

# Chapter 7

## Other Audit Work in Departments and Crown Agencies

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# Other Audit Work in Departments and Crown Agencies

## Background

7.1 The Legislative Assembly approves the budget that sets out the government's financial plans. The duties imposed on our Office require us to audit the actual financial results and report our findings to the Legislative Assembly.

7.2 Our audit work encompasses financial transactions in all government departments. As well, we audit pension plans and other trust funds, including the Fiscal Stabilization Fund.

7.3 We also audit the Crown Corporations, Boards, Commissions and other Agencies which are listed below.

7.4 Agencies included in the Public Accounts:

- Advisory Council on the Status of Women
- Algonquin Golf Limited
- Algonquin Properties Limited
- Kings Landing Corporation
- Lotteries Commission of New Brunswick
- New Brunswick Advisory Council on Seniors
- New Brunswick Advisory Council on Youth
- New Brunswick Credit Union Deposit Insurance Corporation
- New Brunswick Crop Insurance Commission
- New Brunswick Electric Finance Corporation
- New Brunswick Highway Corporation
- New Brunswick Municipal Finance Corporation
- New Brunswick Public Libraries Foundation
- New Brunswick Research and Productivity Council
- New Brunswick Securities Commission
- Premier's Council on the Status of Disabled Persons
- Provincial Holdings Ltd.
- Regional Development Corporation
- Regional Development Corporation - Special Operating Agency

## Scope

### 7.5 Other Agencies:

- Le Centre communautaire Sainte-Anne
- Legal Aid New Brunswick

**7.6** 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 departments. We also test controls surrounding centralized systems.

**7.7** 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.

**7.8** 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.

**7.9** 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, or because public attention to weaknesses in accounting controls before they are corrected could possibly result in loss of government assets.

**7.10** 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.

**7.11** This chapter of our Report summarizes issues related to departments and Crown agencies which we consider to be significant to the Members of the Legislative Assembly.

**7.12** Our examination of the matters included in this chapter of our Report was performed in accordance with Canadian generally accepted auditing standards, including 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.

## Department of Finance

### Tax revenues from Canada

#### Background

##### *Sources of revenue*

**7.13** In the 2005-2006 Budget of the Province of New Brunswick, total estimated gross revenue in the ordinary account is \$5.7 billion.

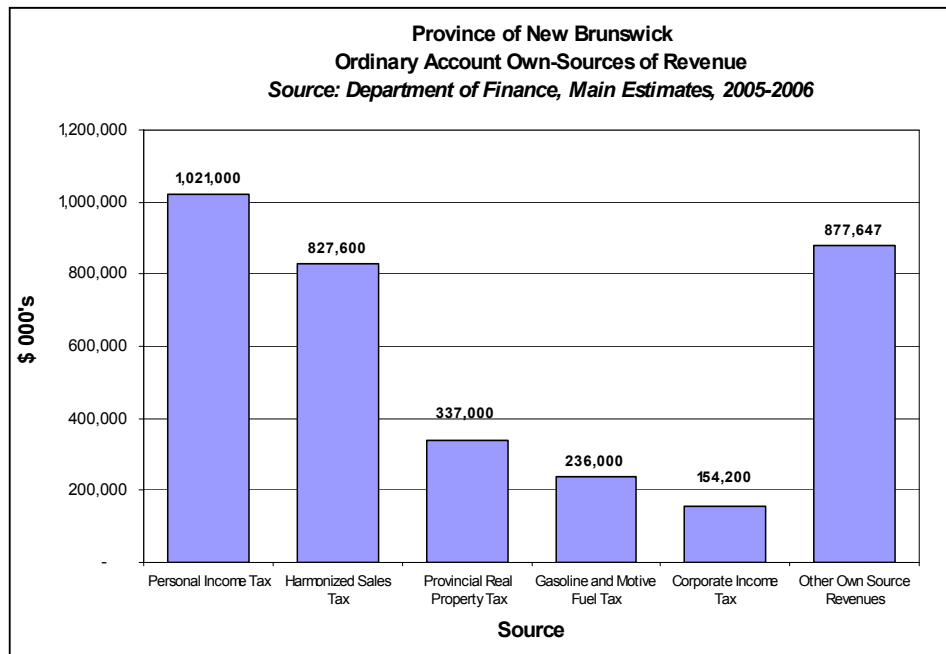
**7.14** Forty per cent of this revenue (\$2.3 billion) comes in the form of grants from the Government of Canada. These grants include equalization payments and transfers for health, education, and other social programs. Sixty per cent of revenue (\$3.4 billion) comes from provincial sources. The provincial Department of Finance (Finance NB) describes provincially-raised revenues as "own-source".

