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CANADA

Report on the Observance of Standards and Codes (ROSC)
Fiscal Transparency Module

Prepared by the Fiscal Affairs Department

Approved by Claudio M. Loser and Teresa Ter-Minassian

January 11, 2002

Executive Summary

This report provides an assessment of fiscal transparency practices in Canada in relation to the requirements of the IMF *Code of Good Practices on Fiscal Transparency* based on the authorities' response to the IMF fiscal transparency questionnaire and other documents provided by the authorities.

Fiscal management in Canada meets the requirements of the fiscal transparency code and in a number of instances represents best practice. Recent reforms by federal and provincial governments continue to improve transparency. The federal government has been particularly innovative in the use of private sector economic forecasts, prudence factors, and a contingency reserve in its fiscal forecasts. The federal and provincial governments extensively employ accrual accounting. Governments in Canada utilize a broad definition of activity by consolidating noncommercial public enterprises into the government universe and recording investments in commercial public enterprises on their balance sheets. Canada also deserves high marks for statistical integrity, impartial tax administration, open procurement, and a transparent regulatory process.

The staff suggested several areas where further improvements would be desirable. A principal improvement would be the preparation of timely, current year estimates of federal and provincial budgets on a comparable basis. Statistics Canada's Financial Management System is well developed in this regard and a good candidate for such a classification. An area for improvement for the federal government is the production of a comprehensive account of the procedures for the budget cycle and expenditure management system. The federal government could also account for the use of funds provided for noneconomic contingencies in the budget, on an ex post basis, by systematically reporting on the use of this reserve through parliamentary appropriations. Finally, the federal government should resume publishing reconciliations between its national and public accounts forecasts of major fiscal aggregates, at least over the forecast horizon. All governments should begin publishing estimates of the magnitude of quasi-fiscal activities.

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ABBREVIATIONS AND ACRONYMS

ARLU	Annual Reference Level Update
CCRA	Canada Customs and Revenue Agency
CHST	Canada Health and Social Transfer
CICA	The Canadian Institute of Chartered Accountants
CPP	The Canada Pension Plan
DBRS	Dominion Bond Rating Service
DMR	Debt Management Report
DMS	Debt Management Strategy
DPRs	Departmental Performance Reports
FAA	Financial Administration Act
FMS	Financial Management System
GAAP	Generally accepted accounting principles
GFS	Government Finance Statistics
NFPEs	Nonfinancial public enterprises
NPIs	Nonprofit institutions
OCG	Office of the Comptroller General
PFIs	Public financial institutions
PSAB	Public Sector Accounting Board
QFAs	Quasi-fiscal activities
QPP	The Quebec Pension Plan
RPPs	Reports on Plans and Priorities
SDDS	Special Data Dissemination Standard
SNA	UN System of National Accounts
TBS	Treasury Board Secretariat

I. Introduction[1]

1. This report provides an assessment of fiscal transparency practices in Canada against the requirements of the IMF *Code of Good Practices on Fiscal Transparency.* The authorities have completed the fiscal transparency questionnaire prepared by the IMF staff. The assessment has two parts. The first part is a description of practice, prepared by the IMF staff on the basis of the questionnaire response and additional information provided by the authorities. The second part is an IMF staff commentary on fiscal transparency in Canada. The focus of the assessment is on the federal government but given the size of provincial (and local) governments in Canada—as well as a number of innovative practices they have undertaken to increase transparency and accountability—some references are made to provinces' practice; their practices are not, however, assessed against the Code.

II. Description of Practice

A. Clarity of Roles and Responsibilities

2. **General government is clearly distinguished from the rest of the economy and is defined according to the 1993 System of National Accounts (SNA) and the Government Finance Statistics (GFS).** General government consists of the federal, provincial and territorial, and local governments, and the social security schemes, the Canada/Quebec Pension Plans (CPP/QPP).[2] It includes nonprofit institutions (NPIs) that are largely noncommercial in nature and mainly financed by governments. Nonfinancial public enterprises (NFPEs) and public financial institutions (PFIs) that are commercial are included in the government business enterprise sector, as per SNA conventions.[3] The CPP is a compulsory, contributory public pension scheme that provides retirement, disability, and death benefits and, since 1998, funds not required to pay CPP benefits and administration costs are invested in financial markets; the QPP is a similar plan. Pensions are the constitutional responsibility of the provinces, but the CPP is operated jointly with the federal government. The CPP and QPP are operated by independent boards and form a separate sector in the SNA.

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[1] Discussions were held in Ottawa, March–April 2001. The staff team, consisting of Messrs. Young (head) and Craig (FAD), met with officials from the Ministry of Finance, Treasury Board Secretariat (TBS) and Office of the Comptroller General (OCG), Statistics Canada, the Auditor General, and the Canada Customs and Revenue Agency (CCRA). It also met with staff of the Dominion Bond Rating Service (DBRS), financial market analysts, and officials from the provinces of Alberta and British Columbia.

[2] There are 10 provinces, 3 territories, and approximately 5,500 local government arrangements in Canada; for details see *Finances of the Nation*, Canadian Tax Foundation, 2000. For details on general government statistics and its operations see the Fund's Special Data Dissemination Standard (SDDS) for Canada http://dsbb.imf.org/country/can/ggobase.htm

[3] Nonfinancial public enterprises and public financial institutions are referred to as commercial or enterprise Crown corporations in Canada; noncommercial Crown corporations are referred to as departmental or "appropriations-dependent" Crown corporations.

