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Introductory Comments

1.1 It is not easy to summarize a year’s work in six pages. In fact it is impossible. There is always the risk that the attempt to produce highlights will overlook matters that will be extremely important to a particular reader. For this reason I hope you read all chapters in our 1998 Annual Report. For instance in Chapter 5 you will learn about our findings on the approval and monitoring of grants to New Brunswick businesses. Chapter 13 reflects some preliminary work we have done on the Fredericton-Moncton Highway. And in Chapter 3 you will find charts that we have produced for the first time that portray the government’s financial condition from the perspective of sustainability, flexibility and vulnerability. There are seventeen chapters in total.

1.2 I will provide the reader however with some observations that I have made as a result of being familiar with all the work we have performed. These observations have been consolidated in the form of themes as opposed to individual issues.

Public-private partnerships

1.3 There has been a great deal of interest in government’s attempt to involve the private sector in the delivery of public services. We are very interested as well, especially since there is every indication that this is a method preferred by government that it will continue to use in the future. As a result of this interest we have examined a number of these arrangements.

1.4 Two of the arrangements that we examined did not proceed to completion, the Revenue Management System (RMS) in the Department of Finance and the New Brunswick Integrated Justice (NBIJ) initiative in the Departments of Justice and the Solicitor General. In both instances the government had to terminate the arrangements with negotiated settlements. We commented on the RMS system last year and there is a chapter in this year’s Report on the $2.9 million negotiated settlement with Andersen Consulting on the NBIJ initiative. In looking at this initiative we were interested in whether the taxpayer received value for the money spent. Our conclusion is that while the payment was reasonable under the circumstances, any value would be of an intangible nature. Last year we noted that the estimated benefits from the RMS system were substantially less than the settlement reached with IBM.

1.5 This year we also examined the payments made to Andersen Consulting as a result of the work they did in developing the NB Case system in the Department of Human Resources Development. The concept of this project was that Andersen Consulting was to be paid from identified savings arising from their work in developing the new system. We were pleased to find that the new system was generating savings which more than supported the payments being made.

1.6 All three of these projects were similar in that the cost of the professional services was to be paid from real savings. No savings, no pay. Only one of the three met the stated objective. We believe, however, that this method of procurement has potential, especially if all business cases for new automated solutions are prepared by somebody independent of the actual work and if large projects are divided into manageable pieces. We made these same observations last year.

1.7 We believe this approach provides a strong discipline to the decision-making process in that tough decisions must be made to realize necessary savings. The savings must exist before payments can be made. We did note that in the NB Case situation, the new system only had to realize savings to cover the payments to Andersen Consulting. The costs of computer hardware and software were excluded from this calculation. We feel that in the future any business case should ensure that savings will cover all the costs of developing and implementing the new solution.

1.8 We also looked at another form of public-private partnership. This is where the government contracts with one provider for the design, construction, operation and financing of a particular project and then enters into a lease arrangement with the provider. A school was built in Moncton in this manner, as was the youth facility in Miramichi. In the past the government would have looked at design, construction and operation as separate components. The government would have then provided any required financing by issuing Province of New Brunswick bonds.

1.9 As a result of the work which we have done, we are not convinced that the taxpayer is receiving the best value for money under these new arrangements. At the outset, government is forfeiting its own borrowing power, and its favourable borrowing rates, to those of a lessor. This would make the cost of financing more expensive. There is reference to this form of public-private partnership permitting government to transfer risks to the private sector, but it is not clear what risks are being transferred and what value is placed on them. Furthermore, risks are not assumed by third parties without cost. So, to the extent that risks are transferred, the question that must be answered is, at what price? And further, is this the best way for government to manage these risks?

1.10 Government has traditionally built and owned facilities such as schools and correctional institutions. This is the business government is in and will no doubt continue to be in. We did not see compelling reasons for this major policy shift from owning such facilities to leasing them.

1.11 We are fully aware that the accounting treatment for these lease arrangements assists the government in meeting the objective of balancing the budget. In fact, we can say with certainty that this is one consistent outcome of the arrangements we have examined. But it may not be the best arrangement from a value-for-money standpoint.

1.12 At the present time the Department of Finance and my Office do not agree on whether these arrangements are beneficial to the Province. Since we do not agree, and since the government intends to continue to use this procurement method, I will be allocating resources to examine more of these arrangements in the future.

1.13 This raises the issue of accountability and how important it is that government be able to easily explain and defend decisions to the public. These arrangements and the advantages of them are not easy to explain. If the approach is to continue we strongly recommend that mechanisms be put in place that make the decisions and the reasons for them transparent to the taxpayer.

Accounting and financial reporting

1.14 We qualified our audit opinion on the Province's financial statements for the year ended 31 March 1998. We had two reservations.

1.15 The first one was related to the Province's investment in NB Power, which we believed should have been written down by $450 million. It was determined during the year that the value of the Point Lepreau nuclear generating plant was permanently impaired in the amount of $450 million. But rather than recognizing the loss, NB Power created an asset in the same amount. We did not agree with this accounting treatment and our position and reasoning is fully explained in Chapter 2. Also in Chapter 2 are the details surrounding the second reservation. This one related to how the Province accounted for the $364 million received from the federal government in connection with the implementation of the Harmonized Sales Tax. The result of both reservations on the 1997-98 financial results was to change a reported surplus of $61.7 million into a deficit of $267.3 million.

1.16 For the first time, the Province recorded in the accounts its liability for retirement allowances, accrued salaries for teachers, vacation pay, and workers' compensation benefits for provincial employees. The total of these liabilities as at 31 March 1998 was $302.3 million. We commend the Province for taking this action. This moves the Province closer to being in full compliance with the Public Sector Accounting and Auditing Board (PSAAB) standards. In Chapter 2 we trace the progress the Province has made over the past ten years in adopting PSAAB recommendations, and are pleased to report that there are few remaining areas where further improvement can be made.

1.17 One area that continues to concern us is the Province's reluctance to recognize in the accounts the net liabilities of its eight regional hospital corporations. At 31 March 1998 the net liabilities of these eight corporations amounted to $70.4 million, an increase of $26.0 million from the previous year.

Failure to follow legislation and resolutions

1.18 This year, we found three examples of actions being taken by government which were not consistent with legislation. In one instance NB Power provided funding of $2.5 million for economic development in the Minto area. The Electric Power Act gives authority for such funding if it was determined to be appropriate from a public policy standpoint by the Lieutenant-Governor in Council. Such authority should have been evidenced and supported by an Order in Council. This was not done. In another situation we found that the Credit Unions Act requires the New Brunswick Credit Union Deposit Insurance Corporation to establish and maintain deposit insurance funds to be used in the event claims are to be paid to depositors. These funds have not been established. Finally we found that expenditures totalling $76.8 million have not been approved by Board of Management or the Lieutenant-Governor in Council even though such approval is required under the Financial Administration Act.

1.19 In addition we found two instances where Board of Management minutes were not followed. In the first instance the Excellence in Education initiatives, which were adopted in 1992, called for separate accounting for the $61.1 million additional funding to be provided over a four-year period. We found there was no separate accounting for approximately 25% of the funding. And secondly, a Board of Management minute authorizing the transfer of money to a specific program was exceeded.

1.20 All of these findings are explained in detail in our Report. We raise the issues here because of the seriousness of the shortcomings. All legislators, and all supporters of motions or minutes, must have confidence that their wishes will be fulfilled. We strongly recommend that great care be taken to ensure that all actions are clearly supported by the appropriate authority, and that any prescribed action by legislation or resolution be acted upon forthwith.

Accountability

1.21 Our Office is very interested in promoting accountability by the government to the people of New Brunswick through the Legislative Assembly. Each year we undertake projects for the sole purpose of commenting on accountability.

1.22 One major project we undertook this year was to examine the governance and accountability of the eight regional hospital corporations. In general our findings on governance issues were positive. We recommended however that accountability would be better served if the Chairs of the boards of the regional hospital corporations and their CEOs appeared annually before a committee of the Legislative Assembly. The results of our work in this area can be found in Chapter 12.

1.23 This year we also examined the outcome of the Excellence in Education (EIE) initiatives which had been announced in June of 1992. The EIE program was carried out over a four year period with a total budget of $61.1 million. One of our objectives in doing this work was to determine if the government had adequate systems in place to measure and report on the effectiveness of the initiatives. Our work revealed that in at least one area, the Early Childhood Initiatives (ECI), the results are not yet known, so any reporting to the Legislative Assembly would be premature. The ECI accounted for approximately 25% of the total budget of $61.1 million. On the other hand, for the EIE initiatives that are completed and could be evaluated, no reporting has taken place. Despite this, the Excellence in Education budgets became part of the participating departments' base budgets in the fiscal year 1996-97. As a result of our work in this area, we believe accountability would have been better served if government reported on the results of completed initiatives and if no money was permanently included in departmental budgets until a final evaluation was completed.

1.24 Last year we commented on the amount of attention given each year to the annual budget of the Province and how very little is ever said about actual results. We suggested that the accountability cycle would be completed if government prepared a narrative explaining how actual results compared to the budget. We were very pleased to see that the Province provided this information this year and not only were major variations from budget explained but in many cases variations from last year's actual results. We commend the government for providing this information.

Our Office performance

1.25 Last year I made reference to how I felt our Office must lead by example. At that time I said "*we cannot make pronouncements on timeliness and not be timely ourselves, and we cannot ask others to identify and report on performance indicators and not do so ourselves. We too spend taxpayers' dollars…*"

1.26 During the last year we undertook a number of initiatives in our Office. We finalized our Strategic Plan, and identified nineteen performance indicators, eight of which we believe are relevant for external reporting. We also conducted a survey of members of the Public Accounts and Crown Corporations Committees. One of the suggestions made to us was the publication of a highlights booklet to accompany the annual Auditor General's Report. Such a booklet was prepared this year. For more information on our Office and our performance over the past year refer to Chapter 17.

1.27 As for timeliness, it is our intention at the time of writing this Report to have our 1998 annual Report tabled in early December. We believe it is very important to be reporting in the same year that we conducted most of our work. A December tabling will be one month earlier than last year.

Acknowledgements

1.28 During the year, staff of my Office are in contact with numerous government employees, as they go about their audit duties. In addition I have contact with a number of senior employees, mostly Deputy Ministers. I want to recognize the cooperation we receive from the Deputies and their staff. I fully appreciate the fact that these employees have numerous responsibilities and in many instances are working towards crucial deadlines. They still, however, show us courtesy and make every effort to respond to our queries and reports, and for this we are most appreciative.

1.29 Although it is my honour to submit this Report, I am indebted 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
Comments on Financial Statements of the Province

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Comments on Financial Statements of the Province

Background

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

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

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

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

Scope

2.4 In fulfilling our responsibility to carry out the audit of the financial statements of the Province of New Brunswick, we conduct audits in accordance with generally accepted auditing standards. Based on the results of our audits, we issue an opinion on the financial statements of the Province. This chapter of the Report presents an overview of the major accounting issues arising from the 1998 audit of the financial statements. Matters that have arisen during the financial statement audits that relate specifically to departmental operations, government programs, Crown agencies and trusts are discussed elsewhere in this Report.

Results in brief

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

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

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

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

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

Our reservations on the Province's financial statements

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

2.21 Paragraph 9 states:

> *Rate actions of a regulator can provide reasonable assurance of the existence of an asset. An enterprise shall capitalize all or part of an incurred cost that would otherwise be charged to expense if both of the following criteria are met:*
>
> *a. It is probable that future revenue in an amount at least equal to the capitalized cost will result from inclusion of that cost in allowable costs for rate-making purposes.*
>
> *b. Based on available evidence, the future revenue will be provided to permit recovery of the previously incurred cost rather than to provide for expected levels of similar future costs.*

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

> *For rate-regulated operations, the regulator may require the difference between net carrying amount and the proceeds on disposal of a capital asset to be considered in the determination of rates charged to customers. In such circumstances the difference is deferred, provided there is reasonable assurance that:*
>
> *(a) any excess of net carrying amount over proceeds on disposal will be recovered through future rates…*

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

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

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

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

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

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

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

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

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

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

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

> *The purpose of the transition payment is to allow the Province to offset, over a four-year period, the fiscal impacts that will result because of adjustments to the Provincial tax structure required to accommodate harmonization. Determining the extent of these fiscal impacts is difficult, and is based on economic estimates and assumptions.*
>
> *The Province has estimated that the value of the fiscal impact on the year ended 31 March 1998 was $11.0 million. This amount has therefore been recognized as revenue in the Statement of Revenue and Expenditure.*

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

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

> *in the period that the events giving rise to the transfer occurred, as long as:*
>
> *a) the transfer is authorized,*
> *b) eligibility criteria, if any, have been met by the recipient, and*
> *c) a reasonable estimate of the amount can be made.*

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

2.33 The letter then said:

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

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

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

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

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

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

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

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

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

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

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

How the Province's financial statements have improved

Background

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

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

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

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

Improvements made in the 1997-98 financial statements

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

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

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

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

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

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

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

Improvements made in previous years

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

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

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

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

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

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

2.53 Other improvements included:

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

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

Full PSAAB compliance calls for further change

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

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

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

Hospital corporations

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

2.58 Because only transactions between the Province and the corporations are reflected in the Province's financial statements, any deficits or surpluses in the corporations (and the related borrowing or surplus funds) are not included. A review of the financial statements of the eight regional hospital corporations shows total current liabilities exceed current assets by $61.3 million at 31 March 1998. In addition there is total long-term borrowing of $7.0 million and capital lease commitments of $2.1 million. These net liabilities, amounting to $70.4 million, are not recorded or reflected in the Province's financial statements or notes. Last year we reported that net liabilities of hospital corporations were $44.4 million, up by 36% over 1996 levels. This year the annual increase was almost 60%. The net position worsened for each of the eight corporations.

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

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

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

Accountability

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

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

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

2.64 This accountability structure is evidenced by the following:

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

Control

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

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

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

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

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

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

Control over revenue-raising

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

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

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

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

"{Hospital Boards} must function within the parameters set by the provincial government. The boards have no ability to increase funds allocated to them…."

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

Control over expenditure and resource allocation

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

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

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

2.75 However:

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

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

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

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

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

Conclusion

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

Tangible capital assets

2.78 In 1997 PSAAB approved accounting and reporting standards for tangible capital assets held by provinces. These assets include land, buildings, equipment, roads, bridges etc. They are defined by PSAAB as non-financial assets having physical substance that are acquired, developed or constructed and:

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

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

- A new statement called the statement of tangible capital assets would be prepared and included with the financial statements currently issued by the Province. The new statement would account for the tangible capital assets and the changes to the net asset balance in the year. The year's amortization of the cost of the assets would be disclosed, as would the accumulated amortization to the end of the year.
- Disclosure requirements will include the amortization method used, the net book value of assets being amortized and the amount of interest capitalized.

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

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

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

Concessionary loans

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

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

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

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

Chapter 3
Indicators of the Province's Financial Condition

Contents

Indicators of the Province’s Financial Condition

Background

3.1 In 1997, a research report published by the Canadian Institute of Chartered Accountants defined financial condition as a government’s “financial health as measured by sustainability, vulnerability and flexibility, looked at in the context of the overall economic and financial environment.”[1]

Scope

3.2 The purpose of this chapter is to provide readers with useful information about the Province’s financial condition using the CICA research report as a guideline.

3.3 Though many potential indicators of sustainability, vulnerability and flexibility were considered in preparing the research report, only ten indicators were found which were relevant, necessary, measurable and clear to users of government financial information. Of these, our Office has concluded that six can be considered meaningful in the context of the Province of New Brunswick. They are:

Sustainability	· *Net debt as a percentage of gross domestic product (GDP)*
	· *Change in net debt and GDP*
Flexibility	· *Cost of servicing the public debt as a percentage of revenue*
	· *Own source revenue as a percentage of GDP*
Vulnerability	· *Federal government transfers as a percentage of total revenue*
	· *Foreign currency debt as a percentage of total debt for provincial purposes*

Restatement of financial results

3.4 In this chapter, our analysis uses restated figures for years prior to 1998. They were obtained from the Office of the Comptroller. These figures are restated for the effect of changes to accounting policies as explained in Note 2 to the financial statements of the Province.

1. Indicators of Government Financial Condition, 1997 published by the Canadian Institute of Chartered Accountants

3.5 The 1998 financial statement figures for revenue have been restated to show the accounting treatment recommended by our Office for the harmonized sales tax transitional payment. Expenditures have also been restated in the current year to recognize the impact of our recommended treatment of the Province's investment in New Brunswick Power Corporation. These issues are discussed in detail in chapter 2 of our Report.

3.6 Prior to 1998 sales tax paid by the Province was included in both its revenue and expenditure. However in 1998 revenue and expenditure no longer include these amounts.

Results in brief

3.7 In general, the five-year trends in sustainability, flexibility and vulnerability show that the Province of New Brunswick's financial condition has improved.

3.8 The two-year trend in flexibility is favourable. Indicators of sustainability and vulnerability during the same period suggest an unfavourable impact on the financial condition of the Province.

3.9 Much of the unfavourable impact on sustainability and vulnerability shown by the two-year trends can be attributed to proper recognition of the harmonized sales tax transitional payment and the investment in New Brunswick Power Corporation.

Sustainability

3.10 Sustainability is the degree to which a government can maintain existing programs and meet existing creditor requirements without increasing the debt burden on the economy.[1]

3.11 It is now well understood by the general public that increases in the cost of servicing the public debt can directly impact the quantity and quality of programs and services to which the public has access. Accordingly, many provinces - including New Brunswick - are striving to reduce their debt in order to ensure an optimum amount of funding is allocated to programs and services.

3.12 There are circumstances when governments may tolerate increases in their debt load. For example, when revenues are increasing, a higher cost of servicing the public debt might be tolerated without impacting existing programs and services. However, the ability to generate such revenues (e.g. through taxes, user fees or licenses) is closely linked to the performance of the economy.

3.13 Therefore, any growth in New Brunswick's debt must remain in line with growth in the economy to ensure that our Province can sustain its programs and services. If debt is growing faster than the economy, New

1. Indicators of Government Financial Condition, 1997 published by the Canadian Institute of Chartered Accountants

Brunswick will suffer reduced capacity for sustainability. Programs and services offered to the public may eventually suffer.

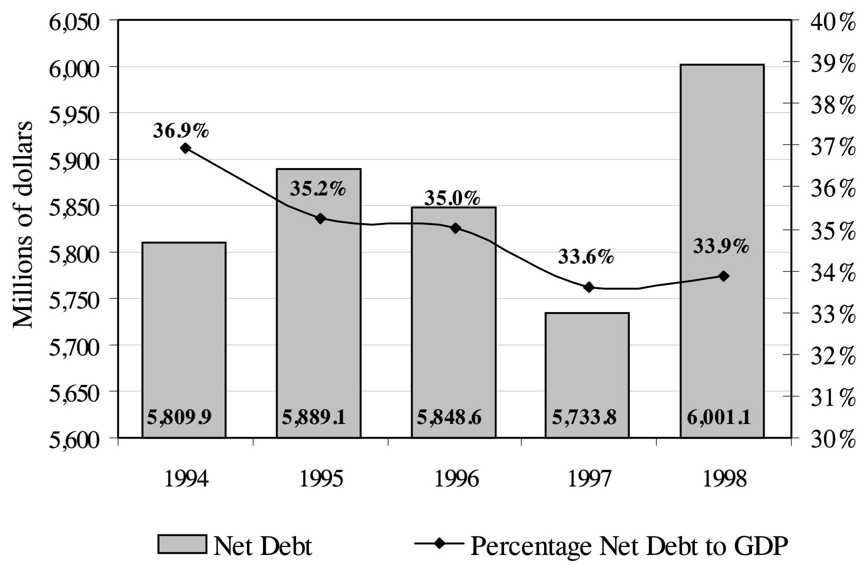
Net debt as a percentage of GDP as a measure of sustainability

3.14 Net debt is an accounting measure of the extent to which total liabilities of the Province exceed financial assets. The net debt of the Province increases with deficits and decreases when surpluses are experienced. The financial statements for 1998 indicate that net debt stands at $5,672.1 million - $137.8 million less than its 1994 level.

3.15 When the net debt is adjusted to reflect the impact of our Office's recommended accounting treatment for the harmonized sales tax transitional payment and the investment in New Brunswick Power Corporation, net debt is $6,001.1 million or $191.2 million greater than its 1994 level.

3.16 However, the New Brunswick economy has also grown. Exhibit 3.1 shows that the Province's net debt to GDP ratio *decreased* in the period 1994 to 1997 - showing the Province's increasing ability to sustain existing programs and services. In 1998, this ratio marginally increased over its 1997 level once the adjustments for the harmonized sales tax transitional payment and New Brunswick Power Corporation are considered.

Exhibit 3.1
Net debt as a percentage of GDP for the last five years [1]



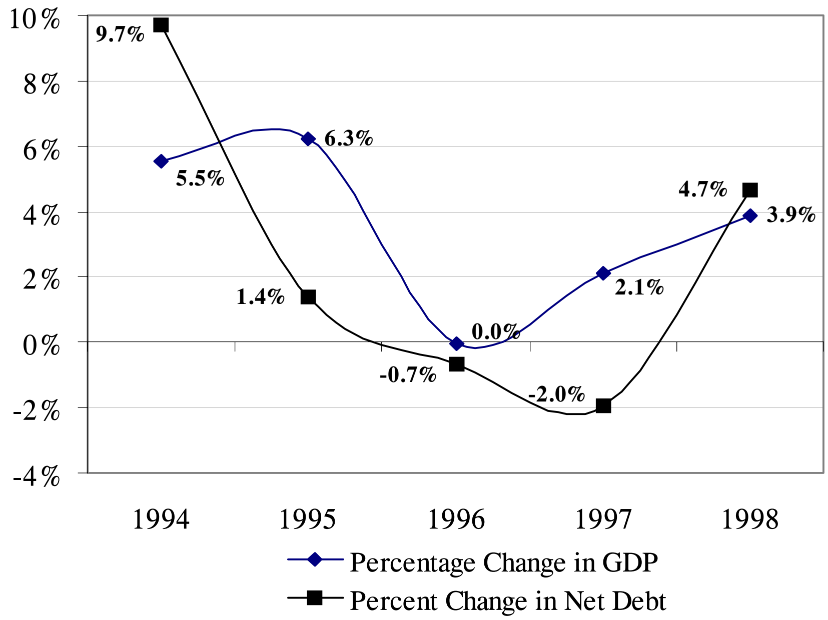
Change in net debt and GDP as a measure of sustainability

3.17 The Province can influence sustainability in two ways: by increasing surpluses (decreasing deficits) and by increasing growth in the economy. Though governments use various political, legislative and regulatory powers to stimulate the economy, the effect is neither guaranteed nor timely.

1. GDP information provided by N.B. Statistics Agency

3.18 The rate of growth in the surplus or deficit and their impact on net debt is much more controllable. Exhibit 3.2 shows that the Province has experienced economic growth in excess of growth in the net debt in three of the last five years. In 1998, growth in the net debt exceeded growth in the economy.

Exhibit 3.2
Change in net debt and GDP for the last five years[1]



Flexibility

3.19 Flexibility is the degree to which a government can increase its financial resources to respond to rising commitments, by either expanding its revenues or increasing its debt burden.[2]

3.20 Funding for programs and services is provided by either revenue or borrowing during the year. It is a useful measure of flexibility to know to what extent the Province is able to raise revenue from existing and potential sources should new commitments arise.

Cost of servicing the public debt as a percentage of revenue (or "interest-bite") as a measure of flexibility

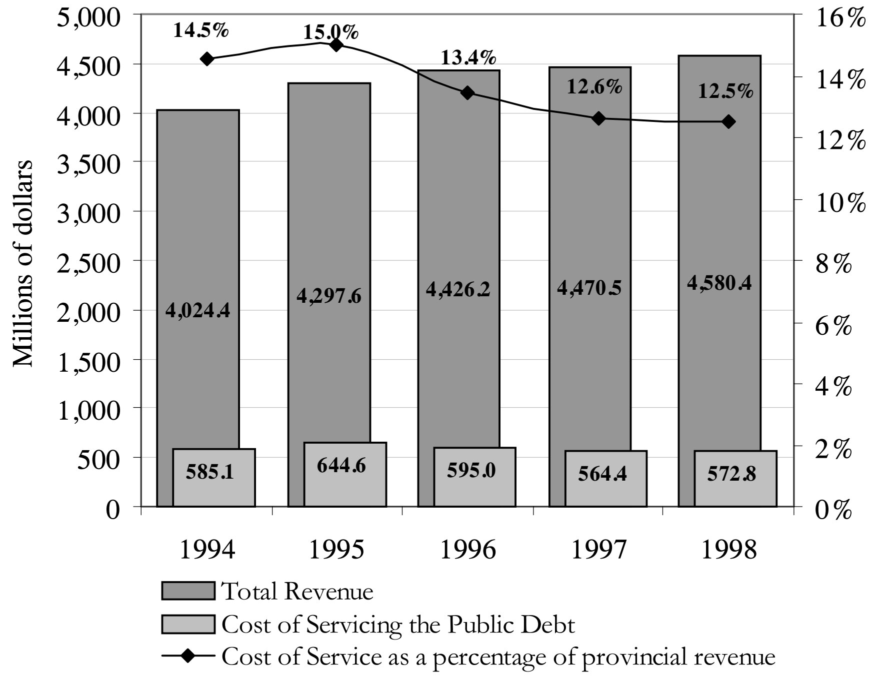
3.21 One of the most publicized factors which affects the flexibility of governments is the cost of servicing the public debt.

3.22 The cost of servicing the public debt is comprised mainly of interest on the funded debt of the Province. It also includes foreign exchange paid on interest and maturities during the year, the amortization of foreign exchange gains and losses, and the amortization of discounts and premiums which were incurred on the issuance of provincial debt. It does not include principal repayments on the funded debt of the Province.

1. GDP information provided by N.B. Statistics Agency
2. Indicators of Government Financial Condition, 1997 published by the Canadian Institute of Chartered Accountants

3.23 Exhibit 3.3 shows debt servicing costs as compared to total provincial revenue for the last five years.

Exhibit 3.3
Cost of servicing the public debt as a percentage of revenue for the last five years



3.24 This exhibit shows the cost of servicing the public debt increased in 1998 over 1997 but still remains $72 million lower than its 1995 peak of $645 million dollars. It also shows that the Province has decreased its overall "interest-bite" percentage from its 1994 level of 14.5% to its current level of 12.5%. This indicates that the Province has more of its total revenues available for current needs today than it did in 1994. This suggests increasing flexibility.

Own source revenue as a percentage of GDP as a measure of flexibility

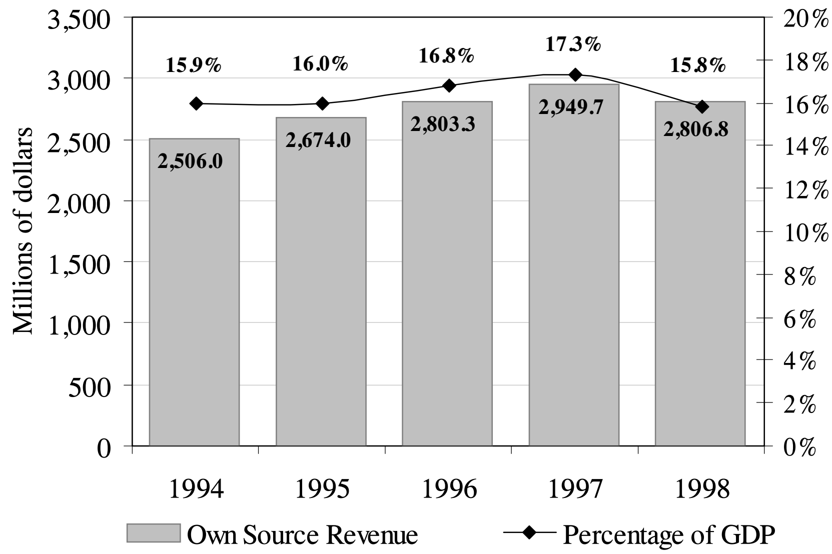
3.25 One could assume that any additional funding for new programs or services might not be possible from existing revenue sources. A reasonable alternative would be to raise revenue from new provincial sources. However, the Province is only able to extract a finite amount of dollars from the economy of New Brunswick before the economy begins to falter. Though the exact capacity of the economy to bear such a burden is not known, one can determine the relative increase or decrease over time.

3.26 Exhibit 3.4 shows the extent to which the Province has removed dollars from the provincial economy through tax dollars and user fees/licenses during the last five years.

3.27 This exhibit shows that the dollars extracted by the Province from the New Brunswick economy as a percentage of GDP gradually increased from 1994 to 1997. This indicates a decrease in flexibility. However, in

1997-98 this trend in Provincial own-source revenue reversed and own-source revenue now stands at 15.8% of New Brunswick GDP.

Exhibit 3.4
Own source revenue as a percentage of GDP for the last five years [1]



Vulnerability

3.28 Vulnerability is the degree to which a government becomes dependent on, and therefore vulnerable to, sources of funding outside its control or influence, both domestic and international.[2]

3.29 Funding for programs and services can only come from two sources: revenue or borrowing.

Federal government transfers as a percentage of total revenue as a measure of vulnerability

3.30 In 1997-98, almost 39% of the Province's total revenue came from federal transfers. This is significant because revenue from federal sources is not considered to be as controllable as revenue generated in the Province.

3.31 Own-source revenue is more controllable because the government can directly impact the amount generated using tax legislation as well as implementation or adjustment of user-fees/licensing rates. Federal transfers are subject to very different variables - few of which are under the jurisdiction of the provincial government. Federal fiscal policy decisions can severely impact provincial governments by determining the amount and timing of future transfers.

3.32 Increasing New Brunswick's reliance on federal transfers will leave the Province more vulnerable to variables outside of its control. Exhibit 3.5 details the Province's reliance on federal transfers over the last five years.

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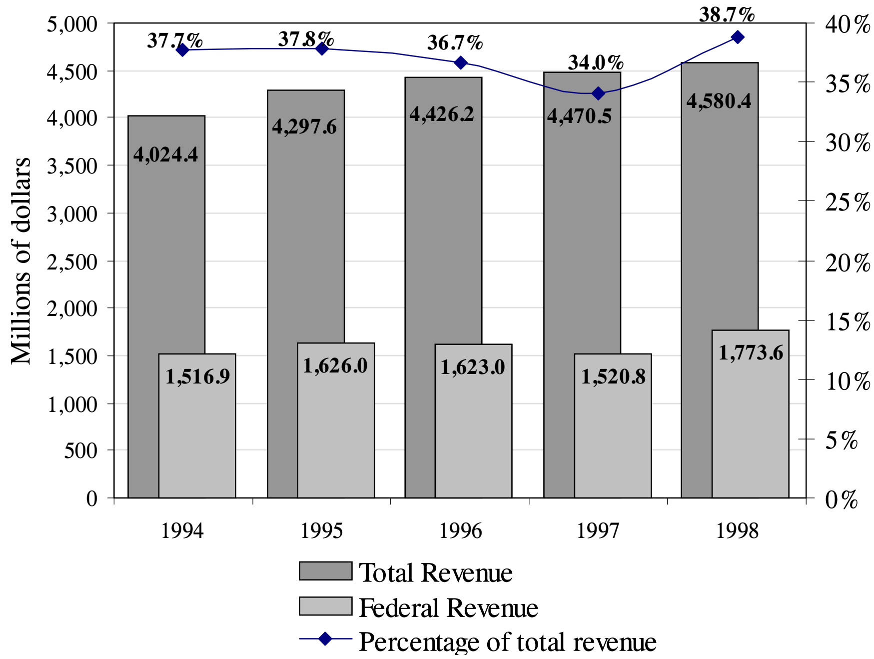
1. GDP information provided by N. B. Statistics Agency
2. Indicators of Government Financial Condition, 1997 published by the Canadian Institute of Chartered Accountants

Exhibit 3.5
Federal government transfers as a percentage of total revenue for the last five years



3.33 This exhibit demonstrates that approximately 39 cents of each dollar of revenue received by the Province comes from the federal government. Though small fluctuations have occurred over the last five years, this ratio has not significantly changed since 1994 - indicating no real change in the vulnerability of the Province to the fiscal policy decisions of the federal government.

3.34 In the above exhibit, both total revenue and federal revenue have been increased by $121.0 million to reflect our Office's recommended treatment of the harmonized sales tax transitional payment.

Foreign currency debt as a percentage of total debt for provincial purposes as a measure of vulnerability

3.35 When borrowing is required, there are choices to be made by the Province. For instance, if the Province chooses to issue its debt in a foreign currency instead of Canadian dollars, the Province will assume the risk of foreign exchange fluctuations. Such fluctuations can increase or decrease the amount ultimately payable in Canadian dollars for interest, and later, redemption of foreign currency debt.

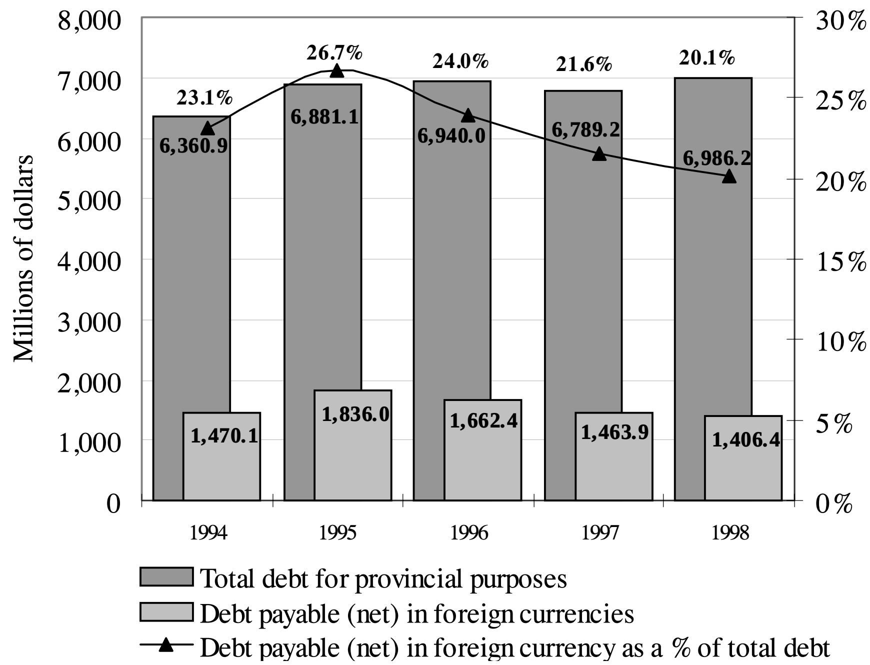
3.36 Exhibit 3.6 shows the relationship of foreign currency debt to total debt for provincial purposes over the last five years. The Province has several alternatives to reduce (hedge) the risk associated with debt repayable in foreign currencies:

- purchasing assets denominated in foreign currencies for the Province's sinking fund;
- entering into debt swap agreements which allow repayment of the debt in Canadian dollars; and

- entering into forward contracts (which allow the Province to purchase foreign currency at a stipulated price on a specified future date).

3.37 The exhibit reflects the Province's exposure to foreign currency risk after eliminating the effect of hedges against foreign currency fluctuations.

Exhibit 3.6
Exposure to foreign currency risk for the last five years



3.38 The above exhibit demonstrates that the Province's vulnerability to foreign currency risk has declined slightly for three consecutive years. In addition, the overall exposure has decreased from its 1994 level of 23.1%.

