

Table of Contents

Contents

Chapter 1 - Introductory Comments

Decision-making Process	3
Contract Administration and Leasing	5
Failure to Follow Legislation and Policies	6
Failure to Have Contracts Signed	6
Governance, Environment and Public Safety	7
Performance Measurement and Effectiveness Reporting	7
Opportunity for Public Accounts Committee	8
Our Office Performance	8
Acknowledgements	8

Chapter 2 - Department of the Environment - Tire Stewardship Program

Background	11
Scope	14
Results in Brief	14
Objective #1 - Planning and Implementation	15
Objective #2 - DOE's Oversight Role	18
Objective #3 - Protection of the Public	25

Chapter 3 - Department of Finance - Consumption Tax

Background	33
Scope	34
Results in Brief	35
Final Audit of Consumption Tax Accounts	36
Collection of Consumption Tax Accounts	40
Performance Information	46
Backlog of Accounts to be Written Off	48
Information for Future Action	49
General Concluding Comments on Collections	50

Chapter 4 - Department of Health and Community Services - Extra-Mural Hospital

Background	53
Scope	54
Results in Brief	55
The Decision-making Process	56
Conclusion	64

Contents

Chapter 5 - Fredericton-Moncton Highway

Background	67
Scope	68
Results in Brief	68
Detailed Findings	70
Conclusion	96
Appendix I - Fredericton-Moncton Highway Project Chronology	98

Chapter 6 - Performance Measurement and Effectiveness Reporting

Background	103
Scope	104
Results in Brief	104
First Value-for-Money Audits	104
First Government-Wide Study of Annual Reports	105
New Annual Report Policy	106
Value-for-Money Audits After Policy Implemented	107
Performance Indicators	108
Review of Annual Reports for 1997-98	110
The Role of the Annual Report	115

Chapter 7 - Contract Administration

Background	119
Scope	119
Results in Brief	121
General Observations	122
Family and Community Social Services (FCSS) Contracts	126
Janitorial Service Contracts	133

Chapter 8 - Leasing of Equipment

Background	139
Scope	141
Results in Brief	142
Compliance with Policy AD-6701	142
Accounting Considerations	157

Chapter 9 - Governance - New Brunswick Liquor Corporation

Background	167
Scope	168
Results in Brief	169
Detailed Findings	170

Contents

Chapter 10 - Regional Development Corporation - Economic Development Fund

Background	195
Scope	197
Results in Brief	197
Submission Requirements	197
Submission Guidelines	198
Approval Process	199
Monitoring	205
Conclusion	207

Chapter 11 - Follow-up on Prior Years' Audit Work

Background	211
Scope	211
Results in Brief	212
Department of Advanced Education and Labour	213
Department of Education	215
Department of Finance	216
Department of Health and Community Services	222
Department of Justice	225
Department of Natural Resources and Energy	230
Department of Supply and Services	233
Department of Transportation	235

Chapter 12 - Office of the Auditor General

Background	239
Office Role and Relevance	239
Performance Indicators	240
Financial Information	243
Staff Resources	244

Exhibit

Sections of the Auditor General Act relevant to the responsibilities of the Auditor General	247
--	-----

Chapter 1

Introductory Comments

Contents

Decision-making Process	3
Contract Administration and Leasing	5
Failure to Follow Legislation and Policies	6
Failure to Have Contracts Signed	6
Governance, Environment and Public Safety	7
Performance Measurement and Effectiveness Reporting	7
Opportunity for Public Accounts Committee	8
Our Office Performance	8
Acknowledgements	8

Introductory Comments

1.1 The Annual Report of the Auditor General normally includes comments on the Province's financial results, and, starting last year, a chapter on financial indicators. This year, due to the lateness in government closing the accounts for the year ended 31 March 1999, we were not able to include such comments in this volume. We intend to prepare a Volume 2, which will include financial observations, after the release of the Province's financial statements. We also plan to include in that volume the work we are finalizing on food service establishments and work in the Department of Transportation on the purchase of engineering services and the management of road construction materials inventory.

Decision-making Process

1.2 Every day decisions are made by government that affect the lives and welfare of New Brunswickers. Decisions are made on public policy issues, operational programming and on administrative matters which have a bearing on how taxpayers' money is spent. Taxpayers in general, and Members of the Legislative Assembly in particular, share a common goal in ensuring that all such decisions are the best ones that could have been made after a careful consideration of alternatives. It is important that decisions and the process that led to them are defensible and readily explained. As Auditor General, I am interested in the decision-making process because of my mandate to ensure that taxpayers' money is being spent with due regard to economy and efficiency. A good decision-making process that delivers good decisions on policies, programs and procedures will go a long way in ensuring the objectives of economy and efficiency are met.

1.3 It is important that a rigorous process be followed to ensure that government makes the best decisions possible, and is accountable for them. Decisions should only be made after a careful consideration of alternatives. Alternatives should only be identified after there has been a clear understanding of the issue being addressed. And, finally, all decision makers, at whatever level, should be given the best information possible. Only then should a decision be made.

1.4 How are decisions made in government? Are they made only after professional staff has been given time to analyze options and bring forward an appropriate recommendation? Or are they made at a high level without the benefit of professional analysis and advice? Are solutions developed before there is a definition of the problem? Or is the problem clearly identified and understood before solutions are identified?

1.5 One theme of our work this year was to acquire an insight into the decision-making process in government. A number of the projects that we are reporting on this year were undertaken with this in mind. We looked at how the decision was made to integrate the Extra-Mural Hospital with the eight regional hospital corporations. We examined the process followed by the Regional Development Corporation in deciding which projects are to receive funding from the Economic Development Fund. Our work on the Fredericton-Moncton highway focused on the government's decision to select the public-private partnership approach to undertake this project. In addition, we examined the quality of the analysis performed in support of decisions to buy or lease various pieces of equipment. And we also examined the government's decision-making process to implement the Tire Stewardship Program.

1.6 We found the implementation of the Tire Stewardship Program to be an example of a good decision-making process. The problem had been clearly identified, alternatives were considered and the process was well documented.

1.7 The other projects which we looked at revealed some shortcomings, which led us to conclude that there is opportunity for improvement. For instance, the objective behind the decision to merge the Extra-Mural Hospital with the eight regional hospital corporations was not clear. Was the reason to save money or was it to improve the continuity of health care? While either reason may be valid, depending on the one selected, different solutions might be developed. Alternatives to save money might differ from alternatives to improve the continuity of care. In the case of this particular decision, we noted that no alternatives were considered; the decision was simply to accept or reject the decision to merge.

1.8 In the case of the Fredericton-Moncton highway, we noted that certain government objectives were key in the process that led to the selection of the public-private partnership approach to development. For instance, the objective of avoiding an increase in provincial debt ruled out the possibility of government using its own borrowing power and its own favourable financing rate in pursuing this project. We believe that the selection of this objective and the other government objectives that had a bearing on the project were in themselves the result of various decisions. For the most part we found that these decisions were made at the ministerial level and we were unable to find any documentary evidence or analysis for the objectives chosen.

1.9 The Board of Management makes all decisions with respect to which projects receive funding from the Economic Development Fund, that is administered by the Regional Development Corporation. We found the role of staff and directors of the Regional Development Corporation, and the Office of the Premier, confusing from an

accountability standpoint and we believe significant improvements could be made in the information given to the decision-makers.

1.10 Our work in the area of leasing versus purchasing of equipment revealed that in some instances there was no supporting analysis for the decision. And in others the quality of the analysis could be improved.

1.11 During our work we were pleased to see a publication titled *Procedures Manual for Executive Council Documents*, which sets out the procedures to be followed to ensure decisions “are based on a complete knowledge of the circumstances that necessitate a decision and of the effect of the recommended action.” While the Manual only applies to decisions made by the Executive Council and its Committees, we recommend that the principles be applied to all decisions in government. One area where we feel the guidance could be strengthened is with respect to the identification and analysis of alternative solutions to the issue being addressed.

Contract Administration and Leasing

1.12 This year we undertook two projects which crossed departmental lines. One was contract administration and the other was the decision-making process related to leasing or buying equipment. Both projects examined the experience in a number of departments with our objective being to draw conclusions that may be beneficial to all departments and not just the ones we reviewed.

1.13 We believe the review of contract administration was relevant because more and more government services are being delivered by contracting out to the private sector. What we found was that there was not always a registry that listed the contracts in existence. We believe such a registry, that should include key financial and non-financial information, would greatly facilitate monitoring to ensure that government got what was contracted for, at the time and price agreed. We were very pleased with the positive response received from the Departments of Health and Community Services and Supply and Services in connection with our recommendations. We recommend that Board of Management ensure our recommendations are applied to all government departments.

1.14 We examined leasing decisions because we were interested in seeing if government was receiving value for money. Our conclusion is that it was not. What we found was that a government policy called “Present Value Analysis of Expenditure Decisions”, which if followed should have resulted in better decisions being made, was either not followed or followed improperly. What was most disturbing however is that in a number of cases the explanation departments provided for not following the policy related to balanced budget legislation. In other words, more expensive decisions may have been made due to the objective of having a balanced budget.

Failure to Follow Legislation and Policies

1.15 As a result of this work we made a number of recommendations to the specific departments we audited. We recommend that Board of Management ensure that all departments follow these recommendations. We also recommend that the Board of Management put in place mechanisms (either policies, directives or guidance) that will ensure all departments are making decisions on the basis of good value for money.

1.16 Last year I expressed a concern over the fact that legislation and government policy was not always being followed. There are more examples this year.

1.17 In regards to legislation, the New Brunswick Liquor Corporation Act requires the Board of Directors to appoint the General Manager (CEO), subject to the approval of the Lieutenant Governor in Council. Instead, the Lieutenant Governor in Council on its own has made the appointment. The Financial Administration Act requires that all government contracts be submitted to the Comptroller, but this is not happening. Our third example relates to the Tire Stewardship Regulation under the Clean Environment Act. We observed that the Tire Stewardship Board was not in compliance with the annual report section of the regulation.

1.18 With respect to policies not being followed, we noted that a number of leases were improperly classified, in violation of the government's policy "Classification of Expenditures." Also the policy to be followed in making lease versus buy decisions has, as indicated earlier, not been followed. And our work on the collection of consumption tax accounts pointed out that some uncollectable accounts were not being written off promptly. This too is a violation of the government's policy.

1.19 I believe that following legislation and policy is a fundamental issue. Legislators and policy makers must have the confidence that their wishes are being fulfilled. If the legislation or policy is no longer appropriate then it should be changed, but until it is changed it must be followed. In this regard we recommend that the government take the necessary steps to ensure that all legislation and policies are followed.

Failure to Have Contracts Signed

1.20 In my Report for the past two years I have commented on the failure of government to have contracts signed before goods or services are received. This year we found further examples of this happening. In the Department of Health and Community Services we examined fourteen Family and Community Social Services contracts and none of them were signed prior to the services being provided. This is another fundamental issue, not only to ensure that the government's position is clearly protected, but also to ensure there is proper authority to make expenditures.

Governance, Environment and Public Safety

1.21 For the past few years we have been doing some work in three topical areas: corporate governance, the environment and public safety. In this Report you will find a chapter on the New Brunswick Liquor Corporation. This continues our examination of corporate governance. The Tire Stewardship Program was our environmental project and it can be found in chapter 2. Our public safety project was a review of the inspection of food service establishments. This work is not complete and will appear in Volume 2 of our 1999 Report.

Performance Measurement and Effectiveness Reporting

1.22 This year we undertook a review of the progress made by the province over the past ten years in the areas of performance measurement and effectiveness reporting. We also reviewed the 1997-98 annual reports of government departments, in order to determine the level of compliance with government policy. The results of this work can be seen in chapter 6. One of the observations made as a result of this work is that the performance measurement system is improving each year, and we are now seeing questions and discussion on performance measurement during meetings of the Public Accounts Committee. The future of accountability in government lies in this area of performance measurement.

1.23 We encourage departments to continue to develop performance indicators that clearly relate to program objectives, and to objectively comment on the reasons why indicators have or have not been met. This initiative, however, needs more attention and I believe this could be given by the Public Accounts Committee.

1.24 Each year departments are required to table annual reports by 1 November, which provide performance measurement information on the previous fiscal year. The Public Accounts Committee would have a very positive impact on the process if public meetings of the Committee were scheduled shortly after the reporting deadline. It would also be very beneficial if the annual reports and the performance measurement information were given more attention by committee members in their lines of enquiry with the departments. We have already seen some examples of excellent lines of questioning by members in this regard, and we encourage their further development.

1.25 At the present time only departments are subject to the performance measurement initiative of government. Crown agencies have been excluded. Furthermore, there are no government wide goals and related performance measures issued in a "corporate level" report.

1.26 We would encourage government to bring Crown agencies into the performance measurement initiative and to establish government wide goals that reflect the highest priority items for government and New Brunswickers. It would then be appropriate for the government to issue an annual report, in addition to departmental ones, which would comment on the progress made in achieving the government wide goals.

Opportunity for Public Accounts Committee

1.27 Throughout our work we make recommendations as a result of our findings. These recommendations are found in the various chapters of this Report. Also we follow up on recommendations from previous years to see if they have been accepted and more importantly if they have been implemented. The results of our work in this area can be found in chapter 11. We could always use more support for our recommendations and in this regard I believe there is a proactive role that could be played by the Public Accounts Committee. From time to time recommendations are made that are directed towards the government as opposed to a particular department. In this opening chapter there are a number of examples of such recommendations. It would be very helpful, and I believe most appropriate, for the Committee to consider endorsing and supporting these types of recommendations.

Our Office Performance

1.28 During our work on performance measurement and effectiveness reporting we were certainly reminded of our own responsibility in this area, because we too must be efficient and accountable. Chapter 12 represents our annual accountability report, which we believe is in compliance with the government's annual report policy. There we report on our goals, performance indicators and results. I am pleased with the results on six of our indicators but strongly believe that we can do a better job on timeliness of our audits and on performing work within budget. While I am not satisfied with our performance in these two areas, I can certainly use our experience as an example of the value in having performance indicators. By having them, we as an Office have identified two areas where improvement can be made, something that may not have happened without them. We look forward to reporting next year with better results in these two areas.

Acknowledgements

1.29 During the year we met on a number of occasions with the Public Accounts Committee and the Crown Corporations Committee. In addition we were invited to participate in orientation sessions for the new Members of the Legislative Assembly and new committee members. We are most appreciative of these opportunities because we firmly believe that our contribution to the Legislative Assembly and New Brunswickers will be most effective by working closely with these committees.

1.30 Although it is my honour to submit this Report, I am indebted once again to the staff members in my Office who worked so hard and diligently to make it possible.

Daryl C. Wilson, FCA
Auditor General

Chapter 2

Department of the Environment Tire Stewardship Program

Contents

Background	11
Scope	14
Results in Brief	14
Objective #1 - Planning and Implementation	15
Objective #2 - DOE's Oversight Role	18
Objective #3 - Protection of the Public	25

Department of the Environment Tire Stewardship Program

Background

2.1 The fire at the tire dump in Hagersville, Ontario, in February 1990 drew attention to the environmental hazards of waste tires. It was immediately evident that when stored in large quantity, they present a potential catastrophic fire hazard. In addition to the fire hazard, water that collects in the tires is a breeding ground for insects and when tires are buried whole, the frost action brings them back to the surface creating problems for landfill management. The cost for managing a used tire in a responsible manner (i.e. recovering and recycling it) usually exceeds the value of the recyclable material. As a consequence, used tires ended up at dumps and landfills, or were stockpiled by someone in the hope that they would someday become profitable. Burying them, either shredded or whole, took up space and shortened the life expectancy of the landfill. Used tires do not degrade.

2.2 In 1992 the Province provided funding through the Environmental Trust Fund to the Fredericton Region Solid Waste Commission for the purchase of a transportable tire shredder. The shredder was available to other solid waste commissions on a cost recovery basis. While the shredder appeared to resolve the immediate environmental risks, it did not resolve the larger issue of long term environmental management of used tires. The Department of the Environment (DOE) viewed this as an interim step to resolve immediate hazards. In addition tire shredding is a step that is required for most forms of used tire recycling. Consequently, the tire shredder was consistent with a more comprehensive tire management strategy.

2.3 The need for a tire-recycling program was also highlighted in the 1993 Atlantic Provinces Special Wastes (APSW) Committee report. The Atlantic Provinces Ministers of the Environment established this Committee. The Committee chair was a DOE employee. The Committee targeted tires as a special waste that demanded appropriate management. It also recognized that the management of tires would not be assumed by the private sector without economic incentives, since the cost of

collecting and recycling exceeds the value of the recyclable material in used tires.

2.4 The basic premise put forward for managing used tires was “stewardship”. The Committee believed the industry that produces the tires should assume responsibility for managing them throughout their lifecycle. The cost for managing the used tire becomes “internalized” (i.e. the cost for waste management gets treated in the same manner as the cost for raw materials, labour and capital that go into making the tire). Costs are borne by industry which in turn passes them on to the consumer of the tires. Internalizing costs results in the user paying for the full cost of the product.

2.5 Several other industry sectors have recognized their responsibility for stewardship of their products and have started to act on that recognition. Chemical producers were some of the first, and more recently grocery product manufacturers have begun to take responsibility for their packaging. The Beverage Container Act is an example of industry stewardship functioning in this Province. Stewardship embodies the broadly accepted “polluter pays” principle.

2.6 The APSW Committee developed a proposal based on industry stewardship and invited industry stakeholders to participate in the development of the program. In November 1994 the Committee issued a call for expression of interest for managing scrap tires in the Atlantic region. From the response, it was determined that a processor/recycler could be found. However, after a number of months New Brunswick decided regional co-operation was moving rather slowly. DOE decided to focus on a provincial initiative.

2.7 To ensure appropriate management, the Committee recommended a co-ordinated recycling program based on the stewardship model. The New Brunswick Tire Stewardship Board (The Board) was established to administer the tire stewardship program in New Brunswick, effective 1 October 1996.

2.8 The New Brunswick Tire Stewardship Board is a not-for-profit organization and its principal business activity is overseeing the collection and recycling of used tires on behalf of the Minister of the Environment for the Province of New Brunswick. New Brunswick was the sixth province in Canada to introduce a tire stewardship program.

2.9 The primary objective of the program, as stated by DOE, is to ensure that scrap tires generated in the Province are disposed of in a manner that does not negatively impact on the environment. A secondary objective is that the management of scrap tires generates economic activity by optimizing the resource value of the material in the tires.

Tires included in the program

2.10 The program covers all new passenger car tires, light and medium truck (road transport) tires as well as tires for motorcycles, recreational vehicles, trailers and agricultural equipment. The tires for all of these vehicles are covered whether they were sold as original equipment when the vehicle was new or as replacement tires.

2.11 The vast majority of the tires attract a \$3.00 levy at the time of sale.¹ This levy is broken down in three distinct portions. The Board retains \$0.50 to cover the costs of administering the program. Of the remaining \$2.50, the Board remits \$1.25 to the recycler for each scrap tire collected. An additional \$1.25 per tire is payable to the recycler once the products containing the recycled material are sold.

Operation of the Board

2.12 The Board's Mission Statement is as follows:

The Mission is to administer with quality and care, a recycling program for tires in accordance with the Clean Environment Act.

2.13 The Board is charged with operating the program on a revenue neutral basis year to year. It must collect enough revenue from the levy to cover the costs to manage tires sold after 1 October 1996, and to pay for the administration of the program. In addition, the Board has the intention to deal with at least a portion of the tires that were in stockpiles at the commencement of the program, as financial resources permit.

2.14 Among the Board's ongoing operational responsibilities are the identification and registration of tire retailers, suppliers and manufacturers, and the monitoring of new tire sales figures. The Board sees itself as working in partnership with the contracted tire recycler to ensure an efficient and successful program.

2.15 In a more strategic sense, the Board sees itself with a role in supporting the production of value-added products made from recycled scrap tires and in the stimulation of the economy through job creation. The Board wants to remain accountable to its stakeholders while educating them about the programs delivered. Stakeholders are broadly defined as the public, retailers, industry, consumer groups and the government.

Used tire recycler

2.16 The Tire Recycling Atlantic Canada Corporation (TRACC) was chosen by a competitive tender to recycle the used tires in the Province. TRACC's contract is with the Board and expires on 31 December 2001. TRACC's mandate in New Brunswick is to operate all the components of scrap tire management: collection and storage; shredding; crumbing; and finally, manufacturing value-added products. In addition, TRACC has its own internal mission, which is to maximize employment

1. Tires with a rim size greater than 17 inches and less than 24.5 inches have a \$9.00 levy added at the time of sale.

opportunities in the Minto area. As of 31 March 1999, the employment level in Minto was approximately 50 full-time positions. Additionally, there are approximately 10-12 truckers employed throughout the Province in the tire collection phase.

Scope

2.17 Our scope included both the planning for and implementation of the Tire Stewardship Program, and the operation of the program up to 31 March 1999. In addition to extensive documentation review, we conducted interviews with several employees of DOE, with the staff and the Chairman of the Board, and with several employees of the Fire Marshall's Office. We also toured the TRACC plant and interviewed the CEO.

2.18 In carrying out our work, we developed the following three audit objectives:

- to determine if the Tire Stewardship Program was established in a well planned, timely and co-ordinated fashion in accordance with DOE's strategic direction;
- to determine if DOE is overseeing the management of the Tire Stewardship Program in accordance with the legislation and regulation; and
- to determine if DOE and any other appropriate government agencies are ensuring the public is adequately protected from danger of tire fires and that appropriate contingency plans are in place to deal with the related disaster issues.

Results in Brief

2.19 The Tire Stewardship Program was established in a well planned, timely and co-ordinated fashion in accordance with DOE's strategic direction.

2.20 We noted that at least two significant private tire stockpiles remain in the Province. We recommended DOE and the Board develop a timed action plan to clean up all remaining tire stockpiles.

2.21 We noted there is no contingency plan in place to ensure the public is adequately protected from the danger of tire fires. We recommended DOE require that a "Contingency Plan" be added to the requirements to operate the scrap tire storage yard.

2.22 The Board's liability for accrued processing fees continues to grow. And it seems to represent a much higher number of tires than are actually on site. We recommended the Board initiate a study to analyze issues surrounding the growing liability for accrued processing fees.

2.23 Although both DOE and the Fire Marshall appear to have responsibilities for monitoring and inspection of the TRACC facility, there is no memorandum of understanding or other such

co-ordinating mechanism between these two government organizations. Our interest is in ensuring that inspections are co-ordinated and that all key responsibility areas are addressed. Therefore, we made recommendations on the need for DOE and the Fire Marshall to improve the planning and co-ordination of inspections.

2.24 The Board's Management Plan and Annual Report are not in compliance with the regulations.

Objective #1 – Planning and Implementation

2.25 Our first objective was to “*determine if the Tire Stewardship Program was established in a well planned, timely and co-ordinated fashion in accordance with DOE's strategic direction.*”

2.26 We had three audit criteria under this objective. The first examined various aspects of the decision-making process employed by DOE. It reads:

The decision-making process should include the following steps:

- *identify the key issues for consideration;*
- *determine the departmental and government strategic directions with regard to these issues;*
- *develop a proposed solution by selection from reasonable alternatives;*
- *appropriately document and authorize the decision; and*
- *prepare an implementation plan.*

Planning

2.27 Overall we found DOE strong in the planning process that led to the creation of the Board and the Tire Stewardship Program. We were pleased that the process appeared to be well documented, helping us to make our assessment. In our Background, we mentioned that DOE identified the need for tire recycling as early as 1992. The APSW Committee, which was chaired by a DOE employee, identified four possible wastes for inter-provincial initiatives: used batteries, biomedical waste, used oil and used tires. The APSW Committee decided to concentrate on used tires proposing a regional approach.

2.28 The Committee decided there were used tires everywhere that required recycling. They also determined a long-term management plan was required for product stewardship.

2.29 The DOE Strategic Plan dated 16 September 1991 had the following strategic objective:

To ensure that Provincial regulations and policies require that proponents assume full lifecycle responsibility for the environmental impacts of their actions.

2.30 In 1992 the Premiers' Round Table on the Environment and the Economy prepared a "Plan for Action" with 38 recommendations directed towards sustainable development. The Province has continued to monitor its progress on the 38 recommendations showing the Plan's strategic importance. One recommendation discussed the concept of life cycle management noting "there should be responsibility for products and packaging from cradle to grave – and back to cradle through recycling." This idea certainly fits the approach DOE adopted concerning the Board. In 1993 the Policy and Priorities Committee of Cabinet also authorized DOE to initiate consultation with industry on a long-term management strategy based on product stewardship. This strategy of industry stewardship is also consistent with the *Beverage Container Act* (BCA) waste management principles. We reported on the BCA in our 1994 Report.

2.31 We were pleased to see that DOE developed a proposed solution by selecting from reasonable alternatives. An August 1994 document reviewed existing programs and developed four design questions from alternative models of scrap tire economic instruments. DOE developed a program using the information in the August 1994 document.

2.32 We reviewed a summary of the minutes of the various meetings of the APSW Committee. These minutes are a chronological history of events that led up to the final Memorandum to Cabinet. In addition, we reviewed a detailed planning document prepared by DOE in the Spring of 1996. By examining the documentation that led up to the Memorandum, and the subsequent regulation which established the Board and the Tire Stewardship Program, it is clear that the decision was appropriately documented and authorized. DOE told us they went to Cabinet four or five times before a program was approved.

2.33 Our discussion in the previous paragraphs shows DOE had systematically prepared for the implementation of the Board and its mandate. There was also a selection process DOE and the Department of Economic Development, Tourism and Culture used to determine the successful recycler/processor. This selection process was finalized by a contract with TRACC.

2.34 In our opinion DOE met the first criterion. DOE exhibited a thorough and well documented planning process.

Implementation

2.35 Our second criterion said "*Implementation should occur on a timely and co-ordinated basis in accordance with the approved plan.*"

2.36 To a large extent, we believe this occurred, although there have been some concerns about delays in the processing. We have discussed the process that led up to the submission to the Policy and Priorities Committee of Cabinet. This process culminated in the governing authority called the *New Brunswick Regulation 96-82* under *The Clean Environment Act*.

2.37 TRACC started collecting the used tires within the time frame provided in the legislation and regulation. However, the recycler was penalized under the contract in March 1997 for a delay in recycling the used tires. It was April of 1998 before any significant amount of recycling took place. Overall, recycling was slow compared to the original intention of the Board.

2.38 Because of this delay in recycling, we believe this criterion was only partially met by DOE.

Evaluation

2.39 With any major new program, we believe that after an appropriate period of time following implementation, the results should be evaluated and necessary changes should be made to the program. This principle then became our third criterion.

2.40 We are convinced there has been ongoing discussion and observation of this program. However, it is too early for a formal program evaluation so we are not making a conclusion on the third criterion at this time. As at 31 March 1999, this program had been in operation approximately two and one half years.

2.41 We do note, however, that DOE made some minor changes to Regulation 96-82 in March 1999. In addition, the TRACC contract was re-assigned from DOE to the Board in March 1998. Very early in the operation of the Board, the need to change compliance from the Canadian Council of Ministers of the Environment guidelines to the National Fire Code of Canada guidelines was recognized. These factors speak to ongoing monitoring of the program and a willingness to change and improve the program as required.

2.42 During our work, we observed a significant issue that should probably be included in a formal review of the program. That issue is what to do about stockpiles of tires that developed prior to the program commencing on 1 October 1996. DOE informed us that the Board has completed a clean up of all tires stockpiled at the regional landfills. Also a number of old village dumps were cleared of tires. However, we noted that one private stockpile of over 100,000 tires still exists in the Province. In addition another stockpile estimated at 6,000 tires is being monitored by DOE.

Recommendation

2.43 We recommended DOE and the Board develop a timed action plan to clean up all remaining tire stockpiles.

Departmental response

2.44 *The Minister will request that the Board develop a plan in cooperation with the Department to address the removal of the remaining scrap tire stockpiles. The plan, with an implementation schedule, will be developed by January 3, 2000.*

Objective #2 - DOE's Oversight Role

2.45 Our second objective relates to the ongoing oversight role of DOE for the Tire Stewardship Program. It reads as follows:

To determine if DOE is overseeing the management of Tire Stewardship Program in accordance with the Legislation and Regulation.

2.46 We developed six criteria to assist us under this objective. They relate to key aspects of the regulation which are:

- the need for a management plan;
- the need to monitor progress against the plan;
- registration and inspection;
- monitoring the after-market;
- reporting on effectiveness; and
- analyzing the fee structure.

Management plan required

2.47 Section 12(1) of the regulation states:

The Board shall, before January 1, 1997, and before the first day of January in every second year following that date

(a) adopt a management plan in the form, and containing the information, required by the Minister for the implementation of the Board's responsibilities under the Act and this Regulation for the two year period beginning on the first day of the fiscal year following its adoption, and

(b) submit the management plan to the Minister for approval

2.48 Our related criterion read that “DOE should ensure that the Stewardship Board has an appropriate management plan in place.”

2.49 The Board's original Business Management Plan (Plan) was dated 27 March 1997. This Plan was an excellent starting point for our audit. According to the regulations, another plan was due on 1 January 1999. We were assured that the Board was working on this second plan. However, it had not been completed by the time our fieldwork finished, at approximately the end of May 1999. Therefore, we concluded the criterion was partially met.

Recommendation

2.50 We recommended DOE ensure the Board finalizes and submits the Plan as soon as possible.

Departmental response

2.51 *The Management Plan is expected within [the first week of October].*

Monitoring the plan

2.52 The second criterion is directly related to the first. Once an appropriate management plan is in place, it is important that DOE have mechanisms to ensure that the plan is carried out. Based on this perspective, we developed the following criterion:

DOE should ensure the Stewardship Board regularly monitors results of TRACC in comparison to the Management Plan and reports the results to DOE.

2.53 Our discussions with the Board indicated there is regular phone contact between the Board and DOE. The same contact exists between the Board and TRACC. Part of this contact between the Board and TRACC would involve interpretation of certain clauses of the contract. TRACC submits to the Board and to DOE a weekly list of the tire stockpile activity. We noted items in the Board minutes that also indicated regular monitoring of TRACC. The Chairman of the Board is an employee of DOE further contributing to effective communication. Overall, there are several indicators of regular monitoring of TRACC and communication with DOE.

2.54 DOE noted to us that the annual report of the Board is intended to play a significant role in the reporting of results in comparison to the management plan. As the program matures, DOE expects the annual report and the management plan to be the keys to any oversight role it might have. We have commented in more detail on both the management plan and the annual report in other sections of this chapter.

2.55 In our review of documentation at the Board, it was evident that staff did not routinely document the phone calls and visits to the TRACC site. Given this, it is impossible for us to verify the actual extent of the monitoring of TRACC's results in comparison to the management plan. We concluded that the criterion was only partially met.

2.56 We have discussed this issue with DOE and have noted it may be prudent for the Board to improve its documentation as part of its standard systems and practices. This would help DOE in more formal monitoring of section 13 of Regulation 96-82. This states that: *"The Board shall ensure that an original or amended management plan, as approved by the Minister, is implemented in accordance with its intent."*

Recommendation

2.57 **We therefore recommended that DOE explore the possibility of requiring the Board to provide more documentation of the monitoring function.**

Departmental response

2.58 *The Department is represented on the Board and its member is regularly appraised by the Board staff of the results of the monitoring of the contract between the Board and TRACC. The Department is satisfied*

that the Board is fulfilling its mandate as it relates to TRACC but will appraise the Board of your recommendation and will urge the Board to maintain adequate documentation of its monitoring.

Registration and inspection

2.59 Two key sections of the Regulation in terms of the Board's responsibilities are sections 16 and 26. In order to emphasize the requirements of these sections, our next criterion states:

DOE should ensure the Stewardship Board has a system in place to register all suppliers as required by section 16 of the Regulation and to conduct appropriate inspections under section 26 of the Regulation.

2.60 In our opinion this criterion has been met. We present our findings separately for each of the two sections.

Registration Under Section 16

2.61 There is a system in place to register suppliers. Tire wholesalers are instructed by the Board only to sell tires to retailers who possess a valid supplier registration number. A toll free telephone number exists to allow wholesalers and retailers to contact the Board for registration verification and other matters.

2.62 The Board has told us it engages independent auditors to verify certain procedures conducted by wholesalers. There are approximately sixty wholesalers in the Province and at 31 March 1999, seven had been audited on behalf of the Board. We were told the auditors are required to verify compliance with certain sections of Regulation 96-82. As an additional procedure the auditors are instructed to verify that wholesalers are recording the retailer's registration number. The Board indicated it relies on these audits for part of the assurance that retailers have valid registration numbers. However the Board does not have any terms of reference with the auditors describing the required verification and compliance procedures. We believe it would be prudent for the Board to develop standard terms of reference for these audits.

2.63 Although we have no direct reporting relationship to the Board, we have spoken to the Chairman concerning our findings. He has agreed that the observations are relevant and has noted an openness towards bringing the matters to the attention of the full Board. Given that the Chairman has been appointed by the Minister, we made the following recommendations.

Recommendations

2.64 We recommended the Chairman advise the Board on the importance of preparing written terms of reference for audit engagements for the purpose of verifying compliance with selected aspects of Regulation 96-82.

2.65 We further recommended that an engagement letter be obtained for each of these audits. The engagement letter should

indicate the Board's reliance on the audit to ensure all suppliers hold valid registrations.

Departmental response to both recommendations

2.66 *The chairman has so advised the Board and staff of the Board. The recommended actions will be undertaken.*

Inspections Under Section 26

2.67 Section 26(1) of the Regulation states:

In order to ascertain whether the provisions of the Act and this Regulation have been complied with, a person who is an inspector designated under the Act or an agent designated under section 25, at any reasonable time and upon presentation of proof of identification on a form provided by the Minister or the Board, as the case may be, may

(a) enter the land or premises and conduct an inspection of the land, premises or personal property where or with which any person distributes, supplies, packages, labels, uses, stores, collects, transports, recycles, processes, disposes of or otherwise handles tires, and

(b) conduct an inspection of any record required to be maintained or kept under this Regulation.

2.68 DOE told us that Section 26 is deliberately broad in order to cover a wide variety of compliance issues under the Act and Regulation. The main activity to date has been the verification of registration under Section 16 as discussed above.

Monitoring the after-market

2.69 One of the key goals of the whole program is to develop recycled products from the used tires. The fee payment structure directly supports this in that the "second" \$1.25 is paid to the recycler only after the recycled products have been sold.

2.70 Because of this goal, and the importance of financial control over the payment of the second \$1.25, we developed our fourth criterion for this objective. That is:

DOE should ensure the Stewardship Board monitors the after-market for the material resulting from the management of used tires to ensure the materials are being appropriately recycled.

2.71 With regard to monitoring the after-market when these tires are processed, the Board said that TRACC submits a monthly invoice for processed Passenger Tire Equivalents (PTEs) (i.e. for recycling the rubber). The Board performs verification procedures on each monthly invoice. In addition, the Board randomly chooses invoices for sales of the recycled product and confirms by phone with the purchaser that a certain product was purchased from TRACC at a certain price. We

noted the stockpile of used tires in TRACC's storage yard has not increased in approximately one year, confirming that something is being done with the daily intake of used tires.

2.72 Currently, it appears that DOE relies mainly on verbal reports from the Board to ensure the Board monitors the after-market for recycled materials. Again, since the Chairman of the Board is a senior DOE employee, this informal reporting appears to provide a sufficient means for DOE to ensure the Board monitors the after-market of materials. In other words, this criterion was met by DOE.

2.73 Notwithstanding our conclusion, we see room for improvement in this area. We believe the Board could possibly engage their financial statement auditors to obtain additional assurance on the conversion of the rubber to an after-market use. This assurance could be communicated to DOE to satisfy the Department that the recycling aims were being accomplished.

Reporting on effectiveness

2.74 Section 13 of the Auditor General Act directs our Office in terms of our reporting responsibilities to the Legislative Assembly. Among the specific areas we are directed to report on are instances where "procedures have not been established to measure and report on the effectiveness of programs, where, in the opinion of the Auditor General, the procedures could appropriately and reasonably be used."

2.75 Or alternatively, we must also report where "procedures established to measure and report on the effectiveness of programs were not, in the opinion of the Auditor General, satisfactory."

2.76 Because of this perspective, we developed the following criterion:

DOE should report on the effectiveness of the tire recycling initiatives to the Legislative Assembly. One possible method could be through tabling the Stewardship Board's Annual Report and annual financial statements.

2.77 We are pleased to report that Section 14 of Regulation 96-82 recognizes the importance of accountability and reporting on program effectiveness. It requires annual public reporting on a variety of performance areas. The section reads as follows:

(1) As soon as is practicable after the end of each fiscal year of the Board, and in any event not later than ninety days after the end of each fiscal year, the Board shall provide the Minister with a copy of its audited financial statement for that fiscal year, and with an annual report in which are set out, respecting that fiscal year,

- (a) the number of tires supplied by all holders of a supplier registration,*
 - (b) the amount of fees remitted to the Board, including, separately, the amount of interest on outstanding fees and the amount of penalties,*
 - (c) the number of scrap tires collected,*
 - (d) the number of scrap tires processed,*
 - (e) the cost of the collection and processing,*
 - (f) the results of any inspections conducted on suppliers or others under this Regulation,*
 - (g) a description of all enforcement activities,*
 - (h) a description of other related activities of the Board,*
 - (i) a description of emerging trends in the field of scrap tire management, and*
 - (j) any other information required by the Minister.*
- (2) The Minister shall submit the audited financial statement and the annual report to the Legislature each year.*

2.78 The Board's December 1997 Annual Report and financial statements were filed with the Clerk of the Legislative Assembly in July 1998. This was approximately three months late. The Annual Report is fairly comprehensive and provides a significant amount of information on the Board and the program. The report and the accompanying financial statements provide information on a number of the items set out in section 14(1) including the amount of fees remitted to the Board and the number of scrap tires collected.

2.79 In a number of cases, however, it appears the report did not meet the requirements of section 14(1). Information was either not available or not easily located for a number of the following requirements:

- (a) the number of tires supplied by all holders of a supplier registration,*
- (d) the number of scrap tires processed,*
- (e) the cost of the collection and processing,*
- (g) a description of all enforcement activities,*
- (h) a description of other related activities of the Board,*
- (i) a description of emerging trends in the field of scrap tire management,*

(j) any other information required by the Minister.

2.80 Regarding requirement (d), there was a brief statement that

.... TRACC has experienced some tire processing delays. In fact, the shredding and crumbing of tires has reached production levels in 1997; however, rubber mats and similar products were only produced in small trial runs towards the end of the year.

2.81 We believe it would have been useful to provide actual statistics on numbers processed. A similar statement could be made for areas such as “the cost of processing” and “a description of all enforcement activities.”

2.82 The preparation of the 1998 Annual Report was not completed at the end of our fieldwork (approximately the end of May 1999). We had some discussion on Section 14 with DOE and were informed the Board may consider including in its next Annual Report a summary by province of the used tire collection and recycling activity. This could be seen as providing “a description of emerging trends in the field of scrap tire management.”

2.83 In our opinion, this criterion is only partially met as a result of the unfiled 1998 Annual Report, the late report in 1997 and the elements of 14(1) that have not yet been reported on.

2.84 One thing the report preparers might consider including would be a table or checklist which listed the requirements of Section 14 along with cross-references as to how the report satisfied each of them.

Recommendation

2.85 We recommended DOE ensure the Annual Report of the Board for 1998 and future years follows the provisions of Section 14 of the Regulation.

Departmental response

2.86 *The Department has reviewed the Auditor General’s views respecting what constitutes fulfilment of the requirements of Section 14 of the Regulation, agrees with them, and has passed the Auditor General’s recommendations on to the Board.*

Analyzing the fee structure

2.87 Several sections of the Regulation deal with the fee and the financial affairs of the Board. One of our criteria relates directly to the fee structure. That is:

DOE should have procedures in place to periodically analyze the fee structure to ensure it contributes appropriately towards the waste management goal.

2.88 Overall, it is too early to evaluate this criterion. The Board has not operated long enough to properly assess the fee structure. However,

we still have some observations. Indeed, these observations will help the reader understand why we are unable to conclude.

2.89 There has been some ongoing concern regarding the HST status of the fee charged by TRACC. The Board and its auditors are actively working on the HST requirements with Revenue Canada. The outcome of this HST work could reflect on the existing fee.

2.90 A second area of concern is the growing liability on the financial statements of the Board. This liability is known as “accrued processing fees.” Accrued processing fees represent the amount to be paid when products containing the recycled material are sold. An effective recycling program would see the balance remaining constant or, ideally, decreasing. This liability has grown from \$246,778 at 31 December 1996 to \$1,709,299 at 31 December 1998.

2.91 Our concern is that the \$1,709,299 equates to approximately 1.4 million passenger tire equivalents¹ (PTEs). Even though there is not an accurate inventory of the PTEs in the storage yard at TRACC, it is not 1.4 million PTEs. One estimate we were given as at 31 December 1998 was approximately 750,000 PTEs. The question arises, what has happened to the other 600,000 to 700,000 PTEs picked up but not in the storage yard? Another related question we have is why has the financial statement liability continued to grow even though the number of tires has remained fairly constant since mid-1998?

2.92 We were provided with several possible explanations for the variance. For example TRACC, with approval of DOE, shredded approximately 175,000 PTEs to be used as a private water filter. TRACC was not reimbursed the second “one-half” of the levy for this project, resulting in a permanent variance for purposes of the calculation. We have not verified the explanations offered but have noted both the recycler and the Board have an interest in the matter.

Recommendation

2.93 We recommended the Board initiate a study to analyze the issues surrounding the growing liability for accrued processing fees.

Departmental response

2.94 *The Department has been aware of the discrepancy identified by the Auditor General and has been working with the Board to clarify the issue. [Our understanding is that the Board has initiated a study to analyze the issues surrounding the growing liability for accrued processing fees.]*

Objective #3 Protection of the Public

2.95 We began the chapter with a brief reference to the tire fire in Hagersville, Ontario in 1990. More recently we have seen a tire fire at a recycling facility in our neighbouring province of Nova Scotia. Our

1. $(\$1,709,299 \div \$1.25 \text{ per PTE})$

third objective was developed with thoughts of the potential danger involved:

To determine if DOE and any other appropriate government agencies are ensuring the public is adequately protected from danger of tire fires and that appropriate contingency plans are in place to deal with the related disaster issues.

2.96 For all practical purposes we have restricted the meaning of the phrase “any other appropriate government agencies” to the Office of the Fire Marshall. The Fire Marshall is an employee of the Department of Municipalities and Housing.

2.97 We had three criteria under this objective. The first dealt directly with how DOE and other agencies address the risk of a tire fire. This is:

DOE and any other appropriate government agencies should ensure that TRACC has an appropriate risk management plan in place to deal with the potential threat of a tire fire.

2.98 Our reporting for this criterion begins with an examination of the original industrial approval granted by DOE.

2.99 DOE issued a Certificate of Approval to Construct and Operate a scrap tire yard to TRACC on 25 September 1996. The Certificate of Approval referred to a Document “A”. Contained in that Document “A” was a reference to a Contingency Plan for the Operation of a Tire Storage Yard and Manufacturing Plant (the Plan). We received a copy of the Plan which was identified as “Draft”. All indications point to this Plan being a requirement of the Certificate of Approval to Construct and Operate.

2.100 The Plan was prepared by TRACC and outlined the standards that TRACC followed to develop a safe tire storage facility and manufacturing plant at Minto, New Brunswick.

2.101 The Plan incorporated procedures to follow in case an environmental emergency occurred, especially a tire fire. It also outlined support services that TRACC had incorporated into the Plan through consultation and direct support from various provincial and federal government agencies.

2.102 The Plan outlined comprehensive procedures, that TRACC would undertake, to cope with environmental emergencies such as fire, outdoor storage of fuel, on site water containment resulting from a fire and on site storage of fire retarding chemicals.

2.103 Overall, the Plan appeared quite comprehensive. It called for a yearly review and appeared to contain numerous benchmarks to use in

measuring performance. However, it appears this Plan remained in a Draft form only. In fact a subsequent Approval to Operate issued by DOE to TRACC on the 10 October 1998 does not mention the Plan.

2.104 As a result of our audit work, we believe there is no official contingency plan in place to adequately protect the public from the danger of tire fires. We have asked TRACC that question and were referred back to DOE. We also inquired of these issues at the Fire Marshall's Office who also referred us back to DOE.

2.105 Without a comprehensive contingency plan in place, a number of questions remain unanswered. For instance, some basic questions related to the involvement of the Minto Fire Department would be:

- does the Fire Department have a physical layout of the tire piles in the yard;
- does the Fire Department have a key to the main gate;
- has the Fire Department had a recent call to TRACC to determine response time;
- has the Fire Department participated in a fire drill at TRACC;
- does the Fire Department have enough Class A foam offsite to fight a tire fire if TRACC's onsite foam is inaccessible as a result of the fire; and
- does the Fire Department believe the public is adequately protected from the danger of a tire fire?

2.106 We consider these are the types of questions a Contingency Plan needs to address. Although we are not experts in fire protection and related matters, the idea of making the Contingency Plan part of the approval certainly seemed to have validity. We have discussed this issue at some length with DOE and the Fire Marshall. Because of our concerns, we have concluded the criterion was not met.

Recommendations

2.107 We recommended that DOE include a contingency plan (similar to the above mentioned draft) as a requirement to operate the scrap tire storage yard.

2.108 Since the Fire Marshall has special expertise in fire prevention and fire fighting matters, we further recommended that DOE and the Fire Marshall co-operate in assessing the appropriateness of the contingency plan.

Departmental response

2.109 *The Department agrees with the Auditor General that there is a value in having a documented plan for dealing with potential environmental emergencies at the TRACC tire storage yard. In light of the proximity of the building to the tire storage yard and the possibility that a fire in the plant could spread to the yard, the plan should also*

address fire prevention and response in the building itself. The Department will work with the Fire Marshall to define the pertinent characteristics of such a plan and will require TRACC to propose a plan. When the plan is submitted, the Department will forward the plan to the Fire Marshall for review and approval and it will become part of the Approval to Operate under the Water Quality regulation. The Department will require that TRACC review the plan annually to ensure that it remains up-to-date and that TRACC document that the review took place.

2.110 *For those issues related to fire prevention and response, and environmental consequences of a fire, the Department will work with the Fire Marshall, TRACC, EMO and the Village of Minto to collectively ensure the safety of the workers, the residents of Minto and the environment. One component of the plan required by the Department will be contingency planning to address the environmental consequences of a fire, e.g. managing the run-off of water and foam used to suppress a fire and managing the by-products of combustion.*

2.111 *As noted in the Audit Report, contingency planning can cover a broad range of issues. Some of the contingency measures are more appropriately addressed outside a DOE required plan. Issues related to evacuation, evacuation routes, etc. are best dealt with by the municipality. Some of the issues in the draft Contingency Plan dealt with normal workplace operation and would not be appropriate in a plan required by the Department, e.g. adequate drinking water supply for workers, the wearing of hard hats and ear protectors, etc.*

Inspections of TRACC Co-ordination required

2.112 Our other two criteria related to the planning, co-ordinating, conducting and reporting of inspections of the TRACC facility. These two criteria are as follows:

DOE and any other appropriate government agencies should have an established and co-ordinated plan to inspect TRACC's facility in accordance with the Industrial Approvals and the CCME\National Fire Code guidelines.