3. **Statistics Canada produces intergovernmentally comparable statistics on what is called a Financial Management System (FMS) basis.** The FMS is the only conceptual framework or accounting system in Canada that provides for the federal government and, on a by-province basis, comparable revenue, expenditure, financial assets, liabilities, net debt, and spending by function.[4] National accounts data are available for the federal sector, the provincial sector and its subsector components, education (universities and colleges), health and social services institutions, and local sector at the Canada total level; unlike the FMS, however, there are no data on a by-province basis or for spending by function. There are ongoing efforts by the Public Sector Accounting Board (PSAB) of the Canadian Institute of Chartered Accountants (CICA) to have governments adopt common accounting standards in their public accounts;[5] CICA standards are generally accepted accounting principles (GAAP) for governments in Canada. The Canadian bond rating service, the Dominion Bond Rating Service (DBRS), makes a number of adjustments to provincial public accounts to make them more comparable, using standards recommended by the CICA; [6] the adjustments tend, however, to be ad hoc. The federal Department of Finance compiles current-year data on federal and provincial public accounts for monitoring and comparison purposes; they are published in the Fiscal Reference Tables, but only historically. Differences in the alternate measures of the budget balance can be significant (e.g., in the order of one percent of GDP between the national and public accounts federal balance).[7]

4. **Quasi-fiscal activities (QFAs) by NFPEs and PFIs do not appear to be extensive for the federal government and while some provinces use NFPEs to pursue noncommercial goals there is no quantification of their size.** At the federal level, QFAs are undertaken by financial institutions involved in housing, farm credit, small business loans, and export credits, but no information is published on these activities. The extent of QFAs at the provincial-local level appears to be more extensive but there is no quantification on their size. However, the consolidation of appropriation-dependent Crown corporations in financial statements on a line-by-line basis and the recording of investments in commercial

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[4] Using data from federal, provincial and local governments' public accounts, as well surveys of universities, colleges, school boards, and health and social services institutions, Statistics Canada standardizes financial statistics for differences in cash and accrual accounting, the definition of the government sector universe, and the recording revenues and expenditures on a gross, rather than net, basis. See *Financial Management System (FMS),* Statistics Canada, Public Institutions Division, System of National Accounts, January 2001.

[5] The Public Sector Accounting Board (PSAB) estimates that governments in Canada have adopted 80 to 85 percent of its recommendations for common accounting practices. See *Survey of Government Accounting, Federal, Provincial & Territorial Governments*, Public Sector Accounting Board, August 2000.

[6] See *CICA Public Sector Accounting Handbook,* Canadian Institute of Chartered Accountants, March 1999.

[7] For a discussion and reconciliation , albeit somewhat dated, of the differences between the public and national accounts measures of deficits and debt see "Measuring the Financial Situation of the Federal Government," *Quarterly Economic Review,* Department of Finance Canada, September, 1989.

Crown corporations on a modified equity basis[8] by the federal and most provincial governments ensure that the financial impact of the QFAs is captured in the budgets of each government.

5. **The central bank is independent and does not carry out QFAs.** The Bank of Canada is governed by the Bank of Canada Act. The Bank acts as the fiscal agent of the government. The Bank is responsible for the day-to-day operation of monetary policy and sets an inflation target jointly with the government. The Minister of Finance is responsible for the Bank. The Bank of Canada is not involved in commercial lending; it intervenes in foreign exchange markets and changes in foreign exchange reserves as a result of intervention are published monthly. The Bank prepares its financial statements according to Canadian GAAP and remits its entire profit to the government annually. The Bank of Canada's website is http://www.bankofcanada.ca.

6. **Government regulation of the private sector is carried out in an open and public manner**. Regulatory policy is the responsibility of Cabinet and a cabinet committee, the Special Committee of Council, is responsible for regulatory policy under a cabinet directive. The committee reviews proposed regulations to assess their impact. A cabinet paper, Government of Canada Regulatory Policy, sets out the principles and processes that departments should follow when developing regulatory interventions. The policy development process aligns closely with OECD procedures and principles[9] and requires the preparation of Regulatory Impact Analysis Statements. Draft regulations and impact statements are usually published in the Canada Gazette followed by a 30-day comment period prior to being considered by the Special Committee of Council for approval.

7. **Government equity holdings in private companies are limited and are clearly reported in the Public Accounts of Canada**. The main government holdings include 18 per cent of the shares of Petro-Canada, a mixed enterprise, and an 8½ percent interest in the Hibernia oil project, through a Crown corporation. By statute,[10] the government is required to submit an annual report to Parliament on the consolidated activities of all parent corporations and other corporate interests.[11] All Crown corporations are required to prepare annual reports and audited financial statements.

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[8] On the equity method of accounting, a government's investment in a government business enterprise is recorded in its financial statements. On a modified equity basis, the equity method of accounting is modified only to the extent that the enterprise's accounting principles are not adjusted to conform with those of the government (see CICA Handbook, section PS 3070). Use of the modified equity basis has the effect that a government's budget balance is not affected by the timing of dividend payments from its Crown corporations.

[9] The OECD's *Regulatory Checklist for Improving the Quality of Government Regulation,* 1995.

[10] Sections 151 and 152 of the Financial Administration Act (FAA).

[11] See *Crown Corporations and Other Corporate Interests of Canada,* 2000, Treasury Board of Canada.

