SUPPLEMENTARY INFORMATION
OBSERVATIONS OF THE AUDITOR GENERAL
ON THE
FINANCIAL STATEMENTS OF THE GOVERNMENT OF CANADA
FOR THE YEAR ENDED MARCH 31, 2003

MAIN POINTS

The purpose of these Observations is to explain certain elements of my report on the financial statements of the Government of Canada as at and for the year ended March 31, 2003:

- This year, the Government has made significant improvements in its financial reporting to Canadians, adopting full accrual accounting and including a discussion and analysis of the financial statements in the *Public Accounts of Canada*. The move to full accrual accounting involved many challenges and the efforts of many public servants, who can be justly proud of the results of their hard work. This move enhances the value of the financial statements to users by presenting a more complete picture of the Government's financial position.
- Since 1997, the Government has transferred $8.7 billion to 15 foundations. It has recorded these transfers as expenses although most of the funds remain in the foundations' bank accounts and investments, accumulating interest. I am concerned about the manner in which the foundations are funded, the accounting for these transfers and the accountability regime for these foundations. I am concerned that accounting rules may be leading the Government in its choices as to the accountability and governance structures involving foundations as well as the manner in which they are funded.
- The accumulated surplus in the Employment Insurance Account stood at $43.8 billion at March 31, 2003. This is about three times the $15 billion that the Chief Actuary of Human Resources Development Canada said in 2001 was the maximum amount needed. In my view, Parliament did not intend that the Account accumulate a surplus beyond what could reasonably be spent for employment insurance purposes given the existing benefit structure, while also providing for an economic downturn. Accordingly, I have concluded that the Government did not observe the intent of the *Employment Insurance Act*.
- While the Government has improved its communication of financial results, further improvements are possible. It should consult with users to determine if there are alternative ways to provide some of the information currently contained in the *Public Accounts*. Further, the Government should also consider how to expedite the production of its financial statements to allow for their more timely release, which would enhance their value to users.

MAJOR IMPROVEMENTS IN FINANCIAL REPORTING

This year, the Government has made a significant improvement in its financial reporting to parliamentarians and other interested Canadians. The enhancements it has made establish Canada as a world leader in financial reporting by a national government. I congratulate the Government on this significant accomplishment. In these Observations, I discuss the following significant improvements in financial reporting:

- Adoption of full accrual accounting;
- Early adoption of the Reporting Model for Senior Governments recommended by the Public Sector Accounting Board of the Canadian Institute of Chartered Accountants;
- Addition of budget information to the financial statements to enable the comparison of actual results with budget;
- Elimination of netting of some revenues and expenses; and
- Inclusion of financial statement discussion and analysis in Volume I of the *Public Accounts of Canada*, which provides an executive overview of the summary financial statements and the significant activities during the year that affected those statements.

Adoption of full accrual accounting

The 2002-03 Summary Financial Statements of the Government of Canada are the first it has prepared on the full accrual basis of accounting. This move shifts the focus of financial reporting from expenditures (recorded when funds are spent) to expenses (recorded when resources are used). It also results in the recording of tens of billions of dollars in additional assets and liabilities in the financial statements. These changes are described in the financial statements and include the recognition of the following items on the Statement of Financial Position as at March 31, 2003:

- $47 billion in capital assets—such as land, buildings, ships and aircraft;
- $35.3 billion of liabilities for benefit plans to employees and veterans for health, dental, disability and worker's compensation;
- $33.5 billion of taxes payable and $43.6 billion of taxes receivable, arising from the move to recognize tax revenues on an accrual basis rather than largely on a cash basis;
- $10 billion of other liabilities related to such items as the cleanup of various contaminated sites, debt under capital lease arrangements, and additional liabilities for Aboriginal claims;
- $6.1 billion of inventories that primarily involve military items such as munitions and other items used during military operations; and
- $1 billion of assets related to certain prepaid expenses.

In the past, these items did not appear on Canada's statement of financial position. They were charged against the annual surplus in the year the asset was acquired, the cash received or the liability paid.

The Government has also recognized pre-1992 equity of $4 billion in enterprise Crown corporations.