Summary

3.39 Exhibit 3.7 summarizes the financial indicators used in the chapter and outlines the impact of the two and five-year trends on the financial condition of the Province.

3.40 In general, the five-year trends in sustainability, flexibility and vulnerability show that the Province of New Brunswick's financial condition has improved.

3.41 The two-year trends for three of the six financial indicators shown below suggest an unfavourable impact on the financial condition. Much of this impact is attributable to the required adjustments to the harmonized sales tax transitional payment and the provincial investment in New Brunswick Power Corporation to comply with generally accepted accounting principles. To properly recognize the harmonized sales tax transitional payment an additional $121.0 million in federal source revenue has been recorded in our analysis of 1998. To properly recognize the investment in New Brunswick Power Corporation, $450.0 million of expenditure has been recorded.

Exhibit 3.7
Summary of financial indicators

Financial Indicator	**1998**	**Impact on Financial Condition of the Province** — **2 year trend**	**5 year trend**
Sustainability			
Net debt as a percentage of GDP	33.9%	Unfavourable	Favourable
Change in net debt and GDP	4.7%/3.9%	Unfavourable	Favourable
Flexibility			
Cost of servicing the public debt as a percentage of revenue	12.5%	Favourable	Favourable
Own source revenue as a percentage of GDP	15.8%	Favourable	No significant change
Vulnerability			
Federal government transfers as a percentage of total revenue	38.7%	Unfavourable	No significant change
Foreign currency debt as a percentage of total debt	20.1%	Favourable	Favourable

Chapter 4
Audits of Crown Agencies

Contents

Audits of Crown Agencies

Background

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

4.2 Agencies included in the Public Accounts:

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

4.3 Other Agencies:

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

Scope

4.4 Our work in Crown agencies is usually aimed at enabling us to give an opinion on their financial statements. During the course of this work, we may note errors in accounting records or weaknesses in accounting controls. We bring these matters to the attention of the agency, together with any recommendations for improvement. This chapter of our Report summarizes those issues which we consider to be significant to the members of the Legislative Assembly.

Results in brief

4.5 The Advisory Council on the Status of Women will address accountability issues surrounding the role and authority of the executive.

4.6 Algonquin Properties Limited needs to obtain more information on assets purchased directly by the Algonquin Hotel.

4.7 The New Brunswick Credit Union Deposit Insurance Corporation is not in compliance with the Credit Unions Act regarding the creation of a deposit insurance fund.

4.8 The New Brunswick Municipal Finance Corporation continues to hold significant amounts of cash and short-term investments.

4.9 We noted internal control weaknesses in a number of Crown agencies.

Advisory Council on the Status of Women

Accountability

4.10 We noted during our 1998 audit instances where we felt financial policies defining the authority of the Chairperson as chief executive officer and her relationship to the Council would have been appropriate. These areas included grants and travel costs.

4.11 We recommended that the Council review the relationship between the executive and the Council. This would ensure that appropriate policy decisions are made that clearly establish the role and authority of the executive.

4.12 The Council agreed to do this.

Internal control weaknesses

4.13 We also reported to the Council a number of weaknesses in internal controls. These dealt with areas such as the proper approval of invoices prior to payment, the authorization for grants made by the Council and travel policies. The Council indicated it has taken action to address all our recommendations.

Algonquin Properties Limited

Purchase of furniture and equipment

4.14 Management of the Algonquin Hotel is permitted to spend up to 1.5% of gross revenue each year to replace furniture and equipment. In 1997 the Hotel spent almost $90,000 on such assets. Management of Algonquin Properties Limited does not need to authorize these expenditures, and may not be aware of the specific items acquired, or any consequential disposal of old assets.

4.15 In order to maintain an appropriate level of control over capital assets, we made the following recommendations:

- **Algonquin Properties Limited should obtain, and maintain, documentation on all capital assets which it owns regardless of**

whether they are acquired by headquarters in Fredericton or directly by the Hotel.

- **Algonquin Properties Limited should also perform a periodic and regular review of assets to ensure that all assets recorded in the sub-ledger of Algonquin Properties Limited exist.**

Internal control weaknesses

4.16 We also reported to staff of the Algonquin Hotel a number of weaknesses in internal controls. These dealt with areas such as payroll documentation, the recording of cash receipts, inventory counts and the documentation of receipt of goods. In addition we recommended the Hotel obtain a formal agreement to document the relationship between the New Brunswick Community College and the Algonquin Hotel.

4.17 Hotel staff responded positively to our observations and recommendations.

Accounting records

4.18 We are pleased to report that the accounting records created and maintained by staff of Algonquin Properties Limited in Fredericton have improved considerably in the last year. The quantity and quality of records provided to us has increased dramatically and helped us to significantly reduce the accounting work we must perform. This has also reduced the time we spend auditing the Fredericton operations.

Kings Landing Corporation

Internal control weaknesses

4.19 In 1997 we reported a weakness in controls surrounding the Emporium’s computer sales terminals. The Corporation’s proposed solution proved ineffective, so we again raised this issue following our 1998 audit. The Corporation agreed to implement additional procedures.

4.20 We also again reported weaknesses in the area of site admissions and the use of tickets. We recommended that signage should be in place informing visitors that they are required to wear their tickets at all times, and that security should monitor this control. The Corporation agreed to implement our recommendations.

4.21 We noted that many personnel files did not contain up-to-date information on pay rates and payroll deductions. The Corporation subsequently reported that the files had been updated.

New Brunswick Credit Union Deposit Insurance Corporation

Non-compliance with legislation

4.22 We raised an issue with the Corporation regarding the failure to create a deposit insurance fund.

4.23 Section 223 of the Credit Unions Act states that:

> *The Corporation shall establish and maintain a deposit insurance fund which may be used….to pay out claims of depositors in accordance with section 220 on the liquidation of a credit union….*

4.24 We understand there is no deposit insurance fund, and that in the event claims were made by depositors, the Corporation would look to the Credit Union Stabilization Boards for funding.

4.25 Sections 224 to 227 of the Act cover a number of things that *"shall"* happen to properly administer and account for a deposit insurance fund. Since there is no deposit insurance fund, none of these mandatory provisions have been complied with.

4.26 We have a number of concerns in raising this issue. In the first instance there appears to be a failure to comply with legislation. We are always interested in pursuing accountability issues. In this situation the legislators have clearly requested something be done by the Corporation, but it has not happened.

4.27 A second concern is with respect to the legal position the Corporation and its Directors would be in if there was a financial failure and depositors were looking for restitution. We questioned whether there was sound legal advice to support the process the Corporation would expect to follow in obtaining necessary funds from the Stabilization Boards.

4.28 The Corporation has a concept as to how the spirit of the legislation would be fulfilled if depositors looked to the Corporation for assistance. If this is the Corporation's preferred method then we suggested that the Legislative Assembly be asked to change the legislation.

4.29 The Board of Directors of the Corporation responded that they have hired independent legal counsel to provide an interpretation of the statutory requirements.

4.30 The Board of Directors advised that it feels there is adequate deposit protection. It is clearly aware of its statutory and fiduciary responsibilities under the Credit Unions Act. As a follow up to the independent legal counsel's report in this regard, the Board of Directors approved resolutions that had the effect of:

- receiving the independent legal counsel's report effective 25 September 1998;
- proceeding in obtaining an actuarial report by 31 December 1998;
- the board at its first meeting in 1999, will receive the actuarial report. It will also take appropriate action after due consideration of the legal counsel's and the actuary's reports.

4.31 The Corporation will be proceeding in the very near future in the selection of an independent, qualified actuary.

New Brunswick Municipal Finance Corporation

Surplus funds

4.32 In previous Reports we have expressed the opinion that surplus funds held by the Corporation were more than was needed to meet future expenses relating to outstanding debentures. The amount of cash and short term investments continues to rise, and at 31 December 1997 totalled $761,000.

4.33 The Corporation continues to assure us that this amount is necessary to fund the Corporation’s future expenses.

New Brunswick Women’s Institute

Internal control weaknesses

4.34 Following our 1997 audit, we brought to the attention of the Institute a number of weaknesses relating to bank reconciliations, documentation supporting expenditures and cheque signing procedures. The Institute subsequently informed us of changes proposed to address our recommendations.

Youth Council of New Brunswick

Internal control weaknesses

4.35 Following our 1998 audit, we brought to the attention of the Council a number of weaknesses relating to casual payroll records and time sheets. The Council subsequently informed us that changes have been implemented to address our recommendations.

Chapter 5
Department of Economic Development and Tourism Financial Assistance to Business and Performance Reporting

Contents

Department of Economic Development and Tourism Financial Assistance to Business and Performance Reporting

Background

5.1 During the 1996-97 audit year, we reviewed government assistance provided to the Centre Plein Air de Kegwick project. Results of that audit were presented in our 1997 Report. We indicated that we intended, during the 1997-98 audit year, to review “certain government programs used to encourage economic development in the Province.”

5.2 We selected the Department of Economic Development and Tourism, and specifically financial assistance to business, for audit for two main reasons. First, as can be seen in Exhibit 5.1, direct financial assistance provided to business over the past five years has grown substantially. This is, in effect, discretionary departmental spending. Second, the actual number of clients dealt with by the Department has also grown dramatically in recent years without commensurate increases in the number of staff available to handle them. Thus, there is an increased risk that important control procedures may not be properly completed.

Exhibit 5.1
Financial assistance to business cash outlays

	1997	1996	1995	1994	1993
New loans	$ 17,182,229	$ 25,132,134	$ 24,645,486	$ 2,478,398	$ 6,160,133
Loan recoveries	(5,128,611)	(6,702,542)	(2,927,630)	(2,053,081)	(678,408)
Payouts on guarantees	1,168,758	621,693	2,060,760	8,678,652	435,601
Recoveries of payouts on guarantees	-	-	(55,329)	(84)	(401)
Strategic assistance	17,177,000	21,515,712	10,803,930	1,200,000	9,162,192
Total cash outlays	**$ 30,399,376**	**$ 40,566,997**	**$ 34,527,217**	**$ 10,303,885**	**$ 15,079,117**

5.3 We decided to focus on the involvement of the Financial Services section in providing direct financial assistance to business. The objective of the Financial Services section is stated as follows in the 1997-98 provincial Main Estimates:

> *Evaluate and make recommendations on financial assistance requests for guaranteed loans, bonds and debentures, direct loans, strategic assistance and equity under the Economic Development Act as well as assistance via Provincial Holdings Ltd. Provide ongoing monitoring of firms which have received financial assistance. Provide staff support to the New Brunswick Industrial Development Board and the New Brunswick Industrial Development Appeal Board.*

5.4 The types of assistance specified cover the great majority of departmental expenditures for direct financial assistance to business. This indicates that the Financial Services section is primarily responsible for controlling the process of providing direct assistance to business. Growth in activity levels in that section over the past ten years has been remarkable. During that period total submissions processed have increased by four hundred and thirty-eight percent. Additionally, the portfolio of clients for which the section is responsible on an ongoing basis has more than tripled. This has resulted from the strong emphasis placed by the current government on job creation and related attempts to encourage business growth in the Province.

Exhibit 5.2
Financial programs section activity level

Fiscal Year	Total Submissions Coordinated and Recommendations Made (Approval/Assessment Process)	Portfolio of Clients Monitored and Advised (Monitoring Process)
1986-87	58	95
1987-88	67	96
1988-89	72	102
1989-90	106	113
1990-91	108	132
1991-92	142	143
1992-93	128	192
1993-94	114	200
1994-95	162	210
1995-96	149	276
1996-97	254	299
10-year growth	438%	315%

Note: Information from departmental annual reports.

5.5 In planning our audit in the Department of Economic Development and Tourism, we decided it would also be a good opportunity to look at departmental performance reporting. A major focus of our work in recent years has been accountability. This is reflected in the mission statement of the Office of the Auditor General which states the following.

> *We promote accountability by providing objective information to the people of New Brunswick through the Legislative Assembly.*

5.6 Government departments and Crown agencies are currently grappling with issues surrounding performance reporting in order to improve accountability. While we recognize that the process is ongoing at the Department of Economic Development and Tourism, we felt it was appropriate for us to make a “status report” on the progress to date in establishing performance reporting in the Department.

New Brunswick economic situation

5.7 At 31 December 1987 there were a total of 282,300 people working in the province. The total number of registered unemployed was 42,700. This meant that the unemployment rate was 13.1%. At 31 December 1997 there were 322,000 people working and 46,400 were registered as unemployed. This meant that the unemployment rate at 31 December 1997 was 12.6%. The province was tied for eighth best among Canadian provinces in 1987 and was also eighth in 1997. The percentage that New Brunswick’s unemployment rate was over the national average was 47.2% at the end of 1987 and 37.0% at the end of 1997. There were approximately 40,000 more people working at the end of 1997 than ten years earlier.

Scope

5.8 Our objective for this audit project was to report under Section 13 of the Auditor General Act, whether financial assistance provided to business under the Economic Development Act is appropriately approved and monitored, and whether an appropriate effectiveness reporting system is in place and functioning.

5.9 Our examination focussed on financial assistance provided in the form of strategic assistance (i.e. forgivable loans and grants), loans, and loan guarantees, and administered by the Financial Services section. It did not look at programs administered outside the Financial Services section (e.g. Self-Start, SECAP). However, in completing our work on performance reporting, it was necessary for us to look beyond the Financial Services section.

5.10 Our work included interviews with all members of senior management in the Department. We also held discussions with departmental staff and examined various departmental and statistical reports. A significant amount of detailed testing was performed on client files in connection with the approval and monitoring sections of this project. We reviewed project reports prepared by other provincial audit offices in the area of economic development. We also referred to general performance reporting literature.

5.11 It is important to note that these findings relate only to financial assistance provided under the Economic Development Act and administered by the Financial Services section. For purposes of this review, financial assistance provided by Provincial Holdings Limited (PHL) has been disregarded, even though that assistance is also administered by the Financial Services section of the Department.

Results in brief

Approvals

5.12 There is an application approval process in place that includes several levels of review. The Financial Services section is key in this process.

5.13 The departmental policy and procedures manual is not consistently adhered to in the application approval process. The policy and procedures manual also requires updating in many areas.

5.14 Client files do not adequately document the decision-making process for applications. They are neither clearly laid out nor well organized. It is often difficult or impossible to determine why decisions such as the approval of financial assistance were made in light of negative information on file.

5.15 Criteria have been established for use in evaluating client applications. However, no benchmarks have been set against most of these criteria regarding what constitutes acceptability.

5.16 Client assertions at the application stage do not appear to be subject to sufficient analysis and review to determine if they are reasonable and achievable.

5.17 The review and approval of client applications by the Board of Management in routine cases and where moderate amounts of assistance are given does not seem to add any additional control or value to the application approval process.

Monitoring

5.18 Current monitoring of departmental clients does not appear to be sufficient to safeguard provincial investments, and to meet other objectives of an effective monitoring program.

5.19 Departmental representatives estimate that only twenty percent of Financial Services available time is spent on monitoring activities.

5.20 The departmental policy and procedures manual is not consistently adhered to in monitoring existing clients.

5.21 There are no routine monitoring programs followed for departmental clients. Monitoring activity is generally limited to dealing with clients who have encountered serious problems.

5.22 Client files do not adequately document the monitoring work that has been performed. They are neither clearly laid out nor well organized. It is often difficult or impossible to determine why decisions such as the forgiveness of forgivable loans were made.

5.23 Client assertions in the loan forgiveness process do not appear to be subject to sufficient review to determine if they are accurate.

5.24 Loan agreements do not provide effective remedies for use in cases where clients have not complied with the terms of their agreements.

Performance reporting

5.25 The Department has made a good start on reporting its performance.

5.26 There is no formal mission statement for the Department.

5.27 The Department has not identified measurable strategic objectives against which performance indicators should be set.

5.28 The Department has set some performance indicators and has established targets for them. Actual results are compared with the targets in the 1996-97 departmental annual report. Additional performance indicators were developed for the 1997-98 fiscal year.

5.29 The 1996-97 performance indicators do not allow for an objective assessment of all mission-critical aspects of the Department's performance. New performance indicators developed for 1997-98 partially address this deficiency.

5.30 The Department does not comply with significant aspects of the Province of New Brunswick Annual Report Policy.

Detailed findings

5.31 We recognise that there have been a number of accomplishments in terms of job creation and successes in attracting businesses to the Province. There are jobs in New Brunswick that would not be here without departmental initiatives. We have also observed that staff is very committed to the task of actively seeking out opportunities for economic development and working to create a climate for development initiatives to succeed. However, we would like to make the following observations relating to the approval and monitoring of financial assistance to business, and performance reporting in the Department. We believe that implementing our recommendations should help ensure the Department provides staff with the tools and direction to build upon past success. They should also ensure that an appropriate environment of accountability exists.

Approvals

Application approval process

5.32 Once a company has indicated an interest in receiving financial assistance from the Province the account is assigned to an individual in Financial Services. Usually this is a project executive, but in some situations a more senior staff member may be assigned. The responsible individual will gather information and perform analysis as required in order to decide if the assistance is warranted. The staff member then prepares a report presenting their approval or rejection of the financial assistance and the reasons for their recommendation.

5.33 A supervisor, either the Director of Financial Services or a project coordinator, will then review the work and decide if sufficient analysis has been done to support the recommendation. The file is passed on to the Director of Financial Services (if applicable) and the Assistant Deputy Minister of Finance, Infrastructure and Policy for approval. If they approve the project it is presented to the New Brunswick Industrial Development Board (NBIDB) for their review. The NBIDB is made up of senior managers from the Department. The NBIDB will either accept or reject the recommendation.

5.34 If the NBIDB approves the recommendation and the assistance request is more than $100,000, a submission is made to the Board of Management (BOM). If the BOM approves the project it goes to the Executive Council for final approval. If assistance is granted, it is documented in an Order in Council. For assistance amounts under $100,000 the Minister of Economic Development and Tourism gives final approval.

Policies for application evaluation

5.35 Policies covering the approval process, including the assessment of financial risk, assistance conditions, and appeal processes for clients have been documented by the Department. Most of these policies are included in the departmental policy and procedures manual. We did note that recently developed economic payback and risk evaluation methodologies have not yet been included in that manual.

5.36 It is our understanding that the policies documented in the policies and procedures manual are intended to be basic approaches taken by the Financial Services section in reviewing projects and not firm departmental policy that must be complied with. This was confirmed by departmental project executives who said they use it more as a reference book than a policy and procedures manual. The Department places a strong emphasis on the professional judgement of the project executives, coordinators, and Director of the Financial Services section in developing recommendations to accept or reject client applications. Our testing of specific client files also indicated that aspects of the documented policy are not complied with in the review of applications and that the procedures applied to applications vary from file to file. Project executives gather evidence on a file until they are comfortable making a recommendation to accept or reject the project. There are no consistently followed standards in evaluating an application.

5.37 We feel that this degree of flexibility in interpreting application approval policies may not be appropriate. We do not discourage flexibility, but there must be some framework within which decisions are made or there can be no accountability for decision-making, and mistakes made are more likely to be repeated. Additionally, applicants for assistance should be treated consistently in the interest of fairness. Only through consistent application of departmental policies is this likely to be achieved. Having clearly stated policies in certain critical areas would also provide guidance for new staff members, thereby improving their effectiveness. We feel it would be appropriate to update the policy and procedures manual identifying policies that must be followed and areas where discretion on the part of financial programs staff is allowed.

Recommendation

5.38 The policy and procedures manual should be updated for the application evaluation area to reflect current practice, including guidance on the current economic payback and risk evaluation methodologies that are in use. Areas of discretionary judgement in application evaluation should be identified as such, and areas where a particular procedure must be followed should also be highlighted. The Department should assess applications consistent with the departmental policy and procedures manual or file sufficient explanations as to why the process was not followed in specific cases. This will ensure consistent evaluation of applications by staff.

Selection criteria - departmental policy

5.39 Because of the day-to-day timing of project applications, it is very difficult to effectively prioritize competing projects in comparison with each other. Therefore we feel that selection criteria and benchmark acceptance levels are necessary to allow for an objective comparison of competing projects as applications are received. Applications should be assessed against these selection criteria and benchmarks.

5.40 Economic payback (i.e. the estimated number of years it will take for the Department to recover a particular investment through direct taxation), overall project risk, and relative fit into the departmental development strategy are three specific decision-making criteria used in the existing process to determine project acceptability. These policies are not covered in the policy and procedures manual. The economic payback factor has had benchmarks set for it for use in rating client applications.

5.41 The policy and procedures manual identifies certain other information to be looked at in evaluating an application. This information includes the results of credit checks, and analyses dealing with such areas as potential market for the product, financial viability of the business, equity investment available, management ability, marketing plans, financial plans, ability to meet the payment terms, and other areas. We note, however, that the policy and procedures manual does not define acceptability “benchmarks” or provide any other guidance on how to evaluate information once it has been obtained.

Recommendation

5.42 The policy and procedures manual should define benchmark acceptance levels for each selection criterion, as well as guidelines for use in evaluating client information.

Selection criteria – practical application

5.43 We looked at a number of approved client files and held discussions with various departmental representatives to try to determine if selection criteria and information identified in the policy and procedures manual was used in evaluating client applications. Economic payback and overall project risk were always considered. However, it was difficult, given the deficiencies in documentation in many files, to determine what other information was obtained and how that information was assessed. This made it difficult to determine if the overall decision was adequately supported. We feel that it would be appropriate to clearly document the decision-making process by providing documented conclusions for each key analysis completed and for each criterion evaluated. A rationale for each assessment should also be provided including reasons why certain information has not been considered.

5.44 In the paragraphs that follow, we will give examples of some of the problems we noted in reviewing a sample of seventeen client files. Each of the clients we selected was approved for financial assistance between 1994 and 1997.

5.45 In some of the files we examined certain selection criteria and information were not considered, but other evidence such as the history and reputation of the company was relied upon. This seems appropriate for well-established, successful companies, although we still feel that some minimal level of analysis would be appropriate. Also, we would have expected to see a rationale on file as to why regular evaluation procedures were not applied. This was not present in the files that we examined.

5.46 Under the Economic Development Act, the Minister has the authority to make an assistance decision contrary to a recommendation from his professional staff. We are not questioning this authority. However, in the file we reviewed where this had happened, there was no documented rationale for the Minister’s decision. We suggest that in the future it would be appropriate to have the rationale for such decisions documented in the file.

5.47 In the case of another application, overall risk was judged to be high, equity input from the client was very low, and economic payback to the Province was extremely long. Thus, the ultimate recommendation to provide financial assistance to this company did not seem to be adequately supported and we were unable to find adequate explanations on file as to why funding was approved. This company ultimately had to come back to the Department for more funding to avoid insolvency.

5.48 Other approved applications indicated other serious weaknesses in criteria evaluations. The analysis of one company indicated that it had questionable management ability. Another had an unproven product and no financial or marketing expertise. A third file indicated the client had no financial expertise, a poor relationship with its commercial bank, and a poor history with the Department. None of these files documented a rationale for the decision to go ahead and provide assistance. Two of these ventures subsequently failed. We feel that where serious shortcomings exist in criteria or key analyses, as in the cases discussed above, and the application is approved, the rationale for approval in light of these negative findings should be documented.

5.49 Departmental clients are usually companies expanding into new markets and/or creating new products. In many cases they approach the Department as a lender of last resort since the banks have already rejected funding requests. Thus, financial assistance is often approved even when criteria evaluations are not all satisfactory. We feel that this may, in fact, be appropriate in some cases. As lender of last resort for many of their clients, the Department must expect some weaknesses. The difficulty comes in determining how much of an impact that identified weaknesses will have on the viability of the operation, and thus on the public investment made by the Department. While some business failures among departmental financial assistance clients should be expected, we have observed that applicants with few identified deficiencies seem to stand a better chance of success. As commercial banks often do, it may be appropriate for the Department to require the applicant to address weaknesses before assistance is approved. Not advancing any monies until these deficiencies are addressed may better safeguard the public investment, while at the same time providing the company with a better opportunity to be successful.

5.50 We also have a concern with the overall risk analyses being done. As has already been discussed, many departmental clients have significant weaknesses. We would, therefore, expect that most of these companies would be evaluated as having high or very high risk. However, we noted in our testing that many such companies were evaluated as being low risk. A lower risk evaluation improves the chance of a client application being accepted under current departmental methodology.

5.51 Clearly documenting the steps in the decision-making process as we have discussed in this section would have several benefits. It would ensure that key criteria and other important information were considered in making the decision. It would also establish clear accountability for decisions that were made. Additionally, it would provide information to facilitate file review, monitoring, and follow-up activities. We also feel that one of the Financial Services coordinators should review all files to ensure that appropriate procedures have been completed in evaluating the application. This review should occur prior to the proposal being taken to the NBIDB.

Recommendations

5.52 Each client file should document each of the selection criteria considered and show whether it meets the established benchmark. Information and analyses supporting the evaluation and a conclusion regarding each criterion and key analysis should be present.

5.53 In cases where approval of the application has been recommended even though one or more benchmarks have not been met, a rationale for the approval should be documented.

5.54 Where not all selection criteria and key information have been considered for a specific client, the rationale for the omissions should be documented.

5.55 Where it would increase the chance of success of the applicant the Department should tie corrective action on the part of the applicant to approval of the assistance.

5.56 One of the Financial Services coordinators should review all client files to ensure all applicable procedures have been completed prior to sending the proposal to the NBIDB.

Verification of client's assertions

5.57 As part of the application process, clients are required to provide certain pertinent information to the Department. This information includes business plans, audited or non-audited financial statements, job-creation forecasts, and other information as required by the Department to analyze the selection criteria. We feel that it is important that this information be assessed for reasonableness by departmental staff to the greatest extent possible. It is to no one's benefit if the Department accepts overly optimistic figures from an applicant. This will generally lead to the applicant being under-funded, thereby putting the Department's investment at greater risk. It may also lead to an additional departmental investment being necessary at a later date, or failure of the enterprise.

5.58 Our discussions with departmental staff led us to believe that some verification of client information is done. Again, due to problems of file organization and incomplete documentation, we were not able to conclude that client assertions had been subjected to sufficient analysis and review in all cases. Also, in some cases we were unsure whether certain key information had been received from the client at all.

5.59 We did note that in several files the clients' forecasts as shown in their business plans, and used in the application evaluation process, were not met. For example, markets were not penetrated or were not penetrated as fast as the client anticipated in business plans. Jobs were not created or not created as fast as forecasts indicated. Construction of facilities was slower than represented in information provided to the Department. Profit margins were not as high as projected. These findings seemed to indicate a tendency on the part of applicants to present an overly optimistic picture of the companies' prospects in order to secure departmental funding.

5.60 While we admit that hindsight is 20/20, we feel that these findings are an indication that more should be done to assess the reasonableness of applicant assertions during the approval process. We believe that an appropriate client analysis would include a review of the client's business plan, financial statements and projections, marketing plans, and other significant representations to ensure the clients' plans are reasonable and achievable. Requirements with regard to the verification of client information should be documented in the departmental policy and procedures manual. It was not clear to us in our review that departmental analysis covered these critical areas in all cases. In certain cases, where specific industry expertise is not available inside the department it might be useful to seek the aid of outside experts.

Recommendations

5.61 Client assertions should be subjected to sufficient analysis and review to determine, within reasonable limits, that plans are reasonable and achievable.

5.62 Requirements to verify client assertions should be documented in the policy and procedures manual.

5.63 Documentation showing the analysis and review performed by the Department in determining the validity of client assertions, along with client backup documents, should be placed in the client files.

5.64 Consideration should be given to using outside experts in evaluating assertions made by applicants where specific industry expertise is not available in-house.

Final approval of assistance

5.65 In general, applications for government assistance we examined were processed in a timely manner. However, we noted that there is one area of duplication of effort built into the approval process. The Industrial Development Board, which is made up of senior civil servants from within the Department, and the Board of Management must both approve financial assistance for most files. Both groups appear to base their decisions on similar analyses prepared by project executives. In our opinion, the Board of Management review adds little incremental control benefit to the approval process, and it does slow down the process by a few weeks as well as adding to the workload of departmental staff. Currently the Board of Management must approve every application for funding that exceeds $100,000 in total. With the large increase in activity in the Department, this has significantly increased the number of files that have to go to the Board of Management for final approval. In our opinion, raising the approval limit to a higher figure would not significantly increase the control risk to the Province. However, it would speed up the approval process by approximately two weeks for many files and would also reduce the work required of departmental staff.

Recommendation

5.66 Consideration should be given to increasing the cut-off for assistance applications that must go to the Board of Management for approval from $100,000 to a higher limit.

Monitoring

Staff assignment

5.67 From the discussions we held with departmental personnel, we learned that over 80% of the time available to loan officers is directed toward the processing and approval of applications for assistance. The balance of just 20% is devoted to monitoring. So, most of the efforts of project executives have been focused on job creation. As job creation is currently the key focus of the Department and one of the most important areas in the evaluation of the individual performance of project executives, this is not surprising. However we feel that monitoring activities are also very important. There are five important outcomes that can be achieved by performing monitoring activities. Those outcomes include safeguarding the provincial financial investment, contributing to the success of the client by identifying problems early enough to correct them and avoid failure, generating performance reporting information, obtaining information to ensure compliance with agreements, and providing a learning tool for financial officers. We feel that the workload and staff requirements should be examined and modified as required to allow time for essential monitoring activities.

Recommendation

5.68 The workload and staff requirements should be examined and modified as required to allow time for essential monitoring activities.

Monitoring program

5.69 In preliminary discussions with departmental staff, we were told that there is no regular schedule or program of monitoring activities that is followed for assistance clients. Project executives told us that most monitoring time is currently spent dealing with clients experiencing serious problems. When such a client is identified, project executives are in frequent contact with that client to try to resolve the situation. Otherwise, monitoring activity is minimal. In files we examined, we were unable to find much indication that monitoring work had been performed. Clients only complied partially with the terms and conditions contained in their letters of offer and their agreements. There was usually no indication that this non-compliance had been identified or dealt with by loan officers.

5.70 We also found that file documentation, where monitoring activity had been undertaken, was very limited. Often, the only way to determine what monitoring activity had been completed was to talk with the responsible project executives. There are currently no policies in the departmental policy and procedures manual or elsewhere establishing how monitoring activities should be documented.

5.71 The departmental policy and procedures manual does include some required procedures related to monitoring called *"Account*

Management Procedures." However, several of the project executives we talked to were not familiar with them and none followed them. Some stated that since project executives are primarily evaluated on their job creation activities (i.e. processing client applications for assistance), monitoring is not considered a priority. In our opinion, the current level of monitoring activity performed on financial assistance clients is not sufficient to meet the objectives of an effective monitoring program.

5.72 During 1997, the Office of the Comptroller performed a review of the strategic assistance program. In their subsequent report, they recommended that client risk level be assessed in determining appropriate monitoring procedures to perform. We agree with this recommendation, and would suggest that the risk evaluation developed during the application evaluation process be used. We also feel that it would be most appropriate to develop a monitoring program for each client as part of the application approval process. This would allow the involved loan officer to determine what information would be required from the client and to document those requirements in the loan agreement. The suggested monitoring program for each client should be presented to the Industrial Development Board for review and approval. Further, for all clients identified as high risk, required monitoring and performance reporting information should include audited financial statements, and audited job creation and payroll information.

5.73 In general, we feel that each client should be subject to routine monitoring on an ongoing and timely basis as documented in their approved monitoring program. Additional, non-routine monitoring activities should also be performed when exception reports indicate client arrears, upcoming forgiveness dates, or where other problems have been encountered. All requirements relating to monitoring programs and file documentation for assistance clients should be documented in the departmental policy and procedures manual.

Recommendations

5.74 A monitoring program should be developed for each client as part of the application approval process. The extent and nature of monitoring procedures in that program should be based upon a risk evaluation of the client. The program should be presented to the Industrial Development Board for approval as part of the assistance approval process. Each client should be subject to routine monitoring on an ongoing and timely basis as documented in their approved monitoring program.

5.75 Monitoring and performance reporting information to be provided by the client should be specified in the formal agreement(s). For all clients identified as high risk, this information should include audited financial statements and audited job creation and payroll information.

5.76 All requirements relating to monitoring programs and file documentation for assistance clients should be included in the departmental policy and procedures manual.

Action taken relating to identified client problems

5.77 As already discussed, due to the limited attention paid to monitoring activities by the Department, client problems are usually not identified until they become serious. It is at that point that most of the monitoring effort takes place. Often, the clients and project executives come up with a solution, which is then forwarded to the Board of Management for consideration and approval. Because of the timing, such solutions often involve additional assistance or other concessions being provided to the client by the Department.

5.78 Actions currently being taken by project executives seem appropriate in the circumstances. However, a regular program of monitoring could give the Department the opportunity to identify client problems before they become serious, thereby allowing for a wider range of possible solutions in many cases.

5.79 There are no documented policies to be followed in cases where clients experience problems. We feel that it would be appropriate to add guidance to the departmental policy and procedures manual in this area.

Recommendation

5.80 Policies should be added to the departmental policy and procedures manual to cover actions to be taken in cases when monitoring activities have indicated client problems. Such policies would be most effectively applied if there was also a regular monitoring regime in place, as this would allow for the early identification of client problems.

Loan forgiveness procedures

5.81 A forgivable loan is advanced to assistance recipients by the Department on the understanding that it will be repayable if certain terms are not met by a specified date. It is important that the Department evaluate compliance by the client on or near that date in order to determine if the client has satisfied those terms, for example that certain levels of job creation have been met, allowing the loan to be forgiven.

5.82 In our review, we noted that forgiveness procedures are often initiated as a result of client contact, rather than as part of regular departmental procedures. Because they are so busy processing applications for assistance, project executives do not deal proactively with this aspect of monitoring.

5.83 There are no policies in place concerning the loan forgiveness process. We were told that project executives use their own judgement in verifying compliance with a loan agreement prior to recommending forgiveness. In files we examined, there was very little or no evidence indicating that a review had taken place. In general, file documentation did not adequately support the contention that the client had met all terms for forgiveness. We feel that compliance with forgiveness clauses should be fully documented and supported with evidence before a loan is forgiven.

5.84 The Office of the Comptroller made many of the same observations relating to the forgiveness of loans in their 1997 review.

Recommendations

5.85 Policies for loan forgiveness should be clearly defined in the departmental policy and procedures manual. These policies should clarify what steps must be taken to verify a client's assertions. They should also clearly indicate under what conditions loan forgiveness may be recommended, and when other actions must be taken.

5.86 These policies should be followed in determining whether to forgive the loan, or whether to take some other action.

5.87 Documentation of steps taken to verify a client's assertions and evidence supporting those assertions should be in the client's file. This documentation should support the action taken.

Action taken when client has not met terms of their agreement

5.88 Each financial assistance client must sign a loan agreement(s) with the Department in which certain terms are specified. We feel it is important that the terms of the agreements signed between the client and the Department be honoured. Timely and appropriate action should be taken when clients have not met the terms of their agreements. This would include cases where the client has not met the terms of a forgivable loan, where a repayable loan client is in principal or interest arrears, or where loan guarantee fees are in arrears.

5.89 In discussions with departmental representatives, we determined that there is no policy in place giving guidance as to actions to take when clients have not met terms of their assistance agreements. Unlike a commercial bank, the Department does not often have the option of quickly seizing assets or taking other actions to recover as much of the initial investment as possible when a client falls into significant arrears. The Department must also assess the impact of possible losses of employment and other economic benefits to the particular region. Therefore, it often delays collection activities. We feel that the effect of this inaction is to put full recovery at risk.

