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Introductory Comments

New Auditor General appointed

1.1 The past year has been one of transition for our Office. Mr. Ralph Black, FCA retired on 4 April 1997, Mr. Ken Robinson, CA served as Acting Auditor General until 31 August and my appointment was effective 1 September 1997. These significant changes seem to have had little impact on the volume of work performed by our Office and our ability to offer objective information and recommendations to government and the Legislative Assembly.

1.2 As I begin my eight-year term as Auditor General, I have looked extensively at our governing legislation (The Auditor General Act) and have been pleased with two sections in particular. Section 13(2) states that "Each report of the Auditor General……shall indicate anything he considers to be of significance and of a nature that should be brought to the attention of the Legislative Assembly." This section enables our Office, which is separate and independent from government, to provide New Brunswick citizens with objective information on the performance of their government. This puts on us a tremendous responsibility to select and report on the issues which will be of most interest to our citizens and legislators.

1.3 The second section of interest is Section 14(2) which states "The Auditor General may advise appropriate officers and employees in the public service of New Brunswick of matters discovered in his examinations and, in particular, may draw any such matters to the attention of officers and employees engaged in the conduct of the business of the Board of Management." This section enables us to be of assistance to the executive branch of government, and this is also an opportunity which I will take seriously. As you read this year's Report of the Auditor General you will find examples of the application of both Sections 13(2) and 14(2).

Government should comment on its own performance

1.4 At the time this Report is being prepared I have been Auditor General for only ten weeks. While this has not been long enough to formalize a set of goals for my term, there are a number of issues which I feel quite comfortable highlighting. The first is improving the accountability of government to the Legislative Assembly and the citizens of New Brunswick, an initiative which has been a priority of ours for a number of years. The ultimate goal in this area would be to have government explain its goals, its activities and its results, in sufficient detail that the citizens of New Brunswick have a good knowledge of how their tax dollars are being spent. Without a high level of accountability, taxpayers will continue to be sceptical and will need to look to other sources for objective information. One such source is our annual Report.

1.5 On this point, I was surprised by the amount of information which we provide in Chapter 2, Comments on Financial Statements of the Province. I now understand the importance of this chapter, because without it, there would be no comprehensive analysis or narrative on the Province's financial results made available to the general public. I believe this type of information should be prepared by government and be incorporated, with the financial statements, into an annual report. A lot of attention is given each year to the Budget which is a document that combines financial information with explanatory narrative. This document, which is government's way of telling the public how it intends to spend its money, is presented in the Legislature and traditionally receives a lot of media attention. The accountability cycle would be completed by government preparing a narrative explaining how actual results compared to the budget. Reporting on and explaining any historical trends, either of a positive or negative nature, would also be appropriate.

1.6 Setting budgets and subsequently reporting on actual results is only one facet of accountability. As important, is knowing the other operating plans of government. What is government planning in the way of service delivery, and what are the performance indicators that make sense for its various departments, Crown corporations and agencies? Are these indicators being identified and reported on? This is a second area where I can see a lot of emphasis being placed in the years to come. A major goal for our Office is to promote the use of relevant indicators and to encourage reporting on them, both from a planning and accomplishment perspective. I understand our Province has already made good progress in this area by publishing departmental performance indicators and targets. Departments will be expected to report their progress towards achieving these targets, beginning with their 1996-97 annual reports.

Timeliness is crucial

1.7 Information is only useful if it is timely. A third objective which I have is to improve the timeliness off all information, whether from government or my Office. As for government, I was very pleased to see the tremendous progress made by the Comptroller's Office in having the 1997 financial statements issued on 13 August, eight weeks earlier than last year and eighteen weeks earlier than two years ago. We still believe the statements can and should be released earlier. In prior years we have pointed to a goal of within three months of year end, which would be prior to 30 June.

1.8 As for our own work, we too must be timely. At the present time we issue one Report before the end of December. This means that work we are performing now, in the fall of 1997, will not be reported publicly until December 1998. This is not acceptable. I will be examining the possibility of issuing two or more reports each year.

1.9 The issue of timeliness is one example of a philosophy which I will maintain throughout my term as Auditor General. The philosophy is that our Office must lead by example. We cannot make pronouncements on timeliness and not be timely ourselves, and we cannot ask others to identify and report on performance indicators and not do so ourselves. We too spend taxpayers dollars and we must demonstrate to New Brunswickers that the money we are given is being spent effectively, and with due regard to economy and efficiency.

Our work over the past year

1.10 Over the past year our Office has undertaken work in the departments of Health and Community Services, Economic Development and Tourism, Education, Municipalities, Culture and Housing, Solicitor General, Supply and Services, Finance and Natural Resources and Energy. The audit at Atlantic Lottery Corporation Inc., which had been undertaken as a joint project between ourselves and the Auditor General's Office of Nova Scotia, was completed. The final report was tabled in New Brunswick with the Lotteries Commission. Details on our work in all these areas and any resulting recommendations can be found in the following chapters. There are three observations which I would like to make at this time.

Contracts should be signed before work begins

1.11 The first observation is related to the failure to have agreements or contracts signed before work is undertaken or services provided. In the past year we noted that IBM undertook to perform work in the Department of Finance without an agreement being signed. In fact an agreement was not finalized until after the project had been terminated. Our review of the Air Ambulance Service noted that the lease agreement with the service provider was not signed until 1 October 1997, eighteen months after the commencement of the service. In our 1995 Report we observed that "…all of the undertakings with Anderson Consulting should have been set out in a contract prior to the firm commencing this work."

1.12 To ensure that the interests of the Province are adequately protected I believe that no work should commence on any project until negotiations are complete and necessary agreements are signed.

The role of Crown agencies needs to be clear

1.13 My second observation is with respect to governance, and in particular the governance of Crown agencies. A lot of public service is being delivered through Crown agencies and it is important that each agency is fulfilling the wishes of the Legislative Assembly, and reports on a regular basis on how its objectives are being met. We want to see more accountability by all government operations in general, and this includes the work undertaken by Crown agencies. This year we highlight the Atlantic Lottery Corporation Inc. and have made a number of observations and recommendations relevant to that corporation. The observations and recommendations can be seen in Chapter 12. Two observations are critical. One is that the strategic plan for ALC has not been approved by the Province. The other is that ALC's annual report does not provide performance reporting information that would allow the reader to assess the degree to which the corporation has met its corporate strategic goals, and therefore its mission. These comments are very similar to ones we made last year as a result of our review of other provincial Crown agencies.

1.14 The Province and its Crown agencies should have a clear understanding of their roles, responsibilities, and duties. Each Crown agency should report sufficient, relevant information to allow the government and the Legislative Assembly to determine the degree to which the agency has achieved its mission.

Public-Private Partnerships need to be assessed

1.15 My third observation is with respect to Public-Private Partnership arrangements. This is a relatively new way for governments in general and New Brunswick in particular to acquire a particular service. This method does not have all the checks and balances that we have become accustomed to in the normal public tendering system.

1.16 This year we examined the Revenue Management System which was to have been developed by IBM. The results of our work can be found in Chapter 6. While we make a number of observations and recommendations on that particular Public - Private Partnership, we are not in a position to generalize on the appropriateness of Public-Private Partnership arrangements. In fact, we are pleased to see innovative thinking and a willingness on the part of government to try new ways of doing things, two attributes government administrations are often accused of not having. Our work however did reveal significant risks in proceeding with Public - Private Partnerships. We were particularly concerned over the lack of independence in preparing the business case, and the fact that there is no separate determination of the best way to achieve results. The success of this procurement process is also very dependant on government’s ability to successfully negotiate and administer the necessary contracts.

1.17 The government is quickly gaining experience with Public-Private Partnerships. It would be appropriate for government to carefully examine its results to date, and to determine whether this procurement method is delivering solutions in the most economical and efficient manner possible.

Acknowledgements

1.18 During the course of our work we were pleased with the professionalism that we saw in provincial staff and their interest in doing good work for the taxpayers of New Brunswick. In those areas where we noted shortcomings and made recommendations we believe they were generally accepted in a positive light, accompanied with a sincere undertaking to take necessary corrective action.

1.19 Although it is my honour to submit this Report I am indebted to Mr. Ralph Black, Mr. Ken Robinson and the staff members of my Office who worked so hard and diligently to make it possible.

Daryl C. Wilson, FCA
Auditor General

Chapter 2
Comments on the Financial Statements of the Province

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Comments on Financial Statements of the Province

Background

2.1 The Auditor General Act requires us to examine the financial statements of the Province of New Brunswick and express an opinion as to whether they fairly present information in accordance with the stated accounting policies of the Province.

2.2 The Province's audited financial statements are included in Volume 1 of the Public Accounts. Volume 2 provides supplementary unaudited financial information. The financial statements of Crown agencies and trust funds are contained in Volume 3.

2.3 We have three primary goals in this chapter of the Report:

- **To help the reader form an opinion on how the financial resources of the Province have been managed.** We do this by reporting a series of indicators of the Province's financial condition and by providing year-to-year comparisons where possible.

- **To help the reader interpret the Province's financial statements.** We explain key changes in the financial statements since the previous year. We also present additional information from an objective viewpoint which provides a clearer picture of matters reported in the financial statements.

- **To focus on important issues related to the financial statements**. There may be situations where we agree with the presentation followed but we feel there are other relevant facts which the reader should consider. In other cases, we may disagree with how an event is reflected in the financial statements. We will explain our point of view.

2.4 From time to time the Province makes major changes in accounting policies. For example, there was a major change in 1994-95 with the introduction of consolidated financial statements for the first time. These changes make year-to-year comparisons of financial results difficult. Because it is not always possible to restate previous years' data, comparisons to that data could be misleading and as a result should be done very carefully. We will attempt to make it clear when we have used data from previous years that was not restated for consistency with subsequent changes in accounting or disclosure.

Scope

2.5 In fulfilling our responsibility to carry out the audit of the financial statements of the Province of New Brunswick, we conduct audits in accordance with generally accepted auditing standards. Based on the results of our audits, we issue an opinion on the financial statements of the Province. This chapter of the Report presents an overview of the main issues arising from the 1997 audit of the financial statements. Matters that have arisen during the financial statement audits that relate specifically to departmental operations, government programs, Crown agencies and trusts are discussed elsewhere in this Report.

Results in brief

2.6 The Province issued its audited financial statements almost eight weeks earlier than the previous year.

2.7 Further changes have taken place in the composition of the reporting entity, but hospitals continue to be excluded.

2.8 There are a number of important accounting issues that the Province should be addressing.

2.9 The government is becoming more involved in leasing buildings instead of constructing them. The change carries accounting and financing implications.

2.10 Costs of highway construction have been recorded as property held for resale at year end in anticipation of a highway lease.

2.11 Government borrowing cost and the net debt balance have fallen for the past two years.

2.12 The Province recorded its second consecutive annual surplus.

The Province met its target for early release of its financial statements

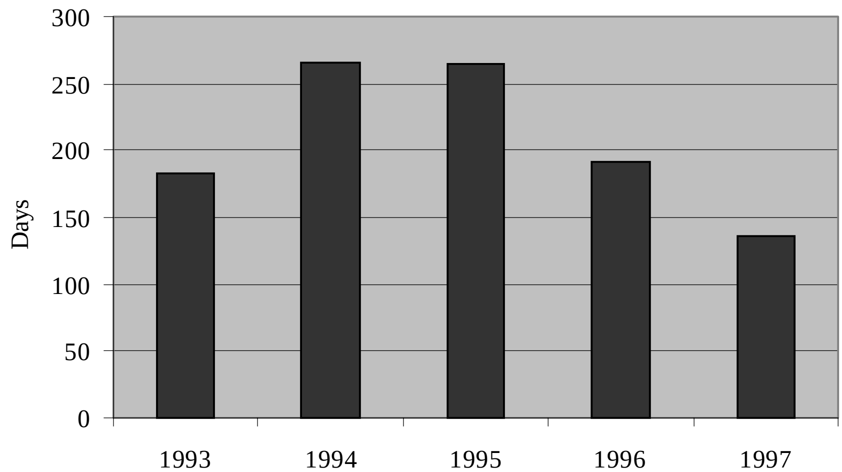
2.13 The 1996-97 financial statements were issued on 13 August, an improvement of almost eight weeks over 1995-96 and an improvement of over eighteen weeks on the 1994-95 year. These are significant improvements!

2.14 For several years we have focused on the need for the earlier issuance of the Province’s financial statements to the public. We expressed concern that there was no commitment by the Province to complete its financial statements in a timely manner. We pointed out there are significant benefits not only to the users of the financial information but also to those involved in the preparation of the financial information if the financial statements are issued consistently on a timely basis.

2.15 The Province responded in 1996-97 by setting a deadline of 31 August for the issuance of the audited financial statements. That deadline was surpassed by over two weeks.

2.16 The number of days between the end of the fiscal year and the issuance of the financial statements for each of the past five years is shown graphically below.

Exhibit 2.1
Number of days between the end of the fiscal year and the issuance of the financial statements



2.17 It is not a simple matter to advance the issue date of the financial statements, particularly in the year of change. Although the Comptroller's Office has the responsibility for preparing the statements, a large number of people in the departments and agencies of government are also involved in the process which supports the preparation of the financial statements.

2.18 The changes made to facilitate the earlier release were significant. The procedures normally followed at year end were altered, leaving less time for preparing and adjusting the financial information used in the statements. Such changes undoubtedly had an effect on work plans and priorities of government staff.

2.19 The impact on our Office was also significant. In each of the last two years, as the deadline for the completion of the audit was set earlier, our audit plan for the Province had to be compressed into much shorter periods. A major effort was put forward by our staff to see that these important deadlines were achieved in spite of the reductions in the available time.

2.20 None of the positive changes would have taken place without the will of government to either allow it or promote it. The government fulfilled its role by instructing staff to issue the financial statements no later than 31 August.

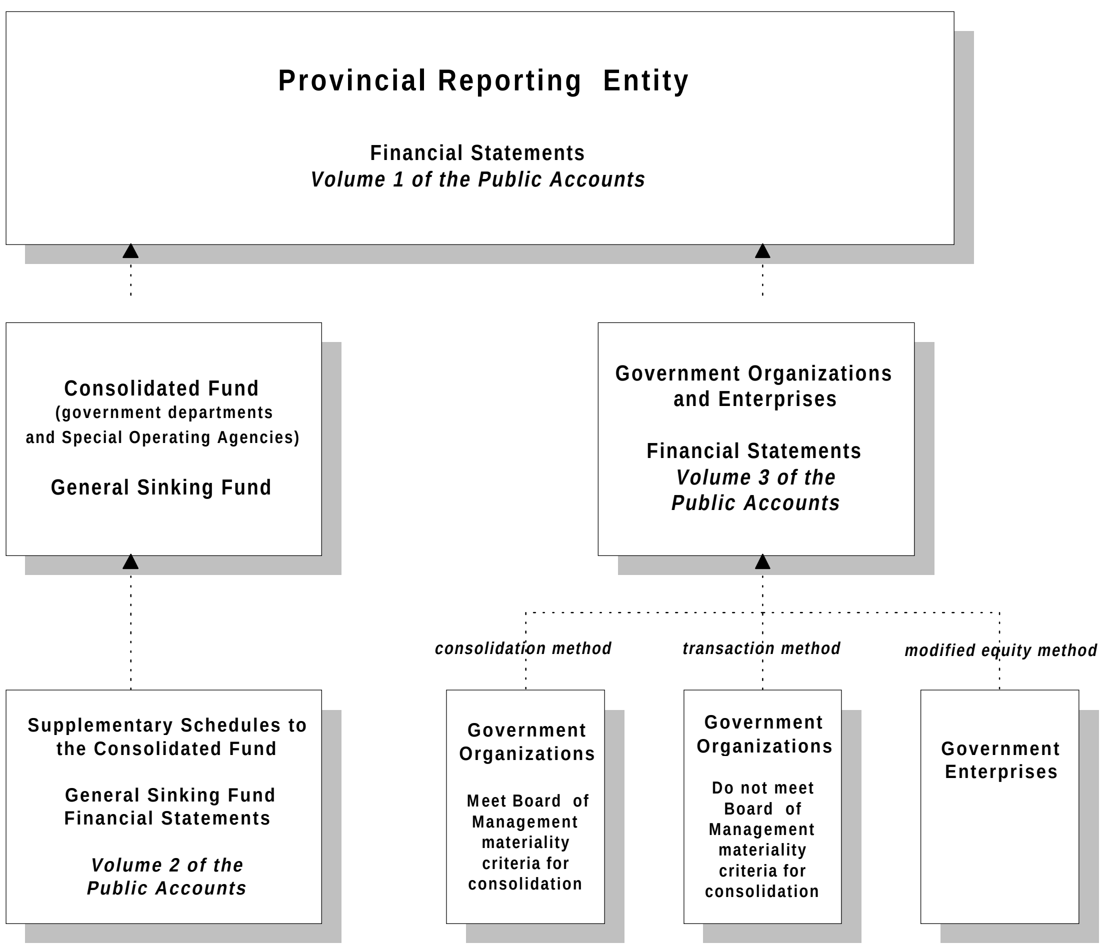
2.21 In our Reports of previous years, we pointed to a goal of issuing the financial statements within three months after year end. We continue to believe this is reachable and we are prepared to cooperate in any way to meet this date should government set this as its goal.

Comments on the composition of the provincial reporting entity

2.22 The term provincial reporting entity is used to describe the combination of organizations that are accountable for the administration of their financial affairs and resources either to a minister of the government or directly to the legislature, and are owned or controlled by the government. Note 1(a) to the financial statements lists the organizations included in the reporting entity and describes the method of accounting through which they are included.

2.23 Exhibit 2.2 provides an overview of the composition of the provincial reporting entity.

Exhibit 2.2
Composition of the provincial reporting entity



2.24 The consolidation, transaction and modified equity methods of accounting are defined in Note 1(a) to the financial statements. The Board of Management criteria for consolidation establish a cut-off point for smaller organizations which, due to their size, are accounted for simply on the transaction basis rather than line-by-line consolidation.

Changes in the reporting entity

2.25 The New Brunswick Credit Union Deposit Insurance Corporation and NB Agriexport Inc. were both added to the list of government organizations included through consolidation. The operating results of these organizations are thus included in the reporting entity.

2.26 The New Brunswick Biotechnology and Technological Innovation Centre of Excellence Inc. is no longer classified as a government organization. This change results from a modification in the composition of the corporation's board of directors such that the corporation is now independent of government.

New Brunswick school districts

2.27 Note 2 to the financial statements explains that during the 1996-97 fiscal year, the method of accounting for New Brunswick school districts was changed from the transaction to the consolidation method. This change was due to the dissolution of publicly elected school boards, which resulted in the school districts being directly accountable to the Minister of Education. We reported last year that, although the effective date of the changes to the school boards was 1 March 1996, the administrative and financial structure of the school boards was retained and continued until 30 June 1996. For this reason, the change in reporting the school board accounts did not take effect until the 1996-97 year.

2.28 This change means that all assets, liabilities, revenues and expenditures of provincial school districts are now included in the Province's financial statements. In addition, an adjustment to opening net debt as at 1 April 1996 of $9.7 million was made. This reflects the difference between the school board expenditures recorded up to 1995-96 and the estimated amount that would have been recorded using the new method of accounting.

Hospital corporations

2.29 Note 1 to the Province's financial statements explains that hospital corporations do not meet the accounting criteria for inclusion in the provincial reporting entity.

2.30 Because only transactions between the Province and the corporations are reflected in the Province's financial statements, any deficits or surpluses in the corporations (and the related borrowing or surplus funds) are not included. A review of the corporations' financial statements shows total current liabilities exceed current assets by $35.2 million at 31 March 1997. In addition there is total long-term borrowing of $6.9 million and capital lease commitments of $2.3 million. These net liabilities, amounting to $44.4 million, are not recorded or reflected in the Province's financial statements or notes. Last year we reported that net liabilities of hospital corporations were $32.7 million, meaning an increase of 36% took place during the past year. The largest component of the increase was the Atlantic Health Sciences Corporation (Region 2). The amount by which its current liabilities exceeded current assets increased by $8.5 million.

2.31 There are long-term investments of $26.4 million contained in five of the corporations' financial statements, an increase of $2.7 million over last year. We understand the use of these investments is restricted.

2.32 The governing boards of hospital corporations are responsible to the Minister of Health and Community Services who, in turn, is accountable to the Legislative Assembly. It is the responsibility of the governing board of each corporation to manage the resources allocated by the provincial government. These boards consist of approximately sixteen members of which one-quarter are appointed by the Minister of Health and Community Services.

2.33 The government has dealt with many important accounting issues over the past few years. A significant issue that has not been fully addressed is the accounting for New Brunswick hospital corporations.

2.34 As recently as June 1996 the Public Sector Accounting and Auditing Board (PSAAB) stated the following:

> *…most universities and hospitals - with the exception of those operating as part of a government department - would be excluded from the government entity.*

2.35 These comments may have led to the hospitals being excluded from the provincial reporting entity in some jurisdictions. Later in 1996 changes were made to the PSAAB recommendations. They no longer refer to the fact that most hospitals would be excluded from the reporting entity.

2.36 PSAAB offers some specific guidance for determining whether organizations should be included in the reporting entity. Organizations must be owned or controlled by government and they must be accountable to a minister of government or directly to the legislature.

2.37 Factors to be considered relative to hospital corporations are:

- the hospital corporations must operate within the budget approved by the Minister of Health and Community Services;
- hospital corporation bylaws have no effect until approved by the minister;
- the hospital corporations are required to submit an annual report to the minister;

- the Lieutenant Governor in Council may, where circumstances warrant, appoint a trustee to assume the responsibilities of a hospital board;
- the Hospital Act refers to ownership by the Province of hospitals and hospital assets (although it acknowledges that not all existing hospitals are owned by the Province). Land, buildings and building service equipment are entrusted to the hospitals;
- control may be implied by the fact that the hospitals derive more than 80% of their revenue from the Province; and
- ownership and control of the hospitals may have been established when the Minister of Health and Community Services directed the administration of the hospitals during a time of reorganization when there were no hospital boards.

2.38 We are not convinced that the present method of accounting for hospital corporations in New Brunswick is the most appropriate. We intend to continue discussions with the Comptroller on this subject over the coming year.

1996-97 approved spending

2.39 An appropriation is defined as an amount that is approved by vote of the Legislature. The appropriation for the 1996-97 year has several components. These components combine to show the total allowed level of spending for the departments and agencies for the year. The components include:

- the main estimates;
- supplementary estimates; and
- special warrants.

Ordinary account spending

2.40 Over the past several years departments have received increasing flexibility to manage ordinary account spending. We have reported on these changes each year. Currently, departments may move their approved funding among ordinary account programs without seeking a supplementary appropriation. Therefore, ordinary account programs may be overspent so long as the total departmental spending on ordinary account falls within the budget.

2.41 This moving of funds is done at the discretion of the department unless the cumulative amount of such transfers exceeds $1,000,000 or 15% of the budget for the program. When the need to make such a transfer occurs, the quarterly report submitted to the Board of Management must identify the amount of funds to be transferred and the implications of the transfers on the delivery of service. The Board’s approval of the quarterly report serves as the authorization for the funding transfer.

2.42 The following exhibit shows the number of departments and programs requiring transfers of funding approval, together with the amount (in millions of dollars) of the transfers on a comparative basis.

Exhibit 2.3
Funding transfers

	1997	1996	1995
Number of departments	13	10	16
Number of programs	22	18	24
Amount	$19.9	$13.2	$10.6

Capital account spending

2.43 Last year we reported the change in capital spending approval which allowed departments to move funds between programs for the first time in 1995-96. Two departments used this provision in the current year to transfer funding approval of $4.3 million between programs. This compares to the prior year where three departments transferred funding approval totalling $5.4 million between programs.

Total spending

2.44 The following exhibit shows the components of the year's expenditure appropriations on a comparative basis.

Exhibit 2.4
Expenditure appropriations
(millions of dollars)

	1997	1996	1995	1994	1993
Main estimates	4,445.0	4,365.6	4,284.1	4,297.1	4,487.4
Supplementary estimates	4.2	45.6	76.1	63.5	31.1
Special warrants	37.8	81.3	0.2	0.3	23.5
Total expenditure appropriated	**4,487.0**	**4,492.5**	**4,360.4**	**4,360.9**	**4,542.0**

2.45 At the time of drafting this Report expenditure totalling $26.8 million has not yet been approved either by way of a special warrant or supplementary estimates. We are therefore required to report that appropriations have been exceeded by this amount.

Net budgeting

2.46 The Financial Administration Act gives the Board of Management the authority to allow net budgeting. Net budgeting is a tool which allows more flexibility in managing programs where services are provided on a cost-recovery basis. Departments are permitted to budget for the net amount of expenditure or revenue for those revenue-generating programs that have received Board of Management approval. Net budgets are approved as part of the annual budget process and are monitored by the Office of the Comptroller on a quarterly basis.

2.47 The Main Estimates provide details regarding the source and amount of the revenue for each net-budgeted program. As well, for reporting purposes, both the revenue and expenditure of these net-budgeted programs is included in the financial statements, ensuring they are properly reflected in the Public Accounts.

2.48 The following list includes all approved net budgeted programs as of 31 March 1997 and provides a comparison of the amounts expensed within each program.

Exhibit 2.5
Net budgeting
(millions of dollars)

Department	Program Description	Gross Expenditure	Revenue Netted	Net Expenditure
Advanced Education and Labour	Student Aid Administration	1.4	0.5	0.9
Advanced Education and Labour	Advocacy Programs	0.5	0.5	-
Advanced Education and Labour	Employment Development Grants	28.5	8.2	20.3
Economic Development and Tourism	Advertising Revenue	12.5	0.2	12.3
Economic Development and Tourism	Connect NB	2.2	0.5	1.7
Economic Development and Tourism	Snowmobile Fees	0.1	0.1	-
Fisheries and Aquaculture	Training Course Fees	0.2	0.2	-
Human Resources Development - NB	Family Support Orders Service	182.3	1.4	180.9
Natural Resources and Energy	Firearm Safety Training	4.8	0.1	4.7
Solicitor General	Adult Institutional Services	14.1	0.6	13.5
Total		**246.6**	**12.3**	**234.3**

Carry-over of unspent appropriations

2.49 The Financial Administration Act gives authority to the Board of Management to approve the carry-over of unspent appropriations from one fiscal year to the next without further authorization by the Legislature. Departments are eligible to apply for approval to spend their unused fiscal year budget in the following fiscal year.

2.50 Board of Management approved an expenditure rollover of $6.0 million in total from 1996-97 to the 1997-98 fiscal year for the four Special Operating Agencies described in Note 5(e) of the Province's financial statements. The Board also approved the carry-over of unexpended capital funds in the amount of $21.6 million for the Department of Transportation.

Unresolved issues affecting accounting policies

2.51 There are several matters relating to the Province's accounting policies which are unresolved and have not been satisfactorily addressed in the financial statements of the current year. In most cases recommendations of the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants (CICA) have been in place for some time. In one case there is an issue on which there has recently been a pronouncement by PSAAB. Although, as explained below, we have provided a positive opinion on the financial statements, we believe collectively these are significant issues which should be dealt with by the Province in the preparation of its annual financial statements.

Retirement allowances

2.52 As we stated last year, the failure to properly account for retirement allowances represents the most significant issue still outstanding. These allowances are not payable by the Province at 31 March 1997. However, the liability for these allowances is incurred as the employees of the Province work each year towards their retirement. The logic for recording the liability and the expense each year for these allowances is similar to that for recording the Province's pension liabilities. In the past we were informed that the primary reason for not recording the liability for retirement allowances was the lack of accurate data to support its calculation.

2.53 We discussed this with the Comptroller. He indicated that during the 1997-98 year he hopes to assemble the information which could be used in support of a possible adjustment to the Province's financial statements.

Accrual of teachers' salaries

2.54 Note 2 to the financial statements explains that during the year ended 31 March 1997 the Province changed its method of accounting for New Brunswick school districts from the transaction method to the consolidation method. This followed the dissolution of the public school boards on 1 March 1996. The former school districts are now accountable to the Minister of Education.

2.55 School teachers have an agreement with the Province which allows them to be paid in every month of the year, despite the fact that the school year covers only ten months. This is made possible by dividing the salary earned, in the ten months, into amounts that can be paid to the teachers over a twelve-month period.

2.56 Based on our review of the agreement between the teachers and the government, the amounts paid to the teachers are in fact earned in the ten-month period. As a result, the salaries earned by the teachers exceeds, by a significant amount, the salaries paid as at 31 March of each year.

2.57 In our opinion, the Province's financial statements should record the amount of salaries earned to 31 March rather than the amount of salaries paid out to that point in time.

2.58 Given the changes to the accounting for the former school districts in 1996-97, we expected an accrual to be made for salaries earned but unpaid at 31 March 1997. This was not done.

2.59 The matter has again been discussed with the Comptroller. Because of the nature of the teachers' salaries that are paid in the summer months, the Comptroller is currently considering them to be of a similar nature to vacation entitlements. At the present time no accrual of salary is expected to be recorded in the 1997-98 year.

2.60 The Comptroller is looking at the whole area of unrecorded employee benefits.

Vacation entitlements

2.61 Government employees earn vacation entitlements for each month of employment. At 31 March each year there are vacation entitlements that have been earned but that have not been taken by the employees. Such entitlements have a value but, as explained in Note 1, no accrual of the expenditure has been recorded.

2.62 We have discussed this with the Comptroller and he indicated that during the 1997-98 year he hopes to assemble the information, which could be used in support of a possible adjustment. However at the present time no accruals are expected to be recorded in the 1997-98 year.

Liability to injured workers

2.63 The Workplace Health, Safety and Compensation Commission of New Brunswick assumes the responsibility for payments to injured workers. Only a portion of the liability for future benefits to workers who are currently injured has been recorded in the financial statements of the Province.

2.64 The Comptroller indicated he would review this issue in the 1997-98 year.

Summarizing the impact of the preceding four issues

2.65 The estimated impact on the financial statements of these matters is as follows.

Exhibit 2.6
Estimated impact of unresolved issues on provincial financial statements

	(in millions of dollars)	
	Impact on net debt	**Impact on 1997 expenditure**
Retirement allowances	150-200	negligible
Teachers' salaries	46	negligible
Vacation entitlements	10-20	negligible
Liability to injured workers	29	0.7

2.66 Adjustment for all of these issues on the 1997 financial statements (using the estimated amounts shown above) would have a large impact on net debt. However the effect on the expenditures of the 1996-97 year would be small.

2.67 The Province’s method of accounting for each of the preceding four issues has been explained in Note 1 to the financial statements.

2.68 It is our opinion that the each of the four matters should be properly reflected in the Province’s financial statements and we recommend that the information necessary to make the adjustments be obtained as soon as possible. We would like to see the appropriate entries made in the 1997-98 year.

Concessionary loans

2.69 For the past two years we raised the issue of concessionary loans. These are defined as loans which have low interest rates, extended repayment terms or forgiveness clauses. When a loan is not required to be fully repaid, including interest charged at market rates, there is a cost incurred by government. The cost must be recognized and accounted for in the proper accounting period and the loans must be correctly valued.

2.70 We reported that the Province does not account for the concessionary loans in compliance with PSAAB recommendations.

2.71 Following our meeting with the Comptroller last year we were informed that finalizing the Province's policy at that time would be premature and we reported that the Comptroller would be addressing the issue in 1996-97.

2.72 The progress in this area was discussed with the Comptroller. He indicated that his staff continues to work on this issue. We would like to see the issue resolved in the 1997-98 year.

Tangible capital assets

2.73 PSAAB has recently approved accounting and reporting standards for the tangible capital assets held by provinces. These assets include land, buildings, equipment, roads, bridges etc. They are defined by PSAAB as non-financial assets having physical substance that are acquired, developed or constructed and:

- are held for use in the production or supply and goods and services;
- have useful lives extending beyond an accounting period and are intended to be used on a continuing basis;
- are not intended for sale in the ordinary course of operations.

2.74 The implications of these standards are significant for the Province. Some of the changes that would take place in the Province's financial statements are as follows:

- A new financial statement called the statement of tangible capital assets would be prepared and included with the three financial statements currently issued by the Province. The new statement would account for the asset balance and the changes to the net asset balance in the year. The year's amortization of the cost of the assets would be disclosed, as would the accumulated amortization to the end of the year.

- Disclosure requirements will include the amortization method used, the net book value of assets being amortized and the amount of interest capitalized.

2.75 PSAAB recommends the adoption of the standards as soon as practicable. It indicates that both new and existing assets should be accounted for in this manner. The standard was issued after the release of the Province's statements for the 1996-97 year so the first opportunity to release a financial statement under the new format would be the 1997-98 year.

2.76 This was discussed with the Comptroller. He indicated he fully supports PSAAB’s recommendations about tracking and recording tangible capital assets. However, because PSAAB’s recommendations on tangible capital assets do not affect annual results, the Comptroller indicated that work on this issue will be deferred until the issues of concessionary loans and employee benefits have been resolved.

Government has leased a school and a correctional facility

2.77 Real estate leases are not new to the Province. They have been used for years as a means of providing office space. The nature of the real estate leases in which the Province has become involved, however, has changed.

Traditional approach to real estate leases

2.78 The Province extensively leases space in buildings owned by the private sector as a means of providing the office space needed for its employees. The terms over which these leases run vary from just a few years to twenty years. Some of the leases are for entire buildings while others are for portions of buildings. The lease costs are normally calculated on a per square foot per year basis.

2.79 Until recently, hospitals, schools and correctional facilities were not among the types of buildings leased by the Province. The Province was directly involved in both the design and the construction of all new facilities of this nature. The costs of construction were recorded as expenditures when they were incurred.

How the leasing practices have changed

2.80 In our last Report we pointed to the fact that two major lease agreements had been signed. A lease for a public school facility was signed during 1995-96 and a lease for a correctional facility was signed subsequent to the 1995-96 year end. Both agreements featured twenty-five year lease terms with a purchase option at the end of the twenty-five year period. The Province must renew the leases for a further ten years at the conclusion of the initial term if the purchase option is not exercised.

2.81 These two new leases differ from those signed in the past:

- the terms of these leases are longer;
- the Province has the opportunity to purchase the facility as part of the lease agreement; and
- the Province plays a greater role in determining how the facilities will be constructed.

Impact of leasing versus constructing

2.82 Leasing rather than constructing these types of facilities results in significant changes to the Province’s finances and accounting.

- **Recognition of the cost -** the cost is recorded over the lease term rather than recording the cost in the period of construction.

- **Cash flow -** the funds required to pay for the use of the facility are paid out over the term of the lease rather than during the period of construction. This has an impact on the borrowing requirements of the Province. The immediate need for cash is eliminated and the required funds can be raised or borrowed over the number of years specified in the lease agreement.

- **Commitment -** expenditures of future years are being locked in place by signing the lease agreements.

Impact of the leases on government expenditure

2.83 Early in the 1996-97 year another lease agreement was signed. It related to a psychiatric facility that is to be constructed by the private sector and leased to the Province.

2.84 Recording these leases as operating leases rather than capital expenditure has the following impact on the Province's expenditures. This table considers the three lease agreements signed by the end of July 1997.

Exhibit 2.7
Impact of leases on the Province's expenditures
(millions of dollars)

	1997	**1998**	**1999**
Recorded as operating leases	0.8	1.6	3.5
Recorded as capital expenditure (traditional approach)	10.7	27.2	3.0
Impact on expenditures	**(9.9)**	**(25.6)**	**0.5**

2.85 For the purposes of the table, the capital expenditure was assumed to be incurred at the point where lease payments began.

2.86 The table shows the trend towards lower costs initially and larger amounts expensed in later years with the operating lease classification.

Accounting issues

2.87 The differences between constructing and leasing these facilities would have less significance from an accounting perspective had the leases been recorded as capital leases. For capital leases, the cost of the assets would be expensed at the beginning of the lease term. However, they have been classified as operating leases which means that the costs are recorded over the term of the lease.

2.88 There are several important considerations in relation to the classification of these leases for accounting purposes.

- Using the recommendations of the Canadian Institute of Chartered Accountants (CICA), the leases would be classified as capital leases. However the CICA refers governments to the Public Sector Accounting and Auditing Board (PSAAB) for direction in determining their appropriate basis of accounting.

- PSAAB accounting recommendations do not address the issue of leases.

- The effects of lease accounting may be less significant for private sector organizations covered by the CICA recommendations. This is because they generally depreciate the cost of their capital assets. Whether it is annual depreciation cost or annual lease cost that is recorded, the impact on the surplus or deficit is normally similar. The impact on the provincial government is very different, as we have explained.

- The Province has an accounting policy that permits the classification of real estate leases as operating leases. This policy is explained in the financial statements and it has been in existence for a number of years.

- The Province's financial statements have been prepared on a basis disclosed in Note 1 to the financial statements. Our auditor's report refers to the accounting policies disclosed in Note 1.

2.89 Note 1 to the financial statements states that long-term leases under which the Province, as lessee, assumes substantially all of the benefits and risks of ownership of leased property, are classified as capital leases. The benefits and risks of ownership of real property leases are considered to have been assumed by the Province if ownership transfers during the lease term or if the lease term is extremely long. Based on this policy, the Province has classified the leases referred to above as operating leases.

2.90 The leases in question are for a term of twenty-five years. At that point they will be either renewed for another ten years or the facilities will be purchased by the Province. However, there are no incentives or bargain purchase options available which would indicate a transfer of ownership is likely. At the end of the renewal period there is no requirement for the Province to purchase.

2.91 The effective lease terms are thirty-five years. The Province indicates that this is not considered to be extremely long for leases of this nature.

2.92 If we found that the accounting policy adopted by the Province was inappropriate or misleading we could not support its use and would take the necessary action to bring this to the attention of the reader of the financial statements. There is no basis on which to definitively say that the accounting is incorrect. In fact, the accounting treatment given to these transactions is consistent with the Province's accounting policy which is disclosed in the notes to the financial statements. The Province freely admits that under the CICA policy they would be forced to record the arrangements as capital leases.

2.93 The uncertainty over accounting for leases is not confined to New Brunswick. The issue is of concern in a number of provinces and without action by PSAAB, the potential for inconsistency and misinterpretation will continue.

The government is planning to lease a highway

2.94 The Province has plans in place to have a toll highway constructed from Fredericton to Moncton, a distance of 195 kilometres. This is a very large project. The total cost of constructing the highway is expected to be $600 million.

2.95 This highway will not be built by the Province or by contractors dealing directly with the Province, as has been the norm for highway construction in the past. Negotiations are under way to select a successful bidder to assume responsibility for the construction and operation of the highway. The successful bidder will lease the completed highway back to the Province.

2.96 The project to find a builder for the highway commenced with a feasibility study that was approved in June, 1996.

2.97 Three companies were then chosen to submit proposals following a call for qualifications. The technical and financial proposals from these three companies have now been received. These proposals are being subjected to extensive review before deciding on the successful bidder.

2.98 As disclosed in the notes to financial statements, the Province intends to complete a contract with one of the bidders during the fiscal year ending 31 March 1998.

Accounting implications

2.99 The Province has already incurred costs in constructing portions of this highway. The successful bidder will be required to purchase these completed portions from the Province and undertake to construct the remainder. In 1996-97 the Province spent $38.9 million on construction and pre-construction activity related to the highway. The intention is that the successful bidder will reimburse the Province for these costs.

2.100 As a result, costs incurred by the Province in the 1996-97 year have not been expensed. Rather, they have been set up as an asset of the Province called property held for resale. When the property is sold to the successful bidder, cash will be received and this property held for resale account will be reduced to zero.

2.101 There were contributions from the Government of Canada which would normally have been recorded as revenue in the 1996-97 year. Since these funds were used to construct a portion of highway that is to be sold, it is not appropriate to record the funds as revenue in the 1996-97 year. They have been deferred and will be recognized as revenue as the Province recognizes the corresponding expenditure.

2.102 When the highway lease agreement is signed it is expected to set out a lease arrangement that will qualify as an operating lease. There are two major implications to this method of accounting.

- The first relates to when the costs are recognized in the financial statements of the Province. The operating lease classification means that the costs will be recorded over the term of the lease. Traditional methods of financing would see the costs shown as expenditure in the year when the construction takes place. The impact on the surplus or deficit will be significant.

- The second relates to the borrowing. If the lease is accounted for as an operating lease the cost of the project will not be paid for by the Province before it begins to use the facility, rather it will be paid for over the term of the lease. Therefore there will be no major borrowing required by the Province, and perhaps no borrowing at all if the lease costs can be covered by future annual surpluses. The impact of this will be that a major financial commitment will not be recorded in the liabilities of the Province.

2.103 We will be monitoring the development of this project in the 1997-98 year.

Surpluses, deficits, borrowing and net debt

2.104 The purpose of this section is to provide readers with useful information and analysis on which to draw their own conclusions about the status of the Province's surplus or deficit, borrowing and net debt. It is not the purpose of this section to provide a conclusion about the financial stability or solvency of the Province or any of the other organizations which make up the provincial reporting entity.

