Chapter 1
Topics of Special Interest

Contents

Topics of Special Interest

Introductory Comments

1.1 On 7 December 1999 I tabled Volume 1 of the 1999 Report of the Auditor General. At that time I indicated that due to the lateness in government closing the accounts for the year ended 31 March 1999 it was not possible to provide our normal commentary on the Province's financial results or to prepare our chapter on financial indicators. The financial statements have now been finalized and our comments can be found in this chapter. For the second year we have prepared a chapter on financial indicators which examines the Province's financial condition from the perspective of sustainability, flexibility and vulnerability. The results of this work can be found in Chapter 2.

1.2 We have also completed a major piece of work in the Department of Health and Community Services, where we reviewed the inspection of food service establishments. We concluded that the current systems and practices are insufficient in ensuring that the food service establishments in the Province are complying with the Regulations under the Health Act. Our findings and recommendations on this topic can be found in Chapter 5.

Significance of a Qualified Audit Opinion

1.3 Last year we did not agree with how the Province accounted for its investment in New Brunswick Power Corporation, or the $364 million in transitional assistance received from the government of Canada in connection with the implementation of the Harmonized Sales Tax. In our opinion these were major disagreements, and as a result we gave a qualified opinion on the Province's financial statements for the year ended 31 March 1998. In other words, we did not believe the financial statements fairly presented the financial results for the year in question. In fact we believed the Province incurred a deficit of $267.3 million. The Province reported a surplus of $61.7 million.

1.4 Subsequent to the release of the financial statements there were occasions when the seriousness of this qualification was downplayed by the view being expressed that this simply represented a "disagreement among accountants". I am not sure how widespread this view might be but I do feel compelled to react. My concern is that the role of my Office, or in reality auditors anywhere, could be greatly diminished if the significance of a qualification can be dismissed as a "disagreement among accountants".

1.5 To fully appreciate the significance of a qualification it is important to first realize that there are two distinct parties involved.

There is the party that prepares the financial statements, in this case the government, and the party that audits them, in this case the Office of the Auditor General. The Office of the Auditor General is independent of the government, as set out in the Auditor General Act.

1.6 A risk in any audit is that the preparer of the financial statements may have a bias as to what the financial results should look like. For instance a business may want to report a steady growth in earnings. A charitable organization may want to report that most of their donation receipts were used for bona-fide charitable activities. A government may want to report a surplus. And sometimes accounting rules are stretched to reach these objectives. The auditor is only interested in the financial results being what they should be. There are no biases.

1.7 To assist preparers and auditors in conducting their work there are generally accepted principles, which provide guidance on how transactions are to be accounted for and reported. In Canada reliance is placed on the principles adopted by the Canadian Institute of Chartered Accountants (CICA) and the Public Sector Accounting Board (PSAB). In the vast majority of cases the auditor will agree with the accounting treatment adopted by the preparer. There may be situations, however, where the auditor is not pleased with the treatment given a transaction but, since it falls within the realm of "professional judgement", there is no basis to disagree. In other words it could be argued that one treatment is just as fundamentally sound as another treatment. Then there are those rare situations where the auditor concludes that the preparer is wrong, and the statements must be changed or else there will be a qualified opinion.

1.8 Even in these situations, it must be realized that a final conclusion is not reached until there is a clear understanding of the preparer's position. This is obtained by sharing views, referencing accounting principles and perhaps researching other authorities on the matter. A lot of time is spent trying to reach a mutually satisfactory conclusion, but when one cannot be reached, the auditor must qualify his opinion. And this will only be done when the auditor believes the preponderance of evidence supports his position.

1.9 So what does all this mean? Well, it means that a qualified audit opinion sends a message, and that message is that the auditor believes the financial statements, as prepared, are biased towards meeting an objective of the preparer. It may be argued that this is all a reader of the financial statements and auditor's report need understand. Sometimes the reasons behind a disagreement between the preparer and the auditor are not easy to understand. But even without this understanding, the very fact that the auditor, who is independent, disagrees with the preparer, who is biased, should send a strong message that the financial results are not credible. Understanding a qualified opinion in this light is much more revealing than believing it is simply "a disagreement among accountants".