The adoption of full accrual accounting enhances the value of these financial statements to users. It provides a more complete measure of the size of government. It reduces distortions that arise through the timing of cash payments, and it properly allocates costs of expensive capital items over the life of their use, rather than in the period when they were acquired. For all these and other reasons, my Office has long held the view that the full accrual basis of accounting is superior to the Government's former basis of accounting.

The move to full accrual accounting has been a major challenge, and it required a great deal of work. For instance, a major effort went into determining the cost of capital assets acquired many years ago, well before the recording and amortizing of costs for accounting purposes was contemplated. The Government met this challenge with innovative solutions such as a tool for estimating the historical costs of real property assets. The result is a fair estimation of the costs of the Government's capital assets—which will be amortized over their remaining useful lives—providing readers with, among other things, a better estimate of the costs of government programs from year to year.

Another challenge was to estimate the cost of cleaning up various contaminated sites. The Government has enhanced its work on assessment of sites and estimates of costs and, based on assessments completed to date, has arrived at an appropriate accounting estimate of cleanup costs.

The Government has developed a methodology to accrue tax revenues, based on a combination of tax returns assessed at a certain date and cash received as a proxy for returns not yet assessed. Tax revenues are recognized in the period when the taxable activity occurs, rather than when the Government receives the cash. This change in accounting policy eliminates distortions that can result from the timing of cash receipts and payments. It also will reflect the impact of changes in tax rates in the year the changes become effective.

In summary, a great deal has been done to implement full accrual accounting. This has involved the work of many public servants throughout Government, both in individual departments and in central agencies. They can be justly proud of the results of their hard work.

Early adoption of reporting model for senior governments

With the move to full accrual accounting, the Government has changed the model it uses to report its financial results. It adopted the reporting model recently recommended by the Public Sector Accounting Board (PSAB) of the Canadian Institute of Chartered Accountants. While PSAB would require implementation of this new model by 2005-06, the Government has implemented this model for its 2002-03 financial statements. The new model retains many features of the model it replaces while providing additional information on annual costs and non-financial assets of the Government. The model gives readers of the financial statements five messages about the state of the Government's finances:

- Net debt position (a measure of the future revenues required to pay for past transactions and events). Canada's net debt at March 31, 2003 was $565 billion;
- Accumulated deficit position (a measure that reduces the net debt position by recognizing non-financial assets, which are resources the Government can use to provide future services). Canada's accumulated deficit at March 31, 2003 was $511 billion;
- Annual surplus (a measure of whether the Government's revenues for the year are sufficient to cover the costs for the year). Canada's annual surplus for 2002-03 was $7 billion;
- Change in net debt (a measure of whether the Government's revenues covered its spending for the year). Canada's net debt decreased by $6.1 billion in 2002-03; and
- Cash flow (a presentation of the Government's sources and uses of cash). Canada's cash flow resulted in an increase in cash of $5.1 billion in 2002-03.

These five messages are designed to eliminate a focus solely on the annual surplus or deficit and provide a more comprehensive picture of the Government's financial situation.

I am pleased that the Government has adopted this model for its financial statements.

Comparison of actual results with budget

This year's Summary Financial Statements include the addition of budget information to enable a comparison of budget with actual results. This comparison completes the accountability chain for the Government by comparing final results for the year with those projected in the Budget, the document that establishes tax rates and sets out the Government's spending plans for the year. In addition to providing good information, it implements a long-standing PSAB requirement and recommendations this Office has made. While PSAB recommends that the comparison be made with the initial Budget, the comparison in this year's financial statements is with the updated figures in the February 2003 Budget—because full accrual accounting had not been implemented when the initial Budget was prepared. In the circumstances, this approach is appropriate. I understand that in future years the comparison will be made to amounts in the initial Budget.

Netting of revenues and expenses

In previous years, certain amounts were presented in the *Public Accounts of Canada* on both a gross and a net basis. The latter involved the Government offsetting certain disbursements against revenues in the Statement of Operations. This netting did not impact the annual surplus, but it did show lower expenses and revenues for the year. We have raised concerns about this practice for a number of years. The items involved included: the Canada Child Tax Benefit, certain Crown corporation revenues and expenses and the GST credit, which, in my view, are properly classified as program expenses rather than a deduction from revenues. This year, the Government has eliminated netting of the larger of these items in the financial statements (with the exception of the GST credit, where the Government has chosen not to adopt my recommendation). It now discloses Crown corporation revenues and expenses and the Child Tax Benefit as separate items on the Statement of Operations. I am pleased that the Government has chosen to present these items solely on a gross basis, as I believe this more properly reflects the nature and size of the Government's revenues and expenses.