5.90 We understand that in serious cases of non-compliance frequent contact with the client usually takes place. Often the result is a proposal for restructuring the funding arrangement between the Department and the client. Collection of outstanding amounts is rarely considered unless the company has gone into receivership or bankruptcy, and recoveries by that point are often insignificant.

5.91 We feel that a departmental policy covering action to take in cases of client non-compliance with loan terms should be developed. While the policy should consider the effect on clients of enforcing agreements, it should also consider the Department's duty to safeguard public investments to the greatest extent possible. The opportunity cost of not recovering these funds, which would otherwise be available for public use, should be taken into account.

5.92 We also determined, in our discussions with project executives, that effective remedies to deal with client non-compliance with loan agreement terms may not exist. Project executives noted that once funds are advanced to the client, they have little recourse when the terms of loan agreements are not complied with. The Department does not usually have a first claim on client assets and assistance advanced is often completely unsecured.

5.93 We feel that effective remedies should be identified and clearly documented in the terms of loan agreements. In addition, use of these remedies in cases of non-compliance should be supported by the Department. In our opinion, the Province, and therefore the public, has provided funds to clients in good faith. In cases where the client has been unwilling or unable to meet their end of the agreement, the Department is quite justified in taking action to recover as much of the investment as is practical. We feel that it is very important to give project executives the tools necessary to recover public investment in cases where non-compliance occurs. This is simply good risk management.

Recommendations

5.94 Effective remedies should be included in loan agreements to cover cases of client non-compliance with agreement terms.

5.95 Policies should be documented in the departmental policy and procedures manual to cover actions to be taken when a client has not met the terms of their agreement.

Performance reporting

Section introduction

5.96 Performance reporting is an important facet of modern public accountability. During the last few years, the Province has taken steps to introduce performance reporting in the public sector in New Brunswick. Our audit work in the Department of Economic Development and Tourism gave us the opportunity to complete a review of performance reporting by the Department. This is the first such review we have performed since the Province introduced performance reporting. We plan to complete additional reviews of performance reporting in other departments in the coming years.

5.97 There is a particular process that needs to be followed to ensure that there is effective reporting of performance. Departments and agencies need to clearly define their strategic objectives, identify performance indicators that will allow for the evaluation of those objectives, set targets for those indicators, and report actual performance against those targets. Variances between targeted and actual performance need to be explained.

5.98 We agree with the provincial annual report policy that indicates that the most appropriate means of conveying performance reporting information is through the annual report. Such information should allow the reader of the annual report to determine, in as objective a way as possible, the extent to which a department has achieved its strategic objectives and its mission.

5.99 Inherent in the process of setting performance targets, and then reporting achievements against those targets, is that targets will sometimes not be met. In performance reporting, this should not automatically be considered as “failure.” An important part of performance reporting is considering explanations as to why targets were or were not reached. Equally important is the identification as to what will be done differently in the following year as a result of experience gained. It is crucial to the success of performance reporting that all parties recognize this and use performance reporting information as a method of improving the organization, and not simply as a source of information in assessing individual or workgroup performance.

5.100 **In our opinion, the Department has made a good start on reporting its performance.** However, we feel that by making the improvements we have recommended, the Department would enhance the effectiveness of its performance reporting.

Performance reporting process

5.101 There are a number of steps in the performance reporting process.

5.102 The first step is to develop a mission statement and strategic objectives for the organization. The mission statement will explain the reason for the existence of the organization. The strategic objectives will identify, in clear, measurable terms, what is required to satisfy that mission.

5.103 The second step is to identify one or more performance indicators for each strategic objective identified for the organization. These performance indicators will identify how success in achieving each strategic goal is to be evaluated.

5.104 The third step is to set targets for departmental performance indicators. These targets should be the levels of performance at which the related strategic objective can be considered to have been achieved for the period covered by the target. Targets should normally be set annually.

5.105 The fourth step is to capture and report on actual achievement against target by performance indicator. Reporting this information would facilitate an objective evaluation of the organization’s performance for the year by annual report readers. In cases where targets have not been met, explanations should be provided and corrective action to be taken should be reported. Departmental performance reporting is required in the Province’s annual report policy.

Strategic and work planning

5.106 There is currently no up-to-date strategic plan in place for the Department. However, a departmental representative told us that, in keeping with the spirit of the 1993 document, *"Toward Self-Sufficiency – Strategy for Economic Development"*, the informal "mission" of the Department is as follows:

> *To stimulate and maintain sustainable growth in wealth and employment for the well being of the citizens of New Brunswick.*

5.107 This statement also appears in the government document *"Performance Measurement – Supplement to the Main Estimates"* for 1998-99 where it is identified as the departmental goal.

5.108 The vision statements and key results areas reported in the Department's 1996-97 annual report were first reported in the annual report of 1991-92. The vision of the Department, as documented in the 1996-97 annual report, includes the following three statements.

- Help create jobs for New Brunswickers
- Serve the customer's needs first
- Do things well or not at all

5.109 The key results areas reported in the 1996-97 annual report were developed in 1991, and were intended to identify the key areas for which the Department had responsibility at that time. It has been a number of years since the list of key results areas was developed, and they have not been updated to reflect organizational and other changes in the Department. For example, there are no key results areas which address the role of the Tourism and Parks Directorate. Also, they may not adequately address the current departmental focus on direct job creation through the provision of financial assistance to business. We feel that the key results areas identified in 1991 should be reviewed and modified as necessary to bring them up to date.

5.110 As previously noted, strategic objectives are simply the goals that an organization must continuously strive to meet in order to achieve its mission. The Department did discuss some strategies for economic development in the 1993 document, *"Toward Self-Sufficiency – Strategy for Economic Development."* However, it has never gone through the exercise of clearly documenting departmental strategic objectives. A departmental representative informed us that the key results areas were not intended to be strategic objectives.

5.111 One obvious strategic objective of the Department is "to create jobs through the provision of direct financial assistance." This can be derived by considering the existing performance indicators for the Department. Also, departmental representatives we talked to identified this as a key objective of the Department. However, we do not feel it should be considered the only strategic objective of the Department. The

Department is involved in some economic development activities that cannot be linked directly to job creation, for example its work in trade and in providing technical support services to industry. So, other strategic objectives should be developed. One objective that would address this area might be *"to maintain provincial jobs through the provision of technical support to New Brunswick businesses."* Given the limited resources available to the Department, another objective might be *"to ensure that Departmental resources are used effectively."* Strategic objectives addressing other mission-critical areas should be considered as well. The important thing is that these strategic objectives be measurable, and that in total they allow for an objective evaluation of the success of the Department in achieving its mission.

Recommendations

5.112 The mission statement of the Department should be formalized.

5.113 Measurable strategic objectives should be developed for the Department. These strategic objectives should allow for an objective evaluation of the success of the Department in achieving its mission.

Existing performance indicators

5.114 The Department developed and monitored two performance indicators for the 1996-97 fiscal year. One relates to tourism and is beyond the scope of this chapter. The other was job creation through strategic investment from the period 1995 to 1999. Both these indicators are defined in the 1996-97 document, "*Performance Measurement - Supplement to the Main Estimates.*" The "jobs" performance indicator as defined is measurable and verifiable. However, we feel that the definition of job creation in that document was not precise enough to allow for consistent measurement of jobs by the departmental staff. Through discussions with loan officers, we determined that actual job creation was interpreted somewhat differently by different staff and for different industries. We feel that a precise definition would have allowed for a more accurate measurement of the effect of departmental activity on this indicator.

5.115 We were pleased to note that the Department expanded the number of performance indicators in the *"Performance Measurement - Supplement to the Main Estimates"* document for 1997-98. Performance indicators now cover "job creation", "incremental wealth creation" and related tax generation, as well as specific measurements relating to the Information Highway Secretariat and Tourism sections. The method of measuring these indicators had not been finalized at the time of our audit. We also noted that the job creation indicator has been expanded and that an additional target has been set for jobs maintained through the provision of financial assistance. Four-year targets have been set for each of these indicators covering the period from 1995 to 1999.

5.116 We understand that the development of appropriate performance indicators for the Department is ongoing. We also understand that performance indicators developed are subject to the approval of the Department of Finance and the Board of Management. However, we would like to take this opportunity to make a suggestion for improvement.

5.117 We note that all current performance indicators, besides those developed for Tourism and Parks and the Information Highway Secretariat, appear to address the results of the provision of direct financial assistance to business. We understand that the current departmental focus is mainly on identifying and developing new opportunities for job creation through direct financial assistance. However, as we discussed in the previous section, we feel that more than direct job creation must be accomplished if the Department is to be successful in achieving its mission. Current performance indicators do not measure the contribution of more support-oriented sections like Industry Services or Trade, thereby ignoring their achievements when reporting departmental performance. This again points to the need for the Department to identify its strategic objectives. Performance indicators could then be developed as necessary to allow for an evaluation of the degree of achievement of each of these strategic objectives.

Recommendations

5.118 The Department should develop more precise definitions for existing departmental performance indicators relating to jobs created and wealth generation.

5.119 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.

Targets for performance indicators

5.120 Targets were set for each of the official departmental performance indicators for the 1996-97 and 1997-98 fiscal years. These were reported in the annual document, "*Performance Measurement – Supplement to the Main Estimates.*" The targets for each of these performance indicators covered the four-year period from 1995 to 1999. Annual targets were not given in this report. However, we understand from our discussions with departmental representatives that annual targets have been set for internal use.

5.121 Reporting only four-year targets in the departmental annual report gives the indication that these performance indicators are not so much measurements of departmental effectiveness, but rather a measure of the government's job creation success during its political mandate. We feel that one-year targets should be reported in the departmental annual report for existing performance indicators to allow for an effective evaluation of the Department's performance for the year under review. One-year targets should also be created for any new performance indicators that are developed.

Recommendation

5.122 The Department should show annual targets for all departmental performance indicators that are reported in the departmental annual report. Reporting against these annual targets should allow for a yearly evaluation of the Department's achievement in meeting strategic objectives. Such annual targets could be part of longer-term targets established in the Performance Measurement supplement to the Main Estimates for particular performance indicators.

Compliance with the Province of New Brunswick Annual Report Policy

5.123 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."*

5.124 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."*

5.125 The 1996-97 departmental annual report includes the vision statements and the thirteen departmental key results areas as previously discussed. The report also showed the two existing departmental performance indicators at the time along with the four-year targets for each. It also reported the actual achievement levels against targeted performance levels. However, the report did not discuss the continued relevance of departmental programs, nor did it cover client acceptance of those programs.

5.126 The annual report policy also states, *"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."* The policy provides a model for presenting this information. The 1996-97 departmental annual report did not present summary actual and budget financial information, nor did it give a narrative explanation of major budget variances.

5.127 We note that the current departmental annual report is laid out by work group. Structuring the annual report in this way may be of more interest to departmental staff than external readers of the report. 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, and therefore its departmental mission. It would also ensure the relevance of information included in the annual report.

Recommendations

5.128 The Department should comply fully with the provincial annual report policy in future departmental annual reports. Specifically, the following content should be added to the annual report:

- **a discussion of the continued relevance of key departmental programs;**
- **a discussion of the level of client acceptance of key departmental programs;**
- **an actual versus budget presentation of key financial information; and**
- **an explanation of any significant variances from budget.**

5.129 Additionally, 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.

Departmental response

5.130 The Department of Economic Development, Tourism and Culture provided the following comments in response to our report.

5.131 *… Government financial assistance, to a large degree, is the result of our banks not taking risks. We believe our programs are filling this gap at acceptable risk levels.*

5.132 *… You commented on the decision making process and how some clients receive financial assistance where there is negative information on file. Our process requires that we clearly document all factors, including negative factors, so that the Board can make balanced decisions. Corporate lending requires good judgement and cannot be done by strictly segmenting information. We believe that risk assessment and decision making is reasonable in view of the loss rates of the Department.*

5.133 *Certainly we always can make improvements as the result of your recommendations. In this regard, we are immediately*

- *Enhancing our model to measure all risk business elements and summarize overall risk.*
- *Putting procedures in place to benchmark applications.*
- *Including a monitoring plan in our approval process.*
- *Have created a staff position to monitor client compliance material like financial statements, client employment, etc.*
- *Strengthening performance indicator systems.*

- *Requesting 2 increased staff positions in the 1999 – 2000 Budget process.*

Chapter 6
Department of Education
Excellence in Education

Contents

Department of Education Excellence in Education

Background

6.1 On 13 November 1991 the Board of Management approved the "establishment of financial requirements for a commission on Excellence in Education." This commission also came to be known as the Landry-Downey Commission after the names of its co-chairs, Aldea Landry and James Downey.

6.2 The Commission was funded jointly by the Department of Education and the Department of Advanced Education and Labour. It carried out its work in two phases, one dealing with the public school system, the other with the post-secondary education system.

6.3 The Commission received an extensive array of briefs and public presentations. It concluded Phase I on 7 May 1992 with the release of its report *Schools for a New Century*. The report contained forty-two recommendations dealing with the public school system.

6.4 On 14 September 1992 the government announced its response to the report at a press conference attended by the Premier and the Ministers of Education, Health and Community Services, and Advanced Education and Labour. At that conference, they announced a $61.1 million program of initiatives responding to *Schools for a New Century*. The program was to take place over a four-year period starting in 1992-93 and ending in 1995-96. The additional funding, as well as certain accounting and audit provisions, had been approved on 2 September 1992 by the Board of Management.

6.5 This press conference brought additional public exposure to the work of the Commission in this high profile area of the education of our children. The initiatives announced that day involved a sizeable outlay of public funds, increasing the profile and significance of the project. But yet despite this early attention, the program rapidly moved off the main public agenda. In our search of the Hansards, we could find no general reference to Phase I after a statement to the House by the Minister of Education on 11 December 1992.

6.6 We believe that in order to demonstrate accountability, it is important for the Government to report on the results of its major change initiatives. Excellence in Education is certainly one of those initiatives and is therefore significant to our client, the Legislative Assembly. Given this, we decided to carry out a value-for-money audit on Phase I of the Excellence in Education (EIE) initiatives in the 1998 audit year.

Scope

6.7 The audit covers the recommendations of Phase I (*Schools for a New Century*) of the Commission on Excellence in Education. The primary departments involved are the Department of Education and the Department of Health and Community Services. We have also directed certain of our observations to the Office of the Comptroller given its significant role with the accounting and audit aspects of the EIE program.

6.8 We had two main audit objectives for this value-for-money audit:

- to determine if the government has adequate systems in place to measure and report on the effectiveness of the Excellence in Education initiatives; and
- to determine whether the government has complied with the accounting and audit provisions established by the Board of Management.

6.9 We developed criteria for each of these objectives. Our detailed findings are organized by those criteria.

Results in brief

6.10 The government response to *Schools for a New Century* was timely and coordinated.

6.11 In our review of the government's response, we could not determine whether all the recommendations had been accepted.

6.12 The government has not reported on the effectiveness of the Excellence in Education initiatives to the Legislative Assembly. Extensive evaluation work is underway, however, with the Early Childhood Initiatives (approximately 25% of the original EIE budget).

6.13 EIE initiatives became part of the participating departments' base budgets after the program terminated on 31 March 1996. Other than the work underway with the ECI, no formal evaluation of effectiveness had been performed prior to establishing the initiatives as regular budget items.

6.14 In a separate review of the four-year EIE program, the Comptroller concluded that "generally speaking, departments used Excellence in Education funds for purposes intended and were in compliance with Board of Management minute 92.0604."

6.15 The Comptroller's review noted "when Excellence in Education funds were added to existing programs, the departments did not account for EIE spending separately. Existing programs by

their very nature contributed to achieving the objectives of the EIE initiative."

Adequacy of government's response to EIE recommendations

6.16 Our first criterion dealt with the quality of the government's response to the EIE recommendations. We wanted to determine if the government had prepared a timely, coordinated and complete response to the recommendations in *Schools for a New Century*. In our opinion, an appropriate response would include an implementation strategy assigning responsibility and timelines.

6.17 Perhaps the easiest way to deal with the adequacy of the response is to look at each aspect of this criterion in some detail. In other words, we want to address the following questions:

- was the response timely;
- was the response coordinated;
- was the response complete; and
- did the response include an implementation strategy assigning responsibility and timelines?

Was the response timely?

6.18 In our opinion the government responded in a very timely fashion to the EIE recommendations. The Commissioners released *Schools for a New Century* on 7 May 1992. Work on the response began almost immediately. Five days later, on 12 May 1992, the Minister of Education stood in the House to say:

> *The work of the commission on primary and secondary education is completed . . . I have already initiated in my Department a thorough analysis of the report, including the cost implications, inherent in the recommendations. . . . . the Minister of Finance indicated in his budget address that he will be tabling a supplementary estimate this fall to deal with the report.*

6.19 On 9 June 1992 the Minister of Education presented his initial response in a Memorandum to the Executive Council. The response included a number of initiatives for immediate implementation. It also identified a number of initiatives for implementation after consultation and study.

6.20 On 16 July 1992 the Department of Education presented a Multi-year Action Plan to a joint committee of the Policy and Priorities and Board of Management Committees via a second Memorandum to Executive Council. The Multi-year Action Plan outlined 67 proposed actions in response to the EIE report. Further, it provided in an appendix "a priorized list of initiatives which could be implemented as of September 1992." This list of 16 initiatives summarized and covered many of the 67 proposed actions. It also provided some initial costing figures.

6.21 During this same period of time, a task force chaired by Policy Secretariat with representatives from the Departments of Education, Health and Community Services and Income Assistance was also established. This task force had the charge to develop a response to the specific recommendations in *Schools for a New Century* aimed at ensuring that all children enter kindergarten “ready to learn”. In a separate Memorandum to the Executive Council signed by the Ministers and Deputy Ministers of Education, Health and Community Services, and Income Assistance, the government documented five recommended actions to address the so-called school readiness recommendations. Again, preliminary budget figures were established.

6.22 By 2 September 1992 the budget figures for the EIE initiatives had been firmly established. The Board of Management “agreed to recommend to Executive Council a four year funding plan . . . for the implementation of the government’s response to the Landry-Downey Report on Excellence in Education.” This funding plan called for $61.7 million to be spent by four different government departments over a four year period. The bulk of the budget went to the Department of Education ($39.2 million) and the Department of Health and Community Services ($16.1 million).

6.23 Less than two weeks later, on 14 September 1992, the government gave its public response at a press conference. The Premier and the Ministers of Education, Health and Community Services, and Advanced Education and Labour all made public statements discussing the various initiatives included in the response. At the conference the government presented cost figures for 15 initiatives in the Department of Education, the Early Childhood Initiatives (ECI) in the Department of Health and Community Services, and two supporting programs in the Department of Advanced Education and Labour (AEL). The total program costs were estimated at $61.1 million, a slight decrease from $61.7 million previously approved by Board of Management. (Neither the Department of Education nor the Office of the Comptroller was able to explain this discrepancy.)

6.24 In effect, then, one can see that the response was timely. Work began quickly, in May of 1992. And the plan had been established and the funds budgeted by September 1992. This was only four months after the delivery of quite a far-reaching report, and in time for the next immediate academic year beginning in September of 1992.

Was the response coordinated?

6.25 In our discussions with staff and our review of documentation we found ample evidence that the response was coordinated between the major players. As noted, the response dealing with school readiness was prepared by a task force chaired by Policy Secretariat with representatives from three major departments. The Memoranda to the Executive Council of 9 June 1992 and 16 July 1992 both showed evidence of interdepartmental consultation. A Board of Management Minute and the public response of September 1992 provided further evidence of a coordinated approach.

Was the response complete?

6.26 This was the most difficult aspect of the criterion to evaluate. The response comprises more than one document or statement. There are three separate memoranda to Executive Council, a Board of Management Minute approving a four-year funding program and a press conference with the announcement of 15 Department of Education Initiatives, the ECI, and two support programs in AEL.

6.27 Were one to select an "official response", it would have to be the information released at the press conference. The Minister of Education in a statement to the House on 11 December 1992 stated:

> *On September 14, 1992, as you know, the Government announced its response to the Report of the Commission on Excellence in Education indicating a commitment to invest $61.1 million in the young people of the province.*

6.28 This makes the firm statement, at least the firmest we have, that the press conference and the listing of initiatives released that day form the official response.

6.29 In all of this documentation, however, we could find no formal statement on the disposition of all of the 42 recommendations, noting whether or not all recommendations had been accepted, modified, postponed or rejected. There was no document that linked all of the 42 recommendations to the 15 initiatives, the ECI and the supporting programs.

Were all recommendations covered anyway?

6.30 The reader might ask, despite the government's weaknesses in the areas of cross-referencing, were all the recommendations dealt with anyway? We attempted to answer this question.

6.31 We tried to cross-reference the various documents to the 42 recommendations. Our goal was to determine if any of the recommendations had been "missed". In our opinion, 4 of the 42 recommendations in *Schools for a New Century* were not addressed by an action in any of the documents. These recommendations are:

> *11. That the faculties of education, arts, and sciences at all New Brunswick universities develop procedures to ensure the effective coordination of teacher education programs, and further that they consider together the best configurations and content of academic courses for those programs.*
>
> *12. That in the light of the almost unanimous judgement of teachers about its value, an extended practicum continue to be a part of pre-service training, and that the universities, the two*

teachers' associations, and the Department of Education redouble their cooperative efforts to select, encourage, support, and reward effective and conscientious supervising teachers.

22. That the provincial government and the teachers' union develop means, including an appropriate process of final offer selection, to reduce the degree of stress and obviate the disruptions created by existing patterns of collective bargaining.

41. That all departmental headships, vice-principalships, principalships, and superintendencies become term positions. Those appointed would hold office for a fixed period (we would suggest, for example, three years for department head and five years for a principal), after which a review of performance would be conducted. Reappointment could occur where there was mutual satisfaction. Otherwise, the incumbent would be entitled to resume full-time teaching.

6.32 The Department's position is that issues 12, 22, and 41 all relate to collective bargaining and therefore intentions would not be announced prior to the start of the bargaining process. Recommendations 12 and 41 have been implemented in subsequent years through the collective bargaining process. With respect to recommendation 11, the Department had noted in the June 1992 memorandum that it would continue consultation with the universities. Further, the Department has noted it has spent considerable time and effort over the past five years coordinating efforts with universities. Our point, however, is that to some extent these recommendations were left hanging. It is not clear that they were accepted from the outset and that initiatives were put in place to address them.

6.33 An additional matter is that in some cases the proposed action or issues address only part of a recommendation. Or they do not cover the full intent of the original recommendation. We have analyzed several examples where this is the case and we present them below.

Recommendations not addressed in full

School year

6.34 Recommendation 33 contains a number of proposals regarding the school year. For example recommendation 33.1 says:

That the following statement be adopted: The school year will constitute 200 days, of which a minimum of 190 days of instruction will be scheduled by each board in every school in each school year.

6.35 The Department responded to this recommendation as follows: "The Department of Education will study the implications of increasing the length of the school year to 200 days with 190 instructional days." This is quite a bit weaker than original recommendation 33.1. And it ignores the remaining parts of the recommendation:

> *33.2 The school year in New Brunswick may not begin before the third week of August and may not end later than June 30. Within these dates each school board will determine when the school year within its jurisdiction will begin and end. Every effort should be made to have the instructional year begin after Labour Day.*
>
> *33.3 Administrative days, professional development days, storm days, marking days, parent-teacher days, and semester turn around days will not count as instructional days.*
>
> *33.4 The organization of the instructional year will be designed to ensure minimum disruption during the year because of professional development in-service, civic or provincial elections, union meetings, etc.*
>
> *33.5 The Department and districts will review the structure and scheduling of the high school semesters to determine the feasibility of completing the first semester to coincide with the Christmas Break.*

6.36 Discussion with staff in the Department indicated that some of these matters could not be addressed in the proposed actions due to collective bargaining issues.

School advisory committees

6.37 Recommendation 36 says the following:

> *That, following consultation with the school boards, the New Brunswick Home and School Association, and Le Comité de Parents du Nouveau-Brunswick, school advisory committees be prescribed by legislation for each school ....*

6.38 The Department's proposed action stated "the Department of Education will promote the establishment of a School Advisory Committee for the purpose of promoting education and improving the quality of school life." The recommendation does not say "promote". It says, "following consultation .....legislate". In 1996, however, the Department did adopt a stronger position by legislating school advisory committees.

Females in management

6.39 We also wondered if the government had fully responded to recommendation 30. Recommendation 30.3 says:

> *that collaboration exist between the Department of Education and the teachers' associations for the implementation of a strategy aimed at preparing female teachers to assume management and administrative positions.*

6.40 Two proposed actions dealt with various human rights, gender and multi-cultural issues. But they did not specifically address the "implementation of a strategy aimed at preparing female teachers to assume management and administrative positions."

School boards

6.41 Another recommendation that should be examined is recommendation 42:

> *That effective steps be taken to strengthen the role and responsibility of school boards in the setting of goals, managing the resources, and assessing the achievements of the schools in their communities, and to create a closer partnership between schools and the communities they serve.*

6.42 The proposed action that most closely related to this recommendation stated:

> *The Department of Education, with the cooperation of the Trustees' Associations, will organize training sessions for school board members to help them develop the attitudes and skills to deal with educational policy matters, to implement such policy and to monitor its performance.*

6.43 But as can be seen in reviewing its wording, this proposed action did not deal directly with the themes of setting goals, managing resources, assessing achievements and creating closer partnerships. The Department has informed us that "in February 1996 a new governance model was announced. This model will give effort to many aspects of this recommendation." This new governance model referred to by the Department included the abolition of elected school boards and the establishment of school parent advisory committees, district parent advisory committees, and two provincial boards of education.

Our conclusion in this area

6.44 Our research indicates that although a great many of the recommendations are addressed, there is a difficult audit trail in attempting to link the announcements of 14 September 1992 to the original 42 recommendations in *Schools for a New Century*. It appears that some of the recommendations were not dealt with. Others were only partially addressed.

6.45 This is not a problem in the sense that the government was free to accept or reject any of the recommendations in whole or in part. Indeed, Commissioner James Downey recognized this at the release of the report with the following statement:

> *Not all of our recommendations will receive support from all stakeholders, but the substance of our report does not hang or fall on any one recommendation. We attempted a careful*

> *balance of measures designed to strengthen the system in a number of places.*

6.46 But we do believe an explicit statement of acceptance, rejection, or modified acceptance on each of the recommendations would have better served accountability. We believe the government should have prepared a formal statement on the recommendations in a pattern such as follows:

- accepted outright,
- accepted with modification, or
- rejected

6.47 Further, we believe the government's implementation strategy announced 14 September 1992 would have better served accountability had it linked the initiatives to the recommendations. Had that been done, there would have been a clear representation to the public as to how the government intended to deal with each recommendation. It also would have made it much easier for the government to establish a trail linking the initial aims of the Commission to the outcomes four years later.

Department of Education response

6.48 *While the Department's 67 proposed actions did, indeed, cover the vast majority of the 42 recommendations, again we must point out that it would have been impossible to have indicated, at that time, an explicit statement of acceptance, rejection or modification for the recommendations that were subject to the collective bargaining process.*

Did the response include an implementation strategy assigning responsibility and timelines?

6.49 In our opinion, the government clearly assigned responsibility for the various initiatives to the respective departments. By assigning the multi-year budgets to the various initiatives, timelines were also clearly established.

Reporting on progress

6.50 Our second criterion noted the government should review and report on its progress with respect to implementing the recommendations in *Schools for a New Century*. Our focus here is on the government's own internal reporting. We concluded that the government has met this criterion in both the Departments of Education and Health and Community Services.

Internal reporting in the Department of Education

6.51 The Department of Education had a variety of internal reporting mechanisms in place. The most complete document we reviewed was a post-program April 1998 update covering all 42 recommendations in *Schools for a New Century*. It covers actions by both the francophone and anglophone sectors of the Department.

6.52 In the early stages of the EIE program, the Premier appeared to take an intense interest in the progress. He met regularly with the two Deputy Ministers in the Department to discuss progress on the recommendations. Although most of the information exchanged was verbal, on at least one occasion the Department recorded its progress on the initiatives in a formal document.

6.53 The Assistant Deputy Minister of Education for the francophone sector required regular formal reporting on EIE. Each of the applicable school districts reported to him on their progress on the EIE initiatives. We were provided with copies of a number of these updates for our file.

6.54 There does not appear to have been quite so formal a system on the anglophone side. But we were provided with three documents that showed evidence of ongoing monitoring. The first was an *Excellence in Education Internal Evaluation - Fall 1994*. This survey asked what changes had taken place as a result of EIE spending for all 15 initiatives. It also asked the respondents to provide indicators or evidence to support comments given. The second document was an internal *Review of Programs – Enrichment, Tutoring, Learning Disabilities, Behaviour Disorders, Enhancement*. This review covered the period July 1993 to June 1994.

6.55 The third example was an October 1996 document prepared by an assistant deputy minister. This document outlined the progress on all 42 of the original recommendations.

Internal reporting in the Department of Health and Community Services

6.56 The Department of Health and Community Services had responsibility for four recommendations or parts of recommendations. The vast majority of the Department's work was in the Early Childhood Initiatives. The Department has developed a sophisticated evaluation approach to measure the impact of ECI. It has also carried out evaluations of its support services to the Department of Education.

Reporting on effectiveness

6.57 Our first two criteria examined the quality of the government response to the EIE recommendations and the government's own internal reporting on its progress in implementing EIE initiatives. Our third criterion states:

> *The Government should perform post-implementation review of the recommendations to determine if the intended results have been achieved.*

6.58 The fourth criterion is similar:

> *The government should report on the effectiveness of the Excellence in Education initiatives to the Legislative Assembly.*

6.59 The third criterion deals with the need to perform an evaluation. The fourth criterion reflects the importance of reporting such results to the Legislative Assembly, closing the loop on the accountability cycle. They call for reflection on the original objectives of the Excellence in Education initiatives with some determination or assessment of whether these objectives have been met.

6.60 Although the two criteria are being looked at jointly, we are dividing the reporting on them here in two sections. One section will deal with the overall thrust of the initiatives of the EIE program; that is, those initiatives largely within the responsibility of the Department of Education. The second will deal with the Early Childhood Initiatives directed by the Department of Health and Community Services.

Effectiveness reporting by the Department of Education

6.61 Our first task in determining compliance with the criteria was to determine the overall objectives of the various EIE initiatives. We found the following statement by Premier McKenna on 14 September 1992 to be a useful account of the EIE objectives. During this public response to *Schools for a New Century* he stated:

> *Our Commission on Excellence in Education put it very well: "The challenge is to cultivate in all children the capacity to think for themselves, to communicate effectively, to know where to find and how to use knowledge, and to develop a pleasure in the arts and sciences that will make them lifelong, adaptable learners." That is our goal, that is our vision. To create an exciting and dynamic learning environment where:*
>
> - *Students want to learn, and are challenged to do their best;*
> - *Where teachers are empowered, supported and rewarded; and*
> - *Where the community is a real part of the system.*

6.62 A short time later, the Minister of Education made a similar statement:

> *If we can develop and sustain a learning culture that is predicated upon the principle that all students can learn to become more self-reliant, skilled, knowledgeable, and positively motivated persons, then we will have met our objective and we will, in fact, be the best we can be. . . .This is my vision for our future and I believe it is a shared vision among many of those in the education community and I would hope, Madame Speaker, among the Members of this House. Having said this, we must now ensure that every initiative that we have introduced will lead to more and better opportunities for youngsters to learn. (Hon. Paul Duffie to House on 11 December 1992)*

6.63 We have noted that the Department prepared a document in April 1998 covering progress to date on all 42 recommendations in *Schools for a New Century*. We also noted a number of references to various EIE initiatives in our review of the Department's annual reports from 1992-93 to 1995-96. This was particularly the case in the year ended 31 March 1993, the first year of the program. But we could find no document that evaluated the overall program with respect to its stated objectives.

6.64 Therefore, in our opinion, these two criteria have not been met for the 15 initiatives in the Department of Education. Staff in the Department expressed the opinion that improvements in educational results would be hard to attribute to any one initiative. Officials believe it would be difficult to separate the results of EIE initiatives from any other initiatives that were underway in the Department at the same time. In addition, certain base data is not available for the pre-EIE period, making it difficult to compare the pre and post EIE results.

Early childhood initiatives

6.65 The Department of Health and Community Services has developed a rather sophisticated approach for evaluating the Early Childhood Initiatives. To coordinate this evaluation, an Interdepartmental Working Committee on the Evaluation of School Readiness was established. Members represent various areas of the Department of Health and Community Services and the Department of Education. A formal plan detailing important elements such as goals and objectives, scope of the evaluation, the units of measurement and data sources and collection can be found in the departmental document *Early Childhood Initiatives – Evaluation Planning Document.*

6.66 The Interdepartmental Working Committee on the Evaluation of School Readiness has defined five questions for study:

- Has pre-natal intervention been effective in enhancing healthy pregnancy outcomes for mothers receiving ECI pre-natal services?
- Have ECI strategies succeeded in bringing about the healthy growth and development of children from birth to age five?
- Have family support services been effective in assisting families of "priority" children to meet their identified needs?
- Have communities been effective in mobilizing resources to remedy the personal and social conditions that place children and their families at risk?
- How effective has the ECI service delivery system been as a process for providing for the needs of "priority" children and their families?

6.67 The over-reaching goal of the ECI is school readiness. Towards this end the Committee's mandate is as follows:

1. *Acquire literature on school readiness, its definition and measurement.*

2. *Identify the meaning of "readiness" endorsed by both Health & Community Services and Education.*

3. *Identify the best indicators for measuring readiness.*

4. *Determine how to link the level of readiness to the impact of ECI in order to determine to what extent ECI has had an effect.*

5. *Develop a plan and a critical path for acquiring baseline readiness data prior to school entry for the first wave of ECI recipients.*

6.68 In addition to the five questions for study, the evaluation is also expected to address whether ECI has met this overall larger goal - to improve the development of children who are at risk of delay in school readiness. Readiness refers to the holistic development of the child in preparation for entry to the school system.

6.69 The evaluation process will include four phases. In that sense, it is being developed in an ongoing fashion. Further, our understanding is that the first group for the study is the children born in 1994 at the point that they first enter kindergarten. To paraphrase one official in the Department of Health and Community Services, this will be their first "graduating class."

6.70 Given this, it is obviously too early to comment fully on these two criteria for the ECI initiatives. However, we are impressed by the thoroughness of the approach and the level of detail covered in the planning.

6.71 We recommend that the results of the evaluation of the Early Childhood Initiatives be tabled in the Legislative Assembly.

Establishing EIE initiatives as regular budget items

6.72 The Office of the Comptroller's special *Excellence in Education Review*, June 1997, discussed various accounting and audit aspects of EIE. The review noted that in 1996 the Excellence in Education budgets became part of the participating departments' base budgets. The review also stated "these departments continue to fund EIE initiatives."

6.73 Our fifth criterion deals with this issue of ongoing funding. It states:

The process for establishing Excellence in Education initiatives as regular budget items should reflect the results of the government's reporting on the initiatives' effectiveness.

6.74 This criterion has not been met. Other than the work underway with the ECI (approximately 25% of the EIE funding), no formal evaluation of effectiveness had been performed prior to establishing the initiatives as regular budget items.