**7.15** The largest own-source revenue is personal income tax (PIT). This is followed in decreasing order by the harmonized sales tax (HST), provincial real property tax, gasoline and motive fuel tax, and corporate income tax (CIT). Other own-source revenues include tobacco tax, licenses and permits, sales of goods and services, natural resource royalties, lottery revenues, and other returns on investments.

**7.16** Exhibit 7.1 shows the relative sizes of estimated own-source revenues for 2005-2006.

*Exhibit 7.1*

*Provincial own-source estimated revenue, 2005-2006*



#### *Significance*

**7.17** The personal income tax, corporate income tax and harmonized sales tax systems are not administered by the Province; rather, they are administered by Canada on behalf of the Province.

**7.18** We chose to review these three taxation systems for the following reasons:

- their significance to the provincial treasury;
- the lack of direct management control by the Province; and
- the volume of tax assessments.

**7.19** These revenue sources are significant to the Legislature because they represent \$2.0 billion, or 58%, of own-source revenue.

**7.20** Since the federal government administers these tax systems, the Province has given up a certain level of control in exchange for the efficiency to be gained from participating in national tax collection systems. This loss of control creates the risk that the Province may not receive all the revenues to which it is entitled. As a result, the Province should have procedures in place to ensure it is receiving an appropriate level of tax revenues from these systems.

**7.21** For 2003, there were 570,223 personal income tax returns filed in New Brunswick. For 2002, there were 24,139 corporate income tax returns filed in the Province. While these are significant volumes for this Province, the numbers are, of course, very small compared to the total number of returns assessed by the federal government for the entire country. There should be concern that sufficient attention is paid by the federal government to the interests of small provinces such as New Brunswick.

**7.22** We have not reported the number of HST returns filed in New Brunswick because the HST revenues received by the Province are not directly linked to the number of returns filed. We will explain how HST revenues are determined later in this chapter.

### ***Financial audit of the Province***

**7.23** Our Office audits the annual financial statements of the Province of New Brunswick. To reach an opinion on the fair presentation of the financial statements of the Province, we annually carry out audit work on the major programs and activities of departments. We audit major revenue items and a sample of expenditures chosen from departments. We also test controls surrounding centralized systems. Our audit of revenue sources received from Canada consists mainly of confirming with the federal Department of Finance (Finance Canada) the amounts received and recorded in the accounts of the Province.

### **Scope**

#### ***Objective***

**7.24** With this review, we wanted to gain a deeper understanding of the tax systems administered by Canada on behalf of the Province. We

also wanted to determine how Finance NB manages the risks of provincial tax revenues being misstated.

**7.25** Accordingly, the objective of our review was:

*To determine if the provincial Department of Finance has implemented appropriate risk management measures to mitigate the risks of misstatement of those tax revenues administered by the Government of Canada on behalf of the Province of New Brunswick.*

### **Parameters**

**7.26** We limited our review to the three largest tax sources administered by Canada (PIT, CIT, and HST). There are other taxes collected on behalf of the Province which are less significant and which were excluded from our review; e.g. large corporations capital tax.

**7.27** There are important jurisdictional relationships that must be understood. Since Canada administers these tax systems, the assessment relationship exists directly between the taxpayer and Canada. Canada provides the Province with taxpayer information relating to taxable income, provincial taxes payable, and other information related to assessments, collections, and payments. Any information provided to the Province is to be kept confidential and used only for the purposes intended under legislation.

**7.28** A number of federal organizations are directly involved in the administration of these taxation systems. These include Finance Canada, the Canada Revenue Agency (CRA), and the Canada Border Services Agency (CBSA). Other organizations, such as Statistics Canada, provide input to the HST system.

**7.29** These federal organizations are audited by the Auditor General of Canada. The provincial government relies upon the work of these organizations and the audits by the federal Auditor General to provide assurance that revenues are appropriately recorded and reported to the Province.

### **Nature of our work**

**7.30** Our work involved a preliminary review of the PIT, CIT, and HST systems. We reviewed processes at both the federal and provincial levels.

