EXPENDITURE MANAGEMENT: LESSONS LEARNED THE HARD WAY

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Purpose

This paper describes the range of lessons learned over the past several decades in the management of government expenditures in Canada and other jurisdictions. The paper points to the absolute necessity of political will and consistency of purpose as a condition for success. It also makes a plea for a sustained incremental approach to reform, rather than dramatic revolutionary change. It emphasizes the significant benefits to be achieved through transparency and accountability mechanisms. The paper reviews a large number of techniques and mechanisms providing a menu from which ideas can be selected. It emphasizes the overriding importance of a conceptual framework and a vision of the ultimate desired structure of legislation, policy and controls that may be achieved after ten or twenty years.

The paper is organized into three major parts – the macro level budgetary process, the management of state-owned enterprises, and selective budgetary policy issues.

A) Macro Level Budgetary Process

Political Will

Political will is the first and most important factor in improving expenditure management in any government. A necessary (albeit not sufficient) condition for success is a strong Finance Minister with political support and credibility. There is no substitute for the support of political leadership and endorsement. The best Canadian example is the experience of the 1995 Program Review exercise.

Program Review was a genuine watershed event in Canadian expenditure management. In a departure from the Canadian political tradition of building consensus, respecting boundaries and resolving conflict, the Program Review Exercise was a directed process conducted under the threat of impending fiscal doom. Ministries were given top-down hard targets for expenditure reductions from forward estimates—for example, a 40 percent reduction for the Ministry of Transport. Ministries were also given top-down policy directives and instructed to do a baseline review of every program and expenditure item. The Treasury Board and Finance Ministry did parallel reviews and gave advice and countervailing arguments to Cabinet. All departments and agencies where included; there were no exemptions; and no successful end-runs for new spending.

It was clear that both the Prime Minister and the Minister of Finance were firmly behind the process:

> *"Martin (the Finance Minister) announced his spending freeze at the start of the (Cabinet) meeting. Across the table, ministers could see (Prime Minister) Chretien looking down, seemingly oblivious. It wasn't clear to anyone but Martin that he had even discussed the matter with the prime minister. About ten minutes into the meeting, one of the ministers spoke on a pet project that required some new money. Martin began to interject. But Chretien cut him off. "Didn't you hear the minister of finance?" he asked. "Just ten minutes ago, he said there wouldn't be any more money." Another ten or fifteen minutes went by and another minister made mention of a new spending initiative. This time Martin turned beet red. But again the prime minister beat him to the punch. His patience was wearing thin, too, as could always be discerned by the way he fidgeted in his chair and tapped his pencil. "Didn't you hear* ***me*** *ten minutes ago?" he demanded sharply. "I said there is no money. Can't you guys understand that? The next one who asks for new spending, I'm going to cut his budget by 20 per cent."…It was at that moment that Martin would later tell his associates, that he knew Jean Chretien would be there for him."*
>
> Edward Greenspon and Anthony Wilson-Smith, *Double Vision: The Inside Story of the Liberals in Power* (Toronto: Doubleday, 1996), 164.

The Program Review was instrumental in dealing with chronic deficits and rising debt levels, and the government has recorded budgetary surpluses in each of the last four years. During that period, net public debt as percentage of the economy came down from 70.7% to 51.8%. While the process has not been repeated – and some argue that it should – it did provide the basis for current efforts to improve desired results from programs through better definition of program objectives, better measurement and reporting of performance, and strengthened accountability.

A long time senior official and respected observer, Jim Mitchell, has listed four keys to successfully combining improved performance with strengthened accountability:

- clarity on the role, mandate, and objectives of the enterprise;
- consistency of purpose on the part of the government;
- quality of management; and
- an appropriate reporting and budgeting regime.

Consistency of purpose is critical. A constant risk for state enterprises is that declared roles and objectives can be subverted by formal or informal means. Mitchell pointed out that "this is almost entirely a matter of political discipline, reinforced if possible by Parliamentary and public opinion." The problem is that in many cases regional and sectoral public opinion will weigh against an effective performance regime, particularly when it comes to state enterprises. An excellent example is DEVCO—the Cape Breton Development Corporation with responsibility for overseeing the phasing out of the coal industry in Cape Breton. Its case history is presented in Annex 1. Regional public opinion demanded that DEVCO maintain employment levels—it was the region's major employer. Performance demanded significant cuts in employment. Yielding to regional public opinion resulted in the Treasury fruitlessly hemorrhaging millions of dollars each year for decades. The relationship between employment levels and public expenditures is illustrated in Annex 2.

The Wisdom of a Sustained, Incremental Approach

Experience of the gradual evolution of reforms in Canada, the U.S. and the U.K argues for a sustained incremental approach. A mature and sophisticated system of expenditure management and accountability takes many years to implement. Indeed countries such as the U.S. and Australia are continually reforming their systems, addressing gaps, and responding to new challenges. Even the shock reforms of New Zealand involved a multi-year process. The PER project paper on Canada, “Annotated History of Major Expenditure Management Reforms in the Canadian Government”, describes the continuous evolution over a thirty year history, starting from a rudimentary line-item system. History is characterized by an inevitable series of reform on the processes of government. Paul Light (in his book “The Tides of Reform, Making Government 1945 – 1995”) listed twelve pages of laws, over 50 years, passed by the U.S. Congress with the purpose of improving government operations. A continuous series of independent and external reform initiatives leads to a lack of the long-term consistency and internal commitment necessary for the effectiveness of any reform. This leads to skepticism of reform initiatives in state enterprises and the government service.

Building a system of budgetary control takes time. It requires a sustained effort and most important, clarity of purpose from the outset. A clear and ongoing commitment by government to prudent expenditure management and control is critical to set the broad direction for an ongoing series of sustained and incremental improvements. Maintaining the focus is not easy. Several years after the 1984 updating of the Financial Administration Act, which introduced many new requirements, the Auditor General reported that, “many deficient corporate plans are approved and the government has limited capacity to challenge them.” The Auditor General also reported “ one half of audit committees were operating below an effective level.” The Government should and did issue more detailed guidelines for the preparation of corporate plans and for the annual report, but the key point is that major budgetary control systems take years to build and much maturing and perseverance to achieve a satisfactory level of effectiveness.

Key Techniques for Fiscal Control

The Canadian budgetary process is characterized by the establishment of an overall government-wide fiscal framework by Cabinet, followed by increasing opportunities for consultation with Parliament and the public in the pre-budget period, with overall management and final decision-making resting largely in the hands of the Minister of Finance with the support of the Prime Minister.

The government's fiscal framework which sets out the expenditure and revenue levels and the fiscal balance is established by the Minister of Finance with the support of the Prime Minister, and subsequently with Cabinet endorsement. It establishes the fiscal targets and overall discipline within which existing expenditures and any proposals for new spending are centrally considered. Along with the government's declared policy objectives and directions, the fiscal framework provides the budgetary context for pre-budget consultations with Ministers, Parliamentarians, provincial governments, and business and social interests. Over the past eight years there has been more extensive and open pre-budget consultation. In the fall the Parliamentary Committee on Finance reviews the economic and fiscal update prepared by the Minister of Finance and provides a report to the government on the upcoming budget. Discipline is centrally maintained in the preparation of the budget by the Minister of Finance.

An important lesson is the set of techniques that Canadian Finance Minister Martin imposed to set the stage for government-wide fiscal control:

- There was the establishment and public commitment to an overall fiscal target. Rather than promise the elimination of the $42 billion dollar deficit, the Finance Minister set an achievable target of $25 billion (3% of GDP). As progress was made each year in achieving more than the annual target, tighter future year targets were established resulting in the fairly rapid elimination of the deficit and the achievement of surpluses.

- The Finance Ministry secured independent external fiscal forecasts, which included ranges of forecasts. The Finance Ministry introduced a "prudence factor" into the budget forecasts using the most pessimistic economic assumptions resulting in the lowest fiscal figures. For further prudence it then reduced this "worst case" scenario by a further 0.5 percent.

- Prudence was applied in estimating revenues to ensure that they were not overestimated and in estimating expenditure to ensure that they were not underestimated.

- For additional prudence the Finance Ministry established a $3 billion annual "contingency reserve" (for unforeseen circumstances). The contingency reserve, if not needed, was used only to retire debt at year-end and not for additional program expenditures.

- The government aimed for zero growth in expenditure, reducing overall program expenditures as percentage of the economy to what they had been in the early 1950s (12%).

- Several major statutory transfer payments to the provinces (health, post-secondary education and social assistance) were consolidated into one transfer payment reducing the incremental pressures that existed under the former fragmented system—only one tranche of money is debated each year. This single bulk transfer allowed the federal government to argue that it was providing more program flexibility and large amounts of money with greater certainty.

The most basic element of budgetary control is the central management of the consolidated revenue fund (CRF) into which all government revenue must flow. Overall budgetary control is impossible if departments and enterprises are permitted to establish their own separate bank accounts. All expenditures by government from the CRF require the approval of Parliament. In Canada, there are almost no exceptions permitting the "earmarking" of revenues for specific purposes. Those few that do exist require legislative approval.

In Canada, a few crown corporations generate some revenue and they have received clear direction with respect to returning revenue to government in the form of dividends. It is important to be very clear with respect to expectations of targets for dividends. As a general principle state owned enterprises should pay dividends rather than taxes. Income taxes should be considered only for those state-owned enterprises that compete directly with commercial enterprises. In this case taxes may be appropriate to ensure a level playing field with respect to treatment by government.

A linchpin of budgetary control is the control of the borrowings of state enterprises. In Canada, because these borrowings are generally guaranteed by the government, the risk to the government is controlled by a legislative requirement that the Minister of Finance must approve all borrowing plans of Crown Corporations. Further the Treasury Board must approve both the capital and the operating budget. (Almost all crown corporations are considered "agents" with the government ultimately responsible for their debts.)

B) <u>Management of State-owned Enterprise</u>

Culture and Context: Transparency and Incentives

This paper provides a series of "lessons" or "tips" to be mindful of in recommendations to establish financial and operational discipline with respect to Russian state enterprises. There are significant challenges to any planning, budgeting and accountability regime. Most recommendations depend implicitly on a strong set of social understandings and behavioral norms of the managers of state enterprises. These elements of "business culture" develop slowly over a long period of time and need constant reinforcement from social and political leaders. Enterprise management is naturally reluctant to entertain or report bad news. The culture of the organization must change. An appropriate mix of incentives and controls must be in place. The most powerful incentives and controls can be achieved by transparency arrangements that extend beyond reporting results; the culture of an organization can change over time if expectations of future performance as well as results are made clear to employees and to the public.

Framework for Planning, Budgeting and Accountability

Any planning, budgeting and accountability system must have three basic elements:

- **Defining Expectations** ("Business Plans"). Objectives, responsibilities, performance expectations and authority must be aligned, clearly defined and understood.

- **Monitoring and Reporting of Performance and Results** ("Annual Reports"). A process must be in place to report on performance and review performance against expectation. Reporting and monitoring must be based on performance measures.

- **Taking Results-Based Actions** ("Audits—Internal and External"). The consequences of meeting, or not meeting, expectations must be enforced. Rewards and redress mechanisms should be in keeping with the success in achieving results.

