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Report of the

Auditor General of Canada

to the House of Commons

NOVEMBER

An Overview of the Federal Government's Expenditure Management System

Chapter 1

Expenditure Management System at the Government Centre

Chapter 2

Expenditure Management System in Departments



Office of the Auditor General of Canada

The November 2006 Report of the Auditor General of Canada comprises Matters of Special Importance—2006, Main Points—Chapters 1 to 12, Appendices, An Overview of the Federal Government's Expenditure Management System, and 12 chapters. The main table of contents for the Report is found at the end of this publication.

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An Overview of the Federal Government's Expenditure Management System

Introduction

- 1. Demands on government are unlimited, but the resources available to meet them are not. Governments must therefore have some means of deciding how much they can afford to spend, what to spend it on, and how to get the most for the money spent. The policies, processes, and practices they follow to deal with these questions constitute the Expenditure Management System (EMS).
- 2. The EMS is at the heart of the operation of government. It touches everything the government does, since all government activities involve spending. A system that works well promotes efficient, responsive, and accountable government. If it does not, nothing that departments and agencies do individually will yield sound overall management of government spending. An effective EMS is therefore essential to getting the results the government wants and accounting to Canadians for what is done on their behalf.
- 3. The EMS in the federal government has evolved considerably over the years, with countless variations in the way the government plans, manages, and reports on its spending. This chapter looks at the system as it appears today. Exhibit 1 outlines the main objectives, inputs, and players of the EMS.
- **4.** In its first budget released on 2 May 2006, the new government announced that it is seeking
 - a new ongoing approach to managing overall spending to ensure that all government programs are effective and efficient, are focused on results, provide value for taxpayers' money and are aligned with the Government's priorities and responsibilities.

Recent spending patterns and trends

5. In the last half of the 1990s, federal spending fell and then remained more or less flat as the government strained to bring the budget deficit under control. Spending then grew steadily, from \$162 billion in 1999–2000 to \$210 billion in 2004–05 (Exhibit 2). It fell marginally in 2005–06, to \$209 billion, owing largely to the dissolution of Parliament, which prevented some planned spending from receiving parliamentary authority to proceed.

6. With the declining debt and lower interest rates, debt service charges have fallen steadily from nearly 30 percent of federal spending in the mid-1990s to just over 16 percent in 2005–06. This shift was the most conspicuous change in the composition of federal spending over the past decade. Among other spending categories, transfers to other levels of government lagged during the 1990s, but they experienced the fastest growth more recently. As a result, the relative distribution of program spending (spending other than debt services charges) in 2005–06 was similar to that of 10 years earlier.

Exhibit 1 The main objectives, inputs, and players of the Expenditure Management System

Basic objectives	Main inputs	Key players
Overall fiscal control	Fiscal strategySpending and revenue forecastsBudget preparation	The Cabinet The Department of Finance
Efficient allocation of resources	 Priority setting Policy development New spending approvals Production of Estimates 	 The Cabinet The Privy Council Office The Department of Finance The Treasury Board and its Secretariat The departments
Operational efficiency	Operational planning Financial management and controls Performance monitoring and measurement	The Treasury Board and its Secretariat The departments
Parliamentary control	Examination and approval of the Estimates Review of Public Accounts and program performance	 The House of Commons Parliamentary committees The Auditor General

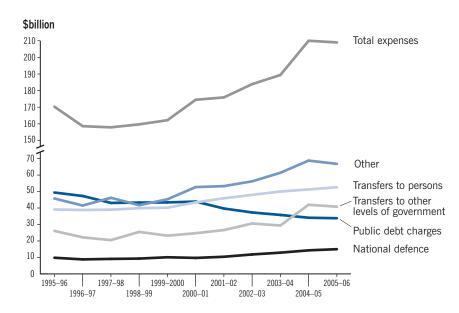


Exhibit 2 Federal government spending by major purpose

Source: Public Accounts of Canada

Setting of limits on total spending

7. To manage public spending effectively, any government needs to exercise fiscal discipline—to establish what it can afford to spend and to live within those limits. Establishing those limits is a key purpose of the annual budget.

What the annual budget is and what it does

8. The annual budget is a financial expression of the government's priorities, policies, and plans. Historically, the budget was released after the presentation of the Main Estimates, which lay out the detailed spending plans of the government. The budget therefore focused chiefly on the "ways and means"—the taxes and other measures needed to fund the government's plans. Over the past two decades, the budget evolved into the main vehicle for announcing new spending initiatives as well as tax measures. It has no legal authority; although measures announced in the budget may take effect immediately, they must be presented for Parliament's approval in separate legislative proposals before they become law.

