



**HOUSE OF COMMONS
CANADA**

ACCRUAL BUDGETING AND APPROPRIATIONS IN THE FEDERAL GOVERNMENT

**Report of the Standing Committee on
Government Operations and Estimates**

**Hon. Diane Marleau, M.P.
Chair**

DECEMBER 2006



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THE STANDING COMMITTEE ON GOVERNMENT OPERATIONS AND ESTIMATES

has the honour to present its

SIXTH REPORT

Pursuant to its mandate under Standing Order 108(2), the Committee has studied accrual budgeting and appropriations in the federal government. After hearing evidence the Committee agreed to report to the House as follows:

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CHAPTER ONE — INTRODUCTION

The House of Commons Standing Committee on Government Operations and Estimates was established to examine government spending, either directly through the Estimates documents or indirectly through the examination of government operations. The Committee's review of government spending and operations is fundamental to holding the government to account on how public funds are spent. To this end, ministers and their senior officials are called to appear before the Committee to answer questions on spending for which they are responsible. Therefore, the Committee has developed a particular interest in, and knowledge of, issues of government accountability in relation to financial management.

In order for the Committee, to properly assess government spending plans it is important that information on policy intentions and on the formulation and implementation of programs be clear and transparent. To achieve this transparency, budget and estimate documents must fully disclose all relevant information in a timely and systematic manner. A key element in achieving transparency in government finances is the accounting basis selected for reporting and budgeting exercises. Traditionally, the government has used a cash based accounting system. In recent years the Canadian government as well as other governments (both provincial and foreign) have moved towards the implementation of accrual based accounting systems.

Past Canadian governments have committed themselves to change over to an accrual based accounting system for government financial activities. During its regular review of the estimates in the spring of 2006, the Committee heard from the Auditor General that there has been a "... continued lack of progress in implementing accrual-based budgeting and appropriations"¹. She emphasized that this inaction has "impeded departments' integration of accrual-based financial information into their regular decision making"². At the time she observed that:

The government has responded by studying this issue since 1998 without ever establishing a clear position as to what direction it will take. After having studied this issue for eight years, it is, in our opinion, time for the government to take a position on this matter. The Public Accounts Committee has recently urged the government to implement accrual-based budgeting and appropriations. The support of your Committee would help reinforce for the government that parliamentarians have an interest in seeing this matter resolved³.

¹ House of Commons Standing Committee on Government Operations and Estimates, Meeting No. 9, Evidence, Tuesday, 13 June 2006.

² Ibid.

³ Ibid.

She also reminded the Committee that:

The lack of progress in resolving this important issue and the weaknesses in internal controls are the chief reasons for the unsatisfactory progress in improving financial information in departments and agencies. I believe that this lack of progress also contributed to the choice of the less cost-effective option noted in paragraphs 7.24 and 7.25 of chapter 7 on the acquisition of leased office space which we discussed with this committee at its meeting on June 8⁴.

In view of these comments, the House of Commons Standing Committee on Government Operations and Estimates felt that it needed to take action on the matter of introducing accrual accounting in government appropriations. Subsequently, it recommended in its Third Report:

That the Committee's fall agenda be set aside to extensively study the implementation of accrual accounting with view to make a recommendation to the House of Commons prior to December 2006.⁵

The Committee began its hearings on accrual accounting in September 2006 in the hope of providing some guidance to the government in resolving the remaining obstacles to the implementation of accrual based budgeting. The results of the Committee's work are presented in this report.

⁴ Ibid.

⁵House of Commons Standing Committee on Government Operations and Estimates, Report 3 — Implementation of Accrual-Based Budgeting and Appropriations (Adopted by the Committee on 15 June 2006; Presented to the House on 21 June 2006).

CHAPTER TWO — OVERVIEW

The climate for improved transparency and accountability often occurs within a broader notion of better ethics in government. Central to improved accountability to Parliament is a greater transparency and adequacy of financial information. This can be achieved by using the most appropriate accounting system available.

A) Historical Perspective

Among most national governments an accrual based accounting system is seen as best meeting the need of greater transparency in reporting public sector financial transactions. As of 2004, a third of the member countries of the Organization for Economic Co-operation and Development (OECD) have adopted accrual accounting in reporting activities and a number of other countries have accepted it for specific transactions⁶. In particular, many countries, including Canada, have introduced, accrual based accounting measure in reporting government financial activities — **accrual reporting**.

However, there is less consensus regarding the adoption of **accrual budgeting** — the introduction of accrual accounting in the publication of government budgets and estimates. Among the major industrial countries, there appears to be a wide divergence of views on the desirability of introducing accrual based budgeting systems. Only three OECD member countries in 2004 had adopted accruals for specific transactions in their budget exercises. Nationally, all provinces and territories have introduced some form of accrual accounting in their finances. Two, the Provinces of Ontario and British Columbia have introduced full accrual accounting in their accounts.

In the 1996 Federal Budget Plan, the Canadian government announced its intentions to move to full accrual accounting for budgeting and accounting purposes. Implementation followed such that the 2002-2003 financial statements in Public Accounts and the 2003 Budget were prepared on a base of full accrual accounting.⁷ According to officials of the Treasury Board Secretariat (TBS), accrual accounting was also implemented to support decisions requiring cabinet-level decisions. Estimates, appropriations and most departmental plans and reports remain on a near-cash basis.⁸

⁶ Jon Blondal, 2004, Issues in Accrual Budgeting, OECD Journal on Budgeting, vol. 4, no. 1, p. 103-119.

⁷ Treasury Board Secretariat, Accrual Accounting for Budgeting and Appropriations, Brief presented to the House of Commons Standing Committee on Government Operations and Estimates, September 2006.

⁸ As of 1 April 2001, all departments and agencies had successfully implemented new financial systems capable of handling accrual financial information for the preparation of summary and reporting financial statements. Report of the Auditor General, December 2002, Chapter 5, p. 1.

Although Canada has committed itself to adopting an accrual budgeting system, it has yet to introduce one. In fact Canada has repeatedly delayed the introduction of accrual budgeting in spite of urgings by the Office of the Auditor General and the House of Commons Standing Committee on Public Accounts to expedite the implementation of an accrual budgeting system⁹.

B) Types of Accrual Bases

While the debate centres on the choice between introducing accrual based budgeting versus retaining cash based budgeting, there are in fact a range of options involving a mix of cash and accrual accounting systems for public sector finances. **Cash accounting** essentially reports cash transactions when cash is received or paid out by an organization. Therefore, financial statement items such as amounts owed to or by the government or other non-cash items are not recorded. At the other extreme, **full accrual accounting** recognizes transactions when they have been earned or incurred rather than when cash comes in or out.

In between these two systems are hybrids like **modified cash accounting** that allows year-end adjustments to recognizing some non-cash items such as accounts receivable and payable. Alternatively, **modified accrual** follows full accrual principles with one significant departure: it does not recognize capital assets on the statement of financial position. Instead these assets are recognized fully as expenditures when bought.

Currently, the federal government employs different accounting bases for different levels of administration. The table below provides an outline of the different bases of accounting and their use.

Table 1

CURRENT STATUS OF ACCRUAL ACCOUNTING IN GOVERNMENT		
	Government-wide	Departmental
BUDGETING PURPOSES		
Federal Budget	Accrual	—
Departmental Budget/Estimates	Near-Cash	Near-Cash
Appropriations	Near-Cash	Near-Cash
REPORTING PURPOSES		
Summary Financial Statements	Accrual	—
Departmental Financial Statements (unaudited)	—	Accrual
Departmental Performance Reports	—	Near-Cash

SOURCE: Office of the Auditor General, Overview of Accrual-Based Budgeting and Appropriations, Briefing to the House of Commons Standing Committee on Government Operations and Estimates, 26 September 2006.