Definitions

2.105 The following definitions explain terms used in the Province’s annual financial statements. These terms together with the corresponding balances constitute important financial information. Our annual Reports attempt to place some of this data in perspective by providing comparative information. Such comparisons are useful in that the reader may better understand the Province’s financial history, current status and future goals.

2.106 To understand the current financial situation of the Province, it is necessary to be familiar with the terminology often used: **surplus (deficit), cost of servicing the public debt, funded debt, bank advances and short term borrowing, sinking fund** and **net debt**.

2.107 The **surplus** in a fiscal year is the excess of the Province’s total revenue over its total expenditure. (A **deficit** is the excess of total expenditure over total revenue.) Total revenue consists mainly of taxes and federal transfer payments. Total expenditure includes the cost of administering the government and its programs, the acquisition of assets which will provide benefits over future periods and the cost of borrowing.

2.108 The **cost of servicing the public debt** is a major component of annual expenditure. It is mainly comprised of interest on the funded debt of the Province. It also includes foreign exchange paid on interest and maturities during the year, the amortization of foreign exchange gains and losses which have not yet been realized, and the amortization of discounts and premiums which were incurred on the issuance of provincial debt.

2.109 **Funded debt** is the total long-term borrowing by the Province. **Funded debt for provincial purposes** excludes borrowing on behalf of NB Power Corporation and usually occurs when the Province's cash inflows are not sufficient to meet its obligations. Long term borrowing usually takes the form of provincial bonds, but it may also include debt issued to the Canada Pension Plan. The debt issued to the Canada Pension Plan accounts for fifteen percent of the Province's debt. This level is consistent with prior years.

2.110 The Province must often incur another form of debt to meet its current obligations. **Bank advances and short-term borrowing** are a form of financing used when the Province's immediate cash requirements do not coincide with its current cash inflows.

2.111 The Province plans for the repayment of its funded debt through the use of a **sinking fund**. This fund is a separate accounting entity which is maintained by the Minister of Finance. The sinking fund receives annual cash instalments from the Province with which it purchases investments. The value of the investments, plus future earnings, is expected to be sufficient to repay the principal portion of the funded debt when it matures or is redeemed.

2.112 Annual surpluses and deficits accumulate in the account called **net debt**. It is important to understand the difference between net debt and funded debt. Funded debt refers to the gross amount of long-term borrowing undertaken by the Province. Net debt is comparable to an accumulated deficit balance which private sector companies would disclose in the owners' equity section of their balance sheet. Net debt is the funded debt and other liabilities of the Province minus assets which can be used by the Province to fulfill its obligations. Therefore, net debt shows the shortfall in resources should all the liabilities of the Province come due at the fiscal year end. It represents the amount of future revenue required to pay for past transactions.

2.113 This chapter of our Report provides the following financial indicators on a comparative basis:

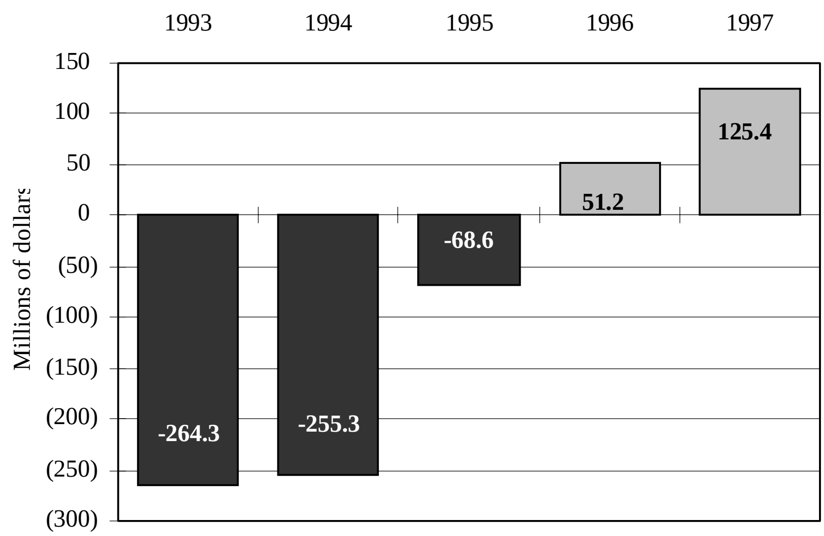
- surplus (deficit) per person and employed person in New Brunswick;
- cost of borrowing per person and employed person in New Brunswick;
- proportion of provincial revenue consumed by cost of servicing the public debt;

- comparison of the change in net debt to the change in funded debt; and
- net debt in proportion to GDP.

Surplus for the year ended 31 March 1997

2.114 The Province had a surplus for the year ended 31 March 1997 of $125.4 million. This amount includes the surpluses and deficits of the government enterprises described in Note 1 of the Province's financial statements. Exhibit 2.8 shows the amount of the Province's surplus or deficit for each of the last five years. The prior years' figures have been restated to conform with the current year's financial statement presentation.

Exhibit 2.8
Provincial surplus or deficit for the last five years

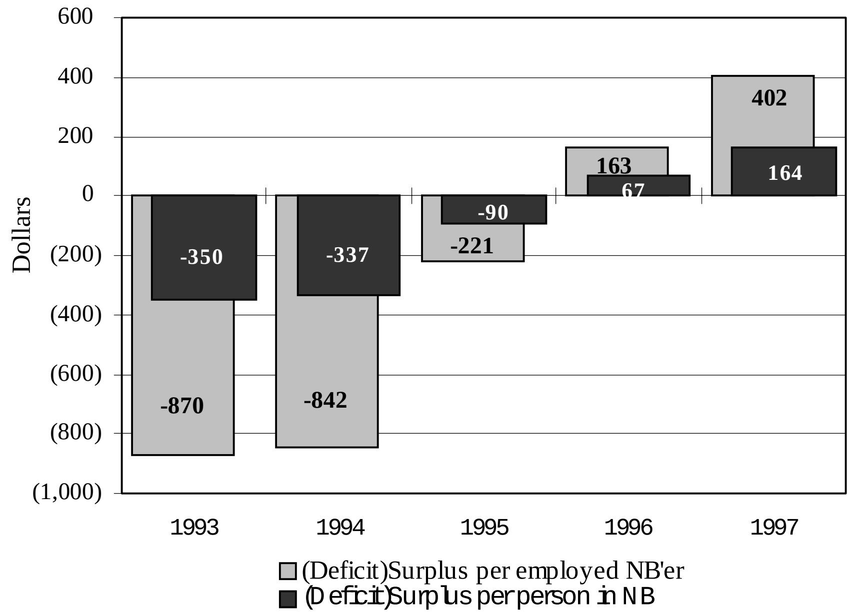


2.115 The 1996-97 surplus translates to a $164 share for each person living in New Brunswick[1]. This is in contrast to last year's surplus of $67 per person.

2.116 Examining the surplus from the perspective of an average employed New Brunswicker might provide a better measure of its size. Exhibit 2.9 shows the amount of the surplus or deficit per person and per employed person in each of the last five years[2].

1. Population as at 31 March 1997 per N.B. Statistics Agency.
2. Employment figures based on annual averages for fiscal years. Data supplied by N.B. Statistics Agency.

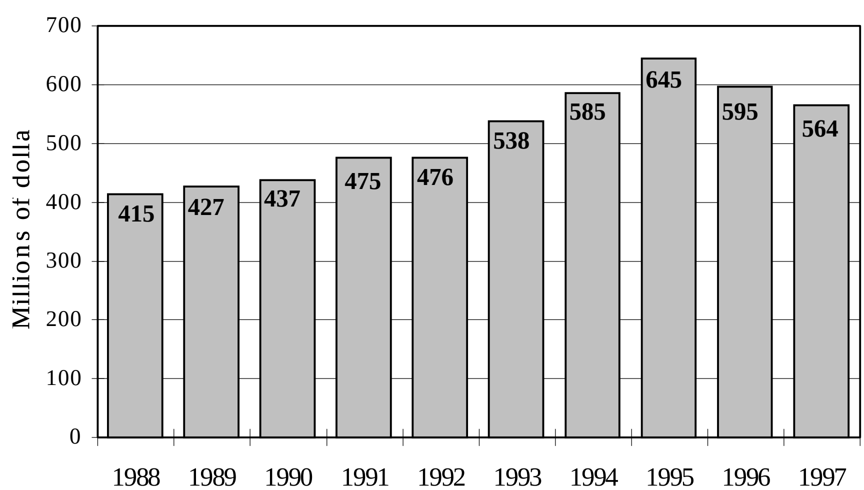
Exhibit 2.9
Provincial surplus or deficit per person for the last five years



Cost of servicing the public debt

2.117 Exhibit 2.10 shows the cost of servicing the public debt by year for the last ten years.

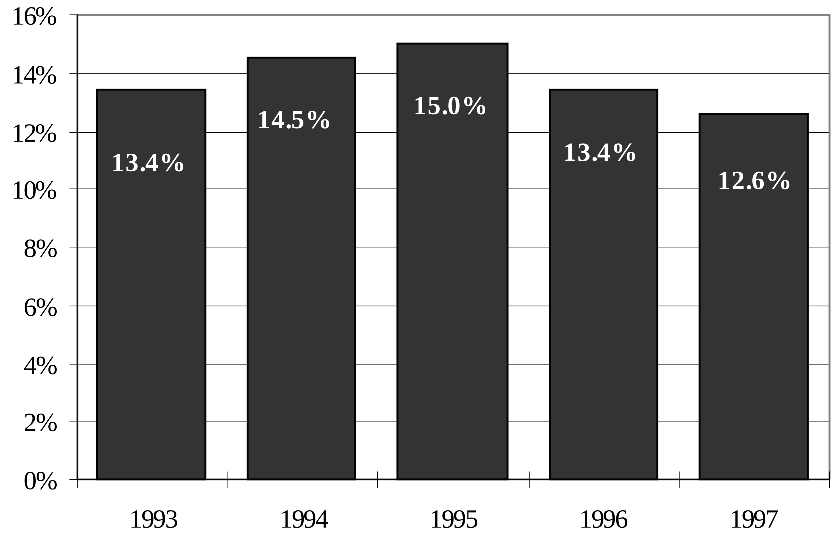
Exhibit 2.10
Cost of servicing the public debt for the last ten years



2.118 During this period the cost of servicing the public debt has risen from a low of $415 million to a high of $645 million in 1994-95. This represents an increase of 55.4% over seven years. For the second consecutive year the cost of servicing the public debt has decreased. It fell to $564 million in 1996-97, a decrease of 5.2% from 1995-96 and a decrease of 12.6% from the 1994-95 level.

2.119 Exhibit 2.11 shows the portion of provincial revenue consumed by the cost of servicing the public debt for the last five years.

Exhibit 2.11
Portion of provincial revenue consumed by the cost of the public debt for the last five years



2.120 The decrease from 13.4% in 1995-96 to 12.6% in 1996-97 is the net result of a decrease in borrowing costs of $31 million combined with an increase in revenue of approximately $44 million. The lower borrowing costs resulted from a decrease in both interest and foreign exchange expenses. The higher revenue was mostly due to an increase in income tax revenue. If 1996-97 revenue had remained at the prior year's level, the percentage consumed by the cost of borrowing would still have decreased to 12.7%.

2.121 This year's cost of borrowing translates to $740 for each person living in New Brunswick[1.] Expressed another way, the Province's cost of borrowing for 1996-97 averages $1,808 for each employed New Brunswicker[2]. Exhibit 2.12 shows this relationship for the last five years.

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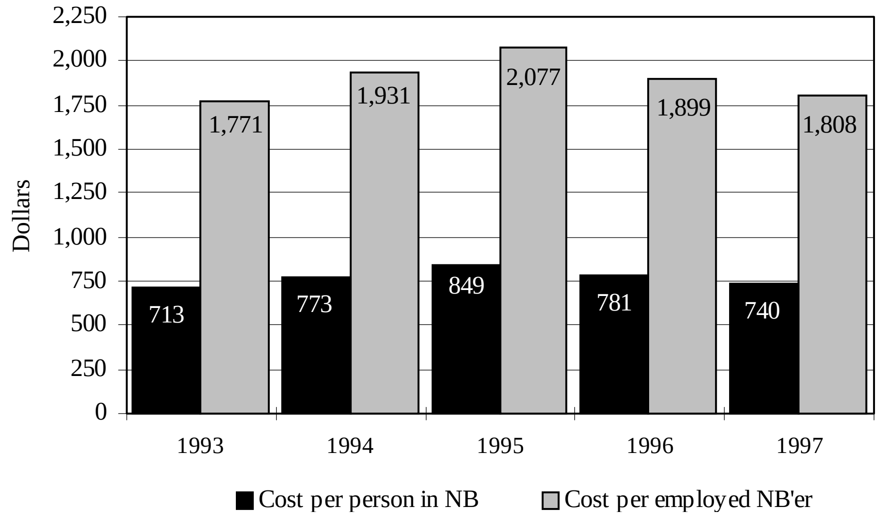
1. Population as at 31 March 1997 per N.B. Statistics Agency.
2. Employment figures based on annual average for fiscal 1997. Data supplied by N.B. Statistics Agency.

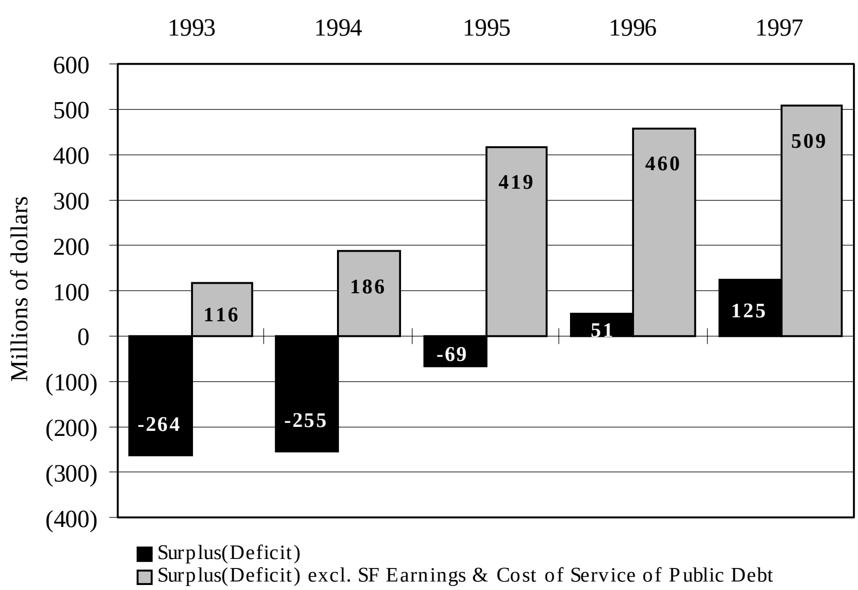
Exhibit 2.12
Provincial cost of borrowing per person for the last five years



2.122 If the Province had not been required to borrow funds in previous years, then there would not exist either the significant cost of servicing the public debt nor interest revenue from the Province's sinking fund. If these items were excluded (other factors remaining the same), the current year would have shown a surplus of approximately $509 million.

2.123 Exhibit 2.13 demonstrates that the Province would have shown significant surpluses in each of the past five years had there been no cost of servicing the public debt or sinking fund earnings.

Exhibit 2.13
Provincial surplus or deficit for the last five years excluding cost of servicing the public debt and sinking fund earnings



Funded debt for provincial purposes

Surpluses and repayment of long and short-term borrowing

2.124 There is not always a direct relationship between the level of annual surpluses or deficits and the ability of the Province to repay or incur debt. Surpluses and deficits are accounting terms used to describe the difference between a current year's revenue and expenditure. Revenue is recorded in the financial statements when earned, expenditure when the obligation arises. However, the related cash receipts or payments may not occur in the same fiscal period.

2.125 These actual cash flows, as disclosed in the Province's Statement of Cash Flows, dictate the extent to which the Province is able to repay funds during the year. Note 18 to the Province's financial statements focuses on both long and short-term borrowing. It explains that the Province was able to reduce borrowing by $373.6 million in 1996-97 despite a surplus of only $125.4 million.

2.126 The components of this $373.6 million decrease in borrowing are bank advances and short term borrowing (which decreased by $315.5 million), long-term borrowing (which increased by $164.7 million) and sinking fund investments (which increased by $222.8 million). Short-term borrowing was reduced due to the receipt of Harmonized Sales Tax Adjustment Assistance. This totalled $364 million and was received from the federal government. According to the federal-provincial agreement, this assistance reflects the foregone provincial revenue due to implementation of the harmonized sales tax system.

Long-term borrowing activity in the current year

2.127 In the past year, provincial bonds were sold with ten-year maturities. Exhibit 2.14 summarizes the activity in the funded debt for provincial purposes account during the last five years.

Exhibit 2.14
Funded debt for provincial purposes for the last five years (millions of dollars)

	1997	1996	1995	1994	1993
Opening balance	6,307.8	6,288.8	5,887.6	5,358.5	4,758.7
Borrowed during the year	530.0	698.1	708.0	634.3	949.1
Debt redeemed	(312.2)	(543.9)	(412.1)	(278.2)	(427.6)
Adjustment for the change in exchange rates	(53.1)	(135.2)	105.3	173.0	78.3
Closing balance	6,472.5	6,307.8	6,288.8	5,887.6	5,358.5

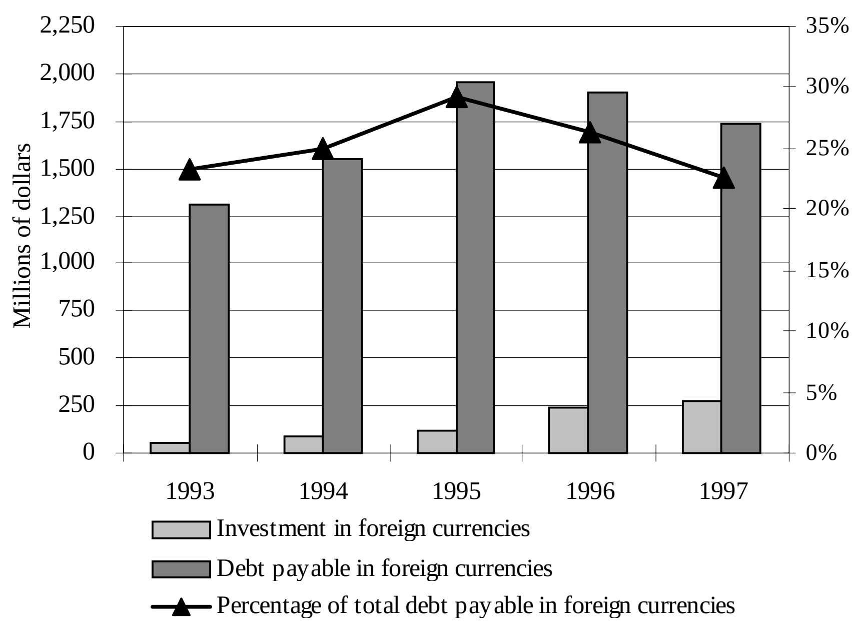
2.128 The increase in total funded debt for provincial purposes during the year is more than offset by an increase in investments of the sinking fund. During the year ended 31 March 1997 long-term debt increased by $164.7 million while the compensating increase in the sinking fund investments was $222.8 million. Where the sinking fund has grown by an amount exceeding the year's long-term borrowing, this could be considered to be a 'principal repayment'. As long as this trend continues, the Province will make significant progress in reducing the balance of funded debt outstanding.

Exposure to foreign currency exchange rate fluctuations

2.129 Debt repayable in foreign currencies is denominated in US dollars, Japanese yen and Swiss francs. Such debt usually requires that annual interest be paid in the same currencies as the original issue. Between 1 April 1996 and 31 March 1997 the Canadian dollar increased in value against all of these currencies. The net result was a favourable adjustment for the Province of $53.1 million. This gain will be recorded in the accounts of the Province as a reduction in expenditures over the remaining life of the related debt. This is the second consecutive year during which the adjustment for the change in exchange rates has reduced the amount of the provincial debt. The adjustment for exchange rate fluctuations increased the amount of the provincial debt in each of the three years preceding 1996.

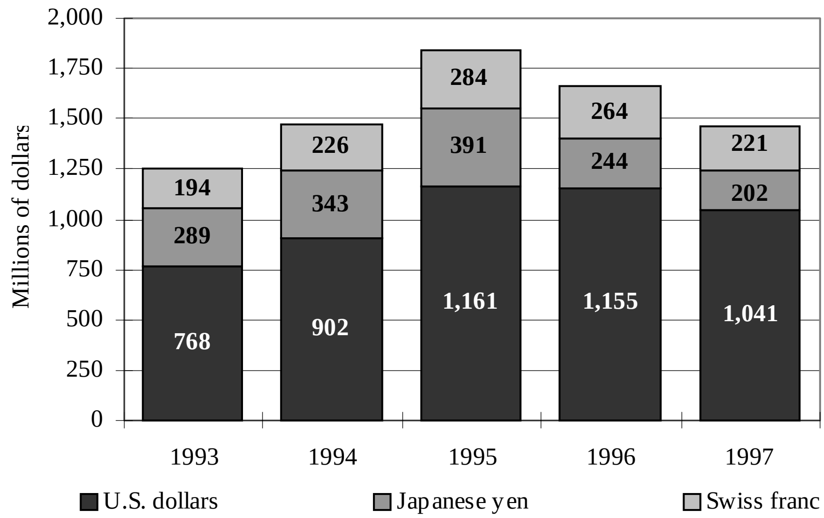
2.130 Exhibit 2.15 demonstrates the change in the Province's net exposure to foreign exchange rate fluctuations over the past five years.

Exhibit 2.15
Net exposure to foreign exchange rate fluctuations over the past five years



2.131 Exhibit 2.16 demonstrates the change in the components of the Province's net exposure to foreign currencies over the last five years. For the purposes of this chart, investment in a foreign currency has been deducted from debt payable in foreign currencies.

Exhibit 2.16
Changes in debt payable in foreign currencies for the last five years



2.132 The previous table shows that exposure to gains and losses due to foreign currency exchange rate fluctuations at 31 March 1997 has decreased by $199 million from 31 March 1996. This is the second consecutive year that the Province's exposure has decreased.

2.133 The Province has several alternatives to reduce the risk associated with debt repayable in foreign currencies. Each of the following will act as a hedge to fluctuations in foreign currencies:

- purchasing assets denominated in foreign currencies for the Province's sinking fund;
- entering into debt swap agreements (which in most cases allows repayment of the debt in Canadian dollars); and
- entering into forward contracts (which allow the Province to purchase foreign currency at a stipulated price on a specified future date).

2.134 Note 11 of the financial statements of the Province discloses the debt that is repayable under swap agreements. This debt is excluded from the above chart and previous table except where the debt was payable in US dollars under a swap agreement.

2.135 At 31 March 1997, the Province had four outstanding forward contracts fixing exchange rates on an exposure of approximately $34 million.

Net debt at 31 March 1997

2.136 As noted previously, net debt decreased by $125.4 million during the 1996-97 year. The amount of net debt at 31 March 1997 stands at $7,137 per person[1] living in New Brunswick or approximately $17,441

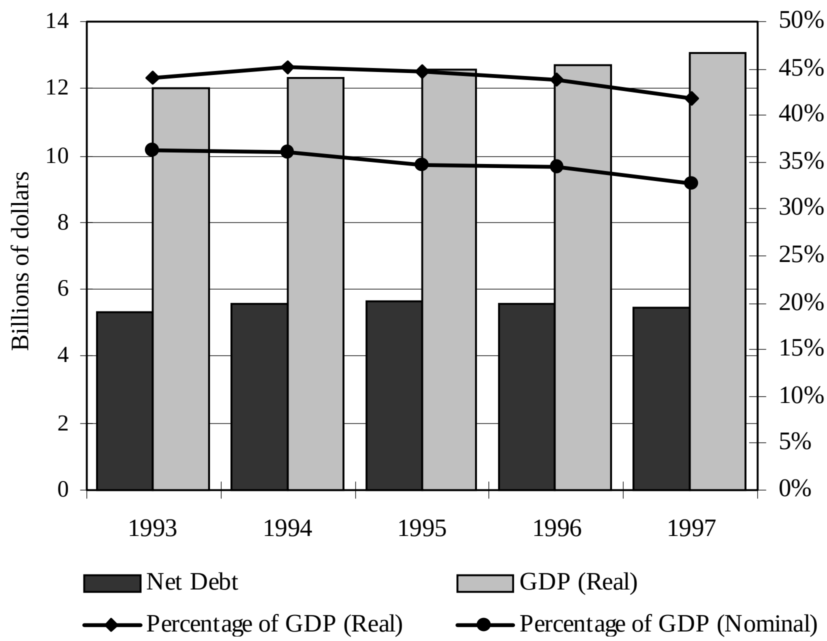
1. Population as at 31 March 1997 per N.B. Statistics Agency.

for each employed person[1] in New Brunswick. The average wage of a New Brunswicker was $26,743[2] during 1996-97.

2.137 Net debt as a percentage of gross domestic product (GDP) is frequently used to measure a government's ability to sustain its debt. GDP is a measure of the current market value of all goods and services produced in the Province during a year. The market value used in the calculation includes taxes (less subsidies) which make up part of the market price. A decreasing ratio of net debt to GDP would indicate that the Province's economy is growing at a greater rate than the debt. This implies that the Provincial economy has more resources available with which it can maintain its debt.

2.138 The following chart shows the relationship between the Province's net debt as a percentage of both real and nominal GDP for the last five calendar years. Both calculations are commonly used to describe the financial status of the Province. Real GDP refers to a calculation of GDP that adjusts for the effect of inflation. Nominal GDP has not been so adjusted. They have both been included in the following chart to facilitate readers' comparison with other sources of information.

Exhibit 2.17
Provincial net debt and GDP for the last five years



Note: 1997 GDP estimate and historical GDP information obtained from N.B. Statistics Agency

1. Employment figures based on annual average for fiscal 1997. Data supplied by N.B. Statistics Agency.
2. Average wage figures based on annual average for fiscal 1997. Data supplied by N.B. Statistics Agency.

2.139 In real terms, the Province's current net debt to GDP ratio is approximately 42%. The net debt to nominal GDP results in a ratio of 33%. Real GDP is expected to increase by 2.5% in 1997 while nominal GDP is expected to increase by 3.5%.

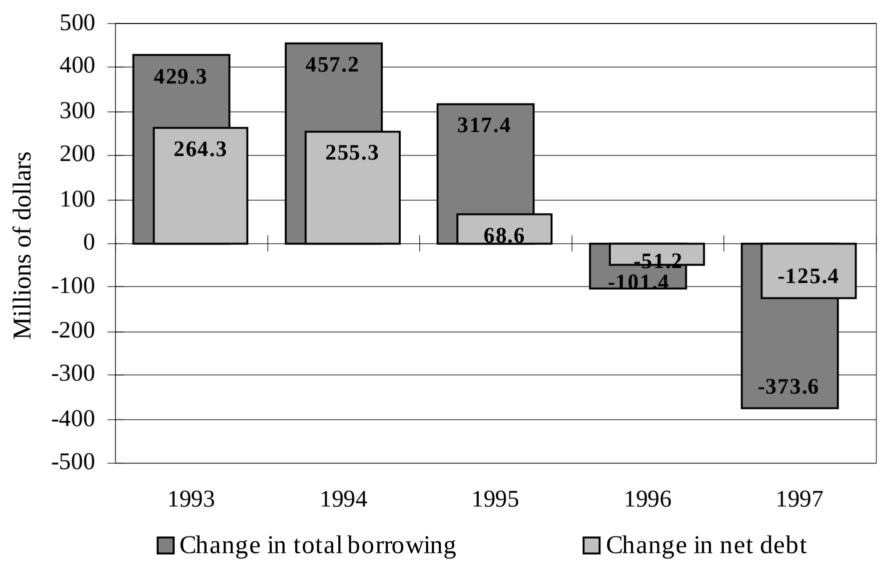
2.140 Last year we reported a modest decrease in the net debt to nominal GDP ratio between calendar 1995 and 1996. This was based on an assumption of 2.75% growth during 1996. However, that level of growth did not materialize. Rather, GDP declined slightly during 1996. This caused the net debt to GDP ratio to remain stable for 1996.

2.141 It is important to recognize that while the net debt may decrease in any given year, funded debt could still increase. This occurred during fiscal 1995-96 when net debt decreased by $51 million. During the same year, funded debt for provincial purposes increased by $19 million.

2.142 This is because there is a difference between the annual surplus or deficit and the annual cash requirements of the Province. Note 18 to the Province's financial statements provides information on the various components which combine to effect a change in provincial borrowing during the year.

2.143 The following chart shows the changes in the Province's net debt as well the changes in total borrowing for provincial purposes during the last five years:

Exhibit 2.18
Changes in borrowing and net debt for the last five years



2.144 Exhibit 2.18 shows that while there may be a correlation between net debt and total borrowing, it is by no means a direct relationship.

Eliminating the net debt

2.145 All levels of government in Canada are trying to come to terms with the problems raised by years of deficits. The Province of New Brunswick is no exception. A plan to reduce the $5.5 billion net debt of the Province was introduced for the first time this year.

Long-Term Net Debt Reduction Plan

2.146 The government introduced a long-term net debt reduction plan in May 1997. The government believes this reduction in the net debt is a crucial factor in New Brunswick becoming a self-sufficient province. The stated benefits of debt reduction include reduced spending on debt service "which would free money to reduce taxes or to provide more or better services to New Brunswickers".[1]

2.147 The goals of the long-term debt reduction plan are as follows:

- eliminate over eighteen years the $2.5 billion in net debt incurred from previous ordinary account deficits and unfunded pension liabilities, by using surpluses to pay down the debt; and
- reduce net debt as a percentage of New Brunswick's Gross Domestic Product from 34.9% to 9.5% by 2013-14.

2.148 The plan requires gradually increasing annual surpluses over the eighteen-year period beginning with the 1996-97 year and ending in 2013-14. Period benchmarks are set every fourth year. In order to achieve the desired reduction in net debt, a surplus of approximately $50 million per year for the first four-year period is required. This must then accelerate by $50 million for each four-year period thereafter.

2.149 The government first introduced balanced budget legislation in 1993. The first period covered by this legislation was 1993-94 through to 1995-96. Ordinary account expenditure could not exceed ordinary account revenue for the three-year period. The second period covered by the legislation is from 1996-97 to 1999-2000 and it covers total expenditure and revenue. Note 6 to the Province's financial statements discloses the details of this legislation.

2.150 The government plans to amend the Balanced Budget Act to state that revenue must exceed expenditure by the scheduled amount as outlined in the debt reduction plan over each four-year period. The Minister of Finance will present a progress report on the debt reduction plan annually in the Legislative Assembly.

Comments on the plan

2.151 The government has taken a first important step toward reducing the net debt by committing itself to a course of action as defined in the plan. We have not studied the plan in detail. Our comments are based on our initial observations and discussions.

1. New Brunswick long-term debt reduction plan.

2.152 The long-term debt reduction plan is based on a number of economic assumptions including growth in the Province’s GDP as well as inflation and interest rate projections. The government proposes to legislate the achievement of the plan benchmarks regardless of the affect future economic performance has on the assumptions contained in the plan. The plan does not contain detailed information on contingency plans should actual results fall short of expectations. It simply states that annual results may deviate; however surpluses will be averaged over each four-year period.

Summary

2.153 Exhibit 2.19 summarizes the impact of the Province’s current financial results from the perspective of a resident of the Province of New Brunswick.

Exhibit 2.19
Summary of provincial financial results

	Per person in N.B.				
	1997	**1996**	**1995**	**1994**	**1993**
Borrowing cost	740	781	849	773	713
Surplus (deficit)	164	67	(90)	(337)	(350)
Net debt	7,137	7,309	7,400	7,335	7,018

	Per employed person in N.B.				
	1997	**1996**	**1995**	**1994**	**1993**
Borrowing cost	1,808	1,899	2,077	1,931	1,771
Surplus (deficit)	402	163	(221)	(842)	(870)
Net debt	17,441	17,775	18,111	18,319	17,433

2.154 We will continue in our attempt to provide understandable information on the Province's surpluses, deficits, borrowing and net debt on a consistent basis in our annual Reports. This will help the reader to understand the issues surrounding the management of the Province's finances.

Revenue and expenditure

2.155 The purpose of this section is to provide readers with useful information and analysis on which to draw their own conclusions about the Province’s revenue and expenditure. It is not the purpose of this section to provide a conclusion about the appropriateness of individual types of revenue or expenditure. Such issues are matters of policy which are more appropriately dealt with by the Legislative Assembly. Accordingly, they do not fall within our mandate at the Office of the Auditor General.

2.156 The Statement of Revenue and Expenditure is a key financial document for the Province. The public, the government, and the media frequently quote facts and figures from this statement. This is because it is one of the timeliest tools available for assessing government's performance and stewardship.

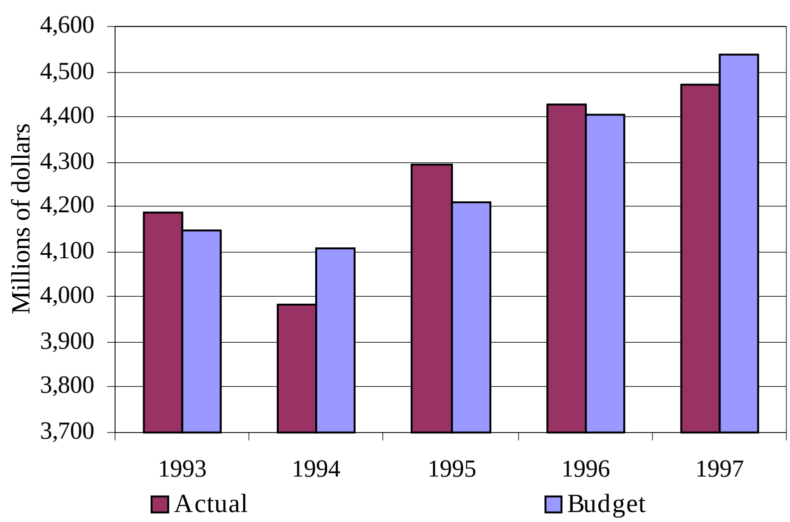
2.157 For instance, one of the chief financial indicators of performance and stewardship is the annual surplus or deficit. This figure has taken on a significantly higher profile in recent years. This is due to the widespread recognition that governments cannot continue to borrow without significant consequences for the future. This principle has been translated into provincial initiatives such as the balanced budget legislation. The Province's current financial success or failure is often measured by the amount of the annual surplus or deficit.

2.158 The financial statements go to considerable length in explaining the accounting policies, the activities and the entities which comprise the Statement of Revenue and Expenditure. Additional details can be found in the notes and schedules to the financial statements. However, some readers may find this amount of detail overwhelming. For this reason, our Report has traditionally provided a brief analysis of revenue and expenditure. It is hoped that by providing objective information on a consistent basis, readers will gain insight into financial patterns, trends, and issues.

Revenue

2.159 Overall, provincial revenue increased by $44.2 million (or 1%) in 1996-97 over the prior year. However, Exhibit 2.20 shows that the Province anticipated more revenue than it received in 1996-97. The shortfall in revenue was $67.4 million. A similar shortfall occurred only one other time in the last five years.

Exhibit 2.20
Comparison of budgeted revenue to actual, by year



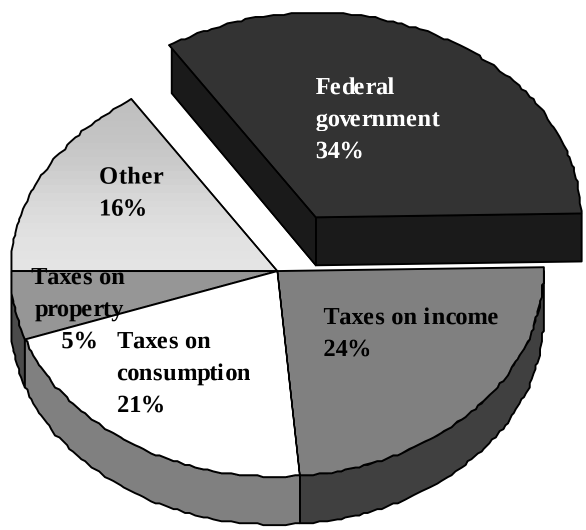
2.160 Though a $44.2 million increase in revenue is not a large increase, it may have been a surprise to some readers. The Minister of Finance predicted a reduction of $150 million in federal transfers during

1996-97 and 1997-98.[1] This expectation materialized, at least in part, during 1996-97. Federal transfers decreased by $102.2 million (or 6.3%) from the prior year.

2.161 Federal transfers have been an area of considerable uncertainty for the Province during its recent history. If the provincial government is to meet its goal of making New Brunswick ‘self-sufficient’[2], it must reduce the degree of uncertainty associated with these federal transfers. Continued uncertainty makes New Brunswick vulnerable to future federal transfer fluctuations.

2.162 New Brunswick’s vulnerability would decrease if federal transfers were to stabilize in both the short and long term. Vulnerability would also decrease if New Brunswick reduced its dependence on these federal transfers. One measure of provincial dependence is shown in Exhibit 2.21.

Exhibit 2.21
Sources of revenue



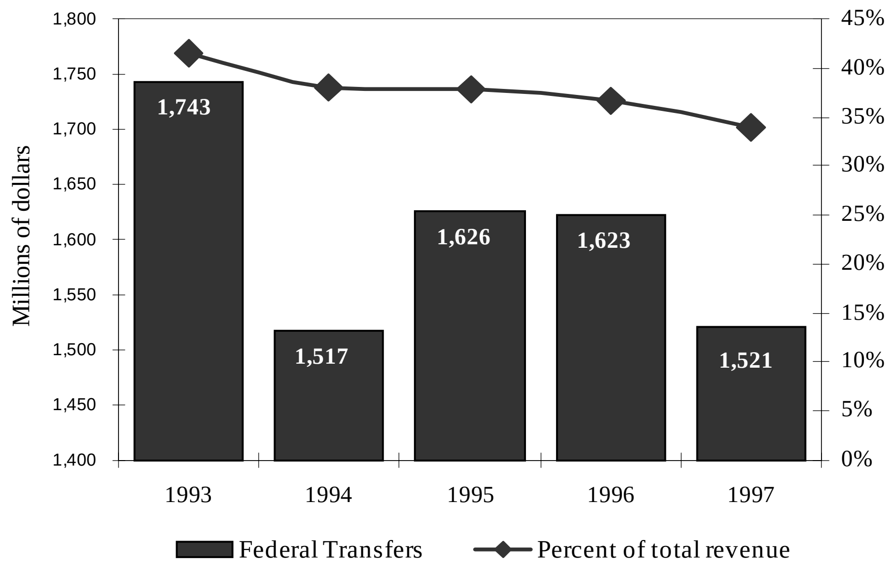
2.163 The Minister of Finance predicted in the 1996-97 Budget Speech that the percentage of total provincial revenue represented by federal transfers will fall to 34% by 1997-98. As Exhibit 2.21 shows, our Office calculates this percentage at 34% in 1996-97 (last year 37%). In this regard, New Brunswick appears to be succeeding. It is important to note that the Province enjoyed a surplus in 1996-97 despite this decrease in federal transfers.

2.164 Overall, there has been a decrease in federal transfer revenue of almost $222 million over the last five years. This translates into a 12.7% decrease in total provincial revenue (using 1993 as a base.) Exhibit 2.22

1. Introduction, 1996-97 Budget presented by Minister of Finance.
2. 1996 Speech from the Throne; and Introduction, 1996-97 Budget presented by Minister of Finance

shows federal transfers as a percentage of total provincial revenue for the period 1993 to 1997.

Exhibit 2.22
Federal transfer revenue and percentage of total provincial revenue, by year



2.165 It is useful to consider these revenues from the perspective of the average New Brunswicker. In 1996-97, the Province recorded revenue of approximately $1,994 per person[1] from the federal government to fund provincial programs and services. This is down from the $2,130 per person that was received in 1995-96[2].

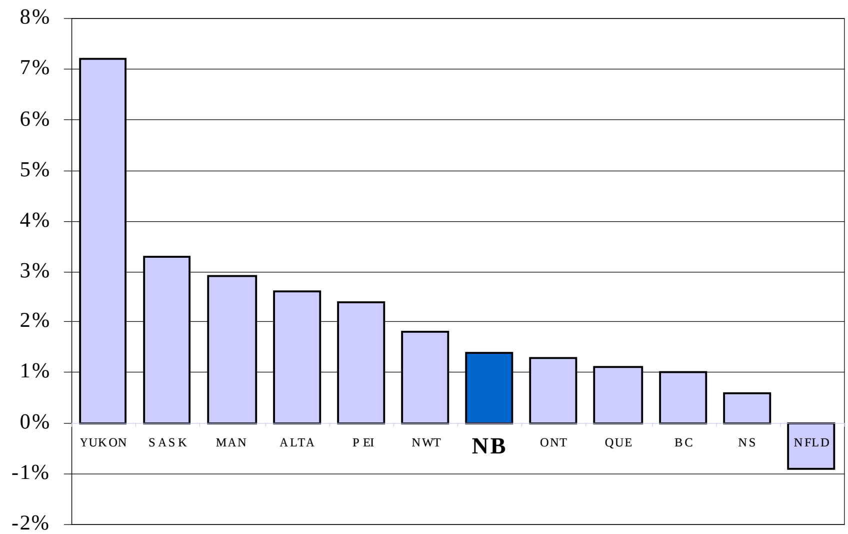
2.166 To compensate for such a reduction in federal revenue, the Province needs to generate a higher level of provincial own-source revenue. However, this type of revenue is largely dependent on the economy. For instance, about 50% of total revenue of the Province in 1996-97 took the form of taxes. When the economy is strong, more people purchase goods and services, more people buy land for homes and business, and more people or businesses are working profitably. These factors will increase consumption taxes, property taxes and income taxes.