- **9**. The budget does three things:
 - reviews recent economic developments and the current economic outlook;
 - announces new spending initiatives and tax changes; and
 - establishes the government's Fiscal Plan, showing how much revenue the government expects to collect over its planning period, how much it intends to spend, and the resulting balance and level of debt.
- 10. In developing its Fiscal Plan, the government establishes a ceiling on its total spending. The key factor that shapes the Fiscal Plan is the budget balance: the government's current stated objective is to maintain a surplus of \$3 billion each year. All decisions on taxing and spending must line up with this objective.
- 11. The government's first step in budget planning, then, is to determine how much it can spend without putting this budget balance at risk. The Department of Finance, which develops the Fiscal Plan, makes projections of revenues and expenses under present policies and expected economic conditions. It reduces the resulting balance by the \$3 billion planned as the surplus. The residual left after these calculations is the amount available for new spending or tax cuts, depending on an assessment of their relative benefits and on the government's priorities.
- 12. Exhibit 3 shows the Fiscal Plan from the most recent budget, tabled in May 2006. It shows that, after the \$3 billion set aside as the target surplus, the remaining surplus of \$0.6 billion in 2006–07 and \$1.4 billion in 2007–08 would be available to fund future priorities.

How the budget is prepared

- **13**. Budget-making is a year-round process involving regular reviews of economic and fiscal developments, program requirements, and policy priorities.
- 14. June to October. The Cabinet holds retreats in early summer and fall to review policies, discuss priorities, and develop a budget strategy and themes. The Privy Council Office (PCO) provides background information on recent developments that could have implications for the agenda set out in the government's election platforms and the most recent Speech from the Throne. The Department of Finance updates the fiscal outlook and discusses fiscal options in light of current economic conditions and the government's objectives.

Exhibit 3 Budget 2006 Fiscal Plan

	Actual	Actual Estimate 2004–05 2005–06	Projections	
	2004–05		2006–07	2007–08
Budgetary transactions	(\$ billions)			
Budgetary revenues	211.9	220.9	227.1	235.8
Program expenses	176.3	179.2	188.8	196.5
Public debt charges	34.1	33.7	34.8	34.8
Total expenses	210.5	212.9	223.6	231.4
Budgetary balance	1.5	8.0	3.6	4.4
Planned surplus			3.0	3.0
Unallocated surplus			0.6	1.4
Federal debt	494.4	486.4	483.4	480.4

Note: Totals may not add due to rounding.

The government's Fiscal Plan shows how much revenue the government expects to collect over its planning period, how much it intends to spend, and the resulting balance and level of debt.

Source: Department of Finance, The Budget Plan 2006, Table 4.4.

- **15. October to November.** Extensive consultations begin formally in the fall with the presentation of the *Fiscal and Economic Update*. The Update is delivered by the Minister of Finance to the House of Commons Standing Committee on Finance. It reviews fiscal results since the previous budget and revises the fiscal outlook in light of recent economic conditions.
- 16. September to December. The House of Commons Finance Committee invites submissions from the public and holds hearings on priorities and issues for the upcoming budget. It reports with recommendations to Parliament in December. The Minister of Finance and the Department also consult with individuals, interested groups, and organizations about the forthcoming budget.
- 17. December to February. Drawing on these consultations and on recommendations from the Cabinet policy committees, the Minister of Finance develops a proposed budget strategy for review by the Cabinet.

Early in the year, the Minister of Finance and the Prime Minister take final decisions on the budget, based on the latest fiscal outlook and the government's priorities. The Minister of Finance presents the budget in the House of Commons, usually in mid-February and normally on a Tuesday afternoon, after financial markets have closed.

- 18. The House debates the budget for an additional four days (not necessarily consecutively). At the end of the debate, it votes on a motion by the Minister of Finance to approve the government's budgetary policy. While approving the motion confers no legal authority on the budget measures, defeat of the motion constitutes a vote of no confidence that spells the defeat of the government. This has happened only twice in Canada's history, in May 1974 and December 1979.
- 19. With the presentation of the budget, the Minister of Finance also tables notices of ways and means motions that detail the tax changes proposed in the budget. In time, these proposals will be incorporated in tax bills and steered through the normal process for passing legislation.
- **20.** New spending proposals receive funding approval either through the supply process (see the role of Parliament on page 18), budget implementation acts, or specific legislative measures, which follow the same process as other legislative proposals by the government.

The budget's spending framework

- 21. Since 2003, budgets show expenses on an accrual basis—revenues and expenses are recorded when the associated activity occurs, not when the government receives or pays out cash. Budget 2006 abandoned the practice of subtracting expenses against associated revenues ("netting"), and instead showed figures on a gross basis. Our Office had expressed concerns about netting because it does not accurately reflect the nature and size of government. This change increased the government's reported expenses by \$13.8 billion. It had no impact on the budget balance, since reported revenues increased by the same amount.
- **22.** The Budget breaks down total spending into public debt charges (interest payments on the public debt) and program expenses. The program expenses are split about evenly between transfer payments and direct program expenses (Exhibit 4).
- 23. Transfer payments consist of transfers to persons and to other levels of government. Transfer payments to persons include payments to individuals for old age security, employment insurance, and child benefits. Transfers to governments are payments to the provinces and the territories, primarily for health care, equalization, and social assistance.

24. Direct program expenses include wages, salaries, and other operating costs; grants and contributions to various groups and organizations; and payments to Crown corporations. They also include amounts set aside for specific purposes, but for which precise allocations have not yet been established at budget time.

