Annual Financial Report

of the Government of Canada

Fiscal Year 1997-98

Canada

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ANNUAL FINANCIAL REPORT

of the Government of Canada

Fiscal Year 1997-98

For the fiscal year 1997-98, the Government of Canada recorded a budgetary surplus of $3.5 billion. This is the first federal budgetary surplus since 1969-70. It represents a major turnaround in federal government finances from a deficit of $42 billion in 1993-94. This is a historic milestone and represents an achievement of which all Canadians can truly be proud. Without their efforts, it would not have been possible. This turnaround also underlines the soundness of the government's fiscal strategy – basing budget plans on prudent planning assumptions backed by a sizeable Contingency Reserve – which has engendered economic conditions conducive to growth and job creation.

The *Annual Financial Report* responds to recommendations by the Auditor General and the House of Commons Standing Committee on Public Accounts. The government shares their view that providing Canadians with accurate, relevant and timely information on its financial activity in an understandable form enhances government accountability, and enables Canadians to play a more active and effective role in guiding government decision making.

The government believes that transparency and accountability to Parliament and Canadians are best served by recording liabilities in the year in which they occur. We have been consistent in this practice.

Department of Finance Canada | Ministère des Finances Canada

Accordingly, I am disappointed that the Auditor General has again expressed a qualified opinion on the financial statements – this year regarding the recording of the liability for the Canada Millennium Scholarship Foundation. The government is of the view that, in substance, this transaction represented a financial liability which must be accounted for in the 1997-98 financial statements. We sought the advice of two leading firms in the accounting profession who indicated that this was an area where the government should be using its professional judgement. In addition, the Standing Committee on Public Accounts endorsed the government's accounting treatment. The government must be held accountable for the liabilities that it makes – in the year they are made – rather than leaving them to some future date.

The financial data in this report are based on the audited results that will appear in the 1998 *Public Accounts of Canada*, scheduled for tabling in the House of Commons this fall. It covers the federal government's spending and revenue performance for the past fiscal year (April 1, 1997 – March 31, 1998) and details the factors affecting these results. Historical data will be published in a separate document entitled *Fiscal Reference Tables*, pending the release of historical revisions to the National Income and Expenditure Accounts by Statistics Canada.

The Honourable Paul Martin, P.C., M.P.
Minister of Finance

TABLE OF CONTENTS

REPORT HIGHLIGHTS

There was a budgetary surplus of $3.5 billion in 1997-98. This was:

- the first surplus since 1969-70;
- an improvement of $12.4 billion from the deficit of $8.9 billion recorded in 1996-97;
- an improvement of $45.5 billion from the record deficit of $42 billion reported in 1993-94; and
- $20.5 billion better than the original deficit target of $17.0 billion for 1997-98 – the fourth consecutive year in which the final outcome has come in better than the original target.

Since 1993-94, there has been a dramatic turnaround in the finances of the federal government. From a budgetary deficit of $42 billion, or 5.8 per cent of gross domestic product (GDP), there is now a surplus of $3.5 billion, or 0.4 per cent of GDP. This turnaround in the budgetary balance of 6.2 percentage points of GDP largely resulted from a 3.9-percentage-point decline in program spending as a share of GDP – representing about 62 per cent of the overall improvement in the budgetary balance. Budgetary revenues increased by 1.9 percentage points of GDP – representing about 31 per cent of the overall improvement in the budgetary balance.

Public debt charges declined by 0.5 percentage point, accounting for 7 per cent of the improvement in the budgetary balance.

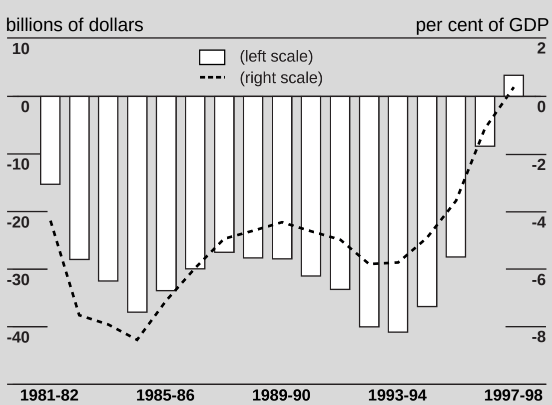
There are two changes in accounting policies that were announced in the 1998 budget. The method used to calculate interest costs on obligations for public sector pensions has been changed in order to comply with the recommendations of the Public Sector Accounting and Auditing Board (PSAAB) and the Auditor General. Also, the method of accounting for assistance to international financial institutions has been changed to more closely correlate recording of expenditures with program activity. The net impact of these changes is to increase the budgetary surplus by $0.7 billion in 1997-98.

The net public debt

The 1997-98 budgetary surplus brought the federal government's net public debt – the accumulation of annual deficits and surpluses – down to $579.7 billion from $583.2 billion in 1996-97.

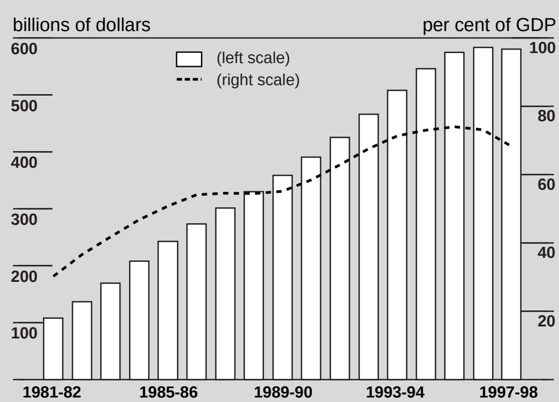
- This marks the first year in which net public debt has declined since 1969-70.

The budgetary balance and the economy



Source: *Public Accounts of Canada* and Statistics Canada.

Net federal debt and the economy



Source: *Public Accounts of Canada* and Statistics Canada.

As a share of Canada's economy, the net public debt dropped to 67.8 per cent, down from 71.1 per cent in 1996-97.

- This was the second consecutive year in which the debt-to-GDP ratio has declined – the first back-to-back declines since the mid-1970s.
- The ratio is now back to where it was five years ago.

The net public debt at the end of 1997-98 was $19,186 for each Canadian, down from $19,501 a year earlier.

Net public debt consists of interest-bearing debt and other liabilities, net of financial assets. Interest-bearing debt, in turn, consists of unmatured, or market debt, and the government's liabilities to internally held accounts such as federal employees' pension plans.

- In 1997-98, interest-bearing debt declined $5.7 billion to $594.8 billion.
- Of this amount, market debt declined by $9.6 billion to $467.3 billion. This reflected a lower stock of Treasury bills (down $23.1 billion) and Canada Savings Bonds (down $2.7 billion), offset in part by higher marketable bonds (up $16.3 billion).

Table 1
Financial highlights

	1993-94	1994-95	1995-96	1996-97	1997-98
			(billions of dollars)		
Budgetary transactions					
Revenues	116.0	123.3	130.3	140.9	153.2
Program spending	-120.0	-118.7	-112.0	-104.8	-108.8
Operating balance	-4.0	4.6	18.3	36.1	44.4
Public debt charges	-38.0	-42.0	-46.9	-45.0	-40.9
Budgetary balance	-42.0	-37.5	-28.6	-8.9	3.5
Non-budgetary transactions	12.2	11.6	11.4	10.2	9.3
Financial requirements/surplus (excludes foreign exchange transactions)	-29.9	-25.8	-17.2	1.3	12.7
Foreign exchange transactions	-2.1	-1.4	-4.7	-7.8	-2.2
Net financial balance	-32.0	-27.3	-21.9	-6.5	10.6
Net change in borrowings	31.2	27.0	28.5	7.3	-9.6
Net change in cash balances	-0.7	-0.2	6.7	0.8	1.0
Financial position					
Total liabilities	-546.4	-584.8	-624.7	-640.7	-638.5
Total assets	38.2	39.1	50.4	57.5	58.8
Accumulated deficit (net public debt)	-508.2	-545.7	-574.3	-583.2	-579.7
Financial results (% of GDP)					
Budgetary revenues	16.0	16.2	16.3	17.2	17.9
Program spending	-16.6	-15.6	-14.0	-12.8	-12.7
Public debt charges	-5.2	-5.5	-5.9	-5.5	-4.8
Budgetary balance	-5.8	-4.9	-3.6	-1.1	0.4
Net public debt	-70.1	-71.6	-71.9	-71.1	-67.8

Note: Results for 1997-98 incorporate impact of accounting changes. These had the effect of increasing program spending by $2.0 billion and reducing public debt charges by $2.7 billion. The net impact was to increase the budgetary surplus by $0.7 billion.

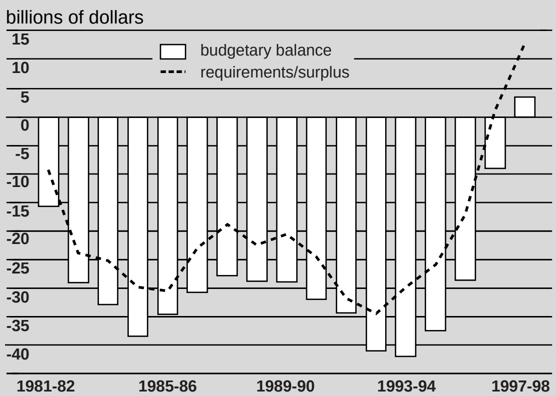
Financial surplus of $12.7 billion

The budgetary balance is one measure of the government's fiscal position. There are other important measures as well. Financial requirements/surplus measure the difference between cash coming in to the government and cash going out. Most industrialized countries currently use a measure comparable to the financial requirements/surplus as their main budgetary measure.