The complexity and scale of the problem in Russia —over 30,000 diverse state enterprises—entails a careful approach, in which choices must be made. Before introducing change, an overall framework must be selected, and the vocabulary chosen carefully. It is essential that the intent of any reforms be clearly communicated and that the strategies announced be credible. Table 1 (below) displays one example of an operational framework for securing budgetary control and program performance. It is essential that the overall framework be established and its basic features put in place to avoid ad hoc approaches that can discredit and even undermine the entire initiative. It is not necessary, nor desirable that everything be done at once. In fact, everything should not be attempted at once, but rather instruments for planning and techniques for measuring and reporting results are best implemented in a phased, but sustained manner.

The task for the policy maker is to select the elements of the framework to be applied and to calibrate the degree of emphasis on each element selected, based on an appreciation of the context and culture of the environment for state enterprises. The policy maker must choose which questions in Table 1 should be pursued first as well as the relative effort to invest in seeking answers to the various questions (all questions in column 1 must be kept in mind from the beginning). Some elements should perhaps be applied initially to a selected category of state owned enterprises. The policy maker must push to the limit of the art of the possible, over a sustained period of time. It is important to not underestimate training requirements that new approaches will entail.

TABLE 1:
Accountability Information Matrix:
Ministry/Crown Corporation Level

<table>
<tr><td>What question should Accountability information Answer?

OPERATIONAL</td><td colspan="2">What information is needed to allow these questions To be answered?

PLANNING   RESULTS</td></tr>
<tr><td>***Is the organization Achieving what it set out To achieve?***</td><td></td><td></td></tr>
<tr><td>What is the purpose of the organization?</td><td>• Legal mandate
• Mission
• Analysis of key issues and trends</td><td></td></tr>
<tr><td>What are the challenges facing the organization?</td><td></td><td></td></tr>
<tr><td>What are its overall long-term goals, and how well is it progressing toward them?</td><td>• Measurable (outcome focused) targets for long-term goals</td><td>• Key outcomes & performance measures on long-term goals</td></tr>
<tr><td>***Are its programs achieving what they are meant to achieve in a cost-effective way?***</td><td></td><td></td></tr>
<tr><td>Are its programs:
• Needed (that is, relevant?)</td><td>• Client profile
• Program objectives
• Link to organization and government-wide objectives
• Intended outcomes</td><td>• Results of evaluations carried out?</td></tr>
<tr><td>• Achieving what was intended (that is, effective)?</td><td>• Schedule of evaluations to be carried out
• Planned service delivery standards
• Intended levels of user acceptance</td><td>• outcome measures
• results of evaluations carried out including details about secondary impacts
• actual service delivery standards</td></tr>
</table>

• Achieving at a reasonable cost (that is, efficient and economical)?	• Planned full cost of programs • Planned unit cost of outputs • Planned quantity/quality of output	• actual levels of user acceptance • actual full cost of programs • unit cost per output • actual quantity/quality of output
Is the organization maintaining the capacity to deliver results in the future?		
Does the organization have the ability to maintain or improve results, and the capacity to deal with the future?	• Details of any specific initiatives, designed to improve organizational capacity	• Assessment of financial condition, protection of assets, employee skills, work environment, and operating controls
FINANCIAL: ***Is the organization achieving its financial objectives?***		
What are its financial objectives, and are they being realized?	• Planned operating revenues and expenditures • Planned capital expenditures • Planned financial position, including debt • Details of any major changes to be made to financial controls	• Actual revenues and expenditures • Actual capital expenditures • Actual financial position, including debt • Management statement of the adequacy of controls

COMPLIANCE: ***Are the organization's affairs conducted in accordance with legislated requirements, and with expected standards of conduct?***		
Is spending kept within the limits approved by the Legislative Assembly?	• Voted appropriations	• Statements of actual expenditures compared to voted appropriations
What laws does the organization need to comply with for (a) the conduct of business and (b) the operation of specific programs, and is it complying with them?	• Identification of relevant laws	• Management statement of compliance
What are its standards of conduct, and is it complying with them?	• Identification of standards of conduct	• Management statement of compliance
What are government's internal social policy objectives, and how well is the organization achieving them?	• Long-term goals • Annual objectives	• Progress towards long-term goals • Annual achievement
Are there adequate controls designed to ensure compliance with legislation and standards of conduct?	• Details of any major initiatives to improve control over compliance	• Management statement of adequacy of compliance controls

Source: Auditor General of British Columbia and Deputy Ministers' Council 1996

The Menu of Accountability Mechanisms

As illustrated in the operational framework for budgetary control and accountability (Table 1 above), there is a large menu available of transparency and accountability mechanisms to apply in a comprehensive system. The mechanisms include:

- business plans to ensure clarity of the expectations for the state enterprise;
- contestability in the delivery of outputs;
- conditions of tenure of the Chief Executive Officer of the state enterprise;
- performance contracts for the Chief Executive Officer and employees;
- extent of performance audits and annual reports
- frequency of reporting requirements;
- publication and dissemination of results and reports;
- use of client surveys;
- extent of oversight of financial accounts- internal and external audit arrangements; and
- bench marking and comparative ratings of groups of similar enterprises.

Transparency and accountability mechanisms do impose implicit (and explicit) costs if Ministers, Chief Executive Officers and employees ignore the rules inherent in these systems. If effectively designed and applied, transparency arrangements provide powerful incentives to play by the rules. Russian authorities should select from the menu those items that are deemed most likely to be effective. Over time, additional mechanisms and refinements can be introduced.

Governance

Effective governance of a large and diversified number of state-owned enterprises requires that they be classified into manageable groupings. It is therefore essential at the outset to decide upon a taxonomy of state enterprises so that an overall framework can be put in place to ensure their effective and efficient control and management. The PER paper on Canada, " A Taxonomy for Budgetary Control of State-Owned Enterprises" describes four categories of state-owned enterprises and sets out the central elements for the effective control of each of these different categories of enterprises. While there is no magic to the number of categories, the former Canadian Auditor General advises that too many categories would be unwieldy with the differences being too small, leading to endless arguments over classification. On the other hand too few categories would not recognize the range and diversity of state-owned enterprises. On balance, he suggests a taxonomy of six categories.

Legislation should provide the basis for the framework for governance and accountability of state-owned enterprises, including:

- A clear portrayal of "who is responsible for doing what"—Parliament, government, board, and management);

- Detailed requirements for business plans and regular reporting; and
- Clear definition of the audit regime.

There is a need for a formal legal system for the establishment, acquisition and dissolution of new corporate entities by state enterprises. In the mid 1970s some Canadian state-owned enterprises were being established without legislative approval from Parliament, resulting in major concerns that nobody knew what the government owned and how many corporations it had. Crown corporations created subsidiaries, acquired private companies. Occasionally Ministers established new crown corporations. In 1979, Canadian crown corporations were required by legislation to obtain Parliamentary approval for these actions.

Legislation should specify the basic elements of the governance structure for state enterprises. A structure including a Board of Directors and a "Resourcing and Budget Process" should be introduced, including provisions for a Board of Directors and Annual Reports. An implementation plan for putting in place governance structures for state enterprises is necessary especially when it will be necessary to move forward more quickly on some types of enterprises than on others. Based on the practical lessons learned from the Canadian experience with crown corporations and from elsewhere, the most important areas on which to focus are: the board of directors, corporate business plans, and annual reports.

<u>Board of Directors</u>

Boards of State Enterprises are critical to management accountability, including financial and budgetary areas. Therefore:

- Government should appoint Directors to Boards.

- There should be a transparent process to nominate Directors. For example, to ensure both meritorious appointments and probity, the United Kingdom established the Commissioner for Public Appointments and adopted a Code of Practice for Public Appointments. The Commissioner issues guidance on making appointments and investigates complaints about individual appointment exercises. The Code sets out principles such as Merit, Equal Opportunities, and Independent Scrutiny.

- Responsibilities of Boards of Directors should include oversight of the Chief Executive Officer; planning, ensuring compliance with legal and administrative requirements; and upholding "values" of the enterprise.

- The Board should have a significant role in, or ideally the responsibility of, selecting the CEO. The CEO is responsible for the day-to-day management and operations of the enterprise.

- Remuneration of the Board Chairman and the CEO should be made public.

- The Board should report to Parliament through a sponsoring Minister.

- Directors on boards of state enterprises should update "conflict of interest" statements each year.

Canada provides a "Guide Book for Chairs, Directors and Chief Executive Officers of Crown Corporations" that gives a better picture of the appropriate governance of a Crown Corporation. There is great diversity among Crown Corporations and the corresponding range in the legislation to which they are subject. Therefore the Guide provides an overview of a range of topics such as accountabilities, the respective roles of management, the Chair and members of the board of directors, and the corporate planning and reporting process to Parliament. The Guidebook makes clear the principles of the Conflict of Interest Code, and compliance measures related to disclosure, outside activities, gifts, and post-employment requirements.

It will take time to put in place professional and effective boards of directors for state enterprises and to ensure close working relationships with the CEOs. Even after fifteen years of experience with the 1984 legislative regime for Crown Corporations in Canada, the Auditor General has concluded that the Boards of Directors need to be strengthened. He noted that boards of directors "lack key skills and capabilities that are needed to function effectively" and that they need to be "more engaged in the selection of their chair as well as the selection of the CEO".

<u>Corporate Business Plans</u>

The ability of diverse state enterprises to balance costs and benefits of public policy objectives against financial costs is critical. The corporate plan is the cornerstone of the control and accountability framework for state enterprise. Therefore,

- Each state enterprise should provide a Corporate Business Plan to its sponsoring Ministry and to Parliament. Annex 3 reproduces the legislation in Canada, which describes the required content of Corporate Plans. Annex 4 reproduces the Treasury Board Secretariat Guidelines to assist Crown Corporations in the development of their corporate plans.

- The government should approve each Corporate Business Plan.

- The government's review and challenge of the Corporate Business Plan should be rigorous, asking questions such as those set out in Annex 5.

- Summaries of the Corporate Business Plans should be tabled in Parliament.

The review of the corporate business plan provides the opportunity to distinguish clearly between public policy objectives of the government and the commercial objectives of the enterprises. The establishment of separate accounts within a single enterprise can be helpful in this regard. For example, the Export Development Corporation is expected to make a profit on its transactions. If the government insists that the Corporation support a transaction that the Corporation considers too risky, then the government finances the transaction in a separate account – "the Canada Account". (Although there is the opinion that any distinction is of second order importance given the ability of EDC borrowing at government rates, which in effect subsidizes EDC relative to competitors who borrow at market rates.)

The review of corporate plans provides the occasion to deal with questions of competition between state-owned enterprises and private sector corporations. Consider Canada Post which is a state owned enterprise, originally a department of government that runs the postal system. In the 1990 s it acquired a private sector courier firm and continued to run it as a subsidiary. Canada Post also established a large number of franchisees who operated on a commercial basis.

