

Chapter 1

Introductory Comments

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Introductory Comments

Introduction

1.1 Each year, we conduct two types of audits; financial audits to express an opinion about the fairness of financial statements, and value-for-money audits, to comment on the economy, efficiency and effectiveness of government programs. During the past year we have examined many parts of government and its programs.

1.2 This volume of our 2006 Report includes only our financial audit related work. It reports on our audit of the Province's financial statements, our financial audits of other government organizations, and provides comments about the Province's financial condition. It also provides information about the operations of the Office of the Auditor General.

1.3 The results of our value-for-money audits will be reported once the Legislature resumes and a Public Accounts Committee and a Crown Corporations Committee have been appointed. We expect to include chapters about:

- the tracking system for wood harvested from private woodlots;
- Community Economic Development Agencies;
- the Health Levy;
- New Brunswick Credit Union Deposit Insurance Corporation;
- the NB 9-1-1 system;
- New Brunswick Investment Management Corporation;
- the Office of the Superintendent of Pensions; and
- the role of the Auditor General.

The Province's financial statements

1.4 Our audit report on the Province's financial statements is included in Volume 1 of the Province's Public Accounts. Mr. K.D. Robinson, C.A., Deputy Auditor General for the Province of New Brunswick, signed the audit opinion. The opinion is dated 28 July 2006.

1.5 The audit opinion says that the Province's "...financial statements present fairly, in all material respects, the financial position of the Province as at 31 March 2006 and the results of its operations, the changes in its net debt and its cash flows for the year

then ended in accordance with Canadian generally accepted accounting principles.”

1.6 This is an unqualified opinion. We have issued unqualified opinions in each of the past eight years.

1.7 Mr. Robinson was responsible for the audit, and, therefore, he issued the audit opinion. I was not involved with the audit of the Province’s financial statements since I had served as the Province’s Comptroller for part of the fiscal year being audited. The rules of professional conduct for Chartered Accountants required that I not take part in or influence the audit.

1.8 We were pleased with the timeliness of the Province’s financial statements for the year ended 31 March 2006. The Province issued the statements on 16 August 2006, a three month improvement over the previous year. Timely financial statements means the information is available to users of those financial statements while it is relevant and useful.

1.9 Even though our audit opinion was unqualified, we were concerned by some items that arose during our audit. These did not result in significant accounting misstatements, and therefore we were able to issue an unqualified opinion. We discuss these issues in Chapter 2 of this volume.

1.10 I want to highlight one item that caused us concern. At the end of the fiscal year, the government paid an extra \$60 million to the universities. The authority for this was obtained by special warrant. However, this \$60 million was not additional funding to the universities, as it was offset by a reduction in the budgeted funding they will receive in the 2006-2007 fiscal year. This is obvious from looking at the 2006-2007 Main Estimates, and actual funding for previous years:

| (\$ millions) | | | | | |
|---------------|-------|-------|-------|-------|------------------|
| 2002 | 2003 | 2004 | 2005 | 2006 | 2007 (Budget) |
| \$168 | \$182 | \$180 | \$185 | \$259 | \$148 |

1.11 The \$74 million increase in funding in 2006 followed by the \$111 million decrease in funding in 2007 shows that the extra \$60 million payment was an accelerated payment of what normally

would be a 2007 expense. If the payments had been made normally, they would have looked something like:

| (\$ millions) | | | | | |
|---------------|-------|-------|-------|-------|------------------|
| 2002 | 2003 | 2004 | 2005 | 2006 | 2007 (Budget) |
| \$168 | \$182 | \$180 | \$185 | \$199 | \$208 |

1.12 The \$60 million payment was properly accounted for. It was authorized and paid during the year ended 31 March 2006 and the Province could not get it back, so it was a legitimate expense of that year. We were satisfied with the accounting for the payment.

1.13 My concern is that the expense may have been incurred with an eye to the 2007 budget, rather than for prudent fiscal management purposes. Had this expense been incurred in the normal fashion, the surplus for the year ended 31 March 2006 would have been \$303.6 million rather than \$243.6 million, and the budgeted forecast for the 2006-2007 fiscal year, assuming no other changes, would have been a deficit of \$38 million rather than a surplus of \$22 million.

1.14 But, of course, in 2007-2008 we would expect the funding to return to its normal level of approximately \$210 million. The accelerated payment allowed a budgeted surplus for 2006-2007, but it did not make a structural change to the Province's expenses; it simply pushed an expense back one year.