- There was a financial surplus (excluding foreign exchange transactions) of $12.7 billion in 1997-98 – the second consecutive year in which a financial surplus was recorded.
- Among the other Group of Seven (G-7) countries, only the United States reported a financial surplus for the 1997-98 fiscal year.

During the course of the fiscal year, there was a net requirement of $2.2 billion relating to foreign exchange transactions. As a result, the net financial surplus, including foreign exchange requirements, was $10.6 billion. This compares to a net financial requirement of $6.5 billion in 1996-97.

Budgetary balance and financial requirements/surplus*



*Excluding foreign exchange transactions.

Source: *Public Accounts of Canada* and Statistics Canada.

The government used this net financial surplus of $10.6 billion to retire $9.6 billion of market debt and to increase its cash balances by $1.0 billion. Cash balances at the end of 1997-98 stood at $10.4 billion.

Budgetary balance improves by $12.4 billion from 1996-97

The budgetary surplus of $3.5 billion in 1997-98 represented an improvement of $12.4 billion from the budgetary deficit of $8.9 billion recorded in 1996-97.

- Budgetary revenues were up $12.3 billion, or 8.7 per cent, mainly reflecting the impact of strong economic growth on personal and corporate income tax collections.
- Public debt charges declined $4.0 billion, or 9.0 per cent, due to a lower average effective interest rate on interest-bearing debt, a decline in the stock of interest-bearing debt, and a change in accounting for interest costs related to public sector pension plans.
- In contrast, program spending increased $3.9 billion, or 3.8 per cent. The entire increase was more than accounted for by one-time factors which added $5.5 billion to program spending in 1997-98: the recording of liabilities for the Canada Millennium Scholarship Foundation ($2.5 billion), compensation for hepatitis C victims ($0.8 billion), the aboriginal healing strategy ($0.35 billion), and the change in accounting for assistance to international financial institutions ($1.8 billion). Without these one-time increases, program spending in 1997-98 would have fallen below its 1996-97 level.

Budgetary outcome betters target for fourth consecutive year

The government's fiscal strategy is to set two-year rolling budget targets, base these targets on prudent economic planning assumptions, and back up these assumptions with sizeable Contingency Reserves. These operating guidelines have ensured that the final fiscal outcome has come in better than targeted in each year this strategy has been in place.

The original deficit target for 1997-98, as set out in the December 1995 *Economic and Fiscal Update* and restated in the 1996 and 1997 budgets, was $17.0 billion, or 2 per cent of GDP. However, on September 23, 1997, the government indicated in the Speech from the Throne to open the First Session of the Thirty-Sixth Parliament of Canada that the deficit would be eliminated no later than 1998-99. In the 1998 budget, the Minister of Finance indicated that the budget would be balanced in 1997-98.

The budgetary surplus was $3.5 billion higher than the balanced budget estimate announced in the 1998 budget.

- Budgetary revenues were $5.7 billion higher, primarily due to higher personal and corporate income tax collections, reflecting strong collections in the final quarter of 1997-98 and recoveries related to previous fiscal years.
- Public debt charges were $0.6 billion lower.
- In contrast, program spending was $2.8 billion higher, reflecting higher-than-expected end-of-year accounting adjustments for liabilities incurred during the year.

The budgetary surplus for 1997-98 was $20.5 billion better than the original deficit target of $17.0 billion, set out in the 1997 budget.

- Budgetary revenues were $15.4 billion higher, of which $6.3 billion was attributable to higher corporate income tax collections, reflecting the much stronger-than-expected growth in corporate profits.
- Public debt charges were $5.1 billion lower, due to lower-than-estimated interest rates and the impact of the accounting change for interest on public sector pension plans.
- The Contingency Reserve of $3.0 billion, included in the original deficit target of $17.0 billion, was not required.
- Program spending was $3.0 billion higher, solely attributable to the one-time spending included in 1997-98.

ECONOMIC DEVELOPMENTS IN 1997

The main factors affecting the financial results are:

- variations in economic conditions;
- the interaction of the tax system with economic developments; and
- the impact of budget actions.

This section briefly reviews economic developments in 1997.

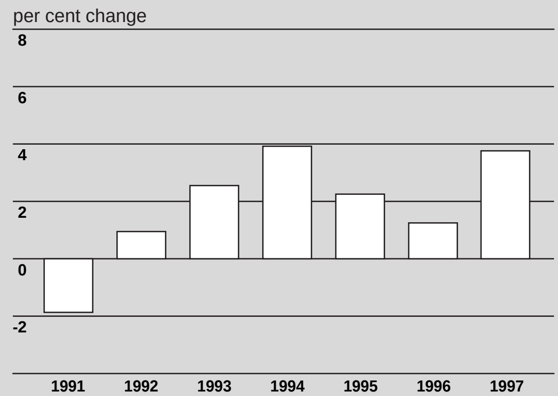
Economic growth rebounded sharply in 1997. Real GDP – which excludes the effect of inflation – grew 3.7 per cent, well above the 1.2-per-cent pace set in 1996. The growth in 1997 reflected a response by the interest-sensitive sectors of the economy to the stimulative monetary conditions prevailing in the latter half of 1996 and throughout 1997. However, owing to the high import propensities of some of the strongest growing domestic demand categories, particularly machinery and equipment investment and consumer durables, import growth outpaced that of exports, making the trade sector a drag on growth in 1997.

Inflation pressures remained subdued in 1997, with inflation remaining in the lower half of the Bank of Canada's target range of 1 per cent to 3 per cent. The inflation rate, as measured by the all-items Consumer Price Index (CPI), was just 1.6 per cent in both 1996 and 1997. The GDP deflator, the broadest measure of domestic prices, increased by only 0.5 per cent in 1997 after rising 1.4 per cent the previous year.

As a result, nominal GDP advanced by 4.2 per cent in 1997, up sharply from the gain of 2.7 per cent recorded in 1996. Among the major income components, corporate profits before taxes were up 16.2 per cent while wages, salaries and supplementary labour income advanced by 3.8 per cent.

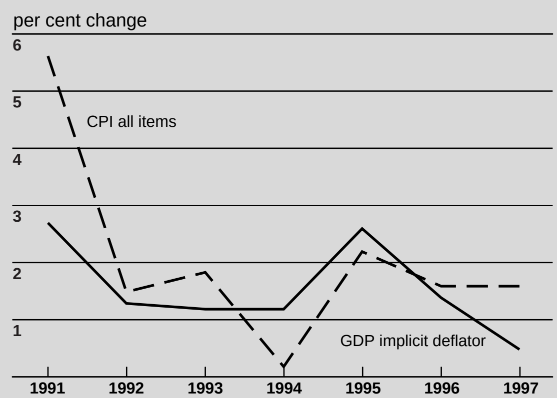
The key economic variables affecting the federal government's financial results are employment growth, personal income, corporate profits, personal expenditures on goods and services, and interest rates.

Real GDP growth



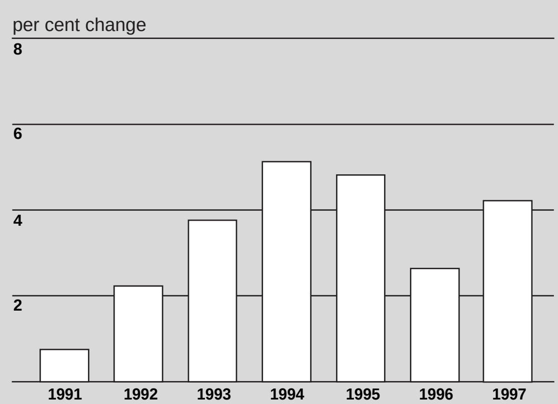
Source: Statistics Canada.

Prices and costs



Source: Statistics Canada.

Nominal GDP growth



Source: Statistics Canada.

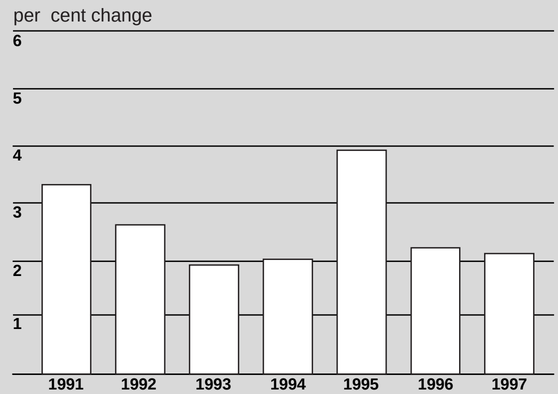
Personal income is the proxy tax base for personal income tax collections. However, personal income tax collections are affected not only by the growth in personal income but also by its composition. In addition, there are some components of income that are taxed, such as capital gains and income from trusteed pension plans, but not included as part of personal income as measured by Statistics Canada. As a result, the growth in personal income may not accurately reflect the growth in assessed income for personal income taxation purposes and, therefore, the growth in personal income tax collections.

Personal income advanced by 2.1 per cent in 1997, down slightly from the increase of 2.2 per cent experienced in 1996. However, labour income (wages, salaries and supplementary labour income), which accounts for nearly two-thirds of personal income, increased a strong 3.8 per cent in 1997 after rising 2.5 per cent in 1996. Employment and wage gains contributed roughly equally to labour income growth in 1997. Employment grew 1.9 per cent in 1997, well above the 1.3-per-cent gain recorded in 1996. Labour income per employee rose 1.8 per cent in 1997, up from 1.2 per cent in 1996.

