Chapter 2
Comments on 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 two primary goals in this chapter of the Report:

- To explain our reservations on the Province's financial statements.
- To compare the financial statements to the Public Sector Accounting and Auditing Board (PSAAB) recommended practices.

Scope

2.4 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 major accounting issues arising from the 1998 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

2.5 We expressed two reservations in our opinion on the financial statements of the Province for the year ended 31 March 1998. One related to a $450 million overstatement of the Province's investment in New Brunswick Power Corporation. The other related to how government accounted for $364 million in transitional assistance from the Government of Canada as a result of sales tax harmonization.

2.6 The net effect of the above two reservations would be to increase the net debt by $329.0 million and to change the surplus for the year of $61.7 million into a deficit for the year of $267.3 million.

2.7 The presentation of the financial statements of the Province has significantly improved over the last ten years.

2.8 Net liabilities of hospital corporations of $70.4 million are not recorded or reflected in the Province's financial statements or notes.

2.9 Based on the PSAAB criteria of accountability and control, hospital corporations qualify for inclusion in the provincial reporting entity on the consolidated basis of accounting.

Our reservations on the Province's financial statements

2.10 Under Section 10 of the Auditor General Act it is our responsibility to examine the financial statements of the Province and express an "..opinion as to whether they fairly present information …….. together with any reservations…" This year we had two reservations. One related to the Province's investment in New Brunswick Power Corporation and the other related to how government accounted for $364 million in transitional assistance from the Government of Canada as a result of sales tax harmonization.

2.11 Reservations, or qualified opinions, are taken seriously, and for this reason numerous meetings were held between our Office and the Office of the Comptroller in an attempt to resolve the issues. Unfortunately we could not agree on how the two matters should be recorded and disclosed in the financial statements. The impact on the financial statements was disclosed in our opinion in the Auditor's Report as follows:

> *The net effect of the above two reservations would be to increase the net debt by $329.0 million and to change the surplus for the year of $61.7 million into a deficit for the year of $267.3 million.*

2.12 We will now explain the rationale behind the two reservations.

Reservation 1 Carrying value of the investment in New Brunswick Power Corporation

2.13 The Province records its investment in government enterprises using the modified equity method of accounting. Accordingly, the financial statements record an investment of $425.3 million in New Brunswick Power Corporation, which represents the Corporation's reported retained earnings at 31 March 1998.

2.14 In the course of our audit we examine reported assets to establish their existence and value. Our audit of the Province's investment in the New Brunswick Power Corporation led to an examination of the Corporation's financial statements for the year ended 31 March 1998. The statements disclosed an asset of $450 million called Deferred Charges - Nuclear Generating Station. This asset was explained in Note 10 as being related to the outcome of a technical and economic study of the Point Lepreau nuclear generating station, which concluded that "the plant will not be able to operate until 2014 as planned without a major refurbishment somewhere around the year 2008."

2.15 The note went on to say that "the carrying value of the plant has been reduced by $450 million, leaving an undepreciated amount that is recoverable over the period to 2008. *An offsetting deferred charge of $450 million has been recorded on the balance sheet as at March 31, 1998"* (emphasis ours). In essence, what this means is that although there was evidence of a loss in the value of the nuclear generating station, this loss was not recorded as an expense. Instead, another asset was created. We found this accounting treatment, of turning a loss into an asset, most unusual.

2.16 Based on our interpretation of the accounting principles to be applied when the value of capital assets is impaired, and what was revealed in the technical and economic study, the Corporation should have recorded an expense. This would have increased the Corporation's loss from $21.2 million to $471.2 million.

2.17 The reason why the Corporation was not prepared to record the expense in its 1997-98 fiscal year is explained in the last paragraph of Note 10.

