

THE ACCOUNTING SYSTEM OF THE PROVINCE OF NEWFOUNDLAND
ITS ROLE IN FINANCIAL DECISION MAKING AND
SUGGESTIONS FOR CHANGE

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THE ACCOUNTING SYSTEM OF THE PROVINCE OF NEWFOUNDLAND
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ABSTRACT

There is an increasing interest in Public Accounts, not only by politicians and government officials but also by financial institutions, universities, news media and by members of the general public. This interest goes deeper than concern with the ever-growing magnitude of government outlays and the incidence of higher taxation. Public finance has come to be vested with its appropriate economic significance and recognized as a major factor in shaping the course of economic and social progress.

With the growth of government activities and related increases in government expenditure, effective financial management in the conduct of government affairs is assuming ever-increasing importance. The development and the strengthening of the management function raises problems concerning the information that is required, the method of accounting for government income and expenditure, the classification of accounting data in a form which best facilitates decision making and the choice of the appropriate reporting and control systems.

In this thesis an analysis is made of the system of accounting and control of public money in the Province of Newfoundland, including the function and organization of the Treasury Board. The necessity of providing adequate information for decision making is stressed and the systems analysis approach to decision making, used mainly in commerce and industry, is discussed. A description of its application to government decision making in the form of the Planning- Programming- Budgeting system as implemented by the Federal Government of Canada and the Provincial Government of Ontario leads to the supposition that this system might well be introduced in Newfoundland with favourable results.

The introduction of the P.P.B. system in Newfoundland would only be possible if changes can be made in the system of accounting and reporting of government transactions. Accordingly the thesis recommends a number of changes in the system of accounting and the presentation of the annual Public Accounts of Newfoundland to ensure that, as far as is practicable, the accounts should provide all interested parties with true and fair statements that disclose essential information in a clear and concise form and present data which convey accurate and relevant meaning.

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1. GOVERNMENT ACCOUNTING

The purpose of a financial accounting system is to ensure responsible accountability and to facilitate effective planning and control. Its role is to assist management in operating an enterprise efficiently and profitably, to furnish data for effective planning and policy formation and to provide the means for controlling the execution of approved plans and policies, to ensure proper custody of and control over cash and property, to facilitate an effective internal and an independent external audit, and to provide the information necessary for adequate and timely financial reporting.

These broad aims are common to all financial accounting systems whether operated by individuals, private businesses, public corporations, the province or the federal government. However, when they are applied to the finances of a provincial (or federal) government, they must be considered in relation to the statutory concepts and principles underlying the operations of that government.

The first principle is that of the sovereignty of parliament, expressed in the statutory rules that no tax shall be imposed and that no public money shall be spent, without the prior approval of the House of Assembly.

The second principle is that all taxing and appropriating measures shall originate in the House of Assembly, ensuring for that body the dominant role in financial matters.

The third principle is that of executive initiation -- the concept that the executive alone has the right and the responsibility to initiate financial proposals -- that all requests for grants must

come to the House of Assembly through responsible Ministers.

The fourth principle -- an extension of the first -- is the principle of appropriation or the rule that all public expenditures shall be made only for the purposes, and within the limits, authorized by the House of Assembly.

Possession of taxing and appropriating powers does not constitute complete control: experience has proved many times that the proceeds of lawful taxes can be spent unlawfully. Therefore, means are needed to ensure that parliamentary directions are faithfully followed.

These means are embodied (fifth and sixth) principles of legislative accountability and legislative audit -- that there should be comprehensive and timely reports to parliament of all receipts and disbursements -- fulfilled by the annual presentation of the Public Accounts to the House of Assembly, and that there should be an independent legislative auditor or examiner to investigate and report to parliament whether the revenues were fully collected and paid into the Consolidated Revenue Fund and whether the appropriations were spent for the purposes intended and authorized by parliament. In Newfoundland, the Auditor General, a legislative officer appointed under the authority of The Revenue and Audit Act, with security of tenure, independence from the executive government, and a salary that is a statutory charge to the Consolidated Revenue Fund, reports annually to parliament on the outcome of his examinations, in terms that capture the headline of the press and provide the House of Assembly with the basis for the most searching enquiries.

The seventh principle is the concept of the consolidated revenue fund, or the rule that there shall be a single fund into which all public money shall be deposited without delay or diversion, and from which all

disbursements for public purposes shall be made.

The eighth principle is that of annuality -- the planning, budgeting, appropriation, accounting and audit of public receipts and expenditures on the basis of an annual fiscal period. Although expenditure program planning over the longer term is now undertaken on a five-year basis, by statute the accounting period remains the twelve months ending on March 31 in each year.

The ninth principle is that of the budget -- the principle that financial control shall be exercised through a budgetary system designed to ensure that all the government's financial plans and prospective resources for each fiscal year are considered at one time so that the government, the House of Assembly, and the people of Newfoundland may be aware of the financial problems as they affect the present and prospective position of the public treasury.

The tenth principle is that of the government's managerial responsibility -- the concept that the executive government has a responsibility to ensure that the resources available to the government are allocated in accordance with needs and priorities existing in the province, and that they are utilized in the most effective and efficient manner.¹

¹Address by Herbert R. Balls, Deputy Minister of Services, to Senior Management Seminar, Department of Supply and Services, Mont Gabriel, Quebec, September 14, 1969.

2. THE TREASURY BOARD

The Treasury Board of the Province of Newfoundland is composed of the Minister of Finance, who is the President, and a number of other members of the Executive Council designated from time to time by the Lieutenant-Governor in Council.²

The Treasury Board acts as a committee of the Executive Council on all matters relating to

- (a) the financial management of the province;
- (b) administrative policy in the public service;
- (c) personnel management in the public service and of a public body; and
- (d) such other matters as may be referred to it in accordance with this Act, or by the Lieutenant-Governor in Council.

The Treasury Board

- (a) prescribes the manner and form in which the accounts of the province and the several departments are to be kept;
- (b) prescribes the manner and form in which the estimates of revenue and expenditure shall be prepared by the several departments;
- (c) prescribes the manner and form in which the public accounts of the province shall be prepared;
- (d) directs any person receiving, managing or disbursing public money to keep such books, records and accounts as the Board deems necessary.
- (e) requires from any department, office, board, officer or other

²Part I of The Financial Administration Act, 1973.

person or body, bound by law to furnish the same to the Government, any account, return, statement, document or information which the Board deems requisite for the due performance of its duties; and

- (f) determines the conduct of collective bargaining negotiations within the public service and for a public body.

The Treasury Board may also

- (a) establish standards of discipline in the public service and prescribe the penalties that may be applied for breaches of discipline;
- (b) determine the manpower requirements and provide for the allocation and effective utilization of manpower resources within the public service and of a public body;
- (c) provide for the classification of positions within the public service and of a public body ;
- (d) determine the pay to which persons employed in the public service or with a public body are entitled for services rendered, the hours of work and leave of such persons and any matters related thereto;
- (e) consider proposals for pensions or gratuities, other than such as are specifically provided for; and
- (f) provide for such other matters, including terms and conditions of employment not otherwise specifically provided for in this subsection, as the Board considers necessary for effective personnel management within the public service and of a public body.

Finally, subject to the approval of the Lieutenant-Governor in Council, the Treasury Board may make regulations

- (a) respecting the collection, management, disbursement and administration of, and accounting for, public money;

- (b) respecting the retention and disposal of records;
- (c) for any purpose necessary for the efficient administration of the public service; and
- (d) respecting any other matters or things referred to it by the Lieutenant-Governor in Council.

In April 1972 the Committee on Government Administration and Productivity was appointed under the Chairmanship of Professor Hugh Whalen. The Committee's Report³ contained the following references to the Treasury Board and its Secretariat:

The Treasury Board Committee of Cabinet is now operating successfully and has greatly expanded and improved its budgetary control function. The Presidency of the Board has normally rested with the Minister of Finance and the Secretary of the Treasury Board has, by statutory authority, been the Comptroller and Deputy Minister of Finance. An enhanced role of the Treasury Board Committee of Cabinet would now appear to be appropriate. This new role should include prime responsibility for the development and operation of a new management improvement function.

As the Board's broadened management improvement function expands, its former emphasis on pure financial control should diminish in relative importance -- although the effectiveness of its regulatory function in this area must not be impaired. This changing emphasis leads the Committee to recommend that the post of Secretary to Treasury Board should be a full time position and that the designation of the Comptroller and Deputy Minister of Finance as Secretary of the Board should be terminated.

³Government White Paper on The Organization of the Public Service of Newfoundland and Labrador, November 1972.

The Committee also recommended that the position of Treasury Board President should be filled by the Minister of Finance. A separation of the two functions is theoretically possible, but, from a practical standpoint, combining the Minister of Finance and President of Treasury Board into a single ministerial function offered a number of advantages, e.g.

- (a) It would help to maintain the co-operative staff linkages between Finance and Treasury Board which are so essential to ensure the implementation of proper expenditure control programs. Such linkages might well diminish if the two staffs, which will henceforth, of necessity, have to operate more independently, were to be directed by two separate Ministers having different daily routine priorities for staff project assignments.
- (b) It would ensure that the Planning and Priorities Committee benefits from the continual perspective of the Finance Minister. This situation would not necessarily occur if the position of Minister of Finance were separated from that of President of Treasury Board as it is the President of the Board who would normally be given Planning and Priority Committee membership due to his role of implementing the expenditure guidelines and priorities discussed and developed in the Planning and Priorities Committee.
- (c) The inclusion of the President of Treasury Board on the Planning and Priorities Committee would also ensure the orderly execution of the guidelines set down by the Planning and Priorities Committee, not only at the time of budget preparation, but throughout the year.

The Report also recommended that, in addition to the President, Treasury Board membership should consist of four other Ministers at least

one of whom should be drawn from the recommended membership of the Cabinet's Planning and Priorities Committee. All positions on Treasury Board, other than that of President, should be subject to periodic routine rotation.

Treasury Board would be a committee functioning in two distinct but interrelated areas:

- (a) It would be the Cabinet Committee for preparation of the annual expenditure budget and the monitoring of expenditure control throughout the fiscal year. As the Committee on the budget, it will be for the Board to propose to Cabinet, in consultation with the Planning and Priorities Committee, the allocation of funds as between the great variety of competing programs and projects, taking into account the priorities of the government and its broad policy directions, the effectiveness of the programs in achieving the government's objectives and the efficiency with which programs are being administered. The Board's job, in short, will be to propose an expenditure plan which will, at one and the same time, present an expression of the government's policies and priorities and result in the optimum allocation of the taxpayer's money in terms of value received for each dollar spent.
- (b) Treasury Board would also be the Cabinet Committee on Management with responsibility for establishing, on behalf of government, the administrative policies and regulations which are considered by Ministers to be desirable in guiding or governing departments in the use of public funds which have been allocated to them. Most of the Board's activity in this regard will focus on the key resources which are allocated to administer approved programs (personnel, accommodation, material and equipment, contracts,

travel and employee expenses, etc.). This latter management function of Treasury Board has been in the process of evolution for some time. This process should now be significantly intensified and expedited.

Several of the Committee's recommendations have been accepted and introduced, others are in the process of being implemented.

3. THE CONTROL OF PUBLIC MONEY

In the Province of Newfoundland all public money over which the Legislature has power of appropriation, other than moneys which may otherwise be specially disposed of by the Legislature, must form part of one Consolidated Revenue Fund to be appropriated to the public service of the province.⁴

Every person who collects or receives public money shall

- (a) forthwith deposit same to the credit of an account of the province at such places and at such times and in the manner prescribed by the Treasury Board;
- (b) keep a record of receipts and deposits thereof in such form and manner as the Treasury Board directs;
- (c) account for same in such manner and at such times as the Treasury Board directs; and
- (d) enter into and give security by bond or otherwise if so required by the Treasury Board.

Control over the administration of the Consolidated Revenue Fund is in the hands of the Comptroller of Finance who, in addition to his discharge of the duties assigned to him as Comptroller of Finance, also discharges the duties falling to the Deputy Minister of Finance.⁵

The Comptroller or any person acting under his direction has free access to the books, accounts, files, documents or other records of any department, and is entitled to require and receive from the officers,

⁴Part II, The Financial Administration Act, 1973.

⁵Part III, The Financial Administration Act, 1973.

clerks, or employees of the public service such information and explanations as he may deem necessary for the proper performance of his duties.

If there is no Comptroller or if the Comptroller is absent for any reason, the Assistant Deputy Minister of Finance, or an officer or clerk designated by name or office by the Lieutenant-Governor in Council has the powers and shall perform the duties of the Comptroller.

No issue of public money shall be made out of the Consolidated Revenue Fund except under authority of the Legislature, except that

- (a) issues of public money received for special purposes or in trust may be made for the express purposes for which the money was received without further legislative authority than the provisions of this paragraph, subject however to the provisions of any particular statute dealing with such special or trust moneys;
- (b) issues may be made for the service of the public debt by way of interest payments and the redemption of loans;
- (c) issues may be made in accordance with certain sections, regulations and other provisions of The Financial Administration Act authorizing any such issues;
- (d) issues may be made to pay all pensions and gratuities authorized by or under any statute, whether or not the statute authorizing any such pension or gratuity provides for the payment of it out of the Consolidated Revenue Fund.

When any sum of money has been granted to Her Majesty by an Act to defray expenses of the public service, as soon as the Lieutenant-Governor in Council has issued his warrant authorizing the payment of such sums as are required to defray such expenses and the expenditure of such sums has been assigned to the several departments, the Comptroller credits the

appropriation accounts maintained in his office with the amounts of the appropriations so authorized to be expended.

At the commencement of each fiscal year there is entered against each Head of Expenditure all unpaid balances of contractual obligations or commitments originating in previous fiscal years.

All issues of public money out of the Consolidated Revenue Fund are made, under the direction and control of the Comptroller, by cheque or other similar instrument but no such issue is made in excess of any appropriation authorized by the Legislature or by special warrant.

Every application of a department for an issue of public money to defray the expenses of the services coming under its control must be accompanied by such documents and certified in such manner as the Comptroller may require.

Except as provided in this Act, no issue of public money out of the Consolidated Revenue Fund is made unless the Comptroller or an officer designated by him has certified that there is a balance available in the appropriation authorized by the Legislature for the specified services.

The Comptroller prepares and forwards to the Auditor General a statement of all issues of public money out of the Consolidated Revenue Fund, together with supporting accounts at such times as the Auditor General may reasonably require.

The Comptroller keeps a ledger in which are entered the departmental appropriations by Heads of Expenditure and by subheads and subdivisions in accordance with the subhead and subdivision allocations exhibited in the estimates for the fiscal year concerned, as amended in accordance with this Act, against which are charged all authorized expenditures.

The Comptroller establishes and maintains a record of commitments chargeable to each appropriation.

The Comptroller furnishes to each Deputy Minister or other officer charged with the administration of a Head of Expenditure a statement of the charges entered against the Head of Expenditure or subheads or subdivisions thereof, and such statements show the charges made during the report period together with the balances at the credit of the Head of Expenditure or subheads or subdivisions thereof at the end of each period concerned.

When a subhead or a subdivision is exhausted, the Comptroller at once notifies the Deputy Minister concerned and the Comptroller does not sanction any further charge to be entered against that subhead or subdivision.

No payment out of public money is made

(a) for the performance of work, the supply of goods or the rendering of services, whether under contract or not, in connection with any part of the public service, unless, in addition to any other voucher or certificate that is required, the appropriate Deputy Minister, or another authorized person, certifies

- (i) that the work has been performed, the goods supplied or the service rendered, as the case may be, and that the price charged is according to contract, or if not specified by contract, is reasonable, or
- (ii) where a payment is to be made before the completion of the work, delivery of the goods or rendering of the service, as the case may be, that the payment is in accordance with the contract; or

- (b) for expenses incurred by persons while travelling on Government business, unless the person who has incurred the expenses certifies that the expenses were incurred on Government business and are in accordance with the rates, amounts and allowances prescribed by the Board.

4. THE PUBLIC ACCOUNTS

The accounts of the province are kept in the Department of Finance by double entry, under the general direction of the Comptroller, who maintains an accounting system to show, among other things

- (a) the current state of the Consolidated Revenue Fund;
- (b) the revenues and expenditures of the current fiscal year;
- (c) the commitments for the current fiscal year chargeable against each Head of Expenditure; and
- (d) the charges expended from the Consolidated Revenue Fund.⁶

The fiscal year of the province is the period commencing on the first day of April in one year and ending on the thirty-first day of March in the following year.

As soon as possible after the end of each fiscal year the Comptroller prepares a report, called the Public Accounts, and submits it for audit by the Auditor General and onward transmission to the Minister for submission to the House of Assembly. The Public Accounts must show in respect of the fiscal year to which they relate at least:

- (a) the state of the public debt;
- (b) the revenue and expenditure;
- (c) all compromises, remissions, refunds and amounts written off; and
- (d) such other accounts and statements as may under good accounting practice be required to show the financial position of the province at the end of the fiscal year.

The Minister of Finance lays the Public Accounts before the House

⁶Part V, The Financial Administration Act, 1973.

of Assembly on or before the thirty-first day of January in the following year if the Legislature is then in session, and, if it is not, then within one week after the commencement of the next ensuing session of the Legislature.

The Public Accounts of the Province of Newfoundland for the year ended 31 March 1973, submitted for audit by the Comptroller of Finance in compliance with the provisions of Section 60 of The Revenue and Audit Act, contained the following financial statements:

STATEMENT OF ASSETS AND LIABILITIES

Change in Excess of Liabilities over Assets

Unexpended Balances and Special Funds -- Assets

Government of Canada Claims in Process

Accounts and Taxes Receivable

Loans, Advances and Mortgages Receivable

Investments

Fixed Assets

Debenture Debt

Unexpended Balances and Special Funds --

Liabilities and Balances of Funds

Current and Long-term Liabilities

Contingent Liabilities

Trust Accounts -- Assets

Trust Accounts -- Liabilities and Balances of Funds

Losses, Uncollectible Accounts, etc., Written Off

CONSOLIDATED REVENUE FUND --

Statement of Receipts and Payments

REVENUE, EXPENDITURE AND APPROPRIATIONS-IN-AID

Summary of Revenue, Expenditure and Appropriations-in-Aid

by Departments

Summary of Net Capital Expenditure

Statement of Current Account Revenue

Statement of Expenditure and Appropriations-in-Aid:

- Consolidated Fund Services
- Legislative
- Executive Council
- All Government Departments

Significant changes from prior years were introduced in 1973. They were in the treatments of inventories, receivables and payables at year-end, and amounts due from the Government of Canada at year-end.

(1) Inventories of supplies and equipment were shown at a nominal value of \$1. The previous treatment of disclosing the full value of inventories as an asset was considered to be inconsistent with the "net debt" form of balance sheet presentation which was introduced in 1973.

(2) The Newfoundland Exchequer was stated as the book balance at March 31. In prior years amounts applicable to the year which were received from the Government of Canada in April of the subsequent year and likewise expenditures applicable to the year but made in April were included as if the transactions had occurred in March. These amounts were now shown as accounts receivable or payable as the case may be.