In contrast, growth in the other components of personal income slowed from 1996. Net income of non-farm unincorporated businesses was up only 2.7 per cent, following an increase of 8.7 per cent in 1996. Interest, dividend and miscellaneous investment receipts declined 4.3 per cent, reflecting the impact of lower interest rates. However, this component does not include capital gains or income from trusteed pension plans which were up strongly in 1997. Transfer payments, which primarily include government transfers such as elderly and employment insurance benefits, increased by only 0.5 per cent, virtually unchanged from the increase of 0.6 per cent for 1996.

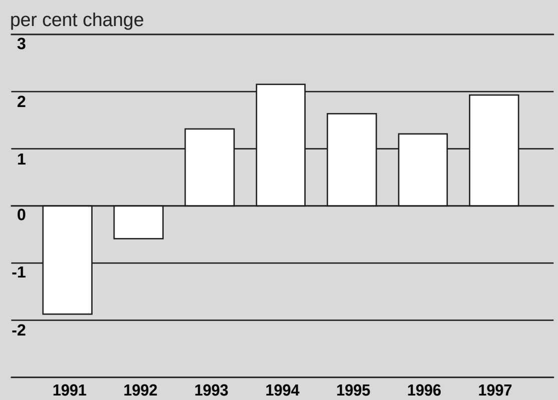
Corporate profits, the applicable tax base for corporate income tax collections, rose 16.2 per cent in 1997, a significant rebound

Personal income



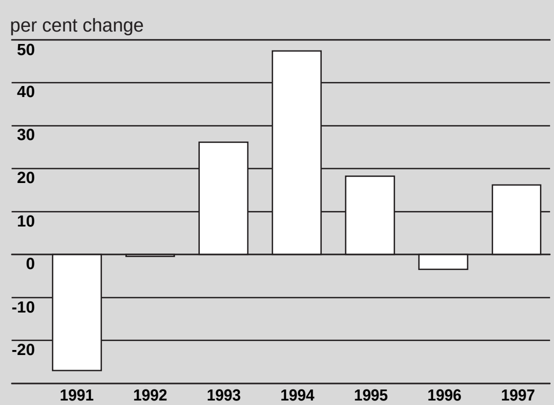
Source: Statistics Canada.

Employment growth



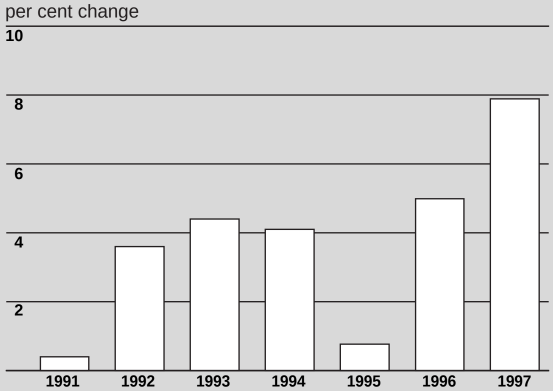
Source: Statistics Canada.

Corporate profits



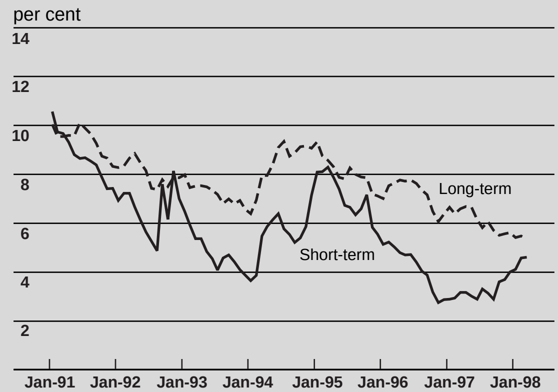
Source: Statistics Canada.

Personal expenditures (excluding food and rent/ including housing)



Source: Statistics Canada.

Interest rates



Source: Statistics Canada.

from the decline of 3.4 per cent reported in 1996. Strong gains were reported in most sectors. The corporate profit share of GDP increased to 9.2 per cent from 8.3 per cent in 1996, and was well above its trough of 4.5 per cent at the beginning of 1992.

A proxy for the goods and services tax base is personal spending on goods and services excluding food and rent but including residential construction. The value of these expenditures increased 7.9 per cent in 1997, up from a gain of 5.0 per cent in 1996. Strong advances were recorded in expenditures on durable goods and residential construction.

Although short-term interest rates rose over the course of 1997, they were lower, on average, than in 1996 (3.2 per cent in 1997 versus 4.2 per cent in 1996). Moreover, the 10-year government benchmark rate declined to average 6.1 per cent in 1997, compared to 7.2 per cent in 1996.

Table 2
Key economic indicators

	1996	1997
	(year-to-year per cent change unless otherwise indicated)	
Real GDP	1.2	3.7
Inflation		
CPI	1.6	1.6
GDP implicit price deflator	1.4	0.5
Nominal GDP	2.7	4.2
Personal income	2.2	2.1
Wages, salaries and supplementary labour income	2.5	3.8
Unincorporated business net income	8.7	2.7
Interest, dividend and miscellaneous investment receipts	-0.5	-4.3
Current transfers	0.6	0.5
Labour market		
Employment	1.3	1.9
Unemployment rate (%)	9.7	9.2
Corporate profits	-3.4	16.2
Personal expenditures	3.9	5.9
Personal expenditures excluding food and rent but including residential construction	5.0	7.9
Interest rates		
3-month Treasury bill rate (%)	4.2	3.2
10-year government benchmark rate (%)	7.2	6.1

BUDGETARY REVENUES

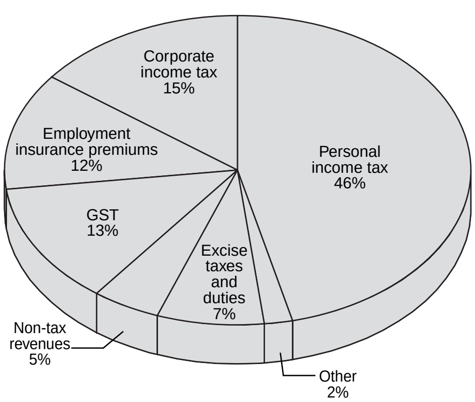
Table 3 shows budgetary revenues on both a budgetary or "net" basis as well as on a "gross" basis. The results on a gross basis are often more reflective of the underlying economic developments, whereas the net figures reflect the way in which the revenue and spending estimates are presented to Parliament. The difference primarily relates to the classification of:

- certain tax expenditures such as the child tax benefit and low-income GST credit;
- revenues of consolidated Crown corporations; and
- revenues levied by departments for specific services such as the costs of police services in provinces.

The major components of budgetary revenues are:

- personal income tax collections;
- corporate income tax collections;
- other income tax collections, primarily consisting of non-resident taxes;
- employment insurance (EI) premium revenues;
- goods and services tax (GST) collections;
- other excise taxes and duties, including customs import duties, excise taxes on motive fuels, and excise taxes and duties primarily on tobacco and tobacco products and the air transportation tax; and
- non-tax revenues which include a return on investments and other non-tax revenues such as net proceeds from the sale of assets, user charges, etc.

Net revenues for 1997-98



Source: *Public Accounts of Canada.*

Budgetary revenues, on a gross basis, amounted to $164.4 billion in 1997-98, an increase of $11.9 billion, or 7.8 per cent, from the level reported in 1996-97. Gross revenues were $11.2 billion higher than net revenues in 1997-98, of which $5.4 billion was for the child tax benefit, $2.9 billion for the low-income GST credit, $1.2 billion for revenues of consolidated Crown corporations, and $2.2 billion for revenues levied by departments which are credited back to the programs giving rise to these revenues. In contrast, old age security benefit repayments increased net revenues by $0.5 billion.

On a net basis, budgetary revenues amounted to $153.2 billion, an increase of $12.3 billion, or 8.7 per cent from the 1996-97 level. This increase was largely attributable to the growth in the economy and the interaction of the tax system with economic developments.

Personal income tax collections in 1997-98, on a net basis, were up $7.5 billion, or 11.9 per cent. This compares to an increase of 5.2 per cent in 1996-97. The increase in net collections in 1997-98 was significantly greater than the growth in personal income – a proxy for the applicable tax base for personal income tax collections – which rose by only 2.1 per cent in 1997. This reflects a number of factors. As noted earlier, there were significant differences in growth rates of components within personal income, with strong gains in wages and salaries, the largest component of personal income, but a decline in personal investment income (interest, dividend and investment receipts) and a substantial slowing in the rate of growth in net income from unincorporated businesses. Within net personal income tax collections, source deductions – which represent withholdings from wages and salaries – were also up strongly, broadly consistent with the gain in wages and salaries. Statistics Canada's measure of personal investment income excludes some components of income subject to taxation such as capital gains and income from trusteed pension plans. These components reported strong advances in 1997, thereby resulting in higher tax collections. In addition, remittance requirements and timing factors also contributed to the stronger increase in collections relative to the increase in the underlying tax base. For example, quarterly instalment payments were up sharply.