Based on these developments, in 1997, the government undertook a mandate review. The outcome was a government decision to allow Canada Post to retain its private sector subsidiary and franchise network – with the proviso that Canada Post must provide an annual statement from its financial auditor on cross subsidization between its monopoly letter mail services and its competitive business. The government established and publicized service standards for Canada Post, and implemented a policy that future rate increases would be implemented no more than once a year, would be less than the rate of inflation, and had to be announced at least six months in advance. In addition to service standards and the basis for postal rate increases, objectives were stipulated on the rate of return on equity and expected dividends. To improve transparency, a Canada Post Ombudsman was created, with the independence and authority to investigate complaints; included was a provision for a Statement from the Ombudsman to be in the Annual Report.

Expect it to take time for state enterprises to be able to articulate their corporate vision and goals, to develop clearly expressed strategies and action plans to achieve their mission, to know the extent to which they are achieving their objectives, and to report adequately on these objectives and strategies. Even fifteen years after passage of the Canadian legislation on Corporate Plans, the Auditor General reported significant deficiencies in the caliber of the Corporate Plans in the majority of Crown Corporations.

From experience in Canada a critical aspect of successful implementation is the need for comprehensive training and skills improvement programs for all those involved with state-owned enterprises including executives, managers, employees, board members, and auditors. It is also necessary to implement a program of recruitment to attract professional and competent personnel to these enterprises.

Annual Reports

The public reporting of performance by state enterprises against published plans is a key component of effective control and accountability. Therefore:

- Each state enterprise should present its Annual Report and Accounts before Parliament. Annex 6 reproduces the Treasury Board Secretariat guidelines for Crown Corporations in the preparation of their annual reports.

- The Auditor General should examine its accounts and report his findings. Parliament's "Public Accounts Committee" should have the power to summon the Chair of the Board, Board members, and the Chief Executive Officer to account to ensure the Corporation is really meeting the objectives set out in legislation. Responsibilities could be spelled out for "sponsoring" Ministries in terms of policy frameworks and roles.

- There could be an Ombudsman (like the U.K. Parliamentary Commissioner for Administration), to provide an element of oversight. Plans, Reports, Budgets and minutes could be made accessible to the public.

- Annual Reports, required from all state enterprises, should provide information, among others on:
  - The formal mandate of the enterprise;
  - Objectives, ranking goals for each objective;
  - Quantitatively, the end products or services that are outputs of the enterprise;
  - Governance practices
  - Environmental practices
  - The functions of the enterprise—quantifying work load; and
  - Goods and services provided free to the enterprise (noting those that are inadequate or low quality).

To enhance accountability, summaries of corporate plans and annual reports should be tabled in Parliament by the responsible Minister. Accountability would be increased if the Ministry of Finance published information on the expected rate of return and the debt limits of state enterprises. State enterprises in the UK, ("non departmental public bodies") are expected to publish an annual report setting out role, responsibilities, and work carried out in the previous year. They must publish annual accounts of expenditures, and annual business plans, and information about the Chairman, board members, and senior staff, including a comprehensive register of members' interests, and information (such as agendas and minutes) on board meetings. They must maintain a web site containing a wide range of information, such as press releases and copies of key publications.

Ideally, there should be an external validation of the enterprise information system, which produces and publishes data. The Auditor General could best undertake this validation through a non-financial systems audit.

Performance Measurement

Performance measures can provide information on three areas: financial performance, public policy, and internal processes. Financial indicators begin with net income, and the percentage of extra budgetary revenue. Public policy indicators are specific to each corporation. Internal process indicators include measures such as administrative expenses as a percentage of total costs and marketing costs as a percentage of revenue.

With respect to performance measurement, it is easier to prescribe than to perform. It is difficult to set meaningful targets in corporate plans and to compare them to actual results. It is difficult to collect performance information on the outcomes of corporate programs and initiatives. Financial information does not provide an indication of productivity or quality. Information is easy to provide on what was done—difficult to provide on what was achieved. The Canadian Auditor General, recognizing these difficulties, suggests bench marking—provide comparative information from similar entities or activities. The Ministry of Finance should assist state enterprises by providing guidance on performance measurement as well as on the contents of corporate plans and annual reports.

Use pilots to test concepts. Before introducing performance measurement in the U.S. across all agencies and departments, as mandated by the Government Performance and Results Act (GPRA) of 1993, the Director of the Office of Management and the Budget (OMB) designated ten agencies over a three-year period to test and assess concepts. The OMB was required to report in 1997 on the usefulness of the pilots, on significant difficulties encountered, and to recommend changes. Similarly, in the later 1990s in Canada, annual departmental performance reporting was tested in a half dozen different departments before being implemented throughout government.

The US Government Performance and Results Act (GPRA) requires that the Head of each agency submit a strategic plan to the Director of the Office of Management and Budget. The strategic plan must cover at least five years, be revised every three years, and include mission statement and description of goals, objectives, environmental scan, and program evaluation used. Each agency must provide an annual performance plan and report, with performance goals, indicators, and the specification of means to achieve the goals.

There is a specific provision in the GPRA regarding programs where it is not feasible to express performance goals in an objective, quantifiable, and measurable form. In this case, the Director of the OMB may authorize a descriptive narrative concerning effectiveness or success -- with a statement provided explaining why expression of the performance goal is impracticable or not feasible.

The US GPRA is no panacea. In August 2000, a US Congressman challenged witnesses - officials of the General Accounting Office, the Office of Management and the Budget and OMB WATCH, a non-profit watchdog – at a House Committee hearing to provide a single example of Congress using the GPRA Act of 1993 to make funding decisions. None of the witnesses could provide an example.

Canada has taken steps to link more closely performance reporting to budgeting in improving reporting to Parliament. In recent years all departments and agencies table in the spring in Parliament "Reports on Priorities and Plans" along with their budget estimates. These forward looking reports set out the department's priorities and objectives, key business lines, and planned expenditures. Separate "Departmental Performance Reports" are tabled in Parliament a year and half later in time for Parliamentarians to review future year budget estimates. While modest progress has been made in providing more systematic and regular public information on departmental performance, in the adversarial Parliamentary system, departments are reluctant to indicate that their programs are not performing. Scandinavian countries have been more candid and transparent in setting out departmental performance.

Performance reports should be made accessible to the public and written in ways that are understandable by the public. Reports laden with jargon and acronyms are not helpful. In the U.S., the Mercatus Center at George Mason University ranks U.S. federal agencies' annual performance reports on 12 factors related to transparency, forward looking leadership, and benefits to the community. Role models and bad influences are identified for each of 12 factors. Agencies are each scored and ranked, with each agency's rank compared to the previous year.

To increase interest in performance measurement and to improve results, the Auditor General of Canada has introduced an Award for Excellence in Annual Reporting by Crown Corporations. This has led to an increase in requests from Crown Corporations for guidance in helping them improve their reports. The Auditor General has encouraged Crown corporations to aim for balance in performance indicators, trying to ensure a balance of input, output, outcome, and efficiency indicators. This being said, the process will vary among state enterprises; there is no "recipe for success", the process of developing and choosing the right critical success factors and performance indicators is unique to each state enterprise. The components of a complete set of indicators used to manage will change over time, to reflect the evolving direction and context of the enterprise.

Internal Audit

There is merit in each enterprise having the discipline of a formal internal control statement, signed by the "Accounting Officer". This would help the enterprise to systematize, and where necessary, overhaul their internal control systems, relying on "assurances" from senior officers that proper controls and systems are in place. The process can make clear the responsibilities of the other senior officers.

Each state enterprise should have an "Internal Auditor" to review programs and performance against plans. The Internal Auditor should have the right to report to the Audit Committee. In contrast, the External Auditor who reports to Parliament should be an independent watchdog, whose focus is on "value for money" and whose reports are made public. The Internal Auditor should have free access directly to the Accounting or Finance Officer and to the Chair of the Audit Committee.

Internal Audit Committee

Each state enterprise should have a formally constituted "audit committee" within its Board of Directors. The Committee should:

- Be chaired by an outside director without a wider role within the organization;
- Have a majority of outsiders. The Chief Executive Officer and the Finance Officer should attend meetings but not be members of the committee;
- Have a mandate to assess all risks, not just financial risks;
- Review internal audit's work program and receive internal audit's report; and
- Have a mandate to challenge both internal and external auditors about their assumptions and methodologies.

External Audit

A conscious policy decision should be made as to the role of the Auditor General with respect to the various categories of state enterprises. An indepth study in the U.K. (the Sharman Report, "Holding to Account", The Review of Audit and Accountability of Central Government Report by Lord Sharman of Redlynch, Feb. 2001) recommended that the Comptroller and Auditor General (C & AG) be the external auditor for all "non-departmental public bodies", i.e., all state enterprises (even though the C & AG has indicated that he would contract out the audits). The U.K. Report also recommended that the C & AG, who reports to Parliament, should provide a report to the Public Accounts Committee of Parliament on major points from audited accounts and on management letters sent by the responsible Minister to the executive of state enterprises. However, a case can be made for allowing enterprises which are commercial and do not depend on government funding to appoint a private sector firm as its external auditor.

C) SELECTIVE BUDGETARY POLICY ISSUES

Budget Controls and Incentives

In addition to the techniques for macro fiscal control set out earlier there is also the need for a set of micro budget controls and incentives. These controls and incentives operate at the level of the enterprise and complement the overall corporate instruments of business plans, monitoring and measuring performance, and audit outlined above.

How the budget estimates of the state enterprise are displayed and reported to Parliament is critical because it shapes the extent to which the enterprise can escape or circumvent budgetary discipline. Canada like several other OECD countries has had a continuous structure for reporting expenditures of departments, agencies and crown corporations to Parliament. It includes the following key elements:

- expenditures are presented by departments on a program by program basis with a statement of objectives,
- each program is broken down into activities and total costs are displayed in terms of objectives of expenditure,
- non-budgetary items (loans, investments, and advances) are individually displayed by program,
- budget estimates by program are presented for the coming year are compared to the forecast of expenditures for the fiscal year just ending and to the actual expenditures of the previous year,
- expenditures are displayed by major categories as: capital, grants and contributions, transfer payments, operating, and payments on the public debt.

Nonetheless, the Canadian experience indicates that maintaining effective budgetary control of departments and crown corporations is an ongoing effort. Multi-year commitments are made which can bind governments for years. For example, commitments made through the Canada Mortgage and Housing Corporation (a crown corporation) for social housing require annual funding of approximately $2 billion for 25 years or more. Loan guarantees made to crown corporations by government can bring unexpected surprises or reduce corporate vigilance over those loans. For example, there have been defaults on loans, guaranteed by government and made by the Export Development Corporation under its “Canada Account” and the Canadian Wheat Board. Extra vigilance is required to avoid crown corporations from using risky and controversial transactions such as “soft loans” rather than outright grants. Canadian experience in the late 1970s and early 1980s with several crown corporations such as Canadair and Atomic Energy of Canada Limited which dramatically overspent their budgets and got into severe financial difficulties graphically highlights the critical importance of effective monitoring by government of state enterprise.

