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PUBLIC ACCOUNTS OF CANADA 2013

Report of the Standing Committee on Public Accounts

**David Christopherson
Chair**

APRIL 2014

41st PARLIAMENT, SECOND SESSION

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THE STANDING COMMITTEE ON PUBLIC ACCOUNTS

has the honour to present its

FIRST REPORT

Pursuant to its mandate under Standing Order 108(3)(g), the Committee has studied the Public Accounts of Canada 2013 and has agreed to report the following:

INTRODUCTION

The Public Accounts of Canada presents the federal government's consolidated financial statements. It is an important accountability report of the government that provides information to Canadians and parliamentarians about the government's financial performance over the previous fiscal year—its revenue, expenditures and budgetary balance. The statements also provide a snapshot of the government's financial position at the end of the fiscal year—its liabilities, assets and net debt.

The Auditor General of Canada provides an opinion and observations on the government's financial statements. The Auditor General examines whether the financial statements:

- present fairly, in all material respects, the financial position of the government;
- are prepared according to the government's own accounting policies; and
- apply accounting policies in a way that is consistent with previous years, while incorporating changes that are consistent with Canadian public sector accounting standards.

If the Auditor General concludes that these criteria are met, then he or she will provide an unmodified, or "clean," audit opinion. If, on the other hand, the Auditor General determines that there are enough misstatements in the financial statements that a person relying on them would be influenced to change his or her decisions, then the Auditor General will include a modification, or reservation, to his or her audit opinion. In addition, the Auditor General may provide observations on specific issues that he or she believes should be brought to the attention of Parliament, which—while important—are not considered of sufficient significance to alter the overall opinion on the statements.

Each year, the House of Commons Standing Committee on Public Accounts (the Committee) considers the Public Accounts of Canada and the Auditor General's opinion on them. This year, the *Public Accounts of Canada 2013* were tabled in the House of Commons on 30 October 2013, and the Committee held a hearing on 20 November

2013.¹ The Committee heard from: Nancy Cheng, Assistant Auditor General, Karen Hogan, Principal, and Louise Bertrand, Principal, from the Office of the Auditor General (OAG); James Ralston, Comptroller General of Canada, Sylvain Michaud, Executive Director, Government Accounting Policy and Reporting, and Michel Vaillant, Senior Director, Public Accounts Policy and Reporting, from the Treasury Board of Canada Secretariat; and Benoît Robidoux, Assistant Deputy Minister, Economic and Fiscal Policy Branch, and Douglas Nevison, General Director, Economic and Fiscal Policy Branch, from the Department of Finance Canada.

THE AUDITOR GENERAL'S OPINION

The Auditor General of Canada, Michael Ferguson, gave the federal government's consolidated financial statements for the fiscal year ending 31 March 2013 an unmodified opinion, the 15th consecutive year in which the government has received such an opinion. He concluded that the financial statements fairly presented the government's financial position, that the statements were prepared in accordance with the government's stated accounting principle, and that these principles were applied in a manner consistent with the preceding year.

It should be noted that the government introduced several accounting changes in the *Public Accounts of Canada 2013*. It gave retroactive effect to a change in the method of accounting for certain tax expenditures. According to new accounting standards adopted by the Public Sector Accounting Board, tax expenditures that provide a financial benefit through the tax system, and are not related to the relief of taxes paid or payable, are now shown as transfer payment expenses instead of being netted against the applicable tax revenue. In other words, some tax expenditures, such as the child tax benefit, are effectively like a cheque—they are a transfer that is administered through the tax system and will be recorded as such. The result of this change is to increase both tax revenues and transfer payment expenses, with no impact on the annual deficit. James Ralston, Comptroller General of Canada, explained that

¹ House of Commons, Standing Committee on Public Accounts, *Evidence*, 2st Session, 41st Parliament, 21 November 2013, Meeting 6.

the change in the standard was made in order “to better reflect the underlying nature of the transaction.”²

The government also adopted the revised recommendations of the Public Sector Accounting Board regarding government transfers, which did not have a material effect on the financial results for 2012–2013, and it recorded, for the first time, an obligation for the accumulated sick leave entitlements of certain employees of the public service, which increased the accumulated deficit by \$1.4 billion.

