



# 2017 Report of the Auditor General of New Brunswick - Volume II

## Financial Assistance to Atcon – Unanswered Questions

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OF NEW BRUNSWICK



VÉRIFICATEUR GÉNÉRAL  
DU NOUVEAU-BRUNSWICK

# Presentation Topics

- Where did taxpayer's money go?
- Did anyone benefit inappropriately?
- Other observations

# Brief Background



- The Atcon Group Inc. (Atcon) was a New Brunswick company headquartered in Miramichi
- Atcon's complex corporate structure consisted of 27 companies in 2008
- Its activities included heavy civil construction, steel fabrication, manufactured wood products and more
- Atcon received over \$77 million in financial assistance from the Province over 19 occasions since 1993

# Background - Financial Assistance

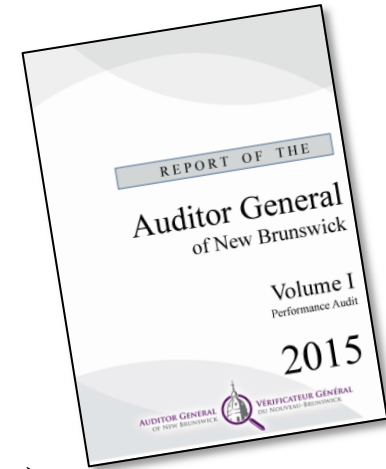
- In 2009, Atcon was operating under **significant cash flow stress**
- In 2010, Atcon was **placed in receivership 9 months after receiving a \$50 million** guarantee from the Province
- This left the Province with close to **\$70 million in unrecovered funds**

# Background – 2015 AGNB Report

*Financial Assistance to Atcon Holdings Inc. and Industry*

## Our 2015 report focused on:

- Government's decision making process in granting financial assistance to Atcon
- How to improve the performance of the Department of Economic Development (DED)  
*(Now Opportunities New Brunswick, ONB)*



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However, we were left with **many unanswered questions**, such as **where did the money go?**

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# Atcon: What We Examined

- Over **15,000 files** from Atcon computers
- **Audited financial statements**
- **Bank statements and cancelled cheques**
- Indexed and searched over **1 million Atcon emails**
- **Interviewed six Cabinet ministers** involved in the decision to grant financial assistance to Atcon
- Had **discussions with staff** at ONB and Attorney General's
- And much more, however...

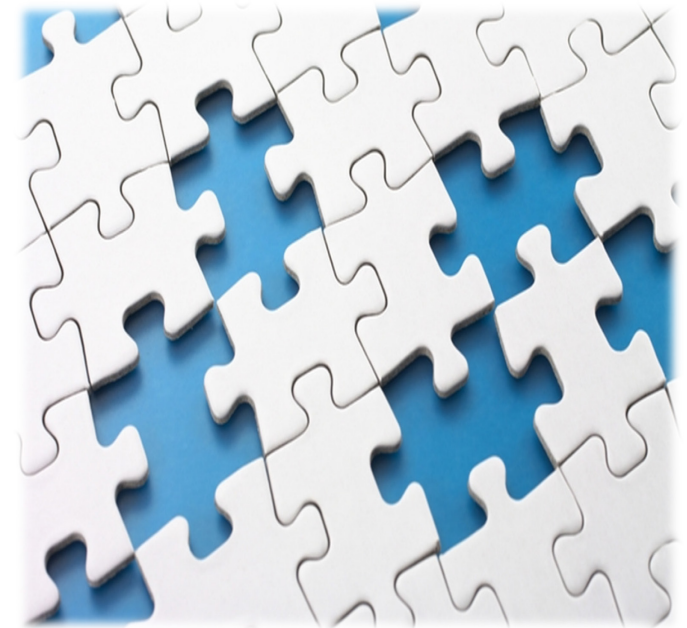
# Significant Gaps in Our Evidence

**We were unable to locate or access certain information including:**

- Various **bank statements** and **cancelled cheques** from different Atcon companies
- **Financial statement audit file** of the auditors of Atcon

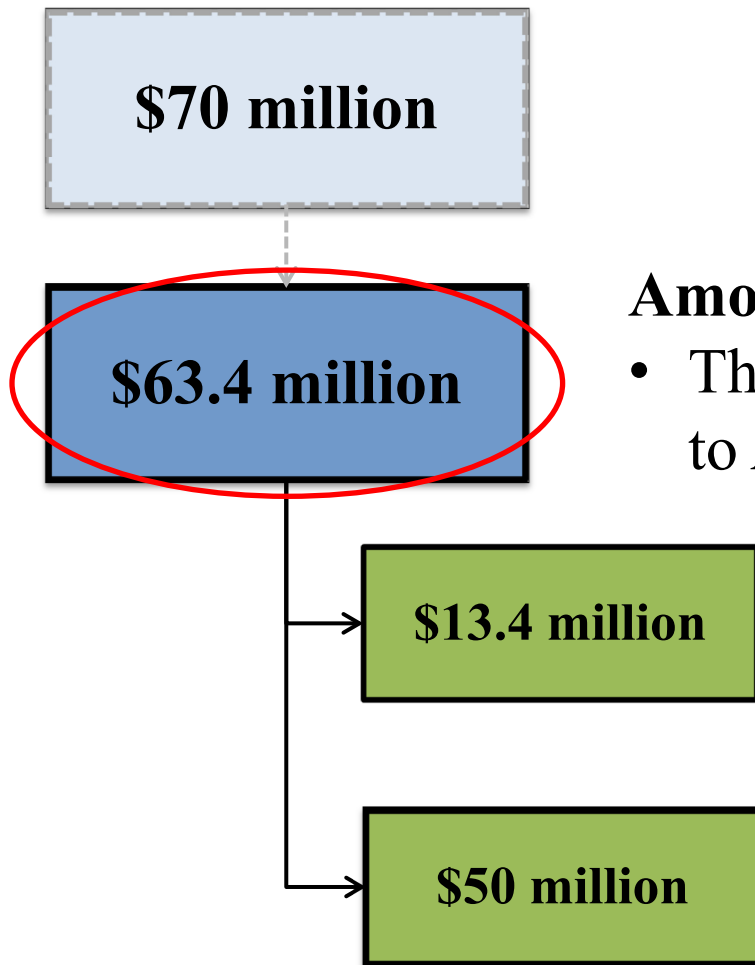
# Significant Gaps in Our Evidence

- Had we been able to examine this missing information, it **may have impacted our findings and conclusions.**