2.167 Taxes on consumption and property increased by a moderate amount in 1996-97. Taxes on income increased by $155.4 million or 17%. This was $125.7 million more than predicted by the Minister of Finance's Main Estimates. This large increase is due, in part, to the settlement of outstanding claims by certain corporate taxpayers.

1. Population as at 31 March 1997 per N.B. Statistics Agency.
2. Population as at 31 March 1996 per N.B. Statistics Agency.

2.168 In New Brunswick, combined taxes[1] per person totalled $2,994 in 1996-97[2]. This is an increase from the 1995-96 level of $2,774 per person[3]. An increase in combined taxes per person may reflect a slowly improving economy. One indicator of a growing economy is the Gross Domestic Product (GDP) of New Brunswick. The Minister of Finance predicted a 2.5% increase in real GDP during the 1996 calendar year[4]. Though the expected level of growth did not materialize, New Brunswick still demonstrated growth of 1.4% during that period[5]. Exhibit 2.23 compares real GDP growth in New Brunswick to growth experienced in other provinces and territories during 1996.

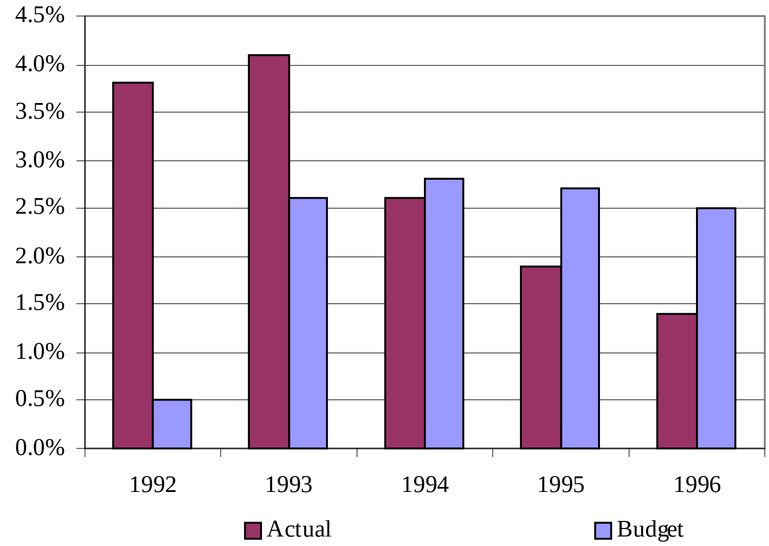
Exhibit 2.23
Growth in the gross domestic product in real terms, by province and territory



2.169 Exhibit 2.24 shows the growth in real gross domestic product for New Brunswick over the last five years. It also shows the percentage growth expected by the Minister of Finance as detailed by the annual budget speeches. There has been actual growth which exceeded expected growth in two of the last five years.

1. Combined taxes include consumption, property, income and other taxes as disclosed in statement of revenue and expenditure
2. Population as at 31 March 1997 per N.B. Statistics Agency.
3. Population as at 31 March 1996 per N.B. Statistics Agency.
4. Economic and Fiscal Context, 1996-97 Budget presented by Minister of Finance.
5. Gross Domestic Product at market prices, at 1986 prices per N.B. Statistics Agency

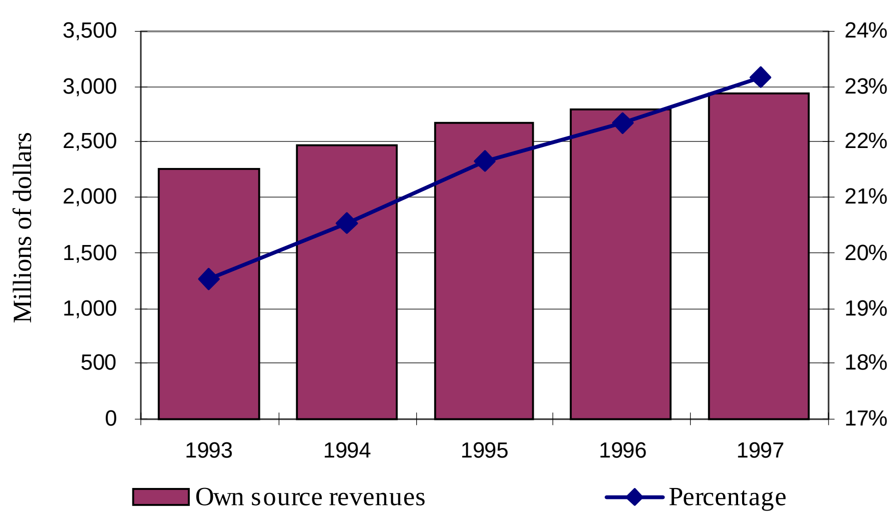
Exhibit 2.24
Comparison of budgeted growth in real GDP to actual, by year



2.170 Where growth in the economy does not meet expectations, government may need to increase taxes or implement higher user fees. Provincial own-source revenue consists mainly of taxes and user fees from the residents and businesses in New Brunswick. As a government increases taxes and user fees, the willingness and ability of the public to tolerate such increases diminishes.

2.171 Exhibit 2.25 shows provincial own-source revenue over the last five years. It also shows the percentage of provincial own-source revenue to the gross domestic product. As the Province extracts more taxes and user fees from the economy, it becomes more challenging to encourage growth, which in turn, reduces the potential for future provincial revenue.

Exhibit 2.25
Provincial own-source revenue and percentage of GDP, by year



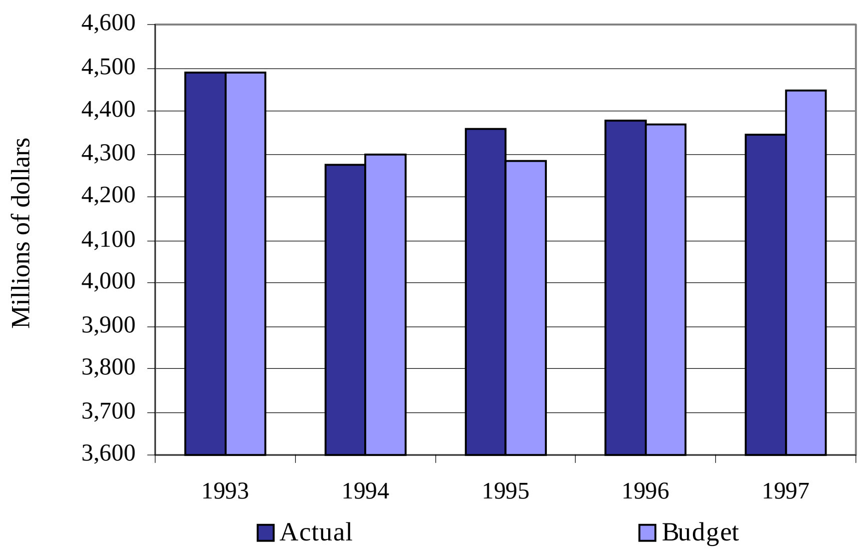
2.172 In recent years, the Province has committed to reducing its reliance on federal revenue. To become less dependent on federal revenue, the Province must inevitably resort to increasing its own-source revenue. The government has succeeded in generating sufficient own-source revenue to compensate in recent years. However, in a moderate or low growth economy there eventually comes a point at which this type of revenue cannot be increased any further.

2.173 It is at this point when the flexibility of a government to obtain money is reduced. Most funding for a government's activities comes from one of three broad categories: federal revenue, own-source revenue or borrowing. If federal funding is unavailable or uncertain and own-source revenues have been maximized, then one of the few options remaining (apart from reducing expenditure) is to finance provincial shortfalls through borrowing. It is important for the Province to maintain a level of flexibility which will prevent the need for dependence on significant, additional amounts of long-term borrowing.

Expenditure

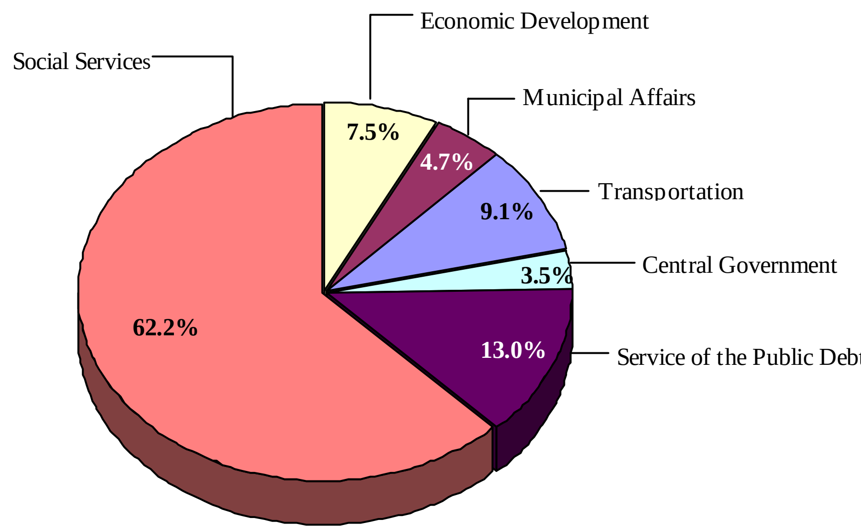
2.174 In total, 1996-97 spending decreased by $30 million (or 0.7%) as compared to the prior year. This year's spending also came in under budget by almost $100 million. Exhibit 2.26 demonstrates that the Province has spent less than budgeted in three of the last five fiscal years.

Exhibit 2.26
Comparison of budgeted expenditure to actual, by year



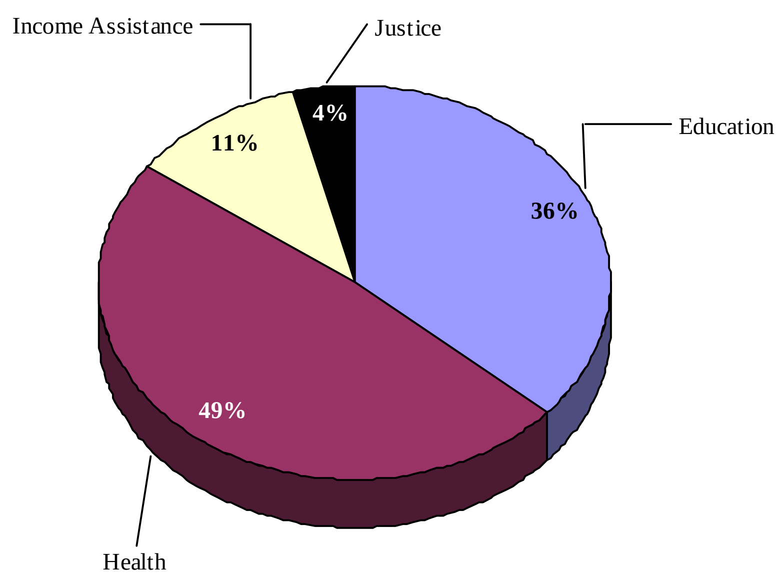
2.175 There has been public concern in recent years that spending on social services is being reduced or eliminated. Exhibit 2.27 shows that 1996-97 expenditure for social services stands at 62.2% of total expenditures. This is actually an increase from the previous year's level of 61.1%.

Exhibit 2.27
Components of total expenditure



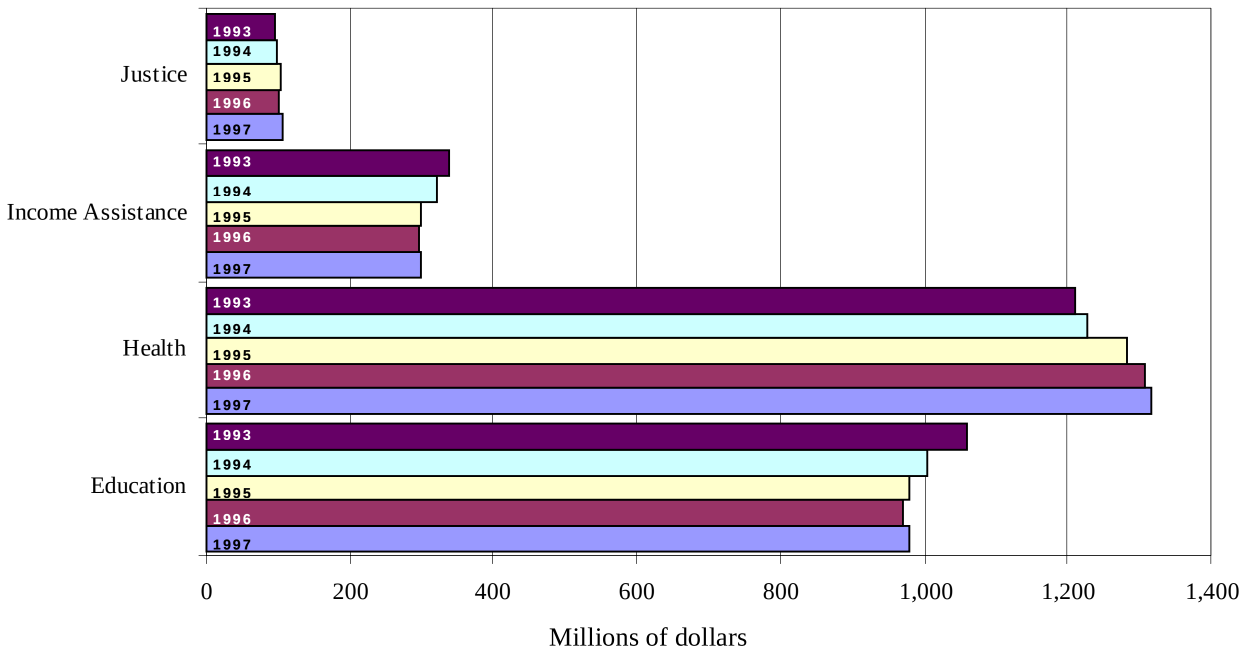
2.176 Social services spending is further broken down into its components: Health, Income Assistance, Education and Justice.

Exhibit 2.28
Components of social services spending



2.177 The largest increase in social services spending during 1996-97 was in Education. Education spending increased by $10 million. As demonstrated by Exhibit 2.29 it is the first time in four years that spending in Education has been increased. Moderate rises in spending in justice and income assistance have also occurred in the current year.

Exhibit 2.29
Social services expenditure, by year



2.178 Spending in health has increased during each of the last four years. However, it is difficult to determine the total cost of health care using the information in the Financial Statements. Assuming hospitals and nursing homes receive the majority of their funding from the provincial government, any deficits that they may experience may eventually impact the expenditure of the Province and the cost of health care in New Brunswick.

2.179 Note 1 to the Financial Statements states that hospital corporations and nursing homes are included in the financial statements using the transaction basis. This means the revenue and expenditure of these entities are not included in the balances of the Province. To improve disclosure, the provincial reporting entity has been expanded in recent years to include more detail on some major organizations that are accountable to the government. However, to get a complete picture, readers may still need to look to other financial information provided by the hospital corporations and nursing homes of the Province.

2.180 It is interesting to note that total spending by the Province for all the social services is approximately $3,541 per person in New Brunswick[1]. This is up from 1996's social services spending of $3,511 per person in New Brunswick[2]. Exhibit 2.30 breaks these amounts down into their component programs.

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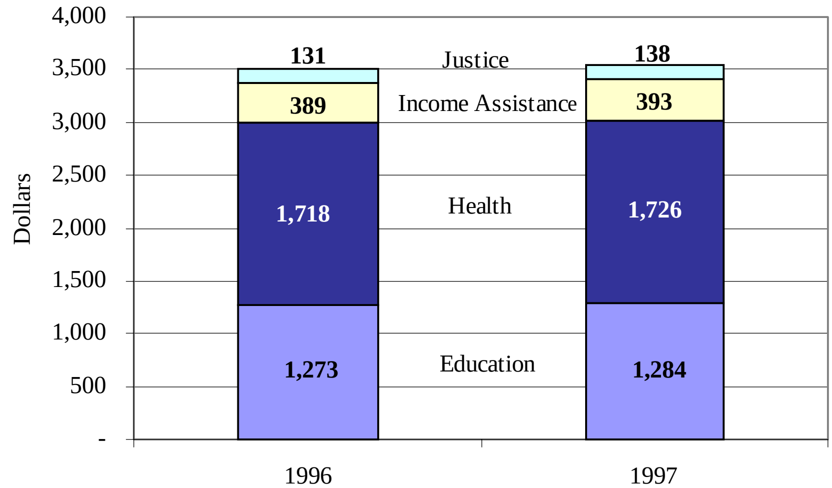
1. Population as at 31 March 1997 per N.B. Statistics Agency
2. Population as at 31 March 1996 per N.B. Statistics Agency

Exhibit 2.30
Components of total social services spending on a per capita basis



2.181 The combined spending increases in Education, Health, Income Assistance and Justice were almost completely offset by spending reductions in Transportation and Central Government. Each program reduced expenditure by approximately $13 million in 1996-97.

2.182 The cost of servicing the public debt decreased in 1996-97 from last year's $595 million to $564.4 million. This is a decrease of over $30 million. This expenditure now consumes 13% (13.6% in 1995-96) of every dollar spent. It is the second consecutive year that the cost of servicing the public debt has decreased.

2.183 This decrease seemed to be unanticipated by the Minister of Finance in his Main Estimates. Main Estimates reflect a budget for Service of the Public Debt of $596 million. This is significantly higher than the actual results at $564.4 million.

Summary

2.184 Exhibit 2.31 examines the Statement of Revenue and Expenditure from the perspective of a resident of the Province of New Brunswick.

Exhibit 2.31
Revenue, expenditure and surplus per person

	Per person in New Brunswick 1997	1996
Federal source revenue	$ 1,994	$ 2,130
Own source revenue	3,867	3,679
Total revenue	5,861	5,809
Social services expenditure	3,541	3,511
Borrowing cost	740	781
Other expenditures	1,416	1,450
Total expenditure	5,697	5,742
Surplus	**$ 164**	**$ 67**

Chapter 3
Pension Plans

Contents

Pension Plans

Background

3.1 The Province of New Brunswick sponsors several pension plans for its employees and for members of the Legislative Assembly. There are over 35,000 active contributors to the plans and approximately 14,500 pensioners. As well, over seven hundred persons entered the various early retirement programs in the year ended 31 March 1997.

3.2 Pension benefits are currently being provided through eleven pension plans and one early retirement/workforce adjustment program. Pension fund investments exist for each of the pension plans, except for the Members' Plans and the Ombudsman Plan. All pension fund investments are kept separate from the finances of the Province.

3.3 All pension plans which hold investments issue audited financial statements on an annual basis, except for the Pension Plan for Certain Bargaining Employees of New Brunswick Hospitals and the Pension Plan for Part-time and Seasonal Employees.

3.4 Pension plans are classified as either defined benefit or defined contribution plans. The classification depends on the terms and conditions of the plan. A defined benefit plan specifies either the benefit to be received by employees or the method for determining those benefits. A defined contribution plan specifies how contributions are determined. Contributions, under a defined contribution plan, are allocated to the specific individuals making the contribution.

3.5 When the Province of New Brunswick provides benefits under a defined benefit plan, it is at risk with respect to the amount of the benefit that each employee will receive. There is a risk because the total amount of the liability is not known with certainty until the benefits have all been paid. Any shortfall between the fund revenues (amounts contributed to the funds by employees and the employer plus investment earnings) and the benefits paid must be funded by the Province. The exception is the Hospitals-Certain plan where any shortfall is the responsibility of the employees.

3.6 Under a defined contribution plan the Province and the employees contribute a specified amount to the fund in connection with services rendered by the employee. The Province has no responsibility to make any further contributions. With a defined contribution plan, it is the employee who is at risk because the amount of the benefit that will be payable to an individual employee is entirely dependent upon the amount of funds accumulated in the employee's account and the investment earnings on the accumulated funds.

3.7 All the Province's sponsored pension plans are defined benefit except for the part-time and seasonal employees.

Scope

3.8 The Auditor General Act states that the Auditor General shall audit on behalf of the Legislative Assembly and in such a manner that he considers necessary the accounts of the Province relating to:

- the Consolidated Fund
- all public property, and
- all trust or special purpose funds.

3.9 The audits of pension plans fall within our responsibilities in two ways.

- As mentioned earlier in the Report, the Auditor General Act requires us to examine the financial statements of the Province of New Brunswick (referred to above as the Consolidated Fund) and express an opinion as to whether they fairly present the information in accordance with the stated accounting policies of the Province. In conducting the associated audit work it is necessary to examine many aspects of the operations of the pension plans. Evidence of this can be seen by examining the level of detail supplied in Note 13 to the Province's audited financial statements.

- The Province holds the pension plans in trust. As trust funds of the Province, we have determined that it is necessary to perform audit work on each of these plans.

3.10 We have comments and observations arising from our responsibilities as auditor of both the Province's financial statements and the pension plans. This chapter includes our comments on the pension information included in the Province's financial statements and our comments to the Department of Finance arising out of the pension plans audits.

Results in brief

3.11 The pension liability for accounting purposes has declined from $1,645.7 million in 1993 to $1,251.8 million in 1997.

3.12 The actuarial liability for the Province's pension plans has declined from $1,292.5 million in 1993 to $189.7 million in 1997.

3.13 In the past five years the pension expense recorded by the Province has fallen from $154 million to $18.2 million.

3.14 The Province's pension valuation committee decided the period between actuarial valuations for pension plans will not exceed three years.

3.15 The pension plans may not be in accordance with the Income Tax Act.

3.16 The Department agreed to improve disclosure practices for pension plan administration expenses.

3.17 The Department has agreed that budgets should be prepared for administration costs charged to the pension plans.

3.18 There should be improvements to the accounting for administration costs and how they are charged to the pension plans.

Actuarial valuations

3.19 The Province's pension obligation results from a promise to provide pensions to employees in return for services. The employees' entitlement to pensions is earned over the term of their employment. When the assets of a pension plan do not equal pension obligations, the difference is called the pension liability or pension surplus and it is calculated through an actuarial valuation.

3.20 The Canadian Institute of Chartered Accountants defines an actuarial valuation as follows:

> *... an assessment of the financial status of a pension plan. It consists of the valuation of assets held by the fund and the calculation of the actuarial present value of benefits to be paid under the plan. The valuation results in a calculation of the required future contributions and the determination of any gains or losses since the last valuation.*

3.21 The valuation provides the information needed to determine the pension liability or surplus and related pension expenditures.

3.22 Actuaries utilize several sources of information in arriving at the estimated surplus or liability at the valuation date. Included are historical government payroll records, government assumptions affecting the future revenue and expenditure of the funds and information available to the actuaries, for example the life expectancy estimates of contributors.

3.23 Each time a valuation is conducted, a new estimate of the plan's liability or surplus is prepared. There are a number of key assumptions which can result in major changes to the liability or surplus. The Province's financial statements list four of the assumptions: rate of return on fund assets, annual wage and salary increases, inflation and rate of pension payment escalation. There are other assumptions that are considered such as mortality rates, retirement ages, percent of members married and rates of employment terminations.

Understanding the liability

3.24 Readers of the financial statements are faced with some rather complex concepts in the area of accounting for pensions. One that is worthy of discussion is the difference between the actuarial pension liability and the pension liability for accounting purposes.

3.25 In the financial statements the focus is primarily on the liability for accounting purposes. However, if the reader is interested in the funding plans for the liability, the focus would be on the actuarial liability since it represents the shortfall in the value of pension fund assets below accrued pension benefits at a point in time.

3.26 Both liability figures are based on results of actuarial valuations and they are very much interrelated. It is important, however, to use them in the proper context. As auditors we refer most often to the liability for accounting purposes. What makes this value different from the actuarial liability is that there is a delay before the liability for accounting purposes recognizes any increase or decrease in the amount of the actuarial liability.

3.27 For example, if a new actuarial valuation is completed and it indicates that the liability is only one half of what was originally estimated, the liability for actuarial purposes falls immediately to the revised level. For accounting purposes, however, such a treatment is not correct. By their nature, pension liabilities, as estimates, are prone to upward and downward adjustments. Because of this tendency, adjustments are not recognized all at once. Rather, they are recorded over a reasonable period of time. If this was not the case then it would be possible to have a huge increase or decrease in expenditure in the year of the new estimate of the liability. This could confuse and mislead users of the financial statements.

3.28 The end result of applying the accepted accounting practice for pension liabilities is to smooth the recognition of the adjustments. This considers the fact that the amounts are estimates, not certainties.

Changes in the year

3.29 The pension liability for accounting purposes has fallen from $1,386.4 million at the beginning of the 1996-97 year to $1,251.8 million at year end.

3.30 The 1997 financial statements disclose the pension liability for accounting purposes in two components. One component represents the adjustments to be recognized in the future ($1,062.1 million). The other component ($189.7 million) is the excess of the accrued pension benefits over the value of the assets held in the funds at year end (also known as the actuarial pension liability).

Declining pension liabilities

3.31 Increases and decreases to the pension liability for accounting purposes are the result of the combined impact of the pension expense and the employers' contributions each year. Pension expense, which represents the current service cost and any amortization of prior years' adjustments, will increase the liability for accounting purposes. Any contribution by the Province will reduce the liability. In 1996-97 the pension expense was $18.2 million. Employer contributions were $152.8 million resulting in a reduction of $134.6 million in the pension liability for accounting purposes.

3.32 The following exhibit shows the declining pension liability for accounting purposes recorded in the financial statements for each of the past five years. It also shows the components of the liability at each year end. The figures used are those previously published for the respective years. They have not been restated for subsequent changes due to new valuations or changes in accounting policies.

Exhibit 3.1
Components of pension liability
(millions of dollars)

	1997	**1996**	**1995**	**1994**	**1993**
Estimated accrued benefits	4,918.7	4,679.7	4,374.3	4,339.0	4,137.3
Less: Value of assets	(4,729.0)	(4,257.0)	(3,701.5)	(3,403.1)	(2,844.8)
Actuarial pension liability	189.7	422.7	672.8	935.9	1,292.5
Plus: Unamortized adjustments	1,062.1	963.7	794.9	650.2	353.2
Pension liability for accounting purposes	**1,251.8**	**1,386.4**	**1,467.7**	**1,586.1**	**1,645.7**

3.33 There has been a steady decline in the pension liability for accounting purposes from $1,645.7 million in 1993 to $1,251.8 million in 1997. During this time, the value of assets increased by 66.2% while the estimated accrued benefits rose by only 18.9%.

3.34 A continuation of special contributions by the Province to the Public Service and Teachers' Pension Plans have accelerated the increase in the value of assets.

3.35 The adjustments made to actuarial assumptions adopted in previous actuarial valuations have reduced pension expense recorded today and into the future. Adjustments to the estimated accrued benefits are being amortized over periods of up to twenty-one years. Despite the fact the adjustments are amortized each year, the level of the unamortized balance (the amount to be amortized in future years) has increased in each of the past five years. It has risen from a zero balance in 1992 to $1,062.1 million at the end of the 1996-97 year. The following exhibit shows how the balance has grown.

Exhibit 3.2
Unamortized pension adjustments
(millions of dollars)

	1997	1996	1995	1994	1993
Opening balance	963.7	794.9	650.2	353.2	-
Adjustments for the year					
Plan amendments	-	(30.5)	(13.9)	-	-
Experience gains	172.4	274.1	-	258.3	377.8
Actuarial assumptions	4.0	-	215.6	85.7	-
Less: Amortization for the year	(78.0)	(74.8)	(57.0)	(47.0)	(24.6)
Changes in the year	98.4	168.8	144.7	297.0	353.2
Closing balance	**1,062.1**	**963.7**	**794.9**	**650.2**	**353.2**

3.36 Annual amortization has gone from $24.6 million in 1993 to $78.0 million in 1997. The cause of this increase can be seen clearly in the adjustments for each year.

3.37 The majority of the adjustments result from experience gains. Experience gains or losses result when the planned performance and the actual results differ. As demonstrated by the experience gains shown in Exhibit 3.2, the recent results have been much more favourable than anticipated in the actuarial assumptions. The other major component in the adjustments is the impact of changes in actuarial assumptions from those used in previous periods.

Pension expense is declining

3.38 Changes to the actuarial pension liability are ultimately reflected in the pension expense through the amortization of the adjustments. The following exhibit shows the pension expense for the past five years. The amounts for 1993 and 1994 have been restated on a basis consistent with that used from 1995 to 1997.

Exhibit 3.3
Pension expense
(millions of dollars)

	1997	1996	1995	1994	1993
Employer's share of pension benefits earned	78.7	82.2	57.8	66.8	85.3
Plus: Pension interest cost	25.3	41.0	45.6	73.8	100.0
Less: Amortization of adjustments	(78.0)	(74.8)	(57.0)	(47.0)	(24.6)
Less: Crown agency special payments	(7.8)	(7.5)	(7.3)	(7.1)	(6.7)
Pension expense	**18.2**	**40.9**	**39.1**	**86.5**	**154.0**

3.39 This exhibit shows the components of the pension expense recorded in the Province's financial statements. It is composed of the employer's cost for the year using the actuarial assumptions, the interest on unfunded amounts, the amortization of adjustments and a reduction for special payments by certain Crown agencies.

3.40 Significant amortization adjustments were recorded in the past four years. Dramatic decreases in pension expense resulted during this period, falling from a level of $154 million in 1993 to $18.2 million in 1997.

3.41 Pension expense has decreased by $22.7 million from last year. This is primarily because of the decrease in the expenses of the Teachers' Plan by $13.6 million and the early retirement program by $7.5 million.

Timing of future actuarial valuations

3.42 The Canadian Institute of Chartered Accountants (CICA) recommends that "actuarial valuations of pension obligations for accounting purposes should be done at least once every three years."

3.43 Last year we were informed that the pension valuation committee composed of senior government officials was addressing the issue. We have since been notified that the valuation committee passed a motion which states that the period between actuarial valuations will not exceed three years.

3.44 Department of Finance officials have informed our Office that a full actuarial valuation will soon be completed for each of the following funds:

- Public Service Superannuation Plan
- Teachers' Pension Plan
- Pension Plan for CUPE Employees of New Brunswick Hospitals
- Pension Plan for General Labour, Trades and Services Employees of New Brunswick School Boards
- Pension Plan for Secretarial and Clerical Employees of New Brunswick School Boards
- Pension Plan for Certain Bargaining Employees of New Brunswick Hospitals

Disclosure of surpluses and liabilities in the Province's financial statements

3.45 The Province's financial statements report the total actuarial pension liability to be $189.7 million. This balance is a net amount made up of actuarial surpluses and deficits. Three plans and the early retirement/workforce adjustment program have an accumulated pension liability of $307.2 million. The remaining five plans have an accumulated pension surplus of $117.5 million.

3.46 There is currently no CICA standard dealing specifically with the netting of the surpluses and the deficits. A recent CICA proposal states "unless an entity clearly has the right to use the assets of one plan to pay benefits of another, a liability required to be recognized for one plan would not be reduced or eliminated because another plan has assets in excess of its accrued benefit liability."

Observations arising from our audits of pension plans

3.47 During the 1996-97 year a number of issues were raised with the Department of Finance. These issues resulted from the completion of the pension plan audits relating to the Province's year end of 31 March 1996.

Purchase of prior years' service

3.48 Records for the purchase of prior service are maintained with a local administrator. We tested six clients for purchase of prior years' service; three where purchase of service was made directly through the administrator and three through payroll deduction.

3.49 One case was noted where the wrong historical salary figure was used which resulted in an incorrect calculation being performed.

3.50 One case was noted where there was no salary figure in the file to support the contribution calculation.

3.51 There was no evidence of a properly approved application in any of the three cases involving payroll deductions.

Recommendation

3.52 The Department should implement procedures to ensure the administrator is keeping sufficient appropriate audit evidence to support the calculation of prior service purchase costs.

Departmental response

3.53 *The two plans which the administrator handles will be repatriated to the Public Service Employee Benefits Branch (PSEBB) in 1998. As a result, this branch will be in a position to administer these plans in accordance with the procedures now in place for the other plans.*

Compliance with the Income Tax Act

3.54 Board of Management approved amendments to the following pension plans:

- Pension Plan for CUPE Employees of New Brunswick Hospitals;
- Pension Plan for Management Employees of New Brunswick School Boards;
- Pension Plan for General Labour, Trades and Services Employees of New Brunswick School Boards; and
- Pension Plan for Secretarial and Clerical Employees of New Brunswick School Boards.

3.55 This was subject to approval by pension committees or collective bargaining. The amendments were designed to ensure the plans comply with the Income Tax Act. The plan amendments covered the following major areas:

- maximum pension for post 1991 pensionable service;

- maximum employee contribution;
- periods of reduced pay and temporary absences;
- permissible employer contributions;
- reciprocal transfer agreements;
- unreduced early retirement; and
- superseding of the Income Tax Act.

3.56 Our concern is whether the plans are in compliance with the Income Tax Act in all respects. According to documentation provided by the Department, failure to comply with the Income Tax Act could result in the revocation of the federal registration of these pension plans.

3.57 During the audit we were not able to obtain the current plan documents for all the pension plans and thus were unable to ensure the necessary changes were made to the plan documents.

Recommendations

3.58 The Department should review the pension plans to ensure all the plan documents are in compliance with the Income Tax Act.

3.59 The Department should ensure the administration of the pension plans is in accordance with the Income Tax Act.

Departmental response

3.60 *Plan documents are currently being reviewed to reflect many changes, including those required as a result of the Income Tax Act. Non-legislated plans will all be updated by December 1997, pending pension committee's approval. Legislated plans will be modified as per the schedule of the Legislature.*

Refunds

Interest on refunds – Public Service Superannuation Plan and Teachers' Pension Plan

3.61 Test results indicated an error in the program logic that caused interest to be understated for certain individuals receiving refunds for the Public Service Superannuation and Teachers' Pension Plans.

3.62 We notified the Benefits Branch of the error. It is our understanding they have since identified the individuals affected and rectified the problem. We have performed no further work to identify the contributors involved or to ensure the error in the program logic was changed.

Recommendation

3.63 There should be procedures in place to ensure systems updates are not being made before they are properly tested.

Departmental response

3.64 *As noted in your letter, PSEBB has rectified the error in the program logic which caused interest to be understated for certain individuals receiving refunds for the Public Service Superannuation and Teachers' Pension Plans. In addition to the correction, the branch is taking measures to prevent the reoccurrence of such an error in the future, including the purchase of new software which will enhance the ability to conduct testing on the program logic. Due diligence will be used in the meantime.*

Update on comments from last year

3.65 Last year we reported a number of errors found in the refunds tested in the Public Service, Teachers'and Judges' Pension Plans. We are pleased to report that in the testing conducted this year pertaining to all the plans, we did not discover any errors of the same type.

Administration expenses

3.66 Exhibit 3.4 summarizes the disclosure of expenses appearing on the financial statements of the pension plans. For the purpose of this section these costs have been collectively referred to as administration expenses.

Exhibit 3.4
Pension plan financial statement disclosure
Administration expenses
Years ending 31 December 1995 and 31 March 1996
(thousands of dollars)

	Public Service	**Teachers'**	**Judges'**	**Hospitals CUPE**	**Schools Management**	**Schools G.L.T. & S.**	**Schools S & C**	**Total**
General administrative expenses	2,022.5	1,278.1	-	555.7	21.7	166.8	51.4	4,096.2
Custodial fees				80.8				80.8
Performance measurement fees				14.0				14.0
Investment management fees				280.9				280.9
Investment management and custodial fees					45.1	217.6	48.7	311.4
Total	**2,022.5**	**1,278.1**	**-**	**931.4**	**66.8**	**384.4**	**100.1**	**4,783.3**

Financial statement disclosure

3.67 Administration expenses were recorded in a number of ways in the financial statements of the pension plans. For example in the Public Service Superannuation Plan there was a one-line disclosure for all of the administration expenses, which includes fees for custodial, performance measurement and investment counsel as well as an allocation of Benefits Branch expenses, Pensions and Insured Benefits Administration system (PIBA) expenses and Department of Finance (now New Brunswick Investment Management Corporation) expenses.

3.68 The Pension Plan for CUPE Employees of New Brunswick Hospitals, on the other hand, provided separate financial statement disclosure for custodial fees, performance measurement fees, investment counsel fees and other administration fees.

3.69 Exhibit 3.4 indicates the inconsistency in the disclosure of similar types of expenses.

3.70 The CICA suggests disclosure of the details of administration expenses showing actuarial fees, trustee and custodial fees and investment management fees.

Recommendation

3.71 The Department should review the disclosure practices for the administration expenses. In our opinion expenses should be disclosed by major expenditure types on a consistent basis for all plans.

Departmental response

3.72 *As suggested by the CICA, more detailed disclosure for administration expenses will be provided for the statements. The disclosure will be consistent among all the plan financial statements.*

Charging out the costs of running the PSEBB

3.73 Not all expenditures of the Public Service Employees Benefits Branch are recoverable from the pension plans. There are some expenditures which, because of their nature, are only partly recoverable. For example, the salary of the director and some of the managers of the Branch are two thirds recoverable from the pension plans with the remaining one third absorbed by the Branch.

3.74 It is our understanding that this arrangement has been in existence for a number of years. During these years there have been changes at the Benefits Branch. It has come to our attention that the Branch is in the process of reviewing these allocations as a result of these changes. It is our opinion that such a review is very timely.

Recommendation

3.75 The Department should conduct a review of expenses being allocated to the pension plans to ensure that the costs which are charged are reasonable for the services being provided.

Departmental response

3.76 *Public Service Employee Benefits Branch is in the process of reviewing the allocation of expenses to the pension funds with the idea of implementing an approach that will provide additional structure to the charge-back process.*

3.77 Benefits Branch expenses and expenses relating to the PIBA computer system are being allocated to the plans based on the total number of contributors and pensioners. For the plans with 31 March 1996 year ends the allocation was based on data at 31 March 1994 and for 31 December 1995 year ends the allocation was based on data at 31 December 1993.

Recommendation

3.78 The Department should be using up-to-date and accurate information as a basis to allocate the expenses to the pension plans.

Departmental response

3.79 *The rates used will be based on the number of contributors and pensioners in each plan at the beginning of our fiscal year. We are currently improving our computer system to provide this information as accurately and timely as practical.*

Administration expense - accountability

3.80 Accountability has been defined as the obligation to answer for authority and responsibility that has been conferred. Accountability relates to two main functions, namely financial stewardship and performance reporting. An important part of the financial stewardship function is the process of monitoring expenditures.

3.81 One method of monitoring expenditures is to compare budget and actual expenditures. Currently the area of monitoring administration expenditures is weak. The main reason for the weakness is the fact there is no budget prepared to outline the administration expenditures expected for each of the pension plans. This weakness is compounded by the fact that the financial system does not report the types of administration expenses incurred.

Recommendation

3.82 A budget should be prepared for the administration costs charged to each pension plan. The Department should be prepared to explain differences between planned and actual charges to the plans.

Departmental response

3.83 *PSEBB will be implementing a system of global budgeting by pension plan for the budget year 1998-99. These budgets will be presented to the respective pension committees. We are proposing that we also report actual expenses compared to budgeted to these committees.*

Accounting records for administration costs

3.84 It is normal practice for the Benefits Branch to incur expenditures on behalf of the pension plans. Expenditures are first paid by the Branch and then allocated to the various pension plans. For example, for non-payroll expenditures, staff at Benefits Branch code each expenditure and staff in accounting calculate the charges to each individual pension plan. Discussions with both parties indicate that this practice of coding and calculating takes a great deal of time and effort.

3.85 From an audit perspective this system presents a challenge as it is extremely difficult to determine if all expenditures initially recorded as being that of the Benefits Branch have been charged to the pension plans. This problem is compounded by the fact that the pension plans have either a 31 December or a 31 March year end.

Recommendation

3.86 The Department should prepare a reconciliation between PSEBB gross expenditures and the amount charged to pension plans at 31 March and 31 December to ensure that the financial statements for the pension plans accurately reflect the expenditures.

Departmental response

3.87 *PSEBB will advise the appropriate parties of the coding required in order to achieve accurate reporting in a more efficient manner. A reconciliation between PSEBB gross expenditures and amounts charged to the pension plans is difficult given the two different pension plan year ends. However, a reconciliation will be attempted for 1997-98.*

Results of testing administration expenses

3.88 There were a number of errors discovered during the audit of administration expenses of the Public Service and Teachers' Plans. Adjustments of approximately $142,000 (net understatement $14,600) for the Public Service Plan and $199,800 (net understatement $199,800) for the Teachers' Plan were made to the financial statements.