**7.31** At the federal level, we made inquiries of staff of the Office of the Auditor General of Canada. We received some technical clarification from staff of Statistics Canada. At the provincial level, we

interviewed staff from Finance NB. We reviewed systems, processes, and documentation related to the PIT, CIT, and HST systems.

## Conclusion

**7.32** Based on the findings of our review, we have concluded that the provincial Department of Finance has implemented appropriate risk management measures to mitigate the risks of misstatement of personal and corporate income tax and harmonized sales tax revenues administered by the Government of Canada on behalf of the Province of New Brunswick.

## Personal and corporate income tax

**7.33** The personal and corporate income tax systems (PIT/CIT) have many similarities; therefore, we will address these systems together.

### *Process overview*

**7.34** The authority to raise income taxes is established in legislation. There is both a federal and a provincial *Income Tax Act*. A tax collection agreement has been in place since 1962 which allows the federal government to administer the personal and corporate tax systems and to remit the provincial portion of taxes to the Province.

**7.35** At the federal level, CRA administers the tax assessment and collection functions. It forwards tax revenues to Finance Canada. Finance Canada remits payment to the Province. Finance NB is responsible for establishing provincial tax policy and managing provincial tax revenues.

**7.36** There are four key components of the income tax system.

### Estimates

**7.37** Finance Canada prepares an official "estimate of payments" of personal and corporate income taxes for each taxation year. A taxation year is the same as the calendar year. Finance Canada supplies federal tax rates and estimates of personal and corporate taxable income figures. Finance NB supplies personal and corporate tax rates for New Brunswick. From these inputs, the estimate document is prepared.

**7.38** Estimates are updated twice during the taxation year.

### Instalment payments

**7.39** The estimate establishes a schedule of payments to the Province. Finance Canada remits payments to the Province. When the estimates are revised, the instalment payments are adjusted accordingly.

### Income tax assessments

**7.40** Income tax returns are filed with CRA. Individuals file personal income tax returns by April 30th following the end of each taxation year. Corporate income tax returns must be filed within six

months of the corporate fiscal year end. CRA assesses the returns in accordance with federal and provincial tax laws.

Reconciliation

**7.41** A “final determination of payments” is prepared following the assessment process. Based upon the final determination of payments, instalments that have already been advanced from Canada to the Province are reconciled to the final tax revenue figures. Any difference is forwarded or withheld by Finance Canada in subsequent remittances to the Province.

**7.42** As a final accounting of income tax revenues, Finance Canada provides an audited statement of income taxes payable to the provinces.

**Risk management**

**7.43** The Province faces three areas of risk relating to income tax revenues.

Completeness of tax revenues

**7.44** The first area of risk involves the completeness of income tax revenues.

**7.45** There is a risk that income will not be reported by taxpayers. Unreported income generated in "the underground economy", for example, reduces the amount of tax revenues otherwise collectible by governments.

**7.46** CRA acknowledges the risk that tax revenues may be understated. In the notes to its 2004-05 audited financial statements, CRA states that the completeness of tax revenues is predicated on self-assessment by Canadian taxpayers. Taxpayers are expected to understand and comply with tax laws. Failure to report all income and taxes owing has an impact on the completeness of tax revenues.

**7.47** To identify and correct situations of non-compliance, CRA has implemented systems, controls and audit procedures. However, CRA says such procedures cannot be expected to identify all sources of unreported income.

**7.48** The Auditor General of Canada audits the tax revenues administered by CRA. Thus, revenues that *are* reported to CRA are audited to ensure they are captured and reported in CRA's financial statements.

**7.49** The Auditor General also audits the annual statement of income taxes payable to the provinces. This statement is the responsibility of the management of both Finance Canada and CRA.