(3) Amounts due from the Government of Canada at March 31st were included in departmental appropriations-in-aid only to the extent of the amount received in April of the subsequent year. In prior years all amounts due from the Government of Canada at year-end were included in

departmental appropriations-in-aid.

(4) The assets and liabilities of the Province were set out in the Public Accounts so as to disclose the dollar amounts of assets on hand, or due to the Province, and amounts owing by the Province at the end of the financial year. Additional modifications were made to the pure "cash" system so as to enable the recording of assets and liabilities which did not directly result from income or expenditure of the current fiscal year. Examples of these items were: accrued interest receivable and the accounts payable of departments at year-end.

(5) The statement of assets and liabilities of the Province was drawn up on the "net debt" basis, following the example set by the federal government and several provincial governments. The objective of this concept is to show the government's financial position rather than the accumulated amounts of assets and liabilities. The government's net debt consists of total direct debts, less the value of convertible assets such as cash, accounts receivable, loans, advances, and investments. The statement of assets and liabilities of the Province is drawn up on this basis and assets which are not considered to be convertible such as fixed assets and inventories of supplies are included only at nominal values.

5. THE AUDIT OF THE PUBLIC ACCOUNTS

For a complete examination of the Public Accounts of the province and for the reporting thereon to the House of Assembly, the Lieutenant-Governor appoints an officer under the Great Seal of Newfoundland, who is called the Auditor-General.⁷

The Auditor General examines periodically the accounts of all departments and takes such further steps as he deems necessary to satisfy himself that the accounts are faithfully and properly kept and that money expended has been applied, subject to The Financial Administration Act, to the purposes for which it was appropriated.

The Auditor General has free access at all convenient times to the books of account and other documents relating to the accounts of the departments and may require that there be furnished to him from time to time or at regular intervals such statements, reports and documents as he thinks reasonable and necessary.

The Auditor General, besides examining from time to time the various accounts of the several departments as provided for by this Act, examines and audits the Public Accounts of the province for each fiscal year. For that purpose statements with respect to such accounts are prepared by such persons as the Comptroller may direct, and such statements must include:

- (a) accounts of all receipts forming the Consolidated Revenue Fund;
- (b) accounts of all expenditures made from the Consolidated Revenue Fund;

⁷ The Financial Adminsitration Act, 1973, Section 58

- (c) accounts current with the several banks and fiscal agents of the province;
- (d) accounts relating to the raising or redemption of loans;
- (e) accounts relating to sinking funds;
- (f) accounts with other governments;
- (g) accounts held in trust for others; and
- (h) all other public accounts.

Each of these accounts is examined under the direction of the Auditor General who reports annually to the House of Assembly the results of his examination of the accounts and financial statements of the province. This report states whether, in his opinion,

- (a) proper books of account have been kept by the province;
- (b) the financial statements of the province
 - (i) were prepared on a basis consistent with that of the preceding year and in agreement with the books of account,
 - (ii) in the case of the balance sheet, present fairly the state of the affairs of the province as at the end of the fiscal year,
 - (iii) in the case of the statement of revenues and expenditures, present fairly the revenues and expenditures of the province for the fiscal year, and
 - (iv) in the case of the Consolidated Revenue Fund, the statement of receipts and payments present fairly the receipts and payments of the Consolidated Revenue Fund for the fiscal year.

If during the progress of an examination conducted by the Auditor General any objection arises in respect of any items charged or to be

charged against any appropriation account, he immediately communicates the objection to the Deputy Minister of the department concerned and to the Comptroller, and if the objection is not answered to the satisfaction of the Auditor General he reports his objection to the Treasury Board.

The Treasury Board, whenever an objection is raised by the Auditor General to any item charged or to be charged against any appropriation account, makes such further examination as it considers equitable, and directs that such action be taken in the matter as appears to it to be just and reasonable, including the surcharge in whole or in part of any excess expenditure against the salary of the officers concerned, and the Auditor General and the Comptroller govern themselves accordingly.

The opinion paragraph of the Auditor General's Report on the Public Accounts of Newfoundland usually runs along the following lines:

In accordance with the requirements of section 59(3) of The Revenue and Audit Act, I report as follows on the results of my examination and audit of the accounts and financial statements of the province for the year ended 31 March 19....

In my opinion, subject to the comments and explanations included in this report,

- (a) proper books of accounts have been kept by the province;
- (b) the financial statements of the province for the year ended 31 March 19.. ,
 - (i) were prepared on a basis consistent with that of the preceding year and in agreement with the books of account,
 - (ii) in the case of the balance sheet, present fairly the state of affairs of the province as at the end of the financial year, and
 - (iii) in the case of the Consolidated Revenue Fund, statement of receipts and payments, present fairly the receipts and payments of the province for the financial year.

Further, in my opinion, subject to the comments and explana-

tions appearing in this report, the summary of revenue, expenditure and appropriations-in-aid by departments and the related departmental statements, present fairly the revenue, expenditure and appropriations-in-aid for the year ended 31 March 19.. .

In addition to his responsibilities under The Revenue and Audit Act, the Auditor General is responsible for the audit of various statutory and other bodies. The number of audits required to be carried out under specific legislative provisions, other than The Revenue and Audit Act, or by arrangement, continues to increase. As at 31 March 1969 the Department of the Auditor General was responsible for the audit of:

Approximately 50 statutory authorities, including Crown corporations, loan boards, corporate bodies and statutory funds. (The financial statements of these are included in the volume of the Public Accounts under the caption Other Public Accounts.)

Approximately 160 municipalities, including town, rural districts and community councils and boards of trustees of local improvement districts, throughout the Province

City of St. John's

City of Corner Brook

Thirteen school tax authorities

Twenty-one hospitals (St. John's General, James Paton Memorial, Dr. Walter Templeman, Sir Thomas Roddick, and seventeen cottage hospitals)

St. John's, Housing Authority

Corner Brook Housing Authority, and

Several other audits

The tasks facing the Auditor General's department in these audits involves auditing the financial records and reporting on financial statements. But, in the case of many of the municipal audits, the auditors have to perform accounting functions in that they have to complete writing up the books and prepare the financial statements to be reported on.

There does not appear to be a general recognition by the Government of Newfoundland that the Department of the Auditor General is a separate Department established by and responsible to the House of Assembly. For years the appropriation for this Department was included in various sub-heads of the Estimates for the Department of Finance. For 1969-70, the Department of the Auditor General's appropriation was separately disclosed in the Estimates, but still appeared as a subhead of the Department of Finance. However, full recognition of the independent status of the Auditor General, as the agent of the Legislature, dictates its separation from any supposed or implied administrative connection with any other Department.

In conclusion it may be of interest to quote a paragraph from the 1968 Auditor General's Report which runs as follows:

"In the performance of the audit I believe it is both the intent of the Legislature and the responsibility of the Auditor General that professional auditing standards be brought to bear on the subject of examination. The end purpose of the audit then becomes the expression of opinion, based on sound judgment, as to the fairness of the financial statements examined. Inadequacies in accounting method and financial control have not facilitated the attainment of this objective. The financial statements now submitted have only been accepted by me after an excessive number of corrections and adjustments were incorporated at my request. Efforts are being made, under the direction of the Comptroller of Finance to effect improvement in financial administration and accounting method and control. However, I have concluded that, despite consultative advice and the efforts made to date, controls are generally lacking or ineffective and accounting method is unwritten and neglected. A prerequisite to any accounting and control system must be a manual of accounts, classifications and procedures. Duties and responsibilities must be clearly defined and adequate instruction and supervision provided. I strongly recommend that effective action be taken to accomplish these objectives without delay."

6. THE ESTIMATES

All estimates of expenditure submitted to the House of Assembly must be for all services coming in course of payment or incurred during the financial year to which the estimates relate or during such other term as they may expressly purport to cover. All balances of appropriations remaining unexpended at the close of any financial year lapse and are written off, except that, in the case of liabilities incurred during the then expiring financial year accounts therefor which are received during a period of thirty days, or such further period as the Lieutenant-Governor in Council may order, following the close of that financial year may be charged to and form a part of the expenditure of that year.⁸

The Estimates are prepared by the departments in a form and a manner prescribed by the Treasury Board and are assembled in the Department of Finance.

The total amount appropriated by the Legislature, the expenditure of which has been assigned to a particular department or office, is referred to as the "Head of Expenditure" of such department or office; the Head of Expenditure of each department or office is usually divided into subheads.

Only when any sum of money has been granted to the government by an Act of the Legislature to defray expenses of any part of the public service, the Lieutenant-Governor may under his sign manual, countersigned by a member of the Treasury Board other than the Minister of Finance, authorize and require the Minister of Finance to issue out of the moneys

⁸The Financial Administration Act, 1973, Section 24.

appropriated for defraying the expenses of such service the sums required from time to time to defray such expenses, not exceeding the sum voted or granted.

The Estimates, in total, thus constitute a plan of expenditure and, like any plan, are also an instrument of control, for the working of each vote not only authorizes the expenditure of funds for the stated purpose, but also restricts the expenditure to that purpose and to that purpose only. At the same time the Estimates also serve as a forecast of future commitments.

Inevitably, there are always some requirements which cannot be foreseen or estimated accurately when the main estimates are under consideration. Others may arise out of new legislation passed by Parliament or as a result of programs approved by the government after the consent of the main estimates has been settled. Consequently, supplementary estimates are submitted to the House of Assembly, usually several weeks before the summer adjournment or prorogation. Further supplementary estimates are introduced two or three weeks before the end of the fiscal year. These are to provide funds for programs, the requirements of which were underestimated when the estimates were prepared some months before. They also authorize reimbursement to Crown corporations and various government accounts for deficits or losses sustained when these cannot be determined in time or accurately enough to be included in the main or supplementary estimates.

If, when the Legislature is not in session, or when the House of Assembly has stood adjourned for more than thirty days, any expenditure in excess of that provided for by the Legislature is not foreseen and not provided for by the Legislature is urgently and immediately required for

the public good the following procedure applies:

Upon the report of the Minister that there is no legislative provision or that there is insufficient legislative provision and that no countervailing savings are available under other subheads of the Head of Expenditure concerned and that in his opinion the necessity is urgent, giving reasons for his opinion, and that if such expenditure is not made grave damage to persons or to property or to the interests of the Crown or the public will occur or excessive additional expense will result from delaying the expenditure until the necessary legislative provision has been made, the Lieutenant-Governor in Council may, on the recommendation in writing of the Treasury Board, order that a special warrant be prepared for signature by the Lieutenant-Governor for the issue of the amount estimated to be required. The amount shall be added to the appropriation under the relevant Head of Expenditure, or an additional subhead shall be set up in the books of the Comptroller against which expenditures on the service shall be charged.

In every case the Minister of Council authorizing the special warrant shall quote the special reasons therefor, and a certified copy of the Minutes of Council shall together with certified copies of the reports referred to and recommendations of the Treasury Board, be tabled in the House of Assembly within fifteen days from the opening of the next ensuing session in order that the necessary legislative provision may be made.

The Estimates for 1973-1974 as approved by the Second Session of the Thirty-Sixth General Assembly of the Government of Newfoundland and Labrador contained the following statements and appendices:

Statements:

A -- Summary of Borrowing Requirements and Sources of Funds

B -- Gross and Net Expenditures by Departments

C -- Current Account Revenue

D -- Expenditure -- Consolidated Fund Services, Legislative, Executive Council, and all Departments

Appendices:

I -- Interest and Debt Retirement

II -- Public Works and Services

III -- Other Government Services

IV -- Summary of Capital Expenditures

V -- Appropriations-in-Aid by Department

The culmination of the annual budget process finds its expression in the budget speech of the Minister of Finance in which the whole range of the government's financial programs and policies is brought into a single focus. In presenting a report of the operations of the fiscal year just ended or ending, it marks the completion of one budgetary period. In setting out the financial plans and programs for the next fiscal year, it marks the commencement of the new budgetary period or cycle. It is thus, on the one hand, a backward-looking review in which the plans and expectations of the previous year are reviewed and compared with the actual outturn. On the other hand, it is a forward-looking survey or projection in which the hopes, plans and expectations for the ensuing year are developed. In this latter aspect, it is the culmination and crystalization of a continuing year-round process in which all the complex and often conflicting considerations that enter into the development of budgetary policy are resolved.

Budget speeches in Newfoundland have tended to follow a definite

pattern of presentation. The outturn of the operations of the previous fiscal year's operations is dealt with first. Revenue and expenditure for the past year are compared with Estimates, and more usual with Amended Estimates, variations are indicated and the reasons (therefore) explained. This is usually followed by a general review of the economic conditions of the province for the preceding year and a brief comment as to the more significant economic statistics or indicators.

A short section of the speech is usually devoted to a summary report on the provincial accounts. The actual revenues and expenditures and surplus or deficit for the year are compared with the forecasts given in the budget speech of the preceding year. There are brief references to the government's non-budgetary transactions and the overall effect of budgetary and non-budgetary operations on the government's cash and debt position. The Minister then proceeds to give a forecast of the probable financial requirements for the year ahead. This takes into account the main estimates before the House and makes allowances for supplementary and further supplementary estimates to come.

After indicating the budgetary surplus or deficit, the Minister outlines what he considers is the appropriate tax policy for the ensuing year. He announces his proposals for increases or reductions in taxes. If no changes are proposed, all existing tax rates remain in effect since it is unnecessary to re-enact the tax laws each year. If changes are proposed in provincial taxes they are sometimes made effective immediately by having the relevant tax laws, when enacted, apply retroactively to the date of the speech. This prevents taxpayers avoiding the effect of tax increases by heavy buying during the period between the budget speech and the enactment of the legislation.

At the close of his address the Minister tables the Estimates, usually with some expression of the government's unshakeable faith in the future of Newfoundland.

7. IDENTIFYING OBJECTIVES

Government exists to discharge certain functions and each government department in turn exists to contribute towards one or more of these functions. The first step in the implementation of any system that is based on planning and control is the formulation of a statement of objectives. The statement of objectives is fundamental in that the particular structure which evolves will be directly dependent on the objectives and the way in which they are stated. The success of the implementation of such a system is therefore critically dependent on the clarity of objectives at all levels -- governmental, departmental and of the lower levels of departmental activities where projects are carried on within the scope of each activity.⁹

The highest level of governmental decision-making calls for choosing alternatives and establishing priorities from a wide variety of public concerns -- to arrive at the Cabinet's policy objectives. These objectives are general statements of intent directed towards achievement in particular goal areas. But to be operationally relevant, they must be more specific than the goal perceptions that prompted them. By and large, discussion about goals tends to be too vague and philosophical to provide a solid basis for identifying policy objectives.

Abstract goals such as "the welfare of the people" have been articulated in many Speeches from the Throne and Budget Speeches and have reflected some of man's most noble (and civilized) aspirations. But while such broad generalizations may achieve wide acceptance as principles, they

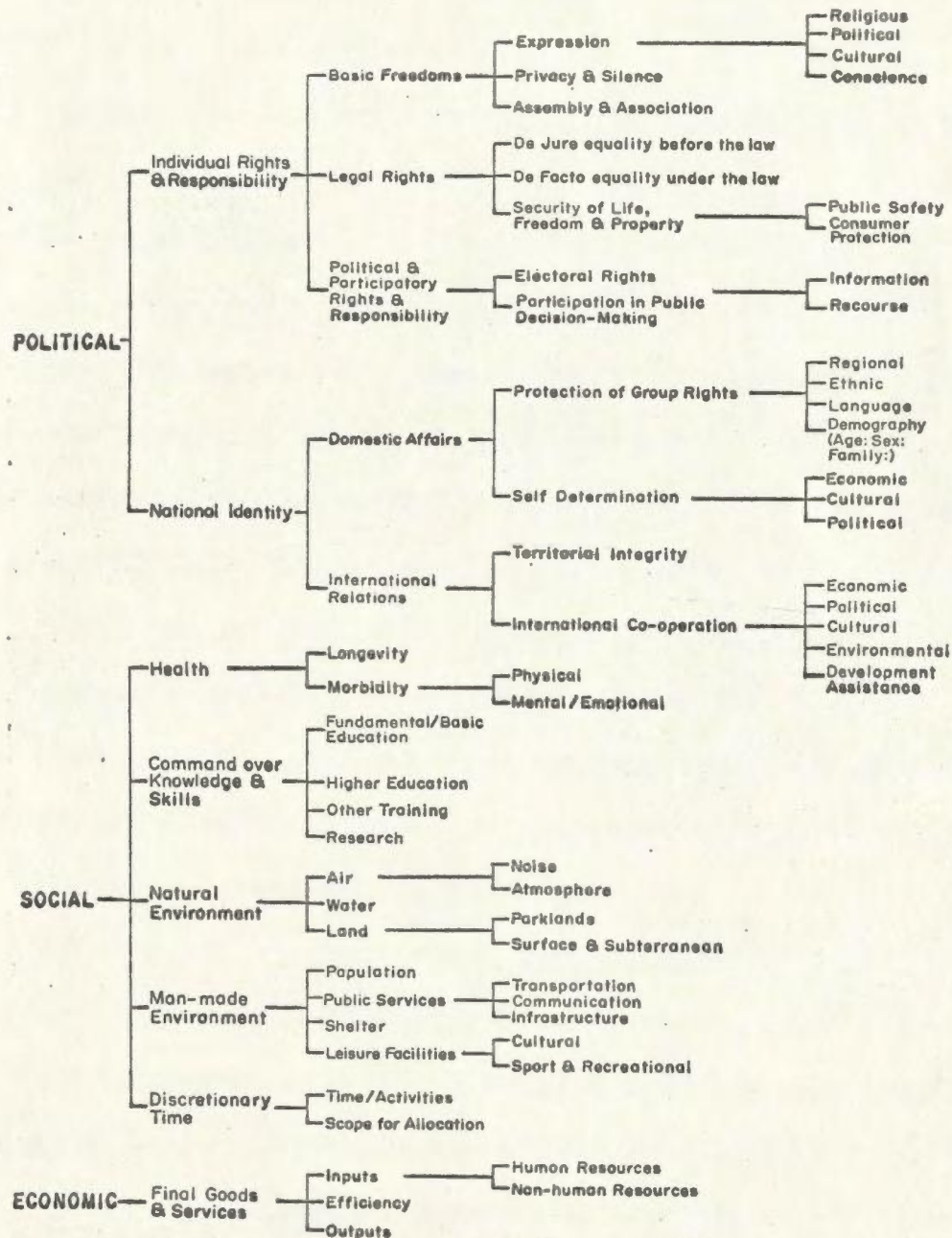
⁹Planning, Programming, Budgeting Guide (Revised Edition), Government of Canada, page 16.

do not provide operational guidelines for policy formation. Goals that seem reasonable, desirable, and universally acceptable are almost invariably too general to provide an adequate basis for policy. As the specification of general goals into detailed objectives begins, the controversy about interpretation arises. The conflict of interest that is at the heart of the political system extends beyond the problem of elaborating the goal to everyone's or no one's satisfaction; it involves choosing among alternative goals and establishing priorities and time preferences. The major difficulty is, of course, that there is no unit of measure that will establish the relative benefits of, for instance, education against those of health. Choices at this high level of aggregation must be developed on the basis of public preferences that largely find their expression in the political process.