Inspections by DOE and any other appropriate government agencies should be carried out on a scheduled basis, with appropriate reporting and corrective action taking place as required.

2.113 Since these criteria are so closely related, we are reporting on them together.

2.114 In our opinion there is no single department or agency co-ordinating the various inspections. Inspections are occurring but there is no "established and co-ordinated plan." We have also concluded that there is not a scheduled co-ordination of the conduct of inspections and the reporting of the corresponding results.

2.115 There is evidence of numerous visits to the TRACC facility by both the Department of Environment and the Fire Marshall. It appears that each department or agency had certain compliance considerations in mind, sometimes overlapping, when conducting these visits. We have also noted a certain amount of sharing of information between DOE and the Fire Marshall.

2.116 DOE's Industrial Approvals Section monitors the TRACC facility. Our understanding is that it is responsible for monitoring only the air emissions and possible ground water run off. The Industrial Approvals Section has responsibility for environmental protection by setting the conditions and standards of approvals and licenses to be issued to industrial and commercial operations. The Certificate of Approval to Construct and Operate mentioned previously was issued by the Industrial Approvals Section.

2.117 It appears that the Office of the Fire Marshall has taken the lead in inspecting and monitoring TRACC's compliance with National Fire Code Guidelines. Our understanding is the Fire Marshall became involved at the facility following a request from TRACC. This has resulted in numerous visits to the TRACC site.

2.118 The Fire Marshall has issued at least three Order documents to TRACC. The Order documents identified certain compliance problems and gave a future date to satisfy compliance. Non-compliance with these orders over a period in excess of one year resulted in a court action against TRACC on 5 May 1999. Two areas of non-compliance addressed excessive height of tire piles and excessive width (area) of the piles. As a result of this excess, the tire yard at TRACC has exceeded capacity by approximately 320,000 tires. TRACC has until early January 2000 to comply with the court order. One can certainly say the court action of 5 May 1999 dramatically illustrates the Fire Marshall's willingness to take corrective action.

2.119 We began this section with our conclusion that there is no established and co-ordinated inspection plan. In addition, there is no formal co-ordination of the conduct of inspections and related reporting. We are not necessarily concluding that the co-ordination issue has led to deficiencies in the inspection coverage itself. But we suggest that improvements can be made so that nothing "slips through the cracks."

2.120 One suggestion we received during our work was a possible need for a Memorandum of Understanding (MOU) between DOE and the Fire Marshall's Office. Given that DOE created the Board, perhaps DOE should take the lead. We believe DOE should clarify in the Regulation or with a MOU, who is responsible for what type of inspections.

Recommendations

2.121 We recommended that DOE and the Fire Marshall develop a comprehensive plan that identifies who will inspect TRACC for the various legislated and contractual requirements.

2.122 Further, we recommended that DOE and the Fire Marshall work together to co-ordinate the scheduling, reporting and corrective action of all inspections of TRACC as required.

Departmental response

2.123 *The Department will work with the Fire Marshall to co-ordinate inspections to ensure compliance with regulatory requirements that relate to fire prevention and response and environmental safety. Contractual requirements of the company and other regulatory requirements not related to environmental matters do not fall in the purview of the Department. The level of risk is in direct proportion to the number of tires stored on site, as the tire storage piles are reduced the risk will decline. When there is the potential for a significant risk to the environment caused by the storage of a large number of tires, the DOE will inspect the facility at least twice a year. The Fire Marshall will inspect the site in relation to fire safety issues at the DOE's request upon renewal of the approval and at other times when the number of tires stored on site is significant.*

2.124 *It has come to the attention of the Department that an independent fire safety review of the facility has been performed on an annual basis. The Department will work with TRACC and the Fire Marshall to ensure that the audit meets the needs of all parties and that the report is distributed.*

Chapter 3

Department of Finance

Consumption Tax

Contents

Background	33
Scope	34
Results in Brief	35
Final Audit of Consumption Tax Accounts	36
Collection of Consumption Tax Accounts	40
Performance Information	46
Backlog of Accounts to be Written Off	48
Information for Future Action	49
General Concluding Comments on Collections	50

Department of Finance

Consumption Tax

Background

3.1 From 1993 to 1997 the provincial Social Services and Education Tax (Consumption Tax) contributed an average of \$680 million per year to provincial tax revenues. This was second only to the federally administered “Taxes on Income” as the major provincial revenue source available to finance government programs. As of 1 April 1997 the Consumption Tax was replaced by the federally administrated Harmonized Sales Tax.

3.2 Most of the Consumption Tax revenue represented taxes collected by New Brunswick vendors and reported and remitted to the Province. Historically, a small percentage of vendors did not report and/or remit funds owing to the Province. A larger percentage of vendors through errors, misinterpretations and omissions, did not always remit the full amount of tax due. To address the taxes owing by these two groups, the Province had long maintained a tax audit function. The arrival of the HST did not immediately end the need for audit. The Province must continue to have an effective and efficient support system for assessing and collecting sales tax until substantially all revenue owing to the Province for tax transactions prior to 1 April 1997 is assessed and collected. This not only provides funds for government programs, but also prevents vendors who do not remit taxes from having an unfair advantage over vendors that do.

3.3 Due to the replacement of Consumption Tax we wanted to ensure that the assessment and collection activities were not scaled back before adequately addressing the unassessed taxes and uncollected tax receivable. Our concerns were magnified by a number of significant comments in prior Reports of the Auditor General.

3.4 In 1992 we conducted a value-for-money audit on the Tax Administration Division of the Department of Finance. We stated in the Auditor General’s Report that we had reservations about the number of sales tax compliance audits. At that time ten audit positions were vacant which represented one quarter of the Division’s audit positions. For each dollar spent on audit activities, \$6.42 of sales tax revenue was found. We questioned whether enough resources were being allocated to this activity.

3.5 In this 1992 review we also commented on collection activities. We recommended that the Division reassess its approach to enforcement including the use of interest, penalties, audits and other methods in order to encourage voluntary compliance.

3.6 Two key observations coming from this 1992 audit were that *“In some cases, efforts to reduce costs in the Division may be at the expense of revenue generation”* and *“the Division needs to establish procedures to measure and report on its effectiveness.”*

3.7 In our 1997 Report we expressed concern about the increase in the accounts receivable balance. Between April 1995 and November 1996 the dollar value of the accounts receivable had increased almost 50%. We have also commented in our 1997 and 1998 Reports that the Department lacked a good basis for determining the amount of these receivables that is uncollectable.

3.8 The factors above and the risk that these areas would be overlooked due to the replacement of provincial sales tax caused us to select the audit and collection of Consumption Tax for review.

3.9 We were also interested in reviewing the collection procedures from the standpoint of being able to make observations and recommendations that may be appropriate to collection efforts in other areas and not just the collection of unpaid sales tax.

Scope

3.10 Our audit objective was to review the economy and efficiency of the accelerated efforts to identify unassessed provincial sales tax and to collect outstanding sales tax. In addition, we reviewed whether the Department has established and reported satisfactory performance measures for these areas.

3.11 In carrying out this objective, we developed four audit criteria for sales tax audit and six criteria for the collection of sales tax to assist in defining our work. We reviewed these criteria with our departmental contacts and obtained substantial agreement prior to beginning fieldwork on this project.

3.12 We carried out a number of audit procedures to assess compliance with these criteria. The audit procedures included detailed interviews with Department staff; examination of policies and procedures; reviews of similar operations in other provinces; examination of submissions to Board of Management; review of Public Accounts and the Department's Annual Report; and a detailed review of collection procedures applied to a sample of thirty sales tax receivable accounts. The findings, recommendations and conclusions from our audit work are organized by the respective criteria in the sections that follow.

Results in Brief

3.13 The Department made a reasonable plan to audit all significant provincial sales tax accounts within a reasonable time following the termination of the Consumption Tax.

3.14 The Department did monitor its progress with respect to implementing the audit of sales tax accounts.

3.15 Suitable performance information for the auditors and the audit effort as a whole was established and monitored. However, this information was not reported publicly.

3.16 Revenue from Consumption Tax audits should have been shown separately in the Main Estimates and Public Accounts. Instead, it was combined with the federally administered HST revenue.

3.17 The relationship between audit revenue and the cost of the audit effort was monitored and the goal of \$4 of revenue to \$1 of cost was greatly exceeded. The actual return was \$7.64 per dollar spent as of March 1999. The Department should determine what ratio of cost to recovery is optimal and continue the audit effort until this is achieved.

3.18 The responsibility for the collection of each sales tax account was not clearly assigned throughout the collection cycle.

3.19 Collection agents were not sufficiently monitored to determine whether collection procedures were applied equitably and consistently.

3.20 Account information needed for the collection agents to determine the priority and other important details was fragmented or not available.

3.21 No suitable performance measures for individual collection agents, or the collection program as a whole, have been established or reported. The objectives of the collections program have not been set.

3.22 We reviewed thirty accounts, and noted shortcomings in the collection effort. There could be improvements in the timeliness of collection procedures.

3.23 Write-offs of uncollectable accounts should be made more promptly to enhance accountability and improve financial reporting.

3.24 Key information on bad debts arising from non-payment of sales tax is not provided to other departments to affect future payments or other dealings with the Province.

Final Audit of Consumption Tax Accounts

3.25 In the four years preceding 31 March 1997, the sales tax audits had been uncovering approximately \$14 million per year in unreported tax revenue. The audits generating these receivables typically applied to the previous five or more years of sales tax. This indicated that a significant amount of revenue remained to be assessed after the tax was replaced on 1 April 1997. Our criteria addressed the planning, conducting and reporting of this special Consumption Tax audit effort.

Effective Planning for the Special Audit Effort

3.26 As with any audit effort, proper planning is a key to successful results. The need for planning was perhaps magnified in these circumstances. That is, the audit effort had to be carried out in a compressed period of time due to the replacement of the Consumption Tax with the HST. Our first criterion addressed the need for planning as follows:

A reasonable plan should be made to audit all significant provincial sales tax remitters within a reasonable time frame following the termination of the Consumption Tax.

3.27 Adequate initial planning is required to establish goals for the program and resources needed to meet these goals. This planning should address the principles of completeness and timeliness in the search for unassessed revenue.

3.28 The Department had prioritized its listing of approximately 20,000 accounts into 7,000 moderate to high risk accounts based on the following factors: average returns; amount assessed in the last audit; and time since the last audit. The Department then applied an average hour per audit factor to determine how many hours were required to audit these accounts. In order to improve collectability, to avoid simultaneous audits by HST auditors and to minimize inconvenience to the vendors, the Department determined two years was a reasonable time limit to complete this Consumption Tax windup audit effort. From these factors the Department determined that they needed 44 additional personnel for the two-year period. The Department sought approval from the Board of Management for additional funding.

3.29 On 31 March 1997 Board of Management approved the hiring of 44 extra personnel for the fiscal years of 1998 and 1999. The extra personnel were hired and the accelerated audit effort began in June 1997.

3.30 In our opinion the Department met our planning-oriented criterion. The Department made a reasonable plan to audit all significant provincial sales tax accounts within a reasonable time following the termination of the Consumption Tax.

Department Monitored Implementation

3.31 For the Department to be held accountable for the cost of the audit effort, progress must be monitored and compared to a realistic

goal. We are pleased to report the Department met our second criterion, which stated:

The Department should monitor its progress with respect to implementing the plan, taking appropriate corrective action as necessary.

3.32 A goal of auditing 7,000 high-risk accounts was established for this two-year program. The Department has been tracking progress on these audits monthly and reports the auditors have audited 7,240 accounts to the end of March 1999.

3.33 The auditors have met or exceeded their goal throughout the audit; therefore no corrective action has been necessary.

Reporting on Performance

3.34 Our legislation directs us towards commenting on whether or not the government is reporting on the effectiveness of programs. With this in mind, we developed a criterion that stated:

Suitable performance information for the auditors and the audit effort as a whole should be established, monitored, and reported on a timely basis.

3.35 In general, we determined the Department established and monitored performance information for the auditors and the audit effort as a whole. The Department is monitoring performance measures such as audit revenue and the ratio of audit to administrative time by region that is used to gauge the performance of auditors, regions and the audit effort as a whole. One key measure disclosed in the submission to the Board of Management was that the extra cost of the audit effort would be offset by increased revenue. As of March 1999 the cost of the regular and enhanced audit for the last two years was \$5.5 million. It has generated revenue of \$41.8 million during this period.

3.36 In our opinion, though, the Department only partially met the criterion due to a lack of public reporting of the effort. For instance, there has been no separate disclosure of Consumption Tax revenue in the Province's *Main Estimates* or *Public Accounts* since 1996-97. The Consumption Tax, which amounted to approximately \$30 million in 1997-98, has been aggregated with HST in the *Public Accounts*. The same aggregation has occurred in the Province's *Main Estimates* for 1997-98 and 1998-99. HST is assessed and enforced by the federal government and is remitted to the Province based on a revenue sharing formula. This is quite different than Consumption Tax which is assessed, enforced and collected directly by the Province. This aggregation obscures accountability for both taxes.

3.37 The Department's annual report does report on the number of audits completed and the revenue generated as a result. However, it does not contrast these figures to expected performance levels. And measures

such as cost per dollar assessed are not disclosed. This audit effort was, in the Department's words "an ambitious undertaking." The Department achieved the coverage goal established at the outset. We believe it should report this performance success more fully.

Recommendations

3.38 We recommended that the Department provide better disclosure of revenue by source in the Public Accounts and Main Estimates.

3.39 We also recommended the Department increase its disclosure in its annual report to include a comparison of budget to actual revenue and accounts audited. In addition, the Department should present the cost/revenue payback ratio for the Consumption Tax audit program.

Departmental response

3.40 *Your first recommendation relates to the Department's aggregate reporting of PST revenue with HST revenue for Main Estimates and Public Accounts purposes since 1997/98. With regard to PST revenue from audits, the Department traditionally viewed the conducting of sales tax audits as primarily a means of measuring and enhancing taxpayer and collector compliance in fulfilling their obligations rather than as a revenue generator. As such, the Department did not deem it appropriate to budget sales tax revenue to be derived from audits. For this reason, it was not included in past Main Estimate PST revenue projections. However, with the implementation of the HST, this practice was changed in that anticipated revenue was budgeted since the purpose of conducting the audits was strictly one of maximizing revenue recovery. In addition, it was not believed necessary to report separately the relatively small amount of PST revenue from the predominant HST revenue. Finally, a significant portion of the \$30 million in revenue referred to in your report actually resulted from the new tax on private transfers of motor vehicles which is imposed by the Harmonized Sales Tax Act.*

3.41 *The second recommendation concerns increased disclosure in the Department's annual report of budget to actual results from the audit initiative. As the 1998/99 annual report has already been prepared, we will consider inserting an addendum to the report providing this information or, at minimum, include a comprehensive final reporting of the two-year audit effort in the Department's 1999/00 annual report.*

Should the Program have Been Extended?

3.42 Our next criterion is reflective in nature. It states:

The relationship between the audit revenue and the cost of the audit effort should be monitored and optimized.

3.43 We would expect the Department to systematically reflect on the ratio of audit revenue to audit cost and to continue to ask if the ratio is being optimized. We believe such an exercise is especially important as the program winds down. It adds a second element to the completeness of the audit effort. The audits may have been carried out according to

the plan. The coverage goal may have been met. But measurement of the ongoing effectiveness of the effort may indicate a change or extension in the amount or type of resources is warranted to optimize tax equity and tax revenue generated.

3.44 The “*Ratio of Net Assessments to Expenses*” has been monitored monthly during fiscal years 1998 and 1999. The Department had an unofficial goal of \$4 of revenue to \$1 of expenditure. This goal was not set in relation to any industry standards or additional costs of collection. Therefore we are unable to establish if a 4 to 1 ratio represents an optimal audit effort.

3.45 The actual ratio for this special program has been consistently over \$7 of revenue for every \$1 of cost. At the end of March 1999 the audit effort averaged \$7.64 of recovery per dollar spent. Based on this simple ratio, an additional auditor added at a cost of about \$50,000 would increase revenue to the province by approximately \$380,000.

3.46 The Department maintains that the returns from audits would greatly reduce now that they have audited the risky accounts. The Department did make a decision to extend the audit effort an additional three months until June 1999 to finish audits in progress at that time.

3.47 During our discussions with the Department we expressed our concerns that, since the recovery ratio continued right to the end at \$7:\$1, perhaps not enough resources were dedicated to the final few months of the audit effort. We would have expected to see a decline from the \$7:\$1 ratio as the program was winding down, indicating the audit effort was approaching its optimal point. Stopping the program when the results were still generating a \$7:\$1 recovery may seem unfair to the taxpayers that have been audited. And it can result in lost revenue.

3.48 Since the return on high-risk accounts has been considerably greater than predicted, it is reasonable to assume lessor priority accounts would also have a greater than expected return. In our opinion it would make sense to test the Department’s theory that the return would drop quickly on smaller accounts.

3.49 We concluded the Department partially meets this criterion. Certainly the relationship between the cost and the dollar benefit of the program was being monitored. However, we cannot conclude that the revenue and audit effort was “optimized.” Since the return has been exceeding \$7 for each dollar spent, we believe the audit effort should continue until the ratio drops to some pre-determined level.

Recommendation

3.50 We recommended that the Department determine what the minimum rate of return per audit dollar spent should be and continue the special audit effort until this target is met.

Departmental response

3.51 *In the planning phase of the accelerated audit initiative, account selection criteria was developed to determine the accounts on which a close out audit was considered necessary. The criteria incorporated such factors as:*

- *the average amount of tax remitted monthly by the business coupled with the length of time since the last audit,*
- *businesses registered for five years or more that had never been audited,*
- *the amount of past audit assessments coupled with the length of time since the last audit, and*
- *businesses registered that were not remitting tax.*

3.52 *From this process, approximately 7000 accounts were identified as requiring a final audit. Accounts that were not selected primarily consisted of those that had received an audit in the past with the results not warranting a further audit at this time. Also, accounts that were considered very low risk, either due to their size or due to the low taxable percentage of their sales, were not selected. The Department believes that the selection criteria adequately addressed any question of fairness between businesses of the same type in terms of those that were to receive a final audit and those that were not.*

3.53 *The Department also considered it very important that the wind up of the audit process for sales tax accounts be confined to two years in order to minimize the impact on businesses as they converted to the HST tax regime. The audit objectives and the resources necessary to accomplish these objectives were determined on the basis of a two-year initiative. These objectives have now been achieved. A pre-determined rate of return may possibly be obtained should the audit effort be continued on low risk accounts. However, we believe that there is little economic benefit to be gained from continuing since the revenue that would be recovered would not, in our view, be material. In addition, we feel that it would represent an undue imposition on businesses. For the above reasons, the Department is satisfied that the audit initiative was appropriately terminated at June 30, 1999.*

**Collection of
Consumption Tax
Accounts**

3.54 The Sales Tax Collections program also had a significant task to perform. Sales tax receivables as of 1 April 1997 totalled approximately \$84 million. Of this amount \$49.5 million was current and was collected in April 1997, leaving \$34.5 million in old accounts at the outset of the special audit effort. Tax collectors are also responsible for collecting receivables generated as a result of this audit effort. The interest cost to finance these uncollected receivables represents a significant cost to the Province. And the longer the accounts are outstanding, the less likely they will be collected in full.

3.55 The major source of our audit findings came from a sample of thirty accounts that were over \$10,000 and greater than one year in arrears. The sample therefore focuses on problem accounts and not the majority of accounts that are either small or are collected without incident. To a certain extent, we realize that by focusing on old accounts we are overlooking successes of the collection program. By definition, the “successes” have been collected in full and are therefore no longer outstanding.

**Responsibility Not Always
Clearly Assigned**

3.56 Our first criterion for collection addresses initial accountability for the application of the collection process. Management must clearly assign each account in order that someone can be held accountable for collection action or inaction. In other words:

Responsibility for the collection of each account should be clearly assigned throughout the collection cycle.

**Observations on the period
under audit**

3.57 In the past, collection responsibility was determined by who had possession of the file. In some cases “head office” would send the particulars of the overdue tax account to a regional Collections Office. In turn, some files were sent from the regions to head office in order to commence legal action. Some files were mislaid. Since the files were not accounted for centrally, this system resulted in unclear assignment of responsibility.

3.58 The collections area also suffered from staff turnover, changes in management and extended sick leave during the period under audit. A further problem occurred when part of the computer system dealing with taxes on purchases was “turned off.” This resulted in a twenty-month period beginning in the winter of 1995 when monthly statements were not sent out to delinquent accounts. In addition, collection officers were not notified that these accounts were in arrears. Therefore in many of these cases no collection activity was performed.

3.59 These explanations were given to us during discussions of our random sample of thirty delinquent accounts. Twenty-two of the thirty accounts we reviewed had “collection gaps.” In other words, quicker or more decisive action should have been applied to these accounts.

3.60 In these twenty-two “collection gap” accounts, most had no collection activity within one year. Several of the accounts had gone two years or more without collection activity. For example one account had no collection activity from June 1996 to February 1999. Another had no collection activity since November 1994. A third showed no evidence of collection activity since May 1996. Obviously, one contributing cause to the “collection gaps” was that the responsibility for the collection of each sales tax account was not clearly assigned throughout the collection cycle. The Department did not meet this first criterion.

Recommendation

3.61 We recommended that the Department maintain a listing that indicates who is responsible for collection activities on each receivable account on a monthly basis.

Recent improvements

3.62 The system of assigning accounts for collection appears to be improving. A call centre has been established where overdue accounts are initially sent for collection. Call centre staff phone delinquent accounts within thirty days after the due date. These employees try to get full payment or an agreement to pay the full amount outstanding within a year. If the call centre is unsuccessful, the account is forwarded to the collection officer.

3.63 On the information systems side, we were informed that as of March 1999, a listing has been produced and distributed to each collection officer that clearly indicates what accounts they should be working on. This is an improvement over what had been used previously.

Neutrality of Collection Procedures Not Monitored

3.64 The tax system depends on people complying with the law. If taxpayers do not believe the law is applied and enforced equitably, they are less likely to co-operate or comply voluntarily. Given this, one can see the importance of a criterion that says:

The collection agents should apply the Department's collection procedures without bias, and this neutrality of application should be monitored on an ongoing basis.

3.65 This criterion addresses fairness and equity in the collection of taxes. A collection system that is perceived as biased and/or grants concessionary terms to certain accounts may soon find an increasing number of accounts refusing to pay.

3.66 In most of the accounts reviewed the Department did apply the collection tools indicated in the collections policy. However, the timing of the application of these tools was inconsistent. In most cases it appeared that the collection activity should have been performed sooner. For example, seizure of assets was seldom successful since by the time the seizure action took place, often no assets were left.

3.67 In addition, there was no evidence of a review of the application of collection tools by the collection agents. Without this monitoring the Department cannot determine if collection tools are applied consistently and without bias. The Department lacks a system to monitor the collection efforts of its agents. In short, the criterion was not met.

3.68 The Department admits that accounts that have the ability to pay are given increased attention. The Department indicated that they take the middle ground between collecting accounts and preventing bankruptcies. They wish to keep the company in business in order to

maximize recovery. The Department informed us they understood how this can be interpreted as bias.

3.69 We cannot determine if the Department's collection procedures are applied without bias since the prescribed collection procedures are at the discretion of the collector. The collection policy does not give definite deadlines as to when each procedure should be applied.

3.70 Likewise the penalty and interest application is subject to discretion. Subsection 38.1 of the Revenue Administration Act states that:

The Commissioner, with the approval of the Minister, may in accordance with the regulations waive in full or in part a requirement under this Act to pay interest or a requirement under section 32 to pay a penalty.

3.71 Whether or not the taxes are actually owed is also subjective. Subsection 4(2) of the Revenue Administration Act also states:

The Commissioner may from time to time and at such intervals as he may consider reasonable, assess and reassess any tax payable under a revenue Act by any taxpayer, and may vacate or vary any assessment or reassessment, and thereupon the tax so determined shall, for the purposes of sections 12 and 22, become due and payable by the taxpayer.

3.72 Since the collection system allows for a significant amount of discretion, we cannot say that the collection procedures employed on any of the thirty accounts violated the policy or the Act. We did, however, find cases where the collection processes applied to some accounts appeared to be more lenient than collection processes on others. In the previous section we referred to "collection gaps" in twenty-two of the thirty items in our sample. Certainly those remaining accounts that were actively pursued for collection could have reason to question the equity of the system.

3.73 Payment arrangements and forgiveness of interest and penalties can potentially introduce inequities into the tax system. They may be perceived as constituting special treatment for individuals who have not paid taxes owing on time.

3.74 The Department's goal in introducing payment arrangements and/or forgiveness of interest and penalties appears to be to collect the maximum possible from these delinquent accounts. Our sample of thirty accounts showed nine such arrangements. While these arrangements were in effect, these nine accounts often collected additional taxes from customers and failed to remit. A number of these nine accounts have subsequently gone bankrupt, resulting in an increase in uncollectable taxes.

3.75 In one sample item, a vendor was allowed to continue adding to the amount that was owed to the Province while dishonouring several payment agreements on past debts. The Province allowed a debt of \$12,000 in September 1994 to increase to \$150,000 by April 1997. Since the tax owing for January to March 1997 has never been audited, the true amount of the debt could exceed this amount. One could argue full collection of this amount, including penalty and interest, is necessary to restore equitable treatment of tax-paying competitors in the same market.

3.76 An offer was made to the Department to settle this account for \$30,000. The Department counter offered in February 1999 for \$70,000. The Department's counter offer would cover the actual tax owing of approximately \$47,000. A significant portion of the interest and penalty would be set aside.

3.77 Another sample item had a balance owing of \$21,000. The Department has agreed to settle for five yearly payments of \$3,000. In another sample a payment agreement was entered into to forgive 50% of the interest provided monthly payments are made.

3.78 The Department's position is that special arrangements are given based on the financial position of the taxpayer. Each is considered on its own merits and subjective judgements are made as to what action should be taken. In our opinion, though, inequities may result from these decisions.

3.79 Companies that are allowed to continue operating despite failing to remit taxes create a competitive disadvantage for other businesses in the same market who are collecting and submitting their taxes on time. There are only so many sales to be made in a particular market-place, and when they are being made by companies who collect but do not remit sales tax, they represent unfair competition to the company which collects and remits sales tax, in accordance with the regulations.

Recommendation

3.80 We recommended that collection procedures be clearly prescribed and documented. Deviations from these should be explained and immediately brought to the attention of management. Circumstances that influence the granting of payment arrangements and the forgiveness of penalty and interest should be clearly defined.

Departmental response

3.81 *The Revenue Division of the Department developed and implemented a collection procedure manual several years ago. This manual gives basic guidelines on routine collection procedures that are followed for the majority of accounts collected. However, there are certain accounts for which hard and fast rules are difficult to apply. In certain cases, standard collection procedures could force a bankruptcy to occur, in which case the Province loses its entire receivable since consumption taxes are unsecured. In situations such as this, the*

Department has preferred to follow a more balanced approach in attempting to maximize its collections while also helping businesses to remain viable. The Department does plan to develop more clearly defined policies associated with granting payment arrangements and supporting recommendations for penalty and interest remissions.

Collection Officers Need Better Information

3.82 The more easily and accurately the collector can determine priority, risk factors, collection action that has been performed to date, and collection action that should be performed, the more effective the collection effort should be. Therefore, we developed a criterion as follows:

Priority, collection history and other important account information should be readily available to the collection agents to assist in efficient conduct of their work.

3.83 As mentioned previously, it is only in the last eighteen months that collection agents have begun using an aged listing of outstanding accounts. Apparently, this listing brought to light many accounts that no one had been working on. Prior to this listing, possession of the file was the main indicator of who was responsible for the account.

3.84 It is up to the collection agent to determine the priority of each account and what collection procedure should be applied. Systems in other provinces send collection officers a prioritized listing of accounts. These systems assign this priority based on collection history and amount outstanding. The collection agent is to follow up on these accounts within the first quarter of each month. Account history seems to be more readily available to collection agents in these other jurisdictions.

3.85 At the time of our audit the Department's collection history and account information came from the following sources:

- the "CDI" computer screen that is updated by collection agents and call centre staff;¹
- a computer screen that gives billing, payment and account balances;
- a contact history report which is also updated by collection agents and call centre staff;
- a diary (manual or computerized) maintained by collection agents indicating the date and action to be taken in the future on accounts;
- manual phone contact records maintained by the manager of collections and others; and

1. The CDI and CTXS account screen has been replaced as of 31 March 1999 as it was not Y2K compatible. An "Oracle" computer system has replaced the account screen.

- the physical collection file containing documentation of significant collection action taken and letters exchanged. There may be more than one of these files for an account at any point in time.

3.86 Collection problems are compounded by a few cases of missing information among the existing sources. For three of the thirty sample items we had specific concerns about missing information in the files that had, or could likely have had, a significant effect on the collection of the account.

3.87 The most notable example was one sample item which did not have documentation for the first six to eight months of collection activity. It appears a full file had gone missing. We were told that among the documents in the lost or missing file was a \$10,000 bond the Department obtained as security on the account. Although the taxpayer did not remit the taxes owing, the Department could not cash the bond since it could not be found.

3.88 Our analysis shows that the account information needed by collection agents was fragmented or not available. Again, a criterion for collections is not met. This information deficit would have affected the efficiency of the collection effort.

Recommendation

3.89 We recommended that the Department's collections information system provide quick access to suggested priorities, courses of action and pertinent account information.

Departmental response

3.90 *The Department agrees with the importance of providing collection officers ready access to historical payment data and relevant current information that could influence beneficially the collection effort. Coupled with revised collection procedures, auditors will be required to provide in their audit reports a statement concerning the financial position of the taxpayer or collector and any other information that could assist in the collection of liabilities established.*

Performance Information

3.91 Our fourth criterion focused on performance information as follows:

Suitable performance information for individual collection agents, and for the collection program as a whole, should be established, monitored and reported. For example, the relationship between collection and the cost of collection should be monitored and optimized.

3.92 This criterion addresses both the accountability of the collection agents to the Department and the accountability of the Department to the Legislative Assembly.

3.93 We determined that performance information for individual collection agents has not been established. There are no work plans for

the agents. The agents indicated that no measures of performance have been communicated to them. None of the collection agents have had formal performance appraisals. There is informal feedback to the agents on how they are doing, but the system does not generate objective evidence on which to base this feedback.

3.94 When we moved to the program as a whole, we noted the Department could not provide us with any measurable goals or objectives for collections. The Department does track some information on the makeup of the receivable balance but not on the evaluation of the collection program. Goals or targets have not been established to match against actual results.

3.95 In our discussions with staff we recommended two specific performance measures that are common to collection activities. The first measure is the collection rate for overdue taxes. This requires that the amount of the receivable that goes into arrears each year is established and the amount of the arrears that are collected within the year is also determined. In a recent Province of British Columbia publication, the collection rate for overdue taxes was stated at 59.3%.

3.96 The other measure we suggested is to take the amount of arrears collected and the total cost of the collection program to find a cost per dollar collected. The Province of British Columbia publication indicated a ratio of three cents per dollar collected. The goal for the Federal Collection Service was five cents per dollar collected.

3.97 We asked the Department to calculate these figures for us. The Department was able to determine that cost of collection for 1998-99 was \$454,000. The Department could not determine the amount of arrears that were collected within the year. The Department was therefore unable to provide us with either performance measure as both required a figure for arrears collected.

3.98 With respect to this cost figure, it should be noted the cost of collection activities is not separately coded in the Province's accounting system. The Department therefore was unable to determine if the resources applied to the collection effort had increased or decreased over recent years.

3.99 The main public reporting of the collection activity was in the Department's annual report for 1997-98. It indicated only that "a strong effort is being put towards the consumption accounts in an attempt to have the sales tax account completely cleared by the end of December 1999." With the large amounts of receivables still being generated by the special audit effort, and the payment agreements that will not expire for many years, this goal is not realistic.

3.100 Because of these observations, we concluded the Department does not meet this criterion.

Recommendation

3.101 Formal objectives for the collection activity should be established. Measurable goals such as cost per dollar collected and percentage collected for the collection program should then be established, monitored, and reported. Results should be used to optimize resources dedicated to this task. These goals should be used to establish work plans for the collectors. Regular performance appraisals for the collectors should be done with reference to these work plans.

Departmental response

3.102 *The Department agrees with this recommendation. Over the course of the next year, the Revenue Division will be developing a set of comprehensive performance goals and measures for each of its operational units. Work plans developed for the collection activity will contain specific objectives. An emphasis will be placed on ensuring that individual performance appraisals, as required by the Performance Management System, are completed.*

Backlog of Accounts to be Written Off

3.103 Our fifth criterion addresses both the accuracy of the receivable balance and the Department's accountability for collection action:

All reasonable collection efforts to collect the maximum amount of tax owing within a reasonable period should be completed prior to write off. When all reasonable collection procedures have been applied, accounts should be written off promptly in the manner prescribed by governmental policy.

3.104 When an account is no longer deemed collectable, it should no longer be shown as an asset. This is consistent with the Province's own policy and the recommendations of the Canadian Institute of Chartered Accountants. Government policy enhances accountability for the collections process since, prior to an account being written off, the name of the uncollectable account, as well as information on the collection effort, is presented to Executive Council.

3.105 In January 1999 the Department believed that 27% of the receivable balance was composed of bankrupt accounts or accounts due to be written off. We identified twelve out of the thirty accounts in our sample (40%) that should have been written off. Therefore, we concluded the Department had not met this criterion. A review of these accounts indicated that the likelihood of collection is very remote and the Department was no longer pursuing collection of these accounts. For example, in one case, the director of the company declared personal bankruptcy in November 1995. In another, the company declared bankruptcy in February 1993. Yet both were still awaiting write-off.

3.106 It should be noted that most of the accounts we identified as needing to be written off also had significant gaps in collection activity.

If prompt collection action had been applied, some of the accounts may have been collected. They may never have reached the write-off stage.

3.107 The Department indicated that few write-offs have been performed since 1995 and the backlog is being addressed.

Recommendation

3.108 Write-offs of uncollectable accounts should be made more promptly to enhance accountability and improve financial reporting.

Departmental response

3.109 *Prior to writing off accounts receivable, the Department exhausts all available means for obtaining payment. Progress has been made on bringing the existing backlog of write-offs and remissions up to date. The Department will consider instituting procedures that would see write-offs being presented to Executive Council sooner than what is currently done.*

Information for Future Action

3.110 A write-off of an account does not relieve the person or company from owing the debt to the Province. Therefore, the Province needs some record to influence its future dealing with a person or company who has had an account written off. Our final criterion addresses this issue. It states:

Key information on accounts written off should be retained in a suitable form to allow for future reference and action. This would include documenting information such as the directors of the company, circumstances of the business failure, etc. These records should affect any future credit granted by the Province and/or payments made to the accounts or directors of the company that defaulted.

3.111 The Department does have a manual information system in place for recording these write-offs. In all cases the account is entered into a Bad Debt Ledger. In addition, the Department will often have previously registered a memorial of judgement against the account as part of its normal collection procedures. If the company or individual has gone bankrupt, however, the step of registering a memorial of judgement may not be done since the judgement is not enforceable after bankruptcy has been declared.

3.112 We held discussions with the Department around extending the use of “vendor hold” to accounts it writes off. While an active account is outstanding, the Department issues a “vendor hold” so that funds payable by the Province for purchases from the vendor can be offset against the taxes owing. This provides a practical way to communicate to all departments that there is a problem with the vendor.

3.113 Accounts that have been written off though are no longer on “vendor hold.” Therefore, at some later date, payments and other transactions may be made between the Province and the delinquent taxpayer without knowledge of the delinquency having occurred.

3.114 Because of this situation, we felt the Department only partially met the criterion. Key information on bad debts arising from non-payment of sales tax is available; however, this information is not in a format that would effectively allow for future reference or action.

Recommendation

3.115 The Department should maintain a vendor hold on all accounts that have been written off.

Departmental response

3.116 *A vendor hold can be instated for accounts that have been written off in addition to holds that are placed on active accounts. However, before accounts are written off, the collection process would have determined that the account is either bankrupt or has been closed for a lengthy period of time. The likelihood that there would be any current amounts due to the account from the Province would be, in my opinion, somewhat remote.*

**General Concluding
Comments on
Collections**

3.117 It should be noted that the Department appeared to agree with many of our findings in this chapter and is acting to improve its performance in this area. The Department indicated that Collections was the last on the list of areas to be reviewed under the Revenue Management System (RMS) re-engineering effort. When RMS was terminated due to the introduction of the HST (see our 1997 Report), many of the Collections issues had not been addressed. This would be a mitigating factor in the condition of the collection system and the lack of performance measures.

3.118 While we realize that the significance of the Consumption Tax receivable will be reduced over the next few years, we believe many of our comments and recommendations on collections, and the collection effort, apply to other taxes receivable.

Chapter 4

Department of Health and Community Services Extra-Mural Hospital

Contents

Background	53
Scope	54
Results in Brief	55
The Decision-making Process	56
Conclusion	64

Department of Health and Community Services Extra-Mural Hospital

Background

4.1 In the autumn of 1995, the Department of Health and Community Services put forward a budget proposal to the Board of Management to close the Extra-Mural Hospital Corporation's head office in Fredericton. The services would continue, but the administration of the services would change. The separate legal entity known as the Extra-Mural Hospital Corporation would be abolished. The same services would be renamed as the Extra-Mural Program and the responsibility for the delivery would go to the general management of each of the regional hospital corporations. Three new positions would be created within the Hospital Services Branch to provide overall guidance and to monitor the program.

4.2 The Extra-Mural Program (EMP) - known by many as New Brunswick's "hospital without walls" - is a home-care program. It provides services in people's homes, as well as in other locations outside the formal institutional setting of a hospital.

4.3 The first unit of the Extra-Mural Hospital Corporation (EMHC) was opened in Woodstock in 1981. Twelve years later in 1993, the program was province-wide and operating through sixteen service delivery units. It continued to expand the services it offered: the oxygen program in 1994 and chemotherapy in 1995. The EMHC was the only province-wide hospital service in Canada. EMHC had a budget of approximately \$30 million. EMHC had 470 staff who made 350,000 home visits to 17,400 clients. It was known world-wide for its excellence in home-care.

4.4 In December 1995, Board of Management (BOM) approved the budget proposal to merge the EMHC into the regional hospital corporations. In February 1996, the Minister of Health and Community Services announced the decision and on 1 July 1996, EMHC became the EMP as it merged into the hospital corporations.

4.5 The decision-making process was selected for audit because it deals with two concepts that our Office feels are important: accountability and compliance.

4.6 *“Accountability is the obligation to render an account for a responsibility conferred”* (Report of the Independent Review Committee on the Office of the Auditor General of Canada). We addressed accountability issues by examining who is responsible for making a decision, how a decision is made, whether a decision is evaluated after it has been implemented, and how a significant decision is reported.

4.7 We looked for compliance with procedures documented in the Executive Council Office publication titled “Procedures Manual for Executive Council Documents” dated October 1994. It describes how the decision-making process of government uses a system of Cabinet Committees. It describes the Committees and the types of decisions assigned to each.

4.8 The Extra-Mural merge decision was selected because Extra-Mural is a high-profile program and it is of much interest to citizens of New Brunswick. There has been considerable media attention given to this program and on two occasions questions were raised in the Public Accounts Committee. Extra-Mural is often made reference to or discussed by the Legislative Assembly.

Scope

4.9 The objective for this audit project was to examine the decision-making process and determine if proper steps were taken in making the decision to merge the Extra-Mural Hospital Corporation into the eight regional hospital corporations. Our work was limited to this one decision in the Department of Health and Community Services. We are not commenting on the decision; the scope of this project did not include an evaluation of the decision made. The objective of the audit was limited to examining the decision-making process, not the decision itself.

4.10 In carrying out our audit work, our first steps were to gain knowledge on decision-making in general, the decision-making process of the government of New Brunswick, and the topic of the decision - Extra-Mural health care in New Brunswick. We carried out interviews with staff at the Hospital Services Branch and at two Extra-Mural units. The Executive Council Office publication “Procedures Manual for Executive Council Documents” dated October 1994, was a key reference used throughout our work. Other documentation we reviewed included literature on decision-making and information on the Extra-Mural Hospital Corporation.

4.11 We are not certain if we examined all the relevant information on the merge decision. There was no main file consolidating all the documentation supporting the decision. We were told that both the

Minister and the Deputy Minister were key participants in the decision; there has been a turnover in both of these positions. We obtained information from several individuals, but there is no way for us to be sure that we saw all the relevant documentation.

Results in Brief

4.12 In the autumn of 1995, the Department of Health and Community Services put forward a budget proposal to the Board of Management to close the Extra-Mural Hospital Corporation's head office in Fredericton. In December 1995, the Board of Management approved the budget proposal. In February 1996, the Minister of Health and Community Services announced the decision. On 1 July 1996, the Extra-Mural Hospital Corporation became the Extra-Mural Program as it merged into the hospital corporations.

4.13 While the Extra-Mural Hospital Corporation became merged into the regional hospital corporations, it was not clear to us whether the objective of the decision was to save money or improve the continuity of care. The evidence we received was not consistent.

4.14 There were no alternatives considered or presented in the budget submission relating to the proposed merger. The decision to be made was accept or reject the proposal to merge.

4.15 Some qualitative and quantitative analyses were done. We found the qualitative analysis to be incomplete and the quantitative analysis to be not well supported.

4.16 The decision was made by the proper authority.

4.17 Responsibility for developing solutions and making the final decision was clearly assigned. However, the manner in which responsibility was assigned may not have led to a full review of options.

4.18 A time frame was applied to the decision-making process. It appears reasonable.

4.19 Procedures which are to be followed in obtaining Board of Management approval were not followed.

4.20 We were pleased to see that the merge decision was reported in the Department's annual report in both the year the decision was made and the year it was implemented.

4.21 The decision has not been evaluated to determine whether the projected savings occurred and other benefits were realized.

4.22 Even though the Department suspected that they may have to defend the merge decision, there was no main file consolidating all

the documentation supporting the decision. We are not certain if we examined all the relevant information on the decision.

The Decision-making Process

4.23 From the literature reviewed, we attempted to develop a succinct description of “a good decision-making process.” In our opinion, a good process must be a logical process. It starts with identifying the problem or opportunity and determining the objective of the decision. Next comes a search for alternatives. Using various methods, alternatives are analyzed and evaluated. In selecting a solution to the problem or opportunity, judgement, experience and intuition is used in addition to analysis. Then the final decision is authorized.

Identifying the Problem or Opportunity and Determining the Objective of the Decision

4.24 We had difficulty identifying the problem or opportunity and determining the objective of the decision to restructure Extra-Mural care. Furthermore, it was not clear to us why the Extra-Mural Hospital Corporation even became the subject of a decision.

4.25 There were no specific problems with EMHC that initiated the decision. An operational review of the Extra-Mural Hospital Corporation was done in the spring of 1995 by an external consulting firm. The report dated May 1995 contained several positive statements about the EMHC. The report said, “*All of EMH’s objectives have been met to some degree, some more completely than others. Major operational problems were not found; EMH services are of very high quality; its management is patient focused and cost conscious; its operations run smoothly and its communications and relationships, both internal and external, are excellent.*”

4.26 In our attempt to find the problem or opportunity being addressed and/or the objective of the decision, the evidence we received was not consistent. As mentioned earlier, there was no central file on the decision so it was necessary for us to gather evidence from various sources.

4.27 The merge proposal was put forward by the Department as a restructuring initiative. It was presented as a specific budget proposal, one of many directed towards the goal of achieving better use of resources.

4.28 A letter dated 20 November 1996 to the Auditor General from the Deputy Minister of the Department states the following:

Since a stated objective of the 1992 Comprehensive Health and Community Services Plan was to redirect resources from non-patient to patient services throughout the system, the Department examined every opportunity to reduce overlap and duplication, as well as overhead costs. Our own internal analysis indicated that as much as 10% of the total cost of the EMH program, or about \$3M annually, could be saved by integration with the Region Hospital Corporations. This

saving would be achieved essentially through reduction of overhead - elimination of EMH head office, phasing out leases and moving regional operations of EMH within existing hospital space whenever possible. This \$3M would be saved without affecting EMH services to patients.

In summary, therefore, the decision to present this option to the government for consideration was not the result of any detailed study or sophisticated analysis. It was part of an ongoing effort to streamline administration and become more efficient in the operation and delivery of health care.

4.29 We discussed the merge decision with a senior departmental staff member who indicated the decision addressed an opportunity, rather than resolving a problem. We were told that the objective of the decision was to put in place an integrated acute care program and to remove organizational barriers between the two entities involved – the EMHC and the hospital corporations.

4.30 We reviewed the Journal of Debates (Hansard) for the time when the Legislative Assembly discussed the proposed legislative amendments required for the merger. When asked the question, “*Except for the economic side of it, is there any additional reason the department is proposing these bills?*” the Minister responded, “*The thing that was more important than the money was that we think that by doing this, we can improve the continuity of care in New Brunswick. That is our primary reason for doing this.*”

4.31 The written evidence and the oral evidence are not consistent. The written evidence we received, including the letter to the Auditor General, indicates the merger was being done for financial reasons. The oral evidence, our interview with the senior staff member, and the Minister’s response in the Legislative Assembly, indicates that the merger was being done to improve the continuity of care.

Conclusion

4.32 It is not clear whether the objective of the decision was to save money or improve the continuity of care. It is vital to the decision-making process that the objective of the decision be clearly understood by all individuals involved in making the decision. The alternatives for saving money within the Department would probably be different than the alternatives for improving the continuity of health-care.

Recommendation

4.33 **When a significant decision is to be made, the problem being resolved or the opportunity being addressed should be clearly understood by all individuals involved in making the decision.**

Departmental response

4.34 *Benefits to be achieved from the integration of the EMP into the region hospital corporations included financial benefits, as well as a*

smoother flow between hospital and home health care; this was clearly understood by all. We do not see any useful purpose in a debate as to which came first.

Searching for Alternatives

4.35 After a problem or opportunity has been identified, the next step in the decision-making process is to search for alternatives.

4.36 We saw no evidence that alternatives were considered. There were no alternatives presented in the budget submission relating to the proposed merger. The decision to be made was to accept or reject the proposal.

Conclusion

4.37 It is likely that the uncertainty of the decision's objective caused the omission of the exploration of alternatives. Identifying alternatives is a vital step in the decision-making process. As stated earlier, the alternatives for saving money within the Department would probably be different than the alternatives for improving the continuity of health-care. We saw no alternatives for either objective.

Recommendations

4.38 Once the problem being resolved or the opportunity being addressed is clearly understood by all individuals involved in making the decision, time should be spent identifying alternatives.

4.39 When making a significant decision, several alternatives should be explored before one is selected as the solution.

Departmental response

4.40 *The alternatives under consideration were clearly understood: the integration of the EMH into the region hospital structure, or the status quo, i.e. the continuation of the provincial Extra-Mural Hospital as a separate organization.*

Analyzing and Evaluating the Alternatives

4.41 The third step in the decision-making process is to select a solution to the problem or opportunity. This is done by analysing and evaluating alternatives, using judgement, experience and intuition and by negotiating among decision-makers. Since only one proposal was considered, that being to merge, it was not possible for us to perform any work on this step of the decision-making process.