# Atcon: Focus of our Work



## Amount we focused on

- This combines **loans guarantees** granted to Atcon by DED between **2008 & 2009**

## We limited our examination to these loan guarantees because they:

- Were the most recent
- Were the most significant in amount
- Led to significant losses for Province



# Where did \$63.4 million of taxpayer's money go?

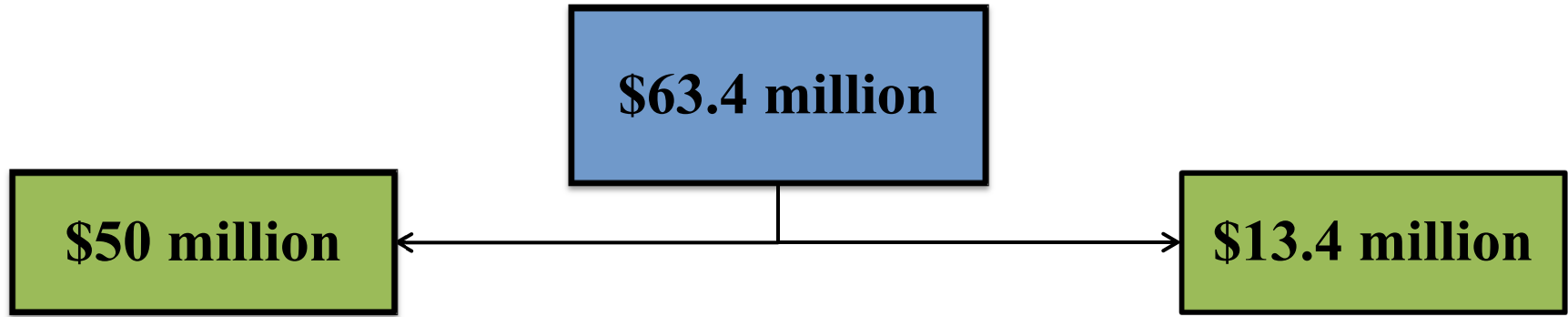
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# Where did \$63.4 million of taxpayer's money go?

The simple answer to the question:



## Bank of Nova Scotia

- Province guaranteed Atcon's loans and when Atcon defaulted, the bank called on the guarantee

## Gov. of Northwest Territories (GNWT)

- Province paid GNWT in connection with guarantee on the **Deh Cho Bridge**

# Where did the \$13.4 million go?

## Deh Cho Bridge - Northwest Territories

- In May 2008, Atcon received a **loan guarantee for \$13.4 million** from the Province, work began in June.
- Purpose was to secure construction **performance obligations**
- In 2010, **Province agreed to pay GNWT \$13.4 million** to correct deficiencies



*Deh Cho Bridge Construction, April 24, 2009*

# Incomplete Review of Support for \$13.4 Million Payment

**We contacted Opportunities NB, and learned it:**

- Requested proof for \$13.4 million payment to GNWT in Feb. 2016; six years after payment
- Has not completed its review of GNWT support for payment