Public concern is usually focused on a limited number of issues at any one point in time. Yet the process of government decision-making stretches potentially across the whole spectrum of public interest and welfare. Chart 5-2, reproduced on the next page, which was published in the Eighth Annual Review of the Economic Council of Canada, illustrates the breadth of political, economic, and social concerns, and provides a simple and admittedly arbitrary arrangement of goal areas. It is designed to include all present and future policy concerns. However, to indicate that the framework is open-ended -- that is, to provide for concerns not yet perceived -- it is deliberately entitled "Illustrative Goal Areas."

The various goal areas in the chart are intended to be readily identifiable and self-contained, although inevitably there are strong interrelationships among them. It is highly important that these interrelationships, which may be complex and very powerful, be recognized since

CHART 5-2
ILLUSTRATIVE GOAL AREAS



they create a major hazard for the best policy intentions.

"The Cabinet will decide what part of the total government responsibility each department will take to be its particular responsibility. Similarly, it is necessary to develop departmental objectives and a series of sub-objectives leading to the division of the department's total responsibility into logically separate parts. When such a set of sub-objectives is finally decided upon, each sub-objective corresponds to a potential activity.

"For each departmental program it is desirable to have a statement of objectives which meets the following criteria:

- (a) the objectives of a program should be compatible with each other;
- (b) they should be directly translatable to explicit benefits, preferably to benefits that can be measured quantitatively;
- (c) they should be stated in a way to encourage the consideration of a number of different yet feasible alternative activities, i.e., the objective should not define the method;
- (d) they should be defined with enough precision to permit identification of any activity within a program which does not contribute to the objectives of that program; and
- (e) they should be consistent with the department's role as set out in the legislation governing its operations."¹⁰

"A departmental program will thus consist of a group of departmental activities, all of which are directed to the achievement of the objective or set of objectives of that departmental program. The activities of a

¹⁰ Planning, Programming, Budgeting Guide (Revised Edition), Government of Canada, page 18.

department are the headings under which the department will negotiate for funds with the Treasury Board, the headings under which requirements can be best explained and the benefits forecast. It will, of course, be necessary to show the interrelationships of activities within a program to provide a clear picture, but when this has been clarified, most of the detailed attention will be given to the activities individually.

"The activities of a department will also provide the focus for planning by the department in deciding how to achieve program objectives. If a department carries on some large operation in each of several offices across the province, these offices are responsibility centres. But, if the operation, no matter where it is carried on, is directed to the achievement of one objective or set of objectives, the operation forms the activity. Therefore, the parts of a single activity may be found in more than one responsibility centre and, conversely, one responsibility centre may be concerned in more than one activity."^{10a}

^{10a}Planning, Programming, Budgeting Guide (Revised Edition), Government of Canada, p. 20.

8. RATIONAL DECISION MAKING

For a rational assessment of the merits of alternative proposals for government action a great deal of information is required. Data describing the components of each alternative project and various project sequences must be examined in order to give a clear idea of which over-all plan or program will be the most desirable. In the interest of efficiency those responsible for this work should consider limitations of a technical nature first.

Thus, before a detailed analysis is undertaken, the various alternative technical possibilities and their limitations must be identified. In any situation there are controlling factors which limit the range of choice. These factors may be physical, legal, or economic. For example in the case of a hydro power project, the topography often limits the range of choice. In some cases, legal rights may prohibit some developments. Having identified the various technical possibilities in this way, a number of questions relating to their benefits and costs may be asked. Clearly, unless the project or program can be shown to be technically possible, there is no point in continuing the analysis.

The accountant's approach to decision making has traditionally been an essentially simple one. It is to total up the actual observed costs of an enterprise and to deduct these from the income so as to measure profit, which is specifically what business asks of him. In recent times, with the development of more refined budgeting methods and their application to capital expenditures, the accountant has been faced with two new conceptions, namely that the spending of a large capital sum now will provide a series of cash flows which may stretch out many years into the future and that,

since money to be received in the future is likely to be worth less than is money presently available, any attempt he may make to plan or budget these flows must necessarily include discounting them back to a base time.

Here we have a useful tool to help with decision-taking, for in the choice between alternative projects the one which can show the greatest profitability, other things being equal, has an attraction which cannot be denied. But "other things" hardly ever are equal, and the variables in any situation involving capital expenditure may be exceedingly complex, so that some attempt to sort them out, and if possible to express them in figures, is called for if only to render management's final hunch a little more scientific.

Consider, for example, the hypothetical situation which might arise in a region of widespread chronic drought. Rain-making attempts are to be made by seeding the clouds from a specially-equipped aircraft, and an operational choice requires to be made between several possible zones in the area.

The cost of the project will vary with the distance of each of these zones from the airfield, while differential profits will result from the ability of the farmers in respective zones to pay the aircraft operator. Over which zone should the latter concentrate his effort?

A direct commercial solution to the problem would be to cater for that zone in which the farmers are prepared to pay the highest charges, thereby allowing profitability to determine the issues. However, there may be other factors to which weight must be given; it may, for example, be a much more risky proposition to operate in Zone C, even though this may be potentially the most profitable. Again, it could be that the entrepreneur, by going for an easy success in Zone B at his first attempt,

hopes to create goodwill and so build up a rapid demand for his services. Furthermore, the important question of need arises, for the farmers in Zone A who are suffering most from water shortage may be precisely those who are least able to pay, and a social benefit would be obtained by concentration of effort in that particular zone -- a pay-off which would be likely to commend itself to the public authorities in the region.

It will of course be argued that all these questions would be answered by normal "market" processes and this, from the operator's point of view, would certainly be so. The regional authorities, however, would see the matter from a different angle. There may be yet other factors entering into the decision and it ought to be possible to tabulate these and by relating costs to quantified benefits to arrive at a final choice which will be more deliberate and more relevant to the community than anything else would be.

In the simpler situations where all costs and benefits can be expressed in a common unit, which for most purposes is a monetary unit, the alternative chosen will be that providing the greatest net benefit (net benefit equals present value of the benefit stream less present value of the cost stream) or the highest benefit-cost ratio. However, even the most ardent enthusiasts of benefit-cost analysis, ~~of course,~~ do not advocate that decisions be made on these grounds alone or that projects or programs with the highest benefit-cost ratios automatically be chosen. Rather, the case for benefit-cost analysis rests on the importance of having before the decision-makers the kind of information that will give them a better appreciation of the economic implications of their choice. If they choose a lower benefit-cost ratio, they should do it consciously and know what they are giving up in the process.

Where costs can be expressed in dollars and benefits only in some non-monetary terms, the decision can be reached by fixing the budgetary limit and choosing the alternative which maximizes the benefit. Conversely, a minimum acceptable level of benefit can be set and the lowest cost alternative chosen. In an Emergency Measures Program directed to the preservation of life, the number of lives likely to be saved is a most appropriate measure of benefit and it would not be necessary in that context to attempt to place a dollar value on the benefit. The mere fact that one alternative offers more net benefits than another is obviously insufficient proof of its preference. The proper criterion for ranking the projects must be expressed in relative terms by means of the benefit-cost ratios of the various alternatives.

Human enthusiasm for a particular project may sometimes obscure the fact that other alternatives exist. Such enthusiasm may lead to the claim that a given proposal is desirable simply because its benefits exceed its costs. Sometimes the mere size of the net benefits is also taken as a valid measure of its desirability. However, the mere existence of net benefits is not enough. Even a large excess of benefits over costs falls short of being a final proof. Each alternative which is open to selection will have differing degrees of feasibility. But not one of the projects should be given priority until it has been ranked against its competitors and its benefit-cost ratio has been shown to be greater than that of relevant alternatives.

However, although the benefit-cost analysis provides a mechanism for ranking alternative projects in their order of merit, the real test of optimum use of government resources is found in the answer to the question: "Can the available resources be used more efficiently elsewhere in the

satisfaction of an alternative need?" The answer to this question requires a search for that course of action which maximizes benefits relative to costs. This search should go beyond a mere examination of project revenues and expenditures. It will call for a weighing of benefits which are neither technical nor strictly financial in character: measures which would help to stabilize prices, attract new industries, and generate more purchasing power, or employ idle workers, are all cases in point.

9. BENEFIT-COST ANALYSIS

Benefit-cost analysis provides a logical framework for the evaluation of alternative projects or programs, the ultimate purpose being the selection of the one which would be the most suitable under existing or expected circumstances. This framework assists the analyst to weigh up the relevant benefits against the costs involved, and to rank alternative projects and programs. The basic objective is to determine the most economically efficient use of the resources concerned.

The theory underlying benefit-cost analysis has its foundation in the teachings of the classical economists. The fundamental concept is akin to that of profit maximization as developed by the classical economists to explain the workings of the private sector. The maximization of profits by the private entrepreneur calls for the determination of the scale of production at the point where the revenue received from the last unit of production just equals the cost of bringing this unit into being. Benefit-cost analysis applies a similar criterion: that the scale of the project ideally should be determined at the point where the incremental benefits derived just equal the incremental costs of providing these benefits. Thus both the theory of the private firm and benefit-cost analysis assume that productive factors will be allocated in essentially the same manner.

The classical school assumed that given a competitive situation the self-interest motive of the individual would give the most favourable results. The role of the government in these circumstances was limited to such activities as defence and protection of life and property. The contribution of welfare economics is that it recognized that there are social costs in addition to the costs to the individual. In the case of public

investment there are benefits and costs which would not be counted if the investment were made by a private firm. A public agency thus is able to engage in many aspects beyond those which would be undertaken by a private firm; through assessment powers normally accorded it, the public agency is also able to recoup its costs, directly or indirectly.

Those who make benefit-cost analyses a basis for decision-making inevitably face certain difficulties. In the first place, they must make a series of judgments or estimates whose validity can only be tested by the passage of time. Besides the hazards of forecasting, there is also the question of measurement. Certain benefits, though recognized in a general way, are not normally measured in dollars and cents. The same applies to costs. To the extent that benefit-cost analysis is able to take these intangible factors into account, it represents an improvement over older and more limited methods of analysis which are more strictly technical and financial in character.

A complete evaluation requires that each project be examined in detail before it is judged against its alternatives. Economies of scale would have to be studied. Different project sequences should be established and whole programs ranked against each other, using different assumptions as to rates of market growth, price trends, interest levels, and so on.

Each of the professions has an important contribution to make. The engineers are in a position to establish the technical feasibility of any scheme or combination of proposals. The accountants who are familiar with financial and accounting matters can help to translate streams of costs and benefits to their "present value." Still others, with a training in the social sciences, can help to trace secondary and intangible effects into related areas of the economy. Benefit-cost analysis, however,

provides us with a comprehensive method of integrating ideas, whereby the right questions may be asked and answers produced in such a way as to provide the means for more intelligent decision-making.

In analyzing any number of projects it is evident that neither the expenditures nor the benefits are likely to occur at precisely the same instant in time but instead there is likely to be a cost time stream and a benefit time stream stretching some years into the future. It is obviously necessary that values arising at different times be adjusted to some common base for comparison. Such an adjustment must recognize that costs which are incurred now are more onerous than future costs and, at the same time, benefits to be enjoyed now are more valuable than benefits to be enjoyed later. This adjustment is made by bringing all future values of costs and benefits to their present value by some discount rate usually related to the cost of borrowing funds for the long term.

10. MEASURING BENEFITS

'Benefits may be defined as advantageous effects. They represent real values resulting from any action which brings about increases in the output of useful goods and services. Benefits are akin to the total output, while costs resemble the total input of goods and services, which are involved in the development and operation of a given project or program.

'Primary or direct benefits consist of the gains which accrue to those people who make use of the goods and services which can be provided by a given project or program. Theoretically, the real value of these primary or direct benefits is the maximum amount of money which the consumers are willing to pay for them. Obviously there is an upper limit to these benefits, as the community will not pay more for these advantageous effects than it would have to pay in order to obtain these same goods and services from the most efficient alternative source of supply.

"The primary or direct benefits of a hydro-power project, for instance, are represented by the market value of the electricity produced by the project. This can be established by multiplying the volume of energy delivered to consumers by the price the consumers would be willing to pay if the most economic alternative source were to provide the power. On the other hand, the primary or direct benefit from an irrigation project may be determined by computing the increase in agricultural income which is directly attributable to the ~~existence~~ of the project.

'Secondary or indirect benefits stem indirectly from, or are induced by, the project or program in question. If, as a result of the provision of irrigation water, a sugar beet factory is set up to process the sugar beets from the irrigation project, the net income of the sugar beet factory

should be counted as a secondary benefit of the project. Although it is not the primary purpose of the project, the existence of this new industry should properly be credited to it.

"Intangible benefits differ from other benefits to the extent that they are services not usually bought or sold at a price or at a fee, nor can their value be derived indirectly from the price of secondary products produced by using these services. They may, however, be measurable in monetary terms by procedures which involve attributing a value to them."^{10b}

Any program or activity which is undertaken will probably have more than one identifiable benefit (or source of costs). A major hydro-electric power dam may provide the additional benefit of flood control. At a secondary level the project may create recreational areas such as a lake for water skiing and swimming while at the same time making marshlands valuable for the hunting of wild fowl and streams for fishing.

Recreation benefits can sometimes be evaluated as direct benefits, e.g. the revenue obtained from the sale of hunting rights and earnings of tourist guides, and so on. In most instances, however, the benefits being "intangible" are not so easy to measure. The ideal measure of benefits to the user is that sum he would be willing to pay (in license fees, etc.) solely in order to enjoy a recreational opportunity. Although such optimum fees are usually purely hypothetical and will never be charged, a benefit-cost analysis must attempt to estimate the amount that could be collected from the users of recreation areas if it were possible to price their services and amenities.

^{10b} Sewell, W.R.D., J. David, A. D. Scott, and D. W. Ross, Guide to Cost Benefit Analysis. Queen's Printer, Ottawa, Canada, 1965, pages 5 and 6.

Four of the techniques which have been employed for estimating recreation benefits are:

(1) The commonly-used expenditure method imputes to the recreational service the whole or part of the amount that hunters, tourists and campers spend while enjoying an area's amenities. There are two main objections to this method being used as a measure of benefit. First, it leads to an understatement of the expenditures since it does not take into account all the outlays made on supplies and transportation, before the recreation area is reached. Secondly, and more important, this method measures only the expenditure which people make to enjoy the benefit. It cannot really measure the benefit itself. Its usefulness is, therefore, limited to making calculations of local secondary benefits in the form of increases in the incomes of the suppliers of food and accommodation, etc. In a benefit-cost analysis conducted from a local point of view, these local increases in tourist income may properly be counted as secondary benefits, but from a national viewpoint many of these secondary benefits are likely to accrue somewhere in the economy even if a particular recreation project is not carried out. Hence, they should be omitted from most project analyses carried out from the national point of view since they would arise both 'with' and 'without' the project.

(2) The cost methods impute to the recreational area a total benefit equal to the cost of providing it. This assumption is sometimes found in financial analysis where the problem is one of assessing a sufficient benefit to cover the cost of a particular recreational facility. It has no place, however, in benefit-cost analyses where the problem may be to decide whether or not to create the recreation amenity, to what scale, and in what location. This method merely begs the question and does not

lead to results which are helpful in decision-making.

A minimum value for some benefits, however, may sometimes be estimated by a variant of this approach. For instance, the benefit from sport fishing may be said to be at least the retail value of fish caught, since they do in fact have this value for a city consumer. This type of estimation method may also be useful for measuring the benefit of a hunting area, but it establishes only minimum values.

In many situations, alternative costs can be used to set upper limits to recreational values. For example, consider the estimation of recreational benefits for a multi-purpose project. It is obvious here that the recreational benefits attributed must not exceed the costs of providing the same amenities by some other means (in another project). In computing the costs of the alternative, account must be taken of any additional costs of transportation, etc., involved in reaching the area.

(3) A third method imputes to the area a benefit equal to the amount the average user saves over the travelling costs of the user coming from the longest distance. The travellers who come the furthest are assumed to just break even on the trip, the recreational benefit to them being exactly balanced by the travelling costs. Then the benefit to the rest of the users is calculated as their savings on travelling costs over the costs incurred by the furthest travellers.

This approach involves some unusual assumptions that must be treated carefully before being employed in any actual measurement. It is likely to produce an underestimate rather than an exaggeration of the amount which users are willing to pay to retain the recreation area or amenity. It has the advantage that it lends itself to forecasts of recreational values. It obviously applies best where recreational facilities in

various regions are more or less uniform, e.g. picnic areas or sports fields, so that travel distances are an important consideration in establishing a new project. It applies least well to unique wildlife or scenic facilities. Also the value of the method appears to be damaged if far-travelling visitors have come to the recreation site in the course of a trip elsewhere, rather than on a deliberate trip to the project itself.

(4) The non-monetary method confines itself to a descriptive, quantitative account of the number of visitors, the length of stay, the amount they spend, the size of their catch, etc.

It must be remembered that the analyst is usually trying to make an estimate of the value of an 'intangible' benefit. The estimate, therefore, has a double element of risk, in that not only is the estimator likely to be wrong but also that those he interviews may have no clear idea themselves of their valuations, since they are never asked to pay for the services. For this reason, it is strongly recommended that all benefit-cost analyses of recreation projects be accompanied by a careful measure of the number of users, the frequency and intensity of their use, and the alternatives that are open to them in other projects. This procedure will usually be sufficient where the recreation benefit is not crucial to the overall decision (i.e. the contending projects have roughly the same recreational values). When it is necessary to attempt a monetary assessment, there should also be an account in non-monetary terms to accompany the benefit-cost analysis.

11. MEASURING COSTS

The Canadian Institute of Chartered Accountants defines cost simply as the amount, measured in money, of the expenditure incurred to obtain goods or services.¹¹ This definition immediately poses the question: What is expenditure? and it is this problem of inclusiveness of cost (i.e. what items should be included in cost) which underlies most of the controversies between accountants in their own field.

To quote an example: Assume five firms producing similar products under similar conditions. One firm is a private enterprise wholly owned by Mr. A. who provided all the capital and equipment himself. The second firm is a partnership and the partners are entitled to, besides a laid-down share in the final net profit, a fixed rate of interest on the amount of capital or goodwill brought into the partnership by each of them. The other three firms are limited liability companies. One has issued ordinary shares and debentures, the other ordinary shares and cumulative preference shares, while the third one is trading on a much smaller ordinary share capital but is making use of a considerable amount of accumulated profits.

When asked to determine costs in each of the five firms under consideration accountants would most likely bring out different results since accounting procedures do not lay down whether or not such items as interest, dividends, etc., should be included under the heading of costs. Until agreement is reached upon this question of inclusiveness of costs little progress can be expected from the side of professional accountants in the solution of problems concerning the concept of costs.

¹¹Terminology for Accountants, The Canadian Institute of Chartered Accountants, page 21.

The position in the economic field is, however, not much better and articles in economic journals often give the impression that on the subject of income and costs as much confusion exists in the field of economics as in the field of accountancy.