Exhibit 4 How the Budget breaks down government expenses

	Actual	Estimate	Projections	
	2004–05 2005–06	2005–06	2006–07	2007–08
	(\$ billions)			
Transfers to persons	51.3	53.2	56.3	59.0
Transfers to governments	42.0	40.8	40.1	41.1
Total transfers	<u>93.3</u>	<u>94.0</u>	<u>96.4</u>	<u>100.1</u>
Direct program expenses	83.1	85.2	92.4	96.5
Total program expenses	<u>176.3</u>	<u>179.2</u>	<u>188.8</u>	<u>196.5</u>
Public debt charges	34.1	33.7	34.8	34.8
Total spending	210.5	212.9	223.6	231.4

Note: Totals may not add due to rounding.

Source: Department of Finance, *The Budget Plan 2006*

Allocation of funds to programs

25. Government spending programs include programs for which funding is governed by continuing statutory authority (legislation) and programs that depend on annual appropriations. Amendments to statutory programs require legislative changes. Their existence and level of funding are therefore not challenged as part of the annual budget cycle. Non-statutory programs need to be reauthorized each year, and their funding is therefore always subject to change. In practice, a combination of entrenched commitments, the cost of change, and the allure of stability for planning purposes affords non-statutory programs substantial immunity from spending cuts in normal circumstances. Budget decisions usually deal with allocating new funds among competing priorities, not reallocating the present funding of ongoing programs. Under Canada's current budget process, new spending is approved on a separate track from ongoing spending.

Approval of spending on existing programs

Reference levels—The amount of funding that the Treasury Board has approved for departments and agencies to carry out approved policies and programs for each year of the planning period.

Fiscal framework—The framework within which the Government makes fiscal decisions. It shows projected expenses and revenues and the financial resources available for new initiatives, given the Government's objectives about the deficit and debt.

Approval of new spending

- 26. The Treasury Board allocates funding for the ongoing delivery of existing programs through a process known as the Annual Reference Level Update (ARLU). In early summer, the Treasury Board Secretariat issues a letter telling departments to update their budgets ("reference levels") for the upcoming fiscal year and the two following planning years. Departments adjust their reference levels to incorporate new spending approved since the previous ARLU review and to reflect certain factors such as the impact of collective agreements, "reprofiling" of funds (shifting funds from one year to another), items whose authorized funding period has ended, and revised spending forecasts for statutory programs.
- 27. The updated reference levels are submitted to the Secretariat in the fall, usually in October. About 125 such submissions are made every year. After reviewing them for accuracy and compliance with requirements, the Secretariat reports its assessment to the Treasury Board. The Board usually considers and approves this report by mid-December.
- **28.** The Treasury Board Secretariat describes the ARLU process as "primarily a technical exercise that updates departmental funding for the next year as well as the two years after that." The reference levels approved by the Treasury Board form the basis for developing both the Main Estimates used to seek Parliament's approval of departmental spending for the next fiscal year and the expenditure plan presented in the annual budget.
- 29. In addition to approving the updated reference levels, the Treasury Board may allocate resources from reserves set aside in the fiscal framework for certain purposes tied to the Board's expenditure management responsibilities. Examples include urgent issues affecting public safety or the integrity of an existing program, investments to improve the efficiency of existing programs, and additional costs resulting from collective agreements.
- **30.** Proposals that involve spending for new initiatives or for enrichments to existing programs can take one of two paths, depending on whether they originate in departments or the government centre. Spending proposals that originate in the government centre normally entail initiatives that straddle a number of departments. Proposals affecting single departments are normally initiated by those departments.

Spending proposals originating in departments

- **31.** Ministers seeking new funds—whether to respond to rising demands in their portfolio, improve levels of service, or fund a new initiative—must first submit a request to the appropriate policy committee of the Cabinet. Under the current government there are three policy committees: Social Affairs, Economic Affairs, and Foreign Affairs and National Security.
- **32.** The instrument by which funding is requested is a Memorandum to Cabinet (MC). The memorandum presents the proposal, the reasons for it, its possible impacts, and the financial implications. The memorandum need not identify a source of funds; at this point, it is policy approval or approval in principle that is sought.
- **33.** The Cabinet committees review proposals and decide whether to approve them. Spending proposals approved by a Cabinet committee are referred for ratification to the Cabinet's Priorities and Planning Committee, which is chaired by the Prime Minister, or to the full Cabinet.
- **34.** Following Cabinet ratification, spending proposals are added to an inventory of possible initiatives for future budgets. The Minister of Finance and the Prime Minister decide which proposals will be included in the Budget, depending on available funding and priorities not yet addressed.
- 35. Once an initiative has been included in the Budget, the sponsoring minister makes a separate submission to the Treasury Board to request that funds be allocated. The submission to the Treasury Board explains how the department will carry out the proposed initiative and with what resources each year, what the department expects the initiative to achieve, and how it will monitor and assess results. The Treasury Board may reject a submission (an extremely rare occurrence), approve it outright, or approve it with conditions. If the funding approved relates to an ongoing new initiative or a permanent expansion of an existing program, the funding becomes part of the relevant department's reference level and gets on the spending track for ongoing programs.