I am, however, very disappointed that the Government continues to use net amounts in its analysis of revenues and expenses in the Annual Financial Report. For the reasons described above, I am of the view that gross revenues and expenses should be used in this analysis. This would also be consistent with the Government's summary financial statements as well as the financial statement discussion and analysis contained in the *Public Accounts of Canada*.

Financial statement discussion and analysis

In July 2003, the Public Sector Accounting Board issued an exposure draft on financial statement discussion and analysis. The purpose of the analysis is to provide an executive overview of the summary financial statements and the significant activities during the year that affected them and the year's fiscal results. Governments are encouraged to experiment with preparing a discussion and analysis of financial statements covering such items as:

- an acknowledgement of government's responsibility for preparing the summary financial statements;
- a financial highlights section summarizing the key messages to allow users to understand the financial statements and the financial results for the year; and
- a financial analysis and review that examines variances and trends in certain elements of financial statements, including significant risks and uncertainties.

Section 1 of this year's *Public Accounts of Canada* is a new section prepared by the Department of Finance and the Treasury Board Secretariat that presents a discussion and analysis of the current year's financial statements. This material reflects the substance of the new PSAB exposure draft, and I view it as an excellent addition to the *Public Accounts*. I applaud the work of the Government in proactively implementing this new guidance from PSAB, and I will work with the Government as it further improves the section in the future.

Ongoing challenges

The Government's success in implementing accrual accounting represents a significant improvement that has positioned the Government well for the future. However, the adoption of full accrual accounting was never intended as an end in itself, but as a part of a wider initiative to improve the Government's financial management and control. For example, the recording of tens of billions of dollars of assets and liabilities should lead to the better management of these items. The Government's new accounting policies and its new financial information systems were only two elements of its Financial Information Strategy. They are essential building blocks supporting the third element of this strategy: providing government managers with access to better financial information for their day-to-day decision making.

The challenge for the Government now is to use this new accrual information effectively in its management decision making and ensure that this new basis of accounting is fully implemented in departments.

In my view, one remaining impediment to the Government's use of this information in decision making is the lack of accrual based budgeting and appropriations. It is essential that the Government resolve this issue, which I have commented on repeatedly. While I accept that this is a complex issue and needs to be considered carefully, I note that after five years of studying the issue the Government is still far from proposing a way forward. Despite the importance of this issue, I am not aware of any substantive progress by the Government in the past year. In my view, until government-wide and departmental budgeting, financial reporting, and appropriations are put on a common basis, effective financial management and control in the Government will not be achieved. (For further information on this issue see Chapter 5 of my December 2002 Report.)

National Defence inventory

Inventories at the Department of National Defence provide an example of the challenge of implementing accrual accounting at the departmental level. Of the $6.1 billion in government inventories, by far the largest amount belongs to National Defence; it includes items such as munitions and consumables (uniforms, machine tools, etc.). Historically, the Department had maintained inventory systems focused primarily on keeping track of quantities; as a result, cost accuracy was not emphasized and errors were made in recording costs. The introduction of full accrual accounting required the Department to validate the costs in its system. Further complicating the challenge, many items remain in inventory for a long time—over 10 years in some cases. As a result, it was difficult for the Department to determine reliably the cost of a large number of items in its inventory. It took a significant effort by the Department to arrive at a reasonable estimate of the cost of its inventory for the preparation of the Government's summary financial statements.

I note that this challenge is not unique to Canada. Many national governments that have attempted to implement accrual accounting have had difficulty determining the cost of their military inventory. In Canada's case, National Defence did a lot of added work to determine a figure for inventory costs that I could conclude was presented fairly in the context of the Government's summary financial statements. It drew statistically valid samples from its inventory, assessed the existing support for recorded prices, and arrived at an acceptable figure as the cost of inventory.

