SUPPLEMENTARY INFORMATION

OBSERVATIONS OF THE AUDITOR GENERAL ON THE FINANCIAL STATEMENTS OF THE GOVERNMENT OF CANADA FOR THE YEAR ENDED MARCH 31, 2000

INTRODUCTION AND MAIN POINTS

My opinion on the Financial Statements of the Government of Canada for the year ended March 31, 2000 will be my last as Auditor General of Canada. During my term as Auditor General, I have rendered 10 such opinions: 7 have been unqualified, or "clean" opinions and three have been qualified opinions. My predecessor was able to issue only one clean opinion during his 10 year term as Auditor General.

Obviously, this is a tremendous improvement for which many should be congratulated. The efforts of the central agencies (Finance, Treasury Board and Receiver General) to improve summary financial reporting have paid off; other government departments[(1)] have improved the financial information they provide to the central agencies; the Standing Committee on Public Accounts has kept pressure on the Government to improve its summary financial reporting practices; and the Public Sector Accounting Board of the Canadian Institute of Chartered Accountants has continued to publish recommendations for governments in Canada that have moved them toward improved summary financial reporting.

For my part, every year I have included in these Observations a number of matters that require continuing attention. During my 10-year term, I have raised 23 such matters (described in the Appendix to these Observations), some of them a number of times. The Government has satisfactorily addressed eight of them and is considering seven. Unfortunately, on three of these matters the Government disagrees with me.

Each of the five other matters I have raised over the years was an observation on a specific transaction, in a particular year, not one repeated regularly. The most recent examples relate to accounting for the transactions with the Canada Foundation for Innovation in 1997 and the Canada Millennium Scholarship Foundation in 1998. That the Government changed its accounting policy to accommodate these transactions continues to trouble me. And because that change in accounting policy remains in effect today, I am worried that the next Auditor General may be faced with similarly inappropriate accounting transactions.

During my term I have issued 7 clean opinions out of a possible 10. The matters raised in these Observations will be a continuing challenge for my successor and the Government.

I do not raise matters in these Observations lightly. My purpose has always been – and continues to be – to draw the Government's and Parliament's attention to issues that, left unresolved, could lead to qualified opinions in future years.

My Observations this year therefore include a number of such matters. In addition, I explain in the Observations how I arrive at my opinion and what assurance it provides and does not provide to users. The main points contained in these Observations are the following:

- Under its Financial Information Strategy, the Government plans to implement full accrual accounting by 2001-02. As that fiscal year starts in about six months, the Government must move quickly to develop auditable estimates of significant assets and liabilities in order to prepare its 2001-02 financial statements. I am concerned that these estimates may not be ready on a timely basis.

(1) Throughout these Observations, the term "departments" includes the Divisions and Branches of the Public Service of Canada listed in Schedule 1.1 of the *Financial Administration Act*.

- The balance of the Employment Insurance Account stood at $28 billion on March 31, 2000. This balance is $13 billion more than the Chief Actuary of Human Resources Development Canada has estimated is necessary – and this excess continues to grow.
- Netting expenditures against revenues obscures large expenditure programs, results in the presentation of information inconsistently, and makes the Government's financial statements difficult to understand.

MATTERS REQUIRING CONTINUING ATTENTION

The Financial Information Strategy (FIS): The move to full accrual accounting

The Financial Information Strategy is designed to modernize government financial systems; introduce full accrual accounting; and result in more informed day-to-day decisions.

FIS is a multi-year project that will modernize financial systems and accounting practices in order to strengthen financial management. It is a cornerstone of the Government's plan to modernize comptrollership in departments. Under FIS, the responsibility for maintaining detailed accounting and other financial information will move from the centre to departments. FIS consists of three components: the implementation of new financial systems, the adoption of full accrual accounting, and the provision of improved financial information to managers for day-to-day decision making and when formulating key decisions. The Government has set a target date of 2001-02 for implementing the first two components of FIS. The third component will take more time, as managers need to become more familiar with using this improved information in formulating key decisions.

The modernization of new financial systems is going well but achieving more informed day-to-day decision making will take longer.