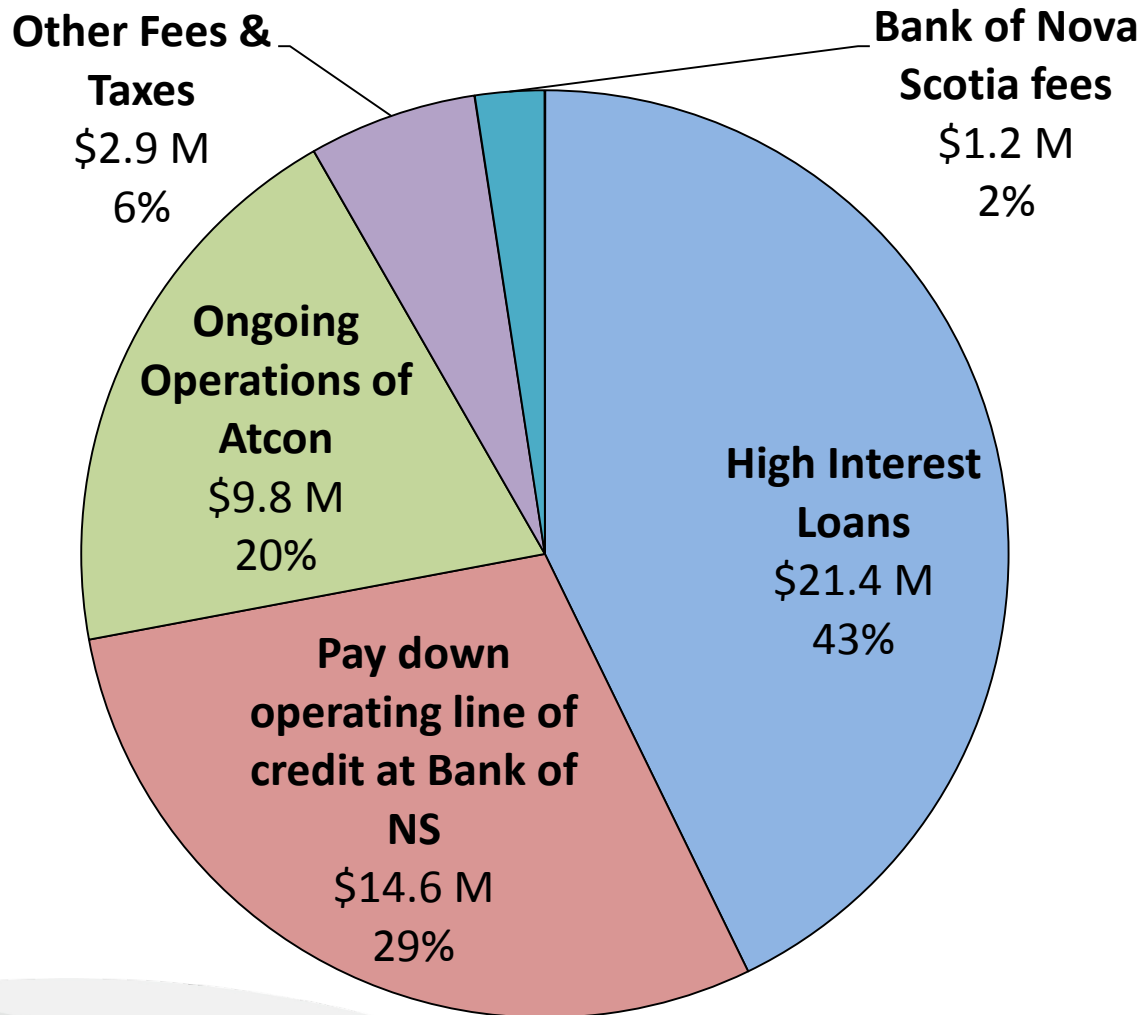
*Deh Cho Bridge opened in Nov. 2012*

# What did Atcon do with the \$50 million?

- We wanted to determine what happened to the \$50 million Atcon received from the Bank of Nova Scotia
- We examined the activity in Atcon's bank accounts, and reviewed available documents



# Where did the \$50 million go?







# Did Anyone Benefit Inappropriately?

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# Did Anyone Benefit Inappropriately?

## Suppliers who Received Payment

Overall, based on our analysis of the movement of the funds once they were in Atcon's control :

- We found the funds appear to be largely used for **business related activities**
- Testing of cheques between July 2009 and March 2010 **did not show** any unusual or large payments to Atcon's companies or its owners

# Did Anyone Benefit Inappropriately?

## Personal Expenses

### Personal expenses paid through Atcon accounts, during the years ended January 31, 2008 to January 31, 2010

Credit card charges deemed personal in nature	\$29,000
Amounts charged to the Shareholder's Account	\$706,000
<b>Total</b>	<b>\$735,000</b>

- We understand this may be normal practice for some companies
- However, **we found it questionable** to do **while applying for financial assistance** from the Province.

# Did Anyone Benefit Inappropriately?

## Personal Expenses Charged to Shareholder's Account

### Income taxes & RRSP

- \$229,000

### Shares & properties in NB

- \$197,000

### Aruba vacation property

- \$57,000

### Luxury car lease

- \$38,000

### Jewelry

- \$15,000



# Did Anyone Benefit Inappropriately?

## Management Compensation in 2007-2009

- Three key management staff **combined** received between **\$554,000 and \$603,000** in annual compensation
- This was **in addition** to **personal expenses and dividends**
- 4% to 5% annual increases during those years
- In our view the increase was not significant enough to indicate an inappropriate benefit

# Did Anyone Benefit Inappropriately?

## Family Member Compensation in 2007-2009

- **Combined** annual compensation to this group of individuals ranged between **\$340,000 and \$378,000**
- We considered compensation paid to some family members as **significant**, given their apparent **limited** or **lack of involvement** in the day-to-day operations of Atcon.

# Observation: Atcon's Corporate Jet

- In 2007, Atcon began leasing a corporate jet at a cost of \$124,000 per month
- We estimate its **operating costs during 2008-2010 was about \$8.2 million**
- We were surprised to find a company under **significant financial pressure**, coming to the Province for financial assistance, would have an item as **extravagant as a corporate jet**.



# Did Anyone Benefit Inappropriately?

**Inappropriate benefit to certain Atcon personnel given request for provincial assistance:**

- Some family of key senior management were salaried with little evidence they did any work for Atcon
- About \$700,000 of personal expenses were put through company accounts.



# Why did Cabinet Grant Financial Assistance to Atcon?

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# Why did Cabinet Grant Financial Assistance to Atcon?

- As we reported in 2015, **senior officials repeatedly advised against** the \$50 million in guarantees
- However Cabinet decided to grant assistance
- We individually interviewed six Cabinet Ministers involved in the decision to grant financial assistance to Atcon

# Why did Cabinet Grant Financial Assistance to Atcon?

Interviews with Six Cabinet Ministers

**It appears decision to grant financial assistance to Atcon was due to factors including:**

- Already depressed economy in Miramichi region
- Many businesses across NB would be negatively affected should Atcon fail
- Atcon's plans moving forward looked promising

# Why did Cabinet Grant Financial Assistance to Atcon?

Many conditions were set by the Province including:

- **Sell or monetize a contract and some assets**
  - Highway maintenance contract and its Swedish assets
- **Set up Advisory Board acceptable to the Minister**
  - Contracts in excess of \$5 million were to be reviewed by the Board to ensure they were acceptable and profitable
- **Pay all outstanding payables owed to NB companies**
  - Atcon agreed to pay \$6.5 million to 314 companies

# Why did Cabinet Grant Financial Assistance to Atcon?

- The Ministers claimed in the interviews to have understood the risks involved with the request from Atcon