1.15 This transaction has made it difficult to understand the fiscal challenges the Province must face in the future. It simply added confusion to any assessment of the Province's fiscal situation. In fact, while the 2006-2007 Main Estimates showed that funding for universities was dropping from \$259 million to \$148 million, the budget speech was highlighting the increased funding the government has provided to universities:

We are increasing funding to universities and we will meet our commitment of a 13 per cent increase over this mandate by 2007-2008. This will mean by 2007-2008, annual funding to universities will have increased by over 34 per cent, or \$54.7 million, since we first came to office in 1999.

1.16 While this statement in the budget speech was correct, there was no mention of how the accounting for the funding was being

used to affect the surplus for the 2005-2006 fiscal year, or its potential impact on the budgeted surplus for 2006-2007.

1.17 By moving regular operating grants in and out of fiscal years, the government makes it difficult for readers of the financial statements to assess the government's fiscal management.

1.18 I recognize that there is now a new government in place in the Province. Nevertheless, I wanted to highlight the importance of the government being clear and transparent in its budgeting and in reporting its results. We will continue to highlight these types of transactions in the future should they occur.

Comments on the Province's financial condition

1.19 Chapter 3 contains our comments on the Province's financial condition. As in past years we present multi-year indicators for sustainability, flexibility and vulnerability. Our analysis shows positive trends in all three of these areas.

1.20 This year we have added some comments about individual components of the Province's financial statements. In this analysis we identify:

- there is room for the Province to improve its collection of loans and receivables;
- the Province's liability for injured workers is growing at a significant rate; and
- in two of the past four years, the percentage growth in expenditures has exceeded the percentage growth in both GDP and revenue.

1.21 We also provide multi-year trends for the components of the Province's Statement of Financial Position and its Statement of Operations as well as items reported in the notes to the financial statements.

Reducing the other audits we do

1.22 Our audit of the Province's financial statements is not the only financial audit we do. We also audit the financial statements of various other government corporations, agencies and boards. These are identified in Chapter 2. For most of these organizations, legislation directs us to perform an audit.

1.23 Auditing these organizations consumes a significant portion of our resources. In the future they may consume even more resources. New assurance standards issued by the Canadian Institute of Chartered Accountants will require us, in common with all other chartered accounting firms, to do more work and to document aspects of our work more thoroughly. This is true for all of our audits, including the audit of the Province's financial statements. We expect that this will increase our financial audit time by 20% to 30%. This will seriously affect the number of value-for-money audits that we are able to conduct.

1.24 One way to offset the increased audit effort would be to reduce the number of organizations audited. Some of the organizations that we audit are small, and the government has access to the information it needs to hold them accountable even without an audit. We would like to have the opportunity to discuss this with government, and to have government remove the legal requirement for us to audit certain organizations. We also intend to stop auditing any organizations that we are not required by law to audit.

Importance of net debt

1.25 In the Introductory Comments to Volume 2 of the 2005 Report of the Auditor General, I commented on the Province's adoption of tangible capital asset accounting. In those comments I stated that:

Readers of the Province's financial statements will need to become familiar with this new method of reporting. Under the old method, the results for the year could be summarized in one number, the increase or decrease in net debt for the year. Under the new model, there are two summary indicators of the results for the year. The increase or decrease in net debt is still reported, but it is no longer the bottom line on the Province's Statement of Operations. The new bottom line is simply called the annual surplus or deficit. For the year ended 31 March 2005, both of these numbers were positive. The surplus for the year was \$242.2 million and the net debt reduced by \$131.5 million.

1.26 For the year ended 31 March 2006, the numbers were again positive. The surplus for the year was \$243.6 million, and net debt reduced by \$122.6 million. (The 31 March 2005 reduction in net debt was restated from \$131.5 million to \$145.3 million as a consequence of an accounting change.)

1.27 The change in net debt is an important measure of the Province's results for the year, just as important as the surplus or deficit for the year. In the financial statements for the years ended 31 March 2005 and 31 March 2006, and in the 2005-2006 budget documents, both indicators were given equal attention.

1.28 However, in the 2006-2007 Budget and Main Estimates, the focus shifted to the budgeted surplus, and it takes some work to find the budgeted increase in net debt of \$87.0 million.