⁹ See: Reports of the Auditor General for the years 2002 (Chapter 5), 2004 (Chapter 6), and 2005 (Chapter 8). The HCSC on Public Accounts has made numerous recommendations to the Government urging it to implement an accrual budgeting system. For a partial list of the Public Accounts Committee's recommendations see the Report of the Auditor General, February 2005, Appendix C.

C) Accounting Standards and Principles in the Public Sector

In the public sector, the basic principles of responsibility and accountability demand that governments provide credible financial information to Parliament and the public. In order for Parliament and the public to perceive this financial information as credible, they must have confidence that it conforms to generally recognized and accepted standards and principles developed by an agency not subject to any political or economic pressure.

Accounting standards specify how transactions and other events are to be recognized, measured, presented and disclosed in government financial statements. In Canada, the authoritative accounting standards for financial accounting and reporting, developed through an organized standard-setting process, are those issued by a recognized standard-setting body: **the Public Sector Accounting Board (PSAB)**.¹⁰

Accounting standards are the primary source of generally accepted accounting principles (GAAP). The CICA Public Sector Accounting (PSA) Handbook contains accounting standards applicable to federal, provincial, territorial and local governments. It also requires that certain public sector organizations follow the CICA Handbook–Accounting unless otherwise directed to specific accounting standards of the PSA Handbook. It should be noted that generally-accepted accounting standards are constantly evolving as they adapt to social and economic conditions. It is important to remember that the senior levels of government in Canada are sovereign and therefore cannot be forced to conform entirely to the CICA's accounting standards. In practice, however, there is a high degree of conformity to the standards.

D) The Benefits of Accrual Budgeting

The change from cash accounting to accrual accounting in the budget process is expected to yield several benefits including improved efficiency, greater transparency, improved financial management, and better accountability. However, accrual budgeting is not universally accepted. The adoption of accrual budgeting is controversial and has been subject to a long standing debate in the public sector accounting literature.¹¹ The many actors interested in governmental accounting have different points of view on the desirability of implementing accrual budgeting in public sector finances. International organizations have been active in promoting the adoption of the accrual basis for governmental accounting. Also supporting a move to accrual accounting have been management consultants, and key public sector reformers. However, all of the witnesses appearing before the Committee acknowledged that the benefits of introducing accrual accounting in the budgeting

¹⁰ The PSAB consists of one Chair and a maximum of 11 members recruited by the Board to serve in an individual capacity, and not as a representative of a government or organization.

¹¹ Jon Blondal, 2004, Issues in Accrual Budgeting, OECD Journal on Budgeting, vol. 4, no. 1, p. 105-107.

and appropriations activities of the government is likely to yield benefits that exceed the costs associated with such an action. In her briefing material presented to the Committee, the Auditor General identified the following advantages of introducing full accrual accounting in government finances.¹²

1. Reflects full scope and size of government's:
 - resources (all financial and non-financial assets)
 - obligations (all liabilities)
 - costs (resources consumed)
2. Greater focus on consumption of resources
3. Better link of the results to the resources used to achieve them
4. Fuller information available to government for improved decision making
 - more focus on assets (maintenance requirements, replacement policies, buy vs. lease)
 - more attention to managing liabilities
 - more focus on full cost of programs and services

The Auditor General clearly stated her view of the benefits of introducing accrual accounting when she noted that:

While we recognized in our financial information chapter that a department's cash requirements and cash flow management will continue to be important information for Parliament, we concluded that Parliament would be better served if it also received information in the estimates and appropriations based on accrual accounting. Such an approach would make the process more consistent with the one used in the government's financial reporting of results.

Mr. Ronald Salole (Vice-President, Standards, Canadian Institute of Chartered Accountants) also preferred that the government introduce accrual accounting into all of its financial records. He reminded the Committee that accrual accounting is:

reporting and it is historical. It is not looking forward necessarily. It's telling it the way it is — not the way people want it to be or the way people like it to be, but the way it is.

He preferred the use of an accrual based system of accounting because:

The accrual basis of accounting is the best way we've developed, internationally, globally, to be able to do that. It portrays a picture and says here are the transactions and events that occurred in this particular period. Here's the balance sheet, the statement of the financial position. It tells you what its assets and its liabilities are, and it tells you what the changes in those assets and liabilities are. We focus on setting standards for that,

¹² Office of the Auditor General, Overview of Accrual-Based Budgeting and Appropriations, Briefing to the House of Commons Standing Committee on Government Operations and Estimates, 26 September 2006.

because we can come up with some rigid, well-based, well-grounded principles, and we reason from them.

He also noted that:

... research shows that financial reports prepared on the accrual basis of accounting, historically, also happen to be the best predictors of what is likely to happen in the future.

Mr. Bruce Bennett, Acting Controller for the Government of Ontario appeared before the Committee to relay Ontario's experience in implementing accrual accounting in appropriations. While he pointed out numerous hurdles that they had to overcome he believes that it was a positive experience. Among a number of benefits arising out of the experience he pointed out that accrual accounting offers:

A better measurement of program expenditure is the most fundamental one, and there is an improved basis for year-over-year comparisons of program expenditures. In other words, the timing of when actual cash payments went out is not as relevant as when the actual expense was incurred or consumed.

It provides a more comprehensive base for legislative and management control of the provincial expenditures ... it really eliminates the confusion from maintaining a different basis of accounting for estimates than was used for the province's summary financial statements and budget.

Mr. Arn van Iersel, the Acting Auditor General of British Columbia also presented a long list of costs and challenges that the Province of British Columbia experienced when the government introduced accrual accounting practices. However, he explained that the decision to go forward was not taken without anticipation of realizing some benefits. On the basis of his experience he believes that accrual accounting enhances transparency and accountability with the estimates and the public accounts on the same basis." He also believes that accrual accounting improves the management of government resources.

We also believe it improves the management or stewardship of resources, capital assets being one of them. In the previous system, where capital assets were expensed, this led to a desire in some cases to buy those assets strictly subject to appropriation room at the end of the year — and then you sort of bought them and forgot about them.

That isn't happening in B.C. now. You purchase assets, but you have to know that whatever the amortization period is, this is a cost that will carry on into your future budgets. If you have significant asset acquisitions, of course, this infringes on other operating costs. So we think it makes people more responsive and more accountable for capital in other resources.

E) Some Concerns

While the witnesses appearing during the Committee's study were generally supportive of introducing accrual accounting in government, the Committee is aware that there are concerns about the process. Having the entire government adopt full accrual accounting is complex and costly. The witnesses from the governments of Ontario and British Columbia were very clear in relaying to the Committee the numerous hurdles and challenges that need to be overcome in order to successfully introduce accrual accounting into government. In addition the Committee reviewed a study commissioned by the Treasury Board Secretariat that considered in detail the issues and problems that the federal government would face in implementing accrual accounting. Undoubtedly the preparation of additional financial statements and the inclusion of new items in the budget and appropriations documents will necessitate additional operating expenses in their preparation that are not incurred in the current system. However, these additional costs will be offset by the elimination of the significant costs that are currently incurred when the government attempts to reconcile its cash accounting items with its accrual accounting statements at the end of each fiscal period. Furthermore the ongoing benefits of greater transparency in government financial documents will lead to additional savings through more accurate effective decision-making by departments.

The Committee found that most of the issues and problems that are cited against the introduction of accrual accounting involve technical accounting matters that on the whole have been solved by accountants in one jurisdiction or another. In particular there are problems involved in valuating heritage and military assets and in valuating environmental and social liabilities. Clearly, these technical accounting problems are not common to the private sector where accrual accounting has long been practiced. The essential problem is that there are unique assets and liabilities in the public sector for which there exist no set rules to guide officials tasked with preparing government financial documents and statements. This lack of guidance could result in inappropriate treatment of assets and liabilities which in turn could have an impact on fiscal policy. Where programs yield future cash flow, accrual budgeting would move cost recognition forward, and so contribute to the evaluation of the sustainability of fiscal policy. On the other hand, where activity involves capital assets, accrual budgeting delays the recording of costs by spreading them over the useful life of the assets, and this could undermine fiscal policy.