In the financial systems component, 14 departments connected their own financial systems to the new FIS central systems maintained by the Receiver General on April 1, 1999. Another 21 departments connected on April 1, 2000. At this writing, the 63 remaining departments are scheduled to connect on April 1, 2001. Therefore, all departments are scheduled to have implemented, by April 1, 2001, new financial systems capable of producing both summary information for government-wide reporting and auditable financial statements for their own operations. All of this financial information will be prepared under full accrual accounting.

What does the move to full accrual accounting mean ?

The Government's current basis of accounting, as described in Note 1 to the financial statements, is known as modified accrual accounting. This term means that while most operating expenditures and non-tax revenues are recorded in the financial statements when they are incurred or earned (even if cash is not paid out or received until later), tax revenues are accounted for when cash is received, and the entire amount of capital acquisitions such as buildings are treated as expenditures when acquired.

Full accrual accounting will recognize resources as they are consumed rather than only when acquired, and revenues as they are earned rather than only when received.

Full accrual accounting means a shift from the expenditure basis (recognition of resources acquired) to the expense basis (recognition of resources consumed), together with the recognition of tax revenues when earned. Using capital acquisitions as an example, "expenses" include only the portion of capital acquisitions that have been used up or consumed during the year, whereas "expenditures" include the entire amount of capital acquisitions.

While the Government's budgeting and reporting will move to an accrual basis of accounting, Parliament's granting of spending authority (appropriations) will remain on the present basis for the time being. The Treasury Board Secretariat (TBS) recently consulted with departments on the issue of accrual-based appropriations through a discussion paper, "Forging Stronger Links". It presented the arguments for changing the present basis of appropriations to an accrual basis so that ultimately appropriation authorities, with budgeting and reporting, would all be accounted for on the same basis, while providing additional information on resources acquired. TBS also held preliminary consultations on accrual appropriations with a sub-committee of the Standing Committee on Procedure and House Affairs.

Full accrual accounting also means that all liabilities and all assets will be recorded or recognized in the financial statements. The recognition of these assets and liabilities, however, will in no way alter the current level of government interest-bearing debt reflected in the financial statements. The next section describes the concerns I have about certain of these assets and liabilities.

What is the status of the move to full accrual accounting ?

The introduction of full accrual accounting is not going quite as well as the modernization of government financial systems.

I am concerned that TBS and departments appear to be putting considerable effort into developing accounting policies that are not currently required in the recommendations of the Canadian Institute of Chartered Accountants' Public Sector Accounting Board (PSAB). For example, a lot of effort has gone into developing policies on the capitalization of inventory for consumption (as opposed to inventory for resale) and intangible assets such as research and development costs and internally developed software.

Quite apart from the need to debate these issues in order to make the right choices for the longer term, many departments, particularly the smaller ones, already have their hands full capitalizing tangible capital assets without the added complexity of these additional policies. I am concerned that if this development continues, departments may not be ready to implement full accrual accounting – as recommended by PSAB – by 2001-02. Worse, information may be insufficient for the Auditor General to audit some of these financial statement components.

Recently, we expressed our concerns to TBS and I am pleased that in response, TBS has established a senior-level committee – on which my Office participates – to investigate the situation. At this writing, the committee was investigating the nature and extent of concerns expressed in departments. I hope this committee will develop practical solutions to those concerns in order to help departments meet the 2001-02 target.

I am also concerned about departmental readiness to implement the following full accrual accounting policies:

Aboriginal claims. The current Government policy for Aboriginal claims (found in Note 1 to the financial statements) does not result in the reporting of a reasonable estimate of the Government's liabilities for two types of Aboriginal claims: those being pursued through the courts and those being pursued through Indian and Northern Affairs Canada (INAC). While INAC currently complies with the policy in Note 1, in 2001-02 that policy will be amended to conform with full accrual accounting. We believe that the progress made to date by INAC to quantify these liabilities is not sufficient to ensure that the 2001-02 deadline will be met. My Office will continue to monitor the Government's efforts to properly quantify its estimated liabilities for Aboriginal claims being pursued through the courts and through INAC.

Prepaid expenses and transfer payments. Towards year end, departments make decisions regarding the timing of payments to recipients – particularly for transfer payments – on the basis more of using up lapsing spending authority than reflecting expenses in the proper accounting period. Further, transfer payments made as repayable contributions are often more in the nature of a loan but are authorized under a budgetary (expenditure) appropriation and therefore not recorded as a loan. A policy to deal with these situations is needed to provide for better reporting of costs in the period to which they relate and more effective budget management. TBS has yet to finalize an accounting policy for these situations.

