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Chair

Mr. John Williams

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• (1625)

[English]

The Chair (Mr. John Williams (Edmonton—St. Albert, CPC)): Order. Good afternoon, everybody. My apologies for being a few minutes late.

We meet today to discuss, pursuant to Standing Order 108(3)(g), *Public Accounts of Canada 2004*, referred to the committee on October 21, 2004. We have video recording today.

Our witnesses today include, from the Office of the Auditor General of Canada, Ms. Sheila Fraser, Auditor General of Canada; Mr. Frank Vandenhoven, principal of the office; and Mr. Doug Timmins, Assistant Auditor General.

From Treasury Board Secretariat we have Mr. Charles-Antoine St-Jean, Comptroller General of Canada, at the comptrollership branch, and Mr. John Morgan, executive director, financial management and accounting policy directorate.

And from the Department of Finance we have Mr. Peter DeVries, special adviser, deputy minister's office.

Without further ado, we'll start with you, Ms. Fraser. Do you have an opening statement?

Ms. Sheila Fraser (Auditor General of Canada, Office of the Auditor General of Canada): I do, Mr. Chair, thank you.

Thank you for inviting us today to discuss the 2004 public accounts. As you mentioned, with me today are Doug Timmins, Assistant Auditor General, and Frank Vandenhoven, the principal, who are responsible for the audit of the summary financial statements of the Government of Canada.

This is the second year that the government has produced its financial statements using full accrual accounting. In last year's observations, I indicated my view that this was a major step that placed Canada as a world leader in financial reporting. I further indicated that the financial community within the government could be justly proud of this accomplishment. I continue to hold that view.

My report on the financial statements is included on page 2.4 of volume I of the public accounts. For the sixth consecutive year, I have been able to issue an unqualified, or clean, opinion on the government's summary financial statements. This gives users the assurance that the government's financial statements present fairly its financial position and the results of its operations.

[Translation]

It is important to note that while I have issued an unqualified opinion on the financial statements, I do continue to identify two other matters for Parliament's attention. These are long-standing issues that I have included in my report for the past four years.

The first is the Employment Insurance Account, which grew by another \$2 billion during the last fiscal year and stood at \$46 billion as of March 31, 2004.

In my view, Parliament did not intend for the EI account to accumulate a surplus beyond what could reasonably be spent on the EI program. Hence, in my opinion, the government has not observed the intent of the Employment Insurance Act.

I note that in the 2003 Budget legislation, the government indicated its intention of having a new rate-setting regime adopted through legislation for 2005. In the 2004 Budget legislation, the government gave the governor in council authority to set the premium rate for 2005, in the event legislation was not passed in time.

Thus, I note with disappointment that this long-standing issue has not been resolved. This matter is discussed in more detail in my observations on page 2.29, volume I of the Public Accounts.

The second issue I raised in my report is my continuing concern about transfers of money to foundations. This topic is further explained on page 2.27 of volume I. To date, the government has transferred \$9.1 billion to foundations and recorded that amount as expenses, while \$7.7 billion of that amount is still sitting in the foundations' bank accounts and investments for eventual distribution.

[English]

My staff is currently discussing with officials of Treasury Board Secretariat the implications of a recent accounting standard on the government reporting entity, which is to be implemented in 2005-06. While TBS officials have indicated their view that their accounting for foundations would remain appropriate under this standard, we are not convinced. I remain hopeful that these discussions can lead to the resolution of this issue with the government. We will also continue to measure progress on another accounting project of the public sector accounting board of the Canadian Institute of Chartered Accountants with respect to government transfers. We'd be pleased to talk about those two standards if members would like.

In addition to my concerns on the accounting for foundations, I have expressed concerns about their accountability regime. I intend to issue a chapter in my February 2005 report that will address, among other things, the government's recent initiatives in this area.

Mr. Chair, in my observations I also address the ongoing accounting challenges at National Defence and at the Canada Revenue Agency. These challenges involve the difficulty in accounting for defence inventory, in one case, and tax revenue and receivables, in the other case, with systems that were not designed to support accrual accounting. This has required significant effort at both organizations to derive appropriate accrual accounting information to support these items. Both organizations need to address the weaknesses in their financial reporting processes over these significant amounts, and implementing solutions should be made a priority.

Mr. Chair, this concludes my opening statement. We welcome any questions the committee members may have.

Thank you.

The Chair: Thank you, Ms. Fraser.

Now we'll turn to Mr. Charles-Antoine St-Jean, the Comptroller General of Canada.

You have a big deck here, Mr. St-Jean. You're going to keep your remarks to five minutes, I take it?

Mr. Charles-Antoine St-Jean (Comptroller General of Canada, Comptrollership Branch, Treasury Board of Canada Secretariat): Yes, indeed.

Thank you very much, Mr. Chair. I have an opening statement I would like to share with you and the members.

I'd like to thank you for the invitation to appear before the committee to discuss *Public Accounts 2004*. As the new Comptroller General of Canada, it's an honour to have this opportunity to review with you the financial results from last year. Since joining the federal government last June, I have come to appreciate its complexity, and I look forward to the many challenges that lie ahead.

With me is Mr. John Morgan and Mr. Peter DeVries. They will help me with the public accounts discussion.

I'd like to perhaps bring it to your attention that unfortunately the government did not have the opportunity to brief this committee on *Public Accounts 2003*.

The Auditor General mentioned the issue of the accrual basis of accounting. I would like to draw your attention to this particular success.

• (1630)

[*Translation*]

After many years of hard work by both the government and the Office of the Auditor General, the government was able to adopt full accrual accounting as the basis of accounting in both the budget and its financial statements.

As outlined to this committee over the last few years, this change has a profound effect on how the government manages and measures its assets, liabilities and fiscal results.

In addition, the government was able to implement a number of other significant changes in its financial statements that improve overall transparency and accountability.

[*English*]

We were extremely pleased to have received an unqualified or, as we call it, a "clean" audit opinion on those financial statements and the recognition by the Auditor General that the Government of Canada was a world leader in summary financial reporting.

As you know, Mr. Chairman, the committee has always been a strong supporter of the adoption of full accrual accounting. I would like to thank you for that support.