3.89 There were several causes of the errors:

- Expenses were recorded in the wrong year. Not all the expenses associated with the Special Operating Agency (SOA), which later became the New Brunswick Investment Management Corporation, were accumulated at 31 March 1996. This resulted in an understatement of approximately $26,900 for the Public Service Plan and $28,300 for the Teachers' Plan.

- Salaries of staff transferred to the Special Operating Agency for the period 1 April 1995 to 31 July 1995 were not allocated to the plans. The result was an understatement of approximately $51,400 for the Public Service Plan and $39,500 for the Teachers' Plan.

- PIBA expenditures for the month of February 1996 were not set up in the Teachers' Plan. This caused an understatement of $68,300.

- Expenses were charged to the wrong plan. There was an overstatement error of approximately $63,700 caused by expenses being charged to the Public Service Plan when they belonged to the Teachers' Plan.

Recommendation

3.90 The Department should take the necessary steps to ensure administration costs are recorded in the correct year and properly charged to pension plans.

Departmental response

3.91 *A number of the errors noted were related to expenses of the SOA during 1995-96. The transfer of the assets for the Public Service and Teachers' Plans to New Brunswick Investment Management Corporation has been completed and these errors will not reoccur. The other errors detailed have been noted and steps have been taken to ensure administration costs are properly recorded.*

Agreement for custodial charges

3.92 On a monthly basis the custodian for the Pension Plan for Secretarial and Clerical Employees charges the plan with custodial fees. The Department could not provide us with a signed copy of the agreement with the custodian outlining the charges. The Department does not obtain invoices or receive details outlining charges to the plan.

Recommendation

3.93 The Department should have a signed agreement with the custodian concerning the custodial charges. The Department should request supporting documentation for invoices detailing the monthly charges.

Departmental response

3.94 *Presently a new agreement and fee schedule are being negotiated with this custodian for the Plan for Secretarial and Clerical Employees. In* *the meantime the fund was being billed using the fee schedule for the Plan for CUPE Employees of New Brunswick Hospitals as agreed by the custodian and the Department of Finance.*

3.95 *For 1997, custodial billing responsibilities will be transferred from the New Brunswick office to an out-of-Province office. The custodian will be billing on an actual basis for each quarter and will be providing improved supporting documentation for departmental and audit purposes.*

Chapter 4
Audit of Crown Agencies

Contents

Audits of Crown Agencies

Background

4.1 We audit the Crown Corporations, Boards, Commissions and other Agencies which are listed below. We expect that by the date this Report is released we will have issued audited financial statements of all of these agencies for the year under review.

4.2 Agencies included in the Public Accounts:

- Advisory Council on the Status of Women
- Algonquin Properties Limited
- Kings Landing Corporation
- Lotteries Commission of New Brunswick
- NB Agriexport Inc.
- New Brunswick Credit Union Deposit Insurance Corporation
- New Brunswick Crop Insurance Commission
- New Brunswick Municipal Finance Corporation
- New Brunswick Research and Productivity Council
- Premier's Council on the Status of Disabled Persons
- Provincial Holdings Ltd.
- Regional Development Corporation
- Youth Council of New Brunswick

4.3 Other Agencies:

- Le Centre communautaire Sainte-Anne
- Legal Aid Fund
- New Brunswick Women's Institute

4.4 We were also appointed auditors of the New Brunswick Highway Corporation under the New Brunswick Highway Corporation Act which received Royal Assent on 29 March 1995. There has been no activity in the Corporation up to 31 March 1997.

4.5 Last year, we reported that the Board of Directors of the New Brunswick Investment Management Corporation had appointed us auditors of the Corporation for the years ended 31 March 1996 and 1997. The Corporation was established on 11 March 1996 to act as trustee for the Province's major pension funds and to provide investment counselling services for the Province's sinking funds.

4.6 In late 1996 the Corporation issued a Request for Proposals for audit services beginning with the year ending 31 March 1998. KPMG was the successful bidder. In our discussions with the Corporation subsequent to the appointment of KPMG, we agreed that it would be more efficient if KPMG undertook the audit of the Corporation for the years ended 31 March 1996 and 1997. Accordingly, the Board of Directors of the Corporation rescinded our appointment and appointed KPMG in our place. Under the provisions of the Auditor General Act, we have full access to the working papers of the auditors of the Corporation, and we can carry out additional work in the Corporation should we consider it necessary to do so. We will be working closely with the auditors of the Corporation to ensure there is no duplication of work between our two offices, nor any gaps in audit coverage.

4.7 NB Agriexport Inc. was established on 23 May 1996. It is wholly owned by the Province. Its mandate is to provide a focal point for the Department of Agriculture and Rural Development's international market development efforts, to facilitate exporters' access to international markets and to help exporters manage the risks of international marketing.

Scope

4.8 Our work in Crown agencies is usually aimed at enabling us to give an opinion on their financial statements. During the course of this work, we may note errors in accounting records or weaknesses in accounting controls. We bring these matters to the attention of the agency, together with any recommendations for improvement. In the majority of cases, we do not consider the issues raised to be significant to the members of the Legislative Assembly, and accordingly do not include them in this Report.

Results in brief

4.9 We are no longer auditors of the New Brunswick Investment Management Corporation.

4.10 The Board of Directors of Algonquin Properties Limited should approve all changes to the remuneration of the General Manager of the Algonquin Hotel prior to their implementation. They should also approve all capital projects undertaken at the Hotel.

4.11 Internal control weaknesses were noted at Kings Landing.

4.12 The Board of Directors of the New Brunswick Municipal Finance Corporation are taking steps to more clearly define their role in the governance of the Corporation.

Algonquin Properties Limited

Compliance with management agreement

4.13 We noted that changes to the remuneration of the General Manager of the Hotel which occurred during 1996 were not brought to the Board of Directors of Algonquin Properties Limited for its *written* approval *prior* to being implemented. We could not find any written evidence of a submission to the Board, or its subsequent approval. The management agreement with Canadian Pacific Hotels and Resorts in effect at the time required this procedure to be followed. This is the third time we have noted and reported this since 1994.

4.14 We believe this important control ensures accountability by Canadian Pacific Hotels and Resorts to the Board of Directors of Algonquin Properties Limited and it should be retained in future contracts. We recommended this in our 1995 Report.

4.15 In January 1997 Algonquin Properties Limited finalized a new management agreement with Canadian Pacific Hotels and Resorts which will expire in 2002. The new agreement states that the remuneration of the General Manager is subject to the approval of Algonquin Properties Limited. However, the requirement for *written* approval has been eliminated. Similarly, the requirement for approval *prior to implementation* has been eliminated.

4.16 We made the following recommendations:

- **Algonquin Properties Limited should ensure that formal means are put in place to regularly obtain up-to-date information from Canadian Pacific Hotels and Resorts regarding the remuneration of the Hotel's General Manager.**
- **Staff of Algonquin Properties Limited should adequately document any procedures put in place to review remuneration of the General Manager. Evidence of the Board's approval should be provided in the minutes of the appropriate meeting.**
- **Staff of Algonquin Properties Limited should regularly review the management agreement. They should also review financial transactions of the Hotel to ensure it is adhering to controls put in place by the management agreement.**

4.17 Algonquin Properties Limited responded as follows:

Review of the Board minutes allows us to concur with your findings concerning the approval of the salary of the General Manager of the hotel. The Board retro-actively approved the January 1, 1997 raise at the June annual meeting. Canadian Pacific Hotels and Resorts has been notified of this concern, and has stated that any proposed review will be available to the Board for review in the fall of each year. This situation will be monitored for compliance.

Inappropriate treatment of holdbacks on capital projects

4.18 One instance was found where a contractor's holdback was deducted from a payment to a contractor and not correctly recorded in the records of Algonquin Properties Limited. In another instance, a contractor's holdback should have been, but was not, deducted.

4.19 **We recommended accounting staff ensure contractors' holdbacks are correctly deducted from payments and properly recorded in the records of Algonquin Properties Limited.**

4.20 The Corporation responded:

The one case where a project holdback was not properly taken was reviewed by the Algonquin Properties Ltd. Directors as well as the Department of Supply and Services construction staff. It was an inadvertant violation of the policy and practice in place and could not be explained. We will attempt to ensure that all holdbacks are properly held in the future.

Lack of proper approval for a capital project

4.21 In reviewing the budget documentation provided to us, we noted one instance where written approval by the Board of Directors of Algonquin Properties Limited was not obtained for a capital project which was requested by the Hotel.

4.22 The records of the Corporation indicated that an approved capital project worth $15,000 was subsequently cancelled. However, expenditures were then made (to the limit previously set for the cancelled item) regarding a project previously delayed by the Board of Directors pending receipt of a “payback analysis.” Staff informed us that approval for this “offset” was verbal between the former General Manager of Algonquin Properties Limited and the General Manager of the Hotel. We could not find any written evidence of Board approval or receipt of a “payback analysis”.

4.23 Disbursements made without formal approval increase the risk that inappropriate projects are undertaken. It may also increase the risk that the intentions of the Board are not being fulfilled. The fact that further analysis was requested, and not subsequently received before disbursement, increases the risk these funds may not have been implemented in the most effective manner.

4.24 **We recommended approval of each capital project by the Board, or its designate, be formally documented in writing. A review of expenditures paid or reimbursed should be performed to ensure they have been approved by the Board.**

4.25 The Corporation responded:

The history of all capital projects was reviewed and we agree with the comments that the former approval process was somewhat difficult to trace. The total capital budget for the current year has been reviewed and approved by the Board. All capital projects are in fact funded by the head office Directors of Algonquin Properties Ltd., therefore proper control does exist. Procedures will be amended so as to assure proper documentation does exist for any minor changes in the annual capital improvement list.

Kings Landing Corporation

4.26 We reported to the Corporation a number of weaknesses in internal controls. Areas of weakness reported as a result of our 1997 audit included:

- controls surrounding the Emporium's computer sales terminals;
- documenting the reasons for differences between admission tickets issued and the cash register record of persons entering the site; and
- controls over food services revenue.

4.27 In addition, we recommended an improvement in the use of cash floats, and a review of the value of the Corporation's book inventory.

New Brunswick Municipal Finance Corporation

The role of the Board

4.28 In 1994 we commented that the role played by the Board of Directors appeared to be minimal. Meetings were conducted over the telephone and the only business conducted was related specifically to the issuance of debentures. We stated we would have expected discussion on other matters related to the operation of the Corporation and we commented that the Board should be actively fulfilling its role since it, in turn, is accountable to the Legislative Assembly.

4.29 In 1995 the Board agreed that annual meetings would be held when there are sufficient matters to warrant the meeting. Such meetings would not be held by telephone. Rather, they would involved a face to face meeting of the Board members. At the time of our 1996 audit, it appeared the Board had taken little action on the issues we raised. However, we understood an annual meeting was planned within the current year.

4.30 The Board of Directors met on 28 August 1997. At that meeting, they approved a set of by-laws for the Corporation setting out the powers and responsibilities of the directors and officers. We are pleased that the directors are taking steps to more clearly define their role in the governance of the Corporation.

Surplus funds held by the Corporation

4.31 In 1994 we commented that the Corporation held surplus funds in the amount of $520,000, which in our opinion was more than was needed by the Corporation to meet the expenses relating to the outstanding debentures.

4.32 Beginning in 1995, the estimated costs incurred by departments in issuing the debentures have been charged to the Corporation. In spite of this change, the retained earnings and the cash and short term investments of the Corporation have continued to grow, although at a slower pace.

4.33 In discussions with departmental staff we have been assured that the excess funds will be consumed within four to five years. This is expected to take place under normal operating conditions.

Chapter 5
Department of Economic Development and Tourism
Centre Plein Air de Kedgwick Project

Contents

Department of Economic Development and Tourism Centre Plein Air de Kedgwick Project

Background

5.1 In October 1996 New Brunswick's Leader of the Opposition sent a letter to our Office. In it he requested an inquiry into the "Centre Plein Air de Kedgwick" tourism development project. He believed this review might lead to observations reportable under the Auditor General Act.

5.2 In October we replied that our Office was preparing our 1996 annual Report and was unable to inquire into the matter immediately. However we did say that we intended to look into the matter during our 1997 departmental audit work. We started our review of the project during the first stage of our audit of the Regional Development Corporation (RDC) in early 1997.

5.3 The federal and provincial governments provided most of their funding for this project through federal/provincial agreements. For the most part, RDC administered these agreements for the provincial government. Various provincial departments, including the former Department of Tourism, Recreation and Heritage and the existing Department of Economic Development and Tourism, were involved in implementing the project.

Project history

5.4 Outdoor recreation centres (centres de plein air) had been in operation in Quebec for a number of years prior to 1982. Provincial and federal government funding aided in the development of most of these centres. Municipalities or non-profit organizations normally ran the facilities.

5.5 The centres offered many types of organized outdoor activities and recreation programs. They also offered different types of accommodation such as chalets, inns, motels and campgrounds. The purpose of having these extensive facilities was to ensure the centres were able to offer many different types of outdoor packages to their clientele.

5.6 In 1982 a consulting firm prepared a Tourism Development Plan for Restigouche County. The plan indicated there was a need to offer tourists various services and facilities to allow them to engage in outdoor activities in the region. In 1983 another consulting firm prepared a feasibility study for a centre de plein air and a forestry museum in the Kedgwick area. The feasibility study gave only marginal support to either concept.

5.7 Later in 1983 the Centre Plein Air de Kedgwick Ltée. (CPAK) was established as a non-profit organization. CPAK was responsible for the museum and the centre de plein air. The primary goal of CPAK was to create a quality tourism destination in the Kedgwick area. Other goals included creating short and long-term jobs and protecting the Restigouche River environment.

5.8 In 1985 CPAK started development. Funding was supplied through federal/provincial programs. From 1985 to 1987 (phase 1) federal/provincial funding allowed the completion of the forestry museum and the construction of five chalets. The museum was built in the town of Kedgwick while the chalets were built on the Restigouche River several miles from the main highway. The chalets were located on land leased from the Province.

5.9 In 1988 CPAK presented a proposal for completion of the final phase (phase 2) of the project. In the fall of 1988 the federal and provincial governments approved funding for this project. Funds were supplied under the Canada/New Brunswick Subsidiary Agreement on Tourism Development - Travel Generator program. In 1990 construction was started and by 1992 CPAK had basically finished the reception center, four more chalets, a campground, and the supporting infrastructure for these facilities.

5.10 By the end of 1991, the provincial and federal governments had provided approximately $2 million in funding to CPAK. Over $1.5 million of this funding went towards development of the plein air facilities. The remainder went to funding the museum.

5.11 In 1991 two consulting firms did a joint interim marketing study on CPAK. They concluded the operation was in trouble and noted serious financial and facility problems. Specifically they did not believe the existing facilities met the needs of the clientele they believed to be the plein air's market niche. They elaborated by saying CPAK needed to provide organized off-site activities. Having these activities would help attract the market segment CPAK needed in order to raise revenues to a level where the project could survive. The consultants also noted that the operation had an accumulated operating deficit to 31 March 1991 of $130,000.

5.12 By 1993 the situation still had not improved. The 31 March 1993 unaudited financial statements of CPAK showed over $1.6 million in capital assets (including landscaping, engineering and survey costs). Over $1 million related to plein air facilities. Total liabilities were over $200,000 with virtually no assets other than the facilities. Cash was only a little over $2,000. The statements also showed that without significant federal and provincial wage subsidies, losses from operations would have been serious (Exhibit 5.1).

Exhibit 5.1
Unaudited financial results of CPAK

	1993	1992	Total
Revenue from operations	$ 64,092	$ 23,464	$ 87,556
Subsidies	114,196	203,416	317,612
Total revenue	178,288	226,880	405,168
Total costs	138,904	236,156	375,060
Profit (loss) including subsidies	39,384	(9,276)	30,108
Profit (loss) without subsidies	**$ (74,812)**	**$ (212,692)**	**$ (287,504)**

5.13 As a result, the Centre Plein Air de Kedgwick Ltée. decided, and the government agreed, to sell the plein air assets. In 1995 CPAK sold the assets, except for the museum and the provincial park, to the private sector for $110,000.

Scope

5.14 In light of the request from, and after a review of the information provided to us by, the Leader of the Opposition we decided to meet with the individuals who originally researched and provided the information. We met with them and reviewed the centre plein air documentation they made available to us. Based on this information, we decided further review of the project was warranted.

5.15 One of our responsibilities under the Auditor General Act is to ensure money is expended with due regard to economy and efficiency. As such we decided to approach the project from the point of view of the government making an investment. Specifically we wanted to determine the process government used to approve and monitor the project and the effectiveness of that process.

5.16 Another issue we investigated was the allegation that $81,600 of public funding was not accounted for. We also investigated whether CPAK incurred secured loans contrary to the terms of the funding agreement.

5.17 We did not review the process used for other projects at that time. Nor did we compare the process with that used to make those same decisions today. We also did not review the records of CPAK.

Results in brief

5.18 From 1985 to 1987, government approved over $900,000 for the construction of a centre plein air and a museum in the Kedgwick area. There was little documentation in government files. This documentation gave only marginal support for the project.

5.19 In 1989, government funded an additional $1 million for the centre plein air project. This was done despite considerable doubt about the project's viability and in the absence of any marketing/ business plan.

5.20 Project monitoring was inadequate. Government was not monitoring either the operation's financial results or the effect on tourism of the new facility.

5.21 While government provided generous capital financing, no operational funding was planned or supplied even though the project's operator was known to have few cash resources.

5.22 The proceeds from the sale of the plein air assets were used to pay off various creditors.

Project evaluation

5.23 As noted earlier, the federal and provincial governments provided over $2 million in funding to CPAK. Over $1.5 million was spent on the plein air portion of the project. Our examination focused on why this project was approved and how government went about approving the project. We also questioned why additional funding was given to CPAK in the late 1980's and early 1990's. To try and see why, and how, this decision was made, we tried to piece together the steps taken in approving the various phases of the project.

Phase 1

5.24 We found little information in government files covering the first phase of development. Because of this we had difficulty in understanding how government evaluated this phase of the project.

5.25 In the documentation we reviewed we found only marginal support for the project. That support was contained in the consultant's feasibility study. The study also contained the only marketing analysis done before the project was approved. However we were unable to find any business plan for the project even though documents showed that CPAK had no financial resources of its own.

5.26 Despite the study's limited support, the lack of a marketing/ business plan and the lack of financial resources, the government approved project funding of approximately $900,000. The funding covered construction of the museum and partial development of the outdoor recreation centre.

Phase 2

5.27 In 1988 the CPAK group submitted an application for funding the second phase of the plein air project. Information contained in government files was more complete for this time period and we were able to review this documentation to determine how the approval of phase 2 came about. This file information revealed that many people in government had serious concerns with the project.

5.28 For example, documents showed that by 1986 government had provided significant funding for a competing plein air project located within five to ten miles of the Kedgwick project. It too was sold to private interests at a considerable discount in the mid 1990s. Government memos noted that the groups running these two facilities “refuse to cooperate with each other” and that “competition between two groups so close in proximity would probably make neither feasible”.

5.29 As importantly, the government committee dealing with the extension of the property lease to CPAK stated that visitor projections and revenues used to support the project were overly optimistic. The committee summary noted the project proposal did not mention the competition from other plein air facilities in the area or competition from landowners across the river from CPAK. It pointed out that the facilities were well off the main tourist route. This meant few tourists would know of the facility, especially without heavy advertising (we did not find any evidence of advertising). The summary also noted that the facility operators never established organized activities that would entice a tourist to visit, or stay at, the resort.

5.30 One reviewing departmental group summarized its findings by saying: “The markets quoted by the applicant (CPAK) are largely imaginary. There are no sources quoted for their statistics; the logic for the facility is ill conceived and the Crown could end up with a nuisance lease as a result.”

5.31 If the doubt expressed by departmental officials was correct and visitor projections were not attainable, the financial viability of the project would be in serious question. Visitor projections had to be attained in order for the project to break even. Different departmental officials again voiced concern as to the economic viability of the project.

5.32 Departmental officials also had other concerns with the project. These included:

- interference with the Department of Natural Resources’ ability to control and manage angling on this section of the river;
- potential danger to fish habitat should sewage disposal problems or siltation occur;
- the site has a potential for flooding; and
- development of the centre would heighten conflicts between canoeists and anglers.

5.33 A departmental official had concerns regarding management of the operation and commented that "based on their (CPAK) performance to date… the group appears to have problems in their ability to get the project organized, such as submitting detailed plans for their proposed development".

5.34 In our review we expected to find documentation and analysis assessing the viability, or the continued viability, of the development project. Most importantly, we expected to find a well-developed and objective marketing/business plan that addressed concerns raised by departmental personnel. The applicant did present some basic information concerning potential markets, but the concerns do not appear to have been addressed. The applicant did not complete a marketing/business plan until 1991, well after government approval for the project was given. Nor did the government verify the applicant's representations. This could have helped the Province determine if the applicant's figures were reasonable.

5.35 We also expected to find ongoing information as to how the project was doing. This information would be essential in determining if the project was being well run and if it was advisable to invest more money. However, we found no financial statements for any period prior to the time the decisions had been made by government to invest in the project. Nor did we find any information showing the effect the project was having on tourism.

Evaluation report

5.36 In late 1988 a federal Evaluation Officer (for the Canada/New Brunswick Subsidiary Agreement on Tourism Development) prepared an Application Evaluation Report on the CPAK proposal. He stated the projections for visitation and operating budget appeared to be realistic and the projections for the third year of operations, while optimistic, might be achievable. He also concluded that CPAK management had, by successfully managing the museum, proved capable of managing a tourist operation. These conclusions were significantly different than those reached by New Brunswick departmental officials.

5.37 The officer stated that a marketing/business plan could be completed during the construction of the second phase of the project. When government is assessing whether to invest a million dollars in a project we believe it is prudent that a marketing/business plan to ensure project viability is done before any large investment is made.

5.38 Even with departmental officials expressing considerable doubt as to the project's viability, and no completed marketing/business plan, the Province accepted the Evaluation Officer's recommendation. Funding of an additional $1 million was approved in 1989.

Findings

5.39 The approval process used for this project was incomplete. Government approved phase 2 of the project without:

- **adequately addressing the concerns raised by many departmental officials;**
- **requiring that a full marketing/business plan, including cash flow analysis, be done to address the serious concerns raised about the project's viability;**
- **any independent verification of the representations made by the operator and its consultants; and**
- **monitoring the ongoing results of the project's operations to ensure the project was worth further investment.**

Project monitoring

5.40 As noted previously, information we expected to find in the files to aid the government in monitoring the project was not present. The funding agreement did not require that government receive any financial information. Perhaps as a result, we found no financial information on the project's operations prior to 1989. The only independent financial statements on file were "unaudited" and for the years 1991-92 and 1992-93. This was after government approved the second stage of the project. It was also after the project had encountered serious financial problems.

5.41 These statements revealed that while government had provided over $2 million in capital funding, only $1.6 million was recorded as capital assets. We were unable to determine what the remaining $400,000 was used for. To ensure accountability in how project monies were being spent, we expected to at least find a requirement for annual audited financial statements.

5.42 Additionally, we found no tracking of visitor statistics. These statistics would have been helpful to government in assessing the tourism impact of the project.

Findings

5.43 Project monitoring was inadequate. Government was not monitoring either the operation's financial results or the tourism impact of the new facility.

5.44 We did not find adequate financial statements that would help ensure government funds were spent appropriately.

Funding

5.45 The government funding strategy was to provide funding for the capital aspects of the project. The non-profit group would then be responsible for funding ongoing operations. However, as noted earlier, CPAK had no money available to it and would have to rely on cash generated from operations to meet its fiscal needs. Establishing a new tourist industry in a non-tourist area with a project group that has little cash requires seed money for operations. This money would be required at least until the project established its reputation. This funding was noted in the files as having been necessary to keep many of the Quebec centres de plein air operating.

5.46 Since few potential customers would have been aware of the new facility, moneys for advertising would be required to establish a client base. As CPAK had little cash, it was faced with a dilemma. That is, the operator needed cash from customers to pay for advertising, but very few customers knew of the resort because there was no advertising.

5.47 The same might be said of the need for organized outdoor activities. The resort needed these activities set up and ready to go before people would come. However, CPAK required funding to set up these activities. With no funding available, no activities would be available and no people would come. The federal Evaluation Officer mentioned the need for organized activities but did not incorporate any provision for meeting this need in his report.

5.48 To help solve the applicant's cash problem, some funding for operations was necessary. Perhaps more coordination with CPAK, or better monitoring by government, might have shown this problem to be significant well before the resort started having financial problems. This might have saved the project. In any case, funding just the project's capital needs did not address the need for operational funding. This was equally important to the success of the venture.

Finding

5.49 While the government provided generous capital financing, no operational funding was planned or supplied even though CPAK was known to have few cash resources. In this project, the failure to recognize the operational funding requirements early on contributed substantially to its eventual failure.

5.50 We reviewed the variance of $81,600 in expenditures noted in the letter from the Leader of the Opposition. Our review showed that this variance resulted from comparing expenditures on different projects. We found no variance in plein air expenditures. However, as noted earlier, we found no audited or other reliable financial records that showed how governmental funds were spent by CPAK.

Finding

5.51 We found no apparent variance of $81,600 in funding.

Loans

5.52 We reviewed the February 1989 project agreement between the Province of New Brunswick and the Centre Plein Air de Kedgwick Ltée. The latter part of section 26 of the agreement states "the Corporation shall not in any manner cause or allow the facility or any of the assets thereof to be sold, converted to cash, accounts receivable, or any other form of indebtedness, currency or equity investment."

5.53 While CPAK did have more than $200,000 in various loans from the local caisse populaire, no assets were pledged against these loans. As government agreed to the sale of the assets, the sale would not appear to contravene section 26 of the agreement. All sale proceeds went to pay off various CPAK creditors including the caisse populaire.

Finding

5.54 The corporation's officers incurred long-term bank debts, but no assets were pledged against these loans. CPAK received all proceeds from the sale of the project.

Conclusion

5.55 Based on our review, we concluded that the project approval process was incomplete and monitoring of the project inadequate. For example, we found limited market analysis and no marketing/business plans. We found that little consideration was given to the financial operating requirements of the project. We also found no indication that financial data was submitted or reviewed on an ongoing basis before the early 1990s. Since the project dates back to the 1980s, government has had time to correct these shortcomings. We would expect that the processes now used to determine and monitor economic development projects would be much improved.

5.56 Our expectations for the project approval process would include:

- well developed and documented project selection criteria. These should ensure that the applications approved are those most likely to achieve established program objectives; and
- documented guidelines and procedures for reviewing and approving applications for funds. These should be in place to ensure decision-makers follow consistent and appropriate approval procedures.

5.57 We expect the monitoring process would ensure:

- project funds are being used for the purpose intended;
- projects are monitored through timely visits and other appropriate methods to ensure adherence to the program's objectives; and
- audit arrangements exist and are adhered to.

5.58 In our review of the project we were able to find little indication that these steps were taken. To assure the public that current programs do meet the above expectations we plan, in the coming year, to review certain government programs used to encourage economic development in the Province. We intend to examine the approval and monitoring processes in this review.

Departmental comments

5.59 *As stated in your report, the conclusions from federal officials, regarding the viability of the concerned project, were more positive and significantly different than those reached by N. B. departmental officials With the majority of the funding being provided by the Federal Government, this project was imposed by the federal authorities of the day, and not necessarily chosen by the Province.*

5.60 *The Department of Economic Development and Tourism inherited this project in late 1991 when the Centre de plein air de Kedgwick was a fait accompli. As a matter of fact, the last payment under the Canada/New Brunswick Subsidiary Agreement on Tourism Development for this project* *was made in June 1991. This Department attempted to do damage control, but most problems were endemic. Due to the decreasing involvement of volunteers and the increasing indebtedness of the Centre de plein air de Kedgwick Ltée, the Department agreed with a request from the Board of Directors to sell the assets to a private operator. This operator has, to the best of our knowledge, invested more money in the facility and is successfully operating it as Centre Echo Restigouche.*

5.61 *In closing, [we] would like to mention that, for projects jointly funded by the federal and provincial governments, the approval process and monitoring are approved by the Management Committee of each funding agreement and implemented by the staff. As a rule, your expectations for the project approval and monitoring processes should be met.*

Chapter 6
Department of Finance
Revenue Management System

Contents

Department of Finance Revenue Management System

Background

6.1 In our 1993 Report, we noted the Department of Finance completed a major re-engineering study, the first of its kind in this government. One of the key areas identified in the study was the need for a change in the management of revenue. In recognition of this need, the Department issued a Request for Proposals (RFP) for a Revenue Management System (RMS) on 14 October 1994. Four companies submitted proposals for evaluation by the Department. On 13 December 1994, the Department selected the IBM Consortium (referred to as IBM) as the successful bidder, and the project officially commenced on 16 January 1995.

6.2 The RMS project consisted of a number of projects designed to improve revenue management within the Department. Over a period commencing in the fiscal year ended 31 March 1995 and ending 31 March 1999, the RMS was supposed to move through 4 phases or “plateaus”, beginning with so-called early start initiatives and ending at the fourth plateau with universal electronic commerce. The anticipated result was an integrated RMS with six major functional components consisting of customer registration, revenue processing, compliance management, information provision, legislation/policy development and various support tools. The benefits of the new system were supposed to allow the system to pay for itself. As the project progressed, the pending implementation of the Harmonized Sales Tax (HST) caused the Department to rethink the RMS project. This was because, according to the Department’s Cost/ Benefit Profile, up to $37 million of the projected benefits of $51.2 million were to come from the improved collection and management of Provincial Sales Tax (PST). It was felt many of these benefits would disappear under harmonization, as tax collection would become a federal responsibility.

6.3 The Department informed us it started negotiating the termination of RMS with IBM as soon as the HST memorandum of understanding was signed with the government of Canada. The government of New Brunswick terminated the RMS project on 26 June 1996.

6.4 Our Office has maintained an ongoing interest in systems implemented through a public/private partnership arrangement. In previous Reports, we have looked at the NBCase Human Resources

Development project and the New Brunswick Integrated Justice project. In early 1996, we wrote the Department to obtain some initial background information on the RMS. The RMS next came to our attention as a result of a transaction selected in our 1996-97 expenditure sample. While examining this sample item and related documentation, we identified a number of issues with potential value-for-money implications.

Scope

6.5 Our work covers both of the Department's contracts with IBM relating to the RMS project. Total expenditures were $9,874,518. Exhibit 6.1 lists all the projects and their related costs.

Exhibit 6.1
Cost of the RMS
Source – Spreadsheets provided by the Department

	Cost per contract		Total project
Project name	**Contract 1**	**Contract 2**	**cost**
Business Case	$ 809,810	$ 31,452	$ 841,262
Accounts Receivable/Account Management	1,216,237	379,069	1,595,306
Activity Based Costing	242,441	-	242,441
Electronic Commerce	116,785	-	116,785
Change Management	20,811	-	20,811
Communications	194,080	4,424	198,504
Consolidated Registration System	527,760	130,067	657,827
Decision Support	247,786	83,080	330,866
International Fuel Tax Agreement	139,162	53,979	193,141
Preliminary Analysis/System Architecture	933,871	236,947	1,170,818
Project Management	1,654,715	279,494	1,934,209
Training/Human Resources	381,667	-	381,667
Technology Management	573,523	50,754	624,277
Total of allocatable costs	**$ 7,058,648**	**$ 1,249,266**	**$ 8,307,914**
Interest	270,072	18,601	288,673
Commercial profit	1,090,207	187,724	1,277,931
Total cost of the RMS project	**$ 8,418,927**	**$ 1,455,591**	**$ 9,874,518**

6.6 Our work included:

- a review of the Department's planning, budgeting, monitoring and controlling of the RMS;
- a review of the travel expenses paid by the Department to IBM;
- an assessment of the reasonableness of IBM's charge-out rates for RMS employees;
- a review of project completion notices for each project;
- a review of the benefits calculated by IBM for the RMS;
- a review of IBM's profit calculation for the RMS; and
- discussions with the Department of its plans for future revenue collection improvements that were identified but not carried out.

Results in brief

6.7 The RMS was terminated due to the anticipated agreement with the government of Canada for the Harmonized Sales Tax.

6.8 The Department of Finance did not have a signed contract until after the project was terminated.

6.9 The Department started working on several RMS projects before the Business Case was completed. In our opinion, work on the other projects should not have proceeded until the Business Case was finished and the net benefits were quantified.

6.10 We had a number of concerns with the Department's monitoring and controlling of the RMS project.

6.11 Hourly charge-out rates paid to the consortium were well in excess of standard government of New Brunswick rates.

6.12 The method of calculating profit was not clearly defined in the contract.

6.13 We recommend the Province analyze its experience to date with public/private partnerships and CPP arrangements.

Introduction to findings

6.14 At the outset, we would like to note that our discussion with the Department indicated that despite the early termination of the RMS, eleven of thirteen projects started were completed. However, we found official completion notices for only three of the projects. We did not perform any testing to determine if the projects had been successfully implemented.

6.15 We have organized our findings according to areas of concern. Where appropriate we have made recommendations, some of which apply to the government as a whole, not just the Department of Finance. These recommendations should be useful to the government for future system development projects and public/private partnerships.

Contracts not signed until after project terminated

6.16 The contracts between IBM and the Department were not signed until after the RMS project was terminated. The project was awarded on 16 January 1995, but the contracts were not signed until 29 June 1996 (contract one) and 23 July 1996 (contract two). The government officially terminated the project on 26 June 1996; neither contract was signed by this date.

6.17 A signed contract would have clearly established how the Province was to compensate IBM, protecting both parties. This was especially important in this case as the RFP response from IBM provided the broadest cost estimate – "between $2 and $40 million but definitely more than two." In addition IBM identified many benefits, however none were quantified. In our opinion, given the unknown magnitude of the project, a signed contract should have been essential before work on the project started.

6.18 In our 1995 Report, we wrote the following with respect to the Andersen Consulting NBCase project:

> *We believe that all of the undertakings should have been set out in a contract prior to the firm commencing this work.*

6.19 We hold the same position with respect to the RMS. In our opinion, the consortium should not have been allowed to proceed in the absence of a signed contract.

Recommendation

6.20 We recommend that the government of New Brunswick develop a policy to proceed with public/private partnerships and other major system developments only after a contract has been signed between the Province and the related parties.

Departmental response

6.21 *It was the department's desire to have a signed contract shortly after the completion of the business case, as evidenced in the letter to IBM dated July 11, 1995; however, negotiations took longer than anticipated. In the interim, the Project did produce a Project Charter that established the framework and guiding principles for working together. Also, near completion was a draft Business Alliance Model that was to represent an umbrella agreement under which detailed contracts would be executed. We concur with your recommendation that future work of this nature should not commence prior to a signed contract or series of contracts.*

Work started before net benefits established

6.22 The Business Case project report indicated that there were eight "early start initiatives", of which the Business Case was one. The Business Case was supposed to be completed by June 1995, however, documentation showed that significant resources were allocated to the Business Case up to October 1995 and some work continued even under the second contract. With one exception, we noted that work on all the other projects began prior to October 1995, before the net benefits had been documented in the Business Case. It should be noted that three of the early start initiatives (Electronic Commerce Pilot, Activity Based Costing, Decision Support) had no benefits specifically documented in the RMS Business Case Summary Report dated 7 March 1996.

6.23 Discussions with the Department indicated it adopted this approach because it was necessary to get some systems running as soon as possible. In our opinion, this early start approach goes against the very principle of the project; that is, that the benefits pay for the costs. Without the benefits being identified and quantified there was no justification to start the project.

Recommendation

6.24 We recommend that the Province develop a policy that major system development projects and public/private partnerships should proceed only after net benefits are quantified.

Departmental response

6.25 *Charges continued against the business case initiative to update the report as new information came to light. In addition, charges were incurred in 1996 to review the impacts of harmonization on the business case.*

6.26 *In addition to the Cost/Benefit Profiles document completed in conjunction with the Business Case Summary Report, each early start initiative was to identify any tangible benefits. For some initiatives such as Project Management, Change Management and Communications the benefits were intangible, but these initiatives play an important role in the overall success of the Project. For this reason, the Project Charter identified that each initiative must be feasible in terms of cost/benefit; however, this did not mean that each initiative must pay for itself. The benefits from the overall project could be used to pay for individual initiatives.*

Concerns with project monitoring and control

6.27 The Department of Finance appears to have been quite thorough in certain aspects of project monitoring and control. In particular, a great deal of attention was placed on ensuring that all time charges billed by the consortium were supported by timesheets. Equipment purchases were monitored to ensure that the Department obtained the equipment at the “best value.” In addition, the Department carried out some analytical work on travel expenses as a means of ensuring that these charges were reasonable.

6.28 However, we have a number of concerns with the Department’s overall project management. These are detailed below.

Project statements varied in quality

6.29 The terms of the RMS contracts required a project statement to be prepared for each project. A project statement outlines such important items as scope, objectives, delivery schedule, required roles and resources, costs and anticipated benefits for a project. This information would have assisted the Department in better monitoring and controlling each project.

6.30 With this in mind, we looked at the project statements for the RMS. Our objectives were to assess the quality of the planning and budgeting information available, to ensure benefits were identified, and to ensure the statements complied with the terms of the contracts. We expected to find the following based on paragraph 3.3 of the contracts:

- a schedule providing evidence that a time frame had been established for commencement and completion of the project;

- an estimate of the proposed human resources and their roles explaining who would have been working on the project and at what job classification;
- an estimate of proposed human resource utilization showing the expected amount of time to have been spent on the project by each person;
- an estimate of costs integrating human resources and other budget items; and
- an estimate of benefits to determine if, in fact, a project should proceed and to provide a projection of the probability of cost recovery.

6.31 Only two project statements met the first three criteria. These were the Business Case, and the Activity Based Costing project. None of the project statements met all five of the criteria.

6.32 The project statements which did have some form of proposed resources and planned resource utilization, tended to be very nonspecific in nature, not giving enough detailed information to do budget comparisons against actual figures.

Recommendation

6.33 We recommend that the Province develop a policy of requiring major systems projects to have reasonable estimates of costs and benefits prior to work commencing.

Departmental response

6.34 *Although the information identified existed for each initiative, it was not all contained within the Project Statements. The department concurs that in future such information should be incorporated in the signed statements.*

Several budgets existed

6.35 We had difficulty in finding one approved budget figure to use in conducting our work. Prior to the delivery of the Business Case in October 1995, most of the projects had some form of budget in the planning documentation or project statements. After delivery of the Business Case, the Department told us it submitted a project budget extracted from the Business Case to the Policy and Priorities Committee of Cabinet (P&P). Our understanding is that the P&P decision did not specifically approve a budget figure.

Departmental comments

6.36 *Throughout the development of the business case the projected cost of the Project continued to be modified. For this reason various projected budgets existed until the final Business Case Summary Report. When asked if the budget was approved at P & P, the department advised your officials that it submitted to the Policy and Priorities Committee its Business Case Summary Report as an attachment to the memorandum, which included a cost/benefit summary (copy of the page from the Business Case Summary Report was provided). In summary, Record of Decision No. 95-31-06 of Policy and Priorities Committee recommended to Executive Council approval for the development of a Revenue Management System and noted three requirements: 1) the creation of a* *strategic business alliance with IBM; 2) agreement in principle to proceed with the development of a framework and a business plan for a Special Operating Agency; and, 3) agreement in principle for legislative and policy changes.*

6.37 *Had the Project not been terminated, the department planned to seek approval from Board of Management of its Business Case and Business Alliance Model. Instead, Board of Management Minute Number 96.0384 reviewed the proposed contract to IBM and made recommendations. Board of Management Minute Number 96.0575 approved the transfer of funds.*

Variances and/or change orders

6.38 Our review of documentation also showed that the project team prepared twenty separate change orders totaling just over $1.5 million. In a document provided to us on 21 October 1997 the Department included these change orders as increases to its budget in a comparison of budgeted expenditures to actual. We are uncertain as to whether these items are true budget amendments or if they may have been more correctly classified as variance explanations. In our view, a budget amendment should not normally be made, as one major purpose of a budget is to provide a means of comparing planned performance to actual results. The more a budget is amended, the less value this comparison will have.

Departmental comments

6.39 *All costs related to Project Statements were based on a limitation of expenditures and not fixed price. This meant any increase in expenditures required a change order. A few change orders resulted in fixed price due to the nature of the work being performed.*

6.40 *The change orders during 1995 are more representative of requirements that had not been identified or envisioned at the time a Project Statement was produced. However, once the decision was made to terminate the Project, all initiatives were reviewed establishing what the projected cost would be to bring the initiatives to completion by October 31, 1996, (closing date for the Project). The remaining effort and projected cost were reviewed by the department. A number of Project Statements covered the period ending March 31, 1996, and new Statements for the next fiscal were to be prepared. Given that the Project was terminating, a decision was made to prepare change orders extending the existing Project Statements to the time frame required to close each initiative. The change orders identified the effort and cost to bring each initiative to completion by October 31, 1996.*

Department did not monitor effort

6.41 Most of the project statements had some estimated budget for the level of human resources required in either hours or days. However, the Project Director informed us that the Department did not compare actual hours or days worked to the project statements.