Taxpayers, primarily the self-employed and those in receipt of investment income, who have tax liabilities not subject to withholding in excess of a specified threshold in one taxation year, are required to make quarterly instalment payments in the following year. Increased tax liabilities in 1996 on income not subject to withholding, resulted in more taxpayers required to make instalment payments in 1997. Taxes paid on filing in early 1997-98 with respect to the 1996 taxation year were higher, while refunds paid in 1997-98 with respect to both taxation years 1996 and 1997 were lower. Finally, the interaction of the personal income tax system to changes in assessed income also contributed to net collections increasing faster than the implied increase in the underlying tax base.

Table 3

Budgetary revenues

	1996-97		1997-98		Net change	
	Gross	Net	Gross	Net	Absolute	Per cent
			(millions of dollars)			(%)
Income tax collections						
Personal income tax	68,122	63,282	75,672	70,787	7,505	11.9
Corporate income tax	17,020	17,020	22,496	22,496	5,476	32.2
Other	2,847	2,847	2,974	2,974	127	4.5
Total	87,989	83,149	101,142	96,257	13,108	15.8
Employment insurance premium revenues	19,816	19,816	18,802	18,802	-1,014	-5.1
Excise taxes and duties						
Goods and services tax	20,951	18,079	22,353	19,461	1,382	7.6
Customs import duties	2,676	2,676	2,766	2,766	90	3.4
Other excise taxes/duties						
Energy taxes	4,467	4,467	4,638	4,638	171	3.8
Other	3,876	3,876	3,995	3,995	119	3.1
Total	8,343	8,343	8,633	8,633	290	3.5
Total	31,970	29,098	33,752	30,860	1,762	6.1
Total tax revenues	139,775	132,063	153,696	145,919	13,856	10.5
Non-tax revenues						
Return on investments	4,276	4,210	4,511	4,427	217	5.2
Other non-tax revenues	8,421	4,623	6,155	2,816	-1,807	-39.1
Total	12,697	8,833	10,666	7,243	-1,590	-18.0
Total revenues	152,472	140,896	164,362	153,162	12,266	8.7

Corporate income tax collections were up $5.5 billion, or 32.2 per cent. Corporate profits were up 16.2 per cent. However, profits were significantly higher in those sectors with higher effective tax rates (primarily the financial sector), while weakness was reported in those with lower effective tax rates (non-financial sector). In addition, a one-time adjustment of $0.6 billion for recoveries from the Provincial Tax Collection Account with respect to taxation year 1996 was included in the 1997-98 results. Other income taxes, primarily non-resident withholding taxes, were up $0.1 billion.

Employment insurance premium revenues declined $1.0 billion, primarily attributable to the remittance change which resulted in a one-time positive cash-flow impact in 1996-97. Effective January 1, 1997, the base to which the premium rates are applied was changed from weekly maximum insurable earnings to annual maximum insurable earnings. Although the annual amount paid is unchanged for most employees and their employers, those employees earning above the annual maximum insurable earnings are now required to pay more of their premium liability earlier in the calendar year and less in the latter part of the calendar year. As the government's fiscal year overlaps the calendar year, there was a one-time positive cash-flow impact in the last quarter of 1996-97 of about $1 billion. The effect of lower premium rates during the fiscal year, from $2.95 (employee rate per $100 of insurable earnings) effective January 1, 1996 to $2.90 effective January 1, 1997 to $2.70 effective January 1, 1998, was offset by more people being employed.

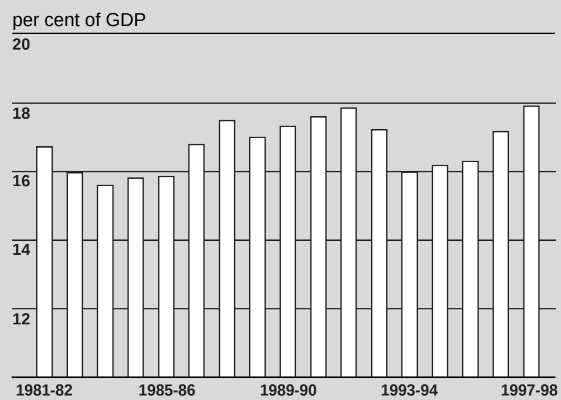
Total excise taxes and duties increased $1.8 billion, or 6.1 per cent in 1997-98, down from the gain of $2.5 billion recorded in 1996-97. However, the gain in 1996-97 was affected by the reclassification of the air transportation tax from program spending to budgetary revenues, effective April 1, 1996.

- GST collections were up $1.4 billion, or 7.6 per cent, in line with the growth in the applicable tax bases.
- Customs import duties were up $0.1 billion, or 3.4 per cent, as the growth in imports in 1997 more than offset the reductions in tariffs specified under international agreements.
- Other excise taxes and duties were up $0.3 billion, or 3.5 per cent, in 1997-98, reflecting the growth in the applicable tax bases.

Non-tax revenues declined $1.6 billion, or 18.0 per cent, in 1997-98. Virtually all of this decline was due to the inclusion in 1996-97 of the net proceeds ($1.5 billion) from the sale of the Air Navigation System.

As a percentage of GDP, net revenue, or the "revenue ratio", stood at 17.9 per cent, up from 17.2 per cent recorded in 1996-97. This increase reflects the interaction of the tax system to changes in the economy, as well as the very strong growth in corporate income tax collections compared to the growth in net corporate profits. In addition, there are some components of income, such as capital gains and pension income from trusteed pension plans, that are subject to taxation but not included in the definition of nominal GDP. These factors serve to overstate the increase in the revenue ratio.

The revenue ratio



Source: Department of Finance and Statistics Canada.

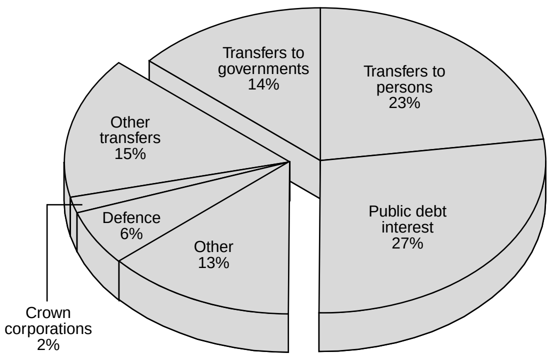
BUDGETARY EXPENDITURES

Table 4 presents budgetary expenditures on both a gross and net basis. Gross budgetary expenditures include certain expenditures that are determined through the income tax system such as the child tax benefit and the low-income GST credit. Gross expenditures include the spending of consolidated Crown corporations rather than the net federal expenditures to these

Table 4
Budgetary expenditures

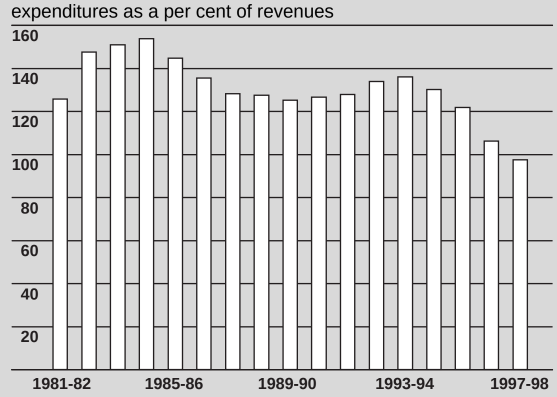
	1996-97		1997-98		Net change	
	Gross	Net	Gross	Net	Absolute	Per cent
	(millions of dollars)					(%)
Major transfers to persons						
Elderly benefits	21,207	21,606	21,758	22,225	619	2.9
Employment insurance benefits	12,380	12,380	11,842	11,842	-538	-4.3
Income tax expenditures						
Child tax benefit	5,239		5,352			
Low-income GST Credit	2,872		2,892			
Total	41,698	33,986	41,845	34,067	81	0.2
Major transfers to other levels of government						
Canada Health and Social Transfer	14,758	14,758	12,612	12,612	-2,146	-14.5
Fiscal arrangements	9,418	9,418	10,000	10,000	582	6.2
Alternative Payments for Standing Programs	-2,014	-2,014	-2,108	-2,108	-94	4.7
Total	22,162	22,162	20,504	20,504	-1,658	-7.5
Direct program spending						
Subsidies and other transfers						
Agriculture and Agri-Food	1,035	1,035	817	817	-218	-21.1
Foreign Affairs and International Trade	2,052	2,052	2,084	2,084	32	1.6
Human Resources Development	2,080	2,080	2,076	2,076	-4	-0.2
Indian Affairs and Northern Development	3,897	3,897	3,978	3,978	81	2.1
Industry/Regional Agencies	2,093	2,093	2,177	2,177	84	4.0
Veterans Affairs	1,369	1,369	1,374	1,374	5	0.4
One-time liabilities	800	800	5,450	5,450	4,650	
Other	4,134	4,134	4,520	4,520	386	9.3
Total	17,460	17,460	22,476	22,476	5,016	28.7
Crown corporations						
Canada Mortgage and Housing Corporation	1,967	1,967	1,863	1,863	-104	-5.3
Canadian Broadcasting Corporation	1,391	997	1,106	806	-191	-19.2
Other	1,465	614	806	-121	-735	-119.7
Total	4,823	3,578	3,775	2,548	-1,030	-28.8
Operating and capital expenditures						
Defence	9,051	8,661	9,240	8,879	218	2.5
All other departments	21,202	18,973	22,113	20,279	1,306	6.9
Total	30,253	27,634	31,353	29,158	1,524	5.5
Total direct program spending	52,536	48,672	57,605	54,182	5,510	11.3
Total program spending	**116,396**	**104,820**	**119,953**	**108,753**	**3,933**	**3.8**
Public debt charges	44,973	44,973	40,931	40,931	-4,042	-9.0
Total budgetary expenditures	**161,369**	**149,793**	**160,884**	**149,684**	**-109**	**-0.1**

Net expenditures for 1997-98



Source: *Public Accounts of Canada.*

The expenditure ratio



Source: Department of Finance.

corporations, and exclude certain revenues directly related to the services being provided which, on a net basis, are credited directly to the department providing the service.

