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## ***Background***

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### **Hiding the Good News: Ottawa's Book-Cooking Is a Troubling Sign for the Future**

by

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The February 1999 federal budget is a “good news” budget, but a much muted one. There is more money for provincial health programs, but no fundamental reform. There are broad-based tax cuts, but they are small. And thanks to buoyant tax revenue, Ottawa’s cash surplus has grown to the \$10-billion-plus range — yet thanks to cooking of the books on an unprecedented scale, this improvement did not show up in the bottom line. Although the signs of a continued turnaround in federal fiscal health are welcome, it is troubling that parliamentarians and Canadians generally can no longer rely on federal budgets, nor on the figures presented in the Public Accounts at the end of each fiscal year, to give a straightforward account of the nation’s finances.

The main tool for manipulating the federal financial numbers is “pre-booked” spending. It is a simple trick: the finance minister announces a program that will not actually begin dispensing money until some future date, but

shows the expected spending as a one-time charge in the current fiscal year. The result: he makes the bottom line look worse than it really is — enlarging a deficit, or shrinking a surplus — and paving the way for exaggerated improvements in the bottom line in future years, when the spending that actually occurs never shows up in the budget.

The first recent use of this trick was in fiscal year 1995/96. That year, the Public Accounts showed \$961 billion in “transitional assistance” spending to provinces that were harmonizing their sales taxes with the goods and services tax. The problem, however, was that the provinces involved had received no money — nor had they even signed the harmonization agreements that would have triggered the payments. The auditor general criticized this practice but, because of other offsetting factors, decided not to attach a reservation to his approval of the Accounts.

The next year, in 1996/97, Ottawa booked an \$800 million transfer to the Canada Foundation for Innovation — despite the fact that Parliament did not vote the expenditure in that fiscal year and the Foundation that was to receive the money did not even exist. The auditor general condemned this move, noting that it caused a material overstatement of the deficit and the accumulated debt, and — for the first time in many years — attached a reservation to his opinion on the 1996/97 Accounts.

The federal government went even further in 1997/98. That year, it booked \$2.5 billion in spending in respect of the Canada Millennium Scholarship Foundation, even though, again, Parliament had not voted the money in that year and the body due to receive it had not been created. The auditor general condemned this move in the 1998 Public Accounts, noting — as he had the year before — that this charge was materially affecting the government's reported balance and overstating the debt.

The political advantages of these misstatements are clear. By repeatedly using one-time charges to hide the extent of the fiscal turnaround, Ottawa has been able to ease some of the pressure for tax relief and new spending. The details of public accounting do not make compelling front-page news items, and the reaction from outside the auditor general's office has been subdued. So, in the most recent budget, Ottawa has gone a step further.

According to the 1999 budget, the accounts for fiscal year 1998/99 will show pre-booked charges of close to \$4 billion. Part of this amount represents additional transfers to the Canadian Foundation for Innovation. The lion's share, however, is a \$3.5 billion pre-booked charge for Canada Health and Social Transfer payments to the provinces. This money will actually flow to the provinces over a period of years, just like other federal-provincial transfers. But the budget proposes transferring it all at once to a "third-party trust," to justify the pre-booking.

It is largely, though not exclusively, because of this charge that program spending in 1998/99 is now shown at \$112.1 billion — a whopping \$7.6 billion over the \$104.5 billion figure presented in the 1998 budget — helping to eradicate what should have been a healthy budget surplus for the year. It is too early to predict how the auditor general will respond to this latest fiddle. But from the record it is safe to say that if he does criticize it, the federal government will ignore him.

Many expert observers — who might ordinarily be expected to line up behind the Auditor General's demands for more honest accounting — seem to have been willing to overlook the odd misstatement when it served the cause of deficit reduction. With Ottawa now in the black, however, it is increasingly difficult to argue that the exigencies of a fiscal turnaround justify cooking the books in this manner. Distorting the picture with pre-booked charges hurts the prospects for further improvement in federal finances in several ways.

Hiding surpluses allows the finance minister to avoid making a public case for debt reduction — which is a shame because the case for debt reduction is strong, and might attract even more support among Canadians than it already does, if the minister deployed his considerable powers of persuasion to the cause of convincing them. Pre-booking charges means that future budgets will contain spending figures that are misleadingly low, creating illusory room for a laxer fiscal stance. It may even affect federal programs and taxes, if programs that appear to lend themselves to this kind of treatment get the nod over priorities — such as debt repayment and tax cuts — that do not. Most fundamental of all, however, is the problem that inspired the auditor general's complaints: the government is presenting Parliament with financial statements that reflect neither what Parliament has actually voted nor an honest picture of Ottawa's fiscal position. Canadians can hardly weigh in with

informed opinions on national priorities if their government is presenting them with figures they cannot trust.

It is ironic that the move from a large federal deficit to a healthy surplus should be accompanied by a decline in the quality of

Ottawa's financial statements. And it is a little unsettling, since fudged figures are often a prelude to trouble. So why not complement the improved state of federal finances with a cleaned-up set of books? Ottawa should stop hiding the good news.

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