With respect to *Public Accounts 2004*, again, I would like to thank the Auditor General and her staff for the professional working relationship and the support she has demonstrated to all our colleagues who have been the preparers of those statements. As mentioned before, this is the sixth consecutive year the Auditor General has provided an unqualified audit opinion on the government's financial statements. While this is very good news—there's no question that we're very proud of it—we also recognize that the Auditor General has highlighted a number of concerns. We do take those concerns very seriously. We will continue to work with her office to try to address them and resolve them.

On the results of the year itself,

[*Translation*]

The government reported a surplus of \$9.1 billion last year which resulted in a reduction of the accumulated deficit, or federal debt, from \$510 billion to \$501 billion. It is important to point out that the reduction in the accumulated deficit by the amount of the annual surplus is a bookkeeping entry. There was no explicit action taken with the surplus. This is a standard accounting convention followed by both the private and public sectors in preparing their financial statements.

[*English*]

The surplus represents the excess of revenue earned over expenses incurred. It's an accrual-based number and does not represent cash received. It represents the change in the government's financial position or net worth as presented or measured by generally accepted accounting principles.

The statement of financial position illustrates how the various assets and liabilities, including debt, have changed over the last year.

Mr. Chairman, we have tabled a slide presentation outlining some of the key financial results for last year as well as our preliminary comments on the observations of the Auditor General included in the *Public Accounts 2004*. So we would be pleased to review those at your pleasure any time you would like to do so.

I would like to conclude on those remarks. We would be pleased to take any questions from the members and the chair. Thank you very much.

The Chair: Thank you very much. That slide deck will be deposited with the clerk, so if anyone wishes to obtain a copy in the future they can get a copy from the clerk's office.

Mr. DeVries, do you have an opening statement?

Mr. Peter DeVries (Special Advisor, Deputy Minister's Office, Department of Finance): No, I do not, Mr. Chairman.

The Chair: Okay, we'll now go to questions.

Mr. Fitzpatrick, for eight minutes, please.

Mr. Brian Fitzpatrick (Prince Albert, CPC): Thank you very much for your reports.

I guess I'll direct my question to Mr. St-Jean. I'll start right off the bat with the employment insurance program. If I heard you correctly—and I guess you could straighten me out—you said you're just following regular, normal, acceptable accounting standards. I would just like to try to get an explanation on this, because it's my understanding, sir, that the premiums being collected under the employment insurance program are just basically going into the general fund and the benefit payments are coming out of the general fund. But then we have some sort of notional account somewhere that we call the EI fund, in which there really isn't any money. We play with this notional account as if it's there.

It's my understanding, too, that \$45 billion more has come into this program than has actually been paid out. We're trying to call this thing an apple or an orange, or something like that, when in reality what we're really talking about is that this is a tax. Some of the tax may be used to pay for EI benefits, but only a small portion of it.

I find this kind of accounting, quite honestly, sir, to be rather misleading. I would like you to really explain to me how these are regular, normal accounting procedures.

•(1635)

The Chair: Mr. St-Jean, s'il vous plaît.

Mr. Charles-Antoine St-Jean: Thank you very much. Could I maybe ask one of my colleagues here to address that very specific issue. I have been looking into it, but really my colleague from the Department of Finance could answer that question.

Mr. Peter DeVries: Thank you, Mr. Chairman.

With regard to the accounting of the EI revenues and expenditures, you're quite right. The revenues are classified as part of overall budgetary revenues. The expenditures are part of overall government expenses, and so they impact on the government's budgetary balance in a direct manner.

The reason that is the case is that the government controls the program as such. It's through government legislation that this program has been established, and it's through government regulations and the specifics of the Employment Insurance Act under which these premiums are levied and the expenses are made. As such, it's no different from any other government program. As a result, it's part of our overall financial statements; so the revenues come in on the revenue side, the expenses go out on the expenses side. That's the accounting of the program.

Mr. Brian Fitzpatrick: But you are going to agree with me that there is a lot more money coming in under this EI program than is required to handle the payouts under the program?

Mr. Peter DeVries: For a period of time, yes, I agree with you that there were more revenues coming in under this program.... It was the period from the mid-1990s to just recently, when more revenues were coming in, despite the fact that the premium rates had been reduced each and every year.

There are provisions within the EI Act under section 66 that state how the premium rates should be set for the upcoming year, and that's where the notion of the employment insurance account comes into effect.

Up to 2002, the commissioners of the Employment Insurance Commission, which is made up of government, labour, and employers, set the EI premium rate according to the provisions in the act. For 2002, 2003, 2004, and 2005, Parliament passed legislation giving the government the authority to set premium rates for those years.

Mr. Brian Fitzpatrick: I'm going to ask you point-blank, and I'm not interested in government legislation on the matter, what in the world is the sense of having a notional account when there really isn't anything in this account? It's a fiction, is it not? What's the purpose behind it?

Mr. Peter DeVries: The account was established in order to track the revenues going in and the expenses going out in order to help set premium rates under the provisions of section 66 of the EI Act. That's why the account is there.

Mr. Brian Fitzpatrick: But it really has no relevance to what's operating right now, does it? It goes into general revenue and comes out of general revenue.

Mr. Peter DeVries: The reason the account was there, as I said, was to help establish the premium rates under section 66 of the Employment Insurance Act. That section was in effect up to 2002. Since 2002, the government has passed legislation to set the rates in a different fashion.

As the Auditor General indicated in her opening remarks, in the 2003 budget and again in the 2004 budget the government indicated that there were flaws in their EI rate-setting process, that it was undertaking consultations on how the rates should be set in the future. It set out a number of principles as to how it felt the rates should be set. It indicated in the 2004 budget that it was going to pass legislation that would be consistent with those principles.

However, that legislation hasn't been tabled yet. As you know, Mr. Chair, an amendment was made to the Speech from the Throne with regard to looking at the issue of how to set EI premium rates, which has been referred to a committee for study.

Mr. Brian Fitzpatrick: How much time have I left?

The Chair: Two minutes.

Mr. Brian Fitzpatrick: Two minutes.