# Atcon's Financial Health

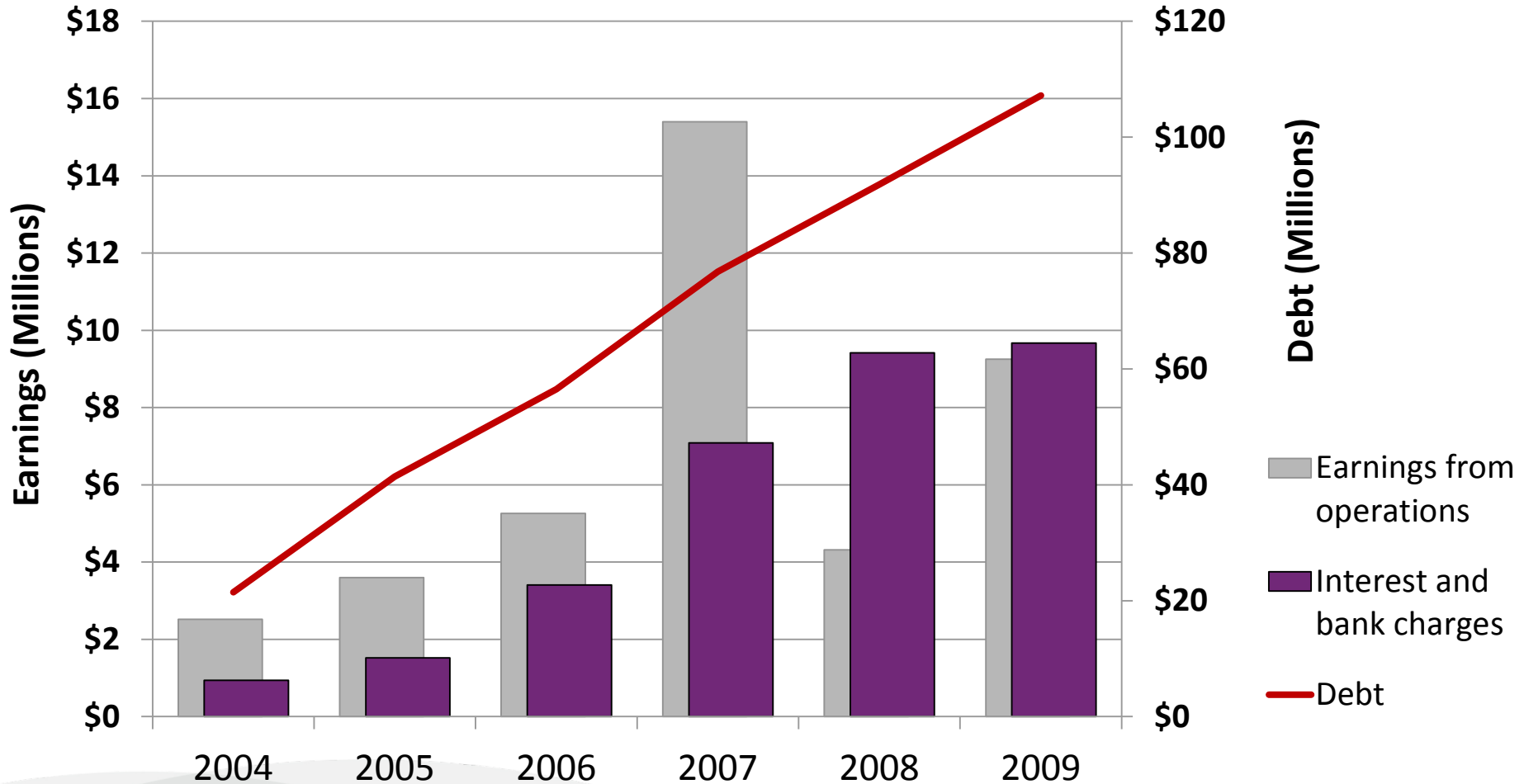
## Analysis Identifies Serious Concerns

- 2008 economic crisis may have contributed to Atcon's financial challenges, however...

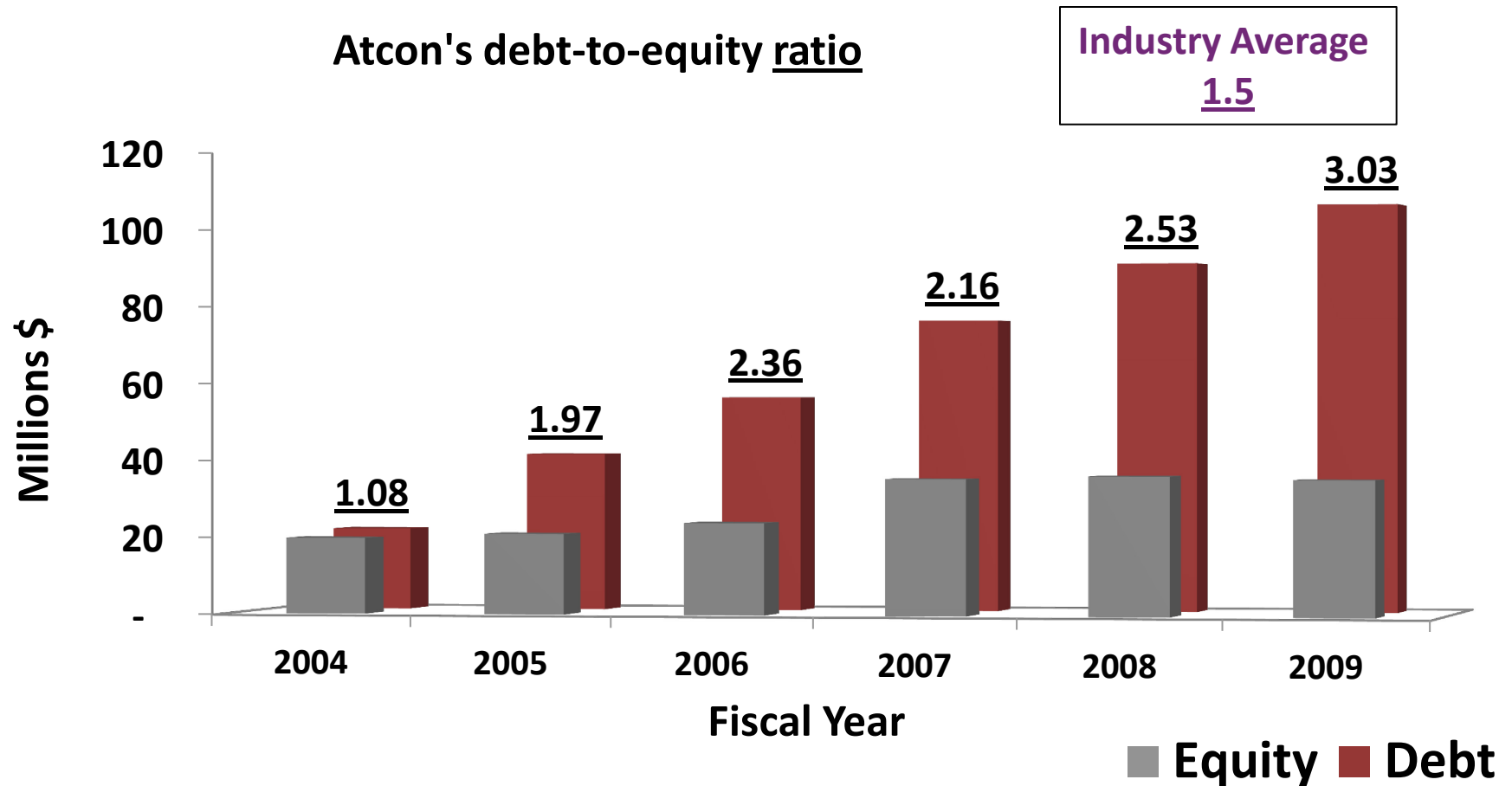
### **Our review identified the following issues:**

