AUDITOR GENERAL OF NEW BRUNSWICK | VÉRIFICATEUR GÉNÉRAL DU NOUVEAU-BRUNSWICK

CLEAN AUDIT OPINIONS ARE IMPORTANT

Auditor General's comments regarding audit opinion on 31 March 2015 financial statement of the Province of New Brunswick

October 1, 2015

Under section 11 of the *Auditor General Act*, I am legislated to audit the financial statements of the Province of New Brunswick (the "Province") and to express my opinion as to the fair presentation of the financial statements.

Professional audit standards establish when it is appropriate for me to express an "unqualified opinion" also referred to as a clean opinion. Alternatively, professional standards establish when a "qualified opinion" or in other words, a reservation is warranted for inclusion in the opinion.
In the auditing profession, a qualified audit opinion is a rare occurrence in the public sector. It indicates to the users of the financial statements that some of the information is misleading or not auditable.

After many meetings and discussions with the Department of Finance and the Office of the Comptroller, on 29 September 2015 I signed the audit opinion on the Province's 31 March 2015 financial statements. On this date, I issued a reservation or a "qualified audit opinion" on the financial statements in regards to the Province's accounting for Shared Risk Pension Plans.

This is first qualified audit opinion on the Province's financial statements in 17 years.

This document has been prepared to clearly explain the significance of issuing a qualified audit opinion. Further details will be contained in my next annual report to the Legislative Assembly, expected to be tabled in December 2015.

Kim MacPherson

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Auditor General of New Brunswick

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1. **What is a qualified audit opinion?**
2. **Why should taxpayers be concerned?**
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4. **In more technical terms, what is the problem?**
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1. What is a qualified audit opinion?

A qualified audit opinion is a rare occurrence in the public sector. It indicates to the readers of the financial statements some of the information presented is either misleading or not auditable. When auditors issue a qualified opinion, they are communicating they have a major concern with:

- The availability of sufficient and appropriate evidence; or
- The entity's compliance with accounting standards (GAAP).

An auditor may issue a qualified audit opinion when parts (but not all) of the financial statements are inaccurate or lack support.

2. Why should taxpayers be concerned?

This is more than a disagreement among accountants. When the Auditor General, who is independent from government, disagrees with the Department of Finance and those responsible for preparing the financial statements, it brings into question the credibility of the numbers.

In this case, the Province's financial statements do not properly account for the four Shared Risk Pension Plans. These four plans contain more than $14 billion in pension plan assets at 31 March 2015. The financial statements do not reflect the risk inherent in the design of a Shared Risk Pension Plan.

In the Auditor General's opinion, this means that readers of the financial statements, such as the public, elected officials and credit rating agencies, cannot fully assess the fiscal situation using the Province's financial statements for the year end of 31 March 2015.

The deficit reflected of $388.6 million would be different had the four plans been accounted for properly, however this difference cannot be determined as sufficient information was not provided by the Province.

Furthermore, when the Auditor General qualifies an audit report for accounting standards compliance, she must continue to qualify it each and every year after until changes are reflected that satisfy the Auditor General.

3. In general terms, what's the problem?

Last fiscal year, the **Defined Benefit (DB) pension plan accounting** was the accounting method used to account for the Public Service Shared Risk Pension Plan (PSSRP). This was agreed on by the Province, Auditor General and external experts.

This year, nothing changed in the pension plans, but the Province changed its accounting to ***Defined Contribution (DC) pension plan accounting.*** This change, however, was not supported by external experts or the Auditor General and the Province did not provide sufficient support to justify the change.

The result of changing from **Defined Benefit (DB) accounting** to ***Defined Contribution (DC) accounting*** means the Province no longer records future pension payments as a liability in the books. For PSSRP, it erases over $4.7 billion in pension assets, which are typically offset by $5.1 billion in liability relating to future pension payments.

4. In more technical terms, what is the problem?

Essentially, the issue relates to the difference between a ***Defined Benefit (DB) pension plan*** and a ***Defined Contribution (DC) pension plan*****.** (Definitions are available at the end of the document)

Public Sector Accounting Standard on pensions (PS 3250 - Retirement Benefits) does not fully address unique arrangements such as shared risk pension plans. PS 3250 also states that "because benefit plans are often complex, careful analysis and professional judgment are needed to determine whether the substance of particular plan makes it a defined benefit or a defined contribution plan."

As of March 31, 2015, four of the Province's pension plans have been converted to a joint trusteeship form of pension plan.

Converted Plan Name	Conversion Date
Public Service Shared Risk Pension Plan (the "PSSRP")	**January 1, 2014**
New Brunswick Teacher's Pension Plan (the "NBTPP")	**July 1, 2014**
Shared Risk Pension Plan for CUPE Employees of New Brunswick Hospitals (the "H-CUPE")	**July 1, 2012**
Shared Risk Pension Plan for Certain Bargaining Employees of New Brunswick Hospitals (the "H-CBE").	**July 1, 2012**

The Province has accounted for the four plans using defined contribution accounting.

In the March 31, 2014 consolidated financial statements, the PSSRP, was correctly accounted for using defined benefit accounting. There have been no changes to this plan during this audit year nor has management provided sufficient justification to support a change to defined contribution accounting. Therefore, defined benefit accounting should have continued at March 31, 2015
For the NBTPP, the H-CUPE, and the H-CBE, given the absence of pre-conversion benefits guarantees, as in the PSSRP, these three plans should have used joint defined benefit accounting. In addition, joint defined benefit accounting should be used for the H-CUPE, and the H-CBE because the past contribution liability of $66.9 million established upon conversion of these plans (for a past shortfall in employer contributions) has now been extinguished.

5. **Has there been a qualified audit for the Province of New Brunswick before?**

Yes, a qualified audit opinion has been issued for the Province before, but it is a rare occurrence. The last time an Auditor General of New Brunswick had a reservation on the Province's audited financial statements was 17 years ago in 1998. In that year, there were two concerns regarding:

- The carrying value of the investment in New Brunswick Power Corporation, and
- The method of recognizing revenue received from Canada relating to the implementation of the Harmonized Sales Tax (HST).

Definitions:

Defined Benefit (DB) pension plan: This method requires the Province to calculate and record a liability for future payments to current and future retirees. It is a less risky structure for the employee, but more risky for the Province. It is structured to provide members with predetermined income benefits at retirement. The Province contributes towards the pension and in addition offers more security to members as the pension promise is based on benefits to be paid during retirement. The Province would step in financially if the investments dramatically crash in order to ensure that members receive their retirement income benefits.

Defined Contribution (DC) pension plan: This method results in the Province not calculating or recording a liability for future payments to current or future retirees. The Province only records its yearly contributions to the plans. It is more risky for the employee, with no risk for the Province. It is structured to provide members with retirement income, but is only meant "to help individuals accumulate retirement savings during their active career"[1]. This means the Province still contributes towards the pension, but does not guarantee a return nor does it guarantee income benefits to be paid at retirement.

GAAP: Generally Accepted Accounting Principles (the industry standard)

[1] https://hoopp.com/Learning-Resources/Defined-Benefit-Plan/Comparing-Retirement-Options/