I have the impression that maybe in the past there was way more money coming in than what was required to handle benefits and to pay for the programs. The impression, sir, with your answer is that it's different now. These things maybe are sort of in balance.

There are an awful lot of people out there, including employers and employees in this country, who feel they're paying for a lot more than EI programs, they're also paying a fairly major chunk of money to the government that's going into general revenues and being used for all sorts of things other than EI. Are you telling this committee today, sir, that the fund now is set up so the premiums coming in are just paying for EI and that everybody can be quite satisfied that this is the way this arrangement is working, or is there still a large surplus of money going into general revenues?

• (1640)

Mr. Peter DeVries: On an annual basis, in the 2004 budget, the government indicated that the premium rates should be set in such a way that the revenues collected are equal to the program cost—the EI benefits and the administration—and there should be a one-to-one relationship to that.

Mr. Brian Fitzpatrick: Has that happened?

Mr. Peter DeVries: When we set the rates for 2004 last year based on the forecast we had at that time, that is what would have happened. For 2005 the rates will have to be set sometime before the end of the year. The government plans to follow those same principles in setting the rates so the premiums generated will be equal to the program cost.

Mr. Brian Fitzpatrick: Can I just ask the Auditor General if she agrees with that assessment or not?

Ms. Sheila Fraser: I have just one point of clarification. The surplus in the EI account for the year ended March 31, 2004, was \$2 billion. Of that, approximately \$1 billion is notional interest. There is an accumulated surplus over the years, which is now \$46 billion, so there is an interest credited to the account. Of course, because there's no actual money, there's no actual interest given.

So about a billion of that is interest. That interest amount is not taken into account in setting the rates. If we eliminate that interest, if you will, there was \$1 billion more in direct premiums over direct benefits.

The Chair: Thank you very much, Mr. Fitzpatrick.

[*Translation*]

Mr. Sauvageau, you have eight minutes.

Mr. Benoît Sauvageau (Repentigny, BQ): We have quite a number of documents and we have heard many witnesses. I don't know exactly where to start. I will start with Mr. St-Jean, if you would allow me. First of all I would like to welcome everyone.

Mr. St-Jean, paragraph 12 of your presentation reads as follows:

It is important to point out that the reduction in the accumulated deficit by the amount of the annual surplus is a bookkeeping entry. There was no explicit action taken with the surplus. This is a standard accounting convention...

Is there a statute in Canada that requires the government to apply all of the \$9.1 billion to reducing the federal debt?

Mr. Charles-Antoine St-Jean: The reason for this bookkeeping transfer is that, according to the generally accepted accounting principles, which are called GAAP, the surplus must be allocated to the accumulated deficit, or, if there is a deficit, the deficit must then be applied to the accumulated surplus. This is a normal accounting standard followed by all companies. When there is either a surplus or

a deficit, it is applied to the accumulated deficit or surplus as the case may be.

Mr. Benoît Sauvageau: Is the government a company?

Mr. Charles-Antoine St-Jean: No, but the government has decided to apply widely accepted accounting standards, as several other governments have done. Therefore, these standards must be followed.

Mr. Benoît Sauvageau: Is there a law preventing the government, which is not a company but a particular kind of entity, to put part of the surplus towards other ends than reimbursing the debt?

Mr. Charles-Antoine St-Jean: I can ask my colleague from finance to tell you if there are indeed rules which prevent us from doing so. According to generally recognized standards, surpluses have to be applied to accumulated deficits. If you will, I would like to get back to you with a more definitive answer.

Mr. Benoît Sauvageau: Madam Fraser, I think you want to say something. I will let you speak.

Ms. Sheila Fraser: I would like to point out that there is some confusion with the terminology. When we talk about accumulated deficit in accounting terms, we refer to the sum of all surpluses and deficits, year over year. The government used the term "federal debt" as though it were the same as the term "accumulated deficit".

In our observations last year, and even more recently, we pointed out that when ordinary people talk about the debt, they think of an interest-bearing debt. Therefore, there is some confusion. There is no law stating that a surplus must be applied to a debt. It is up to the government to decide what it wants to do with its revenues. It would be appropriate to look at slide number 12 in Mr. St-Jean's presentation. You will see that over the past year, there was a surplus of \$9 billion; however, the interest-bearing debt still increased over the course of the year.

These are two different things. It is why we say that it is important to use the right terms, accounting terms. Otherwise there may be confusion. People believe that the \$9 billion in surplus was applied to the interest-bearing debt, but it is not the case. It was put towards the accumulated deficit, which is simply the sum of all surpluses or deficits, year after year, since Confederation. It is an entirely different concept from that of an interest-bearing debt.

I believe it is what Mr. St-Jean wanted to say in his presentation.

• (1645)

Mr. Benoît Sauvageau: I would like to address my question to Mr. St-Jean once again, and I will ask for another answer to specify some things.

First and foremost, I don't know who it was in your department who drafted slide number 20, but this person has a good sense of humour. In answer to the Auditor General's observations on the \$42 billion surplus in the Employment Insurance Fund, you say, "The government is actively working on this issue." I think this sentence is funny. You say that the government is actively working on this issue, whereas Ms. Fraser has been saying, for I don't know how long now, that it is shameful... Wait, she didn't say it was shameful, Madam Fraser has a good vocabulary. She said "The government did not observe the intent of the act". What do you do... I was going to ask you the question, but you are not ministers.

A report on employment insurance premiums was adopted unanimously by the Standing Committee on Human Resources. The Auditor General repeatedly asked that an appropriate premium rate be set for employment insurance. Although you are not ministers and you are not elected officials, you say: "The Government has reduced the premium rate for 2004, the tenth consecutive annual reduction", giving the idea that it's positive. Despite that, the Auditor General said in her observations on page 2.32 of volume I of Public Accounts, that this reduction was not significant in light of the surplus you posted.

Do you intend to not only work actively, but to also take concrete action, as requested by parliamentarians and the Auditor General, to resolve this issue, as raised by my Conservative colleague, namely the issue of the \$42 billion taken from the Employment Insurance Fund to pay down the debt and the accumulated deficit? Let's use the right terms.