- Poor project management practices which lead to higher project costs
- Contractors and suppliers not receiving payment
- Costs incurred for unpaid work
- Poor financial reporting practices

# Atcon's Debt Growth & Bank Charges Outpacing Earnings

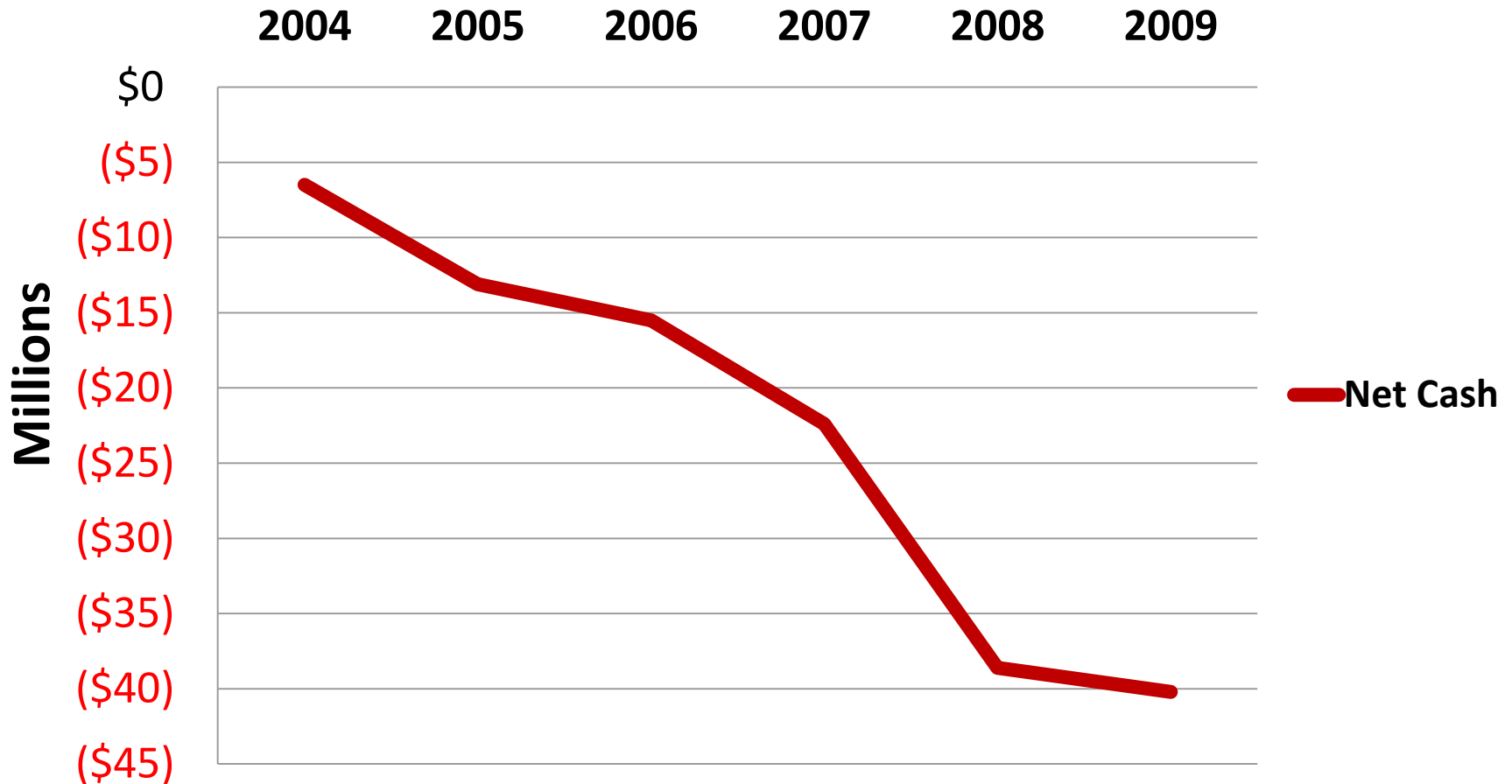


# Atcon's Debt-to-equity Ratio Was Double the Industry Average



# Severe Cash Shortage

Atcon's net cash position at Year end FY 2004 to 2009

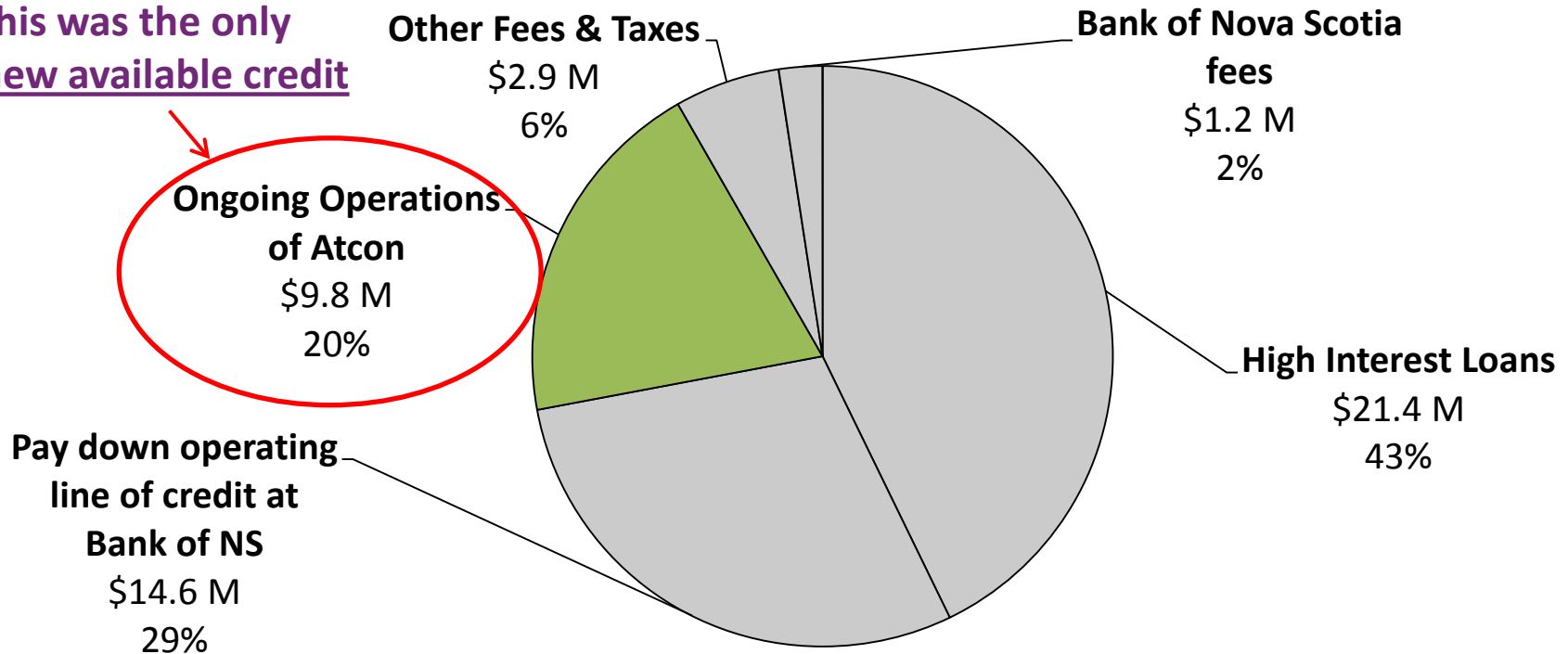