8. **The powers and responsibilities of the federal and provincial levels of government are clearly defined in the Constitution Act, 1982.**[12] Both have broad taxing and spending powers. There are no restrictions on provincial borrowing by the federal government. Local governments are not defined in the constitution; they only have powers delegated to them by provinces. The constitution provides the federal government with exclusive power over defense, foreign affairs, trade and commerce, citizenship, and monetary policy. Provincial governments have exclusive powers over property and civil rights, health, and education. Areas where both levels of government share a role include agriculture, environment, and social policy. The federal government provides significant financial support to the provinces and territories through transfers for equalization, the Canada Health and Social Transfer (CHST), and territorial formula financing.[13] The details governing these transfers are contained in the Federal-Provincial Fiscal Arrangements Act, agreements between the federal and territorial finance ministers, and related regulations.

9. **The federal government may raise revenues by any means while provincial governments have the right to impose only direct taxes.** In practice, both levels of government jointly occupy most tax fields. The federal and provincial governments have entered into tax collection agreements covering personal and corporate income taxes; nine provinces participate in the agreements for personal taxes and seven for corporate taxes.[14] The federal government also has comprehensive agreements with three provinces for the administration and collection of harmonized federal and provincial sales taxes.

10. **The expenditure responsibilities and taxing powers of local governments differ across provinces.** These powers are set out in separate legislation at the provincial level. Local governments receive transfers from both the federal and provincial governments. They may borrow in their own right; however, borrowing arrangements for local governments vary considerably between and within provinces and are typically restricted to capital projects and even then with provincial approval. In a number of cases, local governments borrow through municipal financing agencies operated by provincial governments in order to lower borrowing costs through a provincial guarantee of their borrowing.

11. **Canada is a constitutional monarchy and the roles of the executive, legislative, and judicial branches in financial management are clearly defined.** The executive branch is responsible for proposing the budget and for the use of the public funds approved by the

[12] The Constitution Act is available on the Justice Canada's website http://canada.justice.gc.ca/.

[13] These programs were over $40 billion or 4 percent of GDP in tax and cash transfers in 2000-01. The transfers for equalization and territorial formula financing are unconditional. For the Canada Health and Social Transfer (CHST), provinces must adhere to national standards for health care under the Canada Health Act, including comprehensive scope, universal coverage, and portability; the federal government can withhold payments for user fees and extra billing.

[14] The tax collection agreements and federal/provincial roles in income taxation are detailed in the paper 'Tax on Income' which was included in the document "Administration of Provincial Taxes: New Directions," January 25, 2000.

legislature. Some funds are approved on an ongoing basis by statute (e.g., old age security) while others are voted annually in appropriation bills. The legislature must authorize the executive's proposals to raise revenues by borrowing, taxation, and other levies. The legislature exercises oversight of the budget process via parliamentary committees and the Auditor General, an officer of Parliament. The civil service is responsible to the Prime Minister and Cabinet for the administration of public finances. The judiciary branch, consisting of various federal courts culminating with the Supreme Court, is independent of the executive and adjudicates cases dealing with financial law, including those involving the executive.

12. **A clear legal and administrative framework defines financial management.** The legal framework for financial management for the federal government is contained in the Financial Administration Act (FAA). The FAA provides for the financial administration of the Government of Canada, the establishment and maintenance of the accounts of Canada including parliamentary control of all public funds into and out of the Consolidated Revenue Fund (in effect a single treasury account), the office of the Receiver General, the powers and functions of the Treasury Board and Comptroller General, and the control of Crown corporations. The Department of Finance is responsible for fiscal and economic policy and the budget; the Treasury Board Secretariat (TBS) is responsible for operating and capital expenditures, as well as the general management of government. Under the FAA, the government is required to report on its financial activities in the Public Accounts. Provinces have similar requirements for financial administration.

13. **The government does not undertake extrabudgetary or off-budget activities.** Budgetary transactions consist of revenues and expenditures that impact directly on the government's deficit or surplus. For federal and provincial governments, financial statements are balance sheets consisting of all financial obligations to outside parties as liabilities but only financial assets as assets.[15] The difference between liabilities and financial assets is called net debt; the year-to-year change in net debt is the annual budgetary deficit or surplus. Liabilities include allowances for employee benefits, for loan guarantees and borrowings of Crown corporations that are not expected to be repaid, and for other accrued liabilities. These allowances are audited by the Auditor General. Assets include an allowance for estimated losses on the realization of loans, investments, and advances.

14. **In Canada, an important distinction in governments' financial statements is between budgetary and nonbudgetary transactions.** Nonbudgetary transactions are financial transactions consisting of offsetting liabilities and assets and do not affect net debt.

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[15] For the federal government, this will change with the adoption of full accrual accounting and the expensing of capital assets; the depreciated value of capital will be recorded as assets. The government had intended to move to full accrual accounting in the fall of 2002 with the release of its final audited financial statements for 2001–02. In the December 2001 budget, it was announced that the introduction of full accrual accounting would be delayed for at least a year; the government cited the need to verify and audit certain components of the information needed to move to accrual accounting as contributing to this delay.

They are of three principal types: interest and debt accounts; loans, investments and advances; and trusts or specified purpose accounts. The conversion from accrual to cash accounting is contained in nonbudgetary transactions. Nonbudgetary transactions give rise to sources or requirements for funds.[16] For the federal government, the major specified purpose accounts are for public sector pensions in which the government records a liability for the difference between annual credits to the pension accounts (contributions and accrued interest) and benefits paid. With the new public service pension beginning April 1, 2000, excess contributions to the pension plans are invested in financial markets rather than recorded in nonbudgetary transactions as a liability of the federal government. Nonbudgetary transactions are well defined, transparent, included in the Public Accounts, and audited.