Mr. Charles-Antoine St-Jean: I would like to comment on that point. The way premium levels are established each year is now being studied. The Auditor General referred to the fact that last year, there was a surplus of \$2 billion, one billion of which was interest on the surplus. The goal, to my knowledge, is to strike a balance between what is collected through taxation and what is paid out each year.

With respect to the historical surplus, I defer once again to my colleague from the Department of Finance, who has been managing this file for several years, so he can complete my answer. The goal is to really strike a balance between premium levels and annual payments.

Mr. Benoît Sauvageau: That's fine. On pages 18 and 19 of your document, you talk about foundations. Your first response on page 18 reads as follows: The government has a robust regime to ensure the appropriate accountability of ministers and these not-for-profit entities that have received conditional grants.

On the other hand, your answer on page 19 reads as follows: The Foundations are not-for-profit entities that operate at "arm's length" from and are not controlled by the government.

Which of these statements is true?

[*English*]

Mr. Charles-Antoine St-Jean: Maybe my colleague here will give the answer on this one.

Mr. John Morgan (Executive Director, Financial Management and Accounting Policy Directorate, Treasury Board of Canada Secretariat): Mr. Chairman, I apologize as I'll be responding in English. The foundations, these entities, are not the proper

organizations. They are not considered controlled by the Government of Canada.

However, in terms of reporting to ministers and also ministers reporting to Parliament, we do have an accountability regime in place. It calls upon the foundations, in the first instance, to report back to the departments their compliance with the agreement. There are a number of provisions we've included in the funding agreements with these organizations.

The Auditor General commented in her observations that she was encouraged by the strengthening of the accountability regime that we just have put in place. She's not completely satisfied, but she has been encouraged with the developments.

From that point forward, then, the ministers are required to report, in their reports on plans and priorities as well as their departmental performance reports, the significant plans and results achieved by the foundations. They're responsible for administering these arrangements.

There are a number of foundations that are required to actually table their annual reports in Parliament. Particularly, there are three legislatively created foundations that are required to do so. Over and above that, there are a number of others that have their annual reports tabled in Parliament through their respective ministers.

• (1650)

[*Translation*]

The Chair: Thank you very much, Mr. Sauvageau.

[*English*]

Mr. Morgan, I agree with Mr. Sauvageau that you have two competing statements here. Tabling reports in Parliament is not accountability. When you state that they're not controlled by government, you can't at the same time say you have a robust regime to ensure appropriate accountability. You can have one or the other, but you can't have both.

Mr. Murphy, please, eight minutes.

Hon. Shawn Murphy (Charlottetown, Lib.): Thank you very much, Mr. Chairman.

I'm just going to follow up briefly on the EI surplus, perhaps with you, Mr. DeVries. You indicated to a previous questioner that the premiums have been decreased every year for the past 10 years, and this year the premiums collected were approximately \$1 billion in excess of the benefits paid out.

Mr. Peter DeVries: For fiscal year 2003-04, as the Auditor General indicated, when you exclude the interest as sort of credited on the account balance, then there was about \$1 billion extra. For 2003, the premium rates, the government did not say that the premium revenues or the rates set would generate sufficient funds to completely balance the expenditures on an annual basis. That came into effect for setting the premium rates for 2004.

Hon. Shawn Murphy: I know it may be a difficult question, but do you have any projection as to what might happen for the fiscal period ending March 31, 2005?

Mr. Peter DeVries: As you say, it is difficult to assess what is going to happen, given that there are a lot of variables at play. The economy has turned out to be stronger in 2004 than what was anticipated when the premium rates were set at the end of 2003. So we could be in a situation where there may be a slight surplus in the annual balance over the course of 2004-05.

However, as I said, the premium rates will have to be set this fall again for 2005, and the criterion that will be used is to set the rates so that the revenues generated will equal the program cost as forecast at that time.

Hon. Shawn Murphy: You indicated that it has been 10 years, but in those 10 years the unemployment rate has come down and the participation rate has gone up. In effect the government, to a certain extent, is a victim of its own success. It's trying to play catch-up. But the better job it does in decreased unemployment and the better it does in having employment participation across Canada, it creates its own problem by being successful. Do you agree with that?

Mr. Peter DeVries: You're quite right, the benefits are determined by economic developments. Of course, the revenues that you get from setting a certain premium rate are also determined by economic development. If more people are working, then of course you are going to generate more premiums.

Hon. Shawn Murphy: My next question is to the Auditor General. I'm confused on this—and I've followed this for years and I've read your statements before and I'm quite aware of the surplus in the employment insurance account. But I really wasn't aware of this so-called "notional interest" that has been accrued on the account every year now. You will agree with me that there's no account. It goes into the general revenues of the Government of Canada and the benefits are paid for the Government of Canada, although you track the difference in the amount that's collected and the benefits paid. But now you're adding a notional interest to this accumulated surplus. What is the purpose?

Ms. Sheila Fraser: That is strictly the decision of government. There is no requirement to include a notional interest, but that has always been done since the account has been in surplus, which has been about six or seven years, I guess. It is a government decision to credit interest in the account.

•(1655)

Hon. Shawn Murphy: Does that serve any accounting purpose?

Ms. Sheila Fraser: I think Mr. DeVries mentioned that the account is really established in the act to be used as a mechanism for setting rates. There is a section or a paragraph in the act that says how rates are to be set. This has been suspended and another rate-setting mechanism has been given. It says that over a period of time rates should be equal and there should be enough of a reserve, which the actuary has said should be \$15 billion.

The account is to be used to track the annual surplus and deficits in the account. There is a separate statement produced, on which we give an opinion, of the EI account, and there are restrictions on what can be paid out of that notional account—what those revenues can be used for, if you will. That was all part of the EI Act that was put in place.

Hon. Shawn Murphy: You will agree with me on my previous statement, like Mr. DeVries, that in a certain sense in the last 10

years the government has been a victim of its own success. Unemployment has gone down; participation is going up. It's almost a game of catch-up.

Ms. Sheila Fraser: Well, on a year-by-year basis, but there is a notion in the EI account that you should look at a business cycle. If you see that you are having much better performance than you would expect one year, the way I interpret the act would be that the next year you correct it. Over a period of time, you try to bring it into a balance.