Nancy Cheng, Assistant Auditor General, complimented the government on its achievement of 15 consecutive unmodified audit opinions. She said:

As we have mentioned in the past this is rather rare in terms of the global situation on financial reporting on the government level. We're not aware of too many jurisdictions that actually have clean opinions on consolidated accounts let alone have 15 years of consecutive records like so. The closest I think we could find would be New Zealand and Australia whereby they have consecutive and modified opinions for about four or five years, but not anywhere close to what we have here in Canada.³

She added:

It requires a lot of due diligence on the part of the various departments and agencies that have a role in preparing the financial information. First and foremost, there needs to be the proper systems and processes to capture the data, there needs to be good systems of internal control to be able to ensure that the data collected would be valid, and then there needs to be the central exercise which is under the charge of the Comptroller General to make sure that there's proper consolidation, proper elimination of accounts, and where there are significant accounting judgment on estimates and more complex issues, the Comptroller General would work on those to make sure that we follow the standards.”⁴

Ms. Cheng also told the Committee that, in performing the audit on the *Public Accounts of Canada 2013*, “We have received excellent cooperation from both the Comptroller General's office as well as all the line departments and agencies.”⁵

² Meeting 6, 1645.

³ Meeting 6, 1540.

⁴ Ibid.

⁵ Meeting 6, 1610.

Mr. Ralston said that the 15th consecutive unmodified opinion from the Auditor General “testifies to the high standards of the government’s financial statements and reporting.”⁶

The Committee commends the government for continuing to maintain rigorous financial systems, processes and practices. The dedication and hard work of officials in federal government organizations, the Comptroller General’s office and the OAG mean that Canadians and parliamentarians can have confidence that the government’s consolidated financial statements are reliable. Nonetheless, the Committee noted a calculation error in the French version of the Public Accounts, and believes that every effort should be made to ensure that the English and French versions are in accordance.

NATIONAL DEFENCE – NON-FINANCIAL ASSETS

The Department of National Defence’s (DND’s) inventories account for \$6.5 billion of the government’s total \$7.5 billion in inventories. Its asset-pooled items, i.e., repairable spare parts, have a net book value of \$3.1 billion.

For most of the past 10 years, in the observations on the government’s consolidated financial statements, the Auditor General has been reporting that DND has had difficulties properly recording and valuing its inventory and asset-pooled items. Each year, these difficulties have resulted in hundreds of millions of dollars in adjustments to the government’s consolidated financial statements. The problems relate to pricing, verification of quantities and timely recording of transactions.

As the Committee was concerned with DND’s continued difficulties in this area, in its report on the *Public Accounts of Canada 2012*, it recommended that DND provide the Committee with a plan of how it intends to improve the proper recording and valuation of its inventory and asset-pooled items.⁷ The government’s response to this report, which was presented to the House of Commons on 16 October 2013, stated that

⁶ Ibid., 1535.

⁷ House of Commons Standing Committee on Public Accounts, *Public Accounts of Canada 2012*, Fourteenth Report, 1st Session, 41st Parliament, June 2013.

“[the Department of] National Defence has adopted a deliberate, integrated and systematic approach to improve its inventory management practices.”⁸

In his observations on the government’s consolidated financial statements for the year ending 31 March 2013, the Auditor General noted that while DND continued to work on its improvement initiatives, it had made limited progress in implementing effective compensating controls and process, and that the OAG had found errors that require numerous adjustments relating to valuation, completeness and accuracy of the quantities of inventory and asset-pooled items, as well as concerns with the timely recording of transactions. In addition, DND has extended its timeline to complete the work needed to put in place an effective risk-based system of internal control, which increases the need for effective compensating controls to be implemented in the interim.