6.75 We noted in our 1995 audit of the Department of Justice's enhanced program for Family Support Order Services (FSOS), that the government placed a so-called "sundown" clause on the initiatives. This required an external program evaluation after a set period of operation to determine the success of the enhanced FSOS. The final evaluation was tabled in the Legislative Assembly and the process was discussed at two different meetings of the Public Accounts Committee.

6.76 We would have expected to see a similar approach with these EIE initiatives. Perhaps in hindsight the Commissioners should have added a recommendation 43:

> That after a period of implementation the government should evaluate the results obtained by its initiatives developed in response to *Schools for a New Century*. The results of the evaluation should be used to determine future directions.

Accounting and audit requirements

6.77 Our second audit objective dealt with the accounting and audit provisions established by the Board of Management. The Office of the Comptroller was directed to carry out special audit review procedures. Departments were directed to account for EIE funding separately.

6.78 In June of 1997 the Office of the Comptroller reported its *Excellence in Education Review.* The review covered EIE spending for the four-year period from 1992-93 to 1995-96. The Comptroller concluded "departments had an estimated surplus of $3.053 million on the total Excellence in Education budget allocation of $61,115,000." And further that "generally speaking, departments used Excellence in Education funds for purposes intended and were in compliance with Board of Management minute 92.0604." The bulk of the surplus "related to delays in implementing Early Childhood Initiatives programs and a decreased caseload in the Integrated Daycare Program."

6.79 We reviewed this report and the Comptroller's working papers as part of our assignment. We had three audit criteria for this work:

- the Departments of Education, Health and Community Services, and Advanced Education and Labour should account for the Excellence in Education initiatives separately;
- the Office of the Comptroller should establish special audit review procedures to ensure compliance and accountability with Excellence in Education funding; and
- the Office of the Comptroller's audit results should be reported, and appropriate corrective action should be taken where required.

6.80 Two of the three criteria for objective two are met. The Comptroller did "establish special audit review procedures to ensure compliance and accountability." And results were reported to the departments concerned and to the Board of Management. Since the Comptroller's report contained no recommendations, no corrective action is necessary.

6.81 The one exception dealt with the Board of Management's direction to account for EIE funds separately. The Comptroller's review stated:

> *When Excellence in Education funds were added to existing programs, the departments did not account for EIE spending separately. Existing programs by their very nature contributed to achieving the objectives of the EIE initiative.*

6.82 The major example occurred with the Department of Health and Community Services' Early Childhood Initiatives, which accounted for over 25% of the EIE spending. Here EIE dollars were added to existing budgets under the Department's Family and Community Services and Public Health Divisions. While we recognize that it may have been more practical to add the EIE funding to existing budgets, this nonetheless conflicts with the explicit direction of the Board of Management. The Board of Management called for separate accounting. Indeed it is quite possible that some of the decision makers at Board of Management gave their approval to the supplementary estimate precisely because they thought it would be accounted for separately. Therefore, we are noting it as a finding. (It should be noted that the Department of Education did account for EIE initiatives separately and reports to us that it continues to do so.)

6.83 The Comptroller responded:

> *Although separate accounting for certain initiatives was not in place in the accounting records of the Province, we were able to satisfy ourselves that the departments used the funding for Excellence in Education Initiatives. For example, where Excellence in Education funds were added to existing programs, we assumed that the existing budget funds were utilized first and only funds spent above this threshold were considered as Excellence in Education expenditures. In addition, the Department of Labour accounted for the positions allocated to the Excellence in Education initiatives.*

Chapter 7
Department of Health and Community Services Ambulance Services

Contents

Department of Health and Community Services Ambulance Services

Background

7.1 In our 1996 Report we commented that the Ambulance Services program of the Department of Health and Community Services has, and continues to be, the subject of much study. In fact several studies, with accompanying discussions and debate, led to the Legislative Assembly assenting to the New Brunswick Ambulance Services Act (Act) in 1990. In 1992 the new Act was proclaimed, giving the Department responsibility for the development throughout the Province of a balanced and effective system of ambulance services. This recognizes that effective and efficient ambulance service is an essential service to all New Brunswickers.

7.2 The Department contracted to provide this service to the public through a network of hospital corporations, municipalities, not-for-profit organizations (e.g. St. John Ambulance) and businesses. Until 1996 St. John Ambulance (SJA) was the service provider in 26 locations around the Province. Departmental staff noted that this represented 37% of the total service locations in the Province and just under 20% of the service volume. However in the spring of 1996 St. John Ambulance announced it was withdrawing from the delivery of ambulance services. At the time of our 1996 Report, the Department was in the midst of hiring replacement service providers for SJA.

7.3 As SJA was volunteer-based, and government funding minimal, we expected funding requirements to rise appreciably once the new service providers were in place. To show the impact of the loss of SJA, we planned to review the costs of the replacement services and compare these with 1995 SJA costs.

7.4 In our 1996 Report we also stated that user fees varied widely across the Province. We commented that the mix of provincial and other sources of funding for each service provider varied widely as well. We were concerned that the lack of funding guidelines may have led to inequities in funding. At the time of our 1996 Report, the Department was in the midst of reviewing fees and other funding-related issues, but no final decisions had been made. Given this, we believe it is important to update our previous observations in our 1998 Report.

Scope

7.5 Our work on the Ambulance Services program started in 1996. At that time we completed preliminary interviews with departmental staff and other parties who provided ambulance services to the public. We also reviewed several reports including a key legislative committee report entitled "*Ambulance Services in New Brunswick* ". Finally, we performed some financial analysis on various cost of service issues. However, because of the significance of the withdrawal of SJA service providers, we decided to delay most of our work on funding until the 1998 fiscal year.

7.6 In 1997 we continued our work and reviewed the consequences of the withdrawal of services by SJA. We determined the annualized funding costs to government of the services replacing SJA and compared these to 1995 SJA costs.

7.7 We also reviewed and discussed changes in the departmental funding policy to determine how they might impact on our 1996 Report observations regarding inequities in funding and user fees.

Results in brief

7.8 Replacing St. John Ambulance volunteer services with new providers will cost the Province over $2.8 million per year. This represents an increase in costs of 268%.

7.9 We recommend the Department assess the private sector model and compare the incremental benefits to the increased costs. Results should be reported to the Legislative Assembly.

7.10 We recommend the Department continue to work to develop funding guidelines and standards to use both in determining compensation rates for sole source providers and for evaluating requests for proposals.

7.11 In its new funding policy the Department established standardized user fees throughout the Province.

7.12 The Department is establishing performance indicators for providers and will be holding providers accountable for meeting these indicators. The Department has indicated incentives or penalties will be attributed to providers depending on the level of performance achieved.

Replacement of SJA volunteer service providers

7.13 It is important at the outset that the reader understands why it became necessary to replace the SJA volunteer service providers.

7.14 In our interviews with SJA personnel in 1996 and 1998, staff told us that the proposed departmental requirement that two emergency medical technicians (EMT1s) be on each ambulance call would be impossible for SJA to meet. Further, SJA staff noted an increasing difficulty in attracting enough volunteers and, as a result, several SJA providers were already having problems in meeting the existing “24-hour on call” ambulance staffing requirement. SJA staff believed that if volunteers on ambulance calls had to take EMT1 training on their own time, volunteers would be even more difficult to attract. SJA staff concluded that if government established the new “two EMT1’s standard”, SJA would have serious concerns regarding their ability to continue to provide ambulance services.

7.15 SJA personnel also expressed frustration with the government’s funding policy. Until 1995 SJA was the only service provider for which the Department covered any operating deficit. However, starting in 1996, the Department decided that SJA would have to absorb any deficit. SJA officials made it known that they were very concerned and that they would not be willing to absorb the deficit. SJA staff noted the Department was only paying SJA approximately $800,000 annually to provide ambulance services in its 26 locations around the Province. SJA estimated that if they did not provide the service, the cost to government of replacing these services would be $2-3 million annually.

7.16 The Department did offer a new funding arrangement to SJA where user fees would be established for their ambulance service and these fees would be used to partly fund their operations. However the establishment of user fees was unacceptable to SJA due to its long established principles of operation. Whether the Department and SJA could, or should, have arrived at a compromise arrangement, was not something we examined further. However an agreement between these parties might have saved the taxpayers of the Province significant dollars, as will be seen in a later analysis.

7.17 As a result of the above concerns, and the parties’ inability to arrive at a mutually acceptable funding agreement, SJA decided in 1996 to no longer provide ambulance services in the Province. To date, the requirement that two EMT1’s be on each ambulance has never been implemented.

7.18 However, departmental staff informed us that 78% of patients are now transported with at least two EMT1’s on the ambulance, although with rural non-salaried operations the rate is lower.

7.19 After SJA’s withdrawal, the Department engaged replacement providers. In several cases the Department took the opportunity to replace several service providers with one larger provider. By doing so, some economies of scale may have been achieved.

7.20 In Exhibit 7.1 we compared the 1995 costs of SJA services with the annualized costs of these services today. One should note that the 1995 costs for Miramichi City include $249,318 of non-SJA costs. Since the replacement service included locations once served by SJA and a non-volunteer type provider, this was necessary for comparison purposes.

Exhibit 7.1
Cost increases in ambulance services delivery

Delivery area	Annualized Costs Current	1995	$ Increase	% increase
Kent County	$443,394	$95,289	$348,105	365%
Shediac-Cap Pele	247,857	70,363	177,494	252%
Peticodiac/Salisbury	134,236	40,902	93,334	228%
Hillsborough/Riverside-Albert	305,350	56,729	248,621	438%
Campobello	138,530	36,953	101,577	275%
Kingston Peninsula	63,081	18,816	44,265	235%
Boiestown/Doaktown	508,449	89,003	419,446	471%
Keswick/Stanley	286,974	26,903	260,071	967%
Carleton-York	583,464	71,019	512,445	722%
Baie St Anne/Rogersville	491,571	99,454	392,117	394%
Sub total	3,202,906	605,431	2,597,475	429%
Miramichi City	673,140	446,884	226,256	51%
Total	**$3,876,046**	**$1,052,315**	**$2,823,731**	**268%**

7.21 The exhibit shows the cost increase attributable to replacing SJA volunteer service providers with new providers to be 268% or $2,823,731. If we exclude Miramichi City from the calculation, as it was a mix of non-SJA and SJA providers, the increase would be 429%. The 1995 costs represent provincial government funding only and do not include unknown services in kind received from local groups, municipal cross-subsidy, fundraising, or donations.

7.22 Replacing these volunteer ambulance services with new providers resulted in a large cost increase to New Brunswickers. However, some qualitative benefits were reportedly obtained. Although SJA was meeting the required standards in most cases, it was experiencing increasing difficulties in attracting qualified volunteers. As noted, some SJA providers were experiencing difficulty in meeting the 24-hour on call ambulance staffing requirement and/or having a qualified EMT1 on each call. The new providers must meet these standards or they may be subjected to penalties. This could ensure an improved level of service for New Brunswickers. In this regard, however, the reader should note our 1997 Report documented significant weaknesses in the Branch’s inspection systems and practices. The Department will need a revitalized inspection system in order to ensure the replacement operators attain the high standards envisioned.

7.23 **We recommend the Department assess the success of the private sector model and compare the incremental benefits to the**

increased costs. We promote accountability in our work and in this regard we suggest the results of this analysis appear in the departmental annual report.

Equity in funding service providers

7.24 In our 1996 Report we observed that while the Act allowed the Department to pay grants and to share in the cost of ambulance services, there were no other legislated monetary guidelines specific to the program. Consequently the mix of public dollars, user fees, and fund raising used to finance each service in the Province varied widely and the question of fairness in departmental funding arose.

7.25 With the withdrawal of services by SJA, many service providers are now selected through requests for proposals (RFPs). As a result, departmental funding for these providers is not determined by any formula established by the Department, but rather by whatever the market price is.

7.26 However, there are still many ambulance services that the Department funds without using a request for proposals. While our concern with equity in departmental funding still exists, the Department states it is working to eliminate inequities. To accomplish this the Department is trying to establish appropriate standards or funding guidelines for the various facets of the providers' operations, which it plans to use in future funding contracts with these providers. At the time of our review, the Department was reviewing the experiences of providers to determine what funding is appropriate. Five-year contracts will be signed with these providers. This enhanced knowledge of costs should help the Department in evaluating tenders and RFPs. This is especially useful in ensuring profit margins remain reasonable in these quasi-monopoly situations.

7.27 **We recommend the Department continue to work to develop funding guidelines and standards to use both in determining compensation rates for sole source providers and for evaluating RFPs.**

User fees

7.28 As noted in our 1996 Report, departmental studies showed large variances in how much individual residents of the Province were charged for ambulance usage. In many cases users were not charged for the service but in others they were charged up to $400 for a motor vehicle accident call. Variances also existed in the per-kilometer fee. Various studies and committees recommended user fees continue to be charged but disagreed as to who should set them. We expressed our concern regarding the equitability of these user fees in that Report.

7.29 **In its new funding policy the Department established standardized user fees throughout the Province.** In most cases patients pay $275 regardless of distance traveled. However, where ambulance services are provided by volunteer-type ambulance services, patients pay only $100.

Performance indicators

7.30 We were pleased to note that contracts either now have, or will have, performance indicators. These contracts will require that providers meet all standards established by the Department or risk being penalized for not doing so. Penalties can be as high as 10% of the annual contracted amount or actual loss of the contract.

7.31 In cases where the provider has exceeded performance indicators a bonus is available. The incentive will be a one-year contractual extension or up to 5% of the total annual value of the contract (calculated by formula) for each year where performance targets are exceeded. The selection of the extension versus financial incentive will be at the discretion of the Department. The extensions are one-time, but can be re-earned. A mandatory value-for-money audit will be performed at the four-year mark for each contracted vendor.

7.32 We support the enforcement of meaningful accountability in these contracts. Again, we would like to emphasize that it is important that the Department implement the recommendations in our 1997 Report for strengthening its inspection service.

7.33 The Department is establishing performance indicators for providers and will be holding providers accountable for meeting these indicators. Incentives or penalties will be attributed to providers depending on level of performance achieved.

Chapter 8
Department of Human Resources Development
NB Case System

Contents

Department of Human Resources Development NB Case System

Background

8.1 In December 1993 the Department of Income Assistance, now renamed Human Resources Development (HRD), issued a Request for Proposals with the following requirement:

> *The goal of this requirement is to define the overall needs of the business and to design, develop and implement a totally integrated solution to meet the defined needs. In this context, a totally integrated solution is concerned with designing and redesigning business procedures, as necessary; designing, developing and implementing the required technologies; and assessing the impacts on the organization.*

8.2 Five proposals were received. Andersen Consulting was confirmed as the successful candidate on 25 March 1994. Work on Phase I, development of the Business Case, began 5 April 1994. Work continued until 28 September 1994 when the Board of Management approved the Business Case.

8.3 Andersen Consulting's costs incurred in Phase I were borne by them. If savings could be realized as a result of this initiative, only costs associated with Phase II would be repaid to Andersen Consulting. Phase II includes the design, development and implementation of the Business Case.

8.4 At the request of the Public Accounts Committee (PAC) in 1996, we prepared a separate Special Report. That Report reviewed various procurement activities of the Department of Human Resources Development for compliance with the Public Purchasing Act. Our objective was to form an opinion as to whether the purchase of computer software and computer hardware was made in compliance with the provisions of the Public Purchasing Act. The special report was released in February 1997.

8.5 In our 1996 Report of the Auditor General we made comments on the contract, financing, personnel and projected savings. The Report committed our Office to the following:

> *We will also monitor payments to Andersen Consulting under the contract and the lease agreement, to ensure these payments comply with the terms of the agreement. Part of this process will include forming an opinion on the accuracy and appropriateness of the calculations of savings arising from the restructuring.*

8.6 This chapter fulfils our commitment. It covers the period from the first payment in October 1997 to the end of the fiscal year, 31 March 1998.

Scope

8.7 This chapter of our Report will discuss the payments that commenced to Andersen Consulting in October 1997. Payments were to commence after Andersen Consulting completed all contractual requirements that resulted from Release I of the automated NB Case system. NB Case is used by HRD to manage their entire case load.

8.8 NB Case is designed to improve the delivery of income support from a primarily passive cheque delivery service to an active service delivery through a case management framework. The savings will be generated from a reduction in overall administration costs, avoidance of overpayments, and a reduction in ineligible applicants. HRD believes case managers will no longer have to spend time doing repetitive administrative tasks and will have this time to spend with their clients helping them to become self-sufficient.

8.9 In carrying out our work we developed the following audit objectives:

- to ensure that the payments to Andersen Consulting complied with the terms of the agreement;
- to determine if HRD had a monitoring system in place to calculate savings arising from the implementation of the new NB Case system;
- to determine if the savings were calculated accurately and appropriately in accordance with the agreement; and
- to report on other matters of significance noted in our work.

Results in brief

8.10 HRD has a monitoring system in place to accumulate and report the total benefits (savings) achieved to date as per the agreement.

8.11 Benefits (savings) are calculated accurately and appropriately in accordance with the agreement.

8.12 A separate maintenance and support system is a requirement for the NB Case System. We recommended that HRD prepare a full-cost analysis of alternative methods of operating and maintaining the NB Case System. This analysis should be prepared prior to the expiry of the current agreement with Andersen Consulting.

8.13 Our systems testing indicated a lack of an audit trail in following transactions from the NB Case System to the Province's Financial Information System.

Commencement of payments to Andersen

8.14 HRD and Andersen Consulting agreed on $15,506,250 as the fee to Andersen Consulting for the implementation of the NB Case System. The hardware and software costs were not part of this amount. As mentioned earlier, we prepared a report for PAC in February 1997 that discussed the hardware and software components.

8.15 HRD and Andersen Consulting further agreed by letter dated 9 October 1997 that approximately 80% of the contracted work had been completed during Release I . The other 20%, known as Release II, involved some enhancements to Release I and was not to be completed until the fiscal year 1998-99. The Agreement does not refer specifically to an 80%/20% break down. The initial repayment schedule was calculated using the following numbers in its base:

80% of total solution cost of $15,506,250	$12,405,000
Commitment fees	50,000
Interest accumulated on 100% of Andersen's total solution costs up to 31 October 1997	2,342,572
Total principal to be repaid-release I	$14,797,572

8.16 The repayment was calculated over sixty months with a payment of $287,818 per month using an agreed upon interest rate of 6.48%.

8.17 This total dollar cost will increase upon acceptance of Release II. At that time HRD will owe Andersen Consulting the final $3,101,250 (i.e. 20% of $15,506,250). In addition there will be a financing charge for this remaining 20% to be spread over a future time period.

8.18 In order for the repayment to commence, HRD had to issue a written notice to Andersen Consulting that HRD accepted the first release of the NB Case System. This written notice was dated 17 September 1997. Paragraph 7.6 of the Agreement says "HRD shall provide written notice to Andersen as to the Commencement Date of the Lease which shall be the first day of any month within ninety (90) calendar days from the date of the Interim Response". The first payment was made on 31 October 1997.

Monitoring system

8.19 The Office of the Comptroller had a significant amount of involvement in the HRD/Andersen Consulting project. Part of this involvement was assisting HRD in designing a system to track the savings resulting from the NB Case System.

8.20 A spreadsheet was developed to summarize and report the tangible benefits (or savings) as a joint effort between HRD and the Office of the Comptroller. We spoke to personnel from both organizations and examined the spreadsheet to determine if it provided an adequate monitoring system.

8.21 The key inputs to the system are three reports produced by the Executive Information System (EIS), a subsystem of the NB Case System, and a fourth report prepared by HRD's administration. These four reports and their purposes are:

Report	Purpose
1. EIS-012	Early detection of overpayment report
2. EIS-013	Rejection at time of application report
3. EIS-014	Overpayment recoveries report
4. Workforce reduction report	Number of positions deleted

8.22 One senior financial officer in HRD has been assigned responsibility for gathering these reports monthly and processing the information into the spreadsheet.

8.23 We are pleased to report that the Department established and tested this monitoring system prior to commencing payments.

Accuracy and appropriateness of tangible benefits (savings) calculation

8.24 As noted earlier, the intent of the agreement was that HRD would fund the agreed upon cost from the tangible benefits (savings) derived from the NB Case System. Schedule F of the agreement was devoted entirely to the discussion, identification and explanation of the potential benefits. It was appropriately titled the Benefits Sharing Agreement.

8.25 Schedule F listed the three categories of expected tangible benefits as follows:

> *1. Overpayment Reduction – "…… is measured by the reduction in the incidence of benefits overpayments or unauthorized payments being made. These measures are calculated based on the monetary sample study produced by the Audit and Investigations group of HRD, and are corroborated by the collection of other random samples they have performed over the past few years. Based on the aforementioned studies the "average" person in a situation of overpayment is in that situation for a period of 3.38 months. The overpayment avoidance shall be calculated, on a case by*

case basis, by subtracting the number of months in overpayment from 3.38 and multiplying this resultant figure by the actual last monthly payment before detection. When the number of months of overpayment exceed 3.38, and no amelioration can be noted compared to today, that case is not included in the aggregate benefit calculation.”

2. Overpayment Recovery – “…… is defined by the difference between the amount of overpayments recovered using new or improved processes and the overpayments recovered in the current processes.

Calculation:

(Actual total overpayments recovered per month - $90,000) + (37% of overpayments detected but not collected as a result of policy decisions)

Actual overpayments are defined as overpayments detected and recorded.”

3. Workforce Reduction – “reduction of the total work effort required to perform administrative tasks.” Improved efficiency of how employees conduct their work was an expected result of the implementation of NB Case. This improved efficiency translated into a reduction of the HRD workforce.

Tangible benefits

8.26 The total repayment to Andersen Consulting to 31 March 1998 was $1,726,911. The total of accumulated benefits (i.e. accumulated savings) for the same period was $4,222,703. This total was made up of:

Overpayment reduction	$1,620,910
Overpayment recovery	574,420
Workforce reduction	2,027,373
Total	**$4,222,703**

8.27 Stated another way, HRD had a net saving after the required repayments to Andersen Consulting of $2,495,792. These excess benefits can be carried forward to offset lease payments in future months should future benefits fail to materialize.

8.28 As a result of our testing, we found one error. It related to the calculation of the financing interest. Andersen overcharged HRD by approximately 1% for 3 months in a row for a total amount of $22,591. We contacted HRD on this matter and have been informed the Department plans to deal with the error during negotiations for Release II.

8.29 Other than this one error, our conclusion is that the savings were calculated accurately and appropriately to 31 March 1998 in accordance with Schedule F of the Agreement.

Other matters

Maintenance and support of the System

8.30 HRD signed a system operation, maintenance and support services agreement on 11 March 1998. The effective date was 1 January 1998 for an initial period of three years. The service provider is Andersen Consulting. The costs to HRD for the three years are $2,170,000, $2,270,000 and $2,370,000 respectively. This agreement further indicates that each extension shall have a $200,000 a year increase over the previous year. HRD initially estimated annual maintenance costs to be at least $1.5 million per year. Obviously, they will be considerably higher.

8.31 HRD does not have the technical expertise to operate and maintain this huge NB Case system. Given the current personnel structure, HRD will require contracted expertise indefinitely to operate the system.

8.32 We recommended that HRD prepare a full-cost analysis of alternative methods of operating and maintaining the NB Case System. This analysis should be prepared prior to the expiry of the above-mentioned agreement with Andersen Consulting.

8.33 The Department informed us that:

> *It is our intention to consider all options with regard to obtaining this maintenance service prior to the expiration of our current agreement.*

Control weakness

8.34 We found an important matter during our annual audit work on HRD expenditures. HRD was unable to provide us with the individual transactions that are batched in NB Case and electronically transferred to the Province's Financial Information System (FIS). We referred to this linking of the detailed historical transactions to FIS as the audit trail.

8.35 This lack of an audit trail required us to adopt a different approach to the audit sampling. It also points out a significant accounting control weakness.

8.36 We recommended that the Department facilitate the necessary changes to the NB Case System to provide the appropriate audit trail for all entries to FIS.

8.37 The Department responded:

> *As part of your audit work, your staff asked us to provide you with a detailed audit trail for fifteen payments made by the Department. We were able to provide this information for eight of the payments but we were not able to provide the requested information for the other accounts selected. The reason we were not able to provide this information, for the balance of these cases, is that NB Case has the ability to change cases*

retroactively. The retroactive changes are modifying the original FIS coding. We can recreate the case history and a detailed account of the payments made to a case. However, we cannot recreate the FIS coding for a payment that is associated with a retroactive change. This affects our ability to recreate the detailed audit trail for a payment associated with a retroactive change.

In order to correct this problem we are implementing a system that will enable us to retain a daily file of information from NB Case. We will prepare a file on a daily and monthly basis and we will retain these files for a period of time sufficient to address any situation where we are required to recreate an audit trail. We will be working with your staff and the Office of the Comptroller to develop the specific data elements to be contained in the files as well as determining the desired retention period for the files. We will ensure that this file retention procedure will address all requirements.

8.38 We have subsequently been informed that *"the system to address this item is in place and fully operational."*

Chapter 9
Departments of Justice and the Solicitor General - Integrated Justice Initiative

Contents

Departments of Justice and the Solicitor General - Integrated Justice Initiative

Background

9.1 The New Brunswick Integrated Justice initiative (NBIJ) first came to the attention of our Office during our follow-up of 1993 observations for our 1995 Report. In that Report, our Office noted that the Departments of Justice and the Solicitor General and Andersen Consulting were negotiating a contract which would "create a uniform, integrated operational framework for administering and delivering justice in the province."

9.2 In the 1995 Report, our Office also noted that the proposal by Andersen Consulting represented a new type of procurement process: "our understanding is that the NBIJ proposal is based on the premise that the costs of the project, including the technology solutions, will be financed by Andersen Consulting. Andersen Consulting will in turn be paid from the savings generated by the re-engineered business processes. No savings, no pay."

9.3 At that time, costs of the project were projected at between $8 million and $45 million. The project was approved by Board of Management in December of 1995 when authority to sign the negotiated contract with Andersen Consulting was conferred on the Departments of Justice and the Solicitor General. The NBIJ Solution Development and Systems Integration (SDSI) Agreement was finalized on 13 June 1996.

9.4 In August 1996, Board of Management gave approval to proceed with the NBIJ component projects on condition that Andersen Consulting was able to provide or arrange financing. The Departments of Justice and the Solicitor General were to encourage Andersen Consulting to have financing in place by 31 December 1996.

9.5 Our 1996 Report revisited various recommendations made in our 1995 Report dealing with the Court Services Division of the Department of Justice. At that time, the department responded that virtually all of the recommendations made by our Office were to be addressed by various projects in the NBIJ initiative.

9.6 In April 1997, a press release by the Departments of Justice and the Solicitor General disclosed that the financing for the NBIJ initiative could not be put in place on time. The departments and Andersen Consulting "jointly agreed to sever their business relationship on the project."

9.7 On 12 June 1997, the Board of Management authorized the Departments of Justice and the Solicitor General to enter into a severance agreement with Andersen Consulting of no more than $2.9 million.

9.8 On 26 June 1997, the Deputy Minister of Justice and the Deputy Solicitor General signed a *Termination Agreement and Release* with Andersen Consulting. This agreement required the Province of New Brunswick pay Andersen Consulting a sum of $2.9 million as a result of which "all right, title and interest {including intellectual property rights} in all NBIJ Materials shall be, and become vested in the Province." The $2.9 million was included in the 1996-97 expenditures of the Departments of Justice and the Solicitor General and was paid early in the 1997-98 year.

Scope

9.9 The work performed by our Office is intended to determine whether there is value for the $2.9 million payment to Andersen Consulting based on the information provided by the Departments of Justice and the Solicitor General. We also sought to determine if the amount of the payment was reasonable in the circumstances.

9.10 Information was obtained through a review of the existing documentation maintained by the departments as well as both verbal and written inquiry.

Results in brief

9.11 The Province of New Brunswick has disbursed approximately $4.3 million in regard to NBIJ over the life of the initiative. This includes $2.9 million paid to Andersen Consulting and $1.4 million paid by the Province for other goods and services.

9.12 Value received for the $2.9 million payment made to Andersen Consulting is intangible. There is the possibility that this value to the Province of New Brunswick may not be achieved.

9.13 Based on figures obtained from the departments, and given the circumstances at the date of the Termination Agreement and Release, we conclude that the payment of $2.9 million to Andersen Consulting resulted in a settlement that was significantly less than amounts billed for work completed. There is also evidence that other possible costs were avoided as a result of this settlement.

Value

9.14 The Province has disbursed an estimated total of $4.3 million related to the NBIJ initiative since 1994. In addition to the $2.9 million settlement with Andersen Consulting, the Province (through the

Departments of Justice and the Solicitor General) disbursed $1.4 million on its own.

9.15 Of the $1.4 million, departmental information shows that $0.6 million was disbursed as payroll costs of employees working on the project over the life of the initiative. Another $0.5 million is attributable to miscellaneous expenses. About $0.3 million of computer hardware and software has been acquired over the life of the initiative and this represents the most "tangible" part of the value obtained for these payments.

9.16 In consideration for the $2.9 million settlement, Andersen Consulting surrendered its rights to the hardcopy documentation and intellectual property created during the SDSI contract. These rights now remain with the Province.

9.17 The departments explained that the value of these expenditures lies not so much in the physical ink on paper, but in the training and experience obtained by employees of the departments involved. The methodologies of Andersen Consulting were not only taught to these employees, but were applied during the NBIJ work achieved to date.

9.18 Further, the departments told our Office that value was also obtained as the environment in which NBIJ was to operate was documented. Though some of this documentation can be considered unique or subject to obsolescence, much of it will have future use. As an example, our Office understands that many "architectures" were compiled to describe not only the technical foundation, but the cultural and procedural backgrounds of the departments, their business processes and their employees. The experience obtained from compiling such documentation will provide the foundation for future NBIJ work regardless of the timing. Examples of such documentation have already been put to use in continuing or implementing projects originally envisioned by NBIJ.

9.19 Will the full value of "intangible" assets like knowledge and experience obtained through the NBIJ initiative's contract with Andersen Consulting be fully realized? This can only happen if the departments continue with these projects and if the departments find some way to transfer the knowledge and experience to others - both within their departments as well as throughout the government.

9.20 Other departments continue to undergo re-engineering and change, both in their procedures and their information technology. It would be neither efficient nor reasonable for each to "re-invent the wheel" should they initiate or implement a project as complex as NBIJ in the future.

9.21 Mechanisms presently exist which help departments "advertise" the fact that special knowledge and experience is available (e.g. Information Systems Advisory Committee) to other government departments. The Departments of Justice and the Solicitor General do participate in these mechanisms, however, this may not be enough to ensure the government obtains value from its participation in this project.

9.22 The value obtained for the $2.9 million payment made to Andersen Consulting is intangible. Full value may not be realized unless the NBIJ projects are actively pursued or the knowledge and experience with this type of complex project is transferred throughout government.

Response from the Department of Justice

9.23 *The Department of Justice is currently in the process of replacing the Criminal Justice Information System which is a foundation system for the administration of Criminal Justice. The system design is not as ambitious as originally envisaged under the NBIJ Program, but it is a start and it demonstrates that the Department is committed to the original concept of the NBIJ Program. Throughout this process we have involved key stakeholders including the departments of Transportation, Human Resources Development, Finance, Solicitor General and Health and Community Services to develop the design. We are also committed to following government technology standards.*

Reasonableness

9.24 Prior to the signing of the Termination Agreement and Release on 26 June 1997, the Province of New Brunswick's relationship with Andersen Consulting was governed by the NBIJ Solution Development and Systems Integration (SDSI) Agreement.

9.25 Based on our review of this agreement, we conclude that both the Province and Andersen Consulting held the ability to terminate the agreement on thirty days notice if a breach of material obligation or substantial non-performance occurred on the part of the other party. However, if the Province was found to have given Andersen Consulting cause for terminating the agreement, the Province would have been required to pay Andersen Consulting for all services rendered and expenses incurred at their full standard rate.

9.26 Based on information provided by the Departments of Justice and the Solicitor General, the amount payable to Andersen Consulting, if the market value for their goods and services were paid, would have been approximately $4.1 million during the period of the SDSI agreement.

9.27 In addition to the foregoing clause for termination, the Province also held the ability to terminate the agreement "for convenience" on thirty days notice. Should the Province choose to terminate in this manner, the Province was required to pay Andersen Consulting 125% of the total of services rendered, expenses and "demobilization costs." The additional 25% was compensation for lost revenues or business opportunities to

Andersen Consulting during the term of the agreement. Based on information provided by the departments, these additional amounts could have been as high as $1.0 million.

9.28 The Department of Justice indicated that, had the Province chosen to litigate its severance from Andersen Consulting, the cost to the Province might have ranged from $1.5 to $2.0 million over three years or more. This cost excludes any estimate for liability to Andersen Consulting as a result of the litigation. There is considerable uncertainty as to the outcome of litigation.

9.29 It is important to note that under the original (SDSI) agreement termination clauses, the Province's final payments to Andersen Consulting would still result in the surrender of intellectual property rights to Andersen Consulting for work carried out to date. These rights would likely have remained with Andersen Consulting since no contracted projects had yet been completed, delivered and accepted by the Province as anticipated by the agreement.

9.30 The $2.9 million paid to Andersen Consulting under the Termination Agreement and Release, resulted in the transfer of intellectual property rights to the Province of New Brunswick for work carried out to date.

9.31 Based on figures obtained from the departments, and given the circumstances at the date of the *Termination Agreement and Release*, we conclude that the payment of $2.9 million to Andersen Consulting resulted in a settlement that was significantly less than amounts billed for work completed. There is also evidence that other possible costs were avoided as a result of this settlement.

Response from the Department of Justice

9.32 *… the last sentence of the conclusion may understate the situation….. the conclusion could be revised to state that, "substantial additional costs, including litigation costs, were avoided as a result of this settlement."*

9.33 *I think it worthy to note that every effort was made by this Department to minimize additional costs associated with prolonged litigation to terminate our association with Andersen when it was recognized that the Program could not be completed as planned.*

Chapter 10
The Year 2000 Program

Contents

The Year 2000 Program

Background

10.1 In 1997, we conducted a project to determine the Province's state of readiness for the Year 2000 and the challenges it brings for the government's computer systems. Specifically, our Office reported on the Province's effort to address the Year 2000 programming problem. In our 1997 Report, we commented that insufficient resources may have been allocated. We reported that insufficient resources could prevent the Province's Year 2000 Program from being completed in time.

10.2 Our Office also found that the reporting mechanisms existing at that time did not allow regular, frequent and mandatory reporting to the Board of Management on the government's overall progress in meeting Year 2000 compliance.

Scope

10.3 As a follow-up to our 1997 comments, we conducted a short survey of government organizations (departments and agencies) which we audit. A total of twenty-two surveys were circulated. Respondents were asked to complete the surveys as at 31 December 1997. This was in order to give our Office a point-in-time perspective on the Province's progress in achieving Year 2000 compliance.

10.4 No verification has been carried out to validate the information supplied by these entities.

10.5 The results of our survey were made available to the Secretary to the Board of Management. This chapter reports on our survey findings as of 31 December 1997 as well as a September 1998 update from the Secretary to the Board.

Results in brief

10.6 The response from the Secretary to the Board of Management (Board) indicates that the Board now receives monthly verbal updates as well as full, written quarterly reports from the Department of Supply and Service's Corporate Information Management Services (CIMS).

10.7 The response from the Secretary to the Board indicates that all major application efforts are progressing as planned and that projected completion dates are within the target.