The government has now come out with the policy that the annual premiums should equal the annual payments out of benefits and expenses. That is now, I would say, a new decision that has been made quite recently in recent budgets. Until then, there were very significant surpluses each year being generated in the account. There is this accumulated surplus, if you will, that has been generated of \$46 billion.

Hon. Shawn Murphy: My next line of questioning to you, Auditor General, is this. I know you've done a lot of work—maybe not you yourself, but your office—in other countries, the world, on audits and that. Can you give this committee some indication as to how our accounting and the public accounts compare to other developed countries with respect to the integrity of the reporting, the transparency, the disclosure?

Ms. Sheila Fraser: Obviously, we haven't done an exhaustive study. But I know from discussion with colleagues internationally, first of all, there are very few countries that have gone to full accrual accounting—probably a handful, certainly less than 10. Full accrual accounting means that your capital assets are recorded on your books. Many countries are still struggling, quite frankly, to do just basic cash accounting, which is cash in and out.

So the fact that Canada has gone to full accrual accounting is a major accomplishment. Many countries as well have not been able to get a clean opinion from their legislative auditor on their financial statements. As we say, Canada is a world leader in that the government has produced full accrual accounting statements and that there has been a clean audit opinion given on them.

Hon. Shawn Murphy: The last line of questioning I have again comes back to you. It concerns the foundations. I'm quite aware of your opinion and quite aware of the issue, but I'm not clear on the opinions.... These foundations started to be funded, I believe, in the 1997 fiscal year. Is there new money going in? I didn't get that from your statement. For the fiscal period ending March 31, 2004, were there additional expenditures made to these foundations?

Ms. Sheila Fraser: Yes, there was about \$400 million transferred to the foundations in the year ending March 31, 2004.

The Chair: Thank you very much, Mr. Murphy.

Mr. Christopherson, please, eight minutes.

Mr. David Christopherson (Hamilton Centre, NDP): Thanks very much, Mr. Chair, and thank you all very much.

If I can, I'd like to revisit the whole issue of EI, because I know the Auditor General is very careful about language that's used. In her world, I would think this is pretty strong language. It certainly comes across that way to me. To put it back on the record, I'll quote point six: In my view, Parliament did not intend for the EI account to accumulate a surplus beyond what could reasonably be spent on the EI program. Hence, in my opinion, the Government has not observed the intent of the Employment Insurance Act.

Through the chair, I acknowledge and respect the fact that you're not ministers.

• (1700)

The Chair: Mr. Christopherson, can you give us the page reference for that quote, please?

Mr. David Christopherson: It's the second page of the Auditor General's preamble.

The Chair: You were quoting from the preamble; you weren't quoting from the public accounts.

Mr. David Christopherson: No, I was quoting from her remarks that she made a half-hour ago.

The Chair: Okay.

Mr. David Christopherson: I would like to hear whether or not there's anybody at the table who has a different view. If so, I'd like to hear the rationale. If not, if you agree with the Auditor General's view, why are we still doing this? Why are we at this point? Please, I don't want to hear about what the government's going to do. This has been raised many times before. So either one disagrees with the Auditor General or somebody has not been responding to serious concerns raised by this country's Auditor General.

Some comments, please, through you, Mr. Chair.

The Chair: Who would you like to...?

Mr. David Christopherson: Anyone who would like to take up the challenge.

The Chair: Okay, Mr. DeVries, please.

Mr. Peter DeVries: I guess it's my challenge, Mr. Chairman.

The Chair: I think there are perhaps others, so be brief and succinct and focused, please.

Mr. Peter DeVries: Another committee of this House did look at the EI rate-setting system, the provisions under section 66. There are two provisions there. One is that there should be sufficient revenues generated in order to fund program costs over a business cycle. The second provision is that the rates should be stable over time.

Another committee of the House, the finance committee, back in 1999 recognized that there was a flaw with those two provisions and made a recommendation to the government at that time that they should look at this issue and should make changes to the way the premium rates were set. They recommended to the government at that time that we should not have this backward-looking mechanism anymore, but a solely forward-looking mechanism.

That's what the government decided to do in the 2003 budget when it launched its consultations on a new rate-setting mechanism. It repeated the principles in the 2004 budget and was going to

introduce legislation this fall in order to enact a new rate-setting mechanism.

However, the issue has been referred to a committee of this House for study. The government will consider the recommendations of that committee at that time.

The Chair: Ms. Fraser, do you have anything to add?

Ms. Sheila Fraser: I was just trying to find, Mr. Chair, the documentation we have on the finance committee. I think we would agree that going forward the government has clearly stated its intention that the premiums collected would equal the benefits and expenses related to that program. The major question is, what happens to the surplus that has been accumulated? That is, I think, the major question that has to be resolved.

Mr. David Christopherson: With respect, I would suggest there's a political question. I realize that it's not to be dealt with here, but there is a political question that deserves to be answered, too. Why was it allowed to continue?

You use very strong language, Madam Fraser, where you say that you don't think Parliament intended this. I didn't hear anybody suggest that they had a different view or that their minister has a different view of that. If that's the case, and we've been accumulating this much money, Mr. Chair, somebody has to do some answering. I appreciate that you may not be the folks, but I'll give you an opportunity to do so.

I was very shocked; I really was. After all that the Auditor General has been through, you'd think it would take a lot to shock us all, but I was very shocked that she would come out and say it this way. I'm not hearing anything other than.... And again, I know you're not in the political—capital “P”—arena, but to say more promises is just not going to wash given that we're now looking at an accumulated kitty of \$46 billion. I mean, this has been a cash cow.

This is not the first time, I'm assuming, Madam Fraser, that you've raised this; I'm sure it has been in quite a number of reports. So while a lot of Canadians are caught up with some of the larger issues around the sponsorship program, something like this is very damning. Somebody has to be held to account.

The Chair: Mr. DeVries, do you have any comments?

Mr. Peter DeVries: Well, the only comment I would make is the one that I've made already. The government recognizes there is a problem with the rate-setting mechanism as set out under section 66 of the EI Act. Because of that, it has suspended the provisions of that act since 2002 while it looks for a new mechanism. Hopefully, we'll have a new mechanism in a very short period of time.