15. **Mechanisms for the coordination of budget with PFIs are well defined.** Principal federal financial institutions are the Business Development Bank (loans to small- and medium-sized business), the Canada Mortgage and Housing Corporation (mortgage insurance), the Export Development Corporation (export credits and insurance), and the Farm Credit Corporation (mortgages). Their annual losses or profits are included in the government's financial statements on a modified equity basis. Fiscal activities that are financed by budgetary transfers and administered by Crown corporations on the government's behalf are identified and reported in the Public Accounts.

16. **The legislative basis for taxation, regulation, and administrative procedures is clear and observed in practice.** At the federal level, all tax liabilities, credits, deductions, and exemptions are codified in statutes enacted by Parliament and regulations issued by the Governor General. Tax laws and regulations are published and readily available.[17] Provisions of law are administered by the Minister of National Revenue through the Canada Customs and Revenue Agency (CCRA). The agency is subject to both internal audit and annual external audit by the Auditor General. A Declaration of Taxpayer Rights requires it to apply all tax laws consistently and fairly. The CCRA provides comprehensive information to assist taxpayers through interpretation bulletins and information circulars. The CCRA also provides advice on how specific transactions will be handled under tax law. There is a "Fairness and Equity" package that provides guidelines for: objections and appeals; the cancellation and waiver of interest and penalties; extraordinary refunds; and the acceptance of late, amended or revoked elections. All taxpayers have rights of appeal to the CCRA, to the Tax Court of Canada and, ultimately, to the Supreme Court. The courts are fully independent and have the power to override the CCRA's interpretation of tax law. Employees of the CCRA are protected by public service employment provisions and must comply with a code of conduct and conflict of interest guidelines. Similar arrangements exist at the provincial level for the legislation and administration of provincial taxes.

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[16] Nonbudgetary or internal sources of financing can be significant; in 1998–99 nonbudgetary transactions resulted in a net source of funds of $8.6 billion or 1 percent of GDP for the federal government.

[17] The main tax legislation at the federal level is the Income Tax Act, the Income Tax Application Rules, the Customs Act, the Customs Tariff Act, and the Excise Act.

17. **Public service employees are subject to a code of behavior.** The code, Conflict of Interest and Post-Employment Code for the Public Service, is similar to the United Nations' International Code of Conduct for Public Officials. It applies to public service employees for whom the Treasury Board represents the government as an employer. It sets out compliance requirements for conflict of interest and post-employment, as well as for trusts for employees on interchange agreements. Parliamentarians and senior public office holders appointed by order in council fall under a different but quite similar code administered by the Office of the Ethics Counselor. Federal public service employees are required to swear an oath of office and secrecy and an oath of allegiance as prescribed under the Public Service Employment Act.

B. Public Availability of Information

18. **The federal and provincial budget documents provide a comprehensive coverage of fiscal activity at each level of government.** However, it is difficult to construct comprehensive up-to-date data on general government activity for the federation as a whole. At the federal level, the budget document consolidates all budgetary and nonbudgetary expenditures and the operations of noncommercial Crown corporations. The budget contains key revenue and expenditure aggregates for the initial budget year and the two following years. The estimates are compared to the last revised estimate for the current fiscal year and actual outcomes for the two preceding years. The Main Estimates, which are presented shortly after the budget, contain expenditures by department and an economic classification of expenditures required for the Public Accounts. The budget estimates are updated in the fall in the Economic and Fiscal Update; throughout the year additional expenditures are approved by Parliament in Supplementary Estimates.[18] The documents for the budget and update are available on the Department of Finance's website http://www.fin.gc.ca/). Most provincial governments follow a similar approach to their budgets and financial reporting and have mid-year economic and fiscal updates.

19. **Reports are provided on contingent liabilities and tax expenditures but there is no information on quasi-fiscal activities.** A statement of contingent liabilities for the preceding fiscal year is provided in the report of the Public Accounts to Parliament.[19] The Public Accounts detail the types of contingent liabilities and individual accounts include

[18] Supplementary Estimates are used to obtain authority for revised spending levels that Parliament is asked to approve in an appropriations act, including expenditures required to meet contingencies; they also provide Parliament with information on changes to statutory expenditures. Supplementary estimates are a normal part of the process of obtaining parliamentary approval for changes to appropriations; they differ from a supplementary budget in that they do not involve a change in the fiscal policy stance.

[19] For the federal government, contingent liabilities include loan guarantees for enterprise Crown corporations, contingent liabilities of consolidated Crown corporations, insurance and guarantee programs of the government, callable share capital for international organizations, liabilities for native land claims, and claims for pending and threatened litigation. Most provincial governments also publish annual data on contingent liabilities.

allowances against those liabilities for which a valid assessment of possible cost can be made. While the Auditor General and Comptroller General scrutinize these allowances, the details are not disclosed since that may create a moral hazard for the government (e.g., in respect of allowances for litigation, pay equity, or collective agreements). No separate information on contingent liabilities is included in the budget documentation but a general reserve is included in spending as an undisclosed allowance for the likely realization of contingent liabilities over the budget planning horizon. The size of this reserve is not identified and it is included in "other" departmental spending in the budget. There are no policy reserves in the expenditure framework but an operating reserve for voted appropriations; the size of the operating reserve is not public.[20]

20. **A report is published each spring that provides estimates and projections for federal tax expenditures.** [21] The report provides estimates and projections for concessions from a benchmark tax structure. Canada takes a broad approach in reporting tax expenditures; it reports on items that could be considered as tax expenditures from a narrowly defined benchmark tax system as well as additional items which are reported as memorandum items. Information on tax expenditures at the provincial level is not generally available. For example, Alberta, which otherwise has a high degree of fiscal transparency, recently introduced an energy cost concession to households which is not included in a tax expenditure statement; conversely, British Columbia publishes tax expenditures, including tax expenditures arising from following federal concessions.