Total budgetary expenditures, on a gross basis, by the federal government amounted to $160.9 billion in 1997-98, down $0.5 billion from the level reported in 1996-97. Gross program spending increased by $3.6 billion while public debt charges declined by $4.0 billion.

Total budgetary expenditures, on a net basis, amounted to $149.7 billion in 1997-98, down $0.1 billion from 1996-97.

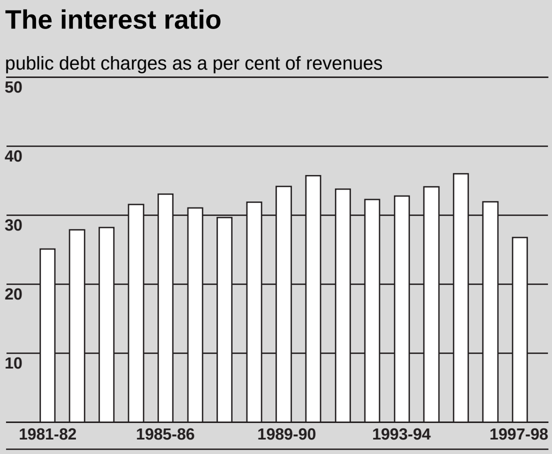
- Public debt charges were down $4.0 billion.
- Program spending was up $3.9 billion, all of which was due to the inclusion of one-time factors, which added $5.5 billion to program spending in 1997-98.

As a percentage of net budgetary revenues, net budgetary expenditures, or the "expenditure ratio", stood at 97.7 per cent, down from 106.3 per cent in 1996-97. This implies that, in 1997-98, revenues exceeded total expenditures by 2.3 per cent. In 1993-94, the expenditure ratio stood at 136.2 per cent, which meant that an amount equivalent to 36.2 per cent of revenues had to be financed by borrowings. This is the first time the expenditure ratio has been below 100 per cent since 1969-70.

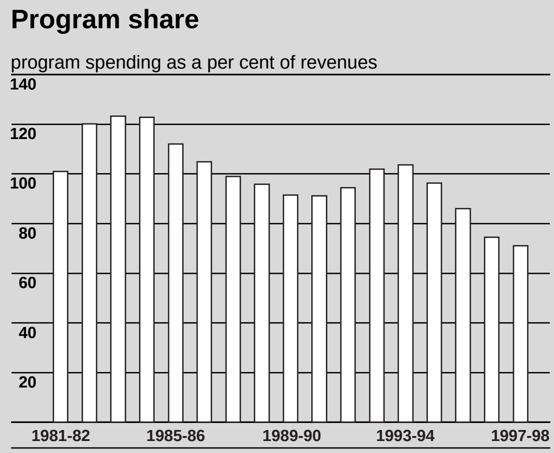
The decline in public debt charges was due to:

- a drop in the average effective interest rate on the government's interest-bearing debt (unmatured debt and pension liabilities) from 7.5 per cent in 1996-97 to 7.3 per cent in 1997-98;
- a reduction in interest-bearing debt from $600.6 billion to $594.8 billion; and
- a change in accounting for interest costs related to public sector pension plans which lowered public debt charges by $2.7 billion.

In his "Observations" on the 1996-97 financial statements, the Auditor General recommended that the government follow the generally accepted accounting principles enunciated by the PSAAB, by calculating interest costs on public sector pension plans on the basis of the actuarial obligation of the pension plans, rather than the balance in the superannuation accounts. At present, the actuarial obligation is significantly lower than the balance in these accounts. In the 1998 budget, the government stated that, beginning with the 1997-98 fiscal year, it would change its accounting practices to conform with the recommendations of the PSAAB and the Auditor General.



Source: Department of Finance.



Source: Department of Finance.

As a percentage of budgetary revenues, public debt charges – the interest ratio – declined from 31.9 per cent in 1996-97 to 26.7 per cent in 1997-98. Of this decline, 1.8 percentage points were attributable to the accounting change for interest costs related to public sector pension plans. The 1997-98 ratio means that the government spent about 27 cents of every revenue dollar in 1997-98 for interest on the public debt.

Net program spending – net budgetary expenditures less public debt charges – increased $3.9 billion or 3.8 per cent in 1997-98. This increase was attributable to one-time factors which increased program spending by $5.5 billion in 1997-98. Excluding the impact of these initiatives from the 1997-98 results, program spending would have been lower than in 1996-97.

As a percentage of net revenues, program spending, or the “program share”, amounted to 71 per cent, down from 74.4 per cent in 1996-97.

Program spending can be divided into the following components:

- major transfer payments to persons;
- major transfers to other levels of government; and
- direct program spending which includes:
  - other transfers and subsidies;
  - expenditures related to Crown corporations; and
  - operating and capital costs of government departments and agencies.

Net major transfer payments to persons consist of elderly benefits and employment insurance benefits. This component increased by $0.1 billion, or 0.2 per cent.

- Elderly benefits consist of old age security payments, guaranteed income supplement payments and spouse’s allowance payments. Total benefits were up $0.6 billion in 1997-98, reflecting higher average benefits and an increase in the number of recipients.
- Employment insurance benefits were $0.5 billion lower than in 1996-97. This was due to a number of factors, including a decline in the number of unemployed, a drop in the proportion of unemployed eligible to receive benefits, and a decline in the average benefit. The latter two factors reflect, in part, the effects of the structural changes implemented in 1996, including changes in qualification criteria and reductions in maximum insurable earnings, benefits for repeat users and maximum benefit duration.

Major transfer payments to other levels of government include the Canada Health and Social Transfer (CHST), Equalization, transfers to the territories and Alternative Payments for Standing Programs, as well as a number of small transfer programs. Net cash transfers declined by $1.7 billion in 1997-98 as higher transfers under fiscal arrangements (up $0.6 billion) were more than offset by lower CHST cash transfers (down $2.1 billion).

- In the 1995 budget, the government introduced the CHST – a new block-funded transfer – which replaced Established Programs Financing (EPF) and the Canada Assistance Plan (CAP). Total CHST entitlements were set at $25.1 billion for 1997-98, down $1.8 billion from 1996-97. Total entitlements – which are the most appropriate measure of federal support – are paid to the provinces in the form of tax point transfers and cash. The tax point transfer represents the value of "tax points" that the federal government made available to the provinces by reducing federal tax rates so that provinces could increase theirs by an equivalent amount, with no impact on taxpayers. The value of these tax points fluctuates with changes in the applicable tax bases – personal and corporate income taxes. The cash portion is a residual and is affected not only by the change in total entitlements but also by the growth in the value of the tax point transfer. Under current legislation, the cash entitlement cannot fall below $12.5 billion per year for the period 1997-98 to 2002-03. Without this "floor", the cash component would have declined to $12.2 billion for 1997-98. In addition, adjustments relating to previous fiscal years for EPF and CAP raised the total cash transfer above $12.5 billion in 1997-98.
- Fiscal arrangements include transfers under the Equalization Program, transfers to the territorial governments, statutory subsidies, other subsidy transfers and recoveries under the former Youth Allowance Program. The largest of these is Equalization transfers which amounted to $8.9 billion in 1997-98. The Equalization Program provides transfers to provinces with below-average per-capita capacity to raise revenue. These transfers enable them to provide public services that are reasonably comparable to those available elsewhere in the country without having to resort to above-average levels of taxation. Higher entitlements were recorded in 1997-98, reflecting much stronger revenue gains in the non-equalization-receiving provinces than in the equalization-receiving provinces.
- The Alternative Payments for Standing Programs represent recoveries of federal tax point abatements under contracting-out arrangements. These arrangements allowed provinces to assume the administrative and financial authority for certain federal-provincial programs. In turn, the federal government provided provinces with tax points, the value of which is netted against total entitlements and, accordingly, recovered from cash transfers. These recoveries reflect the growth in the value of the tax points.

Direct program spending – total program spending less major transfers to persons and other levels of government – consists of subsidies and other transfer payments, expenditures related to Crown corporations, and operating and capital expenditures of departments and agencies.

- Spending in this component amounted to $54.2 billion in 1997-98, up $5.5 billion, or 11.3 per cent, from 1996-97. This increase was attributable to the recording of the special one-time factors: the recording of liabilities for the Canada Millennium Scholarship Foundation ($2.5 billion), compensation for hepatitis C victims ($0.8 billion), the aboriginal healing strategy ($0.35 billion), and the change in accounting for assistance to international financial institutions ($1.8 billion).

Within direct program spending:

- Subsidy and other transfer payments increased by $5.0 billion with all of the increase attributable to the special factors noted above. The Program Review restraint measures announced in the 1995 budget have resulted in fundamental changes to this component of government spending, especially affecting direct subsidies to the agricultural and industrial sectors.
- Expenditures related to Crown corporations were down $1.0 billion. This decline was attributable to the Program Review restraint measures as well as to the improved financial situation of enterprise Crown corporations in 1997-98.
- Operating and capital expenditures include the costs of defence, government administration and of delivering specific services to the public such as:
  - health care to natives and veterans;
  - research undertaken by government departments;
  - operation of national parks and historic sites;
  - collection of taxes;
  - operation of federal correctional institutions and provision of police services; and
  - elderly benefits and employment insurance.