• (1705)

Mr. David Christopherson: One would ask—and I don't know the answer to this question, which is always risky, but I don't know the answer, and so it's through the chair to you—were any further surpluses accrued after that?

Mr. Peter DeVries: There have been surpluses, as the Auditor General indicated, accrued in 2002-03, and as indicated there was a notional surplus or a surplus of \$2 billion in 2003-04, half of which was due to interest. The rates for 2004 were set based on the assumption there would be a balance at the end of the year. Of course, things do change, but that was the assumption made at the time the rates were set for 2004. As I indicated, the rates for 2005 will be set shortly under those principles, whereby the premium rates or the premiums collected are expected to balance the program expenses.

Mr. David Christopherson: Forgive me, I had the impression that your earlier comment was that the government stepped in a couple of years ago, suspended the rate-setting system they had, to deal with this, and yet the problem continued. So it doesn't seem to have been much of an interim measure.

Mr. Peter DeVries: But in the interim measure, the government suspended the provisions of section 66. It received parliamentary approval to do so and it received parliamentary approval to set the rates at a certain level in each of those years. So there was a debate at that point in time as to what the rates would be; those rates were approved by Parliament.

Mr. David Christopherson: How much time do I have left?

The Chair: Fifty seconds.

Mr. David Christopherson: Again, if I'm missing something, I apologize, as I don't mean to badger you.

It sounded to me as if there had been so much pressure that eventually the government had to do something. They stepped in and did something; they said, "We have a longer-term plan in mind for legislative changes, but in the interim we're going to take this measure because we know this is very serious". It just seems to me that it didn't do anything; it didn't change an awful lot, and the problems still continued. The problem exists today, unless and until there's legislation, which takes us into the world of promises. That's a different world.

Am I missing something, sir?

Mr. Peter DeVries: What happened is that the government set rates for 2002, 2003, and 2004 with the view of bringing the premium rates down. They did not state at that point in time that the premium rates would equal the benefits being generated.

Mr. David Christopherson: Wouldn't that have been the point, though?

Thank you, Mr. Chairman.

Mr. Peter DeVries: That was something debated in Parliament at that time.

The Chair: Thank you very much, Mr. Christopherson.

Now we're going to go to Mr. Allison, who is going to share his time with Mr. Kramp.

Mr. Allison, please.

Mr. Dean Allison (Niagara West—Glanbrook, CPC): Thank you, Mr. Chair.

I'm sorry, Madam Fraser, but just for clarification, Mr. Murphy asked about how much was being transferred to foundations. Last year, was it \$400,000 or \$400 million?

Ms. Sheila Fraser: It was \$400 million.

Mr. Dean Allison: It was \$400 million.

So I guess my question then is, given the fact there is a large surplus that has not been spent, why would there be a need to transfer additional moneys to the foundation account if the moneys hadn't already been dispersed?

Ms. Sheila Fraser: I think that's an excellent question, Mr. Chair. Unfortunately, I can't answer that. I think maybe the government would have to answer that.

Mr. Dean Allison: Oh, sure. Okay.

The Chair: Mr. DeVries.

Mr. Peter DeVries: The \$400 million that I think the Auditor General is referring to is the money put in trust to the provinces in order to enhance medical equipment.

Is that not the one, or is it the \$250 million for the sustainable development?

The Chair: Mr. St-Jean, *s'il vous plaît*.

Mr. Charles-Antoine St-Jean: The numbers are \$100 million for the Canada Health Infoway, \$250 million for the Canada Foundation for Sustainable Development Technology, and \$50 million for the Foundation for Climate and Atmospheric Sciences.

Mr. Peter DeVries: Okay, I stand corrected. I apologize. There are too many \$400 millions running around.

The moneys were put out front to give these organizations the security that the money would be there for them to use, so they could then use that money to leverage with other partners in these programs.

Mr. Dean Allison: I understand there is some \$7.7 billion that still hasn't been allocated in the fund. So once again, why would we have an additional \$400 million contributed to the fund when we already have \$7.7 billion that is not allocated at this point in time?

Mr. Peter DeVries: The \$7.7 billion that's referred to is, first, among a number of foundations; it's not all in one foundation. There are a number of different foundations that the money has been allocated to.

The Chair: Ms. Fraser, do you have something to say?

Ms. Sheila Fraser: Perhaps to complicate things a bit.

If we look at the schedule that details it on page 2.28 of the public accounts, volume I, we have in our observations the various foundations, the total funding they received, and the balance.

For example, Mr. St-Jean mentioned Canada Health Infoway, which is the third one down. It has received \$1.2 billion in funding, and at the end of March it had in its bank account \$1.202 billion. So it received additional funding during the year, yet it has spent very little of what it actually received, the \$1.2 billion.

• (1710)

The Chair: Mr. DeVries, have you any comment on that?

Mr. Peter DeVries: The comment I would have on that is that it's meant to be multi-year funding; it's not meant to be spent all in one year. It's meant to be disbursed over a number of years.

It's also meant to be disbursed for a number of different things. And at times incremental funding is provided to the foundations in order for them to undertake something they were not required to undertake before.

The Chair: Mr. Allison.

Mr. Dean Allison: Okay, so we have additional funds...if I could just get my head around this. We have money given to the organizations that has not been spent; we've increased the granting, with the money still not having been spent.

My question then is to the Auditor General. What is your opinion in terms of your ability...have you been able to look at this and reconcile this in terms of the money that's there and what it's being used for or supposed to be used for? Are you able to audit those foundations?

Ms. Sheila Fraser: No, I am not. My mandate does not extend to the foundations.

The Chair: Thank you, Mr. Allison. I'm sorry, I have to cut you off.

Mr. Kramp, please.

Mr. Daryl Kramp (Prince Edward—Hastings, CPC): That lens just opens a Pandora's box. What is the purpose of having these foundations, if we have no access to audit, rather than the traditional, normal agencies or departments? What purpose is served when there's no accountability? Are they there so we don't have access to accountability? I'm a little bit concerned about this.

Ms. Sheila Fraser: Government will argue that these are independent, arm's-length organizations. Government will argue that this is a preferable way of doing these sorts of public policy initiatives.