> *Over the coming fiscal year, the Corporation will identify a new revenue stream designed specifically to recover the deferred charge over a future period. The Province, as owner and legislator, will ensure the enabling environment for implementing the revenue stream to recover the deferred charge. In the event a definitive revenue stream cannot be identified, the deferred charge will be written off against income.*

2.18 In effect what is being said in this paragraph is that this new asset, the deferred charge, has value because the Corporation, in conjunction with the Province, is going to do something about it in the next fiscal year. We do not feel that this representation is sufficient grounds to create an asset. If it is, then there would be no limit on the number or size of assets that could be created.

2.19 We were told, however, that the method of accounting followed by New Brunswick Power Corporation (creating assets on the basis of future actions) has relevance in rate-regulated industries. Our research on this point revealed that assets may be created, but only when the rate regulator has approved the necessary rate increases. We examined accounting guidance on this point, in both Canada and the United States.

2.20 In the United States, the Financial Accounting Standards Board (FASB) has addressed accounting for rate-regulated enterprises. FASB Statement 71 deals with "Accounting for the effects of certain types of regulation." Paragraph 3 states:

> *Regulators sometimes include costs in allowable costs in a period other than the period in which the costs would be charged to expense by an unregulated enterprise. That*

procedure can create assets (future cash inflows that will result from the rate-making process)…

2.21 Paragraph 9 states:

Rate actions of a regulator can provide reasonable assurance of the existence of an asset. An enterprise shall capitalize all or part of an incurred cost that would otherwise be charged to expense if both of the following criteria are met:

a. It is probable that future revenue in an amount at least equal to the capitalized cost will result from inclusion of that cost in allowable costs for rate-making purposes.

b. Based on available evidence, the future revenue will be provided to permit recovery of the previously incurred cost rather than to provide for expected levels of similar future costs.

2.22 The most relevant Canadian guidance is found in Section 3060 of the CICA Handbook:

For rate-regulated operations, the regulator may require the difference between net carrying amount and the proceeds on disposal of a capital asset to be considered in the determination of rates charged to customers. In such circumstances the difference is deferred, provided there is reasonable assurance that:

(a) any excess of net carrying amount over proceeds on disposal will be recovered through future rates…

2.23 While the guidance in this section is related to a loss arising from the disposal of an asset, we believe the principles can also be applied when there is a write-down of an asset, which we had in the case of the nuclear generating station. The principles that are evident from both Canadian and United States authorities are that actions are required by the regulator, increased rates must be charged to customers and there must be reasonable assurance that the required amount will be "recovered through future rates."

2.24 When we applied these principles to the New Brunswick Power Corporation situation described in Note 10 we found the following.

- Note 10 said "the Corporation will identify…." and …"The Province, as owner and legislator, will ensure the enabling environment for implementing the revenue stream." Both the CICA and FASB require action by the regulator, which in New Brunswick would be the Public Utilities Board in conjunction with the Lieutenant Governor in Council. We are not aware of any action taken to date by the regulator.

- Note 10 makes reference to a new revenue stream. The CICA clearly indicates that any deferred asset must be supported by rate increases to customers. FASB makes reference to “future cash flows that will result from the rate making process.” It is not at all clear what the note means when it refers to the Corporation identifying “a new revenue stream”, but when it refers to the Province as “owner and legislator” and not “owner and regulator” it introduces an element of doubt as to whether rate increases are the only solution being considered.

- Note 10 concluded by saying “in the event a definitive revenue stream cannot be identified, the deferred charge will be written off against income.” In other words the asset was set up even though there was doubt surrounding this future revenue stream. Both the CICA and FASB, on the other hand, require that there be reasonable assurance that the deferred amount will be recovered through future rates.

2.25 We concluded that there was insufficient evidence to support the recoverable value of this asset. In an effort to resolve the issue, and avoid qualifying our opinion, we asked to see New Brunswick Power Corporation’s current Five Year Business Plan, a schedule of required rate increases and an indication from the Province, as regulator (and not legislator), that the required rate increases would be supported. We believed this information would have provided the necessary support for the creation of the asset. None of this information has been made available to us.