6.42 In our opinion, this was a significant oversight. We believe it is necessary to monitor the level of effort on a project in order to determine the percentage of completion. In addition, in comparing budget to actual results, it is necessary to be able to split out this human resource component from such things as equipment, materials, expenses and rentals. This allows the managers to take corrective action on any component of the project that exceeds budget at a particular point in time. Without tracking effort against budget, we believe the control function is impaired.

Recommendation

6.43 We recommend the Province monitor budgeted human resource effort to actual effort in carrying out major systems projects.

Departmental response

6.44 *Early in the Project, IBM and the department established a Project Control Office. The role of the Project Control Office was to: establish and enforce project management standards and methodologies; manage the project logs; track and report project status; manage project facilities and inventories; initiate purchase orders; manage and report the project financials; manage the agreements between IBM and its sub-contractors; maintain a project library; process time sheets; and, provide administrative support. The Project Control Officer was accountable to both GNB and IBM's Project Director.*

6.45 *All classifications established for outside resources were reviewed by the department's Project Director and challenged where necessary. Performance issues were addressed as they arose with negotiated solutions.*

6.46 *Although the Project Control Officer was to monitor projected effort to actual, the department's Project Director also maintained records on projected cost to actual as the bulk of the budget (84% of the cost of the Project before interest and profit) related to effort. Had the actual development work commenced for an integrated revenue management system, increased emphasis would have been placed on monitoring effort to actual as the range of resources and classification would grow, as well as costs for hardware, software, etc.*

Travel claims should be reviewed

6.47 Documentation provided by the Department stated that IBM would follow the government of New Brunswick's guidelines for its travel claims. The Department provided the guidelines to IBM. Indeed, there should have been no confusion as to what expenses would have been allowed.

6.48 We tested 28% of the dollar value of the claims submitted by IBM. We found some possible overpayments, ineligible expenses, or items that we felt the Department might want to investigate. Clause 6.7 of the contracts allows the Province to audit and verify any invoice presented by IBM up to four years after the acceptance of all services and deliverables. Based on our testing, it may be useful for the Department to further examine expense claims in order to identify any misunderstandings or errors in travel claim preparation that may have occurred on the part of the consortium.

Recommendation

6.49 We recommend that the Department of Finance examine expense claims for the RMS project.

Departmental response

6.50 *It has always been the plan of the department to do a further review of receipts; however, it is the department's view that there has not been a significant overcharge and it will ensure this is the case.*

No final cost benefit analysis

6.51 One of the thirteen projects included in the RMS was Project Management. One objective of this project was to track the benefits associated with the implementation of the RMS. Project Management attempted to track these benefits until May 1996. By that time, the Department knew the RMS was to be terminated and the project ceased to track RMS benefits. In effect, the project moved from the "funded out of savings" approach to a regular "pay for service" approach.

6.52 The Project Director informed us that benefits up to May 1996 were estimated at $1.9 million. We believe it would have been useful for the Department to do a final comparison of benefits received to the total $9.9 million in payments to IBM.

6.53 In addition, we believe the Department may have benefited by linking IBM's payment to the benefits received. IBM's response to the RFP said "costs of the project will be fully funded by the Company until benefits resulting from the project can be realized." Most projects identified in the Business Case were projected to have positive net benefits. And the Department has stated eleven of these projects were completed. Since the partners had been working for a year and a half without a signed contract and under the assumption IBM would be paid out of benefits, we wonder why this approach could not have been continued until the work was completed. Under this scenario the payments to the consortium may have been significantly less. Since the benefits calculations were stopped in May 1996, we are not able to report on the amount of benefits received.

Departmental comments

6.54 *After [May 1996], it was determined the cost of maintaining a resource to monitor benefits was not adding value. The Project was to be terminated and the initiatives were in their winding-down phase preparing for closure on October 31.*

Only three projects had completion notices

6.55 Both contracts required each project to have a completion notice. Clause 14.3 said:

> *Upon completion of each Project, IBM shall submit to the Province a written confirmation (the "Project Completion Notice") that all Services and Deliverables for the Project have been completed and are ready for acceptance testing. Upon*

receipt of a Project Completion Notice, the Province shall during the Project Acceptance Period carry out such tests on the Services and Deliverables as the Province considers necessary (the "Acceptance Tests") for the purposes of determining whether the Services and Deliverables meets the Project Acceptance Criteria. The Province shall, within thirty (30) days from the expiration of the Project Acceptance Period, provide IBM with

(i) written notice that the Services and Deliverables meet the Project Acceptance Criteria (the "Project Acceptance Certificate"); or

(ii) written notice advising IBM that the Services and Deliverables, or a part thereof, do not meet the Project Acceptance Criteria (the "Project Deficiency Notice").

6.56 Finance informed us that although eleven projects were completed, it had not obtained the required completion notices for them all. Only three projects had completion notices on file. Finance did, however, do a checklist to ensure it had received the key deliverables for each project.

Departmental comments

6.57 *The department recognized the need for completion notices as a way to identify that each initiative had delivered what it was supposed to. However, once the Project started to scale back on effort and resources in 1996, in lieu of completion notices an agreement was reached whereby a listing was prepared of all deliverables from each initiative. Prior to any approval of payment to IBM, this listing was reviewed and receipt of each deliverable was confirmed. Documentation to this effect was shown to your auditors. We believe the confirmation of all deliverables by listing serves the same purpose as completion notices and this should not be an issue.*

Charge-out rates appear high

6.58 During the oral presentation IBM committed to pricing "personnel at NB market rates." There is no further definition in the meeting notes or the contract as to what NB market rates actually meant. We did note, however, some concern in the Department of Finance about the reasonableness of the rates charged.

6.59 An internal memo dated 7 March 1996 discussed a comparison of IBM rates to those under the government of New Brunswick's (GNB) Informatic Professional Service Contract of Supply. (The Department of Supply and Services prepared this Contract of Supply for use by all government departments. It contains rates for various information technology professionals from twenty consulting companies.) The memo indicated that if one compares the IBM rates including their 15% profit margin to the average GNB Contract of Supply rates, IBM's rates are over 100% higher. The memo added, the Department's comparison was very conservative since the highest rates from the Contract of Supply were being compared to the lowest IBM rates for each category.

6.60 Another memo questioned how IBM's daily rates were affected by the number of productive days per year. It said IBM's calculations were based on a productive year being 175 days. This meant they were asking 20% more than if we assume a productive year of 210 days, 26% more if we assume 220 days.

6.61 Since neither party had the protection of a signed contract when the project terminated, we would have expected the Department to attempt to negotiate the rates to a lower amount. One reason we were given for the high rate structure is that IBM was using rates quoted to the government of Canada for so-called common purpose procurement (CPP) projects. Supposedly these rates include a risk premium to cover the various contingencies implicit in these CPP projects. However, in this case, since the project was terminated and the consortium was essentially compensated for all hours billed, it appears the main elements of risk to IBM were removed. We would note as well that nothing in the contracts states that government of Canada rates are equivalent to NB market rates.

Recommendations

6.62 We recommend the Province develop a RFP policy requiring the responses to specify charge-out rates in detail. This would assist the RFP evaluation committee in recommending a successful bidder. Terms such as "NB Market Rates" should be clearly defined.

6.63 We recommend that a contract should not be signed until clear and reasonable rates are established.

Departmental response

6.64 *As there were no GNB CPP rates established, the department was able to review, on a confidential basis, CPP rates IBM charged to their other clients. The department found the rates being discussed to be comparable.*

6.65 *The department does concur with your findings that rates should be clearly established prior to work commencing and contracts signed.*

Charging commercial profit

6.66 The Pricing Strategy in the RMS contracts indicated the amount paid would include "IBM commercial profit of 15%." We were uncertain as to the definition of "commercial profit" as it was not defined in the contracts.

6.67 As discussed in the previous section, it is our opinion that the charge-out rates appeared high. One might argue they were sufficiently high enough to have included a profit component. This was particularly so once the project moved from the "funded out of savings" approach to a regular "pay for service" approach. This change removed an element of risk.

6.68 If this was the case, the Department should have questioned being charged an additional 15% commercial profit on services. The total profit that was charged on services in contract one was $1,051,433. In contract two this amount was $185,652, bringing the total to $1,237,085.

6.69 IBM also charged 15% commercial profit on “integrated materials.” This amounted to $40,846 over the two contracts. Integrated materials include things such as computer hardware and software. IBM purchased these items on behalf of the Province at standard government rates or, as the Department termed it, at the “best value.” Then the Province was to reimburse IBM for the cost of the purchases. IBM charged the Province an additional 15% on the cost of all these purchases. In our opinion, this is not appropriate. It certainly does not meet the term “best value.” If the Province knew IBM was going to charge profit on the purchase of integrated materials, the Province would have been better off purchasing the materials itself.

6.70 We asked the Department what steps it had taken to ensure “commercial profit” had been calculated correctly. We were informed at one point that someone from the Office of the Comptroller assessed the reasonableness of the calculation. However, we could not find any written report from the Office of the Comptroller on this matter.

Recommendation

6.71 We recommend all key terms be defined in contracts prior to their signing. In particular, the method of calculating profit components should be clearly defined.

6.72 We recommend the Department exercise its right to audit under clause 6.7 of the contracts to determine whether it can receive a refund for all or a portion of the commercial profit.

Departmental response

6.73 *Although the contract allowed for 15% commercial profit, which is the percentage used in the formula, we concur with your recommendation that the method of calculating profit components, in future, should be more clearly defined.*

6.74 *It was the decision of government to harmonize its sales tax with the GST. IBM entered into the business alliance fully prepared to accept the risk of being paid from benefits. Up until the decision was made to commence harmonization negotiations, IBM was carrying that risk. It was the decision of the department that IBM be paid in accordance with the business alliance discussions to that point. These commitments included established rates, interest and profit.*

Future considerations

6.75 Throughout this chapter, we have made specific recommendations prompted by our findings related to the RMS project. In our opinion, however, a measure of the success of this chapter is how the Province will use these findings to better manage major systems development projects, common purpose procurement (CPP) arrangements and public/private partnerships in the future.

6.76 One area of consideration for the Province should be an analysis of the method of procurement. It should consider the pros and cons of doing work itself versus contracting out for services. It should consider the value of developing an independent business case and breaking a large project down into many smaller areas as opposed to the integrated methodology used for common purpose procurement.

6.77 When proceeding with CPP, the Province must recognize two important risk factors. These are a lack of independence in preparation of the business case and the fact that there is no separate determination of the best way to achieve benefits. These risks must be carefully weighed against the potential benefits of common purpose procurement prior to requesting proposals.

Lack of independence in the preparation of the business case

6.78 Our understanding is that in the first project, the Business Case, IBM was to identify the benefits, costs and investments required for the RMS. If there were no net benefits from the RMS, IBM would not proceed on the other projects. This approach is typical of CPP projects where the government is seeking a partner to provide a solution to a range of business problems and issues.

6.79 This approach appears to put IBM, or any CPP consultant, into a position where they have control over the amount of future work they will receive. This is particularly true since they are involved in identifying the benefits. By making the consultant’s work on other projects contingent on a successful business case, the Province puts the consultant in a potential conflict of interest position.

No separate determination of best way to achieve benefits

6.80 The arrangement entered into with IBM combined into one analysis both the benefits and the costs. If the costs could be paid from benefits, the project proceeded. In other words there appears to be a strategy that no matter how high the costs, the project should proceed so long as the benefits are greater. Our understanding again is that this is a typical approach for a CPP arrangement. This approach does not follow a traditional business case analysis, and as a result potential savings and efficiencies may be lost.

6.81 What we would have expected to see was the identification of benefits, financial or otherwise, if a particular decision or course of action is followed. Then we would expect to see a separate and distinct determination of the best way to achieve those anticipated benefits. Carrying out the project with the same firm that prepared the business case may not be the best solution, but only a solution. There may be more effective ways to achieve the results, such as contracting out some or all the work, doing the work in small projects with existing staff and buying software packages from another company. There does not appear to have been this type of analysis in the IBM business case, but rather an implicit acceptance that the IBM solution was the best solution for the Province.

The Department's Plans

6.82 The Department appears to be heading in a good direction with its new Preliminary Analysis/System Architecture (PA/SA). This new focus covers approximately twenty new projects, which will be developed over three or four years. These projects will be tendered separately, and no public/private partnership or CPP arrangement will exist. Where possible, the Department is going to use existing software rather than try to develop and market its own software.

6.83 This proposed method of many small projects appears to have several benefits. Smaller projects result in less risk. If they fail, the cost is lower. Also, with smaller projects, the Department can more easily manage costs and resources. This helps with the timeliness of implementation, resulting in less risk of the projects becoming outdated before they can be implemented.

Recommendation

6.84 We recommend the Province analyze its experience to date with public/private partnerships and CPP arrangements. It should determine whether these procurement methods are delivering solutions in the most economical and efficient manner possible.

Chapter 7
Department of Health and Community Services
Ambulance Services Inspections

Contents

Department of Health and Community Services Ambulance Services Inspections

Background

7.1 Ambulance Services is a program of the Department of Health and Community Services. New legislation (Ambulance Services Act and Regulations) for this program came into effect in October 1992. Standards, inspections and licensing were addressed in this new legislation.

7.2 On 1 January 1993 standards came into effect for: services; personnel; vehicles, equipment and supplies; quality assurance; and communication. These standards are set out in a departmental publication called, "Standards for Ambulance Services" (Standards). "Their introduction, along with inspection and licensing requirements, serve to assure the public and health care personnel that ambulance services of a consistent quality will be available across the province" (the Department's Annual Report for 1993-94).

7.3 The Ambulance Services Branch (Branch) is responsible for the 56 service providers (Providers) and the 116 vehicles that currently operate in the Province of New Brunswick. Providers with whom the Province has ambulance service contracts include private businesses, non-profit agencies, and hospitals. Inspection is one of several functions performed by the Branch. There are two types of inspections – inspection of the service and inspection of the vehicle. There are two inspector positions in the Branch.

7.4 Our Office began work in the Branch in 1996. The inspection function was selected as an audit project that began in February 1997. This function was selected for the following two reasons:

- Ambulance service is a very important service that affects the lives of New Brunswickers. The quality of this service could mean the difference between life and death in an emergency situation. The inspection process ensures the required quality of service is delivered.

- We promote accountability. The Branch is responsible for ensuring that Providers meet the Standards. The Branch conducts inspections to determine if these standards are met.

Scope

7.5 The main purpose of this audit project was to ensure the Standards are being met. We also wanted to determine if the inspection process actively contributes to the deliverance of an effective ambulance service and to improvement in Providers' performance.

7.6 Our audit work included the following:

- a literature review;
- observation of an inspector performing both a service and a vehicle inspection;
- interviews with staff in central office and telephone interviews with staff at two provider services; and
- review of several inspection files, computer reports and various documents at the Branch.

7.7 The audit field work was done in February and March 1997. Inspections performed after this date were not considered. File reviews and report analyses were completed in April 1997.

Results in brief

7.8 Policies and procedures for the inspection function have not been clearly established and documented. Some of the effects of this include a lack of consistency in inspection practices and procedures and a low frequency of inspections.

7.9 Improvement in the scheduling of inspections is needed. Inspections are not done on a regular basis in accordance with a predetermined coverage plan.

7.10 Improvements are needed in monitoring of inspections and their results. Some ambulances did not receive a full, documented inspection before being put into service and the number of Providers not meeting some standards remains high.

7.11 Enforcement action plans should be established to help ensure Providers meet the Standards. In 1997 none of the Services inspected and only a few of the vehicles inspected complied with all the Standards. The Standards for Ambulance Services are not being fully met.

7.12 The Branch needs to improve its information system.

7.13 Inspection results are not integrated with licensing. Licensing could be used as a means to help enforce the Standards.

Policies and procedures for inspections have not been clearly established and documented

7.14 Policies and procedures are a useful tool for providing guidance and ensuring consistency in the way things are done. A few years ago, the Branch discussed the need for policies and procedures, however, they have not been formalized and documented. Two of the effects of not having policies and procedures governing inspections are a lack of consistency in inspection documentation and a low frequency of inspections.

Inconsistency in inspection practices and procedures

7.15 Each inspector has his own way of doing inspections and documenting them. This was observed when performing a review of inspection files. Inspection documentation varied from a well-organized file to incomplete checklists. It is important that inspections are properly documented. The skill is in the Branch; however, it has not been transformed into formally written policies and procedures for all inspectors to use.

Frequency of inspections seems low

7.16 “Provider” refers to the individual or organization that is licensed to operate the ambulance service. There were five Providers who, at the time of our audit, had not yet received a documented service inspection. These services had been operating since September 1996, when St. John Ambulance was replaced. They had been operating for half a year without receiving a full inspection.

7.17 In order to analyze the length of time since current Providers and their vehicles had been inspected, we had to make a list of all current Providers and vehicles with the date of their last inspection. We summarized this data in Exhibit 7.1 to show who had been inspected within twelve months, within twelve to twenty-four months and who had not been inspected in over two years. Only twenty-four of the fifty-six current Providers (43%) were inspected in 1996-97. Sixteen of the fifty-six current Providers (29%) have inspections that are one year old, and eleven Providers (19%) have not been inspected for over two years. The ages of the vehicle inspections are very similar. There are no policies and procedures governing the frequency of inspections.

Exhibit 7.1
Ages of Inspections

Type of inspection	(within 12 months)	(12 to 24 months)	(over 24 months)
Service			
Number of inspections*	24	16	11
Percentage inspected	43%	29%	19%
Vehicle			
Number of inspections	55	37	28
Percentage inspected	46%	31%	23%

* There are 5 services (9%) which had not yet been inspected that are not included in this table.

Recommendation

7.18 Appropriate policies and procedures for the inspection process should be clearly established, properly documented, effectively communicated, and updated on an annual basis. Policies and procedures should include, among other things:

- **the objective of inspections;**
- **the responsibilities of inspectors;**
- **when an inspection should be done;**
- **how often inspections should be done;**
- **what the inspection should include;**
- **how inspections should be documented;**
- **how the findings should be reported; and**
- **when to carry out follow-up inspections and enforcement actions**.

Departmental response

7.19 *The establishment of a separate inspection unit, appropriately resourced, and with expertise to design operational policies and procedures will allow this to occur. Design work will commence in November, 1997.*

Better scheduling of inspections is needed

7.20 Inspections are not done on a regular basis and there is not a predetermined coverage plan. The effects of not having a schedule of predetermined coverage include: the inspection coverage seems low, some inspections are very old, and some new services and new vehicles have not yet been inspected.

7.21 The results are that the Branch is not complying with the legislation requiring that all new vehicles be inspected before licensing, and that the Providers are not meeting the Standards because they are not regularly inspected with consequences for non-compliance.

Exhibit 7.2
Inspection Coverage

	1997	1996	1995	1994
Services				
Number of services	56	86	85	88
Number of inspections	28	54	63	75
Percentage of coverage	**50%**	**63%**	**74%**	**85%**
Vehicles				
Number of vehicles	116	122	125	128
Number of inspections	60	72	97	109
Percentage of coverage	**52%**	**59%**	**78%**	**85%**

Note: Figures for 1997 do not include the results of inspections done in March 1997.

The inspection coverage seems low

7.22 Actual inspection coverage for the past four years is presented in Exhibit 7.2. The number of inspections for 1996 and 1995 is lower than reported in the Department's annual report for those years. The

Department agreed that the number shown in the annual reports for 1996 and 1995 was incorrect. The chart shows the following.

- The percentage coverage was virtually the same for both services and vehicles.
- The highest coverage was in 1994, when 85% of the services and vehicles were inspected. The lowest coverage was in 1997, when only 50% and 52% respectively were inspected.
- The coverage has steadily declined since 1994, the first year with the Standards.
- Although the number of services has greatly declined in 1997, and to a lesser extent the number of vehicles has also decreased, the inspection coverage did not increase. With fewer services to inspect, one would expect a higher coverage.

Some new vehicles do not have a documented inspection

7.23 We reviewed the Branch's records for grants to Providers for new vehicles in 1996 and 1997 to determine if these new vehicles were inspected promptly. It was difficult to determine the date the vehicle was put in service and the date of the inspection of the vehicle. However, our review indicated that there was no documented inspection for four vehicles in service at the time. We believe this indicates that the legislation requiring that new vehicles be inspected before being approved for use is not being fully complied with.

Recommendation

7.24 An inspection schedule should be compiled on an annual basis, and updated as needed.

Departmental response

7.25 *Policies in regard to licensing and inspection frequency, criteria, and timing and terms will soon be implemented. These policies will be approved and monitored by the Director.*

Monitoring of inspections and their results needs improvement

7.26 Monitoring of the inspection function needs to be improved. In general, insufficient monitoring often causes the following: 1) work does not get done, and 2) problems do not get identified and addressed. In our opinion, these effects have occurred in the inspection function.

Work does not get done

7.27 The following observations are examples of inspection work not being done.

- Some service inspections date back to 1993 and 1994.
- Twelve vehicles have not been inspected since 1993 and 1994.
- There are a few Providers who have never been inspected.
- Exhibit 7.2 shows that only 50% of the current Providers and 52% of the vehicles were inspected in 1996-97. These are the lowest inspection coverage percentages since the Standards were introduced.
- New vehicles are not always promptly inspected.

Problems are not being identified and addressed

7.28 We identified two problems that are not being properly addressed. Both problems involve compliance with legislation and Standards.

7.29 The first is that the Branch is not complying with legislation that requires all new vehicles be inspected before approving them for use.

7.30 The second is that Providers are not complying with all of the Standards. "Infraction" is the term used by the Branch to denote non-compliance with a Standard. Infractions are discovered when inspections are performed. Exhibit 7.3 deals with service infractions. It shows the percentage of the services inspected that did not meet a specific Standard. To interpret this exhibit properly, it is important to understand that infraction means non-compliance with the Standard; it does not necessarily mean that an item is missing. An item could be present, but if it is lacking in the quality or quantity required by the Standard, an infraction would be recorded.

7.31 Recent infraction reports for vehicles show improvement for some of the Standards that in the past had high rates of non-compliance. On the other hand, some Standards had a higher infraction rate in 1997 than in the past. In 1997, reports show that approximately 40% of the inspected vehicles had infractions relating to fire extinguishers, 30% had infractions relating to short spine boards, and 20% had infractions relating to portable suction.

7.32 In our opinion, the level of non-compliance with the Standards, the severity of the infractions, and the repetitiveness of specific infractions are problems.

Recommendation

7.33 A means of monitoring the inspection function should be established and performed regularly. Possible methods of monitoring include:

- **director's approval of inspection schedule;**
- **director's periodic review of inspection files;**
- **regular review of inspection reports generated by the Branch's computer system by both the inspectors and the director; and**
- **tracking of time spent doing inspections.**

Departmental response

7.34 *The Branch has implemented monthly Inspection Unit meetings between Unit staff and the Director to address inspection activity, results, and plans, and to address administrative issues such as policy administration, long-term trends, and effects on other units within the Branch….. A long-term management approach to ensuring compliance will be designed and implemented.*

Exhibit 7.3
Frequent service infractions - top five infractions for each of the past four years

Standard code	Standard description	Percentage of services inspected having infractions			
		1997	**1996**	**1995**	**1994**
B.-.01	A comprehensive program of quality management activities has been designed to ensure that each patient receives the best possible care.	93	94	99	93
C.-.02	The ambulance service has written policies and procedures that are reviewed and revised as necessary.	75	79	62	87
C.-.01	Each attendant knows how to recognize hazardous materials and procedures to be followed when dealing with hazardous materials.	75	38	61	80
A.-.01	Copies of the maintenance record are available.	46	38	54	63
A.-.02	The service performs a consistent and regular inspection of equipment and replenishes supplies after each use.	36	26	36	57
B.-.02	The ambulance service is available 24 hours a day, with back-up from neighbouring services. **(Note: A written agreement, ensuring back-up service, is required for this standard. The lack of a written agreement appears to be the problem.)**	54	17	15	57
F.-.04	Liaison with other physicians when appropriate to assist the ambulance service in providing the best possible patient care.	*	*	25	66

Notes: 1) 1997 figures are as of 28 February 1997. They do not include the results from three inspections done in March 1997.
2) "*" indicates the infraction was not in the report for the given year.

Enforcement of Standards

7.35 The Branch is not fully enforcing the Standards for ambulance services. In 1996-97, four years after the Standards became effective, none of the twenty-eight Providers inspected complied with all of the service Standards, and only eight of the sixty vehicles inspected complied with all the Standards. The Provider for one area, who has been operating the ambulance service for several years, was inspected in February 1997. The inspection revealed over seventy infractions for the service and its four vehicles. During the same year, another Provider with four vehicles had fifteen infractions.

7.36 Exhibit 7.3 shows the frequency of specific infractions for services. Exhibit 7.3 shows that in the past four years, four infractions have repeatedly been in the top five. In our opinion this indicates that Providers are not taking corrective action on reported infractions and that the Standards are not being enforced. The Providers of ambulance services in New Brunswick do not consistently meet the quality of service required.

7.37 The current inspection process only *verifies* compliance with the Standards. It does not *ensure* compliance. The physical inspection of the vehicles and services only verifies whether or not the Standards are being met. The follow-up of infractions and the enforcement of the Standards are two other important components of ensuring compliance.

7.38 Inspectors have the legal authority to enforce the Standards. However, in practice the Branch does not have a real ability to enforce the Standards because there are no penalties for non-compliance. They do not have a plan to replace the service or other forms of enforcement action.

7.39 The legislated requirements and the "Standards for Ambulance Services" were established to ensure a certain quality of service. If the inspection process does not ensure compliance, then the expected and required quality will not be achieved. Without a plan to replace the service, the Providers do not feel threatened; there are no immediate repercussions to not meeting the Standards.

Follow-up inspection work

7.40 Follow-up on Providers and vehicles that failed to comply with the Standards is very limited. Letters are sometimes sent and re-inspections are rare.

7.41 From our review of a sample of inspection files, we noted that one Provider, who was inspected in May 1993, had eleven service infractions and thirty-seven vehicle infractions. This Provider has not received a service inspection since May 1993, despite the poor results from its last inspection.

Recommendations

7.42 The Branch should ensure compliance with all set Standards and with legislation.

7.43 Enforcement actions should be established. These actions should be used to ensure compliance with the Standards.

7.44 Follow-up inspections should be done to determine if identified deficiencies have been corrected.

Departmental response

7.45 *The Department has a clearly documented compliance process which defines timeframes and conditions under which ambulance services are tracked and monitored. …… With adequate resources, linkages to financial incentives and disincentives and a mechanism to temporarily* *replace an ambulance service in cases where a license was terminated or suspended, this…….is being addressed.*

7.46 *Authority to enforce standards is discrete from the ability to do so. The Department has chosen to provide motivation to ambulance services by linking financial incentives/disincentives to service contract performance. Linkages to license status and an ad-hoc ambulance replacement system will take place, the ability to effectively enforce standards will be established.*

Reporting of inspection results

The computer system rates only fair at meeting users' needs

7.47 The computer system is not user-friendly, has operating problems, and in our opinion rates only fair at meeting users' needs. The programmer is called regularly for help. The system does not have conventional word-processing abilities, so editing is not simple. When inputting inspection results, one can only exit at the end of the program. Inspectors become frustrated when they have problems using the system. The system generates only pre-designed reports and cannot respond to ad hoc inquiries. Inspectors must manually prepare the "*Infraction Report*".

7.48 These problems with the computer system cause delays in getting inspection results to the Provider. Our file review indicated that, in 1996-97, it was common to find a time lag of one month or more between the inspection date and the date on the "*Infraction Report*".

Recommendation

7.49 The problems with the computer system should be formally identified and addressed, by either updating or replacing the current system.

Departmental response

7.50 *Development of a strategic information plan for the Ambulance Services program…..is underway.*

The integration of inspections with the licensing function

7.51 The Ambulance Services Act states that all Providers must have an operator's license and that all vehicles must be approved before being used as an ambulance. In the Branch, licensing could be a useful tool to ensure compliance with the set Standards and legislation. Currently, inspection results are not formally integrated into the annual licensing process. The licensing process is an independent, routine, administrative task that is not tied into the Branch's inspection monitoring system.

Recommendations

7.52 Licensing should be used as a means of enforcing the Standards. The licensing and inspection functions should work together. Inspection results should be reviewed as part of the licensing process.

7.53 The Branch should develop alternatives (ex. probational licenses, temporary suspensions) to the current automatic annual license renewal practice.

Departmental response

7.54 See paragraphs 7.45 and 7.46.

General departmental comments

7.55 *[We] find your review to be substantively accurate; however, it is important to note certain contextual issues which are not included within your report. The fiscal year 1996-97……was a period of significant transition in the Ambulance Services program. St. John Ambulance-New Brunswick Council unexpectedly withdrew…..service in 26….communities and was successfully replaced. Work was underway on a comprehensive ambulance services funding and administrative policy, and work was accelerated to bring this forward to government.*

7.56 *………your review notes some areas for improvement which the department had identified during its own internal assessment, and on which action had already been initiated prior to your review. This does not diminish the importance of the matters noted; however, it does serve to note that the Department was aware of and was addressing these matters.*

7.57 *Certain steps towards addressing these issues were announced in February 1997. These actions....., which have already been accomplished, include.....re-organization of the Branch to provide a separate Inspections Unit. This will provide 2.0 full-time equivalents dedicated to the inspection and regulatory processes. Previously, each inspector held various administrative functions.....reducing the availability of inspection time to 1.0 or less full-time equivalents.*

Chapter 8
Department of Health and Community Services
Air Ambulance

Contents

Department of Health and Community Services Air Ambulance

Background

8.1 There are two important reasons why we chose the New Brunswick air ambulance service for review as part of our work in the Ambulance Services Branch. The first is that this new service has increased costs to the public. Second, the mission of our Office involves promoting accountability by providing objective information to the people of New Brunswick through the Legislative Assembly. This project allowed us to address our mission by enabling us to report information on key aspects of the decision to set up a stand-alone air ambulance service for the residents of New Brunswick. It also allowed us to review and report upon the first year of operations of the new service.

8.2 The following is a brief chronology of the events that lead up to the commencement of the stand-alone New Brunswick air ambulance service on 1 April 1996. Prior to that date, the Province was obtaining air ambulance services on an "as needed" basis from any one of a number of different service providers.

- In 1987, a consultant's report prepared for the Province recommended that the need for air ambulance services be made the subject of in-depth review by the Department of Health and Community Services. The report further recommended that funding not be provided to an air ambulance service without first ensuring there was adequate financial support for the road-based, pre-hospital Emergency Medical Service (EMS) system.

- In 1988, the provincially established Social Policy Committee presented a green paper on Ambulance Services. The green paper summarized comments made in public hearings held during that year. Among other things, it recommended that a helicopter-based air ambulance service be developed for New Brunswick.

- The green paper led to the preparation of the 1989 report, *"Ambulance Services in New Brunswick"*. It further recommended that the proposed air ambulance service be developed parallel to ground ambulance service, and that it be obtained in the most cost effective manner possible. The government accepted the recommendation and announced its intention to implement a public air ambulance service for New Brunswickers.

- In 1991, the Department of Health and Community Services went to the Priority and Planning Committee of the Province with proposals for substantial changes in departmental operations. These included the regionalization of hospital services, and the creation of a public air ambulance service to be used in providing emergency transportation for New Brunswick residents. The Priority and Planning Committee approved most of the proposals, and changes commenced.

- At about the same time, departmental officials became aware of a similar air ambulance initiative then underway in Nova Scotia. New Brunswick representatives approached Nova Scotia about the possibility of developing a joint Maritime air ambulance service. In 1992, discussion began involving representatives from Nova Scotia, Prince Edward Island, and New Brunswick as to the form such a service might take.

- In August 1993 at the Council of Maritime Premiers conference, New Brunswick and Nova Scotia announced their intention to enter into a joint initiative to provide air ambulance service for residents of the two provinces. A committee was set up that included four representatives from each province. Prince Edward Island had opted out after initial discussions due to budget constraints. The proposed service was to have a dedicated aircraft and air medical crews based in Halifax, and a coordination centre to receive, screen and coordinate calls located in Moncton.

- The first request for proposals (RFP) from potential service providers was developed and issued in the fall of 1993. The initial target date for start-up of the program was December 1993. This date was subsequently extended several times. A second, revised RFP was issued in early 1994.

- In March 1994, upon consideration of submissions relating to the second RFP, a service provider was chosen and announced. However, in June 1994, that company sought bankruptcy protection.

- In July 1994, the Medical Transport Coordination Center (MTCC) became operational. The MTCC currently operates from the Moncton Hospital annex. Its function is to receive, screen, and coordinate calls for emergency air ambulance service. It is also intended to handle similar functions related to calls for air and ground ambulance patient repatriations. Repatriations are transfers of provincial residents back to New Brunswick from out-of-province facilities.

- In late 1994, a third RFP was issued. The second selection of an air service supplier was made by the committee in March 1995 and approved by the Ministers of Health in the two provinces. Unfortunately, due to disagreements between the two provinces, the decision was never ratified and the Maritime initiative was discontinued. The main areas of contention seemed to relate to the type of aircraft, the choice of an air service provider, and the appropriate means of governing the air ambulance service.

- In May 1995, the Department of Health and Community Services issued a press release indicating its intent to secure an air ambulance service for New Brunswick. In June 1995 a RFP was issued. A service provider was selected in December 1995.

- A stand-alone New Brunswick air ambulance service commenced operations on 1 April 1996.

8.3 The Department of Health and Community Services, Ambulance Services Branch (ASB), has established a unit known as Air and Dispatch Operations to handle the operations of the air ambulance service and the MTCC. The unit is the responsibility of the Director of ASB. The air ambulance service is known as NB AirCare. The fixed-wing aircraft used to provide service is located at the Moncton airport. Air and Dispatch Operations unit employees are located in the Moncton Hospital annex.

8.4 The Province of Nova Scotia has also set up a provincial air ambulance service, using a helicopter as its primary aircraft. The two provinces have agreed to provide back up to each other when the need arises.

Scope

8.5 Two objectives were stated for this project in our planning documents:

- to ensure that the existing New Brunswick Air Ambulance service is meeting its mandate with due regard for economy and efficiency while complying with established legislative and policy guidelines; and
- to ensure that the Department of Health and Community Services has established satisfactory procedures to measure and report on the effectiveness of the Air Ambulance program.

8.6 Our examination procedures for this project included discussions with the Director of ASB, the Manager of the Air and Dispatch Operations unit, and various other individuals who were involved with the implementation of the New Brunswick service. We examined various documents and files relating to the decision to implement a stand-alone air ambulance service in New Brunswick. We also reviewed information and documents relating to operations of the service during the 1996-97 fiscal year.

Results in brief

8.7 The decision to create a stand-alone air ambulance service was based upon the need to improve the quality of service and to meet the demands of a regionalized hospital system.

8.8 The Department selected a fixed wing aircraft instead of a helicopter because the service was primarily intended to be a method of transporting stabilized patients from one medical facility to another.

8.9 A decision was made to lease the aircraft without the preparation or consideration of a financial comparison between the lease and buy options.

8.10 The lease agreement with the service provider was not signed until 1 October 1997, eighteen months after the commencement of the air ambulance service.

8.11 No measurable strategic goals have been established against which to assess the performance of NB AirCare.

8.12 There are no regular operating reports currently being prepared by NB AirCare and provided to the Ambulance Services Branch.

8.13 Out-of-province users do not appear to be paying all costs associated with their usage of the air ambulance service.

8.14 The facilities at the Coordination Center and hangar in Moncton need improvement.

8.15 One hundred and fifty-two services were provided during the 1996-97 fiscal year. One hundred and two of these services were provided to New Brunswick residents.

8.16 The net cost of air ambulance service to the Province for the 1996-97 fiscal year was $1.65 million.

New service decision

Rationale for stand-alone air ambulance service in New Brunswick

8.17 The decision to proceed with the establishment of a stand-alone air ambulance service for New Brunswick appears to have been based on two factors, quality of service and the regionalization of hospital services.

Quality of service

8.18 During the late 1980s and early 1990s, the Province relied heavily upon the free service of the Maritime Command of Air Search and Rescue for emergency transfers within the Maritimes. The Quebec Aeromedicale service was used when transfers to Quebec hospitals were required. Other service providers were sometimes called upon as well. Costs of the service providers varied significantly. Also, using such a variety of service providers meant that neither response times nor the quality of service provided were consistent. Additionally, we were informed that there were cases where acceptable service providers were simply not available, leading to significant delays in moving patients.

8.19 The quality of service provided to northern New Brunswick was considered deficient by residents of that area. Air Search and Rescue did not provide service for non-emergency transfers. Therefore, because of the cost of hiring other service providers, ground ambulances were normally used for these non-emergency transfers. As a result, patients being transferred routinely faced road transfers of five hours or more to facilities in Saint John or elsewhere.

8.20 Air Search and Rescue is still available as a service provider, but has recently added a requirement that users pay a fee for service. Additionally, they cannot guarantee that nurses or physicians will be assigned to flight crews.

8.21 Implementation of a stand-alone New Brunswick air ambulance service was seen by decision-makers as a way of improving and standardizing the quality of air ambulance service in the Province.

Regionalization of hospital services

8.22 In the early 1990s, the delivery of hospital services was regionalized. Regionalization meant that more specialized services would only be offered on a regional or provincial basis. Planning documents prepared by ASB in the late 1980s and early 1990s recognized that this initiative would increase pressure on ASB. The ability to transfer patients between facilities in an efficient and effective manner would become more important. The provision of adequate air ambulance services was seen as one facet of an effective transfer system in the new environment. The availability of such a service was seen as being particularly useful when the rapid transfer of patients was warranted or where long distances were involved.

Cost considerations

8.23 The decision to create a stand-alone New Brunswick air ambulance service appears to have been primarily taken in order to improve the quality of service, and to meet the demands of a regionalized hospital system. A departmental representative confirmed that, within limits, cost considerations were secondary. A departmental document dated May 1995 indicated that the decision to contract a single air service provider would cost the Province an additional $350,000 to $450,000 per annum. The proposed budget for the service as included in the document, *"Air Ambulance Service A Proposal"*, dated 14 June 1995, showed gross expenditures of $1.4 million and anticipated recoveries of approximately $0.4 million for a net cost per annum of $1.0 million. It was this proposal upon which the decision to proceed with a stand-alone air ambulance service for New Brunswick was based. Qualitative factors led the Department to make the decision to go ahead with a stand-alone service despite the expected increase in costs.

Aircraft selection decision

Aircraft options available

8.24 There are two primary airmedical response options available. They include the "scene response" option and the "inter-facility transfer" option. "Scene response" involves a rotor-wing aircraft (helicopter) flying directly to major trauma or medical calls and transporting the patient directly to an appropriate facility. "Interfacility transfer" can be performed by rotor-wing or fixed-wing aircraft, and usually involves delivery of a higher level of care for a longer time period.

Factors in the decision taken

8.25 The Department's position is that the New Brunswick service was intended mainly for use in transporting stabilized patients from one medical facility to another (i.e. the inter-facility transfer option). Other considerations in choosing a fixed-wing aircraft over a helicopter included the ability of fixed-wing aircraft to operate in icing conditions, the relative cost of the two options, and the greater availability of runways in the Province in comparison with helipads.

Selection of service provider

Lease versus buy decision

8.26 The Department decided to lease the aircraft, including pilot services, from a third party rather than to buy an aircraft and hire pilots. We were told that this decision was made in order to avoid the large capital investment involved in purchasing a plane. It was also indicated to us that the Province is not in the "air service business." However, to the best of our knowledge, a cost comparison of the lease option versus the purchase option of buying and maintaining an aircraft and hiring pilots was not done. Therefore, we were unable to determine if leasing was the most economical decision.

Departmental comments

8.27 *On consultation with the industry and government transportation resources, the Department chose not to operate the aviation component of the air ambulance service directly. …. This decision was made because air ambulance aviation expertise is limited in the industry as a whole and did not exist in government. Thus, consideration of leasing versus purchase of the capital asset was a limited consideration.*

RFP process and approval

8.28 From our review, the Department appears to have complied with pertinent aspects of the Public Purchasing Act, and related clauses in the provincial Administration Manual, relating to the acquisition of services.

Lease contract

8.29 At the time of our audit, there was no signed lease agreement with the service provider. The service provider was operating under the terms of a signed memorandum of understanding between it and the Department of Health and Community Services. Because of delays in getting the lease signed, the period covered by the memorandum of understanding had to be extended. On 6 October 1997, the Department provided us with a lease contract. The lease contract had been signed on 1 October 1997, eighteen months after the commencement of the air ambulance service.