Spending in this area was up $1.5 billion, or 5.5 per cent, from 1996-97. The increase was attributable to increases in the allowances for liabilities incurred during the year.

THE BUDGETARY BALANCE, FINANCIAL REQUIREMENTS/SURPLUS AND DEBT

The budgetary balance is the most comprehensive measure of the federal government's fiscal position. It is presented on a modified accrual basis of accounting, recording government liabilities when they are incurred regardless of when the cash payment is made. The budgetary balance covers only those activities over which the government has legislative control.

In contrast, the financial requirements/surplus measure the difference between cash coming in to the government and cash going out. It differs from the budgetary balance as the former includes transactions in loans, investments and advances, federal employees' pension plans, other specified purposes accounts, and changes in other financial assets and liabilities. These activities are included in non-budgetary transactions. The conversion from accrual to cash accounting is also reflected in non-budgetary transactions.

Non-budgetary transactions in 1997-98 resulted in a net source of funds amounting to $9.3 billion, down $0.9 billion from 1996-97. This decline was attributable to the change in accounting for interest costs related to public sector pension plans, offset in part by the inclusion in the budgetary balance of the fiscal cost of liabilities incurred during 1997-98 for which no payment was made in that year. Although these factors impact on the budgetary balance, they have no effect on financial requirements/surplus. As a result, there is a corresponding change in non-budgetary transactions.

With a budgetary surplus of $3.5 billion and a net source of funds from non-budgetary transactions of $9.3 billion, there was a financial surplus, excluding foreign exchange transactions, of $12.7 billion in 1997-98,

Table 5

Budgetary balance and financial requirements/surplus

	1993-94	1994-95	1995-96	1996-97	1997-98
			(billions of dollars)		
Budgetary balance	-42.0	-37.5	-28.6	-8.9	3.5
Non-budgetary transactions					
Loans, investments and advances	0.6	0.3	2.7	0.3	2.0
Pensions and other accounts					
Public sector pensions plans	6.2	6.9	6.8	6.3	3.3
Canada Pension Plan	-0.1	0.7	0.2	0.1	0.5
Other	0.2	1.0	0.6	0.5	0.1
Total	6.2	8.7	7.6	6.9	3.8
Other transactions	5.4	2.6	1.1	3.0	3.4
Total	12.2	11.6	11.4	10.2	9.3
Financial requirements/surplus (excluding foreign exchange transactions)	-29.8	-25.8	-17.2	1.3	12.7
Foreign exchange transactions	-2.1	-1.4	-4.7	-7.8	-2.2
Net financial balance	-32.0	-27.3	-21.9	-6.5	10.6
Net change in borrowings	31.2	27.0	28.5	7.3	-9.6
Change in cash balances	-0.7	-0.2	6.7	0.8	1.0
Cash in bank (March 31)	2.1	1.9	8.6	9.4	10.4

compared to a financial surplus of $1.3 billion in 1996-97. This marks the second year in a row in which a financial surplus was recorded.

Financial requirements/surplus include foreign exchange transactions. Foreign exchange transactions represent all transactions in international reserves held in the Exchange Fund Account. The purpose of the Exchange Fund Account is to promote order and stability of the Canadian dollar in the foreign exchange market. It fulfils this function by buying foreign exchange (selling Canadian dollars) when there is upward pressure on the value of the Canadian dollar and selling foreign exchange (buying Canadian dollars) when there is downward pressure. The buying of Canadian dollars represents a source of funds from exchange fund transactions while the selling of Canadian dollars represents a requirement. The changes in foreign currency liabilities, which are undertaken to change the level of Canada's foreign exchange reserves, also impact on foreign exchange transactions. During 1997-98, foreign exchange transactions resulted in a net requirement of funds amounting to $2.2 billion, compared to a net requirement of $7.8 billion in 1996-97.

As a result, there was a net financial surplus – the budgetary surplus plus non-budgetary and foreign exchange transactions – of $10.6 billion in 1997-98, compared to a net financial requirement of $6.5 billion in 1996-97.

With this net financial surplus, the government was able to retire $9.6 billion of its unmatured (market) debt and to increase its cash balances by $1.0 billion. Cash balances as of March 31, 1998 stood at $10.4 billion.

Interest-bearing debt includes unmatured debt and liabilities to the public sector pension plans and other accounts. As of March 31, 1998, interest-bearing debt amounted to $594.8 billion, down $5.7 billion from the level of $600.6 billion at the end of 1996-97. As noted above, market debt was down $9.6 billion while the liabilities to the pension plans and other accounts increased by $3.8 billion.

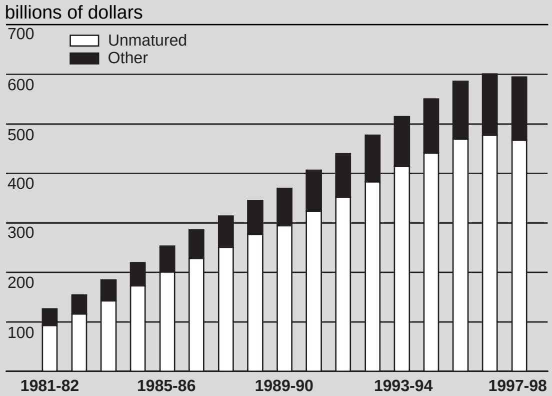
Foreign holdings of the Government of Canada's outstanding market debt are estimated at $113.8 billion at the end of March 1998. This represented 24.4 per cent of the government's total market debt – the lowest ratio since 1990-91.

Table 6

Outstanding debt at year-end

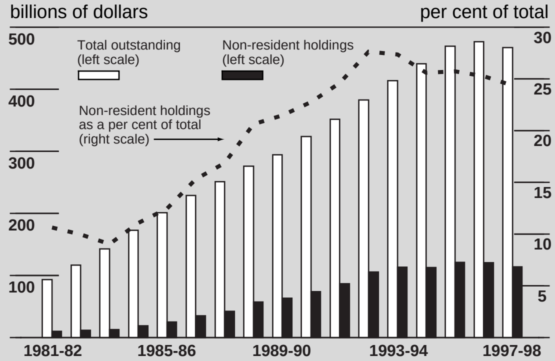
	1993-94	1994-95	1995-96	1996-97	1997-98
			(billions of dollars)		
Interest-bearing debt					
Unmatured debt	414.0	441.0	469.5	476.9	467.3
Pension and other accounts	100.5	109.2	116.9	123.7	127.5
Total	514.5	550.2	586.4	600.6	594.8
Other liabilities	31.9	34.6	38.3	40.1	43.7
Total liabilities (gross debt)	546.4	584.8	624.7	640.7	638.5
Financial assets	38.2	39.1	50.4	57.5	58.8
Accumulated deficit (net public debt)	508.2	545.7	574.3	583.2	579.7

Interest-bearing debt



Source: *Public Accounts of Canada.*

Foreign holdings of Government of Canada debt



Source: Statistics Canada.

THE "SCORECARD"

This section compares the actual outcome for selected economic indicators and for the financial results with the forecasts presented in the February 1997 and 1998 budgets.

As part of the government's overall fiscal strategy, the fiscal targets are based on the average of private sector economic forecasts available at that time. In addition, a prudence factor is applied to the interest rates in the average private sector forecast and the impacts are allowed to flow through to output and inflation. This procedure reflects the advice given at a December 1993 meeting with private sector economists and the recommendations of the House of Commons Standing Committee on Finance. The fiscal targets also include a Contingency Reserve to cover risks arising from unpredictable events and unavoidable inaccuracies in the economic and fiscal models used to translate the economic assumptions into detailed budget forecasts. In 1997-98, the Contingency Reserve was at $3.0 billion.

In the 1998 budget, the government indicated that the budget would be balanced in 1997-98. There was a budgetary surplus of $3.5 billion for 1997-98. Budgetary revenues were $5.7 billion higher, program spending was $2.8 billion higher, and public debt charges were $0.5 billion lower than estimated in the 1998 budget. Personal income tax collections were $2.4 billion higher than estimated, primarily reflecting recoveries from the Provincial Taxation Collection Account. Corporate income tax collections were $2.5 billion higher, in part reflecting much higher-than-expected collections in the February/March settlement period as well as recoveries from the Provincial Taxation Collection Account related to overpayments in previous fiscal years. The higher outcome for program spending was concentrated in direct program spending (up $2.3 billion), primarily reflecting higher-than-expected end-of-year accounting adjustments.

For the 1997 budget, real economic growth of 3.2 per cent was assumed, up from 1.4 per cent in 1996. With GDP inflation of 1.5 per cent, nominal GDP was assumed to grow by 4.7 per cent in 1997. Short-term interest rates were assumed to average 4.0 per cent in 1997, down from 4.2 per cent in 1996. However, the 4.0 per cent rate included a prudence factor of 80 basis points. Long-term rates were assumed, for budget planning purposes, to be virtually unchanged at 7.1 per cent. This included a prudence factor of 50 basis points.

Real economic growth amounted to 3.7 per cent in 1997. Although this was stronger than assumed for budget planning purposes, inflation, as measured by the GDP implicit price deflator, advanced by only 0.5 per cent with the result that nominal GDP increased by only 4.2 per cent. Interest rates were much lower than assumed for budget planning purposes. Short-term rates were 80 basis points lower, while long-term rates were 100 basis points lower.