2.26 By concluding that the asset called Deferred Charges – Nuclear Generating Station has no value, we believe, as we stated earlier, that the loss of $450.0 million in the Point Lepreau generating station should have been recognized as a charge against income in the 1997-98 fiscal year. This would have more than eliminated the Province’s investment in New Brunswick Power Corporation of $425.3 million.

Reservation 2
Method of recognizing revenue received from Canada relating to the implementation of the Harmonized Sales Tax

2.27 During the year ended 31 March 1997, the Province received a Harmonization Transitional Payment from the Government of Canada in the amount of $364 million. The amount was recorded as deferred revenue at that time because the new Harmonized Sales Tax (HST) scheme was not to become effective until 1 April 1997.

2.28 As part of our 1997-98 audit we looked at the plan to take the deferred revenue into income over the four-year transitional period. The Province presented us with a number of revenue recognition formulas it had developed to allocate the $364 million. Each of these formulas relied heavily on internally generated data and appeared to favour allocating a large portion of the revenue to the 1999-2000 fiscal year.

2.29 The Province eventually determined it would recognize only $11 million of the total of $364 million in 1997-98. The remaining $353 million has been deferred to the last three years of the transitional period. The Province’s reason for this is explained in Note 1 to the financial statements.

The purpose of the transition payment is to allow the Province to offset, over a four-year period, the fiscal impacts that will result because of adjustments to the Provincial tax structure required to accommodate harmonization. Determining the extent of these fiscal impacts is difficult, and is based on economic estimates and assumptions.

The Province has estimated that the value of the fiscal impact on the year ended 31 March 1998 was $11.0 million. This amount has therefore been recognized as revenue in the Statement of Revenue and Expenditure.

2.30 We disagreed with this representation because it assumes that full discretion is left with the Province as to when the income can be recognized during the four-year transitional period.

2.31 We believe this revenue should be recognized in a manner consistent with PSAAB recommendations which state that government transfers should be recognized as revenue:

in the period that the events giving rise to the transfer occurred, as long as:

a) the transfer is authorized,
b) eligibility criteria, if any, have been met by the recipient, and
c) a reasonable estimate of the amount can be made.

2.32 It is therefore very important that the eligibility criteria established by the Government of Canada be closely examined. The eligibility criteria were set out in a letter dated October 1996 from the federal Minister of Finance to the Minister of Finance of the Province of New Brunswick. In that letter the federal minister stated that the assistance ($364 million) depended on the Province meeting three conditions. The first condition called for the Province to implement the harmonized sales tax on the agreed upon date, 1 April 1997. The second condition was that the “provincial element” of the HST rate remain at 8% during the four-year transitional period. And the third condition was that the Province remain a party to and in full compliance with the terms of the agreement during the four-year transitional period.

2.33 The letter then said:

If at any time the foregoing conditions are not met, it is understood and agreed that the adjustment assistance, or any portion thereof, that relates to that part of the adjustment assistance period during which the Province is not a party to or is not in compliance with the CITCA [agreement] will become immediately due and repayable by the province as a debt due Canada with interest.

2.34 In our opinion this letter sets the conditions for determining revenue recognition over the period of transition.

2.35 The first condition has been met because the Province implemented the HST on the agreed upon effective date, 1 April 1997. However, in order to know if the Province has fulfilled the second and third conditions, we must wait for the passage of time. Only with the passage of time will we know if the Province maintained the "provincial element" at 8% and only over time will we know if the Province remained in compliance with the terms of the agreement. We do know that the Province met these two conditions for the year ended 31 March 1998, and this entitled them to recognize a portion of the $364 million. To determine how much should be recognized we must look at how the transitional assistance was determined.

2.36 The amount of assistance was determined as the difference between current (i.e. at the time of the March 1996 offer) sales tax revenues and projected HST revenues. All provinces in Canada were offered transitional assistance on this same basis at the same time. The federal government agreed to provide $364 million of assistance to New Brunswick as follows:

> 100% of the assistance amount in year one ($132 million);
> 100% of the assistance amount in year two ($132 million);
> 50% of the assistance amount in year three ($66 million);
> and
> 25% of the assistance amount in year four ($34 million).