Readers can take my opinion on the Government's financial statements to indicate that National Defence's inventory is properly valued in the context of the Government's summary financial statements as a whole. However I do not believe that costs as currently recorded could be used for management decision making.

The Department has agreed to implement a plan to ensure that appropriate controls are in place to record the costs of future purchases properly in its inventory system; to relieve the costs of old inventory properly over time as the inventory is used; and to monitor usage properly and determine ongoing adjustments to reflect the obsolescence of inventory items. While National Defence has committed to doing this work, the challenge is great and it may be many years before its inventory records are suitable for management decision making.

YEAR-END SPENDING

The 2002-03 Statement of Operations includes $4 billion in transfers to trust funds for the provinces and territories as part of the Accord on Health Care Renewal and $1.2 billion in transfers to foundations—spending initiatives for 2002-03 that were included in the February 2003 Budget.

Specifically, the Budget included commitments to provide the following:

- $2.5 billion in a Canada Health and Social Transfer supplement to relieve existing pressures;
- $1.5 billion to improve access to publicly funded diagnostic services. This would involve new investments including support for specialized training and equipment;
- $600 million to accelerate the development of a national system of electronic health records;
- $500 million for research hospitals; and
- $100 million to other foundations.

Transfers to trust funds

The first two commitments involve transfers to provinces through irrevocable trust agreements, signed and dated March 31, 2003. The agreements provide for the funds to be distributed to the provinces on a three-year schedule of payment (2003-04 to 2005-06). The Budget and the Schedule to the Trust Agreement anticipate that the provinces will use these funds over three years ($1.5 billion in the first two years and $1 billion in the last year). However, the agreements allow for the provinces to ask that payments be accelerated—in effect, the provinces could access all their funds immediately.

Payments to the trusts received parliamentary approval when the *Budget Implementation Act* received royal assent on June 19, 2003. Payments were made to the trusts on June 23, 2003.

While the Accord for Health Care Renewal included a commitment by first ministers to establish a Health Council that would monitor and report publicly on the implementation of Accord priorities, the trust agreements themselves do not require provinces to indicate that the funds are to be used for the purposes indicated in the Accord. Thus, the drawdown of these funds is not contingent on a requirement to demonstrate that the priorities will be addressed.

As indicated in note 4vi of the Government's Summary Financial Statements, the payments were recorded as an expense in 2002-03, lowering the Government's annual surplus by $4 billion.

In assessing the accounting for these transactions, I concluded that the Government's accounting treatment was acceptable because the Government:

- had agreed to make the payments;
- had established the trust agreements by year end;
- had not included in the trust agreements a requirement for proof that costs had been incurred for the purposes indicated in the Accord on Health Care Renewal; and
- had authorization from Parliament to make the payments before the financial statements were finalized.

Foundations

The other commitments involve transfers to foundations. Since 1997, the Government has used several foundations to carry out certain public policy objectives. Over the past seven years it has recorded $8.7 billion in transfers to these foundations as expenses in its financial statements (see Table below). At March 31, 2003, $7.8 billion was either still in the foundations' bank accounts and investments accumulating interest or was receivable by the foundations from the Government. The funds had yet to be distributed to the ultimate intended recipients or used for the ultimate purposes announced by the Government for this spending.

Summary financial information on Foundations, 1996-1997 to 2002-2003

Foundation [1]	Year Announced	Funding received[2]	Grants Provided[3]	Interest Earned	Adminis-tration	Balance March 31, 2003[4]	Funding Commitments Signed[5]
	($ millions)						
Canada Foundation for Innovation	1997	3,651	881	560	29	3,301	1,140
Canada Millenium Scholarship Foundation	1998	2,500	857	569	34	2,178	7
Canada Health Infoway Inc.	2001	1,100	9	39	13	1,117	158
Genome Canada	2000	375	105	41	13	298	205
Aboriginal Healing Foundation	1998	350	171	76	35	220	115
Green Municipal Investment Fund[6]	2000	200	5	26	7	214	23
Canadian Health Service Research Foundation	1997	152	26	10	5	131	7
Other foundations under $100 million[7]	Between 2000 and 2002	134	22	14	3	123	20
Pierre Elliot Trudeau Foundation[6]	2002	125	0	2	0	127	1
Foundation for Sustainable Developmnent Technology	2001	100	0	3	1	102	6
Total		8,687	2,076	1,340	140	7,811[8]	1,682