The use of “sunset legislation” can be of some limited help in managing the expenditures of state enterprise. However, the Canadian experience has indicated that the threat of demise of the program or agency usually focuses the public forces for their continuation. Similarly, program evaluations served to focus concerns around the effectiveness of programs but they have rarely resulted on their own in the outright elimination of the program. The legislative requirement to review programs can however have positive benefits. For example, parts of the municipal water supply system in Canada have recently experienced major crises despite having functioned quietly and effectively for many years out of the spotlight of the public and the media. The requirement for regular and systematic review of the system might have anticipated the pending problems and perhaps even prevented the crisis.

Extra Budgetary Revenue

Canada has had considerable experience with departments and agencies supplementing their budgets with extra budgetary revenues through user chargers and other revenue creating devices. The key lesson learned is to ensure that such revenues are treated as public money within the overall fiscal framework of the government and not as proprietary money of the particular organization which it could use to finance their activities. In Canada, all user-charge revenues collected are public monies governed by the *Financial Administration Act*. Authority to spend those revenues requires prior Parliamentary and Treasury Board approval. Individual cases are judged on their own merits. As a general rule, the Treasury Board will recommend approval to spend user-charge revenue only when the revenues are being used to finance the service from which they are generated, and where there is a direct relationship between the costs incurred and the charges collected. User charges must be reported and included as part of the business plan of the enterprise.

Experience in Canada has indicated that there is a great need for clear and enforceable rules when it comes to budgetary controls over extra-budgetary revenues. Two areas of concern have been the inappropriate "netting of revenues" and "bartering for services". Netting of revenues occurs when departments generate revenues through the sale of various services and then apply these revenues against expenditures. The result is that departmental expenditure increases without Parliamentary approval. Also cash strapped departments, such as the Department of Fisheries and Oceans have been known to barter privileges for services in order not to record certain expenditure and revenues.

There are two mechanisms in Canada – net voting and revolving funds -- that allow departments to use certain of their revenues to finance their directly related expenditures. Both of these two special revenue re-spending authorities require approval from the Treasury Board and from Parliament. Annex 7 reproduces the Treasury Board procedures for securing approval for these authorities. While both of these authorities reduce dependence on appropriations from general revenues, they differ significantly in purpose and in application.

Revolving funds are generally appropriate for large, distinct, self-sustaining activities that provide client-oriented services. Size is an important criterion because of the significant costs associated with setting up and managing revolving funds. Revolving funds provide a multi-year focus for revenues and expenditures. While surpluses or deficits may occur from year-to-year, these are expected to balance out over a business cycle. Revolving funds are funded through non-lapsing appropriations, providing the flexibility needed to deal with changes in level and timing of receipts, expenditures, and net income and to manage substantial investments in inventory and capital. In light of the importance of non-cash transactions in these investments, a full accrual basis of accounting is used to prepare financial statements.

Net voted operations may or may not be self-sustaining and the scale of operations is less significant than is the case for revolving funds. Under this mechanism, there is normally a well-established core level of activity funded through appropriations. The net-voting authority is provided to fund fluctuating special demands from user groups where such funding requirements would otherwise jeopardize the relatively stable "core" budget of the department. Net voting is not meant to enable unfettered growth.

Revolving fund and net voting authorities may be appropriate for activities having a stable mandate, identifiable client groups, and operations financed in whole or in part from user fees or from other sources of revenue internal or external to the government. Revenues and expenditures must be closely related. This means that if demands are unexpectedly high, higher service levels and expenditures will be financed through increased revenues. The reverse is also true: a decline in demand is expected to reduce expenditures and revenues. Accordingly, these two authorities should not be viewed as a means to secure spending rights or to supplement available resources that would not otherwise be forthcoming.

There are two fundamental differences between these mechanisms:

- The revolving fund is a continuing or non-lapsing authorization while net voting is an authorization that lapses at the end of the fiscal year;
- The aim of a revolving fund is to achieve self-sufficiency over its business cycle, while net voting provides that certain revenues offset related expenditures within a fiscal year.

The following case illustrates instances where a revolving fund could have been used by a government organization to increase efficiency and accountability in their operations.

Several years ago, British Columbia’s Department of Lands, Parks, and Housing owned Manning Park Lodge in a provincial park near the town of Hope. Like other programs of the ministry, the lodge was budget-funded, that is, an expenditure budget was set each year as part of the ministry’s estimates, and revenues from lodge business went back into the government’s Consolidated Revenue Fund. A Treasury Board official who was discussing the budget for the lodge was told by ministry officials that “the budget is fine as long as it doesn’t snow.” Since the lodge was in the ski business, this was not a reassuring statement. Sure enough, it snowed heavily before Christmas, the lodge had a surge of customers and it spent its whole annual budget after only nine months. The lodge could not, therefore, afford to buy food and liquor to re-sell to its guests for a profit, because all revenues had already gone back to government coffers rather than to the business. The more business the managers generated, the worse the budget situation became.

In some cases it is better to privatize certain activities rather than continuing to provide them through public enterprises. For example, several years ago British Columbia’s Department of the Comptroller General began to charge back to departments for its training programs. Although the revenue went back into the program budget, Treasury Board would not agree to increasing the number of training staff to accommodate an increased demand for training. (The political incentive, when the public sector is under public scrutiny, is to restrict the number of public servants.) The comptroller general's training staff saw a market opportunity and ultimately negotiated an employee buy-out of the training function. In essence, they privatized themselves and the training service. Once in the private sector, they delivered their former services under contract, while expanding their client base throughout the public sector. Freed from the operational restrictions of government, the new training company has prospered.

Some state enterprises that receive significant extra-budgetary revenues should not be privatized but instead assigned to a specific legal structure, rather than a government department. (See the PER paper on Canada, "A Taxonomy for Budgetary Control of State-Owned Enterprises") Each state enterprise should be required to conform to the requirements for raising and reporting revenues of the legal structure of the category to which it is assigned.

Some government agencies should be prohibited from raising extra-budgetary revenues. Care must be taken to ensure administrative controls are in place to account for revenues that may occur to these agencies – revenues for example, from charitable contributions or revenues from leasing of surplus assets. It is essential that all extra-budgetary revenues be identified and reported, to be included in the state budget.

A responsibility center should be established to review the costing and pricing of goods and services provided by state enterprises. For services of significance, government approval in some form, perhaps the formal approval of the head of the responsible ministry, should be required for changes in fees and other charges. In general, pricing of services offered to the public should be based on consideration of full costs of delivering the services. This principle can be extended to pricing internal services. Care must be taken to ensure that fees are based on costs.

Ontario had an interesting example, where a Provincial fee for probate of wills was deemed illegal by the Supreme Court, because the amount of the fee was not directly related to the cost of the service provided. The logic was that if there is no relationship between the fee and the value of the service, the revenue raised by the fee should be considered a <u>tax</u>, which requires legislative approval. This requirement leads to an obligation on state-owned enterprises to maintain relevant costing information, to support decisions on fees, and prices of services. However, this kind of information should be available anyway in order for the enterprise to manage its operations economically and efficiently.

<u>Incentives</u>

Over time Canada has found that it has had to gradually introduce increased incentives for departmental and crown corporation managers to ensure that administrative and budgetary rules did not contribute to inefficiency. Over the decade of the 1990s six important management tools have been put in place:

- single operating budgets for departments to increase the flexibility between salary and operating budgets and the elimination of controls on the number of employees;

- carry forward to the following year of up to 5% of departments' budgets for operating expenditures;

- increased retention for departments of funds raised from cost recovery;

- more flexibility in the deployment of human resources, most notably, allowing certain operating agencies to function as "separate employers" to negotiate labour contracts, and recruit, hire and fire staff on their own rather than through the central processes of the Public Service Commission and the Treasury Board;

- establishing "performance pay" for executives and thereby linking part of their remuneration (no more than 20%) to the achievement of performance targets by the enterprise; and

- rewards and recognition programs to celebrate excellence in public service by visibly recognizing public servants for innovative projects and achievements.

While incentives for the managers of state enterprises are important, the Canadian experience indicates that they should be gradually put into place over time and in concert with continued improvements in budgetary controls, corporate plans, and performance monitoring and reporting.

From time to time specific and visible sanctions are required in order to reinforce control and discipline. These sanctions do not need to be administered often but rather consistently and even-handedly. Having potential sanctions "on the books" to be used when needed can provide a credible threat to encourage sound management. For example, in Ontario the Minister of Health has legislative authority to by-pass the local health board in times of demonstrated mismanagement and to appoint a new chief executive officer to operate a hospital.

Efforts to increase the efficiency in the provision of public services have focused not just on a balanced mix of controls and incentives for managers of state enterprises. Some jurisdictions have had experience with the use of market mechanisms as means of introducing competitiveness and hence greater efficiency in public services. One such mechanism used in areas such as education and social housing is vouchers.

Vouchers and Other Market Mechanisms

A voucher is a subsidy that grants purchasing power to an individual to choose among a restricted set of goods and services. Vouchers are a tool of government that can compete with or complement other alternatives – direct government delivery, contracting of government services, competitive public suppliers, direct cash payments, and loans and guarantees. Vouchers have been in use, particularly in the United States for many years in the areas of food, college aid, and public housing. More recently, vouchers have been extended through specific programs in the areas of childcare, job training, and legal aid.

Proponents of vouchers claim that they can widen choice for recipients, improve equity for some, increase competition and hence efficiency, and strengthen budgetary control. Choice provides the potential for greater client satisfaction and value. Vouchers can contribute to equity when poorer people gain access to better schools or housing across district boundaries. Vouchers can break the monopoly of central decision-making in public schools by allowing clients to determine which schools are supported and which are not. Maintaining fixed limits on per capita subsidies can ensure that vouchers provide for a degree of budgetary control.

There is considerable opposition to educational vouchers, based on the view that vouchers compete with public and private funds for overall improvements in public schools. (This is apart from the opposition that views public funding of private religious schools as unconstitutional or inappropriate.) The claim is that there is evidence that where vouchers are in place – Milwaukee, Cleveland, and Florida – a two-tiered system has been set up that holds students in public and private schools to different standards. The basic criticism of educational vouchers is that there is no compelling evidence that vouchers make public schools better by promoting competition. Competition implies that there will be "winners" and "losers" – which could be disastrous for students in those schools that "lose".

Vouchers do require a regulatory framework. Which consumers are eligible? How is eligibility affected by marriage? by moving to another jurisdiction? by increasing income through marriage, employment or inheritance? Which suppliers of goods and services are eligible? Childcare facilities must be certified; educational facilities must be accredited. Vouchers go hand in hand with increased regulations on eligibility and accreditation processes.

Annex 8 sets out some limited evidence on the use of vouchers. To achieve success there are some very significant conditions and requirements that must be met:

- An effective regulatory regime to go hand in hand with vouchers;
- The ability of voucher recipients to obtain information about the value and quality of service; and
- Whether migration and mobility of recipients is allowed.

In addition important decisions must be made on voucher design:

- Expenditure or tax credit;
- Pay beneficiaries or suppliers; and
- Make the subsidy refundable or non-refundable.

The Australian and New Zealand Experience

There has been a considerable amount written about the Australian and New Zealand experience as it relates the public sector reform in general and expenditure management in particular. Given the small size of Australia and New Zealand relative to Russia, care must be taken in extrapolating these examples to the Russian experience. Two particularly useful pieces dealing with Australian and New Zealand public sector reform, prepared by the Office of the Canadian Auditor General, can be found on the web under: http://www.oag-bvg.gc.ca/domino/other.nsf/html/aus.html and http://www.oag-bvg.gc.ca/domino/other.nsf/html/nzbody.html.