We have had several reports on the foundations and we were very concerned about many of the accountability arrangements. I will say that government has improved much of the reporting of the foundations, and some of the conditions that existed previously that were perhaps more egregious have been corrected.

We still do have some concerns that have not been addressed. We have concerns about the audit provisions, because the foundations have financial audits done but there are no performance audits or broader-scoped audits. We have taken a position that Parliament's auditors should have access to these foundations and it should be the ones given significant amounts of money. In fact, I believe the public accounts committee had recommendations to that effect last year or the year before.

We also have some concerns about the ability of ministers to intervene should things go wrong. There is limited capacity for ministers to intervene in the foundations.

So as I mentioned in my opening statement, we are doing an audit or follow-up review of what has changed since our last report and we will be reporting on that in February.

Mr. Daryl Kramp: Thank you, and my apologies should I not have the historical background on this, but am I to understand, then, that you do not have the authority to investigate the accounting practices of the foundations?

Ms. Sheila Fraser: That's correct.

Mr. Daryl Kramp: That's my question on that.

I have another little aside. I'm really pleased to see the significant movement to accrual accounting. You should really be tremendously thanked on behalf of our citizenry because it gets a little closer to the real truth of where we really stand.

Yet I see there are some concerns. Naturally, nothing works easily. For example, in DND, how do we set the rate of depreciation for an airplane when we may be the only people who have it and there are no comparables? It's not like setting a 5%, 10%, or 15% depreciation rate. It's not a house, a fridge, or an automobile.

So when we have a lack of track record on this—and you mentioned there are only eight or ten other countries that are moving toward this—my concern would be how and when are we going to have something consistent from year to year? Are we going to be in a steady flux, so that you really don't know where you're going and we really don't know where you're going, because we're still in a changing market from the accelerated rate...to be able to make progress in this accrual process?

What do you think? Can you give us an idea?

Ms. Sheila Fraser: I'll talk about the two issues we flagged. One was in National Defence, as you mentioned, and it was largely what we call inventory—supplies and spare parts. Actually, on the capital assets the government did a really good job, and while there will always be improvements over time, that to us is not the major concern. The major concern is what we call spare parts and inventory, like munitions and things. As you can imagine, the systems were designed to control the quantities. They were never designed to have price and cost information. That is the big challenge. A lot of these supplies could have been purchased many years ago or don't turn over a lot, so trying to get an evaluation of what the cost of that inventory is will be a significant challenge.

The department has put in considerable effort every year to be able to get a number that is reasonably acceptable from an audit point of view, given the materiality that we work with on the summary financial statements. It has committed to us to put systems in place, and they have been working now. We do see improvement. It's slower than we would like, which tends to be the case in many things, but there is progress being made.

• (1715)

The Chair: Thank you, Mr. Kramp.

Mr. Holland, are you splitting your time with Mr. Wrzesnewskij?

Mr. Mark Holland (Ajax—Pickering, Lib.): That's correct.

Thank you very much for the opportunity. I guess I have a couple of questions around the surplus in the employment insurance account.

Obviously we've just come through a period of time where we've had a very robust and strong economy over the last 10 years. Our employment rate has been very strong. I wonder if during a period like that, when you're using prudent and cautious estimates, you're going to have a structural surplus built in by the fact that you're being conservative and the economy is consistently outperforming.

Conversely, would it be a situation when the economy—and hopefully we won't experience this—is in a different cycle, where it's underperforming and our unemployment rate is increasing, that we would have built in a structural deficit?

If that is the case, I guess the question would be, what is an acceptable range that you would see over a period of time, and over what period of time would one look to get an accurate reflection of what is fair and right in terms of fluctuations in that account? The micro fluctuations need to be looked at in a sort of macro level.

Ms. Sheila Fraser: I agree very much with what you're saying. Now, how to do it, I think, is up to government, but that is the essence of section 66 of the act, which was suspended. The act says that the premiums should equal the expenses over a business cycle. We would understand that you need to, if you will, build up a surplus so that immediately before you go into a downturn, you wouldn't be at zero. So we have asked the government, actually many times—and this is part of the audits we've been doing—to define what the business cycle is, what an appropriate level of surplus would be, how you would do this.

But that part of the act was suspended and it was to be part of this whole review. The actuary of HRDC at the time did a study and said that \$15 billion would be sufficient. Well, we're now at \$46 billion.

There needs to be clarity given to all of that, how that mechanism works. That is what the study was to have done and what the new legislation was to have done.

Mr. Mark Holland: I think that's a pre-eminently fair statement. From my perspective—and I would be interested in your comments on this—if we had that, if we had a construct where the business cycle is defined and where we understand what the macro picture is and what our expectations are inside of that, then I'm presuming you would have a greater level of comfort seeing surpluses in particular given years if it fit within that construct.

Secondarily, one doesn't want to go the opposite direction, where we cut too close to the marrow, if you will, in our projections and our estimates, such that we wind up in a situation where things don't unfold in the way in which we predict—the opposite direction—and we start recording deficits year over year and start accumulating a deficit position; and suddenly we have an underfunded program, where instead of 10 years of decreasing rates, we're going to have to start increasing them. I certainly would much rather be in a situation where we're tweaking them downwards, as opposed to a situation where we miscalculate the other way and have rates rising on us.

I suppose that's just a cautionary note. I don't know if you want to comment on that. That's my principal concern in this regard.

• (1720)

Ms. Sheila Fraser: I think much of what you discuss is really a policy decision as to how the program continues to run on this principle that premiums equal benefits over a certain period of time.

That is obviously a policy decision. That policy decision could be changed.

The concern we're flagging is that when that clause was introduced in the act, we interpreted it as an intention of Parliament that over a period of time they should equal out with a certain surplus at the end. The surplus that has been generated is much higher than that, so now what happens to the surplus that has been accumulated? The excess of premiums received over benefits paid, what happens to that now? That's one of the major issues we're bringing forward.

The Chair: Thank you, Mr. Holland.

Mr. Wrzesnewskyj, please.

Mr. Borys Wrzesnewskyj (Ettobicoke Centre, Lib.): I was curious about what portion of the accumulated positive \$46-billion account is fictional accumulated interest.