Although differences of opinion exist about both the accounting and the economic concepts of cost there is one aspect of it about which there seems to be general agreement, namely its use. Accountants and economists are becoming more and more aware that development of doctrine and analysis should be guided in the direction of practicability, i.e. that the concepts developed must have definite and useful purposes. It is with this thought in mind that theorists are now working to develop concepts of cost to such a perfection that the decision-maker will be able to use the final 'formula' in the solution of his problems.

The tendency is to include in the determination of cost for decision making: the primary or direct cost, the associated cost and the secondary or indirect cost.

"Primary or direct costs consist of the goods and services which must be surrendered in order to construct and operate a given project or program. Not only do they include all the monetary expenditures, but provision must also be made for economic losses whether compensated or not. Interest during construction should be taken into account, as should promotional expenses, engineering and supervision, acquisition of land and the relocation of existing facilities. The cost of financing is also a factor as is the problem of tax allowances.

"Associated costs are those costs which are incurred by the primary beneficiaries of a given project or program and which must be made in order

to realize the full value of the benefits.

"There are two schools of thought about how associated costs should be treated in the analysis, and both schools have their adherents. One school subtracts associated costs from primary benefits. Usually the projects involved have irrigation as a main purpose, and the associated costs in this case are the private associated costs incurred by farmers in preparing to use irrigation water provided by a public authority. The aim of the analyst in this instance is to isolate private from public costs involved in the project.

"The other school of thought is not interested in the division between public and private outlays. They argue that all benefits should be confronted by total costs, by whomsoever they are incurred.

"Since it is possible to affect the magnitude of the benefit-cost ratio by subtracting the associated costs from the numerator rather than adding them to the denominator, the analyst must ensure that whatever procedure is used for analyzing one project, the same procedure must be used for all projects analyzed and compared. It is recommended that since the division of associated costs must always have an arbitrary element in it, it is advisable to put all costs together in the denominator. The division of expenses can then be dealt with in the financial analysis.

"Secondary or indirect costs comprise those costs involved in the production of secondary benefits. For example, in the case of the sugar beet factory cited earlier, whose establishment resulted from the development of an irrigation project, its income constitutes a secondary benefit of the project. The costs involved in the production of sugar at the factory are secondary costs of the project.

"Intangible costs, like intangible benefits, are those values which

are not usually priced in the market. One example might be the loss of a sports fishery as a result of the construction of a dam or other works which interfere with the flow of a river. In this case, a value of recreation may be determined by one of the methods used for measuring benefits.

"An attempt should be made to attach monetary values to such effects as far as possible. Where unmeasurable costs -- such as the loss of scenic values or other aesthetic values -- are involved, a qualitative statement should be prepared, and considered together with the benefit-cost ratio in the decision-making. Treated in this way they can, at times, tip the balance away from one alternative and result in the selection of another.

"Historical or sunk costs consist of sacrifices of goods and services which have been incurred in the past. To this extent they represent a sacrifice which is over and done with. Although they have a bearing on future development, their amount cannot possibly weigh in favor of one future course of action as opposed to another. Historical or sunk costs, therefore, must be excluded from decision-making analysis. Benefits resulting entirely from historical expenditures must similarly be excluded from the analysis. In both private and public decision making, bygones must be bygones. ~~We~~ One starts with a clean slate and the purpose is to decide which future course of action is most appropriate.

"Joint costs are those expenditures of goods and services which cannot be identified with a single specific purpose. They must, in other words, be shared among several purposes. Joint costs must be distinguished from separable costs, as the latter can be fully attributed to particular purposes. In a multi-purpose water project which provides both hydro-electric power and flood control benefits, expenditures on the dam might

constitute a joint cost; whereas the cost of the turbines and generators might be fully allocated to that of the production of electricity, and expenditures associated with the erection and operation of flood gates allocated to flood control. The latter two cost categories are obviously separable costs. They can be identified with a given use; something which is not possible in the case of joint costs."^{11a}

^{11a}Sewell, W.R.D., J. David, A. D. Scott, and D. W. Ross, Guide to Cost Benefit Analysis. Queen's Printer, Ottawa, Canada, 1965, pages 6, 7 and 8.

12. THE SYSTEMS ANALYSIS APPROACH TO
DECISION MAKING

The nature of government is such that ad hoc responses to crises, and incremental changes in policy will always be facts of life. It is not possible to plan ahead for every contingency nor is it always possible, or even entirely desirable in the interests of political consensus, to avoid the trial and error process of moving ahead by small changes. Yet in our increasingly complex, interdependent society, short-range and ad hoc responses to the problems of growth and change seem increasingly inappropriate in many instances.

The conviction that there must be better ways of making decisions has led to the exploration of a variety of innovative approaches. None of these is a cure-all but they provide additional perspectives by looking at society's problems in more systematic and comprehensive ways.

One of these new aids to decision-making is the systems analysis approach. The essence of systems analysis as it relates to decision-making and control is deceptively simple. It consists of an assumed, if preliminary, objective; the derivation of alternative paths towards achieving this objective, which may itself change as the options are enumerated; the estimation of performance and cost/effectiveness measures to ensure that the chosen objective is being met by an efficient use of inputs in relation to outputs; and finally a closing of the circle through feedback mechanisms that review actual performance in the light of objectives. This process is usually dynamic -- that is, on-going and repetitive -- involving a continuous re-evaluation of alternatives, objectives, and results.

One important effect of the systems way of thinking about decisions is to stress interrelatedness. Indeed, a key ingredient in all views of

the systems approach to decisions is interrelatedness, which leads in turn to a consideration of the whole system and all the factors that bear on it. This approach is greatly appealing, but it is patently impossible to consider and quantify everything. The illusion that everything is, or can be, taken into account in decision-making may be misleading. Nevertheless, the systems way of looking at a problem and of attempting to identify the pieces provides the basis for recognizing, at least in part, what is and what is not accounted for.

Since its early trials and successes in defence and space programs in the United States, systems analysis has found a wide variety of applications. One adaptation of systems analysis to public decision-making that has received a good deal of emphasis in the last few years is the Program, Planning and Budgeting System. It is convenient to explain the systems analysis approach to decision-making under the three headings: 1) identifying the objectives, 2) designing the program-activity structures, and 3) cost-benefit analysis. In some of the literature on PPB, the terms systems analysis and cost-benefit analysis are used interchangeably though some writers have attempted to draw fine distinction between the two terms. I consider "Systems analysis" to refer to the whole analytic process including the identification of objectives and the defining of programs and activities. Thus, systems analysis, in my opinion, includes cost-benefit analysis.

The three steps in the analytical process should be taken in the order stated. Each "step," however, is unlikely to be taken just once but may recur a number of times. Tentative objectives are proposed and from these a set of potential programs are inferred. A first cost-benefit analysis is undertaken and this is likely to suggest the reconsideration

of the potential objectives and their associated programs. These restated objectives would be expected to lead to more likely programs but further cost-benefit analysis may indicate the wisdom of a second reconsideration of objectives and programs. Since the process is intended to provide a basis for action and is not carried on for its own sake, it must, of course, be suspended at some point. The essential idea to be grasped is the integrated character of systems analysis, even though for expository reasons the three main divisions of the analysis are presented separately.

Not surprisingly, systems analysis and its most distinguished offspring, PPBS, seem recently to have lost some lustre. An instinctive need for a quick and easy approach to resolving difficult and complicated social problems has often led to excesses of enthusiasm, and to "oversell." Nevertheless, it is likely that when the fad has disappeared, the idea of systems analysis and its related applications to decision-making will have survived both exaggerated claims and misguided and half-hearted implementation. Its most successful exponents have grasped and interpreted the systems concept, not as a magic wand, but as an improved way of looking at things.

While giving an important new dimension to the complex process of decision-making, systems analysis did not meet, nor could it be expected to meet, every need. On the one hand, the real world of policy-making is far too complex to fit neatly within a systems framework. On the other hand, systems analysis and PPBS were not designed to deal with issues that stand outside their organized analytical frameworks.

13. THE PPB APPROACH IN THE U.S.A.

President Johnson explained to his cabinet members and agency heads on August 25, 1965:

Good government demands excellence.

It demands the fullest value for each dollar spent. It demands that we take advantage of the most modern management techniques.

This is what I want to introduce today -- a new planning-programming-budgeting system developed by our top management experts led by Budget Director Charles Schultze. Once in operation, it will enable us to:

- (1) Identify our national goals with precision and on a continuing basis.
- (2) Choose among those goals the ones that are most urgent.
- (3) Search for alternative means of reaching those goals most effectively at the least cost.
- (4) Inform ourselves not merely on next year's costs, but on the second, and third, and subsequent year's costs of our programs.
- (5) Measure the performance of our programs to insure a dollar's worth of service for each dollar spent.

This system will improve our ability to control our programs and our budgets rather than having them control us. It will operate year round. Studies, goals, program proposals, and reviews will be scheduled throughout the year instead of being crowded into 'budget time.'

The formal system developed for PPB in the U.S.A.¹² was based on several premises: First, PPBS would be tied into the budget cycle, partly because this is the only recurring administrative process through which almost all major decisions must pass and partly because it is the government's formal resource allocation process and decision forcing mechanism.

¹²Allen Schick, "The Road to PPB: The Stages of Budget Reform," Public Administration Review, vol. 26, no. 4, December 1966. This summary on the PPB approach in the United States draws heavily on this article.

Second, the major responsibility for developing PPBS would belong to the agencies. It seemed obvious that no improvement in the decision processes or increase in the quality of information and analysis brought to bear on major issues could be made unless the decision-makers were interested in the improvement; thus, 98 percent of the staff increases went to the agencies, not the Bureau of the Budget, and, for research in support of PPBS, reliance was placed on agency funds and capabilities. The Budget Bureau did not attempt to create a capacity to do independent research of its own. Third, since many diverse agencies were to be covered, the system established had to be somewhat flexible so as to allow scope for adaptation.

Five formal parts of the PPB system were identified and their use incorporated into the budget process. These were and are program structures, issue letters, program memoranda, special analytic studies, and program and financial plans. Each of these is intended to fulfill a particular role within the process. To summarize this conception briefly, the functions of these diverse elements are as follows:

Program Structures

This is a grouping of agency activities into objective-oriented classifications so that programs with common objectives or common outputs are considered together, along with the cost of each. Programs whose outputs are closely related and are, therefore, substitutes or complements are grouped together in broad categories such as "education." Each category is further subdivided into, for example, "development of basic skills," "development of vocational and occupational skills," etc. These sub-categories are further subdivided into more detailed elements.

The major purpose of the program structure is to make possible

better analysis of agency programs by organizing cost and output information so as to include all areas relevant to a problem.

Twenty-six agencies have developed program structures. These differ widely in quality and utility. Generally, they do represent helpful ways of looking at agency activities for analytic purposes, involvement in their preparation has been educational, and they do tend to highlight programs which should be considered together. In some cases, they have had impact on officials who had not realized the breadth or triviality of agency efforts in particular fields and in pursuit of particular objectives.

Because they have not been the central focus for decision making, they have not always resulted in generation of alternatives and new ideas from the agencies. Final budgets are still resolved primarily by reference to the appropriations structure, although, increasingly, budget reviews are being conducted on the basis of the program structures with the use of a crosswalk to obtain the appropriations structure for submission to the Congress.

There are obvious improvements to be made on many of the structures. Some of them reflect primarily the present organization of an agency and do not represent a serious attempt to think through objectives; others set objectives at too low a level, thus, automatically cutting off major alternatives. Nonetheless, the concept is useful.

For the first time, for the fiscal year 1970, the U.S.A. budget included a tabulation of expenditures by agency according to the program structure.

Issue Letters

These are letters from the Budget Director to the agency heads defining the major program issues that should receive attention during the current planning and budgeting cycle. They are the product of negotiations between the Budget Bureau and each agency. The rationale behind the identification of major issues is the need to focus the limited analytic resources on the more important problems, the importance of reaching agreement upon the nature of the problems involved, and the value of analysis which can broaden the range of policy alternatives considered by the agency and the President.

The issues definition process has presented some problems. The Budget Director has had difficulty in sending the letters to the agencies early enough in the planning and budgeting cycle, in defining the issues with sufficient specificity, and in limiting the number of issues posed in relationship to scarce analytic capability.

Statistics have shown that about one-half of all issues were analyzed. The reasons for unresponsiveness range from insufficient time or analytic capability to reluctance to deal formally with sensitive problems. When analysis has been done, the proportion of analyses that have proven useful ranges from 16 percent in the human resource programs to nearly 90 percent in the community and economic development programs. In part, this reflects the greater difficulty in analyzing human resource problems than physical resource problems. It also reflects the shorter history of serious analysis or interest in analysis in the human resource agencies.

Program Memoranda

The program memorandum for a selected major program category is

intended to be a brief document summarizing the decisions made by an agency on major issues in the program category and articulating the reasons for them. It incorporates the results of any analysis bearing on the issue, identifies the alternatives considered and states explicitly the assumptions made in the evaluation.

The requirement of a program memorandum helps insure that decisions are in fact made on the basis of evidence and after consideration of alternatives, that the choices made are deliberate rather than accidental, and that they do in fact represent the decisions of the agency head. Further, program memoranda are intended to serve as bases of discussion by identifying similarities and differences in the judgments of the bureaus, agencies, and subsequently the Budget Bureau, thus promoting focused, relevant discussion of major problems. Program memoranda also should show not only current year costs, both direct and indirect, of new projects or programs but also costs in the future as well. Finally, they may serve as a means of policy guidance within an agency.

Statistics have shown that the program memoranda have been of uneven quality. Most of them have contained useful information, but only about 25 percent could be judged as adequate to excellent. Most of the others have not identified major alternatives, have not concentrated on policy decisions, or have not presented a multiyear strategy directed toward specific objectives and outputs. Many of the program memoranda tend to be descriptive, verbose, non-analytic accounts of existing and proposed programs, together with an impassioned plea for funding at the full request. This is not very helpful in making resource allocation decisions, since it is difficult to know if an "urgent necessity" is more important than a "dire national need," a "must expenditure," or a "vital

responsibility."

However, program memoranda have become important sources of program information at all levels in the executive branch because they do give a summary of information related to specific issues within an objective-oriented program category, something that seldom existed before. Where there has been a wide involvement of agency staff in preparing each program memorandum, the broad educational gains for executives and subordinates in itself may have made the exercise worthwhile.

Special Analytic Studies

This category of document is extremely broad; it means any piece of work analyzing a particular problem with the object of coming to conclusions that can be used in the policy-making process. Such studies could be economic analyses, sociological evaluations, data collection efforts, development of useful techniques, mathematical models, or almost anything else that is appropriate to the particular issue. Ideally, special studies are done in advance on the major issues that should be covered in the program memoranda. In practice, of course, the process is seldom that tidy. As a result, there are two basic types of studies: those that analyze -- in terms of whatever theory and data are immediately available -- questions which must be decided in the course of the current planning and budgeting cycle, and those that develop concepts or information for decisions which must be made in the future.

This aspect has been a successful part of the PPB innovation in the U.S.A. There is no complete census of the number and results of analysis of studies, but good ones have been done and have been inputs into major policy decisions. In some cases, public policy bargaining has

been sharpened and needless friction avoided because of revealing analysis. The preferences and judgments of the decision-maker have been applied more knowingly than would otherwise have been the case.

However, there are great difficulties involved in doing usable public policy analysis. First, analyses aimed at identifying ways to achieve national objectives are greatly constrained by the fact that several tiers of government, often with many agencies in each tier, are involved in federal grant-in-aid programs to state and local governments. Seemingly obvious improvements can be thwarted by the multiplicity of agencies and program managers, each with a de facto veto over change. Analysis concerned with improving institutions for serving the public may have higher payoff than that which merely measures returns from public investment or who benefits or who pays.

Second, some agencies tend to concentrate their limited analytical people upon fairly minor issues involving a relatively small amount of dollars or a minor social impact. Sometimes the major issues involving many millions of dollars are left to rather superficial treatment.

Third, individual agency studies do not usually encompass the full breadth of program problems when these are related to the activities of several different agencies. For example, additional manpower training objectives can be partly or completely satisfied by programs in the Labor Department, the Office of Economic Opportunity, the Department of Health, Education, and Welfare, the Veterans' Administration, and the Department of Defense. This has been a major shortcoming of the planning and budgeting process to date.

Program and Financial Plans (PFP's)

This document lays out, by program category, and for the next 5 years, the funds committed to various program areas by past decisions and, wherever feasible, projected program outputs for the same period. (It also includes 2 preceding years and thus includes a total of 7 years; for example, the 1970 program and financial plan would include budgetary commitments for fiscal year 1968 through fiscal year 1974 budgets.)

In the beginning, the agencies were asked for planning figures on how much and in what way they would spend money in the future; the result was a series of lengthy wishlists of what the agencies would like to spend on their programs if no fiscal constraints were imposed. Some agencies showed program increases in all areas of more than 25 percent per year while other agencies showed small increases reflecting a level they thought politically feasible. The lack of consistent constraints on the future availability of public resources made this exercise almost useless.

The definition of the program and financial plan was then changed to include only those future appropriations to which the government is committed by legal or moral obligations resulting from past decisions or required by present decisions. Unfortunately the definition of "commitment" used had to be somewhat amorphous which has restricted the utility of the modified program and financial plans because many agencies use a somewhat different definition of commitment and then impose an individual standard of resource limitations.

14. THE PPB APPROACH IN CANADA

In Canada, the first in the series of steps that were to lead to the introduction of PPBS was the appointment on September 27, 1960 of the Royal Commission on Government Organization under the chairmanship of J. Grant Glassco

to inquire into and report upon the organization and methods of operation of the departments and agencies of the Government of Canada and to recommend the changes therein which they consider would best promote efficiency, economy and improved service in the despatch of public business, and to report upon steps that may be taken for the purpose of

- achieving improved management of departments and agencies
- making more effective use of budgeting, accounting and other financial measures as means of achieving more efficient and economical management of departments and agencies, etc.

In volume I of the Commission's report, Management of the Public Service, a new concept, a new philosophy of management, formed the central thesis, summed up in the proposal that

departments should, within clearly defined terms of reference, be fully accountable for the organization and execution of their programs and enjoy power commensurate with their accountability.

Laying the groundwork for program budgeting, the Commission recommended, inter alia:

- (1) that the form of the estimates be revised so that the votes would more clearly describe the purposes of expenditure, that more comparable and complete supporting information be provided, and that unnecessary information be deleted;
- (2) that all cost elements of individual programs be consolidated within a reduced number of parliamentary votes;
- (3) that estimates of expenditures in these votes be prepared on the basis of programs of activity and not be standard objects of expenditure;
- (4) that more objective standards for analysis and comparison be developed and employed by senior departmental management and the Treasury Board in the expenditure review process; and

- (5) that departments and agencies be given the necessary financial authority and be held accountable for the effective management of the financial resources placed at their disposal.