1 The foundations reflected in this Table have each received over $10 million in total funding from the Government since 1997, specifically for spending in a future year more than a year ahead.
2 Transfers include $1.2 billion announced in the February 2003 Budget that were receivable by the foundations at March 31, 2003.
3 In addition to grants this column includes eligible project expenses.
4 These balances are at the date of the latest annual reports, where March 31, 2003 financial statements are not yet available – modified to include the $1.2 billion announced in the February 2003 Budget.
5 Figures based on representations from foundations, where not disclosed in their financial statements.
6 These are endowment funds; only the earnings are disbursed.
7 These are Foundation for Climate and Atmospheric Sciences; Clayoquot Biosphere Trust Society (endowment fund); Forum of Federations; Pacific Salmon Endowment Fund Society; Canadian Institute for Research on Linguistic Minorities, University of Moncton (endowment fund); and Frontier College Learning Foundation (endowment fund).
8 In addition to funding for foundations and endowments included in this table, $465 million was transferred to other organizations that clearly are at arm's length from the Government; $352 million of the transferred amount had yet to be used at March 31, 2003. These other organizations are Canadian Institute for Health Information; Green Municipal Enabling Fund; Precarn; Canadian Network for the Advancement of Research, Industry and Education (CANARIE); and Canadian Institute for Advanced Research.

These funds were transferred to foundations well in advance of need, in some cases many years in advance. It is worth noting that the Treasury Board Secretariat's own policy on transfer payments indicates that payments should not be made in advance of need, though this policy does provide for exceptions subject to the Treasury Board's approval. It gave the required approvals for transfers to foundations, involving at least a dozen individual approvals.

In the past, I have noted that many factors led me to question whether the funds transferred to foundations should more appropriately be recorded as expenses when they are used for their ultimate purposes. These factors included:

- the Government's role in creating the foundations;
- the foundations' obligation to achieve Government policy objectives;
- the Government's role in appointing the foundations' directors; and
- the prescriptive nature of detailed funding agreements between the foundations and the Government.

As noted in the Budget, foundations have become important tools for implementing public policy. It seems to me that foundations such as the Canada Foundation for Innovation and the Canada Millennium Scholarship Foundation are, in effect, delivering a government program using public money. I have therefore questioned whether the Government's accounting for these transfers as transfers to "arm's-length" organizations is appropriate.

PSAB recently issued a new accounting standard on the government reporting entity. The standard provides guidance to assist governments in determining if an organization is controlled by government. I have encouraged the Government to consider the effects of this new accounting standard for each of the foundations. In addition, PSAB has a second project underway that is considering the accounting for government transfer payments, including multi-year funding. Together with government officials, I will be monitoring the progress of this project and considering the possible implications for the Government's accounting for transfers to foundations.

Beyond the funding issue and the accounting treatment, I have also raised broader and perhaps more important concerns about the accountability regime for foundations. Some of these concerns included inadequate reporting to Parliament; weak oversight of foundations; the inability of the Government to make adjustments should there be a major change in public policy; and the lack of independent, credible reviews and evaluations that are made available to Parliament.

In its 2003 Budget, the Government announced changes in the accountability and governance structures for foundations. I note that the Government intends to introduce some positive measures, particularly for reporting to Parliament and the public. These and several other measures proposed in the Budget clearly have the potential to improve the accountability and governance of foundations.

However, it does not appear that these changes will address all my concerns, particularly the inability of the Government to make adjustments should there be a major change in public policy and the lack of independent, credible reviews and evaluations that are made available to Parliament. Further, much depends on how well these measures are implemented in new and existing foundations. I will assess the revised accountability and governance framework for foundations in future audits.

I emphasize that I express no view on the merits of foundations as a vehicle to deliver government programs. My concerns relate solely to the funding of these organizations in advance of need, provision for their accountability and governance, and the way the Government accounts for its transfers to them. Similarly, my comments should not be interpreted in any way as a criticism of the individuals in charge of the foundations. However, as I have noted before, foundation appointees' determination to make the foundations succeed is not sufficient to overcome the weaknesses in accountability structures.