# Atcon's New Available Credit

- Atcon was left with just under \$10 million of actual new credit

Of the \$50 million  
this was the only  
new available credit



# \$50 Million Was Not Going to Save Atcon

- \$9.8 million of new credit not sufficient to solve Atcon's financial challenges
- Unless drastic restructuring, a company in a debt spiral runs out of credit and goes bankrupt
- Atcon declared bankruptcy in March 2010

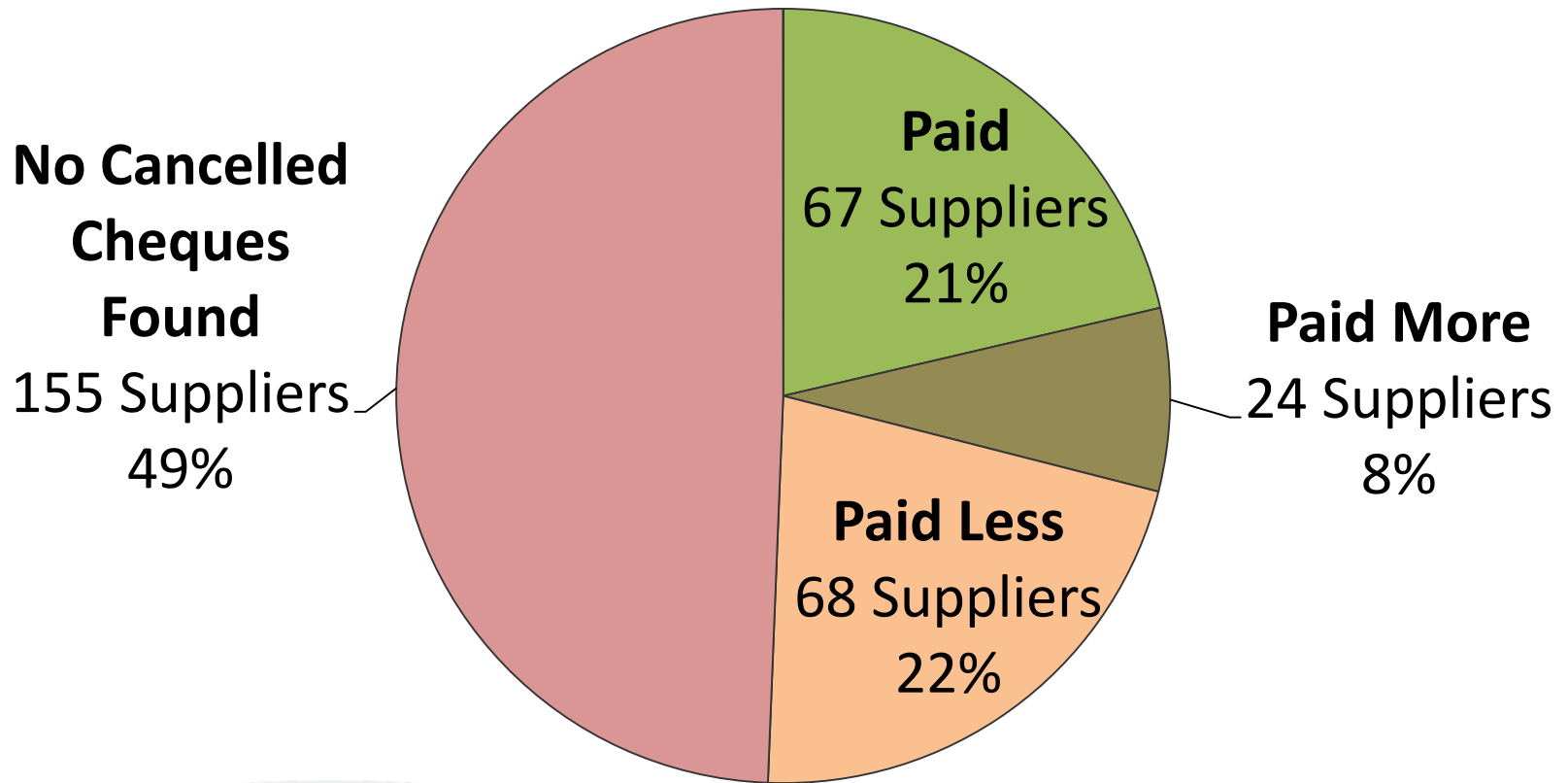
# Regarding Cabinet's Rationale to Grant Financial Assistance to Atcon