Tangible capital assets. All tangible capital assets held by departments on April 1, 2001 must be identified and valued at historical cost. Many departments are having difficulty determining historical cost because original acquisition documents are often difficult to retrieve. To address this difficulty with real property, TBS and some departments are considering the use of the Book Value Calculator (BVC) developed by the Chief Appraiser of Public Works and Government Services Canada to establish reasonable estimates of these costs. This approach for real property seems reasonable, and my Office plans to use the Chief Appraiser's assessment in our future audits. While departments are making progress in valuing and taking inventory of their tangible capital assets, a significant amount of work remains to be done before the 2001-02 target.

Environmental liabilities. TBS has not yet approved a formal accounting policy for reporting environmental costs and liabilities. It issued a draft *Policy on Accounting for Costs and Liabilities Related to Contaminated Sites* in February 1999. Subsequently it issued in draft form the *Treasury Board Federal Contaminated Sites and Solid Waste Inventory Policy*, which was formally approved in June 2000. This inventory policy requires all custodial departments to input into the TBS inventories information on contaminated sites and solid waste landfills identified as at April 1, 1998. This initial input is to be completed by March 31, 2001. Both the accounting policy and the inventory policy are closely linked, yet the accounting policy remains in draft form.

In addition, TBS recently introduced the Federal Contaminated Sites Assessment Initiative. One of the Initiative's key goals is to improve the quality of the cost estimates of environmental liabilities that are to be reported in 2001-02. Although much work remains to be done in some departments, TBS is committed to its timeframe for reporting environmental costs and liabilities in 2001-02.

Can the Government implement full accrual accounting for 2001-02 ?

The Government has an enormous challenge to achieve its objective of implementing full accrual accounting for 2001-02. The effort and time this will take should not be underestimated.

The effort it will take to implement full accrual accounting should not be underestimated.

FIS is critical to the Government's continuing ability to produce the Public Accounts and to the Auditor General's ability to audit the financial statements contained therein. It will also be critical to the production of departmental financial statements and their potential future audit. My Office will continue to devote resources to monitoring this important project carefully. In my December 2000 Report to Parliament, I will report the results of a follow-up to both my September 1998 Chapter "The Financial Information Strategy: A Key Ingredient in Getting Government Right" and my November 1999 Chapter "Financial Information Strategy: Departmental Readiness". The follow-up will report on progress to date in all aspects of FIS implementation, including systems, policies and people. Future chapters will look at the actual implementation.

The excessive and growing balance in the Employment Insurance Account

The Employment Insurance Account is an integral part of the Government's financial statements (in other words, it is consolidated). Included in Section 4 of this Volume are the audited financial statements of the Account. The balance of this Account at March 31, 2000 stood at $28 billion, almost twice the maximum amount considered necessary by the Chief Actuary of Human Resources Development Canada in his report for 2000. My opinion on the financial statements of the Employment Insurance Account is in Section 4 of this Volume. It draws attention to this situation and urges the Canada Employment Insurance Commission to clarify and disclose the way it interprets the *Employment Insurance Act* in setting premiums to ensure that the intent of the *Act* has been observed.

The balance in the Employment Insurance Account is $13 billion more than the Chief Actuary of Human Resources Development Canada considers is necessary.

The House of Commons Standing Committee on Finance made certain recommendations on the issue of the Employment Insurance Account balance in its Report on Budget 2000. The Government's response to the Committee, summarized in *The Budget Plan 2000*, stated that it would "closely examine the recommendations...".[2]

(2) *The Budget Plan 2000*, p.62.

Canada Health and Social Transfer (CHST) program

In the 2000 Budget, the Government announced a $2.5 billion Supplement to the CHST program. This was similar to the $3.5 billion Supplement announced in the 1999 Budget. These Supplements were accounted for in the March 31, 2000 and March 31, 1999 financial statements, respectively. Although legislative authority for these Supplements did not receive royal assent until after the end of the respective fiscal year, in my view the accounting was appropriate in both years, since the Supplements met the accounting criteria for recognition in those years.

