A World Leader in Financial Reporting by a National Government

Adoption of Full Accrual Accounting by the Federal Government

Louise Breton

Louise Breton

Louise Breton joined the Treasury Board of Canada Secretariat in 1998 as a senior analyst in Government Accounting Policy. In 2003, she was responsible to oversee the reformatting of the federal government's financial statements and the implementation of full accrual accounting policies in the Public Accounts of Canada. She recently completed a term as member of a Task force of the Public Sector Accounting Board of the Canadian Institute of Chartered Accountants. Since 1990, Ms. Breton has occupied various positions at the Department of National Defence, including Director of Finance of the Canadian Forces Housing Agency. Before joining the federal government, she was comptroller in a commercial real estate corporation and previously a manager at Price Waterhouse in Québec City, after a two-years tour at their Bermuda office. Ms. Breton graduated from Laval University in 1979 and became a chartered accountant in 1981.

On November 4, 2003, the federal government achieved a major milestone when the Public Accounts of Canada 2003 were tabled with their consolidated financial statements prepared under a brand new reporting model using full accrual accounting. After years of groundwork involving essentially the entire federal financial community, this represents one of the most significant accounting changes since Confederation. The improvements of 2002-03 obtained high praise from the Auditor General of Canada. In addition to her clean audit opinion on the new accrual financial statements, the Auditor General, in her observations, referred to Canada as "a world leader in financial reporting by a national government."

The main improvements made in 2002-03 include:

- The retroactive application of some ten new accounting policies, including the recording of capital assets, tax accruals and employee future benefit liabilities;
- The early application of the government financial statement reporting model recommended since January 2003 by the Public Sector Accounting Board (PSAB) of the Canadian Institute of Chartered Accountants (CICA); and
- The preparation of a new section on Financial Statement Discussion and Analysis, with restatement of 10 years of information on the accrual basis and the reformatting of various other sections of the Public Accounts.

The accrual accounting project came to life in 1995 with a Budget announcement of the government's intention to move from the modified accrual basis to full accrual accounting for its budget and financial statements. The task was brought under the umbrella of the Financial Information Strategy (FIS). The FIS contemplated a new decentralized accrual accounting financial environment for departments and agencies, to improve their access to timely and relevant financial information, as well as their accountability. The new environment also had to support the reporting of appropriations, which to this date, remains on a partial cash basis.

A three-year phased implementation of departmental financial systems, policies and training started on April 1, 1999. Throughout this time, at the Receiver General for Canada, both the old and the new suites of central systems were being maintained, as departments were gradually moving over to the new systems. And a vast and complex exercise was taking place to convert new accrual data to non-accrual numbers to continue preparing the government's financial statements on an expenditure basis.

In parallel with the government-wide FIS undertaking, additional initiatives were carried out for changes involving individual departments or central agencies. Emerging PSAB accounting standards were constantly monitored to assess their potential impact on the changes already planned.

The changes made in 2002-03 to the accounting policies of the federal government were all applied retroactively, with the restatement of the prior year's financial statements. Fine-tuning and external audit of the new accrual data of 2001-02, 2002-03 and of the changes to the April 1, 2001 opening balances were completed in September 2003, with the approval of Canada's 2003 audited financial statements. The main changes are summarized at Table 1 and described below.

Table 1
Impact of Changes in Accounting Policies on the April 1st, 2001 Opening Balances

	Accumulated Deficit	Net Debt
	($ billions)	
Non-financial assets		
Tangible capital assets	-42.8	1.4
Inventories and prepaid expenses	-7.5	0.0
Total non-financial assets	-50.3	1.4
Tax revenues	-11.0	-11.0
Employee and veteran future benefits	34.5	34.5
Other liabilities	10.0	10.0
Investments in enterprise Crown corporations	-4.0	-4.0
Total opening balance adjustments	**-20.8**	**30.9**
Opening balance - before restatement	**545.4**	**545.4**
Opening balance - restated	**524.6**	**576.3**

Non-financial assets

Non-financial assets are comprised of tangible capital assets, inventories and prepaid expenses. These were previously expensed upon acquisition. They are now recorded at historical cost as assets on the balance sheet. Capital leases are included in capital assets, with a counterpart interest-bearing liability. With the exception of land, the costs of capital assets including military assets are amortized to expense over their useful life, while inventories and prepaids are expensed when used.

Obtaining and documenting the original cost of older capital assets turned out to be a considerable challenge. Necessity being the "mother of invention", the Appraisals Director of Public Works and Government Services Canada and his team developed a creative solution called the "Book Value Calculator". Starting with an estimation of the current value, the program extrapolated back in time the asset's estimated original cost. Estimations of costs were considered acceptable since older assets would generally be fully amortized. The methodology was endorsed by the Office of the Auditor General and was used on over 30,000 Crown-owned assets by various departments and agencies. The Book Value Calculator was so successful that other provincial and foreign governments who face similar challenges have expressed their interest in using it.