21. **Data on government debt and financial assets are regularly reported.** A Debt Management Report (DMR) and a Debt Management Strategy (DMS) are published annually by the Department of Finance. The DMR provides a comprehensive record of the federal government's debt operations for the previous fiscal year; it must be tabled in Parliament within 45 sitting days of the tabling of the Public Accounts. The DMS provides detailed information on the federal government's debt management strategy for the coming fiscal year; it must be tabled before the end of the current fiscal year. Data on financial assets, including international reserves, are included in the Public Accounts and the DMR. Information on the level and composition of debt and financial assets is also released monthly in the Fiscal Monitor. The data, which are included in the IMF's Special Data Dissemination Standard (SDDS), include: total gross outstanding debt, broken down into current liabilities and interest-bearing debt, with interest-bearing debt further broken down into market debt, pension liabilities, and other accounts; outstanding market debt, broken down into debt payable in domestic and foreign currencies, both further broken down by type of security; a breakdown of total gross outstanding debt by short-term and long-term maturity on a remaining residual maturity basis; and total outstanding loan guarantees.

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[20] Some additional funds are also available for "Program Integrity" to meet shortfalls in funding that have arisen from periods of restraint and which are needed to ensure that programs are sustainable. The adjustments, generally small, require Cabinet approval on the basis of recommendations from the TBS.

[21] *Government of Canada Tax Expenditures* (http://www.fin.gc.ca/toce/200/txexpnote.html).

22. **There is a public commitment to produce regular fiscal reports.** After the financial year is completed, the Department of Finance publishes the Annual Financial Report that covers the government's revenue and expenditure performance in the past year and details the factors affecting the results compared to forecasts. A set of Fiscal Reference Tables accompanies the Annual Financial Report and provides summary financial information back to 1946–47 and detailed historical information on federal revenue and expenditures and balance sheet data back to 1961–62. Subsequently, the detailed annual Public Accounts of Canada are published in the fall providing comprehensive audited details on actual expenditures in the previous fiscal year.[22] The Public Accounts can be viewed at the Receiver General's website http://www.pwgsc.gc.ca/recgen/text/pubacc-e.html. All provinces and territories produce final accounts within 12 months of fiscal year-end. Six provinces report on their financial activities quarterly, within two or three months of quarter-end.

23. **Defense expenditures are included in the budget**, as are expenditures for security and police. When the government adopts full accrual accounting, defense equipment will be shown in the balance sheet and depreciated over time.

24. **Canada subscribes to the IMF's SDDS** and meets all data dissemination standards for fiscal data; it produces an advance release date calendar showing times of release of fiscal data as required under the SDDS. For general government operations, covering the government sector as defined in the 1993 SNA, precise release dates for the next 15 months are announced by Statistics Canada in the "The Daily" in November of each year (see Statistics Canada's website http://www.statcan.ca/). For central government operations, the one-quarter ahead approximate release dates for the monthly Fiscal Monitor are disseminated on the Department of Finance's Internet site.

C. Open Budget Preparation, Execution, and Reporting.

25. **The budget preparation process is open and extensively documented.** Canadian governments have taken a number of steps to strengthen their budget preparation processes in recent years. The federal government prepares its fiscal projections on the basis of average private sector economic forecasts, a prudence factor for economic risks, and a contingency reserve to cover risks from forecasting inaccuracies and unpredictable events. Box 1 contains a detailed description of the federal budget process.

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[22] There is a legal requirement in the FAA to present audited accounts to Parliament by December 31 following the fiscal year ending March 31 but the authorities have made an administrative decision to meet a September/October deadline.

Box 1. The Federal Budget Process in Canada

Canada's budget process formally begins in the fall with the presentation of an Economic and Fiscal Update to the House of Commons Committee on Finance. In preparation for the update, Department of Finance officials meet with the chief economists of the major chartered banks and private sector economic forecasting firms to agree on a set of economic assumptions for planning purposes. Based on this common set of assumptions the forecasting firms develop projections of the fiscal aggregates for the current fiscal year and each of the next five years. The forecasts are based on existing policy assumptions.

The Department of Finance makes two adjustments to the private sector estimates of the budget balance. First an amount for "economic prudence" is established, based on an analysis of the risk to the budgetary projections of variations in key economic assumptions, such as GDP growth and interest rates. Second, an annual contingency reserve is set aside. The contingency reserve provides an extra measure of back-up against errors in the economic forecast. If not needed, it is used to pay down debt. The contingency reserve had been in the order of $3 billion per year. In the December 2001 budget, the contingency reserve was scaled back and the amount for economic prudence eliminated. The government intends to rebuild the normal reserve and contingency factor as soon as possible. The update document provides the economic and fiscal context to the public discussions of and consultations on the overall budgetary strategy and initiatives for the upcoming budget. The key forum for these discussions is the parliamentary Committee on Finance. Based on public consultations, the committee provides its recommendations for the upcoming budget before the end of the calendar year.