1.29 The statement of surplus or deficit included in the budget plan attached to the 2005-2006 budget speech included a line that showed the budgeted decrease in net debt. It also included a statement of net debt that reported the budgeted decrease in net debt. The 2006-2007 budget speech did not report the budgeted increase in net debt in any of the statements attached to it. The only reference to the budgeted increase in net debt in the 2006-2007 budget documents is contained on page 15 of the Main Estimates.

1.30 In my opinion, the government should give equal attention to both the surplus or deficit for the year and the increase or decrease in net debt for the year. One of these indicators should not be de-emphasized when it does not reflect an improvement.

Net debt and the *Fiscal Responsibility and Balanced Budget Act*

1.31 In my opinion, net debt is important. It needs to be managed. I was therefore disappointed when the new *Fiscal Responsibility and Balanced Budget Act* did not include a target for net debt. In fact, even if the government achieves all of the targets included in this legislation, the Province's net debt could grow.

1.32 For example, the Act sets out the objective that the total amount of expenses for the period not exceed the total amount of revenue. Since net debt changes by the difference between revenue and expenditures, not revenue and expenses, and since the amount of expenses can be significantly different than the amount of expenditures because of capital asset acquisitions, the government can produce a balanced budget while net debt is increasing.

1.33 The Act also includes an objective to reduce the ratio of net debt to Gross Domestic Product (GDP) over the period. Again, this can be achieved even while net debt increases. Volume 1 of the Province's 2006 Public Accounts includes the following information:

| | (\$ millions) | | |
|--------------------------|---------------|----------|----------|
| | 2004 | 2005 | 2006 |
| Net Debt | 6,923.6 | 6,778.3 | 6,655.7 |
| GDP (31 December) | 22,179.0 | 22,976.0 | 23,727.0 |
| Ratio of Net Debt to GDP | 31.2% | 29.5% | 28.1% |

1.34 If net debt at 31 March 2006 had been \$7,400 million rather than \$6,655.7 million, that is if net debt had increased by about \$740 million rather than decreased by about \$270 million, the net debt to GDP ratio would still not have exceeded the 31 March 2004 percentage.

1.35 So, my concern is that the new legislation about fiscal responsibility includes the easy targets but does not address the harder issue of managing the absolute amount of net debt.

1.36 The government of the day made a decision not to include any specific net debt targets in the new legislation. In my opinion, the government should make sure there is a plan to manage the amount of net debt even though it is not set out in the Act.

Appointment of Grant Thornton

1.37 The new government contracted with “the independent accounting firm Grant Thornton to conduct a review of the financial situation of the Province.” The government stated in its 11 October 2006 press release that:

The accounting firm will be asked to review, comment and make recommendations on such items as the anticipated current year financial results, future financial obligations already committed to, financial challenges in the health care system and the funding status of pension plans.

1.38 I believe that this is an appropriate course of action for a new government, and I have full confidence in the ability and professionalism of Grant Thornton. However, I am concerned that this review has been called an independent audit in multiple media stories, including in quotes attributed to members of the government.

1.39 As the press release clearly states, Grant Thornton is acting as a consultant to government to look at a number of specific issues. It is not conducting an audit of the Province.

1.40 Under the *Auditor General Act*, the Auditor General is appointed the auditor of the Province's financial statements. I am required to report to the Legislative Assembly, not to any member of government, which, coupled with my professional responsibilities as a chartered accountant, means that the work of the Office must be conducted in an independent and objective manner.

1.41 The independence provided to us under our Act is what fundamentally sets us apart from government and allows us to fulfill our duties.

1.42 When media reports refer to the government bringing in Grant Thornton to perform an independent audit, I, as well as staff in the Office of the Auditor General, become concerned that this diminishes the work we do.

1.43 It is important to me that government makes it very clear to the media, and in their comments to the media, that Grant Thornton is not conducting an audit. And that while Grant Thornton is an independent accounting firm, the Office of the Auditor General comprises the group of independent auditors who are responsible to annually audit the Province's financial statements.

Acknowledgements

1.44 I want to acknowledge the cooperation that we receive from government departments and agencies during the course of our financial audit work; they are universally helpful to us. Specifically the cooperation we get from the Office of the Comptroller is critical to our work.

1.45 I want to thank all of the staff of the Office of the Auditor General for their fine work during my first full year in the position, and specifically Mr. Ken Robinson, C.A. for taking responsibility for the audit of the Province's financial statements, and the everyday operations of our Office.



Michael Ferguson, CA
Auditor General