It may be helpful however to review the Australian and New Zealand experience in public expenditure management in terms of three categories of outcomes (Campos and Pradhan (Journal of Policy Analysis and Management, Vol. 16 (1997)):

- aggregate level of spending, and hence the deficit;
- composition of the expenditures; and
- technical efficiency in the use of resources.

Each of the three categories of outcomes relates to different challenges:

- aggregate fiscal discipline must confront pressures inherent in "the tragedy of the commons";
- "optimal" composition of expenditures requires prioritization of competing claims; and
- technical efficiency requires managerial autonomy, predictability and competent staff.

Campos and Pradhan believe that institutional arrangements affect incentives that govern the allocation and use of budgetary resources. Institutional structure affects outcomes. Design of institutional arrangements and mechanisms to achieve these three categories of outcomes must recognize there are tradeoffs as well as interactions among these three levels. The manner of imposing aggregate fiscal discipline affects strategic prioritization and technical efficiency. There are transaction costs in setting up systems for each of the three outcome categories. The incentives of key actors get oriented towards specific expenditure outcomes. Given the complexity of the systems, and the scale of the problem, it is prudent to consciously select the approach to be taken, cognizant of the tradeoffs among objectives.

Using this framework of three categories of outcomes, analysis of the 1990's reforms in New Zealand and Australia reveal several similarities in their approaches but some critical differences due to their respective contexts. Both New Zealand and Australia reforms shared a focus on incentives, transparency, devolution to line agencies, introducing "contestability", and a binding commitment to aggregate fiscal discipline.

There was a difference in terms of New Zealand's emphasis and insistence on technical efficiency in the delivery of outputs—autonomy, predictability, and competence of line agencies— while Australia emphasized strategic priority setting and the cost effective achievement of outcomes (the impacts of the outputs on individuals).

New Zealand (pre-1985, as interventionist as East European centrally planned economies), undertook an extensive campaign of privatization. It abolished the permanent tenure of public servants, putting CEO's on five-year performance contracts with power to hire and fire. To provide clarity and transparency, it split enterprises into different business units (for example, service provider versus purchaser of service). To provide transparency, financial statements were put on an accrual basis, and published and made available to the public. It provided an incentive to agencies to clearly specify their outputs by mandating that any given appropriation must be linked to one of seven specified categories. CEO's were responsible under contract to provide program outputs (e.g., number of students graduating) to ministers who were responsible for program outcomes (quality of education). New Zealand legislated the benchmarking of actual performance vis-à-vis published aggregate fiscal objectives.

Australia focused less on privatization and more on strategic prioritization. In a sense, Australia asked the question "what are we trying to accomplish?" while New Zealand asked the question "How many, at what cost?" Forward estimates were introduced - 3 year forecasts of the minimum cost of continuing existing policies and programs. Ministries were required at year end to publish reconciliation tables, explaining deviations between their estimates and actual expenditures. Across Ministries, forward estimates were aggregated and reconciled with the target deficit.

To deal with competing priorities, a powerful Expenditure Review Committee of cabinet challenged all spending and savings proposals, to decide on targets. Consolidation of programs into "portfolios" lessened fiscal pressure by forcing prioritization and tradeoffs across similar programs. Administrative and salary costs, some 20 line items were consolidated into one budget item- "running costs". Enterprises were allowed to carry over or bring forward up to 10% of running costs year to year with the Treasury extracting an annual 1% "efficiency dividend" as a quid pro quo. While, Ministries were required to provide program performance reports and ex post evaluations, commentators have indicated that these reports and evaluations had limited impact on budget allocations but did assist in moving towards a performance oriented organizational culture.

Conclusion

This paper has set out a series of lessons learned about the management of government expenditures in Canada with references to other jurisdictions. It has stressed the absolute requirement for political will as a necessary (albeit not sufficient) condition for success. The paper recommends a sustained incremental approach to improved expenditure management and increased public sector efficiency. Based on practical experience the paper sets out a framework for planning, budgeting and accountability premised on increased transparency.

The paper reviews a menu of techniques and mechanisms for strengthening expenditure management and increasing efficiency in government. Drawing upon practical examples it provides guidance on critical governance issues for efficient management of state enterprises in the areas of boards of directors, corporate plans, annual reports, performance measurement, and internal and external audit. The merits and risks associated with various budget controls and incentives for state enterprises are described and assessed with an emphasis on expenditure reporting, extra budgetary revenues, vouchers and other market mechanisms, and instruments to encourage flexibility in budgeting. The ongoing expenditure management reforms in Australia and New Zealand are reviewed. The paper includes a series of annexes describing in detail various techniques and mechanisms of expenditure management and accountability.

ANNEX 1: CAPE BRETON DEVELOPMENT CORPORATION CASE STUDY

Introduction

The case history of the Cape Breton Development Corporation (DevCo) provides a good example of several issues involved in budget financing of a state enterprise. This note provides a narrative history of DevCo, from its inception in 1967 to its demise last year.

Background

The history of Cape Breton, Nova Scotia, is one of coal and steel. Coal has been mined from abundant sources there since the 18th Century. However, since the end of the First World War, the coal and steel industries have been in serious decline, due to increasingly unfavorable competition from alternative fuel sources.

In the 1960s, the primary employer in the Cape Breton region was a private sector firm, the Dominion Steel Corporation, which owned both a major steelworks and several coalmines in Sydney, Nova Scotia. However, competitive factors eventually proved too great for Dominion Steel. In April 1966 they announced the termination of their coal operations.

Nationalization and Creation of Cape Breton Development Corporation

With the collapse of the Dominion Steel Corporation, the Government of Canada was faced with a dilemma. While it was clear that the coal industry in Nova Scotia was not competitive, there were almost 7000 employees who would be laid off with the closure of the mines. With virtually no alternative employment opportunities the layoffs would have lead to the economic collapse of Cape Breton, and the devaluing of the land and assets in the region.

A Royal Commission was convened to deal with this crisis, and a “solution” put forward. With no private investor on the horizon, the Federal Government would nationalize the coal mining operations of the Dominion Steel Corporation, and run it as a state-owned enterprise.[1] However, the goal was not to continue mining in perpetuity: rather, the Royal Commission recommended that planning for the new Crown corporation be based on "the assumption that the Sydney mines will not operate beyond 1981."

The Cape Breton Development Corporation (DevCo) was born, a wholly owned Crown corporation of the Federal Government (with some control over board membership given to the Province of Nova Scotia). DevCo was given the mandate to oversee the gradual phasing out of the coal industry in Cape Breton. For this reason, it is classified under Part 1 of Schedule III of the Financial Administration Act, which did not require it be fully

[1] The Dominion Steel Corporation steelworks were 'provincialized' by Nova Scotia

commercially competitive. For the period of 1968-1973, the phasing out of mines was reasonably successful: 3 mines were shut down, and production decreased from 3.1 million tons to 1 million tons.

The Oil Crisis and A Renewed Interest in Coal

In 1973, the global oil crisis precipitated a massive change in direction for DevCo. A reversal of fortunes based on the increased price of oil meant that there was suddenly a market for coal as a fuel source. The Federal Government decided to support DevCo's expansion to meet the new demand for coal, providing funds to re open 2 mines and undergo a massive program of mechanization. By the late 1970s, production had returned to 2.6 million tons, while the monetary value of the production doubled between 1976 and 1978. However, even with the substantially improved market, DevCo continued to record financial losses, requiring large annual Federal subsidies.

This process of mechanization did however affect the levels of employment at the mines. As can be seen in Annex 2, between 1968 and 1988, 3000 jobs were eliminated at the mines.

Refocus of Mandate

By the early 1980s, DevCo was in serious trouble, requiring ever-larger appropriations from the Federal Government. This included more than $120m in 1982 and $153m in 1987, for a total of $784m in the period of 1980-1987.

In 1985, the Government directed DevCo that its new mandate was to become more commercially successful. To clarify this mandate, the Government removed the Industrial Development Division, the portion of DevCo that was responsible for reducing Cape Breton's dependence on coal-based primary industry. This function, not expected to make a profit, was reincorporated in the Enterprise Cape Breton Corporation.

Threat of End of Subsidy

However, five years later, in 1990 DevCo was still not commercially viable: the level of Parliamentary appropriations had fallen from their 1987 high, but DevCo was still receiving more than $30 million a year from the Federal Government.

In light of this continued failure, the federal government, through the Treasury Board, issued an ultimatum to DevCo: achieve financial self-sufficiency by 1995, or face complete privatization. DevCo attempted to respond by continuing to rationalize their workforce, reducing the number of employees to 2300 by 1995 (down from 3500 in 1988). While this reduction was substantial, it was not enough. As the Chairman reported to the Federal Standing Committee on Economic Development in 1999:

> "The business plan, for example, called for a workforce in 1995 of 1,700. I got involved in the corporation in 1995 and at that time, there were about 2,300-and-some employees at the corporation. That meant that if you figured that we were 400 employees too many on the payroll at an average cost of about $50,000 a year, that is about $20 million a year it was costing us for those additional employees who were not in the business plan."

Due in large part to this inflated employment profile, DevCo failed to meet the Federal Government's target of commercial viability.

End of Subsidy and Maintaining the Course

DevCo received no Parliamentary appropriations in 1996, although the threat of privatization did not materialize at this time. DevCo convinced the Federal Government that they were on the path to success, by pointing to the fact that their appropriations in 1995 were the lowest in twenty years. The Government decided to continue funding in the short term, and provided $43 million in 1996, as well as giving a loan of $69 million to assist in further mechanization of the mines.

The optimism was short-lived: in 1998-99, DevCo again required substantial Parliamentary appropriations. The $41 million provided that year proved to be the catalyst for the final decision that DevCo was not currently, and would not in the future ever be, a viable commercial enterprise (by 1999 there were only 1700 employees of DevCo).