With respect to this issue, Ms. Cheng told the Committee that:

[W]e have been reporting concerns about those items at [the Department of] National Defence for 10 years. We wish to re-emphasize the importance of taking action and actively monitoring the completion of these improvement initiatives. Given the nature and value of inventories and asset-pooled items, significant errors increase the risk of misstating the consolidated financial statements and making decisions without accurate information.⁹

She noted that the pricing differences were fairly significant for DND—over \$100 million—but were not large enough to be material and lead to a modified audit opinion.¹⁰

When asked to comment on DND’s overall work plan, as laid out in the government’s response to the Committee, Ms. Cheng said, “We basically just got a copy of it ourselves so we haven’t really looked at it closely, and it will be part of the audit that we would do in 2013-14.”¹¹

⁸ Government of Canada, *Government Response to the 14th Report of the Standing Committee on Public Accounts: Public Accounts of Canada 2012*, October 2013.

⁹ Meeting 6, 1530.

¹⁰ Meeting 6, 1600 and 1640.

¹¹ Meeting 6, 1600.

As DND continues to have difficulties with respect to the proper recording and valuation of its inventory and asset-pooled items, which lead to significant adjustments to the government's consolidated financial statements, the Committee encourages it to implement compensating controls and processes in a timely manner, in accordance with its work plan. The Committee will consider the OAG's examination of DND's progress in its audit of next year's consolidated financial statements.

FINANCIAL PERFORMANCE

The Public Accounts of Canada begins with a discussion and analysis of the federal government's financial performance during the preceding fiscal year, which is tied to the country's economic performance.

Canada had modest economic growth of 1.7% in 2012, rising to 2.2% in the first quarter of 2013. As of the second quarter of 2013, real gross domestic product (GDP) was 5.5% higher than its pre-recession level.¹² Benoît Robidoux, Assistant Deputy Minister at the Department of Finance Canada, compared Canada's economic performance to other countries, stating:

Despite being fairly weak over 2012–13, Canada's economy relative to other advanced economies is still doing very well. Again, despite exports being fairly weak in that year because of global developments, the domestic economy, which is consumption and investment by business, has been fairly strong in Canada's housing sector. It was kind of slowing at that time, but it was also contributing to growth. Those domestic conditions were good and supported the economy through that year. As a result, as many of our documents show, since the beginning of the recovery, Canada has been the best country in the G–7, relative to employment gain or GDP gain.¹³

In recent years, the government has included a downward adjustment for risk to revenues of \$3 billion within the fiscal framework to hedge against unexpected economic shocks. Mr. Robidoux told the Committee that Canada's GDP growth in 2012–2013 was lower than expected due to global developments, weak commodity prices and weak domestic prices, such that “the fall in GDP was important enough to go

¹² Receiver General of Canada, *Public Accounts of Canada 2013*, Volume I, page 1.3.

¹³ Meeting 6, 1555.

beyond the \$3 billion [adjustment for risk], which forced us to reduce our forecast for revenues. I guess in itself it speaks to the fact that the \$3 billion in some years is not enough to cover the potential high risk that we face.”¹⁴ Mr. Robidoux commented on the approach, stating, “This is a prudent approach to budgeting. It's supported by the IMF, the private sector economies we consult for, and the OECD.”¹⁵

The federal government posted a budgetary deficit of \$18.9 billion in 2012–2013, down from a deficit of \$26.3 billion in 2011–2012, with revenues up \$7.5 billion and total expenses up \$0.2 billion from the previous year.¹⁶ The ratio of revenues as a percentage of GDP was 14.1% in 2012–2013, down from an average of 18% over the 1996–1997 to 2000–2001 period.¹⁷ Mr. Robidoux explained why the ratio has been declining:

The revenue ratio has been declining essentially because of a reduction in tax rates, both for personal income and for corporate income, through that period. Plus there's the impact of the recession in that year, which played some role. But tax reduction has been a significant factor in that. They have not been increasing since then because the government has not increased tax rates in any way through that period. So it remains stable as a share of GDP.¹⁸

With respect to expenses, transfer payments to persons and other levels of government were up \$3.5 billion, other transfer payments were down \$2.9 billion, other program expenses were up \$1.5 billion, and public debt charges were down \$1.9 billion.¹⁹ When asked to compare the expenses of 2012–2013 to 2011–2012, Mr. Robidoux replied:

The government has a plan to balance, and part of that plan is to control spending. There is some control of spending for sure. ... If we go into detail and we look at transfers to persons and transfers to other levels of governance, that spending has been growing year after year. The part that is more stable or slightly declining is direct program spending. Overall, you

¹⁴ Ibid., 1615.