10.8 The response from the Secretary to the Board indicates that CIMS has recently established a Business Continuity Planning Unit designed to assist departments with their contingency planning. At

31 December 1997, our survey indicated a lack of contingency planning.

10.9 Government organizations are aware that the impact of the Year 2000 programming problem extends well beyond their organization's information technology branch or division.

10.10 Organization sponsors not only demonstrate a corporate outlook, but also have the ability to set priorities and allocate resources.

10.11 The Province of New Brunswick has implemented a standard set of criteria to evaluate its progress toward Year 2000 compliance: the Gartner Group's COMPARE methodology (COMpliance Progress And REadiness).

10.12 At 31 December 1997, our survey revealed that only fifty percent of government organizations had created formal, documented "terms of reference" for guiding managers and their year 2000 projects. Of those, one was found to reflect only software applications; hardware and embedded technology were not mentioned.

Frequency and timing of updates

10.13 At 31 December 1997, only twenty-eight percent of those responding had updated their senior managers on progress toward Year 2000 compliance. Fifty-five percent of surveys indicated that updates may be occurring no more than once per year.

10.14 This reinforced our Office's previous position. A mandatory reporting mechanism should be in place to provide senior managers (including the Board of Management) with regular and frequent information on the Province's progress towards Year 2000 compliance.

Response from the Secretary to the Board of Management

10.15 *I agree it is important for Board of Management to be kept appraised of the state of readiness of the Province in meeting Year 2000 compliance.*

10.16 *Board of Management receives not only the regular Quarterly Reports presented by the Program Management Office of the Department of Supply and Services detailing departmental progress but also monthly verbal updates to ensure that any problems associated with funding or the progress of an initiative are quickly addressed.*

10.17 *Exception reporting is also requested when the Board requires further information on a specific department or application. In addition, the Information Technology Strategic Steering Committee (ITSSC) of Deputy Ministers has been mandated to monitor the ongoing progress of the Year 2000 initiative.*

Funding of Year 2000 programs

10.18 Year 2000 experts have stated unequivocally that the scarcity of qualified personnel will continue. As these resources become more scarce, costs will increase dramatically. Lack of immediate funding could increase the total cost of Year 2000 programs.

10.19 Most importantly, however, delays in any government organization due to funding may in fact extend the expected implementation and testing dates for mission-critical systems beyond the deadline. Business interruptions may result.

10.20 Our survey suggested that three organizations (or seventeen percent) suffered delays in the Year 2000 Program initiatives due to insufficient funding.

Response from the Secretary to the Board of Management

10.21 *The latest verbal report assured the Board that all major application efforts were progressing as planned and that projected completion dates are within the target.*

10.22 *The Project Management Office and Departments have been directed to take what action is necessary to solve the Year 2000 problem within the following guidelines:*

1. *Focus existing resources whenever possible. Establish priorities.*

2. *After reviewing priorities, and the dollars available, departments requiring additional funding will present their requests to the Board.*

10.23 *Board of Management wants to ensure Departments do everything in their power to fund the problems themselves, but when it becomes clear additional funding is necessary that funding will be provided.*

Contingency planning

10.24 Our surveys of 31 December 1997 indicated that approximately thirty-three percent of government organizations will not implement their mission-critical systems until at least mid-1999. For some of those reporting, the deadlines appear to be very tight. There is little, if any, margin for contingencies which might delay full implementation of mission-critical systems.

10.25 Our surveys also revealed that only one department had developed a contingency plan for the eventuality that affected systems will not function, or function properly, when the deadline is reached. Seven departments (or thirty-nine percent) reported that staff had been assigned to deal with this issue. However, at least three of these staff were assigned to this task on a part-time basis.

10.26 Based on the results of our surveys, we found a lack of contingency planning and this concerned our Office. Should the repair, development or acquisition of these systems suffer any

significant delays or should they fail when implemented, it may be too late to prevent interruptions in the business of the organizations. The federal Task Force Year 2000 recommends that contingency plans should be completed between mid-1998 and mid-1999.

Response from the Secretary to the Board of Management

10.27 *The Program Management Office [PMO] has been expanded and has established a Business Continuity Planning Unit. This Unit is available to assist departments with their contingency planning.*

10.28 *In fact, the PMO has been advising departments in the issue of risk management, especially in Mission Critical areas and this Unit will provide support and information to departments to conduct this effort by developing a detailed guideline on Year 2000 Business Continuity Planning.*

10.29 *In addition, this Unit will manage the formation and subsequent activities of corporate Year 2000 emergency response teams for the final days of 1999 and the first days of 2000. There will be one plan for corporate issues and one to support departments. Departments will also be assisted in the formation of departmental Year 2000 emergency response teams.*

Sponsorship of the Year 2000 Program

10.30 Last year, our Office concluded that responsibility for planning, implementation and testing of Year 2000 compliant systems resides solely within government organizations. It is therefore imperative that all organizations demonstrate their understanding of, and commitment to, this initiative.

10.31 The federal Task Force Year 2000 makes the following statement in its report, *A Call to Action*:

> *When first confronted with the Year 2000 problem, the reaction of most business executives is to rely on their information specialists to come up with a relatively short process leading to a reasonably simple solution. But as they begin to look into the problem, it becomes apparent that this is a much more complicated, serious and expensive problem than they had originally thought. They also soon realize that the solution requires the involvement of every facet of a corporate operation. It is a critical business challenge.*

10.32 This concept applies equally to our government's Year 2000 Program. The level of organizational sponsorship should be a reflection of the importance of the Year 2000 programming problem to the everyday business of government organizations.

10.33 Based on the results of our survey, our Office found that seventy-eight percent of organizational sponsors held Administration, Finance or other corporate-oriented positions as opposed to

information technology positions. This indicated organizations were aware that the impact of the Year 2000 programming problem extends well beyond their information technology branch or division.

10.34 Commitment to the Year 2000 Program would be demonstrated if organizational sponsorship responsibility has been given to those who are in a position to influence the setting of priorities and the allocation of resources.

10.35 Our survey found that fifty percent of organizational sponsors held the position of Deputy Minister or Assistant Deputy Minister (and equivalent). A further twenty-two percent held the position of Executive Director. Based on these results, our Office can conclude that most organizational sponsors not only demonstrate a corporate outlook, but have the ability to influence and allocate resources.

Progress in meeting Year 2000 compliance

10.36 In response to the concerns expressed in our 1997 Report, the Corporate Information Management Services (CIMS) of the Department of Supply and Services stated that they endorsed a process which provides timely and appropriate information to the PMO. This information would be compiled for regular reporting to the Information Technology Strategic Steering Committee (ITSSC) and the Board of Management (BOM).

10.37 The proposed methodology was the Gartner Group COMPARE (**COM**pliance **P**rogress **A**nd **RE**adiness) methodology. The COMPARE methodology provides a set of standard criteria to evaluate progress toward Year 2000 compliance that can be used by many types of organizations, including the Province and its departments.

10.38 The response from the Secretary to the Board indicates that the COMPARE methodology will be used in future reporting to reflect the Province’s current state of readiness.

Year 2000 project management

10.39 The Year 2000 deadline is inflexible. Given increasing scarcity of resources like time, qualified personnel and money, it may be prudent for departments and other organizations to put aside other information technology or business initiatives and focus primarily, if not solely, on the Year 2000 Program to ensure that it is completed in time. Additional full time personnel may be required.

10.40 Even if sufficient personnel are obtained, they must have clear direction on what is to be accomplished. Project managers and staff must deal with a multitude of conflicting priorities, deadlines and budgets in meeting Year 2000 compliance. Even the definition of “Year 2000 compliance” is subject to some debate. Organizations must create and document adequate “terms of reference” which will guide the managers and their projects. This kind of mandate gives project managers the authorization to achieve the necessary result within a specified area of responsibility.

10.41 Without such a key piece of planning being documented, the implementation of Year 2000 programs may suffer. The worst case scenario is that a mission-critical part of the organization may be missed entirely.

10.42 Our survey as at 31 December 1997 revealed that only fifty percent of organizations had created formal, documented "terms of reference" for guiding managers and their year 2000 projects. Of those, one was found to reflect only software applications; hardware and embedded technology were not mentioned.

Chapter 11
Other Departmental Audit Work

Contents

Other Departmental Audit Work

Background

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

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

Scope

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

11.4 We take a similar approach to our testing of the Province's pension plans. Our objective in doing this work is to reach an opinion on the financial statements of each plan.

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

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

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

Results in brief

11.8 At the time of writing this Report, expenditures of $76.8 million in the 1997-98 year have not been approved by the Legislature nor by the Board of Management.

11.9 The Department of Human Resources Development transferred money to the Rural Experience Program without clear authority to do so.

11.10 We continue to have concerns about the adequacy of provisions for possible losses on accounts receivable for consumption taxes and property taxes.

11.11 Payroll documentation in employees' files is inconsistent and often incomplete.

11.12 Year end settlements for hospital corporations and nursing homes for the 1996-97 year were still incomplete at the time of writing this Report.

General expenditure test results

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

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

11.15 We noted the following deficiencies in our 1998 audit of expenditures:

- individuals who were not on an approved signing authority list but who authorized a document, or who exceeded their authorized spending limit (7 items);
- no evidence that goods were received (1 item);
- insufficient documentation to support payment (1 item);
- payment made in error (1 item);
- documents not signed or initialled to indicate accuracy or approval (3 items);
- differences between amounts recorded and the back-up documentation on file (2 items); and

- possible violations of the Public Purchasing Act regarding tendering (3 items).

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

Legislative approval of the Province's expenditures

11.17 The Province's expenditures are approved each year by the Legislative Assembly. In addition to the initial approval of Main Estimates there can be supplementary estimates passed during the year when the Legislature is in session.

11.18 Expenditures incurred during the year that exceed the approved levels can also be authorized by special warrants. They normally follow a sequence that sees approval by the Board of Management, by the Lieutenant Governor in Council and then, when the Legislature is next in session, approval by the Legislature itself. Such a sequence is in compliance with the provisions of the Financial Administration Act.

11.19 From an audit perspective we have a concern with the process. When our annual Report is issued each year, the Legislative Assembly may not have approved all expenditures incurred in the year under review.

11.20 The Financial Administration Act states the following:

When

a) the legislature is not in session,

b) expenditures not foreseen or provided for by the legislature are required urgently for the public good and

c) the Board of Management approves,

the Lieutenant-Governor in Council may order a special warrant prepared, to be signed by the Lieutenant-Governor in Council, authorizing payment out of the consolidated fund of the amount included in the special warrant.

When a special warrant has been issued pursuant to this section, the amounts appropriated thereby shall be submitted at the next ensuing session of the Legislature by means of a special Appropriation Act for the amounts so appropriated in each fiscal year.

11.21 At the date of our Report, the approval process is not fully in compliance with legislation. We are required under the Auditor General Act to report such examples of non-compliance.

11.22 At the time of drafting this Report, expenditures of $76.8 million in the 1997-98 year have not been approved by the Legislature. In fact neither Board of Management nor the Lieutenant-Governor in Council had approved the amount at this date.

11.23 Last year we reported that there was a total of $26.8 million that had not received approval by either special warrant or by supplementary estimate at the time of our Report. Approval for the amount was later granted by the Legislature through a Special Appropriations Act on 26 February 1998.

Losses through fraud, default or mistake

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

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

Department of Human Resources Development
- Cheques cashed by persons not eligible to receive the funds.This loss is comprised of social assistance cheques that recipients reported lost or stolen $64,720

Department of Finance
- Loss of equipment $4,755

Department of Municipalities, Culture and Housing
- Theft of cash by employee $3,334

Department of Natural Resources and Energy
- Theft of cash by employee $2,493
- Loss of equipment $1,350

Department of Education
- Loss of equipment $2,700

11.26 Losses reported by our Office only include incidents where there is no evidence of break and enter, fire or vandalism.

11.27 The Province reports in Volume 2 of the Public Accounts the amount of lost tangible public assets (other than inventory shortages). In 1998, the Province reported lost tangible public assets in the amount of $172,111.

Department of Human Resources Development

Board of Management authorization exceeded

11.28 During our 1998 audit we noted that a transfer from the Department to the Rural Experience Program administered by the Regional Development Corporation (RDC) exceeded the amount authorized by the Board of Management. The Board of Management authorized a transfer of up to $4.9 million to RDC for the fiscal year 1997-98 for the Rural Experience Program, but the actual amount transferred was $5,981,274.

11.29 Under Section 13(2)(d) of the Auditor General Act we are required to inform the Legislative Assembly of any expenditure that "was made without authority". It is our opinion that the amount transferred in excess of the amount authorized by the Board of Management represents an expenditure made without authority.

11.30 We brought this matter to the attention of the Department. It is the Department's contention that they did not exceed their authority in transferring funds to RDC. In support of their position, the Department referred to various submissions made to the Board of Management.

11.31 Our opinion is that a Board of Management Minute should stand on its own as an authoritative document, and should mean what it says. If a Board of Management Minute incorrectly or incompletely describes the situation to which it refers, it should be rescinded and replaced. To our knowledge, this has not been done in this case.

Department of Finance

Consumption and property taxes

11.32 In our 1997 Report we stated our concern that "Consumption tax receivables are growing, and we have concerns about their collectibility."

11.33 Because of this concern we recommended the Department review its method of developing a provision for doubtful accounts. We wanted the Department to ensure it considers the age of the originating transaction and the ability of the taxpayer to pay in establishing its provision. We stated our intention to continue to discuss this matter with the Department during the current year.

11.34 We wrote the Department in February 1998 to continue that discussion. At that time we raised similar issues around the provision for doubtful accounts for property tax and the write-off of both consumption and property taxes.

Provisions for losses

11.35 We noted that the Department traditionally determined the provision for loss against consumption taxes receivable by specific identification of large accounts as doubtful and, by adding to that, 10% of the remaining balance.

11.36 However, we found many cases where the identification process did not take into account long outstanding receivables. In addition, we could not find any supporting rationale for taking a 10% provision on the remaining balance.

11.37 In our opinion, the traditional method used to determine the provision for doubtful accounts for property tax also had some serious weaknesses.

11.38 For instance, at 31 March 1997, the “Not-for-Profit” property tax provision was based on a flat rate of $200,000 per year for fiscal years 1990 to 1997. Historically, the Department also totalled all property taxes assessed since 1969 and added a small percentage of this total to the provision. Both calculations appeared to have little to do with the collectibility of the accounts receivable.

11.39 The Province’s Administration Manual states that:

> *The determination of an adequate level of provision for possible losses on loans and accounts receivable is based on the professional judgement of the Comptroller’s Office.*

11.40 We recommended that the Department of Finance and the Office of the Comptroller review and formally document a method for developing allowances and provisions for accounts receivable for both consumption taxes and property tax to ensure it reflects the Department’s collection efforts and the ability of the taxpayer to pay.

11.41 The Department responded:

> *The Department has attempted to establish what we feel is an adequate provision for losses with consultation and advice from the Office of the Comptroller. We have modified the methodology used to determine the allowance in order to reflect the impact of specific measures taken by the Department over the past two years which should assist with the collection of accounts.*
>
> *My staff will be working closely with the Office of the Comptroller to establish the 1998 provision expense as part of the current year-end accounting process.*

Write-offs

11.42 In our February 1998 letter we noted the Department had failed to write-off many accounts it had deemed to be uncollectable. The CICA handbook states:

> *An account or note receivable should be written off as soon as it is known to be uncollectable or should be written down to its estimated realizable value as soon as it is known that it is not collectable in full.*

11.43 The government’s administrative policy on Accounting for Revenue and Receivables directs that when a debt to the Province is deleted, a statement showing what steps have been taken to collect an account should accompany the write-off listing. This information must go to Board of Management and Cabinet for approval before the account can be written off. This forces the Department to be accountable for its collection efforts and exposes the debtor to the potential of public scrutiny. These are both important factors in maintaining the equity and accountability of the taxation system.

11.44 We recommended that all accounts currently flagged for write-off be submitted for write-off. In addition, all accounts that are not being actively pursued for collection should be written-off or written down to their net realizable value. In our opinion, to be defined as actively pursued, the account must have documented collection activities occurring in the last six months.

11.45 In reply, the Department stated:

To address the issue of write-offs, submissions have been prepared, which are currently before the Board of Management, requesting authorization to write off all consumption tax accounts deemed uncollectable as of December 31, 1997 and property tax as of May 31, 1996.

Property tax accounts have not been brought up to date at this time as we are awaiting the decision of the New Brunswick Court of Appeal with respect to a legal challenge of the legislative amendments of 1996, which could have an impact of the security position of the province in pending bankruptcy cases.

11.46 For the year ended 31 March 1998 we noted the Department wrote off $7.8 million in consumption taxes and $11.3 million in property tax no longer deemed collectable.

Payroll

11.47 The Province’s Administration Manual outlines the documentation requirements for employee files for regular departmental employees hired after 1 August 1993. The policy states:

The following documents must be completed by the applicant and returned to the department:

- *Acceptance/Non Acceptance card;*
- *Proof of age;*
- *Affirmation/oath of office; and*
- *TD1 form.*

11.48 Deficiencies were found in the documentation in employees’ files. We tested approximately forty regular employees who commenced after the effective date of the policy. Approximately 50% of the employee files were lacking one or more of the required documents. When asked to explain these deficiencies, payroll personnel across all departments replied with a common theme: payroll personnel ask for the required documentation, the employees fail to comply and there is little or no follow-up.

11.49 While the Administration Manual policy referred to above applies to regular employees, there are no similar requirements for casual employees' files.

11.50 Practice varied among the six departments tested. Three departments required only TD1 forms and oaths of office while two others requested the TD1 form only. The other department requested both the TD1 and a birth certificate.

11.51 From an internal control perspective, administration of casual employees tends to carry a higher risk than regular staff. This is due to the extensive short-term hiring that takes place. Establishing documentation requirements for casual employees would help to ensure that sufficient documentation is held on a consistent basis by all departments.

11.52 We reported our detailed findings to the departments involved. In addition, we informed the Department of Finance, which is responsible for developing government administrative policies. The Department of Finance pointed out that the staffing function has been delegated to departments, and it is their responsibility to ensure all documents are supplied by the new employee. However, the Department went on to say:

> *. . . staffing workshops for departmental staff are being planned by the Compensation and Staffing Policy Branch which would provide the forum for review of the required documents for a new hire. [We] will ensure that the importance of obtaining appropriate documentation is communicated to those planning the staffing workshops.*

11.53 The Department of Finance also agreed to revise the administrative policy dealing with temporary and casual appointments. The revision will give guidance to departments on the type of documentation to be obtained from causal employees.

Pension funds

Purchase of prior years' service through payroll deduction

11.54 When purchasing past service credits, eligible pension fund contributors have the option to buy through payroll deduction. The contributors are given up to the maximum number of months they are purchasing, to buy the past service credits. Therefore, at year-end, it is not unusual for there to be amounts owed to the funds. In past years these receivables and the corresponding revenues were not recorded on the financial statements of the funds.

11.55 We brought this matter to the attention of the Department, which provided an initial listing of amounts owing at 31 March 1997. Our testing of this listing suggested it might not be complete, and we requested and supervised the extraction of a subsequent listing. This also contained a number of inconsistencies, suggesting that the system producing the data might not be reliable.

11.56 We recommended the Department take the necessary steps to ensure that the data used to record the account receivable for past service contributions is complete and accurate.

Reciprocal transfers out Trust Funds 4 and 7

11.57 An error was discovered relating to the recording of reciprocal transfers out. An amount of approximately $161,000 was recorded as a payment from Trust Fund 4 (Public Service Superannuation Plan) when the amount should have been recorded as a payment from Trust Fund 7 (Teachers' Pension Plan).

11.58 We recommended the Department reconcile their records to the warrants prepared and the amounts recorded by the New Brunswick Investment Management Corporation, to ensure that the amounts recorded on the pension fund financial statements are complete and accurate.

Interest on refunds Trust Funds 4 and 7

11.59 The following response was provided last year by the Department when we raised the issue of errors occurring in the calculation of interest on refunds.

> *PSEBB [Public Service Employee Benefits Branch] has rectified the error in the program logic, which caused interest to be understated for certain individuals receiving refunds. In addition to the correction, the branch is taking measures to prevent the reoccurrence of such an error in the future, including the purchase of new software which will enhance the ability to conduct testing in program logic.*

11.60 This year we tested ten refunds and found one error in the calculations. The error was the same type (causing interest and the subsequent refund to be understated) as reported last year.

11.61 We recommended the Department take steps to ensure interest on refunds is being calculated correctly.

11.62 We have been recently notified that there are still people who have not been refunded monies owed to them because of the error in the program logic.

Department of Health and Community Services

Hospital Services and Nursing Home Services

11.63 The scope of this audit work was the recurring payments to hospital corporations and nursing homes.

11.64 Hospital corporations and nursing homes are required to submit audited financial statements to the Department by 31 July. The year-end settlements are done by the Financial Services branch shortly thereafter and are usually finalized by the fall.

Year-end settlements not done promptly

11.65 The year-end settlements for 1996-97 have still not been done for the hospital corporations and nursing homes. They are now one year late. Although accruals were made estimating the year-end settlements, these settlements should be done promptly so the accounting records can be finalized.

11.66 We recommended that year-end settlements for hospital corporations and nursing homes be done promptly each year.

11.67 The Department indicated that the delays in 1996-97 were related to the implementation of a new hospital financial information system and the inability to obtain necessary information from nursing homes.

Chapter 12
Hospital Corporation Governance

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Hospital Corporation Governance

Background

12.1 Promoting accountability is the most important part of our work. This is reflected in our own mission statement. We also believe that appropriate accountability cannot be established in Crown agencies unless effective governance structures and processes are in place and functioning. Therefore, in 1998, we continued our review of corporate governance and accountability by looking at the eight regional hospital corporations.

12.2 We chose to review governance and accountability arrangements in the regional hospital corporations for two main reasons. First, the boards of trustees of the eight regional hospital corporations are in charge of a budget of approximately $600 million, a significant portion of the total provincial budget. Second, we expressed concerns about a potential lack of accountability in our 1996 Report because regional hospital corporations do not appear before the Crown Corporations Committee.

12.3 It has been over five years since the regional structure was set up for New Brunswick hospital services. The governance structure has had time to develop and mature. However, the role of a board member remains a complex one. The July 1995 document prepared by the Department of Health and Community Services called “Hospital Corporation Accountability” states:

> *Since 1967, successive New Brunswick governments have developed accountability mechanisms which relate to the responsibilities of hospital boards. These mechanisms call for hospital administrators to be responsible, through their boards, to the Minister; and for the Minister to be accountable to the Cabinet and to the Legislative Assembly.*

12.4 It goes on to say:

> *Boards of hospital corporations face the difficult and delicate task of balancing the needs of residents with available resources. They must function within parameters set by the provincial government. The boards have no ability to increase funds allocated to them except by voluntary fund-raising (mainly for equipment purchases). They do not have the authority to collect taxes from residents of the regions they*

serve. Hospital corporation boards are responsible for allocating resources and do not directly control who is admitted and treated: that is the domain of doctors. Clinical/ Technical decisions with regard to the sick and injured are not made by boards, but by doctors and other health care personnel. The hospital system is extremely complex and not as predictable as the school system. Hospital corporation boards oversee medical staffs who must have wide discretion to admit, treat and discharge people in the government-funded system. This is fundamentally different than the school system, which has a predictable number of students it serves every year, as well as a pre-established curriculum. Hospital corporation board members receive no remuneration for their services. They are reimbursed for out-of-pocket expenses.

12.5 Governance for regional hospital corporations can be defined as the process and structure used to direct and manage the business and affairs of a corporation with the objective of achieving the corporate mission. The process and structure define the division of power and establish mechanisms for achieving accountability between management, the board of trustees, the Minister of Health and Community Services, and the Legislative Assembly. The direction and management of the business should take into account the impact on stakeholders such as patients, employees, and others.

12.6 Accountability can be defined as the obligation to answer for authority and responsibility that has been conferred. Regional hospital corporation management is accountable to their board of trustees. Boards of trustees are accountable to the Minister of Health and Community Services.

12.7 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;
- know and obtain the information they require to exercise their responsibilities;
- 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.

12.8 We feel that effective regional hospital corporation boards, as defined above, are in the best position to contribute to the success of their corporations. They do this by making informed decisions that take all pertinent factors into account, thereby promoting appropriate corporate activities.

12.9 Effective boards also create an important accountability link between a regional hospital corporation and the Minister. Hospital corporation boards that are serious about accurately assessing and communicating the degree of success of their corporations in achieving their missions must ensure that effective governance structures, processes, and accountability reporting arrangements exist to allow them to do this. This is important to the Legislative Assembly and the public because effective boards will be providing the information needed to determine the degree to which they have achieved their mission. On the other hand, when governance and accountability structures are weak, users must question the validity of assertions made concerning the results achieved by a hospital corporation.

Scope

12.10 Our objective for this project was as follows.

> *To gain an understanding of the governance arrangements relating to regional hospital corporations in the Province and to solicit the views of board members on certain issues impacting the role and effectiveness of hospital corporation boards.*

12.11 Our work included sending governance surveys to the one hundred and twenty-three current members of the boards of New Brunswick regional hospital corporations. A total of ninety-four board members responded to our survey. We also held extensive interviews with sixteen board members, including the Chair and one other member from each of the eight boards. We held discussions with representatives of the Department of Health and Community Services and the New Brunswick Healthcare Association (NBHA). In addition we reviewed the annual reports of the eight regional hospital corporations for the year ended 31 March 1997 and assessed their usefulness as accountability documents for the corporations. We also reviewed pertinent governance and accountability literature, and other documents pertaining to the New Brunswick health care system.

Results in brief

12.12 Board members devote a significant amount of time and effort to governing their corporations. The responsibilities they have been assigned under the current hospital services model are onerous, and very important to the proper functioning of the healthcare system in New Brunswick.

12.13 The appointment process for board members appears to be well defined and informally addresses perceived weaknesses in the skill set of boards as a whole. Better defining and documenting needed skill sets may help improve the screening of potential board members.

12.14 It does not appear that the election of any part of the regional hospital corporation boards would yield significant improvements in the quality or effectiveness of boards.

12.15 Most current board members were given orientation sessions when they were appointed to their board. However, a few either did not receive an orientation, or opted out of the sessions offered. We feel orientation sessions should be given to all new board members and should be mandatory.

12.16 Board members indicated some confusion as to the roles, responsibilities, and accountabilities of their regional boards. Position descriptions have not been prepared for individual board members, nor have roles, responsibilities, and accountabilities of boards as a whole been documented. We feel that such descriptions should be prepared.

12.17 In our opinion, regional hospital boards are directly accountable to the Minister of Health and Community Services alone. However, they are responsible to a number of different stakeholder groups including patients, staff, the public, and others.

12.18 All regional hospital corporations provide educational opportunities to their members. However, not all have developed a board education policy for members, nor do they have a requirement for certain core training to be completed by all members.

12.19 All regional hospital corporations have corporate mission statements and strategic plans. Most are updated on a regular basis. In some regions, board members are involved in the development of these plans. In others, they only approve them. We feel that corporate strategic plans should be updated on a regular, periodic basis. We also feel that boards, in order to provide strategic leadership, should be directly involved in the development of strategic plans.

12.20 Many of the regional boards have attempted to define, in writing, the division of responsibilities between the board and the CEO. A few have not. We feel that the division of responsibilities between the CEO and the board should be defined in writing for each regional hospital corporation.

12.21 The division of responsibilities between the regional hospital boards and the Department has been documented, but the

documentation needs clarification or enhancement, particularly in areas of policy-setting and decision-making.

12.22 The Department currently provides regional hospital corporations with annual operating budgets. To facilitate effective strategic and operational planning, we feel the Department should provide hospital corporations with long-range budgets. Boards should be given the opportunity to provide input into the long-range budgeting process.

12.23 Board members feel that the Department of Health and Community Services does not regularly communicate policy decisions and directives to the regional hospital corporations on a timely basis. They also feel that their input is not sought before decisions effecting their corporation are made.

12.24 Regional hospital corporations have not developed performance indicators that will allow for an objective evaluation of their success in achieving their corporate strategic goals. We feel that such performance indicators should be developed and annual targets should be set for each of them.

12.25 Currently, strategic planning is done at the impetus of the regional hospital corporations. We feel that the Department of Health and Community Services should require periodic strategic planning by each regional hospital corporation. The establishment of performance indicators and related targets should also be required by the Department. Additionally the Department should be approving all strategic plans, performance indicators and targets to ensure that they are congruent with departmental plans. We feel that management reporting to the board should be formally structured to provide comparisons between actual and targeted performance.

12.26 Regional hospital corporations appear to be doing a good job in disseminating information to stakeholders on day-to-day operations, changes in services provided, and other general matters.

12.27 The annual reports of the regional hospital corporations do not comply with the Province's annual report policy.

12.28 Regional hospital corporations do not currently appear before the Crown Corporations Committee or the Public Accounts Committee (PAC) of the Legislative Assembly of the Province of New Brunswick. The opportunity to ask questions about the operations of the regional hospital corporations is limited to the annual appearance of the Department of Health and Community Services before the PAC. We feel that the Chairs of the boards of the regional hospital corporations and their CEOs should appear before a committee of the

Legislative Assembly annually to answer questions relating to operational areas.

Detailed findings

12.29 In 1996, we did a general study of board governance among New Brunswick Crown corporations. At that time, we developed six criteria for use in evaluating the effectiveness of governance for public sector boards of trustees. While we will not be providing assessments against these criteria for this project due to its general nature, we will present our findings within a framework defined by those criteria.

12.30 We received an excellent response to our survey from board members. Additionally, we got valuable feedback from members whom we interviewed. They expressed concern about many important matters and we have tried to reflect those concerns in this chapter. We have attempted to summarize at least some of the most important points. Additionally, we have made recommendations where we felt improvements could be made in governance and accountability structures and processes.

12.31 In 1992, when hospital services delivery was regionalized, the Department of Health and Community Services prepared a set of model regional hospital corporation bylaws to be used by the hospital corporations as a starting point. We make reference to these bylaws from time to time in the chapter.

Board composition

12.32 The first of our governance evaluation criteria is as follows.

> *Boards of Crown Agencies should be comprised of people with the necessary knowledge, ability, commitment, and level of independence to fulfil their responsibilities.*

Appointment of board members

12.33 Regulation 92-84 of the Hospital Act, Section 5, states:

> *A board of trustees shall consist of a minimum of fourteen to a maximum of eighteen members. The members of a board of trustees shall be as follows: four voting members appointed by the Minister, three voting members appointed by the board of trustees, one voting member appointed by the religious order that owns in whole or in part a hospital facility operated by the hospital corporation, …, the remaining voting members selected or appointed in accordance with the hospital corporation by-laws.*

12.34 The Act goes on to state that no more than 40% of voting members may be from the largest urban centre in the region.

12.35 The exact composition of boards varies by region, but generally, local municipalities appoint about one half of the members. The appointments controlled by the Minister and the board are usually made after those of the local municipalities, and are used to fill in perceived deficiencies in the skill set of the board as a whole. It was indicated to us that there is a fair degree of cooperation between the Minister and the boards in making their appointments to the board.

12.36 Board members generally indicated satisfaction with the current role of their board in the appointment process. Overall, they felt that a board is in the best position to identify needed skills and weaknesses in the existing board composition. A small minority of board members did not feel that the board should be involved in appointing board members at all.

Election of board members

12.37 In 1997, the Standing Committee on Law Amendments recommended *"that the Department of Health and Community Services establish a process whereby the members who are currently appointed by the board are elected instead through a democratic process."* This would mean that three board members would be elected for each board.

12.38 We are not able to see the benefit of having regional hospital boards partially elected, as recommended by the Standing Committee on Law Amendments. Board members do not have the ability to raise revenues through regional taxation so they can not be held accountable by voters for spending public funds. Further, elected accountability for regional hospital corporations already exists through the Minister of Health and Community Services. Therefore, there appears to be no benefit in terms of accountability. Additionally, based on feedback from board members, the overall skill sets of the boards may be adversely affected by requiring the election of some or all of the board members.

12.39 The issue of the election of board members came up in many of the interviews and returned surveys. For the most part, board members indicated that they are opposed to the election of any of the regional hospital corporation board members. They are comfortable with the appointment process as it now stands, because it allows boards to fill in gaps in their skill sets through the use of board appointments.

Skill sets of board members

12.40 Board members believe that the current appointment process for members is effective in building well-rounded boards. Many of the boards have nominating committees for identifying potential new board members, but they are not provided with formal guidance on the type of people needed. Boards have not developed formal board member profiles that could be used in identifying potential new board members. In our opinion, board members' comments relating to this area point to the need to constantly be aware of the board's composition and weaknesses. We feel that the establishment of a model profile for new members would be of use. This would allow boards to narrow down possible choices for board vacancies, selecting the person who best meets the board's current needs. The model profile should be updated regularly to properly reflect the board's requirements.

Recommendation

12.41 We recommend that regional hospital corporation boards develop and maintain model profiles for new members in consultation with the Minister of Health and Community Services. These model profiles should be referred to by the board and the Minister in screening potential new board members. Such profiles should include generic requirements and should also attempt to reflect the special requirements of individual boards.

Board roles and responsibilities

12.42 Our second governance evaluation criterion is as follows.

Boards of Crown Agencies should have a clear understanding of their roles, responsibilities, and duties, and the accountability structure within which they operate.

Enabling legislation

12.43 We feel that enabling legislation should define the key roles of a board. A board's key roles would normally consist of linkage to the stakeholders including the Minister, preparation of governance policies, and assurance of management performance. Enabling legislation should not limit the ability of a board to fulfil its key roles.

12.44 The Hospital Act (Section 10(1)) states:

The objects and purposes of a body corporate established by this Act or the regulations are, subject to the provisions of this Act and the regulations,

- *to establish, operate and maintain hospital facilities, not for pecuniary gain but exclusively for charitable purposes,*
- *to deliver hospital services in the hospital facilities established, operated and maintained, or operated and maintained, by the body corporate,*
- *to engage in programs to train persons in the medical and allied professions, and*
- *to do such additional things as are approved by the Minister or prescribed by regulation.*

12.45 The board of trustees is therefore responsible for directing the corporation in these matters. The Department of Health and Community Services document, *"A Health and Community Services Plan for New Brunswick"* expands the regional responsibilities of the eight regional hospital boards to the following items:

- *organizing resources;*
- *establishing organizational structures to deliver all approved programs;*
- *planning, budgeting, managing and reporting on hospital expenditures and other financial issues;*

- *overseeing the medical credentialling process and approving hospital privileges for physicians within their respective regions on the recommendation of boards' medical advisory committees;*
- *onsuring all resources in the facilities are utilized effectively and efficiently;*
- *ensuring that approved hospital services are delivered following federal and provincial quality and efficiency standards;*
- *planning and distributing services as established through the Hospital System Master Plan;*
- *dealing with all day-to-day operational issues in relation to patient-care needs, as well as all issues regarding how, when, and where to deliver services to accommodate those needs;*
- *establishing the necessary hospital policies and procedures which facilitate the delivery of approved services;*
- *ensuring, on behalf of the government, that all entrusted buildings, equipment and land are used for the purposes for which they were received, and are well maintained; and*
- *maintaining on-going working relationships with other related care or service providers, government, and the public they serve.*

Bylaws

12.46 We feel that bylaws should clearly and concisely define all administrative aspects of a board's operations. Bylaws for regional hospital corporations are prepared or developed by the boards, but must be approved by the Minister of Health and Community Services before they come into effect.

