and an absence of data on matters such as forecast cash flows, results expected to be achieved, and numbers of clients to be served. A political firestorm was unleashed by the release of the report and continued for months afterwards. More controversy ensued when the Auditor General released his report on HRD in October.

In assessing the audits and the reaction they generated, it is useful to be clear about some factual matters. First, how much money was involved?

Some initial reports last January spoke of \$3 billion. Although it became clear fairly soon that this was a considerable over-statement, the figure has continued to be used by some. As recently as last October 21, the Leader of the Opposition was quoted as saying, "the Auditor General's report...talks about one department alone wasting and

mismanaging something like \$3 billion per year.” In fact, however, the Auditor General's report said no such thing. The figure of \$3 billion represents HRD's total annual expenditures on grants and contributions. Of this total, some \$2 billion is transferred annually to provincial governments, or co-managed with them. These funds are used for training, counselling, job placement, and other activities to develop the Canadian labour force. There has been no suggestion that these programs were mismanaged, indeed, they did not even in the department's audit or the report issued by the Auditor General.

Presumably, therefore, it is the remaining \$1 billion that is at issue. It is this sum that has given rise to the phrase, “billion dollar boondoggle”, which has recurred like a mantra in media reports. Here again, some factual data can be an aid to thought.

The components of the \$1 billion include youth employment programs, expenditures under agreements with community organizations, aboriginal programs, training for the disabled, sectoral agreements with business and labour, and experimental programs. In brief, the “\$1 billion jobs fund” that has been endlessly spoken of does not exist. There is no “\$1 billion ...pot to create short-term, dead-end jobs”, as a *Globe and Mail* editorial put it. The department has repeatedly described the components of the \$1 billion to the media, which have just as repeatedly ignored them, for reasons I am unable to discern.

Most of these grants and contribution funds are transferred to some 60,000 organizations across the country, which deliver programs on behalf of the department. The recipients include worker associations, not-for-profit groups, the voluntary sector, and other levels of government. Here is a sample of the recipients in 1998-99:

- Council of Canadians with Disabilities, Winnipeg - \$1,019,000
- Literacy Co-ordinators of Alberta, Calgary - \$188,000
- Labrador Inuit Association - \$835,000
- College Communautaire, Campbellton, N.B. - \$700,000
- CAMO fonds d'integration, Montreal - \$11,000,000
- Saskatchewan Indian Training and Assessment Centre - \$15,800,000
- Canadian Mental Health Association, Kitchener, Ontario - \$174,000
- Red River Community College, Winnipeg - \$208,000

The list in the Public Accounts of Canada goes on for pages and is readily accessible by the media. I therefore have some difficulty understanding the *National Post's* warning that expenditures of this kind “undermine commercial discipline” and destroy “the entrepreneurial instincts of the Canadian economy”. There are some things, such as training the disabled, that cannot be accomplished by entrepreneurship, tax cuts and the workings of market forces.

Perhaps, however, the *Post* was referring to the Transitional Jobs Fund and its successor, the now defunct Canada Jobs Fund. It is the case that these programs, unlike the others, had as their objectives the direct creation of jobs through contributions, primarily to small

and medium businesses. There is also room for debate about the economic benefits of such programs. It is however important to be clear about the arithmetic. The Transitional Jobs Fund represented approximately \$100 million per year - not a small sum, but not the famous \$1 billion, either.

While a 1998 evaluation found that the Transitional Jobs Fund had produced a number of positive results on employment, the audit reports were critical of the loose terms and conditions that governed it and its successor. In Parliament and the media, partisan influence in decision-making about allocations of these funds has attracted particular criticism, and quite rightly so. I view with the same hostility as much of the public the manipulation of taxpayers' money by any government for partisan political purposes. And if some or all of the current police investigations result in charges being laid, so be it.

I would however point out that if political influence is seen to be the main problem, closer adherence to financial directives by officials is no answer. A Minister who decides to announce a project before an application has been received is going to do so regardless of what the department's manual of financial procedures may say. The appropriate way of dealing with partisan interventions is political accountability and not by the multiplication of paperwork.