The fact that certain assets and liabilities may accrue in one period but be expensed or amortized in another also creates concerns. Accrual based accounting recognizes those events which raise the prospect of granting multi-year appropriations or of acquiring assets with an amortization period that goes well beyond a parliamentary mandate. Such a prospect worries many people concerned about budget discipline.

Finally, if the federal government were to adopt full accrual accounting, it would require a complete reworking of the content of the budget reports presented

to Parliament. The budget documents would be remodeled to take account of the government's financial performance and the state of its finances and cash flow.

The Committee discussed all of these concerns with the various witnesses and its views are expressed in subsequent chapters.

After examining the evidence it received on the benefits and concerns about introducing accrual accounting in government finances, the Committee concluded that the benefits and advantages of operating under a full accrual accounting system outweigh the concerns expressed by the critics. The Committee therefore recommends:

RECOMMENDATION 1

That the Government of Canada adopt full accrual accounting for budgeting and appropriations.

CHAPTER THREE — BETTER COST INFORMATION FOR BETTER RESOURCE MANAGEMENT: REGARDING TANGIBLE CAPITAL ASSETS

... the failure to use accrual information was a factor when departments chose the less cost-effective option for office accommodation.

Sheila Fraser, Auditor General of Canada, Tuesday, September 26, 2006

The main advantage of full accrual accounting is that it makes it possible to measure an organization's performance by focusing primarily on assets, on the management of liabilities and on the full cost of programs and services. In short, accrual accounting encompasses all resources management, not only the availability of funds or the short-term cash flow balance. In a modified cash accounting method as the federal government uses, attention is focused almost exclusively on expenses. Amounts spent on capital assets are more or less written off and are no longer shown anywhere. With an accrual-based budgeting method they continue to appear in the accounts as a cash acquisition creates an asset that has value. It is this concept of value that is the very basis of the philosophy underlying accrual accounting.

The accrual accounting method has many other advantages, the most important being that it gives managers a more comprehensive picture of their program's financial performance. Thus, it offers a better tool for deciding how best to manage available resources. Full accrual accounting should make it easier for Parliament to hold the government responsible for managing its assets, for the total cost of its programs and for its capacity to respect its short- and long-term financial obligations.

A) Capital assets: The example of the acquisition of leased office space

The May 2006 report from the Office of the Auditor General, whose Chapter 7 on the acquisition of rented offices occasioned a meeting of the Committee, provided a telling example of the potential advantages of full accrual accounting when the federal government is deciding whether to lease or buy office space. According to the Office of the Auditor General, under the present accounting method, the government does not always choose the most economical solution for the accommodation needs of its departments and therefore the taxpayers' money is not always used in the best possible way. This is because decisions concerning the funding of capital assets are dependent on the availability of funds (parliamentary appropriations), which can be a major obstacle to the effective management of resources.

B) A typical example

Under a cash accounting method, the entire amount spent to acquire a real asset is listed as an expenditure during the fiscal year in which the transaction takes place. Besides not providing any information on the value of the government's capital assets or on the costs associated with using them in the delivery of services during subsequent years, the cash method introduces a negative bias with respect to capital expenditures and the government's acquisition of assets in the context of expenditure controls. Under this scenario the government will prefer to lease office space on a long-term basis rather than purchase it, so as to minimize its expenditures in the short term. This is often not the best solution.

On the other hand, under full accrual accounting, the government would no longer assign the entire cost of acquiring an asset to a single fiscal year if the asset's use extended over a number of years. Instead, the government would include this new acquisition in its portfolio of assets and spread out the costs of using and maintaining this asset (including amortization) as expenditures over subsequent fiscal years. Asset management would thus make greater use of concepts such as *useful life* or *life cycle*.

Consider the following fictitious case, presented to the Committee by the Office of the Auditor General on September 26, 2006, illustrates this situation:

On April 1, 2004, the government purchases a piece of equipment costing \$100,000. The equipment is expected to last for 10 years and to contribute to operations evenly over that period.

- Under the accrual accounting method, the government would record the \$100,000 cost as an asset in the 2004-2005 fiscal year in which it was purchased and then record \$10,000 of amortization expense for each year of its useful life, that is 10 years.
- Under the cash method of accounting, the government would have recorded, in the 2004-2005 fiscal year, the entire cost (\$100,000) as an expenditure for that year.

In addition, the accrual method continues to track the outstanding annual balance of the asset until it is sold or removed from service. The cash accounting method, however, would not have reported that any balance was remaining.

Table 2

PURCHASE OF EQUIPMENT COSTING \$100,000		
	March 31	
	2004-2005	2005-2006
Impact on operations	—	—
Cash accounting	(100 000 \$)	0
Accrual accounting	(10 000 \$)	(10 000 \$)
Impact on balance sheet (tangible capital assets)	—	—
Cash accounting	0	0
Accrual accounting	(90 000 \$)	(80 000 \$)

Source : Office of the Auditor General.

C) Better management of government assets

Given the evidence it heard, the Committee is of the opinion that accrual-based budgeting and appropriations at the departmental level may be a catalyst for wide-ranging reforms in government management. Adopting full accrual accounting could thus open new perspectives on investment decisions, accountability and the stewardship of government assets by:

- providing a context conducive to debates on maintaining, renewing, replacing and funding assets;
- establishing a common basis of measurement to assess the value of assets;
- providing a point of departure to evaluate the physical condition of infrastructures and other assets on a regular basis over the years;
- providing a better idea of the costs related to the delivery of services to the public that require the use of real property or other assets.

In addition, the Committee thinks that better information on real property and assets in general will allow the government to make better decisions in order to:

- dispose of surplus assets more quickly and at a better price in order to use the product to reduce public debt or invest in other government operations;

- better anticipate the normal deterioration process of real property and infrastructures in order to take the necessary measures to limit the future costs of maintaining, renewing or replacing them.

CHAPTER FOUR —

PUBLIC SECTOR ACCOUNTING CHALLENGES: LONG-TERM ASSETS AND LIABILITIES

The adoption of full accrual budgeting by governments raises certain technical difficulties that do not exist in the private sector, where accrual accounting has long been in use.

The essential problem is that there are unique assets and liabilities in the public sector for which there exist no set rules to guide officials tasked with preparing government estimates documents and financial statements. This lack of guidance can result in the inappropriate treatment of assets and liabilities which in turn could have an impact on fiscal policy.

Before recommending the adoption of accrual-based budgeting and appropriations, the Committee wanted to clarify the situation with experts in the field. The aim was to ensure that the difficulties encountered in the public sector were not insurmountable obstacles that would turn the proposed accounting reform into a nightmare for the government and end in failure.

A) Long-term assets and liabilities

During its hearings, the Committee focused its efforts on the difficulties associated with infrastructure, heritage and military goods and equipment and with environmental liabilities.

1. Public infrastructure

First, the inherent difficulties in the valuation of infrastructure assets have led some Committee members to wonder whether the benefits of valuing them for accountability, management, and insurance purposes outweigh the potentially enormous valuation costs.

In countries that have adopted accrual-based accounting, there are different approaches to valuing infrastructure assets of governments, each with potentially different impacts on the ultimate value of the assets. For instance, in New Zealand, highways are recorded at depreciated replacement cost based on the estimated present cost of constructing the existing asset. The land on which roads are constructed is valued using an opportunity cost based on adjacent use. In the United Kingdom, road networks are valued on the basis of current replacement cost depreciated to reflect the overall condition of the network. In Sweden, roads and railways are recognized at acquisition value minus depreciation. Another approach is

to use historic cost less any accumulated depreciation and any accumulated impairment losses as the benchmark.