In large measure, a PPB system represents an attempt to render budgeting (and policy evaluation) more goal-oriented -- more rational in the broad sense of the term. A program budgeting approach, as perceived by its exponents such as Treasury Board staff, is characterized by a union of strategic goal-oriented planning on the one hand and the budgeting process on the other. With this explicit attention to organizational objectives, and with the complementary institutionalization of a systematic scrutiny of all budgetary decisions, PPB at least on paper advances significantly beyond the scope of its predecessor budgetary models. In the words of a Treasury Board manual on the subject, a central characteristic of PPB

. . . is in its concentration on the results or output and benefits as opposed to just a consideration of the resources required. Intensive study is made of feasible alternative ways of attaining defined objectives with a view to determining the . . . greatest benefit for a given cost or . . . the approach by which a given objective will be achieved at minimum cost.¹³

In effect, an attempt is made to meaningfully relate and evaluate the resources available and possible courses of governmental action to the ends to be sought. Within the process, explicit provision is made for a systematic determination of objectives, separate from a tabulation of means available. Once objectives have been crystallized budgets can be drafted in terms of programs of operation. The aim of this structuring into operative programs in budgeting is to group the activities of an agency into

¹³ Government of Canada, Treasury Board, Planning, Programming Budgeting Guide, rev. ed.; (Queen's Printer, 1969), p. 4.

a set of program categories that facilitate analytic comparisons of the costs and effectiveness of alternative programs. Such a clustering of expenditure objects makes comprehension easier of the many governmental expenditure items, and at the same time relates these in meaningful ways to the broader goals and social functions of the public sector.

The entire PPB exercise is thus viewed as an essentially rational undertaking, the coordinate steps of which are distinct yet integrated. A basic premise of PPB "is that the relationship between the structure and implementation of budgets and the determination of policy objectives should be made explicit!"¹⁴

Thus, PPBS may be described as an information system aimed at helping management make better decisions on the allocation of resources among alternative ways to attain government objectives. Its essence is the development and presentation of relevant information as to the full implications -- the costs and benefits of the major alternative courses of action. As its name implies, planning, programing, budgeting is a combination of three related, mutually supporting, but quite distinct phases.

Planning is the initial step. It involves the formulation and projection of goals and objectives towards which the organization must direct all its activities, and the development of strategies to achieve these goals and objectives. Specifically, it involves the selection of objectives and of courses of action to attain those objectives through a systematic consideration of alternatives, using various techniques including that which is known as systems analysis.

¹⁴J. Cutt, "The Program Budgeting Approach to Public Expenditure: A Conceptual Review," Canadian Public Administration (Winter, 1970), p. 396.

Programing, the second stage, is the devising of the means that are to be utilized to achieve the objectives. It is the more specific determination of the manpower, materials, facilities and funds necessary for carrying out agreed programs -- the process of producing a long range plan that is organized by identifiable programs and activities rather than by objects of expenditure as traditional budgets are. In other words, it is a plan classified by the outputs of the organization rather than by the inputs in which the resource requirements are identified with or related to these program outputs. It is also a process that extends far enough into the future to show to the extent practical and necessary the full resource requirements for the program outputs. It, too, to be well done, is dependent on systems analysis.

The third phase, budgeting, which in its traditional form has been described unflatteringly as a means of ensuring the uniform distribution of dissatisfaction, is the process of transforming long range programs into the terms of a periodic fiscal budget, the process of laying down in the form of a detailed budget the financial implications of the programs and activities to achieve the agreed objectives.

It is to be noted that, in a very real sense, the entire PPBS process is a planning process that is concerned with time, substance and money -- short range planning concerned primarily with the use of existing facilities and resources, intermediate range planning concerned primarily with the procurement and construction of new facilities, and long range planning concerned primarily with the planning of new developments with very long lead times. Charles J. Hitch has distinguished between what he calls substantive planning and fiscal planning. Fiscal planning is the planning of future budgets -- determine the amount of money that is

available and how it is to be spent. Substantive planning is the planning of objectives -- ultimate objectives and intermediate objectives -- and developing the means to achieve them.

Crucial in the planning and programing process is the technique known as systems analysis, which has been defined as an approach to problems of decision making which proceeds by ascertaining objectives, determining constraints, elaborating alternatives and estimating costs, benefits and risks of feasible alternatives. Although there is a qualitative aspect to this process, it is primarily quantitative analysis designed to maximize, or at least increase, the value of the objective achieved by an organization in relation to the cost of the resources it uses. It involves the identification and description of alternative ways of achieving objectives; the enumeration of the principal benefits expected and the related costs; the devising of appropriate measures, preferably in monetary terms, for these costs and benefits; the construction of mathematical models for experimenting with the proposed alternatives; which in turn involves obtaining an understanding of how each proposed alternative will function, identifying the key variables and the variables that can be neglected, establishing the relationship between the key variables, and gathering the data necessary to use the models in testing alternatives under various assumptions; determining the cost of each alternative and placing a value on the benefits produced by each; and deciding on decision criteria for ranking the alternatives. It involves the use of discounted cash flows, and the introduction of interest considerations in the calculation of costs and benefits in recognition that only an interest rate can establish a relationship between values at different periods of time. In short, systems analysis involves the use of some or all of the tools that

analysts use -- mathematical equations, computer simulation models, benefit-cost ratios, discounted cash flows, utility functions or cost-benefit analysis -- to improve the planning process.

However, regardless of the complexity or sophistication with which it is applied, it is important to bear in mind that cost-benefit analysis is not the magic technique that leads directly and inevitably to the right solution. It is not, nor can it ever be, a means of eliminating the exercise of judgment. It can, however, improve judgment by encouraging the consideration of more than one course of action, by narrowing the range over which pure judgment must be applied (as more factors are known to be measurable in quantitative terms), and by making apparent the uncertainties against which plans should make provision.

To sum up, the concepts common to all planning-programing-budgeting systems are:

- (1) the setting of specific objectives;
- (2) the systematic analysis to clarify objectives and to assess alternative ways of meeting them;
- (3) the formulation of plans of achievement year by year for each program;
- (4) the projective of the costs of these programs a number of years in the future;
- (5) the framing of budgetary proposals in terms of programs directed towards the achievement of the objectives; and
- (6) an information system for each program to supply data for the monitoring of achievement of program goals and for the reassess-

ment of program objectives and the appropriateness of the program itself.¹⁵

¹⁵Planning-Programming-Budgeting Guide (Revised Edition), Government of Canada, page 8.

15. THE PROGRAM STRUCTURE APPROACH IN ONTARIO

The Treasury Board of the Province of Ontario has recently introduced a so-called 'Program Structure Approach' to the on-going task of planning and management in the public service.¹⁶

The process of establishing a program structure is essentially the systematic and hierarchical listing of functions, programs, activities and sub-activities which contribute to the achievement of approved goals and objectives. In building up a total government program structure, sub-structures are normally built for each individual department and for complete functions. In fact, the total government structure is usually arrived at through aggregation of departmental program structures.

The Program Structure serves several purposes:

- (1) It focuses attention on the basic goals and objectives of the government and of the individual departments.
- (2) Insofar as a program groups together a set of interrelated activities designed to achieve the same objective, it serves as a meaningful framework for the detailed programing of operations to accomplish objectives and to evaluate the effectiveness of programs.
- (3) The Program Structure can also be used as a framework for decision making. It indicates the interrelationships between programs and activities, it displays various possible trade-offs and alternatives, and it provides the basis for establishing the level at

¹⁶C. S. MacNaughton, Effective Management through P.P.B.S. published by the Treasury Board of Ontario, undated. This summary of the program structure approach in Ontario draws heavily on this publication.

which funding decisions should be made, i.e. the Cabinet and its committee should concentrate on the allocation of funds between functions and programs, departmental management should concentrate on the suggested allocation of funds within programs and between activities, lower levels of management should concern themselves with the allocation of funds on the sub-activity level and below.

- (4) Since budget allocations are made on the basis of program and activities the Program Structure becomes the basic network for information and reporting flows. As such it becomes a meaningful instrument for the management and control of operations.

In Ontario three basic categories have been adopted within the Program Structure: functions, programs and activities. Functions represent the major fields of involvement of the Ontario Government. They cross departmental lines and each function consists of several departmental programs. The functions focus attention on the fundamental goals and objectives of government.

Following is a list of the nine functions which have been identified for the Ontario Government:

- (a) General Government
- (b) Public Safety
- (c) Social and Economic Welfare
- (d) Health
- (e) Education
- (f) Recreation and Culture
- (g) Home and Community Environment
- (h) Transportation and Communication
- (i) Industrial Development and Provincial Resources

A program consists of a set of departmental activities which have a common objective. Programs usually focus attention on the principal objectives of a department.

Criteria for identifying a program:

- (a) A program must have an objective and be a complete entity;
- (b) A program is normally the managerial responsibility of one person;
- (c) A program must be capable of being costed, and normally of being evaluated in quantitative terms.

There are three types of programs:

- (a) Operational programs which provide a produce or service to or for the public, either directly or through intermediaries, e.g. Urban Transportation Program, Income Maintenance Program.
- (b) Departmental Support Programs which consist of the shared administrative and supporting services of a department.
- (c) Government Support Programs which provide resources or services to support the internal operations of the government, e.g. Department of Public Works: Provision of Accommodation Program.

Activities and/or sub-activities are segments of a program that identify homogeneous types of work carried out by various organizational units which contribute to the program objective:

Criteria for identifying activities and sub-activities:

- (a) An activity or sub-activity is an identifiable service, operation or process within a program, e.g. Highway Safety Program: Driver Examination, Inspection of Vehicles.
- (b) It has an intended end result within the overall objective of a program, e.g. Vehicle Safety Inspection: reduction of accidents caused by mechanical failures -- overall objective -- reduction

of number and severity of highway traffic accidents.

A sample Program Structure is shown on the next page.

The basic criteria for the development of the Program Structure are:

- (a) The Program Structure must be objective oriented, i.e. focus upon the basic goals and objectives.
- (b) The Program Structure must be a display of various alternatives and trade-offs. Within a functional area it shows the various programs, within each program it shows various alternative activities.
- (c) Programs and activities must be capable of being costed. In addition, in the case of an operational program, the social or economic benefit must be capable of being identified.

Other considerations in connection with the development of the Program Structure are:

- (a) It is essential to the successful formation of a Program Structure and the proper functioning of the system that goals and objectives are defined in fairly precise terms. The level of precision, of course, varies from quite precise at the activity level to rather broad at the function level.
- (b) Once departmental objectives have been established and approved, programs and activities can be identified within the department. During this process it should be possible to clarify which activities are included in each program and who has management responsibility for each segment. Inability to group tasks and assign responsibility is usually a sign that further study is needed. Each program should include all activities required to plan,

develop and maintain the program.

- (c) The Program Structure need not correspond to the formal organization of a department. Similar activities are normally grouped together in one organizational unit for sound administrative reasons. However, these objectives may contribute to the accomplishment of the objective of various programs. For example, one laboratory may provide analytical services to more than one program and may constitute an activity in each of the programs.
- (d) Care must be taken that for each program and activity the relevant costs, whether they be research and development, capital investment or operational costs, are identified. Difficulties arise normally where central agencies or units provide services to one or more departments and/or programs. Where apportionment of costs is impractical for accounting purposes, it will still be meaningful to identify such costs for purposes of planning and analysis.
- (e) The grouping of activities will seldom be neat and tidy. Many activities will be applicable to more than one departmental program. Probably the most frequent solution will be to place such activities in that program to which they contribute most. When sufficiently accurate and meaningful information is available, parts of the cost of one activity can be allocated to various programs. Inevitably there will be activities for which there is no reasonable basis for cost allocation and little would be gained by the attempt to assign their costs to individual programs. In such cases these may be placed in the Departmental Administration Program.
- (f) Program Structures will need to be developed and changed as condi-

tions change or as is indicated by experience. As with objectives a periodic review of the Program Structure will be required.

- (g) Descriptive statements indicating the interest, scope and content of each program, activity and sub-activity should be formulated. Titles should be short, clear and reflect the objective. A proper choice of title reflects an understanding of the issues and helps project the idea to others.

16. PROBLEMS WITH PPB SYSTEMS

With the benefit of hindsight,¹⁷ it appears that in the U.S.A. the Planning-Programing-Budgeting System was introduced abruptly, on too large a scale, and without adequate advance preparation and study. In issuing his sweeping, across-the-board order to implement PPBS, President Johnson acted against the wishes of some of the Cabinet Members who favored a more slow and careful development of PPB conceptual tools. On balance it would seem that a period of study, experimentation, and refinement of technique prior to actual implementation by all departments would have helped to eliminate much of the confusion accompanying the installation of PPBS; this might also have increased the probability of its ultimate success. Another difficulty encountered by departments was the development of meaningful measures of effectiveness or criteria for evaluation. The experience in the Department of Defence proved of little value since it was not readily transferable to other departments: it is one thing to quantify the benefits from the application of a stated volume of firepower to a specified target but it is quite a different problem to quantify the benefits to the individual, his family, and society generally of a program to rehabilitate alcoholics or criminals. As an official of the U.S.A. Department of Agriculture put it: "Perhaps the principle problem which has confronted us in the implementation of PPBS has been the development of means to measure the tangible and intangible benefits, in terms of dollars

¹⁷ U.S. Joint Economic Committee, "The Analysis and Evaluation of Public Expenditures: The PPB System," a compendium of papers submitted to the Subcommittee of Economy in Government, 91st Congress, 1st Session (Washington: U.S. Government Printing Office), 1969.

and cents, which result from the investigation phase of our operations."¹⁸

Based on criteria of an ideal system, the success of the PPB system in the U.S.A. has been limited. However, based on the criteria of improvements to the existing decision-making process, Dr. J. W. Carlson asserts that PPB has been and continues to be moderately successful, and that it has made and will continue to make an important contribution to public policy decision-making.

The basic problems, according to Dr. Carlson, are:

"1. The resources available to the government are obviously limited, and demand for their use always exceeds supply. Since few demands for government funds are clearly and completely without merit, the Cabinet needs techniques for defining objectives and priorities and insuring that public funds are used most effectively in achieving them.

"2. The portion of the budget over which the Cabinet, or the House of Assembly has effective control in any given year is small because the legal and moral commitments made by past decisions are great. Effective government requires that some technique exist to ensure that the small portion of the budget subject to discretion is foreclosed only through deliberate policy choice, not by inadvertence. This requires recognition of the extent to which present decisions, possibly minor at first glance, commit the government to future expenditures.

"3. The problems of evaluation and coordination of programs are large and intractable. It is easy to overestimate the extent to which we know the results of programs, even in terms of the simplest output

¹⁸ S. B. Bothner, Four Years of P.P.B., an Appraisal. Public Administration Reviews, July-August 1970, page 425.

measures. Readily available measurement techniques of statistics, social science, or common sense can often supply this information, but it is important that government departments and agencies use these techniques and that a method exist for incorporating their results into the government decision-making processes.

"4. Because of the size of the government and the uncertainties inherent in the problems with which it deals, the government tends to be sluggish in implementing new ideas. A large number of agencies and persons are involved in any given policy area, and the difficulties of communicating, agreeing to, and implementing policy changes are immense.

"5. There are some programs in any government which do not pay off because their costs exceed their calculated benefits, or because they do not really assist the intended target groups. The existence of moral or political claims upon society may cause such programs to continue indefinitely. No one would deny that such claims should receive careful consideration, but the government still needs a method of identifying such programs, calculating the cost of meeting the claims, and developing less costly or more effective alternatives.

"6. Planning methods devised to meet these difficulties have not been adequate. Too often, there is no link between long-range plans and either the resources which will realistically be available or the likely effect of past decisions on future resource claims. Better links between plans and probable resource availability need to be developed and more extensively applied.

"7. There is still a need to develop time-cost-performance measures and to use them. Once money is committed in a budget, there are only limited attempts to hold program managers to any predetermined plan

to use this money on a time-phased basis with performance tied to resource use."¹⁹

Dr. Carlson gives a somewhat negative picture of progress to date under PPBS when comparing the actual with the ideal: "Compared with the high hopes and expectations during 1961 in Defense and during 1965 in 20 other agencies, the system has not done as much as anticipated."²⁰

In 1968 the Bureau of the Budget of the U.S.A. Government conducted a study of the implementation and utilization of the PPB system in 16 of the federal government departments. The study attempted to ascertain how these departments had dealt with the basic changes in their policy decision-making process which were to lead to the eventual integration of the planning, program analysis and budget functions into a single decision-making process.²¹

The study reached the conclusion that in most of the departments the planning, programing and budgeting functions were not performed much differently than they were before the introduction of PPBS. Many of the departments had made some progress towards developing a decision-making process that systemized these functions but only a few had made important steps towards developing such a system.

The most important factor determining the relative effectiveness of a department's PPB effort was the active support and use of PPB by the

¹⁹ Jack W. Carlson, The Status and Next Steps for Planning, Programming and Budgeting. Joint Economic Committee Report, Volume 2, pages 614-615.

²⁰ Ibid., page 613.

²¹ "Implementation and Use of PPB in Sixteen Federal Agencies" by E. L. Harper, F. A. Kramer, A. M. Rouse, Public Administration Review, Nov.-Dec. 1969, page 623.

head of the department. Where the head of the department was interested in using PPB he saw to it that the department developed factors that aided the development of the PPB effort. The report pointed out, however, that respondents to questionnaires in most departments viewed the heads of their respective departments as being indifferent to the PPB effort. Heads of departments were classified as supportive if they evidenced their support for systematic planning and analysis by formally asking for and using analytical data and by informally talking about the benefits and usefulness of analysis.

The report found that the departments that had made substantial progress toward implementing systematic planning and analysis were characterized by the following factors:

- (a) A sufficient number of analysts were assigned to both bureau and agency level staffs.
- (b) The analysts were well qualified.
- (c) The analytic effort had access through the formal organizational structure to the heads of the agencies and bureaus, to program managers, and to lateral, particularly budget, staffs.
- (d) The informal relationships between analytic staffs and agency heads, program managers, and lateral staffs supported the analytic effort.
- (e) Agency heads strongly supported the development and use of analytic outputs.
- (f) The general attitude in the agency was that the analytic effort is primarily for the benefit of the agency rather than for the

Bureau of the Budget.²²

The confusion as to whether PPB is for the use of the Federal Bureau of the Budget (as an agency of the Cabinet) or for each department's internal use was considered to be a major deterrent factor in the implementation process. It began with the ambiguity in President Johnson's original statement on PPB when it was not clear whether the President was referring to his Office or to the Cabinet members or to both when he told his Cabinet that PPB would "improve our ability to control programs and our budgets rather than having them control us." This statement has never been satisfactorily clarified and the uncertainty still exists. Some proponents of PPB within the Federal Bureau of the Budget want to use the Departments' PPB outputs in rationalizing budget allocations among departments whereas others are concerned with building up the analytic capabilities of the Departments for departmental use. This dichotomy of interest is undoubtedly a major deterrent factor.²³

Other factors that contributed to or impeded the development of an analytic activity integrated into the decision-making process and which critically affected the development and use of analysis in some agencies but which were considered as part of the process of maturation of PPB systems in specific agencies were listed as follows:

1. The extent of the participation in system and process design of officials most concerned with the effects that the system may have

²²"Implementation and Use of PPB in Sixteen Federal Agencies" by E. L. Harper, F. A. Kramer, A. M. Rouse, Public Administration Review, Nov.-Dec. 1969, page 624.