Turning now to the specifics of the audit findings, the evidence is clear that HRD's grants and contribution programs had been under-managed. Officials of the department themselves expressed concern during the 1991 and 1994 audits that the resources available to them for financial management were inadequate. The problem was exacerbated by the major staff cuts that were initiated following the government's 1995 budget.

All of that being said, much of the criticism that has been heard since last January reflects a considerable misunderstanding of how the department actually conducted its operations. I sometimes allow myself to speculate that, because most journalists and Members of Parliament have little or no experience in managing large organizations, they are more apt to take a two-dimensional view of management issues than might otherwise be the case.

Auditors are important people, and they should be part of every Chief Executive's management team. I also want to express here, as I have elsewhere, my admiration for Denis Desautels. He is in my view the best incumbent of the Auditor General's office since I came to Ottawa in 1958. His reports while pointed, have been balanced and constructive. I think, however, that Mr. Desautels might agree with my view that, important as auditors are, it does not follow that they should have the last word in all circumstances, because audit reports tell only part of the story.

Audit reports are done by reviews of files, and are not based on observation of actual operations, for example, in a field office. Such reports do not and cannot reflect the degree to which staff in HRD's 300-plus offices across the country know their

communities. In parallel with their professional functions, these officials are also members of the Kiwanis Club and cud at the local rink. They know who the reliable business people are, what are the strengths and weaknesses of the local community college, and which voluntary organizations are well run.

All of this is highly relevant to a reading of the various audit reports that have been the subject of debate. The illustrations that follow are not dissents from the auditors' findings, but rather are intended to fill in some missing pieces of the picture.

One criticism by the auditors was that some 85% of the projects were approved without an application on file. This does not mean, notwithstanding months of assertions in the erstwhile Hollinger press, that staff mindlessly shovelled out funds without asking what they would be used for. Most commonly, what you would find was that the local manager had several meetings with the proponent, consulted knowledgeable people in the community, perhaps obtained an assessment from the local credit union - but then didn't put a memo on file.

Secondly, a recurring criticism in the audits was the absence of monitoring reports concerning various projects. However, as the 1999 internal audit acknowledged, the absence of such reports did not necessarily mean that no monitoring had taken place. Example: a manager returns to the office in late afternoon from a monitoring visit and finds several people waiting to discuss a training project they have been developing. The manager has a choice: see them and provide advice about their proposal, or tell them to come back tomorrow because he/she has to write a memo to file about the monitoring visit. On the basis of my four years as Deputy Minister of the predecessor department of HRD, there is no doubt in my mind that the manager I just hypothesized would choose to see the people with the proposed training project. But one day the auditors arrive and find there aren't many monitoring reports on file, and - well you know the rest.

The audit reports also call for more forecasting of what results are to be achieved by a given expenditure, and quite rightly so. One does however need to be conscious as well of some limitations on what can be measured. I recently spent nearly two years as a member of a panel looking at governance and accountability in the voluntary sector. In our draft report we recommended more attention to assessment of results. At a consultation meeting about the draft report that I chaired in Winnipeg, one person got up and said, "Look, I'm working with teen-age prostitutes in North Main. It will be five years before I'll know what results I'm achieving." She had a point.

One final example. When the government approves a grants and contribution program, the responsible department then has to draw up a set of terms and conditions which are to govern the disbursement of the funds. These are sent to the Treasury Board which quite often adds some stipulations to tighten them up. When the approved terms and conditions are then distributed to the field, they usually meet most of the situations that staff have to deal with - but not necessarily all. It is not uncommon for staff to be presented with a proposal that has high potential to meet a problem, perhaps resulting from layoffs at the local pulp mill, but does not conform to the approved terms and conditions of the

program. In the past, staff have tended to tailor their decisions to the needs of the situation, even at the risk of not strictly following the book.