4.42 We found the qualitative analysis (discussion of benefits and disadvantages) to be incomplete for the following reasons:

- There was no reference to the external evaluation of EMHC. This operational review had been done at the request of the Department and it was only a few months old. Although the scope of the evaluation was the effectiveness of the program, the report did have comments on its delivery (structure and management). We expected that this would be a valuable resource in the analysis.
- There is no evidence that the Extra-Mural Hospital Corporation's head office functions were examined to determine where there was

duplication with the hospital corporations and which roles would need to be maintained by the Hospital Services Branch. Whether it would be possible to assign specific responsibilities to the existing hospital corporations and the proposed Hospital Services Extra-Mural Program staff is an important step in maintaining service quality. The potential disadvantage of the loss of central quality control and direction over the EMH services was identified by the Department. With this serious potential disadvantage being known, it is unusual that it was not fully addressed in the analysis. We expected that the staff requirements for the newly created Hospital Services Extra-Mural Program component, along with their specific responsibilities, would be considered in the decision process in order to minimize the risk of loss in service quality.

- The analysis was done at a very high level with little or no consideration to the intricacies of service delivery. These include some of the program's key success factors (staff morale, information systems, purchasing of supplies, vehicle management) and the projects in progress for improving the program (a new documentation system in Sussex using handheld computers known as Patient Care Technology and a pilot-project in Miramichi for assessing and charting).

4.43 Quantitative analysis on the proposal to merge was done and both personnel and financial issues were considered. It indicated the reduction of 30 positions (FTEs) and anticipated net annualized savings to be \$1 million in 1996-97, \$2.6 million in 1997-98 and \$3 million in 1998-99.

4.44 We found that the quantitative analysis was not well supported. Phasing out leases and moving regional operations of EMHC within existing hospital space was reported as "*a significant portion of the anticipated savings (about 38%)*." The financial analysis assumed that the leases had cancellation clauses and some penalties were included in the analysis. However, as it turns out, there are some ten-year leases with no cancellation clauses.

4.45 The Department agrees that a sophisticated analysis was not done.

Conclusions

4.46 Only one option was analyzed and presented to BOM for consideration.

4.47 Some qualitative and quantitative analyses were done. We found the qualitative analysis to be incomplete and the quantitative analysis to be not well supported.

Recommendations

4.48 All significant decisions should be adequately supported by qualitative and quantitative analysis. The qualitative analysis should recognize the potential problems of the suggested solution and

indicate how they will be managed. The quantitative analysis should be done using reliable figures and where estimates and assumptions are used, they should be clearly identified.

4.49 The advantages of the selected solution over all other alternatives should be explained.

Departmental response

4.50 *We agree..... that the analysis of all the potential ramifications was not as complete as a retrospective, in-depth review permits; the quantitative analysis was done using the information available at the time, in the strict confines of the confidential nature of the measure.*

Authorization of the Decision

4.51 The Policy and Priorities Committee approved in principle a policy framework for the Department which included reference to the merger. BOM approved the decision when the budget was approved on 6 December 1995. The Minister announced the decision on 12 February 1996. The Policy and Priorities Committee and the Executive Council authorized the necessary legislative changes in February and March. The Orders in Council authorizing the legislation changes are dated 13 June 1996 and effective 1 July 1996.

Conclusion

4.52 The decision was properly authorized.

Responsibility for Developing Solutions and Making the Final Decision

4.53 Responsibilities should always be clearly assigned. In the decision-making process of government, the responsibility for developing solutions rests with management in the departments.

4.54 In the merge decision, four senior individuals in the Department were responsible for developing the proposal. Due to the sensitivity of the decision (closure of the EMHC's head office), the decision-making process was considered confidential and the group was kept small and limited to Department staff. A conscious decision was made not to include EMHC staff on the decision-making team.

Conclusion

4.55 Responsibility for developing solutions was appropriately assigned to departmental staff. However, the manner in which responsibility was assigned may not have led to a full review of options. The weaknesses in the analyses are likely the result of the composition of the decision-making group; no one had detailed knowledge of the subject of the decision, the EMHC.

The Time Frame of the Process

4.56 The decision-making process followed the Department's budget preparation and submission process. We were told that the merge proposal was discussed at meetings during the summer of 1995. The first formal documentation relating to the decision is dated 27 October 1995, titled *Merge NB EMH into the region hospital corporations*. This documentation accompanied the budget submission in November.

4.57 The Board of Management approval of the 1996-97 budget including the merge proposal occurred on 6 December 1995. The Minister announced the decision on 12 February 1996. The merger occurred on 1 July 1996.

Conclusion

4.58 A time frame was applied to the decision-making process. It appears reasonable.

Procedures for Executive Council Documents

4.59 The decision to merge the Extra-Mural Hospital Corporation into the eight regional hospital corporations did require approval by the Executive Council. This being the case, we determined that the appropriate reference for determining compliance with government procedures was the "Procedures Manual for Executive Council Documents." This manual was published by the Executive Council Office in October 1994. The Introduction to the Manual states:

The purpose of this manual is to outline for departments and agencies of the Government of New Brunswick the procedures that are to be followed in obtaining Executive Council approval of policies and legislation. The procedures outlined will ensure that decisions of the Executive Council, the Policy and Priorities Committee and the Board of Management are based on a complete knowledge of the circumstances that necessitate a decision and of the effect of the recommended action.

4.60 The procedures to be followed are quite specific. For instance, all information is to be presented under sections and no other sections are to be added. The ten sections to be used are as follows:

- subject;
- recommended action;
- background;
- legal authority for recommended action;
- interdepartmental consultation;
- external consultation;
- financial considerations;
- communications plan;
- contact person; and
- attachments.

4.61 Each section has its purpose and this is explained in detail in the Procedures Manual. We were particularly interested in the sections that have a direct bearing on the decision-making process and these are: Background, Interdepartmental Consultation, External Consultation and Financial Considerations.

4.62 The *Background* section requires “a concise but complete statement of the facts upon which the Recommended Action is based”. The manual requires all stakeholders to be identified and an explanation in non-technical terms as to what the current situation is and what problems are being addressed. It should normally offer alternative solutions. And if the decision is related to Public Health, there must be information on the impact that it will have on the health of New Brunswickers.

4.63 The purpose of the *Interdepartmental Consultation* section is to give the decision-makers the names of government departments and Provincial agencies that have been consulted and the substance of their replies. It is important to indicate whether there is agreement or disagreement with the recommendation. “This section should satisfy Cabinet Committee Members that proper interdepartmental consultation has been carried out, and what the results were.”

4.64 In the *External Consultation* section there should be a list of all groups, organizations and relevant businesses that have been consulted, and their responses. The objective of this section is the same as the section on Interdepartmental Consultation.

4.65 The *Financial Considerations* section must present all cost and revenue estimates for the action being contemplated. “The financial impact on other departments and agencies as well as external groups and organizations should also be included. Savings that will result from a proposed action for the current fiscal and each of the succeeding two fiscal years should be shown.”

4.66 In our attempt to establish compliance with the “Procedures Manual for Executive Council Documents,” we were informed that no document was presented to the Board of Management in accordance with the prescribed guidelines.

4.67 The only document received by the Board of Management that addressed the issue was part of the 1996-97 budget submission for the Department of Health and Community Services. This budget submission was a large, 181-page document, of which only three and one-half pages were devoted to the merge decision. We examined these three and one-half pages and noted that many fundamental provisions from the guidelines were not included. For instance, there was not a clear description of all stakeholders and no alternatives were considered. There was no reference to any interdepartmental or external consultations. We did note, however, that there was clear indication as to what impact the decision would have on budgets for the current and succeeding two fiscal years.

Conclusion

4.68 The procedures that are to be used in obtaining Executive Council approval were not followed.

Recommendation	4.69 All managers and staff involved in the decision-making process should familiarize themselves with the Manual to ensure that decisions requiring approval by the Executive Council, the Policy and Priorities Committee and the Board of Management are prepared for submission according to the documented procedures.
Departmental response	4.70 We agree with the recommendation and we believe we conformed to it. One must recognize the particular context and processes associated with the annual budget submission to government by departments.
Significant Decisions are Reported in the Annual Report	4.71 The merge decision was referred to in the <i>Annual Report for Health and Community Services</i> in two consecutive years. The 95–96 <i>Annual Report</i> , the year of the announcement of the merge decision, lists the legislation changes regarding Extra-Mural Hospital Corporation. The 96–97 <i>Annual Report</i> , the year of implementation of the merge decision, states the decision and the chief benefit of decentralizing these services.
Conclusion	4.72 We were pleased to see that the merge decision was reported in the Department's annual report in both the year the decision was made and the year it was implemented.
Evaluation of the Decision After it has Been Made and Implemented	<p>4.73 After a significant decision has been implemented, it should be evaluated to determine if the objective of the decision was met and whether the outcomes were as expected; and if not, why. Our review of the Journal of Debates (Hansard) for the time when the Legislative Assembly discussed the proposed legislative amendments required for the merger, showed that the Department recognized the importance of evaluating this particular decision. When responding to the statement, "I would like the minister to indicate to the House if he can point to one jurisdiction that stands as having had success with merging home care under the auspices of institutions?" the Minister said, "There is no jurisdiction I can point to that has an Extra-Mural Hospital system similar to what we have had in NB. We have to watch this to make sure that we get the gains we think we are going to get and do not end up with losses. That is a judgmental thing. It requires us to be vigilant as we go along." We were surprised to learn that the Department has not evaluated the decision and has no intention of doing an evaluation.</p> <p>4.74 The decision was made in December 1995 and the merger occurred in July 1996. As of January 1999, the decision to integrate the EMHC into the hospital corporations had not been evaluated. There are no plans to do so.</p>
Conclusion	4.75 The decision has not been evaluated. There has not been an analysis to determine whether the projected savings occurred and there has not been a review to determine whether any of the other benefits were realized.

Recommendation **4.76** All significant decisions should be evaluated to determine if the objective of the decision was met and whether the outcomes were as expected; and if not, why. Where the results dictate, necessary changes should be made.

Departmental response **4.77** *We agree with the recommendation, in the general context of limited resources and associated priorities of Government.*

Conclusion **4.78** We examined the decision-making process to determine if proper steps were taken in making the decision to merge the NB Extra-Mural Hospital Corporation into the eight regional hospital corporations.

4.79 We gathered evidence through reviewing documentation and interviewing. Based on this evidence, it appears that not all the attributes of a good decision-making process were present. The most serious shortcomings we identified were: a failure to identify the objective of the decision; a failure to identify and analyze alternatives to resolving the problem or opportunity; sending an information package to the decision-makers that was not completed according to the prescribed guidelines; and not evaluating the decision after it had been implemented. However, we are not sure that our examination was complete and that we examined all the relevant information. Therefore, we are unable to conclude as to whether all proper steps were taken by the Department of Health and Community Services when making the decision to merge the Extra-Mural Hospital Corporation into the eight regional hospital corporations.

4.80 There was no central file on the decision. This made it difficult to establish whether or not appropriate steps were taken by the Department of Health and Community Services. We think important information supporting major decisions should be kept in one file. This could serve several purposes. It would preserve the "corporate memory" of the entity, as turnover in positions is inevitable. It could serve as a reference for future decisions. It would serve the accountability function by presenting justification and rationale, should a decision be questioned after the fact.

Recommendation **4.81** When a significant decision is to be made, a file should be maintained holding all relevant information including: the problem or opportunity being addressed and the objective of the decision; the names of the individuals involved and consulted with in the process; the time frame; the alternatives considered; qualitative and quantitative analysis; and conclusions made.

Departmental response **4.82** *We agree with the recommendation.*

Chapter 5

Fredericton-Moncton Highway

Contents

Background	67
Scope	68
Results in Brief	68
Detailed Findings	70
Conclusion	96
Appendix I - Fredericton-Moncton Highway Project Chronology	98

Fredericton-Moncton Highway

Background

5.1 There are a number of reasons why we feel it is important that we look at the Fredericton-Moncton Highway project. First, it represents a large commitment of public money. Additionally, it is the largest public-private partnership arrangement ever entered into by the Province, and the first toll road to be constructed in New Brunswick. There is also a high degree of public interest in this project, particularly related to the tolling issue. For all these reasons we feel reporting from our Office on this project should be of considerable interest to the Legislative Assembly.

5.2 The agreements for the Fredericton-Moncton Highway project are now signed. However, we do not feel that our work will simply be a historical review. There may well be some lessons learned that can be applied to future provincial public-private partnership arrangements. It is in those areas where our recommendations are targeted.

5.3 We also feel that our review provided us with valuable information on the government decision-making process in general and that our recommendations may provide some guidance for future government decision-making.

5.4 In this chapter we will be addressing the decision-making process that led up to the issuance of a Request for Proposals to three short-listed bidders on the project on 27 March 1997. By that date, all substantive decisions about structure, financing, tolling, risk transfer, and the role of the private sector partner in design, construction, operation, and maintenance of the highway and tolling system had been made and approved in principle by the government.

Fredericton-Moncton Highway Project description and chronology

5.5 In our 1998 Report, we included a description of the Fredericton-Moncton Highway project, along with an analysis of the accounting treatment of the transaction. The project represents a commitment on the part of the Province to make “sub-lease” payments totalling \$1.514 billion over the first 30 years of the agreement. In addition, the Province is committed to fund operation, maintenance and rehabilitation (OMM) costs of the highway and tolling system over that period. (Highway OMM payments are fixed at \$168 million plus adjustments for inflation over the first 20 years. Tolling system OMM

payments are fixed at \$35.2 million plus adjustments for inflation over the first 10 years.) The Province will receive an estimated \$321 million in concession fees from the project over a 30 year period, mainly consisting of toll revenues in excess of what is required to fund toll-based debt repayments and interest.

5.6 On 4 April 1997, the Minister of Finance formally announced the Province's intention to create a public-private partnership to build the Fredericton-Moncton Highway. It was noted that it would be the biggest public works project in New Brunswick history. That announcement included confirmation that the business model had been developed by RBC Dominion Securities Inc. Appendix I shows a chronology of key milestones in the decision-making process for the Fredericton-Moncton Highway project. It covers the period up to the date of issuance of the Request for Proposals to the three short-listed bidders.

Scope

5.7 Our audit objective for our 1999 work on the Fredericton-Moncton Highway project was as follows:

To determine if the Province employed an adequate decision-making process in planning the existing structure for the Fredericton-Moncton Highway project.

5.8 In doing our work we considered significant decisions made, relating to the highway, up to 27 March 1997, the date the Request for Proposals was issued to the three short-listed proponents. We first reviewed the government objectives set for the project. We then looked to see how these objectives were translated into specific terms in the Request for Proposals. Our approach was to establish whether the decision-makers had access to sufficient, accurate information, that alternatives were considered, and that the decisions made seem reasonable in light of available information.

5.9 Our work included discussions with representatives of the Department of Transportation and the Department of Finance. We also reviewed documents provided by those representatives, along with many other pertinent documents, including Hansard, the government's new public-private partnership guidelines, and other government information releases. Additionally, we prepared our own analyses as required.

5.10 Our work was intended to examine the provincial decision making related to government objectives for the Fredericton-Moncton Highway and the contents of the Request for Proposals. We did not attempt to determine whether government objectives had been or were likely to be met, as that was beyond the scope of our planned work for 1999.

Results in Brief

5.11 Selection of government objectives for the project was made at the ministerial level over a period of several years. For the most

part, we were unable to find any documentary support for the objectives chosen, where alternatives existed.

5.12 Three financial objectives were developed and provided to RBC Dominion Securities Inc. by the government and were intended to form the basis for their structural recommendations. Ten general project objectives were developed by departmental staff and hired consultants for inclusion in the Request for Qualifications (RFQ) and Request for Proposals (RFP). Taken together, we feel that these objectives should be considered the government objectives for the project.

5.13 The structure of the Fredericton-Moncton Highway project was closely based on the public-private partnership model recommended by RBC Dominion Securities Inc. Other structural options for the project were proposed and analyzed, but the option chosen appears to have been the only one that would allow for the achievement of all government objectives as defined.

5.14 The Province has the option of buying back the highway at the end of the lease term at fair market value. A fair market value payment will be required despite the fact that all lease-based and toll-based debt will be paid off by that time.

5.15 In June 1996 the government announced its intention to pursue a four-lane highway project between Fredericton and Moncton. The decision-making process from that point up to the issuance of the RFP appears to have been well co-ordinated. Responsibility was assigned to various individuals or groups for each decision that had to be made. In addition, the Province hired a process consultant (KPMG) who was involved in the decision-making process after the June 1996 announcement and provided a positive opinion after the process was completed.

5.16 The gross interest cost between the issue date for the lease-based debt of 19 February 1998 and the commencement of repayments will total approximately \$214 million on the original \$540 million debt.

5.17 The terms of the RFP provide for the transfer of significant additional risks to the private sector over the traditional Department of Transportation highway construction approach. Departmental representatives indicated that all decisions made were subject to extensive discussion between departmental representatives and hired consultants. However, we did not see documentation supporting the decision to transfer those risks on cost benefit or other bases.

5.18 The additional costs associated with having project debt issued by a third party were significant. There were benefits

accruing to the Province from this decision. However, we did not see analyses that established that the value of these benefits met or exceeded the additional costs incurred.

5.19 The decision to allow RFP bidders to place more than the minimum amount of toll-based debt will have negative cost consequences for the Province.

5.20 Proposed Fredericton-Moncton Highway toll rates are comparable with those in other jurisdictions in North America.

5.21 Board of Management approved the tolling protocol and certain other items pursuant to their approval of “Financial Parameters for the Fredericton to Moncton Project – Finance” on 27 February 1997. Otherwise, the contents of the RFP were not approved by the Board of Management or Executive Council. Those bodies relied on departmental staff and hired consultants to ensure the RFP contents were appropriate.

Detailed Findings

Groups or Individuals Involved in Decision-Making Process

5.22 Government financial objectives for the project were decided upon at the ministerial level with reference to consultants’ reports. Other objectives, specific to the project, were developed by departmental staff with the assistance of hired consultants. Co-ordination of all decision-making starting with the formal project announcement in June 1996 was assigned to the Project Manager, a senior government official from within the Department of Transportation. From that point, all steps in the process appear to have been completed within established timeframes. The contents of the Request for Qualifications (RFQ) were based upon the RBC Dominion Securities Inc. interim report. The contents of the Request for Proposals (RFP) were developed by a number of small committees that included representatives of government and various private sector consultants who were hired by the Province to provide their expertise. Certain of these consultants also provided some input to the RFQ and were involved in the assessment of responses to that document.

5.23 Departments represented in the decision-making process up to the issuance of the RFP included the Department of Transportation, the Department of Finance, the Department of Natural Resources and Energy, the Department of the Environment, the Department of Justice, the Department of Economic Development and Tourism, the Department of Supply and Services, the Department of Agriculture, and the Department of Municipalities, Culture, and Housing.

5.24 The planning/decision-making phase of the project included fairly heavy reliance on consultants. Many of the consultants who were hired had significant previous experience working on public-private partnership arrangements in other jurisdictions in Canada and elsewhere.

Decision-Making Information

5.25 There were a number of reports upon which decision-making was based for the Fredericton-Moncton Highway project. The key report was prepared by RBC Dominion Securities Inc. It dealt with the feasibility of a public-private partnership arrangement for the Fredericton to Moncton highway and recommended the structure that was subsequently adopted for the project. Material from that report was used extensively by decision-makers. Other reports that provided important input included the provincial white paper *“Highways for the Next Century”*, the *“Feasibility Study for Toll Highways and Private Sector Involvement for Highway Development in New Brunswick”* prepared by ADI Limited, and the traffic study prepared by Wilbur Smith and Associates. All these documents are discussed in more detail in the project chronology presented in Appendix I.

5.26 Aside from reports, we were told that valuable information was obtained through dialogue with other jurisdictions that had employed public-private partnership models for similar projects. Those projects included the Ontario 407 highway, the Nova Scotia highway, and the Confederation bridge.

5.27 We noted one case where information used by decision-makers may have been misleading. The RBC Dominion Securities Inc. report includes the comment, *“...a public private partnership approach could be used to achieve: i) construction cost savings estimated by ADI Ltd of \$60 million...”* The \$60 million figure came from a report by ADI Limited. That company was requested in 1996 to provide an independent assessment of cost estimates for design and construction of the proposed Trans-Canada highway between Fredericton and Moncton. Terms of reference included the following statement.

“Review current plans for the highway and develop estimates of the cost of the work to be done (both design and construction separately). Separate estimates are required on the basis of traditional approach to designing and building through a number of tendered contracts, and on the basis of a single design-build project...Costs of designing and installing toll facilities have not been addressed in this estimate.”

5.28 ADI made the following comments in their October 1996 report.

“....When the Highway 407 project in Ontario was initiated, design-build costs were estimated at 90% of traditional methods. This has since proven accurate.... Anticipated savings on design-build projects are not as much a function of the type of project (traditional vs. design-build) as they are to the scale of the undertaking. Design-build economies are maximized through large scale ventures such as the Fredericton to Moncton Highway Project. However, this project is sufficiently large that cost savings could also be

significant should the decision be made to break the work into several sections.”

“A design-build proponent would expect to achieve economies on highway design and construction through the following measures:

- Longer sections of highway under construction at the same time within the same contract will encourage more efficient balancing of cuts and fills, especially through use of large off-road earth moving equipment.*
- Large contracts will permit establishment of specialized crews for specific and repetitive tasks, hence more efficiency. (i.e. Excavation, borrow, sub-base, etc.)*
- Due to the size of design-build contracts, mobilization costs will be reduced.*
- Under a design-build approach, the design review process will be streamlined.”*

5.29 The report goes on to list areas where economies could be expected on bridge structures construction.

5.30 The RBC Dominion Securities Inc. report implied that the \$60 million cost savings could be attributed to the public-private partnership structure. However, the original ADI report clearly indicates that the savings relate to economies of scale, not project structure. Therefore, we feel that the RBC Dominion Securities Inc. report may have misled decision-makers in the design-build area.

Departmental comments

5.31 *We believe that the RBC Dominion Securities report is quite clear and not misleading when it states “...a public private partnership approach could be used to achieve: i) construction cost savings estimated by ADI Ltd of \$60 million...”. It does not attribute the savings to the public private partnership but rather states that this is one possible way to achieve the savings identified by ADI Ltd. as possible in a Design-Build project. The source of the savings was understood by the decision makers.*

Fredericton-Moncton Highway Project Objectives

5.32 In our opinion, the selection of government objectives for the Fredericton-Moncton Highway project was one of the two key decisions made for the project. (The other was the decision to sign the final agreement with the Maritime Road Development Corporation.)

5.33 The basic government goal for the Fredericton-Moncton Highway project was to increase public safety by improving the highway system between Longs Creek and Moncton. More specific government objectives for the highway project were formulated at the ministerial level over a number of years of preliminary planning starting with the

provincial “*White Paper*” in 1993. We feel that it would have been appropriate to limit these government objectives to such broad statements as “for lowest cost to the Province” and “as quickly as possible” rather than providing more specific objectives to provincial staff. Doing this would have enabled provincial staff to be more creative in completing the project, while still meeting the broader goals and objectives of government. Departmental representatives indicated that the financial goals selected by the government, and the resulting public-private partnership structure for the project, limited their ability to identify acceptable alternatives for many of the project objectives that they later formalized.

5.34 We found lists of objectives in two places. Three government financial objectives were provided to RBC Dominion Securities Inc. when they were contracted to provide structural recommendations for the project. In addition, a list of ten project objectives considered relevant to bidders was developed by departmental representatives with the assistance of hired consultants and presented in the Request for Qualifications (RFQ) document. This list was prepared after the RBC Dominion Securities Inc. interim report was issued and the structure of the project had been decided. It appeared again in the Request for Proposals (RFP) with slightly modified wording. Some of these objectives, such as the four-year completion goal, had already been referred to by government in their previous announcements. We consider the three government financial objectives combined with the ten project objectives to encompass the government objectives for the project.

5.35 The three government financial objectives provided to RBC Dominion Securities Inc. were:

- to avoid an increase in provincial debt;
- to achieve a reasonable cost of funds; and
- to achieve an optimal degree of risk transfer to the private sector.

5.36 Upon consideration of these financial objectives, RBC Dominion Securities Inc. recommended the project be structured as a public-private partnership with at least a minimum level of funding being provided by third party (i.e. toll and ancillary) revenues. This recommendation was accepted by decision-makers and project planning proceeded to the RFQ phase under the assumption that a public-private partnership structure would be adopted.

5.37 Departmental staff said that the government objectives for the project were sometimes competing. For example, they understood that transferring risks and requiring certain construction and environmental standards would lead to additional cost for the Province. These objectives had to be balanced when deciding what to include in the RFP.

5.38 Our work on government objectives for the project included developing a clear understanding of the meaning of each objective. We then attempted to determine if reasonable alternatives existed to those selected. Where reasonable alternatives did exist, we determined if analyses had been prepared that compared the alternatives and made decision-makers aware of the limitations their selection would make on structural options for the project as well as the benefits. We then assessed the objective selected for reasonableness given the information presented. Government objectives for the project are discussed individually below.

5.39 In doing our review of objectives, we noted a lack of documentation supporting the selection of specific objectives where reasonable alternatives existed. Lack of staff involvement may be the reason for this deficiency in the case of government financial objectives. The Departments of Transportation and Finance indicated that they only became involved in the decision-making process for this project after the official announcement that the project would proceed, in June of 1996. However, there is evidence that these issues were discussed at the political level prior to that date, including the various reports that were requested as previously discussed and Hansard documentation from the Legislative Assembly. Departmental representatives indicated that very tight timelines for planning the project led to the lack of documentation supporting project objectives selected for inclusion in the RFQ and RFP. They did note, however, that decisions related to project objectives were subject to intensive discussion and debate between departmental staff and hired consultants.

Government financial objectives

5.40 As previously noted, RBC Dominion Securities Inc. was given three government financial objectives in their work for the Province early in 1996. Two of them related directly to financing aspects of the proposed project. They were, “to avoid an increase in provincial debt”, and “to achieve a reasonable cost of funds.” They are discussed below. The third relates to risk transfer and is covered under “*Project Objective 4*” later in this chapter.

To avoid an increase in provincial debt

5.41 This objective can be interpreted as requiring the Province to enter into an operating lease arrangement and to have an arm’s length third party arrange for the financing of the project. The obvious alternative would be not to have such an objective, thereby permitting the Province to finance the project.

5.42 There were two arguments made supporting the need for this objective. The first was the possible effect of more provincial borrowing on the provincial debt rating, and therefore future borrowing rates. The second was the requirement of the Province to live within the financial boundaries established by the provincial balanced budget legislation.

5.43 The argument that additional borrowing by the Province may adversely affect the future borrowing rate supposes that the debt rating agencies would ignore debt issued by a third party, but supported by government payments. In fact, in their 1997 report, RBC Dominion Securities Inc. made the following statement in referring to the likely effect of project debt being issued by Project Co.

“... Credit rating agencies will count \$580 million commitment (89% of capital costs) now ...”

5.44 Their opinion was confirmed in a November 1998 Standard and Poors report that discussed the 1 June 1998 affirmation of the Province of New Brunswick’s credit rating.

“Tax-supported debt (net of cash holdings), which includes all provincial direct and guaranteed debt as well as municipal debt, but excludes the self-supporting obligations of NB Power...rose once again in fiscal 1998. This was entirely due to the issuance of lease-based debt (not directly by the province, but by the New Brunswick (F-M) Project Co., a not-for-profit company incorporated earlier this year) to help finance the construction of the Fredericton-Moncton Highway project. While this debt does not represent a direct obligation of the New Brunswick government, and therefore does not affect provincial direct debt..., Standard and Poors considers it appropriate to treat it as tax-supported debt because the province (through its Crown Corporation, New Brunswick Highway Corp.) is ultimately responsible for making the sublease payments to cover the debt service on the lease-based debt. These payments will be a charge on the province’s consolidated fund, are statutory appropriations that are not required to be voted on annually by the Legislative Assembly of the province, and must be paid from the date that the highway is fully open to traffic for the full term of the lease-based debt.”

5.45 So, the only debt that the Province would have avoided in their credit rating evaluation would have been the toll-based debt of \$174.5 million. That is because it will not be repaid through provincial tax revenues, but rather by highway user tolls. The Province was aware of the RBC Dominion Securities Inc. opinion on the likely treatment of the lease-based debt, and chose to adopt the public-private partnership structure anyway. Therefore, we do not feel that the possible effect on the provincial credit rating of additional debt should have been a significant factor in the adoption of this objective.

5.46 The other argument made for adopting this objective would be that balanced budget legislation would not be met if highway design and construction costs were treated as capital expenditures over a four year

construction period. This issue was also covered in the RBC Dominion Securities Inc. report to the Province of New Brunswick dated 25 June 1997. The report states, *“To achieve the Province’s fiscal objectives, it is important that the financing approach achieves operating lease treatment and does not result in consolidation of the project financing onto the accounts of the Province.”*

5.47 On 19 December 1997, the Minister of Finance made the following comments in the Legislative Assembly:

“We could probably build it if we decided we would not touch one single kilometre or mile of road anywhere else in the province. Over the next four years, if we dedicated every single penny of capital construction to this project, we probably could do something. However, if we followed the normal fiscal framework, if we took into account the fact that we have balanced budget legislation that we have to respect, it would take us between 15 to 20 years to accomplish this. All we are saying to you is that it is not uncommon for a jurisdiction to move into this area of partnering with the private sector to accomplish projects that would otherwise take a lot longer for us to do. ... Why are we doing the project? Why is it a better deal? It is a better deal because we would not have the project if we didn’t do it with the aid of the private sector partnering. We simply cannot afford to do it in the normal circumstances because of our financial situation.”

5.48 Also on 17 December 1997 in the Legislative Assembly the Minister of Transportation made the following statement. *“The decision was made by Cabinet that we would have a toll highway.....But the fact of the matter was with no toll highway, we would not have a highway...”*

5.49 In our opinion, these comments do not refer to a lack of available borrowing room for the Province. They would have needed only to borrow and service an additional \$174.5 million in toll-based debt. Rather it refers to the need, alluded to by RBC Dominion Securities Inc., to have at least 11 % of total funding for the project come from outside of government. This minimum level of toll revenue was necessary to ensure the project would qualify for operating lease treatment under current accounting rules.

5.50 In our opinion, the provincial balanced budget legislation led to decision-makers adopting the objective *“to avoid an increase in provincial debt.”* However, we saw no evidence that consideration was given to making a one-time exception and ignoring the balanced budget legislation for the Fredericton-Moncton Highway project. Since the balanced budget legislation does not impose any penalties on the Province when it is not met, we feel that such an option should have been considered. Not setting this objective for the project would have freed the Province up to issue debt for the project directly. The

implications of direct provincial debt issuance will be discussed later in this chapter.

To achieve a reasonable cost of funds

5.51 This objective is related to the value-for-money objective, but recognized that the borrowing cost for this project would be somewhat higher because debt would be issued by a third party rather than the Province. This higher borrowing cost was effectively payment for transfer of certain repayment risks to the private sector.

5.52 RBC Dominion Securities Inc. reflected this in comments in their 1997 report.

“... We estimated a cost of funds of 30 basis points above the Province’s 30 years bullet bond rate for the lease-based debt and a cost of funds of 100 to 125 basis points over Canada bonds of similar duration for the toll-based portion. On a blended basis, the cost of funds then represents a 36 to 38.5 basis point premium to the Province’s 30 year bullet bond rate.”

5.53 This objective is closely linked to the previous objective “to avoid an increase in provincial debt.” In order to meet that objective, it was necessary to have debt issued by a third party. The debt could have been issued at the provincial borrowing rate had the Province chosen to guarantee its repayment. However, this would have precluded meeting the first financial objective because the full amount of the sub-lease commitment would have had to be recorded as debt. Conversely, had the Province guaranteed repayment of the debt, or had debt been issued directly by the Province, a “cost of funds” objective would not have been needed.

Other government project objectives as documented in the request for proposals

Project Objective 1, “To ensure the safety of the travelling public.”

5.54 The provincial white paper “*Highways for the Next Century*” that was released on 28 September 1993 identified safety as a major concern with the existing highway between Fredericton and Moncton. It was felt that by expanding the Trans-Canada Highway to four lanes, it would be safer for travellers. We did not attempt to identify alternative highway structures or determine if statistical evidence supported the improved safety claims surrounding the four-lane option. As we have already stated, we feel that the basic goal of the project was to improve public safety. There is no reasonable alternative to this objective.

Project Objective 2, “To ensure that the Highway is developed, designed, constructed, operated, managed, maintained and rehabilitated in a manner that meets or exceeds current Provincial standards.”

5.55 The reference to provincial “standards” refers to the New Brunswick Department of Transportation (DOT) standards. An evaluation of DOT’s standards was beyond the scope of our work, so we

are assuming that they are appropriate in the circumstances. Therefore, we feel that there is no reasonable alternative to this objective.

Project Objective 3, “To ensure that the Highway is developed, designed, constructed, operated, managed, maintained and rehabilitated in an environmentally responsible manner.”

5.56 “Environmentally responsible manner” is defined for purposes of this objective as complying with provincial environmental laws and regulations. As with the DOT standards, it is beyond the scope of our work to evaluate provincial environmental standards. Therefore, we are assuming that they are appropriate in the circumstances and that there is no reasonable alternative to this objective.

Project Objective 4, “To share the risks of the Project between the private and public sectors.”

5.57 This objective was developed once it was decided to consider adopting a public-private partnership model for this project. Since all highway projects completed in the Province involve the sharing of risk to some degree with the private sector, the objective appears reasonable as written. However, it appears that the intent is more in line with one of the financial objectives provided to RBC Dominion Securities Inc. by the Province in their engagement to analyze the feasibility of applying a public-private partnership approach to the Fredericton to Moncton Highway project. That objective was “to achieve an optimal degree of risk transfer.” Therefore, it appears that the definition of Project Objective 4 exceeds traditional DOT practice. The RFP summary of various risk components of the project and who will bear them confirms this interpretation.

5.58 Much of the risk sharing analysis that was completed was performed by RBC Dominion Securities Inc. pursuant to the assignment discussed above. However, we found no indication that cost benefit analyses were performed by RBC Dominion Securities Inc. or the Province covering the transfer of additional risks to the private sector. Additionally, we saw no evidence that other risk transfer options were considered. We were told that departmental representatives and outside consultants held extensive discussions relating to risk transfer and felt the objective selected was most appropriate in the circumstances. However, this decision was not supported by documented analyses.

5.59 We did some quantitative analysis on financing risks transferred that is discussed later in this chapter.

Project Objective 5, “To obtain optimal value for money for New Brunswick Highway Corporation (NBHC).”

5.60 CCAF/FCVI defines value for money as “the term that summarizes three separate but interrelated values: economy, efficiency, and effectiveness...” For this project, departmental representatives told

us that it was initially defined as “lowest cost, best quality with consideration of risk.” It was subsequently changed to make it more specific, but not until after the RFP was finalized. We feel that the Province should always strive to achieve optimal value for money in every project it undertakes. In our opinion there does not appear to be a reasonable alternative to this objective.

Project Objective 6, “To minimize the financial contribution of NBHC to the Project.”

5.61 Our understanding is that this objective means to minimize gross provincial payments to the Project Co. through NBHC. The objective does not factor in the cost of tolls to provincial taxpayers. Additionally, it does not consider the netting effect of concession fees (i.e. excess toll revenues) to be paid to NBHC by Project Co. This second omission is discussed later in this chapter.

5.62 A reasonable alternative to this objective would have been “to minimize the financial contribution of New Brunswick taxpayers to the Project.” As the provincial government represents the taxpayers of the Province, we would have expected this option to have been considered. However, we found no evidence that this or any other alternative was considered. Additionally, we saw no quantitative or qualitative analyses supporting the objective that was selected, and no evidence that Executive Council was made aware of the effect their selection of this objective would have on other decision-making for the project.

Departmental comments

5.63 *The RFP was issued on the premise that, if the Project proceeded, it would be a toll highway. In that context minimizing the financial contribution of NBHC minimizes the cost to taxpayers. To the extent that budgetary expenditures are lowered, the taxpayers benefit....*

5.64 *It was estimated that use of the highway will provide savings approximately equal to the cost of the tolls for commercial vehicles. For non-commercial users, since there is an alternate route, motorists choosing to use the four-lane highway will do so because they consider the benefits to equal or outweigh the cost of the toll.*

5.65 *It should also be recognized that to the extent that a number of users of the highway will be from out of province, this would transfer cost and risk from New Brunswickers.*

Project Objective 7, “To open the entire Highway for safe operation by November 30, 2001 and to fully complete the Highway by June 30, 2002.”

5.66 It has been publicly stated that the rapid construction was due to the Province’s concern for public safety on the route. Therefore, the decision to set an objective to have the highway completed within four years appears to have been due to the requirement to build the highway

as quickly as possible. According to DOT engineers, four years was the minimum time in which the route could be completed, given the complexity of certain aspects of the highway construction (i.e. bridge construction). Obviously there are many other alternatives for the timing of completion of this highway up to and including the fifteen years identified as being the time to complete the highway under traditional practices. The option of building the highway in sections according to relative safety risk could also have been considered. However, we were unable to determine if other options for completion date were considered or what effect they might have had on the cost of the project. We did not see any cost/benefit analyses comparing alternative completion dates that would have been used as input to this decision.

Project Objective 8, “To defer payments by NBHC for the Project (other than on account of highway operations and maintenance) until after the opening of the completed Highway.”

5.67 This objective was intended to defer the start of operating sub-lease payments by NBHC to Project Co. until a point after the full traffic availability date for the highway. Provincial representatives felt that it would be prudent business practice to defer payments on the highway until after the completion of construction. Additionally, they noted that at the time this objective was being set, it was felt that four years out the provincial surpluses would be in the range of \$60 to \$75 million. Those surpluses would cover the costs of the highway when sub-lease payments began in 2003. We were not provided with documentation to support this opinion. Additionally, we saw no evidence that other alternatives were considered for a start date on sub-lease payments. We did note that the gross interest cost between the issue date for the lease-based debt of 19 February 1998 and the commencement of repayments was approximately \$214 million on the original \$540 million debt. We feel that cost benefit analyses of various commencement dates should have been completed and provided to decision-makers.

Project Objective 9, “To maximize the economic and industrial benefits to the citizens and industries of New Brunswick.”

5.68 This objective deals with the economic development benefits to the Province from the Fredericton-Moncton Highway project. This objective would have had cost consequences for the project, since it would somewhat limit the use of suppliers, sub-contractors, etc. by restricting their ability to find the lowest cost providers. However, to the best of our knowledge, analyses of these cost consequences were not prepared and no other options were considered. It may well be that the “price” of this economic development opportunity was quite low for the Province, but we would have expected it to be analyzed before this objective was decided upon.

Departmental comments

5.69 *The Government wished to ensure that New Brunswick benefited from the construction of this project. Compliant proposals were evaluated on the basis of lowest overall net cost for the Project. Economic and Industrial Benefits were to be used only in the event of a “tie”. Therefore, while it required proponents to make a commitment to this objective and to their plan for Economic and Industrial Benefits we believe there was little if any additional cost to the Province resulting from the adoption of this objective.*

Project Objective 10, “To provide a high level of service to the Highway users at a low cost.”

5.70 This objective established that the highway would be tolled. It related project objective two *“To ensure that the Highway is developed, designed, constructed, operated, managed, maintained and rehabilitated in a manner that meets or exceeds current Provincial standards”* to a user pay system of tolls. The tolling option was first raised in the 1993 provincial White Paper.

5.71 The effects of charging user tolls on the highway were analyzed for the reference of decision-makers. Specifically, it was determined that toll revenue at the levels proposed would lead to operating lease treatment for the project on the provincial books. This would allow the achievement of one of the financial objectives previously discussed, namely, *“to avoid an increase in provincial debt.”* Additionally, a toll highway would contribute to the achievement of project objective 6 as interpreted by the Government, *“to minimize the financial contribution of NBHC to the Project.”* Departmental representatives also indicated that it was felt that a system that required users to make a contribution was desirable in that it would somewhat reduce the burden on New Brunswick taxpayers in other parts of the Province who would not be using the highway. We did not see analyses documenting the net benefits of a tolling system (i.e. gross toll revenues less related costs).

5.72 A reasonable alternative to this objective would have been to have no tolls on the highway. This would have required either increased federal funding or an increase in planned provincial sub-lease payments. We saw evidence that additional federal funding was pursued and that tolling was seen as an option if federal funding was not available. The Province was unable to obtain additional federal funding during the period in which decisions were being made about the Fredericton-Moncton Highway. However, we saw no evidence that the option of larger sub-lease payments was considered. Actual provincial sub-lease payments are expected to be in the order of \$58 million per annum with the tolling system now in place. Projected sub-lease payments without tolling would have been approximately \$71 million per annum.

Departmental comments

5.73 *The decision to toll falls out of the government financial objectives not out of this objective. This objective was achieved by*

establishing standards for the Developer and the Operator and through the use of the Toll Protocol to ensure reasonable toll rates.

Recommendations
Government objectives for the project

5.74 Because of the importance of selecting appropriate project objectives, we would like to make the following recommendations to apply to the selection of objectives for future public-private partnerships and government decision-making in general.

- For each type of objective under consideration, alternatives should be identified, where applicable.
- Each alternative should be analyzed for its effect on the cost of the project, its effect on the structure of the project, and its effect in helping achieve the planned outcome of the project. These analyses should be clearly documented for reference by decision-makers.
- Consideration of the alternatives by decision-makers should include reference to analyses and the rationale for decisions taken should be documented.
- The Province should ensure for accountability purposes that the list of project objectives is complete, clearly documented and that objectives are clearly understood by all parties involved in the project.

Departmental response

5.75 *It is our position that the issues you have raised were addressed through consultation with the appropriate experts and discussion with senior management and the Government. We are confident that alternatives, issues and risks were properly considered in reaching all decisions.*

Project Structure

5.76 RBC Dominion Securities Inc. proposed and analyzed three structural alternatives for the project. They were:

- New Brunswick Highway Corporation issues stand alone revenue bonds;
- arm's length entity owns, finances against tolls and provincial lease; and
- private sector owns, finances against tolls.

5.77 An interim report was issued by RBC Dominion Securities Inc. on 28 October 1996. In it they recommended the second option and documented a model for how the arrangement should be structured. Their report stated:

“Given the Province’s three financial objectives for the highway project a business and financial model was developed utilizing an arm’s length not-for-profit corporation funded through debt raised by the successful RFP proponent and through debt raised by this Project Company against a

long-term operating lease commitment of the New Brunswick Highway Corporation.”

5.78 It went on to say:

“In summary, our analysis of the Fredericton to Moncton Highway project indicated that a public private partnership approach could be used to achieve:

- i) construction cost savings estimated by ADI Ltd. of \$60 million;*
- ii) time savings estimated by the Department of Finance of 14 years;*
- iii) meaningful risk transfer to the private sector in both the construction and operating phases of the project;*
- iv) no direct increase in provincial debt; and*
- v) a cost of funds 36 to 38.5 basis points greater than the Province’s rate for long-term government bonds.”*

5.79 Based on our understanding of the government’s financial objectives for the project, a public-private partnership that involved leasing appears to have been the only structure under which the project could have proceeded. The objectives as set precluded alternatives such as:

- public-private partnership for all aspects of the project except financing;
- public-private partnership without tolls;
- straight contracts for design, construction, and operation; and
- straight contracts for design, construction, operation, and tolling.

5.80 Under terms in the final agreement, the Province has the option of buying back the highway at the end of the lease term at fair market value instead of for a nominal amount. What makes that option unusual is that the lease-based and toll-based debt will be paid off by the end of the lease term. The requirement to have the final agreement structured this way was clearly specified in the recommendations contained in the RBC Dominion Securities Inc. report. The only apparent reason for this requirement relates to accounting rules for operating leases. An arrangement does not qualify for operating lease treatment for accounting purposes if there is any sort of “bargain purchase option” available at the end of a lease term. As has already been discussed, this arrangement had to qualify as an operating lease or the project would not have proceeded.

Request for Qualifications

5.81 A Request for Qualifications (RFQ) was issued on 18 December 1996 to identify parties qualified to be the private sector partner for the project. At the time of the announcement of the RFQ, the Ministers of Transportation and Finance indicated that a public-private partnership

approach had been selected. The project structure described in the RFQ (and later in the RFP) mirrored the model laid out in the RBC Dominion Securities Inc. report.

5.82 Five submissions were received in reply to the RFQ. Once the submissions were received, there was a clearly laid out process, with groups being assigned specific duties.

5.83 As noted in Appendix I, the process consultant involved in the design and implementation of the RFQ and RFP processes was KPMG. In a letter dated 4 May 1998, KPMG provided the following opinion to the Department of Transportation.

“Based on our review and our involvement in the matters discussed in this letter we are of the opinion that the evaluation process leading to the selection of the preferred proponent was:

- designed to be fair and equitable in its treatment of proponents and their proposals,*
- conducted in accordance with a pre-established process,*
- carried out using pre-established criteria, which were consistently applied.*

And that as a result, the evaluation and selection process was undertaken in a diligent, fair and equitable manner.”

5.84 We were told that the Province was strongly advised by its hired consultants to select three proponents to advance to the RFP stage. It was felt that because of the cost to bidders of preparing an RFP submission, the Province would get more competitive bids if the field was limited. The Minister of Transportation announced the three finalists in the Legislative Assembly in February 1997 and the three short-listed proponents were sent a copy of the Request for Proposals on 27 March 1997. The remainder of this chapter deals with the decisions made translating project objectives into terms in the Request for Proposals.

Request for Proposals

5.85 Once the government’s project objectives were finalized, it was necessary to translate them into detailed specifications for the project as shown in the RFP. Contents of the RFP were prepared by staff of various government departments, along with representatives of various private consultants hired to provide input to the project.

5.86 For purposes of our review of the decision-making process for the RFP, we looked at several key areas. These areas included risk sharing, design-build, operations and maintenance, tolling, financing, and final authorization of the RFP contents. These key areas covered certain of the project objectives as previously discussed. We wanted to

examine in more detail how these objectives were rolled out into the RFP and how that decision-making process worked.

Risk transfer

5.87 According to the Province's recently-released guidelines for public-private partnerships, *"The essence of a public-private partnership arrangement is the sharing of risks. Central to any successful public-private partnership initiative is the identification of risk associated with each component of the project and the allocation of that risk factor to either the public sector, the private sector or perhaps a sharing by both. Thus, the desired balance to ensure best value (for money) is based on an allocation of risk factors to the participants who are best able to manage those risks and thus minimize costs while improving performance....The transfer of risk for various elements has a value that must be quantified where possible."*

5.88 The provincial project objective regarding risk transfer was *"to share the risks of the Project between the private and public sectors."* The Province clearly specified the risks to be transferred to the private sector, and those to be retained by the Province, in a table near the front of the RFP document. That table divided project risks into four categories:

- development, design and construction risks;
- demand risks (related to tolling);
- operation and maintenance risks; and
- financing risks (related to debt issuance).

5.89 From our review of the risk transfer table with departmental staff, we feel that the RFP does provide for the transfer of significant additional risks to the private sector over the traditional DOT approach. However, we were not provided with analyses supporting the decision to transfer those risks on cost benefit or other bases, and we were unable to develop any substantive evidence supporting risk transfer decisions on our own. We had to rely on anecdotal evidence from the departments. Departmental representatives stated that they wanted risk to be assigned to the party best able to bear it, thereby lowering the overall cost of the project. They also indicated that all risk-transfer decisions were subject to intensive discussion between themselves and hired consultants prior to being made.