The final outcome for 1997-98 represented an improvement of $20.5 billion from the 1997 budget deficit target of $17.0 billion. Budgetary revenues were $15.4 billion higher than estimated in the 1997 budget, program spending was $3.0 billion higher, and public debt charges were $5.1 billion lower. The Contingency Reserve of $3.0 billion was not required.

In the 1997 budget, it was assumed that the revenue yield would decline from 17.0 per cent in 1996-97 to 16.5 per cent in 1997-98. In part, this decline reflected the impact of one-time factors which had temporarily pushed up the rate in 1996-97. However, the rate increased in 1997-98 to 17.9 per cent from a revised 17.2 per cent in 1996-97. This increase reflected much stronger growth in corporate and personal income tax collections than indicated by their respective tax bases.

Corporate income tax collections were $6.3 billion higher than assumed in the 1997 budget while personal income tax collections were up $4.3 billion. Part of the higher corporate income tax collections was attributable to the stronger growth in profits in those sectors with a higher average effective tax rate.

Changes in remittance procedures and strong growth in components of income not included in personal income, but subject to taxation, contributed to the higher personal income tax collections. GST collections were $2.0 billion more than expected in the 1997 budget, reflecting stronger-than-expected growth in consumer demand.

All of the $3.0 billion increase in program spending was attributable to the special one-time factors not anticipated at the time of the 1997 budget. Public debt charges were $5.1 billion lower than forecast in the 1997 budget. This reflected the lower outcome for interest rates, a much lower-than-expected stock of interest-bearing debt and the impact of the change in accounting for interest costs related to public sector pension plans.

Non-budgetary transactions were $1.7 billion lower than assumed in the 1997 budget, primarily related to the change in accounting for interest costs related to public sector pension plans. With a budgetary surplus of $3.5 billion and a net source of funds from non-budgetary transactions of $9.3 billion, there was a financial surplus of $12.7 billion in 1997-98 rather than a net requirement of $6.0 billion.

Table 7

The “scorecard”: comparison of actual results to 1998 and 1997 budget estimates

	Actual	1998 Budget	1997 Budget	Change from 1998 Budget	Change from 1997 Budget
		($ billions unless otherwise stated)			
Economic indicators					
Real GDP (%)	3.7	3.8	3.2	-0.1	0.5
Nominal GDP					
Per cent change	4.2	4.5	4.7	-0.3	-0.5
$ billions	855.1	857.0	835.0	-1.9	20.1
Interest rates					
91-day Treasury bill rate (%)	3.2	3.2	4.0	0.0	-0.8
10-year government bond rate (%)	6.1	6.1	7.1	0.0	-1.0
Financial results					
Budgetary revenues					
Personal income tax	70.8	68.4	66.5	2.4	4.3
Corporate income tax	22.5	20.0	16.2	2.5	6.3
Other income tax	3.0	2.4	2.1	0.6	0.9
Employment insurance premium revenues	18.8	18.7	19.3	0.1	-0.5
Goods and services tax	19.5	19.8	17.5	-0.3	2.0
Customs import duties	2.8	2.7	2.1	0.1	0.7
Other sales and excise taxes/duties	8.6	8.8	8.1	-0.2	0.5
Non-tax revenues	7.2	6.8	6.1	0.4	1.1
Total	153.2	147.5	137.8	5.7	15.4
Program spending					
Major transfers to persons					
Elderly benefits	22.2	22.2	22.3	0.0	-0.1
Employment insurance benefits	11.8	12.0	13.5	-0.2	-1.7
Major transfers to other levels of government					
Canada Health and Social Transfer	12.6	12.5	12.5	0.1	0.1
Fiscal arrangements	10.0	9.5	9.4	0.5	0.6
Alternative Payments for Standing Programs	-2.1	-2.1	-2.1	0.0	0.0
Direct program spending					
Subsidies and other transfers	22.5	19.6	16.5	2.9	6.0
Crown corporation expenditures	2.5	3.9	3.9	-1.4	-1.4
Defence	8.9	8.4	9.0	0.5	-0.1
All other program spending	20.3	20.0	20.8	0.3	-0.5
Total	108.8	106.0	105.8	2.8	3.0
Public debt charges	40.9	41.5	46.0	-0.6	-5.1
Contingency Reserve			3.0		-3.0
Budgetary balance	3.5	0.0	-17.0	3.5	20.5
Non-budgetary transactions	9.3	12.0	11.0	-2.7	-1.7
Financial requirements/surplus (excluding foreign exchange transactions)	12.7	12.0	-6.0	0.7	18.7

Opinion of the Auditor General on the condensed financial statements of the Government of Canada

To the Minister of Finance:

The accompanying condensed statements of revenues and expenditures, assets and liabilities and changes in financial position are derived from the complete financial statements of the Government of Canada as at March 31, 1998 and for the year then ended on which I expressed a qualified opinion in my report dated July 27, 1998. My opinion stated that except for the recording of a transaction related to the Canada Millennium Scholarship Foundation as if it were a liability and an expenditure, which understates the 1997-98 surplus by $2.5 billion and overstates accounts payable and accrued liabilities as well as the accumulated deficit by the same amount, the complete financial statements are, in all material respects, fairly presented. My opinion also stated that the complete financial statements present information in accordance with the stated accounting policies of the Government of Canada set out in Note 1 to the financial statements and, except for the changes in accounting policies for assistance to international financial institutions, interest costs on obligations for public sector pensions, and transfer payments, the Government's stated accounting policies have been applied on a basis consistent with that of the preceding year. The fair summarization of the complete financial statements is the responsibility of the Government. My responsibility is to report on the condensed financial statements.

In my opinion, the accompanying condensed financial statements fairly summarize, in all material respects, the related complete financial statements in accordance with the criteria described in the applicable Assurance Guideline of The Canadian Institute of Chartered Accountants.

These condensed financial statements do not contain all the disclosures required for a full and fair presentation of the Government's financial position, results of operations and changes in financial position. Readers are cautioned that these statements may not be appropriate for their purposes. For more information on the Government's financial position, results of operations and changes in financial position, reference should be made to the related complete financial statements to be included in Volume I of the 1998 *Public Accounts of Canada*, expected to be tabled in the House of Commons later this year.

L. Denis Desautels, FCA
Auditor General of Canada

Ottawa, Canada
July 27, 1998

CONDENSED FINANCIAL STATEMENTS OF THE GOVERNMENT OF CANADA

The fundamental purpose of these condensed financial statements is to provide Parliament and the public with an overview of the financial affairs and resources for which the government is responsible. Responsibility for the integrity and objectivity of these statements rests with the government.

The condensed financial statements reflect the financial position of the government at the end of the year, as well as results of its operations, and changes in its financial position for the year. These financial statements and the accompanying notes are extracted and condensed from the audited financial statements included in

Table 8

Government of Canada
Condensed statement of revenues and expenditures
for the year ended March 31, 1998

	1998	**1997**
	(millions of dollars)	
Revenues		
Tax revenues		
Income tax	101,142	87,989
Excise taxes and duties	33,752	31,970
Employment insurance premiums	18,802	19,816
	153,696	*139,775*
Non-tax revenues	10,666	12,697
Total gross revenues	***164,362***	***152,472***
Amounts deducted to arrive at net revenues	11,200	11,576
Total net revenues	***153,162***	***140,896***
Expenditures		
Transfer payments		
Old Age Security and related payments	21,758	21,207
Other levels of government	20,504	22,162
Employment insurance benefits	11,842	12,380
Other transfer payments	28,909	25,571
	83,013	*81,320*
Crown corporation expenditures	3,775	4,823
Other program expenditures	31,142	30,253
Total gross program expenditures	***117,930***	***116,396***
Amounts deducted to arrive at net program expenditures	11,200	11,576
Total net program expenditures	***106,730***	***104,820***
Interest on debt	43,620	44,973
Total net expenditures	***150,350***	***149,793***
Surplus (deficit) for the year before changes in accounting policies	**2,812**	**(8,897)**
Net effect of changes in accounting policies	666	–
Surplus (deficit) for the year	**3,478**	**(8,897)**
Accumulated deficit		
Beginning of year	583,186	574,289
End of year	**579,708**	**583,186**

Table 9

Government of Canada
Condensed statement of assets and liabilities
as at March 31, 1998

	1998	1997
	(millions of dollars)	
Liabilities		
Payables, accruals and allowances		
Accounts payable and accruals	32,783	29,667
Allowances for guarantees and employee benefits	10,917	10,433
Interest-bearing debt	*43,700*	*40,100*
Unmatured debt		
Marketable bonds	294,583	282,498
Treasury bills	112,300	135,400
Canada Savings Bonds	29,769	32,470
Bonds for Canada Pension Plan	3,456	3,468
Total payable in Canadian currency	440,108	453,836
Payable in foreign currencies	27,183	23,016
	467,291	*476,852*
Pension and other accounts		
Public sector pensions	117,457	114,205
Canada Pension Plan (net of securities)	4,205	3,718
Other	5,872	5,782
	127,534	*123,705*
Total interest-bearing debt	*594,825*	*600,557*
Total liabilities	***638,525***	***640,657***
Assets		
Cash and accounts receivable		
Cash	11,691	10,175
Accounts receivable	4,122	4,416
	15,813	*14,591*
Foreign exchange accounts	28,968	26,813
Loans, investments and advances		
Enterprise Crown corporations	12,601	13,842
National governments and international organizations	6,869	8,691
Other	3,832	4,088
	23,302	*26,621*
Less: Allowance for valuation	9,266	10,554
	14,036	*16,067*
Total assets	***58,817***	***57,471***
Accumulated deficit	**579,708**	**583,186**

Section 1 of Volume I of the 1998 *Public Accounts of Canada*, which are expected to be tabled in Parliament later this year. These condensed financial statements were prepared by the Government of Canada in accordance with the accounting policies set out in the accompanying notes on a basis consistent with that of the preceding year, except for the changes in accounting policies explained in the notes.