I think it is clear from the Auditor General's report that HRD staff carried the exercise of discretion too far in some cases. It passes the bounds of good governance if officials decide for themselves which rules they are going to observe, and which they will ignore. On the other hand, not all exercises of discretion in response to local conditions are bad. If the public is to be well served, officials need to be given latitude to take risks and innovate, which means they must also be given latitude to make mistakes. Consequently, there can be benefits in framing the terms and conditions of their programs less tightly than financial purists might like.

How risky would such an approach be?

A subject that has attracted a lot of critical comment is that the problem of inadequate financial controls has existed for many years, as most recently documented in audit reports of 1991 and 1994, but that not much was ever done about it. Why was this?

The reason, I suggest, is that the audits dealt with deficient documentation, and warned that the absence of good financial controls carried a risk of abuse. What they were not usually able to demonstrate, however, was that significant financial abuse had actually taken place. Had they done so, I know Public Service managers well enough to be certain that corrective action would have been taken promptly and vigorously. In the absence of such findings, however, managers had to weigh the need to strengthen financial management against a number of other pressing claims on their limited resources.

Here is a quotation from the 1994 audit: "our sample ..revealed a number of serious irregularities in the way project funds were being used. Most of these irregularities did not result from misappropriation of funds, but rather from the use of project funds in manners contrary to the terms and conditions of the program".

The message about no misappropriation of funds deserves to be underlined. Despite years of inadequate financial controls, there has been no indication - none - that staff of the department took advantage of the situation to divert funds for their own benefit. In many countries this would seem incredible; in Canada we regard it as normal.

There is also a striking absence of evidence of abuse on the part of the recipient organizations. It is true that, in the case of the \$100 million Transitional Jobs Fund, evidence has come to light that, out of over one thousand projects financed, there were some twenty in which private sector firms may have used funds improperly. These cases were however the exceptions in HRD's overall program of grants and contributions that annually transfers funds to tens of thousands of organizations across the country.

Personally, I find nothing surprising in the fact that organizations in the voluntary sector and other groups I described earlier did not try to exploit HRD's thin financial controls.

People do not go to work on community literacy programs in order to line their own pockets.

So, taking an overall view, perhaps the system wasn't so deficient after all. To express the point another way, while it has been found that HRD's grants and contributions programs did not work in theory, they seem not to have worked too badly in practice.

All of that being said, the audit findings that emerged over the last year left no room for doubt that corrective action had to be taken, and it has been. There can be no question that financial controls on HRD's grants and contributions program are now much stronger than they were before. This change can be a source of reassurance, but it also carries a certain price.

The Treasury Board has issued new directives, senior oversight committees have been established in the department, over 3000 staff have been trained, headquarters has issued detailed guidance on the steps that must – must – be followed in the approval and management of projects and so on. The department has also reallocated \$50 million from its labour market programs and other areas to ensure that adequate resources will henceforth be brought to bear on financial management.

That, one might remark in passing is a substantial sum, particularly when viewed against a history in which overpayments and the occasional diversion of funds by business recipients have involved only a few hundred thousand dollars in typical cases. Taken together, problem cases have amounted to perhaps .04% of the funds dispersed in a year. In the universe of what is called risk management, I am not sure how many private businesses would set aside \$50 million per year as an insurance premium against risks of this order. Nevertheless, this sum probably represents the minimum needed to respond to the Auditor General's recommendations, given the large number and diversity of the organizations that are recipients of funds from HRD.

Increased expenditures aside, one unmistakable effect of the HRD affair has been to re-bureaucratize government. I know that the President of the Treasury Board and various senior officials have said that we mustn't over-react and return to the old ways. These however are no more than expressions of pious hopes. After the scorching public debate that has taken place, the message to the Public Service could not be more clear: forget all those things you've been reading and hearing in recent years about improving service, reducing delays, and showing flexibility to local needs. The only way to keep out of trouble is to do things by the book, and here is a new, much thicker book to replace the one you've been using.

The messages to Ministers from this affair are equally clear: make sure that your department doesn't do anything that could result in you becoming the next Jane Stewart. And it is a fair assumption that in the provinces Ministers have also been watching and have drawn their own conclusions.