Spending proposals originating in the government centre

36. The process of allocating funds for new initiatives does not always originate with spending proposals by government departments. Departmental proposals often follow decisions already made at the centre of government—by the Cabinet, the Prime Minister, or the

Minister of Finance—to increase funding in a particular policy area. These decisions are usually announced at budget time, but they can also be made outside the regular budget process. An example of the latter is the government decision announced last fall to allocate \$2.4 billion over the following five years to cushion the impact of energy-cost increases on low-income families and to encourage energy conservation efforts. When a decision is made to fund an initiative, funds are notionally set aside in the fiscal framework for the appropriate departments. The departments then submit proposals to the Treasury Board for allocations from the earmarked funds, based on specific program design and implementation details.

37. A point to note from the above description is that specific allocations to departments require Treasury Board approval. Funding requests for existing programs are approved by the Treasury Board alone; allocations for new policies or enrichments need to first receive policy approval by the Cabinet and to have a source of funds identified. They then receive legislative authority through the Estimates process. In some cases, spending initiatives formulated in the Budget receive legislative approval directly through a budget implementation act, bypassing the TB submission and Estimates process (Exhibit 5).

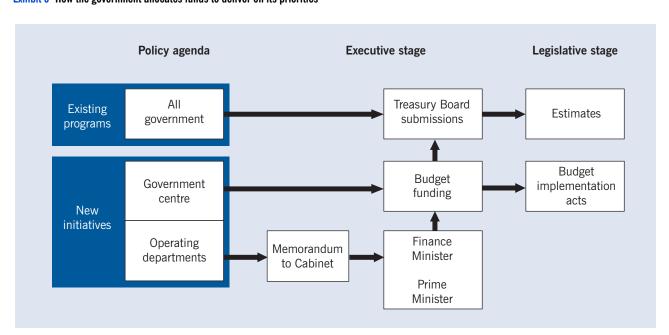


Exhibit 5 How the government allocates funds to deliver on its priorities

Promotion of efficient management of resources

38. Delivering public services efficiently while complying with authority and the requirements of due process is the joint responsibility of departments and the Treasury Board and its Secretariat. Departmental statutes and the *Financial Administration Act* make ministers responsible for maintaining control over spending in their departments, but the Secretariat has a central role in promoting good management practices and in ensuring that departmental operations are consistent with the government's priorities and meet its standards for efficiency and probity.

The policy framework

- **39**. The *Financial Administration Act* authorizes the Treasury Board to act on all issues of administrative policy, financial management, spending and estimates, human resources management, and any other matters that administering the federal public sector entails. In effect, the Treasury Board acts as the government's "management board" and was officially designated as such in June 1997.
- **40.** The Treasury Board performs two main functions as a management board: It sets management policies and standards for departments, and it oversees departments' compliance with them.
- 41. Some high-profile failures of departmental management in recent years have generated stronger oversight from the government centre, but the general trend over the past four decades has been toward less intrusion and involvement by central agencies in the decisions and activities of departments. The purpose of this change is to give departmental managers the flexibility to manage their departments in ways that improve performance. The shift is reflected in the declining numbers of submissions received annually by the Treasury Board, from some 16,000 in the early 1960s to 1,850 in the early 1990s, and under 1,000 today.
- **42.** With this change comes the need for appropriate mechanisms to hold managers accountable for their use of resources. The Treasury Board has explored various mechanisms for this purpose over the years, and it currently uses a set of expectations for public service management under an initiative called the Management Accountability Framework.

- 43. Introduced in 2003, the Management Accountability Framework consists of 10 "essential elements of sound management" (Exhibit 6), with indicators and measures of performance for each. It was developed not only as an instrument for holding departmental managers accountable for delivering on agreed objectives, but also as a means for departments to assess their own performance and report on it. The Management Accountability Framework is also expected eventually to inform Treasury Board decisions on resource allocation, but at present it is not part of the budget process.
- 44. Another recent initiative shaping the way the government manages and reports what it does is the Management Resources and Results Structure. The Management Resources and Results Structure has three components: strategic outcomes, programs aimed at achieving those outcomes, and information on the resources and performance of each of the programs. All departments are required to organize their operations within the framework of the Management Resources and Results Structure to provide for a common approach to collecting and reporting information across the whole government.
- **45.** The Management Resources and Results Structure is supported by the proposed new Expenditure Management Information System, an electronic database intended to link spending to results on a common basis government-wide. Timely, reliable information on what government programs cost and what they achieve is necessary for effective resource management, accountability, and oversight. It does not yet exist across all of the government.

Exhibit 6 Elements of the Management Accountability Framework

The elements of the Management Accountability Framework are

- · public service values;
- governance and strategic directions;
- · results and performance;
- · learning, innovation, and change management;
- · policy and programs;
- · risk management;
- · people;
- · stewardship;
- · citizen focused service; and
- · accountability.