In the period leading up to the February budget, the Department of Finance provides an update of the fiscal aggregates presented in the fall update. This update is based on the average private sector economic forecasts, which is used by the department to generate an estimate of the budget surplus or deficit. The department fleshes out detailed statutory estimates, translates the private sector forecasts from the national accounts to public accounts used in the budget, and makes detailed refinements to the fiscal forecast. After allowing for the prudence factor and the contingency reserve, the scope for new policy initiatives is gauged. An important element in the revised budgetary projections is the revisions to the costs of existing nonstatutory programs. These revisions are determined by the Treasury Board Secretariat (TBS) in a process known as Annual Reference Level Update (ARLU). The results of the ARLU reflect updates to ministries and agencies three-year business plans, determined in consultation with TBS. In practice, this involves adjustments to about 35 percent of total expenditures that are, for the most part, expenditures appropriated annually—the so-called voted expenditures. Most expenditure reference levels are set in nominal terms on a three-year rolling basis and departments and agencies are expected to generate efficiency gains to offset any larger-than-expected cost increases. Nevertheless, some ARLU adjustments are required to take account of unavoidable cost increases (e.g., exchange rate adjustments for overseas operations).While the projections in the update are presented over a five-year period, the fiscal projections presented in the budget and budget objectives are identified over a rolling two-year planning horizon (though expenditures must be voted annually). The government follows this approach to help ensure that it does not commit resources which may not materialize over the medium term.

A separate process is followed for new policy initiatives. Ministers present their proposals through the cabinet committees for economic policy and social policy, which ultimately identify those proposals to go forward for final consideration by Cabinet. The budget documents distinguish between new and existing policies, with new policies being separately documented.

There are two main sets of budget papers—the budget and the estimates. The budget speech presents the government's major policy initiatives. The Minister of Finance also tables various budget documents, including the Budget Plan. It provides the government's overall plan for revenues and expenditures, including a separate costing of new initiatives and existing policies.

Box 1. The Federal Budget Process in Canada (continued)

The President of the Treasury Board tables the estimates in four parts. Part I, the Government Expenditure Plan, links total planned spending in the budget to the Main Estimates while Part II, the Main Estimates, supports annual spending legislation. They are tabled together several days after the budget. They contain detailed plans for both statutory expenditures and expenditures that are voted for the coming fiscal year, tabulated by department and agency. They include summary classifications, including departmental and agency expenditures classified by major line of business and as well as by economic object. The Main Estimates do not include funding for new policy initiatives announced in the budget which require Cabinet and parliamentary approval. Once approval is obtained, authorization for this spending is normally sought in Supplementary Estimates.

Part III of the estimates is comprised of two components: departmental Reports on Plans and Priorities (RPPs) and Departmental Performance Reports (DPRs). They are prepared by individual departments and agencies and are tabled by the President of the Treasury Board. The RPPs, which must be tabled no later than March 31, contain information on total planned spending announced in the budget, including amounts not yet included in departmental estimates, and on objectives, initiatives and planned results, including performance measures and financial plans, over a three-year time horizon. Eighteen months later, in late October or early November, corresponding departmental and agency DPRs, which report on performance in relation to the expenditure plans and expected results presented in the RPPs, are tabled. Estimates publications can be accessed at the TBS website (http://www.tbs-sct.gc.ca/tb/estimate/ESTIME.HTML).

26. **Clear fiscal targets are set.** The federal fiscal policy presently aims to achieve a "balanced budget or better" to ensure that the public debt-to-GDP ratio remains on a clear downward track. Although the ex ante target aims at budget balance, the prudence allowance and contingency reserve have led to de facto budget surpluses. While the government provides projections of future debt levels, it has not set a formal debt target. The Fiscal Reference Tables provide historical estimates of federal and general government cyclically adjusted and primary-cyclically adjusted budget balances but there is no forward-looking calculation of these balances in the budget document. Most provincial governments—including the largest provinces of Ontario, Quebec, British Columbia and Alberta—have legislated fiscal rules that, in all but one case, involve balanced budget legislation with varying degrees of flexibility and sanctions for not meeting fiscal targets.

27. **Performance against aggregate fiscal targets is carefully monitored at both federal and provincial levels.** At the federal level, the Department of Finance publishes a monthly Fiscal Monitor that provides comprehensive financial information on budget outcomes in accordance with the conventions followed in the Public Accounts. The Fiscal Monitor focuses on net pubic debt; the budget balance; and financial requirements or surplus.[23] There are presently no within-year reports on program performance by departments and agencies at the federal level. However, the government's policy reviews (recently replaced by new Internal Audit and Evaluation Policies) require departmental managers to

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[23] Financial requirements or surplus correspond to the budget balance plus nonbudgetary transactions and constitute borrowings or retirement of market debt on capital markets.

monitor, evaluate and audit key aspects of their programs and performance. These studies are made available throughout the year to Parliament and the public as a matter of policy, subject only to privacy and security constraints. The TBS leads evaluations on selected programs and provides Parliament with a report "Managing for Results" that includes information on collective results and societal indicators. It accompanies DPRs for all departments and agencies for the previous fiscal year.[24] Similar procedures apply at the provincial level where both quarterly and annual reports are generally available on fiscal operations and measures of program performance.