Basically, the different valuation bases are related to the question of capital maintenance and this is important in designing the appropriate accrual budgeting system. Moreover, according to the accounting literature, choosing a current cost accounting base might be helpful in maintaining the operating capability of infrastructure.

Along with these rather technical considerations, the issue of preserving assets and the "infrastructure deficit" quickly became an important concern of the Committee. It is generally recognized that Canada faces a major "infrastructure deficit" in terms of infrastructure maintenance and upgrading that many compare to a "national debt." As a portion of these infrastructures belong to the federal government, the deficit associated with it could well show up on the government's balance sheet.

However, according to Ronald Salole, while financial statements prepared using the accrual basis of accounting very clearly describe the transactions and events that occurred in a particular period, they are not as clear when accounting for what has not yet been spent on maintaining the asset. Currently, accrual accounting aims primarily at providing information about historical costs and actual transactions, rather than fair market values.

Given the potentially astronomical costs of the different liabilities that the government might be called upon to cover, in addition to those relating to infrastructures, the Committee then explored the need to report or refer to certain liabilities in the government's books, and the validity of considering the infrastructure deficit as a liability. According to the CICA definition, a liability becomes an actual liability when a future economic benefit is going to be lost and there is no way of avoiding it or there is a constructive liability (an amount allocated to settle a specific debt).

In this regard, the Committee understood that items that may be considered long-term liabilities and to which the government has not made a commitment should be accounted for in a manner that allows for an objective statement of the value of the obligation. This might take the form of a note to the financial statements and not necessarily as an item in the financial statements.

Today it might be the infrastructure deficit. Why wouldn't somebody down the road come up and say there's an education deficit, we have a liability, we have to put it up there? Or some other deficit somewhere else. Those things do not, the way we think in standards setting, meet the definition we have for a liability.¹³

¹³ Ronald Salole, hearings of the House of Commons Standing Committee on Government Operations and Estimates, Thursday, October 5, 2006.

2. Heritage assets

The Committee also looked into accounting for heritage assets, that is just as problematic as infrastructure because of the numerous practical difficulties in setting a value on a country's cultural, historical or environmental assets.

No one disagrees that these are national assets and as such should appear in the government's financial statements. Furthermore, it is usually agreed that these assets are not generally subject to a depreciation allowance (with the possible exception of buildings). In New Zealand, they are listed as government "Property, Plant, and Equipment" and are accompanied by additional explanations in the supplementary information to the financial statements. They are valued on a "modified historic cost basis" (historical cost adjusted for revaluations). In the United Kingdom, a value must be set on what is referred to as operational heritage assets (heritage assets that continue to provide services to the country). This valuation is set at the lower of replacement cost and recoverable amount (the higher of net realizable value and value in use). For a number of other assets, described as non-operational heritage assets (including museum and gallery collections, archaeological sites, burial mounds, ruins, monuments and statues), there is no requirement to enter a value in the government financial statements. However, if there is a market in assets of that type, then they may be valued in government financial statements at the lower of depreciated replacement cost and net realizable value.

According to Ronald Salole, from the Canadian Institute of Chartered Accountants, the accounting treatment of heritage assets is an issue that has not yet been totally resolved and that illustrates very clearly the limitations of financial reporting. Accounting for heritage assets, in addition to being costly, is likely to overburden the financial statements. Despite the experiences of other countries, and at a time when the International Public Sector Accounting Standards Board (IPSASB) is looking into the relevance of entering heritage assets in accounts at their fair market value, the major trend is to deal with them outside of the financial statements. The Committee shares this view and recommends:

RECOMMENDATION 2

That the Government of Canada include a note in the financial statements and in the estimates documents on its infrastructure and heritage asset liabilities.

3. Military goods and equipment

Another issue involves the accounting treatment of military assets used in war. The difficulty lies mainly with equipment and munitions, rather than with bases, naval facilities or airfields as the latter can be valued in the same way as other government land and buildings. The problem in accounting for military assets is

determining whether the items are to be considered assets that can be amortized over several years or as an annual expense because the economic nature of military items changes when the country goes to war. In peacetime, military equipment and munitions can be considered assets in the government's balance sheet, subject to some form of depreciation. In wartime, however, they can be used and destroyed very quickly. In New Zealand, they are considered special equipment and recorded as assets in the government's balance sheet. In the United Kingdom, they are considered capital expenses, and their value is amortized over time.

Despite these differences, military equipment, like other assets, can be recorded in government financial statements. In wartime, they may be treated like an extraordinary item and posted in the financial statement as operating costs. The importance of including these items in government financial statements is that it gives a better idea of the magnitude of public spending on military equipment and highlights the government's ability to manage its resources. Disclosing the amount of military spending can also contribute to greater transparency in a democracy where decisions have to be made on the allocation of government funds to meet competing demands. Therefore, the Committee recommends:

RECOMMENDATION 3

That, for the purpose of greater transparency, explanatory notes to the financial statements and budgetary documents should record any changes in the accounting treatment of military goods and equipment.

4. Other Departments and Organizations

Other government departments and organizations, not only the Department of Defence, can also suffer a sudden loss of their goods and equipment, although perhaps not with the same frequency. However, as in the case of military goods and equipment, the Committee expects that in the event of a catastrophic loss of government assets, that the impact on the financial statements and estimates be accompanied by an explanatory note. The Committee therefore recommends:

RECOMMENDATION 4

That, for the purpose of greater transparency, explanatory notes to the financial statements and budgetary documents should record any changes in the accounting treatment of any government goods and equipment.

5. Environmental liabilities

Governments have a general responsibility to maintain the overall quality of the country's environment. They also have a specific responsibility to rectify any impact their activities, in particular their past activities, may have on environmental quality. These responsibilities translate to possible government obligations that must be mentioned in the financial accounts.

In this respect accrual accounting requires that the estimated costs of clean-up and remediation work be recorded as a liability. The actual amounts spent on the clean-up, remediation and management of affected sites are considered expenses that reduce the value of the liability. Under the cash accounting system, the clean-up, remediation and site management costs appear simply as expenses and only when funds are spent to carry out the work.

In the 2005-2006 fiscal year, a new accounting standard came into effect, whereby federal government departments are to record an estimated liability for a contingency¹⁴ once it is assessed as likely to result in a liability and it can be reasonably estimated.

The application of the accounting treatment related to contingent liabilities in specific situations is illustrated below:

Table 3

	Event Likely	Event Not Determinable	Event Unlikely
Amount Estimable	Record an estimated liability	Disclose in notes	Do not disclose in notes or record
Amount Not Estimable	Disclose in notes	Disclose in notes	Do not disclose in notes or record

Source: Treasury Board Secretariat

The liability recorded for a likely contingency continues to be recognized until it is settled or otherwise extinguished, or until the probability of the occurrence of the future confirming event is considered unlikely.

That being said, to improve the reporting of environmental liabilities and to enhance transparency in the move to full accrual appropriations, the Committee believes it is important that the government continue the objective declaration of environmental liabilities by each department through a statutory appropriation. Moreover, to strengthen parliamentary oversight, the Committee feels it important

¹⁴ Treasury Board Accounting Standard 3.6 — Contingencies
http://www.tbs-sct.gc.ca/pubs_pol/dcgpubs/accstd/con-eve1_e.asp

that members of Parliament vote on the allocation of funding for remediation or site management activities. Therefore, the Committee recommends:

RECOMMENDATION 5

That the Government of Canada introduce a double-appropriation system for environmental liabilities, which would include a statutory appropriation for the valuation of liabilities and an annual voted appropriation for the expenses related to remediation and site management.

RECOMMENDATION 6

That explanatory information relating to potential environmental liabilities be included in the financial statements and the estimates documents prepared by the government.