The Transition to Private Enterprise

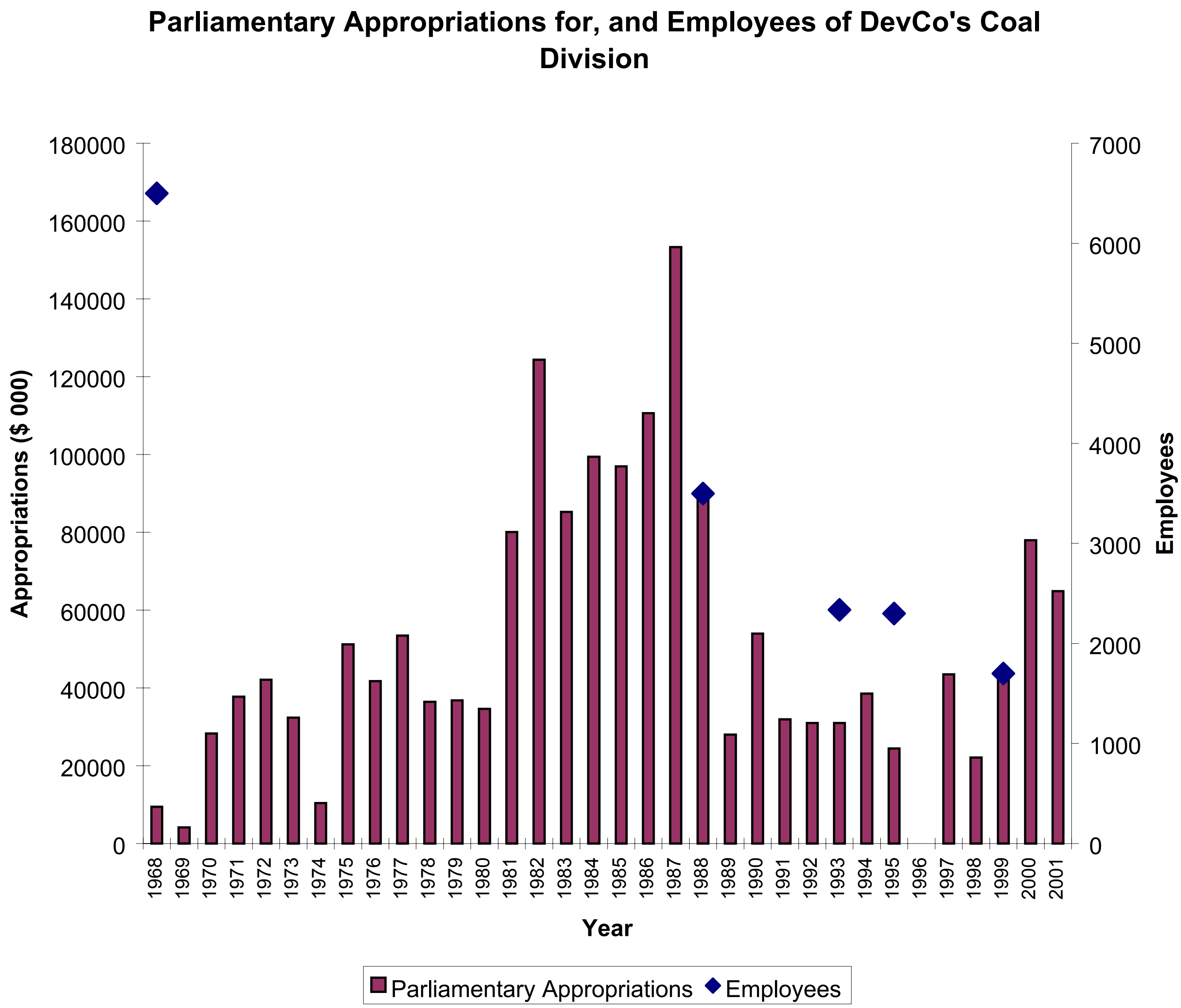
On January 28th 1999, the Federal Government announced its privatization plan to close the final mine by the end of the year 2000. This announcement came in conjunction with substantial new funds to ease the transition: $111 million was provided for workforce adjustment, and $68 million for a long-term economic development program to be administered through the existing programs in Cape Breton. However, there were still considerable additional costs: in 2000, more than $70 million was required to sustain DevCo after a mineshaft closed and in 2001 another $28 million was given to the ECBC and the CBGF, to assist in the transition.

The Government introduced legislation in October 1999 to give the Cape Breton Development Corporation the right to sell its assets (The Cape Breton Development Corporation Divestiture Authorization and Dissolution Act). There were several interesting aspects to the legislation, mostly aimed at reducing barriers to sale. The internal structure was changed to allow for fewer directors, removal of certain oversight mechanisms in the appointment process, and a removal from its mandate of any wording relating to general economic development that remained from the era of the Industrial Development Division.

The Government, in order to remove some of the fears of potential buyers, agreed to accept all DevCo liabilities that may arise after the sale. This includes liability for any future environmental cleanup and compensation, and liability for employees' pensions, which taken together, by one estimate, could total more than $400 million dollars.

Even with these guarantees, the Cape Breton Development Corporation remains on the market, burdening the Government with both environmental clean up and pension liabilities in the future.

ANNEX 2: DEVCO EMPLOYMENT AND PUBLIC EXPENDITURES



ANNEX 3: CANADIAN LEGISLATION DESCRIBING THE REQUIRED CONTENTS OF CORPORATE PLANS

122. (1) Each parent Crown corporation shall annually submit a corporate plan to the appropriate Minister for the approval of the Governor in Council on the recommendation of the appropriate Minister and, if required by the regulations, on the recommendation of the Minister of Finance.

Scope of corporate plan

(2) The corporate plan of a parent Crown corporation shall encompass all the businesses and activities, including investments, of the corporation and its wholly-owned subsidiaries, if any.

Contents of corporate plan

(3) The corporate plan of a parent Crown corporation shall include a statement of:

(*a*) the objects or purposes for which the corporation is incorporated, or the restrictions on the businesses or activities that it may carry on, as set out in its charter;

(*b*) the corporation's objectives for the period to which the plan relates and for each year in that period and the strategy the corporation intends to employ to achieve those objectives; and

(*c*) the corporation's expected performance for the year in which the plan is required by the regulations to be submitted as compared to its objectives for that year as set out in the last corporate plan or any amendment thereto approved pursuant to this section.

Form of corporate plan

(4) The corporate plan of a parent Crown corporation shall be prepared in a form that clearly sets out information according to the major businesses or activities of the corporation and its wholly-owned subsidiaries, if any.

Restriction on business or activity

(5) No parent Crown corporation or wholly-owned subsidiary of a parent Crown corporation shall carry on any business or activity in any period in a manner that is not consistent with the last corporate plan of the parent Crown corporation or any amendment thereto approved pursuant to this section in respect of that period.

Amendment to corporate plan

(6) Where a parent Crown corporation, or a wholly-owned subsidiary of a parent Crown corporation, proposes to carry on any business or activity in any period in a manner that

is not consistent with the last corporate plan of the corporation or any amendment thereto approved pursuant to this section in respect of that period, the corporation shall, before that business or activity is so carried on, submit an amendment to the corporate plan to the appropriate Minister for approval as described in subsection (1).

ANNEX 4: GUIDELINES FOR THE DEVELOPMENT OF CORPORATE PLANS

1. Purpose

These guidelines are intended to assist management of Crown corporations, in conjunction with their boards of directors, in the development of their corporate plans. The guidelines expand upon and clarity key corporate plan content requirements set out in the *Financial Administration Act* (FAA) and the *Crown Corporation Corporate Plan, Budget and Summaries Regulations.*

The guidelines are not intended to limit the inclusion of information judged to be relevant by a corporation, or to inhibit the style of its presentation to the appropriate Minister and to Cabinet.

11. General Principles

1) The corporate plan is the centerpiece of the accountability regime adopted by Parliament for Crown corporations. This regime allows Crown corporations greater managerial autonomy than departments in order that they may pursue both commercial and public policy objectives efficiently and effectively with a minimum of government intervention. To balance this greater autonomy, the regime requires Crown corporations to keep the government informed of activities, strategies, strategic issues, and plans, and to report regularly on how well the plans were achieved.

2) As with business plans of private sector firms, the corporate plan should result from an in-depth analysis of the company and its environment by the corporation's senior management and its board of directors. It should commit the corporation to a planned strategic direction over the planning period (e.g. its goals/objectives, strategies, etc.).

3) The corporate plan should be based on and should present an assessment of the corporation's current strategic position including an analysis of the corporation's business and its operating environments. The plan should clearly identify the key strategic issues the corporation will face over the planning period. It should outline the planned actions for addressing them.

4) Corporate plans should establish a clear linkage among strategic issues confronting the corporation, the corporation's objectives for the planning period, and the strategies developed for the achievement of these objectives. They should also contain related performance measures with targets to serve as benchmarks for reviewing results in subsequent corporate plans.

5) Corporations should utilize the corporate plan as an early warning system to alert the government to future developments. Anticipated major events and decisions likely to

be required from the government over the planning period should be described and assessed.

111. Contents of Corporate Plans

Corporate plans should include:

1. Executive Summary

The executive summary should highlight the strategic issues requiring attention over the planning period, the corporation's major objectives, and planned strategies. Anticipated major decisions facing the firm during the planning period should be reviewed, including for example key capital projects, new programs or activities, and financing plans.

2. Mandate

This section outlining the corporation's mandate (including legislative and related Cabinet decisions) should include a description of the corporation's public policy role.

3. Corporate Profile

This short overview of the corporation's businesses and activities should describe for example the corporation's history, its principal programs or businesses, its organizational structure, its financial condition, etc. and should include summary statistics where appropriate. Where relevant, these should be accompanied by an overview of the economic or policy sectors in which the corporation operates including descriptions of the important opportunities, threats, and changes facing the corporation. This section should also provide a brief summary of the competition faced in each major business segment, and of any other government assistance programs aimed at the same clientele (both federal and provincial).

4. Strategic Issues for the Planning Period

The key strategic issues facing the corporation should be identified. This identification should be based on assessments of: recent actual performance, the anticipated external business environment, and the corporation's strengths and weaknesses. These issues, as identified by the corporation's management and its board of directors, should constitute the basis for formulation of the corporate strategy for the planning period. This section should include:

a) Assessment of Results: The analysis of strategic issues should start with, and build upon, an assessment and explanation, including quantitative information, of significant differences between recent actual (projected) results and planned performance.

b) Analysis of the External Business Environment: The corporation's analysis of its external economic and business environment as projected over the planning period is an important element of the corporate plan. This should focus on the main external determinants of success including such things as the level of competition faced by the corporation, markets, labour relations, inflation levels and interest rates. This presentation should facilitate a clear understanding of the strategic issues related to the external operating environment (both threats and opportunities) of the corporation.

c) Assessment of Corporate Resources: The corporation's assessment of corporate strengths and weaknesses, based for example on actual performance relative to the previously established objective and relative to the performance of competitors, should be presented. This assessment often leads to the identification of strategic issues requiring corrective actions in the planning period. These could for example included the need to improve labour productivity or profit margins, to divest non-core business operations, to improve the targeting of services, to improve management information systems, to better match the term structure of assets and liabilities, etc.

5. Objectives, Strategies, and Performance Measures

This section constitutes the heart of the corporate plan and should clearly indicate corporate intentions over the next five years describing, for each major business segment, the objectives the corporation intends to achieve, how it proposes to do so (i.e. strategies), and the related performance benchmark measures for assessing progress.

This description of the corporation's objectives, strategies and related performance targets, as approved by management and the board of directors for the planning period, should build upon the previous analysis of strategic issues. It should include:

a) Identification of Objectives: The corporation's objectives for each business segment over the next five years should be clearly specified. The objectives should be specific in nature and should flow from and be linked to the strategic issues identified for the planning period. (The should not simply be restatements of the corporation's ongoing mandate.) Objectives might include, for example, statements relating to assuring financial viability, improving the corporation's ability to compete, maintaining the corporation's asset base, etc.

b) Description of Strategies: The description of the chosen strategies should explain how their implementation will achieve the objectives. Strategies might include, for example, actions aimed at containing or reducing costs, modernization or expansion involving new capital expenditures, initiatives aimed at increasing market share, measures to improve employee relations, etc. The anticipated impact of each strategy on current corporate policies, businesses, activities or management or operating practices. These should, to the extend possible, be quantified.

c) Establishment of Performance Measures and Targets: Specific performance measures and targets, both operational and financial, should be established for the identified objectives. Performance measures adopted might, for example, relate to productivity increases (%) or reductions in costs ($) relative to what would have happened in the absence of any change. The plan should indicate why these targets are believed to be attainable.