5.90 We were also unable to compute the ultimate cost of risks transferred or establish whether the cost was reasonable, except for the financing area. Results of that analysis are presented later in this chapter. Risk transfer as it relates to specific areas of the RFP is covered further in the sections that follow.

Development, design and construction risks

5.91 For this project the Province decided to transfer more risk to the private sector in this area than the traditional DOT practice. Normally design work, operations, and maintenance on highways in the Province

are done separately, mainly by DOT staff. However, in the case of the Fredericton-Moncton Highway, the Province wanted to transfer risk by including all phases of highway work in the RFP. Aside from preliminary surveying work and preliminary soil tests, the RFP made bidders responsible for everything including final detailed surveys, soil tests, and all design work. There were also a few risks transferred in construction, most notably “weather risk” which was to be borne by the successful bidder, but is normally the responsibility of the Province. It was not possible to determine how much it ultimately cost the Province to achieve this degree of risk transfer as it was built into the MRDC bids for design-build and operations and maintenance. However, we feel that the decision to reduce risk by combining the design-build and maintenance components of the project into one agreement provides some protection for the Province against unforeseen future maintenance expenditures.

Operation and maintenance risks

5.92 We were told that the rationale for including operations and maintenance on the highway along with the design-build component was to reduce the risk to the Province of design or construction deficiencies. Design or construction deficiencies subsequently discovered would be the responsibility of the successful bidder under the operations and maintenance part of the agreement. That is because the exact amount to be paid by the Province, and the level of service to be provided, would have already been established.

5.93 Operations and maintenance agreements as proposed in the RFP were divided into two sections, highway operations and maintenance, and tolling operations and maintenance.

5.94 The RFP required a twenty-year time commitment from bidders to highway operations and maintenance. There were no analyses prepared supporting this position. However, departmental representatives indicated that the decision was subject to extensive discussion prior to being taken.

5.95 Our concern is that there are no hand-back standards in the RFP for the end of year 20, even though the initial maintenance agreement ends at that point. Hand-back standards were only set for the end of year 30 or in the event of a default by the successful bidder under the RFP. The successful bidder will continue to maintain the highway during years 21 to 30, but the cost schedule will have to be negotiated between the successful bidder and the Province at that time. Therefore, we feel that despite the standards that are to be met on a year-by-year basis as documented in the RFP, some risk remains that some maintenance activities will be postponed by the successful bidder until after the initial 20-year period has passed. Whether this will have a significant dollar cost to the Province during the period from year 21 to year 30 is not possible to estimate at this point. The Province expects that much of the major maintenance work required during the first 30 years will have

been covered by the end of year 20 (e.g. replacement of bridge decks). However, if the intention of the RFP was to ensure that the Province got what it paid for (ie. a four-lane highway with a thirty year life) we feel that a thirty year highway maintenance agreement would have been more appropriate.

Recommendation

5.96 We recommend that where future public-private partnerships “bundle” construction and ongoing maintenance activities for bidding purposes, either:

- **a fee schedule for maintenance activities should be set at the beginning of the agreement to cover the term of the agreement; or**
- **hand-back standards should be included in the agreement for the date at which the initial maintenance agreement ends.**

Departmental response

5.97 *The optimal length of the initial fixed cost period for highway operations and maintenance was set at 20 years after lengthy discussions with the consultants. The difficulty of projecting maintenance costs so far into the future was recognized. Project staff and consultants agreed that a 20 year period was realistically the maximum time period that should be considered. It was agreed that a substantial premium would be paid for committing a developer to a longer term. Automatically setting the term of the fee schedule to match the term of the agreement could result in an arrangement that is not cost-effective.*

5.98 *While recognizing that there is risk in trying to look forward 20 or 30 years, the contract as you note does contain standards regarding ongoing maintenance and rehabilitation which protect the Province.*

5.99 The RFP also required a ten-year commitment from bidders for tolling operations and maintenance. The rates specified in the agreement covered that ten-year period. The rates for subsequent five year periods have to be renegotiated and the Province has the option of seeking an alternate operator of the tolling system after the first ten years of the agreement. The shorter time frame for tolling operations and maintenance was due to recognition of likely technology changes in future that would reduce costs. Since the Province assumed that costs of tolling would actually drop over time, they did not want to “lock in” tolling operations and maintenance payments over a longer term. Again there were no analyses supporting this decision. However, the verbal explanations we were given were reasonable.

Demand risks

5.100 The demand risks covered in this section refer to the risk that tolling revenues collected will not be as high as projected, thereby impacting on the availability of that stream of revenue for toll-based debt servicing and concession fees. This risk can be broken down into two components, the risk that there will be problems in collecting monies

due, and the risk that traffic volumes will be lower than expected. We do not expect collection risk to be significant. However, we have some concerns regarding the conclusions drawn about traffic volume risk.

5.101 The planning estimate of likely toll revenue over the first 30 years of highway operation was \$650 million. This revenue stream was to be used first as a source of funds with which to service the toll-based debt, and second as a pool of “excess toll revenues” to be paid to the Province as concession fees. Toll-based debt servicing was projected as totalling \$329 million over that period. “Excess toll revenues” were estimated to be approximately \$321 million.

5.102 A traffic study of the Fredericton-Moncton corridor by Wilbur Smith and Associates estimated that about 58% of toll revenues (i.e. about \$377 million) will come from commercial traffic. The other 42% will come from non-commercial traffic. Since commercial traffic is obliged to use the toll highway, it is practical to assume that commercial toll revenue is guaranteed. Based upon these estimates, even if there was no non-commercial traffic, toll-based debt could be serviced. The effect of short term fluctuations in toll revenue would be mitigated by the tolling reserve fund which will be sufficient to cover one year of toll-based debt servicing and must be fully funded before excess toll revenues are paid to the Province. Even with the effects of a serious recession, we feel that a minimal level of non-commercial traffic would ensure sufficient revenues to cover toll-based debt servicing. Therefore, in our opinion, the possibility of toll revenues not being sufficient to cover toll-based debt servicing is remote. Consequently, we feel that little demand risk has been assigned to the toll-based lenders.

5.103 On the other hand, the Province loses \$1 for every \$1 drop in toll revenue from \$650 million down to the \$329 million required to service the toll-based debt.

5.104 This opinion contradicts what is documented in the RFP risk transfer schedule. It appears that the Province believed it was transferring significant demand risks to the toll-based lenders and had paid a risk premium on interest rates to cover that risk transfer. In fact toll-based lenders may well have built a very low risk premium into their interest rates relating to demand risk, although we have no way of confirming if that was the case. There is also no way to determine what effect a more equitable sharing of demand risks for the Fredericton-Moncton project would have had on the interest rates on the toll-based debt.

Recommendation

5.105 We recommend that care be taken in the RFP to accurately identify risks being transferred between the Province and their private sector partner pursuant to the terms of the RFP.

Departmental response

5.106 *Presenting the toll-based debt service and the estimated excess revenues in nominal dollars is misleading. These amounts are very different as the larger excess toll revenue amounts are in the later years. A net present value calculation for each would be more appropriate.*

5.107 *The comment that: "...it is practical to assume that commercial toll revenue is guaranteed." is incorrect. Although trucks are required to use the highway, the amount of toll revenue anticipated to be generated from trucks is only an estimate. The toll-based lenders are the only lenders who are bearing the demand risk. The only source of funds for the payment of interest and principal on their investment is the toll revenue. If there are not sufficient funds to pay those amounts, they will lose their interest income as well as their initial investment. Toll revenue in excess of that required to service the toll-based debt accrues to the Province since it is providing the right of way upon which the highway is being built.*

5.108 *Demand risk was transferred to the toll-based lenders as indicated in the RFP. The market is efficient and prices such risk. Had the market perceived that there was little risk transfer, the interest rate on the toll-based debt would have been lower.*

5.109 *The comments on demand risk also ignore the risk associated with any development of alternative transportation routes or methods.*

Financing risks

5.110 *The terms documented in the RFP transfer some financing risk away from the Province. They require all debt funding for the project to be issued by a third party. They also specifically identify how the repayment of that debt is to be funded and when and under what circumstances repayments are to commence.*

5.111 *The lease-based debt was to be issued by the Project Company. The Department of Finance was to provide assistance in identifying parties willing to invest in the lease-based debt. It will be repaid commencing in November 2003 through sub-lease payments received from the Province. Provincial payments are subject to statutory appropriation, meaning that they do not have to be voted on by the Legislative Assembly each year. This constitutes, in effect, a guarantee to lease-based bondholders that the Province will make sub-lease payments regularly once the highway is completed. The Minister of Finance made the following statement in the Legislative Assembly on 19 December 1997 when referring to the lease-based debt. "... By doing it through statutory appropriation, we bring the risk down in the minds of the bankers and the bondholders. If it is done through statutory appropriation as opposed to yearly budgeting, there is a lower cost."*

5.112 *The interest rate on the lease-based debt ultimately turned out to be 33 basis points above the provincial rate because it was issued by Project Company. The cost of this decision therefore turned out to be*

\$25 million in 1998 dollars, meaning that where Project Company was able to borrow \$540 million, the Province would have been able to borrow \$565 million with the same repayment schedule.

Departmental comments

5.113 *The interest rate on the lease-based debt issued by the Project Company was higher than the Provincial borrowing cost for a number of reasons: the lenders accepted completion risk, the issue contained an amortizing feature, the issue was relatively large, etc. It is therefore inappropriate to compare the issue to a typical Provincial debenture issue.*

5.114 The Province received two benefits from the decision to have lease-based debt issued by Project Company. First, they were able to transfer the risk of non-completion of construction of the highway to the bondholders. In other words, if the highway is not completed, the Province will not have to make scheduled sub-lease payments. Second, having the debt issued by an arm's-length organization (i.e. Project Company) and partially funded by revenue sources from outside the government was necessary to ensure that it would not show up as provincial debt for accounting purposes. There appears to be no ongoing financing risk transfer related to lease-based debt once construction of the highway is completed. However, interest rates will be higher for the duration of the repayment period.

5.115 The toll-based debt was to be placed by the successful bidder on behalf of Project Company. Toll-based debt was broken down into senior and subordinate groupings. The interest rates for senior toll-based debt totalling \$149.5 million ultimately turned out to be 60 (for \$138.0 million) and 100 (for \$11.5 million) basis points above the provincial borrowing rate. The interest rates for the two groupings of subordinate toll-based debt totalling \$25 million will be 286 (for \$15 million) and 486 (for \$10 million) basis points above the provincial borrowing rate when they are issued.

5.116 The Province received three benefits from the decision to have toll-based debt issued by Project Company. First, as for the lease-based debt, they were able to transfer the risk of non-completion of construction of the highway to the bondholders. In other words, regardless of whether the highway is completed or not, the Province will never be liable to make toll-based debt repayments. Second, the bondholders bear a small percentage of the traffic and collection (i.e. demand) risk as previously discussed, because the only source of funds for repayment of toll-based debt is toll revenue. Third, having the debt issued by an arm's-length organization (i.e. Project Company) and funded by revenue sources from outside of the government was necessary to ensure that it would not show up as provincial debt for accounting purposes.

5.117 MRDC arranged the toll-based debt structure. For its part, the Province has tried to make the toll-based debt issues as attractive as possible to potential lenders by managing construction risk through bonding, insurance, and developer selection, by establishing a clear tolling protocol and by pre-funding a debt service reserve fund before taking any concession fees.

5.118 As is now stated in the recently-released provincial guidelines for public-private partnerships, we feel that the optimal allocation of risk between partners in a public-private partnership must be based upon which partner is best suited to manage and/or mitigate each risk. We feel, in general, that the partner best suited to deal with risk will be the one who can deal with it on the lowest cost basis. On that basis, it appears that the Province was best able to deal with the financing risk on this project because it had access to the most favourable financing rates. The Province did receive some benefits from additional costs incurred and it did take all possible steps to lower financing costs. However, as analyses comparing the extra cost of funding with the benefits received were not prepared, we cannot confirm that the decision to have debt issued by a third party was appropriate.

Recommendation

5.119 We recommend that the Province prepare cost benefit analyses prior to making the decision to have project debt issued by third parties for public-private partnerships when financing costs will be higher than provincial rates. Specifically, the cost of higher interest rates should be compared with the benefits accruing from this decision.

Departmental response

5.120 *Consultants were hired to bring a broad based knowledge of the alternatives and the associated risks. The fact that the financing cost of the lease-based debt was higher than the Province's borrowing cost indicates that risk was transferred and that a cost was placed on that transfer by the market. Capital markets are viewed to be efficient; therefore the risk transfer was properly priced.*

5.121 In our 1998 Report we indicated we would try to determine the rationale and potential consequences of issuing most of the debt required for the project in advance. In fact, the model for the public-private partnership, as presented by RBC Dominion Securities Inc. in their 1996 interim report, actually recommended this approach. "... our financial model envisions borrowing 100% of the requisite debt at the outset of the project, to lock in current rates and to fully transfer financing risk away from the Province. There is a cost to the negative carry on undrawn debt, minimized by short-term investing and any tolls collected as segments of the road are opened."

5.122 The benefit of this decision to the Province was that it would lock in interest rates, thereby eliminating one aspect of financing risk for the project (i.e. the risk that interest rates would go up during the period

when debt was being issued). Representatives of the Department of Finance informed us that this is no different than what the Province does on its own debt issues. This approach appears to be reasonable. It also appears, based on the statement by RBC Dominion Securities Inc., that the cost of this decision would be reasonable and manageable.

Other Issues

Minimum level of toll-based debt

5.123 The RFP required that the successful bidder guarantee the placement of at least 13% (i.e. \$114.01 million) of the total capital cost of the project of \$877 million as toll-based debt. The Province appears to have had three reasons for making this requirement:

- to transfer repayment risk in the event toll revenues would not cover toll-based debt repayment to the bondholders, thereby addressing the project objective of sharing risks between the private and public sectors;
- to ensure that the transaction was treated as an operating lease for accounting purposes, thereby addressing the project objective of not adding debt to the Province's books; and
- to reduce the provincial sub-lease payment to Project Company to as low a level as possible, thereby addressing the project objective of minimizing the financial contribution of NBHC to the project.

5.124 We question the rationale for the decision to allow the successful bidder to issue more than the minimum required level of toll-based debt. Because of the way in which debt servicing payments are made, it appears that it will, in fact, increase net costs to the Province. By allowing additional, higher interest rate toll-based debt to be issued in lieu of the same amount of lower interest rate lease-based debt, the overall total cost of debt servicing is increased. Departmental representatives were unable to describe tangible benefits accruing from this decision.

5.125 Using actual numbers, a total of \$174.5 million in toll-based debt has been or will be issued for this project. That means \$60.49 million more toll-based debt than was required was placed by MRDC. To date \$149.5 million of toll-based debt has been issued, \$35.49 million over the 13% minimum. Based on the difference between the lease-based interest rate of 6.47% and the toll-based rates of 6.74% and 7.14%, the extra cost of financing has a net present value of \$2.2 million in 1998 dollars. This extra cost figure will be substantially increased when the additional \$25 million in toll-based debt is issued before the end of the construction phase of the project. That toll-based debt will bear interest rates of 9% and 11% and will be held by the successful bidder, MRDC.

5.126 Since the extra toll-based debt servicing cost comes directly from toll based revenues, it has the effect of reducing the excess toll revenues (i.e. provincial revenue) that would otherwise be paid to the

Province. This reduction in excess toll revenues will exceed the reduction in provincial sub-lease payments. Therefore, the net effect to the Province of this decision is negative. We feel that this effect would have been noted had a cost benefit analysis been prepared. However, such an analysis was not completed prior to the issuance of the RFP.

Recommendation

5.127 We recommend that cost-benefit analyses be prepared prior to finalizing RFP terms where they would provide significant decision-making information.

Departmental response

5.128 *The bidding structure allowed for as much toll-based debt as possible from an estimated stream of revenue. It was not known at the time of release of the RFP that Government would receive the excess toll revenue as bidders were given the opportunity to suggest a sharing arrangement for any excess toll revenue. None of the bidders proposed a sharing mechanism so any excess accrues to the Province.*

5.129 *Anticipated total toll revenue was based on estimates only and therefore there is no guarantee that the Province will receive any funds. However, the amount of lease-based debt is known and the annual sub-lease payment is fixed. Therefore, the risk and the cost to the Province are reduced by a lower amount of lease-based debt.*

Toll rates

5.130 Decisions relating to toll rates were intended to address the project objective of providing a high level of service to highway users at a low cost. They also addressed the objective of minimizing the provincial contribution to the project. Decision-making with regard to toll rates appears to have adequately addressed applicable provincial project objectives.

5.131 In September 1996 ADI Limited was contracted to conduct a traffic study of the Longs Creek to Moncton corridor in conjunction with Wilbur Smith and Associates of New Haven, Connecticut. As part of their work, they suggested maximum toll rates for the Fredericton-Moncton Highway. A departmental representative told us that these rates were believed to be too high by the Premier and Minister of Transportation. Therefore the rates approved for inclusion in the toll protocol in the RFP were somewhat lower. At the time the RFP was being prepared, toll revenues to be collected over the thirty years of the sub-lease agreement were estimated to be \$650 million.

5.132 As part of the decision-making process for toll rates, an analysis was prepared comparing proposed Fredericton-Moncton toll rates with those in other jurisdictions in North America. Proposed rates for the Fredericton-Moncton Highway equated to 3.5 cents per kilometre. This rate was comparable with other surveyed highways such as the Maine (3 cents per kilometre) and New Hampshire (6 cents per kilometre) turnpikes and the Coquihalla highway in British Columbia (5.1 cents per

kilometre). Based on this analysis, proposed Fredericton-Moncton Highway toll rates appear to be reasonable.

5.133 RFP terms made the Project Company responsible for initiating toll rate increases. The RFP limited toll rate increases to 90% of the increase in the Consumer Price Index (CPI), and only allowed toll rate increases to be made after the highway was completed. The RFP also stated, *“The Project Company may choose to implement toll rates which are below those permitted under the Toll Rate Protocol, provided that such decisions achieve an objective of maximizing gross toll revenues net of collection costs.”* So, once toll rate increases are permissible, Project Company must raise toll rates annually by 90% of the increase in the CPI unless they can prove that a lower or no increase will improve net toll revenues. Without such a term, Project Company would have had no reason to raise toll rates. Because toll-based debt repayment amounts are fixed over the life of that debt, we feel that 100 percent of the benefit of toll rate increases accrues to the Province.

Departmental comments

5.134 *The Project Company might default on the toll-based debt or the toll-based debt might not have been raised. The rate increases do not necessarily 100% benefit the Province. The increases in toll rates might or might not compensate in bad years for lower than anticipated volumes. Relating toll fee increases to changes in the NBCPI was part of the toll protocol considered by the lenders in pricing and sizing the toll-based debt.*

5.135 The Province cannot raise toll rates itself. However RFP terms require the maximization of toll revenues by Project Co., thereby covering fixed toll-based debt servicing requirements and maximizing concession fees to be paid to the Province. This RFP term therefore addresses the provincial project objective of minimizing the financial contribution of the Province to the project by maximizing the concession fee they will receive from Project Co. It also protects the interests of the toll-based lenders and would likely have had an impact on the interest rates they offered.

Concession fee

5.136 The RFP does not define the terms “concession fee” or “excess toll revenue.” However, they are referred to in Section 4.4.3, *“Use of Toll and Ancillary Revenue.”*

“Gross toll revenue and ancillary revenue will be available to service Toll Based Debt. Any toll and ancillary revenue not required to service the Toll Based Debt will be for the account of the Project Company. Such revenue net of payments made pursuant to any incentive arrangement will be used to reduce subsequent sublease payments by NBHC. ...”

5.137 Departmental representatives explained that the concession fee is intended to be a way of making toll revenue not required for debt servicing available for provincial use. The concession fee was not just

intended to be a fair market value payment for the use of the provincial land corridor upon which the highway is built. It is to pay for all rights conveyed to the Project Company with respect to the project. This becomes apparent when you consider that the total cost of land acquired for the highway by NBHC was in the range of \$12.1 million, while the estimated concession fee over 30 years is \$321 million.

5.138 During the construction period, excess toll revenues will be used to build up a reserve fund on behalf of toll-based lenders. The reserve fund is to be enough for two years' toll-based debt servicing during the construction period and one year's toll-based debt servicing when the highway has been completed.

Authorization of Project Decisions

5.139 In completing our review of decision-making for this project up to the Request for Proposals stage, we wanted to ensure that key decisions had been properly authorized. We feel that the recommendation to proceed to the RFP stage with a public-private partnership arrangement and the recommended contents of the RFP should have been prepared for submission to an authorizing body (Board of Management/Policy and Priorities Committee/Executive Council) in accordance with the *"Procedures Manual for Executive Council Documents."* Authorizing bodies should then have properly approved these recommendations.

5.140 In our review, we noted that the Board of Management and the Policy and Priorities Committee approved a recommendation from the Committee of Deputy Ministers to advance to the RFP phase with a short list of three potential private sector partners. However, only certain of the tolling requirements, as documented in the RFP, were approved by the Board of Management. Specifically, they approved the tolling protocol and certain other items pursuant to their approval of "Financial Parameters for the Fredericton to Moncton Project - Finance" on 27 February 1997. Otherwise, the contents of the RFP were not approved by the Board of Management or Executive Council. Those bodies relied on departmental staff and hired consultants to ensure the RFP contents were appropriate. We feel that Executive Council approval of the contents of the RFP prior to issuance would have been desirable in order to ensure that government objectives for this important project were properly reflected in the terms to be met by the bidders.

Departmental comments

5.141 *A number of presentations were made to Cabinet to keep them informed and to obtain approval at key points in the process. The material in the RFP is complex and involved several binders. The government depended on the experience of its staff and the experts it engaged for this complex project.*

New Government Guidelines

5.142 We were pleased to note that the Province released a document on 28 January 1999 entitled *"Public-private Partnerships (Guidelines*

and Protocols).” Under the “guiding principles” section of that document, the following comments were made:

“As with any proposal, the first step is a full evaluation to determine whether it is a government priority. A public-private partnership may be pursued only after alternative methods of delivering the project have undergone careful evaluation, it has emerged as the best alternative, and where it offers the best solution demonstrated through a sound business case.....

All public-private partnerships will be based on the following guiding principles:

- 1. Project definition: the project is of sufficient size and/or complexity to provide opportunity for the private sector to demonstrate its initiative, innovation and expertise in providing best value to New Brunswick.*
- 2. Competitive private sector market: sufficient qualified private sector proponents exist to ensure a competitive process.*
- 3. Shared rewards: the public receives “value for money” from the initiative, while the private sector can reasonably expect to receive a fair return on its investment.*
- 4. Premise of risk transfer: risks are allocated to the partner best suited to assume the risk.*
- 5. Procurement process: must be fair and transparent and will be subject to due diligence.*
- 6. Signed contract: the acceptance of a usually long-term relationship established through signed contractual arrangements.*
- 7. Communications: a proactive, ongoing and transparent communications plan designed to keep people informed is implemented.”*

5.143 We feel that the document will provide a useful benchmark for future public-private partnership initiatives undertaken by the Province.

Conclusion

5.144 In June 1996, the government announced its intention to pursue a four-lane highway project between Fredericton and Moncton. In our opinion, the decision-making process after that date was effective in translating government objectives into specific requirements for the project. However, we are less comfortable with the process that lead up to the June 1996 announcement. Government objectives were set prior to that date which severely limited the ability of departmental staff to adopt flexible approaches in pursuing the project. Setting these objectives was certainly a very important part of the decision-making process for the

project. For that reason we feel that objective-setting by the government should have been subject to the same rigor and analyses that was applied in later decision-making by departmental staff and consultants. We would encourage future decision-makers to adopt a more formal approach to decision-making and to adequately document the rationale for their decisions.

Appendix I

Fredericton-Moncton Highway Project Chronology

The provincial white paper "*Highways for the Next Century*" was released on 28 September 1993. It formally introduced the idea that the government of New Brunswick would be considering partnership arrangements with private sector interests to build and finance certain portions of planned highways. It also indicated that the government would actively pursue the implementation of tolls on portions of new highways so that traffic which benefits from the new transportation links would share in the cost of the project.

The final report of the Select Committee on New Brunswick's Highway Policy (All party committee) was presented on 8 April 1994. The Committee recommended that appropriate funding mechanisms to allow the completion of the national highway system be determined and agreed upon in the near future. They also recommended that the Province obtain a significant commitment of funds from the federal government.

In June 1994, the report "*Feasibility Study for Toll Highways and Private Sector Involvement for Highway Development in New Brunswick*" was completed for the New Brunswick Department of Transportation and the New Brunswick Department of Finance by ADI Limited, Price Waterhouse, and Transroute Consultants. It was prepared to examine the feasibility of toll highways and private sector involvement in highway development in the Province.

The Act creating the New Brunswick Highway Corporation was signed by the Lieutenant Governor on 29 March 1995. The Act introduced the concept of tolling into legislation. NBHC was intended to be a business enterprise established to design, construct, operate, maintain, toll and own certain highways. We made some comments relating to the intended purpose of NBHC in our 1995 Report.

The routing decision for the Fredericton-Moncton Highway project was announced on 11 June 1996. The Lieutenant Governor in Council approved the Trans-Canada Highway routing presented and studied in the Environmental Impact Assessment with certain provisos.

The official announcement that the project would proceed was made on 14 June 1996. It was announced that the four-lane section between Longs Creek and Moncton would be completed by 2000. It was also announced that RBC Dominion Securities Inc. had been engaged by the Province to do a financial feasibility study of the project. The Province identified federal-provincial funding as the preferred option. In the absence of federal funding, it was indicated that the Province was prepared to look at other options such as a public-private partnership, tolls and/or gasoline and diesel fuel taxes.

On 26 June 1996, the Board of Management and Executive Council approved the engagement of RBC Dominion Securities Inc. to analyze the feasibility of applying a public-private partnership approach to the proposed Fredericton-Moncton Highway project. RBC Dominion Securities Inc. was provided with the following fiscal objectives of the Province, which had to be met by any proposed structure.

They were:

- to avoid an increase in provincial debt;
- to achieve a reasonable cost of funds; and
- to achieve an optimal degree of risk transfer to the private sector.

On 2 July 1996 the Project Office was set up for the Fredericton-Moncton Highway project and various experts from across government were seconded to the project. Until that time, departmental involvement in the project had been limited to that of senior civil servants.

During summer and fall of 1996, four other key specialist consultants were retained including KPMG (public-private partnership process), Delcan (engineering), Goodman Phillips & Vineberg (legal), and Washburn & Gillis (environmental).

In September 1996 ADI Limited was contracted to conduct a traffic study of the Longs Creek to Moncton corridor in conjunction with Wilbur Smith and Associates of New Haven, Connecticut. The Toronto-based IBI Group was also involved.

The interim report on the Fredericton to Moncton Highway project for the Province of New Brunswick was issued by RBC Dominion Securities Inc. on 28 October 1996. It presented three structuring alternatives and indicated RBC Dominion's recommended proposal (a carefully-structured public-private partnership) that has subsequently been implemented.

A Request for Qualifications (RFQ) was issued on 18 December 1996 to identify parties qualified to partner for the project. At the time of the announcement of the RFQ, the Ministers of Transportation and Finance indicated that a public-private partnership approach had been selected. They also indicated that the highway would include user tolls. The revised deadline date for completion of the highway was announced as 2001.

By the deadline date of 23 January 1997, five RFQ submissions had been received. Four evaluation teams of government staff and consultants had been established to evaluate the five responses received to the RFQ. The teams included a development team, a technical team, a financial team, and an operational and maintenance team.

All four evaluation teams signed off on their evaluations of the five proposals on 19 February 1997. The Steering Committee also signed off, approving the advancement of three proponents to the RFP stage on the same date. The Steering Committee was primarily composed of senior officials from the Department of Transportation, but also included representatives of the Department of Finance.

The Committee of Deputy Ministers signed off approving the advancement of three proponents to the RFP stage on 21 February 1997. This committee was established for review purposes and was made up of the Deputy Ministers of Transportation, Finance, Justice and a senior representative from the Premier's Office.

On 25 February 1997, the Board of Management and Policy and Priorities Committee recommended to Executive Council that a shortlist of three proponents advance to the RFP stage in accordance with the process identified in the RFQ document. Included in the shortlist were the Maritime Highway

Corporation, the Maritime Road Development Corporation, and Peter Kiewit Sons Co. Ltd. The Executive Council approved the advancement of the three proponents to the RFP stage on the same date and a public announcement of the shortlist of proponents was made.

On 27 February 1997, the Board of Management and Executive Council approved the following financial parameters for inclusion in the RFP.

- i) A ban on through trucks on the existing Trans Canada Highway. Special permits for trucks with local business.
- ii) Government will make the Province's sub-lease payments a statutory appropriation.
- iii) An initial minimum toll for trucks of \$22 one way.
- iv) An initial toll for cars in the range of \$6.75 to \$7.00.

A final traffic study report was issued by ADI Limited on 21 March 1997. It indicated the most likely toll revenue for the first 30 years of the sub-lease would be in the range of \$650 million.

A Request for Proposals was issued to three short-listed proponents on 27 March 1997. On that same date an Order in Council proclaimed changes to the New Brunswick Highway Corporation Act and stated that the changes would come into force as of 27 March 1997. These changes gave NBHC the ability to contract with a private partner.

Chapter 6

Performance Measurement and Effectiveness Reporting

Contents

Background	103
Scope	104
Results in Brief	104
First Value-for-Money Audits	104
First Government-Wide Study of Annual Reports	105
New Annual Report Policy	106
Value-for-Money Audits After Policy Implemented	107
Performance Indicators	108
Review of Annual Reports for 1997-98	110
The Role of the Annual Report	115

Performance Measurement and Effectiveness Reporting

Background

6.1 This chapter examines the development of performance measurement and effectiveness reporting in the Province of New Brunswick over the last ten years. This year marks the tenth anniversary of our Office's effectiveness reporting mandate and also the tenth anniversary of the Province of New Brunswick's first annual report policy.

6.2 Our Office carried out and reported on its first value-for-money audit in 1989. This expansion of the Office's role into value-for-money auditing was accomplished by adding to the list of reportable items under the Auditor General Act cases where:

- money has been expended without due regard to economy or efficiency;
- procedures have not been established to measure and report on the effectiveness of programs, where, in the opinion of the Auditor General, the procedures could appropriately and reasonably be used; and
- procedures established to measure and report on the effectiveness of programs were not, in the opinion of the Auditor General, satisfactory.

6.3 These amendments to our legislation in December 1988 established the so-called "Three E's" (economy, efficiency, and effectiveness) in legislation. From the outset, our Office realized that reporting under that third "E" of effectiveness would be a challenge, especially given the fact that there was no effectiveness reporting framework in place. Paragraph 5.15 of our 1989 Report raised the issue with the following statement:

At present there is no consensus on the concept of providing information on the effectiveness of programs in some form of public document. It is in this context that we have carried out the audit [of the Facilities Management Branch of the Department of Supply and Services] and provide our recommendations relating to effectiveness information.

6.4 In this chapter we would like to look at some of the highlights of that challenge over the last ten years. And as we provide that retrospective, we also discuss the somewhat simultaneous development of the Province's annual reporting and performance measurement policies.

Scope

6.5 This chapter gives an overview of comments in previous Reports of the Auditor General relating to annual reports of departments and agencies and effectiveness reporting. As well, the chapter addresses various policy and reporting developments by the Province, beginning with the original policies of 1989, the annual report policy AD-1605 from 1991, and the implementation of "Performance Measurement: Supplement to the Main Estimates" in 1996-97.

6.6 Similar to some of our earlier Reports, we have also carried out a review of annual reports to determine if government departments are complying with the annual report policy. In this respect, the scope includes the 1997-98 reports of government departments, the latest ones available at the time of our review.

6.7 We had three objectives in carrying out this special study:

- to provide an overview of our audit efforts and the progress by the Province in the areas of performance measurement and effectiveness reporting over the last ten years;
- to review annual reports of government departments for 1997-98 using our scorecard methodology developed in prior audits; and
- to promote the use of the annual report as an accountability document.

Results in Brief

6.8 The performance measurement system in New Brunswick continues to expand and improve each year.

6.9 We have seen improvement in the level of compliance with the annual report policy. We recommend the policy be revised to include direction that each annual report should indicate how it complies with the policy.

6.10 The Legislative Assembly, through its Public Accounts Committee (and possibly the Crown Corporations Committee), could have a role to play in improving annual reports, "the major accountability document for the Legislative Assembly and the general public."

First Value-for-Money Audits

6.11 Our first value-for-money audit, in 1989, covered the Facilities Management Branch of the Department of Supply and Services. That audit included an effectiveness reporting component. We actually suggested a number of indicators the Department might use in reporting on the Branch's effectiveness.

6.12 We faced a difficulty, however, in that the government of the day had no generally accepted manner or document for addressing this need for performance information. Recognizing this, we made a recommendation that:

The information to be included in the Department of Supply and Services Annual Report, the New Brunswick Main Estimates, and the New Brunswick Public Accounts should be reviewed. The purpose of this review would be to establish the types and amounts of information to be reported to enable the Legislative Assembly and the public to form an opinion on the effectiveness of the facilities management function. The review should establish which documents should include this information or if another document should be created to report this information.

6.13 The Department responded that it had some difficulty with our recommendations. It noted that both the Main Estimates and the Public Accounts “are prepared in accordance with an established format that is set by government and we have no input into same.” The Department did agree to undertake a review of the annual report, however, “to determine the information that should be included.”

6.14 Our second value-for-money audit was in the Nursing Home Services Branch of the Department of Health and Community Services. And again, we faced similar issues when it came to our comments and recommendations on effectiveness reporting. The Department responded as follows:

While there is no objection to participating in efforts to develop refined accountability reporting, additional resources and central agency leadership are seen as prerequisites. Since central government agencies have a direct interest in such matters, they should take the lead role in this area and establish, in consultation with operational departments, a suitable general framework.

First Government-Wide Study of Annual Reports

6.15 It was in this context that in 1989-90 our Office carried out its first government-wide study of annual reports. It was seen as an important background study to help the Office fulfil its new-found responsibilities in the area of effectiveness reporting.

6.16 The Office developed audit criteria in five key areas: timeliness; physical layout; goals, objectives and related performance data; financial disclosure; and understandability. In developing criteria we were aided by the fact that the government had issued two major annual report policy statements shortly before the audit began. The first, dated 1 March 1989, was developed by the Premier’s Office. It was superseded by a policy dated 8 September 1989 from the Cabinet Committee on Communications. We took great interest in the fact that

one of the policies spoke of reporting “the results obtained by expenditures.” We saw this statement as a reference towards reporting on the effectiveness of the expenditure of funds.

6.17 Our general conclusion was that the annual reports did not present the information needed by the Legislative Assembly and the public to judge program effectiveness. There was insufficient performance information to tell the accountability story. As well, reporting was not timely. The Auditor General’s major recommendation was as follows:

I recommend the Cabinet Committee on Communications revise the requirements for annual reports. Annual reports should reflect how effective departments and agencies have been in the use of government funds.

New Annual Report Policy

6.18 We were pleased, and somewhat surprised, by how quickly and thoroughly the government responded to our recommendation. Our public Report was issued in late 1990. On 26 June 1991 the Cabinet Committee on Communications issued a new annual report policy which addressed our recommendation. It answered the questions of where and how performance information should be reported, the very questions that departments had raised in our first two value-for-money audits.

6.19 This new policy was given Executive Council approval on 6 December 1991. It was incorporated into the government’s administrative policy manual system as Policy AD-1605 and remains virtually unchanged to this day. And it clearly established that reporting was everybody’s responsibility. That is, the government stated that the policy applied to all four parts of the civil service. This included government departments and agencies, Crown corporations, hospital corporations, and school boards.

6.20 We would like to quote from various sections of the policy to illustrate the manner in which it has established a framework for performance reporting.

6.21 The objective of the policy is stated as follows:

The prime function of an annual report is to be the major accountability document by departments and agencies for the Legislative Assembly and the general public. It serves as the key public link between the objectives and plans of a government entity and the results obtained.

6.22 We believe this was a key statement. In setting out the “prime function” of the annual report, it clearly established where government departments and agencies are to report accountability information.

6.23 The policy goes on to describe various elements or standards of content:

To the degree possible, departments and agencies should give a clear account of goals, objectives and performance indicators. The report should show the extent to which a program continues to be relevant, how well the organization performed in achieving its plans and how well a program was accepted by its client groups.

Actual and budget financial information in summary form and a narrative explaining major variances as well as other aspects of financial performance are to be included in all annual reports.

6.24 By covering these areas, the policy addresses key aspects of performance reporting.

6.25 Recognizing the importance of understandability, the policy also calls for annual reports to be written in clear and simple language. In order to emphasize the importance of timeliness, the policy calls for all reports to be submitted to the Clerk of the Legislative Assembly by 1 November following each 31 March fiscal year.

6.26 We were also pleased to see that the new policy covered several areas of interest identified by MLAs in a survey regarding annual reports. We had carried out this survey in conjunction with our first review of annual reports.

Value-for-Money Audits After Policy Implemented

6.27 After the policy was implemented, our work regarding the third “E” of effectiveness became a little easier. At least we knew where to look for performance information.

6.28 From our 1992 Report on, we have tended to have at least one major audit each year that focuses on a department or agency annual report. Policy AD-1605 provides ready-made criteria for such an audit. In almost every case we have made recommendations for improvement. We have never been able to conclude that any annual report that we examined was in full compliance with the policy.

6.29 We have covered a wide variety of organizations from the Department of Finance’s Tax Administration Division to the Department of Transportation’s road construction activity to the Environmental Trust Fund. We have extended our reach to cover Crown corporations such as the New Brunswick Geographic Information Corporation and the Lotteries Commission of New Brunswick. In 1998 we communicated with the regional hospital corporations on this issue as part of our governance study. At the conclusion of a discussion on public reporting we made the following recommendation:

We recommend that regional hospital corporations comply fully with the provincial annual report policy in future corporate annual reports.

Across-the-board surveys

6.30 In addition to detailed examinations of annual reports and departmental effectiveness measures, we have also carried out two general studies of annual reports across government. The first of these was more of a "report card" style of study where we reviewed each annual report and "checked off" if there was something there that seemed to fit the policy requirement. There was no formal assessment (or assurance provided) of the quality or reliability of the information.

6.31 For example, departments are required to present summary financial information with variance analysis. We did not assess the quality of the variance analysis. If the department had an analysis, it received the checkmark.

6.32 Our 1995 Report contained our survey of deputy ministers' self-assessment of their own annual reports. We had provided each deputy minister with a checklist of the policy requirements and asked them to carry out their own analysis. We were pleased that all the deputy ministers responded to our survey. The deputy ministers' responses included several frank admissions that the corresponding departments did not meet aspects of the policy. For example only four departments felt they had information on client acceptance as called for in the policy. A number of deputy ministers admitted the annual reports did not discuss program relevance.

6.33 We were encouraged to see that in a number of cases the deputy ministers spoke of planned improvements in their report. Departments and agencies saw themselves moving towards compliance with the policy.

Performance Indicators

6.34 One requirement in the policy is to "give a clear account of performance indicators." In a number of our audits of departmental annual reports, we had negative comments with respect to this aspect of compliance. For example, our 1995 audit of the Department of Advanced Education and Labour contained the following recommendation:

We recommend the Department ensure that benchmarks and performance indicators are established for all key activities of the college system. The results should be reported publicly as part of the Department's annual report.

6.35 In the Department of Economic Development and Tourism in 1998 we recommended that

The Department should develop performance indicators to report against all strategic objectives. This would allow for

an evaluation of the degree of success of the Department in achieving its strategic objectives and therefore its mission.

6.36 To some extent, this one area of non-compliance was contemplated by the policy. One paragraph of the policy reads as follows:

It is recognized that management information systems in many departments and agencies do not produce sufficient relevant data to meet this goal. However, over time, departments and agencies are expected to develop performance indicators and to include this information in their annual reports.

6.37 For the first several years that the policy was in existence, we had to consider this qualifying statement. Commencing, however, with the budget process for 1996-97, the government has embarked on a performance indicator process that should see that qualifier becoming less and less relevant.

6.38 In 1995 the government announced a performance measurement initiative which was implemented by the Department of Finance for the 1996-97 budget year. All departments and agencies were asked to establish public benchmarks and other measurements to assess the performance and impact of the programs they administer.

6.39 Now in its fifth year of development, the plan has been based on the concept of incremental progressive improvement. In the latest report *Performance Measurement, Supplement to the Main Estimates 1999-2000*, fifteen departments have identified core businesses and goals, with related performance indicators and targets for most key result areas. One of the major factors in its success to date has been acceptance and buy-in to the process by departments, demonstrated by their co-operation and dedication to ongoing improvement of the system.

6.40 The Province currently measures performance only at the departmental program level. Departments are required to prepare performance information as part of the Main Estimates process. Departments clarify their mandates through the identification of their core business areas and for each area identify the key goals. For each key goal, indicators are outlined together with targets and sources of information. This information is collected from all departments and consolidated into a supplement to the Main Estimates.

6.41 The responsibility for the performance measurement initiative has been recently transferred from the Department of Finance to the Executive Council Office. This office acts as developer and co-ordinator of the initiative, as well as advisor to departments. All performance indicators and targets are subject to approval each year, currently by the Board of Management. Departments are then required to publish the results in their annual reports.

The initiative in perspective

6.42 The performance measurement system in New Brunswick continues to expand and improve each year. We have been informed that this approach has been viewed as very successful by government, allowing officials to deal with growing pains as encountered and to plan ongoing strategies. This has also allowed a gradual evolution and growth of the process, while ensuring departments have never been overwhelmed by it as yet another central agency request. One key executive put it succinctly - "While recognizing the limitations of our current process, we are encouraged by its demonstrated improvement each year."

6.43 Our Office is encouraged to see the development of this process as well. We recognize that the publication *Performance Measurement, Supplement to the Main Estimates* was not developed directly to support the reporting requirements of the annual report policy. Departments were never directed they had to do this in order to comply with that policy. *Performance Measurement* was instead a product of central direction stemming from a commitment in a 1995 government platform document. But nonetheless, *Performance Measurement* does provide an important link to the annual report discussion on performance. And we believe this to be a good thing. It should lead to overall improvements in the annual reports of departments as the years progress.

6.44 A key improvement to the performance measurement system is training sessions currently being provided to key departmental personnel to encourage better use of performance measurement as an internal management tool. With these more recent developments it is hoped to change the focus from that of just reporting to one of using the information received to improve both planning and decision-making at all levels throughout government.

Review of Annual Reports for 1997-98

6.45 As noted, we believe it is important to continue emphasizing the annual report policy. It is a key part of a focus on accountability. As the policy states "the annual report is to be the major accountability document by departments and agencies for the Legislative Assembly and the public."

6.46 It is from this perspective that we approached our second objective, to review annual reports of government departments for 1997-98 using our scorecard methodology developed in prior audits. This year we reviewed the annual reports of the fifteen government departments which presented indicators in *Performance Measurement, Supplement to the Main Estimates* for the year ended 31 March 1998. This was the most recent fiscal year for which all annual reports were available. We did not include the reports of Crown agencies this year. We wanted to focus on the departments only, because the Crown agencies have been excluded to date from the performance measurement initiative of government.

6.47 Our review was similar to that of previous years. It looked at the policy requirements and compared these requirements to the reports. In other words, the review asked, what does the policy call for and is it easily identifiable in the report? The review was not designed to evaluate the quality of the information; just whether or not the information required was presented.

6.48 Our questions arising from a review of the requirements of the policy are as follows:

- was a report prepared?
- are the goals/objectives of the organization stated?
- are performance indicators presented?
- does the report discuss achievement of plans?
- is there discussion of program relevance?
- are details available on level of client acceptance?
- is actual and budget financial information presented?
- does the report explain variances from budget?
- was the report tabled with the Clerk of the Legislative Assembly by 1 November?

Was a report prepared?

6.49 We are pleased to report that all departments included in our review prepared annual reports.

Are the goals/objectives of the organization stated?

6.50 All departmental reports have stated goals and objectives in some recognizable form. This is a major improvement over our previous surveys. Perhaps part of the reason for this change can be attributed to the performance measurement system. The performance measurement system requires departments to identify the key goals for each core business area.

Are performance indicators presented?

6.51 All of the reports reviewed contained a section that outlined key performance indicators for the year.

Does the report discuss achievement of plans?

6.52 As a general rule, reports follow the department's organization structure. That is, each branch or section of the department has a discussion of its various activities for the year. They are often activity oriented. To quote for illustrative purposes from the *Introduction* of one report – "the annual report for 1997-98 outlines the activities and major events undertaken." These activities are not necessarily linked to any strategic objectives and operating plans although in at least four cases they appear to be linked to the program component objectives present in the *Main Estimates*. Some departments have presented information from their strategic planning processes, but this is not directly referenced to the various activities reported on elsewhere in the report.

6.53 In our 1998 Report we commented at some length on reporting with respect to achievement of plans in a more detailed examination of the 1996-97 annual report of the Department of Economic Development and Tourism. We made the following recommendation as part of that work:

Once departmental strategic objectives have been defined, it would be useful to have performance indicators and narrative descriptions of achievements presented by strategic objective in the annual report. This would make it much easier for a reader to evaluate the degree of success of the Department in achieving its strategic objectives.

6.54 This is a recommendation that probably still has general applicability. Some form of improved reporting is necessary to enable the reader to determine how well departments are doing in achieving their plans.

Is there a discussion of program relevance?

6.55 This topic was not given separate attention in any report we reviewed. But of course a number of departments referred to their process of strategic planning. And, as noted, the performance indicator process includes the identification of core business areas. Therefore, one could not say relevance has been ignored.

6.56 When we carried out our 1995 survey of deputy ministers, we received several interesting comments on program relevance. One respondent reported:

It is my sincere opinion that program relevance should not be discussed as an issue in the annual report. Discussing the merits or faults of each program or service offered would be like second-guessing the decisions taken by government. Once decisions are made by government to eliminate programs no longer relevant, or to implement new programs this information could be part of the annual report, along with information on the process used to determine why such a change was necessary.

6.57 Another in reference to certain regulatory programs stated:

We have traditionally assumed that the relevance of such requirements was subject to extensive public and legislative debate when the statutes were initially passed, and as a result, presenting rationales for their application in an annual report is no longer required.

6.58 These comments, and our observations on the general lack of discussion of the issue, point out that program relevance may be one area where additional guidance on compliance might be needed.

Are details available on level of client acceptance?

6.59 As with program relevance, client acceptance was not a topic that the reports systematically addressed. It should be noted, however, there are often statistics on the volume of users of programs. This does provide some information on the extent to which intended beneficiaries are taking advantage of programs. But we believe that in order to fully answer the question on client acceptance, there should be some discussion of the extent to which various users judge a program to be satisfactory. In this regard, at least one performance indicator did speak clearly to the issue. "The percentage of client satisfaction with archives services as reported through annual customer surveys" is an indicator in the Department of Supply and Services.

Is actual and budget financial information presented?

6.60 All departments presented budget versus actual financial information.

Does the report explain variances from budget?