Parliament normally leaves the accounting for individual transactions up to the Government, but for the 1999 and 2000 Canada Health and Social Transfer Supplements, the accounting treatment was legislated.

However, an unusual feature of the legislation authorizing the Supplements was the stipulation of the fiscal year in which they were to be recorded in the government's financial statements. Both the *Budget Implementation Act, 2000* and the *Budget Implementation Act, 1999* contain the following words: "The Canada Health and Social Transfer shall consist of…a cash contribution of $2.5 billion [or $3.5 billion in 1999] **for the fiscal year beginning on April 1, 1999 [or April 1, 1998]**,….."[3] (Emphasis added.) Normally, the accounting for economic events is determined by the Government and audited by the Auditor General in accordance with the standards for governments enunciated by the Canadian Institute of Chartered Accountants. For these Supplements, however, the stipulation of the fiscal year in the Budget Implementation Acts is, in my view, a parliamentary direction on the way the Government shall account for these amounts in its financial statements.

I fully recognize Parliament's legislative supremacy. To date, however, Parliament's control over fiscal matters has provided authority for payments into and out of the Consolidated Revenue Fund without specifying how economic events should be accounted for under accrual accounting. My point is a delicate one. I am concerned, however, that the practice of dictating accounting treatment in legislation, if continued, may undermine the certainty implicit in the use of the accounting treatment determined according to objective accounting standards, which users of the Government's financial statements expect. The practice may even put the Auditor General in the awkward situation of disagreeing with such directions. I make these observations simply to bring to Parliament's attention a major implication of this practice.

Netting

I have had no success in convincing the Government to stop the practice of netting expenditures against revenues; I will elaborate on this issue in my next Report to Parliament.

On several occasions I have described my concern about the Government's practice of offsetting expenditures against revenues. In my 1999 Observations I noted that a $5.7 billion expenditure program was netted against personal income tax revenue; that the Government's Annual Financial Report[4] included financial statements on a gross basis, whereas the remainder of the Report presented analyses on a net basis; and that the presentation of both gross and net in the financial statements published in the Public Accounts resulted in a cluttered statement that was difficult to understand.

The Government's response to my 1999 Observation stated, "The net presentation is the appropriate approach for the budget because it is consistent with the way that Parliament appropriates funds. Furthermore, programs like the CCTB [Canada Child Tax Benefit] and the quarterly GST credit are integral parts of the tax system. These programs are administered through the tax system. They are thus netted from tax revenues for budgetary purposes."[5]

(3) *Budget Implementation Act, 2000*, Section 13 and *Budget Implementation Act, 1999*, Section 4.
(4) The Department of Finance publishes the *Annual Financial Report* of the Government of Canada. It presents and analyzes information taken from the *Public Accounts of Canada*, but in a concise and summarized form.
(5) *The Budget Plan 2000, p.190.*

I do not agree with this position and again in these Observations I call for information to be presented only on a gross basis. However, to ensure that Parliament understands my rationale completely, I will be discussing this in more detail in my October Report.

Debt Servicing and Reduction Account (DSRA)

I have been concerned about the DSRA for some time now. I have continually suggested that the Government and Parliament may wish to re-examine whether the DSRA is still needed and useful.

After I raised this issue last year, the House of Commons Standing Committee on Finance recommended the elimination of the DSRA. And yet the Government's response to my 1999 Observations – and presumably to the Committee – stated, "At this time, the DSRA provides important information to Canadians on the flow of GST revenues, gifts to the Crown and the net gains associated with disposals of investments in Crown corporations. This information is enhanced through the presentation of a separate audited statement. As a result, the government does not propose any changes be made at this time."(6)

I completely disagree with this position. In my view, the DSRA creates more confusion than useful information.

The DSRA was created along with the introduction of the GST. Essentially, it keeps track of GST and other revenues (gifts to the Crown and the gains on disposals of investments in Crown corporations). The *Debt Servicing and Reduction Account Act* requires that after interest is paid on the Government's debt, any remaining such revenues be used to actually pay down the debt. If that sounds complicated, it is – so let's look at some of the numbers in the DSRA financial statement that is included in the several pages just before my Observations.

The GST and other revenues amounted to $23 billion in 1999-00 ($21 billion in 1998-99). The interest on the public debt that this amount must cover before being applied to the debt itself amounted to $31 billion in 1999-00 ($31 billion in 1998-99)(7). So unless the GST increases significantly in the near future, or interest on our debt decreases significantly in the near future, it will be a long time – if ever – before these "earmarked revenues" can be used to retire our debt.