¹⁵ Meeting 6, 1615.

¹⁶ Receiver General of Canada, *Public Accounts of Canada 2013*, Volume I, page 1.4.

¹⁷ Ibid., page 1.5.

¹⁸ Meeting 6, 1650.

¹⁹ Receiver General of Canada, *Public Accounts of Canada 2013*, Volume I, page 1.7.

are right, that spending has been stable. ... It's a fact of life that public spending is not falling.²⁰

The government's accumulated deficit—the difference between total liabilities and total assets—increased by \$18.9 billion in 2012–2013 and stood at \$602.04 billion as of 31 March 2013.²¹ The accumulated deficit was 33.1% of GDP, up from a low of 29% as of 31 March 2009,²² and relatively unchanged from 34% as of 31 March 2010.²³ Mr. Robidoux confirmed that the government had achieved a flat-lined accumulated deficit as a percentage of GDP notwithstanding the world-wide economic recession and notwithstanding a number of tax reductions.²⁴

The ratio of public debt charges as a percentage of revenues has been decreasing, from 36.6% in 1990–1991 to 11.4% in 2012–2013.²⁵ Mr. Robidoux explained the significance of this change:

Well, the best way to describe the importance of it for every Canadian is to consider that back in [the 1990s], effectively one-third of every dollar in tax collected by the government was used to pay down interest, to service the debt. It was not directed specifically towards current services or used, for example, to fund new programs or reduce taxes; it was used to pay down interest on the debt. As of now, as you have said, we are down to about 11%, so only one-tenth of each dollar that we collect through taxes is used to service the debt, which allows more of the revenues to be directed towards services to Canadians or be used to reduce taxes so that Canadians pay less in taxes.²⁶

The government estimates that foreign holdings of its unmatured debt are \$175.9 billion, representing approximately 26.4% of the total unmatured debt.²⁷ Mr. Robidoux told the Committee that the share of foreign held unmatured debt had been increasing, because “[w]ith the crisis, we had suddenly an increase in [debt] emissions. Canada's fiscal situation across the world was good before the recession,

²⁰ Meeting 6, 1620.

²¹ Receiver General of Canada, *Public Accounts of Canada 2013*, Volume I, page 1.9.

²² Receiver General of Canada, *Public Accounts of Canada 2009*, Volume I, page 1.10.

²³ Receiver General of Canada, *Public Accounts of Canada 2010*, Volume I, page 1.10.

²⁴ Meeting 6, 1640.

²⁵ Receiver General of Canada, *Public Accounts of Canada 2013*, Volume I, page 1.6.

²⁶ Meeting 6, 1600.

²⁷ Receiver General of Canada, *Public Accounts of Canada 2013*, Volume I, page 1.10.

and it's even better now. Foreigners are quite interested in buying Canadian debt, and we have seen that they are doing so.”²⁸

Douglas Nevison, General Director at the Department of Finance Canada, told the Committee that the government’s debt management strategy is published as an annex to the budget and presented before Parliament. He continued:

The objective of the debt management strategy is to raise stable, low-cost funding while ensuring a well-functioning Government of Canada securities market. So there isn't a strategy to pursue or target-specific types of issuance. It's to get the lowest cost possible and appropriate debt structure. Since Canada is one of the global economy's few Triple-A credits with a good fiscal situation, there is a lot of demand for Canadian securities, particularly amongst central banks and sovereign wealth funds that are reallocating their portfolios towards a fairly secure asset.²⁹