Ms. Sheila Fraser: I'm sorry, I don't have that number with me. I don't know if—

The Chair: Mr. Morgan, do you have the number?

Mr. John Morgan: No, sir, I don't. In the last couple of years it's been \$1 billion a year, so moving that forward, it could be probably at least \$10 billion. My colleague tells me that we could get that for you.

Mr. Borys Wrzesnewskyj: I think that would be helpful, because it would be a more realistic number.

The Chair: Mr. DeVries, you can submit a letter to the committee?

Mr. Peter DeVries: I will, Mr. Chairman.

Mr. Borys Wrzesnewskyj: Prior to 2002, when there were employment insurance commissioners, they used a different approach, different mechanisms, to arrive at the level of premiums that they set. Taking into account that we had come out of a very serious recession, did they build in at that time, when they went through their process, a buffer, and if so, what kind of buffer did they look at?

Ms. Sheila Fraser: I could perhaps begin an answer.

When we went back and began to raise this issue, we compared the rates that the chief actuary was suggesting and the kinds of surpluses that were being created with the rates that were being established by the commission. You'll notice that in the first few years we were asking why there was a difference in the rate and what was the justification for that, based on the section 66 that was then in force. Our audit finding at that time was that there was no justification given to us. We could understand if there was something over and above what the actuary was recommending as a base rate, but we were never given an explanation, an analysis, any details as to why that increase, so I don't believe that exists. We certainly never received it. This was one of many comments we were making at that time.

Mr. Borys Wrzesnewskyj: This is my final question. I'm curious, what was the forecasted unemployment rate used for the previous year?

Mr. Peter DeVries: I'm sorry, I don't remember what it was. I will get it for you, though. It would have been the unemployment rate that was underlying the fall 2002 economic and fiscal update, so it is in there. But I will get it for you.

The Chair: All right. That will come to committee. It will be circulated when received.

Mr. Borys Wrzesnewskyj: The assumption is that it was significantly higher than it is at the present time.

Mr. Peter DeVries: It was somewhat higher. I don't think it's significantly higher, but it was somewhat higher than what it has actually turned out to be for 2003. You were talking about the year 2003.

Mr. Borys Wrzesnewskyj: Yes.

Mr. Peter DeVries: That would have been in the 2002 economic update. A forecast would have been made of the unemployment rate for 2003, and the premium rate set accordingly, or set in that context.

Mr. Borys Wrzesnewskyj: When you do your present forecasting, is a buffer put in place in case premiums are not collectable?

• (1725)

Mr. Peter DeVries: Not per se. The buffer is in the contingency reserve, the \$3 billion that the government sets aside in its budget plan. In the event that the revenue forecast does not come in as expected or estimated, or expenses are higher than estimated, then there's that buffer in order to cover it off so the government can still meet its fiscal target.

The Chair: Thank you, Mr. Wrzesnewskyj.

I have a question of my own. We've had some issues regarding submarines of late. The government acquired these submarines from the British government, and I understand there were some trade-offs. It wasn't just a cash payment for these submarines. We are providing training for their military.

How has that been accounted for? Now with accrual accounting, we should have an asset on our books equal to four submarines. Whatever the value may be is debatable, but that's the point. We have a continuing expenditure, as we are providing training. How are we accounting for this ongoing expenditure for the submarines?

By the way, we're not going to start a second round. We're going to wrap this up in a few minutes. I apologize, but we were late getting started.

Mr. Morgan.

Mr. John Morgan: Mr. Chair, I'm not familiar with all the details of the acquisition of the submarines. I can tell you that the asset value of the submarines is included in the capitalized value on the balance sheet of the government.

The Chair: Was that put in at cash paid or at cash plus other value to be provided?

Mr. John Morgan: I'm sorry, I can't comment on what exactly the value represents. It is included in the assets. There's a lease component as well as an asset component.

The Chair: Ms. Fraser.

Ms. Sheila Fraser: It's my understanding, Mr. Chair, that there was one outright cash purchase and two lease arrangements, so capital leases. The asset was recorded and the debt related to the lease was recorded.

The Chair: Was that an actual debt with a cash payment or an actual debt to be paid by services provided?

Ms. Sheila Fraser: It is an eight-year lease with a payment schedule.

The Chair: Cash payment schedule?

Ms. Sheila Fraser: Yes, that's my understanding, that it's a cash payment schedule.

The Chair: Could you confirm, Mr. Morgan, that it is a cash payment? We'd been led to believe that some trade-offs were provided. How are these trade-offs properly accounted for? We need to know what these submarines actually cost and the basis on which we bought them. We don't really want to get into bartering, and misleading the Canadian public on the cost of these things. Can you do that?

Mr. John Morgan: Yes.

The Chair: Okay.

I apologize that we can't start a second round. We normally finish up with some closing comments by the Auditor General.

Do you have some closing comments, Madam Fraser?

Ms. Sheila Fraser: I'd just like to thank the committee, Mr. Chair, for their interest in *Public Accounts 2004*. I think this is really important, obviously; these are the financial statements for Canadians. And our opinion issues do come back in our November report, so I'm sure we'll have other opportunities to discuss foundations in the employment insurance account.

Thank you.

The Chair: Thanks to all for coming here this afternoon.

I have one announcement. Earlier on, when we were in camera... the issue of the commission of inquiry, the Gomery commission, and the issue of parliamentary privilege will be discussed in the Tuesday meeting at 3:30. I will be issuing an invitation to the House of Commons legal counsel at the commission, Ms. Catherine Beagan Flood. I will also be sending a letter to the lawyers who have asked that this waiver be granted, so that they can come here and explain why we should even contemplate this waiver. Rather than having six, eight, or ten lawyers come at the same time, I'm asking that they appoint themselves a spokesperson to come here and explain to us why we should even consider a waiver. As I say, we will also have House of Commons lawyer, Catherine Beagan Flood, here.

That will be Tuesday afternoon, at 3:30 p.m., room 253-D at Centre Block. As well, there will be a steering committee on Monday afternoon, at 3:30, I presume.

The meeting stands adjourned.

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