The Debt Servicing and Reduction Account financial statement may not be very meaningful to Canadians and Parliamentarians.

Recently, I have seen several articles generally related to the disclosures contained in the DSRA financial statement. The articles imply that if the GST revenue had been applied to reduce our debt, we would have retired hundreds of billions of dollars of debt by now. But, of course, if all GST revenues collected since its introduction had been applied to reducing our debt, the Government would have had to borrow an equivalent amount to finance its operations – resulting in a nil net reduction; or it would have had to reduce spending by an equivalent amount; or to the extent available, draw down on its cash reserves or other assets. There is also perhaps a misconception that money actually flows into and out of a separate DSRA bank account. It does not. All public money first flows into the Consolidated Revenue Fund, and Parliament then appropriates funds for spending, including debt servicing and debt retirement. The DSRA is simply a tracking account; the notion that it is anything more is simply a myth.

I recommend that the Government accept the recommendation of Parliament, through the House of Commons Standing Committee on Finance, to eliminate the DSRA.

(6) The Budget Plan 2000, p.192.

(7) Note 3 to the *Debt Servicing and Reduction Account Statement of Transactions* in this section explains why this amount differs from the amount for Public Debt Charges reported in the Statements of Revenues, Expenditures and Accumulated Deficit.

MY AUDIT OPINION

What my audit opinion means

Readers of the Government's financial statements should review my audit opinion every year.

This section of my observations discusses in more detail the messages that I convey in my audit opinion. As explained below, I have structured my audit opinion to highlight key messages. To understand the opinion properly, the reader should carefully review each paragraph, every year. It is inadvisable to assume that my opinion remains the same from one year to the next. Normally, my audit opinion consists of three paragraphs, plus an additional paragraph when I have a reservation in my opinion.

My responsibility. The introductory paragraph begins by listing the financial statements covered by my opinion. It is important to note that my audit opinion relates only to the financial statements and related notes contained in Section 1 of Volume I of the *Public Accounts of Canada*. It does not extend to the more detailed information presented in other sections of Volume I, or to Volume II.

The introductory paragraph concludes by confirming that the financial statements are the responsibility of the Government, and that my responsibility is to form an opinion on three distinct aspects of the financial statements as required by section 6 of the *Auditor General Act* and as outlined below.

The scope of my audit. In the second paragraph of my opinion, I state that my audit work on the Government's financial statements has been conducted according to generally accepted auditing standards. These standards are prescribed by the Canadian Institute of Chartered Accountants, and I follow them to ensure that my audit is conducted with appropriate rigour and professionalism. I also indicate that I perform my audit procedures to assess whether the financial statements are free of material misstatement.

I go on to explain that my audit includes assessing the reasonableness of significant estimates made by the Government. There is a good deal of judgment required in preparing and auditing financial statements for an entity the size of the Government of Canada. Many of the significant amounts reported in the financial statements, such as allowances for valuation of various assets and liabilities, are based on estimates made by the Government. These amounts are inherently imprecise. When considering whether misstatements exist in these estimates, I determine for each estimate a range of values that I believe would be reasonable. If the estimate as determined by the Government falls within that range, I conclude that the specific estimate is not misstated.

Finally in the paragraph, I note that my audit also includes assessing the appropriateness of the accounting policies used by the Government and evaluating the overall presentation of the financial statements. In order to make that assessment, there must be standards that I can use as a basis for my judgments. The standards that I continue to use this year are the stated accounting policies of the Government of Canada set out in Note 1 to the financial statements, pertinent legislation, and the recommendations of the Canadian Institute of Chartered Accountants' Public Sector Accounting Board.

My opinion. It is important to note that my opinion is not a statement of fact; rather, it is an expression of my professional judgment. The opinion paragraph contains my overall conclusions about three important matters:

1. Whether the financial statements present information fairly (fairness).
2. Whether the financial statements were prepared in accordance with the Government's stated accounting policies (compliance).
3. Whether the Government's stated accounting policies were applied on the same basis as in the preceding year (consistency).