6.61 Eleven departments had narratives explaining variances from budget. Four of those surveyed did not.

Was the report tabled with the Clerk by 1 November?

6.62 Three departments tabled their reports prior to 1 November. Another department came close by tabling on 2 November, the first working day in November. Two other departments tabled in the first week of November.

6.63 This is a fair improvement over our last two surveys. In both 1993 and 1994 only one department met the deadline, tabling its report in late October. Nonetheless, we believe there is room for continued improvement. Less than half of the departments had a report on time or within the first week of the deadline. One department did not table until 29 March 1999 according to the Clerk's records. Another tabled in February. Three tabled in January.

6.64 Perhaps one of the reasons for the failure to table reports on time is the fact that little attention is given to them until the public meetings of the Public Accounts Committee. In this regard we would encourage the Public Accounts Committee to meet as early as possible after the 1 November reporting deadline. Not only would this result in a more timely review of the year just past but it would also allow for input into the budget process for the next fiscal year.

Where to from here?

6.65 In general, we have seen improvement in the level of compliance with the annual report policy. We expected to find some level of improvement simply through the implementation of the performance measurement system. We are pleased by this progress.

6.66 Departments are to be commended as well for the attention paid to improving reports. From time to time we are asked by departmental representatives to provide some advice with respect to their upcoming annual reports. We are certainly pleased to be able to share our experience with departments when we receive such requests. While we

are able to discuss our past reviews of annual reports with departments, we do not have a definitive format or template that we can give to guide them through the process.

6.67 We noted how most departments are organizing their reports around the branches or sections of the department. One department appears to have developed a more strategic approach in that the information is organized under three core business areas. Each core business section describes various services and programs provided along with certain statistical information. Performance measures are presented in a separate section that is also organized by the same core business areas.

6.68 At least four other departments have organized their reports by program objective. Objectives are stated for the various program components followed by a section on various activities carried out during the year. These objectives are essentially the same as those presented in the *Main Estimates*. Another department began each section of the report with a subtitle “Mandate” followed by “Major Achievements for 1997-98.” After these achievements are discussed, the reader is informed on “Priority Projects for 1998/99”, the upcoming fiscal year.

6.69 Perhaps what we need is some sort of model around which the annual reports can be structured and further improved. For example, earlier in this chapter we stressed the importance of linking strategic goals and achievement of plans. We repeated a recommendation made in our 1998 Report. Organizing annual reports to tie into the strategic objectives may be one acceptable approach. Organizing it under core business areas may be another.

6.70 We have talked about the issues of program relevance and client acceptance as not being particularly clear in the annual reports. We also talked about the issue of timeliness. These could become part of the focus of improvements in the process.

6.71 In the interim, we would like to repeat a recommendation we made in our 1995 Report. In that Report, we noted we were pleased to see the interest deputies demonstrated regarding compliance with the policy. We went on to state the following:

We believe that it would be useful for departments and agencies to discuss their compliance with the policy in a section of their annual reports. A department or agency could place a chart near the front of the report listing each of the aspects of the policy. In a second column the chart could show where in the report each element of the policy was complied with. For instance, in response to the requirement to state goals and objectives, the chart could refer the reader to such things as excerpts from the strategic plan or an overview

message from the deputy minister. Regarding budget and actual financial information, the chart could refer the reader to the financial statements contained elsewhere in the report.

Recommendation

6.72 We recommend that the annual report policy be revised to include direction that each annual report should indicate how it complies with the policy.

6.73 Our Office has actually adopted such an approach. We have included a chart of this type in our chapter “Office of the Auditor General” for the last several years.

The Role of the Annual Report

6.74 Over the years our Office has continued to be a steady supporter of the annual report as an accountability document. This is consistent with our Office’s strategic goal to “Promote accountability and performance reporting by government, by individual departments and by Crown agencies.” With the development of the Province’s performance measurement program, we look forward to continued improvements in annual reports. And we intend to continue to focus on the importance of performance indicators in keeping with our “effectiveness” legislation.

6.75 We are pleased that the message seems to be getting through. In the 5 June 1998 meeting of the Public Accounts Committee a member began his questioning of a deputy minister with the following remarks:

We have had sessions here with the Auditor General, and he impressed upon us the importance of performance indicators. Does your department function with performance indicators? Is there some sort of measuring stick you utilize to assess whether you are efficient or whether you are achieving certain goals or objectives?

6.76 Another member questioned a deputy minister as follows:

Your performance measurements begin on page 33. I see that you are making good progress on the first goal, which is operating costs for procurement services per total dollar value of goods and services procured. Are you thinking you can continue to improve upon that, or are you getting to the point of more or less maximum efficiency?

6.77 The deputy minister responded:

We are trying to, but as you know, savings are harder and harder to find. We are hoping to keep proceeding on that one.

6.78 In a third example, a member began directly with the performance indicators of a government department as presented in the annual report. His questioning started as follows:

Another area I want to review with you is performance measurement. I find it quite fascinating to look at the government's move into performance measurement..... In this case you have all the challenges that are being faced in this year, and you have indicators that you do not appear to be hitting. Have we set the goals too high? Are they realistic? Should they be reassessed?

6.79 This type of questioning, focused on the performance indicators of the departments and agencies, could lead to a whole new level of debate on the effectiveness of government organizations. It could transform the functioning of the Public Accounts Committee and the Crown Corporations Committee as they work towards ensuring accountability is achieved when public money is spent.

6.80 The Legislative Assembly, through its Public Accounts Committee (and possibly the Crown Corporations Committee), could have a role to play in improving annual reports. By examining specific reports and comparing them to the policy, the members could create an impetus for improved compliance with the policy. A model report might be a possible outcome from committee deliberations aimed at improving the annual report, "the major accountability document for the Legislative Assembly and the general public."

Chapter 7

Contract Administration

Contents

Background	119
Scope	119
Results in Brief	121
General Observations	122
Family and Community Social Services (FCSS) Contracts	126
Janitorial Service Contracts.	133

Contract Administration

Background

7.1 In our 1997 Report, we noted three instances where the Province failed to obtain signed contracts before goods and services were provided by suppliers.

7.2 Two instances occurred in the 1996-97 fiscal year. The first involved work by IBM for the Department of Finance while the second was a lease agreement for Air Ambulance Services. In neither case were signed contracts obtained until significantly after the term had begun. The third instance related to work performed by Andersen Consulting and was discussed in detail in our 1995 Report.

7.3 Contracts were also prominently featured in our 1998 Report. Some of our work during 1997-98 dealt with departments like Economic Development and Tourism, Health and Community Services, Justice and the Solicitor General, as well as the Fredericton-Moncton Highway, Evergreen and Wackenhut projects. Related work included a review of contract approvals and monitoring procedures for contracts dealing with funding, leasing, and the purchase of goods and services.

7.4 It is readily apparent from our work and findings over the last two years that contracts between the Province and its suppliers are very important. On signing a contract, parties are guided and governed as to their relationship and responsibilities. Contracts are especially important when they have implications over numerous fiscal years.

7.5 More and more government services are being delivered by the private sector through privatization, public-private partnerships and straight contracting-out arrangements. Many such contracts have lives extending over multiple fiscal years.

Scope

7.6 The objective of this broad scope audit project was to determine what systems are in place to ensure contracts are being administered in accordance with negotiated terms and conditions.

7.7 The term “contract” has very broad meaning in common usage. Our Office does not have sufficient resources to audit all types of contracts in all departments of the provincial government.

7.8 For the purposes of this audit project, we have defined a “contract” as an agreement between the Province and at least one outside party (not including Crown agencies or corporations, hospitals or nursing homes). We restricted our work to those contracts having a

term equal to or greater than one year and that are used to meet ongoing operational (as opposed to capital) commitments.

7.9 Our first goal was to determine the extent to which senior managers in government were aware of contracts which were in existence at the time of our review. Awareness was defined as the extent to which senior managers were able to provide important information about their existing contracts, including whether or not the contracts were being properly monitored.

7.10 To assess awareness of contracts in departments, our Office developed four key criteria. Our findings for each of these criteria are discussed under the heading of General Observations.

7.11 In assessing this first goal we conducted surveys and interviews with representatives of eight major departments of the government of New Brunswick. Following this work, we identified two further goals. One was to determine the extent to which contract performance is monitored and reported. The second was to determine the extent to which contracting delivers what was agreed, when it was agreed and for the price agreed. To assess monitoring, reporting and delivery we identified additional criteria. These criteria were used to review contract administration in selected areas of the Department of Health and Community Services and the Department of Supply and Services.

7.12 Our work in these departments consisted of a review of fourteen contracts in the Department of Health and Community Services and five contracts in the Department of Supply and Services. The contracts in the Department of Health and Community Services were for a variety of services related to the Family and Community Social Services Division. These ranged from homemaker service to counselling and rehabilitation service. For the year ended 31 March 1999, our Office estimates that our sample of contracts represented \$12 million of annual Family and Community Social Services expenditures in the Department of Health and Community Services.

7.13 The contracts at the Department of Supply and Services were for janitorial services administered under the Facilities Management Program. For the year ended 31 March 1999, our Office estimates that our sample of contracts represented \$338,000 or 1% of the annual expenditure of the Facilities Management Program in the Department of Supply and Services.

7.14 Our findings related to monitoring, reporting and delivery are presented under the headings of Family and Community Social Services Contracts and Janitorial Contracts.

Results in Brief

7.15 Government is not following the Financial Administration Act requirement that all contracts be submitted to the Comptroller.

General Observations

7.16 No central registries of key financial or non-financial stipulations for contracts are maintained on a department-wide basis. Such registries would facilitate monitoring.

7.17 Responsibility for monitoring contracts has been appropriately assigned.

7.18 Responsibility for monitoring contracts rarely falls to senior management in the Province of New Brunswick. There is no formalized reporting to senior management on the status of key financial and non-financial stipulations.

**Family and Community
Social Services Contracts**

7.19 Of fourteen contracts reviewed, two were not signed by the end of the contract term. All remaining contracts reviewed were signed after their contract start dates.

7.20 For ten of the fourteen contracts reviewed, fluctuations in the volume of service delivered would not impact payments to the contractor on a timely basis. This may be due, in part, to payments being more in the form of a grant, than for the purchase of service.

7.21 Where program standards were applicable, no explicit reference was made in the contract to the effect that non-compliance would have on contract payment amounts or schedules.

7.22 Relevant, reliable information exists with which contractor performance can be assessed. However, this information does not appear to be always obtained in order to allow the Department to assess contractor performance.

7.23 Where such assessment information is both available and obtained, analysis of this information does not appear to be occurring on a timely basis. In addition, requirements for this information may not be formally stated in the contract terms.

7.24 The Department needs to implement a more structured, proactive approach to ensuring that contractors are providing services which meet quality and other standards as specified in the terms of the contracts. This would include providing regular feedback to contractors on its satisfaction with their services.

Janitorial Contracts

7.25 The Department should ensure that the nature and frequency of contractor evaluation and the deadline for evaluations is specified within the conditions of future contracts.

7.26 The Department should obtain relevant, reliable information that can be used to evaluate contractor performance. The regular use of checklists to document inspection of the cleaner's work should be considered.

7.27 The Department needs to implement a more structured, proactive approach to ensuring that services being provided by suppliers meet quality and other standards as specified in its contracts.

General Observations

7.28 Our first criterion was:

Departments should be aware of, and able to provide documentation about, contracts which are outstanding in their departments at any given point in time.

7.29 In our effort to determine what contracts were outstanding at the time of our review, we noted that a central governmental registry for contracts should exist.

7.30 The Financial Administration Act [Section 38(3)] states, "Every contract involving the payment of public money is to be submitted to the Comptroller when made." Until October 1998, the government Administration Manual assigned responsibility for ensuring the Comptroller has a copy of legal contracts to the individual exercising payment authority. This requirement has now been dropped.

7.31 Our inquiry has determined that the requirements of the Financial Administration Act have not been followed for some time. Due to the large amount of documentation this practice would involve, the Office of the Comptroller has interpreted the Act to mean that the contracts must be maintained by departments and made available to the Comptroller on request.

Recommendation

7.32 Government should follow the Financial Administration Act. If the application of the Act is seen to be impractical or if there is a better way to ensure control is exercised over contracts, then consideration should be given to amending the legislation.

Departmental response

7.33 The Office of the Comptroller replied to our recommendation as follows:

Our Office decided that it would be more efficient for departments to maintain their contracts and make them available if we wanted to review them. We advised departments accordingly.

It is our intention to change section 38(3) to read that departments will be responsible for maintaining contracts.

7.34 Since no central governmental registry currently exists, departments have (by default) been assigned responsibility for contract record-keeping.

7.35 Virtually all departments have taken a decentralized approach to organizing their contracts. Within a department, responsibility for contracts is assigned to the branch or division having responsibility for the related program and budget. These are responsibility centres for which a manager is held accountable.

7.36 Since contracts are assigned to numerous responsibility centres, a departmental perspective on the number, nature or dollar value of contracts outstanding at a given point in time is not available. Only the responsibility centre manager is able to generate detailed information about the nature, number and dollar value of contracts outstanding in their branch or division.

7.37 Our findings in the Department of Health and Community Services confirm this. For Family and Community Social Services (FCSS) contracts signed in the central office, a Project Co-ordinator in the Executive and Program Support Unit was able to provide general information about the nature, number and dollar values involved. Though more detailed information was not immediately available, it was readily compiled by obtaining and reviewing the contracts involved.

7.38 For FCSS contracts signed in a region, the Regional Director and Regional Administrative Co-ordinator were able to provide general information about the nature, number and dollar values involved. Similar to the centrally signed contracts, more detailed information was compiled by obtaining and reviewing the contracts involved.

7.39 In the Department of Supply and Services, our Office was able to obtain a detailed listing of janitorial service contracts which had previously been compiled by the Manager of Financial and Support Services of the Facilities Management Branch.

7.40 Our second criterion was:

Departments should be aware of, and able to provide documentation about, key financial and non-financial undertakings for contracts which are outstanding in their departments at any given point in time.

7.41 Based on the preceding observation that no governmental or departmental registry of contracts existed at the time of our review, our Office similarly concluded that no such registries of key financial or non-financial undertakings in those contracts could exist. Registries of financial and non-financial undertakings, if they existed, would be limited to each responsibility centre.

7.42 This was confirmed in our surveys and interviews with departments.

7.43 In the Department of Supply and Services, some financial and non-financial undertakings were included as part of information maintained and provided by the Department. Though important non-financial information like the term of the contract and any extensions were included, other non-financial stipulations were not included in the registry. Examples of other non-financial information we considered important include: the results and dates of cleaning inspections, that a Certificate of Insurance has been filed with the department by the contractor as stipulated in the contract, and the results of criminal record checks where applicable.

7.44 In the Department of Health and Community Services, no responsibility centre registry existed which detailed or summarized financial and non-financial stipulations for contracts in either the central office or the region.

7.45 Without any contract registry of key financial and non-financial undertakings at the departmental or responsibility centre level, it is possible that key administrative issues may be overlooked. For instance, renewal options and notification dates, the right to inspect and conduct audits and the filing of key documents such as insurance policies may be overlooked when there is no registry to highlight them.

Recommendation

7.46 **A registry of contracts should exist at either the responsibility centre or departmental level. This registry should include information on key financial and non-financial undertakings and be organized in a manner which permits effective review and follow-up.**

7.47 Our third criterion was

Responsibility for monitoring each contract or class of contracts, if not exercised by senior management, should be designated to an appropriate employee.

7.48 Responsibility for monitoring contracts is largely delegated by senior management to responsibility centre managers and their employees using the mechanism of spending authority. The government Administration Manual explains that individuals having spending authority are responsible and accountable for expenditures charged to their budgets and are responsible to verify contract requirements and to ensure that prices paid for goods and services are correct and reasonable.

7.49 In the case of the FCSS division of the Department of Health and Community Services, responsibility for the monitoring of contracts was assigned mainly according to whether the contract was signed by

personnel of the Department at head office or in one of the regional offices.

7.50 Responsibility for monitoring contracts signed in the regions falls to the Regional Director who has spending authority over payments on these contracts. The Department's Purchase of Service Standards Manual assigns responsibility to a contract officer in the region. Unless delegated to others in the region, the Regional Director fulfils this role.

7.51 Responsibility for monitoring centrally signed contracts is given to a Project Co-ordinator in the Executive and Program Support Unit who has spending authority over payments on these contracts. The Department's Purchase of Service Standards Manual assigns responsibility for monitoring these contracts to a provincial contract officer. The Project Co-ordinator referred to above appears to be serving in this capacity.

7.52 The Department of Supply and Services has assigned monitoring duties for janitorial services in a similar manner. These contracts are assigned to Regional Managers, each of whom has the responsibility to ensure that buildings in their geographic area are being maintained and that service providers are performing in an acceptable manner. Each Regional Manager has also been designated as having spending authority for payments to contractors.

7.53 Therefore, our Office can conclude that responsibility for monitoring contracts has been reasonably and appropriately assigned to employees having adequate knowledge of the contractor and their performance, as well as the authority to impact payments to the contractor.

7.54 Our fourth criterion was:

Departments should monitor, or receive regular documentation from designated employees regarding, key financial and non-financial undertakings for contracts that are outstanding at any given point in time.

7.55 Our surveys and interviews suggest there is no formalized reporting to senior management on the status of key financial and non-financial undertakings. This type of reporting could allow senior managers to ensure contractors, or groups of contractors, are complying with signed agreements. Objective performance indicators (like tasks, standards to be adhered to, etc.) should be documented, applied, and their status reported on a timely basis to allow departments to deal with poor performance on a proactive basis.

7.56 Senior management receives reports on an 'as-needed' basis only. This type of reporting may await a top-down request by an immediate supervisor and might not be volunteered by responsibility

centre managers. In both the Department of Health and Community Services and the Department of Supply and Services, interviews revealed that regular, formalized reporting to senior management on the status of outstanding contracts has not occurred.

7.57 A lack of regular, formalized reporting may increase the probability that senior managers are not kept abreast of significant administrative and operational issues, which could result in receipt of unsatisfactory goods and services from the Province's contractors.

Family and Community Social Services (FCSS) Contracts

Monitoring and Reporting of Contracts

Contracts should be properly executed, signed and dated

7.58 Our office reviewed eight FCSS contracts signed at the central office with which the Department of Health and Community Services purchased goods or services over the 1998-99 fiscal year.

7.59 One of the 1998-99 contracts was still not signed by the date of our review and therefore was not finalized at any time during the term of the contract. The remaining seven contracts were finalized between 21 and 162 days after their respective contract start dates. At the date of our review in late May 1999, none of the contracts for 1999-2000 had yet been finalized and signed.

7.60 Our Office also reviewed six FCSS contracts signed at the regional office level. One of the contracts for the 1998-99 year was not signed at the date of our review and therefore was not finalized at any time during the contract term. The remaining five contracts were finalized between 154 and 217 days after their respective contract start dates.

7.61 These findings cause us some concern. In order to protect the interest of the Province and its taxpayers, all contracts should be signed before services are received and payment made.

7.62 In some cases where contracts expired before renewal, the Department indicated it did not wish to finalize a new contract until the prior year's audited financial statements were received and/or the Department's budget for the upcoming year was approved. These concerns would have to be addressed if contracts are to be finalized on a timely basis. One solution would be to incorporate a clause in the contracts to allow for future adjustments of payments.

Recommendation

7.63 The Department should ensure that all contracts are negotiated and signed prior to the contract start date.

Departmental response

7.64 *It has been the Division's practice for a number of years that contracts continued in effect past April 1 until new contracts were signed. Community agencies are aware of this practice, recognizing that government needed to be assured of available dollars in the budget and be in receipt of audited annual financial statements before signing (audited financial statements are important in cases where the funding*

arrangement is similar to a grant). The standard contract will be reviewed to ensure wording reflects intent and practice.

Payment and volume of service

7.65 Based on our review of these contracts, our Office observed that the amount of payments was dependent on the rate paid (fixed by the Department) and the volume of activity (units of service provided by the contractor). In the case of some contracts, the contractor is also required to comply with additional program standards.

7.66 However, our review of the fourteen sampled contracts, and subsequent discussions with departmental staff, indicated that ten contracts were in actuality either lump-sum payments or a series of payments which would not be immediately affected by changes in volume or compliance with standards. Should the contractor deviate from the contract terms, payments would only be affected through an adjustment in future months or the following year.

7.67 Our Office determined that in many of these instances the Department was using a model contract designed for purchasing service from contractors on a “per unit of service” basis even though the payments more closely resembled a grant. In three contracts, the term “grant” appeared within the conditions which described the payments the contractor would be receiving. This model contract is found in the Department’s “Purchase of Service Standards” manual.

7.68 For these contracts, the contract amounts are calculated using a budgeted lump-sum payment and annual volume amount as its starting point. The payment schedule, however, was based not on volume, but on fixed monthly amounts. No invoices were submitted by these organizations to receive this funding, though statistical reports are later received which should support the payments actually made by the Department.

7.69 The four remaining contracts in our sample of fourteen contained explicit terms that made payments dependent on volume and contractors must submit invoices to initiate the payment process.

7.70 Based on these results, it is evident that, depending on whether the intention of the Department was to provide a grant or to purchase services, a contractor’s failure to meet anticipated volume might affect their payment schedules and amounts in very different ways. Regardless, the same model contract is being applied to both. In doing so, the Department is confusing both departmental and contractor staff as to the meaning and implication of conditions in the contract which require a monthly volume of service from contractors. For the majority of contracts reviewed, fluctuations of volume would not affect payments in any timely manner.

7.71 A wide spectrum of agreements might be appropriate between the Department and its suppliers. Where a grant relationship might exist, a grant agreement or conditional grant agreement might be more appropriate than the current purchase of service model contract which is being employed.

Recommendations

7.72 The Department should review the appropriateness of applying the “Purchase of Service Standards” and its model contract, which links payments to volume, to those organizations for which grant funding is most appropriate.

7.73 Where the model contract is deemed appropriate, the Department should ensure that contracts with suppliers make explicit reference to the effect on payment schedules and amounts should the contractor fail to meet the anticipated volume.

Departmental response

7.74 *The Department will examine its approach and contractual arrangements with service providers to ensure there is an appropriate application of the purchase of service policy, which links payments to volume. If the purchase of service model contract linking payment to volume is not appropriate for a particular service, the department will utilize grant funding and reflect the change in our contractual arrangements with agencies.*

Meeting program standards

7.75 Seven of the contracts reviewed contained explicit reference to the fact that “program standards” applied to the provision of service by the contractor. In those contracts, there was no explicit reference to the effect on payment or payment schedules should the contractor cease to meet those “program standards”.

Recommendation

7.76 The Department should ensure that contracts with suppliers make explicit reference to the effect on payment schedules and amounts should the contractor fail to comply with program standards.

Departmental response

7.77 *When regional staff are aware that contractors fail to comply with program standards, appropriate action is taken to correct the situation. If the client is at risk, the contract can be terminated....*

7.78 *However, the Department will review contracts to ensure, where it is appropriate, that payment schedules and relevant program standards are clearly linked.*

Relevant, reliable information should be obtained to judge contract performance

7.79 Based on our review of the model contract and the actual contracts sampled, we compiled a list of areas on which the majority of contractors could be assessed. These areas included:

- ensuring the contractor provided the service;
- the department’s satisfaction with the service;

- the maintenance of proper program and financial records by the contractor;
- the provision of service in accordance with standards;
- the adequacy of personnel policies; and
- the provision of financial and program reports by the contractor.

7.80 The reliability of information provided by contractors is difficult to establish. However, a condition exists in the model contract that would allow the Province to establish whether information produced by a contractor is reliable. The model contract states, “*Both Parties agree to jointly review the program and financial records of the Agency, at least annually.*” Were this review undertaken by the Department, it would be much easier to establish the reliability of the information being produced by the contractor.

7.81 Based on our review of departmental documentation as well as interviews with departmental and contractor staff, our Office concluded that relevant information is only obtained by the Department in the areas of financial reports and program (statistical) reporting.

7.82 The reliability of the information has not been reviewed by the Department. There is little concern about the reliability of financial information provided to the Department, since each contractor undergoes an annual audit of their financial statements. However, the annual audit does not cover the program records (statistics) which are being reported to the Department. Further, the Department has not undertaken its annual review of program records outlined in the contracts. These factors increase the probability that the Department may base payments or other decisions on contractor information that is not sufficiently reliable.

Recommendations

7.83 Where a purchase of service contract is implemented, the Department should obtain relevant and complete information that can be used to assess contractor performance.

7.84 The Department should ensure that the information obtained from contractors for use in assessing performance is reliable.

Departmental response

7.85 *The Department will identify key program standards, by category of service, and specifically define what is required to monitor performance in those categories. This will result in a standardized framework that will be used in all regions for monitoring and assessing contractor performance. In addition, the Department will conduct operational audits, based on risk indicators and regional input. The audits will provide an opinion on the reliability of the data provided by the agencies.*

Analysis of financial information

7.86 Only eight of the fourteen contracts sampled specified that financial and program reports need be submitted by the respective organizations. Of these eight contracts, seven of them were readily identifiable as being under the monitoring mandate of central office. While two of these contracts explicitly required quarterly reporting, four others stated that either monthly or quarterly reporting was required along with an annual financial report at year end. Only one contract explicitly stated that annual reporting was sufficient.

7.87 Our interview with central office personnel responsible for monitoring these seven contracts indicated that reports received during 1998-99 were not being compared to the appropriate contract budget or the prior year's figures. The project co-ordinator noted that these monitoring duties would be done at year end, as this is the appropriate time to do so. Though it may be true that monitoring at year end will allow adjustments to be made to the following year's contract budget and payments, it does not allow timely adjustment of amounts paid should anomalies in the volumes reported by contractors occur sooner.

7.88 Contracts which were regional in nature did not contain conditions which explicitly required program or financial reports. We were informed that for half of the contracts sampled reporting is not required since the invoices and billings are sufficient to support payments. For the other half of these contracts, staff agreed that such information is useful and, in fact, is received from contractors since no invoices or billings are available to support payments.

7.89 At minimum, annual financial reporting provides a basis for the next year's payments. Despite this, our Office found one instance where no financial statements for the previous fiscal year (ended 31 March 1998) were received to support the 1998-99 payments to one contractor. Our Office noted that a specific request was made for this information in the Department's cover letter accompanying the 1998-99 contract. Departmental staff admitted this lack of follow-up was an oversight both on behalf of the contractor and the Department.

7.90 Interviews with both central office and regional staff suggest that interim reporting for some contracts may be unnecessary. This might be the case if the relationship with suppliers more closely resembles an annual grant-funding relationship than a purchase of service. Where the Department does not consider interim reporting necessary, the Department should amend the terms of the relevant contracts to eliminate the extra reporting requirements, thus saving both contractor and departmental staff valuable resources. Where interim reporting is deemed necessary, the Department should ensure reporting is formally requested in the conditions of contracts and adequate monitoring of this information is in place.

<i>Recommendations</i>	<p>7.91 The Department should ensure that the conditions of all contracts formally and specifically request program and financial reporting where such reporting is deemed appropriate.</p>
	<p>7.92 The Department should ensure adequate monitoring is undertaken for interim reporting required by conditions of its contracts with suppliers.</p>
<i>Departmental response</i>	<p>7.93 <i>Based on the monitoring framework to be developed and previously mentioned, the Department will review and ensure reporting requirements are appropriate; if appropriate, the reporting requirements will be specifically identified in the contracts, and monitored accordingly. If not appropriate, the contract will be amended to eliminate this requirement of contractors.</i></p>
<i>Delivery of contracted service</i>	<p>7.94 Government should get what was contracted for, to the quality or specifications contracted for, at the time and price agreed. Government should completely fulfil its contractual obligations to the contractor.</p>
<i>Volume and price</i>	<p>7.95 Only four of the fourteen sampled contracts required an invoice from the contractor to initiate payments. Interviews with staff of the Department indicate that the Department has a system of internal controls in place to ensure that the correct volume of service is received at the right time and price. In the other ten instances, payments are made first, with the subsequent program reporting being intended to support them.</p>
<i>Quality or specifications</i>	<p>7.96 Our Office could not be assured that a system of internal control existed in the Department to ensure that it received the quality and specifications for which it contracts.</p> <p>7.97 Of the fourteen sampled contracts, seven of them contained a condition requiring services to be provided in accordance with ‘program standards’. Three of these seven contracts were for the provision of homemaker services to clients of the Department. An example of program standards in these three cases is that service providers must have completed a certified home care worker training program. There is also a condition in the model contract which not only allows but requires the Department to assess contractors on their compliance with such standards. Given the significant nature of the standards and the potential vulnerability of the Department’s clients, the Department needs to assess compliance with such standards in order to determine its satisfaction with services received.</p> <p>7.98 Interviews with departmental staff indicate that there should be an annual review of contracts to assess financial matters and changing program needs. There should also be feedback to the contractor on the Province’s satisfaction with its services. However, this is not taking</p>

place. Staff noted to us that the positions of contract officer (in regions) and provincial contract officer (in central office), as envisioned in the “Purchase of Services Standards” manual, were intended to perform these significant assessments and monitoring duties. These positions have been either eliminated or restructured so that resources may not currently exist to adequately perform the necessary work.

7.99 However, interviews also suggest there is a low risk of non-compliance with standards or other similar issues because the organizations with which the Department contracts are credible and well established. Considerable reliance is placed on the watchful eyes of caseworkers as well as complaints from the client or their friends and family to detect performance which does not meet standards. This is a reactive approach.

7.100 One interviewee within the Department indicated that a number of homemaker service contractors might be providing acceptable levels of service but do not meet all the criteria set out in the standards.

7.101 Should this be the case, the implications may be serious. One contractor even expressed dissatisfaction that these standards were not being enforced for the protection of the Department’s clients. Our Office is of the opinion that a more proactive approach may be appropriate. We are not alone in expressing this opinion. The Department’s own “Purchase of Service Standards” manual envisioned this approach when it made the provincial contract officer responsible for arranging an annual evaluation of services purchased by the Department from external parties.

7.102 Such a proactive evaluation of services would help ensure clients of the Department receive the best care and will also ensure that the Department’s expenditures obtain the maximum value for money.

Recommendation

7.103 **The Department needs to implement a more structured, proactive approach to ensure that services being provided by suppliers meet quality and other standards as specified in its contracts. This would include providing regular feedback to contractors on the satisfaction with their services.**

Departmental response

7.104 *The Department currently monitors that services being provided by suppliers meet quality and other standards as specified in its contracts. This is done on an informal basis by the caseworkers in the regions. As stated previously, the Department will develop a monitoring framework that will be used in all regions, to standardize and formalize the process.*

7.105 *The Department will clarify with service providers and in the contract what type of feedback the Department will provide with respect to contracts.*

Janitorial Service Contracts

Monitoring and Reporting of Contracts

Nature and frequency

7.106 During our review of janitorial service contracts, we observed that conditions existed in the contracts that would help determine the nature of any evaluation of contractor performance.

7.107 Examples of these conditions are:

- the work to be performed by the contractor on a daily, weekly, monthly and bi-annual basis is clearly set out in the contract;
- “the execution of the work by the contractor shall be subject to the direction and approval of the representative of the Owner....”; and
- “if the contractor, in the opinion of the Owner, abandons the work set out in the specifications.....carries out the work in a manner detrimental to or in a manner other than that set out in the specifications attached the Owner shall be entitled to dismiss the contractor.....”.

7.108 From the above conditions, it is clear that the contractor will be evaluated by the Owner (the Province). However, the contracts do not specifically state that inspections are to be performed. Further, the contracts do not set out how the evaluations will be carried out. The contracts should clearly state the nature of the evaluation. By way of example, the contracts could state that the contractor would be evaluated against a predetermined checklist.

7.109 The frequency of contractor evaluations is not set out in the contracts. As a result, some buildings are checked weekly, while others are checked monthly. Without explicitly stating the frequency of evaluations in the contracts, the Province runs the risk of having some buildings inspected frequently while others are overlooked even though the buildings are used for similar purposes. Further, there is the possibility that some buildings require a higher frequency of inspections due to a high requirement for cleanliness related to the nature of activities carried out in the buildings. For example, provincial labs would require a higher standard of cleanliness than a regular office. The contracts should clearly state the frequency of inspections for a given building.

7.110 The contracts do not discuss any deadline for evaluations. Because evaluation deadlines do not exist for janitorial contracts, there is an increased probability that information being submitted is not timely. There is also an increased probability of misunderstandings or disputes. To reduce this probability, the Department should specify all significant reporting deadlines in the conditions of its future contracts.

Recommendation

7.111 The Department should ensure that the nature and frequency of contractor evaluations and the deadline for evaluations is specified within the conditions of future contracts.

***Relevant, reliable information
should be obtained to judge
contract performance***

7.112 Basically, the cleanliness of a building provides all of the information needed to judge a contractor's performance. A contract outlines the duties to be performed daily, weekly, monthly, and bi-annually. However, it is impossible for the Department to be sure the contractors are actually performing all of these duties. To ensure this, a departmental employee would have to watch them as they work. Instead, as one Regional Manager stated, the contract stipulations regarding the work to be performed are a 'guideline' or tool. If the contractors follow the specifications outlined, the buildings will be clean. If they choose to carry out their work in a slightly different manner that is fine, as long as the quality of cleaning is acceptable. We found that this is reasonable.

7.113 In four out of five contracts, regular building evaluations consist of visual inspections by Department of Supply and Services employees. For two of these contracts, according to the Regional Manager, quarterly (approximately) deficiency lists are produced whereby the buildings are inspected and things the inspectors feel should or could be done better are documented. Complaints of the Department of Supply and Services employees as well as complaints of employees using the facilities are passed on to the contractor either verbally or in writing.

7.114 For one of the buildings sampled, a monthly checklist is used whereby a Department of Supply and Services employee ranks the cleanliness of the building (by floor and area) as poor, fair, and good. Copies of the checklist are then forwarded to the Regional Manager, as well as the contractor. This is an effective tool for providing feedback to the contractor. Further, using a checklist eliminates some of the subjectivity associated with performing visual inspections or maintaining deficiency lists where structured guidelines are not followed. Checklists direct inspectors to look at each area in the building and consciously rank the cleanliness. Using checklists also supports decision making regarding the renewal and termination of contracts. We were told that checklists are occasionally used for two of the contracts, however, copies were not produced as requested.

Recommendation

7.115 The regular use of checklists to document the inspection by the Department of the cleaner's work should be considered.

Delivery of contracted service

7.116 Government should get what was contracted for, to the quality or specifications contracted for, at the time and price agreed. Government should completely fulfil its contractual obligations to the contractor.

Time and price

7.117 As mentioned previously the contracts outline the work to be completed daily, weekly, monthly, bi-annually and as required. We have concluded that it is impossible for a Regional Manager to know that the cleaners are performing everything outlined in the contract. However, as noted previously, the specifications are a guideline. As long as the buildings are clean, that is acceptable.

7.118 In four of the five contracts the price as agreed was paid. In the fifth contract there was an amendment made to accommodate operational changes and provide additional security.

Quality or specifications

7.119 Our Office could not be assured that a system of internal control existed in the Department to ensure that it received the quality and specifications for which it contracts. In most buildings regular documentation is not produced to support this.

7.120 Our Office conducted a survey of six randomly selected government offices to get an idea as to whether the employees using the buildings were satisfied with the cleaning. On a scale of 1 (unsatisfactory) to 9 (excellent), four departments rated the cleaning as 7 while the remaining two rated it as 4. From the survey results we can conclude that there is room for improvement. In only two cases had the person completing the survey or their staff been solicited for input regarding the performance of the cleaners. In five of the six offices staff had registered complaints regarding the cleaning, and in all cases there was timely improvement.

7.121 The Regional Managers interviewed realize there are problems with the cleaning and that there is room for improvement.

7.122 Considerable reliance is placed on the watchful eyes of Department of Supply and Services employees as well as complaints from the government employees using the buildings to detect performance which does not meet standards. This is a reactive approach.

7.123 Our Office is of the opinion that a more proactive approach may be appropriate. The checklist used in one of the five contracts is proactive. It provides reliable and relevant feedback to both the Regional Manager and the contractor.

7.124 Such a proactive evaluation of services would help ensure that clients of the Department receive the best service. This approach will also ensure that the Department's expenditures obtain the maximum value for money.

Recommendations

7.125 The Department needs to implement a more structured, proactive approach to ensuring that services being provided by suppliers meet quality and other standards as specified in its contracts. Using checklists and conducting surveys of satisfaction with the service on a regular basis should form the basis of this approach.

7.126 The Department should provide regular, formal feedback to contractors on its satisfaction with their services.

Departmental response

7.127 *We have reviewed the recommendations made in your report and we will endeavour to incorporate them into our administrative process in future contracts.*

Chapter 8

Leasing of Equipment

Contents

Background	139
Scope	141
Results in Brief	142
Compliance with Policy AD-6701	142
Accounting Considerations	157

Leasing of Equipment

Background

8.1 The question of leasing versus outright purchase has a direct connection to our Office's mandate. The Auditor General Act directs us to report where "*money has been expended without due regard for economy.*" Based on various observations over the years as professional accountants, our staff has observed that one key area where economy can be compromised is in the decision to lease instead of purchase. Leasing, despite its attractiveness from a budget perspective, is often less economical than purchasing outright. This is particularly so in the case of the Province where most leasing companies could not match our low rates of financing.

8.2 Because of the requirements of the Canadian Institute of Chartered Accountants (CICA), leasing decisions can also generate somewhat complicated analysis in order to determine whether expenditures should be classified as operating versus capital. Given our responsibility for comments on the fair presentation of the financial statements, we want to ensure that this type of analysis is carefully performed and well documented. The goal should be to make the correct business decision, which is then correctly classified based on standard accounting criteria. In both government and business there is a long trail of case history to show that, in fact, the opposite can occur. That is, because an organization wishes to show a short-term advantage by classifying a lease as operating, it may structure its contracts to influence accounting classification decisions.

8.3 Because of this perspective, our Office decided to begin a study of equipment leasing transactions in the fall of 1997. In conducting that review one of the first documents we encountered was a "*Lease and Rental Expenditure Review*" prepared in July 1995 by the Office of the Comptroller.

8.4 In this report the Comptroller analyzed rental or leasing transactions in several departments in the areas of leased premises, heavy equipment, light vehicles, computers and photocopiers. A key finding was "for each asset category examined, leasing/rental decisions were not cost effective." This finding was qualified by indicating that this only applied to the sample of transactions selected and did not preclude that some rental/lease decisions may be cost effective.

8.5 The Comptroller's conclusion was as follows:

We recognize the importance of government to focus on restricting growth of the Province's net debt. However, current government practices of leasing/renting rather than purchasing assets because of limits placed on capital budgets and its levelling effect on budget expenditures are not always cost effective. Existing budget practices and purchasing policies are causing uneconomical financial decisions and are negatively impacting budget expenditures and the Province's net debt.

8.6 The Comptroller had several recommended actions. Two that touched directly on our concerns over economy were:

Lease/rental versus purchase options should be fully analyzed, determining the cost to government over the useful life of the asset. Impact on the global budget (capital and ordinary) and the province's net debt should be considered.

Administration Manual Policy Number AD-6701 "Present Value Analysis of Expenditure Decisions" should be strictly enforced and provide the basis for analysis and cost effective decision-making.

8.7 We examined this policy and were impressed by a number of aspects. The objective of the policy is "to ensure that a comparative analysis of costs is performed as a partial basis for decision-making when major expenditures with cash disbursement options are contemplated." It goes on to specifically identify the purchase of equipment versus the lease of equipment as an example of when the analysis should be applied. It provides a description and example of the analysis that should take place. In our opinion, implicit in the policy is the notion that if the decision to lease is made despite higher costs, the decision should be supported by other considerations.

8.8 This policy gives an excellent description of when and how to apply the present value analysis. It also serves as a control to prevent departments from leasing simply to meet their current year's budget target and deferring costs to subsequent years.

8.9 It appeared from our reading of the policy, and the Comptroller's review, that if Departments diligently followed the policy, then many concerns over the economy of leasing transactions would be addressed. We decided, therefore, to examine a number of leasing transactions to determine the degree of compliance with this important policy.

8.10 In addition, we noted the Comptroller recommended:

The Province should review Administration Manual Policy Number AD-6203 "Classification of Expenditures", in regard to inconsistencies in defining capital expenditures.

8.11 This recommendation seemed to support our interest in the accounting side of leasing transactions. It provided us with a second government policy that we could use to develop criteria for an examination of equipment leasing transactions.

Scope

8.12 Our audit objectives were to ensure that decisions to lease were made with due regard for economy and that leases were properly recorded in the books of the province.

8.13 In carrying out these objectives we developed two audit criteria to assist us in our work. These were:

- leasing transactions should comply with the principles of Administrative Policy AD-6701 "Present Value Analysis of Expenditure Decisions;" and
- departments should record lease transactions in a consistent manner across government, ensuring the accounting reflects the substance of the transaction.

8.14 Our work covered five separate government departments as follows:

Department of Education – six leases for various numbers of personal computers;

Department of Supply and Services – standing offers for three separate types of photocopiers;

Department of Agriculture and Rural Development – one lease of a radial spectrometer and another for an infra-red analyzer;

Department of Municipalities and Housing – one lease for computer equipment and another for a lease of nine fire tankers; and

Department of Transportation – a lease for ten graders and, in addition, joint responsibility with the Department of Municipalities and Housing for the lease of the nine fire tankers.

8.15 We also corresponded with the Department of Finance and the Office of the Comptroller given their respective central agency roles in a number of the leasing transactions we examined.

Results in Brief

8.16 The analysis required in policy AD-6701 “Present Value Analysis of Expenditure Decisions” was not adequately performed in the leases we examined. Four of the five departments did not prepare any present value analysis to support leasing decisions. And although the Department of Education carried out a number of present value analyses, each lease we examined did not meet a number of the principles set out in the policy.

8.17 Some of the documentation we reviewed indicated that leasing was being pursued for budget reasons, not value-for-money reasons.

8.18 Based on our calculations, in almost every case leasing proved more expensive than buying.

8.19 A number of the so-called operating leases are actually capital. In addition, five operating leases in the Department of Education are in a grey area that suggests the Department may have additional capital leases.

8.20 If we could make a general comment, it might be that the quality of supporting analysis for decision-making needs to be improved.

8.21 Our detailed findings are presented in two distinct sections, organized by the two main criteria. First we deal with many key requirements of policy AD-6701. The second section deals with accounting considerations for the leases.

Compliance with Policy AD-6701

8.22 Our first criterion refers to compliance with the policy “Present Value Analysis of Expenditure Decisions”. The objective of this policy is to “ensure that a comparative analysis of costs is performed as a partial basis for decision-making when major expenditures with cash disbursement options are contemplated.” The policy notes that one example of such a decision is the purchase versus the lease of equipment. By requiring a comparison of the leasing option to an outright purchase, the policy recognizes the principle of due regard for economy.

8.23 In four of the five departments in our sample (Agriculture and Rural Development, Municipalities and Housing, Transportation, Supply and Services), we found no evidence of present value analysis on file. The policy requires that when leasing “every proposal should be analyzed with the potential lessee determining the cost of a leasing plan against the cost of raising the same amount of capital through long-term debt financing.” This does not appear to have been done in these four departments.

8.24 In the other department in our audit, the Department of Education, we did find present value analysis on file for all six leases examined. In our opinion, however, the analysis required by the policy was not adequately performed. Although the Department carried out a number of present value analyses, each lease examined did not meet a number of the principles set out in the policy.

8.25 Officials in three of the five departments (Agriculture and Rural Development, Municipalities and Housing, Education), actually informed us that they were not aware of the policy prior to our audit. We maintained throughout the audit that since the policy has been in existence since 1977, its principles should have been complied with from that date.

8.26 We have segregated our findings regarding compliance with the policy according to two broad categories as follows:

- no present value analysis prepared;
- analysis prepared, but not in compliance with policy.

8.27 The first category is further sub-divided along departmental lines. Under each heading we discuss our audit findings and the related recommendations.

No present value analysis prepared

8.28 As noted previously, four of the five departments did not have a present value analysis supporting leasing transactions. For those four departments we prepared our own analysis of the present value of the leasing transaction versus the purchase alternative and presented the results to the departments. In each case examined, we found leasing to be more expensive than buying.

Department of Transportation

8.29 In the Department of Transportation we reviewed a decision to lease ten graders. The graders had an outright purchase cost of approximately \$1.4 million. Based on our calculation, the net present value of leasing is \$1.475 million. In other words, leasing added about \$75,000 to the cost of the transaction.

8.30 There was no evidence that the Department had documented the extra cost of leasing or that the extra cost was offset by other considerations as required by the policy. The overriding consideration appeared to be that the funds to purchase outright were not available. This is consistent with one of the key findings of the Comptroller's Office in their 1995 report. They said "Because of limits placed on capital budgets, departments do not purchase outright even when it is cost effective to do so."

Department of Municipalities and Housing

8.31 In April 1995 the Department entered into a five-year lease for computer equipment for the Emergency Measures Organization. The equipment had an outright purchase cost of \$159,500. The present value

of the lease payments added between \$17,000 and \$22,000 to the cost of the transaction.

8.32 We reviewed a second transaction for a lease of nine fire tankers in August 1997. The fire tankers could have been purchased for a cost of approximately \$1,015,000. Leasing added about \$50,000 to the cost of the transaction.

Department of Agriculture and Rural Development

8.33 Both of the Department of Agriculture and Rural Development leases are discussed later under “Accounting considerations.” The first lease was a four-year lease of a radial spectrometer. The second was a three-year lease of an infra-red analyzer. The net present value of leasing the spectrometer exceeds the outright purchase cost of \$135,000 by about \$5,000. The lease cost of the infra-red analyzer was a little over \$2,500 more than the outright purchase cost of approximately \$220,000.

8.34 It should be noted that in total the two leases added only a slight amount to the overall cost of the assets (slightly over 2%). However it does confirm our frequent observation that the cost of financing through leasing typically exceeds the Province’s cost of financing. If all other factors are equal, this makes leasing the more expensive option.

Department of Supply and Services

8.35 Our approach with the Department of Supply and Services was somewhat different than with the other departments. We did not look at leases the Department negotiated for its own purpose. Instead, we looked at the guidance that the Department’s Central Purchasing Branch gives to the purchasing decisions of other departments through the list of “Standing Offers.” We examined and discussed with the Department three standing offers for photocopiers. In one of the three cases, we noted that one photocopier cannot be purchased outright. This makes it very difficult to perform a present value analysis of leasing versus an outright purchase.

8.36 In the other two cases, our calculations indicated leasing was more expensive than purchasing. The extra costs of leasing were \$250 and \$1,800 per unit respectively.

8.37 Although these amounts of \$250 and \$1,800 might appear to be small, if these additional costs are representative of the hundreds of photocopiers the Province has, the extra costs are significant. The Comptroller’s 1995 report looked at a sample of 21 photocopiers and concluded that the extra cost of leasing rather than purchasing increased the cost to the Province by \$46,000 over five years.

Correspondence with these four departments

8.38 Because of our concerns over due regard for economy and non-compliance with policy, we wrote to all four departments. We were concerned that no present value analysis was on file. Although the

wording may have differed slightly from department to department, we made a common recommendation which essentially reads as follows:

We recommended that in making future lease versus purchase decisions the Department comply with the requirements of policy AD-6701.

