SUPPLEMENTARY INFORMATION
OBSERVATIONS OF THE AUDITOR GENERAL
ON THE
FINANCIAL STATEMENTS OF THE GOVERNMENT OF CANADA
FOR THE YEAR ENDED MARCH 31, 2009

For the eleventh consecutive year, the government has received an unqualified audit opinion on the summary financial statements. I congratulate the government on this accomplishment, especially because an unqualified audit opinion is achieved by few countries. Each year, this involves a great deal of work by public servants throughout government, both in individual departments and in central agencies. I thank those involved for their assistance and for the co-operation extended to my Office during our audit.

The purpose of these Observations is to comment on matters that have come to my attention during the audit of the current year's summary financial statements and that will require continuing attention in future years.

CANADA'S ECONOMIC ACTION PLAN

In 2008 and early 2009, the global economic situation deteriorated significantly. In the November 2008 Economic and Fiscal Update and the subsequent Canada's Economic Action Plan (Budget 2009), the government announced and introduced various financial and economic stimulus measures. The government is providing up to $200 billion to improve access to financing for both businesses and consumers and has committed over $40 billion in economic stimulus initiatives. Much of this spending will occur in 2009–10 and 2010–11.

As part of my audit of the summary financial statements, I reviewed the government's disclosure of the various financial and economic initiatives in the notes to the summary financial statements. I concluded that the government's accounting and disclosures of the new measures are adequately reported in the 2008–09 summary financial statements. As well, I am pleased to note that Volume I, Section 1 of the Public Accounts includes a discussion about the economic stimulus commitments made during the fiscal year–such as investment in infrastructure spending.

MANAGEMENT ESTIMATES—TAX REVENUES

Tax revenues are the largest and most complex of the management estimates in the government's financial statements. Due to the deterioration in the global economic situation, certain corporations operating in hard-hit sectors of the economy have experienced significant financial losses. Current and prior year changes to assessed tax revenue for these corporations account for a significant portion of the $11 billion decrease in corporate tax revenues from the previous year as reported in the 2008–09 Statement of Operations.

The methodology for estimating tax revenues used by the Canada Revenue Agency is primarily based on an average of previous years' experience. For this year's audit, we also reviewed selected corporations' tax information and the impact of these current year operating results on the government's estimated corporate tax revenues. For 2009, I have concluded that the government's estimate for corporate tax revenue is presented fairly in the government's financial statements. As this is the first year where the accrual methodology will be tested in a significant economic downturn, it will be important for the government to use this experience to identify and implement further improvements to its methodology to ensure it continues to provide a reliable management estimate of tax revenues.

DEPARTMENTAL FINANCIAL STATEMENTS

This year, my Office has continued to follow the progress on the initiative of the government to transform and strengthen public sector financial management, which included a plan to have the annual financial statements of 22 large departments audited.

I reported last year that my Office would undertake a review of the readiness of the Department of Justice to undergo an audit using reliance upon controls as the primary source of audit assurance. I am pleased to report that I have recently signed the first audit opinion for departmental financial statements, and issued an unqualified opinion on the Department of Justice's financial statements. Senior management of the Department of Justice is to be congratulated on its commitment to this initiative.

Having the first of the 22 large departments undergo an external audit of their financial statements is an important step toward the objective of improving internal controls and providing credible financial information.

During the fall of 2009, my Office will undertake a review of the readiness of Industry Canada for a controls-reliant approach to the audit of their financial statements. Management of Industry Canada and the Office of the Comptroller General have determined that the Department is ready for a controls-based audit. In addition, one other department anticipates being ready for an audit during the 2009–10 fiscal year and six departments have indicated their readiness by the 2010–11 fiscal year. The remaining departments have indicated they will be ready at various times after 2011.

I continue to say that when departments are ready for an audit, my Office will gladly play its part in the process. The Office of the Comptroller General must continue to provide leadership in this project, which includes the resolution of the outstanding significant accounting and reporting issues related to departmental financial statements.