28. **Some analysis of economic risks is undertaken.** Sensitivity of federal budget aggregates to macroeconomic variables is published in the budget documents. Similar analyses appear in many provincial budgets. The federal budget document does not include a comprehensive analysis of fiscal risks nor the medium- to longer-term sustainability of fiscal policy. Some of the key issues affecting fiscal sustainability analysis are outside the federal budget process. In particular, the Office of the Chief Actuary prepares actuarial reports on the financial status of the CPP.[25] Studies are being undertaken on the longer-term costs of ageing, including health care, as part of a study with the OECD.[26]

29. **All government accounts are regularly reconciled with both appropriations and bank accounts.** The federal public accounts include two cash reconciliations: a statement of Changes in Financial Position that present the net change in cash from operations, investments, and foreign exchange activities after accounting for financing activities; and a Summary Statement of Transactions that shows the extent to which cash coming into the government exceeds cash going out and the net reduction in borrowing. Budgetary and nonbudgetary transactions, foreign exchange, and unmatured debt are reconciled to bank deposits at the end of year.

30. **Clear statements of accounting policy are included in the budget and the Public Accounts.** The accounts of federal and most provincial government are currently on a modified accrual basis (i.e., accrual accounting of all liabilities and financial assets, but excluding capital assets). Standards are set by the PSAB of the CICA. The federal government intends to move to full accrual accounting next year, including the capitalization of all nonfinancial assets. Federal government accounting standards are GAAP, endorsed by

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[24] The TBS also releases evaluation reports on selected performance issues during the course of each year and is piloting a mechanism by which up-to-date planning and performance information will be available on-line.

[25] Concerns about the sustainability of the Canada Pension Plan (CPP) led to passage of legislation in 1998 to put the system on an actuarially sound basis. Contribution rates are gradually being increased from 6.4 percent of contributory earnings in 1998 to 9.9 percent in 2003 at which point the ratio of assets to expenditures is expected to remain constant over the long run.

[26] See Dang, T.T., P. Antolin and H. Oxley (2001), "Fiscal Implications of Ageing: Projections of Age-Related Spending," *OECD Economics Department Working Papers No. 305.*

the PSAB and the Auditor General, and accord with OECD best practice.[27] The government employs modified equity accounting for its investments in enterprise Crown corporations and plans to move to full equity accounting. The Comptroller General has published a manual detailing the changes in accounting required by the change to accrual accounting.

31. **Internal management controls are open and effective.** Controls over finances, procurement, and employment in general government are of a high standard. Ministries and agencies are required to audit their programs and operations to assess whether the management framework is well designed and working as intended. Internal audit policy and standards provide departments with a basis for carrying out cost self-assessment and improving quality. Audit findings and recommendations are used to achieve program and operating objectives, including good stewardship and accountability in the use of departmental resources. The government adheres to international trade agreements and protocol in its purchasing arrangements.[28] Employment and pay regulations are well defined and clearly stated; appointments are made on the basis of open competition and merit.[29] Terms and conditions of employment are set out in the relevant collective agreements under the authority provided in the Public Service Staff Relations Act. These are supplemented in the Public Service Terms and Conditions of Employment Regulations and other policies under the authority provided in the FAA. The Clerk of Privy Council, as the head of the public service, reports annually to the Prime Minister and to Parliament on the public service.

D. Assurances of Integrity

32. **Independent auditors at both the federal and provincial level carry out external audit.** At the federal level, the Auditor General is independent of the government and is appointed for a ten-year period. The Office has the freedom to recruit its own staff and set the terms and conditions of employment for its staff. The Auditor General Act provides the right to request any information needed to meet its specified responsibilities. The Auditor General submits reports directly to Parliament and these reports are publicly available. The reports are often discussed at the Public Accounts Committee. Those that require a follow-up response must do so within a predetermined time frame. Audited agencies are expected, but not

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[27] *OECD Best Practices for Budget Transparency*, OECD, Public Management Service, September 2000.

[28] Canada is a signatory to the World Trade Agreement on government procurement as well as the procurement provisions of the North American Free Trade Agreement. Governments in Canada also adhere to the provisions of the Agreement on Internal Trade. All three agreements require the use of the on-line electronic tendering service, MERX, for government contracts in excess of $2 million.

[29] The federal government public service employment arrangements are set out in several pieces of legislation. The FAA empowers the Treasury Board to act as employer and to set job classification and employment standards. The Public Service Staff Relations Act governs collective bargaining. The Public Service Employment Act gives the Public Service Commission, an independent agency reporting to Parliament, responsibility for oversight of the appointment to the public service on the basis of open competition and the principle of merit. Responsibility for these policies is delegated to the heads of ministries and agencies, under the oversight of the Treasury Board and the Public Service Commission.

required, to respond to comments on issues raised by the Auditor General and a report is subsequently made to Parliament. The Auditor General and external auditors audit the financial statements of Crown corporations. Similar arrangements apply at the provincial level. Annual reports and other publications are available through the Auditor General's website (http://www.oag-bog.gc.ca/).

33. **Existing audit capacity is strong at both federal and provincial level.** The audit profession has played an important role in promoting transparent fiscal practices in Canada. Financial audits at the federal and most provincial level are conducted in accordance with the standards prescribed by the PSAB of the CICA. Audits are conducted to assess whether the financial statements are free of material misstatement and include an assessment of the reasonableness of significant estimates made by the government. The appropriateness of the accounting policies is reviewed and the overall presentations of the financial statements are evaluated. There has been a considerable expansion in value for money audits in recent years for all governments and at the federal level this activity now constitutes the largest resource commitment in the audit function.