CHAPTER FIVE — OPTIONS

In this chapter the Committee reports on its review on the options considered for introducing accrual accounting in budgeting and appropriations. It also reviews some of the issues that affect Parliament directly.

A) The Price Waterhouse Cooper Study

During its hearings, the Committee was provided with a study, commissioned by the Treasury Board Secretariat, on the issues surrounding the introduction of accrual accounting in government. The study, prepared by Price Waterhouse Cooper and entitled “Increased Use of Accrual Accounting in the Budget and Expenditure Cycle” (PWC Study) was submitted to the Secretariat on 31 March 2006. The Committee was able to discuss the findings of the PWC Study with both the Comptroller General and the Auditor General.

The objective of the Treasury Board Secretariat was, to obtain a study of the concepts of accrual accounting to determine whether, and if so, how, they should apply to the development and execution of the Budget and Expenditure Cycle (BEC) of the Government of Canada. The Secretariat sought to understand if increasing the use of accrual accounting in the BEC would improve for parliamentarians, central agencies, departmental management and the Canadian public, the transparency, accountability and financial management of federal resources.

The mandate given to PWC’s Study was essentially to identify options for introducing accrual accounting in government and to consider the consequences of these options. The report proceeded to identify preferred options that might be of interest to the government and considered the issues that need to be addressed if accrual accounting were introduced into the government over a five-year period.

As part of its work, Price Waterhouse Cooper examined the budgeting and appropriations processes in other jurisdictions. It provided the results of the research into the implementation of accrual accounting in other countries and in the provinces of Alberta, Ontario and British Columbia. The PWC Study also provided a summary and review of the materials obtained from Canadian and international accounting and other organizations.

As a result of this work, the PWC Study was able to outline some key considerations relating specifically to Canadian issues surrounding the introduction of accrual accounting in the federal budgeting and appropriations process. It assessed the readiness and capability of the federal government to implement more accrual accounting in the budget and expenditure cycle and was able to develop some alternative approaches on increasing the use of accrual accounting.

The PWC Study developed six accrual accounting options for consideration, one of which was the Status Quo. Based on consultations with TBS, Senior Financial Officers in government departments and senior management from central agencies it reduced the options to three for testing the readiness of the government to implement change and for use in developing an implementation plan. In the end this number was reduced to one option, which the Study described as the preferred option.

On the basis of its work, the PWC Study assumed that it will take five years for the government to introduce accrual accounting into the public service. Therefore, the PWC Study developed an outline for a five-year implementation program of phased introduction of accrual accounting. The Study also provided a cost estimate based on the consideration of the readiness of the Government of Canada as well as the Canadian issues it has identified. These issues are discussed in greater detail in the next chapter.

B) The Preferred Option for Accrual Accounting

The preferred option, involves the introduction of the 3-way financial statements into the Budget cycle (i.e. a statement of Forecasted Financial Position, a statement of Forecasted Operations and a forecasted statement of Cash Flow). This would entail introducing a statement of Financial Position into the Budget and dividing the current expenses report into a statement of Operations and a statement of Cash Flow. Pro forma financial statements for the whole of government would also be included in Part 1 of the Estimates and departmental pro forma statements included in the Reports on Plans and Priorities. Under the preferred option, the government would also move to an accrual appropriation, although only cash items would be funded (e.g. depreciation would not be funded). Appropriations would have to be so structured as to make the distinction between an item that relates to a future disbursement (“funded”) or an expense related to a past expenditure. The introduction of non-cash items such as depreciation to the appropriations process would improve information available for decision making and acknowledge the importance of these items in managing the affairs of the government.

Under the preferred option, there would be an increased use of accrual accounting and a new focus on the statement of financial position. It represents a moderate change in the financial management of the federal government and moves to address the concerns articulated by the Standing Committee on Public Accounts and the Office of the Auditor General.

C) Parliamentary Control

The Committee discussed the essential features of the preferred option identified by the PWC Study with officials of the Office of the Auditor General, the Office of the Comptroller General and the Treasury Board Secretariat to ascertain

the suitability of this approach for Canada and reviewed the potential impact that it might have on Parliament and the public service. It soon became clear that the adoption of accrual accounting could have a significant implication on the Parliament's control over government spending plans.

Parliament votes on the overall fiscal plan as embodied in the Budget and Appropriations. Parliamentary control of supply is a critical element that drives the design of the Canadian model for departmental budgeting and appropriations. In considering a change in the accounting base, the federal government needs to ascertain what changes might be necessary in the way that Parliament votes appropriations. Mr. Moloney of the Treasury Board Secretariat outlined for the Committee some of the key questions that Member's of Parliament need to answer:

- What control does Parliament want to exercise over specific expenditures, or revenues, within the fiscal plan set by the Budget?
- What information is needed to support the controls? Where and when is the information needed?

He reminded the Committee that the answers to these questions would influence not only the form and coverage of appropriations but also the information in the Estimates documents against which departments will be held to account. This in turn has an effect on the way that departments conduct their financial management activities. To understand some of the implications on Parliamentary control of introducing accrual accounting, Mr. Moloney presented the Committee with a simple tangible capital asset example which is reproduced below.

We assume that equipment is to be constructed over a 2-year period. Construction costs involve expenditures of \$25 million in the first year and \$75 million in the second. The equipment is put in use in year 3 and will last 10 years. The information is presented in the table below. This investment decision immediately affects the Balance Sheet but does not affect the Statement of Operations (annual surplus/deficit) until years 3 through 12.

There are four appropriation models offered by the Treasury Board Secretariat for consideration in dealing with this information in the Estimates. Each option is considered in turn.

TABLE 4

Simple Tangible Asset Acquisition Example			
Year	Acquisition costs Millions of dollars	Accrual Millions of dollars	
		Asset	Expense
1	25	25	
2	75	75	
3		(10)	10
...		(10)	10
12		(10)	10
Total	100	0	100

Source: Treasury Board Secretariat, Accrual Accounting for Budgeting and Appropriations, Presentation to the Standing Committee on Government Operations and Estimates, 7 November 2006.

Option 1, is the current practice whereby Parliament votes appropriations for acquisition costs only (a vote of \$25 million in year one and a vote of \$75 million in year 2). There are no votes on the annual amortization expenses of \$10 million for years 3 through 12. In this model, Parliament continues to vote only on the traditional cash outlays but not on the accrued expenses of amortization. Under this model, Parliament has a Vote that provides approval for a level of expenditures to acquire or improve tangible capital assets. The Estimates provide information on capital expenditures for the appropriate year, and there is accountability for expenditure decisions made by managers.

There are certain issues identified with using Option 1:

- There is difficulty in obtaining capital funding, which can contribute to the deterioration of assets;
- There is distortion in the departmental lease-buy decisions;
- Multi-year projects can create commitments on the part of government beyond the annual appropriation cycle;
- The information provided is skewed in favour of the ongoing cost of service delivery; and

- It fosters a short-term focus on the part of managers.(See Chapter 3, for more discussion on this issue.)

Under **Option 2**, Parliament might choose not to vote on the cash acquisition costs but instead choose to have ten annual votes of \$10 million under the amortization expenses in years 3 through 12. In this approach there is a vote that provides “approval” for the consumption of tangible capital assets in service delivery. The option’s benefits are that it:

- Removes short-term cash constraint from departmental lease-buy decisions;
- May make capital asset replacement easier;
- Provides better information on cost of ongoing service delivery — it matches costs with consumption of resources; and
- Should promote longer-term view of resource management.

There remain issues surrounding Option 2:

- There is no parliamentary control over asset purchases or construction;
- It could weaken government-wide cash management;
- While it seems to provide control of amortization, generally, amortization is governed by accounting standards which might limit managerial or parliamentary discretion on amortization;
- It does not spell out the consequences of Parliament not approving amortization expenses in any given year;
- It does not deal with the consequences for exceeding a vote due to unexpected non-cash expenses; and
- There is weaken accountability because the current government and managers are being held accountable for past decisions and future governments and

managers will be accountable for effects of current decisions.