Departmental functions

- **46.** Departments have the primary responsibility for managing the resources allocated to them and delivering the results they committed to deliver. Departmental statutes explicitly assign to ministers responsibility for the "direction and management" of their departments. The *Financial Administration Act* also assigns to ministers and their deputies additional, more specific responsibilities for prudent management of resources allocated to their departments.
- 47. These additional responsibilities include requirements that govern payments made from the Consolidated Revenue Fund, including the requirement to maintain records of financial commitments and to ensure that payments
 - do not exceed funds appropriated for the purpose by Parliament;
 - are requisitioned by a minister or authorized officer in a form prescribed by the Treasury Board; and
 - are made only after the departmental officer responsible certifies that performance conditions were met if the payments are for services or goods received, or that the recipient is entitled to the payment if it is a grant or a contribution.
- **48.** These basic legal requirements are designed to ensure that spending complies with parliamentary appropriations and that funds are not diverted to unauthorized uses. Departments are also expected to have appropriate management systems and processes to promote the efficient and effective use of funds.
- 49. Within the budgets voted by Parliament and the policies and limits issued by the Treasury Board, departments are free to decide on the appropriate mix of resources that will deliver their programs cost-effectively. They set objectives and allocate resources to achieve them, establish controls to ensure that decisions are implemented as intended, monitor performance, and maintain financial accounts and records. As part of their planning, they assess risks to and pressures on their programs and adjust their operations to manage them. When they determine that they need additional resources, they prepare submissions to the Cabinet and the Treasury Board for approval of funding.

The role of Parliament

- **50.** Parliamentary control of the public purse is fundamental to responsible government. Granting government the authority to spend is one of Parliament's principal functions and is a key part of holding the government to account. Parliament's power to grant this authority is founded on two basic principles:
 - The government may not raise money without Parliament's approval.
 - The government may not spend money except for purposes authorized by Parliament.
- **51.** These principles were already well established at the time of Confederation and were incorporated in the *Constitution Act*, 1867. To support parliamentary control of public money, the Constitution directs that all "duties and revenues" shall be paid into one Consolidated Revenue Fund, and all payments made from the Fund must be appropriated by Parliament.
- **52.** Parliamentary authority to spend is granted through a process known as the Business of Supply. Rules governing the process are codified in the Constitution, statutes (primarily the *Financial Administration Act*), and the Standing Orders of the House of Commons. Grounded in centuries of parliamentary tradition, these rules are intended to ensure that parliamentarians have adequate opportunity to scrutinize and debate the government's spending proposals before they approve them.

Form and content of the Estimates

- **53.** The Constitution specifies that all spending measures must be initiated by the Crown—that is, the executive—and must originate in the House of Commons. In other words, it is the job of the government to prepare a spending plan and bring it to the House. The government presents this plan in the form of the Estimates.
- **54**. Currently, the Estimates are structured in three parts:
 - Part I, The Government Expense Plan, provides an overview of projected federal spending for the fiscal year and relates the Estimates to the planned spending presented in the budget.
 - Part II, The Main Estimates, provides details of proposed spending by department and program, in a form that Parliament will be asked to approve in order that the government may proceed with its spending plans.

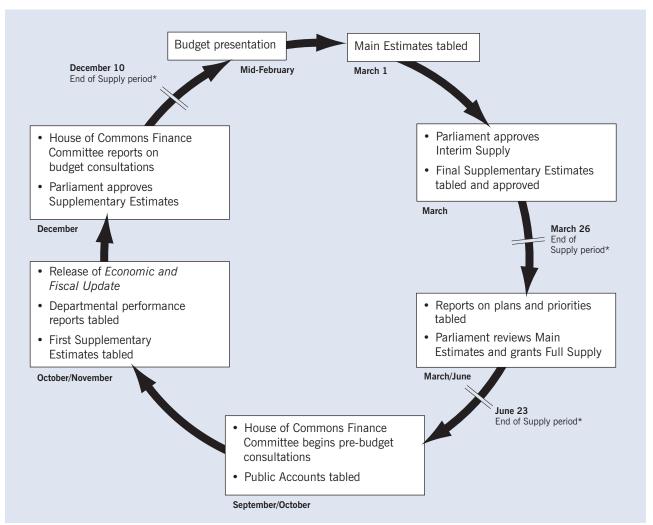
- Part III, departmental expenditure plans have, since 1997, been split into
 - reports on plans and priorities (RPPs), which present more detailed information on what departments do and plan to do over the next three years (based on their strategic plans); and
 - departmental performance reports, which report the results achieved against the plans set out in previous RPPs.
- 55. The Estimates include statutory and non-statutory—voted—expenditures. Statutory expenditures are those that have already been authorized by legislation; they are presented in the Estimates for information purposes only. Statutory expenditures today account for about two thirds of total federal spending.
- **56.** Voted expenditures are those for which the government must seek Parliament's approval annually. These expenditures are set out in "votes" for each department and agency. A vote is an individual item in the Estimates indicating the amount of funds required by the government for a particular activity or program. The most common types of vote are the following:
 - Capital expenditures—used when capital spending equals or exceeds \$5 million.
 - Grants and contributions—used when spending on grants and contributions equals or exceeds \$5 million.
 - Operating expenditures—used for other than capital spending or grants and contributions, when spending amounts for capital or grants and contributions are large enough (over \$5 million) to be listed under a separate vote.
 - Program expenditures—used when neither capital spending nor grants and contributions exceeds \$5 million. In that case, all expenditures are charged to this one vote.
 - Non-budgetary—used for spending in the form of loans and investments. This type of spending does not affect the budget balance (because each payment generates a corresponding asset), but it still requires parliamentary approval.
- **57.** Most departments and agencies have only one vote, a program expenditures vote. Some 20 larger departments have several votes.
- **58.** Once approved by Parliament, the wording of the vote and the specified amounts become the conditions under which the government