## We wanted to know if Atcon:

- Sold or monetized a contract and some assets?
  - No, Atcon was unable to monetize its assets in time
- Set up Advisory Board acceptable to the Minister?
  - Yes, but we believe the Board was put in place too late to have a positive effect
- Paid all outstanding payables owed to NB companies?
  - We cannot determine with assurance that all NB suppliers received payment (*Details on next slide*)

# Condition for Assistance – Pay NB Suppliers

## 314 NB Suppliers to be Paid by Atcon



# Condition for Assistance – Pay NB Suppliers

## NB suppliers paid as per Atcon’s declaration to Province

Amount traced to cancelled cheque	Number of companies	Amount per declaration (millions)	Amount per cancelled cheques (millions)
<b>Equal</b> to amount on declaration	67	\$ 1.2	\$1.2
<b>Greater than</b> amount on declaration	24	0.2	0.3
<b>Less than</b> amount on declaration	68	2.9	1.4
<b>No cancelled cheques found</b>	155	2.2	-
<b>Total</b>	<b>314</b>	<b>\$ 6.5</b>	<b>\$ 2.9</b>



# Analysis of Atcon's Audited Financial Statements

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# Summary of Estimated Adjustments to Atcon's Financial Information (in millions)

	<b>Richter - Estimated Misstatements</b>	<b>Advisory Board - Write-downs</b>	<b>AGNB - Irregularities Noted</b>
<b>Adjustment Total</b> (Prior to this report)	<b>\$ 28.3 - \$ 35.4</b>	<b>\$ 32.1</b>	
<b>AGNB New Finding</b> Financial statement reclassification			<b>\$ 21.7</b>

# Technical Terms Walkthrough

## Reclassification

**Simply put**, in accounting a **reclassification**:

- Is an amount moving from one account to another
- Can be used legitimately to make adjustments

**However, a reclassification could affect:**



- Ratios used to determine financial health
- Going concern vs. not going concern (vice-versa)



# Technical Terms Walkthrough

## Going Concern vs. Not a Going Concern


Simply put, if a company is a:

- **Going concern** = assumption that normal operations will continue for the foreseeable future 
- **Not a going concern** = Doubtful that normal operations will continue, could lead to ceasing operations, liquidating assets 

# Atcon's Year End of 2009

## Going Concern Issue

**Based on our review of audited financial statements, we can tell that prior to the new financing agreement:**

- Atcon was in violation of its debt covenants
- Atcon owed more to suppliers than it could pay
- Atcon likely would have been unable to continue normal operations → **Not a going concern** 

# Atcon's Year End of 2009

## Going Concern Issue

- Atcon made an adjustment showing the anticipated effect of new financing (\$50 million)
- This improved the appearance of Atcon's ratios and financial health



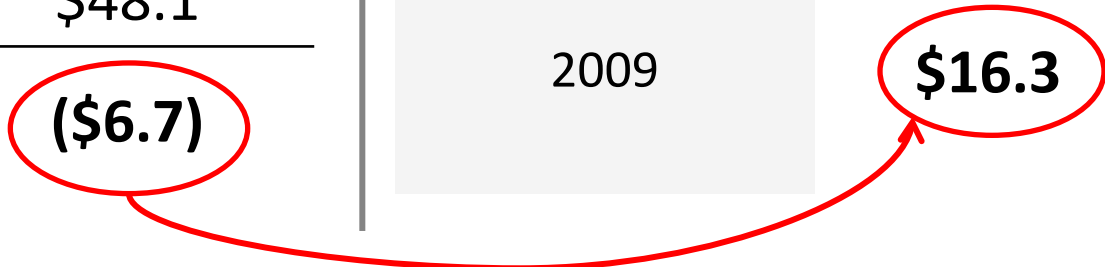
# Irregularities in Audited Financial Statements

**We noted irregularities in the audited financial statements of Atcon:**

1. Discrepancy of \$23 million
2. Questionable reclassification of \$21.7 million

# 1. Discrepancy of \$23 million in Audited Financial Statements

Balance Sheet		Statement of Cash flow	
Payables and Accruals (\$millions)		Change in Payables and Accruals (\$millions)	
2009	\$41.4		
2008	\$48.1		
Balance Sheet Change	<b>(\$6.7)</b>	2009	<b>\$16.3</b>