My opinion on each of these three aspects of the Government's financial statements for 2000 does not include any reservations. The readers are therefore entitled to conclude that the amounts shown in the financial statements are fairly stated within the limits of materiality. Further, the Government has prepared its financial statements in compliance with its stated accounting policies set out in Note 1 to the financial statements. The reader may also conclude that the accounting policies used by the Government to prepare the financial statements are the same policies as were used last year.

My opinion on the Government's financial statements for 2000 states that they are "fairly" presented, are prepared in compliance with stated accounting policies and use policies that are consistent with 1999.

How I arrive at my opinion

If I conclude that in the aggregate the financial statements are free of material misstatement, I report that the information is "presented fairly". If I conclude that the statements are materially misstated, I describe the nature and extent of my concerns. I then go on to say that information is presented fairly "except for" the issues in my reservations.

The aggregate of all misstatements in the financial statements is considered material if, in the light of surrounding circumstances, it is probable that the misstatements would change or influence the decision of a person who was relying on the financial statements and who had reasonable knowledge of the Government and its activities. If I believe this is the case, I will include a reservation in my audit opinion.

Before commencing my audit, I make a judgment based on the Government's total expenditures as to what dollar magnitude (materiality) of misstatements in the financial statements would influence the decisions of users. That dollar amount is then used as a basis for determining the nature, extent and timing of the audit work required. For this year's audit, I set materiality at approximately one half of one percent of total gross expenditures of $166 billion.

Thus, to be in a position to render my audit opinion, generally accepted auditing standards require that I have "reasonable assurance" that my audit will reveal any misstatements aggregating to more than my predetermined level of materiality. In planning my audit, I accept some small amount of risk that my audit procedures will fail to detect whether the financial statements are materially misstated. I accept this minimal risk because it is cost-effective to do so. However, in conducting my audit, I perform specific audit procedures that reduce this risk to a level I consider acceptable. These include, for example, testing a sample of transactions and account balances, performing analyses, confirming year-end balances with third parties and, where considered necessary, reviewing significant internal controls.

In all of my audit work on these financial statements, I also take into account the basic requirement that the Government comply with parliamentary authorities to spend, borrow and raise revenues.

What my audit provides and does not provide

To summarize, my audit of the Government's financial statements provides an opinion on whether they present information fairly. An auditor's opinion enhances the credibility of reported financial results or, in some cases, may alert readers to problems in the financial statements. In describing what my audit opinion provides to readers, however, it is important to highlight what the opinion does not do. My audit opinion does not address the issue of the economical, efficient and effective use of resources by the Government; that aspect of our work is separate from our audit of the Government's financial statements.

My opinion adds credibility to the Government's financial statements; it does not address value-for-money issues.

Furthermore, my audit of the Government's financial statements is neither extensive enough nor specifically designed to provide assurance of the integrity of each of the Government's many and varied systems of internal control, nor its compliance with the spending limits on each of its several hundred individual appropriations. My Office conducts additional work in each of these areas on a cyclical basis in departments and Crown corporations. I consider the results of all of this work in developing my opinion on the Government's financial statements. If issues have been identified that I believe are significant to the users of the financial statements, I will mention them in my opinion or in my observations. Although this year we identified some issues of internal control and compliance with authority, none required mention in my opinion on the financial statements.

Finally, my audit work on the Government's financial statements is not designed to, and the opinion does not, provide assurance that all the transactions of the Government are in compliance with laws and regulations. I have reported different cases of non-compliance with authorities in my previous separate reports to the House of Commons. My audit work in this area is continuing and I will report to Parliament any significant cases observed in the course of my additional audit work.

CONCLUSION

Notwithstanding issues raised in these Observations, the Government of Canada remains a world leader in government-wide financial reporting

Throughout my term as the Auditor General of Canada, I have said publicly that the Government of Canada remains a world leader in government-wide financial reporting, as evidenced by the financial statements included in the Public Accounts and the Annual Financial Report. In this, my final year as Auditor General, I again congratulate those responsible for this significant and continuing achievement.

Why do I emphasize this? Just take a look at the summary-level financial reporting practices of other nations. In the United States, my counterpart has had to deny an opinion on that government's financial statements because he has been unable to audit some of the key components in those statements. My counterpart in the United Kingdom has not yet been asked to render such an opinion because that government has not yet produced a summary-level financial statement, although this is coming. And while my counterparts in New Zealand and Australia have been able to render “clean” opinions on their governments' financial statements, summary-level or government-wide reporting has been provided only in the past few years. In Canada, we have been doing this for decades. All Canadians should be proud of their government's achievements in this area.