In **Option 3**, Parliament could choose to vote on both the acquisition costs and on the amortization expenses. This means that there is a vote on acquisition costs in the Estimates for year 1 of \$25 million, a vote on the acquisition costs in the Estimates for year 2 of \$75 million, and one vote on amortization expenses in each of the Estimates for years 3 through 12 of \$10 million. Altogether, Parliament would vote twelve times in the Estimates on this project. The double-voting approach of Option 3 provides approval for the level of expenditures on tangible capital assets and “approval” for the consumption of tangible capital assets in the form of amortization expenses. The potential benefits are that it:

- Assists in levelling playing field for departmental lease-buy decisions;
- Provides information on both cost of program (expense) and major capital acquisitions (expenditures) so there is no decrease in current level of information for cash management;
- Helps to explain why there could be cash requirements in a period of annual accrual-based surpluses; and
- Gives consideration to both short-term and longer-term impacts of decisions.

The possible issues that might arise if Parliament were to adopt Option 3 are that it:

- May be confusing to vote on and to manage both the acquisition costs and amortization expenses;
- While it seems to provide control of amortization, generally, amortization is governed by accounting standards which might limit managerial or parliamentary discretion on amortization;
- It does not spell out the consequences of Parliament not approving amortization expenses in any given year;
- It does not deal with the consequences for exceeding a vote due to unexpected non-cash expenses; and

- Only partially resolves the issues of weakened accountability and government-wide cash management.

Option 4 proposes a Parliamentary vote on the acquisition costs and a statutory appropriation on the amortization expenses. In this model Parliament would consider a vote on acquisition costs in the Estimates for year 1 of \$25 million, a vote on the acquisition costs in the Estimates for year 2 of \$75 million, and one statutory appropriation on amortization expenses in each of the Estimates for years 3 through 12 of \$10 million. Under this option, the Estimates provide approval for both the level of expenditures on tangible capital assets and information on the consumption of tangible capital assets (amortization). However, the statutory appropriation would require changes to the Financial Administration Act to permit their use in this situation. The potential benefits of Option 4 are that it:

- Assists in levelling the playing field for lease-buy decisions;
- Provides information on both the cost of a program (expense) and on major capital acquisitions (disbursements) so there is no decrease in cash management;
- Helps to explain why there could be a cash requirement in a period of annual accrual-based surpluses;
- Gives consideration to short-term and longer-term impacts of decisions; and
- Avoids issues associated with the control of amortization.

The potential issues associated with Option 4 are:

- Possible confusion over two separate amounts for one project in the Estimates; and
- Parliamentary and managerial emphasis may remain focussed on acquisition costs.

In reviewing the characteristics of the four options the Committee became aware that adopting an accrual accounting base for the government budget and expenditure cycle introduces new items in the government Estimates that might require Parliament's attention. Although many of the possible changes arising out of the introduction of accrual accounting in budgeting and appropriations might be

handled in a straightforward manner, the addition of information on capital assets and liabilities requires that Parliament provide some direction. Mr. Moloney reminded the Committee of the different approaches used in the last two reforms of the Estimates.

- a) The reform of the structure and contents of the Estimates in the early 1980s followed a recommendation by the House of Commons Standing Committee on Public Accounts that the Office of the Auditor General and the Treasury Board Secretariat surveyed individual members of Parliament for their input (25 members were selected from list of 51 interested MPs. The names were provided by caucus chairs).
- b) In the mid 1990s, the House of Commons Standing Committee on Procedure and House Affairs observed in its 110th Report, 1995: "...the primary focus of any revisions to the Estimates and other related material must be on the needs of Parliament." In that reform, the Treasury Board Secretariat worked with a Parliamentary Working Group on a detailed model of revised Estimates. The result was that a motion was introduced in the House of Commons to split the Part III of the Estimates into a Spring Report on Plans and Priorities and a Fall Departmental Performance Report.

After considering the benefits and issues surrounding each of the four options put forth by the Treasury Board Secretariat, the Committee feels that the preferred route in the introduction of accrual accounting in the budget and appropriations is for Parliament to adopt Option 4, which allows a vote for appropriations on capital acquisitions and a statutory appropriation for the related amortization expenses. The Committee therefore recommends:

RECOMMENDATION 7

That the Government of Canada provide in the Estimates for voted appropriations on the acquisition costs of capital assets and statutory appropriations on the related amortization expenses.

In its discussions with the Auditor General and the Treasury Board Secretariat, the Committee became aware that Parliament might be asked to consider the acquisition of a capital asset that requires cash outlays in more than one year. Currently, such a capital investment would require that Parliament vote each year's cash requirement until the projected investment is complete. No further votes would be required. Under accrual accounting the entire investment is recognized when the decision is made to invest in the capital project. Parliament could approve the investment, recognizing that funds will be disbursed in later years as they are required to complete the investment. Alternatively, Parliament might want to continue to vote on each disbursement of funds. The issue of multi-year appropriation is considered further in the following section.

D) Multi-Year Appropriations¹⁵

A multi-year appropriation is an appropriation with a specific purpose and monetary limit granted by Parliament that can be utilized over more than one fiscal year. Generally, Parliament votes an appropriation for a specific purpose for a given fiscal year. However, such an approach has been known to create difficulties. Annual appropriations can often fall short of the sum required to meet the longer term needs of government policies. A focus on annual appropriations can lead to a variety of distortions such as over-consumption or under-investments. While the use of accrual accounting might identify such potential distortion in the management of government resources, their elimination may require the introduction of multi-year appropriations.

The advantage of using multi-year appropriations is that they provide a number of benefits that may enhance the value for money of public expenditure by:

- improving linkages between budget decisions in the current year and expenditure requirements in subsequent years;
- reducing administrative costs associated with annual appropriations;
- providing greater flexibility in conducting government activities;
- reducing the likelihood of wasteful year-end spending practices;
- shortening debates over the same issues year after year and allowing more time to be spent on oversight; and
- encouraging a longer-term budgeting focus.

The perceived disadvantages of multi-year appropriations are that:

¹⁵ For a broad discussion of multi-year appropriation consult: Anderson, Barrett B., [Statement on Biennial Budgeting](#), Subcommittee on Legislation and Budget Process Committee on Rules, U.S. House of Representatives, 27 July 2005. OECD, "Models of Public Budgeting and Accounting Reform", *OECD Journal of Budgeting*, Volume 2, Supplement 1, 2002. The Treasury, [A Guide to the Public Finance Act](#), Government of New Zealand, August 2005. The Treasury, [Multi-Year Appropriations](#), Treasury Circular 2000/17, Government of New Zealand, 21 December 2000.

- the process would be more lengthy and contentious the first year because the fiscal stakes would be higher;
- Parliament is supposed to approve spending plans annually. The use of multi-year spending appropriations does not allow a Parliament to review government planned expenditures annually. This is not to be confused with statutory expenditures, over which Parliament has no annual control, but at least the expenditure plan is reported and voted upon annually.
- without annual appropriation, Parliament begins to lose a degree of oversight on government spending. Any problems that Parliamentarians might capture under the current system could go unnoticed for a longer period.

In order to ensure that multi-year appropriations are well managed and evaluated, responsible departments should have sound financial management systems and practices. In addition, a multi-year plan of expenditure should include key milestones, termination points and progress report requirements.

Currently, New Zealand and the United Kingdom both employ some form of multi-year appropriations.¹⁶ In New Zealand, multi-year appropriations are permitted for a maximum period of five years. They are used in situations that are well-defined and self-contained, where the costs fall across two or more financial years. Usually, the use of multi-year appropriation is desired because there is considerable uncertainty about the distribution of costs across financial years.