- We expected these two amounts to match
- Total difference of \$23 million

# 1. Discrepancy of \$23 million in Audited Financial Statements

## With the discrepancy:

- Operations = **Positive cash flow** (in appearance)

## However, without the discrepancy:

- Operations = **Negative cash flow**
- Would have been consistent to previous years

## 2. Questionable Reclassification of \$21.7M

### In simple terms:

- The reclassification, **as it was prepared**, presumed Atcon was going to pay \$21.7 million to suppliers
- However, in our answer to “*Where did the \$50 million go?*” **we did not find that \$21.7 million went to pay suppliers**

## 2. Questionable Reclassification of \$21.7M

- We find the **method in which the reclassification was done questionable**
- To obtain an explanation, we requested access to the financial audit file from the auditors of Atcon, but they **questioned our authority**:

*“...we believe the information in the file will be of no benefit to you given our understanding of your current mandate ...confirm under which provisions of ...the Auditor General Act you are proceeding.”*





# Why did Cabinet Release the Province's Security?

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# Why did Cabinet Release Province's Security?

- The bank requested the Province give up first position on security in favour of the Bank
- The security held by Province was an important mitigating factor against significant risks
- Cabinet rejected this change in security position twice before approving it

# Why did Cabinet Release Province's Security?

- It appears a lot of hope was placed solely on the fact that a prominent businessman was going to head the Advisory Board
- We consider Cabinet's decision to **release Province's security as the critical failure in the Atcon file**
- However, Cabinet Ministers interviewed offered no clear explanation for their decision

# Bank Nova Scotia Recovered: 78%

## Estimate of amount recovered by Bank of Nova Scotia following Atcon's Bankruptcy (\$ millions)

<b>Amount owed to Bank of Nova Scotia</b>	<b>\$ 99.2</b>
<b><u>Less Recoveries:</u></b>	
<b>Payment from Province of NB</b>	(50.0)
<b>Disbursements from Receivers</b>	(27.2)
<b>Estimated net loss to the Bank of Nova Scotia</b>	22.0
<b>Total recoveries</b>	<b>\$ 77.2</b>

# Province Recovered: 4.5%

- Security held by Province was an important mitigating factor against significant risks
- As mentioned, Province had to pay the Bank of NS \$50 million as required under the guarantee agreement.
- Subsequently, **Province only recovered \$2.8 million** of \$63.4 million it was owed by Atcon.
- **Estimated loss for NB: Over \$60 million**

# Cabinet's Release of Security

## Critical Failure in the Atcon File

Had Cabinet not given up the Province's security we estimate:

- **The Province could have recovered in the range of an additional \$12 to \$19 million**

# Cabinet's Release of Security

## Critical Failure in the Atcon File

- Cabinet reversed measures to protect the Province from substantial financial losses
- Public expectation justifiably remains for these elected officials to be transparent and give the rationale for this **inexplicable** multi-million dollar decision





# AGNB Recommendations & Ongoing Matters

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# 2015 AGNB Recommendations

- ONB has made progress in the development of policies and guidelines that address many of the issues we highlighted in 2015. However...

<b>Summary of implementation status of recommendations from 2015 report</b>		
	<b>As assessed by ONB</b>	<b>As assessed by AGNB</b>
<b>Recommendations implemented</b>	15	4
<b>Recommendations not implemented</b>	4	15
<b>Total recommendations</b>	19	19

# 2015 AGNB Recommendations

**We recommended ONB report expected and actual results of job creation and job maintenance in annual report (2.113)**

- Not implemented
- ONB has reported *expected* results only
- Inconsistent use of words “committed” and “created” made it difficult to assess performance.

# 2015 AGNB Recommendations

## We recommended ONB track and report 10-year history of performance (2.123)

- Not implemented
- ONB response indicates implementation is in progress
- However, in a report to the Board Chair and CEO of ONB, the CFO stated: *“while we believe this is an important exercise and that it is prudent to continue this practice into the future, we do not believe the benefit of a 10 year look back will justify the substantial cost and investment.”*

# 2015 AGNB Recommendations

- **Little effort by ECO** to ensure recommendations are applied to all entities providing financial assistance
- Unfortunate given, since 2015, **\$313 million** has been spent on financial assistance to industry

## Financial assistance to industry since 2015 (\$ millions)

Entity	2016	2017	Total
Opportunities NB	\$ 36.9	\$58.3	\$95.2
Regional Development Corporation	73.0	134.4	207.4
Provincial Holdings Ltd	1.0	4.8	5.8
Other	3.0	1.7	4.7
<b>Total</b>	<b>\$ 113.9</b>	<b>\$ 199.2</b>	<b>\$313.1</b>

# 2017 AGNB Recommendations

- 9 new recommendations made to strengthen financial analysis provided to Cabinet in future

**Overall, relating to scenarios where financial assistance requested is:**

- Significant amount; and
- Considered high risk

# Ongoing Matters

- Attorney General pursuing personal guarantee by Mr. Tozer, President of Atcon Holdings Inc.
- Province's legal action against auditor of Atcon in progress
- CPA professional conduct complaint not resolved

# Atcon File Continues to Cost Taxpayers

<b>Estimated additional costs to provide \$50 million guarantee to Atcon in 2009</b>	
Conflict of Interest Commissioner's investigation	\$ 225,000
Legal bill for Hon. Shawn Graham	72,000
Litigation: PNB vs. Grant Thornton (Atcon's auditors)	1,166,700
RSM Richter report	765,000
Deloitte consultation for ONB to implement AGNB recommendations	155,000
AGNB : Atcon I	131,000
AGNB : Atcon II	373,000
<b>Estimated additional costs paid for by the Province</b>	<b>\$ 2,887,700</b>

# Questions?