²³Ibid., page 628.

on programs.

2. Identification of common areas of interest and a process which focuses on these areas.
3. Performance of studies which demonstrate the usefulness of analysis and the publicizing of such studies.
4. The attitude of the congressional committees responsible for an agency's substantive activity and its appropriations.
5. The attitude of the major clientele groups affected by the agency's programs.
6. The attitude of the examining group within the Bureau of the Budget responsible for reviewing and evaluating the agency program.
7. The age of the agency and/or its programs.
8. The extent to which the agency has an already developed analytic capability and the nature of the process through which these activities are incorporated into decision making.
9. The susceptibility of the agency mission to analytic effort, notably the difficulty in designing benefit measures for the evaluation of programs.
10. The difficulty of or the extent to which appropriate data and accounting systems have been developed.
11. The degree of congruity between the analytic program structure and the agency's organization structure.
12. As an outgrowth of the previous two factors, the difficulty associated with translating cost and other information from the basic appropriations accounts in which it is examined and in which programs are evaluated.

²⁴Ibid., page 631.

To be effective, the PPB system will require a good deal of centralization within the administrative branch of government, and this can pose serious problems.²⁵ If lower-level officials are left with little authority, they lose their incentive to consider and propose alternative courses of action. This problem is especially important if a variety of decisions need to be made in regional offices, which is, for example, a common case in the natural resources field. Moreover, central authorities may, in the long run, feel less pressure to consider alternatives and more pressure simply to get decisions made. As a result, they may be tempted to neglect a variety of choices open to them. More importantly, they may be inclined to underestimate uncertainties. Such trends could be dangerous since the view of the future held by these central officials plays a greater role in decisions than the view of officers in lower echelons. Central authorities may also want to limit the flexibility of lower-level officials. The result could be over-management from the top and neglect of substitution possibilities and alternative courses of action throughout the hierarchy.

Perhaps the most practical way to guard against these hazards would be to use the budget as an effective information system that would leave considerable authority at lower levels. It might be used not to increase, but to check, centralization. It could be set up to help officials reach decisions and enforce major program choices above a given dollar threshold, but not as an instrument of detailed control by a central authority. To ensure that lower-level officials will retain some decision making

²⁵ Roland N. McKean and Melvin Anshen, "Limitations, Risks and Problems," Program Budgeting (Cambridge: Harvard University Press, 1965), pp. 294-364.

authority -- for the sake of both flexibility and incentive -- these thresholds could be set relatively high.²⁶

McKinsey and Company, Inc., a management consultant firm engaged by the Bureau of the Budget to design an "integrated system development effort," reported in 1969²⁷ that "the basic mechanism for planning, programming, budgeting, and execution exists today." However, McKinsey analysts found:

- There are too many issues, often of marginal interest, typically poorly analyzed, and often submitted too late to be of practical value.
- The key Spring Preview step lacks solid input, does not systematically take a cross-agency view of the program, and produces only spotty programatic guidance to set up subsequent budget formulation.

Dr. J. E. Frank has suggested a framework for the analysis of PPB success which can be used as an initial typology of variables for a subsequent, more systematic, examination of the accumulated PPB experience.²⁸ The framework consists of two major elements. First is a typology of PPB variants which is useful for identifying a range in the degrees of success possible in PPB. Second is a set of causative variables or factors which are the primary determinants or explanatory variables contributing to the

²⁶Werner Z. Hirsch, "Toward Federal Program Budgeting" (Public Administration Review, December 1966), pp. 259-269.

²⁷"Strengthening Planning, Programming, and Budgeting in the Bureau of the Budget, A Study Briefing, prepared by representatives of McKinsey and Company Inc., mimeographed, undated.

²⁸Dr. J. E. Frank, A Framework for Analysis of P.P.B. success and Causality, Administrative Science Quarterly, December 1973.

degree of PPB success. The analysis leading to the typology of success variants proceeds from the examination of the data configuration aspects to analytic aspects and suggests six variables on the basis of which success can be measured. The analysis of causal factors distinguished between purely technical considerations, in which the technology of measurement, program analysis, and goal identification play an important role, and behavioral aspects in which the development of implantation strategies is the central concern.

An outline summary of the major factors or variables in this framework is as follows:

PPB SUCCESS VARIANTS

Data Configuration Aspects

- (1) No program categorization/program categorization
- (2) Single year costing/multiyear costing
- (3) Direct impacts/indirect impacts

Analytic Aspects

- (1) Measurement of inputs/outputs/effects
- (2) Analysis of existing/alternative programs
- (3) Latent goals/identification of existing goals/identification of alternative goals

CAUSAL FACTORS IN PPB SUCCESS

Technical Factors

Data Configuration Domain

- (1) Amount of modification needed in information network
- (2) Amount of modification needed in type of information reported

Analytic Domain

- (1) Technology of measurement

- (a) Specification problem
- (b) Instrumentation problem
- (c) Resource problem
- (d) Administrative problem

(2) Program analysis

- (a) Specification problem
- (b) Instrumentation problem
- (c) Resources problem
- (d) Administration problem

(3) Conflicting cycle times

Political-Bureaucratic Factors: Implantation Strategy

- (1) Change catalyst
- (2) Change agent
- (3) Bureaucratic response
- (4) Interaction of behavioral and technical variables

Since the inception of the PPB system in the U.S.A. and in Canada, many assertions have been made about both the wisdom and the efficacy of the effort. Many failures have been documented and well publicized. Successes have also been claimed. These have received far less attention. However, even the most enthusiastic advocate of the PPB system admits that, for a number of reasons, substantial progress toward the goal of a rational, consistent, and economic budgetary and decision process has yet to be made.

From the outset, the PPB system has encountered serious obstacles which impeded improvements in the public decision process. Among the primary impediments which have been cited by observers of the system are the following:

- The failure of many heads of departments to develop program analysis

imposed by the annual budget cycle and process to which the PPB system is tied;

- A serious scarcity of analytical personnel in the PPB offices of civilian agencies;
- A basic resistance by many government employees to economic analysis and the difficult job of program evaluation;
- The lack of professional agreement on certain basic analytical issues, such as the appropriate public interest rate for discounting long-lived public investments, the development of shadow prices when outputs are not marketed, the evaluation of expenditures with multiple objectives, and the evaluation of public expenditures in regions or periods of less than full employment;
- The lack of adequate data from which to develop measures of the social benefits of outputs and social costs of inputs.

The PPB system appears to be anchored to centuries of tradition and evolution during which time budgeting has always been conceived as a process for systematically relating the expenditure of funds to the accomplishment of planned objectives. In this sense there has always been a PPB approach in every budget system. However, the planning of the objectives and activities of government was never explicitly recognized and reflected in the budget systems -- federal, provincial and municipal -- because the management of ongoing activities and the control of spending were the two functions of budgeting which, in the past, have been given priority over the planning function of the budget. Often the planning, management and control functions tended to become competing processes in budgeting with no neat division of functions among the various participants who were often loaded with management and control functions at the expense

of the planning function. The initial problem issue of the PPB system is the balance among the three vital functions of planning, management and control and as planning takes its rightful place the transition must involve a change in staffing policy with a shift from accountants and administrators to economists since economic analysis -- macro and micro -- will play an increasing part in the shaping of budgetary policy and solving some of the problems arising from the implementation of PPBS.

17. FUNCTIONAL CLASSIFICATION OF EXPENDITURES

The Treasury Board of the Federal Government has adopted a functional classification of government expenditures which recognizes that government activity falls into a number of main areas or functions subdivided into sub-functions, functional programs and projects or activities.²⁹

A function may be defined as a major division of the total organized effort of government -- the purpose of which is to provide a distinct and separate public service such as education, public health, agriculture. It represents a grouping of the programs and activities according to the purposes they serve, each of which has significance from the standpoint of the duties and responsibilities of the government as a whole. A functional classification is useful primarily for providing general information on the nature of government services, and on the share of public expenditures devoted to each particular service. As used in the budget process, it is more informative for the general public; is of primary interest to top level legislative and executive review; and is most meaningful for the formulation, review, and implementation of broad policy objectives.

A program may be defined as a meaningful segment of the effort comprising a function -- the purpose of which is to provide an end product that is part of the basic service of government. It represents a grouping of activities that is of significance from the standpoint of the responsibilities of the organization and, at the same time, is identifiable as a part of a function. As such, it furnishes a basis for reviewing progress

²⁹ Planning-Programming-Budgeting Guide (Revised Edition), Government of Canada, Appendix A.

toward the objectives in a given functional area.

The program classification thus provides a link between the broad governmental services shown in the functional categories, and the activities that reflect the work plan of the operating agencies. This provides a useful basis for top level executive and legislative decisions on the allocation of resources among the major components of a functional area, according to their contribution to the end objectives of the total work plan.

A desirable characteristic of a program is that it produces an end product that is measurable. This is more feasible for some programs, however, than it is for others. A highway program, for example, produces a certain mileage of road; while the end product of a medical research program may be difficult to identify and measure. The lack of a measurable end product tends to militate against the establishment of a program that otherwise meets the criteria of providing a suitable basis for evaluating the achievement of functional objectives.

A project or budget activity may be defined as a division of the total effort under a program into reasonably homogeneous types of work -- the purpose of which is to contribute to accomplishment of the end product of a program. It represents a grouping of work operations that has administrative identity within the responsible organization and provides a basis for evaluating the achievement of program objectives.

Projects or activities serve as the focal point for management, providing the basis for development and presentation of budget estimates, and for accounting and reporting in budget execution. The distinctive feature of an activity is that it represents a grouping of work effort that is useful to government officials for management decisions and performance

analysis. To be of maximum value for those purposes, it is desirable that activities be capable of some form of statistical measurement -- in such terms as workload handled, employee utilization, unit costs, etc. Such measurements, however, should be developed on a practical basis in relation to the specific needs of management for evaluation of work performance under each activity. There is no standard form of measurement required for every activity in a performance budget.

For the fiscal year 1970-71, Estimates were for the first time presented to the House of Commons entirely in the program format with expenditures classified both on the basis of department, and governmental function which showed that the Treasury Board of the Federal Government of Canada had adopted the following functional classification of government expenditures: General Government Services, Foreign Affairs, Defence, Transportation and Communications, Economic Development, Health and Welfare, Education Assistance, Culture and Recreation, and Internal Overhead Expenses. The expenditures involved in Fiscal Transfer Payments to the provinces and in Public Debt are set aside under two special functions. This system has three tiers at the governmental level, function, sub-function and functional program and, to the extent that individual departmental programs fall wholly within one functional program, they form a fourth tier. The individual activities which make up departmental programs should each fall entirely within a functional program and thus make up the fifth tier.

I have attempted to set out a functional classification of provincial governmental expenditure itemizing the functions and sub-functions. The classification will, of course, require amendment as the pattern of government expenditures changes. Changes are also likely to occur because,

as the concepts and techniques of PPB become familiar and are put to use, new program-activity structures are likely to emerge which will call for a realignment of the functional relationships as suggested.

PROVINCIAL GOVERNMENT EXPENDITURE BY FUNCTION

ADMINISTRATION:

COLLECTION OF TAXES AND DUTIES

GENERAL OFFICE

CULTURE AND RECREATION:

LIBRARIES

MUSEUMS

PARKS

SPORTS

EDUCATION:

MEMORIAL UNIVERSITY OF NEWFOUNDLAND

PRIMARY EDUCATION

SECONDARY EDUCATION

UNIVERSITY COLLEGES

VOCATIONAL SCHOOLS

EXECUTIVE COUNCIL:

ELECTORAL OFFICE

GENERAL OFFICE

LIEUTENANT-GOVERNOR'S OFFICE

PREMIER'S OFFICE

HEALTH SERVICES:

DENTAL SERVICES

HOSPITAL CARE

MEDICAL SERVICES

PUBLIC HEALTH

HOUSING AND URBAN RENEWAL:

GRANTS TO MUNICIPALITIES

GRANTS TO UNINCORPORATED AREAS

HOUSING

LOCAL PLANNING AND DEVELOPMENT

NEWFOUNDLAND AND LABRADOR HOUSING CORPORATION

URBAN RENEWAL

LEGISLATIVE COUNCIL:

ALLOWANCES

EXPENSES

NATURAL RESOURCES:

AGRICULTURE

FISHERIES

FORESTRY

MINES

POLLUTION CONTROL

WATER

WILDLIFE

PROTECTION OF PERSONS AND PROPERTY:

CONSUMER SERVICES

CORRECTIONAL SERVICES

FIRE PROTECTION

LAW ENFORCEMENT

POLICE PROTECTION

PUBLIC DEBT:

SERVICING

TRADE AND INDUSTRIAL DEVELOPMENT:

NEWFOUNDLAND INDUSTRIAL DEVELOPMENT CORPORATION

PRIMARY INDUSTRIES

SECONDARY INDUSTRIES

TOURISM

TRADE DEVELOPMENT

TRANSPORTATION AND COMMUNICATIONS:

AIR TRANSPORT

HIGHWAYS AND BRIDGES

ROAD TRANSPORT

WATER TRANSPORT

WELFARE SERVICES:

AID TO AGED PERSONS

AID TO HANDICAPPED PERSONS

AID TO THE INDIANS AND ESKIMOS

AID TO NEEDY PERSONS

CHILD WELFARE

18. CHANGE FROM CASH BASIS TO ACCRUAL BASIS

Accounts kept on a cash basis record receipts and payments without regard to the financial period within which the activities giving rise to such cash movements relate. Receipts of one year may include moneys attributable to the preceding year's operations and exclude current year's revenues to the extent that they remain uncollected at the end of the year. Payments may include the settlement of debts incurred in previous financial periods and ignore liabilities arising within the current year to the extent that they are unpaid at the year-end.

Under accrual accounting goods and services for immediate consumption are charged to current expenditures when received, not when the account is paid; materials for later consumption are charged to operations only when consumed; revenues are taken into account when first determinable, not at the time they are collected.

In any discussion of the relative merits of cash and accrual accounting for the Government of Newfoundland, the differing nature of two distinct areas of need must be recognized. The overall accounts of the government must be related to the parliamentary process, in particular the Estimates and the Budget. Parliament votes money on an annual basis and is not greatly concerned with the position of expenditures month by month. Tax revenues are also budgeted over an entire year, and scrutiny of tax collections at shorter intervals has little significance.

The second need for accounting in government is quite different, for it relates to the conduct of operations by government departments and agencies. Here, the need is for accounting procedures which will effectively assist and control the operations of the Minister and his staff and

will provide accurate financial information on the cost of various programs and activities for purposes of assessing performance.

The twentieth century has witnessed the emergence in the private sector of the large and complex corporate organization which assembles vast quantities of capital and manpower to exploit industrial and commercial opportunities on a scale previously unknown. Many factors have contributed to this development, but one of its essential features has been the ingenuity applied to financial record-keeping so that the growing enterprise could continue to be managed and controlled. Thus, the relatively simple, record-keeping processes of the past has given way to modern accounting, specifically designed and continuously developed to facilitate management and to provide dependable reports on periodic performance. It was recognized that a mere analysis of receipts and disbursements of money was insufficient for the needs of the growing organization. Accrual accounting was developed to portray the results of operations in a particular period based on actual transactions rather than on the moneys passing through the cashier's window.

Today, except for very simple operations, accrual accounting is in general use in commerce and industry. An operation of any complexity cannot be satisfactorily accounted for in any other manner. By attempting to manage the operations of provincial government intelligently with records based largely on cash movements, the quality of its performance is necessarily impaired through lack of a very essential tool.

The accounting system presently in use is imperfect and illogical as the so-called modified cash basis brings into account most, but not all, expenditures on goods and services applicable to a financial year but fails

to take into account many of the revenues uncollected on the last day of the financial year.

The effort that goes into any accounting system is justified only to the extent that it produces useful information. In commerce and industry, accounting provides information for cash control and a simple receipts and disbursements system is often adequate for this purpose. The main factors influencing the design of accounting systems in the private sector of our economy are the need (1) to provide information for planning purposes, and (2) to provide information for control purposes.

Accounting facilitates planning primarily by providing cost data. Through accumulating and analyzing the costs of an organization, a product, a manufacturing process or a service, management can predict future costs assuming either the same or revised methods of operation. Points of departure for measuring the impact of change are established. Without this, the performance of the planners goes untested for there are few other objective means of measuring the results of the recommended changes. The lack of reliable, consistently prepared cost data for purposes of both planning and the assessment of plans is perhaps one of the biggest shortcomings of the government's present financial system. Unfortunately, in the current rush to develop more sophisticated planning techniques insufficient attention appears to be given to the accounting tools necessary to determine whether all the sophistication is producing results. This is particularly unfortunate since the analytical techniques, being introduced as part of the planning process, are most admirable -- however, they also require better cost data.

Accounting can provide control by recording transactions in relation

to pre-determined plans. Accounting can be like a gauge that measures progress at every step along the way, or it can record results only after the journey is over and it is too late to make any changes. Accounting information is useful only if produced regularly and quickly to cover activities over a reasonably short period of time, say a month. If plans are revised on a monthly basis and accounting information is produced on a monthly basis, it is possible to take corrective action to control progress in order to attain planned objectives by the year end.

Because the authority granted by parliament has been on a cash basis the government's accounts have not been very useful for planning or control purposes. Because of the absence of accrual accounting, costs are incomplete and inappropriate for either purpose. Although the central accounting office department has taken action to produce financial statements comparing actual and planned expenditures on a monthly basis by areas of responsibility, excessive time is spent in remedying the deficiencies of the available cash data.

True records of revenues and expenditures are necessary -- meaningful, periodic statements are essential, to the establishment of accountability. Operations of any complexity can only be satisfactorily accounted for on the basis of accrual accounting and it is difficult to see how the operations of the government can be intelligently controlled and accounted for with records based only on cash movements. The quality of the Public Accounts and of the monthly departmental performance reports will be impaired through lack of up-to-date information which can only be obtained through the adoption of the accrual system. Both the central accounting office of the Department of Finance and the various departments, agencies

and Crown Corporations should keep their accounts on the basis of accrual accounting to show currently, completely, and clearly all assets and liabilities and the full amounts of expenditure and revenue.

The basic requirement that expenditures are to be accounted for when the liabilities are incurred and that revenues are to be accounted for when earned or due, will undoubtedly result in the necessity to maintain a considerable number of accounts payable and accounts receivable. However, with a greater utilization of available computer services this aspect should pose no unsurmountable problem.

A prime requisite for the introduction of accrual accounting would be that the general ledger, kept in the central accounting office of the Department of Finance which contains the summarized accounts for the government as a whole, would have to be maintained on the accrual basis. As the information and accounting data used by the central accounting office originate for the greater part in the various departments a second requisite for the introduction of accrual accounting would be the introduction of accrual accounting as part of the departmental accounting systems.

The central accounting office would continue to keep the central accounts of the government based on the monthly summaries submitted by departmental heads while the more detailed accounts, including those for accounts payable and accounts receivable, would be maintained exclusively by the various departments.