Accounting considerations influencing decision making

I am encouraged by the Government's intention to strengthen these accountability and governance structures; however, I am concerned that accounting considerations may be preventing the Government from making all necessary improvements. In a recent Public Accounts Committee hearing on foundations, Government officials indicated that in their view, significantly enhancing the accountability measures could mean that the foundations would be controlled by Government, and therefore considered inside the entity for accounting purposes. In that case, the $8.7 billion in transfers to the foundations could not be treated as expenses (and therefore not be used to reduce the Government's surplus) until the foundations used them for their intended purposes. This view has also been cited by senior Government officials in many discussions I and my staff have had with them.

I am therefore concerned that accounting rules may be leading the Government in its choices as to the accountability and governance structures involving foundations as well as the manner in which they are funded. In my view, decisions on funding and accountability should be based on the need for sound management of public funds; they should not be based on the goal of achieving a desired accounting result such as reducing the reported annual surplus.

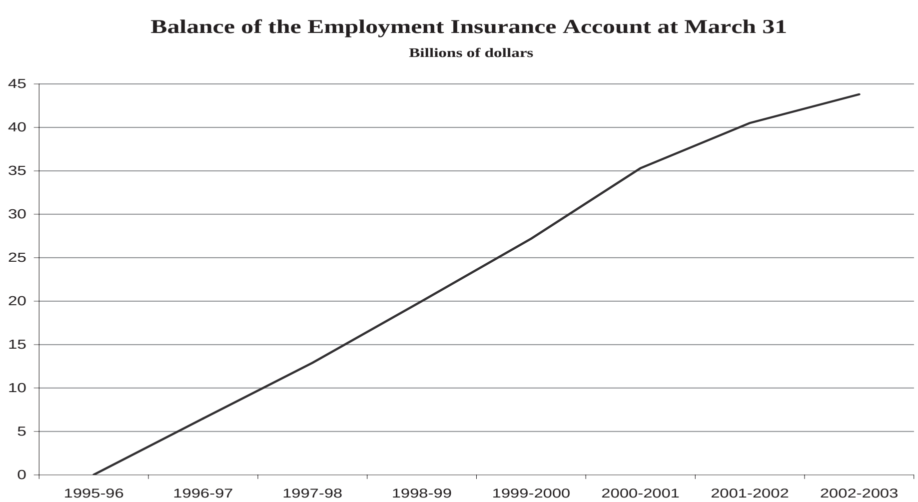
Conclusion

I encourage the Government to implement proper accountability and governance structures for the foundations and not constrain itself from achieving this end by a desire to achieve a particular accounting result.

EMPLOYMENT INSURANCE ACCOUNT SURPLUS

The Government has still not addressed the long-standing issues related both to setting premium rates for Employment Insurance and to the appropriate size of the surplus in the Employment Insurance Account.

In 2002-03, Employment Insurance (EI) surplus grew by $3.3 billion to $43.8 billion. This is about three times higher than the Chief Actuary of Human Resources Development Canada said was necessary in his 2001 report on Employment Insurance premium rates. Because Employment Insurance is a government program, EI premiums and benefits are included in the financial statements of the Government of Canada. As a result, these transactions increased the Government's annual surplus by $3.3 billion for 2002-03 and reduced the accumulated deficit at March 31, 2003 by $43.8 billion.



Section 66 of the *Employment Insurance Act*, which is currently suspended, requires that as far as possible, premiums paid by contributors provide the EI Account with enough revenue over a business cycle to pay authorized amounts charged to the Account while maintaining relatively stable premium rates. In my view, this means that Employment Insurance premiums should equal expenses over a period of time, while providing for a reserve sufficient to keep rates stable in an economic downturn.

I note that in the 2003 Budget, the Government stated that the following rate-setting principles would guide its ongoing consultations:

- Premium rates should be set transparently and on the basis of independent expert advice;
- Expected premium revenues should correspond to expected program costs; and
- Premium rates should mitigate the impact on the business cycle and be stable over time.

These principles are, in my view, consistent with an interpretation that Parliament intended the EI program to be run on a break-even basis.