Department of Transportation response

8.39 *In order to address the condition of the fleet, while purchasing equipment within the capital allotment, as approved by government, the decision was made to lease ten graders for the Department in September of 1996. The lease was necessary to ensure that the Department could meet its operational needs, particularly in heavy trucks and graders. Leasing, with the option to purchase, also allowed flexibility at the end of the lease term. In order to achieve the best possible terms, the financing involved was tendered. By properly managing leases, there should be no negative impact on meeting future budget targets.*

8.40 *As a result of the renewed capital program and leasing of equipment, the Department's fleet is starting to approach the optimum replacement time. The Department is now performing lease vs. purchase analysis, including potential cost savings of newer equipment, to evaluate the best alternatives and mix of replacement assets within the fleet. It should be noted that the extra costs associated with leasing must be weighed against the operational savings resulting from the ability to purchase other equipment within the capital allotment, and as such avoid costly maintenance on older assets.*

Department of Municipalities and Housing response

8.41 *The Department of Municipalities and Housing will advise responsibility centre managers of the necessity to follow the Present Value Analysis of Expenditure Decisions policy and to contact our Financial Services Branch for assistance in the analysis of lease or purchase decisions.*

Department of Agriculture and Rural Development response

8.42 *While the Department accounting staff did not conduct an official present value analysis, we were aware of the lease/purchase cost versus the outright purchase cost because the bids that came in through the tendering process were presented to us for analysis and decision on awarding the tender.*

8.43 *I believe this process certainly ensured that we received competitive prices and the best possible deal on the interest.*

8.44 *In future I have instructed our Chief Financial Officer to again ensure that Policy AD-6701 is followed.*

Department of Supply and Services response

8.45 *While the photocopier contract prices photocopiers for various financing options, the Central Purchasing Branch does not evaluate or require justification by individual departments for their purchasing decisions. I believe this is their responsibility. Many factors affect a purchasing decision by a department including, but not limited to price,*

changing program needs, variable services demands, budgets, and emergency or unforeseen events affecting a department's financial decision making.

8.46 *I have raised the issue of comparing lease financing to "government" financing in the past, and confirm that Board of Management review the larger projects/purchases. Board has, however, acknowledged that on these smaller value items, departments can have the final say.*

8.47 *I agree it is important, therefore, that individual departments (the lessee) continue to evaluate the financial options in their purchase decision. It is however incumbent on us to provide sufficient options to allow departments to do the evaluation. The trend, I understand, both here as well as other provinces is toward rental only policy for convenience copiers due to rapid changing technology and anticipated life of these machines.*

Concluding comments on these departments

8.48 We were pleased to see a commitment by all four departments to present value analysis. The first paragraph of the Department of Supply and Services response eloquently summarized a common element of our discussion with departments included in the audit. We noted repeatedly in our audit that the policy does allow for departments to use discretion when deciding whether or not to lease. It alludes to the fact that present value analysis is a "partial basis for decision making." It goes on to add, "analysis does not preclude the considered judgement and intuition of the decision maker as to which is the best choice from a standpoint of experience and knowledge." In our opinion, however, if there were qualitative factors that may have caused the Department to favour the higher cost alternative, it would have been prudent to document these factors in the lease files. In other words, the reason for the decision must be adequately documented.

Analysis prepared, but not in compliance with policy

8.49 The Department of Education was the only one of the five departments sampled that carried out present value analysis. Since their files contained this analysis, there was actual documentation we could use in applying some of the detailed sections of the policy. We had, in fact, developed sixteen detailed sub-criteria which we believe focus on many requirements of policy AD-6701. We shared them with a number of departments but in most cases the point was moot. If the departments had not carried out any form of present value analysis, there was no point in asking a detailed series of questions as to whether the analysis was done in accordance with policy. Thus this section of the chapter deals exclusively with the six leases we examined in the Department of Education. We believe, though, that a fairly thorough discussion of the Department's analysis is important for illustrative purposes. The policy provides excellent guidance to departments by requiring "a comparative analysis of costs....as a partial basis for decision making." However, if this analysis is not carried out correctly, departments run a risk of

uneconomical decisions. Based on our calculations, we have concluded that risk is real. In almost every case, leasing proved more expensive than buying.

8.50 It should be noted that five of the six leases were the subject of presentations to the Board of Management. In our opinion, this further focused our attention on the importance of examining the details of the policy. The importance of the quality of analysis in support of a decision is heightened given that the Department's presentations to the Board showed leasing produced significant savings over outright purchasing. This was contrary to our findings. For this reason, among others, we had concerns about the quality of information presented to decision-makers.

8.51 We are not reporting each of our findings for each of the detailed sub-criteria for each and every lease. We are instead focusing on certain key elements of the policy where we feel compliance can be improved.

Interest rate not always documented

8.52 As noted earlier, many leasing companies cannot match the Province's low rate of financing. If all other factors are equal, this makes leasing automatically more expensive than purchasing. Because of this reality, one of our sub-criteria says:

The interest rate implicit in the lease should be clearly documented and verifiable to allow the Department to determine if the lease offers a financing advantage over the Province's financing rate.

8.53 Only two of the six leases we reviewed had clear documentation in this respect. In the two cases where the information was available, the lessor had an implicit interest rate of 7% versus the Province's rate of approximately 5.9%. Clearly, the Province's cost of financing was cheaper.

8.54 In a couple of the other cases, we tried to determine the implicit rate based on other information disclosed in the lease contract. In these cases we also found that the calculated rate exceeded the Province's own financing rate.

8.55 One can see the value of having the financing rate disclosed. Disclosure of the implicit interest rate immediately shows to the decision-makers that the lease could be more expensive. The lessor will have to come up with some other considerations, or there will have to be qualitative factors brought into play, in order to make leasing a good value-for-money decision.

Outright purchase price not obtained, or obtained and not used

8.56 Drawing on sections of the policy, we developed a sub-criterion stating "an outright purchase cost should be determined for the same asset or assets as specified in the lease proposal." This information is

important for the analyst to have in doing an accurate comparison of the lease option to the purchase option. Otherwise the analyst has to guess at what price the department may have been able to purchase the same quantity of equipment it was leasing. As we will discuss later in this chapter, the purchase price information is also important to good accounting decisions.

8.57 In only one of the six leases we examined did the Department use an outright purchase price for the same quantity of units that it leased. In two other cases the Department had fairly recent information on a bulk purchase price but did not use it in its calculations. Instead, in most of its analyses, the Department appeared to be relying on an estimated purchase price loosely based on the government's standing offer.

8.58 The problem with using this approach can be shown by illustration. One of the leases we looked at was a lease for 2,479 workstations dated 1 November 1997. The computers are to be returned by 31 October 2000.

8.59 The actual purchase price quoted by the supplier on 15 July 1997 was approximately \$1,630 per unit. Instead of using this \$1,630 figure, however, the Department's present value calculation for the purchase option was based on the Province's standing offer for an equivalent computer (approximately \$2,000 per unit). The standing offer, though, assumes a department will be purchasing one or relatively few units at a time. It does not take into account the volume discounts that would be available by ordering 2,479 similar units at one time. In fact, the standing offer notes that for cases where a department is purchasing a large number of units it can seek a separate tender.

8.60 The Department's analysis, then, was not comparing two equal options. The lessor was building a volume discount into its figures but the Department was using a low volume price for calculating the purchase option. By using the price of \$2,000 for the purchase option, the lease option appeared much cheaper. It is an unfair comparison in terms of the requirements of the policy.

8.61 The Department's rationale for using the standing offer price is that if it had to purchase the units, it would have purchased a much smaller quantity and therefore would not qualify for a volume discount. The Department states its method of analysis compares the lease price with the cost of similar microcomputers that it would have purchased in a historical pattern. This historical pattern, with the exception of some major initiatives, was to distribute funds to the school districts and have the districts buy units from the government or educational standing offer.

8.62 Further, departmental staff said that they would have never purchased outright this quantity of computers for two reasons. The first was that they did not feel the budget was sufficient to permit this. The second was that *“We were solving a refresh problem. This problem is that computers in important courses were ageing and again there was no mechanism in place to ensure regular refresh.”*

8.63 However, policy AD-6701 clearly states “every proposal should be analysed with the potential lessee determining the cost of a leasing plan against the cost of raising the same amount of capital through long-term debt financing.” Instead, the Department has computed a price at which it believes it could have bought a few units, and multiplied that by “many” units, in this case 2,479 computers. The resulting number does not represent the cost of the alternative of purchasing 2,479 units en masse.

8.64 The Department did not in fact perform the type of present value analysis required by the policy. The comparison that is being made is between leasing a high volume of computers with purchasing a low volume of computers many times.

8.65 A final observation we would make in this section, is that since the Department did not always have good purchase information to perform its analysis, this also means it did not always have the necessary information to make the purchase. Without obtaining such information, one could question whether purchasing was ever a serious option.

Residual value not based on documented evidence

8.66 Another of our sub-criteria reads:

The residual value should be based on documented evidence at the time of entering the contract.

8.67 The term residual value refers to what the computer would be worth at the end of the period contemplated in the analysis. Section 14 of the policy states:

Where alternative expenditure projects have unequal lives, comparisons may be made either over the useful life of the long-lived project, or over the useful life of the shorter lived project. This policy recommends that what the residual values will be at the end of the longer lived project be estimated. This makes sense primarily because the decision maker should extend his or her time horizon as far as possible. If he or she is considering a long lived project, serious consideration should be given to what would be done in the time interval between the termination dates of the shorter lived and longer lived projects.

8.68 In comparing a purchase to a lease, a time interval or unequal lives does become a concern. Most of the leases are for three years. At

the end of the three years a leased computer must be returned to the lessor. If the Province had bought that same computer, it could continue to use it for the remainder of its useful life. Perhaps another year, maybe longer.

8.69 This raises the question then, of what time period should one consider and, therefore, what residual value should the analyst use in the calculation? In some leases we examined, the leased units can be bought at the end of the lease term based on a buy-out option negotiated by the Province. In these cases one might say the best estimate of residual value the analyst has is the price stated in the buy-out option. Then the two alternatives can be placed on equal footing by comparing the lease payment stream plus the eventual buy-out to the cost of purchasing the item at the outset.

8.70 Another method would be to match the cost of leasing a computer for the three-year term to the cost of purchasing the computer and then disposing of it at the end of three years. The relevant residual value in this case is what value the Province could get out of the computer at the end of the three-year period. It could be a price the Province would get by selling a unit to a third party. (This appears to be the method most often used by the Department.) Or it could be an implied value for putting the computer to an alternative use elsewhere in government. But whatever the case, we return to the principle of our sub-criterion: the residual value should be based on documented evidence at the time of entering the contract. In the analysis we looked at, this was not so.

8.71 In most of its analysis the Department used a residual value of 10% of the purchase price. This was an estimate of what it could sell the computers for at the end of three years. This may or may not have been reasonable. There was nothing on file to indicate the source of this estimate. When this became the subject of discussion during our audit, the Department provided a variety of current literature regarding the resale value of computers.

Reasonable buy-out options

8.72 The policy states:

One of the principal disadvantages of lease financing is that the lessee does not own the asset; any residual value after the basic lease period goes to the lessor.

8.73 One of our sub-criteria is:

Given that "not owning" is cited as a disadvantage of leasing, lease agreements should provide a buy-out option at a reasonable price.

8.74 We were pleased to find that four of the six leases did have a buy-out option, although with one of these we did have a concern as to whether or not it was at a "reasonable price." In that case, the

Department could purchase the equipment at expiry for the lower of 22% of the original cost or fair market value as determined by the lessor. In fact, as we discuss later under Accounting Considerations, the Department did decide to effectively exercise the option at 22% in 1997.

8.75 It would seem in hindsight that allowing the lessor to determine fair market value might have placed the Department at a disadvantage. One departmental document dated June 1997 estimated the value of the equipment at 16%.

8.76 In such a situation it may have been beneficial to have an arbitrator determine fair market value. The Department has actually instituted such a clause in another of its leases.

Advantages of owning not documented

8.77 Another of our sub-criteria is that:

Careful consideration should be given to the relative advantages of owning versus not owning and the results should be documented in the files.

8.78 We did not find any such documentation in the files. We realize we have the benefit of hindsight, but it seems rather unfortunate that no such discussion was documented, at least in the case of the one lease the Department already bought out.

8.79 When the lease was originally approved by the Board of Management, the Board Minute noted approval was conditional on “negotiating a lease arrangement with the supplier which when discounted on a present value basis is equal or less expensive than direct purchase.” In other words, it was enforcing the requirements of Policy AD-6701.

8.80 The Department did a present value analysis and we were able to review a copy. The Department calculated the present value of the lease option at \$1,114,151 as opposed to \$1,114,535 for the purchase option. This was a difference of only \$384.

8.81 For a lease of this magnitude, the Department’s own calculation of a difference of only \$384 means the options are indistinguishable. Even based on its own numbers, one might say the Department gave up the benefits of ownership for only \$384.

8.82 As discussed earlier, the Department exercised the buy-out option in this lease in 1997 because it deemed the units were still valuable to its programs.

8.83 One of the major factors it considered in exercising the buy-out option was its estimate that it would cost \$400 per unit (or \$120,000 in total) to prepare, pack and ship the units back to the lessor. This cost may seem high, but the Department informed us that each unit would

require significant technician time to erase confidential material from the memory. In fact, one departmental document we reviewed estimated the cost even higher at approximately \$140,000.

8.84 In our opinion, at the time of the original purchase and lease decision, the Department should have known that the computers were being put to a use which carried with it such a significant cost of data transfer.

Qualitative factors not documented

8.85 Policy AD-6701 does not prohibit a department from accepting the more expensive of the two alternatives. Section 5 notes that a comparative analysis of costs is performed as “a partial basis for decision making.” Section 7 adds:

The analysis does not preclude the considered judgement and intuition of the decision maker as to which is the best choice from the standpoint of experience and knowledge.

8.86 Based on this, one of our sub-criteria reads

Other key factors such as “considered judgement” of the decision-maker should be appropriately documented in departmental records.

8.87 In one of the leases we examined the Department provided us with information indicating that the lease of certain computers was estimated to cost \$4,740 more than purchasing. This was not immediately apparent in the submission to the Board of Management as the \$4,740 excess was combined with the Department’s estimated savings on another lease with a totally separate vendor.

8.88 In our view, this lease was an occasion where these qualitative factors should clearly have been discussed. If there were valid reasons for proceeding with this more expensive lease option, the Board of Management and other decision-makers should have been informed.

No, or limited, evidence of review

8.89 One of our criteria relates to the importance of a review of documentation supporting a decision. Our sub-criterion stated:

The recommended decision and the supporting documentation should be subjected to review by an appropriate senior official (or officials) to ensure the numbers used in the present value calculation are adequately supported and challenged, and that the calculation is done accurately.

8.90 This criterion is based on a section of the policy which states:

While the present value method will indicate the optimum expenditure decision on an economic basis, the answer is only as good as the data input to the technique.

8.91 We previously noted how two totally separate leases were combined in one analysis.

8.92 We are concerned about the fact that the Department provided the Board of Management with an analysis that combined two distinct transactions. In its submission to the Board of Management, the Department projected net savings of leasing over purchasing of \$924,323 for the two leases combined.

8.93 In most of the leases we examined we had concerns that the documentation supporting the decision did not seem to have evidence of review. In this case, however, we noted that the copy of the Department's submission to the Board of Management contained a number of hand-written notes showing evidence of some review and/or consultation. The notes indicated some involvement by the Office of the Comptroller, a senior financial officer in the Department of Education and the Budgets Branch of the Department of Finance.

8.94 We were surprised that on the documents reviewed, not one indication was available that any of these officials challenged the fact that leases were being lumped together in one calculation. Neither was there any indication on file that the huge net savings forecasted in the Department's present value analysis were questioned. The Department's submission to the Board showed savings of \$924,323¹ over a net present value of purchasing of \$4,529,243 (roughly 20%). No one appears to have documented the logical question of how can leasing be so much cheaper than buying. No one asked 'how can the Department be saving 20%', especially since the expectation would be that the lessor would have a higher financing rate than the Province. No one appears to have documented a concern that the Department was comparing the cost of leasing many units to the cost of purchasing one unit many times.

8.95 On another lease we found some errors and/or omissions that may have been detected had a review been conducted by an appropriate senior official. In one example, already mentioned, the Department predicted savings of \$384 by leasing versus outright purchase.

8.96 We reviewed the Department's present value calculation and found two errors. The purchase option included 11% provincial sales tax while the lease option did not. In addition, the present value of the lease payments was calculated as if the payments were due at the end of the month. Payments were actually due at the beginning of the month. These errors amounted to approximately \$130,000, turning the \$384 savings into a significant loss.

1. Our calculations showed the lease savings were probably closer to \$90,000. This is one case where the three-year lease appears to save money.

8.97 We have discussed earlier how this lease was later bought out at 22%. The buyout was actually arranged by a third party vendor who on 1 October 1997 packaged the 22% buyout with a separate lease of 264 servers and 271 workstations. The leasing company financed this new lease of 264 servers and 271 workstations and, in addition, purchased the used servers and workstations to lease back to the Department. This old lease was due to expire in December 1997.

8.98 This combined lease was actually two transactions. Similar to the previous case, they were combined in a submission by the Department to the Board of Management.

8.99 The Board of Management gave authorization on 16 July 1997 to the Department to buy out the old lease and lease the new equipment in this combined lease, based on projected net savings of leasing over purchasing of \$69,694. As we have earlier noted, this combination approach obscures valuable information in the decision-making process.

8.100 According to our understanding of the events, the new lessor paid the 22% residual value as required in the conditions of the old lease. It also made a payment to the first lessor of \$155,000 which represented principal and lost interest for four months remaining in the original lease. It was effectively buying out the lease, early, on the Department's behalf.

8.101 This settlement appears excessive. Had the Department continued paying for the remaining lease term, it would have paid only \$105,513. Then the Department could have exercised the same 22% buy-out of \$242,039 (or perhaps even a lower rate given its estimate that the computers were worth 16% of the original price). Therefore, the cost of waiting to the end of the lease to buy the computers would have been \$347,552. This is about \$50,000 less than the sale price to the new leasing company of \$397,189. This is not due regard for economy. A wait of four months would have saved considerable funds.

8.102 Again, we return to our point in this section. A review may have questioned some of the key assumptions in this case.

Looking ahead

8.103 In our opinion, the analysis required in policy AD-6701 "Present Value Analysis of Expenditure Decisions" was not adequately performed in the leases we have examined. Although the Department carried out a number of present value analyses, each lease examined did not meet a number of the principles set out in the policy.

8.104 The policy provides excellent guidance to departments by requiring "*a comparative analysis of costs.....as a partial basis for decision making.*" However, if this analysis is not carried out, departments run a risk of uneconomical decisions. Based on our

calculations, in almost every case leasing proved more expensive than buying.

8.105 This finding is consistent with the Comptroller's 1995 review. In the section "Key Findings" the Comptroller stated:

For each asset category examined, leasing/rental decisions were not cost effective. When compared to build/purchase options, lease/rentals led to higher cumulative budget expenditures and net debt to the Province over the useful life of the asset.

Purchase versus lease/rent options should be fully analyzed, determining the cost to government over the useful life of the asset using present value analysis.

8.106 The Comptroller went on to recommend:

Administration Manual Policy Number AD-6701 "Present Value Analysis of Expenditure Decisions" should be strictly enforced and provide the basis for analysis and cost effective decision-making.

8.107 Let us look at some of the key sub-criteria based on the policy where we found weaknesses in compliance:

- The interest rate implicit in the lease should be clearly documented and verifiable to allow the Department to determine if the lease offers a financing advantage over the Province's financing rate.
 - Only two of the six leases had clear documentation in this respect.
- An outright purchase cost should be determined for the same asset or assets as specified in the lease proposal. – This was only done in one of the six leases. In two others, the Department had a recent purchase price but did not use it in the analysis.
- The residual value should be based on documented evidence at the time of entering the contract. – In most cases residual value was set at 10% without any supporting documentation on file. The number may well have been reasonable. It just wasn't supported.
- Careful consideration should be given to the relative advantages of owning versus not owning and the results should be documented in the files. – As discussed, this was not done.
- Given that "not owning" is cited as a disadvantage of leasing, lease agreements should provide a buy-out option at a reasonable price.
 - Four of the six leases did have buy-outs.
- Other key factors such as "considered judgement" of the decision-maker should be appropriately documented in departmental records.
 - The Department did not believe this to be a requirement of AD-6701 and therefore excluded it from the discussion.

8.108 A consistent theme in this chapter is the deficiencies in the quality of the supporting analysis behind decisions. For instance, if the purchase option is to be clearly examined, a department should get a quote from the supplier for the same number of units it intends to lease. Not only does this provide the department with the information it needs to do a proper analysis, it also allows it to clearly separate the acquisition decision from the financing decision. This financing issue leads directly to another point. The department should know the implicit interest rate in the lease so it can compare the lessor's financing rate to that of the Province.

8.109 Another important area is discussion of qualitative factors. We believe a department should clearly document the other qualitative factors that influence the decision. Sensitivity analysis should be carried out to allow decision-makers to understand the impact of various estimates.

8.110 It seems quite simple in principle, yet as the Department of Education has informed us, it is sometimes difficult to meet all the principles of properly documenting decision-making in the face of various pressures to do things quickly.

8.111 On the other hand, the pressures of the hectic administrative and program environment would seem to make policy AD-6701 even more relevant. The rigour imposed by the requirements of the policy would add a quality and consistency to the supporting analysis behind the decisions. The decision-makers should have confidence that the recommendations were supported by a meaningful analysis consistent with the requirements of the policy. Because of the inherent value of policy AD-6701, we made the following recommendations.

Recommendations

8.112 We recommended the Department of Education review the requirements of policy AD-6701 to ensure that the key elements of the policy are complied with in future leasing decisions. We suggested that our sub-criteria be used as an input to this review.

8.113 This leads to several more specific recommendations.

8.114 We recommended that in future lease versus purchase decisions:

- an outright purchase cost be determined for the same asset or assets as specified in the lease proposal;
- the residual value should be based on documented evidence at the time of entering the contract;
- careful consideration should be given to the relative advantages of owning versus not owning and the results should be documented in the files;

- the analyst should use sensitivity analysis to provide an immediate financial measure of possible variances in forecasting;
- other key factors such as the “considered judgement” of the decision-maker should be appropriately documented in departmental records; and
- the recommended decision and the supporting documentation should be subjected to review by an appropriate senior official (or officials) to ensure the numbers used in the present value calculation are adequately supported and challenged, and that the calculation is done accurately.

8.115 To cover those cases where the Department decides to lease, we added a further recommendation.

8.116 We recommended that all lease agreements should provide a buy-out option at a reasonable price. Consideration should be given to such factors as dispute resolution and using an arbitrator to determine fair market value.

8.117 During our discussions with the Department, we found a fairly high acceptance of our sub-criteria. The Department appeared supportive of adding a standard checklist to the policy. This working paper would list key requirements of the policy and a senior financial officer or other key official could sign it off. This would ensure the department properly documented its present value analysis of expenditure decisions.

8.118 We recommended the Department of Education develop a standard working paper or checklist to assist in the implementation of policy AD-6701.

Accounting Considerations

Policy requirements

8.119 Our second criterion refers to the appropriateness of the accounting classification. Section AD-6203 in the Province’s Administration Manual sets out the Province’s policy for classification of expenditures. The policy draws on CICA recommendations to define when a lease should be accounted for as a capital lease. That is, if substantially all the benefits and risks of ownership of the asset transfer to the Province, the Province has effectively purchased the asset and the accounting should disclose this. Three indicators of this transfer are:

- there is a reasonable assurance the Province will obtain ownership at the end of the lease;
- the lease term is such that the Province will receive substantially all the economic benefits from the leased equipment. This is deemed to be the case if the lease term is 75% or more of the economic life of the equipment; and
- the lease conditions are such that the leasing company is assured of recovering its investment in the equipment during the life of its lease

agreement with the Province. This is deemed to be the case when the present value of the lease payments is 90% or more of the fair market value of the asset.

Several leases classified incorrectly

8.120 All of the leases we examined were classified as operating leases by the respective departments. In our opinion, however, several of the leases are capital in nature.

Too late to correct three leases

8.121 In the case of the Department of Agriculture and Rural Development we examined and discussed the two leasing transactions. The first was the four-year lease for the radial spectrometer finalized in March 1997 with a net present value of approximately \$140,000. The second was the three-year lease for the infra-red analyzer finalized in June 1997 with a net present value of approximately \$220,000.

8.122 The Province's policy says that a lease should be classified as a capital lease if "there is a reasonable assurance that the lessee will obtain ownership of the leased property by the end of the lease term." Both these leases end with the ownership of the equipment automatically transferring to the Department. The equipment purchases are capital in nature and they should therefore have been accounted for as capital leases and capital expenditures.

8.123 We encountered a similar situation in the Department of Municipalities and Housing. In April 1995 the Department entered into the five-year lease agreement for a computer system for the Emergency Measures Organization (EMO). The system had a present value of approximately \$175,000.

8.124 According to the policy, a lease should be classified as a capital lease if substantially all the risks of ownership of the asset transfers as a result of the lease. One of the indicators of risk transfer is that the present value of the lease payments is 90% or more of the fair market value of the asset. Our calculations show that the present value of the lease payments is actually more than 110% of the original fair market value of the asset. For this reason we believe the lease should have been accounted for as a capital lease.

8.125 The proper treatment of capital leases requires the present value of the lease payments to be expensed when the lease is entered into. Instead, the Department is expensing the lease payments when they are made over the five-year leasing period. This caused an understatement of ordinary expenses of about \$140,000 in 1995-96 and an overstatement of expenditures of about \$35,000 in fiscal years 1996-97 through 1999-2000.

8.126 In both of these departments we noted that a significant portion of the terms of the leases had already expired. Given that, we concluded there is probably not much that can be done to meaningfully correct the

accounting errors. There must, however, be controls put in place to ensure that government policy is followed. Therefore, we made the following recommendation to both departments.

Recommendation

8.127 We recommended that the Department take appropriate steps to ensure that government policy AD-6203 is followed.

Department of Agriculture response

8.128 *We agree that Policy AD-6203 was inadvertently overlooked and should any purchases of this nature occur in future, we will ensure that the Policy is adhered to and the purchases are capitalized.*

8.129 *Just to clarify our decision to lease-purchase, this came about as a result of a budget problem in that funds did not exist to outright purchase these two large pieces of laboratory equipment. In the case of the equipment for the Soils Laboratory, this was more or less an emergency or urgent purchase because the old equipment ceased to function and was deemed not worth repairing.*

8.130 *The Dairy Laboratory Analyzer lease-purchase on the other hand, was planned in advance and a net budget was obtain and approved by Board of Management. In fact the cost of the equipment including the lease interest is being fully recovered from the Dairy Industry with no cost to the Province.*

Department of Municipalities and Housing response

8.131 *The Department of Municipalities will advise responsibility centre managers of the necessity to follow the Classification of Expenditures policy and to contact our Financial Services Branch for advice on categorising lease transactions.*

At least one lease in the Department of Education is classified incorrectly

8.132 As noted, the Department of Education classified all six of the leases we examined as operating leases. One lease, however, clearly is capital in nature. And our analysis has raised enough questions about the other leases to suggest that the whole question of capital versus operating needs to be more clearly addressed.

8.133 The particulars on the capital lease are as follows. On 1 October 1997 the Department leased 264 servers and 271 workstations. In addition, the leasing company purchased used servers and workstations from a third party to lease back to the Department. This third party was already leasing these servers and workstations to the Department and the three-year lease was due to expire in about four months.

8.134 In our opinion, the buy-out of the used servers and workstations and the related lease back to the Department is clearly capital since it results in the Department owning the assets at the end of the lease term. The other part of the lease covering the 264 servers and 271 workstations is capital as well. We have noted the Department determined that the fair market value of the new computers after four years is zero. Therefore, it has effectively acquired the benefits and

risks of ownership. In other words, the Department will consume 100% of the economic life of the asset, clearly meeting the 75% rule set out in the policy.

8.135 This misclassification caused an understatement of expenditures in 1997-98 of approximately \$1.5 million. In each of the subsequent three years it results in an overstatement of expenditures of about \$400,000. In the final year of the lease the overstatement drops to approximately \$200,000. Because our recommendations were provided to the Department prior to finalizing the financial statements for 1998-99, we felt there may be an opportunity to correct the accounting error. In other words, to date the error has only been recorded incorrectly in one fiscal year.

Recommendation

8.136 Therefore, we recommended that the Department classify this lease as a capital lease.

Other leases in the Department of Education may also be misclassified

8.137 The policy lists three distinct conditions, any one of which would cause a lease to be classified as capital. We noted that for the six leases audited, there was not adequate documentation on file (such as a systematic checklist with appropriate supporting back-up) to ensure that these “operating” leases did not meet any of the three indicators specified in the policy. In one of the files we did find some documentation on the classification decision, but it appears that all three questions were not adequately addressed. In the case of another lease, a departmental document said:

The Department has consulted with the Comptroller’s Office on this matter and it is agreed that this is an operating lease and not a capital lease.

8.138 But we could not find any documentation on file that showed how all three indicators in the policy were addressed.

Indicator #1

8.139 With regard to the first question of reasonable assurance of ownership, we cannot be conclusive. We do know that the Department has already bought out the lease referred to above.

8.140 None of the other leases have expired. And the Department’s position is that, unlike the case already noted, it does not intend to own the computers at the end of these other leases.

8.141 There are a couple of factors, however, which we would like to present for consideration. First, in three of the remaining leases, the Department has negotiated a buy-out or purchase option. This indicates the Department could become an owner at the end of the lease term. The buy-out rates vary between 7.5% and 17% of the original purchase price. Buying may seem to be a convenient option as these leases expire.

8.142 We also noted that all the leases expire during the school year, not after the year has ended. Educational programming considerations may combine with budgeting concerns, making it difficult for the Department to replace classroom units in the middle of an academic year. This may cause the Department to rethink its ownership decision as time passes.

8.143 These factors aren't conclusive in determining reasonable assurance of ownership. But they do point to ownership as a consideration that should be addressed and documented as part of each leasing decision.

Indicator #2

8.144 The second indicator relates to the lease term and the economic life of the equipment. The policy dictates that the Province will receive substantially all the economic benefits from the leased equipment if the lease term is 75% or more of the economic life of the equipment.

8.145 Most of the six leases examined are for three-year terms. If the units are assumed to have an economic life of four years or less, then the Department has entered into capital leases. That is, it has consumed 75% or more of the economic life. With rapid changes in technology one could argue that four years of economic life is on the generous side. Such a view is supported by the Department's estimate that it could recover no more than 10% of the purchase price if it sells a computer after three years. Further, in the one lease in our sample with a four-year term, the Department assumed a unit would have no resale value for purposes of its calculations. In effect, for this lease at least, the Department has estimated four years is the sum total of a computer's economic life.

8.146 Of course, one could counter that in the school system a computer has a much longer economic life than four years. For example, older units could be "pushed down" to a lower grade where the educational program was not so dependent on the latest technology.

8.147 The problem with the "push down" argument, though, is that if one agrees that because of it a lease does not meet the second indicator, it then becomes a valid reason for a lease being capitalized under the first and third indicators. That is, since an older computer still has considerable intrinsic value in a school system, a value that exceeds use in a commercial venture, then the Department is much more likely to exercise a reasonable buy-out option (the range in the leases we examined is 7.5% to 17%). Indeed, this is what happened already with one lease we examined. The Department saw a 22% buy-out as an excellent opportunity to place older computers in a spot where none or few were being used before. In fact, in its presentation on this matter to the Board of Management the Department said:

There is a requirement for the existing equipment to be redistributed within the school administrative areas to

improve productivity and as a result, the Department would like to purchase it rather than return it to the lessor. The equipment is still very functional and would fulfil the requirements of this area (emphasis ours).

Indicator #3

8.148 The third indicator might be termed the 90% rule. The lease is determined to be capital if the present value of the lease payments is 90% or more of the fair market value of the asset.

8.149 In most of the tenders or requests for proposals for the leases, the Department did not obtain an outright purchase price from the supplier. This makes it more difficult to positively determine whether the present value of the payments exceeds 90% of the fair market value of the computers.

8.150 In our opinion, however, the approximate price of the computers between the wholesale vendor and the lessor can be either calculated from, or is evident in, the lease. If these calculated prices are assumed to be equivalent to a provincial purchase price, all but one or two of the leases would be capital leases under the third indicator.

*Conclusion re classification
issues in Department of
Education*

8.151 As already noted, one of the Department's leases is clearly capital. We are recommending that the accounting error be corrected immediately. When we examine the remaining leases under the Province's three indicators for capitalization, the Department's accounting classifications move into, at best, a grey area. It would seem appropriate to review each of these so-called operating leases in some detail and properly document the classification decision. Since the Department has a number of other leases that we have not tested, it would be appropriate to extend the review to all of its operating leases.

Recommendations

8.152 We recommended for future requests for proposals and tenders for leases, that the Department obtain an outright purchase price as one of the options. This would enable the Department to more easily determine and document the appropriate accounting treatment for the leases. And it would allow the Department to separate the acquisition decision from the financing decision.

8.153 We recommended the Department evaluate all its present leases and clearly document its reasons for accounting classification decisions. All three conditions of the administrative policy should be addressed and documented in the exercise. Any changes resulting from the exercise should be discussed with the Office of the Comptroller to determine the impact on the financial statements of the Province.

8.154 We also recommended that the Department take appropriate steps to ensure that the administrative policy is followed in the future.

*Department of Education
response to our
recommendations on both
compliance with policy
AD-6701 and accounting
considerations*

8.155 We recommended that the Department develop a plan to deal with both the educational programming and technology replacement issues associated with the expiry of leases within an academic year.

8.156 *The Department has evaluated the observations outlined in your report and we maintain that our decision to lease computers was the best alternative at that time.*

8.157 *Our position is based on the following advantages of leasing computers;*

- 1. Computers have an extremely high rate of obsolescence. By leasing, we are able to replace computers every three years and thus provide schools with relatively current hardware.*
- 2. By leasing, our equipment is always on warranty and we are able to financially penalize the supplier if our strict warranty deadlines are not met. For example, under the terms of the leasing agreement, we can withhold lease payments if warranty work is not performed to our satisfaction.*
- 3. The purchase price of computers is continually dropping while the processing power is increasing, which makes purchasing and owning computers less desirable. Furthermore, as processing power increases, software companies add features that require this additional processing capacity. By leasing approximately one third of school computers, we can expose students to newer software products and enhanced learning opportunities.*
- 4. Overspending our budget to purchase a large quantity of computers in order to reduce the price per unit was simply not an option. Nevertheless the Department benefited from large volume discounts by leasing in large quantities. For example the implied cost in one lease was \$1,626, a savings of \$817 per unit when compared to the regular provincial government purchase cost (standing offer) of \$2,443.*
- 5. Leasing allowed for a large number of computers to be introduced in schools as quickly as possible. This enabled more students the opportunity to be exposed to up to date computer technology.*
- 6. There are over 15,000 computers currently in use in New Brunswick schools; 5,000 of which are leased. As noted above, there is a constant need to refresh a portion of these computers in order to keep up with the need for more computing power. Leasing is an important component of*

our overall strategy to continuously replace older computers in our schools.

8.158 *With regards to the emphasis placed in your report on the importance of policy AD-6701 “Present Value Analysis of Expenditure Decision”, we are of the opinion that aspects of this policy are outdated, especially in terms of deciding whether to lease or purchase microcomputers and servers. This policy was written in 1977 before the introduction of microcomputers and at a time when many assets increased in value and obsolescence was not an important issue. There is also a need to place more emphasis on the importance of the non-financial benefits of leasing. The Comptroller’s Office has advised us that they recognize that this policy needs to be revised.*

8.159 *We do agree with the need for improving the quality of supporting documentation and it is our intention to do so in the future, particularly with regards to the non-financial benefits of leasing.*

8.160 *It is important to note that this response has been prepared after consultation with the Department of Finance and the Comptroller’s Office, which participated in the original assessment of leasing versus purchasing computer equipment for schools.*

8.161 *We firmly believe that we made the correct decision, both financially and educationally, in our assessment to lease rather than purchase computer equipment for the public school system. We are confident that students, parents, teachers and the taxpayers of New Brunswick have garnered tangible benefits from this decision.*

Our concluding comments on the Department of Education response

8.162 We have included the Department’s response in its entirety. We have the following observations on their comments.

8.163 The Department is of the view that aspects of policy AD-6701 are outdated. If this is in fact the case, then we would have expected to see the policy changed or amended. No department should be able to exempt themselves from all or part of a government policy.

8.164 We are of the view, however, that the policy is still valid and the various points raised by the Department as “non-financial” benefits of leasing could have been included as qualitative factors in the decision-making process. Section 7 of the policy states “*The analysis does not preclude the considered judgement and intuition of the decision maker as to which is the best choice from the standpoint of experience and knowledge.*” Providing information on “non-financial” benefits will enable decision-makers to weigh their significance, when being asked to select a more expensive alternative.

Chapter 9

Governance

New Brunswick Liquor Corporation

Contents

Background	167
Scope	168
Results in Brief	169
Detailed Findings	170

Governance New Brunswick Liquor Corporation

Background

9.1 Under the New Brunswick Liquor Corporation Act,

The purposes of the Corporation are to carry on the general business of manufacturing, buying, importing and selling liquor of every kind and description.

9.2 The New Brunswick Liquor Corporation (NBLC) is a highly profitable Crown agency that has improved customer service markedly over the past few years with such changes as more locations, longer hours, acceptance of debit and credit cards, Sunday openings, specialty products and festivals. NBLC still has a monopoly over liquor sales in the Province. However, its business environment has changed. Recently, NBLC has been addressing such issues as the Year 2000 problem, meeting market demands, the introduction of agency stores which now account for twenty percent of corporate revenue, and improving the quality and timeliness of information through the installation of new point of sale terminals.

9.3 In 1996 we conducted a preliminary review of the governance structures and processes at a number of New Brunswick Crown agencies, including the New Brunswick Liquor Corporation. At that time, we indicated that we intended to do more detailed reviews of governance at certain of those Crown agencies in the future. We feel that all boards, even the boards of corporations that appear to be performing well, can improve the effectiveness of the governance they provide and accountability processes they promote. In 1998-99, we continued our review of corporate governance and accountability by looking at the New Brunswick Liquor Corporation.

9.4 The Conference Board of Canada, in a report dated January 1999, stated that *"Empirical data demonstrate clearly that corporate governance affects the performance of companies."*

9.5 Governance is defined as the process and structure used to direct the business and affairs of a corporation with the objective of achieving

the corporate mission. The process and structure define the division of power between the board and management. They also establish mechanisms for achieving accountability between management, the board of directors, and the Legislative Assembly.

9.6 CCAF/FCVI Inc. (formerly the Canadian Comprehensive Auditing Foundation) has developed a list of the characteristics of effective boards. If a board truly exemplifies these characteristics, it will be providing effective governance and accountability. According to CCAF/FCVI, effective boards:

- are comprised of people with the necessary knowledge, ability and commitment to fulfil their responsibilities;
- understand their purposes and whose interests they represent;
- understand the objectives and strategies of the organization they govern;
- understand what constitutes reasonable information for good governance and obtain it;
- once informed, are prepared to act to ensure that the organization's objectives are met and that performance is satisfactory; and
- fulfil their accountability obligations to those whose interests they represent by reporting on their organization's performance.

9.7 We feel an effective board, as defined above, is in the best position to contribute to the success of its corporation. A board can demonstrate its effectiveness by making informed decisions that take all pertinent factors into account, thereby promoting appropriate corporate activities, and by appropriately discharging their accountability obligations.

9.8 We believe that promoting accountability is the most important part of our work. We also believe that appropriate accountability processes cannot be established in Crown agencies unless effective governance structures and processes are in place and functioning. Effective boards will strive to promote corporate activities that they feel will best contribute to the achievement of the corporate mandate. Effective boards will also assess and report on the effectiveness of those activities to those to whom they are accountable. This is important to the Legislative Assembly and the public because those boards will be providing the enhanced accountability information needed to determine the degree to which the corporation has accomplished what it was set up to do.

Scope

9.9 Our objective for this project was as follows.

To conduct an in-depth review of the governance and accountability structures in place at the New Brunswick

Liquor Corporation and to offer recommendations for improvement where appropriate.

9.10 Our work included sending governance surveys to the six members who were on the Board when our review commenced, including the CEO. We also held extensive interviews with all six of the Board members. Additionally, we had a brief general discussion with the new Board chair who was appointed after our review had already commenced. We held discussions with a representative of the Department of Finance. We also reviewed the Board minutes for the period from April 1997 to October 1998, the 31 March 1998 Annual Report of the corporation and other documentation as provided by corporate management. Finally, we reviewed some general governance and accountability literature in preparing this report.

Results in Brief

9.11 The Board provides no guidance to the Lieutenant-Governor in Council regarding the skills or qualities it would recommend that new Board members possess.

9.12 There is a good mix of skill sets represented on the current Board of NBLC.

9.13 A Board position description has not been prepared documenting the roles, responsibilities and accountabilities of the Board. We feel that such a description should be prepared.

9.14 Current NBLC Board members generally seemed to be unfamiliar with recent publications on the topic of governance. We feel that the Board members should familiarize themselves with at least some of this material.

9.15 The corporation has a current strategic plan covering the period from 1998-99 to 2001-2002. It includes a mission statement, but does not identify corporate strategic objectives, performance indicators, or a plan for how those performance indicators are to be measured, evaluated, and reported.

9.16 Information the Board currently receives from management does not seem to be sufficient to enable the Board to fulfil all the roles and responsibilities we would expect them to assume, particularly in the areas of monitoring the achievement of corporate plans, and compliance with corporate policies.

9.17 The Board does not appear to be reviewing Internal Audit reports to determine if systems and controls are sufficient to ensure that corporate assets are safeguarded.

9.18 The Board does not select the corporate CEO, despite the fact that the Act gives it the power to do so. Instead, in practice, the

corporate CEO has been selected by the Lieutenant-Governor in Council.

9.19 The Board does not formally assess the performance of the CEO.

9.20 The Board has no involvement in the preparation of the NBLC Annual Report. We feel that it should be considered as the principal vehicle through which the Board discharges its accountability obligation to the Minister of Finance. Therefore, the Board should review and approve it before it is published.

9.21 The annual report of the New Brunswick Liquor Corporation does not comply fully with the Province's annual report policy.

9.22 The NBLC Board chair does not appear annually before the Crown Corporations Committee.

Detailed Findings

9.23 In our 1996 general study of Board governance among New Brunswick Crown corporations, we developed six criteria for use in evaluating the effectiveness of governance for public sector boards. The findings we present in this chapter are divided up by those criteria.

9.24 We observed during our review that the Board of NBLC seems to function mainly as a scrutinizer of management decisions and reports. The suggestions and recommendations that follow would require the Board to make a fundamental shift in the way it sees itself. This is not intended to be a criticism of the way the Board currently operates. It functions in much the same way that other boards do. It is our belief however that the Board could build on the strengths its individual members bring to the table by adopting some new approaches to governance. By adopting these new approaches now, the current Board would be providing valuable guidance to future Boards.

Board Composition

9.25 The first of our governance evaluation criteria is as follows:

The board of the New Brunswick Liquor Corporation should be comprised of people with the necessary knowledge, ability, commitment, and level of independence to fulfil their responsibilities.

Appointment of Board members

9.26 Board members believed that appointments to the NBLC Board are based on skill sets, regional representation and linguistic ability. When asked why they felt they were appointed they gave a number of reasons including their general business knowledge, their knowledge of their own local area, and their knowledge of government. Appointees are selected by the Lieutenant-Governor in Council. The CEO commented that he feels the quality of Board members during his ten years as CEO has been quite high.

9.27 Board members are appointed for varying terms of two, three or four years. We were told that the terms are staggered to ensure Board continuity. Among the current Board members, one was first appointed in 1989, another in 1990 and three more in 1997. The current chair was appointed in November of 1998.

Board's involvement in the appointment process for new Board members

9.28 We feel that a Board that is interested in being as effective as possible must start by doing what it can to ensure that appropriate people are appointed. The Board should be in the best position to know the skill sets and other attributes that are required of NBLC Board members. We therefore feel that it would be worthwhile for the Board of NBLC to provide decision-makers with some guidance for their reference when appointing new Board members and the chair.

9.29 NBLC Board members have strong opinions on the skills and aptitudes required of effective NBLC Board members. Board members who responded to our survey felt that general business knowledge was the most important attribute that an NBLC Board member could possess. They also believed that professional expertise, knowledge of government, related industry experience, and prior board experience were all of some importance.

9.30 Survey respondents also indicated their belief that there is a good mix of skill sets on the current Board. They specifically noted the mix of experience and knowledge, length of service, skills and abilities, and demographic and geographic representation provided by the current Board. We would encourage Board members to share these opinions with decision-makers. Members stated that the Board currently has no involvement in the selection of new Board members or the chair. The CEO stated that the current Board has the best mix of skill sets of any Board during his tenure. We would agree that there is a good mix of skills on the Board. We note the presence of Board members with legal, accounting, and general business backgrounds. We feel the mix of skill sets on the Board is a significant improvement over what existed during our general governance review in 1996. The Board should attempt to ensure that future Boards bring strong skills and abilities to the table by providing their input to the appointment process. One effective way of doing this would be through the preparation and regular updating of a Board member profile which could be provided to decision-makers when new Board members are being chosen.

Recommendation

9.31 We recommended that the Board prepare Board member and chair profiles and provide them to decision-makers when Board vacancies are to be filled.

Board response

9.32 *Agreed. The Board will review the sample profile....and will prepare a similar document for future reference.*

Independence of Board members

9.33 The Act screens out potential Board members with involvement in liquor-related organizations. Additionally, Board members sign a “*Declaration of Interest by Director*” form when they join the Board. There is also an informal requirement for Board members to excuse themselves from the Board table if a matter comes up for discussion in which they have an interest. A “*Standards of Conduct*” policy does exist at NBLC but it applies only to management and staff. We feel that it would be appropriate to extend that policy to include Board members.

9.34 We note that under the Act the CEO of NBLC is a full voting, ex-officio member of the Board. This means that the head of the management team is able to vote on matters taken to the Board for its approval. While we acknowledge that the CEO has only one vote on a Board of seven members, the situation does tend to blur the respective roles of the Board and management. We believe that the ability of the Board to function independently of management would be enhanced if the CEO did not have voting rights.

9.35 In the words of John Carver, author of the Book “Boards that Make a Difference”:

The chief executive must be able to rely on the board to confront and resolve issues of governance while respectfully staying out of management. The board must be able to rely on the chief executive to confront and resolve issues of management while respectfully staying out of governance.

Recommendations

9.36 We recommended that the existing corporate *Standards of Conduct Policy* be extended to cover Board members.

9.37 We recommended that consideration be given to having the CEO continue as an ex-officio member of the Board, but on a non-voting basis. This could be done by a change in legislation.