Initially, the Deputy Minister of Finance should assist in establishing suitable and adequate accounting records based on the accrual system and he should have the right to review departmental systems to

ensure that the accounting data presented to him for integration into the central accounts of the government conform with his requirements.

19. CHANGE IN EXPENDITURE AUTHORITY

Aside from the cash nature of the recording of transactions, the other main feature of the government's accounting system is the dominant influence of commitment accounting. Commitment accounting on a centralized basis is maintained because of the tendency of departments to overspend their appropriations. Parliamentary appropriations are subdivided into allotments for purposes of executive control, and the allotments are further subdivided into encumbrances as funds are committed. As a result the accounting breakdown has become very detailed and numerous accounting entries are required to set up and eliminate commitments.

This centralized commitment system has led to an elaborate and detailed accounting system with limited usefulness because the system that is designed to prevent over-expenditures succeeds only in warning departments to request supplementary estimates or to delay the processing of expenditures as the year draws to a close; over-expenditures will only be avoided if departments are required to commit funds when the expenditure is first anticipated. Under the present system, departments can still undertake activities that would result in over-expenditures if all liabilities are discharged: The system succeeds only in preventing cheques being issued in excess of the cash balances authorized by parliament.

In order to be fully effective, the system of expenditure control

should be changed so as to allow for expenditure authority at departmental level which would also enable a more effective use of the whole budgetary system of planning and control.

Budgets in the business sector of our economy are normally guides to, not limits on, executive authority. In government, by contrast, the budgetary system was designed to establish the principle that all authority must emanate from parliament. The subdivision of the annual estimates into votes was designed both to provide authority and to limit it. The centralized commitment accounting procedures of the provincial government are designed to restrict departments to the authorities and funds provided by parliament. This has led to a proliferation of executive regulations in order to ensure that executive authority existed wherever legislative authority was absent or unclear. Unclear regulations were in turn clarified by more regulations. As a result, public servants appear to take little responsibility for the results of their actions provided there are regulations to authorize them.

I should like to recommend that departments be made responsible for expenditure authority by taking away the crutch that will exist as long as prior expenditure approval is required of a central authority. The federal government put this arrangement into effect on April 1, 1969, and the result has been an increased sense of responsibility on the part of federal public servants. There is no reason why the same effect cannot be achieved at the provincial level of government administration.

Statutory responsibilities, at present with the Deputy Minister of Finance, should be altered to place responsibility on departmental heads for certifying that expenditures will be lawful charges and that funds are available. The responsibility of the Deputy Minister of Finance should

then be to ensure that the departmental officers providing this certificate are properly authorized and to test checking to see that these authorities are properly exercised.

Administratively, the greatest gain may well be the escape from the cumbersome system of keeping track of commitments. Commitment control, as presently applied, represents a time consuming and inefficient means of remedying one of the basic deficiencies of cash accounting; that is, its failure to protect against over-spending by not recognizing transactions until they result in movements of cash. In this area alone, important savings in time and money will result from scrapping the present laborious procedures in the central accounting office and relying on the departmental accounting statements which should record transactions on an accrual basis to protect against over-spending.

20. REVISED FORM OF ESTIMATES

To facilitate the compilation of the Estimates, to co-ordinate the classification and analysis of financial data, and to utilize available data processing capabilities to retrieve and communicate information quickly, the Treasury Board of the Federal Government established in 1967 a program analysis group.

As the then President of the Treasury Board, the Honourable Edgar J. Benson, explained in announcing the creation of the group on January 26, 1967:

The group will attempt to design a computer-based system that will bring together vital information from both the public and private sectors for use by planners in the central agencies and in the various departments of the federal government. These planners will use this data to develop long-range plans for allocating expenditure based on meaningful alternative courses of action. This entire process will provide the different decision-making levels of the federal government, ranging from Parliament itself down to individual managers, with a computer-based system which will lead to decisions and courses of action, to maximize the return for the taxpayers' dollar.

It is envisaged that the same data will be used by central agencies and departments to control the operations created to fulfill these plans.

Subsequently, a classification of expenditure programs, based on economic and national accounts classifications, was developed setting out the broad functional areas of government activity including transportation and communications, economic development, health and welfare, education

assistance, culture and recreation, public debt, general government services, and internal overhead expenses.

A new classification by objects of expenditure was also developed. The estimates of all departments were revised to reflect proposed expenditures according to programs and activities, with the objectives of each program clearly stated and the activities within each program clearly described.

In the spring of 1968, a comprehensive overview of the proposed resource allocations for the fiscal year 1969-70 classified, not by departments, but by the new functions and activities, together with a forecast of the prospective revenue, was presented to ministers. On the basis of this information, the Cabinet was able to establish priorities and to make allocation decisions in terms of national objectives without the pressures that the more parochially oriented departmental estimates usually aroused.

In the spring of 1969, the federal ministers were furnished with a five-year projection of estimated revenues and resource allocation requirements in this new, departmentally independent format, and again were able, not only to consider the appropriate magnitude of the overall governmental expenditure program, but also to review and establish priorities and guidelines for resource allocation.

Allied to this emphasis on program and activities was the requirement that each department should have a financial accounting and reporting system and should develop and use indicators or measures of performance to measure the efficiency and effectiveness of programs and to enable it and the Treasury Board to evaluate the performance of the various levels of management within the department.

For 1967-68, five departments submitted their main estimates in the proposed new form organized by program and activity, together with a statement of the objective of each program, as well as in the traditional form; for 1968-69, twenty-six departments and agencies submitted their estimates in the traditional and new form; for 1969-70, all departments submitted their estimates in both forms.

For 1970-71, the estimates of all departments were prepared and submitted to Parliament in the new form only. In one section, expenditures by activity, program and object classification were shown for each department and in another they were classified according to function. In the latter section, all activities relating to an individual function of government were brought together regardless of whether they were carried on by two or more departments. In this way, members of Parliament and others are able to ascertain at a glance the total expenditures for each functional area -- health and welfare, and economic development for example.

The vertical presentation by activities is extended horizontally to show the expenditures for each activity under the headings of operating expenditures, capital expenditures, grants and contributions, total budgetary expenditures, and loans, investments and advances.

A statement of objectives and, usually, of sub-objectives is provided for each program and the program is explained through a description of the work carried on in each activity in pursuit of program objectives.

Expenditures for each program are forecast under the following twelve standard objects of expenditure.

- 01 Personal
- 02 Transportation and Communications
- 03 Information
- 04 Professional and Special Services

- 05 Rentals
- 06 Purchased Repair and Upkeep
- 07 Utilities, Materials and Supplies
- 08 Construction and Acquisition of Land, Buildings and Equipment
- 09 Construction and Acquisition of Machinery and Equipment
- 10 Transfer Payments
- 11 Public Debt Charges
- 12 All Other Expenditures

Significant changes have also been made in the process through which the Estimates are prepared for presentation to the Federal Parliament by the introduction of a two-stage approach to the examination of departmental expenditure plans.

The first stage is a review (during the summer months) of departmental five-year forecasts of estimates' requirements, on the basis of which targets are set for the following fiscal year. Each department whose funds are provided by parliamentary appropriations, either in whole or in part, is asked to provide the Treasury Board with a program review submission, setting out the department's plans for the next five years, according to programs and activities, formulating in detail the requirements for funds and personnel year by year, and seeking to justify these requirements in terms of the objectives to be served and the benefits to be gained.

The officers of the Treasury Board examine the proposals contained in these submissions individually and in their totality in the light of a set of expenditure guidelines and priorities that are in themselves the product of extensive and detailed consideration by ministers in the light of the best economic and financial information available.

A set of expenditure recommendations for further consideration by ministers is prepared. Since these recommendations almost inevitably

entail expenditure levels below those proposed by departments, they are discussed in detail with departmental officials before being put before ministers in order to attempt to achieve an agreed position and to take into account departmental preferences as between programs to the extent that these are consistent with the cabinet expenditure guidelines. With the information and advice available to them, ministers set financial and manpower targets for each program for the ensuing fiscal year.

Following this program review, the second phase of Estimates preparation and review for the substantial fiscal year begins: With the approval in principle of their plans for each program, and against the financial and manpower targets that have been set for each program, departments are asked to develop their detailed operational plans for the next fiscal year -- establishing recognized goals for each centre of budgetary responsibility and allocating the necessary funds within individual programs.

The Treasury Board's review of the Main Estimates submissions consists of an examination of departmental proposals, and of their detailed plans to confirm that they are in line with previously approved targets, and the government's expenditure policy for the forthcoming fiscal year. In addition, the Board reviews at this time the departments' detailed costing of the operational plans for each program for the new year.

The development of such a consistent and practicable pattern of Estimates for the Government of Newfoundland would require a comprehensive review of all existing program areas of the provincial government and a detailed study of the departments, agencies and establishments which carry out these programs. The Treasury Board, the Comptroller and Deputy Minister of Finance and each department will have to collaborate in an

intensive study to develop budget breakdowns suitable for both Parliamentary and operating purposes.

This study and the subsequent preparation of circulars and manuals will to a certain extent assist in the process of educating departmental staff in the new system. This in itself will, however, not be sufficient and I therefore recommend that consideration be given to the possibility that under the auspices of the Treasury Board, and possibly in co-operation with Memorial University, a number of courses in management and public accounting be developed to train departmental staff in the application of the new process and that, as a matter of deliberate policy, departments be encouraged to permit suitable members of staff to attend these special lectures which should cover all aspects of the planning, organizing and operating of the new procedures.

21. CHANGE IN THE FORM OF THE ACCOUNTING REPORTS

The accounting system of the Government of Newfoundland was designed mainly for legislative oriented control over revenues and expenditures. As a result the accounting reports produced at the Central Accounts Division of the Department of Finance do not provide all the information necessary for the efficient administration and management of government finance. In order to supplement the information it will be necessary to change the form and content of the accounting reports so that they will contain the sort of information needed to efficiently and effectively plan, organize, direct and control the management of the government's finance.

The reports presently produced at the Central Accounts Division show only yearly budget figures and actual figures to date. It is recommended that this be changed and that monthly and year-to-date figures be shown for both actual and budgeted items of revenue and expenditure and that variances between actual and budgeted figures be indicated, thereby improving the usefulness of each report.

I have listed a number of suggested accounting reports which should be produced monthly. The form, content and range of circulation of these and other accounting reports will, however, have to be determined jointly by the Budget Division of the Treasury Board and the Central Accounts Division of the Department of Finance.

Basically each form should supply the following information:

Detail		Budget		Actual		Variance	
Subhead number	Subhead name	Current month	Year to date	Current month	Year to date	Current month	Year to date
		\$	\$	\$	\$	\$	\$

1. Statement of budgetary expenditure

per department and listing appropriate subheads

Users: Departments, Central Accounts Division, Treasury Board,
Loan Guarantee and Debt Management Division

2. Statement of non-budgetary expenditure

per department and listing appropriate subheads

Users: Departments, Central Accounts Division, Treasury Board,
Loan Guarantee and Debt Management Division

3. Summary of budgetary expenditure

listing aggregates of expenditure per department

Users: Comptroller, Central Accounts Division, Treasury Board

4. Summary of non-budgetary expenditure

listing aggregates of expenditure per department

Users: Comptroller, Central Accounts Division, Treasury Board

5. Monthly budgetary expenditure transaction report

listing for each expenditure subhead: budget, commitments
brought forward, expenditure, commitments carried forward,
available balance

Users: Departments

6. Monthly non-budgetary expenditure transaction report

listing for each expenditure subhead: budget, commitments
brought forward, expenditure, commitments carried forward,
available balance

Users: Departments

7. Outstanding commitments

a listing and age analysis of outstanding commitments under
each subhead of expenditure by department

Users: Departments, Central Accounts Division

8. Available balances

a listing of available balances under each subhead of expenditure per department

Users: Departments, Central Accounts Division, Loan Guarantee and Debt Management Division

9. Statement of revenues

per department and listing appropriate subheads

Users: Departments, Central Accounts Division, Treasury Board

10. Statement of appropriations-in-aid

per department and listing appropriate subheads

Users: Departments, Central Accounts Division, Treasury Board, Loan Guarantee and Debt Management Division

11. Summary of revenues

listing aggregates of revenues per department

Users: Comptroller, Central Accounts Division, Treasury Board

12. Summary of appropriations-in-aid

listing aggregates of appropriations-in-aid per department

Users: Comptroller, Central Accounts Division, Treasury Board, Loan Guarantee and Debt Management Division

13. Monthly revenue transaction report

listing for each revenue subhead: opening balance, monthly receipts, receipts for year-to-date and comparisons with budget

Users: Departments

14. Outstanding appropriations-in-aid

a listing and age analysis of outstanding appropriations-in-aid by department

Users: Departments, Central Accounts Division

22. CHANGE IN THE FORM OF THE
PUBLIC ACCOUNTS

There appears to be an increasing measure of interest in public accounts, not only by the Members of the House of Assembly and government officials, but also, and perhaps more so, by financial institutions, universities, news media and the general public. This interest goes deeper than concern with the ever-growing magnitude of government outlays and the incidence of taxation and loan provisions. Public accounts have come to be vested with an economic significance which went almost unrecognized until recent years; they have become, as budget speeches and statements in the House of Assembly now regularly acknowledge, a major source of information which is used in shaping the economic and social conditions in the province.

Although much has been said and written in professional accountancy journals about the need for accountants to adapt their methods to the changing times, the comments have applied almost exclusively to the business world. Little has been said about one of the most important sectors of the economy -- the various levels of government which each year seem to account for a greater part of the economic activity.

Provincial governments, as Canada's biggest and fastest-growing business, are not exempt from the need to publish clear, understandable financial statements. These should be based on sound accounting principles and should reflect the efficiency of the various government departments.

In 1961, the Standing Committee on Public Accounts reported to the federal government that it had reviewed the form of the Public Accounts "from the standpoint of clarity, conciseness, and attractiveness of presentation" and "from the standpoint of the necessity of relative importance

of the material and the advisability of including it in the Public Accounts rather than in other documents such as annual departmental reports to the House of Commons." Most of the changes recommended by the Standing Committee on Public Accounts have now been incorporated in the Public Accounts of the Federal Government which are contained in three separate volumes, as follows:

Volume I

Summary of budgetary and non-budgetary transactions and changes in cash position;

Budgetary transactions;

Non-budgetary transactions (excluding unmatured debt transactions);

Unmatured debt transactions;

Change in cash position;

Change in debt position;

Federal government revenue and expenditure on the National Accounts basis

Volume II

(a) details of Expenditures and Revenues by departments;

(b) departmental sections, with details of expenditure and revenue, a summary of accounts receivable, appendices relating to operating accounts, statements showing the estimated value of major services provided to the department, the cost of which is not included as a charge to the department's appropriations, and the estimated value of major services provided to other departments for which no reimbursement is received;

(c) special statements in respect of costs of financial assistance to persons on educational leave; losses incurred as a result of

the accidental destruction of, or damage to, assets which would normally be covered by insurance had such coverage existed; all material declared surplus during the year, showing, to the extent it can be determined, its original cost and the value obtained on disposal; and accounts properly chargeable to the current fiscal year which have been carried over to the next fiscal year; and

(d) statements as required by the Financial Administration Act.

Volume III -- Financial Statements of Crown Corporations and the audit reports thereon. The table of contents lists the Crown Corporations by name and indicates in each case the minister or other government official who is responsible for the presentation of the financial statements.

As pointed out earlier, the public accounts have come to be vested with an economic significance which went unrecognized until recent years; it has become, as budget speeches and the reports that accompany the Public Accounts now regularly acknowledge, a major factor in shaping the course of economic conditions in the province.

Accordingly, it has seemed to me that changes in the form and presentation of the public accounts must proceed in part from a desire to ensure that, in the highest degree that may be practicable, the published statements -- or at least such of them as are most widely used -- shall give the public full, clear and properly proportioned information as to the conduct of the financial affairs of the province. Due recognition must be given to the extra-Parliamentary demand for clearly presented data which convey their own accurate and relevant meaning.

Accordingly, my suggested changes of the form and content of the Public Accounts proceed from a desire to ensure that, as far as is practi-

cable the accounts should provide all interested parties with true and fair statements of account that disclose essential information in a clear and concise form and present data which convey accurate and relevant meaning.

To meet the requirements of a true and fair presentation of the financial transactions of the Government of Newfoundland, it is suggested that the following principal statements should be produced from the accounting system of the province:

- (a) Statement of Assets and Liabilities,
- (b) Statement of Budgetary Transactions,
- (c) Statement of Non-Budgetary Transactions, and
- (d) Statement of Source and Application of Funds.

The principal statements of the new form of Public Accounts will thus be the Statement of Assets and Liabilities, which will report the liabilities, assets and net debt of the province at a given point in time, the Statements of Budgetary and Non-Budgetary Transactions, which will summarize the revenues and expenditures for each accounting period and will reflect both the changes in the net debt and the Statement of Source and Application of Funds which will summarize the changes in the cash position.

In its new form the Public Accounts will set out more clearly than before the changes in the financial position of the province from year to year and the reasons therefor. The new form will not, however, in any way alter the basic accounting pattern which is dictated by traditional methods of Parliamentary control and will therefore not require changes in The Revenue and Audit Act.

23. STATEMENT OF ASSETS AND LIABILITIES

In my opinion a most significant change in the form of the Public Accounts of Newfoundland, which took place in 1973, was the replacement of the Balance Sheet by a Statement of Assets and Liabilities in which the balancing figure is the Province's "Net Debt," a figure which represents the excess of current and long-term liabilities over the stated book value of the assets that have been included in the statement.

In commercial enterprises fixed assets are acquired for the purpose of earning a return, or, what in the long run amounts to the same thing, for the purpose of reducing future costs. It is accepted accounting practice that such assets are included in a balance sheet and the method used in their valuation be disclosed. In government, however, assets such as highways, roads and bridges, ferries, airstrips and pasture lands are acquired for the purpose of providing a public service. They may earn a return but this is regarded as being of secondary importance.

The procedure of including the capital assets in the Public Accounts under the heading of fixed assets (as was done from 1949 to 1972) resulted in an ever-increasing stated money value of the government's investment in such capital assets which, for financial statement purposes, became a useless figure. It is, of course, necessary that internal records be kept which reflect these investments in capital assets for control purposes, but if the Public Accounts are to serve their purpose of reflecting the financial position of the government and not as an instrument of control the inclusion in the annual balance sheet the ever-increasing amount of capital assets has little to commend.

The capital assets of the Government of Newfoundland are now

included in the Statement of Assets and Liabilities under a separate heading "Fixed Assets" at a stated nominal value of \$1.

The adoption of this procedure has also eliminated the presentation of "Extraordinary Expenses Capitalized" (formerly Schedule No. 7) on which the Auditor General commented in his 1969 Report as follows:

A cursory review of the items listed in Schedule No. 7 will instantly reveal that this item is not representative of assets of realisable value. In any calculation which attempts to derive the financial condition of the Province, this item should be eliminated.