may spend. The amounts in the vote establish a maximum amount that may be spent—they do not represent a commitment to spend the full amount.

The parliamentary calendar

59. The present rules of the House divide the parliamentary calendar into three Supply periods, during which 22 days are allocated to the Business of Supply: there are 7 days in the period ending December 10, 7 days in the period ending March 26, and 8 days in the period ending June 23 (Exhibit 7). On the allotted days, members in opposition to the government may propose motions for debate on any matter falling within the jurisdiction of the Parliament of Canada, as well as on committee reports concerning the Estimates.

Exhibit 7 Parliamentary financial cycle



^{*}Latest date by which House of Commons must concur in Estimates and approve the associated appropriation act

- **60.** The Main Estimates must be tabled in the House of Commons no later than March 1. They are tabled the same day or the next sitting day in the Senate. Reports on plans and priorities are tabled later in the spring, and performance reports in the fall.
- 61. Once tabled, the Main Estimates are referred to the various standing committees of the House of Commons, by subject matter, and to the Senate Standing Committee on National Finance. Estimates for programs delivered by more than one department or agency are normally referred to the House of Commons Standing Committee on Government Operations and Estimates. House committees have until May 31 to review the Main Estimates and report back to the House; if they do not, the Main Estimates are deemed to have been reported.
- **62.** In considering the Main Estimates, committees may approve, reduce, or "negative" (not approve) a vote. A committee may not increase the amount of a vote or change or redirect the funds involved, since that would infringe on the constitutionally prescribed financial initiative of the Crown.
- 63. The Main Estimates, as reported by the standing committees or as deemed reported, must go through several more stages before the government is considered to have authority to spend. Under normal circumstances, on the last allotted day in the Supply period ending June 23, the House votes on a motion to concur in Main Estimates. Following this motion, an appropriation bill incorporating the Main Estimates is introduced and must be approved by the House of Commons. The bill is then sent to the Senate, where it must also pass. Once the bill is passed by both Houses, it receives Royal Assent and becomes law. Only then is the government authorized to make withdrawals from the Consolidated Revenue Fund, up to the limits set in the Main Estimates and for the purposes specified in the votes.
- 64. Spending authority lapses at the end of each fiscal year for all departments and agencies, except Parks Canada, the Canada Revenue Agency, and the Canada Border Services Agency, which are authorized by legislation to carry unspent funds into the following year. To encourage good cash management practices, other departments and agencies are also allowed to carry forward unused appropriations up to five percent of their operating and capital budgets, but these require Parliament's approval annually. Funds carried over are accessed through the use of Supplementary Estimates in the following fiscal year.

Interim Supply

65. The government's fiscal year begins April 1. Normally, the Main Estimates are not approved until late June. So it can continue to operate in the meantime, the government requests "Interim Supply" by the end of March. A vote to concur in Interim Supply occurs on the last allotted day in the Supply period ending March 26. The amount granted is usually 3/12 of each vote in the Main Estimates. As with the Main Estimates, the granting of Interim Supply also requires that an appropriation bill be passed.

Supplementary Estimates

- 66. During the fiscal year, there will inevitably be calls on public funds that were not anticipated or for which the precise allocation had not been decided when the Main Estimates were put together in the fall of the previous year. The government seeks authority for these new demands through Supplementary Estimates, which are also used to transfer funds between votes and to write off debts or adjust loan guarantees. Supplementary Estimates are usually tabled twice a year, in the late fall and in March, though they can be tabled more often if necessary. They are referred to various committees and deemed reported back to the House three sitting days before the final sitting or the last allotted day in the Supply period. Motions to concur in the Supplementary Estimates take place on the last allotted day in the Supply period.
- 67. The traditional purpose of the Supplementary Estimates is to finance unanticipated spending by the government. In recent years, however, they have become a vehicle for new spending and programs announced outside the normal budget cycle. During the fiscal years from 1997–98 to 2004–05, supplementary appropriations averaged 10.5 percent of the total appropriations, up from an average 4.5 percent in the previous eight years.