Recommendation

8.30 **We recommend that future lease agreements be signed in advance of the period covered by the agreement.**

Departmental response

8.31 *[We] concur that it is optimal to completely conclude final contract negotiations prior to the initiation of any contract for service, but it was necessary to begin providing service prior to this occurring……the Department and the service providers did duly execute a memorandum of agreement prior to service initiation binding both parties to the provisions, conditions and limitations of the Request for Proposal and the service provider's response to it. The Department of Justice reviewed this document, and considers such documents to be legally binding on both parties.*

Mandate and objectives

ASB strategic plan

8.32 The strategic plan for ASB does not specifically identify a mandate or mission for the air ambulance service. ASB's mission, as defined in the 1997 strategic plan for the branch, is

> *"to create and maintain an environment that enables efficient and effective use of resources in the provision of prehospital and inter facility patient care."*

8.33 In reviewing the strategic plan for the ASB, it appears that both the mission and related strategic goals relate specifically to ASB's coordination role in the delivery of ambulance services. They only address air ambulance operations in a general way.

Air ambulance mandate

8.34 The Manager of Air and Dispatch Operations has drafted a distinct written mandate for the air ambulance service. The Director of ASB has approved this mandate, and it reads as follows.

> *"To provide a rapid response, critical care dedicated air ambulance for New Brunswick and Maritime patients."*

8.35 However, there have been no measurable strategic goals established which are linked to this mandate. Therefore, there is no means of assessing the degree to which NB AirCare has met its agreed-upon mandate.

Recommendation

8.36 We recommend that clear, measurable objectives be designed for the air ambulance service and linked to the existing air ambulance mandate.

Departmental response

8.37 *An application for accreditation of the service by the Commission for the Accreditation of Air-Medical Services will take place during the 1998-99 fiscal year. The application process requires that goals and objectives be set and measured. These will be linked to the mandate.*

Information capture and reporting

Information captured

8.38 A great deal of information is captured for each transfer or requested transfer. Most of this data is readily accessible through a database system. Computers are physically located at the MTCC. The database system used was designed in-house and seems to be very flexible in terms of reporting information that is available. Document packages are filed at the MTCC.

8.39 From information captured on the database system, we were able to determine that NB AirCare provided a total of 152 services during the 1996-97 fiscal year. Of those, 102 were provided to New Brunswick residents, 20 to Nova Scotia residents, and 30 to Prince Edward Island residents. Of the services provided to New Brunswick residents, 36 were for transfers within New Brunswick; 49 were for transfers out of New Brunswick; 16 were flights back to New Brunswick from out-of-province facilities; and one related to a transfer between two out-of-province facilities.

Information reported

8.40 Currently, NB AirCare does not provide any formalized operating reports to ASB on a regular basis. Reports are requested on an ad-hoc basis by ASB, and these reports usually deal with specific issues. For example, recent information requests have related to the planned addition of a neo-natal team to air ambulance service in New Brunswick. Regular monitoring of operations is limited to frequent discussions between the Director of ASB and the Service Manager of NB AirCare. Management within ASB review financial reports relating to air ambulance as produced from the provincial financial information system on a regular basis.

8.41 It is our understanding that work is underway on a standard reporting package relating to the operations of NB AirCare.

Additional desirable reporting

8.42 Incident reports are prepared each time a procedure has not been fully complied with in providing air ambulance services. Currently, these incident reports are not summarized anywhere by NB AirCare. They are verbally discussed with ASB management, but are not otherwise reported. While we did not note any significant problems in our review of incident reports, we do feel that it would be appropriate to summarize them and report them on a regular basis to head office.

8.43 Additionally, airmedical staff of NB AirCare provides feedback questionnaires to receiving and sending facilities each time a service is provided. Again, as with the incident reports, questionnaires returned are not summarized anywhere nor incorporated into periodic reports for head office. We were told that the responses received to questionnaires have been nearly all positive during the first year of operation.

Recommendations

8.44 We recommend that an appropriate group of operating reports be developed by NB AirCare and provided to the Ambulance Services Branch on a regular basis. These reports should allow management to monitor operations at NB AirCare and to assess the degree to which strategic objectives are being met.

8.45 We further recommend that incident reports and responses to questionnaires be summarized and included in regular reporting to Ambulance Services Branch management.

Departmental response

8.46 *This……will be addressed in two ways: development of a strategic information plan for the Ambulance Services program to provide an integrated approach to contractual and finance, air and land operations, patient information, and inspection and enforcement needs; and development of the application for accreditation of the service, which will require comprehensive standardized reporting for the air ambulance service to be available.*

Recoveries from users of the service

New Brunswick residents

8.47 NB residents pay a co-pay fee of $50 for each inter-hospital transfer, regardless of whether the individual is transferred by land or air. No additional charges are levied.

Non-residents of New Brunswick

8.48 The primary role of NB AirCare is to transport New Brunswick residents between hospitals in New Brunswick or to hospitals elsewhere in the Maritimes or central Canada as required. As a secondary role, NB AirCare provides service to residents of Nova Scotia and Prince Edward Island when called upon to do so.

8.49 New Brunswick and Nova Scotia have agreed that each will bill an $8,500 reciprocal fee when the other province uses their service. The majority of the services provided to Nova Scotia occur during the winter months when Nova Scotia's helicopter-based service is often grounded due to icing conditions.

8.50 The majority of services currently provided by Nova Scotia relate to neo-natal transfers. Neo-natal transfers by Nova Scotia account for most of the "Purchased services (excluding repatriations)" as shown in Exhibit 8.1. The requirement to buy service from Nova Scotia for neo-natal cases should be significantly reduced after 1 November 1997. Starting on that date, NB AirCare will begin handling most New Brunswick neo-natal transfers. Training of air medical staff and drafting of policy and procedures manuals relating to that specialty are currently underway.

8.51 There is an understanding between the two provinces that they will not compete with each other for third party business.

8.52 New Brunswick has also agreed with Prince Edward Island to bill that province $10,850 each time service is provided to a resident of Prince Edward Island.

8.53 The gross cost of the air ambulance service for 1996-97 (excluding purchased services), as can be determined from information presented in Exhibit 8.1, was $1.9 million. The average cost of the 152 services provided during the year was therefore approximately $12,600. The average cost for the 102 services provided to New Brunswick residents during the year, net of recoveries, was $13,850. These average costs are higher than the amounts currently being billed to Prince Edward Island and Nova Scotia. Therefore, we must conclude that fees billed for non-resident use of the air ambulance service did not cover all costs associated with providing the service during the 1996-97 fiscal year.

Recommendation

8.54 We recommend that the rates per service currently being charged to the other provinces be re-evaluated to ensure that they adequately cover all costs associated with the provision of air ambulance service.

Departmental response

8.55 *The current tri-partite agreement between Nova Scotia, PEI and New Brunswick expires March 31, 1998. These comments will be considered at that time..…. During negotiation of any such agreements, care must be taken to not exceed the market value of such a service.*

Facilities

8.56 During the course of our review, we had the opportunity to tour the Air and Dispatch Operations facilities in Moncton. We noted that the office assigned to the MTCC in the Moncton Hospital annex did not, in our opinion, provide adequate space for the coordination function. We also noted that office and storage facilities at the hangar at the Moncton airport were in a state of disrepair. Additionally, our understanding is that facilities at the hangar are not heated during the winter months, meaning that out-of-town air medical staff has no base at which to wait between air medical flights. We have been told that administrative staff is making attempts to improve the quality of facilities in both locations.

Recommendation

8.57 We recommend that the current facilities be reassessed and that improvements be made as necessary.

Departmental response

8.58 *We are working with the aviation service contractor to examine opportunities for improvement; however there is currently no additional hangarage at the Moncton Airport. In regard to the physical plant provided for the coordination function, a detailed examination will be undertaken as part of the evaluation of a pilot for land ambulance dispatch. Changes will be made as appropriate subsequent to this evaluation.*

Conclusion

8.59 Our conclusion is presented in response to our project objectives as identified in the “scope” section of this chapter.

8.60 *To ensure that the existing New Brunswick Air Ambulance service is meeting its mandate with due regard for economy and efficiency while complying with established legislative and policy guidelines.*

8.61 A mandate has been defined for the New Brunswick Air Ambulance service by the Manager of Air and Dispatch Operations and approved by the Director of Ambulance Services. However, since measurable strategic objectives have not been defined for the service, we were unable to assess the degree to which this mandate is being met. Strategic objectives should more specifically define what the service is intended to accomplish and give a focus to reporting provided to management.

8.62 We did not note any cases where legislative or policy guidelines were not complied with. Additionally, we were pleased to note that the policies and procedures relating to the operations of the air ambulance service appear to be complete and well written.

8.63 *To ensure that the Department of Health and Community Services has established satisfactory procedures to measure and report on the effectiveness of the Air Ambulance program.*

8.64 Reporting relating to air ambulance operations is done on an ad-hoc basis. We feel there are improvements that should be made in this area. Appropriate reporting should be developed to allow management to assess the degree to which the air ambulance service has met its mandate. Such reporting should be tied to defined strategic objectives for the air ambulance service.

Exhibit 8.1
Comparative cost of service

	1996-97 Fiscal Year Budget	1996-97 Fiscal Year Actual	1995-96 Fiscal Year Actual
Service provider	$ 927,721	$ 915,579	$ -
Purchased services (excluding repatriations)	216,750	185,241	454,753
Payroll, administrative, and other costs	1,078,795 (1)	1,000,990	591,456 (2)
Gross cost (excluding repatriations)	2,223,266	2,101,810	1,046,209
Less: Recoveries	(538,000)	(504,300)	-
Net cost (excluding repatriations)	$ 1,685,266	1,597,510	1,046,209
Purchased services (repatriations)		54,859	213,788
Net cost of air ambulance service		**$ 1,652,369**	**$ 1,259,997**

(1) Includes one time start-up costs budgeted at $318,889 for the 1996-97 fiscal year.

(2) Some one time start-up costs were incurred during the 1995-96 fiscal year and are included in this figure. However, the actual amount could not be determined from available information.

Chapter 9
Department of Natural Resources and Energy
Mining Taxes and Royalties

Contents

Department of Natural Resources and Energy Mining Taxes and Royalties

Background

9.1 Our last detailed review of the Metallic Minerals Tax Act was in 1984. Potash royalties were last reviewed in 1987. In those reviews we had concerns about the vagueness of the accounting definitions in the Act as well as about the adequacy of the audit coverage of the two revenue sources. Given the length of time since our last audit, our findings at that time and the significance of mining revenue in the current year, we decided to review this area once again.

9.2 For 1997 revenue from mining taxes and royalties is approximately $18.9 million. This total is up significantly since 1987. Although the revenue from the Metallic Minerals Tax Act has remained relatively constant, potash revenue has increased by about three times to over $12 million per year.

9.3 This chapter presents the detailed discussion and recommendations separately for these two revenue sources starting with the Metallic Minerals Tax Act. The section entitled Results in Brief, however, applies to both revenue sources.

Scope

9.4 Our review focused on revenues received under the Metallic Minerals Tax Act and royalties pertaining to potash mining since 90% of the Department’s mining taxes and royalties comes from these sources. Our objective was to ensure the systems in place are adequate to guarantee compliance with legislation and that the required amount of dollars are collected from mining activities in New Brunswick. Our report covers the taxation years since 1991 although not all years were examined with the same level of detail.

Results in brief

9.5 The Department has taken steps to enhance the credibility of its review of mining tax revenue since our last review.

9.6 Some improvements in audit coverage and approach are necessary for both revenue sources.

9.7 The Metallic Minerals Tax Act and Regulations need updating.

9.8 Revisions to the potash leases, which have been under negotiation since 1989, should be finalized and the Department should ensure the two potash producers compute royalties on the basis of the signed leases.

9.9 Once the current potash leases expire, the Department may be able to improve cash flow under the potash leases by moving to monthly remittances.

9.10 The Department should analyze alternative potash royalty rate models prior to exercising the Ministerial option in 2002.

Metallic Minerals Tax Act

Positive steps taken by the Department since last review

9.11 The Department has taken some significant steps to enhance the credibility of its review of Metallic Minerals Tax since our last review. The Mine Assessor position is now filled by a professional accountant. The Mine Assessor now reports to the Director of Finance rather than the Mining Division. This minimizes the potential problems with one section of the Department trying to promote the industry and tax it at the same time.

Failure to use proper forms

9.12 We noted one case of non-compliance with the Act and Regulations. Regulation 84-185 under the Metallic Minerals Tax Act prescribes the forms that must be submitted with the yearly reconciliation of tax owed. Presumably these forms were added to the Regulations to facilitate the Department's process of checking taxpayers' compliance with the Act.

9.13 The only taxpayer filing under the Metallic Minerals Tax Act (MMTA), has not been submitting all of the specific forms required under Regulation 84-185. In our opinion the working papers the taxpayer does provide make it difficult to check for compliance with the Act. Our field auditor performed a detailed examination of the most recent tax return and noted a number of areas that must be reviewed with the taxpayer to ensure that the company has paid the correct amount of taxes.

9.14 We have discussed these problems with the Department. We understand that the new Mine Assessor has been working with the company on developing electronic tax forms and schedules to replace those in Regulation 84-185. The intent is that these forms will make the Assessor's review process more effective.

9.15 We encourage this development. Once the new package is complete, it would seem appropriate to revise Regulation 84-185 to reflect these changes.

Recommendation

9.16 The Department should continue its efforts to improve the Metallic Minerals Tax submission forms and it should ensure the Regulations are revised as appropriate.

Departmental response

9.17 *The Department is in agreement with this recommendation. The Department will continue its efforts to improve the Metallic Minerals Tax submission forms and this continuing project will result in the incorporation of the electronic version of the forms in the Regulations.*

9.18 *The Department is currently reviewing the Metallic Minerals Tax Act (MMTA) and regulations and these changes will be completed by March 1998 to be incorporated in the legislative package for the fall session in 1998.*

Changes to Act required

9.19 The Act and Regulations have remained basically unchanged since inception in 1977. The Legislation needs updating. It is showing its age in some areas such as referring to the Mine Assessor as a "he" and referring to "actual and proper costs". But of more concern from our perspective is the lack of an audit requirement in the Act. This is especially relevant given the inherent difficulty in auditing under the MMTA.

Difficulty in auditing under MMTA

9.20 In our opinion the taxpayer's MMTA tax return is difficult to audit. We performed a detailed examination of the most recent tax return and noted a number of areas that were difficult to reconcile. We provided the Mine Assessor with a copy of our working paper showing a number of examples of taxpayer deductions to follow-up on and possible problem areas to review when the Department does its next tax audit.

9.21 One main reason for this difficulty is that the costs and revenues from mining related activities are difficult to separate from the taxpayer's non-mining related activities. Transfer pricing between related parties brings an added dimension of difficulty to the process.

9.22 As well, since the company does not classify its revenue or expenditures in the same way as the Act requires, each relevant account must be reconciled to the allowable deductions named in the Act . One example is transportation costs.

9.23 A deduction is permitted for transportation costs in subsection 2.1(5)(a) of the Metallic Minerals Tax Act. The company does not appear to have a financial statement line item to gather transportation costs. Instead, it makes adjustments to its "marketing costs" to arrive at a figure for transportation costs in its MMTA submission. Sales commissions are included in this claim, however, they do not appear to meet the definition of a transportation expense. To audit for compliance with the Act the auditor would have to do extensive vouching and reclassification of costs to verify the claim for transportation costs.

Mines assessor needs to begin with audited figures

9.24 The Department has typically used two or three of its own personnel over a two to three week period to perform an audit of two to four taxation years for this tax. The Department may find that the effectiveness of its MMTA tax audit would be improved if it started the process with audited figures.

9.25 There does not appear to be any requirement for the company's New Brunswick operations to have audited financial statements. In our opinion, this makes the Mine Assessor's task even more difficult as she begins the reconciliation process with unaudited figures. This may add considerable time and complexity to the Department's audit process. A preferred approach is to add an audit requirement to the Metallic Minerals Tax Act.

9.26 The parent company is audited annually by a firm of independent auditors. Part of this audit would already require verifying the tax expenses incurred by the company. The increased costs of having the company's auditors provide an opinion to the Province on the accuracy of the Metallic Minerals tax calculation may not be significant.

9.27 This option would allow the Mine Assessor to reconcile the various figures in the tax return to an audited statement. The Mine Assessor's approach could be more oriented towards investigating difficult areas such as transfer pricing on inter-company transactions.

Recommendation

9.28 We recommend that the Department amend the MMTA to include a requirement that the taxpayer provide an audited statement of its operations in New Brunswick or an audit opinion on a statement of taxes payable under the MMTA.

Departmental response

9.29 *We agree and will take steps to include the requirement in the forthcoming legislative package to be completed by March 1998.*

No reference to GAAP

9.30 We noted the Act uses terms such as "actual and proper costs" and "in the opinion of the Minister" to allow for various accounting interpretations. The Act makes no reference to GAAP. In our opinion, this oversight should be corrected.

9.31 Generally Accepted Accounting Principles (GAAP) provide guidance for determining costs and revenues. GAAP is also updated to take into account new or evolving accounting issues. Reference to these principles in the Act would ensure financial statements provided to the Department had an appropriate basis of accounting. We noted the revised leases with potash producers include a reference to GAAP.

Recommendation

9.32 The MMTA should be amended to indicate the basis of accounting is Generally Accepted Accounting Principles. Where the Act does not specifically address an accounting issue, these principles will then apply.

Departmental response

9.33 *We agree and a reference to Generally Accepted Accounting Principles will be incorporated in the legislative package to be completed by March 1998.*

Potash mining leases and royalties

9.34 There are two potash producers in New Brunswick. Each company operates under a mining lease. Both mining leases were signed in 1978 and are for 21 years with a renewal. In accordance with the mining leases, the companies are required to pay royalty on any salt or potash which is sold. Royalties in excess of $12 million are collected annually from the two producers.

Updating mining leases

9.35 In the late 1980s the Department and the producers agreed to amend the leases. The amendments were to clarify what could be used for deductions for determining the selling price. Depending on whether potash was sold f.o.b. mine site, f.o.b. the ship or delivered, certain deductions would apply. There was also a need to clarify the treatment of sales through any affiliated company of the lessee. The 1978 signed leases required that royalty be computed on a monthly basis and paid quarterly while the proposed change is that the royalty will be calculated quarterly and paid quarterly.

9.36 The proposed leases appear to contain some significant improvements. The main improvement is that selling price is more clearly defined and includes a reference to Generally Accepted Accounting Principles. Quarterly sales, rather than monthly sales, are assessed to reduce monthly fluctuations.

9.37 The revised leases have never been signed. Despite this, one of the companies has been using the new quarterly average formula since March of 1993. The other company has continued to compute its royalty monthly based on the signed lease.

9.38 We requested the Mine Assessor to perform a recalculation of royalties on a sample basis for the company using the formula in the unsigned lease. The Mine Assessor was able to get information from the company to analyze three quarters. The results ranged from an overpayment of $257,000 to an underpayment of $110,000. It appears the overpayment was the result of an unusual price fluctuation. The net effect on potash royalties can only be determined by full recalculation from 1993 to the present.

9.39 We believe it is important from the point of consistency that both producers compute royalties on the same basis. As the Mine Assessor's sample recomputation shows, there may be financial implications as well.

Recommendation

9.40 The Department should finalize the revised unsigned potash leases.

Departmental response

9.41 *We are in agreement with this recommendation and we are working on finalizing the leases in conjunction with our solicitor at the Department of Justice. These negotiations are complex and time consuming therefore we are targeting a time frame of three to six months to complete this exercise (i.e. by March 31, 1998).*

Recommendation

9.42 The Department should ensure both producers compute royalties on the basis of the signed leases.

Departmental response

9.43 *Your recommendation is noted and steps are being taken to ensure both companies comply with the existing leases notwithstanding the current negotiations. However we do note that with the quarterly basis of reporting versus monthly, because of the fluctuations in selling price and production, that there would be an opportunity cost in the amount of approximately $280,000 which operates in the Province's favour. This figure is based on information supplied by the company for the period of July 1995 to March 1997.*

Revisions to consider when mining leases expire

9.44 Both the signed and the 1991 proposed leases call for quarterly royalty payments. It appears that both companies tender their payments promptly. Cash flow, however, would be improved by treating these royalties in the same way as tax payments are treated under the Metallic Minerals Tax Act. The MMTA calls for monthly payments based on an estimate of tax owed. Since the potash leases and the royalties are estimated at $12 million the province could reduce its borrowing cost by approximately $55,000 per year if payments were made on a monthly as opposed to a quarterly basis.

9.45 Consideration could also be given to using yearly sales rather than quarterly or monthly sales for royalty computation. This may reduce the work requirement for the company to calculate royalties and the verification work that must be done by the Department. In addition, the audited annual financial statements could then be supplied to assist the Mine Assessor's audit.

Recommendation

9.46 When the present leases expire the Department should improve cash flow by requesting monthly remittances from potash producers.

Departmental response

9.47 *Your recommendation is noted and will be reviewed by both parties during the negotiations for renewal of the leases in 2001.*

Royalty rate

9.48 The Minister has the option to unilaterally establish a new royalty rate in the year 2002. In our opinion, the Department should consider establishing a royalty rate based on a fixed rate per tonne mined rather than on sales. The trend in the industry is to have increasing sales to related parties. This makes it more difficult for the Department to establish a fair market price for potash sales in order to verify royalty calculations.

9.49 A rate based on production volume would be more easily verifiable. It would remove the problems associated with trying to establish a fair market value for related party sales. We recognize the Department would have to consider the financial and employment implications of such a change for the companies.

Recommendation

9.50 We recommend the Department develop an analysis of the various royalty alternatives prior to the Minister's option to unilaterally change the royalty in 2002. We recommend that a royalty based on production be one of the alternatives.

Departmental response

9.51 *Your recommendation is noted and we agree that alternatives for royalty determination will be explored in advance of the renewal of the leases in the year 2001.*

Departmental audit should be better documented

9.52 We reviewed the latest audit of one of the potash producers. The last audit was done in February of 1996 by the former Mine Assessor and the present incumbent. The file lacked any documentation of planning the audit, no audit program was provided and no opinion was expressed. There was an observation that a related party transaction cost had been erroneously deducted from the royalties owed to the Province. This matter has yet to be settled.

9.53 In two days of field work the Mine Assessor checked two quarterly returns. Since the period between audits has been tentatively set at five years, this review represents the audit of $20 to $30 million in royalties revenue. There was no indication of whether two days of field work could sufficiently cover this much revenue. We understand extenuating circumstances may have prevented a more extensive audit at that time.

9.54 In our opinion the Department's royalty audits should be more formally documented. Some guidance may be available from publications such as the CICA's *Standards for Assurance Engagements*. Specifically, evidence of proper planning and adequate documentation should be on file. Errors discovered should be quantified. An opinion on the accuracy of the royalties collected could be provided based on the results of the audit.

9.55 The Department has informed us that it has contracted with an experienced Mine Assessor from another jurisdiction to assist in its next royalty audit. We support this initiative and are pleased to see the Department adopting this approach.

Recommendation

9.56 The Department should improve its approach to the audits of potash producers. This would include more formal documentation of the planning, conducting and reporting of the audit.

Departmental response

9.57 *We agree with this recommendation and have just recently developed and carried out a significantly strengthened audit approach to potash audits which addressed your recommendation for a more formal documentation of the planning, conduct and reporting of the audit.*

Chapter 10
Other Departmental Audit Work

Contents

Other Departmental Audit Work

Background

10.1 The Legislative Assembly approves the financial plans of government. The duties imposed on our Office require us to audit the results of these plans and report our findings to the Legislative Assembly.

10.2 Our audit work encompasses financial transactions in all government departments. As well, we audit the pension plans and other trust funds and special purpose funds.

Scope

10.3 To reach an opinion on the financial statements of the Province, we carry out audit work on the major programs and activities in departments. In addition, we audit major revenue items and a sample of expenditures chosen from all departments. We also test controls surrounding centralized systems, to supplement work done at the departmental level.

10.4 We take a similar approach to our testing of the Province's pension plans. Our objective in doing this work is to reach an opinion on the financial statements of each plan. We also audit certain expenditures incurred by the Department of Municipalities, Culture and Housing which are cost-shared with the federal government. These expenditures relate to various housing programs formerly administered through New Brunswick Housing Corporation. Our objective in doing this work is to reach an opinion on the financial statements submitted to Canada Mortgage and Housing Corporation to support the cost-sharing claims.

10.5 Because of the limited objectives of this type of audit work, it may not identify matters which might come to light during a more extensive or special examination. However, it often reveals deficiencies or lines of enquiry which we might choose to pursue in our broader-scope audit work.

10.6 It is our practice to report our findings to senior officials of the departments concerned, and to ask for a response. Some of these findings may not be included in this Report, because we do not consider them to be of sufficient importance to bring to the attention of the Legislative Assembly.

10.7 Our examination of the matters included in this chapter of our Report was performed in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances. The matters reported should not be used as a basis for drawing conclusions as to compliance or non-compliance with respect to matters not reported.

Results in brief

10.8 Our testing gives us confidence that provincial expenditures reported on the financial statements are correct in all material respects.

10.9 Consumption tax receivables are growing, and we have concerns about their collectibility.

10.10 A plan is in place to collect amounts owing to the Department of Education by First Nations.

10.11 The Department of Municipalities, Culture and Housing is making progress in collecting surpluses built up by non-profit housing groups, but more could be done.

10.12 The Office of the Comptroller reached a positive conclusion on their audit of the Province's Victim Services and Victim Compensation accounts. The revenues available to these funds have declined steadily over the last four years.

General expenditure test results

10.13 As discussed under "Scope", we select for testing a sample of expenditures from all government departments. This sample is selected using statistical sampling techniques. The approach is designed to give us confidence that, in total, provincial expenditures reported on the financial statements are correct in all material respects. We were able to reach that conclusion.

10.14 Our tests are not just designed to reveal monetary errors, of which there are few. We also check to ensure the expenditure is properly approved, is reasonable in the circumstances and complies with the legislation, regulations and policies which give authority to the transaction. We find more deficiencies in these areas. When we suspect a deficiency is more than just an isolated incident, we may schedule additional audit work in that particular area to confirm or deny our suspicions. This additional work may take place in a subsequent audit year.

10.15 We noted the following deficiencies in our 1997 audit of expenditures:

- an individual who was not on an approved signing authority list but who authorized a document (1 item);
- no evidence that goods were ordered or received; the goods were also different from those listed on the standing offer contract (1 item);

- documents not signed or initialled to indicate accuracy or approval (6 items); and
- minor differences between amounts recorded and the back-up documentation on file (4 items).

10.16 We must re-emphasize that the Province spends in excess of $4 billion each year. The instances referred to in this chapter of our Report represent a tiny fraction of these expenditures. No large organization can operate perfectly, all the time. Errors can occur, and mistakes can be made. By far the overwhelming majority of transactions processed by the Province are accurate, authentic and in compliance with established policies and legislation. Our role is to ensure that this continues to be the case, and to encourage departments and agencies in their task.

Losses through fraud, default or mistake

10.17 Section 13(2) of the Auditor General Act requires us to report to the Legislative Assembly any case where there has been a significant deficiency or loss through fraud, default or mistake of any person.

10.18 During the course of our work we became aware of the following significant losses. Our work is not intended to identify all instances where losses may have occurred, so it would be inappropriate to conclude that all losses have been identified.

Department of Human Resources Development	
• Cheques cashed by persons not eligible to receive the funds. This loss is comprised of social assistance cheques that recipients reported lost or stolen.	$81,825
Department of Justice	
• Losses of funds by Rentalsman and Court offices. Over 50% of this loss resulted from duplicate cheques issued because of an error in the Rentalsman's computer software.	5,283
Department of Education	
• Theft of cash by employee. The employee was released from his job and charges were laid.	5,000

10.19 Items reported by our Office do not include incidents of break and enter, fire and vandalism.

10.20 The Province reports in Volume 2 of the Public Accounts the amount of lost tangible public assets (other than inventory shortages).

10.21 In 1997, the Province reported lost tangible public assets in the amount of $887,006. This compares to $290,665 reported in 1996. This variance is almost entirely a result of the losses incurred in the destruction by fire of the Department of Fisheries and Aquaculture regional office in Bouctouche.

Department of Finance

Consumption Tax

Collection activities

10.22 Our testing during the year, of vendors in arrears, showed some unfavourable trends. From April 1995 to November 1996 the number of outstanding receivable accounts rose from 4,576 to 5,882. During that same period the dollar value of accounts receivable increased almost 50% from $21.3 million to $31.1 million.

10.23 We expressed our concern about the increase, and asked the Department to provide us with details of collection activities undertaken to address this apparent problem.

10.24 The Department responded as follows:

The Department has seen an unfavourable increase in both the number and dollar value of accounts receivable over the past two years. This has been largely attributable to a very ambitious tax auditing program carried out over that same period which has produced record numbers of tax assessments.

To address this deficiency, the following specific measures will be implemented:

- *the accounts receivable Call Centre, established in 1995, will now concentrate its efforts on the collection of consumption tax accounts. Formerly, this unit was more involved with the collection of property tax;*
- *the Department will employ additional collection resources assigned to consumption tax;*
- *the Department will take steps to ensure that appropriate legal remedies are utilized where required to obtain collection;*
- *a system to provide a more timely identification of taxpayers in default on payment agreements will be developed; and*
- *the Department will review and develop an action plan for each non-current liability in excess of $10,000 for which a payment agreement has not been obtained.*

We expect that the preceding measures will be effective in reducing accounts receivable.

10.25 We were very pleased to learn of the Department's initiative to undertake an ambitious tax auditing program. This places all taxpayers on a level playing field and generates extra revenue for the Province. The large increase in receivables which has resulted from this new initiative gives rise to the following comments.

Allowance for uncollectible accounts

10.26 Each year the Department estimates an allowance for uncollectible tax accounts. The allowance is based primarily on a formula tied to the age of the accounts receivable. However during our audit for the year ended 31 March 1996, we were not provided with a clear analysis which allowed us to verify that the formula was properly applied.

10.27 Further, we confirmed during our 1997 interim audit that the formula may not properly account for two key risk factors in determining collectibility. These are the "real" age of the account and the taxpayer's ability to pay.

10.28 With respect to the age of accounts, the formula considers how long the account has been set up in the Department's records, not the actual time since the taxable transaction occurred. Accounts may be long overdue but the aging analysis only discloses the date the receivable is identified by the Department, for example as a result of an audit. Older accounts are usually considered less collectible. The current formula would treat any such recently identified accounts as being fully collectible.

10.29 The second factor noted is ability to pay. The process for developing the allowance does not appear to consider the size of an individual receivable in relation to a company's overall size and capacity to pay. Our understanding is that the Department's recent efforts to identify tax liabilities going back several years has yielded a number of receivable balances that are quite significant to various taxpayers' financial positions. The size of such an account puts collectibility in doubt. However, the current formula would not consider any portion of such receivables as doubtful until they passed a specified age. Therefore, it is possible that the allowance may be significantly understated.

10.30 We recommended the Department review its current method for developing an allowance for accounts receivable to ensure it considers the age of the originating transaction and the ability of the taxpayer to pay.

10.31 The Department responded:

> *With respect to establishing an adequate allowance for uncollectible accounts, we have noted the recommendation that an allowance consider the age of the originating transaction and the ability of the taxpayer to pay. However, the vast majority of liabilities identified each consist of a multitude of transactions made over a period of years. For this reason, we feel that it would be impractical to attempt to establish an*

> *allowance on the basis of originating transaction. Certainly, the ability of a taxpayer to pay must be considered.*
>
> *The Department has recently established its provision requirement for the year ended 31 March 1997 and, in so doing, has conducted a more detailed analysis in assessing the collectibility of its receivables.*

10.32 We are still not completely satisfied with the method used by the Department in establishing its provision for uncollectible accounts. Nor are we completely satisfied that the amount of the provision represents the full amount which might ultimately prove to be uncollectible. We will continue to discuss this matter with the Department during the current year.

Department of Education

Collection of accounts receivable

10.33 The Province enters into tuition agreements with First Nations which allow the Province to recover the costs of on-reserve native students attending New Brunswick public schools. The Department was owed $5.3 million under these agreements at 31 March 1996 by various self-governing First Nations, $3.6 million of which was over ninety days old. By the time of our field work in September 1996, the balance over ninety days had grown to over $4.3 million. Of this total, $1.4 million related to the 1993-94 and 1994-95 academic years.

10.34 Because of the concern over the collectibility of these balances, the matter was discussed at some length with departmental staff.

10.35 Our understanding was that the Department was in the process of developing a collection strategy for these receivables. As outlined by the Department, the strategy included establishing a formal collection plan with each First Nation, and corresponding directly with the Minister of Indian Affairs and Northern Development to request his assistance in resolving the matter.

10.36 Because of the significance of amounts involved, we asked to be kept informed on the progress of this matter.

10.37 The Department subsequently provided us with copies of signed collection strategies and evidence of discussions with both the First Nations and the Minister of Indian Affairs and Northern Development. The Department also committed to an individual appraisal of each account receivable at 31 March 1997 in order to determine the allowance for doubtful accounts. The Department noted that it had collected $1.5 million since increasing its collection efforts.

10.38 At 31 March 1997 the amount receivable from First Nations had increased to $7.3 million. However, we noted agreements in place with all the major debtors. Each debtor is now making installment payments against the amount outstanding. We were therefore in a position to conclude that the amounts receivable from First Nations at 31 March 1997 are collectible. Nevertheless, because of the significance of the amounts involved, we will continue to monitor the Department's collection efforts.

Department of Municipalities, Culture and Housing

10.39 During the year we audited the books and records of the Department of Municipalities, Culture and Housing (MCH) for those programs cost-shared with Canada Mortgage and Housing Corporation (CMHC). In the course of our audit we made a number of observations that we have summarized below.

Surpluses held by non-profit housing projects

10.40 Each non-profit housing project must submit an annual audited financial statement within four months of the fiscal year end. If the non-profit project has had a surplus for the year, it is obligated to return the surplus funds to MCH.

10.41 These surpluses are not recorded as revenue until the cash is actually received. MCH does not set up these unpaid surpluses as accounts receivable. It does, however, keep a record of the outstanding amounts.

10.42 In effect, MCH is providing an additional subsidy to the non-profit organizations that do not promptly repay their surpluses. In one example, we noted an amount of $8,028 that since 1987 has been recorded on the balance sheet of one of the non-profit organizations as due to MCH.

10.43 MCH files showed total outstanding surpluses of $320,000 for year ended 31 March 1997. This was a decrease over the $439,000 outstanding at the end of the previous year. We are pleased by this development. This shows that MCH has taken action with regard to our recommendation in the prior year to improve collection procedures for surpluses due from non-profit groups.

10.44 We recommended that MCH continue to devote attention to improved collection of surpluses due from non-profit housing groups. Further, we recommended that MCH record the surpluses as accounts receivable in its books and records.

Departmental response

10.45 *We agree with your recommendation that MCH record the surpluses as accounts receivable in our books. We are currently pursuing the collection of outstanding surpluses by setting up formal procedures. As the transfer of the federal non-profit portfolio has recently been achieved on October 1, 1997, we anticipate that the additional staff resources now in place will result in quicker turnaround time for the collection of surpluses due.*

Receivables for non-profit advances

10.46 In addition to the outstanding surpluses mentioned above, as of March 1997, MCH records show a balance of $213,675 in outstanding advances to the non-profit groups. Some of these advances date back as early as December 1988.

10.47 We recommended MCH collect these advances as soon as possible.

Departmental response

10.48 *As noted above, transfer of the federal portfolio has resulted in a re-distribution of the non-profit accounts over a larger staff complement. As portfolio officers oversee the daily administration of their accounts, they will also concentrate their efforts on matters such as these outstanding advances.*

Non-profit projects – review of audited financial statements

10.49 In last year's Report we indicated our concerns about the timeliness of submission of non-profit housing project financial statements. We noted last year that 47 statements were overdue as of September 1996. This was a substantial improvement over the 106 outstanding in 1995.

10.50 There were 62 outstanding statements as of August 1997. It appears that MCH is trying to improve the submission of statements, and has suspended subsidies for some non-profit organizations that have not complied with requests from MCH. We did not note any undue delays in the statement review process once the Department had received the statements.

10.51 We recommended MCH continue action to improve the timeliness of the submission of audited financial statements by non-profit project administrators.

Departmental response

10.52 *The additional resources allocated to this function noted above should result in marked improvement in receipt and review turnaround times.*

Public housing – modernization and improvement variances

10.53 We were unable to obtain adequate explanations for Saint John being $154,000 over budget for modernization and improvement (M&I) expenditures. In addition, one M&I project had a budget of $130,000 however only $10,000 was spent on it. Given the importance of budgeting as a planning tool, our concern is that significant expenditures were made without proper planning. This could call into question the value for money obtained from these expenditures.

10.54 In addition, unplanned expenditures on jobs totalling less than $5,000 appear to be more correctly classified as a maintenance rather than M&I expense. About $18,000 of M&I expenditures in Saint John fall into this category. Other regions also showed significant variances from budget by job and had small budgeted jobs charged to M&I.

10.55 We recommended the Department formally document explanations for significant variances of modernization and improvement expenditures from budget. Further, the Department should clarify its definition of modernization and improvement expenditures to exclude small "maintenance type" jobs.

Departmental response

10.56 *MCH has obtained adequate explanations for all variances documented in the audit letter and we will ensure in the future that formal procedures are set up to record all variances.*

Department of the Solicitor General

Victim Services and Victim Compensation Accounts

Introduction

10.57 From time to time we conduct examinations of special purpose funds and trust funds of the Province. In the 1996-97 year we had planned to examine the Victim Services and Victim Compensation accounts. Part of the reason for our examination was to follow up on questions raised by a member of the Public Accounts Committee.

10.58 When we began to prepare for the project we discovered that the Office of the Comptroller had recently completed a review of a similar nature. We decided to limit the scope of our work, as a result, and conduct a review of the Comptroller's report together with an examination of some general aspects of the operations of the accounts.

10.59 Compensation to victims of crime has been available since the early 1970s. Originally, compensation to victims of crime fell under the authority of the Compensation for Victims of Crime Act, however, this Act has since been repealed. In May 1991 the Provincial Offenses Procedures Act was approved to authorize a source of funding for victims. Now both the victim services and the victim compensation accounts fall under the authority of the Victims Services Act. The Act received Royal Assent on 27 June 1987, and was proclaimed in two parts on 1 May 1989 and 29 April 1991.

10.60 A Victims Services Committee was established under the Victims Services Act. It consists of no less than five members who are appointed by the Solicitor General. The committee performs such functions as:

- determining whether or not a person or class of persons is a victim for the purposes of the Act;
- making recommendations to the Solicitor General regarding the use of funds;
- developing policies respecting victims services; and
- any other matters within the scope of the Act which the Solicitor General refers to the Committee for its recommendation.

Sources of funding

10.61 Revenue for the victim services account is provided by a 20% victim surcharge on all provincial and municipal statute fines imposed for convictions under various acts prescribed by the Victims Services Act. On the other hand, revenue for the victim compensation account involves a federal victim fine surcharge under the Criminal Code. This requires judges to impose a 15% surcharge on criminal fines and a $35 surcharge on other dispositions.

10.62 All revenue received is deposited into the victim services fund but is accounted for separately under the victim services and victim compensation accounts. This fund is located in the Consolidated Fund and receives no interest. The fund is administered by the Department of the Solicitor General.

Nature of the disbursements

10.63 Expenditures from both the victim services and victim compensation accounts are approved by the minister, or a person designated by the minister. Expenditures may be authorized for:

- financial compensation for victims of crime;
- promotion and delivery of victims services;
- research into victims services, needs and concerns;
- distribution of information respecting victims services, needs and concerns;
- remuneration of members of the committee for their services and for reimbursement of reasonable expenses incurred on behalf of the committee; and
- any other purpose the minister considers necessary for carrying out the purposes and promoting the principles set out in the Act.

10.64 The foregoing expenditures are accounted for as follows:

- compensation for victims of crime is paid entirely from the victim compensation account; and
- all other costs are paid from the victim services account.

Results of the Comptroller's audit

10.65 The Office of the Comptroller recently conducted an audit of the victim services and victim compensation accounts for the 1996-97 year. As a result of their audit, several conclusions were reached:

- revenue from federal and provincial sources was properly collected and remitted to the Office of the Solicitor General;
- expenditures incurred were in compliance with the provisions of the Victims Services Act;
- payments were properly authorized and approved; and
- adequate provision had been made in the accounts for outstanding compensation claims.

10.66 Certain administrative costs relating to victim services and victim compensation were not charged to the victim services account. The Comptroller's Office suggested all related administrative expenses should be paid from the special purpose account to ensure proper accountability.

10.67 In the past the responsibility for follow up on outstanding fines and the corresponding surcharges that were due to these accounts was not clearly assigned. Beginning in early 1997 however, the Department of Justice established a program to collect outstanding fines which are estimated to be in excess of $1 million. Federal, provincial and municipal surcharges are included in this collection process.

10.68 The Comptroller also raised the issue of the annual domestic legal aid grants of $250,000. These were originally approved for payment over a three-year period. However, this period had expired and further funding approval had not been given.

Financial history of the accounts

10.69 The following financial summary was prepared by the Comptroller's Office and shows the receipts and disbursements of the two accounts for the past four years. The amounts shown are calculated on the cash basis so accruals are not reflected.