It is a generally recognized and accepted principle of accounting that the basis of valuation of assets be disclosed in financial statements and that where the carrying value of an asset, or class of asset, is different from current value this fact should be disclosed. I should like to go a step further and recommend that in accordance with the practice, already adopted by the Federal Government, the decrease in value of any asset, or class of asset, should be taken into account by the creation of a reserve for losses on realization of assets.

To take into account the decrease in value of any asset, or class of asset, implies, firstly, the calculation or estimation of the loss in value; secondly, the recording of this loss in value by means of a credit to the reserve for losses on realization of assets; and, thirdly, appropriate action by government in acknowledging the loss in value and including the amount to be set aside to reserve as an expenditure item in the Public Accounts.

In order to estimate the initial amount which would be required to set up this reserve account it would be necessary that a thorough review be made of the present value of both the current and non-current assets included in the Statement of Assets and Liabilities. Particular attention

will have to be given to the valuation of the Government's investments in Crown Corporations and limited companies in which the Government of Newfoundland has a financial interest. Capital assets which are already recorded at their lowest possible nominal value (\$1) need not be considered for valuation purposes. The review of the current value of assets will have to be made annually in order to estimate the amount required to adjust the balance on the reserve account.

The creation of the reserve and any subsequent adjustment will, however, require the appropriation of funds for this purpose. This means that the House of Assembly will become directly concerned with the valuation of assets and their presentation in the Public Accounts, which, in my opinion, is consistent with the principle of legislative review of all revenue and expenditure.

Under this arrangement the assets of the Province shown on the Statement of Assets and Liabilities would include current assets, investments held for the retirement of unmatured debt, loans to and investments in Crown Corporations, deferred charges, and funds held in trust. From the aggregate amount of these assets would be deducted the amount of the reserve for losses on realization of assets.

To determine the correct amounts which should be included under each heading is a formidable task; in particular the valuation of investments and the estimation of the reserve for losses on the realization of assets will require a great number of man-hours of highly qualified staff. Also, in order to obtain comparative data it will be necessary to revise the corresponding financial statement of the previous year. The form and presentation of the Statement of Assets and Liabilities, in accordance with the stated recommendations, would be as follows:

GOVERNMENT OF NEWFOUNDLAND
STATEMENT OF ASSETS
as at 31st March,

	<u>(\$'000)</u>	<u>(\$'000)</u>
<u>CURRENT ASSETS</u>		
1. Cash on hand and in transit	\$	
2. Cash on deposit in foreign banks	\$	
3. Temporary investments	\$	
4. Accounts and taxes receivable	\$	
5. Prepaid expenses and deferred charges	\$	
6. Unexpended balances	<u>\$</u>	
Total Current Assets		\$
<u>NON-CURRENT ASSETS</u>		
7. Unsecured loans and advances	\$	
8. Secured loans and advances	\$	
9. Investments in Crown Corporations	\$	
10. Other investments	\$	
11. Investments held for retirement of unmatured debt	\$	
12. Securities held in trust	\$	
13. Unamortized bond discounts	\$	
14. Capital assets	<u>\$</u>	
Total Non-Current Assets		<u>\$</u>
Total Recorded Assets		\$
15. Less: Reserve for losses on realization of assets		<u>\$</u>
16. TOTAL NET ASSETS		<u><u>\$</u></u>

The total liabilities of the Province would be referred to as the gross debt and would include current and demand liabilities, trust accounts, deferred credits, and the full amount of the Province's outstanding unmatured debt.

GOVERNMENT OF NEWFOUNDLAND
STATEMENT OF LIABILITIES
as at 31st March,

	<u>(\$'000)</u>	<u>(\$'000)</u>
<u>CURRENT AND DEMAND LIABILITIES</u>		
17. Bank overdraft	\$	
18. Demand noted	\$	
19. Treasury bills	\$	
20. R.C.M.P. service rental	\$	
21. Road building contracts	\$	
22. Other current liabilities	<u>\$</u>	
Total Current and Demand Liabilities		\$
<u>LONG TERM LIABILITIES</u>		
23. Central Mortgage and Housing Corp.	\$	
24. Road building contracts	\$	
25. Other long term liabilities	\$	
26. Special funds	\$	
27. Trust funds	<u>\$</u>	
		\$
28. <u>UNMATURED DEBT</u>		<u>\$</u>
29. <u>TOTAL LIABILITIES</u>		<u><u>\$</u></u>

The balancing figure of the Statement of Assets and Liabilities would be referred to as "Net debt represented by excess of liabilities over net recorded assets":

	<u>(\$'000)</u>
Total Liabilities	\$
Total Net Assets	<u>\$</u>
Net debt, represented by excess of liabilities over net recorded assets	<u><u>\$</u></u>

The first supporting schedule to the Statement of Assets and Liabilities would present a reconciliation of the net debt positions as at the beginning and at the end of the financial year as follows:

Net Debt

Balance March 31,		\$
Add:		
Deficit for fiscal year 19../19..		
Budgetary expenditure	\$	
Less: Budgetary revenue	<u>\$</u>	
		<u>\$</u>
Balance March 31, 19..		<u><u>\$</u></u>

Although one might find fault with the nomenclature of net debt, a balancing Statement of Assets and Liabilities accompanied by a reconciliation statement showing the budgetary surplus or deficit for the year is a very useful financial statement, easily understood by the general public. Its adoption for presentation of part of the Public Accounts of Newfoundland is therefore recommended.

24. STATEMENT OF BUDGETARY TRANSACTIONS

The Statement of Budgetary Transactions and its supporting schedules should comprise all items of budgetary revenue and expenditure included in the Estimates or in additional Special Warrants for the year under review.

When the Estimates are tabled in the House each item of budgetary revenue and expenditure should be presented with its comparative figure of the (revised) Estimates for the previous year. The comparative figures for the previous year serve a useful purpose in that they indicate what amounts were appropriated under each heading for the previous year and so make possible a meaningful comparison for each item included in the Estimates for the current year.

Once the Estimates have been approved by the House the comparative figures covering the previous year have only historical value. It is therefore recommended that at the end of the financial year to which the Estimates apply the following accounting data be shown in the Statement of Budgetary Transactions and its supporting schedules: (a) the amounts of budgetary revenues received or receivable during the year, (b) the amounts of budgetary expenditures paid or payable during the year, and (c) the amount under each heading of revenue and expenditure which was included in the Budget and in Special Warrants for the year under review, i.e. the revised Estimates for the current year.

In the Statement of Budgetary Transactions budgetary revenues from Provincial sources and budgetary revenues received from the Government of Canada should be shown under separate headings. Under each heading revenues should be listed by major sources with the (revised) Estimates for each

item shown as comparative figures. If so desired, the departments or administrative units responsible for the collection of revenue or for the receipts of appropriations-in-aid can be listed on supporting schedules.

The budgetary expenditures included in the Statements of Budgetary Transactions should comprise all Parliamentary and statutory appropriations for departmental operating expenditure on current account as well as expenditure on capital assets.

Although expenditure on items of a capital nature will be charged to budgetary expenditure at the time of acquisition or construction, the distinction between expenditure on current account and expenditure on capital assets should be maintained in the Statement of Budgetary Transactions. This will assist the Government in formulating financial policies and in appraising the prudence of these policies. Moreover, the authority to borrow which is granted by the House to the Government is often based on statutory designations of certain expenditure as capital expenditure.

As the entire costs of construction or acquisition of buildings, public works, equipment and other capital assets will be charged to budgetary expenditures at the time of construction or acquisition, no provision need be made in the annual accounts for depreciation of capital assets.

All expenses of the Public Service of the Province of Newfoundland are defrayed from moneys granted by Parliament in appropriations under Supply Acts and supplementary Supply Acts. A substantial part of the payments, however, are made from appropriations-in-aid received from the federal government and from amounts received by various departments for services rendered by these departments or from the sale of surplus stores, etc.

The total amount of these appropriations-in-aid for the year ended 31st March, 1969, was approximately \$85 million. This amount has been analysed and a detailed statement, classifying the appropriations-in-aid by department and by source is presented in an addendum to this report.

For the purposes of control and accountability it is desirable that moneys received into the Consolidated Revenue Fund should be kept strictly separate from payments made out of the Consolidated Revenue Fund. It is therefore recommended that in the Public Accounts of Newfoundland the "netting" of expenditure and appropriations-in-aid be discontinued and that in the Statement of Budgetary Transactions appropriations-in-aid be shown as revenues (distinguishing appropriations from provincial sources and appropriations from the Government of Canada) and that the budgetary expenditure be recorded in full, i.e., without the deduction of appropriations-in-aid.

The following pro-forma Statement of Budgetary Transactions for the year ended 31st March 1969, is submitted for illustrative purposes only. The figures used have been derived from the Public Accounts for the year ended 31st March 1969, but because of limitations of time for detailed analysis the amounts included in the Statement must be considered to be estimates only.

GOVERNMENT OF NEWFOUNDLAND
STATEMENT OF BUDGETARY TRANSACTIONS
for the year ended 31st March, 1969

BUDGETARY REVENUE

	(\$'000)	(\$'000)
From Provincial sources:		
Taxation	\$154,275	
Other Revenue	<u>56,357</u>	
		\$210,632
From the Government of Canada:		
Grants in Aid	53,433	
Subsidies and Awards	<u>9,656</u>	
		<u>63,089</u>
Total Budgetary Revenue		\$273,721

BUDGETARY EXPENDITURE

Operating Expenditure	254,828	
Expenditure on Capital Assets	<u>81,979</u>	
Total Budgetary Expenditure		<u>\$336,807</u>
Deficit on Budgetary Transactions		<u>\$ 63,086</u>

Supporting schedules should give a breakdown of the major sources of budgetary revenue and budgetary expenditure, each heading and sub-heading to coincide with the items listed in the Estimates for the year under review. Comparative figures should be based on the related amounts set out in the revised Estimates for the current year.

An excess of budgetary revenue over budgetary expenditure during a financial year will result in a surplus on the Statement of Budgetary Transactions. An excess of budgetary expenditure over budgetary revenue will result in a deficit.

A surplus on the Statement of Budgetary Transactions will favourably affect the Province's net debt position as there has been an excess of moneys received over the amount of moneys expended. A deficit on the

Statement of Budgetary Transactions will adversely affect the Province's net debt position as there has been an outflow of money (to meet budgetary expenditure) in excess of the amount of money received (as budgetary revenue).

Thus the relationship between the Statement of Budgetary Transactions and the Statement of Assets and Liabilities will be that if the budgetary transactions during a financial year result in a surplus or a deficit (disclosed on the Statement of Budgetary Transactions) a corresponding improvement or deterioration in the Province's net debt position will result (disclosed in the Statement of Assets and Liabilities). The two statements are therefore related in the same way as a corporation's statement of profit and loss is related to its balance sheet.

25. STATEMENT OF NON-BUDGETARY TRANSACTIONS

The Statement of Non-Budgetary Transactions should summarize all financial transactions of a capital nature which have resulted in an increase or a decrease of the government's assets or in an increase or a decrease of the government's liabilities as disclosed on the Statement of Assets and Liabilities.

Non-budgetary transactions will include, inter alia, receipts from the issue of government bonds, receipts from the repayment of loans and advances, receipts from the disposal of investments. Non-budgetary disbursements will include, inter alia, amounts invested by the government in Crown Corporations and other limited companies in the form of shares and advances, and amounts required for the current redemption of government bonds or the repayment of other public debts during the financial year.

An excess or shortfall of non-budgetary receipts over non-budgetary payments will result in a surplus or deficit on the Statement of Non-Budgetary Transactions. This surplus or shortfall will be reflected in changes in the cash position of the government, which changes will be set out in detail in the Statement of Source and Application of Funds. A surplus or deficit on non-budgetary transactions will not, however, affect the Province's net debt position as reflected on the Statement of Assets and Liabilities.

Payments made by the government under guarantee arrangement and redemption of Crown Corporations debts should be treated as non-budgetary disbursements if such amounts are subsequently included as assets on the Statement of Assets and Liabilities.

If payments under guarantee arrangement or redemption of Crown

Corporation debts do not result in the creation of assets the amounts so disbursed should be treated as budgetary expenditure. If, because of their extraneous nature, the amounts so to be disbursed were not included in the Estimates for the year under review, appropriate Special Warrants will have to be obtained to allow for the payment of such expenditure.

Additions to sinking funds are amounts which in terms of issue of debentures or bonds have to be set aside in order to build up a fund which will eventually be used for the redemption of the debenture or bond liability. Since these additions to sinking funds are in the nature of transfers from the Consolidated Revenue Fund to a separate savings account, such transactions will not affect the Province's net debt position. It is therefore recommended that the setting aside of amounts as additions to sinking funds be regarded as non-budgetary transactions and be included as such in the Statement of Non-Budgetary Transactions.

The following pro-forma Statement of Non-Budgetary Transactions for the year ended 31st March 1969, is submitted for illustrative purposes only. The figures used have been derived from the Public Accounts for the year ended 31st March 1969, but because of limitations of time for detailed analysis the amounts included in the Statement must be considered to be estimates only.

GOVERNMENT OF NEWFOUNDLAND
STATEMENT OF NON-BUDGETARY TRANSACTIONS
for the year ended 31st March, 1969

<u>NON-BUDGETARY RECEIPTS</u>	<u>(\$'000)</u>	<u>(\$'000)</u>
1. Proceeds from demand loans	\$138,896	
2. Proceeds from sale of debentures	58,574	
3. Proceeds from sale of treasury bills	22,750	
4. Loans from C.P.P. Investment Fund	14,237	
5. Proceeds from loan repayments	1,504	
6. Loans from N.M.F.C.	485	
7. Loans from C.M.H.C.	412	
8. Proceeds from investments	<u>194</u>	
Total Non-Budgetary Receipts		\$237,052
 <u>NON-BUDGETARY PAYMENTS</u>		
1. Repayment of demand loans	131,096	
2. Purchase of treasury bills	34,439	
3. Investments in N.I.D.C.	9,496	
4. Repayments of loans	9,142	
5. Payments into sinking funds	7,361	
6. Investments in Churchill Falls (Lab.) Corp. Ltd.	<u>2,500</u>	
Total Non-Budgetary Payments		<u>194,034</u>
 EXCESS OF NON-BUDGETARY RECEIPTS OVER NON-BUDGETARY PAYMENTS		 <u>\$ 43,018</u>

26. STATEMENT OF SOURCE AND APPLICATION
OF FUNDS

This accounting statement, designed to highlight the changes in the financial position between the beginning and the end of the financial year, should show in summary form the amounts and the sources of funds that became available to the government during the year and the uses to which these funds were applied. The statement should not be regarded as a supporting schedule to the Statement of Assets and Liabilities or to either of the operating statements even though it is based on the data contained in those statements. The Statement of Source and Application of Funds should be regarded rather as a complimentary statement, important in its own right in that it presents, for the financial year under review, a significant summary of financial aspects which information cannot easily be obtained from the other financial statements.

I therefore recommend that the present Statement of Source and Application of Funds be extended to include additional information on the acquisition and disposition of funds and that the new statement becomes one of the three major operating statements of the Public Accounts. Some of the detailed information presently included in the Consolidated Revenue Fund Account (Statement No. 2 of the Public Accounts) may very well be included in the revised Statement of Source and Application of Funds.

The revised Statement of Source and Application of Funds should be a clear statement of the source and application of all moneys flowing into and out of the Consolidated Revenue Fund during the financial year and should reflect the impact of all governmental income and expenditure on the balance in the Exchequer account. The statement should, therefore, include both the budgetary and non-budgetary transaction.

On the receipts side, in addition to the budgetary tax and non-tax revenues, it should include receipts from the repayments of loans, investments and advances; premiums, employee and government contributions and interest credits to pension and other trust accounts, as well as moneys received and credited to the deposit and trust accounts.

On the disbursements side, it should include, in addition to budgetary expenditures, net loans, investments and advances to Crown Corporations, municipalities, limited companies and individuals; pension, and other benefit payments; and deposit and trust fund payments. The proceeds of government borrowing and of the sale of government securities, less the redemption of matured government bonds, and the purchase of securities for the government's investment and sinking fund portfolios are added to the net budgetary and non-budgetary transactions to determine the net increase or decrease in the Exchequer Account.

The Consolidated Revenue Fund Account published as part of the Public Accounts is a summary statement of receipts and payments for the year under review signed by the Comptroller of Finance and certified by the Auditor General. The major items shown on the debit side are the Exchequer Account overdraft with the Bank of Montreal at the beginning of the year, the revenue and appropriations-in-aid received and the proceeds of debenture issues (net of discounts and commissions). The major items on the credit side of the account are the expenditure on Consolidated Fund Services, the expenditure on various Supply Services (details of which are given in a supporting statement), net redemption of temporary borrowings and the amount of temporary investment made during the year. The balancing figure on the Consolidated Revenue Fund Account is the Exchequer Account overdraft with the Bank of Montreal at the end of the year under review.

It is my contention that the introduction of the four major accounting statements, as recommended, will provide a clear and informative summary of all the financial operations of the Government of Newfoundland during a financial year. To add to these operating statements an extract of a cash account (namely, the Consolidated Revenue Fund Account) appears to me to be superfluous. Such extracts may be, and in the government's system of accounting certainly are, of great value for internal control and management purposes but they add little, if anything, to the value of the Public Accounts. I therefore recommend that on the introduction of the four major accounting statements the Consolidated Revenue Fund Account be deleted from the Public Accounts.

27. CONCLUSION

The P.P.B. system is not just a complex way of preparing a budget, it is an important management tool which will help the Provincial Government in its planning and in its day-to-day decision making. However, in order to be effective the P.P.B. system must be linked to an efficient public accounting system that can provide summaries of data on all plans, programmes and budgets on a continuously updated basis so that the whole fabric of government activities is, as it were, always on view. The accounting system should be organised in such a way that the performance data of accepted government programmes are provided side by side with the budgeted figures, so that meaningful comparisons can be made from which can be judged whether realization is keeping pace with the intended progress and progress can be monitored against fulfilment of the approved objectives.

Admittedly there are many and various problems of implementation such as the difficulty, often impossibility, of measuring future costs and benefits. Nevertheless, it may be concluded that a system of this kind, through the marshalling and meaningful presentation of the applicable data will help to reduce the amount of guesswork which inevitably must take place in government planning and budgeting. Perhaps the most important aspect of the suggested system will be that the plan, the programme, the budget and the execution thereof are brought together in the system of public accounting. Facts will become at once apparent and will enable the government to decide from day to day what changes to make in certain programmes or how much additional finance will have to be provided.

This linking of the P.P.B. system with the system of government

accounting will also be very useful when applied to the overall financing decisions of the Provincial Government. The traditional provincial budget summaries have always been presented in the form of estimates of all the government departments and agencies that use public funds, under separate headings: so much for this department, so much for that department, and so on. When the new system is fully operative the estimates for a fiscal year will be drawn up in terms of the accepted government programmes and, at the end of the fiscal year, the Public Accounts will repeat the amounts of the original (or amended) estimates under similar headings and will disclose the amount actually spent on each programme during the fiscal year (determined on the accrual basis of accounting).

The effective linking of the provincial government's planning and programming with its budgets and public accounts must result in a system that will facilitate policy decision making and lead to a better allocation and use of the province's financial resources.

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