- 7.50** If Finance NB is aware of incidents of non-reporting of income, staff will advise CRA accordingly.
- CRA tax assessments
- 7.51** A second area of risk involves the accuracy of CRA's tax assessment process.
- 7.52** The risk with the greatest potential impact would be the misallocation of provincial tax revenues. In the tax collection agreement, Canada covenants to provide the Province with a reasonable degree of diligence and service level for issues related to province of residence and inter-provincial income allocation.
- 7.53** For individuals, assessment of provincial taxes is based upon the province of residence on December 31. Thus, an error in CRA's recording of the province of residence would overstate the taxes received by one province while understating it for another.
- 7.54** For corporations, taxable income is allocated to provinces where the corporation maintains a permanent establishment. Based on this allocation, provincial taxes are assessed to the corporation. Determining the allocation to each province is a technical exercise subject to varying interpretations of the facts by CRA and the corporation. Also, there is the potential for corporations to choose to allocate income to the province with the lowest rate of tax. Further, provinces are motivated to challenge one another over the appropriate allocation to their respective jurisdictions.
- 7.55** Actions by several parties serve to reduce the possible impact of this risk.
- Canada Revenue Agency
- 7.56** CRA audits personal and corporate tax returns. They use risk assessment criteria to identify returns with potentially higher risk of errors or omission.
- 7.57** For corporate returns, CRA has a policy requiring a mandatory review of the provincial income allocation whenever a corporate tax return is audited. CRA also serves as arbiter in disputes between provinces over the provincial corporate income allocation. It does not allow joint audits of corporate returns with any provincial auditor.
- Auditor General of Canada
- 7.58** As provided in the tax collection agreements between Canada and the provinces, the federal Auditor General audits the statement of income taxes payable prepared by Finance Canada. The Auditor General's objective is to conclude whether the individual assessments recorded in CRA's systems are made in accordance with CRA's

practices. Second, they must conclude whether the assessment information provided by CRA to Finance Canada, plus the tax payments and balances payable to the provinces, are fairly presented in the statement of income taxes payable.

**7.59** To accomplish these objectives, the Auditor General conducts a number of audit procedures. One procedure involves selecting and auditing a statistically-based sample of personal and corporate tax returns. An appropriate number of samples are selected for each province. The number of samples is based upon the respective levels of financial materiality determined by each province's legislative auditor. The Auditor General also asks Finance Canada to confirm with each of the provinces the entitlements, payments and balances outstanding. These confirmed details are reconciled by the Auditor General to the records of Finance Canada. From this audit, each province may be assured its reported tax revenues are fairly stated.

**7.60** Under recent amendments to the tax collection agreements, Finance Canada will periodically provide the provinces with opinions of the federal Auditor General based on the results of a review of relevant control procedures at CRA. The agreements provide that the timing, scope and purpose of such reports will be determined by the Auditor General after consultation with the provincial auditors.

**7.61** Subject to the agreement of the Auditor General of Canada, the provincial legislative auditors may participate in the work of both of these audits.

*Finance NB*

**7.62** Within Finance NB, the Audit and Inspection Services section reviews and challenges the provincial income allocation for all corporations operating within the Province. They communicate with CRA on all changes to permanent establishments in the Province. Finally, they represent the Province's point of view in discussing any allocation issues raised by other provinces.

**7.63** Audit and Inspection Services has undertaken a new initiative with respect to personal income taxes. They have asked CRA to identify high income earners who live and work in more than one province. These individuals have a motive to report income in the province with the lowest rate of tax; therefore, the Province and CRA will perform additional audit procedures to ensure the assessment of tax occurs in the most appropriate province.

Finance Canada estimates and payments

**7.64** The third area of risk involves the estimating and payment of funds to the Province.

**7.65** There is a risk of error in the calculation of tax estimates by Finance Canada and in transferring funds from Finance Canada to the Province.

**7.66** Several parties perform procedures designed to reduce this risk of misstatement to the Province.

*Auditor General of Canada*

**7.67** In the financial audit of the Government of Canada, the Auditor General confirms all relevant financial transactions between Finance Canada and the Province. They review all estimates, instalment payments, and balances payable to the Province.

*Finance NB*

**7.68** Finance NB staff review in detail each estimate and revised estimate of payments as prepared by Finance Canada. There is frequent and open communication between provincial and federal staff.

**7.69** Finance NB periodically updates a multi-year financial projection document for use by the provincial Cabinet. This document is considered confidential advice to Cabinet and thus was not made available for our review. However, staff indicated the document provides a continuous monitoring of estimated versus actual tax revenues. It is used to produce current financial forecasts, fiscal updates, and budget estimates.

**7.70** A final accounting of tax revenues is ultimately provided in the Public Accounts of the Province.

*Auditor General of New Brunswick*

**7.71** The Public Accounts are audited by the Auditor General of New Brunswick. Our Office reviews the estimates, payments, and balances due from Canada. We confirm all tax payments and balances with Finance Canada.

**7.72** As previously noted, our Office may participate with the federal Auditor General in their audits of tax revenues and controls at CRA. In addition, provision is made in the tax collection agreement for our Office to perform audit examinations of selected CRA tax assessment information.