Governor General special warrants

- **68.** Special warrants are instruments that authorize government spending without prior legislative approval. The *Financial Administration Act* (FAA) establishes specific conditions that must be met before special warrants will be issued:
 - A special warrant can only be issued if Parliament has been dissolved.
 - A minister must report that a payment is urgently required for the public good.
 - The President of the Treasury Board must report that there is no other appropriation for the payment.

- 69. Special warrants may only be issued from the date of dissolution of Parliament until 60 days following the date fixed for the return of the writs after a general election. The FAA further requires that every special warrant be published in the *Canada Gazette* within 30 days after it is issued. Within 15 days of Parliament's return, the President of the Treasury Board must table a statement in the House of Commons showing all warrants issued while Parliament was not sitting. Retroactive legislative approval is provided in the first appropriation bill passed in the new Parliament.
- **70.** While the last Parliament was dissolved, the Governor General issued four special warrants for a total of \$15.6 billion.

Reporting and audit

- 71. Departments gain access to funds appropriated by Parliament by submitting requisitions to the Receiver General for Canada, who is responsible for administering the Consolidated Revenue Fund. Departments are required to maintain detailed accounts of the payments they make and to reconcile them monthly with the central, or control, accounts of the Receiver General. The individual accounts of departments are rolled up into the accounts of Canada. Together with other records that departments maintain, these accounts are the source of information used to prepare the *Public Accounts of Canada*—the government's annual report on how it has spent the funds appropriated by Parliament.
- 72. By law, the Public Accounts must be tabled in the House of Commons within nine months of the end of the fiscal year to which they relate. In practice, they are usually tabled in early fall. They are produced in three volumes:
 - Volume I contains the summary financial statements of Canada, as well as discussion and analysis of the government's finances, including a 10-year comparison of financial data.
 - Volume II presents financial operations by ministry.
 - Volume III provides additional information required by the *Financial Administration Act*, such as the financial statements of revolving funds, spending on professional and special services, real estate acquisitions, transfer payments, and public debt charges.
- 73. The Auditor General of Canada examines the summary financial statements included in the Public Accounts to determine whether they are presented fairly in accordance with the government's stated accounting policies, which conform with Canadian generally accepted accounting principles. The Auditor General's opinion and

observations are included in Volume I of the Public Accounts. The Office of the Auditor General also examines operations and programs in departments and reports to Parliament whether they are run economically and efficiently and whether the government has the means to measure their effectiveness.

74. The *Public Accounts of Canada* and the Auditor General's reports are referred to the House of Commons Standing Committee on Public Accounts for review. The Committee's mandate is to ensure that public money is spent for the purposes authorized by Parliament. The Committee holds hearings at which officials from both the Office of the Auditor General and audited departments appear to answer questions about the reported audit findings. Other parliamentary committees also hold hearings on the audit reports that cover areas within their mandate. After its hearings, a committee may report to the House and recommend action the government should take. The audited departments are generally expected to report back to the committee on what they have done in response to these recommendations. Committees have the right to ask government to respond to their recommendations in writing within 120 days.

Inherent tensions in management of public spending

- 75. As already noted, the federal government over the years has considerably changed the way it organizes and carries out its expenditure management functions. This is not surprising: as conditions affecting public spending and the government's capacity to deal with them change, the systems for managing public spending would be expected to change as well. For example, a system suited to times of fiscal stress is not necessarily the best one for periods of fiscal abundance. Changes in the scale and nature of government spending will call for corresponding changes in how spending is managed. Advances in computing and communications create new capacities to monitor performance and coordinate activities, which may favour new approaches to managing spending. For all these reasons, a system as large and complex as Canada's Expenditure Management System is almost constantly changing.
- **76.** Certain issues persist, however, through all variations of the EMS. They remain perennial challenges to every EMS, because they are tensions inherent in the functions that every EMS serves. They include the following:
 - linking priority setting with resource allocation,

- balancing central control with management flexibility for departments, and
- accommodating ongoing review of spending with predictable funding.

Linking priority setting with resource allocation

- 77. A basic requirement of any EMS is that it support the government in setting priorities and allocating resources to achieve them. To a significant extent, these are political tasks, governed largely by the values and preferences of the principals involved. There is no fully objective way to set priorities and allocate resources.

 Nevertheless, the information that decision makers have and the process they use affect the outcome of their decisions. It helps therefore to have a process that promotes careful consideration of spending options and sound information on the costs and benefits of alternatives, including information on long-term costs and the sustainability of funding.
- 78. The key element in that process is ensuring that decisions on resource allocation are made within a framework of affordable spending limits. In the absence of limits, decision makers could adopt policies and approve programs without taking into account the costs of their decisions—when money is no object, everything can be done. Budgeting within spending limits, however, forces decision makers to recognize that resources are limited and every program has to compete for them. It encourages careful review of spending proposals and comparison of their merits with what must be given up to adopt them.
- 79. An effective EMS should also enable the government to reallocate resources from less-valued uses to more-valued ones when needs and priorities change. To do this, the government needs the capacity not only to compare and choose from among new spending initiatives, but also to transfer resources from existing programs. New spending accounts for a small fraction of total spending in any year, usually much less than 10 percent. Significant reallocation is thus impossible without transfers from existing programs.
- 80. Reallocation from existing programs is often difficult, protected as they are by inertia, past commitments, and vested interests. In any case, it would be costly and impractical to scrutinize all ongoing programs from top to bottom as part of the annual budget allocation process. However, it is a good practice to compare new spending proposals with related existing programs and explore possible synergies and trade-offs among them. It is also feasible and useful to review all programs periodically and assess how efficient, effective, and relevant

they are. Resources cannot be channelled to new priorities if, once established, programs are immune to cutbacks.