Board response

9.38 *The Board concurs that the “Standards of Conduct” Policy can be expanded to cover Board Members and will take the appropriate action in this regard.*

9.39 *The Board does not, however, agree that there is a need to make the CEO a non-voting member. ...*

9.40 *An ex-officio Board member has the same responsibilities and liabilities as other members of the Board under the NBLC Act and the NB Companies Act. Consequently, an ex-officio member does, and should have full voting rights which was the intent of the legislation. ...*

Commitment of Board members

9.41 We noted from a review of Board minutes that attendance at Board meetings is very good. In fact, members rarely miss meetings. This level of commitment is very important for the NBLC Board in that the corporate bylaws specify that five of the seven voting members must

be present for a quorum to exist. Survey respondents indicated that ten to twelve Board meetings should be held each year. The Board of NBLC currently meets on a monthly basis, i.e. twelve times per year. The majority of survey respondents also felt that Board members need to spend on average ten or less hours per month in fulfilling their duties.

Board self-assessments of performance

9.42 Board members indicated in interviews that the Board does not “self-assess” their own performance or the performance of individual Board members. The CEO indicated that he does not involve himself in assessing the performance of the Board of Directors either because “they are my boss.” However, if necessary he would discuss Board performance problems with the chair that impacted negatively on the performance of the corporation.

9.43 Board members provided some general information on the performance of the Board in their responses to the survey. They rated the overall effectiveness of the governance provided by the Board as “very good.” They also agreed that:

- the Board acts immediately when presented with clear evidence of a problem;
- the Board does not involve itself in the day-to-day management decisions of the Corporation;
- decision-making is not compromised because some Board members represent special interests;
- Board members understand the organization well enough to participate in effective decision-making;
- the Board does not act as a “rubber stamp” for conclusions reached by management;
- the Board works well together as a team;
- the Board works to resolve conflicting positions;
- Board members have sufficient opportunity to express their views at Board meetings;
- Board members appear to devote sufficient time to Board meetings; and
- attendance at Board meetings is not a problem.

9.44 We feel that it would be very useful for the New Brunswick Liquor Corporation Board to conduct an annual self-assessment of its performance to ensure it is being as effective as possible. Such a self-assessment would provide an excellent opportunity for Board members to identify how they might improve their contribution to the success of NBLC. Annual performance assessments of the Boards’ individual members would also be desirable. These would likely be

conducted by the Board chair. Adopting such a policy now would also be beneficial to future, less experienced Boards of NBLC.

Recommendation

9.45 We recommended that the Board conduct formal annual self-assessments of its performance.

Board response

9.46 *The Board does not agree that such formal self-assessments are necessary nor appropriate. If at any time anomalies are noted, the Chair addresses the individual Board member(s) directly. Our performance evaluation is the year-end operational results. The out-put is the only meaningful Board self-assessment criteria and our successful yearly record speaks for itself.*

Board Roles and Responsibilities

9.47 Our second governance evaluation criterion is as follows:
The Board of the New Brunswick Liquor Corporation should have a clear understanding of their roles, responsibilities, and duties, and the accountability structure within which they operate.

Enabling Legislation

9.48 The New Brunswick Liquor Corporation Act defines the role of the NBLC Board as follows:

The Board shall administer the affairs of the Corporation on a commercial basis and all decisions and actions of the Board are to be based on sound business practices.

9.49 Specific Board responsibilities identified in the Act include:

The Board, subject to the approval of the Lieutenant-Governor in Council, shall appoint a General Manager of the Corporation.

The Board shall, before the thirty-first day of December in each year, prepare and submit to Board of Management a budget containing estimates of the amounts required for working capital and for capital expenditures required during the next year for the purposes of the Corporation and forecasting the estimated net profit of the Corporation for the next year.

The Board shall submit to the Minister of Finance, at such times as he may prescribe, reports setting out the net profit and net profit forecasts of the Corporation and such reports shall contain such information as he may prescribe.

9.50 There is no other specific direction provided to the Board of NBLC as to their roles and responsibilities.

Bylaws**9.51** The Act states:

Subject to this Act, the Board may make by-laws for the management of the property, effects, affairs and business of the Corporation or relating to any other thing that may be necessary for carrying out the purposes of the Corporation and for the exercise of any other powers of the Corporation incidental thereto.

9.52 The Board of NBLC has created corporate bylaws. Like the Act, the bylaws are very general in describing the roles and responsibilities of the Board. They simply repeat what is documented in the Act, namely:

The Board shall administer the affairs of the Corporation on a commercial basis and all decisions and actions of the Board are to be based on sound business practices.

Board members' roles and responsibilities

9.53 NBLC board members' comments indicated that there is some disagreement as to whether the board should see itself as a governing board, or simply as an administrative manager.

9.54 All survey respondents felt that "setting strategic direction and goals" and "setting significant policies by which the Corporation operates" are very important areas of responsibility for the Board. A majority of respondents also felt that "ensuring that the Corporation has adequate resources", "making all critical business decisions", "ensuring effective management information systems are in place", "bringing an external viewpoint to the Corporation's attention" and "ensuring accountability obligations are discharged", are very important.

9.55 The CEO felt that the major roles of the Board included "giving guidance on where to go", "debating and discussing issues brought forward", and approving policies, operating plans, and strategic plans.

9.56 We also looked at some Board minutes to determine what items are included on typical Board agendas. The following is a list of areas included:

- review of monthly financial statements;
- review of other regular reports (on a quarterly basis);
- approval of tenders for suppliers of capital or operating items;
- approval of new agency stores;
- approval of lease arrangements for NBLC stores;
- approval of policy/bylaw changes as initiated by management (e.g. adjustment of mark-up list, beer listing policy);
- discussion of sale of NBLC properties which are no longer needed; and
- divisional managers presentations - education.

9.57 The comments from Board members indicate that the Board, as a whole, feels that its roles and responsibilities involve a mix of governing and administrative management areas. Our review of the Board minutes seems to confirm this opinion. However, we noted that there seems to be some variance in the views of individual Board members as to what the Board should involve itself in. This is not surprising given that the Act and by-laws are very general in describing the roles and responsibilities of the Board. A fair degree of interpretation is required by Board members.

9.58 We feel that it is very important that NBLC Board members, now and in the future, have a common understanding of the roles and responsibilities of their Board. The most effective way of ensuring this common understanding exists is for the Board to document its roles and responsibilities in a Board position description and refer to it often. Such a document would help keep the Board focused on their own roles and responsibilities. It would be a useful reference source for current Board members, and also an excellent orientation document for new members joining the Board. Also, by specifying Board roles and responsibilities, the roles and responsibilities of management are also clarified. By default anything not on the position description of the Board becomes the responsibility of management.

Recommendation

9.59 We recommended that the Board carefully consider its roles and responsibilities and document a Board position description that clearly summarizes them.

Board response

9.60 *Although the Board feels very comfortable with its roles and responsibilities, we will proceed with an orientation document on those roles and responsibilities.*

Board accountability

9.61 There are two questions relating to NBLC Board accountability that need to be answered. Very basically they are, “*accountable for what?*” and “*accountable to whom?*” A related question is “*how is the board’s accountability obligation discharged?*”

9.62 Accountability can be defined as the obligation to answer for authority and responsibility that has been conferred. We feel that as a governing board, the Board of NBLC is accountable for all activity at NBLC. In other words, the NBLC Board is accountable for the overall performance of the corporation. Much of the responsibility for achieving an acceptable performance level has been delegated to the CEO, who in turn has delegated responsibility to his staff. However, accountability for performance rests with the Board rather than the Minister of Finance or the staff of NBLC.

9.63 Board members, except for the CEO, are appointed by the Lieutenant-Governor in Council. The CEO is a member by virtue of his position under the Act. However, we do not feel that the Board should

consider itself accountable to the Lieutenant-Governor in Council (in effect the Cabinet). Accountability must flow upwards, finally reaching the Legislative Assembly. Since the Cabinet is protected by its right to secrecy, there can be no flow of accountability information from Cabinet to the Legislative Assembly. In order to circumvent this barrier, direct accountability to the Legislative Assembly for NBLC has been assigned to a representative of the Cabinet, the Minister of Finance. The Minister of Finance must answer questions in the Legislative Assembly relating to NBLC. Therefore, we feel the Board of NBLC should consider itself to be accountable to the Minister of Finance and should report to him in discharging its accountability obligation. The majority of Board members agreed that the Board is accountable to the Minister of Finance. However, this accountability flow is not established in the Act or elsewhere and should be clarified.

9.64 The NBLC Act requires the Board to submit annual budget figures for net profit and capital expenditures. It also requires the Board to provide net profit reports as required by the Minister of Finance. Otherwise, the Act gives no specific guidance to Board members as to how they are to discharge their accountability obligation to the Minister of Finance. In normal circumstances, boards discharge their accountability obligations by reporting actual performance against planned performance and explaining any variances. As we will discuss later in this chapter, formal mechanisms have been set up in government to ensure that accountability obligations are properly discharged through the annual reporting process.

9.65 As is the case with board roles and responsibilities, we feel that accountability issues should be clarified and final positions should be documented by the Board for future reference. Such documentation could be combined with the roles and responsibilities document discussed in the previous section.

Recommendations

9.66 We recommended that it be clearly established what the Board of NBLC is accountable for, to whom they are accountable, and how that accountability obligation is to be discharged. This would be most appropriately done through legislation.

9.67 We recommended that the Board include in their roles and responsibilities document, a description of what they are accountable for, to whom they are accountable, and how that accountability obligation is to be discharged.

Board response

9.68 *Disagree. The NBLC Act provides appropriate direction and guidance in this regard. Sections 3, 4, 5, and 6 of the Act establish the basic responsibilities of the Board while sections 8, 18(1), and 20 define accountability requirements.*

Board Members' Knowledge of the Business Environment

9.69 Our third governance evaluation criterion is as follows:

The board of the New Brunswick Liquor Corporation should develop and maintain sufficient expertise relative to the corporation including a working knowledge of the environment in which the agency operates and the needs of its customers.

9.70 We feel that knowledgeable Board members are the most effective Board members. Individuals who are appointed to a board normally have business or professional experience along with a wide range of other experiences that they can draw on in their deliberations at the board table. What they often do not have is specific industry or governing experience. It is towards these two areas that we feel the majority of orientation and development opportunities for board members should be directed.

Orientation sessions for new Board members

9.71 All Board members indicated that they received orientation sessions when they joined the Board of NBLC. Directors stated that they found the orientation sessions to be useful. Those who responded to the survey indicated that topics covered included the following:

- the relationship of the corporation to the Department of Finance;
- their personal conduct as directors;
- their roles and responsibilities as directors;
- presentations on various aspects of the business operations of the corporation;
- information on how the Board is structured and how it operates; and
- government policies and practices impacting on the corporation.

9.72 We would encourage those setting up future orientation sessions to include the following topics as well:

- the accountability structure within which the Board operates; and
- information on strategic plans adopted by the Board.

Developmental opportunities for Board members

9.73 We noted, during our interviews, that Board members seemed to have a good knowledge of the business environment at NBLC. They indicated that they are given informational presentations during Board meetings. These presentations, which are given on a rotating basis every few years as new members come on the Board, relate to individual sections within the corporation. Board members indicated they felt developmental opportunities provided sufficient information to allow them to be effective in their roles as Board members. We agree that there are significant developmental opportunities for Board members with regard to knowledge of NBLC and its business environment.

Knowledge of General Governance Issues

9.74 In the survey we asked Board members if they were familiar with certain governance-related publications. Some of the most important of those publications included the following:

- “*The Six Characteristics of Effective Governance*”, as developed by the CCAF/FCVI Inc. and noted in the background section of this chapter. It is a very good general reference for boards of directors.
- The Toronto Stock Exchange (TSE) publication – “*Guidelines for Improved Corporate Governance in Canada*.” Even though it is directed towards the private sector, major sections of the TSE report are applicable to the public sector as well and may be particularly applicable to a business enterprise like NBLC.
- The book “*Boards that Make a Difference*” by John Carver. It provides a valuable theoretical discussion of modern public-sector governance.

9.75 Publications by the Canadian Institute of Chartered Accountants and the Conference Board of Canada on the topic also provide useful reference material.

9.76 Survey respondents had a limited or no knowledge of these governance publications. We believe that they represent a good cross-section of material covering modern governance practices aimed at enhancing the effectiveness of boards of directors. We therefore feel that the Board of NBLC should familiarize itself with these publications.

Recommendation

9.77 We recommended that Board members of NBLC familiarize themselves with at least some of the governance publications referred to above. This could be achieved by providing group presentations to the Board, or through individual review of these publications.

Board response

9.78 *Agreed. The Board will follow up accordingly.*

Circulation of Board meeting materials

9.79 We feel that all material to be presented or discussed at Board meetings should be circulated to Board members sufficiently in advance of meetings to allow for review and reflection. Board members noted that information is received on a timely basis, allowing them adequate time for review prior to Board meetings.

Board’s Involvement in Strategic and Policy Issues

9.80 Our fourth governance evaluation criterion is as follows:
The Board of the New Brunswick Liquor Corporation should provide strategic direction to the corporation, along with a framework of corporate values and ethics within which management may operate.

Strategic and operational planning at NBLC

9.81 There are two planning documents prepared by the management of NBLC, the strategic plan and the master operating plan. Both are discussed in the sections that follow.

Strategic plan

9.82 We feel that as a governing Board, one of the key roles of the Board of NBLC is to provide strategic direction to management. The Conference Board of Canada, in their January 1999 newsletter, stated “Companies with boards that assume more strategic responsibilities are often leaders of their industries (by profit growth and revenues).” One important way in which they can do this is by challenging and approving the strategic plans of management.

9.83 Strategic planning can be defined as a continuous and systematic process in which corporate leaders focus on the broad policy questions facing an organization such as the corporation’s basic mission and purposes, along with alternative courses of action or strategies to achieve those missions and purposes. Strategic planning is ongoing. It does not end with the publication of a plan. Rather, its success depends on it being a never-ending cycle. We feel that every strategic plan should contain the following components:

- a mission statement;
- a list of strategic objectives;
- a list of related performance indicators; and
- a plan for how strategic objectives are to be achieved, evaluated and reported.

9.84 The current NBLC strategic plan covers the period from 1998-99 to 2001-2002. It was prepared by management and approved by the Board. We noted that the current NBLC strategic plan lacks some of the basic components that we feel are important. Our comments follow.

Mission statement

9.85 A corporate mission statement normally summarizes the reason for the existence of an organization. For NBLC, this would essentially mean that the mission statement should be a translation of the corporate mandate outlined in the New Brunswick Liquor Corporation Act. All respondents to the survey agreed that the purpose of the corporation has been translated into a clear mission statement. The current mission statement of NBLC (called a statement of principles in the strategic plan) reads as follows:

Our mandate is to manufacture, buy, import and sell liquor of every kind and description.

Our objective is to do so by providing high quality service and product selection to the public.

Our obligation is to operate in a controlled environment with appropriate social responsibility guidelines at the forefront.

Our accountability is to function efficiently and effectively to optimize financial returns to the Province of New Brunswick.

9.86 While it does define the purpose of NBLC, the current mission statement also appears to include a description of certain strategic objectives of the corporation as discussed below. We feel that it could be improved by being shortened and made more concise. During one of our interviews, one Board member defined the mission of NBLC this way:

To produce a profit for PNB and at the same time to give product to the public at a reasonable price and keep control on it.

9.87 In our opinion, a statement of this sort defines why NBLC exists in a much more concise manner. We feel the Board, in conjunction with management, should attempt to clarify the mission statement of NBLC. This may seem like an unimportant exercise, but a clear mission statement provides an overriding goal for all members of the corporation to strive towards. Also, without a clear mission statement, the identification of appropriate corporate strategic objectives becomes more difficult.

Strategic objectives

9.88 The body of the current strategic plan discusses ongoing and completed initiatives. As such, we do not feel it is as forward-looking a document as we would expect. A major weakness of the plan is that it does not identify corporate strategic objectives that would serve to focus the efforts of the corporation. We would define strategic objectives as written statements that describe an intended outcome. They clearly describe measurable targets that, if achieved, mean that the corporate mandate has also been achieved.

9.89 During our review, we attempted to identify the implied strategic objectives of NBLC. We derived these from the responses of Board members to our interview questions and surveys, and from our review of the strategic plan, master operating plan, and other corporate documents. The two most important would appear to be the following:

- to return maximum profit to the Province; and
- to achieve an optimal level of customer satisfaction with NBLC service (e.g. access to service, product selection, pricing).

9.90 Three other strategic objectives, of somewhat lesser importance, could be added to the list. They include:

- to comply with appropriate social responsibility guidelines;
- to develop and train staff and provide them with a challenging work environment; and

- to ensure that systems in place support the strategic objectives, and that any planned system enhancements will improve the level of achievement of one or more of the previous four strategic objectives.

9.91 These are solely based upon information we gathered during our review and could no doubt be improved upon by corporate leaders (i.e. the Board and senior management). By developing appropriate corporate strategic objectives, corporate leaders can have a big impact on the success of the corporation. If the corporate strategic objectives they identify are properly defined and complete, their achievement on a continuous basis should mean the legislative mandate of NBLC has also been achieved.

9.92 The CEO and, by extension, the Board, also have an important role in ensuring that strategic objectives are clearly understood by all staff. This is critical because all corporate activity should be assessed in terms of whether or not it contributes to the achievement of corporate strategic objectives.

9.93 We did note that all planned activity in the existing strategic and master operating plans seemed to be related to the achievement of one or more of the strategic objectives on our list. This indicates to us that these objectives are implicitly understood by corporate leaders. But we also feel they should be documented as part of the corporate strategic plan.

Performance indicators

9.94 The strategic plan should also define how success in achieving strategic objectives is to be defined, measured, evaluated, and reported. One or more performance indicators should be developed for each strategic objective. A performance indicator is a yardstick, or standard, used to measure success in achieving a strategic objective. Defining performance indicators is an area where we feel the Board members' general business expertise would prove very useful. For example, we note that to date there have been a number of initiatives at NBLC that have greatly enhanced the level of customer service. However, no attempt has been made to identify what the optimal level of customer service might be in terms of access, product selection, pricing, etc. As an example, performance indicators for the strategic objective "*To achieve an optimal level of customer satisfaction with NBLC service*" might be built around the responses to specific questions on customer surveys.

Plan for measuring, evaluating, and reporting performance indicators

9.95 The strategic plan should then go on to identify a plan for how performance indicators are to be measured, evaluated, and reported. To continue with the above example, one measurement might involve the results of province-wide tabulations of customer satisfaction with product selection. The evaluation plan might be to compare actual results with an annual target and explain any positive or negative variances. And the strategic plan would normally require the reporting

of results through the corporate annual report for all significant indicators.

Recommendations

9.96 The Board should promote a strategic planning process that:

- develops a clear and concise mission statement;
- develops an explicit list of strategic objectives for the corporation;
- develops performance indicators for each of the strategic objectives; and
- develops a plan for how performance indicators are to be measured, evaluated, and reported.

9.97 Performance results should be reported through the corporate annual report.

Board response

9.98 *Disagree. The Board is comfortable with the current mission statement and the strategic planning process. Note that the strategic plan is a long term guideline. The strategic objectives are clearly identified in the annual operating plan. Performance indicators are incorporated into the budget itself, and interim financial reviews, together with the Annual Report, provide adequate and appropriate measurements of performance.*

Master operating plan

9.99 The NBLC master operating plan is prepared annually by management. It documents corporate plans and initiatives for the year. The Board reviews and approves this plan. Respondents to the survey felt that the activities documented in the master operating plan are closely linked to the corporate strategic plan. Based upon our review, the 1998-99 plan seems to address all of the strategic objectives on our list to some degree. It specifically identifies plans for agency stores, future space requirements, major store renovations, etc. As would be expected, the focus is on financial results and customer service.

9.100 We note that annual performance targets are not set in the master operating plan. It would be necessary to set performance targets for each performance indicator if a strategic plan as discussed previously was in place.

Recommendation

9.101 The master operating plan should identify annual performance targets for each performance indicator identified in the corporate strategic plan.

Board response

9.102 *Annual performance targets are established within the operating budget and are clearly identified and reported in our Annual Report.*

Governance Information Used by the Board

9.103 Our fifth governance evaluation criterion is as follows:

The Board of the New Brunswick Liquor Corporation should monitor the performance of the corporation by obtaining

appropriate governance information from management. The Board should take corrective action where warranted.

9.104 The Act provides no direction related to this criterion. Corporate by-laws state:

The President shall carry out all lawful directions given to him by the Board and shall give to the directors or any of them at all reasonable times information they require regarding the affairs of the Corporation....

Information provided by management

9.105 We asked Board members some general questions about information they receive from management. Board members indicated that they felt the quantity of information and level of detail provided in management reports to the Board was appropriate. They agree that the Board is presented with sufficient, relevant information to make informed decisions.

9.106 They also indicated that management provides them with information on demand.

9.107 Board members further indicated that management information currently provided to the Board:

- allows the Board to safeguard the corporation's assets;
- allows the Board to monitor performance against plans;
- is received in a timely manner for effective decision-making; and
- sufficiently describes significant issues, changes or problems which affect the corporation.

9.108 In general, the Board should ensure that sufficient, appropriate, and timely information is reported by management to allow them to fulfill their roles and responsibilities. Specifically we feel the Board needs information:

- to monitor degree of achievement of strategic objectives, thereby determining the relative success of the corporation;
- to monitor management success in achieving the master operating plan;
- to monitor management compliance with corporate policies;
- to ensure assets of the corporation are safeguarded (i.e. not subject to undue risk);
- as support for required authorization of management decision-making; and
- for informational purposes to maintain an understanding of the current corporate environment.

9.109 In the paragraphs that follow, we will consider each of the listed areas.

Reporting on the success of the Corporation

9.110 We asked Board members how they determine whether the corporation is successful (i.e. whether corporate strategic objectives are being achieved). Board members all agreed that the bottom line is the primary indicator. Financial reports comparing actual results with budget are provided to Board members on a monthly basis for their review. Board members also noted that they consider complaints or calls from the public to be a negative indicator related to customer service. However, we are unaware of regular reporting to the Board that summarizes customer complaints or provides information related to other strategic objectives. We feel that a periodic “report card” on the degree of achievement of non-financial corporate strategic objectives would be very useful to the Board. It would allow them to identify problem areas for possible action and to make an overall evaluation of the success of the corporation.

Reporting on management success in achieving the master operating plan

9.111 We found no one report that would allow Board members to assess the degree of achievement of the annual master operating plan. Board members seem to focus on the achievement of financial plans. These are covered quite well by monthly financial reporting. We were told that various aspects of the master operating plan are discussed at Board meetings in order to obtain necessary Board approval or in response to Board members’ questions. Otherwise Board members are required to draw conclusions about activity indirectly from other reporting such as the quarterly capital expenditures reports. We feel that the Board could be more efficient and effective in monitoring achievement of the master operating plan if it received a comprehensive, periodic (e.g. quarterly) progress report. In fact, management does a periodic review of the master operating plan for its own use in determining progress in achieving annual goals. So, the information is available. It is just not being presented to the Board as a single, user-friendly document.

Reporting on management compliance with corporate policies

9.112 On a quarterly basis, the Board of NBLC is provided with a report detailing corporate compliance with statutory obligations under the NBLC Act and other legislation. However, we saw no evidence of any management reporting to the Board with regard to compliance with corporate policies as approved by the Board. Some Board members indicated that they rely on management to inform them if a situation of non-compliance has arisen. We are not aware of any such situations, but feel that it is the Board’s responsibility to ensure that corporate policy is complied with. We feel that the Board should occasionally require management to provide information that confirms their compliance with corporate policy. The Internal Audit Group could be useful in providing such reporting, as discussed below.

Reporting on the safeguarding of corporate assets

9.113 The external auditors do provide some limited assurance to the Board with relation to corporate control systems, mainly in the financial area. However, we saw no evidence of management reporting to the Board in relation to the adequacy of other control systems. We feel that protecting corporate assets from undue risk is a key responsibility of the Board. In many corporations, the Board discharges this responsibility by reviewing reports prepared by the Internal Audit Group and following up on significant issues raised to ensure that they have been dealt with. Our understanding is that the Board of NBLC is able to ask the Internal Audit Group to undertake special audits in areas of concern to them.

9.114 NBLC has an Internal Audit Group of five people (mainly professional accountants). The Internal Audit Group does monitoring of agencies and stores including cash audits, inventory audits, and “full” audits (which include cash, inventory and financial statement audit work). They also audit agency stores for compliance with agreements and do special audits within head office. All audit findings go to a management audit committee composed of the CEO, Executive Vice-President, and the Comptroller. Our understanding is that a summary of these findings is also provided to the chair of the Board. However, in our review of Board minutes we were unable to find any indication that such reports were discussed at the Board level or that there is any direct communication between the Board and the Internal Audit Group. Also, at least one Board member was unaware of the existence of the Internal Audit Group.

Information supporting management recommendations/ information that allows the Board to maintain an understanding of the current corporate environment

9.115 Board members indicated that they are provided with sufficient reference information when they are called on by management to authorize a management recommendation. They also appear to be provided with sufficient information to allow them to keep abreast of the current business environment at NBLC.

9.116 From the discussion in the previous paragraphs, we feel that there are some areas where management information to the Board is lacking. It is the Board’s responsibility to ask for this information. Our understanding is that management is very compliant in terms of providing requested information to the Board. In fact, the CEO indicated that his policy is to make the Board aware of everything that is going on. To that end he communicates with the Board chair on a weekly basis, briefing him on the results of monthly senior management meetings and weekly Executive Management Committee meetings. Our concern is that a future CEO may not be as forthcoming with information and without some commitment to a policy of regular and comprehensive sharing of information, Board effectiveness could be adversely affected.

9.117 It is the Board’s responsibility to be proactive in determining its information needs and obtaining them from management.

Recommendations

9.118 We recommended that the Board reconsider its informational needs in light of the information presented in this section and other sections of this chapter. It appears that additional or repackaged information would be appropriate to aid the Board in assessing management progress in achieving plans, in ensuring that corporate assets are not subject to undue risk, and in ensuring that corporate policies are complied with. Additional information needed should be requested of management.

9.119 We also recommended that, as a minimum, summary level Internal Audit Group reports be provided regularly to all Board members for their review.

Board response

9.120 *The Board continues to be satisfied with the overall information flow and content from management. To date, all supplementary information requests have been fulfilled. With respect to Internal Audit Group report summaries, the Board will be receiving these on a regular basis in the future.*

Relationship between Board and CEO

9.121 The CEO has a close relationship with the Board of Directors of NBLC. He is an ex-officio member of the Board, and is the key management link with the Board. By-laws specify that *"The President shall report to the Board of Directors."*

9.122 Regarding the appointment of the CEO, the Act states in Section 9(1) that *"The Board, subject to the approval of the Lieutenant-Governor in Council, shall appoint a General Manager of the Corporation..... The General Manager shall not be suspended, dismissed, terminated or otherwise removed from office by the Board without the approval of the Lieutenant-Governor in Council."*

9.123 In practice, however, the CEO is selected by the Lieutenant-Governor in Council (LGIC) alone, which was not as we would have expected. The Board has no input into the CEO's appointment. The Board only approves any salary increases.

9.124 The NBLC Act seems to specify quite clearly that the Board is to appoint the CEO, and that the appointment is to be approved by the LGIC. As a comparison, the CEO of Service New Brunswick is also appointed by the Lieutenant-Governor in Council. However, the Service New Brunswick Act clearly states in Section 11(1), *"The Lieutenant-Governor in Council shall appoint a President of the Corporation."* We feel that the intent when the NBLC Act was drafted was different from that laid out in the Service New Brunswick Act. Our interpretation is that the NBLC Act intended that the Board should select and recommend candidates for CEO to the LGIC. The LGIC should not be initiating this process.

9.125 Based upon the definition of accountability as noted previously (i.e. the obligation to answer for authority and responsibility that has been conferred) the CEO should be accountable to the Board. This accountability would normally be discharged through a regular Board performance review of the CEO. However, Board members indicated that the CEO is not subject to a formal performance evaluation. Some Board members consider the positive comments received from the external auditors to be an endorsement of the CEO's performance. Otherwise, they told us that they evaluate his performance informally on a day-to-day basis.

9.126 We feel that the Board should formally evaluate the CEO on an annual basis. In order for such a review to be meaningful, the CEO must have a job description complete with preset objectives against which to evaluate his performance. In normal circumstances these objectives would mirror the strategic objectives and annual operating goals of the corporation. Such formal reviews are now common in Canadian corporations in both the public and private sector. In their January 1999 newsletter on governance, the Conference Board of Canada stated, *"Almost all corporations have position descriptions for their CEOs. Most boards conduct formal CEO performance evaluations."* Given the small size of the NBLC Board, we feel that all Board members should provide input to the evaluation process.

Recommendations

9.127 We recommended that the Board select and recommend to LGIC future candidates for the position of NBLC CEO, in compliance with the NBLC Act. Alternatively, the Act should be changed to reflect actual practice.

9.128 We recommended that the Board perform a formal performance appraisal of the CEO on an annual basis. All Board members should be given the opportunity to provide input into the process.

9.129 We recommended that a job description for the CEO be prepared.

Board response

9.130 *The Board is satisfied that the section of the NBLC Act which deals with the appointment of the CEO is workable and practical as presently written.*

9.131 *While the Board is comfortable with the current approach to CEO appraisals, the Board will look at current practices relative to other Crown Corporation CEOs and departmental Deputy Ministers. With respect to a potential job description, Section 9 of the NBLC Act together with the bylaws, define the duties and responsibilities for this position.*

Board External Reporting

9.132 Our sixth governance evaluation criterion deals with governance and accountability issues:

The Board of the New Brunswick Liquor Corporation should ensure that sufficient, relevant information is reported through the Minister of Finance to allow the government and the Legislative Assembly to objectively assess the performance of the corporation.

9.133 As previously discussed, the Act gives limited guidance to Board members as to how they are to discharge their accountability obligation to the Minister of Finance.

***Accountability information
provided by the Board – the
NBLC annual report***

9.134 As previously discussed, we feel that the Board of NBLC is accountable to the Minister of Finance for the performance of the corporation. In order to discharge their accountability obligation to the Minister, they have to provide him with information through which he can objectively assess their performance (i.e. the performance of the corporation). The vehicle for communicating that information is the NBLC annual report.

9.135 The CEO noted that the Board has little involvement in the preparation or issuance of the NBLC annual report. They are involved in approving the annual financial statements and meeting with the external auditors to discuss the results of the annual financial audit. Also, the annual report includes a brief transmittal letter from the chair to the Minister of Finance. Otherwise, the Board has no involvement and they receive a copy of the NBLC annual report at the same time the public does. The CEO stated that he feels the current annual report is a management report (i.e. just an audited financial statement plus some statistics and narrative). However, we feel that it should become the document through which the Board discharges its accountability obligation by reporting on corporate performance. Therefore, we believe that the Board should review it and provide their input prior to its issuance.

9.136 In 1994, the Province of New Brunswick adopted an annual report policy for all government Departments and Crown agencies. It establishes certain requirements regarding the form and content of annual reports. The policy defines the prime function of an annual report to be *“the major accountability document by departments and agencies for the Legislative Assembly and the general public. It serves as the key public link between the objectives and plans of a government entity and the results obtained.”*

9.137 The policy goes on to state, *“To the degree possible, departments and agencies should give a clear account of goals, objectives and performance indicators. The report should show the extent to which a program continues to be relevant, how well the*

organization performed in achieving its plans and how well a program was accepted by its client groups."

9.138 The policy is applicable to Part IV of the public service (i.e. the New Brunswick Liquor Corporation). Therefore, we undertook a brief review of NBLC's annual report for the year ended 31 March 1998 to see how well this policy is being complied with. In general, we found that there are significant areas of non-compliance with the Province's annual report policy.

9.139 Areas where the annual report policy was complied with included:

- information was presented on the level of client acceptance. We feel that for NBLC, the level of sales is the primary indicator of client acceptance of programs.
- actual versus budget comparisons of financial information were presented. Budget variances were explained at a summary level.
- the annual report was tabled well in advance of the deadline date for submission under the Act.

9.140 Areas where the annual report policy was not complied with included:

- the corporate mission statement was not disclosed.
- corporate strategic objectives were not presented since they have not been documented.
- non-financial performance indicators were not presented as they have not been established for the corporation. Some statistics were presented, but there is no information tying them to specific strategic objectives or attempting to interpret or evaluate the results they portray.
- there was some discussion of achievement of corporate plans, but not in connection with strategic objectives.
- since strategic objectives have not been documented by the organization, there could not be a discussion of program relevance in relation to these objectives.

9.141 We feel that the 1997-98 annual report of the New Brunswick Liquor Corporation does not act as a complete accountability document. As noted above, it lacks several of the attributes specified in the provincial annual report policy. All of these relate in some way to performance reporting and therefore accountability.

Recommendations

9.142 We recommended that the Board take ownership of the NBLC annual report as the vehicle through which it discharges its accountability obligation to the Minister of Finance.

9.143 We recommended that the annual report be modified to comply with the provincial annual report policy.

Board response

9.144 *While the Board has not exercised editorial control over the Annual Report, the ongoing reporting relationship has ensured that the report is consistent with the Board's position. Future issues will be subject to final review at the Board level prior to release.*

9.145 *With regard to the provincial Annual Report Policy, NB Liquor's publication is prepared with a varied audience in mind. In addition to its statutory reporting obligations to the Legislature, the report is circulated to other jurisdictions and various suppliers around the world. Consequently, the format and content have been structured with these audiences in mind, consistent with other Canadian Liquor Jurisdictions. The Corporation had previously been granted a compliance exemption by the Premier's office through the Clerk's office.*

Public reporting/liaison

9.146 Board members indicated that they do not have a lot of contact with the public. When they are contacted, they refer individuals to NBLC management. The Board also has little formal contact with the Minister of Finance or other provincial representatives.

Board Relationship with Crown Corporations Committee

9.147 NBLC currently appears annually before the Crown Corporations Committee of the Legislative Assembly of the Province of New Brunswick. The CEO attends on behalf of NBLC. We were told that the chair had attended up to the mid-1980s at which point he was replaced by the CEO. We feel that it would be appropriate for the Board chair to appear along with the CEO. The chair would be there to respond to governance-related questions, thereby ensuring that Board accountability for performance was addressed. However, in practice the CEO would continue to respond to the majority of the Committee's questions.

Recommendation

9.148 We recommended that the NBLC Board chair appear annually before the Crown Corporations Committee along with the CEO.

Board response

9.149 *Checks with other Crown Corporations have confirmed that NB Liquor's practice is consistent with those Corporations in this regard. Further, it is the Corporation's understanding that the purpose of this Committee is to give members direct access to the CEO, consistent with the practice of having Deputy Ministers appear before the Public Accounts Committee.*

9.150 *It is the position of the Board that the CEO is the appropriate official to represent the Corporation before this Committee.*

Chapter 10

Regional Development Corporation

Economic Development Fund

Contents

Background	195
Scope	197
Results in Brief	197
Submission Requirements	197
Submission Guidelines	198
Approval Process	199
Monitoring	205
Conclusion	207

Regional Development Corporation

Economic Development Fund

Background

The Corporation

10.1 The Regional Development Corporation is a provincial Crown agency incorporated by an Act of the New Brunswick Legislature. The role of the Corporation as stated in its 97-98 Annual Report is as follows:

Today, the Corporation is the lead agency in the planning and negotiation process for federal and provincial economic development arrangements and agreements. The Corporation also makes recommendations to Cabinet concerning provincial economic development priorities.

The Corporation's ongoing role is to provide financial and administrative management for all federal and provincial agreements. The delivery of programs and projects is primarily the responsibility of provincial line departments....

The Regional Development Corporation is also responsible for the implementation of the Development Assistance Program, the Action North Initiative, the overall management and coordination of the Economic Development Fund, the financial management of its Special Operating Agency and coordination of the Joint Economic Development Initiative on behalf of the Province.

Decision to review the Economic Development Fund

10.2 Last year we performed a broad scope audit in the Department of Economic Development and Tourism, and since the Regional Development Corporation is also involved in the economic development sector, we thought it would be beneficial to review the Corporation's economic development programs.

10.3 When undertaking financial audits in previous years, our Office often found it difficult to determine who is accountable for projects coordinated by the Regional Development Corporation (RDC). RDC administers funds and initiatives, like those of the Economic Development Fund, which are then carried out by other departments.

Costs are budgeted and actual expenditures recorded at RDC but are spent by these other departments.

10.4 The departments are accountable for their spending in relation to their budgets. However, money provided to the departments by RDC is not part of the department's regular accountability process. We wanted to understand and evaluate the accountability process at RDC through examining its role in the approval and monitoring of these initiatives.

10.5 The amount of federal contributions and the method of funding are also changing. The 1997-98 RDC Economic Development Fund annual report states the following: *"The end of sector specific federal-provincial agreements, as well as overall reductions in federal cost-sharing over the next five years have meant the province has had to look for new ways to finance high priority development initiatives. The Economic Development Fund is one answer."*

10.6 The Economic Development Fund is one of the major tools used by RDC to promote regional development and it is entirely funded by the Province of New Brunswick.

The Economic Development Fund

10.7 The Economic Development Fund was established by the Province of New Brunswick's Executive Council in October 1995 and began its operations on 1 April 1996. The Fund helps finance priority development initiatives not funded through the new federal-provincial Agreement on Regional Economic Development or through departmental budgets. Funding is provided entirely through the RDC annual budget.

10.8 The Fund is designed to respond to the strategic economic priorities of provincial departments and agencies. Having all departments submit their proposals at the same time makes comparisons easier and helps the decision-makers to look at initiatives from a provincial perspective instead of a departmental perspective.

10.9 A total of 21 initiatives out of the 36 submitted were approved during the 1997-98 fiscal year. Total expenditures amounted to \$15,174,833. Initiatives funded included Crown land silviculture, tourism marketing, agriculture development, fisheries development, mineral development, Film New Brunswick, training in the information technology sector and capital costs related to the establishment of government call centres.

10.10 Priority is given to initiatives that fall under the economic development strategy of the Province of New Brunswick. Activities of the Fund are reported in the RDC Economic Development Fund's annual report.

Scope

10.11 We reviewed the operations of the Regional Development Corporation and in more detail the Economic Development Fund.

10.12 Our objective in conducting this work was to ensure that adequate systems were in place related to the approval of funding and monitoring of initiatives.

Results in Brief

10.13 In our opinion, the Economic Development Fund represents a good tool for responding with a provincial perspective to strategic economic funding requests from provincial departments and agencies, but improvements should be made.

10.14 The mandatory elements to be included in a proposal submission are, if fully complied with, sufficient and appropriate for the staff and Board of Directors of RDC to evaluate the initiatives.

10.15 Submissions presented by the departments should be improved by providing more complete information (quantitative and narrative) to assist the users to review thoroughly the initiatives and to evaluate the reasonableness of the figures.

10.16 The Board of Directors does not approve the recommendations concerning the investments of the Economic Development Fund prior to submission to Board of Management.

10.17 Recommendations to Board of Management should include an evaluation of each initiative based on the review criteria.

10.18 Significant improvements on the information for decision-makers would take place if the review criteria were applied thoroughly for the evaluation process and followed up in the monitoring process.

10.19 A system should be put in place to ensure sufficient information is included in the progress reports from the departments.

10.20 The Board of Directors should consider and document, in the guidelines, remedial action to be taken in those cases where there has been poor progress in achieving goals.

Submission Requirements

10.21 The 1997-98 RDC Economic Development Fund's annual report states:

The Economic Development Fund (EDF) provides financing for selected departmental economic development activities that are:

- *additional to a department's current service level;*

- *consistent with the identified government priorities for job creation and sustainable economic development;*
- *able to demonstrate that best possible use has already been made of other relevant federal and provincial government programs and services.*

The Regional Development Corporation is coordinator of the Economic Development Fund.... In this role, the Corporation assists departments in identifying the most appropriate source of external funding for priority activities.

10.22 This could involve identifying other provincial or federal programs applicable to the initiatives.

Submission Guidelines

10.23 In February 1996, Cabinet approved Management Guidelines for the Economic Development Fund that listed the elements to be included in the proposal submissions presented by the departments.

10.24 The format included the following:

- Summary of proposal
 - purpose and objectives
 - strategic rationale (how it relates to N. B.)
- Proposal description
 - activities and beneficiaries
 - costs
 - partners (involvement)
- Results evaluation
 - measurable benefits
 - developmental benefits (long-term growth)
- Implementation
 - management
 - resource requirements
- Accountability reporting
- Consultation
- Environmental considerations
- Communications plan

Observation

10.25 The mandatory elements to be included in submissions are, if fully complied with, sufficient and appropriate for the staff and Board of Directors of RDC to evaluate the initiatives.

10.26 Initiatives for Film NB and Crown Land Silviculture with a total expenditure of \$1,161,852 and \$5,400,000 respectively were the biggest

Economic Development Fund expenditures for the fiscal year 1997-98. Together they represent over 43 % of the Fund's total expenditure of \$15 million for 1997-98.

10.27 The Film NB submission contained general statistics of previous productions and impacts on the Province's economy. The submission for Crown Land Silviculture requesting \$5.4 million was a little more than four pages long and consisted mostly of qualitative material.

10.28 Measurable benefits are crucial for users to monitor achievements. In the files examined, costs and measurable benefits were not adequately identified nor were there any timetables related to those topics.

10.29 In the Crown Land Silviculture initiative, we saw no detailed calculations of the costs. No information was provided on the hourly rate for the workers, their weekly pay or in which regions the work would be done. (This would help demonstrate how the initiative addresses a major review criteria, the effect on easing unfavourable economic conditions in particular regions of the Province.)

10.30 As for the Film NB initiative, there was no detailed information on the costs to be incurred in New Brunswick. In the proposal for funding, the implementing department only referred to the total costs to the Province and not to the costs to be incurred by the producers in the Province.

10.31 Although we can understand that details on future productions are hard to get, we feel that past productions could have provided information on the impact of previous investments by the Province. This would help decision-makers evaluate the benefits of this investment.

10.32 In both files examined, we found no indications that the best possible use has already been made of other relevant programs.

Recommendation

10.33 Departmental submissions should be improved by providing more complete information (quantitative and narrative) to assist the decision-makers to evaluate thoroughly the initiatives and to appreciate the reasonableness of the figures.

Approval Process

10.34 The Regional Development Corporation receives proposals from departments and non-commercial Crown corporations during the provincial budget process. This allows for implementation of funding decisions at the beginning of the next fiscal year.

10.35 Departments have to provide indicators of anticipated results and benefits of their proposed activities. The review process used in allocating funds allows for prioritization of the proposals based on this information.

10.36 Allocations of funds are on a fiscal-year basis. When a submission is approved, the line department is advised about the funding, the terms and conditions attached to the approval, and the implementation measures to be followed.

Information on Priorities

10.37 *“Toward Self-Sufficiency”* and *“Moving Ahead Together”* are the two documents outlined in the Economic Development Fund (EDF) Management Guidelines to identify the government’s priorities. At the time of our audit, those documents would represent, in our view, the main tool for RDC to link their recommendations concerning EDF investments to the “government priorities.”

10.38 Although the document *“Moving Ahead Together”* is subject to regular updates, *“Toward Self-Sufficiency”* was produced in April 1993 and has not been updated since.

10.39 In our opinion, the economic situation of New Brunswick may be too volatile to rely on a document over five years old as one of the main sources of information for initiative evaluations.

10.40 RDC management informed us that other sources of information have to be considered in order to have a better knowledge about the government priorities. For example, the Speech from the Throne may be used.

10.41 Discussions with the members of the Board of Directors (who are primarily departmental deputy ministers), the departments and the Office of the Premier are also a very good source of information as it relates to the government priorities. This provides information on what are the current priorities of government.

10.42 We believe that by having appropriate consultation with the involved parties, RDC is providing sufficient opportunity to the departments to point out their “most important” priorities.

10.43 We agree with RDC staff on the issue that it is hard to understand what are the top government priorities. There is no priorities list and priorities also change. Key documents, as noted above, may become outdated.

Observation

10.44 **Determining the top priorities of government is not easy. Top priorities become understood as the consultative approach outlined above progresses. They are not always known in advance.**

Review Criteria

10.45 The EDF Annual Report states that *“Proposals are considered under the “business case” approach, so that measurable benefits of proposed activities are clearly demonstrated.”*

10.46 The EDF Management Guidelines refer also to a *Business Case Approach* for the proposal submissions and is defined as follows:

....the extent to which the proposed activities demonstrate their value or contribution to economic development in New Brunswick in terms of expected results and measure them according to their ability to contribute to the creation of jobs and economic growth in New Brunswick which are self-sustaining in the long term.

10.47 The EDF Management Guidelines state also:

The following criteria will be used when reviewing proposals for financial assistance under the Economic Development Fund:

- Significant positive economic impact in terms of creation of employment, expansion of the economic base or improved labour market conditions.*
- Significant impact in terms of addressing unfavourable economic conditions in particular regions of the province.*
- The extent to which the initiative enhances opportunities for value-added production within New Brunswick industries.*
- The extent to which the initiative contributes to increasing the global competitiveness of New Brunswick businesses and industry sectors through gains in productivity and efficiency.*
- The extent to which the targeted sector, region or community endorses and is willing to participate in the initiative, financially and otherwise, as a result of meaningful and appropriate consultations.*
- Inability to proceed without assistance from the Fund because of location, scope, timing or risk.*

10.48 RDC management informed us that no formal evaluation of the submitted initiatives is performed following those criteria. Instead, “government priorities” were mainly used to review the initiatives.

10.49 We were also told that evaluations are hard to make on those criteria and are based on subjective judgement only.

10.50 Although we agree that judgement has to be used in this process, we feel it should be exercised in the context of established criteria.

10.51 The Order in Council creating the Fund establishes its purpose as “funding high priority economic development initiatives.”

10.52 We agree with RDC staff on the issue that government priorities should be considered in the decision-making process. But we are also of the opinion that RDC's approval process should make use of the Management Guidelines.

10.53 The criteria listed in the Management Guidelines are in our opinion consistent with the objectives of the Fund and its *"business case approach."* They should be used in order to provide recommendations to Board of Management on the initiatives submitted by the departments. The elected officials would then have the information they need for decision-making purposes.

Recommendation

10.54 There should be a formal evaluation of each initiative against the review criteria.

10.55 Information related to the criteria should be available in order to facilitate the evaluation process and to ensure consistency. For example, when proposals refer to jobs created, it would be helpful if all proposals had the same definition of a job. It would also be useful if the areas with unfavourable economic conditions, referred to in the Management Guidelines, were listed.

Recommendation

10.56 Guidelines for reviewing initiatives could be enhanced in order to facilitate the evaluation process and to ensure consistency between applications.

Board of Directors

10.57 The Board of Directors of RDC is chaired by the RDC President, and is composed of provincial deputy ministers. RDC staff joins the Board meetings as support staff.

10.58 In preparation for the meetings, RDC staff consult the different departments regarding their projects.

10.59 The purpose of the meeting with the Board of Directors is to obtain their input and collaboration in order for RDC staff to make their recommendations.

10.60 Prior to making the annual recommendations to the Board of Management concerning investments from the Fund, RDC staff consult and send a draft of their recommendations to the Office of the Premier for feedback. After considering the Premier's Office input, the recommendations are then forwarded to the Board of Management for consideration, and to Cabinet for final approval.

10.61 The process described above appears to be inconsistent with the EDF Management Guidelines which state: *"The priorities retained by the Board (of Directors) will be presented to Board of Management (in a memorandum prepared by Regional Development Corporation) for their final decision on the allocation of the fund."* This guideline appears to be

suggesting that the Board of Management should be receiving a representation on priorities from the RDC Board of Directors, and not from the staff of RDC.