Tax revenue accruals

The accrual of tax revenues constitutes one of the most significant changes made in 2003. Previously, these revenues were recognized when the cash was received or the refund was paid.

They are now recorded in the period in which the event giving rise to the revenue takes place. In other words, they are recognized when the taxpayer earns the income subject to the tax.

A core group of Canada Customs and Revenue Agency employees, in concert with the Department of Finance and the Treasury Board Secretariat, developed an innovative methodology to overcome the complexity of our taxation system. For instance, personal income taxes, which make up the major part of federal revenues, are assessed on a calendar year basis and can be filed until one month after the fiscal year-end of March 31. For these revenues, a large part of the accruals is based on assessments processed up to a cut-off date after year-end. The remainder is estimated from the cash received either on filing or through instalments or deductions, after adjustments for historical patterns of refunds and late filings. This accrual method is expected to be responsive to changes in the economy and to provide better tax revenue information than the former cash based results.

Employee future benefits and other changes

The early application in 2002-03 of the PSAB standards for recording post-retirement and post-employment benefits is also worthy of mention. While pension and severance liabilities were already recorded, other employee future benefits (health and dental plans for retirees, workers' compensation, and various benefits provided to veterans) were previously recorded when they were paid. Their cost is now recognized throughout the career of employees as benefits are earned, or when events like accidents occur to give rise to a liability. The costs and obligations are determined actuarially and the annual expense includes the cost of financing the actuarial liability. This follows essentially the same accounting rules as those in place for public sector pensions.

By reporting the costs in the year the service is rendered by employees and the impact of policy decisions in the year plan amendments are made, these new policies allow for better accountability and decision-making. They also better reflect the government's financial position at any point in time. The CICA does not require full implementation of these standards before 2004-05. However, fast-tracking this change to combine it with full accrual accounting enabled the government to prevent another restatement of its financial statements in a future year.

Amongst the other changes in 2003, new liabilities were set up for environmental and aboriginal claims. Following a multi-year government-wide exercise to identify and classify contaminated sites, the estimated cost of cleaning-up contamination on federal sites is recorded when the contamination occurs or is discovered, rather than when the clean-up takes place. The policy on contingent liabilities was also extended to apply to all aboriginal claims, which are now recorded as liabilities when their outcome is assessed as likely and estimable. Finally, the carrying value of investments in enterprise Crown corporations was adjusted to comply with the modified equity method of accounting recommended by PSAB.

New financial statement reporting model

In January 2003, PSAB issued new accounting standards that endorse full accrual as the only acceptable basis of accounting for senior governments in Canada. Sections PS1000 and PS1100 set out the objectives and concepts underlying government's financial statements, while PS1200 recommends general reporting principles and standards for their presentation. Implementation is not required before 2005-06, but their issuance in January 2003 was timely since it enabled the federal government to incorporate the recommendations of this new conceptual framework with its implementation of full accrual accounting.

The new PSAB reporting model recognizes that a government's financial condition can only be assessed through a combination of various financial indicators:

- The annual surplus/deficit measures the extent to which the government's revenues were sufficient to cover its costs;
- The accumulated deficit provides the measure of the net economic resources available to the government;
- The net debt measures the revenues required to pay for past transactions and events;
- The change in net debt measures whether the annual revenues covered the spending; and
- The cash flows provide the government's source and use of cash.

In line with the PSAB recommendations, the 2003 format of the Government of Canada's financial statements is meant to present these various facets of the government's financial condition, while demonstrating accountability for the government's results and its use of economic resources. Table 2 summarizes the main financial statement's indicators of Canada at March 31, 2003.

Table 2
Canada's financial statement's main indicators March 31, 2003 ($ billions)

Annual surplus	7
Accumulated deficit	511
Net debt	565
Change in net debt, decrease	6
Cash flow, increase in cash	5

To implement the new accounting policies and reporting model, many improvements were made to the government's 2003 financial statements.

The most significant change affecting the Statement of Operations (formerly Statement of Revenues and Expenditures) is the shift in reporting the annual surplus from an expenditure to an expense basis. Mostly, it means that amortization now enters in to the calculation of the surplus as opposed to the capital expenditures that were previously used. The statement was reformatted to present revenues and expenses on a gross basis only and it better enables accountability by including a comparison of actual results against amounts budgeted.

The Statement of Accumulated Deficit reconciles the variations in the accumulated deficit in the year, also on an expense basis, and details the impact of the changes in accounting policies that affected the opening balances.

Since tangible capital assets, inventories and prepayments are recorded as assets, the Statement of Financial Position (formerly Statement of Assets and Liabilities) provides a better picture of the resources entrusted to the government. However, unlike a traditional commercial balance sheet, the introduction of a non-financial asset category provides two distinct financial indicators: the net debt and the accumulated deficit. Under modified accrual accounting, the accumulated deficit consisted of the government's liabilities less its financial assets. This now represents the net debt, while the accumulated deficit is calculated on an expense basis.