Last year I was concerned about the timeliness of information provided by departments and the central agencies. This year, departments have significantly improved in meeting the reporting deadlines established. As a result, I have been able to sign my opinion on the government's financial statements earlier than at any time during my 10 year term.

But we must not rest on our laurels. The issues that I raise in these, my last Observations, will be a continuing challenge for my successor and the Government. I urge the Government to take action on a priority basis to address and resolve these issues.

As I complete my term as Auditor General over the next few months, I take great personal satisfaction in the role I have been privileged to play in Canada's achievements at summary-level financial reporting. I consider the aspects of my role that relate to these Public Accounts and the Annual Financial Report as one of the most important parts of my mandate. And I wish my successor and the Government well in this important area.

SUMMARY OF AUDIT OBSERVATIONS
1991 to 2000

Appendix

	Observation	Year(s) Made	Description of Issue	Resolved (Yes/No/In process/ Single occurence)
1	Improper accounting for the effect of short-term wage restraint on employee pensions	1991	The Government's adjustment of its pension liability did not fully conform to PSAAC's Accounting Statement 5, nor did it use the Chief Actuary's assumptions when estimating employee pension liabilities at year-end.	Single occurence
2	Improper accounting for a reduction in the value of the investment in Petro-Canada	1991	The Government restated previously reported deficits rather than including the reduction in value in the current year's deficit. The amount of the allowance was not in question, just the Government's handling of it. In previous years, all such allowances were charged to the deficit of the year in which they occurred. As such, there is a lack of consistency.	Single occurence
3	Improper accounting for income tax revenue collected on behalf of provinces	1991	The Government's approach to adjusting tax revenues due the provinces resulted in an overstatement of the deficit and an overstatement of the associated liability account.	Yes
4	Publishing a "scorecard"	1991, 1992	The Government should consider publishing a comparison of actual results with budget forecasts to inform Canadians about its performance in carrying out its action plan for deficit reduction.	Yes
5	Accrual accounting for tax revenues	1991, 1997, 1999	The Government currently recognizes tax revenue on the cash basis of accounting. With full accrual accounting, however, tax revenue would be recognized in the year that gave rise to the revenue. The accounting systems currently in use are not capable of dealing with full accrual of tax revenue. Therefore the Government should take the time necessary to ensure the integrity and auditability of that information.	In process (to be implemented with full accrual accounting)
6	Modified equity method of accounting for enterprise Crown corporations to be used in place of recording an allowance	1992, 1993, 1994, 1995, 1997, 1998, 1999	The Government currently uses allowances to include corporate profits and losses in the surplus for the year rather than the more appropriate modified equity method of accounting.	In process (to be implemented with full accrual accounting)
7	Allowances for loans	1992	The Government has not reassessed the allowance for loans made to other sovereign states since 1990. This reassessment should be done on a regular basis. The shortfall was not material in 1992 but it may become so in future years.	Yes
8	Offsetting Child Tax Benefit disbursements against revenues – "netting"	1992, 1994, 1999, 2000	The Government has offset disbursements under the Canada Child Tax Benefit program against personal income tax revenues. However, these disbursements are more properly classified as "program spending" and should be reported as such.	No