What is happening in government is a major shift from seeking partnerships and innovation to a rules-based approach. This change carries important implications for future relations between the government and the public. A study released by the Public Policy Forum last month was only the latest to report serious criticism by the private sector of the slowness of government decision making. The high tech sector has been particularly vociferous on this subject. Given the environment that has developed in response to the HRD affairs, however, Ministers and public servants who are disposed to streamline procedures and show flexibility will do so at their peril.

The damage does not end there. The 25,000 staff of HRD feel with considerable reason that they have been vilified, slandered, and held up to ridicule in their communities. An editorial widely carried by the Sun chain, to cite only one of many possible examples, denounced “incompetence and corruption” in the department. It is impossible to think that the treatment that has been meted out since last January has had no effect on the way officials are now going about their jobs.

Journalists sometime speak of “libel chill”, by which they mean a fear of libel suits that constrains them from expressing themselves freely. What has settled over government operations in recent months could be described as “audit chill”.

Those who are bearing the brunt of the changes that are in train are the thousands of organizations across the country that annually receive funds, not just from HRD, but from other departments and other governments. Those Members of Parliament who so angrily demanded greatly improved financial management are getting their wish, but I am not sure that all of their constituents are enjoying the experience.

Even before the audit reports of the past year, many recipients of HRD’s contributions complained of burdensome paperwork. Organizations in the voluntary sector in particular are not well endowed with accountants and management consultants to assist them in responding to requirements for cash flow forecasts and the like. They are having an even more difficult time now.

Most of the recipient organizations chose to remain silent, at least before the election, lest they end up on the wrong side of whomever formed the government. However, I have first-hand knowledge that one research organization now finds that it takes twice as much time to conclude a normal research contract with the government. I know of two organizations that have had to hire additional staff to cope with the increased paper work. The Executive Director of the Centre for Community Living testified before the Standing Committee on Human Resources Development on the experiences of her organization, which is a federation of some 400 local associations dealing with people who have intellectual disabilities. She told the Committee that her operation had been brought to the brink of bankruptcy because of delays in transfers of funds from the government. The March of Dimes protested to their Member of Parliament about the cumbersome, complex, and time consuming application procedures they now have to follow. Across the country, there are reports of organizations having to divert scarce funds and the time of overworked staff to meeting the increased government demands upon them.

We can await a demonstration at some future date that heavier supervision of these organizations by government is producing a net benefit to the public.

It would be easy to say that the increased requirements imposed on recipients of HRD's contributions are an over-reaction. However, the department's critics cannot have it both ways. They cannot denounce HRD for "a reckless disregard for the most elementary aspects of financial control", and for handing out "taxpayers' money...willy nilly", and then turn around to criticize the department for doing what had been demanded of it.

At the heart of the issue is the question of balance. There is an inherent tension between flexibility and responsiveness in serving the public on the one hand and the dictates of financial management on the other. Finding a balance between the two is the perennial problem of governance. A perfect solution to this problem will never be found, but some workable approximations may be attainable provided the problem is approached with pragmatism and moderation – two qualities that have been little in evidence during the past eleven months.

My final subject is the role played by Parliament and the media in this affair.

I have no history as a critic of the media, but I have to confess that I have never seen such a display of pack journalism as has transpired since last January. A few honourable exceptions aside, the degree to which ideology and partisanship have determined the coverage of this story has been reminiscent of 19th century journalism in Canada.

Let me quote a succinct comment by Mr. Al Hatton, Executive Director of the Coalition of National Voluntary Organizations: "The press haven't wanted to hear about the effect on people and services. It's been about some political stuff."

Interestingly enough, the worst offenders appear to have been some editors and television producers, who had apparently made up their minds about what the story should be – sometimes to the embarrassment of their own reporters, as I can attest from some private conversations. In a period of less than eight weeks last spring, the Deputy Minister of HRD – who is an official, not a politician – found it necessary six times to write to various editors protesting distorted reports, false assertions in editorials, and misleading headlines. In one case, a headline in the Ottawa Citizen proclaimed, "\$200 million in cheques get lost in the mail: HRD job grants sent to wrong addresses" – notwithstanding the fact that the article itself said just the opposite.