In my view, Parliament did not intend for the Account to accumulate a surplus beyond what could reasonably be spent for employment insurance purposes given the existing benefit structure, while also providing for an economic downturn. Accordingly, in my opinion, the Government did not observe the intent of the *Employment Insurance Act*.

In 2001, when it first suspended section 66 of the EI Act, the Government indicated that it would undertake research and public consultations on the process of setting premium rates. By the February 2003 Budget, those consultations had not taken place. In that Budget, the Government announced again that it would hold consultations on a new rate-setting process to be implemented for 2005. I have been advised that the Government has solicited and received public submissions on the matter and is analyzing them.

In the interim, the Government set the 2004 premium rate at $1.98 per $100 of insurable earnings; at this level, premium revenues are intended to equal projected program costs in that year. While this may ensure that the surplus does not grow significantly in 2004, it does nothing to address the $43.8 billion surplus that has accumulated.

Conclusion

The EI surplus had grown to $43.8 billion by March 31, 2003. In the past, I have called on the Government to expedite the completion of its study on the process for setting premium rates. I note with disappointment that public consultations did not occur before the rates were set for 2004, as had been announced. Instead, the Government chose to prolong the suspension of section 66 for another year. I strongly urge the Government to resolve this long-standing issue.

COMMUNICATING RESULTS

As I have indicated earlier in these Observations, this year the Government has made significant improvements in its financial reporting. I believe that further improvements are possible. Currently a broad range of both summary and detailed financial information is provided in two key documents—the *Public Accounts of Canada* and the *Annual Financial Report*. The *Public Accounts* contain a tremendous amount of information, much of it extremely detailed. The Annual Financial Report is much more a summary document, however it is not written to explain the Government's financial results to a general audience. I believe the Government, in consultation with key users, should review this information and determine the best way to provide it to parliamentarians and other interested Canadians. For example, the Government should consider whether one set of *Public Accounts* (in multiple volumes) is appropriate or whether providing some of this information separately in other formats would be more useful. It may also be appropriate to consider whether all of this information is needed or whether other vehicles meet the same need.

Currently, the Government's summary financial statements are tabled some six months or more after year end. This reflects a number of factors including the size, diversity and complexity of Government operations as well as some of the challenges in determining tax revenues on an accrual basis of accounting. Nonetheless, for financial statements to have full value it is essential that they be produced as soon after year end as possible. Therefore, in addressing the issue of improved financial reporting, the Government should also consider how to complete and table its summary financial statements more expeditiously.

In addressing this issue, the Government will need to consider the trade off between timeliness and accuracy. To illustrate this point I will highlight the case of tax revenues. Under accrual accounting, tax revenues are measured from amounts assessed to May 31 and from estimates of amounts not yet assessed based on cash received. Greater accuracy could be achieved by increasing the amount of revenue recorded based on assessments. Greater timeliness would be achieved by only considering assessments to March 31 for example. As the Government gains experience in using its methodology, it should assess the predictive reliability of its estimates and determine if it is feasible to increase the timeliness without significant negative impact on accuracy.

When results are communicated, it is important that they be relayed in generally recognized and consistent language. I am concerned that the Government has chosen to use the term "federal debt" when discussing the accumulated deficit in some of its communications. The accumulated deficit—the difference between the Government's total liabilities and its total assets, both financial and non financial—was $511 billion at March 31, 2003. I fear that the use of the term "federal debt" may confuse readers. In particular, this term could be confused with "net debt"—the Government's liabilities less its financial assets ($565 billion at March 31, 2003) or "interest-bearing debt" ($621 billion at March 31, 2003). Both of these figures are significantly higher ($54 billion higher and $110 billion higher respectively) than the Government's accumulated deficit of $511 billion at March 31, 2003. Thus, I fear that Canadians may get a picture of the Government's financial position that is confusing or, worse, inaccurate. I believe results should be communicated clearly to Canadians and I encourage the Government to present its financial results using generally recognized and consistent terminology in all its communications.

MY AUDIT REPORT EXPLAINED

In past year's Observations I have explained my audit report in some depth. This year I have chosen to provide this information to interested readers on my Web site together with my Observations (www.oag-bvg.gc.ca).