Engagement of the "Independent Auditor"

1.10 During the month of June, it was reported that the government was planning to engage an independent auditor to review the government books. We were concerned about this reference to an independent auditor because under the Auditor General Act, the Auditor General is the independent auditor of the Province of New Brunswick. We communicated our concern to the government and we were pleased to note that all subsequent references to the engagement were in the context of a "financial review of the Province of New Brunswick." It is still common however to hear and read about the engagement in the context of an independent audit. I have been asked on a number of occasions to explain the role of my Office in light of the engagement of this new independent auditor. I thought it would be useful to explain the differences between the role of my Office and that of an auditing firm that the government may engage.

1.11 The first difference is the accountability or reporting relationship. Under the Auditor General Act, the Auditor General is an officer of the Legislative Assembly. This means that I am accountable to the Legislative Assembly and I communicate my findings, opinions and recommendations to that body. A firm that is engaged by the government of the day to undertake a study or review is only accountable to that government.

1.12 A second difference is with respect to the scope of our work. A firm engaged by the government can only do what they have been asked to do. In the case of Grant Thornton, they were engaged to examine twelve things, of which six were related to accounting issues. So in this sense the scope of their work was limited. There may have also been limitations on how long they could take and how much they would be paid. It is also conceivable that in consulting type engagements there may be other restrictions imposed by the government. These are significant differences from the environment under which I and the members of my Office operate. With the benefits and protection of the Auditor General Act, there are no limitations on what we can look at, or who we can talk to. There are no provisions that would permit anyone to restrict the work we do or to influence the time we take on projects, our opinions or recommendations.

Our Audit Opinion in 1999 was Unqualified

1.13 One year ago, as stated earlier, we did not agree with how the Province accounted for its investment in New Brunswick Power Corporation, or the $364 million in transitional assistance received from the government of Canada as a result of sales tax harmonization. These disagreements were of such magnitude that we issued a qualified opinion.

1.14 Last year we also did a significant piece of work in documenting the major improvements to the financial statements of the

Province over the previous ten years. We did this because one of the performance indicators for our own Office is to measure, on an annual basis, the extent to which the accounting and reporting recommendations made by PSAB are accepted and implemented by the Province. What we found was that the Province had made significant progress over the ten-year period, but three major areas of non-compliance still existed:

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

1.15 This year we were extremely pleased to see the Province make the necessary adjustments concerning its investment in New Brunswick Power Corporation and its accounting for the sales tax transitional payment. This enabled us to express an unqualified opinion on the Province's financial statements. In addition the Province, for the first time, included the hospital corporations in the provincial reporting entity and properly accounted for its concessionary loans. What this means is that the Province's financial statements are now presented substantially in accordance with PSAB recommendations except for the accounting and reporting of tangible capital assets. We see this as a significant milestone, because as we move forward the readers of the Province's financial statements will be able to draw conclusions and make decisions with the knowledge that all liabilities have been recorded and all significant Crown corporations and agencies are included.

Changes in Net Debt

1.16 The net debt of a government, and annual changes to it, have become significant financial indicators. An increase in net debt is seen as placing greater demands on taxpayers' resources in the future, whereas a reduction in net debt is seen as increasing a government's flexibility and sustainability. An annual surplus will reduce net debt whereas a deficit will increase it.

1.17 The net debt of a government is the amount by which liabilities exceed financial assets. Financial assets are those assets that could provide resources to discharge existing liabilities or finance future obligations. If in any year a government generates revenues in excess of expenditures, it will have a surplus, and this will result in a reduction in net debt.