***Analysis***

**7.73** We have noted numerous actions taken at the federal and provincial levels to address the risks associated with personal and corporate income taxes. In summary, we believe the following actions are particularly relevant:

- CRA has numerous internal controls and audit procedures designed to address the risks surrounding the completeness and accuracy of tax assessments for both personal and corporate returns. Their

policy of reviewing the provincial corporate income allocation in every audited corporate tax return is a significant measure designed to reduce the risk of misallocation of tax revenues between provinces.

- The federal Auditor General performs audits of CRA and the Government of Canada, providing assurance that income tax assessments are completed in accordance with CRA's practices and that the resulting provincial income tax revenues are fully accounted for and paid to the provinces.
- Finance NB's review of the official estimates provides additional assurance that the income tax revenues are fairly reported and paid to the Province. With respect to corporate income taxes, the review of provincial corporate income allocation appears to be a particularly effective initiative undertaken by Finance NB.

**7.74** We believe these are appropriate measures taken to mitigate the risks associated with personal and corporate income tax revenues of the Province.

## **Harmonized sales tax**

**7.75** Effective April 1, 1997, the Province aligned its provincial sales tax with the federal Goods and Services Tax (GST) to create a harmonized sales tax (HST). The HST is a value-added tax of 15%, composed of the federal GST (7%) and a provincial component of 8%. The HST is applied to the same base of goods and services as the federal GST.

**7.76** The other provinces participating in the HST model are Nova Scotia and Newfoundland and Labrador.

**7.77** GST is collected on goods and services *consumed in Canada*. For example, it is collected on televisions imported from China and sold in Canada. It is not collected, however, on furniture manufactured in Canada but exported for sale in the United States.

**7.78** The domestic consumption principle also applies with the HST. Goods and services consumed in the three participating provinces attract the full HST. For example, a business in Ontario shipping refrigerators to New Brunswick would charge the 15% HST to its customer. In contrast, a New Brunswick company shipping lumber to Ontario would only charge the 7% GST to its customer.

## ***Process overview***

**7.79** The HST is collected in accordance with federal and provincial legislation.

**7.80** The parties involved in the operation of the HST include Finance Canada, the Canada Revenue Agency, the Canada Border Services Agency, and the participating provinces. Statistics Canada provides essential economic data for the HST revenue model.

**7.81** Each participating province has a tax collection agreement with Finance Canada detailing the operation of the HST. Under the tax collection agreements, representatives from each of the participating provinces and the federal government serve on committees which monitor the operation of the HST and propose revisions to tax policy when required.

**7.82** The HST system operates quite differently from the PIT/CIT system. For PIT/CIT, revenues are based *directly* on tax returns filed by individuals and corporations. With the GST/HST, both GST and HST revenues are *combined* into a revenue pool. This revenue pool is *allocated* to the governments of the participating provinces and Canada based upon a statistical model reflecting the economic activity in each jurisdiction. Thus, there is not a *direct* link between the GST/HST revenues and the GST/HST returns filed by businesses.

**7.83** There are four key components of the GST/HST system.

#### Entitlements

**7.84** Finance Canada annually prepares an initial estimate of the federal and provincial entitlements under the GST/HST. This estimate is driven by a revenue allocation formula. The revenue allocation formula captures a broad base of economic activity in each province and territory. Collectively, this represents the economic activity in Canada. Based on the proportion of economic activity occurring in each participating province, they are entitled to a calculated percentage of the pool of GST/HST revenues collected.

**7.85** For the taxation year 2005, the first estimate of federal GST revenues, collectable on sales of goods and services in all provinces and territories in Canada, was \$39.4 billion. The provincial tax component for the three participating provinces was estimated at \$2.6 billion, giving a total estimated GST/HST revenue pool of \$42.0 billion. New Brunswick's share of that revenue pool was forecast at 2.01%, yielding \$842 million in HST revenue for the Province.