12.47 We reviewed a set of "model" bylaws sent out to the regional corporations in 1992 by the Department of Health and Community Services to serve as a starting point. Each of the regional corporations has subsequently made amendments to its bylaws to reflect the circumstances in its own corporation. However, the Department informed us that the eight sets of regional bylaws are still, by and large, similar to the original "model" bylaws. Article 2 of the model bylaws addresses the roles and responsibilities of the board of trustees. It includes the following items.

> *The Board shall control and manage the business and affairs of the Hospital Corporation.*
>
> *Each Trustee, before taking office, shall accept in writing any mission statement approved by the Board and shall serve on the Board in accordance with the spirit and intent of the mission statement.*
>
> *Each trustee shall faithfully attend meetings of the Board. If the Trustee is absent from three consecutive regular meetings, his membership on the Board shall be automatically suspended*

pending a review by the Board. Upon review, the Board may either lift the suspension or remove the Trustee from the Board.

12.48 The duties of the Chairperson, the Vice-Chairperson, the Treasurer and the Secretary are also covered in the bylaws. Other administrative issues relating to the board, as shown in the model bylaws, are referred to in other sections of this chapter.

Orientation sessions for new board members

12.49 We feel that new board members should be provided with orientation sessions that make them thoroughly familiar with their roles and responsibilities, the current values and perspectives of the board they are joining, and the accountability structure within which they operate. Orientation sessions should also include a discussion of the mission and strategic objectives of the corporation, the environment in which it operates, and current issues of concern. All new board members should be required to attend orientation sessions.

12.50 Of ninety-four board members who responded to the survey question, *"After your appointment, did you receive an orientation?"* seventy-eight said they did. Fourteen said they did not, and two said they opted out of available orientation sessions. Topics covered included the following:

- board structure and operation
- roles and responsibilities as a board member
- conduct as a board member
- government policies and practices affecting the corporation
- the business operations of the corporation
- the relationship of the corporation to the Department of Health and Community Services
- background on the health care industry
- discussion of corporate strategic issues (mission, vision, strategic goals)
- information on the operations of specific departments
- general governance issues
- the accreditation process
- conflict of interest
- confidentiality
- risk management
- the board's relationship with staff and doctors
- legal liability/responsibility of the board
- long-range issues and planning
- organizational structure
- dealing with the media
- ethics

12.51 Almost all respondents indicated that the orientation session they received was useful to them.

12.52 Board members told us that for some boards, orientation is a formal program. For other boards it is more informal. In most cases it involves meeting with the Chair, the CEO, and other management staff. New board members are also provided with reference materials. The CEO normally coordinates orientation activities.

Recommendation

12.53 **We recommend that orientation sessions be given to all new board members and that attendance at those sessions be made a requirement of serving on the board.**

Board members' understanding of their roles, responsibilities, and accountabilities

12.54 It is very important that each board member understand their roles, responsibilities and accountabilities in order for that member, and their board as a whole, to be effective. Seventy of ninety-three members agreed that their board role was consistent with their expectations at the time they were appointed. Seventy-five of ninety-three agreed that they had sufficient information as to their duties and personal responsibilities as a board member. However, we did receive comments from members that indicated at least some of them are uncertain about their roles, responsibilities, and accountabilities. There also appears to be a great divergence of opinion regarding what hospital boards are trying to accomplish.

12.55 The majority of board members surveyed considered the following board duties as "very important."

- setting strategic direction and goals;
- selecting the CEO and evaluating their performance;
- setting significant policies by which the corporation operates;
- ensuring that the corporation has adequate resources;
- monitoring the achievement of goals and objectives;
- ensuring effective management information systems are in place;
- developing a communication plan for stakeholders;
- bringing an external viewpoint to the corporation's attention;
- evaluating the performance of the board; and
- ensuring accountability obligations are discharged.

12.56 There is an important distinction that must be made between responsibility and accountability. It is possible, and is likely desirable, that boards be responsible to a number of groups. However, a board may only be accountable to the individual or organization who conferred authority and responsibility on them.

12.57 When asked to whom they are responsible, most board members surveyed indicated they have multiple responsibilities. In order of preference, choices included:

- the patients of their own regional hospital corporation;
- the public at large in their regions; and
- the corporation itself.

12.58 The Department of Health and Community Services was mentioned infrequently.

12.59 Seventy-six of ninety respondents indicated it is clear to whom hospital corporation boards are accountable. The other fourteen indicated that it is not clear to them. However, differences of opinion emerged when we asked board members to whom they see themselves as accountable. Respondents indicated many different stakeholder groups. Eighty-eight board members indicated they are accountable to the Department of Health and Community Services (i.e. the Minister). Eighty-three indicated that they are accountable to the public in their own region. Sixty-seven indicated accountability to the corporation itself. Fifty-two indicated accountability to the government of the Province. Forty-six noted accountability to the public in the Province. Twenty noted other stakeholder groups to which they see themselves as being accountable. These include physicians, nursing staff, town councils, unions and native groups.

12.60 Responses to our survey and interview questions indicated to us that there is some confusion as to the roles, responsibilities, and accountabilities of the regional boards. When board Chairs were asked what they consider to be the major roles and responsibilities of their position as a Chair, they gave many diverse replies. We feel that each regional hospital board should create explicit position descriptions for each officer of the board and for individual board members. They should also prepare a roles, responsibilities and accountability description for the board as a whole. These documents should be relatively similar from region to region, but may vary slightly due to local circumstances.

12.61 We also feel that board accountabilities should be discussed, decided upon and communicated to new board members so that they will know to whom they are accountable. The current differences of opinion may result from a lack of understanding about what accountability means in the government context. Accountability is defined as the obligation to answer for authority and responsibility that has been conferred. Since authority comes from the Hospitals Act and through the Minister, it appears as though hospital boards should consider themselves as solely accountable to the Minister of Health and Community Services. While they are responsible to the public in their own region as providers of health care, they are not directly accountable to them. As we will discuss later in this chapter, there are formal mechanisms set up to ensure an appropriate accountability flow between the boards and the Department of Health and Community Services. The Minister of Health and Community Services is currently accountable to the public for hospital services in the Province under these mechanisms.

Recommendation

12.62 **We recommend that each regional hospital board develop clearly-stated position descriptions for individual board members,**

along with a roles, responsibilities, and accountability description for the board as a whole.

Board members' knowledge of the health care environment

12.63 Our third governance evaluation criterion is as follows.

Boards of Crown Agencies should develop and maintain sufficient expertise relative to the Crown Agency which they govern including a working knowledge of the environment in which the agency operates and the needs of its customers.

Developmental opportunities for board members

12.64 We feel that there should be an ongoing program to ensure that board members maintain and enhance their knowledge of the organization and issues related to its operation. This should include direct communication with all stakeholders. Unless board members develop and maintain a real understanding of the corporation's operations, they will be unable to recognize incipient problems or participate effectively in discussion about plans for the future. Quite simply, as one board member put it in their survey response, *"Board members have to be well-informed to be effective…"*

12.65 Of ninety-three respondents, eighty-eight indicated that they had been provided with developmental opportunities during the past two years. The large majority of respondents found these developmental opportunities useful. However, we received a lot of suggestions about training that would be of use. They covered areas such as medical terminology, ethics, conflict-of-interest, community needs assessment, corporate objectives, current issues in healthcare, planning, roles and responsibilities of board members, and policy-based governance.

12.66 We asked interviewees if they feel that the orientation sessions and ongoing training currently being provided are sufficient to allow them to properly understand and fulfil their responsibilities as board members. Most indicated that current orientation and ongoing training are sufficient. However, some seemed to indicate that members do not always take advantage of training offered.

12.67 While there is a fair amount of training available to board members, we feel it would be appropriate to have a more structured approach to the provision of this training. We would therefore recommend that boards develop an overall education policy for board members. This policy should be applied to ensure that all board members have sufficient knowledge about pertinent areas.

Recommendation

12.68 We recommend that all boards develop an education policy for their board members. Such a policy could include a requirement for certain core training to be completed by all board members. The policy should be reviewed and updated regularly.

Boards' involvement in strategic and policy issues

12.69 Our fourth governance evaluation criterion is as follows.

Boards of Crown Agencies should provide strategic direction to their Agency, along with a framework of corporate values and ethics within which management may operate.

Boards' involvement in strategic planning

12.70 A strategic planning exercise normally produces a corporate mission statement which summarizes the "raison d'etre" of an organization. It also involves identifying a corporate vision and values. Additionally, it involves identifying strategic objectives that, if achieved, will mean that the corporate mission has also been achieved. Strategies must be developed for achieving those objectives, the resources needed to carry out those strategies must be obtained, and performance indicators must be identified that will aid in determining how successful those strategies have been in achieving those strategic goals. Strategic objectives must therefore be both clearly defined, and measurable.

12.71 Eighty-four of ninety-three survey respondents indicated that the purpose of their corporation has been translated into a clear mission statement. Fifty-one of ninety-two members responded that divisional/ business plans are closely linked to the corporation's strategic plan. Thirty-seven respondents were unsure about this statement. Fifty-one of ninety-four also indicated that they feel that budgets reflect the priorities of the business/strategic plans and the corporate strategic plan. Twenty-two respondents were unsure about this statement and twenty-one disagreed with it.

12.72 Board members indicated that corporate strategic plans are updated as often as annually or as infrequently as every five years, depending on the region. Board involvement in the strategic planning process varies from region to region. Some boards are heavily involved in strategic planning through committees, board retreats, and other means. In other cases management does the planning and the board simply approves the resulting strategic plan.

12.73 We feel that strategic plans should be updated regularly, at least every three years, in order to keep them relevant in today's dynamic healthcare environment. We also feel that, in their responsibility as strategic leaders of the hospital corporations, boards should be involved in the development, as well as the approval of corporate strategic plans.

Recommendation

12.74 We recommend that corporate strategic plans be updated at least every three years. Boards should be involved in the development of these plans, not just in their approval.

Board decision-making

12.75 We feel that appropriate board decision-making should involve all members of the board. Board members should be informed about the organization and the environment in which it is operating. The majority of members (sixty-eight of ninety-four respondents to the survey) feel that board members understand their organization and the issues facing it, thereby facilitating the decision-making process. We did note, however, that twenty-six of ninety-four respondents felt that decision-making is complicated by the fact that some members represent special interests rather than the corporate interest. This indicates that some members may not clearly understand whose interests they represent on regional hospital corporation boards.

12.76 A large majority (eighty-five of ninety-four) of the board members answering the survey felt that their board receives the administrative support it needs to fulfil its role. Seventy-five of ninety-three respondents indicated that the board acts immediately when presented with clear evidence of a problem.

12.77 In our opinion regional hospital corporation boards should be careful not to become too involved in making or approving management-level decisions. In that area, they should restrict themselves to developing or giving its interpretations of board policy where they feel it is appropriate. Whatever means the CEO chooses to achieve strategic goals should not be questioned, provided they are within the guidelines suggested by board policies. This method of policy-based governance is proposed in the book *"Boards that Make a Difference"*, by John Carver. Many board members indicated they were familiar with this book.

12.78 Sixty-three of ninety-one survey respondents felt that the board does not become too involved in the day-to-day management decisions of the corporation. Fourteen felt that they do, and fourteen were unsure. This feedback indicates to us that at least some of the regional hospital corporation boards may be involved in making certain decisions more appropriately left for management.

12.79 When asked to what extent the respective decision-making authorities of the board and CEO had been clearly defined, approximately half of respondents indicated this had been done completely and the other half indicated that it had been done to some extent. It is important that the division of responsibilities between the CEO (i.e. the management) and the board (i.e. the direction) be clearly defined in writing in order that decisions be made by the appropriate party.

Recommendation

12.80 We recommend that the division of responsibilities between the CEO and the board be defined in writing for each regional hospital corporation.

Effect of Department of Health and Community Services involvement on policy setting/decision-making by the board

12.81 The extensive involvement of the Department of Health and Community Services in the policy-setting and decision-making processes for hospital corporations is a major issue for nearly all board members who provided us with feedback.

12.82 We asked board members what types of board decisions must go to the Minister or the Department for final approval. They indicated that the Minister sets the direction for hospital services. There is a hospital master plan that the regions had input into. The Minister approves new services, strategic plans, the roles of regional facilities, the addition of staff, budget levels, bed closures, hiring physicians, the purchase of capital equipment, the CEO's salary, the corporate by-laws, and other key decisions taken.

12.83 In our survey, we asked board members to respond to the following quotation and question:

> *Compared to private and non-profit boards, the Board of the Corporation faces a unique environment, characterized by having to share authority, responsibility and direction-setting with government bodies, and having to work within the ambiguities arising out of this complex mix. What kind of problems, if any, does this cause for your board?*

12.84 The following is a list of some of the responses provided by board members.

12.85 *Plenty! We get critical funding information much too late! Also, there is no global means of comparison with other corporations with respect to operating efficiency indicators and funding allocation appears not to reward those who exercise effective management control.*

12.86 *The perception that major decisions have already been taken by government before board input. The fact that the corporation does not have responsibility for the continuum [of] healthcare in the region.*

12.87 *There is a constant concern about budget deficits and patient care is our highest priority.*

12.88 *The board can not always make the decisions it wants because funding comes from elsewhere.*

12.89 *… We do not have the necessary authority to provide sufficient health care for the region.*

12.90 *Difficult to obtain the proper authority to hire and recruit a sufficient number of doctors.*

12.91 *We cannot be as entrepreneurial as one might wish. We can only advise the Minister and then wait for an answer or direction.*

12.92 *If we try and direct the corporation as a business many beneficial opportunities are missed waiting for 3rd party approval. Also, we are not funded for what we do.*

12.93 *It's never clear whether the board has ultimate financial authority or not. Where "Push comes to shove" the government usually comes through with money to cover our expenditures.*

12.94 *The board is a "front" for government officials and bureaucrats. The board is expected to implement or rubber stamp government policies, programs, and decisions.*

12.95 *… Very difficult to maintain a plan and stay on budget with government constantly making changes.*

12.96 *Long-range planning hard to do, harder to implement. Inability to control our destiny.*

12.97 *… Contract negotiated and signed in Fredericton, regions have to live with settlements and may not receive funding. Too much control out of region.*

12.98 These responses indicate a fair deal of frustration on the part of board members. We note from these comments that there may be a tendency on the part of the Department to try to make all significant decisions, thereby slowing down the policy-setting and decision-making processes. This may be due to tight budgets, but it creates uncertainty and a feeling of powerlessness among board members.

12.99 We also asked what kind of changes the board members would propose to improve the problems identified above. Board members provided us with many suggestions.

12.100 *The corporation should be given enough money to run it properly not having to run to government and beg for money.*

12.101 *Three year budget in order to do long-range planning.*

12.102 *Boards should have control over own funding and expenses, hiring should be set at board level, not by practitioners, control to be in each hospital and make them accountable.*

12.103 *Decentralize decision-making power so as to induce action and to create an environment of belonging and participation at the local and regional level … not the opposite.*

12.104 *Allow the board to make the decisions they see fit and are able to function with financially. Some government decisions force our board to take the heat for decisions made beyond our control.*

12.105 *The Health Act must be changed to truly empower the board to function in accordance with the responsibilities it has been assigned.*

12.106 *Greater authority over complementary delivery components…e.g. physician, nursing homes. This is the integrated model of health care.*

12.107 *Establish a wellness coefficient for the Province. Allow each region to meet that level. Reward those that come close to the coefficient by increasing their budget.*

Recommendations

12.108 We recommend that the Department of Health and Community Services, in consultation with the regional hospital corporations, clarify and document the roles and responsibilities of regional boards and Department vis-à-vis policy-setting and decision-making.

12.109 We recommend that the Department provide the hospital corporations with long-range budgets in order to facilitate board strategic and operational planning. Boards should be given the opportunity to provide input into this long-range budgeting process.

Communication of Department of Health and Community Services' policies and directives to regional hospital corporations/boards

12.110 Many comments from board members identified the need for improved communications between the Department of Health and Community Services/Minister and regional hospital corporations/boards. Board members indicated that many decisions are made at the last minute and without regional consultation. They also expressed the belief that the Department does not seem willing to listen to the concerns of boards nor deal with those concerns on a timely basis.

12.111 The board Chair deals directly with the Minister and occasionally has meetings with members of the Department of Health and Community Services. Board members occasionally meet with the Minister. The CEO and corporate management deal with departmental staff. Some board members noted that there are some communication difficulties between departmental and corporate staff. Our impression from feedback we received is that while communication between the Minister and board Chairs is good, other communication between the Department, and the regional corporations/boards could be improved.

12.112 When asked if there is sufficient coordination between the corporations and the Department of Health and Community Services, thirty-four of ninety-one survey respondents indicated that there was not. An additional thirty-three respondents were unsure. Only twenty-four agreed that there is currently sufficient coordination between the Department and the corporations. Twenty-six of ninety-one respondents also felt that the Department is not providing a consistent message to hospital corporations about government expectations.

12.113 From feedback provided by board members, it appears that the Department/Minister passes information on new policies and directives to the CEO and the Chair at about the same time. Operating information provided by the Department goes directly to regional management. There may be some regional variations in this process.

12.114 Interviewees noted that budget information, government policy changes, internal directives, and other information are regularly received from the Department/Minister by the board. However, many board members indicated that this information often comes through management.

Recommendations

12.115 We recommend that the Department develop more formalized mechanisms for obtaining the feedback of regional corporations/ boards with regard to policy decisions and directives being considered by government.

12.116 We also recommend that the Department strive to improve its timeliness in communicating policy-decisions and directives to the regional corporations/boards.

Departmental involvement in the strategic direction of the regional hospital corporations

12.117 As already discussed, the Department is heavily involved in policy-setting and long-term planning for hospital services. In our opinion, the Department should be ensuring that regional hospital corporations have up to date mission statements and strategic plans. The Department should assess those mission statements and strategic plans to see that they are in line with departmental plans and approve them prior to their adoption.

12.118 We feel it is very important that the Minister/Department provide sufficient up front information to allow corporations and their boards to prepare appropriate strategic plans. In our survey fifty-three of ninety-four respondents agree that the Minister of Health and Community Service's expectations as to the corporation's strategic direction have been provided to the board. Forty-nine of ninety-two thought that the corporate strategic plan had been approved by the Minister of Health and Community Services. However, only thirty-one of ninety-three respondents agreed that the Minister of Health and Community Services has identified specific performance targets that he expects the Corporation to achieve.

Recommendation

12.119 We recommend that the Minister/Department review and formally approve the strategic plans of the regional hospital corporations before they are adopted.

Governance information used by boards

12.120 Our fifth governance evaluation criterion is as follows.

> *Boards of Crown Agencies should monitor the performance of the corporation to assure themselves that strategic plans are being followed, that board policies have been complied with, and that executive limitations have been respected. Where necessary, boards should take action to correct deficiencies.*

Monitoring of management by boards

12.121 We asked board members how they determine whether the corporation is doing a good job. Board members indicated that they make this evaluation in various ways. Most involve looking at reports prepared by management.

- They look at various reports to determine how well their regional corporation is doing in relation to the strategic plan. (Some board members mentioned that their boards are trying to develop performance indicators.)
- They look at negative public feedback and complaints.
- They look at budget versus actual financial results.
- They look at the results of the accreditation process.
- They assess overall corporate performance during annual board retreats.
- They consider the results of patient surveys.
- They request presentations relating to specific sections of the hospital operation.

12.122 We feel that each corporation should develop its own set of performance indicators that are tied to its strategic objectives. Annual targets should be set for these indicators and actual results should be compared against these targets in reports provided to the board by management. The Minister should require each corporation to develop these performance indicators and targets and approve them. Other reports to the board should address the degree of compliance with board policy, or the education of board members. In fact, many of the reports would contain information similar to that indicated above. The reporting format would simply be more formalized.

12.123 As one board member said:

> *We need to provide better definitions of services being provided by a corporation, better measures of the resources needed to provide that service, and then establish realistic funding formulas to ensure that the service is provided effectively. Coordination will then be needed of services between regions and incentives provided for effective use of provincial resources.*

Recommendations

12.124 We recommend that the Minister/Department require the regional hospital corporations to develop performance indicators for their strategic objectives and set annual targets for each performance indicator identified. The Minister should approve these performance indicators and targets. The Minister/Department should also consider setting standard performance indicators for all regional corporations where considered appropriate. These could be used for comparative purposes.

12.125 We recommend that management reporting to the board be formally structured to provide comparisons between actual and targeted performance. Additionally, some reporting should address management compliance with board policies and the education of members. Such reporting should be provided on a regular, periodic basis.

Board external reporting

12.126 Our sixth governance evaluation criterion is as follows.

> *Boards of Crown Agencies should ensure that sufficient, relevant information is reported to Government and the Legislative Assembly, through the Minister responsible, to allow the assessment of the success of the Agency in meeting its strategic goals and satisfying its mission.*

12.127 Fifty of ninety respondents to the survey indicated that their board has developed guidelines on the information to be provided to each group it accounts to. Fifty-two respondents felt that the information provided is sufficient to allow an evaluation of how well the corporation has performed.

Public reporting/liaison

12.128 Board members indicated that most of the regional boards have an external communication policy or are in the process of developing one. In general, external communications are handled by the Chair, the CEO, and an assigned communications person from corporate staff.

12.129 Board members identified many stakeholders with which their board has important relationships. These included the Minister, the Department of Health and Community Services, local councils, other regional hospital corporations through the NBHA, hospital foundations, other health-care organizations (Victoria Order of Nurses, nursing homes, and others), boards of trade, Members of the Legislative Assembly, community leaders, service clubs, medical staff, etc.

12.130 In most regions, some of the board meetings are open to the public and media. Board meeting packages are provided to the media on these occasions. Boards also provide information to stakeholders through regional newsletters, the corporate annual report, community meetings, press releases, and employee bulletins. Operations reports and more detailed financial information are provided to the Department of Health and Community Services.

12.131 We noted in our review that at least one region does not hold public board meetings. We repeat the recommendation of the NBHA, "*That all NB hospital corporations move as soon as possible to open board meetings….*"

12.132 In our interviews we asked board members how performance information is communicated to major stakeholders. Interviewees most often mentioned the news media (through press releases), public meetings and regional newsletters. The annual report was mentioned only once by the sixteen board members we interviewed.

12.133 We also asked interviewees if they felt that information currently provided is sufficient to allow external parties to properly evaluate the degree of success of the corporation in achieving its mission and strategic goals. Ten of fourteen who responded felt that there was sufficient information provided. Four said that improvements could be made. One director thought their corporation should find a more systematic way of informing the public about corporate activities and suggested regular meetings with the public. Another noted that while their board was working on developing performance indicators, they had no plans to report against them externally.

12.134 There seem to be two distinct types of information to be provided to stakeholders. The first level involves day-to-day operations, changes in services provided, and other information of a general nature. Based on what we have been told, we believe that the boards are doing a good job in disseminating this type of information. The second level involves accountability information and will be discussed in the next section. Although some boards have started looking at this area, we feel that there are significant improvements that should be made to ensure that appropriate accountability information is provided to stakeholders.

Accountability information provided by the boards – annual report

12.135 In 1991, 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.*

12.136 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.*

12.137 The policy is applicable to Part III of the public service (i.e. the regional hospital corporations). Therefore, we undertook a brief review of regional hospital corporation annual reports for the year ended 31 March 1997 to see how well this policy is being complied with.

12.138 In general, we found that there are significant areas of non-compliance with the Province's annual report policy. A list follows.

- There is no discussion of the level of client acceptance of key corporate programs.
- There is no discussion of the continued relevance of key corporate programs.
- In all but two cases, corporate strategic objectives were not disclosed.
- None of the annual reports presented budget versus actual comparisons, and only a couple provided any information explaining why intended financial results had not been achieved.
- We were unable to identify any performance indicators that had been linked to the strategic objectives of the corporation. Some statistics were presented by certain corporations, but they had not been identified as performance indicators nor linked to specific strategic objectives.
- We noted the extensive use of photos in many of the annual reports. This is not permitted under the annual report policy. The policy in fact states, *"Annual reports are not normally to be used as promotional vehicles. When promotional activities are required, this will usually be accomplished through a separate publication."*
- We also noted that, in a couple of cases, the corporate mission statement was not presented.

12.139 As we mentioned previously, we feel that much of the information that would be required to report performance is currently available and being considered by boards. Providing such information through the annual report should allow all stakeholders to see which targets were met. The report should also provide explanations where targets were not met, and explain actions to be taken in future to improve performance. In certain cases, the board may feel that established targets are not achievable. For example, some board members indicated in their feedback to us that it is impossible to deliver defined services with the financial resources currently being provided by the Department. The annual report would be an appropriate place to make this observation, and back it up with objective information.

Recommendation

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

Board relationship with Crown Corporations Committee and Public Accounts Committee

12.141 Regional hospital corporations do not currently appear before the Crown Corporations Committee or the Public Accounts Committee (PAC) of the Legislative Assembly of the Province of New Brunswick. The opportunity to ask questions about the operations of the regional hospital corporations is limited to the annual appearance of the Department of

Health and Community Services before the PAC. Even there, the officials of the Department are not able to respond to detailed questions concerning hospital spending.

12.142 In 1995, both the Crown Corporations Committee and the Public Accounts Committee recommended that senior administrators or board members from hospital corporations be required to appear before them annually. This issue was also discussed in the Standing Committee on Law Amendments pursuant to a review of the discussion paper *"Hospital Corporation Accountability"* tabled in the House on 26 March 1996. That committee was divided on the issue of whether senior administrators or board members from hospital corporations should be required to appear before a legislative committee. The committee did agree, however, that a requirement for open meetings would ensure a means of public accountability. They therefore recommended *"that a period of public input and participation be included as a mandatory part of all regular and annual meetings of hospital corporation boards."*

12.143 The terms of reference of the Standing Committee on Crown Corporations state:

> *All annual reports of provincial agencies, boards and commissions stand permanently referred to the Crown Corporations Committee. For purposes of the Committee, provincial agencies, boards and commissions mean any provincial agency, board, commission or corporation*
>
> - *That is accountable through a Minister to the Legislative Assembly of New Brunswick for the conduct of its affairs; and/or*
> - *To which the Lieutenant Governor in Council makes some or all of the appointments: and/or*
> - *In which the Crown in right of New Brunswick is a majority shareholder.*

12.144 Regional hospital corporations are accountable through the Minister of Health and Community Services to the Legislative Assembly of New Brunswick for the conduct of their affairs. Therefore, we conclude that regional hospital corporations fall under the terms of reference of the Standing Committee on Crown Corporations.

12.145 Most representatives of the Department, the NBHA, and the boards of trustees of the regional hospital corporations that we talked to felt that the corporations should not appear before a legislative committee.

12.146 The former Minister of Health and Community Services made the following argument against regional hospital corporations appearing in a letter to the Crown Corporations Committee. *"Under the Hospital Act hospital corporations are accountable to the government through the Minister of Health and Community Services for the efficient, effective* *provision of quality hospital services within the approved budget and subject to established services."* He listed a variety of ways in which the Department monitors corporation operations, including financial and service reports, liaison with staff, regular meetings between the Minister and departmental staff and corporation board Chairs and staff, and assessment by the Canadian Council on Health Services Accreditation. He went on to say, *"In addition, the Auditor General annually reviews operational and financial statements, and the department establishes operational policies for corporations. The Canadian Council on Health Services Accreditation is exacting accountability from a corporation's board of trustees by requiring compliance with its standards. And many different avenues are used to ensure accountability to the government. Accountability to the community, however, is less prescribed. Of course, there is accountability through the courts and the power of the public media. Pre-determined selection criteria for recruiting trustees, their continuing education and performance evaluation are also helpful in dealing with the question of accountability."*

12.147 Other arguments advanced against the appearance of regional hospital corporations before the Crown Corporations Committee included the following:

- Public accountability is already being served through the Minister.
- It would provide a public platform for each corporation to advocate for more resources.
- It would provide for expression of potentially diverging, if not conflicting, interpretations of government policies and how they should apply. Each of the eight corporations would likely offer its own interpretation.
- It would result in officials circumventing their own board and the Department as well as the Minister in answering directly to the committee of the Legislature.

12.148 We agree that regional hospital corporations can only be held accountable for limited, mainly operational, aspects of the hospital services provided to New Brunswick residents. However, many of the arguments made as to why they should not appear before the Crown Corporations Committee could be advanced for any one of a number of New Brunswick Crown Agencies that appear before the Committee.

12.149 Regional hospital corporations are covered in the terms of reference of the Crown Corporations Committee. Also, they are generally responsible for making decisions in the area of operations that impact upon approximately $600 million per annum of health care spending. Many much smaller Crown corporations appear before that committee. Therefore, we feel that their appearance before the Crown Corporations Committee would be appropriate. As an alternative, a case could be made for their appearance before the PAC with the Department of Health and Community Services.

12.150 We gave consideration to suggesting that the Minister appear before the Crown Corporations Committee. This would reflect the reporting responsibility of the regional hospital corporations to the Minister, and the Minister to the Legislative Assembly. While there may be merit to this approach, we note that the practice has not been followed for either the Crown Corporations Committee, or the PAC. We are therefore not recommending any change in the established practice. We do feel however that it would be important for the Chair of each board to appear along with the CEO. The Chair would respond to questions with the assistance of the CEO. This would ensure that board accountability for performance is addressed.

12.151 Boards do hold regular public meetings. However, these meetings are generally intended to disseminate information about operations to stakeholders, and are not sufficient for formal accountability purposes.

Recommendation

12.152 We recommend that the Chair of the board and CEO of each regional hospital corporation appear annually before the Crown Corporations Committee. Discussions should be limited to operational issues and the corporate annual report. Policies set by the Department of Health and Community Services should not be covered. They would more properly be discussed with the Department of Health and Community Services at Public Accounts Committee hearings. As an alternative, the Chair and CEO of each regional hospital corporation could appear with the Department of Health and Community Services before the Public Accounts Committee.

Chapter 13
Fredericton - Moncton Highway

Contents

Fredericton - Moncton Highway

Background

13.1 On 22 January 1998 the Province, through the New Brunswick Highway Corporation (NBHC), entered into agreements with a private sector consortium (the Maritime Road Development Corporation) and a not-for-profit company (the New Brunswick (F-M) Project Company Inc.) to develop, design, build, operate, maintain, rehabilitate, and finance a toll highway between Longs Creek and Moncton. The most recent Department of Finance estimate of the total capital costs of the project including construction financing is $864.8 million. These capital costs include the $584.4 million fixed price contract with the Maritime Road Development Corporation, $119.9 million in Crown construction costs, $143.8 million in net interest costs, and $16.7 million in other costs.

13.2 The highway will be an approximately 195 kilometre, four-lane toll highway designated as a controlled access highway pursuant to the provisions of the Highway Act. Thirty-one kilometres of four-lane highway and nine kilometres of two-lane highway have already been constructed by the New Brunswick Department of Transportation (DOT). An additional thirty-one kilometres of two and four-lane highway sections that will form part of the highway are currently under construction by DOT. Construction costs relating to these segments of the highway are being transferred to NBHC as incurred and sold to New Brunswick (F-M) Project Company Inc.(Project Co). A total of $119.9 million in DOT construction work will have been sold to Project Co by the date of full traffic availability (i.e. the date that the highway is open for end to end use).

13.3 The highway is being built on land provided by DOT and transferred to NBHC. NBHC will lease this land to Project Co for a concession fee. Project Co will own the entire 195 kilometre highway and other improvements to these lands, including segments of the highway constructed by DOT. Project Co will sub-lease the highway to NBHC. NBHC is responsible for making the sub-lease payments to Project Co using funding provided by the Province. Under these agreements NBHC will be required to make sub-lease payments of principal and interest totalling approximately $1.514 billion. This amount will be paid through 49 equal semi-annual payments of $30.9 million, starting 30 November 2003.

13.4 We feel it is important that we look at this project because of the large commitment of public money that was made by the Province. This chapter is intended to give an overview of significant details of the project. Over the coming years, we will be looking at important aspects of the project, particularly in respect to value-for-money issues.

13.5 The following is a brief chronology of events relating to the Fredericton-Moncton Highway project.

- The project was officially announced on 14 June 1996.
- "Request for Qualifications" (RFQ) for the project was issued on 18 December 1996. The RFQ was intended to provide the Province with the opportunity to determine whether interested parties had the qualifications to undertake the project. Eighteen parties registered to obtain the RFQ.
- Five RFQ submissions were received by the 23 January 1997 deadline.
- By 25 February 1997, three of the applicants had been put on a shortlist for further consideration.
- On 27 March 1997 a Request for Proposals (RFP) was issued to the three applicants on the short list. RFP submissions were to be broken into three sections, and a deadline was set for each section. All technical submissions were received by 23 July 1997. All quality management plans were received by 6 August 1997. All financial, legal, economic and industrial benefits submissions were received by 22 September 1997.
- Seventeen evaluation teams were set up to review submissions as they were received. Members of these teams included forty-five provincial employees, two federal employees, and twenty-seven individuals from consulting firms. Consultants involved included KPMG (process), RBC Dominion Securities (financial feasibility study), Delcan (engineering), Goodman Phillips & Vineberg (legal) among others. Additionally, twenty-four individuals were called in as expert resources on an as-needed basis. More than 18,000 person hours were spent evaluating RFP submissions in a restricted-access evaluation room.
- On 20 November 1997, the Cabinet selected bidder "B", which was later disclosed to be the Maritime Road Development Corporation. Cabinet also authorized a negotiating team to finalize the project agreements with that organization.
- On 22 January 1998 final agreements were signed with the Maritime Road Development Corporation (MRDC). Terms of those agreements were announced publicly that day.

13.6 The projected date upon which the highway will be completed to the point of full traffic availability is 30 November 2001. There may be additional work to do after that date, but it is not expected to have any impact on the flow of traffic.

Scope

13.7 The objective of our review was to prepare an overview of the Fredericton-Moncton Highway project. The overview was to include information relating to the selection process, the organizations involved, the agreements, the toll rates, the financing arrangements, and provincial accounting for the highway project.

13.8 Our work consisted of meetings with representatives from the Department of Finance, the Department of Transportation, the Office of the Comptroller, and a private sector process consultant. We also reviewed the agreements and various other documents.

Results in brief

13.9 A toll highway will be built between Longs Creek and Moncton by the Maritime Road Development Corporation. It is scheduled to be available for end to end use by 30 November 2001.

13.10 The toll highway will be paid for and owned by New Brunswick (F-M) Project Company Inc. (Project Co). That company has issued long-term debt totalling $689.5 million to fund construction of the highway.

13.11 The land corridor on which the highway is built will be owned by the New Brunswick Highway Corporation and leased to Project Co for fifty years for a concession fee. During the first thirty years, the concession fee will be equal to toll and other revenues in excess of amounts needed to service the toll-based long-term debt issue. After year thirty, the concession fee will be $6 million per year in 1997 dollars.

13.12 The toll highway will be sub-leased from Project Co by NBHC for public use. NBHC will make forty-nine semi-annual sub-lease payments of $30.9 million starting 30 November 2003 under the highway sub-lease. These sub-lease payments will total approximately $1.514 billion and will be funded by the Province. Additionally, NBHC will be responsible for making operating and maintenance payments to Project Co over the first thirty years of the sub-lease. These payments will include $168.0 million (in 1997 dollars) in highway operating and maintenance payments over the first twenty years of the sub-lease and $39.2 million in tolling system operating and maintenance payments over the first ten years.