2.37 The federal Minister of Finance's letter notes that if the Province does not remain in compliance with the conditions, it must repay the portion "that relates to that part of the adjustment assistance period (i.e. the four years) during which the Province is not a party to or is not in compliance with the CITCA." In fact that part of the assistance "will become immediately due and repayable . . . with interest." The key then, is to know how much of the assistance would have to be repaid if the Province failed to comply with the conditions.

2.38 As at 31 March 1998 New Brunswick had remained part of the program for one year and met all the conditions. Therefore, it is legitimate to recognize $132 million in revenue. The remainder of the assistance must remain in deferred revenue. As time under the agreement passes, the Province could recognize additional revenue under the formula.

2.39 During our discussions with the Province, we were told that there were no restrictions on the use of the money, as long as it was all recognized in income over the four year transitional period. If this was the case then, in our opinion, all of the $364 million should have been recorded in 1997-98 and none of it deferred. If there were no restrictions or conditions on the use of the revenue, then there is no argument for deferral.

2.40 Our conclusion is that there are conditions, and they must be met before revenue can be recognized. When revenue is recognized it must be in accordance with the formula. In 1997-98 the Province should have recorded $132 million as revenue, not $11 million. The difference of $121 million was significant and for this reason we qualified our opinion.

Compliance with the recommendations of the Public Sector Accounting and Auditing Board

2.41 The Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants issues recommendations and guidance to serve the public interest by strengthening accountability in the public sector through developing, recommending and gaining acceptance of accounting, financial reporting and auditing standards of good practice. Originally established as the Public Sector Accounting and Auditing Committee in 1981, PSAAB took its current form in 1993. For PSAAB purposes, the public sector refers to federal, provincial, territorial and local governments.

How the Province's financial statements have improved

Background

2.42 The financial statements issued by the Province of New Brunswick reflect significant improvements in recent years. The majority of the changes can be directly linked to PSAAB recommendations.

2.43 One of our Office's performance indicators calls for us to measure the extent to which the accounting and reporting recommendations made by PSAAB are accepted and implemented by the Province.

2.44 In support of our efforts to meet this performance indicator, we undertook a project to document the major improvements to the financial statements of the Province over the past ten years. The improvements we noted included changes to structure, to disclosure and to accounting policy.

2.45 Following is a review of some of the more significant changes.

Improvements made in the 1997-98 financial statements

2.46 There were four important changes made to the Province's financial statements in 1997-98. The impact of the changes was significant in dollar terms, increasing the opening balance of net debt by $289.8 million and decreasing the surplus recorded in 1997-98 by $12.5 million.

2.47 The changes were made to record the following liabilities which had not been reported in the past:

- retirement allowance benefits earned by employees but paid only upon retirement;
- salaries for teachers which had been earned but were unpaid at year end;
- vacation entitlements earned but not taken by employees at year end; and
- workers' compensation benefits payable in future to those currently injured.

2.48 In the financial statements of past years, the Province reported that its accounting policy for expenditures did not include the accrual of the liabilities for employee retirement allowances, vacation entitlements and future benefits payments to injured workers. The past policy on accounting for year-end liabilities to teachers for pay earned but not disbursed was slightly different. The unstated policy was to record teachers' pay the same way as the other provincial employees, over a twelve-month period. This was not appropriate given the period over which the salaries were earned.

2.49 In our 1997 Report we presented our concerns about these liabilities. We also indicated that the Comptroller was expected to be examining the issues during the 1997-98 year. The necessary work was completed and appropriate adjustments were recorded.