- 81. It is precisely because ongoing programs are difficult to change once in place that new proposals need to be reviewed and challenged rigorously before they are adopted. Central agencies need to ensure that the financial implications of proposals have been thoroughly assessed, alternative options have been considered and their relative risks identified, and expected results are clearly specified so that ongoing performance can be measured and monitored.
- **82.** In sum, strategies that promote the integration of priority setting with resource allocation include
 - setting spending caps on broad policy areas to encourage reallocation in meeting new demands for spending;
 - systematic, regular review of spending programs to determine whether they are effective and still relevant; and
 - rigorous review and costing of new spending proposals, within a framework that encompasses spending on existing programs.

Balancing central control with management flexibility for departments

- 83. When the Royal Commission on Government Organization (the "Glassco Commission") examined the organization of the federal government in the early 1960s, departments were the main vehicles of service delivery as they are today, but they had very little autonomy to decide how to manage what they did. Spending estimates itemized in great detail how departments were to spend the money allotted to them, and the Comptroller of the Treasury had to approve all payments before they were made. The Glassco Commission concluded that this way of managing the public service was dysfunctional, and it recommended that significant authority be delegated to departments to "let the managers manage."
- **84.** The Commission was also clear that this delegation had to take place within a framework that protected the need of the government for unity and proper regard for the general interest of Canadians. In the words of the Commission:

Above all, departments should, within clearly defined terms of reference, be fully accountable for the organization and execution of their programmes, and enjoy powers commensurate with their accountability. They must be subject to controls designed to protect those general interests of government which transcend departmental interests. But every department should be free of external controls which have no such purpose.

- 85. Delegating authority to departments makes their managers more directly responsible for the results of their programs. It both enables and encourages managers to use their knowledge and judgment to manage the resources under their control more efficiently. But as Glassco stressed, money allocated to departments is not departmental but "public money," and the government collectively is responsible to Parliament and the public for its proper use. An effective expenditure management framework must seek to satisfy simultaneously the government centre's need for enough control to provide overall direction and departments' need for enough autonomy to operate efficiently.
- **86.** More specifically, the government centre must be able to set policies and provide guidance to departments to ensure that they operate in line with government priorities, comply with authorities in their spending, and give due regard to efficiency and effectiveness. It must also oversee departments and hold them accountable for their performance. This requires that clear expectations and measures of performance be established before spending authority is granted.
- 87. Departments, in turn, must be able to manage their operations within the policies and standards set from the government centre. They must understand those standards and have controls to ensure that they are met. Both the centre and departments need to have their respective responsibilities clearly specified and reliable information available on costs and performance to aid their decisions.

Accommodating ongoing review of spending with predictable funding

- 88. Continuity is a desirable feature in programs, both for their beneficiaries and their managers. For example, Canadians need to know what social security benefits they can depend on when they retire or what health care services will be available when they fall ill. For program managers, predictable funding—the financial equivalent of program continuity—facilitates planning and assignment of resources. It makes it easier to attract people with the right skills and to contract for necessary services over time. Predictability contributes to more efficient and effective program delivery, and for that reason it is a widely accepted principle of managing public spending.
- 89. However, sound management of public spending also requires ongoing review and evaluation of programs to ensure that they remain effective and consistent with the government's present priorities. These assessments could show at any time that spending on a particular program should be changed or eliminated. Clearly, ongoing review and funding certainty are not entirely compatible.

- 90. Procedures for reconciling the two include transparent budgeting, careful planning, and medium-term expenditure frameworks. Transparent budgeting makes clear to program managers the risk that funding could change, so they can anticipate and manage it. Careful planning helps limit the effects of funding cuts by timing them and distributing them in ways that minimize cost and disruption. It avoids easy measures that produce gains in the short term but have negative long-term impacts—measures such as skimping on key capital expenditures or critical control functions to make up for funding shortages. A medium-term expenditure framework commits funding over several years, providing stability within the planning horizon but flexibility in later years for reallocations. It does not preclude adjustments to unanticipated events, but it does give program managers reasonable certainty that funds will be available over the time horizon of the expenditure framework.
- **91.** These considerations apply to the funding of ongoing programs. Funding for a special project or an infrastructure investment would take into account the project's time frame for completion and align funding commitments to requirements over that period. It is difficult to plan a project over several years without funding certainty, and it can be highly wasteful to tailor the project's completion to funding that does not materialize.