1.18 For our 1999 Report we thought it would be useful to examine the changes in net debt in the Province of New Brunswick over the past ten years. Our reason for examining these changes is that, over the years, not all the changes in net debt arose from reported surpluses and deficits. This is because one-time accounting adjustments that are needed to implement new accounting policies may be made directly against the opening net debt position for a year. These adjustments are never reflected in the reported surpluses or deficits. Exhibit 1.1 shows the effects on net debt of the reported surpluses and deficits for the last ten years, and the cumulative effect of accounting adjustments.

Exhibit 1.1

Changes in Net Debt (millions of dollars)

Net debt 1 April 1989	**2,993.1**
Changes related to reported surpluses and deficits	
1990 deficit	20.1
1991 deficit	173.4
1992 deficit	366.6
1993 deficit	297.4
1994 deficit	290.7
1995 deficit	64.0
1996 surplus	(51.1)
1997 surplus	(125.4)
1998 surplus	(61.7)
1999 deficit	164.3
Change in net debt due to deficits exceeding surpluses	1,138.3
Changes due to accounting changes	1,780.6
Net debt 31 March 1999	**5,912.0**

1.19 As can be seen, the net debt of the Province has increased from $2,993.1 million at 1 April 1989 to $5,912.0 million at 31 March 1999. Of this increase, $1,138.3 million was due to deficits exceeding surpluses and the remainder, $1,780.6 million, was due to retroactive adjustments being made directly to net debt. There were a number of adjustments to net debt over the ten-year period but the most significant was in 1994 when government recorded a $1,645.7 million liability for pensions. Another major increase took place in 1998 when $289.8 million was set up for retirement pay, vacation pay, summer pay for teachers and workers' compensation benefits. A reduction in net debt of $376.2 million occurred in 1995 when government recognized its investment in Crown corporations for the first time.

1.20 It is important to realize that the various adjustments that have been made were only recognizing realities. For instance the fact that the Province in 1998 recognized $289.8 million for unrecorded liabilities, was not of itself the problem. The problem was that these liabilities, although never recognized, did in fact exist. While our preference certainly is to see the proper accounting performed at the time a decision is made, we realize that accounting practice evolves over time. Sometimes it is necessary to make a large, one-time adjustment in order to bring the accounting records into line with generally accepted current practice.

1.21 We now believe, however, that our Province is at a stage where all significant adjustments that should have been made have been made. In the future we would expect to see the annual statement of revenue and expenditure capture the results of all decisions in the year that had an impact on the government's financial position. This should lead to better decision making. It should also result in a more meaningful trend analysis of net debt, one that changes only by surpluses and deficits.

Tangible Capital Assets

1.22 At the present time there is no reporting on the Province's financial statements of the cumulative investment in tangible capital assets. The Province's annual expenditures on capital assets are reported, but the cumulative investment in assets such as hospitals, schools, highways and bridges is not disclosed. To the extent that these assets are used in the delivery of services for a number of years, there should be an annual allocation of their cost. This does not happen in the Province of New Brunswick.

1.23 PSAB's view on the matter is as follows:

> *Governments need to present information about the stock of tangible capital assets and its amortization in the summary financial statements to demonstrate stewardship and the cost of using those assets to deliver programs.*

1.24 Flowing from this view are specific principles, some of which are as follows:

> *tangible capital assets should be accounted for and reported as assets on the statement of tangible capital assets;*
>
> *tangible capital assets should be recorded at cost; and*
>
> *the cost.…of a tangible capital asset with a limited life should be amortized over its useful life in a rational and systematic manner appropriate to its nature and use by the government.*

1.25 We acknowledge that the PSAB guidance for tangible capital assets is relatively new. However, there is a lot of work to be done leading up to full compliance and we would encourage the government to develop an implementation plan. The first step would be to identify all tangible capital assets and their cost. This would remedy a significant shortcoming which currently exists in that government does not have a complete and easily accessible record of what it owns. With good records on tangible capital assets, the government would be able to fulfil its stewardship responsibility to New Brunswick taxpayers, and be positioned to implement further PSAB principles related to tangible capital assets such as amortization and the costing of programs.