34. **Macroeconomic models and economic assumptions are subject to external scrutiny.** The economists of Canada's chartered banks and major forecasting groups prepare the macroeconomic forecasts used. Internal forecasts and updates are also prepared using the Department of Finances econometric model. The Department of Finance's macroeconomic model is published and available to the public.

35. **The national statistics office is given legislative assurance of independence**. All statistics collected and published by Statistics Canada are governed by the Statistics Act. The legislation establishes the independence of Statistics Canada. The Act requires Statistics Canada to publish data on the national accounts, including general government operations. As a government agency, neither the government or Parliament can annul or otherwise interfere with decisions made by Statistics Canada in the application of its mandate. The Statistics Act prescribes that statistics are to be objective and available to the public. Statistics Canada cannot publish, or otherwise make available, statistics that would enable the identification of data for any individual person or entity. The Statistics Act can be accessed the Justice Canada website http://www.canada.justice.gc.ca/.

III. Staff Commentary

36. **Fiscal management in Canada is of a high standard and meets or exceeds the requirements of the fiscal transparency code.** Both the federal and provincial governments have made conscious efforts to make their fiscal operations transparent. Reforms at the federal level include:

- the innovative procedures used to develop the macroeconomic framework for fiscal policies, including the use of private sector forecasts and explicit factors to allow for uncertainty, including a contingency reserve;

- the use of this framework to lay out an indicative five-year program for taxation, spending initiatives, and debt reduction;

- the announced intention to move to full accrual accounting;

- the extensive reporting of departmental and agency program objectives, plans, initiatives, performance measures, and financial plans over a three-year time planning horizon;

- the comprehensive reporting on financial operations for the broad government sector, including Crown corporations and other corporate interests;

- the clear responsibilities for the federal and provincial governments and transparent arrangements for equalization and the block funding of health and social services; and,

- statistical integrity, impartial tax administration, a transparent regulatory process, and open procurement.

The federal government meets OECD best practice with respect to the comprehensive reporting of financial assets and liabilities including market debt, the timely publication of fiscal data, an assurance of independent economic and fiscal forecasts, and an independent national audit authority reporting to Parliament, to mention a number of practices.

Similar initiatives are evident at the provincial level, several of which are providing the lead in developing new techniques for performance measurement, comprehensive accounting for government, and regular financial reporting.

37. **Nonetheless, there is scope for improvement in a few areas; perhaps the most important is the need to improve the information on fiscal developments for general government.** While member governments of the federation are quite transparent with respect to their own fiscal operations, these elements are difficult to consolidate into a transparent whole on a timely and consistent basis. Thus, in terms of the Fund's Code, it is difficult for observers to put together comprehensive data on national fiscal operations covering the latest fiscal year plus budget year estimates and forward years. This difficulty reflects the diversity of budget techniques and is not easily overcome.

38. **Another issue, at both federal and provincial levels, is the development of more comprehensive fiscal strategy statements in budget documents.** While present documents provide useful discussions of the likely future evolution of fiscal policy, it would be useful if such statements could be expanded to provide additional qualitative and, to the extent appropriate, quantitative material on any flexibility in targets to deal with developments over the business cycle and to the sustainability of fiscal policy, particularly in respect to medium- to longer-term developments, including the aging of the population. The importance of the long-term costs for public pensions and health underscores the need for sustainability analysis at the general government level.

39. **An issue that warrants consideration at the federal level is the regular publication of the procedures used to prepare the budget, the budget cycle, and the expenditure management system.** This would include the procedures used to develop the macroeconomic forecasts, including the roles played by the Ministry of Finance and the private forecasters, and the step-by-step development of the estimates for both statutory and voted expenditures in the budget cycle.

40. **It would also be desirable to publish a reconciliation between the national accounts fiscal forecasts produced by the private sector and the public accounts forecasts used by the government in the budget, at least over the forecast horizon.** The government used to publish this reconciliation in the budget and in the Public Accounts. Providing a reconciliation in the budget would increase transparency as private sector forecasters project fiscal data on a national accounts basis and the Department of Finance translates this data to a public accounts basis for the budget. Statistics Canada should document and publish a reconciliation between the two sets of data on a historical basis.[30]

41. **There should be an ex post accounting of the use of the funds in the reserves for noneconomic contingencies, including appropriations, and a clear presentation of this item in the government's budget and financial statements.** Ex ante, the government should identify the reserves in the budget.

42. **Information presently available elsewhere should be brought into the main budget and Economic and Financial Update documents so that users have a comprehensive overview of federal finances in one source.** This information would include summary functional and economic classifications of budget operations (preferably using internationally accepted definitions); a summary table on tax expenditures; more extensive analysis of fiscal risk and sustainability issues, including contingent liabilities; reconciliations between the budget estimates and appropriations (which will become more important as the government moves to accrual budgeting but retains cash appropriations); and the calculation of alternative budget balance measures, including forward-looking cyclically adjusted balances for the federal and general government.[31]

43. **Governments, federal and provincial, should begin publishing estimates of quasi-fiscal activities.** While there are difficulties in quantifying their size, it would nonetheless be instructive to be able to gauge and assess their magnitude.

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[30] Ongoing revisions to the national accounts have made direct comparisons with the public accounts data of limited value. Statistics Canada will provide this information but only with a considerable lag.

[31] Some of this information is available in the Main Estimates and Public Accounts, the latter within six months of the end of the fiscal year in each of the last two years, and providing the suggested data would need to take account of the interlinkages between the two sets of data.