The strategy is developed by the Department of Finance Canada in consultation with the Bank of Canada and with market participants. According to Mr. Nevison, “There's a significant investor relations program to make sure that we are tapping investor demand appropriately, getting the right structure of debt to pursue the objectives of the strategy.”³⁰

According to the Organization for Economic Cooperation and Development (OECD), Canada’s total government net debt-to-GDP ratio was 34.5% in 2012, which is the lowest among G-7 countries.³¹ Mr. Robidoux explained the result:

It reflects a fairly low debt at the federal level, a fairly low debt at most provinces--some provinces are almost in surplus. It also reflects net assets in the Canada Pension Plan and the Quebec Pension Plan to pay for future benefits of Canadians. ... Canada is one of the few countries that has set aside funds to pay for future pensions of Canadians. Very few countries do that, indeed, although it's the right thing to do.³²

²⁸ Meeting 6, 1700.

²⁹ Meeting 6, 1700.

³⁰ Ibid., 1700.

³¹ Receiver General of Canada, *Public Accounts of Canada 2013*, Volume I, page 1.14.

³² Meeting 6, 1555.

The loans, investments and advances of enterprise Crown corporations and other government business enterprises totaled \$133.3 billion as of 31 March 2013, compared to a total of \$14.6 billion as of 31 March 2004.³³ The loans are recorded at cost.³⁴ The fair market value of these assets may differ from their cost, such that a sale or outflow of the assets would affect the budgetary balance. Mr. Robidoux committed to follow up with the Committee about whether information about the fair market value of these assets exists.³⁵

CONCLUSION

For the 15th consecutive year, the Auditor General gave an unmodified, or “clean,” opinion on the federal government’s consolidated financial statements. It is a considerable achievement to have such an unbroken string of clean audit opinions—the OAG could only identify two countries that have consecutive, unmodified audit opinions for about four or five years. The Committee commends the work of officials in government organizations, the OAG and the Office of the Comptroller General for their efforts in assuring Canadians that the government has presented its financial position fairly.

DND continues to experience difficulties in the recording and valuation of its inventory and asset-pooled items, which has led to significant restatements during the preparation of the government’s consolidated financial statements. In its response to the Committee’s report on the *Public Accounts of Canada 2012*, DND set out a work plan and timelines for implementing corrective measures. The Committee will return to this issue when considering next year’s Public Accounts of Canada to ensure that DND is making adequate progress.

According to the Public Accounts of Canada 2013, “While Canada’s economic performance has been resilient, any setbacks in the global economic recovery can be

³³ Receiver General of Canada, *Public Accounts of Canada 2013*, Volume I, page 1.18.

³⁴ *Ibid.*, page 9.4.

³⁵ Meeting 6, 1720.

expected to have an impact on Canada.”³⁶ The government will need to take into account continued downside risks to the outlook for the Canadian economy.

³⁶ Receiver General of Canada, *Public Accounts of Canada 2013*, Volume I, page 1.3.

APPENDIX A LIST OF WITNESSES

Organizations and Individuals	Date	Meeting
<p>Department of Finance</p> <p>Douglas Nevison, General Director, Economic and Fiscal Policy Branch</p> <p>Benoît Robidoux, Assistant Deputy Minister, Economic and Fiscal Policy Branch</p> <p>Office of the Auditor General of Canada</p> <p>Louise Bertrand, Principal</p> <p>Nancy Cheng, Assistant Auditor General</p> <p>Karen Hogan, Principal</p> <p>Treasury Board Secretariat</p> <p>Sylvain Michaud, Executive Director, Government Accounting Policy and Reporting, Office of the Comptroller General of Canada</p> <p>James Ralston, Comptroller General of Canada</p> <p>Michel Vaillant, Senior Director, Public Accounts Policy & Reporting</p>	2013/11/20	6

MINUTES OF PROCEEDINGS

A copy of the relevant *Minutes of Proceedings* ([Meetings Nos. 6, 10 and 14](#)) is tabled.

Respectfully submitted,

David Christopherson
Chair