2.50 These are significant issues and represent major improvements to the Province's annual financial statements.

2.51 Another issue was clarified in the 1997-98 financial statements. This related to the Workplace Health, Safety and Compensation Commission (WHSCC). In the past, the description of the relationship between the Province and WHSCC was not complete. It did not clearly describe that there are limitations or internal restrictions that have been placed on the assets and earnings of WHSCC as a result of the wording of the legislation. Although the Province may recognize the net income of WHSCC, it should be clear that the income and the assets are the property of the Commission to be used for its operations. PSAAB requires that there be disclosure in the financial statements of the Province of this type of internal restriction. The Province's financial statements now point out the restrictions on these amounts.

Improvements made in previous years

2.52 The following major improvements have been implemented in the nine years preceding 1997-98:

- **Consolidation of the financial statements (1995)** – A new definition of the reporting entity accompanied the introduction of consolidated financial statements. Each year, the Province and the Crown agencies issue financial statements. However, prior to 1995, the financial results of the Crown agencies were not incorporated in the Province's financial statements. The new format incorporated the results of the larger agencies either on the full consolidation basis or through modified equity accounting.

- **A more timely issuance of audited financial statements (1994-1997)** – In recent years the audited financial statements of the Province have been released on a more timely basis. The audited financial statements of the 1993-94 year were issued on 22 December, 266 days after year-end. In 1996-97, they were issued on 13 August, only 135 days after year end.

- **One statement of revenue and expenditure (1993)** – Prior to 1993 the Province's financial statements included three separate revenue and expenditure statements: ordinary, net capital and special purpose. In 1993, a combined statement was included for the first time.

- **Accounting for pension expense and liability (1994)** – Prior to 1994, pension liabilities were disclosed only in the notes to the financial statements. Pension expense was the amount paid into the pension plans by the Province rather than the true pension cost for the year. Since 1994, pension liabilities have been recorded in the statement of financial position. As well, the true pension expense has been recorded in the statement of revenue and expenditure. This method of recording pension expense and liability is consistent with the recommendations of PSAAB.

- **Budget estimates presentation (1989)** – Each year, the Province issues its Main Estimates which details the budget for the upcoming year. Beginning in 1989, the budget figures reported in the audited financial statements reflect the Main Estimates as originally tabled in the Legislature. Prior to that year, the reported budget figures included both the Main Estimates and any subsequent changes approved through Supplementary Estimates during the year. This change provides a better comparison of the budget to actual results, because it uses the original budget rather than a budget that has been updated as the year progressed.

2.53 Other improvements included:

- The debt incurred by the Province for the New Brunswick Power Corporation is now shown on the Statement of Financial Position.
- Schedules to the statement of revenue and expenditure have been added to Volume 1 of the Public Accounts. These provide a more detailed account of the Province’s revenue and expenditure.
- A borrowing authority note showing where government has exceeded its borrowing, investing or expenditure limits is now included in the notes to the financial statements.
- A statement of responsibility from the Minister of Finance has been added to Volume 1 of the Public Accounts. It states that financial statement integrity and objectivity are the responsibility of the government.
- There is better disclosure of provincial borrowing and costs of borrowing, pension plan benefits and expenditures by primary classification (i.e. Personal services, materials and supplies, property and equipment, contributions, grants and subsidies).

2.54 The improvements are evidence that the Province has made many enhancements to its financial statements in the past ten years and now much more closely follows the recommendations of PSAAB. The improvements have had a major impact on the level of disclosure in the statements. The number of notes to financial statements has increased from 7 in 1987-88 to 20 in 1997-98, while the size of the statements has increased from 29 pages to 53 pages over the same period.

Full PSAAB compliance calls for further change

2.55 There are a number of areas in which the Province still does not comply with PSAAB's recommendations for provincial governments. Some of these areas would have a major impact on the financial statements while others would be relatively minor.

2.56 The three most significance areas of non-compliance are:

- failure to include hospital corporations in the provincial reporting entity;
- accounting and reporting of tangible capital assets held by the Province; and
- accounting for concessionary loans.

Hospital corporations

2.57 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.