13.13 At the end of year thirty, and again at the end of year forty, NBHC will have the option of purchasing the toll highway from Project Co for fair market value. If NBHC does not exercise either of these options, it will purchase the highway for $1 at the end of year fifty.

13.14 We feel that the planned accounting treatment of the sub-lease had a major impact on the way in which the project was structured. The Province has accounted for the sub-lease agreement as an operating lease, which is in accordance with generally accepted accounting principles as defined by the Canadian Institute of Chartered Accountants. This allows the construction costs to be spread over the term of the lease. Had the sub-lease met the criteria for a capital lease, the full cost of construction would have been expensed when the sub-lease agreement was signed in the 1997-98 fiscal year. This would have had a significant impact on the Province's deficit or surplus over the near term, and also on the Province's compliance with its own balanced budget legislation.

Detailed findings

Selection process

13.15 The evaluation teams considered all aspects of the RFP submissions received from the three short-listed competitors. This included evaluating all technical submissions, all quality management submissions, and all submissions covering financial, legal, economic, and industrial benefits factors. The final decision was made by selecting the competitor who met all basic requirements and provided the Province with the lowest net cost. The Department of Finance also indicated that consideration was given to risk.

13.16 Exhibit 13.1 shows some of the key financial information that was evaluated in selecting the successful bidder.

13.17 Based on the RFP evaluations, MRDC (bidder "B" in the table) was selected. Reasons given for selecting that bidder included the following:

- Superior financial offer
  - lowest net cost to NBHC with consideration of risk
  - lowest guaranteed maximum price (construction)
  - excellent financing package
- Very strong financial capability
- Technically compliant
- Experienced developer/operator
- Best economic and industrial benefits package

Organizations involved

13.18 There are three main organizations that were party to one or more of the agreements for the Fredericton-Moncton Highway project. They are the New Brunswick Highway Corporation (NBHC), the New Brunswick (F-M) Project Company Inc. (Project Co), and the Maritime Road Development Corporation (MRDC). They are described in the paragraphs that follow.

Exhibit 13.1
Evaluation of bids
(all figures in millions of dollars)

	Bidder "A"	Bidder "B"	Bidder "C"	Department of Transportation Estimate
Construction price	$ 779	$585	$ 755	$ 758
Crown completed work	130	130	130	130
Interest costs	183	158	208	191
Other	30	19	37	14
Total capital cost of highway	$1,122	$892	$1,130	$1,093
Various net present value figures (1997 dollars)				
Net cost to Province of project	$870	$681	$852	$807
Revenue				
Tolling	$224	$206	$220	$210
Other	6	2	3	-
Total	$230	$208	$223	$210
Operating and maintenance costs				
Highway	$143	$100	$101	$114
Tolling infrastructure	31	30	24	22
Total	$174	$130	$125	$136
Economic benefit to New Brunswick (Wages and Salaries)	$270	$305	$275	-

13.19 The New Brunswick Highway Corporation (NBHC) is the Province of New Brunswick's direct representative in the Fredericton-Moncton Highway project. It is a provincial Crown agency that is the signatory for the Province in all agreements relating to the Fredericton-Moncton Highway project. As such, the Corporation is responsible for monitoring, controlling and administering those agreements to ensure that agreement terms are respected by other signatories and that provincial commitments are met. This includes ensuring that the construction of the highway and any required refurbishments are completed as required in those agreements. It also includes ensuring that the ongoing operation, management, and maintenance of the Fredericton-Moncton Highway are conducted in accordance with the agreement terms.

13.20 All monies owing to Project Co for sub-lease or maintenance payments will be paid through NBHC. NBHC will also own the land corridor on which the highway is being built and lease it to Project Co. Additionally, NBHC will collect all concession fees owed by Project Co. The Province is in the process of transferring all required land to NBHC.

Approximately seventy percent of the necessary land has been transferred to date.

13.21 The New Brunswick (F-M) Project Company Inc. (Project Co) is a not-for-profit corporation. Project Co will ensure that the highway is developed, designed, constructed, operated, maintained and rehabilitated according to the terms of the signed agreements. It will own the improvements, including the highway, constructed on NBHC's land and will lease the completed highway back to NBHC for public usage. Additionally, Project Co will collect tolls on the highway and pursue other highway-related revenue such as concession fees from restaurants and gas stations, utility right of way fees, and advertising revenues. It will also oversee the financing for the highway, issue debt and make payments to the toll and lease-based lenders, MRDC and the operator.

13.22 Project Co is directed by a Board of five members, two of whom were nominated by the Province, two by MRDC and one of whom was selected by the first four. The fifth member serves as Chair, under a renewable three-year term of service. The Chair may not be an employee of either the Province or the MRDC. Project Co has no direct reporting or accountability relationship with any provincial Minister. Any residual interest in Project Co will accrue to a charity selected by Project Co from a list provided by NBHC.

13.23 The Maritime Road Development Corporation (MRDC) is the consortium of thirty-seven companies that was the successful bidder on the project. Dragados FCC Internacional de Construccion, S.A., of Spain, Miller Paving of Ontario, and GTMI (Canada) of Quebec are the principal companies involved in this consortium. MRDC is responsible for building the highway in conformance with technical and other specifications included in the agreements. It will also be the operator of the highway for the first thirty years of the agreement.

Agreements

13.24 There are four key project agreements that were signed relating to the Fredericton-Moncton Highway. Exhibit 13.2 shows those agreements and illustrates the organizations who were signatories to them. The remainder of this section gives a summary of each agreement.

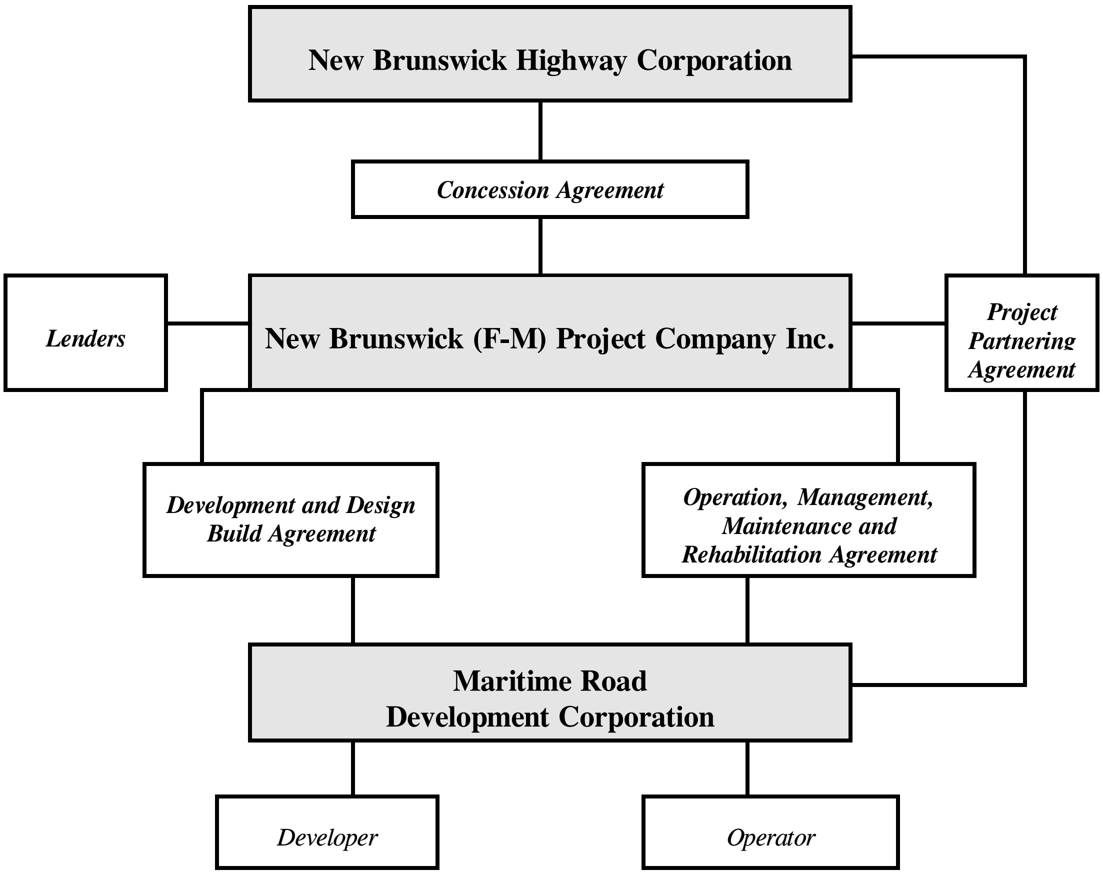
Project Partnering Agreement

13.25 The Project Partnering Agreement was signed by NBHC, Project Co and MRDC. It is a global agreement that covers such general areas as relationships and dealings between the parties, what constitutes acceptable contractual performance, allocation of risk between the parties, the expected level of quality of the project, costs and timing, law and regulations, the environment, and economic and industrial benefits.

Concession Agreement

13.26 The Concession Agreement was signed by NBHC and the Project Co. From the provincial perspective, it is the most important agreement. It covers a fifty-year period. However, upon completion of the initial thirty-year period, and again at the end of year forty, NBHC will have the option to cancel the agreement by acquiring the highway from Project Co for fair market value. Fair market value is defined as the present value of Project Co's projected net cash flows for the remaining years of the concession agreement. If NBHC does not exercise its right to buy the completed highway after year thirty or year forty, ownership reverts to the Province for $1 in year fifty.

Exhibit 13.2
Overall project organizational structure



13.27 The agreement covers, but is not limited to, the following areas:

- NBHC grants to the Project Co a concession to develop, design, build, finance, operate, toll, manage, maintain and rehabilitate a four-lane highway between Longs Creek and Moncton. The concession commences on 22 January 1998 and continues throughout the term of this agreement.

- It establishes the terms under which Project Co is to lease the necessary land corridor from NBHC. It also restricts use of these lands to the development, design, construction, operation, tolling, management, maintenance and rehabilitation of the four-lane highway.

- It establishes the concession fee that Project Co must pay to NBHC for use of the land. This fee is monthly excess revenues during the first thirty years of the concession agreement. Monthly excess revenues are the sum of toll and ancillary revenues received by the Project Co less the cost of servicing the toll-based debt. The Province has projected that these excess revenues will total $321 million over the initial 30 years of the agreement. Almost all of this excess will come from toll revenue. After year 30, providing NBHC does not exercise its option to buy the toll highway at fair market value, all toll revenue will be retained by Project Co. From that point until the end of the agreement term in year 50, a concession fee of $500,000 per month in 1997 dollars will be paid by Project Co to NBHC.

- It sets guidelines for the initial toll rates, the start of tolling, and increases in toll rates.

- It transfers highway segments already completed by DOT from NBHC to Project Co and establishes transfer pricing for uncompleted DOT work.

- It establishes Project Co as the owner of the toll highway.

- It establishes terms for the sub-lease under which NBHC leases the toll highway from Project Co for use as a public highway. It also establishes terms of sub-lease payments during the first 30 years of the concession agreement. Lease payments will commence after the highway is fully open and available for use.

- It establishes the requirement for NBHC to make monthly payments for highway operations, maintenance and rehabilitation costs during the first thirty years of the agreement. After year thirty, assuming NBHC does not exercise its option to buy the toll highway at fair market value, these expenditures will be borne exclusively by Project Co. Payments for operations, tolling and maintenance commence during the 1998-99 fiscal year.

Development and Design-Build (DDB) Agreement

13.28 NBHC signed the Development and Design-Build Agreement with Project Co and the principal companies involved in the MRDC consortium. The agreement requires the toll highway to be developed, designed and built by MRDC in accordance with specific guidelines, and for the Guaranteed Maximum Price of $584.4 million. It covers technical specifications, construction standards, environmental matters, timing of work, audit and inspection of work, and other areas.

Operation, Management, Maintenance and Rehabilitation (OMM) Agreement

13.29 The Operation, Management, Maintenance and Rehabilitation (OMM) Agreement was signed by NBHC, Project Co, the MRDC Operations Corporation, and the principal companies involved in the MRDC consortium.

13.30 The agreement covers the appointment of an independent agent, the work to be handled by the operator, reporting requirements and rights and duties of NBHC and the Project Co. It also covers the collection and disbursement of gross revenues, dispute resolution, and other areas related to the ongoing operations of the toll highway.

13.31 MRDC is responsible for the operations, maintenance and rehabilitation of the highway for the first thirty years of the agreement. During the first twenty years of the agreement NBHC is reponsible for making operating, maintenance and rehabilitation payments to Project Co based on a pre-set schedule attached to the agreement. Payments for the first twenty years of the agreement will total $168.0 million in 1997 dollars. Amounts to be paid for operations, maintenance and rehabilitation during years twenty-one to thirty will either be mutually agreed upon by the parties to the agreement or determined by binding arbitration.

13.32 MRDC is also responsible for operations, maintenance and rehabilitation of the tolling system for the first ten years of the agreement. Payments of $39.2 million in 1997 dollars will be made by NBHC to Project Co based on a pre-set schedule attached to the agreement. After year ten, Project Co will be responsible for renewing the tolling system operations, maintenance and rehabilitation agreement for five-year periods with either MRDC or another organization at an agreed upon fixed price.

13.33 Project Co has appointed Delcan Corporation to be the Independent Agent for the project. The independent agent's role, as specified in the Independent Agent Agreement (IAA), is to provide such services as progress measurement and certification of payments, quality auditing, and change management. The independent agent must regularly report to NBHC and Project Co with respect to its activities and findings. Independent Agent services will be paid on an hourly basis at rates established in the IAA to a maximum of $10.0 million, adjusted for inflation. The Independent Agent's contract ends on 30 November 2002.

Toll rates

13.34 Initial toll rates and the mechanism and limits on increases were set in the OMM and Concession agreements. Tolling of segments of the highway will commence as those segments are opened. Tolling of the Riverglade to Moncton section of the highway was to have been started effective 1 July 1998.

13.35 Initial maximum tolls at the date of full traffic availability are to be as shown in Exhibit 13.3. Annual increases after that date are to be no more than ninety percent of the increase in the consumer price index starting at December 2002 (i.e. one year after the full traffic availability date of 30 November 2001).

13.36 MRDC is responsible for tolling the highway in return for a fixed amount for the first ten years of its operation. After this initial ten-year term, Project Co has no obligation to renew the tolling arrangement with MRDC but it has an obligation to enter into an agreement with an alternate toll operator if it does not renew the tolling agreement with MRDC. Project Co will collect tolls on the highway and pursue other highway-related revenue such as concession fees from restaurants and gas stations, utility right of way fees, and advertising revenues.

Exhibit 13.3
Maximum tolls to first year after full traffic availability date

	Fredericton – Moncton	Longs Creek - Moncton
Passenger Car	$ 6.00	$ 7.00
Recreational Vehicle	$ 8.25	$ 9.75
Commercial Vehicle		
2-axle	$ 7.75	$ 9.25
3-axle	$ 11.50	$13.50
4-axle	$ 15.50	$18.25
5-axle	$ 19.25	$22.75
6-axle	$ 23.25	$27.50

Financing arrangements

13.37 Project Co issued debt to cover the long-term financing of project expenditures. The debt has been divided into two parts.

13.38 Part “A” debt (the toll-based debt) is repayable over a twenty-nine year period and will be repaid from the gross tolls collected from users of the highway and ancillary revenues. Toll-based debt totalling $149.5 million was issued on 22 January 1998 at interest rates of 6.74% and 7.14%. Toll and ancillary revenues have been assigned as security on the toll-based debt. The interest rates are between 0.58% and 1.00% above the 22 January 1998 provincial borrowing rate of 6.14%.

13.39 Part “B” debt (the lease-based debt) will be repaid from the payments made by NBHC under the toll highway sub-lease. Security for the Part “B” debt will comprise a pledge of the Province’s covenant to make the semi-annual lease payments under the sub-lease agreement, supported by legislation which makes these payments statutory appropriations. Lease-based debt was issued on 5 March 1998 giving proceeds of $540.0 million. The debt was issued at an interest rate of 6.47%. Principal and interest payments will commence on the lease-based debt in November 2003. The interest rate on this debt is 0.31% above the provincial borrowing rate of 6.16% that was in effect at the time the lease-based debt was priced.

13.40 All debt will have been repaid by the time the first thirty years of the concession agreement have been completed.

Provincial accounting for highway project

13.41 The sub-lease agreement is the agreement under which Project Co will lease the toll highway to NBHC for public use. The Province has determined that the sub-lease is an operating lease for accounting purposes rather than a capital lease. In completing our audit of the financial statements of the Province of New Brunswick for the year ended 31 March 1998, we evaluated the accounting treatment of the sub-lease agreement. The Canadian Institute of Chartered Accountants requires capitalization of a lease if one of the following statements apply.

13.42 *There is reasonable assurance that the lessee will obtain ownership of the leased property by the end of the lease term. Reasonable assurance that the lessee will obtain ownership of the leased property would be present when the terms of the lease would result in ownership being transferred to the lessee by the end of the lease term or when the lease provides for a bargain purchase option.*

13.43 The sub-lease term for the toll highway is thirty years. At the end of that term, NBHC may purchase the toll highway from Project Co at fair market value. Therefore, there is no bargain purchase option or other guarantee that NBHC will acquire the toll highway after the thirty year sub-lease period. The sub-lease is not a capital lease by this measure.

13.44 *The lease term is of such a duration that the lessee will receive substantially all of the economic benefits expected to be derived from the use of the leased property over its life span. Although the lease term may not be equal to the economic life of the leased property in terms of years, the lessee would normally be expected to receive substantially all of the economic benefits to be derived from the leased property when the lease term is equal to a major portion (usually 75% or more) of the economic life of the leased property.*

13.45 The estimated useful life of the highway has been estimated to be fifty years. The sub-lease term is only thirty years, or sixty percent of the total useful life. The sub-lease is not a capital lease by this measure.

13.46 *The lessor would be assured of recovering the investment in the leased property and of earning a return on the investment as a result of the lease agreement. This condition would exist if the present value, at the beginning Mof the lease term, of the minimum lease payments, excluding any portion thereof relating to executory costs, is equal to substantially all (usually 90% or more) of the fair value of the leased property, at the inception of the lease.*

13.47 We reviewed and agree with Department of Finance calculations showing the present value of lease payments to be in the range of eighty to eighty-five percent of the cost of construction. The sub-lease is not a capital lease by this measure.

13.48 It is obvious that the toll highway is being built for public use during the next fifty years and for no other purpose. We also feel that the Province’s commitment to make lease payments over a thirty-year period is not substantially different from a commitment to make debt payments to bondholders for thirty years.

13.49 Because the sub-lease has been accounted for as an operating lease, the Province is only required to show current year lease payments as an expense. Since there were no lease payments during the 1997- 98 fiscal year, no expenditure amount was shown. Additionally, the Province is not required to show the committed amount as a liability on its balance sheet. Total lease expenses will be spread over the thirty-year term of the sub-lease. On the other hand, had the sub-lease met the criteria for a capital lease, the Province would have been required to show the entire expenditure, recorded at the discounted value of future lease payments, in the year in which the sub-lease commitment was made. This would have meant an additional $709.8 million in expenditures being shown in the 1997-98 financial statements of the Province. It would also have had to show a liability for the same amount. Obviously then, the accounting classification of the sub-lease has a large impact on the ability of the Province to meet its balanced budget legislation.

13.50 We feel that the planned accounting treatment of the sub-lease had a major impact on the way in which the project was structured. Regardless, our primary concern is whether the way in which the project was structured gave the best value for money to the taxpayers of New Brunswick. We will be looking at this and other issues related to the toll highway project in the years ahead.

Future work

13.51 The stated objectives of the government of the Province of New Brunswick for the Fredericton-Moncton Highway are as follows:

- to improve safety for the travelling public;
- to ensure the development, design, construction, operation, management, maintenance and rehabilitation of the Fredericton-Moncton Highway meets or exceeds current Provincial standards;
- to ensure the development, design, construction, operation, management, maintenance and rehabilitation of the F-M highway is done in an environmentally responsible manner;
- to share the risks of the project between the private and public sectors;
- to obtain optimal value for money for the Province;
- to minimize the financial contribution of the Province to the project;

- to open the entire highway for safe operation by 30 November 2001 and to fully complete the highway by 30 June 2002;
- to defer payments by the Province for the project (other than on account of highway operations and maintenance) until after the opening of the completed highway;
- to maximize the economic and industrial benefits to the citizens and industries of the Province; and
- to provide a high level of service to the highway users at a low cost.

13.52 In the coming months we will be addressing many of these goals to determine if they have been accomplished, or are likely to be, within the parameters established by the agreements. Additionally, we will be pursuing answers to the following questions.

- Have substantial risks been transferred from the Province to private sector entities and, if so, was the consideration paid for those transfers reasonable?

- Did the issuance of long-term debt well in advance of the commencement of the bulk of the construction work have any positive or negative consequences on the Province’s cost?

- Is it reasonable that, in an arrangement where all lease-based and toll-based debt will be paid off by the end of year thirty, the Province is still required to pay fair market value to purchase the highway at the end of year thirty?

Chapter 14
Special Report for the Public Accounts Committee Evergreen and Wackenhut Leases

Contents

Special Report for the Public Accounts Committee Evergreen and Wackenhut Leases

Background

14.1 At the meeting of the Standing Committee on Public Accounts held on 1 April 1997, during the appearance of the Office of the Auditor General, the following motion was adopted by the Committee:

> *That the Auditor General undertake to review the financial terms of the Evergreen and Wackenhut leases and compare the total cost under the private sector arrangements as compared to traditional government methods.*

Evergreen School

14.2 The Evergreen School project (Moncton North School) was announced in March of 1994 as a project that would be developed through a public-private partnership. At that time, an architectural firm retained by the Department of Supply and Services had already started the design of the school.

14.3 In October of 1994, the Department of Supply and Services publicly advertised for expressions of interest in a public-private partnership for the construction of Evergreen. Five submissions were received. The Public-Private Advisory Committee, composed of individuals from the private sector and public sector, reviewed the submissions and recommended to the Minister of Supply and Services that all five developers be requested to submit proposals.

14.4 Proposals were received from the five developers by 7 March 1995 and evaluated by the Public-Private Advisory Committee on 6 April 1995 following interviews with each of the proponents.

14.5 The evaluations resulted in Greenarm Corporation of Fredericton being approved by Cabinet on 18 May 1995 to negotiate a development agreement from which a lease agreement would be finalized.

14.6 Negotiation parameters for the development agreement were as follows:[1]

- fixing the financing costs;
- accepting or rejecting alternatives to fix the final construction cost;
- accepting a lease agreement that equitably shares risks;
- committing the developer to creating a marketing plan that maximizes the revenue generation for after hours use of the facility; and
- fixing the buyout price at the end of the twenty-five year term.

14.7 The agreement with Greenarm was signed on 5 October 1995.

Wackenhut

14.8 The Department of Supply and Services issued, in September 1994, an invitation for expression of interest. This was for the designing, building, maintaining, financing, ownership, leasing back and program delivery for the Miramichi Youth Facility. The expression of interest submissions were evaluated and three proponents were invited to submit proposals. The evaluation of the proposals resulted in Wackenhut Corrections Corporation being chosen as the proponent with whom to negotiate an agreement.

14.9 On 14 June 1995 Board of Management approval was given to the Minister of Supply and Services to negotiate a development agreement with Wackenhut. The initial proposal was changed by a letter dated 6 October 1995 from Wackenhut whereby the program delivery would be deleted from the project.

14.10 A development agreement was negotiated and it included the following documents:

- purchase and sale agreement;
- plans and specifications;
- performance specifications for capital construction of young offender secure custody facility;
- construction schedule;
- lease agreement; and
- industrial benefits agreement.

14.11 The agreement with Wackenhut was signed on 20 June 1996.

Government evaluation process

14.12 The Department of Finance (Department) evaluated the two leases on an equivalent level of service basis. This means that the Province developed a generic model for each project. The generic model assumed that the Province would build, operate and finance each facility itself. It contained the same type of costs that the proponents would have to incur to meet the request for proposal requirements. To make the comparison

1. As per Memorandum to Executive Council

the Province included costs that may not be incremental such as legal, audit and overhead.

14.13 The purpose of the Department's analysis for each project was to determine which alternative would be the cheapest. Would it be cheaper to build, operate and finance by using the generic model, or would it be cheaper to enter into a public-private partnership? The Minister of Supply and Services made the following comment in the Legislature on 30 November 1994 "...the government has indicated that it would only do private-public partnership projects if they turned out to be cheaper, in the long run and in the short run than by building them themselves."

14.14 Further, the Executive Director of Budget Planning and Financial Services for the Department of Finance made some relevant comments at a Commercialization and Privatization conference in Ottawa on 21 and 22 September 1995. At that time he indicated there were a number of key outcomes expected from the two lease agreements and these were as follows:

- 7 – 15 percent saving on design and construction;
- capital financing to private partner very close to government long-term borrowing rate;
- improved level of service;
- major capital repair/replacement risk eliminated;
- increased use of traditional public sector resources;
- off-balance sheet accounting;
- efficient construction time frames; and
- long-term flexibility to government.

Scope

14.15 The Department of Finance, with the assistance of several other departments, prepared an analysis of each leasing project to evaluate the alternatives of leasing and owning. We reviewed the analyses prepared by the Department for the Evergreen and the Wackenhut leases and selected a sample of the components of the analyses for testing. The items chosen were discussed with staff from the Departments of Finance and Supply and Services. Those items that were considered reasonable based on a limited review were not pursued further. The remaining sample items were examined in more detail and we attempted to obtain appropriate evidence to support the information used. In many instances it was not possible to obtain verifiable evidence to support the estimates used by the Department in their analysis. As a result of our work we too made estimates, and where they were different than those used by the Province, we provide explanations.

Results in brief

14.16 Using the Department of Finance's own figures, the capital cost of the Evergreen School would have been $594,576 less had the Province done the work itself. Our adjustments increased the difference to $774,576.

14.17 The Department of Finance calculated operating savings, in the first year of operation of the Evergreen School, of $64,628 by engaging Greenarm. We believe that costs would have been approximately the same under either option.

14.18 We conclude that the total cost of the Evergreen School would have been less under the traditional method than under the private sector arrangement. The Department of Finance has not agreed with most of the adjustments we have made. However, using the Department's own figures, the most economical option would have been to construct and finance the school in the traditional way and contract with Greenarm, or another third party, to be responsible for operations. We estimate that the cost of financing alone is approximately $400,000 more by financing through Greenarm than by the traditional method.

14.19 The Department of Finance estimated a capital cost saving of $708,384 by engaging Wackenhut to construct the Miramichi Youth Facility.

14.20 The Department of Finance estimated operating savings, in the first year of operation, of $19,536 by engaging Wackenhut. Our adjustments have the effect of making Wackenhut more expensive by $51,073 in the first year.

14.21 We conclude that the total cost of the Miramichi Youth Facility would have been less under the traditional method than under the private sector arrangement. The Department of Finance has not agreed with most of the adjustments we have made. However, using the Department's own analysis, the most economical option would have been to have Wackenhut construct and operate the facility and for the Province to be responsible for financing. We estimate the cost to the Province of financing through Wackenhut to be $700,000.

Evergreen School

14.22 We examined the Department's analysis of each project in three parts: capital (construction), operating, and financing. We will discuss our findings under each of these headings and then offer an overall conclusion for each project. The first project that we examined was the Evergreen School.

14.23 The Province developed a generic model for the evaluation. This represented the Province's potential cost of meeting the same request for proposal requirements faced by the proponent. The model was developed from the design plans of the school.

Capital costs

14.24 Exhibit 14.1 compares the capital cost of construction, if the Province had done the work itself, to the costs negotiated with Greenarm. We have made adjustments to reflect what we believe to be a more realistic comparison of the two alternatives.

Exhibit 14.1
Capital cost of construction
Evergreen School

	Government's Generic Model	Greenarm
Land	$ 275,000	$ 275,000
Construction	7,354,835	7,299,018
Equipment	600,000	600,000
Soft costs (professional fees, interim financing, etc.)	1,045,000	1,808,847
Administration fee	50,000	
Issuance cost	63,454	
Total capital costs as determined by Department of Finance	9,388,289	9,982,865
Adjustments as a result of our review		
Construction contingency	(130,000)	
Administration fee	(50,000)	
Total capital costs, as adjusted	**$ 9,208,289**	**$ 9,982,865**

14.25 It is noted that the Province's own analysis indicated that they could construct the school $594,576 cheaper than contracting with Greenarm. Adjustments which we made as a result of our review have the effect of further reducing the estimated cost of construction, had the Province done the work in the traditional way. We will now examine some of the components reported in Exhibit 14.1.

Land

14.26 Land is included in the generic model at a cost of $275,000. This land was already owned by the Province and did not require an additional outlay of cash. The land was transferred to the proponent as part of the lease. The result of this is a sale of the land to Greenarm and a lease of the land back to the Province. The effect of this transaction is to borrow $275,000 at Greenarm's average interest rate of 9.065% and use the proceeds to reduce other government borrowing which would have incurred interest at approximately 8.787%. This is not an economic way to raise capital.

Construction

14.27 The generic model used a construction cost figure of $7,354,835. This amount was determined by using the estimate from the architectural firm of $6,874,712, and adding to that adjustments made by the Department of Supply and Services, based on that Department's experience in building schools. It was not possible to verify these adjustments. We did note, however, that $7,354,835 fell within the range of estimates received from the five proponents.

14.28 The generic model has a construction contingency of $210,000 as part of the construction costs. This contingency was provided in anticipation of there being design changes and other possible costs during construction. The design changes were anticipated due to a school design being used for the first time. Greenarm was constructing the school from the same design and the Province would have been responsible for change orders under the contract with Greenarm. A provision of $80,000 was factored into the Greenarm proposal. We have removed $130,000 of the contingency from the generic model to be consistent with Greenarm.

Administration fee

14.29 The Department of Supply and Services included as part of the capital costs an amount of $50,000 that was to represent the cost of having a departmental employee on site for the construction period. This is not an incremental cost unless the Department of Supply and Services hired a new employee. We believe the Department of Supply and Services already employed this person; therefore this amount would not be an increase to the Province's expenditures and should not have been included in the analysis.

Issuance cost

14.30 In the Province's generic model, the cost of issuing bonds was reflected as an additional cost of financing. Seven basis points were added to the Province's long term borrowing rate and used as the discount rate. To be more comparable to the private sector proposal, an amount of $63,454, approximately $0.70 per hundred dollars of the amount borrowed, could have been added to the capital costs and the discount rate reduced accordingly.

14.31 Including this amount as part of the generic model capital cost allows direct comparison of capital costs under the two models. This is a change in presentation only for the purposes of Exhibit 14.1; the net present value calculation does not change.

Opinion on capital costs

14.32 Exhibit 14.1 presents the capital cost used by the Department of Finance in preparing the analysis to evaluate the most cost-effective way of doing the project. By using the Department's own figures the capital cost would have been $594,576 less had the Province done the work itself. Our adjustments increased the difference to $774,576.

Operating costs

14.33 Exhibit 14.2 compares the operating costs, if the Province had done the work itself, to the costs tendered by Greenarm. We have made adjustments to reflect what we believe to be a more appropriate comparison of the two alternatives.

14.34 It is noted that the Province's analysis indicated that they could not operate the school, meeting the request for proposal requirements, cheaper than contracting with Greenarm. Our adjustments however have the effect of reducing the estimated operating costs to the Province under their generic model to the extent that there is really no material difference between the two options. We will now examine some of the components reported in Exhibit 14.2.

Exhibit 14.2
Annual operating costs
Evergreen School

	Government's Generic Model	Greenarm
Utilities and energy	$ 90,000	$ 89,000
Insurance	10,000	6,200
Legal and audit	5,000	
General maintenance and repairs	184,729	118,950
Capital reserve	73,548	15,000
Salaries and benefits	16,014	30,000
Administration	40,000	95,513
Total annual operating costs as determined by Department of Finance	419,291	354,663
Adjustments as a result of our review		
Utilities and energy	(1,000)	
Legal and audit	(5,000)	
General maintenance	(34,697)	
Capital reserve adjustment	(1,800)	
Administration	(25,420)	
Total annual operating costs as adjusted	**$ 351,374**	**$ 354,663**

Utilities and energy

14.35 The comparison of the utilities and energy cost between the generic model and Greenarm's did not use the same figure. The lease agreement states that the Province will pay the actual cost incurred so the amount should be the same in both models. The generic model was overstated by $1,000 per year.

Legal and audit

14.36 Some amounts shown as operating costs in the Province's generic model will likely not represent additional cash outlays. These amounts were included by the Province to meet the request for proposal requirements and in an attempt to make the comparison between the two alternatives valid. We do not believe these will be incremental costs and for this reason we have excluded them.

General maintenance and repairs

14.37 Within the estimated costs for general maintenance and repairs is an amount of $124,697 for cleaning. This amount was calculated by following the terms of the collective agreement with the cleaning staff. The Province however is not required to use that union contract to staff a new school. They have the option to contract out the cleaning similar to what the proponents did in their tender documents. For example, Greenarm factored in a cost of only $60,000 for cleaning as compared to the Province's $124,697. We feel that had the Province built the facility and contracted out the cleaning they could have conservatively obtained a tender of approximately $90,000, based on our review of the bids actually received. Therefore, we reduced the Province's generic model by $34,697 ($124,697- $90,000) to reflect a more realistic figure.

14.38 The lease agreement allows for an increase/decrease in the cleaning and maintenance portion of operating costs for years after the first year (base year). The Province pays any increase, or benefits from any decrease, in subsequent years' costs that exceed the base year's costs. There is a risk in that there is no limit on possible increases. The analysis did factor in an increase of 3% per year for years after year one, in cleaning and maintenance costs.

Capital reserve

14.39 The generic model includes $73,548, as an estimate of the amount that the Province would pay for minor and major repairs over the term of the lease period. This is calculated at 1% of construction cost. The provision of $15,000 under the Greenarm proposal is for minor repairs only. We understand, from the Province, that Greenarm has made adequate provision for major repairs within the administration category of expenditures.

Administration

14.40 The generic model included $40,000 to reflect how much it would cost the Province to open the school after hours for public use. We reviewed the breakdown of this amount and noted that only a portion of the estimate was incremental cost to the Province. A large portion, $25,420, was for overhead and we do not believe it is appropriate to charge such costs to the generic model.

Opinion on operating costs

14.41 Exhibit 14.2 presents the operating costs used by the Department in preparing the analysis to evaluate the most cost effective way of doing the project. We reflect our adjustments on the same exhibit. The Department calculated operating savings, in the first year of operation, of $64,628 by engaging Greenarm. We believe that costs would have been approximately the same under either option.

14.42 The annual operating costs as adjusted in Exhibit 14.2 show a slightly lower cost for the generic model. Exhibit 14.3 considers the whole lease term and shows a lower present value cost for the Greenarm option. This is caused by the Greenarm costs escalating at a rate of 2.5% per year while the generic model costs increase by 3% annually.

Financing issues

14.43 The sections on capital and operating costs examined and compared costs in terms of current day dollars. These costs however will be paid in the future. The capital costs would be paid either by way of principal and interest on bond issues if the Province had proceeded in the traditional way or by lease payments under the public-private partnership arrangement. In order to compare the two alternatives on an equal basis we must look at the present value of the respective cash flows. The Province has an administrative policy, called "Present Value Analysis of Expenditure Decisions", which we have used as a basis in performing our analysis in this area.