A new Statement of Change in Net Debt reconciles the annual surplus calculated on an expense basis to the annual change in net debt and highlights the capital spending of the year and how it affects the government's net debt.

The Statement of Cash Flow (formerly Statement of Change in Financial Position) explains the source and use of cash for the main government's activities, operating, capital, investing and financing. The statement was reformatted to provide a better link with the Statement of Financial Position and to present main cash movements on a gross basis.

Other changes to the Public Accounts

A Financial Statements Discussion and Analysis (FSD&A) section is now presented at the front of the Public Accounts of Canada. This section provides an executive overview of the financial statements and their results and discusses the significant events that affected the results. A FSD&A was already available in the Annual Financial Report of the Government of Canada prepared by the Department of Finance. While the discussion in the Annual Financial Report is presented on a net basis to correspond to that of the government's budget, the new section in the Public Accounts is entirely presented on a gross basis, making it easier for the reader to refer to financial statement data.

Table 3
Areas of financial reporting where Canada compares favourably internationally

Country	Consolidated financial statements (CFS)	Full accrual CFS	Auditor's opinion on CFS	Tax revenue accrual	Veteran's benefit accrual
Canada March 2003	Yes	Yes	Clean opinion	Yes	Yes
USA Sept 2002	Yes	Yes	Disclaimer of opinion	Modified cash	Yes
Australia June 2003 (for assessments only)	Yes	Yes	Qualified opinion, mostly due to tax revenues not being accrued	Partial accrual	Cash basis
New Zealand June 2003	Yes	Yes	Clean opinion	Yes	Cash basis
UK	Planned for publication in 2006-07	Currently at agency level only	N/A	Not available yet for CFS	Cash basis at agency level

Changes were required to various sections of the Public Accounts to present accrual-based supplementary information. However, the sections that report the use of authorities (appropriations) still remain presented on an expenditure basis, so that various tables were amended to reconcile accrual-based results with the detailed expenditures authorized for departments and agencies.

The accrual accounting environment also affected the accounting terminology used in the financial statements and Public Accounts, as it was essential to make a clear distinction between expense and expenditure (respectively "charge" and "dépense" in French). The French term « recette » was also changed to « revenu » to standardize with the accounting literature used in Canada.

International experience

Many national governments endeavoured to improve financial reporting in recent years. No one country can be considered to lead in all aspects, but a few are known for their progress in specific areas, especially as it relates to accrual accounting.

For instance, Australia led the way in the 1990's in implementing accrual reporting, while New Zealand subsequently introduced both accrual reporting and accrual budgeting at the same time. The UK has already implemented accrual reporting and budgeting for its agencies, but is planning for 2006-07 the first publication of its consolidated financial statements. And while the US pioneered a few years ago in recording their veteran's benefit liability, various problems, including difficulties in eliminating internal transactions, still caused them a disclaimer of opinion on their consolidated financial statements last year. In contrast, Canada has issued consolidated financial statements with a clean audit opinion for years and the new full accrual accounting statements are no exception.

The lack of consistency in use of accounting standards by governments makes it difficult to directly compare financial reporting practices internationally. Nonetheless, we can seek various benchmarks, for example, whether the statements are consolidated, the content of the auditor's opinion, timeliness of reporting, whether departments prepare audited statements, etc.

Table 3 presents a snapshot of certain areas where Canada compares itself favourably with its peers. Areas such as the work done on the Book Value Calculator or the Receiver General's reconciliation process on interdepartmental settlements that allows for a smooth consolidation are also examples of where Canada is well positioned amongst its peers.

The next step

By providing better disclosure of the costs of programs, resources available and liabilities, accrual accounting is expected to strengthen the accountability of the government. The more comprehensive information it provides for decision-making is also expected to improve stewardship and lead to overall better financial management throughout government. As financial management is changing in the federal government, financial reporting must continue to be the stepping-stone in the process and to lead the way to continue improving the tools that managers require to make the best decisions possible.

When the Auditor General refers to Canada as "a world leader in financial reporting by a national government", it is a very prestigious compliment to the whole federal financial community, as it includes us amongst countries known for their distinctive achievements. And with the pride of receiving compliments comes the responsibility to continue to live up to them.

Improvement in Canada's financial reporting is still possible as well as necessary. Timeliness of reporting, departmental financial statements, accrual budgeting and streamlining financial reporting to the needs of Canadians and parliamentarians are only a few areas where much work remains. But the expertise and the dedication of the federal financial community will no doubt continue to bring Canada even further amongst the leaders in government financial reporting.

The Public Accounts of Canada 2003 are available at http://www.pwgsc.gc.ca/recgen/text/pub-acc-e.html. ■