As these condensed financial statements are, by their nature, summarized, they do not include all disclosure required for financial reporting by governments in Canada. Readers interested in the disclosure of more detailed data should refer to the audited financial statements in the Public Accounts.

Table 10

Government of Canada
Condensed statement of changes in financial position
for the year ended March 31, 1998

	1998	1997
	(millions of dollars)	
Cash provided by operating activities		
Surplus (deficit) for the year	3,478	(8,897)
Add expenditures not requiring cash	13,867	9,228
	17,345	*331*
Net payments from pension and other accounts	(5,110)	(3,902)
Net change in receivables, payables and accruals	(470)	4,165
	11,765	*594*
Cash provided by investing activities		
Net decrease in loans, investments and advances	*1,467*	*991*
Cash provided by (required for) foreign exchange activities		
Net increase in foreign currencies borrowings	4,167	6,207
Less net increase in foreign exchange accounts	2,155	7,759
	2,012	*(1,552)*
Net cash generated before financing activities	***15,244***	***33***
Cash used for (provided by) financing activities		
Net decrease (increase) in Canadian currency borrowings	13,728	(1,098)
Net increase in cash	**1,516**	**1,131**
Cash at beginning of year	10,175	9,044
Cash at end of year	***11,691***	***10,175***

Government of Canada
Notes to the Condensed Financial Statements

Introduction

These notes are a brief summary of the accounting policies followed by the Government of Canada and other explanatory material related to these condensed financial statements. For more detailed notes on accounting policies and for more extensive information on the financial position and results of operations of the government, the reader should refer to the audited financial statements in Section 1 of Volume I of the 1998 *Public Accounts of Canada*.

Significant accounting policies

Reporting entity

The Government of Canada as a reporting entity includes the financial activities of all departments, agencies, corporations and funds which are owned or controlled by the government and which are accountable to Parliament, except for enterprise Crown corporations which are not dependent on the government for financing their activities. These corporations are reported as investments at their original cost adjusted by an allowance for valuation to reflect their annual profits or losses. The Canada Pension Plan, which is under joint control of the government and participating provinces, is excluded from the entity. It is financed from contributions by employees, their employers, and self-employed persons, and interest earned on investments which are mainly in provincial government securities.

Basis of accounting

The government accounts for transactions on an accrual basis with two notable exceptions:

- Tax revenues and related refunds are generally accounted for on a cash basis (when taxes are collected and refunds are paid out), except for certain significant refunds which are reported on an accrual basis.
- Capital assets and inventories are fully charged to expenditures at the time of acquisition or construction.

As a consequence, the only assets recorded on the Condensed Statement of Assets and Liabilities are financial assets, as they can provide resources to discharge liabilities or finance future operations. These assets include cash, gold, receivables, as well as loans, investments and advances. Assets are recorded at the lower of cost or net realizable value, except for gold (1998 – 3.1 million ounces at $66.38 per ounce; 1997 – 3.1 million ounces at $67.20 per ounce), which is valued at its approximate cost in foreign currency terms.

Liabilities are recorded on an accrual basis. Certain non-recurring transfer payments are accrued when announced by the government prior to the year-end if they subsequently receive appropriate parliamentary approval. Public sector pension and severance liabilities are determined on an actuarial basis. Valuation allowances are established for outstanding loan guarantees, concessionary and sovereign loans, and other obligations. Unmatured debt is recorded at face value with foreign currency amounts translated to Canadian dollar equivalents using rates at March 31.

Some amounts in these statements are based on estimates and assumptions made by the government. Such amounts include public sector pension obligations, valuation allowances for loans, investments and advances, borrowings of Crown corporations, expenditures related to contingent liabilities, and transfer payments and liabilities for tax collections to other levels of government. By their nature, such estimates are subject to measurement uncertainty, although all of them are believed to be reasonable. If actual events differ from these estimates and assumptions, this could have a significant effect on the results reported in the condensed financial statements in future years.

Comparative figures for 1997 are reclassified to conform to the current year's presentation, except for the impact of the changes in accounting policies described below.

Changes in accounting policies

In 1998, changes have been made in accounting for assistance to international financial institutions, and for interest costs on obligations for public sector pensions. Their net impact is to increase the surplus for 1998 by $0.7 billion. The one-time change in accounting for assistance to international financial institutions decreases loans, investments and advances, and the surplus for 1998 by $1.8 billion. The reduction of interest costs on obligations for public sector pensions after April 1, 1997 increases the surplus for 1998 and decreases the liability for public sector pensions by $2.5 billion.

Reporting of revenues and expenditures on a gross basis

Detailed amounts on the Condensed Statement of Revenues and Expenditures are presented on a full (gross) disclosure basis only. The Statement of Revenues, Expenditures and Accumulated Deficit in the audited financial statements in the Public Accounts presents amounts on both a gross and net basis.

Gross revenues include revenues of consolidated Crown corporations, and revenues of government departments which, on the net basis, are deducted from expenditures for budget and parliamentary authority purposes. Gross expenditures include expenditures determined through the tax system, such as child tax benefits and quarterly GST tax credits, that are deducted from revenues on the net basis.

Authorities for transactions

Authority of Parliament is required before revenue can be raised and moneys spent or borrowed by the government. Spending authorities on a net basis granted by Parliament were $152.7 billion ($153.5 billion in 1997), whereas $149.7 billion ($149.8 billion in 1997) was spent. Of the total borrowing authority available of $4.0 billion ($18.7 billion in 1997), none ($6.8 billion in 1997) was used.

Significant transactions

Certain significant transactions recorded as other transfer payments in expenditures and as liabilities of the government during the year include a $2.5 billion grant to the Canada Millennium Scholarship Foundation. The decision to make this grant was announced by the government in the February 1998 Budget and received parliamentary approval in June 1998. Other transfer payment transactions recorded include the government's $0.8 billion share of financial assistance to persons who contracted Hepatitis C through the Canadian blood system between 1986 and 1990, and disaster financial assistance of $0.6 billion.

Unmatured debt

The following table presents the amounts of unmatured debt that will mature during the next 5 years.

Maturing year	Amount (in billions of $)
1999	164.5
2000	45.2
2001	29.7
2002	25.2
2003	28.2

The effective average annual interest rates for debt with a fixed term range from 5.87 to 10.22%, while the rates for debt with variable terms range from 3.61 to 5.49%.

Public sector pensions

Public sector pension liabilities are estimated annually using the government's best assumptions for demographic and economic factors affecting these pension obligations. Separate funds are not set aside to provide for payment of public sector pension benefits. Changes in assumptions can result in significantly higher or lower estimates of these liabilities.

Contractual commitments

The nature of the government's activities requires negotiation of contracts that are significant in relation to its current financial position or that will materially affect the level of future expenditures. Contractual commitments pertain to transfer payment agreements, operating and capital leases, benefit plans for veterans, capital asset acquisitions and other purchases, and funding of international organizations. At March 31, 1998 contractual commitments amounted to approximately $29.4 billion ($27.0 billion in 1997). Estimated annual payments related to these commitments for the next five years decrease from $7.8 billion in 1999 to $3.7 billion in 2003.

Contingent liabilities

The contingent liabilities of the government, generally, are potential liabilities which may become actual liabilities when it is likely that a future payment will be made and the amount of the potential loss can be reasonably determined. Contingent liabilities result from the exercise of guarantees; environmental contingencies; callable share capital in international organizations; claims, and pending and threatened litigation; and like items. At March 31, 1998, these contingent liabilities amounted to approximately $71.7 billion ($71.7 billion in 1997).

Insurance programs are operated by three enterprise Crown corporations for the government on a self-sustaining basis. In the event that the corporations have insufficient funds, the government will have to provide financing. Insurance in force at March 31, 1998 amounted to approximately $485 billion ($462 billion in 1997). The government expects that it will not incur any costs to cover the claims for these insurance programs.

Other sources of information

The Public Accounts of Canada

The *Public Accounts of Canada*, as required under Section 64(1) of the *Financial Administration Act*, are tabled in the fall of each year by the President of the Treasury Board. This report is presented in two volumes:

- Volume I contains the government's audited financial statements and supporting schedules and information; and
- Volume II contains details of financial operations by Ministry (Part I) and additional information and analyses (Part II).

The Budget

The budget that is introduced, usually in February, presents the government's overall fiscal plan, incorporating revenue projections and spending plans which combine to determine the resulting budgetary deficit. The budget also introduces proposals for changes in taxation.

The Estimates

The Estimates are the detailed annual expenditure plans submitted to Parliament each spring. The Estimates are presented in three parts:

- Part I presents an overview of the government's expenditure plan;
- Part II outlines spending according to departments, agencies and programs; and
- Part III provides additional detail on each department and its programs.

The Debt Management Report

This annual document provides an overview of the federal government's borrowing operations. It outlines the key elements of current federal debt strategy and describes various strategic and operational aspects of the government's debt program and cash management activities over the past fiscal year.

The Fiscal Monitor

This monthly newsletter produced by the Department of Finance highlights the financial results of the government together with the reasons underlying major variances.