2.58 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 financial statements of the eight regional hospital corporations shows total current liabilities exceed current assets by $61.3 million at 31 March 1998. In addition there is total long-term borrowing of $7.0 million and capital lease commitments of $2.1 million. These net liabilities, amounting to $70.4 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 $44.4 million, up by 36% over 1996 levels. This year the annual increase was almost 60%. The net position worsened for each of the eight corporations.

2.59 There are long-term investments of $29.9 million contained in five of the corporations' financial statements, an increase of $3.5 million over last year. We understand the use of some of these investments is restricted.

2.60 During the year we completed a review of the relationship between hospital corporations and the government. Our focus was on whether hospital corporations should be included in the provincial reporting entity. The two criteria governing inclusion or exclusion related to accountability and control.

2.61 Our work consisted primarily of a review of the relevant PSAAB pronouncements, legislation, departmental documents and hospital corporation financial statements. As well, our Office discussed the issue with staff of the Department of Health and Community Services.

Accountability

2.62 *"Accountability is defined as the obligation to answer for authority and responsibility that has been conferred."*

(Hospital Corporation Accountability, Department of Health and Community Services, July 1995.)

2.63 Based on our review of PSAAB and relevant legislation, our Office concludes that hospital corporations are accountable to the Minister of Health and Community Services, and hence, to the government of the Province of New Brunswick.

2.64 This accountability structure is evidenced by the following:

- The Hospital Services Act (section 19(1) of Regulation 84-167) states that a hospital corporation must submit an annual budget to the Minister of Health and Community Services to qualify for payments.
- The same regulation (section 19(3)) requires that hospital corporations provide any further documentation that is required by the Minister of Health and Community Services.
- This regulation (section 20(a)) also states that the Minister of Health and Community Services shall approve a budget for each of the hospital corporations.
- The Hospital Act (section 25(2)b) states that hospital corporations shall operate within the budget approved by the Minister under the Hospital Services Act.
- The Hospital Act (section 25(2)c) states that hospital corporations must submit an annual report including financial statements and audit report to the Minister.

Control

2.65 Our Office concludes that the Province's ability to determine revenue-raising activities and resource-allocation policies of hospital corporations represents control over these organizations.

2.66 Control of hospital corporations stems from the Hospital Act, section 34(3). This section states that "the Minister may establish parameters and issue directions in relation to the planning, organization, management and delivery of hospital services by hospital corporations." This has far-reaching implications regarding control over hospital corporations.

2.67 The Department acknowledges this form of control in documents that state:

> *"Within the policies and parameters established by the government, boards of trustees bear the responsibility for overseeing day-to-day operations and ensuring the best use of resources allocated to their corporation."*
>
> (Hospital Corporation Accountability, Department of Health and Community Services, July 1995.)

2.68 PSAAB elaborates on government control when it states, “A government controls an organization when, without requiring the consent of others or changing existing legislative provisions, it has the authority to determine the financial and operating policies of that organization.” It explains that control would be evidenced if the Province determines the revenue raising, expenditure and resource allocation policies of an organization.

2.69 Departmental staff suggest that the Province may not have control over hospital corporations unless it influences the day-to-day operations. However, PSAAB states that, “…a government does not need to manage the organization’s activities on a day-to-day basis to control the organization.”

Control over revenue-raising

2.70 *“The evolution of accountability has been primarily influenced by… almost total funding provided through the provincial government.”*

(Hospital Corporation Accountability, Department of Health and Community Services, July 1995.)

2.71 In addition to annual budget constraints imposed by the Department of Health and Community Services, the Hospital Act (section 16(2)) reads that a corporation may not deliver any hospital services unless prior written approval of the Minister is obtained. Further, no hospital service can be provided that is not approved by the Minister (per section 17).

2.72 The Province, therefore, has the ability to control which services shall be provided by each corporation. Since such services give rise to virtually all of the revenue earned by hospital corporations and since this revenue is funded by the Province, the Province can be said to control the “purse-strings” of hospital corporations. This is demonstrated by a quote from the department itself:

> *“{Hospital Boards} must function within the parameters set by the provincial government. The boards have no ability to increase funds allocated to them….”*
>
> (Hospital Corporation Accountability, Department of Health and Community Services, July 1995.)