At one point, an Assistant Deputy Minister in HRD taped a long interview for CBC in which he set out a number of facts about the affair. Late the same day the reporter called to ask if the official would agree to do a further interview, ostensibly because of problems with the tape of the first one.

The interpretation placed on this incident by some in the department is that the reporter's producer found that what the official had explained did not fit with the established view

of the issue, and therefore sent the reporter back to try again. Perhaps this interpretation was unfair. Officials of the department, however, do not think that they have any lessons to learn from the media when it comes to fairness and balance on this particular subject.

Turning now to Parliament, I make my comments with some reluctance. I spent my working life deferring to elected people, and developed a sufficient regard for them that I once delivered a speech to the Toronto Empire Club entitled, "In Praise of Politicians". I have therefore watched with dismay the intemperate attacks that characterized the daily Question Period and the proceedings of the Standing Committee over much of the past year.

What has been drowned out in this cacophony is the complex question of balance that I referred to earlier – i.e., how officials across the country should balance financial management with flexibility in serving the needs of a diverse population. This question was in fact raised last June in the majority report of the Standing Committee, which invited the Auditor General to comment on the subject. Regrettably, the opposition members of the Committee showed no interest in this question, limiting their minority reports instead to stridently partisan denunciations of the department and the government. Taking an overall view of events since last January, it is necessary to ask whether Parliament still has a claim to be regarded as a deliberative forum or whether it is now merely a political cockpit?

Let me summarize what I have been saying. The so-called billion dollar boondoggle wasn't. The most that can be said is that in a particular job creation program that represented 10% of the famous \$1 billion, there was evidence of partisan political manipulation, and that some business may have made improper use of the funds they received. What is particularly striking is the way that the other \$900 million, which is used by non-governmental organizations across the country for purposes such as literacy training, community development, preparing aboriginal people to participate in the labour force, and training the disabled, has been virtually ignored. To quote the Director of the University of Ottawa's Centre on Governance, "the search for blood and blame" has obscured the question of whether these programs were effective.

It is also important to recognize, as very few have, that outside the relatively modest job creation program I just referred to, no evidence has been adduced anywhere that funds were used for improper purposes. Having done an exhaustive review of some 17,000 active files, the department knows where every dollar went and what it was used for.

My title refers to accountability, and I will conclude with a brief commentary about it. In recent years the public has come to demand much greater accountability from governments, and quite rightly so. However, the HRD affair is a "how not to" case of holding someone to account. Public respect for governments has been damaged, the staff of a major department have been slandered and demoralized, governments are being re-bureaucratized, and organizations across the country are now struggling under and increased paperburden.

The delivery of government services requires continuous trade-offs between conflicting objectives, and the use of imperfect instruments in the pursuit of desired results. It always stands in need of improvement, as auditors are paid to point out. Improvements can however be brought about only by a measured assessment of practical alternatives, and it is this element that has been so conspicuously absent in the past year. Unless there is a degree of moderation in the debate, measures to hold governments to account can do more harm than good.

Finally, and still on the subject of accountability, it is necessary to ask what accountability the media may have for having created across the country a view that is arithmetically, factually wrong – simply wrong. Do the media consider themselves accountable only to their proprietors and shareholders, or do they in any sense recognize an accountability to the public as well?

In the case of the HRD affair, the damage has been done and cannot be undone. The public across the country now have firmly implanted in their minds a picture of officials mindlessly shovelling out huge sums, as one editorial put it, in “dead-end subsidies” to “business, interest groups, and political cronies”. There is now a solid consensus across the country that the government – all governments – are hopelessly profligate in the use of public funds. The adverse consequences of this public perception will be with us for a long time to come.

I can think of only one positive outcome that might perhaps be looked for from this affair. It would be if we all concluded in retrospect that, the next time this kind of thing comes up, we should handle it differently.