Exhibit 10.1
Victim services fund

	1997	1996	1995	1994
Receipts				
Federal Revenue – Victim Compensation	$ 289,352	$ 329,128	$ 368,367	$ 405,975
Provincial Revenue – Victim Services	889,151	898,518	1,037,637	1,026,002
	1,178,503	1,227,646	1,406,004	1,431,977
Disbursements				
Victim Compensation Expenditures				
Compensation to Victims	351,761	310,848	511,154	514,705
Victim Services Expenditures				
Direct Program Delivery	457,885	687,505	601,786	483,521
Grants to Domestic Legal Aid	250,000	250,000	250,000	250,000
Other Grants	104,700	56,332	141,313	76,800
Projects	100,378	156,499	114,585	120,660
Trauma Counseling	81,281	102,304		
	1,346,005	1,563,488	1,618,838	1,445,686
Excess of disbursements over receipts	(167,502)	(335,842)	(212,834)	(13,709)
Balance of fund – beginning of year	566,823	902,665	1,115,499	1,129,208
Balance of fund – end of year	**$ 399,321**	**$ 566,823**	**$ 902,665**	**$ 1,115,499**

10.70 The balance held in the fund has fallen steadily since the end of the 1993-94 year. This is primarily the result of revenue levels that have declined each year since 1993-94. Disbursements have been fairly steady, fluctuating between $1.3 million and $1.6 million annually.

10.71 The Department believes the decline in revenues is a result of fewer fines being imposed and a drop in such offenses. A recent increase in the surcharge should have a significant impact on future revenue levels.

10.72 Between 1993-94 and 1996-97 virtually all expenditures made under the victim compensation account were for compensation payments to victims.

10.73 As noted by the Comptroller, the administration costs were not charged to the victim services account for the 1996-97 year. These costs include such disbursements as travel, lodging, telephone, parking, rentals, printing and copying. In 1995-96 the administration costs amounted to roughly 6% of the total expenditures of the victim services account.

10.74 The Department of the Solicitor General is considering the findings and recommendations of the Comptroller and will decide whether to charge the victim services account with the administration costs.

Recent activity and future plans

10.75 In January 1997 the Solicitor General put forward the following plans for the 1997-98 year.

- Dedication of resources toward enhanced direct service delivery for clients through victim service coordinators.
- Allocation of increased provincial revenues to the program by increasing the surcharge from 15% to 20% (this change took place in October 1996). Revenue to the account is expected to increase by approximately $300,000 per year as a result of this change.
- Services have been realigned to provide for delivery at the regional level including the receipt, evaluation, and awarding of crime compensation to victims.
- Increased focus on child witness preparation for court.
- An increase in the volume of victim impact statements is anticipated due to recent changes in the criminal code which opens the way for victims to play a more significant role in court proceedings.

Chapter 11
The Year 2000 Program

Contents

The Year 2000 Program

Background

11.1 Like many organizations, the Province of New Brunswick relies on the efficient and effective operation of its information technology for the management and delivery of its programs and services. Corporate Information Management Services (CIMS) and its consultant recently carried out an inventory of the Province's information technology platforms and applications. (CIMS is a branch of the Department of Supply and Services.) They found that there were over 670 automated applications currently being used by the provincial government. Departments reported that these applications were run on various platforms including a mainframe processor at the Data Centre, approximately 400 departmental servers and 19,000 workstations. Such figures demonstrate the extent of our reliance on information technology for the operation and management of government programs and services.

11.2 Computer programmers over the last few decades have typically used two digits in denoting a four-digit date. This programming convention was used in the past because it saved valuable computer memory.The true impact of this convention is only now becoming apparent. As the Province's computers pass from 31 December 1999 to 1 January 2000, they may cease functioning correctly. In fact, some computer systems may cease functioning altogether. Certain computer systems may *already* be performing inaccurate calculations. This could occur in systems that forecast financial information and which are already using calculations that include the year 2000.

11.3 When applications or computer software encounter the two-digit "00", various outcomes could result. The systems may abort, they may reset to the date the applications or systems went online, or, they may believe that this two-digit date actually means "1900". Consider identification cards like driver's licenses or Medicare cards. Assuming a program to produce such cards would function at all, consider the resulting confusion if the expiry dates, intended to be 2000, instead produced cards with a reset date of 1980 or an assumed date of 1900.

11.4 The potential impact of this problem is significant.

11.5 Our Office is but one voice in a chorus of reminders going out to both public and private-sector organizations. The federal Office of the Auditor General conducted considerable work in this area during the 1996-97 fiscal year. The media is becoming increasingly aware of these issues as the turn of the millenium draws near. The message is clear: the

Year 2000 programming problem is not a discretionary item. Delays in addressing this issue only serve to increase its importance.

11.6 The Province's response to the Year 2000 programming problem is known as The Year 2000 Program.

Scope

11.7 The general objective of our work was to determine the Province's state of readiness for the Year 2000. Specifically, we sought to determine:

- whether the Province of New Brunswick has demonstrated an appropriate awareness of the Year 2000 problem;
- whether measures have been taken to properly plan and coordinate the provincial initiative to become Year 2000 compliant.

11.8 Our review chiefly consisted of discussions with the staff of the Corporate Information Management Services branch of the Department of Supply and Services. We also reviewed their consultant's report and selected other documentation.

11.9 No verification has been carried out to validate the information supplied by the CIMS branch of the Department of Supply and Services or its consultants.

Results in brief

11.10 The Province has demonstrated its awareness of the Year 2000 problem since mid-1996.

11.11 In April 1997, financial resources were allocated to the definition and eventual resolution of the Year 2000 problem.

11.12 Resources allocated to the project may not be sufficient given the inflexible deadlines and given major changes in the scope of the project. Though funding, personnel, and computerized tools are of considerable importance, the most important resource is time.

11.13 Responsibility for ensuring departmental Year 2000 compliance resides largely in departments with coordination provided by the Project Management Office.

11.14 With the existing reporting mechanisms, the Project Management Office of CIMS may not be able to effectively report on the government's overall progress in meeting Year 2000 compliance.

Awareness of the Year 2000 problem

11.15 The implications of the Year 2000 problem reach far beyond the boundaries of information technology. Because indifference or lack of vision could result in loss of services to the public, it is important that senior management be fully informed so they may better understand the potential impact.

11.16 During 1996, presentations were made to the Board of Management and the Policy and Priorities Committee. These two committees represent the highest levels of government administration.

11.17 In addition, presentations were made to the departmental Year 2000 coordinators and to members of the Information Systems Advisory Committee as early as April 1996. These presentations raised awareness among information technology personnel across all departments. In May 1996, presentations were made to the Information Technology Strategic Steering Committee. This committee consists primarily of Deputy Ministers and is mandated to advise the Board of Management on information technology issues.

11.18 In July 1996, the Board of Management approved a general strategy to resolve the Year 2000 programming problem. In September 1996, Board of Management authorized the Department of Supply and Services to negotiate with a private-sector company to carry out the Define and Document phase of the Year 2000 Program. This company was asked to propose a solution, a plan of action, and provide cost projections for any additional phases of this project.

11.19 In October 1996, Board of Management received a preliminary budget estimate to complete the Year 2000 Program. In turn, the Board requested a list of systems (prioritized by fiscal year) that would be affected by the Year 2000 programming problem. The final report delivered by the consultant included this list.

11.20 The consultant's final report (dated 13 January 1997) stated that "awareness…is not necessarily consistent across all departments, nor among all senior management of these departments." Our Office has since been assured by CIMS that all departments are now appropriately aware of the importance of the Year 2000 problem.

Financial resources for the Year 2000 Program

11.21 In April 1997, Board of Management approved funding which would help the Province deal with the Year 2000 programming problem.

11.22 Specifically, an amount of $200,000 was approved to implement a Project Management Office (PMO). The PMO would be made up of staff from CIMS (and consultants, as required). In addition, over $340,000 was approved for solving technology infrastructure issues. These funds will be used to develop or acquire hardware and software. These tools will be used to test the systems developed or acquired by departments in addressing the Year 2000 programming problem.

11.23 Funding of over $2.8 million was allocated to departments for application repair costs. These funds are to be paid out over three years and only if the departments cannot find funds in their operating budgets with which to perform the necessary work.

11.24 Exhibit 11.1 shows the estimated costs to repair government applications as reported by departments. Some of these costs are to be funded through normal operating budgets. Exhibit 11.1 also shows the amount of funding required which could not be found in existing operating budgets. This additional funding was requested through a submission to the Board of Management.

11.25 In consultation with the PMO, the Board of Management approved 70 to 100% of most departments' submitted requests. Any difference between the amounts requested and funded would need to be found in existing operating budgets.

11.26 The Board of Management has requested that revised forecasts for the Project Management Office and technology infrastructure be submitted for 1998-99 and for 1999-2000. Additional funding for the PMO, technology infrastructure and applications repair costs will be considered at that time.

The Year 2000 Program's scope has changed considerably

11.27 The original estimates were updated in September 1997. Revisions noted in Exhibit 11.1 take into account the termination of two major public-private partnership initiatives prior to completion. Upgrades to systems in the departments of Health and Community Services, Justice and the Solicitor General did not occur as planned, leaving the remaining systems potentially susceptible to the Year 2000 programming problem.

11.28 The addition of these significant systems to the scope of the Province's Year 2000 Program increases estimated repair costs by approximately $2.7 million. As before, some of these repairs can be funded from existing budgets. However, at least $1.9 million will be required in excess of existing budgets for these three departments. A formal request for funding has yet to be made.

11.29 Even if all necessary funds are obtained for personnel and tools, the true issue has now become time. The process of evaluating and choosing alternatives, then planning, implementing and testing solutions is a time-consuming one. There simply may not be enough time left to complete work on the late-additions before the turn of the millenium.

Responsibility for ensuring Year 2000 compliance resides in departments

11.30 The Year 2000 programming problem is unique. It is a pervasive problem whose impact does not stop with computers or information technology personnel. It can affect an organization at every level. This problem also has a very specific, and inflexible, deadline.

Exhibit 11.1
Applications repair costs by department

	Revised Estimated to Repair	Additional Money Required	Amount Approved by BOM
Advanced Education and Labour	$ 300,000	$ 200,000	$ 200,000
Education	951,600	951,600	666,120
Environment	27,000	27,000	18,900
Executive Council			
Finance	757,800	757,800	530,460
Fisheries and Aquaculture	175,000	175,000	122,500
NBGIC	670,000		
Health and Community Services	100,000	100,000	70,000
Justice	20,000	20,000	14,000
Auditor General	21,500	5,500	5,500
Legislative Assembly	6,000	6,000	4,200
Municipalities, Culture and Housing	1,019,000	992,000	713,300
Natural Resources and Energy	17,500	17,500	
Office of the Comptroller	102,000	2,000	2,000
Solicitor General			
Supply and Services	11,000		
Transportation	771,504	491,504	491,500
Agriculture and Rural Development			
Economic Development and Tourism			
Human Resources Development			
Sub-total- prior to September	4,949,904	3,745,904	2,838,480
Added in September 1997			
Health and Community Services	1,600,000	1,120,000	
Justice	732,800	532,960	
Solicitor General	364,500	255,150	
	$ 7,647,204	**$ 5,654,014**	**$ 2,838,480**

Notes: 1) Updates to “Revised Estimate to Repair” in Exhibit 11.1 were made in September 1997 based on the initial estimates of departments. The estimates for the departments of Justice and the Solicitor General are based solely on the industry’s cost per line of programming code. The departments have developed a strategy to address the Year 2000 issue as well as some operational issues that have arisen as a result of slowing down the integrated justice system. CIMS is working with these departments to review and validate their strategy.

2) Updates to the “Additional Money Required” are based on the assumed funding from departments’ operating budgets of 30%. Submissions to determine the precise amount and nature of funding for additional systems in Health and Community Services, Justice and the Solicitor General have not yet been made to the Board of Management for approval.

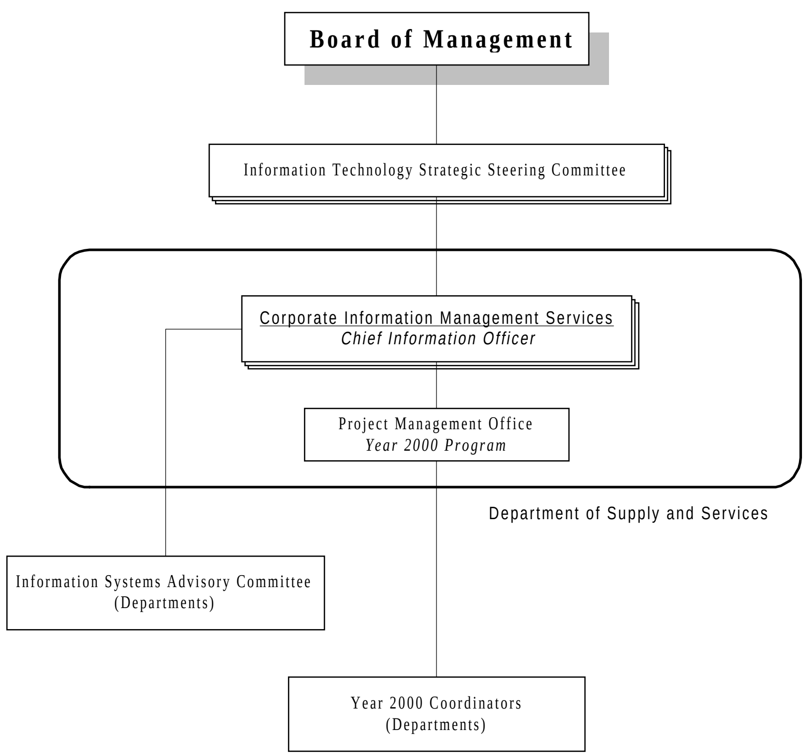
11.31 Added complexity exists because every organization must deal with this issue at the same time. The demand for experienced personnel and adequate tools to combat this problem is increasing. These resources are becoming more valuable, and therefore, more costly. This creates the need to use existing resources efficiently and effectively. The Province’s consultant emphasizes that the successful completion of such a large project requires "world-class" project management skills.

11.32 In general, information technology in the Province of New Brunswick is the responsibility of individual departments. The Province has taken steps to provide assistance and to co-ordinate the work of departments where possible, including the creation of the Project Management Office.

11.33 The consultant envisioned the PMO's role to include the monitoring of "the overall status of departmental progress toward the Year 2000 issue." This responsibility included "reporting progress to senior government officials."

11.34 This is accomplished by PMO reporting to the Chief Information Officer in CIMS. The Chief Information Officer, in turn, attends meetings of the Information Technology Strategic Steering Committee (ITSSC). The Board of Management relies on ITSSC for advice on information technology matters. The Board of Management submission approved in April 1997 stated that "regular status reports {on the Year 2000 Program} be provided to the Information Technology Strategy Steering Committee" by the Department of Supply and Services (CIMS or PMO).

Exhibit 11.2
Reporting structure for The Year 2000 Program



11.35 This type of communication is vital. Progress of all departments should be reported to the Board through ITSSC to ensure that adequate planning (including target deadlines and budget benchmarks) is in place. Implementation and testing of each department's solution should also be monitored to ensure sufficient progress is being made to meet the deadlines. Such communication will allow the government to better distribute "best practices" to other departments. It will also allow the Board of Management to issue directives to departments who are not achieving adequate progress toward the goal of Year 2000 compliance.

11.36 The consultant's report, which recommended that the PMO take responsibility for monitoring "departmental progress", recognizes that the PMO's role in provincial government is "more of a support role versus in a control mode." This leaves the responsibility for planning, implementation and testing of Year 2000 compliant systems solely within departments.

PMO may not be able to effectively report departmental progress

11.37 The PMO has neither the mandate nor the authority to require that departments cooperate by providing detailed information about their progress and status. In addition, there is no enforceable policy that would require departments to submit this type of information to the PMO.

11.38 Despite this, the PMO has obtained significant cooperation and has kept up to date on some of the major Year 2000 projects being conducted. The PMO has made special efforts to obtain updates for applications whose estimated costs to repair are equal to or exceed $100,000.

11.39 Exhibit 11.3 shows applications whose repair or testing costs are equal to or greater than $100,000. Many of the departments listed have shared information with the PMO. However, not all departments have done so and complete cooperation has not occurred. When requested, the Project Management Office was unable to provide our Office with a report citing the current status of each department in achieving Year 2000 compliance.

11.40 Since it is the PMO that prepares the briefings that are ultimately submitted to the Board of Management, our Office is concerned that the senior management of the Province may be unable to obtain frequent and regular information about provincial progress on the Year 2000 Program.

11.41 Though departments may indirectly deal with this issue through annual budget submissions to the Board of Management, any update will be very likely financial in nature. The business focus of the Year 2000 programming problem may be lost to the financial focus. In addition, the review of the Year 2000 Program on a department-by-department basis may not afford the Board a truly "provincial" perspective.

Exhibit 11.3
Applications whose repair or testing costs are equal to or greater than $100,000

	Application	Revised Estimate to Correct
Advanced Education and Labour	Employment Development 92	$ 100,000
Advanced Education and Labour	Civil Survey Package	200,000
Education	Other Systems	200,000
Education	Education Payroll and Related	700,000
NBGIC	Property Tax System	605,000
Finance	Property Tax System	605,000
Finance	Human Resource Information	100,000
Fisheries and Aquaculture	Fisheries and Account Management	175,000
Health and Community Services	Medicare Suite	1,600,000
Health and Community Services	Applications in Regional Offices	100,000
Justice	JOML Online Mailing Labels	165,000
Justice	LCIS Justice Information System	330,000
Justice	Young Offender Information System	237,800
Solicitor General	Young Offender Information System	356,700
Municipalities, Culture and Housing	Cross Application	150,000
Municipalities, Culture and Housing	Public Housing	150,000
Municipalities, Culture and Housing	Loans	440,000
Municipalities, Culture and Housing	Emergency Repair	100,000
Transportation	Vehicle Registration	500,000
Transportation	Inventory	104,809
		$6,919,309

Recommendation

11.42 A mandatory reporting mechanism should be implemented to ensure the Board of Management receives regular, frequent information on the progress of all departments in achieving Year 2000 compliance. Such reporting would provide the Board of Management with the information necessary to ensure the Year 2000 programming problem is addressed in an appropriate manner.

11.43 This mechanism would most likely include mandatory reporting, by each department, to the Project Management Office. Departments should report for each major technology or application contained in the inventory taken during the earlier phase of the Year 2000 Program. Target deadlines and budget benchmarks should be submitted and progress regularly up-dated. This information could be summarized and passed through the existing channels for submission to the Board of Management on a monthly or bi-monthly basis.

11.44 Our recommendation will give the Board of Management an opportunity to address areas of concern in a timely and proactive manner. This will help emphasize the importance of this project to individual departments, as well as to the Province as a whole. In addition, this opportunity will allow the Board of Management to assess any additional funding requirements that may arise as the scope of the project changes. Finally, the Board of Management can focus its resources and attention on those departments who may not be making satisfactory progress in meeting Year 2000 compliance.

Response from Corporate Information Management Services

11.45 *A proposed process by which Departments will be required to report to the Project Management Office (PMO) on a regular and more formal basis has been presented to the Information Systems Advisory Committee. The objective of the process will be to have departments provide timely and appropriate information to the PMO for regular reporting to the Information Technology Strategic Steering Committee (ITSSC) and the Board of Management (BOM). Progress reports will be submitted to both the ITSSC and the BOM as information items on a more regular basis. If required, corrective action will be defined and recommended to ISAC, ITSSC and/or BOM as appropriate.*

11.46 *The proposed standard status format and methodology is the Gartner Group COMPARE methodology (**COM**pliance **P**rogress **A**nd **RE**adiness.) This process is used by thousands of companies worldwide and is seen as the preferred choice by the industry.*

11.47 *The proposed process will be discussed at the November meeting of ISAC and presented to ITSSC in December.*

Chapter 12
Crown Corporation Governance

Contents

Crown Corporation Governance

Background

What is corporate governance?

12.1 Corporate governance can be defined as the process and structure used to direct and manage the business and affairs of an organization with the objective of achieving the corporate mandate. Without effective corporate governance, establishing effective accountability is impossible.

What are the characteristics of effective governance?

12.2 The following is a list of the characteristics of effective governance. Boards must:

- be comprised of people with the necessary knowledge, ability and commitment to fulfill their responsibilities;
- understand their purposes and whose interests they represent;
- understand the objectives and strategies of the organization they govern;
- know and obtain the information they require to exercise their responsibilities;
- once informed, be prepared to act to ensure that the organization's objectives are met and that performance is satisfactory; and
- fulfill their accountability obligations to those whose interests they represent by reporting on their organization's performance.

12.3 If a board truly exemplifies these characteristics, it will be providing effective governance, thereby promoting accountability.

How does effective governance promote accountability?

12.4 For accountability to be achieved, three conditions must exist. First, all parties must understand and agree with the mandate, mission, and strategic goals of a corporation. Second, information that adequately communicates the degree of achievement of the mandate, mission and goals of the organization, and compliance with guidelines must be passed upward through the accountability chain. Third, those in authority in the accountability chain must be willing to act within their authority in response to information received. All three of these conditions will be met in an environment of effective governance.

Why did we undertake this project?

12.5 As we mentioned in last year's Report, it was our intention to perform a detailed governance review of at least one New Brunswick Crown corporation during the 1996-97 audit year. Because an audit project had already been scheduled in the area of governance, accountability and management control framework pursuant to the joint audit of the Atlantic Lottery Corporation Inc. (ALC) with the Auditor General of Nova Scotia, we chose that corporation. ALC is a Crown corporation under provincial legislation and we felt that any findings from the joint audit project could also be used in completing our own governance review. In effect, then, our work in the governance and accountability area for ALC fulfilled a dual role. It helped us to meet our commitment relating to the joint audit of ALC while at the same time allowing us to do a detailed governance review of a New Brunswick Crown corporation.

Why is effective governance important for ALC?

12.6 ALC has four shareholders, representing four distinct provincial jurisdictions. Therefore, the establishment and maintenance of appropriate accountability relationships is very important. As we discussed above, the board can promote accountability by effectively fulfilling the governance role it has been assigned by the shareholders.

Why is this important to the Legislative Assembly of the Province of New Brunswick?

12.7 It is clear that the main objective of the Atlantic Lottery Corporation is to maximize its profits, thereby maximizing the dollars available for public use in the four shareholder provinces. However, provincial policies sometimes restrict ALC’s ability to meet this primary goal. For example, the Province has placed certain restrictions on games in order to try to limit the perceived negative social consequences of gaming. Measurement of the degree of success in achieving ALC’s mandate, then, is more complicated than simply looking for growth in the bottom line.

12.8 If there is effective corporate governance, the board of ALC will be providing the Province with the information it needs to evaluate the degree to which ALC has achieved its mandate. That information can be used as an important Legislative control.

12.9 On the other hand, if governance and accountability structures are weak, then the Legislative Assembly may lack some of the information it needs to make accurate assessments of ALC’s performance.

The Corporation

12.10 The Atlantic Lottery Corporation was incorporated under the Canada Business Corporations Act in 1976 to be a co-operative venture between the four Atlantic provinces in the lottery business. Both revenues and net profits paid to shareholders have shown substantial growth over the past twenty years, coinciding with rapid growth in the lottery business in North America during the same time period. Many new games have been introduced both nationally and regionally. From relatively modest beginnings, the corporation has grown to employ a staff of over four hundred and twenty-five persons, with head offices in Moncton, and regional offices in Nova Scotia and Newfoundland.

12.11 The environment in which ALC operates has changed rapidly in recent years. While technological advances have led to major improvements at ALC, they have also created significant risks, particularly in the area of competition. When ALC was incorporated, it had a monopoly in Atlantic Canada over public gaming, with the exception of charity events and harness racing. However, with the rapid growth of the Internet, competition from gaming organizations outside the Atlantic provinces could soon become a very important strategic issue.

Governance at ALC

12.12 ALC is an unusual public-sector corporation in that it has not just one government's set of interests to consider, but the interests of four provincial governments. This puts the board of ALC in the unique position of having to ensure all provincial concerns are dealt with, while still attempting to make decisions that are in the best interests of the corporation. The full board of directors of ALC is made up of eight members, two of whom are appointed by each of the four provincial shareholders. The shareholders include the Lotteries Commission of New Brunswick, the Nova Scotia Gaming Corporation, the government of the Province of Newfoundland and Labrador, and the Prince Edward Island Lottery Commission.

Scope

Objective

12.13 Our objective in carrying out this project was to review the governance, accountability and management control framework for the corporation's activities, including an assessment of the quality of information and reporting available on its plans and performance. However, for purposes of this chapter, we have focussed on findings relating to governance and accountability issues only.

Criteria

12.14 For purposes of our governance review, we have used the first six criteria developed for use in the joint audit project. Because these criteria were developed in consultation with the Auditor General of Nova Scotia, they are not identical to the governance criteria we developed last year and reported in our 1996 Auditor General's Report. However, we do not feel the differences to be significant. These criteria are presented in the "findings" section of this chapter.

Procedures

12.15 Our examination procedures for this project included surveying and interviewing all seven of the ALC directors who were on the board at the time of our examination. Additionally, we interviewed the President of ALC, along with several members of senior management. We reviewed minutes of the Board of Directors, the Audit Committee, and the Senior Management Committee. We also reviewed pertinent reports and documents at ALC. General governance and accountability literature was also referred to in completing our work.

Results in brief

12.16 Many of the findings from the joint audit of ALC relating to governance and accountability are included in this chapter. We would like to note that we have expanded upon certain items in the Shareholder's Audit Report issued by the Auditor General of Nova Scotia. A summary of our observations and key suggestions / recommendations relating to this project is presented in the "findings" section. Some highlights follow.

12.17 There is a defined governance structure for ALC.

12.18 At the time of our audit, there was no code of conduct in force setting standards of behaviour for board members, management, and staff.

12.19 The corporate mission statement and high-level strategic objectives for the corporation were developed by management as part of their strategic planning exercise. The strategic plan was approved by the board of directors. At the time of our audit, it had not been formally approved by the shareholders.

12.20 Under the current governance structure, the "directing minds" of ALC are the four Ministers responsible for the four provincial shareholders, not the board of directors.

12.21 The roles, responsibilities and accountabilities of the board of directors have not been documented.

12.22 The division of responsibilities between management and the board of directors has not been documented.

12.23 Board members have traditionally been senior public servants from the four shareholder provinces.

12.24 Current directors cannot meet the standard of performance relating to independence as required in the Canada Business Corporations Act.

12.25 The two New Brunswick board members are in a conflict-of-interest situation because they also serve on the board of ALC's regulator in the province, the New Brunswick Lotteries Commission.

12.26 The board has not developed a high-level policy framework that provides guidance to management in areas of concern to the board.

12.27 Current reporting by management to the board does not address the degree of achievement of non-financial strategic objectives.

12.28 ALC's annual report does not provide performance reporting information that would allow the reader to assess the degree to which the corporation has met its corporate strategic goals, and therefore its mission.

12.29 It is important to note that while we make a number of observations and suggestions for improvement relating to governance practices at ALC in this chapter, nothing was identified during our work which would directly impact on or cause a loss of integrity or credibility related to the quality of the gaming products that are being delivered by the Corporation on behalf of its shareholders.

Exhibit 12.1
Atlantic Lottery Corporation
Findings

Criteria	***Criteria Assessments***	**Observations**	**Key Suggestions / Recommendations**
There should be a governance structure and process in place and operational for the Corporation, complete with guiding principles/values and a dispute resolution mechanism.	Criterion met	1. There is a governance structure and process in place. 2. A list of corporate guiding principles exists. 3. There is no code of conduct in force setting standards of behaviour for board members, management, and staff. 4. Basic dispute resolution mechanisms have been established in the corporate bylaws.	1. The board should ensure that appropriate comprehensive standards governing board, management, and staff behaviour are adopted for ALC. (See R10 in the shareholder's audit report)
The Corporation's mandate, mission, goals and objectives should be clearly and concisely defined, properly approved and reflected in its strategic priorities and operational activities.	Criterion met	1. The corporate mandate for ALC is defined in the shareholders' agreement and reads as follows. *"The Atlantic Lottery Corporation, a body corporate incorporated under the Canada Business Corporations Act, is designated as and hereby becomes an agency of Her Majesty in right of the province of New Brunswick, … for the purpose of conducting and managing lottery schemes in each of those Provinces and other Provinces."* 2. The corporate mission statement and high-level strategic objectives for ALC were developed by management and reviewed and approved by the board. We feel that it would be more appropriate for the board to take a leadership role in developing the corporate mission and high-level strategic objectives for ALC. They should also ensure that all four shareholders agree with the corporate mission and strategic goals. In an environment of performance reporting, the board has a vested interest in ensuring that strategic objectives are complete, measurable and therefore useful in evaluating the degree to which ALC has achieved its mission.	1. The board should assume responsibility for the development and regular review of the corporate mission statement and high-level strategic objectives for ALC. 2. The board should seek formal shareholder approval of future mission statements and high-level strategic objectives developed for ALC. (See R5 in shareholder's audit report.)

Exhibit 12.1 - cont.
Atlantic Lottery Corporation
Findings

Criteria	***Criteria Assessments***	**Observations**	**Key Suggestions / Recommendations**
The roles, responsibilities and authority requirements or limits of the Board of Directors and management should be defined, understood and adhered to.	Criterion partially met	1. The *"directing mind"* of a corporation is the individual or group who has the power to set key policies for the corporation and is ultimately accountable for achievement of the corporate mandate. The "directing minds" of ALC are therefore the four Ministers responsible for the four provincial shareholders. 2. The board of ALC is an administrative management board with some governing responsibilities, particularly in administrative areas. They are not a governing board because they are not the "directing minds" of the corporation. 3. Corporate bylaws define the specific powers assigned to the board of directors by the shareholders of ALC. 4. Various documents explain the day-to-day responsibilities of management. 5. There is no documentary evidence of the four Ministers' expectations of the board's roles, responsibilities and accountabilities. Also, the board has made no attempt to document, in consultation with the "directing minds" of the corporation, its own roles and responsibilities. The board appears to act as another layer of management rather than an integral part of the governance structure of ALC. 6. The lack of clearly documented roles and responsibilities for the board in turn creates difficulty in establishing the boundary between board and management roles. The board has made no attempt to document the division of responsibilities between the board and management, which leaves ambiguity in the relationship between the board and management.	1. The board members should, in consultation with the four provincial Ministers responsible for ALC, clarify their roles and responsibilities as directors and document them. As a minimum, the board should include the following items when defining its roles and responsibilities. • The board should be the communications link between the corporation and the shareholders. • The board should be responsible for developing a high-level policy framework within which management may run the corporation. • The board should monitor and evaluate organizational performance and communicate their evaluation of that performance to the shareholder governments. The board should also take corrective action to improve performance where they deem it necessary. 2. The board should, in consultation with management, clearly document the division of responsibilities between itself and management and ensure that all parties understand and respect the division.

Exhibit 12.1 - cont.
Atlantic Lottery Corporation
Findings

Criteria	***Criteria Assessments***	**Observations**	**Key Suggestions / Recommendations**
The Board of Directors should be comprised of people with the necessary knowledge, ability, commitment, and independence to fulfil their responsibilities.	Criterion partially met	1. Board members have traditionally been senior public servants and that continues to be the case. Five of seven directors at the time of our audit were either deputy ministers or working at an equivalent level within government, including both of the New Brunswick representatives. 2. The board of directors is comprised of people with the necessary knowledge, ability, and commitment to fulfil their responsibilities as board members. 3. The Canada Business Corporations Act (CBCA), under which ALC is incorporated, sets standards of performance based on the assumption that directors have the ability to act independently in the best interests of the corporation. ALC directors are not able to act independently in all cases because they are not the "directing minds" of ALC. They must defer to the wishes of the responsible Minister in their jurisdiction where required. Therefore, current directors of ALC cannot meet the standard of performance in the CBCA. 4. Two New Brunswick board members of ALC are also on the board of the Lotteries Commission of New Brunswick (LCNB), the provincial shareholder. As LCNB is charged with regulating gaming activity within New Brunswick, it appears that these directors are in a conflict-of-interest situation.	1. The conflict between the standard to which the board is held under the Canada Business Corporations Act and their ability to act independently due to the current governance structure should be resolved. 2. The apparent conflict-of-interest of New Brunswick representatives on the ALC board of directors should be resolved.

xhibit 12.1 - cont.
Atlantic Lottery Corporation
Findings

Criteria	***Criteria Assessments***	**Observations**	**Key Suggestions / Recommendations**
Policies and procedures should exist and be operational for key areas or aspects of the Corporation's management and other activities.	Criterion partially met	1. The board has not developed a high-level policy framework, in consultation with the shareholders where necessary, that provides guidance to management in areas of concern to the board. Corporate policy is currently developed at the initiative of management. 2. Management-level policies seem to address day-to-day operations on a reasonable basis.	1. The board should adopt a policy-based approach to governance, wherein the board develops a high-level policy framework that provides guidance to management in areas of concern to the board. Such a policy framework should cover the following areas. • A list of high-level corporate strategic goals, along with an indication of the information that management must provide to the board. This information should allow the board to evaluate and report upon the degree to which strategic goals have been achieved. • Limitations on the range of acceptable management actions. • The relationship between the board and management, including their respective roles and responsibilities. • The process of corporate governance at ALC.

Exhibit 12.1 - cont.
Atlantic Lottery Corporation
Findings

Criteria	***Criteria Assessments***	**Observations**	**Key Suggestions / Recommendations**
There should be sufficient, appropriate and timely information available and reporting on the Corporation's plans and performance, from both the financial and program perspectives.	Criterion partially met	1. The external auditor has issued unqualified audit opinions relating to financial statements provided in the ALC annual report. 2. Management provides the board with regular financial reporting, including budget comparisons and variance explanations. 3. There is an established annual planning and budgeting process. The board approves resulting plans and budgets. 4. Management has not been asked by the board, and does not provide regular reporting that addresses the degree to which non-financial corporate strategic objectives have been achieved. Only two of the eleven corporate strategic objectives are addressed in management reporting to the board, and both are financial objectives. 5. The 1997 annual report of ALC does disclose the corporate mission and strategic objectives, an improvement over prior years. 6. The ALC annual report, the board's key accountability document, does not provide performance reporting information that would allow the reader to assess the degree to which the corporation has met its corporate strategic goals, and therefore its mission.	1. The board should consider if it continues to be in support of the current corporate strategic objectives of ALC. If so, it should ensure that it obtains sufficient appropriate information from management to evaluate the degree of achievement of the current corporate strategic objectives. If not, the board should rewrite the corporate strategic objectives to bring them into line with what the board feels is needed to achieve the corporate mandate. (See R14 in the shareholder's audit report.) 2. The board should have the annual report enhanced to make it an ALC accountability document for the use of shareholder provinces and stakeholders. As a minimum, there should be a narrative explaining initiatives taken to meet each individual strategic objective and an analysis of the degree of achievement of the objective. However, a longer-term goal should be to develop and present a set of performance indicators that would allow the reader to objectively assess the degree of corporate success in achieving each strategic objective. (See R8 in the shareholder's audit report.)

Chapter 13
Privatization

Contents

Privatization

Background

13.1 The 1996 Report of the Auditor General made reference to our interest in the government's privatization initiatives. We indicated that some privatization projects would be selected for review in future years.

13.2 During the year we reviewed the May 1995 decision by government to privatize its data processing facility.

13.3 A consortium consisting of partners Datacor/ISM and Unisys agreed to a seven year contract with the Department of Supply and Services to operate the Province's Data Centre.

13.4 The Master Service Agreement (MSA) between the contracting parties is a fairly complex document. It contains approximately three hundred and forty-five pages of agreement detail. Separate agreements are part of the package and cover:

- employee transfers;
- industrial benefits;
- premises lease; and
- transition services.

13.5 The MSA is quite specific in detailing the benefits that the government was to achieve by this privatization initiative. The benefits articulated on the first two pages of the agreement are:

- creating an environment that maximizes the benefits from the current investment in data processing and encouraging participation by government departments and agencies in both the existing centralized data processing facilities and a common and standardized client server platform;
- creating cost savings in the delivery of technology to government departments and agencies;
- ensuring increased technology industrial benefits and associated ancillary industrial benefits;
- developing technology solutions to improve the integration of data and applications which shall enhance the delivery and effectiveness of government programs; and
- establishing an environment which encourages marketplace opportunities for maximizing any additional capability of the Consortium to provide services.

Scope

13.6 The objective of our review was to compare the results obtained during the first two years of private Data Centre operation with the expectations set out in the MSA and its various schedules.

13.7 Our work consisted of interviews with government contract administrators, consortium managers and users of Data Centre services. The MSA was reviewed in detail and various reports and financial documents were analyzed covering the first two years of operation by the Consortium.

Results in brief

13.8 Users report that the quality of service remains as good and in some cases better than prior to privatization.

13.9 There were no cost savings accruing to government as a result of this new arrangement. In fact savings from staff reductions implemented by the government in their last year of operating the Data Centre were lost when the Centre was privatized.

13.10 A control study of the Data Centre by an independent firm of chartered accountants indicates serious control weaknesses exist. Although it was a requirement of the contract between the government and the Consortium, little has been done to bring the Centre up to industry control standards. The lack of a complete disaster recovery plan is part of this problem at the Data Centre.

13.11 Provisions in the contract that would see up to 15% of personnel resource costs per year transferred from staff reductions in the main frame environment to other government work have not materialized. At the time of our review no efficiencies had accrued to the government from the Consortium's ability to operate the Centre with considerably fewer staff than was funded in the contract.

Quality and cost of the private service

13.12 Users of the Data Centre indicated the quality of the service being provided by the Consortium run Data Centre had improved since the change was made in 1995. Production data also suggests that transaction volumes have increased since the takeover. However the impact on any anticipated government cost savings is not as clear.

13.13 The base funding to be provided to the Consortium was developed using the 1993-94 actual Data Centre expenditures. This analysis indicated a funding level of $11.9 million as the adjusted cost of services the Data Centre provided in 1993-94 that would be turned over to the Consortium. This was augmented by an extra $100,000 to arrive at a minimum service guarantee of $12 million for the initial three years of the contract. In addition to this approximately 19,000 square feet of office space is provided by the government to the Consortium at a nominal fee of $120 annually.

13.14 The government agreed to fund the Consortium for 52.5 person years. According to the Department of Supply and Services the actual staffing had been reduced from the 1993-94 level of 52.5 person years to 44 person years at the time of the take-over in May 1995. This efficiency (52.5 py - 44 py = 8.5 py) was lost when government agreed to fund the Consortium at the old (93-94) level of 52.5 person years.

13.15 In our opinion the Consortium has provided the government with a quality and volume of services that is equal to or better than that formerly provided by the government run centre. The costs are no less, though, than those under the government run system. It would appear as though the efficiencies gained when the government cut back staff at the Data Centre (reduction of 8.5 person years between 1993-94 and 1994-95) were lost under the privatized contract.

Departmental comments

13.16 *The goal of this particular outsourcing was to achieve equal or better service for equal or better cost . . . . .this has been achieved. Also there were other goals besides cost savings such as industrial benefits, and demonstrating a commitment to downsizing/outsourcing.*

13.17 *The staffing reduction referenced (52.5 py – 44 py) is not really relevant to the contract. The contract was based on 1993-94 Business As Usual (BAU) costing. It was necessary to choose a snapshot point to ascertain costs relative to a given scope of work. Some time period had to be chosen. The 44 py's were associated with a different cost period 1994-95. There was also an element of "business not as usual" in 1994-95 which impacted on human resources as the department prepared for the imminent hand-over by re-deploying resources and holding back on new activities.*

Our comment on the response

13.18 One of the five benefits articulated in the agreement with the Consortium was "to create cost savings in the delivery of technology to government departments and agencies". We were unable to identify any cost savings arising out of the privatization of the Data Centre.

Contract

13.19 The Master Service Agreement (MSA) is a lengthy and complex document. There are several sections dealing with requirements for information or some specific action requirement on the part of the Consortium and/or government. Our analysis of the various requirements is contained in this section of the report.

No service auditor's report prepared

13.20 The MSA requires that the Consortium deliver to the Auditor General, Comptroller, and Department of Supply and Services a copy of a Service Auditor's report on control procedures at the Data Centre by 31 March 1996 and not less than every second year thereafter. Such report shall be in respect of the control procedures as at a date not more than four months prior to the date the report is required to be delivered.

13.21 In our 1996 Report we commented that this part of the agreement had not been followed. Since that time a firm of chartered accountants was engaged to carry out this audit of Data Centre controls. They were unwilling to issue an audit report because of several unresolved issues. The main issue seemed to be the use of a security protocol (TTSS Software) by the Data Centre that was not recognized by the industry. The firm made several suggestions for improvements.

13.22 At the time of our review the control requirement had not been brought up to standards suggested by the accounting firm.

Recommendation

13.23 We recommend the Department of Supply and Services ensure the Consortium bring the Data Centre in line with control requirements set out in the chartered accountants' report.