In the United Kingdom, multi-years appropriations apply only to select spending items. They exclude expenditures which cannot reasonably be subject to firm, multi-year limits, such as: social security benefits, agricultural policy payments, transfers to local authorities, debt interest, payments to EU institutions, etc. Multi-year appropriations can extend for up to three years and limits to departmental expenditures are established. This gives greater financial stability to departments and helps them control their own costs over the medium term.

In Canada, the Estimates provide for bi-annual appropriations for the Canada Border Security Agency, the Canada Revenue Agency and Parks Canada. The Committee believes that there are other instances where the acquisition of capital assets might be conducted in a more efficient and effective manner if departments were able to avail themselves of multi-year appropriations. The Committee therefore recommends:

¹⁶ In Canada, the provinces of Québec, Nova Scotia and Saskatchewan are known to make some use of multi-year appropriations.

RECOMMENDATION 8

That the Government of Canada introduce multi-year appropriations, of up to 5 years, into its budgeting and expenditure cycle.

CHAPTER SIX — IMPLEMENTATION: STRONG LEADERSHIP FOR INTRODUCING BETTER TOOLS FOR DECISION-MAKING

Full accrual is probably going to cost you more, especially initially, because of the information technology infrastructure investment you may need. You have to have some fairly good accounting skills. You've definitely got to do some upfront training to get everybody up to speed. But at the end of the day, I feel that you're going to get better information for decision-making.

Jim McCarter (Auditor General, Office of the Auditor General of Ontario),
Thursday, October 26, 2006

The evidence provided by senior officials from Ontario and British Columbia confirmed the Committee's belief that the adoption of accrual accounting for budgeting and appropriations will be an undertaking that requires a great deal of determination, leadership and resources on the part of the government. However, the Committee considers that accounting reform is worth pursuing and that the government has already met more difficult challenges — bringing in the metric system, for instance, and introducing the Goods and Services Tax (GST).

A carefully planned implementation, which entails a realistic timeframe, adequate human and financial resources and periodic follow-up for tracking progress, is essential to the success of the reform process.

A) Statement of the government's intention

However, the Committee believes that the government must send a strong signal by clearly announcing its intention to move ahead with full accrual accounting. Furthermore, the Committee feels that the will to move forward must come from the Cabinet and be reflected in a bill making the necessary changes for the introduction of the new accounting system.

B) Project Implementation Office

To provide the momentum that will result in the changes required for accounting reform, and to ensure that efforts are coordinated and resources mobilized, the government should set up a Project Implementation Office (PIO), headed up by a highly visible and well respected person, who, without necessarily being an expert, is an excellent communicator and can sit down with assistant deputy ministers in the various departments, bring them together and win everyone over to the cause. As suggested in the PWC research report tabled with the

Committee by the Treasury Board Secretariat, the PIO should have the following responsibilities:

- **Project Management** — Being the focal co-ordination point of the project, providing momentum to the project, managing the implementation plan, identifying dependencies, providing risk management, coordinating reporting, managing project finances and providing administrative support;
- **Change Management** — Providing leadership and central direction of project activities to create the necessary changes required in processes, systems and people to accept the project deliverables;
- **Communications** — Developing and delivering planned communication of results to project stakeholders;
- **Stakeholder management** — Creating awareness and responsiveness in the people involved with the project or affected by the project; and,
- **Training** — Developing the training strategy to support delivery of the project.

Furthermore, in their evidence to the Committee, the senior officials from Ontario and British Columbia emphasized how important it was that the PIO be made up of people from a variety of different disciplines and who have a genuine interest in the estimates, their purpose and the reform process. They could be past legislators, academics, and so forth. Similarly, the Committee learned that, in its transition to accrual accounting, the government of British Columbia had set up an accounting policy advisory committee, comprised of respected professional accountants from the outside. The committee was set up by legislation and continues to provide the provincial government with advice on accounting matters.

The Committee agrees that striking an advisory committee and recruiting experts from outside the federal public service are good ideas, but it would prefer to give the government the flexibility it needs, so as not to place unnecessary constraints on the implementation process. Therefore, the Committee recommends:

RECOMMENDATION 9

That the government of Canada establish a Project Implementation Office with a clear mandate and

responsibilities for implementing accrual accounting in budgeting and appropriations.

C) Human resources and training

The Canadian government's move to accrual budgeting and appropriations has a significant human dimension and will require the development of an extensive training plan for the entire public service. The Committee learned that, in Ontario, it was almost necessary to provide elementary accounting courses for some of its departmental financial officers. This training initiative was deemed vital to the success of the conversion.

The human resources aspect is even more important since accountants are in short supply across Canada; many of the government's financial officers do not have professional accounting certification and are not necessarily familiar with the latest developments in accounting standards. Moreover, this major change will likely meet with resistance from some public servants, and a major effort in terms of persuasion and communications will then be necessary. The PIO's role will be decisive.

Finally, the Committee was particularly interested in the fact that training and communications must not be limited to employees in the departments' financial services. The senior officials from Ontario and British Columbia told the Committee that, in order to maximize the advantages of this major accounting reform, it was desirable to ensure that those outside the financial services, particularly program managers, also had a good understanding of accrual accounting and reporting. The managers would have better information and they would thus be able to make better decisions. This view was well received by the members of the Committee because it is believed that the accounting reform provides an opportunity to government to bring about some necessary cultural changes in the federal public service.

RECOMMENDATION 10

That the government of Canada develop a training and communications plan for its financial officers and that it make its program managers aware of the new possibilities afforded by accrual accounting through an emphasis on the management of public resources, assets and liabilities.

The Committee believes that it may be necessary to provide some assistance to members of Parliament in order that they become familiar with the changes in budgetary and appropriations documents as accrual accounting is introduced. The Committee therefore recommends:

RECOMMENDATION 11

That the government of Canada organize information sessions for Members of Parliament so that they may become familiar with the general principles of accrual accounting and the changes it brings about in the budgetary and estimates documents.

D) Financial systems and resources

The adoption of accrual-based budgeting and appropriations will require additional financial resources. The PWC report put the estimated total cost of implementing the accounting reform somewhere between \$40 million and \$160 million. According to Charles-Antoine St-Jean, Comptroller General of Canada, \$150 million is a realistic figure.¹⁷

The Committee believes that a more accurate estimate of the implementation costs will accompany the implementation plan to be prepared by the Project Implementation Office in the next few months.

That being said, the experience gained in Ontario and British Columbia shows that the final cost will depend primarily on the financial software systems chosen. The main costs of the conversion are in fact related to software costs, whether purchased new or upgraded. Human resources training will likely constitute only a small proportion of the total cost. (The PWC report puts training costs at about \$6 million.)

The scope and complexity of the federal government, which has seven different financial software systems, will be the main challenge and it is likely therefore that the conversion to accrual-based accounting for budgeting and appropriations will probably take more time and be more difficult than in the provinces. British Columbia, for instance, which had only a single software system for all its departments and agencies from the very beginning.

In this regard, the Auditor General of Canada and the Comptroller General of Canada told the Committee at its meeting on November 7, 2006, that it was not necessarily a good idea for the federal government to completely change all of its financial software systems, given the fact that a major investment had been made in them just a few years ago. As long as the software systems are compatible and meet the new requirements, operating with more than one system would be likely to

¹⁷ The Committee does not have at its disposal information that would allow it to ascertain precisely, the cost of implementing accrual budgeting and appropriations. Similarly, it can not estimate the additional net operating costs associated with accrual budgeting and appropriations. However, the Committee is confident that the overall impact on government operations is positive.

keep the costs down and ensure that the government is not held hostage by a single software provider.