ACCRUAL APPROPRIATIONS BY DEPARTMENTS AND AGENCIES

I reported last year that the government had outlined a plan to implement accrual-based budgeting in phases, and would complete an evaluation of the costs and benefits of accrual appropriations in the 2012–13 fiscal year, after accrual-based budgeting had been implemented. Accrual-based appropriations would provide Parliament with a basis for control and approval over voted spending that is on the same basis as the overall government financial plan and the summary financial statements.

As I noted last year, and I continue to observe, the government has not yet made a commitment on an implementation date for adopting accrual appropriations, nor provided a clear explanation of why it would not be prudent to do so.

INTERNATIONAL FINANCIAL REPORTING STANDARDS

The move to International Financial Reporting Standards (IFRSs) is an important change to Canadian financial reporting. The conversion to IFRSs could have a significant impact on the underlying accounting policies for entities subject to these requirements. This change may affect most federal Crown corporations. The adoption of IFRSs by federal Crown corporations can have an impact on the government's financial statements. It will be necessary to harmonize the accounting policies of some Crown corporations in order to report the consolidated results in the government's financial statements. This year, my Office has continued to follow the progress made by the Government and the Crown corporations in preparation of the conversion to IFRSs.

The official date of the changeover to IFRSs conversion is for fiscal years beginning on or after January 1, 2011. However, comparative numbers are required to ensure they are properly presented under IFRSs. Therefore, well before 2011, those Crown corporations adopting IFRSs must have analyzed the differences between the current accounting policies and IFRSs; must have selected the appropriate accounting policies when choices exist, and must have made required changes to underlying processes and information systems. Complying with the changeover to international standards involves a rigorous conversion process and a significant investment in human and financial resources in order to meet the deadline.

Operational working committees have been created in order to build a network of Crown corporations and to address specific IFRS conversion issues. In addition, many of the federal organizations affected have identified or are in the process of identifying differences between their current accounting policies and IFRSs, and any required changes to underlying processes and information systems.

I am pleased that the government and the federal Crown corporations are working toward the transition to International Financial Reporting Standards and have adopted a process that would help identify issues early. These initiatives will provide valuable assistance to Crown corporations dealing with IFRS implementation.

STATUS OF ITEMS REPORTED IN PREVIOUS YEARS

Observation	Current status
Canada Revenue Agency—Estimate for Corporate Tax Revenue	Accrual accounting for tax revenues is intended to ensure that the government recognizes tax revenues in the period when the taxable activity occurs, rather than when the government receives the cash. Tax revenues are the most significant estimate in the government's financial statements. It is important that the government regularly monitor the reliability of its estimation processes and modify them, where necessary, to improve the accuracy of its reported tax revenues. Since the introduction of accrual accounting in 2003, my Office has regularly expressed to the government the need for constant monitoring and improvement of the process by which it produces the year-end tax revenue estimates. For two years, I reported that the government's own analyses indicated that there had been a recurring understatement of tax revenues earned but not yet assessed, particularly in the area of corporate tax revenues. These amounts, while under-estimated in the year they are earned, are included in the following year's tax revenue. In response to a subsequent request from the Standing Committee on Public Accounts for modifications to the tax revenue estimation methodology, several changes to the methodology have been implemented for the March 31, 2008 and 2009 tax revenue estimates. Updated analyses now show that the recurring understatement of corporate tax revenues by tax year has been reduced from prior-year levels. Some of these improvements can be directly related to the government's changes to its methodology. The impact of methodology changes on the overall accuracy of the government's reported corporate tax revenues will only be known in the future when tax assessments are completed.
Canada Revenue Agency—Allowance for Doubtful Accounts	The allowance for doubtful tax receivables must be assessed each year ($9.5 billion in 2009 and $8.7 billion in 2008). In 2008, the government implemented a new methodology for determining this significant management estimate. I reported that there were delays in finalizing this management estimate as a result of data integrity problems, concerns about the validity of management assumptions and calculation errors. In addition, I commented that the Office of the Comptroller General and the Department of Finance should have more actively monitored the progress of this important project. For 2009, I have concluded that the Canada Revenue Agency's estimate of the allowance for doubtful accounts is presented fairly in the government's financial statements. I also observed that the Canada Revenue Agency has implemented methodology and project management improvements in response to the three areas of weakness reported last year. It remains important for the Canada Revenue Agency to complete all of the planned enhancements to the methodology for allowance for doubtful accounts, and to continue monitoring and improving its control procedures over the process. In addition, the Office of the Comptroller General and the Department of Finance need to ensure they provide the necessary oversight and challenge function on the changes to the methodology.