Departmental response

13.24 *The Consortium, in consultation with this department, is addressing the issues identified for improvement. The TTSS security protocol replacement is a very costly undertaking to government as major modifications are required to a large suite of customized applications. These changes are being made as systems are replaced and as applications support budgets permit. The pace of reaching the requirement is heavily dependent on budget available for this priority with respect to the TTSS replacement.*

External auditor's report

13.25 The MSA indicates that the Consortium will provide, annually, an External Auditor's report on the financial statements of each member of the Consortium and any management letters as they related to the Services provided under the Agreement.

13.26 This requirement would appear to anticipate that audited financial information for each partner's operation be provided to government. This is not being provided.

13.27 One consortium partner provided a copy of the company's standard audit report with no financial statements or management letter. The other consortium partner provided a copy of their annual report and indicated they do not have a financial audit carried out.

13.28 The Department is not clear on just what is required and have accepted the above noted documentation as evidence that the requirement has been met.

Recommendation

13.29 We recommend that the relevent section of the agreement be clarified so that appropriate financial information can be obtained from the Consortium partners.

Departmental response

13.30 *. . . . . the purpose of this section was to ensure we would annually have evidence of the solvency of the Consortium companies. It is not clear. . . . . that this is in fact what is requested and whether an Auditor's Report,* *not a financial statement, is the requirement. In any case we would not expect any "management letters" unless the external auditor found discrepancies. In the case of Datacor/ISM they did submit a letter that basically testified that the audit had been done. In the case of Unisys, they replied with an Annual Report stating that "Unisys Canada Inc. does not complete external audits on their financial statements". As you know however the U.S. parent is a publicly traded company, and their financial position was investigated when the clear path technology was acquired in 1996-97. The contract allows for a "report on the financial statement" not audited financial statements. Perhaps the external audit report from Datacor/ISM should be more detailed. Unisys, clearly has not attempted to fulfil their requirement here unless one accepts the Annual Report as evidence of solvency.*

13.31 *It should also be noted that the Province has extensive right to audit under 4.12(a) on a confidential, non-disclosure basis all "books, records, documents and other evidence…". There has not been any evidence that financial problems, in either partner, has impacted on the performance of the contract so no audit has been initiated by ourselves.*

Value assurance audit

13.32 The MSA requires the Consortium to engage an independent, unaffiliated, expert firm (the "Consultant") to evaluate some or all of the Services provided pursuant to this Agreement at a fee of approximately $50,000 for the first review and a reasonable relative fee for each subsequent review. These fees will be shared one-third by the government and two-thirds by the Consortium. The purpose of this evaluation is to review the Service Levels and the Charges for the Services, assess the appropriateness of both and, if required, make recommendations. The Consultant must conduct its evaluation and base its report (including any recommendations) on standards which reflect the environment within which the Consortium operates as compared to the information technology industry marketplace.

13.33 The MSA talks quite extensively about a value assurance audit being done on a regular basis. It appears to be an attempt to assure the various parties to the agreement that the Data Centre is operating efficiently. At the time of our audit a draft performance report had been prepared by Compass Analysis Canada Limited. The final results, in particular the comparison of IBM environments to the Unisys environments, need to be evaluated by the Consortium as well as the government.

Recommendation

13.34 Our recommendation is that the Department analyse the results of the value assurance study, document the results, make recommendations for change where appropriate and prepare an appropriate action plan.

Departmental response

13.35 *The Department has done this. The results of this study were reviewed by Department of Supply and Services (DSS) Contract*

Management and communicated to the Departments. The Departmental contract advisory committee (DCWG) was given the report and it was discussed and accepted at their 21 March 1997 meeting.

13.36 *The value assurance report is required every two years under the contract. The objective is to get a price comparison of our facility to comparable environments elsewhere.*

13.37 *It was difficult to find a good set of comparison sites for our. . . . . Unisys environment. Compass used six European facilities. . . . . for the Unisys reference group. They also used another comparison group of five IBM sites.*

13.38 *The findings are documented on page 13 of the report. Although our gross costs appeared to be $2.2M higher than the Unisys comparison group maximum, adjustment of $2.638 M attributable to back-end loaded past lease arrangements brings our cost below the Unisys reference. In other words, our costs compare favourably, when the "sunk" costs built into the contract are recognized.*

13.39 *The IBM reference group was substantially lower in cost. This is probably not especially relevant because:*

- *it would be extremely costly to convert our applications to run in that environment; and*
- *we have an outstanding Unisys lease running until 2002.*

Disaster recovery

13.40 Disaster recovery planning is important to ensure continued operation of government operations should some major event occur impacting the Data Centre.

13.41 The MSA acknowledges that the Data Centre did not have a disaster recovery plan at the time it was taken over by the Consortium. The agreement does recognize the need and talks about working together (government and Consortium) to develop such a plan.

13.42 At the time of our review some progress was being made. A consultant was working with the various stakeholders and some plans had been developed and documented. However, a key decision on whether to spend considerable monies on securing a back-up computer site had not been made.

13.43 The need for a disaster recovery system is also pointed out in the Chartered Accountants' study of controls and in previous Auditor General's Reports.

Departmental comments

13.44 *The Province, with the assistance of the Consortium, is in the process of finalizing a technical recovery plan. In the 1997-98 fiscal year* *we will be presenting to government the findings and costs of acquiring this service.*

Administering the Master Service Agreement (MSA)

13.45 It is incumbent on government to ensure it maximizes the value of the taxpayer's dollar which has been committed under the agreement with the Consortium.

13.46 In order to do this the Department of Supply and Services (DSS) assigned experienced staff to manage the MSA. They meet bi-weekly with Consortium management to discuss and resolve problems and plan new initiatives. DSS staff are also responsible for helping user departments understand the contractual arrangements with the Consortium.

13.47 At the time of our review the DSS staff were embarked on a major effort with the Consortium to more specifically identify Data Centre overhead costs. DSS expects the results of this study to provide the basis for lower pricing of new services by the Consortium. Some other areas, noted below, have the potential to improve the return the government gets for its data processing dollars and will need to be monitored closely by DSS.

Allocation of costs to user departments

13.48 The method used by the Department of Supply and Services to allocate data processing costs to user departments was a problem prior to privatization and continues to be a problem under the new set up. The problem is primarily due to the commitments for certain mainframe costs that have to be paid regardless of the usage. As departments move to client server environments the government could be in the position of paying twice for the same service, once for the commitment for their old system which operated on the mainframe and again for their new client server systems which may or may not be operated by the Consortium. The Department of Supply and Services is aware of this possibility and has a strong resolve to see this duplication does not happen. As well the departmental user group has studied the situation in some detail and has put forward proposals to improve the process. These proposals include:

- strong contract management by Supply and Services to ensure the government is not over charged or double charged for services;
- a business case should be required for departments that want to use other than the central services provided by the Consortium; and
- the annual planning process should be strengthened so departmental agreements with the Consortium can be signed prior to the beginning of a new year.

13.49 Several other suggestions were aimed at helping make the current funding model more responsive to the budgets and needs of user departments.

Recommendation

13.50 We recommend the Department review the cost allocation model currently in place and give consideration to suggestions put forward by the user group.

Departmental response

13.51 *This is in process. Principles have already been discussed with the ITSSC. Some detail issues remain but we are in the process of coming up with a recommendation. We are very cognizant of the issue of "paying twice for the same service". Each service including the mainframe is priced separately and care is taken with each new order to ensure the price reflects competitive market rates. As departments migrate off the mainframe there may be an issue of the remaining departments having to cover the price of the mainframe but this is now being watched to ensure decisions account for sunk costs and value for money. This is a government problem and is being addressed through collective planning. A cost allocation model is under review and will shortly be taken to the government by DSS for ratification.*

Reallocation provisions of the MSA

13.52 One key provision in the agreement between the government and the Consortium has to do with the reallocation of personnel resources from the mainframe environment to client server environments. Generally the agreement anticipates up to 15% of the mainframe personnel resource costs being available annually to the government to fund new client server environments at the Data Centre.

13.53 During the first two years of the contract this transfer has not materialized. If this transfer is not achieved the results will be very costly for government. As noted previously the government will in effect pay the full cost of the mainframe until the year 2002 plus the costs of client server environments for those applications which move to other hardware.

Recommendation

13.54 We therefore recommend the Department of Supply and Services take advantage of provisions of the agreement that transfer up to 15% of the mainframe personnel resource costs annually from mainframe to client server environments or re-negotiate this part of the agreement if necessary.

Departmental response

13.55 *The government usage of the mainframe has continued to increase since the Consortium has assumed its operation. As (and when) this utilization decreases the Contract Management will diligently pursue the reallocation benefits.*

Attraction of new business by the consortium

13.56 The MSA sets out quite specifically that the Consortium is expected to attract new clients to supplement its government business. The idea is that it would create employment as well as contribute to some of the Consortium fixed costs of operating the Data Centre. This in turn should benefit the government through lower pricing of services by the Consortium.

13.57 In the first two years of the agreement the Consortium had not attracted any significant amount of non-government business. The reasons given were that the Unisys equipment could not adequately separate and secure government data from non-government data. Therefore this significant value added component of the privatization concept was never really viable.

13.58 The original hardware was replaced in January 1997. The new equipment may provide some more options to attract new business.

Departmental comments

13.59 *The issue of security of government data had limited business development options, for the mainframe. However, you are correct that Datacor has not explored opportunities for the Centre itself.*

13.60 *However certain Year 2000 work is now heading for processing in the Data Centre.*

Computer lease

13.61 The quality assurance review carried out for the Consortium by Compass Analysis Canada Limited raised an issue about leasing practices for the Unisys mainframe. The analyst's report makes an adjustment to the annual lease cost of $2,638,000.

13.62 The analyst's note reads as follows:

> *Adjustments*
> *The Consortium inherited the lease obligations at the commencement of this contract. Consequently, the current cost structure should include some adjustment for the difference between reference group ownership costs and the inherited lease obligation. COMPASS calculates that the inherited lease obligation is $2,638,000 per year higher than the reference group ownership costs for similar sized equipment.*
>
> *It should be emphasized that this was the difference at the beginning of the contract period. Most organizations who find themselves in this situation are able to reduce this difference through negotiations with the vendors on subsequent acquisitions.*

13.63 The past practice of rolling the payouts of lease obligations of equipment that is no longer in use into leases for new equipment created much of this problem.This is a poor accounting practice at best and has served to inflate the costs of the Unisys mainframe environment to where the lease payments were $2.6 million a year over the market rate at the time the above noted study was carried out.

Departmental comments

13.64 *The adjustment to the lease obligations, as raised in the Compass Analysis Canada Ltd. review, has been addressed earlier and is a* *necessary cash payment but a "sunk" cost relative to the Consortium arrangement.*

Chapter 14
Lotteries Commission of New Brunswick/Atlantic Lottery Corporation Inc.

Contents

Lotteries Commission of New Brunswick/Atlantic Lottery Corporation Inc.

Background

14.1 In our 1996 Report we discussed a number of issues relating to the Lotteries Commission of New Brunswick and the Atlantic Lottery Corporation Inc. (ALC). The most significant of these issues were highlighted in *Results in brief*, paragraphs 12.7 through 12.12 of that Report and covered:

- the joint audit of ALC carried out with our colleagues from the Office of the Auditor General of Nova Scotia;
- a recommendation for segmented financial information showing separately the results of the Video Lottery Program (VLP) and ALC's ticket games;
- a recommendation that the Lotteries Commission prepare a comparative cost analysis of two models of operation for the VLP prior to expiry of the agreement with the New Brunswick Coin Machine Operators Association on 31 March 2002;
- the need for the Lotteries Commission to improve reporting on regulatory functions;
- a recommendation that the Lotteries Commission request ALC to provide sufficient financial reporting to demonstrate compliance with the regulated payout percentages for the VLP; and
- a statement that Commissioners serving on the Lotteries Commission have a conflict of interest if they are also serving on the board of ALC.

Scope

14.2 In this chapter we are following up on the issues previously highlighted in the 1996 Report of the Auditor General. The issue on conflict of interest has been dealt with in Chapter 12, *Crown Corporation Governance*.

Results in brief

14.3 Together with the Office of the Auditor General of Nova Scotia, we completed the joint audit of ALC. The Auditor General of Nova Scotia released the *1996 Shareholder's Audit Assignment Report* in March 1997. Results are summarized in Exhibit 14.1.

14.4 ALC has improved its reporting by providing a schedule of *Segmented Operations by Province* in its annual report.

14.5 Neither the Lotteries Commission nor ALC have yet published information to demonstrate that the Video Lottery Program complies with the payout percentages established by regulation.

Follow-up on issues discussed in 1996

ALC joint audit

14.6 In our 1996 Report, we discussed the ongoing audit of the ALC being carried out in conjunction with the Office of the Auditor General of Nova Scotia. We have completed the audit. The Auditor General of Nova Scotia issued the *1996 Shareholder's Audit Assignment Report* to the Nova Scotia Gaming Corporation in March 1997. We in turn delivered copies to the Lotteries Commission of New Brunswick.

14.7 We believe it is important that this joint audit receive some coverage in our 1997 Report. Consequently, we have prepared Exhibit 14.1. This exhibit reproduces the Results in Brief from the *1996 Shareholder's Audit Assignment Report* and therefore should serve in providing the Legislative Assembly and the general public with a synopsis of the findings.

Segmented reporting by ALC

14.8 Last year we dealt with the need for ALC to show the results of operations segmented by ticket games and the Video Lottery Program. We were pleased to find this type of reporting in ALC's 1996-1997 Annual Report. ALC presented the information in a supplemental schedule called *Segmented Operations by Province*.

Comparative costs of operation for VLP

14.9 In last year's Report we discussed the comparative costs of the Video Lottery Program in New Brunswick and Nova Scotia. We recommended the Lotteries Commission prepare an analysis of the comparative costs prior to expiry of the agreement with the New Brunswick Coin Machine Operators Association Inc. That agreement expires in 2002.

14.10 It has been widely reported that the government has entered into discussions with the Association. At a meeting of the Standing Committee on Crown Corporations on 26 September 1997 the Deputy Minister of Finance stated:

> *The Minister and the government are on the public record, and have been for some time, saying that they will not wait until the year 2002 to look at the program and see if there is another model that will work. It will essentially begin and will be put in place well before the expiration of the contract. There will be a new revenue sharing formula to replace the one that is there now, and it will work to produce extra revenue for the province.*

14.11 During the past year we asked the Lotteries Commission about two aspects of the existing agreement that had come to our attention. These are:

- The agreement appears to be signed by only one member of the Lotteries Commission of NB. Our understanding of the Commission bylaws is that at least two signatures are required.
- Clause 7 of the agreement states “The Commission warrants that it is authorized by the Lieutenant Governor in Council, pursuant to the requirements of the New Brunswick Lotteries Act, to enter into this agreement.” We were unable to identify an Order in Council authorizing the contract although one appeared to be necessary.

14.12 The Commission has informed us that our understanding is correct.

Reporting on regulatory activity

14.13 Our 1996 Report discussed the importance of the Lotteries Commission providing sufficient and appropriate reporting of its regulatory activity in its annual report. Our understanding is that the Commission has accepted our 1996 recommendation in this regard. At the 26 September 1997 meeting of the Standing Committee on Crown Corporations the Deputy Minister of Finance indicated this type of reporting would be included in the Commission’s 1996-97 annual report.

14.14 Our 1996 Report also discussed the value in having ALC providing the Commission with an annual representation giving assurance that it has fulfilled its regulatory responsibilities under provincial regulation. We were informed that the Commission has placed this issue on the agenda of its November 1997 board meeting.

Compliance with video lottery payout percentages

14.15 In our 1996 Report we discussed the importance of demonstrating compliance with section 6(h) of Regulation 90-142 under the Lotteries Act of New Brunswick. The section states that a video gaming device “shall be programmed to award as prizes not less than eighty per cent, and not more than ninety percent, *of the money it accepts*.” *(Emphasis ours).* We reviewed the ALC financial statements and annual report for the year ended 31 March 1997 and noted this information was not included.

14.16 As part of our report for the prior two years, we presented a schedule showing that *prize expense/cash out* is deducted from *gross video lottery receipts/cash in* to arrive at the ALC financial statement line item called net video lottery receipts. We would like to update this schedule for this year’s Report to include results for the year ended 31 March 1997. We have included it as Exhibit 14.2.

14.17 In examining this exhibit, it is evident that the cash out or prize expense does not fall in the range of 80%-90%. We recognize that the Commission and ALC maintain that in order to demonstrate compliance with the regulation, one has to look at additional information on credits won and credits played. Yet the regulation seems quite clear in referring to *the money it accepts*, not credits won plus the money it accepts. What Exhibit 14.2 may be showing then, is that the VLP program is not in compliance with the regulation.

14.18 We recommend that the Lotteries Commission review Regulation 90-142 and the results of the Video Lottery Program to determine if the program is in compliance.

Exhibit 14.1
Results in brief from 1996 Shareholder's Audit Assignment Report

28.1 At the outset, we feel it appropriate to observe that while we are reporting on a number of matters with respect to the management and control of ALC's operations, nothing was observed that would indicate the integrity of ALC's lottery and other gaming products has been adversely affected.

There has been, and continues to be, considerable time and resources invested by ALC to implement improved updated systems and practices to support the ongoing management and control of the corporation. Such changes or initiatives have had, and should continue to have, a constructive impact on the overall adequacy of ALC's management systems and practices. During the course of this 1996 audit, a number of opportunities for further improvement were identified, the more significant of which are presented in this report for consideration and, where appropriate, action by the appropriate combination of ALC's management, Board of Directors, shareholders and/or shareholder provinces.

28.2 Based on the results of the audit, most of our defined criteria for the identified lines of inquiry were assessed as either met or partially met. We have identified some opportunities to improve the level of control and reporting in selected areas, and have included recommendations in this report for consideration by the appropriate combination of ALC's management, Board, shareholders and/or shareholder provinces. ALC's response to this report indicated that action has been taken or planned to address certain of our recommendations and suggestions.

28.3 ALC is an established organization, with various systems, processes and procedures in place to manage and control its ongoing operational responsibilities. Considerable time and resources have been and continue to be invested in implementing new or updated systems and practices to support the corporation's operations and activities. With respect to more traditional internal accounting or procedural controls, we did not identify any significant control weakness that would impact upon the overall integrity of financial records of ALC. This is also supported by the results of other audit and review functions associated with the corporation's activities.

28.4 Changes necessary to improve the overall governance and accountability arrangements with respect to ALC need to be considered. For example, during our audit we noticed a number of issues which indicate the inter-provincial agreements and corporate bylaws should be revisited to determine if they provide the appropriate level of guidance to ALC and its shareholders. These key issues include:

- the requirement to more precisely define ALC's status as a crown agency;
- concerns over the content and method of accountability reporting to the Legislature in each shareholder province;
- a responsibility to more explicitly define the division of business and social responsibility for gaming between ALC and the shareholder governments;
- a need for periodic re-examination of the profit allocation methodology;
- concerns over the fairness and equity of the distribution of corporate activity among shareholder jurisdictions;
- the applicability of legislation from various shareholder provinces (e.g., wage restraint, financial budgeting and reporting); and
- moves towards increased Atlantic co-operation in various fields.

Exhibit 14.1 - cont.
Results in brief from 1996
Shareholder's Audit Assignment Report

We suggest the inter-provincial agreements and the corporate bylaws be revisited by the shareholders and the shareholder provinces to ensure they provide the necessary guidance with respect to the operations and overall accountability and control of an inter-provincial organization of the size and complexity of ALC.

28.5 While matters like business ethics and conflict of interest are dealt with to some extent in certain management-level policy statements, there is no formal corporate code of conduct policy statement. One has been drafted, but not finalized and released to staff. As a result of Board discussions in late 1996, and subsequent to our audit fieldwork, in January 1997 a policy relating to past Board members and employees involvement with corporate suppliers was approved.

28.6 The Board does not receive sufficient information to evaluate the degree of achievement of most of the corporate strategic objectives. Additionally, sufficient and appropriate information and reporting on the corporation's plans and performance (i.e., financial and non-financial) should be available to the shareholders and the Legislature in each province on a timely basis. The content and distribution of ALC's annual report needs to be improved.

There are opportunities for improved disclosure in the corporation's financial statements and/or elsewhere in its annual report. Four key improvements in our view would be:

- disclosure of gross profit by game type;
- reconciliations demonstrating compliance with the video lottery payout regulations for each of the shareholder provinces;
- inclusion of depreciation expense in the divisional expenses; and
- comparison of budget figures to actual with appropriate variance analysis.

28.7 In general, our review of procurement activities indicated ALC's procurement policies were being complied with. We did identify some opportunities for improvement in policies, including improved reporting which would support an enhanced level of review with respect to compliance and due regard for economy.

28.8 The corporation is subject to external and internal audit coverage in selected areas. However, information technology systems and resources, which are seen as mission critical, should be subject to expanded audit coverage to ensure the Board has the appropriate assurance as to the adequacy and operational performance of controls in this area.

Further, the internal audit function, an important and integral element in the corporation's overall control framework, should formalize its planning for the use of available resources on an annual and assignment basis, including an expanded focus on value for money issues.

28.9 ALC's profit allocation methodology was established in 1991 when the Video Lottery Program (VLP) was just being implemented. This key program, which now represents 58% of ALC's net sales, is not charged with any of ALC's general overheads. Further, certain costs related to the VLP are being allocated instead to ALC's other games. This inconsistency has highlighted the need to re-examine the whole profit allocation methodology. In our view, ALC management should have identified such matters to the Board so the shareholders could have determined if an earlier review of allocation methodologies was in order.

Exhibit 14.1 - cont.
Results in brief from 1996
Shareholder's Audit Assignment Report

Our analysis indicates that the manner in which costs and profit are currently being allocated results in certain shareholder provinces, in essence, subsidizing the results in other jurisdictions by having more than their share of direct costs charged against their net sales. This latter point is especially relevant to retail commissions and depreciation, which more reasonably should be charged directly to each province as opposed to being allocated based on net sales.

28.10 Our review and analysis raised concerns about the adequacy of the audit/management trail supporting the Board's deliberations and decisions relating to the acquisition of ALC's new head office facilities, which will consolidate head office staff and related activities in one location. Although the issue of ALC's head office space was dealt with at numerous Board meetings, the net benefits to accrue to shareholders as a result of the additional costs to be incurred were not formally quantified and provided to the Board as part of its decision making process. Further, it is unclear as to the extent of review, challenge or approval provided with respect to key assumptions made and analysis provided by management (i.e., average space standard per position and projections for staff growth).

Further, the Board's decision by majority vote, was made at a time when one of the shareholders was in the process of reviewing the structure and arrangements for the corporation. This should have warranted deferral of a decision until such matters could be fully resolved by the shareholders.

28.11 The Board decided in the late fall of 1996 to proceed with the $31 million New Retail Terminal Project. The project represents a significant revision to what ALC had originally detailed in its 1992 IT Strategic Plan. The project has been subject to several discussions at the Board level supported by presentations and analysis prepared by management, including some aspects reviewed by external consultants. It is our understanding that the net benefits of this project to accrue to the shareholders through future profit distributions were not specifically and formally updated from those that had been identified in 1992. In our view, it would have been appropriate for this to have taken place.

28.12 The current commission rates for VLT site-holders are set by the shareholder governments through regulation, and are among the highest in Canada. We are not aware of ALC or others having formally assessed the costs and risks associated with the VLT site-holders involvement or responsibilities with respect to the VLP to justify the level of commission paid. This suggests that the issue of commissions should be examined in some detail.

Exhibit 14.2
Atlantic Lottery Corporation Inc.
Video Lottery Receipts
(thousands of dollars)
Source: ALC & ALC's external auditor

	New Brunswick		Prince Edward Island		Nova Scotia		Newfoundland		Total	
1996 - 1997	$	%	$	%	$	%	$	%	$	%
Cash In	287,971	100.0	38,478	100.0	374,307	100.0	222,802	100.0	923,558	100.0
Cash Out	171,697	59.6	21,605	56.1	268,300	71.7	162,009	72.7	623,611	67.5
Net Sales	116,274	40.4	16,873	43.9	106,007	28.3	60,793	27.3	299,947	32.5
1995 - 1996										
Cash In	254,204	100.0	36,001	100.0	345,992	100.0	202,495	100.0	838,692	100.0
Cash Out	146,904	57.8	19,825	55.1	246,809	71.3	144,107	71.2	557,645	66.5
Net Sales	107,300	42.2	16,176	44.9	99,183	28.7	58,388	28.8	281,047	33.5
1994 - 1995										
Gross Video Lottery Receipts	211,718	100.0	32,659	100.0	311,006	100.0	160,918	100.0	716,301	100.0
Prize Expense	120,020	56.7	17,936	54.9	220,646	70.9	111,192	69.1	469,794	65.6
Net Video Lottery Receipts	91,698	43.3	14,723	45.1	90,360	29.1	49,726	30.9	246,507	34.4
1993 - 1994										
Gross Video Lottery Receipts	180,093	100.0	31,152	100.0	225,350	100.0	117,272	100.0	553,867	100.0
Prize Expense	100,286	55.7	17,755	57.0	160,585	71.3	79,748	68.0	358,374	64.7
Net Video Lottery Receipts	79,807	44.3	13,397	43.0	64,765	28.7	37,524	32.0	195,493	35.3
1992 - 1993										
Gross Video Lottery Receipts	176,464	100.0	32,502	100.0	258,271	100.0	70,937	100.0	538,174	100.0
Prize Expense	105,367	59.7	19,560	60.2	183,029	70.9	46,321	65.3	354,277	65.8
Net Video Lottery Receipts	71,097	40.3	12,942	39.8	75,242	29.1	24,616	34.7	183,897	34.2
Totals - five years										
	1,110,450	100.0	170,792	100.0	1,514,926	100.0	774,424	100.0	3,570,592	100.0
	644,274	58.0	96,681	56.6	1,079,369	71.2	543,377	70.2	2,363,701	66.2
Net Video Lottery Receipts	466,176	42.0	74,111	43.4	435,557	28.8	231,047	29.8	1,206,891	33.8

Figures for 92/93 to 94/95 provided by KPMG; figures for 95/96 and 96/97 provided by ALC

Chapter 15
Crown Agencies Audited by Others

Contents

Crown Agencies Audited by Others

Background

15.1 We do not audit the financial statements of the Crown Corporations, Boards, Commissions and other Agencies listed below.

15.2 Agencies included in the Public Accounts:

- Board of Commissioners of Public Utilities
- Forest Protection Limited
- New Brunswick Geographic Information Corporation
- New Brunswick Liquor Corporation
- New Brunswick Museum
- New Brunswick Power Corporation
- Strait Crossing Finance Inc.
- Workplace Health, Safety and Compensation Commission of New Brunswick

15.3 Other Agencies:

- Atlantic Lottery Corporation Inc.
- Provincial hospital corporations.

15.4 The Auditor General Act requires the auditors of these agencies to submit the agencies' audited financial statements to our Office annually. The auditors must also provide copies of any reports and recommendations arising out of their audits.

Scope

15.5 We review the financial statements and other documents as they are received. We also visit the auditors periodically to review their working papers. We do this to determine whether we can continue to rely on their work in carrying out our audit of the financial statements of the Province. During the year we reviewed the 1997 working papers of the auditors of New Brunswick Power Corporation and the Workplace Health, Safety and Compensation Commission of New Brunswick.

New Brunswick Power Corporation

15.6 We were satisfied with the work done by the auditors of the Corporation for the year ended 31 March 1997. This work is directed towards reaching an opinion on the financial statements of the Corporation. As a result it may not identify all those matters which a broader scope or special examination might raise.

15.7 At the completion of the audit, the auditors issued a management letter to the Corporation. The auditors noted that the Corporation had resolved a large number of the issues raised in the 1996 management letter. One major issue still outstanding is the preparation by the Corporation of a Business Continuity Plan to ensure the continuity of operations should information systems become unavailable as a result of a disaster. New matters raised with the Corporation in 1997 dealt with information systems' security procedures, accounting processes, year 2000 compliance and environmental management.

15.8 The Corporation's management responded with an action plan to address all the issues raised by the auditors.

Workplace Health, Safety and Compensation Commission of New Brunswick

15.9 We were satisfied with the work done by the auditors of the Commission for the year ended 31 December 1996. This work is directed towards reaching an opinion on the financial statements of the Commission. As a result it may not identify all those matters which a broader scope or special examination might raise.

15.10 The auditors issued a management letter to the Commission at the conclusion of their audit. The letter raised a number of issues regarding computer controls. It also contained recommendations to improve investment management activities.

15.11 The Commission noted the actions which had been taken or will be taken to address the issues raised by the auditors.

New Brunswick Geographic Information Corporation

15.12 The auditors issued a management letter to the Corporation at the conclusion of their audit. The letter raised issues relating to internal controls at the Corporation. It also recommended the Corporation consider accruing a liability to the developer of one of its systems. The Corporation has an agreement with the developer to make minimum payments of $2,300,000 over a five-year period ending in the year 2000. Payments to 31 March 1997 were $223,257, leaving a remaining commitment of $2,076,743. This is noted in the financial statements of the Corporation, but not included in its liabilities.

Hospital corporations

15.13 We have received copies of management letters issued to hospital corporations by four of the eight auditors. These letters arose out of their audits of the financial statements for the year ended 31 March 1997. The letters dealt with weaknesses in internal controls and included recommendations to improve accounting procedures. In two of the four management letters, the auditors expressed their concern at the lack of a formal disaster recovery plan for computer systems.

Chapter 16
Office of the Auditor General

Contents

Office of the Auditor General

Background

16.1 Our 1996 Report contained a checklist relating to our assessment of our compliance with the Annual Report Policy of government. A comparative version for 1997 is presented below.

Exhibit 16.1
Self assessment checklist

	1997	**1996**
Was a report prepared?	Yes	Yes
Is there a discussion of program relevance?	Yes	Yes
Are goals and objectives stated?	Yes	Yes
Does the report discuss achievement of plans?	Yes	Yes
Are performance indicators presented?	Partial	Partial
Are details available on level of client acceptance ?	Partial	No
Is actual and budget financial information presented?	Yes	Yes
Does the report explain variances from budget?	Yes	Yes

16.2 It is our intention to continually improve the information available in our annual Report on the performance of our Office. The above checklist sets out our assessment of progress over the last two years. We have made some progress in the development of performance indicators but still have not been able to completely address the client acceptance criterion.

Office role and relevance

Role

16.3 Our role within the provincial public service is unique. We are independent of the government of the day and provide information directly to the Legislative Assembly. The Legislative Assembly uses our information to help fulfil its role of holding the government accountable for how public monies are managed. We also assist government by providing recommendations to senior officials of the departments and agencies we audit.

Our vision

16.4 **We are committed to making a difference for the people of New Brunswick by promoting, in all our work for the Legislative Assembly, productive, open and answerable government.**

Our mission

16.5 We promote accountability by providing objective information to the people of New Brunswick through the Legislative Assembly.

Values

16.6 Our values impact our performance. We are committed to:

- ***Independence and objectivity*** - Being independent and objective, in fact and appearance.

- ***Accountability*** **-** Being accountable ourselves, and promoting accountability through example and reporting. In doing so, we strive to be a key influence for effective government.
- ***Adding value*** **-** Focusing our resources on areas of government where value can be added.
- ***Learning*** **-** Enhancing quality by placing emphasis on staff learning and development.
- ***Improvement*** **-** Improving our work through innovative thinking and the use of technology.
- ***Fairness and respect*** **-** Developing and maintaining professional relationships by treating our own staff and those we contact with fairness and respect.

Office Relevance

16.7 Our 1996 Report generated significant interest. Over six hundred copies were printed and distributed. Access to our Report is also available on the Internet and over one thousand inquiries were recorded by this means. Debates in both the Legislative Assembly and the Public Accounts Committee are evidence of the continuing relevance of our work. In addition we were invited for the second time in the history of our Office to discuss our Report with the Standing Committee on Crown Corporations.

16.8 Each year we include in our Report matters that we believe are significant to the Legislative Assembly and the public. These include our findings, conclusions and recommendations arising out of our audit work during the year. Our 1997 Report contains 62 recommendations. In addition in 1997 we completed a special report on the Department of Human Resources Development’s compliance with the Public Purchasing Act in its contract with Andersen Consulting. This report was the result of a special request of the Public Accounts Committee. Two more requests for special studies were received from the Committee in 1997.

16.9 Our service also includes separate audit conclusions on the reliability of financial statements. These conclusions (auditor’s reports) are provided to the Legislative Assembly with the financial statements for the Province as well as the Agencies and Trusts that we audit.

16.10 We see our work remaining relevant and contributing to:

- public confidence in our system of government;
- the Legislative Assembly’s ability to carry out its responsibility of holding the government to account; and
- the government’s ability to carry out its responsibilities using sound management systems and practices.

Goals and objectives

16.11 We have not yet identified specific goals or objectives for our Office for 1998. We will do this before the end of 1997. This Report updates the status of the objectives we listed last year.

Encouraging performance reporting by government

16.12 For 1996-97, and again for 1997-98, the government issued a supplement to the Main Estimates setting out specific performance indicators and targets which departments have developed. In turn, the departments will be expected to report their progress towards achieving these targets, beginning with their 1996-97 annual reports. We support this government initiative, and will be monitoring its progress.

16.13 We also believe there may be a place for an audit of the reported results to ensure they are reasonable and based on consistent and reliable information. However, it would be inappropriate to establish such a regime until the performance measurement system has been allowed to evolve and reach a level of maturity.

16.14 We have made several suggestions in recent Reports that we believe have improved the Province's reporting of its financial performance. Each year we discuss issues with the Comptroller which, in our opinion, would provide more meaningful information on the Province's financial results. We continue to encourage the presentation of budget information with the financial statements of Crown agencies; this is a specific initiative of our Office.

Improving our service to the Legislative Assembly

16.15 We were invited in 1996, and again in 1997, to appear before the Standing Committee on Crown Corporations to discuss our Report comments relating to certain Crown agencies. We were pleased to accept these invitations to talk about our work and our role.

16.16 As mentioned earlier in this chapter, we also prepared a special report for the members of the Standing Committee on Public Accounts, and were asked to carry out two more special studies.

16.17 We are also investigating ways in which we might provide more timely service to the members of the legislative committees we deal with. Options might include briefings to the committees concurrent with the release of our Report, or meeting to discuss our Report comments as soon as possible following the release of our Report.

Developing a better understanding of the needs of users of our Report

16.18 We have found it difficult to obtain consistent and direct feedback from the people we serve. We try to make changes to things like the structure and readability of our Report but most changes are ad hoc and not the result of any well designed survey of our users. We feel that by developing a closer working relationship with the legislative committees (as discussed above), we will be able to better understand their needs.

Developing and implementing a staff appraisal system capable of supporting performance pay

16.19 A staff appraisal system is now fully operational. It incorporates individual, team and Office goals, and links pay to performance.

Identifying and proposing needed changes to the Auditor General Act

16.20 Little work has been done in this area in 1997. We intend to address this issue in the coming year.

Improving our use of technology

16.21 Computer technology available to the Office continues to change and progress rapidly. We must make the most economical, efficient and effective use of technology available to us. Some of our auditees are moving quickly toward a paperless accounting environment, so our audit practices must adapt to that situation. Another significant issue we must address is the decentralization of government documents and accounting records, perhaps coupled with the introduction of imaging systems in departments.

16.22 While we have made significant advances in our practice via the use of a local area network, E-mail, Internet connections etc., we still have significant challenges ahead.

Continuing to develop meaningful performance indicators

16.23 The Board of Management has embarked on a very positive initiative to improve the indicators of performance being reported by government departments. While we are not covered by the requirement we certainly feel obligated to conform with the spirit of the directive.

16.24 In our 1996 Report, we identified what we considered to be two meaningful indicators for our Office. They were:

- a comparative analysis of the audit hours and cost of our audits; and
- the status of the recommendations that we make to departments and agencies as a result of our audit work.

16.25 In order to generate accurate and reliable data to measure the first indicator above, we need to enhance the time reporting system currently in use in our Office. We had hoped to complete an evaluation of various commercial time and billing software packages and make a decision on the upgrading or replacement of our present system during 1997. We were unable to complete this work because of other priorities, and because of the difficulty in finding a commercial system suitable for our needs. A preliminary analysis of staff time in 1996 indicates that approximately 57.8% of total time (including vacation time, statutory holidays, study leave and other absences) was spent on audit activities. Our goals are to increase this to at least 60%, and at the same time to increase the proportion of this time spent on broad scope audit work from its present 23.4% to 30%. We will do this by continuing to look for efficiencies in our financial audit work and by closely monitoring and managing non-audit time.

16.26 We have begun a process of tracking the status of recommendations we make to departments and agencies. We expect to be able to provide an analysis of progress in this area in our 1998 Report.

Timeliness of audits

16.27 A third performance indicator for our Office is the timeliness of completion of our audit work. The following table summarizes the completion dates for the significant aspects of our work.

Exhibit 16.2
Audit completion dates

	1997	1996	1995
Audit of Provincial Financial Statements	30 July 1997	20 September 1996	30 November 1995
Crown Agency Audits Completed	22 September 1997 (1)	8 November 1996 (1)	22 January 1996 (1)
Release of Auditor General Report	31 December 1997	31 December 1996	19 February 1996

(1) Date of audit report of last Crown agency completed.

The Office is a trainer

16.28 Our Office continues to provide experience and training to our employees. New employees must enroll in a professional accounting program, namely CA (Chartered Accountant), CMA (Certified Management Accountant) or CGA (Certified General Accountant). Before staff begin this professional training they must have, as a minimum, one university degree at the bachelor level.

16.29 In the past six years eleven people in our Office have received a professional accounting designation. Five of these people have moved to important financial positions in government. One person moved to a government position in another province, another to a quasi regulatory organization in New Brunswick; two people have remained in our Office and two have joined the private sector. The feedback that we have received on the quality of our staff is favourable. We consider our contribution of qualified staff to other government organizations to be a positive indicator for our Office.

Financial information

16.30 Budget and actual expenditure for 1995-96 and 1996-97 by primary classification is shown in the exhibit below. The approved budget for the 1997-98 year is presented for comparative purposes.

Exhibit 16.3
Budget and actual expenditure
(thousands of dollars)

	1998	1997		1996	
	Budget	Budget	Actual	Budget	Actual
Wages and benefits	1,365.5	1,386.4	1,247.4	1,384.8	1 309.5
Other services	105.7	107.2	102.2	120.5	95.8
Materials and supplies	7.9	8.6	7.8	10.5	7.3
Property and equipment	22.1	24.5	53.7	44.5	83.1
	1,501.2	**1,526.7**	**1,411.1**	**1,560.3**	**1,495.7**

16.31 Staff costs continue to account for approximately 90% of our budget and were underspent by $139,000 for the year ended 31 March 1997. Two employees left during the year and were not replaced until after 31 March 1997. A third position was vacant for part of the year, and two employees were out on maternity leave.

16.32 Other services were underspent by $5,000. Professional services not utilized in the year resulted in a saving of $4,000.

16.33 Property and equipment was overspent by $29,200. We again used a portion of the savings in staff costs to support additional costs for computer software and hardware. We purchased additional notebook computers for use by staff when out of the office, and also upgraded a number of our desktop computers to improve their speed and capacity.

Staff resources

16.34 The staff complement in our Office has remained constant at 27 for the past few years. At 31 March 1997 there were 24 people on staff, with three vacant positions. Brent White CA, Paul Jewett CA and Phil Vessey CA are the directors for our three audit teams. At 31 March 1997 there were fifteen professional staff with accounting designations. Our staff also included six students who hold a university degree which is a prerequisite for both enrollment in an accounting program and employment at our Office. The three remaining members of our staff provide administrative support services. The following is a list of staff members at 31 March 1997:

Lorna Bailey(1)
Ralph Black, FCA
Jeffrey Chown (2)
Cathy Connors Kennedy, CA
Murray Gill, CMA
Don Harrington (2)
Eric Hopper, CA
Peggy Isnor, CA
Paul Jewett, CA
Cecil Jones, CA
Kimberley LeBlanc (2)
Greg Mignault, CMA
Gordon Nowlan (2)
Bill Phemister, CA
Ken Robinson, CA
Brian Soeler (2)
Tammy Sterling (2)
Diane Swan (1)
Al Thomas, CA
Phil Vessey, CA
Tim Walker, CA
Deborah Whalen, CMA
Brent White, CA
Darlene Wield (1)

(1) Administrative support
(2) Student enrolled in a professional accounting program.

16.35 Subsequent to 31 March 1997, Murray Gill and Ralph Black retired. Mr. Gill was an audit director, and had worked in the Office for seventeen years. He was instrumental in developing our approach to broad scope audits following the change in our legislation in 1988. Mr. Black had been Auditor General since 1993 and during his term worked to improve the accountability of government to the Legislature and the citizens of New Brunswick. He also was instrumental in developing a strategic plan for the Office and increasing the profile of our work.

16.36 The wisdom and experience which Mr. Gill and Mr. Black brought to our Office will be missed.