Control over expenditure and resource allocation

2.73 *“Hospital corporation boards and their administrators are responsible for allocating resources…”*

(Hospital Corporation Accountability, Department of Health and Community Services, July 1995.)

2.74 This is supported by the Hospital Act (section 10(2)) which states that hospital corporations have the capacity and, subject to the Act and Regulations, the rights, powers and privileges of a natural person for the purposes of carrying out its objects and purposes. In addition, it states that the business and affairs of a hospital corporation shall be controlled and managed by a Board of Trustees appointed or selected in accordance with the Regulations (section 11(1)). This implies a Board is free of government influence in its expenditure and resource allocation decisions.

2.75 However:

- The Province can determine which services shall be provided by hospital corporations (type of services) as well as the level of service provided by the hospital corporations (quality).

- There is also significant control by the Province over their level of expenditure since the Province has assumed the responsibility and authority to negotiate the salaries, wages and benefits of employees at the hospital corporations. In assuming this authority, the Province plays an active part in determining the cost of one of the largest expenditures which hospital corporations make on an annual basis. (In 1997, salaries and wages comprised up to 76% of total expenditures recorded by hospital corporations).

- The Province can also allocate fixed assets. The Hospital Act (section 35(1)c) indicates that the Lieutenant-Governor In Council may reallocate most fixed assets (with the exception of land, building and building service equipment) among corporations as the Province deems necessary.

- In addition, hospital corporations receive special funding from the Province (of up to 90%) for major updates, alterations, and additions to existing fixed assets. No significant capital initiative (including closure, abandonment, leasing etc.) can be undertaken by any hospital corporation without the approval of the Minister.

2.76 Since the Province controls capital expenditure and allocations, determines the level of operating expenditure (through salaries and wages) and determines the type and quality of services provided, it is increasingly obvious that the Province controls the broad resource allocation policies of hospital corporations.

Conclusion

2.77 Since hospital corporations are both controlled by and accountable to the Province, they are eligible for inclusion in the provincial reporting entity. Since they do not meet the criteria for a government business enterprise, they should be accounted for on the consolidation basis.

Tangible capital assets

2.78 In 1997 PSAAB approved accounting and reporting standards for 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 of goods and services;
- have useful lives extending beyond an accounting period and are intended to be used on a continuing basis; and
- are not intended for sale in the ordinary course of operations.

2.79 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 statement called the statement of tangible capital assets would be prepared and included with the financial statements currently issued by the Province. The new statement would account for the tangible capital assets 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.

2.80 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 was the 1997-98 year.

2.81 We discussed these new standards with the Comptroller. He responded as follows:

> *Our Office and the Department of Finance have had some preliminary discussions about accounting for tangible capital assets. This is a complex issue that will take time to resolve.*
>
> *We know that two Provinces have adopted PSAAB's recommendations, and others have plans to do so. We understand, however, that they do not all plan to comply with all of PSAAB's recommendations. PSAAB is monitoring how Provinces are implementing tangible capital asset accounting, and they will determine if they need to re-examine their existing recommendations.*
>
> *We fully expect to continue to explore this topic, but because of the uncertainty that exists around the proper accounting treatment, the extent of information needed, and the policies that need to be adopted, we can not yet commit to a date when tangible capital asset accounting will be adopted.*

Concessionary loans

2.82 For the past three years we have 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.

2.83 The Province does not account for concessionary loans in compliance with PSAAB recommendations.

2.84 Following discussion with the Comptroller last year we expected to see the issue resolved in the 1997-98 year. It was not, and we received the following update from the Comptroller.

> *As I have previously indicated, I am concerned that we have not as yet completed our review of loans that may have concessionary terms. Fortunately at this time, we do not believe the amount of such loans to be significant. Unless we see the number of concessionary loans increase significantly, we will not make a recommendation on this issue until the fiscal year 1999-2000.*