Observation	Current status
Canada Border Services Agency—Tax revenue system deficiencies	For several years, I have stated that the Canada Border Services Agency needs to improve its tax revenue accounting systems and practices. Its accrual of tax revenues is assessment-based and it gathers data primarily from the various tax program systems. These were not designed to function as accounting systems. Each year, significant adjustments to accounting data are necessary to report revenues and receivables on an accrual basis. This manipulation of data involves complex and cumbersome manual processing and reconciliation. Despite these efforts, differences still exist between the amounts receivable in the general ledger and the various reports taken from the tax program systems in support of the reported amounts. Management of the Canada Border Services Agency has identified underlying causes of some of their unreconciled differences. However, unexplained differences continue to remain at year-end.
National Defence—Inventory, repairable spare parts, and realty asset records	For many years, I have observed the difficulties National Defence has experienced in the proper recording and valuation of its inventory and repairable spare parts. I acknowledge the progress National Defence has made and the importance the Department has placed on continued improvements in the accounting systems and practices in this area, including the recognition of the capitalized value of previously expensed parts and the supporting policy development. However, issues remain such as pricing and the timely recording of transactions. Continued action by National Defence is needed to ensure that the value of inventory and repairable spare parts is properly recorded. National Defence has also had issues related to the proper recording and amortizing of the costs of its capital assets. Subledgers that are used to capture detailed data are complex and not always reconciled to the general ledger in a timely and accurate manner. The capitalization of work-in-progress and the write-off of disposed assets continue to challenge the Department. It is important that National Defence continue its work in this area to ensure that the information recorded in the general ledger is accurate, complete, and timely.
Payables at year-end policy	In previous years, it became apparent during discussions that my Office and the Treasury Board of Canada Secretariat held different interpretations of section 37.1 of the *Financial Administration Act* and of the government's policy on payables at year-end. The difference involves whether debts per section 37.1 of the *Financial Administration Act* include all items that would be recognized as liabilities. This difference results in a lack of clarity about the nature of items to be appropriately charged to an appropriation. Since 2006, the Treasury Board of Canada Secretariat issued various frameworks and related policies as part of its Policy Suite Renewal Initiative. However, the payables at year-end policy is still in the process of being revisited. In the past, I indicated to the Office of the Comptroller General that, in our view, there needs to be greater clarity regarding charges to appropriations. I have raised this issue for three years and still no changes have been implemented. I am concerned that it remains quite possible that the departments will neither charge amounts against their appropriation nor record a liability because they do not meet this legally binding definition, despite the fact that these are, in substance, liabilities. I continue to encourage the government to clarify its position with respect to the substance of these transactions. The government needs to ensure that expenditures are properly and consistently charged to appropriations and that they are recognized as liabilities at year-end. Given the importance of ensuring that expenditures are properly and consistently charged to appropriations, I encourage the Office of the Comptroller General to resolve this matter.

Observation	Current status
Audit opinion in accordance with Canadian generally accepted accounting principles	Under the auditing standards of The Canadian Institute of Chartered Accountants, I am required to report on fair presentation in accordance with Canadian generally accepted accounting principles for the public sector. However, recognizing the importance of following our legislative mandate, which requires me to give an opinion on whether the government's financial statements "… present fairly information in accordance with stated accounting policies of the federal government …," my opinion refers to both bases. The government's accounting policy indicates that its stated accounting policies are based on Canadian generally accepted accounting principles for the public sector, and that the presentation and results using the stated accounting policies do not result in any significant differences from Canadian generally accepted accounting principles. I would prefer that the government indicate its commitment to conforming to Canadian generally accepted accounting principles.

EXPLANATION OF MY AUDIT REPORT

For readers who would like a more in-depth explanation of my audit report, I have provided that information on my website, together with my Observations (www.oag-bvg.gc.ca).