10.62 We reviewed RDC's Board of Directors' minutes for the last two years and found no indications that the Board of Directors voted on the submitted initiatives. In one year, the Board did recommend to the Board of Management the allocation of funds by department, although no position on specific initiatives was taken. In fact, other than approval of the minutes of the last meeting, we found that there were very few motions presented to and voted on by the Board.

Observation

10.63 The Board of Directors does not approve the recommendations concerning the investments of the Economic Development Fund prior to submission to Board of Management.

10.64 We also reviewed the Corporation's legislation as it pertains to the Board of Directors. The only reference to the Board of Directors is that *"The Lieutenant-Governor in Council may appoint persons... to be directors of the Corporation."*

Observation

10.65 The role, authority and responsibility of the Board is not defined in the enabling legislation

10.66 As stated earlier, RDC's 1997-98 annual report refers to the fact that *"The Corporation also makes recommendations to Cabinet concerning provincial economic development priorities."*

10.67 With this concept in mind, the most reasonable and logical assumption would be to believe that *"The Corporation"* would mean the Corporation's highest authority, and that this authority would be assisted by staff - not the other way around.

10.68 We were told, however, that in the past, the process of having the Board of Directors make a recommendation to the Board of Management was adversarial in nature and affected the ongoing relationship between the directors.

Recommendation

10.69 The Board of Directors should approve the recommendations concerning the investments of the Economic Development Fund prior to submission to Board of Management. If the Board of Directors is not to make such recommendations, the guidelines should be re-worded to clearly explain the role of staff and the Board of RDC in the decision-making process.

Corporation's response

10.70 *It should be noted that the Management Guidelines state, "priorities retained by the Board..." and not approved by the Board of Directors of the Corporation. We believe that there is a significant difference in the interpretation of these two statements... The*

management guidelines do not require the approval of the RDC Board of Directors, only that they review them and that those retained by the Board be forwarded to Board of Management for approval. There may be a case for making the wording in the guidelines more concise as it relates to the role the RDC Board of Directors in the decision making process.

Information for the Board of Management

10.71 We reviewed the information presented to the Board of Management concerning the funding recommendations for the Economic Development Fund.

10.72 The information that was provided to us was composed of a brief description of each initiative. The descriptions varied from two phrases for some initiatives up to a couple of paragraphs for others.

10.73 Also included were the names of the implementing departments, the total costs for the up-coming year, the requested funding and the EDF funding or other recommended alternatives.

10.74 Very little information was included concerning the review criteria outlined in the Management Guidelines. The Management Guidelines which were approved by Board of Management include criteria with which initiatives must be reviewed by the Board of Directors under the “business case” approach.

10.75 The results of the review against those criteria would be useful information in approving or rejecting the funding recommendations for the Economic Development Fund.

10.76 The elected officials and their political advisors would then be in the best position to select the initiatives based on their government priorities with full knowledge of the review based on the “business case” approach.

10.77 In our opinion, the information provided to the Board of Management could be improved by providing the above information.

Recommendation

10.78 **Board of Management should be provided with an evaluation of the submitted initiatives against the review criteria specified in the Management Guidelines.**

Corporation’s response

10.79 *Board of Management is provided with a Cabinet Memo with detailed supporting documentation on the priorities recommended for approval. The Cabinet memo complies with guidelines for Cabinet submissions. Officials from the RDC provide a detailed briefing to the staff of the Department of Finance on each proposal. Officials from the Corporation appear before Board of Management to present the item to Ministers and to answer any questions that Board members may have on the proposals. The selection process is based on priorities previously*

identified by government and are being forwarded for a funding decision and the timing of implementation. We are satisfied that Cabinet Ministers have sufficient information to make informed funding decisions and we have never been led to believe differently.

Monitoring

Progress Report

10.80 Once a year, the implementing departments provide a report to the Board of Directors on the progress and achievements of their projects. This information is then included in the annual Economic Development Fund report. These reports provide information on measurable outcomes achieved and planned targets.

10.81 The progress reports are presented to the Board of Directors for information only. The Board, in cases of poor progress, imposes no remedial actions other than taking that fact into consideration when examining next year's submissions.

10.82 The two major initiative files we examined (Film NB and Crown Land Silviculture) provided limited information in the progress reports. Coupled with the lack of information on the measurable benefits, discussed earlier, the monitoring process is of little value.

10.83 The Film NB initiative progress report did not provide details on important issues. No information was found in relation to full or part time jobs for New Brunswickers and no information was provided on the quality or appropriateness of the training received within this initiative.

10.84 As for the Crown Land Silviculture initiative, the Management Guidelines refer to "*Significant impact in terms of addressing unfavourable economic conditions in particular regions of the province.*" We saw no information as to what region the silviculture initiative was impacting nor did we find information as to the salary level of the employees. This lack of information makes it impossible to evaluate the extent to which the initiative is providing sufficient salaries for workers. Also it makes it hard to determine whether the initiative is addressing the problem of regions with unfavourable economic conditions.

10.85 The initiative has the objective "*of maximizing the present sustainable level of softwood and hardwood, and also to provide for long-term volume increases of both hardwood and softwood.*"

10.86 From the documentation presented on the 1997-98 results, information is provided on how many hectares were planted, but there is no information on how many hectares were harvested. This makes it hard to evaluate the extent to which the objective has been achieved.

Recommendations

10.87 A system should be put in place to ensure sufficient information is included in the progress reports from the departments.

10.88 The Board of Directors should consider and document, in the guidelines, remedial action to be taken in those cases where there has been poor progress in achieving goals.

Monitoring Procedures

10.89 RDC management has no formal process in place to ensure the accuracy of the information provided in the progress reports. Staff of RDC did not acknowledge that this was part of their responsibilities.

10.90 It is our opinion that monitoring procedures should be performed by the Corporation to determine if the information provided is accurate. This would assist in holding people accountable for the money they were provided.

10.91 We understand that these procedures need not be as tight with a department as with a transaction with the private sector, but we are still of the opinion that the implementing departments should be subject to some scrutiny by the fund providers.

10.92 This could take the form of a periodic review through inquiry and/or observation of how the department obtains its information or prepares its calculations.

10.93 Definitions of key assertions could also be reviewed for reasonableness (for example, the definition of a “job created”). This would help ensure reasonableness and consistency in reporting by departments.

10.94 The 1997-98 EDF annual report reports some of the activities of Film NB as follows:

Film NB has helped to create more than 450 person years of work.

10.95 The new administration of Film NB disagreed with this statement when contacted for further details. According to their calculations, 1997-98 production costs generated around 170 person years of work of which about only half, 85 person years, was provided to New Brunswickers.

10.96 Not only is the “450 person years of work” statement included in the EDF annual report, but the same information was also provided as a progress report to the Board of Directors as part of the following year’s submission.

10.97 We are aware that those figures take into account a “multiplier effect” which provides the “total spin-off effect” for the Province. Nevertheless, we strongly believe that this kind of information is misleading. Direct full time jobs for New Brunswickers should be one of the standard denominators for reporting and performance measurement.

Wordings like “*helped to create*” are confusing as to their real meaning and should be avoided when reporting on performance.

Recommendations

10.98 Monitoring procedures should be put in place by RDC to ensure the reasonableness and consistency of the information provided to them by the implementing departments.

10.99 RDC should put in place sufficient detection procedures as part of the monitoring process to ensure they are aware of non-compliance with the conditions of the initiatives.

Conclusion

10.100 In our opinion, the Economic Development Fund represents a good tool for responding with a provincial perspective to strategic economic funding requests from provincial departments and agencies, but improvements should be made.

10.101 The guidelines for approving initiatives are appropriate and useful and contribute to reaching the overall objectives of the Fund. However, they are not fully used to evaluate the proposals. Use of the guidelines would ensure that a business case approach is followed.

10.102 Significant improvements in the information for decision-makers would take place if the review criteria were applied thoroughly for the evaluation process and followed up in the monitoring process.

Chapter 11

Follow-up on Prior Years' Audit Work

Contents

Background	211
Scope	211
Results in Brief	212
Department of Advanced Education and Labour	213
Department of Education	215
Department of Finance	216
Department of Health and Community Services	222
Department of Justice	225
Department of Natural Resources and Energy	230
Department of Supply and Services	233
Department of Transportation	235

Follow-up on Prior Years' Audit Work

Background

11.1 One of the performance indicators for our Office is to measure the extent to which recommendations which appear in our annual Report are accepted and implemented. We believe that each of our recommendations, if implemented, would either have a positive impact on the cost or delivery of a government service or would improve the accountability of government to New Brunswick taxpayers. Where a recommendation is not implemented we feel it is important to understand the reason why. It may be necessary for us to raise an issue again, if we believe the action or the response on a recommendation is not satisfactory.

11.2 Our policy is to track the disposition of our recommendations for a period of four years.

Scope

11.3 In August 1998 we contacted government departments and Crown agencies to obtain their assessment of the current status of all recommendations made in our 1993 to 1997 annual Reports. The responses indicated a high level of acceptance of our recommendations (89%), but a much lower level of implementation (51%). A number of recommendations were assessed as partially implemented (4%) or were in the process of being implemented (28%).

11.4 During 1999 we performed a follow-up review to determine the current status of recommendations arising out of our broad scope audits first reported in our 1995 through 1997 Reports. This follow-up review consisted of examining the response we received at the time of the audit and the assessments received in 1998 as well as talking to appropriate officials in each department. We also asked departments and agencies to provide us with their assessment of the current status of recommendations included in our 1998 Report. Since there has been only eight months between the time our 1998 Report was published and when we did our follow-up work we thought it would be premature to comment on progress to date. We will review these self-assessments during 2000.

11.5 This chapter includes only the original recommendations made by our Office, the departmental responses and our current assessments. In order to fully understand the issues that gave rise to our original

recommendations, it may be necessary for the reader to refer back to the Auditor General's Report where we first discussed the audit and our findings.

Results in Brief

11.6 The Department of Advanced Education and Labour (now the Department of Education) has substantially implemented the recommendations included in our 1995 Report, relating to community college operations and private training organizations.

11.7 The Department of Education has implemented the recommendation included in our 1996 Report, relating to school district financial reporting.

11.8 The Department of Finance has implemented the recommendations included in our 1996 Report, relating to cash management.

11.9 The Department of Finance has substantially implemented the recommendations included in our 1997 Report, relating to the revenue management system contract and its termination.

11.10 The Department of Health and Community Services is making some progress in implementing the recommendations included in our 1997 Report, relating to air ambulance service.

11.11 The Department of Health and Community Services has substantially implemented the recommendations included in our 1997 Report, relating to the inspection function of the Ambulance Services Branch.

11.12 The Department of Justice is taking steps to implement the recommendations included in our 1995 Report, relating to the Court Services Division.

11.13 The Department of Natural Resources and Energy is taking steps to implement the recommendations included in our 1997 Report, relating to revenues received under the Metallic Minerals Tax Act and royalties pertaining to potash mining. However, progress has been slower than anticipated.

11.14 The Department of Supply and Services has fully implemented only one of the recommendations included in our 1997 Report, relating to the privatization of the Province's data processing facility.

11.15 The Department of Transportation has implemented the recommendations included in our 1996 Report, relating to the Vehicle Management Agency.

**Department of
Advanced Education
and Labour
(Now the Department
of Education)**

11.16 In our 1995 Report, we made four recommendations as a result of an audit of training programs offered at community college campuses, and a review of the Department's role in relation to private training organizations operating in New Brunswick.

11.17 We recommended the Department ensure that the mission, operating principles and values identified in the corporate strategic plan are effectively integrated into campus plans.

11.18 In our 1996 Report, we reported the Department's own assessment of its progress, as follows:

The intent is still to ensure all sections of the Department, including the NBCC are in line with the corporate planning cycle. The NBCC-Special Operating Agency formed April 1, 1996 has accepted the planning cycle and intends to adopt it. Also a business plan for the NBCC- SOA will be updated on a yearly basis. This business plan will act as the SOA's corporate plan and be linked to the Department's corporate plan. In turn, each of the ten colleges will have individual business plans linked to the SOA plan and the Department plan.

11.19 We recommended that the Department ensure all campuses set reasonable implementation goals for integrating distance education technologies into their programs.

11.20 In our 1996 Report, we reported the Department's own assessment of its progress, as follows:

The Department continues to move toward co-ordination of distance education activities. A position in the TeleEducation-NB is dedicated to co-ordination and elimination of duplication. As the Virtual Campus becomes a reality, some of the issues surrounding cooperation and co-ordination with the private sector in the delivery of courses on-line will be addressed. TeleEducation will be integrated with the Virtual Campus with strong representation from the private sector and clearly defined outcomes will be identified.

11.21 We recommended that the Department implement procedures to ensure all private trainers that require registration under the Trade Schools Act are complying with the Legislation; and implement a process which will ensure a high quality of private training is maintained in New Brunswick.

11.22 In our 1996 Report, we reported the Department's own assessment of its progress, as follows:

An additional consultation with Industry occurred on June 25, 1996 to discuss alternative structures for the proposed

statutory corporation. It is anticipated that amendments to the Trade Schools Act will be introduced during the next sitting of the Legislature, with implementation expected early in 1997.

When responding to the 1995 Report of the Auditor General, the Department had indicated that it was not administratively nor economically feasible to register all Private Training Institutions.

Currently, Operators are being monitored and if necessary contacted and advised that failure to comply is a violation of the legislation and may result in legal action being taken. To date, this action has resulted in more schools being registered. Although the Department has had reasonable success with this approach, it is anticipated that the new legislation will further improve compliance with registration requirements.

The Department feels that quality is a matter of contractual obligation between the student and the training provider. It is critical that both parties understand the significance of their involvement and consequently a new Student/Training Organization Contract is being proposed.

This will contain many statements that will clearly define responsibilities, deliverables and expectations. The consumer will receive more pertinent information and be in a better position to make an informed decision on quality issues prior to making a commitment to a particular Training Organization.

11.23 We recommended the Department ensure that benchmarks and performance indicators are established for all key activities of the college system. The results should be reported publicly as part of the Department's Annual Report.

11.24 In our 1996 Report, we reported the Department's own assessment of its progress, as follows:

The Department had two indicators accepted by the Board of Management earlier in 1996. Both these performance indicators were related to the NBCC. These indicators were:

- 1) Percentage of individuals who graduate from NBCC. (Target: 77% by 1999);*
- 2) Percentage of graduates who find employment. (Target 80% by 1999). Additional indicators have been developed and will be submitted to the Board of Management in mid-November.*

11.25 Based on our 1999 review, we are satisfied that the Department has substantially implemented our recommendations. However, the Department's role in relation to private training is still reactive rather than proactive. For the most part, the Department reacts to student and operator complaints, rather than trying to mitigate potential complaints and problems. The Department continues to believe that the quality of training is a contractual responsibility between the training provider and the student, within the regulatory environment established by the Department.

11.26 These recommendations were first included in our 1995 Report. Since four years have passed, in accordance with our policy we will no longer be tracking their status.

Department of Education

11.27 In our 1996 Report, we recommended the Department provide budget to actual comparisons of the results of the eight administrative units constituted under the new administrative structure and include the results in the annual report.

11.28 The Department responded at the time:

The Department is of the opinion that your report outlines, in a fair manner, the difficulties which were encountered while attempting to provide to you a clear and detailed analysis of where savings were actually realized. This includes the inconsistencies in the reporting of administrative costs and also the global funding of school district operations which allowed for the reallocation of funds for administration prior to the abolition of local school boards in February 1996.

With the new education structure, district actual spending patterns versus amounts budgeted will be monitored in the same way as in other parts of government. The districts will be expected to live within administrative budgets and will not have the same freedom to take resources away from the classroom. The 1995 Report of the Auditor General, and the exercise of preparing the analysis for the four districts has highlighted the need for this type of accountability so that spending patterns that result from changes can be monitored and reported.

11.29 We reviewed the Department's 1997-98 annual report, and confirmed the inclusion of budget to actual comparisons for the eight administrative units. This recommendation has been implemented.

Department of Finance

Cash management

11.30 In our 1996 Report, we made twelve recommendations as a result of an audit of the cash management function of the Department's Treasury and Debt Management division.

11.31 In 1998, we asked the Department to assess the current status of each recommendation. The most recent departmental response follows each recommendation.

11.32 We recommended the Department record the cash managers' practices and procedures. There should be clear documentation of the reporting relationships which exist between the central cash managers and other parts of government. Clear documentation of the sources of all information used in making the decisions to either invest or obtain financing in the short term should also be included.

11.33 The Department responded:

The cash managers' practices and procedures are documented in various forms. Contacts and sources of information are now documented. Files have been created on the components that make up cash inflows and outflows. As well, job descriptions and performance appraisal mechanisms have been established which will result in improved documentation of the cash managers' procedures and practices and the relationship that exists with other parts of the government.

The prime function of the cash manager is to meet the day to day funding requirements of the Province. The elements making up the funding requirements are forecasted on a macro level and adjusted daily at the micro level. The daily cash requirements, expected cash requirements, market receptiveness, interest rate levels, etc. all impact on the final decision-making process. Sources of information are documented within the cash management function. Regular weekly meetings are held to discuss issues facing the Division, including cash position, financing needs and short term investing. Reports are issued weekly and daily to the Executive Director.

11.34 We recommended the Department formally define the role and responsibilities of the Money Market Analyst.

11.35 The Department responded:

The Department has formally defined the role and responsibilities of the Money Market Analyst.

11.36 We recommended the Department more clearly communicate to all departments and Crown agencies the role and responsibilities of the Province's central cash managers.

11.37 We recommended the Department evaluate the need for additional instruction and direction to departments and Crown agencies regarding special reporting and referral of cash flows to the central cash managers. Any measures implemented should specifically address offices and districts in outlying areas of the Province.

11.38 The Department responded:

Currently central cash managers maintain contact with department and agency representatives responsible for program delivery in order that a consolidated cash flow forecast can be made. Contact is maintained throughout the year to track variances from initial expectations. The larger revenue/expenditure areas are obviously of most immediate interest to central cash managers and here contact is frequent. The Deputy Minister of Finance has sent out a memo to all departments in this regard.

11.39 We recommended the division consider the issues of accountability and internal control when undertaking its review of the accounting systems related to the cash management function.

11.40 The Department responded:

As indicated in the Auditor General's commentary respecting this recommendation, cash position and transaction records are submitted and reviewed by the Executive Director. As evidence of this examination a file is maintained by the Executive Director. Tickets have been developed to document and enact all transactions. They must be signed and authorized. A back office function has been established for Treasury and proper specialized Treasury Management systems are currently being examined.

11.41 We recommended the Department formally and objectively review the cash management function, its information requirements and its related reporting systems.

11.42 The Department responded:

Coincident with the reorganization of the Division, a review of functions, information and reporting systems has been undertaken to ensure continued efficiency and effectiveness in cash management operations and changes have occurred.

11.43 We recommended the Department ensure adequate performance standards are established and implemented for the evaluation of the central cash managers. These performance standards should support the achievement of the Department's objectives.

11.44 The Department responded:

Performance standards and benchmarks are currently being developed and updated. This initiative is consistent with the overall objective of enhanced performance in the public service.

11.45 We recommended the Province's negotiated banking arrangements with financial institutions be supported by written proposals together with clearly documented analyses in support of the final decision. The signed agreements should be kept on file in the Department.

11.46 We recommended the Department consider an alternative to the current procurement of banking arrangements, such as tendering for banking services. All decisions regarding banking arrangements should be based on a formal and thorough cost-benefit analysis.

11.47 The Department responded:

Formal contracts signed by PNB and banks have been put in place for banking arrangements.

All arrangements for banking services have been made within the terms of the Public Purchasing Act. The department satisfies its banking requirements by using competitive methods to acquire specific services. This approach recognizes that factors such as branch locations, credit considerations, cost constraints, the quality of execution on transactions, etc. play a role in the selection process. Under the current practice, the Province chooses from the various banks those services which can, most cost effectively, be delivered by that bank while ensuring a broad range of banking services to the Province and its clients.

Decisions regarding banking arrangements have been made on the basis of an assessment of the merits and costs of the respective proposals. This is more completely documented in the files.

11.48 We recommended the Province's negotiated banking arrangements with financial institutions be monitored on a regular basis to ensure compliance with the provisions of the agreements.

11.49 The Department responded:

The Department monitors banking arrangements by checking monthly charges and credits as to their reasonableness using current volumes and rates. However in the future, the Department will monitor its banking arrangements on a formal and regular basis to ensure compliance with the provisions of the agreements.

11.50 We recommended the Department request that the banks adopt uniform core names and classifications for Province of New Brunswick bank accounts. This will improve control over the accounts from the banks' perspective and facilitate identification and reporting when dealing with the Province.**11.51** The Department responded:

This concern is primarily a bank issue and not a departmental one. The Province has no direct control over the banks' internal accounting systems. However, the Department has and will continue to use uniform core names and classifications for Province of New Brunswick bank accounts whenever accounts are updated and through all external communications and will continue to request that the banks do the same.

11.52 We recommended the Department ensure that reconciliations of the government records to the bank records be completed for all banks. Differences should be resolved.**11.53** The Department responded:

Treasury and Debt Management authorizes the opening of new accounts to ensure consistency in banking arrangements and to be aware of cash flow implications which may be significant to the Province. However, the day to day operation of the account (for example, accounts opened in remote areas to handle DNR license revenues, Justice fees, etc.) is the responsibility of the respective department. Treasury and Debt Management does confirm annually the status of accounts with departments.

It is the Department's opinion that central administration and control over bank accounts is most effectively accomplished through the departments. However, the Division will discuss the recommendations for account reconciliation with the Comptroller's Office.

11.54 Based on our 1999 review, we are satisfied that the Department has implemented our recommendations.

Revenue Management System

11.55 In our 1997 Report, we made ten recommendations as a result of an audit of the Department's contract with the IBM Consortium to implement an integrated revenue management system. As discussed in our 1997 Report, the contract was terminated in 1996 as a result of the introduction of the Harmonized Sales Tax which transferred sales tax collection to the federal government.

11.56 In 1998, we asked the Department to assess the current status of each recommendation. The most recent departmental response follows each recommendation.

11.57 We recommended 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.

11.58 The Department responded:

The department continues to concur that signed contracts are a necessity prior to work being undertaken on major system developments.

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

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

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

11.62 We recommended 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.

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

11.64 We recommended 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.

11.65 The Department responded:

The Department is currently developing protocols and guidelines that will address all these issues. They are expected to be completed by Fall 98.

11.66 In January 1999 the Department issued a document entitled "Public-private Partnerships (Guidelines and Protocols)". The document addresses most of the issues raised in the above recommendations. However, to our knowledge, the Province has not completed a formal analysis of its experience to date with public/private partnerships.

11.67 We recommended that the Department of Finance examine expense claims for the RMS project.**11.68** The Department responded:

The Revenue Division has identified in its work plan for fiscal 98/99 the audit of supporting documents for expenses claimed by IBM towards the RMS project. A letter has been issued to IBM advising of our intent to review their supporting documentation this year to which they have acknowledged receipt.

11.69 We were subsequently informed that this audit is in progress.

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

11.71 We recommended 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.

11.72 The Department responded:

The Department continues to concur that the method of calculating profit components should be clearly defined in future contracts.

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.

Although the department will be carrying out an audit of the expenses claimed by IBM towards the RMS project, it will not be looking at the area of commercial profit for the reasons already stated. We will ensure future contracts more clearly represent the discussions taking place on the method, as well as the rate, for calculating profit.

11.73 Based on our 1999 review, we are satisfied that the Department has substantially implemented our recommendations.

Department of Health and Community Services

Air Ambulance

11.74 In our 1997 Report, we made six recommendations as a result of an audit of the air ambulance service that is administered by the Ambulance Services Branch of the Department.

11.75 We recommended that future lease agreements be signed in advance of the period covered by the agreement.

11.76 The Department responded at the time:

[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.

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

11.78 The Department responded at the time:

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.

11.79 We recommended 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.

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

11.81 The Department responded at the time:

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.

11.82 We recommended 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.

11.83 The Department responded at the time:

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.

11.84 We recommended that the current facilities be reassessed and that improvements be made as necessary.

11.85 The Department responded at the time:

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.

11.86 Based on our 1999 review, the Department is making some progress in implementing our recommendations. The Department now receives service volume, response time and financial reports monthly, and quarterly summary activity reports. However, there are still no measurable objectives for the air ambulance service. The current rate agreement with Nova Scotia and Prince Edward Island expired on 31 March 1999, but, by mutual agreement, the terms will continue in effect until a new agreement is signed. The current rates are similar to those in effect at the time of our 1997 audit. With regard to the facilities,

there are plans for staff to move to a larger, improved Dispatch Centre late this year.

Ambulance services

11.87 In our 1997 Report, we made nine recommendations as a result of an audit of the inspection function of the Ambulance Services Branch of the Department.

11.88 We recommended appropriate policies and procedures for the inspection process be clearly established, properly documented, effectively communicated, and updated on an annual basis.

11.89 The Department responded at the time:

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.

11.90 We recommended an inspection schedule be compiled on an annual basis, and updated as needed.

11.91 The Department responded at the time:

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.

11.92 We recommended a means of monitoring the inspection function be established and performed regularly.

11.93 The Department responded at the time:

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.

11.94 We recommended the Branch ensure compliance with all set Standards and with legislation.

11.95 We recommended enforcement actions be established. These actions should be used to ensure compliance with the Standards.

11.96 We recommended follow-up inspections be done to determine if identified deficiencies have been corrected.

11.97 We recommended licensing 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.

11.98 We recommended the Branch develop alternatives (ex. Probational licenses, temporary suspensions) to the current automatic annual license renewal practice.

11.99 The Department responded at the time:

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.

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.

11.100 We recommended the problems with the computer system be formally identified and addressed, by either updating or replacing the current system.

11.101 The Department responded at the time:

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

11.102 Based on our 1999 review, we are satisfied that the Department has substantially implemented our recommendations.

Department of Justice

Court Services Division

11.103 In our 1995 Report, we made twelve recommendations as a result of an audit of the Court Services Division of the Department. Our audit focused on three areas:

- recommendations arising out of a Quality of Service Study (QSS) completed by the Department in 1992;
- the Family Support Order Services (FSOS) system; and
- the system for the collection of fines, bail and restitution.

11.104 In our 1996 Report, we reported the Department's own assessment of its progress. In 1998, we again asked the Department to

assess the current status of each recommendation. The most recent departmental response follows each recommendation.

11.105 We recommended that the costs of Department of Justice programs and services be established to provide a means of determining the savings generated by the NBIJ project.

11.106 The Department responded:

No longer applicable as NBIJ is no longer a government initiative.

11.107 We recommended that the Department prepare a formal update of the QSS recommendations and determine the current status of the *Implementation Plan*. In doing this, the Department should disclose:

- which recommendations are non-applicable or in need of revision;
- which recommendations will not be implemented;
- to what degree the Department has fulfilled the purpose of the QSS (i.e. to address four primary issues facing the Court Services Division); and
- how and when the NBIJ initiatives will impact QSS recommendations.

11.108 The Department responded:

AS NBIJ is no longer a departmental initiative, the update was not completed as planned. An update on the status of implementation will be provided by November 30, 1998.

11.109 The Department did provide us with an update on the status of implementation of the QSS recommendations.

11.110 We recommended the Department continue to work with the Interdepartmental Committee to resolve the issue of responsibility for Court Security. Further, we recommended that the Department of Justice request the Interdepartmental Committee to engage the RCMP to perform a follow-up review of the 1992 study. This would provide an independent assessment of the progress towards implementation of the recommendations.

11.111 The Department responded:

A status report on implementation of the recommendations was completed by the Department. It is the opinion of the Department that an independent review of the 1992 study is therefore not necessary as a follow-up plan is being currently developed to address the remaining recommendations.

As it relates to Court Security specifically, discussions are on-going with municipalities, police chiefs and the Department of Justice and Solicitor General. In three cities, Sheriff officers provide security and transportation services for the Provincial Court since it was determined that this was the most cost effective model. On-going attempts are being made to formalize this current practice with the municipalities.

A follow-up plan will address the recommendations of the RCMP report related to security personnel for the court buildings and the construction plan for Miramichi Court House. This plan will target these areas for action in future years. There are no immediate plans to act on these recommendations.

11.112 We recommended the Department improve accessibility through reducing complexity in the Court system with the implementation of QSS recommendations #26-#29.

11.113 The Department responded:

***MOVE program:** was initiated by the group for Mediated Offender Victim Encounter for the Moncton region. The Department was a participant in this initiative whereby a pilot project was established to evaluate its effectiveness. A sampling of 30 cases were chosen for the pilot. This measure was a post-conviction pre-sentencing measure which required the involvement of numerous volunteers, on average amounted to 12 hours per case instead of a short court appearance and involved 2 court appearances instead of one court appearance. An evaluation was carried out following the pilot project. It was determined that this type of measure was not cost effective.*

Instead, the Department was a participant in the Alternative Measures Program implemented by the Department of the Solicitor General which is a pre-charge option with no formal charges being laid, but evidence to proceed with charges required.

***Circle sentencing:** Discussions between departments and native communities have been on-going since 1995. With the recent implementation of the Alternative Measures program by the Department of the Solicitor General, current discussions will focus on how best to benefit native communities through this program. Two instances of circle sentencing have taken place at the request of the accused and/or their counsel over the last year.*

***Unified Criminal Court:** this project is no longer being pursued by the federal and provincial Departments of Justice.*

***Small Claims:** The Small Claims Act was assented to on February 28, 1997. It established a court to hear claims up to \$6000. Provincial appointees will hear small claims. The program will be up and running January 1, 1999. This newly constituted court will provide improved access to justice and a less expensive alternative to the Court of Queen's Bench.*

***Child Support Guidelines:** Amendments were made to the Divorce Act and Income Tax rules governing child support on May 1, 1997. Amendments to the Family Services Act and a new regulation incorporating the federal child support guidelines came into effect on May 1, 1998 in New Brunswick. With federal funding assistance, additional resources were obtained to deal with the influx of child support variations resulting from the legislative amendments.*

11.114 We recommended the Department implement objective standards for locating and maintaining satellite courts. These standards should consider all related costs, not just Department of Justice costs.

11.115 The Department responded:

Standards have been developed which need to be formally approved. As noted, costs to the Department of Justice are not the only consideration.

11.116 We recommended the Department implement an ongoing monitoring process as discussed in QSS recommendations #23 and #36. This should include monitoring the costs of services.

11.117 The Department responded:

As Enforcement status process was established in 1996-97 whereby all enforcement cases can now be tracked as to their enforcement status and payment/default profile. Enforcement and management reports are generated to assist enforcement officers and managers monitor progress of caseload and achievement of performance targets.

The JIS (Justice Information System), YOAIS (Young Offenders...Information System) and the MAES (Maintenance and Enforcement System) are being currently replaced. Monitoring mechanisms are part of the systems' designs.

11.118 We recommended the Court Services Division provide training and procedural direction to the bookkeepers and

enforcement officers in the regions. The new policy and procedures manual should be implemented at the same time.

11.119 The Department responded:

Training sessions were held in 1996 and manuals reviewed and distributed. A case management program was also introduced to enforcement officers to enable them to track the enforcement status of their caseload by producing computer generated enforcement reports.

11.120 We recommended all trust account bank reconciliations be completed and maintained on a regular basis.

11.121 The Department responded:

Regions consolidated banks accounts resulting in fewer bank reconciliations to be carried out and also reducing the opportunity for errors. Furthermore, reconciliations are now much simpler in the Family Support Orders Service. Reconciliations are now automated and a Central Unit now has the responsibility to issue all support payments.

11.122 We recommended that in order to improve the efficiency of the bookkeeping and enforcement activities, the Department should develop a system that will eliminate the need for duplication and strengthen the financial controls in FSOS.

11.123 The Department responded:

All ledgers cards have been eliminated in the regional bookkeeping offices. The MAES automated system is being replaced and Phase 1 component of the new system will be operational by year end. This new system should eliminate the need for staff to duplicate their efforts and assist in strengthening the financial controls.

11.124 We recommended the Department develop procedures which determine who in each region is responsible for follow-up on outstanding Warrants along with recommended follow-up actions.

11.125 The Department responded:

An alternative process to the Warrant of Committal has been implemented – Default Hearings. Prior to the issuance of a warrant in response to a Criminal Code offence, a default hearing must take place to determine the reasons why an individual has not paid the fine. This process has resulted in an increase in payment of fines avoiding issuance of warrants.

11.126 We recommended the Department consider making it easier for the public to pay a fine.

11.127 The Department responded:

With the replacement of JIS and YOAIS, the long term plan is to design interfaces to Service New Brunswick and other payment outlets. The design also includes the usage of debit and credit cards.

11.128 We recommended the Department take immediate steps to collect outstanding fines. The steps taken should address the causes of the increase identified in the various studies and reports.

11.129 The Department responded:

A project was undertaken in 1997 to collect outstanding fines. The primary finding of the project was that there were many fines on the system for which time had already been served. Work continues in an effort to increase compliance of a court order. Recently more Judges of the Provincial Court have begun conducting default hearings in criminal matters in order to enforce their orders. This has had positive results.

11.130 Based on our 1999 review, we are satisfied that the Department is taking steps to implement our recommendations. The Department initially planned to address many of our recommendations through the New Brunswick Integrated Justice (NBIJ) initiative. This was to be a “uniform, integrated operational framework for administering and delivering justice in the province”, to be developed by Andersen Consulting in cooperation with the Departments of Justice and the Solicitor General. This arrangement was terminated in 1997 (see comments in our 1998 Report), and the Department then had to implement alternative solutions. In the circumstances, it is understandable that progress in some areas has been slow.

11.131 These recommendations were first included in our 1995 Report. Since four years have passed, in accordance with our policy we will no longer be tracking their status.

Department of Natural Resources and Energy

11.132 In our 1997 Report, we made eight recommendations as a result of an audit of revenues received under the *Metallic Minerals Tax Act* and royalties pertaining to potash mining.

11.133 We recommended the Department continue its efforts to improve the Metallic Minerals Tax submission forms and ensure the Regulations are revised as appropriate.

11.134 The Department responded at the time:

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.

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.

11.135 We recommended 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.**11.136** The Department responded at the time:

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

11.137 We recommended the MMTA be amended to indicate the basis of accounting is Generally Accepted Accounting Principles.**11.138** The Department responded at the time:

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

11.139 We recommended the Department finalize the revised unsigned potash leases.**11.140** The Department responded at the time:

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).

11.141 We recommended the Department ensure both producers compute royalties on the basis of the signed leases.**11.142** The Department responded at the time:

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.

11.143 We recommended that when the present leases expire, the Department improve cash flow by requesting monthly remittances from potash producers.

11.144 The Department responded at the time:

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

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

11.146 The Department responded at the time:

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.

11.147 We recommended the Department improve its approach to the audits of potash producers.

11.148 The Department responded at the time:

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.

11.149 Based on our 1999 review, we are satisfied that the Department is taking steps to implement our recommendations. However, progress has been slower than anticipated.

11.150 Proposed changes to the Metallic Minerals Tax Act have not yet been submitted to the Legislative Assembly. And although there is now only one potash producer in the Province, the Department has still not finalized the revised unsigned potash lease.

Department of Supply and Services

11.151 In our 1997 Report, we made five recommendations as a result of an audit of the government's decision to privatize its data processing facility.

11.152 We recommended 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.

11.153 The Department responded at the time:

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.

11.154 We recommended that the relevant section of the agreement be clarified so that appropriate financial information can be obtained from the Consortium partners.

11.155 The Department responded at the time:

.....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.

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.

11.156 We recommended 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.

11.157 The Department responded at the time:

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.

11.158 We recommended the Department review the cost allocation model currently in place and give consideration to suggestions put forward by the user group.

11.159 The Department responded at the time:

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.

11.160 We recommended 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.

11.161 The Department responded at the time:

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.

Department of Transportation

Vehicle Management Agency

11.162 Based on our 1999 review, we are satisfied that the Department is taking steps to implement our recommendations. However, only one of the recommendations has been fully implemented to date. We will continue to monitor progress towards implementation of the remaining recommendations.

11.163 It should be noted that the make-up of the Consortium operating the Province's Data Centre has changed. It now consists of Unisys Canada Inc. and MITI Information Technology Inc.

11.164 In our 1996 Report, we made four recommendations as a result of an audit of the Vehicle Management Agency. The Agency is a Special Operating Agency created to manage the fleet of government vehicles.

11.165 We recommended the Agency ensure monthly vehicle usage reports are submitted on time for all vehicles, including those assigned to executives.

11.166 The Department responded at the time:

Reporting of monthly usages for executive vehicles is not required for billing purposes, since executive vehicles are only charged a fixed cost per month. However, the Agency will work toward receiving complete monthly usage reports for all executive vehicles.

11.167 We recommended the Agency ensure the reports for monitoring fuel are used for the purpose intended.

11.168 The Department responded at the time:

There are a number of reports designed to monitor fuel consumption. Most of these reports have not been perfected to enable detection of the inconsistencies they were intended to highlight. The client departments also have some responsibility to monitor their own drivers' fuel usage. We agree with the general direction and are working on making changes to improve the exception reports generated and to follow-up on these reports.

11.169 We recommended the Agency properly monitor credit card transactions.

11.170 The Department responded at the time:

We agree with the recommendation. Staffing problems and the ongoing enhancements to the Fleet Management System have caused delays in commencing this activity. We plan to meet the commitment to audit credit card transactions in the near future.

11.171 We recommended the Agency re-evaluate two review processes, and the necessity to fax reports from each District, each day.

11.172 The Department responded at the time:

The AFS does not currently provide all the information recorded on the manual ledgers in a format suitable for performing required reconciliations. The Agency is presently working on an enhancement to the AFS which will eliminate the requirement for these manual ledgers.

When the AFS was first installed, central office was required to monitor these reports closely and provide advice on corrective action. Since district staff are now better trained, the Agency will stop the requirement to fax reports daily. We will reassess this practice should problems recur in this area.

11.173 Subsequent to our audit, the Agency has implemented a new Fleet Management System and has enhanced its Automated Fuel System. Based on our 1999 review, we are satisfied that the Agency has implemented our recommendations.

Chapter 12

Office of the Auditor General

Contents

Background	239
Office Role and Relevance	239
Performance Indicators	240
Financial Information	243
Staff Resources	244

Office of the Auditor General

Background

12.1 In recent years, our Reports have contained a checklist relating to our assessment of our compliance with the Annual Report Policy of government. A comparative version for 1999 is presented below.

12.2 It is our intention to continually improve the information available in our annual Report on the performance of our Office.

Exhibit 12.1
Self assessment checklist

	1999	1998
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?	Yes	Yes
Are details available on level of client acceptance	Yes	Yes
Is actual and budget financial information presente	Yes	Yes
Does the report explain variances from budget?	Yes	Yes

Office Role and Relevance

Our role

12.3 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

12.4 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

12.5 We promote accountability by providing objective information to the people of New Brunswick through the Legislative Assembly.

Our values

12.6 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

12.7 Our 1998 Report generated significant interest. Over six hundred copies were printed and distributed. Access to our Report is also available through the Internet. Discussions of our findings in the Legislative Assembly and the Public Accounts and Crown Corporations Committees are evidence of the continuing relevance of our work.

12.8 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.

12.9 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.

12.10 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.

Performance Indicators

12.11 Early in 1998 we finalized a strategic plan for the Office. This plan identifies our priorities and strategic goals. As part of this exercise, we also established performance indicators. We are tracking our progress against these indicators. This section of our Report identifies each indicator by strategic priority, and discusses our progress to date.

Responding to the needs of users

12.12 We will survey Members of the Public Accounts and Crown Corporations Committees on an annual basis in order to measure our effectiveness in meeting their needs.

12.13 We sent out a survey to all members of the Public Accounts and Crown Corporations Committees in April 1999. The response was disappointing, although understandable in view of the election call in May and the election itself in June. Nevertheless, the respondents overwhelmingly indicated that our annual Report helped them to do their

job better. Committee members were satisfied with both the content and the length of our Report, and also appreciated the condensed report of highlights that we introduced in 1998 in response to a previous survey. Committee members also found useful the in-camera briefing our Office provided on the day the 1998 Report was released, and were satisfied with the information we presented during our attendance at the public meetings of the Public Accounts Committee on 19 November 1998 and 31 March 1999 (the Crown Corporations Committee did not have a public meeting during the period covered by our survey). The respondents indicated their belief that the Office of the Auditor General contributes to improved public sector accountability and provides the taxpayers of New Brunswick with good value for money.

12.14 We are pleased with the results of our surveys, and we will seek to maintain, or even increase, the level of satisfaction with our work.

12.15 We will measure the extent to which the recommendations which appear in our annual Report are accepted and implemented. The disposition of all recommendations will be tracked for a period of four years.

12.16 Chapter 11 of this Report provides an overview of the recommendations included in our 1995 through 1997 Reports, arising out of our broad scope audits. It details the departmental responses to our recommendations, and our assessment of the acceptance and implementation of those recommendations. We are generally satisfied with the results.

12.17 In June 1999 we asked government departments to indicate the current status of recommendations included in our 1998 Report. We will be conducting follow-up work over the next year in order to assess the responses.

12.18 We will measure the extent to which accounting and reporting recommendations made by the Public Sector Accounting Board of the CICA are accepted and implemented by the Province of New Brunswick.

12.19 We are tracking this indicator as part of our annual audit of the financial statements of the Province. We will be discussing the Province's progress in implementing the PSAB recommendations in Volume 2 of our 1999 Report.

12.20 The Province of New Brunswick audit will be completed by June 30th and all Crown agency and Trust Fund audits will be completed by September 30th.

12.21 We did not meet this performance indicator in 1999. At the date of writing this Report, our audit report on the financial statements of the Province had still not been issued. The change of government in

June 1999 was followed by the announcement of a review of the financial affairs of the Province, undertaken by a public accounting firm. The government delayed the completion of the financial statements of the Province for the year ended 31 March 1999 until they received the results of this financial review. This caused delays in the completion of our audit work.

12.22 Our goal continues to be to facilitate the issuance of the audited financial statements of the Province within three months of the year end.

12.23 As for the Crown agency and Trust Fund audits, eleven audits were completed and the auditor's reports signed before September 30th. Another eight had the audit fieldwork completed before September 30th, but our internal file review process had not been completed. And there were seven audits that still had outstanding audit work as of September 30th. In some cases our failure to meet the targeted completion date was due to problems with our client. In many other cases, however, we could have done a better job. As an Office, we have learned from this experience and we plan to do better next year. We also found we had different interpretations in the Office of what we mean by completion. Did it mean the completion of the audit fieldwork, or did it mean the actual signing of the auditor's report, which means the statements are ready for release? For next year we will be striving to have all auditor's reports signed, and the statements available for release, by September 30th.

*Making effective use of
resources*

12.24 All financial and broad scope audits will be performed within the time allotted.

12.25 We establish detailed time budgets for each of our audits. During the audit, we monitor the time spent by staff members on individual sections of the work. At the end of each audit, we summarize the total time spent, compare it to the total budgeted hours and analyze major fluctuations. For our financial audits, we use the results of this analysis to help us prepare the budget for the following year's work.

12.26 For the eleven financial audits completed and the auditor's reports signed before September 30th, only two exceeded the budget by more than 50 hours. We were quite pleased with this result. For the nine major broad scope audits completed and reported in this Report only three were under budget. For those that were over budget our analysis indicates that in some cases we may have underestimated the complexity of the work, but in other cases we could have been more efficient, especially during our report writing stage.

12.27 60% of all professional paid time in our Office will be spent directly on financial statement audits or broad scope audits.

12.28 A detailed analysis of staff time for 1998 indicates that 60.29% of the total paid time of all staff, with the exception of our three

administrative support staff, was spent directly on audit work (including work on our annual Report). Non-audit time includes statutory holidays, vacations, courses for accounting students and professional staff, sick leave and administrative duties not chargeable to a specific audit. For the first six months of 1999, this number dipped to 58.32%.

12.29 Of the total time spent directly on financial statement audits and broad scope audits, 30% will be spent on broad scope audits.

12.30 Our analysis indicates that, in 1998, we spent 31.96% of total audit time on broad scope audits. For the first six months of 1999, this number rose to 45.78%. This reflected a conscious effort to complete broad scope audit projects in the early part of the year.

Maintaining professional standards

12.31 We will meet the standards required by the New Brunswick Institute of Chartered Accountants Mandatory Practice Review Committee.

12.32 The latest inspection of our Office files and procedures by the Institute was in 1996. The inspection concluded that we continue to meet the standards required by the Institute. No exceptions were noted.

Financial Information

12.33 Budget and actual expenditure for 1997-98 and 1998-99 by primary classification is shown in Exhibit 12.2. The approved budget for the 1999-2000 year is presented for comparative purposes.

*Exhibit 12.2
Budget and actual expenditure
(thousands of dollars)*

	2000	1999		1998	
	Budget	Budget	Actual	Budget	Actual
Wages and benefits	1,375.4	1,392.1	1,296.5	1,419.1	1,288.6
Other services	118.4	118.4	111.2	105.7	124.8
Materials and supplies	7.9	7.9	7.2	7.9	8.4
Property and equipment	22.1	22.1	36.0	22.1	76.4
	1,523.8	1,540.5	1,450.9	1,554.8	1,498.2

12.34 Staff costs continue to account for approximately 90% of our budget and were underspent by \$95,600 for the year ended 31 March 1999. A senior employee was out on maternity leave for a large part of the year. Delays in filling vacant positions caused the balance of the underspending.

12.35 Property and equipment was overspent by \$13,900. We 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.

12.36 Our legislation requires an annual audit of our accounts by a qualified auditor, appointed by the Speaker of the Legislative Assembly on the advice of the Board of Management. This audit is conducted by the Office of the Comptroller and their audit report is tabled before the Legislative Assembly.

Staff Resources

12.37 Our Office continues to provide experience and training to our employees. New employees must enrol 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.

12.38 In the past seven years, eleven people in our Office have received a professional accounting designation. Six of these people have moved to important financial positions in government. One person moved to a government position in another province; 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.

12.39 The cumulative effects of fiscal restraint have caused us to reduce our staff complement from 27 to 25. Brent White CA, Paul Jewett CA and Phil Vessey CA are the directors for our three audit teams. At 31 March 1999 there were fifteen professional staff with accounting designations. Our staff also included five students who hold a university degree which is a prerequisite for both enrolment in an accounting program and employment at our Office. The three remaining members of our staff provide administrative support services. Two positions were vacant. The following is a list of staff members at 31 March 1999:

Lorna Bailey ⁽¹⁾	Ken Robinson, CA
Jeffrey Chown, CA	Yvonne Samson ⁽²⁾
Cathy Connors Kennedy, CA	Brian Soeler ⁽²⁾
Eric Hopper, CA	Tammy Sterling ⁽²⁾
Peggy Isnor, CA	Diane Swan ⁽¹⁾
Paul Jewett, CA	Al Thomas, CA
Cecil Jones, CA	Phil Vessey, CA
Kim Langille ⁽²⁾	Tim Walker, CA
Kim Embleton ⁽²⁾	Brent White, CA
Greg Mignault, CMA	Darlene Wield ⁽¹⁾
Eric Maurant, CA	Daryl Wilson, FCA
Bill Phemister, CA	

⁽¹⁾ Administrative support

⁽²⁾ Student enrolled in a professional accounting program.