As with objectives, performance measures should relate to areas over which the corporation has some meaningful degree of control. The performance measures adopted for the first year of the plan are of course of particular significance. As a general rule of thumb, in order to facilitate accountability, the number of performance measures should normally not exceed one or two for each objective.

It is recognized that the degree of uncertainty involved in formulating objectives, strategies and performance measures, as well as financial projections, increase in the latter years of the planning period. These should nonetheless be reasonably distributed throughout the five-year planning period.

6. Financial Statements

The corporate plan should include financial statements covering the two years prior to the start of the planning period (actual results for the first year and projections for the current year) and pro forma statements of retained earnings.

a) Income Statements: These should indicate major categories of revenues and expenses for each major business segment, and include statements on retained earnings.

b) Balance Sheets

c) Statement of Changes in Financial Position: These should reflect all cash flows, including all budgetary and non-budgetary transactions with the Consolidated Revenue Fund. For appropriation-dependent corporations, statements should be provided for both the corporation's financial year and the government's financial year if these are different.

The corporate plan should also contain an analysis of the financial statements including:

- A description of the detailed assumptions underlying the corporation's forecasts.
- For key assumptions, an analysis of the sensitivity of plan projections (e.g., profitability and cash flow) to changes in these assumptions.

- A description of planned major capital expenditures and their importance in relation to strategic issues and objectives identified for the planning period.
- Details of borrowing and investment plans (if any) and related strategies, including those relating to foreign exchange and interest rate risks. Borrowing plans should set out aggregate borrowings, principal repayments and total amounts outstanding for borrowings with terms greater than one year. For borrowings with terms to maturity of one year or less, the maximum and total amounts outstanding should be stated. Details on the matching of borrowing terms and the useful life of assets should also be included.

d) Number of Employees: The corporate plan should also set out the number of employees at the end of the financial year immediately preceding the current year, and as projected for the current year and over the planning period. The reporting basis for these data (e.g. person-years, full-time equivalents or full-time employees) should be clearly stated.

7. Specific Approvals, Notification of Restricted Transactions and Land-use Plan.

Corporations should generally seek Cabinet approval of their capital budgets (and operating budgets for Part 1, Schedule 111 corporations) as part of their corporate plan submission. They may also wish to take advantage of the corporate plan approval process to seek other Treasury Board or Governor-in-Council approvals such as approval or restricted transactions. Requested approvals should be clearly identified as such.

The corporate plan submission (or subsequent amendment thereto) should also be used as the means to notify the appropriate minister and President of the Treasury Board of restricted transactions undertaken by the corporation since the last corporate plan submission.

Where the corporation is an agent of the Crown and has real property, it should disclose its plans for any significant disposals or acquisitions, including leases.

8. Support for Government Policies

The corporate plan can also serve as an appropriate vehicle for reporting to the government on implementation of various policies (e.g. wage restraint).

9. Title Page Requirements

To facilitate the timely processing of corporate plans, capital and operating budgets, or amendments thereto, by appropriate ministers' departments and offices and by Treasury Board Secretariat, the title page of each corporate plan, capital and operating budget or amendment thereto, should include:

- The name of the parent Crown corporation
- The title of the document
- The planning period (for corporate plans) or budget year (for budgets) covered by the document.

Example:

Corporate Plan for the 2002 to 2006 Planning Period
Capital Plan for the 2002 Budget Year
Operating Budget for the 2002 Budget Year
Amended Corporate Plan for the 2002 to 2006 Planning Period

IV.Confidentiality

Corporate plans are highly confidential in nature. They contain highly sensitive and often commercially-confidential information. As submissions to Cabinet and as confidences of the Privy Council, corporate plans are treated in a manner comparable to Memoranda to Cabinet and are subject to the same strict protective measures. Corporations are advised to assist in maintaining this security by adopting their own security measures such as restricting and numbering copies of their plan.

The corporate plan should be distinguished from the corporate plan summary which is tabled in Parliament. Sensitive material contained in plans (e.g. commercially detrimental information referred to in Section 153(1) of the FAA) should not be incorporated in the corporate plan summaries since these become public documents.

ANNEX 5: ILLUSTRATIVE QUESTIONS FOR THE GOVERNMENT REVIEW AND CHALLENGE OF STATE ENTERPRISES

- Has the enterprise properly interpreted its mandate?
- Are the enterprise’s objectives, strategies and targets appropriate and do its performance indicators provide a strong basis for holding it to account?
- Are the trade-offs the enterprise has made between its commercial objectives and its public policy objectives reasonable?
- Do its performance targets sufficiently “stretch” the enterprise?
- Has the plan taken government priorities into account?
- Is the enterprise capitalized appropriately, and are the targets for dividends and return equity appropriate?
- Has the enterprise met its past performance targets?
- Is there a need to assess whether the enterprise’s mandate is still relevant?

ANNEX 6: GUIDELINES FOR PREPARATION OF ANNUAL REPORTS BY CROWN CORPORATIONS

I PURPOSE

This paper is intended to assist management of Crown corporations, in conjunction with their boards of directors, in the preparation of their annual reports. Matters raised in this paper expand upon and clarify annual report requirements as set out in the Financial Administration Act (FAA).

A number of general principles applicable to the preparation of annual reports by Crown corporations are presented.

II BACKGROUND

The current control and accountability framework for Crown corporations set out in the FAA, including the provisions relating to annual reports, was adopted by Parliament in 1984. This represented the first update of the legislative framework for Crown corporations in more than 30 years. While the main elements of the new framework were embodied in the 1984 legislative provisions of the FAA, it was recognized that it was important to ensure some flexibility in their application over time.

On at least four occasions since 1976, the Report of the Auditor General of Canada commented critically on the quality of Crown corporation annual reports. The Auditor General (AG) focused on several aspects of Crown corporation annual reports, but in particular, on the reporting of performance of objectives. In its view, performance reporting is the essential link on the process of accountability: it directly affects the information available to Parliament, it allows Parliament to assess management's responsibility to implement sound management practices and it comments on the comprehensiveness of the accountability regime itself. At the same time, increasing stakeholder pressure for increased disclosure and transparency has affected the evolution of annual reports.

This paper is intended to confirm and clarify the requirements set out in the FAA, particularly in light of the evolution of private sector reporting practices and requirements in recent years.

Perhaps more than at any time in the recent past, corporations operate in a "goldfish bowl". Any corporate acquisition or investment may be subjected to the close scrutiny of interested, articulate and organized stakeholders who demand greater corporate transparency and accountability. The demand for such transparency has been building over time. The impact on single-industry towns, ethical foreign investing, energy efficiency and pollution control and environmental degradation have all in turn been seen as critical topics for disclosure. Stakeholders expect such disclosure to be elaborated upon in an annual report. Annual reports now generally provide considerably more additional information to assist stakeholders in better understanding and elaborating on corporate operating results and financial condition as well as providing more non-financial information.

The trend toward improved accountability in annual reports is exemplified by recent requirements relating to inclusion of a discussion and analysis by corporate management of recent results, financial condition, and future outlook. This material, often referred to a Management's Discussion and Analysis (MD & A), is intended to provide the reader with a better understanding of operations from management's perspective. It is now a requirement of the both Ontario and Quebec Securities Commissions, as well as the Securities and Exchange Commission in the United States, and is recommended by the Canadian Institute of Chartered Accountants (CICA). A CICA survey of Canadian corporations has indicated that almost all (98%) included such information in their 1990 annual reports.

Another example relates to environmental reporting. The Ontario and Quebec Securities Commission require listed companies to include the impact (current fiscal year and expected future implications) of meeting environmental protection requirements on a corporations capital expenditure, earnings and competitive position. CICA standards now refer to "desirable disclosures" with respect to provisions for future waste removal and site restoration costs.

III CROWN CORPORATION ANNUAL REPORTS: GENERAL CONSIDERATIONS

1) Essential Component of Accountability Regime

Annual reports are one essential component of the accountability regime adopted by Parliament for Crown corporations. They serve to highlight the interplay among the stakeholders of the accountability regime: the corporations themselves, their boards of directors, central agencies and Parliament. Clearly articulated corporate objectives and a means of measuring and reporting performance is a critical link in the accountability regime.

2) Management Perspective

The annual report should contain a discussion and analysis, written from management's perspective, of the corporation's recent results, financial condition, and future prospects and outlook.

3) Performance Evaluation

The annual report should provide an evaluation of how well the corporation has achieved clearly-articulated objectives relative to established performance measures.

4) Corporate Context

The annual report should identify and describe developments in the corporation's external business environment over the past year significant to its condition, performance and prospects, including compliance with government policies affecting operations, e.g. those relating to environmental protection, the commercial practices of Crown corporations and domestic and international trade obligations of government falling on Crown corporations.

5) Use as Corporate Communication Tool

Annual reports not only report on the corporation's financial health, but they reflect an "image" which management and the board of directors wish to communicate to the stakeholders.

IV COMMENTARY ON THE GENERAL CONSIDERATIONS

1) Essential Component of Accountability Regime

The annual report is an essential component of the accountability regime adopted by Parliament. To balance the degree of managerial autonomy accorded Crown corporations by the FAA -- in order that they may pursue commercial and public policy goals with a minimum of government interference -- it is necessary that both Parliament and the government be kept fully informed of the results of Crown corporation operations and financial condition through provision of comprehensive and effective annual reports.

The importance assigned by Parliament to annual reports in the effective functioning of the accountability regime is reflected in the extent and nature of related provisions of the FAA. These include requirements relating to annual audits, the role of the audit committee, use of generally accepted accounting principles (GAAP), and reporting on performance in relation to objectives. Other sections provide for submission of the annual report to the appropriate Minister and to the President of the Treasury Board, and for tabling of the annual report in Parliament and reference to Parliamentary Committee.

2) Management Perspective

A discussion and analysis of the corporation's operations and financial condition, written from management's perspective, is an important supplement to the financial statements and other descriptive material contained in the annual report.

Viewing the operations of each major business segment through management's eyes sensitizes the reader to the dynamics affecting the corporation's operational results and financial condition. This is more than summarizing numeric changes in operating results--it identifies and discusses commercially relevant considerations in sufficient detail to allow readers to assess their implications for the corporation.

An assessment of future prospects is not mandatory for Crown corporation annual reports; however, a discussion by management is encouraged of the firm's future prospects, e.g., market trends, major upcoming events, risks and uncertainties.

3) Performance Evaluation

The annual report should provide a comparison and evaluation of results achieved in each major business segment in relation to the objectives and performance targets adopted by the corporation for the year under review as set out in the corporate plan summary provided to Parliament.

A meaningful evaluation of performance in annual reports, linked to planned objectives and performance targets, is important to the functioning of the accountability regime for Crown corporations envisaged by Parliament.