Exhibit 14.3
Total cost summary – Evergreen School
(Summary prepared on a present value basis)

Analysis prepared by Department of Finance	Government's Generic Model	Greenarm	Potential (Cost)/Saving
Capital costs/purchase option	$ 9,324,835	$ 10,188,449	$ (863,614)
Operating cost	5,562,524	4,514,238	1,048,286
Total costs as prepared by Department of Finance	**$ 14,887,359**	**$ 14,702,687**	**$ 184,672**
Analysis as a result of our review	**Government's Generic Model**	**Greenarm**	**Potential (Cost)/Saving**
Capital costs/purchase option	$ 9,144,835	$ 10,188,449	$ (1,043,614)
Operating cost	4,658,213	4,514,238	143,975
Total costs as a result of our review	**$ 13,803,048**	**$ 14,702,687**	**$ (899,639)**

14.44 Exhibit 14.3 presents figures from the present value analysis prepared by the Department of Finance. The exhibit also includes the impact of the differences noted as a result of our work.

14.45 It is noted that on a present value basis the Province, by their calculations, would save $184,672 by entering into the agreement with Greenarm.

14.46 This saving arises as a result of the cash flows for operating costs (as calculated by the Province) being more favourable under the Greenarm alternative. These savings however are substantially reduced as a result of the cash flow related to construction and the fact that Greenarm's average borrowing rate is higher than the Province's borrowing rate. The Greenarm borrowing rate, as calculated under the agreement, and used in the analysis, was 9.065%. The Province of New Brunswick bond rate was set at 8.787%. This difference in rates has cost the Province approximately $400,000.

14.47 Our adjustments have the effect of changing the analysis from a potential present value savings of $184,672, as prepared by the Department, to a potential present value cost of $899,639.

Conclusion on Evergreen School

14.48 We were asked by the Standing Committee on Public Accounts to "compare the private sector arrangements as compared to traditional government methods".

14.49 We have done this by making adjustments to the figures presented by the Department of Finance in their generic model. As a result of these adjustments, we would conclude that the total cost would have been less under the traditional method than under the private sector arrangement. The Department has not agreed with

most of the adjustments we have made. However, using the Department's own figures, the most economical option, as summarized in Exhibit 14.3, would have been to construct and finance the school in the traditional way and contract with Greenarm, or another third party, to be responsible for operations. We estimate that the cost of financing alone is approximately $400,000 more by financing through Greenarm than by the traditional method.

Miramichi Youth Facility

14.50 A generic model was developed by the Province to represent the potential cost of constructing, operating and financing the facility in order to compare with the Wackenhut proposal. In addition, the Province entered into an Industrial Benefits Agreement as part of the Miramichi youth facility project. This agreement had a major impact on the Department's final decision to proceed with Wackenhut.

Capital costs

14.51 Exhibit 14.4 compares the capital cost of construction, if the Province had done the work itself, to the costs negotiated with Wackenhut. According to the analysis performed by the Province there was a saving of $708,384 by proceeding with Wackenhut.

Exhibit 14.4
Capital cost of construction – Wackenhut

	Government's Generic Model	Wackenhut Corrections Negotiated Contract
Land and site preparation	$ 1,475,000	$ 1,355,700
Construction	13,270,945	11,985,300
Soft assets (professional fees, interim financing, etc.)	5,248,452	6,083,142
Furnishing/equipment *	850,000	850,000
Issuance cost	138,129	
Total capital costs as determined by Department of Finance	**$ 20,982,526**	**$ 20,274,142**

* Financed by the Province

Generic model is larger facility than the one constructed by Wackenhut

14.52 We have not made any adjustments in the figures prepared by the Department of Finance with respect to the capital cost of the Wackenhut project. We are concerned however that the generic model was costed on a larger facility than the one designed and constructed by Wackenhut.

14.53 The generic model costs were developed based on program space requirements of 101,568 square feet. The Wackenhut design for the facility was finalized at 96,114 square feet. The Department of Supply and Services informed us that the fact the Wackenhut facility is smaller is a reflection of their success in meeting program requirements in a more efficient way. The analysis performed by the Department of Finance compares the cost of the Province constructing a 101,568 square foot facility to Wackenhut constructing a 96,114 square foot facility. This difference in square footage resulted in the Wackenhut proposal being $1,073,659 less than the generic model.

14.54 Under the traditional approach, the Province would have completed a detailed design before proceeding to construction. Without this input it is difficult to give full credit to the Wackenhut approach, because a detailed design by the Province may have also realized space reduction.

Issuance cost

14.55 In the Province's generic model, the cost of issuing bonds was reflected as an additional cost of financing. Seven basis points were added to the Province's long term borrowing rate and used as the discount rate. To be more comparable to the private sector proposal, an amount of $138,129, approximately $0.70 per hundred dollars of the amount borrowed, could have been added to the capital costs and the discount rate reduced accordingly.

14.56 Including this amount as part of the generic model capital cost allows direct comparison of capital costs under the two models. This is a change in presentation only for the purposes of Exhibit 14.4; the net present value calculation does not change.

Opinion on capital costs

14.57 Exhibit 14.4 presents the capital costs used by the Department of Finance in evaluating the most cost-effective way of doing the project. The Department of Finance estimated a saving of $708,384 by engaging Wackenhut.

Operating costs

14.58 Exhibit 14.5 compares the operating costs, if the Province had done the work itself, to the costs negotiated with Wackenhut. We have made adjustments to reflect what we believe to be a more appropriate comparison of the two alternatives.

14.59 It is noted that the Province's analysis indicated that they could not operate the facility, meeting the request for proposal requirements, cheaper than contracting with Wackenhut. Our adjustments have the effect of reducing the estimated cost of operations, had the Province done the work. We will now examine some of the components reported in Exhibit 14.5.

Provincial overhead

14.60 The amount shown as provincial overhead in the Province's generic model will likely not represent additional cash outlays. This amount was included by the Province to meet the request for proposal requirements and in an attempt to make the comparison between the two alternatives valid.

Exhibit 14.5
Annual operating costs – Wackenhut

	Government's Generic Model	Wackenhut Corrections Negotiated Contract
Maintenance*	$ 75,000	$ 75,000
Grounds*	25,000	25,000
Utilities*	181,000	181,000
Provincial overhead	20,000	
Trust profit (to beneficiary)		10,000
Insurance	20,000	13,464
Capital repairs and maintenance	388,000	385,000
Furnishings and equipment	12,750	12,750
Total annual operating costs as determined by Department of Finance	721,750	702,214
Adjustments as a result of our review		
Provincial overhead	(20,000)	
Capital repairs and maintenance	(50,609)	
Total annual operating costs as adjusted	**$ 651,141**	**$ 702,214**
* Province pays actual		

Capital repairs and maintenance

14.61 This number was developed when it was decided that Wackenhut would not get the program delivery side of the operations. Capital repairs and maintenance is an estimate of expenditures that may be needed for capital repairs and day-to-day operating expenses. The back-up provided for this number is a spreadsheet of Wackenhut numbers. The Province then rationalized, for reasonableness, the cost of the different factors used, to develop the annual cost of $388,000 (which increases by 3% per year). Our review of the costs shows that a management fee of 15% is factored into the amount. This cost, which is calculated at $50,609, would not be incurred if the Province operated the facility.

Opinion on operating costs

14.62 Exhibit 14.5 presents the operating costs used by the Department of Finance in evaluating the most cost-effective way of doing the project. The Department of Finance estimated operating savings, in the first year of operation, of $19,536 by engaging Wackenhut. Our adjustments have the effect of making Wackenhut more expensive by $51,073 in the first year.

Industrial Benefits Agreement

14.63 An Industrial Benefits Agreement was signed as a part of the Miramichi Youth Facility project and as such was factored into the analysis by the Department of Finance. This is an agreement which requires Wackenhut Corrections Canada Inc., the general contractor Maxim Construction Inc. or their project subcontractors, or any other mutually agreed to companies, to create a certain level of employment and to make a significant capital investment in New Brunswick. The Department assigned a value to these undertakings and included them in the analysis supporting the decision to engage Wackenhut.

Employment creation commitment

14.64 The commitment calls for the creation of forty new jobs for New Brunswickers, which are in addition to the direct construction related jobs at the Youth Facility. The additional positions may result from increased employment by Wackenhut or other companies in New Brunswick through expanded business opportunities in New Brunswick. The Department attempted to quantify the benefit to the Province based on the required job creation. To calculate the benefit the Department made an estimate that assumed a benefit over a ten-year period. This benefit calculated on a present value basis is $525,826 and is shown on Exhibit 14.6 as a favourable consideration in supporting the Wackenhut decision.

14.65 We do not accept the Department's calculation in this area for two reasons. In the first instance the Province estimated the benefit on the basis that jobs would be created for a ten-year period, whereas the agreement only covers five years. The second reason is there is no assurance that the jobs will ever materialize, or that any job created could be linked to this agreement. We did note however that the agreement does provide for Wackenhut to make a financial contribution to the Province should any of the forty jobs not be created. Although we considered the value of the "guarantee", we have reservations as to whether it will be realized.

Capital investment commitment

14.66 According to the agreement, Wackenhut and the other companies must invest in New Brunswick at least $2.6 million, by 31 December 2002, to take advantage of expanded business resulting from new industrial opportunities in New Brunswick. The Department assumes that the benefit to the Province is equal to the present value of the $2.6 million capital investment commitment, and for this reason reports $1,721,172 on Exhibit 14.6, as a favourable consideration in supporting the Wackenhut decision.

14.67 At the time of preparing our report no capital investment had been made, nor were we made aware of any plans that will see this commitment fulfilled. Because of this, and the fact that the Province has no protection in the agreement, we did not give any value to this factor. Another concern we had with respect to this matter was the assumption that the financial benefit to the Province would be equal to the amount of the capital investment. The Province would certainly benefit from sales tax and income taxes arising from such a capital investment, but there is no evidence supporting the conclusion that the Province would benefit dollar for dollar.

Financing issues

14.68 Exhibit 14.6 presents figures from the present value analysis prepared by the Department of Finance. The exhibit also includes the impact of the differences noted as a result of our work.

Exhibit 14.6
Total cost summary – Wackenhut

(Summary prepared on a present value basis)

Analysis prepared by Department of Finance	Government's Generic Model	Wackenhut Corrections Negotiated Contract	Potential (Cost)/Saving
Construction and operating costs			
Capital costs/purchase option	$ 20,844,397	$ 20,578,368	$ 266,029
Operating costs	9,553,456	9,264,328	289,128
Total costs as prepared by Department of Finance	30,397,853	29,842,696	555,157
Industrial benefits			
Employment creation commitment		(525,826)	525,826
Capital investment commitment		(1,721,172)	1,721,172
Total value of industrial opportunity benefits as determined by Department of Finance		(2,246,998)	2,246,998
Net costs as prepared by Department of Finance	**$ 30,397,853**	**$ 27,595,698**	**$ 2,802,155**

Analysis as a result of our review	Government's Generic Model	Wackenhut Corrections Negotiated Contract	Potential (Cost)/Saving
Construction and operating costs			
Capital costs/purchase option	$ 20,844,397	$ 20,578,368	$ 266,029
Operating costs	8,593,920	9,264,328	(670,408)
Total costs as a result of our review	**$ 29,438,317**	**$ 29,842,696**	**$ (404,379)**

14.69 It is noted that on a present value basis the Province, by their own calculations and without considering industrial benefits, would save $555,157 by entering into the agreement with Wackenhut.

14.70 This saving arises as a result of the cash flows for operating and capital costs (as calculated by the Province) being more favourable under the Wackenhut alternative. The potential savings however are substantially reduced as a result of the fact that Wackenhut’s average borrowing rate is higher than the Province’s borrowing rate. The Wackenhut borrowing rate, as calculated under the agreement, and used in the analysis, was 8.8% and the Province of New Brunswick bond rate was set at 8.6%. This difference in rates has cost the Province approximately $700,000.

14.71 Our adjustments have the effect of changing the analysis from a potential present value savings of $2,802,155, as calculated by the Department, to a potential present value cost of $404,379.

Conclusion on Wackenhut

14.72 We were asked by the Standing Committee on Public Accounts to “compare the private sector arrangements as compared to traditional government methods”.

14.73 We have done this by making adjustments to the figures presented by the Department of Finance in their generic model. As a result of these adjustments, we would conclude that the total cost would have been less under the traditional method than under the private sector arrangement. The Department has not agreed with most of the adjustments we have made. However, using the Department's own analysis, the most economical option would have been to have Wackenhut construct and operate the facility and for the Province to be responsible for financing. We estimate the cost to the Province of financing through Wackenhut to be $700,000.

Ownership

14.74 In comparing these two private sector arrangements with traditional government methods, we wish to make a further observation. In both cases the Province will pay over 100% of the cost of the land and building, over the lease period, and they do not intend to take ownership. The Province would have ownership under the traditional approach.

Observations from the Department of Finance

14.75 We provided a copy of our findings to the Department of Finance. The following is an extract from their response.

14.76 *The basis upon which the Auditor General has compared the leases (i.e. traditional government methods) is not consistent with the basis upon which government evaluates alternatives and makes final decisions with respect to public-private partnerships (i.e. value for money). The major differences between the Auditor General and the government can be summarized under the following headings:*

- *Total Package Concept*
- *Incremental and Overhead Costs*
- *Industry Practices*
- *Additional Factors*

Total Package Concept

14.77 *'Traditional government methods' as defined by the Auditor General implies that government would have designed, tendered, constructed, financed and operated the facilities under the same terms and conditions which it has historically used in the past. That is, each item is a separate component within the process for the acquisition and operation of an asset and should be evaluated independently. Such an approach does not take into account changing circumstances, objectives, or any intention to improve upon past practices. The Auditor General assumes that the best deal for the public is to evaluate each component separately.*

14.78 *However, the Auditor General does not recognize the rationale or merit of tendering projects on a "total package basis" which promotes the concept that a more economical price can be obtained when the ownership, construction, financing, operations and maintenance are unified under one procurement request and, eventually, one contract. This total package approach recognizes not only the long-term nature of the relationship between the government and the private sector, but also the* *allocation of certain risks to the private sector which will result in value for money to the public.*

Incremental and Overhead Costs

14.79 *The Auditor General has come to the conclusion that the only valid additional costs when comparing the Generic Model to the private sector proposal are those classified as incremental or which result in "additional cash outlay." The Auditor General does not recognize the validity of overhead costs or certain construction/operational costs which may normally be absorbed in the overall administration of government.*

14.80 *All costs provided in the Generic Model reflect the "full cost" to government. Costs which would be incurred or any costs which would be otherwise avoidable have been included. To presume that certain costs can be absorbed in the overall cost of government is untrue. Resources are required to provide these support services and must be quantified.*

Compliance with Industry Practices

14.81 *The general philosophy applied by the New Brunswick government in these evaluations is consistent with accepted practices and advice provided by private sector consultants; and consistent with practices accepted by industry.*

Additional Factors

14.82 *As more experience is gained, government is learning more about two key factors, those being:*

- *risk transfer – identifying all risks that would be retained by the government or transferred to the private sector;*
- *confidence level – quantifying all estimates and risks with a reasonable degree of certainty.*

14.83 *In developing its proposals, the private sector has taken these cost elements into account and quantified them. Reliable evaluation criteria for these two factors had not been developed when these two early projects were being reviewed. However, for later initiatives, the evaluation of these two elements enhanced the savings opportunities for the private sector proposals….*

14.84 *It should be noted that both these projects were among the first public-private partnerships undertaken by this government. The learning curve inherent in the delivery of these projects provides that processes and practices applied are improved as more experience is gained. For instance, current reviews involve significantly more evaluation in the areas of risk transfer and confidence levels. This learning curve is a necessary and evolutionary aspect, both in New Brunswick and across Canada.*

Chapter 15
Special Report for the Public Accounts Committee - NB Power Funding of Minto Economic Development Activities

Contents

Special Report for the Public Accounts Committee NB Power Funding of Minto Economic Development Activities

Background

15.1 On 1 April 1997 the Standing Committee on Public Accounts adopted a motion requesting

> *That the Auditor General inquire whether economic development activities in the Minto area which are funded by NB Power are in accordance with the legislative authority granted to NB Power under the Electric Power Act.*

15.2 On 25 April 1997 we received a letter from the Clerk Assistant of the Legislative Assembly formally asking our Office to make this inquiry. We replied that we intended to look into the matter in late 1997.

History of the Minto economic development fund

15.3 In February 1994 the President of NB Coal Ltd. presented to the board of directors of NB Power (board) a business case on the evaluation of a mining plan with three alternatives for mining coal in Minto. He recommended that the tonnage of coal mined be reduced in 1994-95 to 300,000 tons from 450,000 tons with a consequent reduction in personnel. Importing cheaper offshore coal would make up the shortfall. The resulting annualized cost saving to NB Power was estimated at being $7.8 million to $9.5 million. On 24 February 1994 the board approved the recommended reduction to 300,000 tons for 1994-95.

15.4 In March 1994 the board approved the 1994-95 budget and, as part of the business case, included a $2.5 million funding commitment for economic development in the Minto region. NB Power also agreed to an additional five-year commitment of $150,000 per year to the Minto Regional Economic Development Corporation.

15.5 On 23 June 1994 the board was advised that the $2.5 million in respect to the Minto region obligation had been expensed in the 1993-94 fiscal year. Therefore, it was recommended that the 1994-95 budget be revised accordingly. By motion, the board approved the removal of the Minto region expenses from the 1994-95 budget.

15.6 NB Power has implemented the strategy set out in the business case gradually since 1994-95. NB Power staff indicated significant savings have occurred already but that the full effect will not be felt until 1998-99. In a letter to us in February 1998 NB Power management estimated the annual cost savings from this reduction at $9,423,000 for 1998-99.

Scope

15.7 In light of the request from the Standing Committee on Public Accounts we met with NB Power officials on 9 December 1997 to discuss whether the corporation had the legislative authority to pursue economic development the way it did in the Minto area. At the meeting it was agreed that NB Power would provide a written response to the issue. We received their written response on 16 February 1998.

15.8 We reviewed the Electric Power Act to determine if it, in our opinion, permitted such expenditures. We also reviewed the analysis NB Power prepared comparing reducing production levels at NB Coal with continuing production at existing levels. Finally we spoke to NB Power and NB Coal staff regarding the analysis and inquired as to whether expected savings had been achieved.

Results in brief

15.9 Based on our review and the information provided to us, we conclude that the board's decision to pursue coal production cost-savings was a good business decision, and certainly well within its authority.

15.10 NB Power was under no obligation to provide development funding. If public policy required that NB Power provide funding of $2.5 million for economic development in the Minto area, we believe this should have been evidenced and supported by an Order in Council. It is our opinion that, because there was no such evidence, the expenditure of $2.5 million by NB Power was not in accordance with the legislative authority granted to it under the Electric Power Act.

Legislation

15.11 As our first step we met with NB Power officials and reviewed the issue of NB Power funding economic development activities in the Minto area. NB Power staff offered to provide a written submission to the issue and we agreed.

15.12 We also reviewed the governing Act of NB Power, the Electric Power Act. Section 2 of the Act states:

> *The intent, purpose, and object of this Act is to provide for the continuous supply of energy adequate for the needs and future development of the Province and to promote economy and efficiency in the generation, distribution, supply, sale, and use of power.*

15.13 In our opinion this is the primary purpose of NB Power.

15.14 In the official response from the President of NB Power, we were told that the corporation considered section 3(7) of the Electric Power Act as giving the authority for the funding of the development expenditures. This section states:

> *The board of directors shall administer the affairs of the Corporation on a commercial basis and all decisions and actions of the board of directors are to be based, subject to public policy as determined from time to time by the Lieutenant-Governor in Council, on sound business practice.*

15.15 NB Power officials believe the board's decision to supply development funding for the Minto area was in compliance with this section. That is, the board made the decision and it was based on sound business practice.

15.16 We believe that 3(7) is a relevant section. This section could give the board of directors the right to fund development activities if the board could show it made the decision based on sound business practice. The section also allows NB Power to be used as an instrument of public policy, provided there is direction given to that effect by the Lieutenant-Governor in Council.

Business decision

15.17 The next step was to assess whether the board's decision to fund development in the Minto area was based on sound business practice.

15.18 While implementation of the business case did not occur as quickly as originally planned, savings have occurred gradually since 1994-95. As noted earlier, NB Power management estimates the annual cost savings from reduced mining activity in the Minto region at $9,423,000 for 1998-99. NB Power and NB Coal staff stated planned reductions have now been achieved and the cost of a ton of coal has dropped appreciably. Altogether, the savings will be significantly more than the funds NB Power supplied for economic development in the Minto region.

15.19 We agree that the board's decision to proceed with the planned reduction in mining activity was a good business decision. However, we would also note that from a purely business point of view we do not believe it was necessary for NB Power to supply any developmental funding. Many companies make decisions to reduce or

close out activities in an area and yet, except for meeting legal requirements, provide no other monies.

The decision-making process

15.20 Thus our third and final step was to try and determine why, and how, the funding decision was made. To do this we reviewed the minutes of the Standing Committee on Public Accounts and discussed the decision with various NB Power staff. We also reviewed media releases and correspondence relating to the funding.

15.21 In a December 1993 media release the Premier and the NB Power Chairman announced that with respect to the Minto area, "There will be various initiatives to further develop the local economy". The same release also announced "NB Power will contribute to a community economic development fund in the Grand Lake region". In a December letter to the mayor of Minto the Premier states "We are committed to supporting economic development in the area". Additionally a letter in late December 1993 from the Chairperson of the Minto Regional Economic Development Committee to the Chairman of NB Power noted that in discussions with the Chairman and the Premier "it was suggested that funds would be made available to the Minto area for job creation". The January 1994 reply from the Chairman stated the level of funding from NB Power would be contingent upon the impact of reduced coal production in the Minto area and done in concert with the Department of Economic Development and Tourism.

15.22 We believe this information shows that government several months prior to NB Power board approval made the decision for NB Power to supply funding to the Minto area. That is, the government determined that a development fund was required and they asked NB Power to supply the required funding.

15.23 Section 3(7) does state "subject to public policy as determined from time to time by the Lieutenant-Governor in Council". Thus there may be instances where public policy, as approved by the Lieutenant-Governor in Council, would allow NB Power to pursue actions in the public interest.

15.24 It is clearly the government's responsibility to set out public policy. However, the wishes of the Lieutenant-Governor in Council are usually expressed by means of an Order in Council. In this case, in order to reflect the open and transparent setting of public policy, we believe an Order in Council should have been issued authorizing NB Power to provide the required funds. This was not done.

Chapter 16
Crown Agencies Audited by Others

Contents

Crown Agencies Audited by Others

Background

16.1 We do not audit the financial statements of the Crown Corporations, Boards, Commissions and other Agencies listed below.

16.2 Agencies included in the Public Accounts:

- Board of Commissioners of Public Utilities
- Forest Protection Limited
- New Brunswick Geographic Information Corporation
- New Brunswick Investment Management Corporation
- New Brunswick Liquor Corporation
- New Brunswick Museum
- New Brunswick Power Corporation
- Strait Crossing Finance Inc.
- Workplace Health, Safety and Compensation Commission of New Brunswick

16.3 Other Agencies:

- Atlantic Lottery Corporation Inc.
- Provincial hospital corporations.

16.4 The Auditor General Act requires the auditors of these agencies to submit the agencies' audited financial statements to our Office annually. The auditors must also provide copies of any reports and recommendations arising out of their audits.

Scope

16.5 We review the financial statements and other documents as they are received. We also visit the auditors periodically to review their working papers. We do this to determine whether we can continue to rely on their work in carrying out our audit of the financial statements of the Province. During the year we reviewed the 1998 working papers of the auditors of New Brunswick Power Corporation and the 1997 working papers of the auditors of three hospital corporations.

New Brunswick Power Corporation

16.6 We were generally satisfied with the work done by the auditors of the Corporation for the year ended 31 March 1998. However, we did not agree with the auditors' conclusion on the deferred asset of $450 million relating to the Point Lepreau nuclear generating station. This matter is discussed in chapter 2 of our Report where we explain our reservations on the Province's financial statements.

16.7 The auditors issued a management letter to the Corporation at the conclusion of their audit. The auditors noted that a large number of issues raised in the previous year had been resolved to their satisfaction. However, they again stressed the importance of the security of core business systems and the need for the completion of a disaster recovery plan for critical operations.

16.8 A number of new matters were raised by the auditors in their 1998 management letter. One related to financial risk management in the Corporation. The auditors encouraged the Corporation to continue its current review of existing financial risk management strategies. This review should take into account the use of any new financial products, anticipated activity in transactions in foreign currencies and expectations around energy costs and debt management. The Corporation indicated that they had engaged consultants in this regard, and had created a new Financial Planning and Treasury department.

16.9 A second matter concerned the outcome of the discussion paper "Electricity in New Brunswick Beyond Year 2000". The auditors recommended the Corporation develop a decision support system to ensure it has sufficient time to review and react to issues such as the carrying value of assets, which may be affected by fundamental changes in the electric utility industry in New Brunswick. The Corporation undertook to review the carrying value of their plant assets "when there is sufficient information about the future operating and regulatory environment to make such a review meaningful."

Workplace Health, Safety and Compensation Commission of New Brunswick

16.10 The auditors issued a management letter to the commission at the conclusion of their audit for the year ended 31 December 1997. A number of their recommendations dealt with computer controls in areas such as security standards, software change procedures, Year 2000 readiness and disaster recovery planning. Management agreed with the recommendations and noted the actions that had been taken or will be taken to address the issues raised.

Hospital Corporations

16.11 We have received copies of management letters issued to hospital corporations by five of the eight auditors. These letters arose out of their audits of the financial statements for the year ended 31 March 1998. The letters dealt with weaknesses in internal controls and included recommendations to improve accounting procedures. One auditor also raised concern regarding the hospital corporation's working capital deficiency. The auditor pointed out that "cash and investment reserves have been exhausted and it is unlikely that the existing bank line of credit will prove adequate in the long term to enable the Corporation to discharge its liabilities as they come due." We comment on the financial position of hospital corporations in chapter 2 of this Report.

16.12 We were satisfied with the work done by the auditors of the three hospital corporations whose 1997 audit files we reviewed.

Chapter 17
Office of the Auditor General

Contents

Office of the Auditor General

Background

17.1 Our 1997 Report contained a checklist relating to our assessment of our compliance with the Annual Report Policy of government. A comparative version for 1998 is presented below.

Exhibit 17.1
Self assessment checklist

	1998	1997
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	Partial
Are details available on level of client acceptance ?	Yes	Partial
Is actual and budget financial information presented?	Yes	Yes
Does the report explain variances from budget?	Yes	Yes

17.2 It is our intention to continually improve the information available in our annual Report on the performance of our Office. The above checklist sets out our assessment of progress over the last two years.

Office role and relevance

Our role

17.3 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

17.4 **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

17.5 **We promote accountability by providing objective information to the people of New Brunswick through the Legislative Assembly.**

Our values

17.6 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

17.7 Our 1997 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.

17.8 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. In addition our 1998 Report includes the findings of two special studies carried out at the request of the Public Accounts Committee.

17.9 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.

17.10 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

17.11 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 have 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. Since our indicators were established effective 1 January 1998, some of the statistics reported this year will cover less than a twelve-month period.

Responding to the needs of users

17.12 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.

17.13 We sent out a survey to all members of the Public Accounts and Crown Corporations Committees in September 1998. 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, although they also suggested a condensed report of highlights would be useful. Committee members also found useful the in-camera briefing our Office provided on the day the 1997 Report was released, and were satisfied with the information we presented during our subsequent attendance at the public meetings of the Committees. 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.

17.14 We are pleased with the results of this survey, and we will seek to maintain, or even increase, the level of satisfaction with our work.

17.15 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.

17.16 From 1993 to 1997 we made 232 recommendations in our annual Reports. Based on responses received from government departments and Crown agencies, we have assessed the level of acceptance of those recommendations as follows:

Exhibit 17.2
Acceptance of our recommendations

Accepted	206	89%
Partially accepted	1	--
Not accepted	14	6%
Noted for future action	2	1%
No longer applicable	9	4%
Total	232	100%

17.17 In August 1998 we asked government departments and Crown agencies to indicate whether the recommendations referred to above had been implemented. We received responses from all organizations except the Department of the Environment, which was the subject of 19 recommendations in our 1994 Report. The responses are summarized as follows:

Exhibit 17.3
Implementation of our recommendations

Implemented	109	51%
Partially implemented	9	4%
Implementation in progress	59	28%
Not implemented	22	10%
Noted for future action	4	2%
Responsibility transferred	2	1%
No longer applicable	8	4%
	213	100%

17.18 We will be conducting follow-up work over the next year in order to confirm the above responses. We want to better understand the reasons why some of our recommendations have not been implemented, or have been only partially implemented.

17.19 We will measure the extent to which accounting and reporting recommendations made by the Public Sector Accounting and Auditing Board of the CICA are accepted and implemented by the Province of New Brunswick.

17.20 We are tracking this indicator as part of our annual audit of the financial statements of the Province. We discuss the Province's progress in implementing the PSAAB recommendations in chapter 2 of this Report.

17.21 The Province of New Brunswick audit will be completed by June 30 th and all Crown agency and Trust Fund audits will be completed by September 30 th.

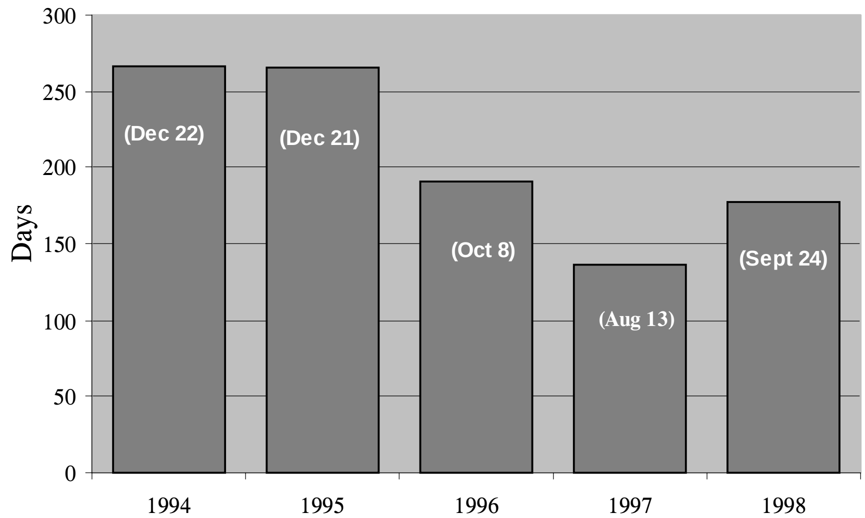
17.22 Our audit report on the financial statements of the Province was dated 28 July 1998. The final Crown agency audit report was dated 22 October 1998. All our other sixteen Crown agency audit reports were dated on or before 30 September 1998. The final Trust Fund audit report was dated 4 November 1998. None of the seven Trust Fund audit reports were dated prior to 1 October 1998. It should be noted that these dates relate to the point at which our audit work was substantially complete. There will always be a gap between this date and the date the financial statements are issued.

17.23 In our 1997 Report we discussed the solid improvement that had been made in issuing the Province's financial statements earlier than in the past. Last year the financial statements were issued on 13 August. This was an improvement of almost eight weeks over the 1995-96 year and was eighteen weeks earlier than the 1994-95 year.

17.24 This year, this improvement was not sustained. Significant accounting issues, and related discussions, delayed the issuance date by a number of weeks.

17.25 Exhibit 17.4 shows on a five-year comparative basis the number of days between the year-end and the date of the issuance of the audited financial statements.

Exhibit 17.4
Number of days between the end of the fiscal year and the issuance of the financial statements.



17.26 Our goal continues to be to facilitate the issuance of the audited financial statements of the Province within three months of the year end.

Making effective use of resources

17.27 All financial and broad scope audits will be performed within the time allotted.

17.28 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.

17.29 We are in the process of analyzing our performance on our 1998 audit work. Once this analysis is complete, it will form the basis for establishing future years' time allocations. We constantly strive to find efficiencies in our work. We also acknowledge that our time reporting system and budgeting process lacks sophistication. We are searching for a better time reporting system, but have not yet found one that meets our needs.

17.30 60% of all professional paid time in our Office will be spent directly on financial statement audits or broad scope audits.

17.31 A detailed analysis of staff time for the first six months of 1998 indicates that 60.24% 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.

17.32 Of the total time spent directly on financial statement audits and broad scope audits, 30% will be spent on broad scope audits.

17.33 Our analysis indicates that, in the first six months of 1998, we spent 31.07% of total audit time on broad scope audits.

Maintaining professional standards

17.34 We will meet the standards required by the New Brunswick Institute of Chartered Accountants Mandatory Practice Review Committee.

17.35 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

17.36 Budget and actual expenditure for 1996-97 and 1997-98 by primary classification is shown in Exhibit 17.5. The approved budget for the 1998-99 year is presented for comparative purposes.

Exhibit 17.5
Budget and actual expenditure
(thousands of dollars)

	1999	1998		1997	
	Budget	Budget	Actual	Budget	Actual
Wages and benefits	1,362.1	1,419.1	1,288.6	1,386.4	1,247.4
Other services	118.4	105.7	124.8	107.2	102.2
Materials and supplies	7.9	7.9	8.4	8.6	7.8
Property and equipment	22.1	22.1	76.4	24.5	53.7
	1,510.5	**1,554.8**	**1,498.2**	**1,526.7**	**1,411.1**

17.37 Staff costs continue to account for approximately 90% of our budget and were underspent by $130,500 for the year ended 31 March 1998. The former Auditor General retired in April, 1997 and his replacement was not appointed until September. A senior employee was out on extended leave for a large part of the year, and a third position was vacant until January, 1998.

17.38 Other services were overspent by $19,100. This was primarily the result of contracting out one of our Crown agency audits to a local accounting firm.

17.39 Property and equipment was overspent by $54,300. 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.

Staff resources

17.40 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.

17.41 In the past seven years, eleven people in our Office have received a professional accounting designation. Five of these people have moved to important financial positions in government. One person moved to a government position in another province, another to a quasi regulatory organization in New Brunswick; two people have remained in our Office and two have joined the private sector. The feedback that we have received on the quality of our staff is favourable. We consider our contribution of qualified staff to other government organizations to be a positive indicator for our Office.

17.42 The staff complement in our Office has remained constant at 27 for the past few years. Brent White CA, Paul Jewett CA and Phil Vessey CA are the directors for our three audit teams. At 31 March 1998 there were fifteen professional staff with accounting designations. Our staff also included nine 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. The following is a list of staff members at 31 March 1998:

Lorna Bailey[1]
Jeffrey Chown [2]
Cathy Connors Kennedy, CA
Don Harrington [2]
Eric Hopper, CA
Peggy Isnor, CA
Paul Jewett, CA
Cecil Jones, CA
Kim Langille [2]
Eric LeBlanc [2]
Kimberley LeBlanc [2]
Greg Mignault, CMA
Eric Mourant, CA
Gordon Nowlan [2]
Bill Phemister, CA
Ken Robinson, CA
Yvonne Samson [2]
Brian Soeler [2]
Tammy Sterling [2]
Diane Swan [1]
Al Thomas, CA
Phil Vessey, CA
Tim Walker, CA
Deborah Whalen, CMA
Brent White, CA
Darlene Wield [1]
Daryl Wilson, FCA

[1] Administrative support
[2] Student enrolled in a professional accounting program.