Summary of Audit Observations 1991 to 2000

	Observation	Year(s) Made	Description of Issue	Resolved (Yes/No/In process/ Single occurence)
9	Making loan guarantees	1992	All loan guarantees are disclosed in a note to the financial statements. However, these guarantees are not recorded as expenditures until they are honoured. This is too late. If it is likely a guarantee will have to be honoured and the amount can be reasonably estimated, an expenditure should be recorded.	Yes
10	Tax expenditures – delivering programs by forgoing revenues	1992	Tax expenditures can be used as substitutes for direct expenditures in the pursuit of public policy goals. However, tax expenditures are all but invisible. As such, they should be disclosed on a regular basis in a note or supplementary table.	Yes
11	Understandable financial statements	1992, 1993	The Government's financial statements would be more understandable if they were presented in a comprehensive but succinct annual financial report.	Yes
12	Timely financial statements	1993, 1994, 1999	The Public Accounts are tabled too late for meaningful analysis and discussion by members of Parliament and other users of the audited financial statements.	Yes
13	Capitalization of fixed assets as part of the adoption of full accrual accounting	1995, 1996, 1997, 1999, 2000	The OAG supports the Government's decision to adopt full accrual accounting and the capitalization of fixed assets. There are a few cautionary notes, though. For example, the capitalization and depreciation of physical assets and the Government's appropriation process should be harmonized. In addition, certain physical assets may require special consideration.	In process (to be implemented with full accrual accounting)
14	Accounting for environmental liabilities and contingencies	1995, 1996, 1997, 1998, 1999, 2000	1995 was the first year when the Government disclosed potential environmental liabilities of $2.8 billion in the notes to the financial statements. The Auditor General commends this step forward and encourages the Government to improve its reporting of these types of potential liabilities.	In process (to be implemented with full accrual accounting)
15	Recording of transitional assistance for harmonizing GST and PST	1996	The Government expensed and recorded a liability of $961 million for transitional assistance. However, the Auditor General disagreed that a liability existed because the eligibility criteria had not been met by the three provinces as of March 31, 1996.	Single occurence
16	Accounting for employee pensions	1996, 1997	The pension liability reported in the financial statements is significantly higher than the actuarial obligation. Part of the discrepancy is caused by the way the Government calculates pension interest expense. If it were to fully comply with PSAAB recommendations, the difference would be reduced over time.	Yes
17	Overstatement of the 1996-97 deficit by inappropriately recording a transfer payment to the Canada Foundation for Innovation	1997	The Government recorded both an expenditure and a liability of $800 million. However, the recipient of the money, the Canada Foundation for Innovation, did not even exist until April 25, 1997. As well, the funding agreement that set out the eligibility criteria was not signed until July 2, 1997.	Single occurence

Summary of Audit Observations 1991 to 2000

	Observation	Year(s) Made	Description of Issue	Resolved (Yes/No/In process/ Single occurence)
18	Statement of Transactions of the Debt Servicing and Reduction Account	1997, 1999, 2000	The Debt Servicing and Reduction Account applies specific revenues against charges associated with public debt. However, the very nature of the Consolidated Revenue Fund ensures that all revenues are deposited into it and all expenditures coming from it are authorized by Parliament. As a result, there is no need to issue a separate auditable statement; note disclosure would suffice.	No
19	Understatement of the 1997-98 surplus by inappropriate recording of a transfer payment to the Canada Millennium Scholarship Foundation	1998	$2.5 billion was recorded as owing to an organization that was not in existence at March 31, 1998. Although this was in accordance with the Government's stated accounting policies, this particular policy was considered inappropriate. Note that the Government had changed its policy on transfer payments following the payment to the Canada Foundation for Innovation and its associated issues.	Single occurence
20	Recorded and contingent liabilities for Aboriginal claims	1998, 1999, 2000	The Government needs to develop an appropriate accounting policy that addresses both the quantification of contingent liabilities for Aboriginal claims and the point in time at which they should be recognized in the financial statements as actual liabilities. In order to do this, the Government needs to improve the systems and processes that are used to monitor and provide management information on these claims.	In process (to be implemented with full accrual accounting)
21	Financial Information Strategy (FIS): the move to accrual accounting	1998, 1999, 2000	FIS involves significant changes in the Government's accounting systems and rules over the next several years. These changes include systems renewal, accrual accounting throughout the year, accrual accounting for tax revenue and full accrual accounting for capital assets. This strategy will be monitored carefully over the next few years.	In process (to be implemented with full accrual accounting)
22	Simplified and useful financial statements	1999	The annual financial report should be revised so that it is more useful and understandable. As well, it should be easy to access by interested Canadians.	In process
23	Employment Insurance Surplus: clarification of the intent of the legislation	2000	In view of the size and the continued rate of growth of the accumulated surplus in the Employment Insurance Account, it is important that the Commission clarify and disclose the way it interprets the *Employment Insurance Act* in setting premiums. Such clarification and disclosure are necessary to ensure that the intent of the *Act* has been observed.	No

SUMMARY OF AUDIT OBSERVATIONS
1991 to 2000