E) Timeframes and follow-up

The Committee is well aware of the magnitude of the task facing the government. Nevertheless, it is convinced that the project can be implemented within a reasonable timeframe. The roadmap in the PWC report should be seriously considered by the government. The Committee is of the opinion that a five-year timeframe should enable the government to complete the accounting reform, progressing at a rate that provides enough flexibility for correctly adapting the budget and expenditure cycle, training human resources and setting up new financial software systems.

Furthermore, the Committee believes the government must report on its progress to the House of Commons every year.

RECOMMENDATION 12

That the government of Canada complete the implementation of accrual-based accounting for budgeting and appropriations within five years and report annually to the House of Commons on its progress and the costs involved.

F) User-friendliness of reports presented to Parliament

The move to accrual-based accounting for budgeting and appropriations means that reports to Parliament will contain richer and more complex information. In order to maintain and increase MPs' interest in the review of appropriations, the presentation of the government's assets, liabilities and amortization expenses should be such that they can take full advantage of the information. The Committee is of the view that the adoption of accrual-based accounting for budgeting and appropriations affords a unique opportunity to proceed with a fundamental redesign of the format and content of reports presented to Parliament. This is essential to facilitating their review by MPs. Although some progress has been made, the information in the estimates documents remains uninspired and the observations made by the Committee¹⁸ in 2003 are still valid:

It is essential that, in reports submitted to Parliament, the federal government enhance its ability to communicate clearly the information considered relevant by its clients — MPs and the Canadian public — and release it in an appropriate format. Like other economic or financial publications containing numerical data, beginning with estimates documents, for example, reports submitted to Parliament should make more intensive use of statistical tools such as trends and annual variations and present ideas and findings in tables and graphs; these tables and

¹⁸ [Report 6 - Meaningful scrutiny: Practical improvements to the estimates process](#) (adopted by the Committee on September 24, 2003; tabled in the House of Commons on September 25, 2003).

graphs should be accompanied by brief texts with value added to substantiate the figures. Apart from basic information on the budget allocation, reports should highlight failures as well as successes of programs, departments and agencies, their causes and the corrective measures to be taken to reach the objectives.

The Committee considers it necessary to arrange the information into categories dealing with, for example, appropriations (to be voted or statutory) on the government's operating budgets, capital assets and now liabilities, in Part II of the *Estimates*. Therefore, the Committee recommends:

RECOMMENDATION 13

That the government of Canada develop, in consultation with members of Parliament, a format for presenting information about appropriations in the estimates documents.

CONCLUSIONS

The Committee's work has confirmed its original impression, expressed in the motion of June 15, 2006, that the government of Canada must move ahead with the adoption of accrual-based accounting for budgeting and appropriations.

This reform of accounting practices, which the Committee strongly supports, will be an additional tool that the government may use to improve the management of its affairs.

The Committee firmly believes that this reform of government accounting practices is in the interests of Canadians and that it will offer a new perspective on the way in which public funds are used. Therefore, the Committee feels that the reform process should be carried out as quickly as possible in light of the recommendations made in this report.

LIST OF RECOMMENDATIONS

RECOMMENDATION 1

That the Government of Canada adopt full accrual accounting for budgeting and appropriations.

RECOMMENDATION 2

That the Government of Canada include a note in the financial statements and in the estimates documents on its infrastructure and heritage asset liabilities.

RECOMMENDATION 3

That, for the purpose of greater transparency, explanatory notes to the financial statements and budgetary documents should record any changes in the accounting treatment of military goods and equipment.

RECOMMENDATION 4

That, for the purpose of greater transparency, explanatory notes to the financial statements and budgetary documents should record any changes in the accounting treatment of any government goods and equipment.

RECOMMENDATION 5

That the Government of Canada introduce a double-appropriation system for environmental liabilities, which would include a statutory appropriation for the valuation of liabilities and an annual voted appropriation for the expenses related to remediation and site management.

RECOMMENDATION 6

That explanatory information relating to potential environmental liabilities be included in the financial statements and the estimates documents prepared by the government.

RECOMMENDATION 7

That the Government of Canada provide in the Estimates for voted appropriations on the acquisition costs of capital assets and statutory appropriations on the related amortization expenses.

RECOMMENDATION 8

That the Government of Canada introduce multi-year appropriations, of up to 5 years, into its budgeting and expenditure cycle.

RECOMMENDATION 9

That the government of Canada establish a Project Implementation Office with a clear mandate and responsibilities for implementing accrual accounting in budgeting and appropriations.

RECOMMENDATION 10

That the government of Canada develop a training and communications plan for its financial officers and that it make its program managers aware of the new possibilities afforded by accrual accounting through an emphasis on the management of public resources, assets and liabilities.

RECOMMENDATION 11

That the government of Canada organize information sessions for Members of Parliament so that they may become familiar with the general principles of accrual accounting and the changes it brings about in the budgetary and estimates documents.

RECOMMENDATION 12

That the government of Canada complete the implementation of accrual-based accounting for budgeting and appropriations within five years and report annually to the House of Commons on its progress and the costs involved.

RECOMMENDATION 13

That the government of Canada develop, in consultation with members of Parliament, a format for presenting information about appropriations in the estimates documents.

APPENDIX A LIST OF WITNESSES

Organizations and Individuals	Date	Meeting
Office of the Auditor General of Canada	2006/09/26	15
Sheila Fraser, Auditor General of Canada		
Clyde MacLellan, Principal		
Douglas Timmins, Assistant Auditor General		
Treasury Board of Canada Secretariat		
Charles-Antoine St-Jean, Comptroller General of Canada		
David Moloney, Senior Assistant Secretary		
Canadian Institute of Chartered Accountants	2006/05/10	18
Martha Denning, Principal		
Ronald Salole, Vice-President		
Government of Ontario	2006/10/26	22
Bruce Bennett, Acting Comptroller		
Office of the Auditor General of British Columbia		
Arn van Iersel, Acting Auditor General		
Office of the Auditor General of Ontario		
Jim McCarter, Auditor General		
Office of the Auditor General of Canada	2006/07/11	25
Sheila Fraser, Auditor General of Canada		
Clyde MacLellan, Principal		
Douglas Timmins, Assistant Auditor General		

Organizations and Individuals	Date	Meeting
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Treasury Board of Canada Secretariat

Charles-Antoine St-Jean, Comptroller General of Canada

David Moloney, Senior Assistant Secretary

APPENDIX B LIST OF BRIEFS

Organisations and Individuals

Canadian Institute of Chartered Accountants

Office of the Auditor General of Canada

Office of the Auditor General of British Columbia

Office of the Auditor General of Ontario

Treasury Board of Canada Secretariat

MINUTES OF PROCEEDINGS

Tuesday, December 12, 2006
(Meeting No. 32)

The Standing Committee on Government Operations and Estimates met *in camera* at 11:07 a.m. this day, in Room 269, West Block, the Chair, Diane Marleau, presiding.

Members of the Committee present: Harold Albrecht, Omar Alghabra, Hon. Navdeep Bains, Raymond Bonin, Daryl Kramp, Hon. Diane Marleau, James Moore, Richard Nadeau, Peggy Nash, Pierre Poilievre, Louise Thibault and Chris Warkentin.

In attendance: Library of Parliament: Guy Beaumier, Analyst; Philippe Le Goff, Analyst.

Pursuant to Standing Order 108(2), the Committee resumed its study on Accrual Budgeting.

The Committee resumed consideration of a draft report.

It was agreed, — That the draft report be adopted.

It was agreed, — That the report be entitled: *Accrual Budgeting and Appropriations in the Federal Government* .

It was agreed, — That the Chair, Clerk and analyst be authorized to make such grammatical and editorial changes as may be necessary without changing the substance of the report.

It was agreed, — That the Chair present the report to the House on Wednesday, December 13, 2006.

The Committee proceeded to the consideration of matters related to Committee business.

At 11:56 a.m., the Committee adjourned to the call of the Chair.

Bibiane Ouellette
Clerk of the Committee