In introducing the legislation providing for the new regime in Parliament in 1984, the President of the Treasury Board stressed that one of its key goals was to ensure Parliament has access to a systematic flow of timely, pertinent information to allow it to judge whether Crown corporations have met their stated objectives for each planning period.

The review of objectives and performance targets should include any related material necessary for a full understanding of performance, such as an evaluation of the strategies adopted by the corporation for the achievement of objectives.

4) Corporate Context

The annual report should include an assessment of the corporation's external business and operating environment during the year under review.

Topics which may be addressed in this regard will vary somewhat from corporation to corporation, depending on the nature of their operations, but could include topics such as changing market conditions, labour relations, impact of inflation levels and interest rates, and compliance with government policies affecting operations.

A discussion of market conditions would include description and assessment of the competition faced by each major business segment, and of any other government assistance programs aimed at the same clientele (both federal and provincial). The discussion of compliance with government policies affecting operations would, where relevant, include a discussion of government initiatives relating to, for example, environmental protection. This would review related corporate policies, practices, and spending levels. Corporations may also wish to use the annual report to review developments relating to other government policies in areas such as wage restraint and employment equity.

5) Use as Corporate Communication Tool

A well thought-out and well-presented annual report can be valuable as a means of defining a corporation's image and of conveying to shareholders management's position on a range of issues facing the corporation. Certainly, style and format are important. The "public relations" dimension of annual reports requires constant attention to and sensitivity about the needs of selected stakeholders (e.g., Parliament). In light of fiscal constraints faced by government and imposition of other public policy objectives [for example, eleven Crown corporations would be subject to specific "procurement" obligations under the proposed North American Free Trade Agreement (NAFTA) legislation when it is implemented] portraying the appropriate image can affect financial resources of the corporation and its mandate

ANNEX 7: REQUIREMENTS FOR SECURING APPROVAL FOR SPECIAL REVENUE SPENDING AUTHORITY

Policy

1. Departments seeking a special revenue spending authority must ensure that:

   (a) The operations of the unit responsible for the mechanism support the approved program objectives of the department.

   (b) The expenses incurred to produce goods and services are directly related to the revenue produced through the sale of these goods and services. Revenues are spent on intended uses and there is no cross-subsidization.

   (c) The authority sought to respend revenues previously deposited to the Consolidated Revenue Fund will correspondingly reduce the A-base of the department so that there is no net increase in the draw on the CRF.

   (d) The objectives and activities of the unit, the conditions, as well as the commitments of the department governing the use of the mechanism are clearly described.

   (e) Appropriations for net voting and revolving funds are classified as budgetary.

Additional Requirements for Net Voting

2. Departments with a special revenue respending authority for net voting must establish policies and procedures to ensure that:

   (a) There is a control mechanism in place to ensure that the net dollar amount (expenditures-revenues) approved by Parliament is not exceeded.

   (b) Only the revenues associated with costs incurred within net-voted activities are applied towards these costs. The revenues which are not associated with costs incurred are recorded as non-tax revenue.

Additional Requirements for Revolving Funds

3. Departments seeking a special revenue spending authority for a revolving fund must:

   (a) Identify the source of funds to support the operations of the revolving fund, including the amount of the drawdown authority sought when the revolving fund is created.

   (b) Agree to provide forecasts of expected drawdowns under the established authority, and to operate within that forecast unless otherwise authorized by the Treasury Board.

(c) Recognize that any write-off of accumulated deficits, requires the identification of a source of funds.

(d) Obtain Treasury Board approval of the roles and responsibilities of the Deputy Head and the revolving fund management.

4. Departments with a special revenue spending authority for a revolving fund must establish policies and procedures to ensure that:

(a) The dollar amount of the non-lapsing authority approved by Parliament is not exceeded.

(b) Activities financed by the fund are maintained separately from the activities financed by appropriations. Costs unrelated to the business of the revolving fund must not be charged to it.

(c) Initiatives that have no identifiable user group from which to recover costs are not funded from the revolving fund.

(d) Financial statements are prepared annually in accordance with Treasury Board Secretariat accounting policies based on Generally Accepted Accounting Principles.

(e) The revolving fund's financial statements are audited to assess compliance with the Treasury Board Secretariat accounting policies.

(f) Appropriated funds are not carried over from one fiscal year to the next by transferring them to revolving funds or by pre-paying for goods and services from revolving funds.

5. Departments with a special revenue spending authority for a revolving fund must:

(a) Review the mandate and viability of the revolving fund every 3-5 years. The review should include:

- a review of the agreement outlining the respective roles and responsibilities of the Deputy Head and the revolving fund management to ensure that it continues to be appropriate;
- a comparison of financial and operational performance in relation to the business plan; and
- if self-sufficiency has not yet been achieved, a plan to demonstrate that the revolving fund will become self-sufficient in the next review period or a plan for winding-up the revolving fund.

(b) Annually submit to Treasury Board with the ARLU, a multi-year business plan for each revolving fund in a form approved by the Treasury Board Secretariat. The business plan must include:

- the planned use of the drawdown authority, if any. Any increase over that forecast annual drawdown will require the advance approval of the Treasury Board; **(Note: The Treasury Board Secretariat will establish a frozen allotment for the drawdown authority in excess of the approved ARLU forecast)**
- a long-term capital plan, if applicable;
- the rates or the basis for the rates to be charged in the next fiscal year.

(c) Delete an ongoing accumulated surplus of the revolving fund according to the following formula:

- if there is an accumulation of surpluses beyond three years, of half of the amount;
- if there is an accumulation of surplus beyond five years, of the full amount that is more than five years old;
- except to the extent that the Treasury Board has approved the carry-forward of such accumulated surpluses or part thereof.

(d) Prior Treasury Board approval for any drawdown in excess of the annual forecast is not required if the same is to be funded through an offsetting reduction in the department's existing resources.

(e) Treasury Board approval is required for any write-off of accumulated deficits.

Monitoring

(a) Departments should conduct periodic reviews and audits of their compliance with this policy.

(b) Treasury Board Secretariat will monitor the effectiveness of this policy by reviewing departmental internal audit reports.

(c) Performance indicators should relate primarily to:

- the relationship between service levels and revenues
- the impact of the business cycle on revenues and related expenditures.

ANNEX 8: EVIDENCE ON THE USE OF VOUCHERS

Evidence on the use of vouchers in legal aid indicates that improvements in efficiency and savings in costs are not likely to materialize without some negative impact on the quality of services. In short, there is a direct and significant relationship between the quality of services and the cost of providing them.

Delivery of legal aid in Canada traditionally follows the mixed model concept of both staff and judicare delivery options. Some legal aid plans, notably Ontario, New Brunswick, B.C. and Alberta have predominantly private bar or judicare delivery systems. The judicare system is one in which lawyers in private practice are issued certificates or vouchers from the legal aid system to provide aid to clients. A staff lawyer delivery system is one in which the service is provided by salaried lawyers employed directly by the legal aid plan. Other jurisdictions such as Quebec, Manitoba, N.W.T. and the Yukon have mixed delivery systems that utilize both staff and private bar lawyers.

In comparing salaried and judicare schemes (Tamara Goriely, Legal Aid Delivery Systems: Which Offer the Best Value for Money in Mass Casework? Lord Chancellor's Department, London, 1997), the following findings emerge:

- When costs data are available, they usually indicate that salaried services are cheaper on a cost-per-case basis. This is particularly true in criminal defense, where the Canadians have carried out some reasonably sophisticated studies (Brantingham 1981, Sloan 1987).
- In Canada, in the criminal field, those jurisdictions that use salaried services tend to have lower costs-per-case overall than those using judicare systems. The same is not true in the USA, where some very cheap schemes in the South and Midwest use assigned counsel. However, there are several quality concerns about very low-cost judicare schemes.
- The reason salaried lawyers are cheaper is that they tend to spend less time per case (Brantingham 1981, Sloan 1987, Domberger and Sherr 1981). An Australian report found little difference in what it costs to employ a lawyer in private practice and what they cost to employ in a staff office. Another study found that salaried lawyers and judicare lawyers were receiving around the same costs per hour - though in some circumstances judicare lawyers were able to charge the same time to two or more different cases (Brantingham 1981).

There is a lively controversy concerning legal aid rates in Canada. In Ontario the voucher rates are $500 per trial day and $500 for all pre-trial preparation. A judge has just ordered the government to pay $500 per day for <u>all</u> pre-trial days of preparation (for a high profile Hell's Angels trial). This example demonstrates that setting the rates for vouchers is a sensitive and difficult matter.

Rather than proceeding with vouchers, Australia has introduced an alternative market mechanism in the form of a sophisticated scheme of differential tuition fees and repayment for university education. The Australian Higher Education Contribution Scheme has three key components:

- Differential pricing, based on cost of delivery and expected incomes of graduates
- Guaranteed tuition loans for citizens; and
- Repayment of tuition loans through the tax system

The Australian scheme provides for "value for money" or market competitive rates for tuition, while guaranteeing access for all, and ensuring that repayments are made according to the eventual impact of education on incomes.

The Higher Education Contribution Scheme (HECS) was introduced in 1989 to provide "a fair and equitable way of ensuring that students contribute to the cost of their higher education". The HECS is administered under the Higher Education Funding Act 1988 by the Department of Education, Training and Youth Affairs, the Australian Tax Office, and higher education institutions

There are three main dimensions:

- Differential Pricing

The most innovative aspect of the HECS is the creation of three bands of pricing. The formula for deciding on the price ranges is based upon the **cost of delivery** for the program and the **expected earnings** of the graduates of the program. In 2001, the bands are as follows:

Band 1:	\$3521 Arts, Humanities, Social Studies/Behavioral Sciences, Education, Visual/Performing Arts, Nursing, Justice and Legal Studies
Band 2:	\$5015 Mathematics, Computing, other Health Sciences, Agriculture/Renewable Resources, Built Environment/Architecture, Sciences, Engineering/Processing, Administration, Business and Economics
Band 3:	\$5870 Law, Medicine, Medical Science, Dentistry, Dental Services and Veterinary Science

These bands do not restrict cross-disciplinary coursework. Rather, the bands determine the prices for courses delivered in a particular faculty or department.

- Guaranteed access to funds

  Under the HECS, the government guarantees tuition funds for Australian citizens. HECS payments can be deferred with very few requirements. If the student wishes to pay the HECS fees up front, they will receive a discount; however, the HECS is designed specifically to ensure that "students are not prevented from participating in higher education if they are unable to pay the contribution up front."

- Inclusion of the Tax Office in Repayment Mechanism

Repayment of deferred HECS fees is contingent upon the former student's income and their capacity to repay. As income increases, so does the required payment. The calculation, shown in the table below, is based upon information gathered and administered by the Australian Tax Office.

Range	Percentage of Income to be Applied to HECS Fees
Below $22 346	0%
$22 346 - $23 565	3.0%
$23 566 - $25 393	3.5%
$25 394 - $29 456	4.0%
$29 457 - $35 551	4.5%
$35 552 - $37 420	5.0%
$37 421 - $40 223	5.5%
$40 224 and above	6.0%