**7.86** The 2005 entitlements of each participating province and the federal government are shown in Exhibit 7.2.

## Exhibit 7.2

## 2005 GST/HST revenue pool entitlements

| Jurisdiction               | Percentage entitlement | Entitlement (in millions of dollars) |
|----------------------------|------------------------|--------------------------------------|
| New Brunswick              | 2.01 %                 | \$842                                |
| Nova Scotia                | 2.76 %                 | \$1,157                              |
| Newfoundland & Labrador    | 1.45 %                 | \$610                                |
| Canada                     | 93.78 %                | \$39,366                             |
| Total GST/HST Revenue Pool | 100.00 %               | \$41,975                             |

## Instalment payments

**7.87** Finance Canada begins each taxation year making monthly instalment payments to the three provinces based on the first estimate. Twice during the year, Finance Canada updates the estimate of the revenue pool and the percentage entitlements based on updated economic data provided by Statistics Canada. The instalment payments are adjusted accordingly.

## Revenue pool

**7.88** When goods are imported into Canada, GST/HST is collected at the border. Goods may be imported three ways: commercially, through the postal and courier systems, or personally by travelers. For *non-commercial* goods destined for individual consumption, the full 15% HST is collected by CBSA. For *commercial* goods destined for re-sale or for other industrial or institutional use, the legislation provides that only the GST portion is collected by CBSA while the provincial portion is reported by the importing business to CRA.

**7.89** When Canadian businesses sell goods to their Canadian customers, they collect the GST/HST, file periodic assessment returns with CRA, and remit the tax accordingly.

**7.90** Both federal GST revenues and provincial HST revenues are combined into one revenue pool. The revenue pool is allocated by Finance Canada to the Government of Canada and the participating provinces.

## Reconciliation

**7.91** For four years subsequent to each taxation year, the size of the revenue pool is updated to reflect actual GST/HST returns filed by Canadian businesses with CRA. The percentage entitlements are also adjusted to reflect the most recent economic statistics from Statistics Canada. Adjustments are made each year to reconcile instalment payments with the revised entitlements.

**7.92** At the end of the fourth subsequent year, final economic statistics are provided by Statistics Canada. Finance Canada prepares

final entitlement figures, reconciles instalment payments made over the combined five-year period with the final entitlements, and makes an appropriate adjustment with the provinces to reflect any shortfall or overpayment.

### **Risk management**

#### Completeness of tax revenues

**7.93** A number of risk areas could expose the Province to a misstatement of HST revenues.

**7.94** The first area of risk involves the completeness of the GST/HST revenue pool.

**7.95** As previously noted with personal and corporate income taxes, CRA acknowledges the risk of understated tax revenues given Canada's self-assessing tax system. CRA has implemented systems, controls and audit procedures to identify and correct situations of non-compliance. Such audit procedures include verifying that the correct rate of tax is charged by vendors in non-participating jurisdictions to customers in the participating provinces. CRA says, however, it cannot be expected to identify all unreported tax.

**7.96** CBSA now provides the customs services previously included under the umbrella of the Canada Customs and Revenue Agency (CCRA). The same control procedures are in place at CBSA to collect GST/HST at the border.

**7.97** As we previously noted, the Auditor General of Canada audits the tax revenues that are administered by CRA. As an example of the work performed, the Auditor General tests a representative sample of GST/HST returns filed by taxpayers. They also ensure that all GST/HST remittances and assessments are accounted for in the appropriate financial period. This audit work provides assurance as to the completeness of GST/HST revenues on a global basis.

**7.98** The customs collection systems previously audited by the Auditor General at CCRA are now audited at CBSA. This audit provides assurance as to the fairness of the administered revenues reported by CBSA in the Public Accounts of Canada.

#### Revenue allocation formula

**7.99** The second area of risk involves the revenue allocation formula.

**7.100** The revenue allocation formula is clearly set out in the tax agreements and does not change without the agreement of all participating provinces and Canada. It is, however, very complex. This complexity could lead to errors or omissions in the preparation of HST

entitlements. As a result, the HST entitlement could be incomplete or inaccurate, and one province's gain in revenue would be another jurisdiction's loss.

**7.101** In response to this risk, Finance NB performs a number of tasks. They conduct an intensive review of every HST estimate and the related instalment payments. They participate in the HST review committees. These committees provide an open forum for discussion of the entitlement results with peers from all jurisdictions. They also consider proposals to improve the revenue allocation formula and tax policy changes.

**7.102** Finally, as previously described in the PIT/CIT section, the multi-year fiscal projection prepared by Finance NB for Cabinet includes HST revenues. Changes in HST entitlements from estimate to final determination are noted, analyzed, and considered in revising financial projections.

#### Data sources

**7.103** The third area of risk for the Province lies in the sources of input data.

**7.104** Input data is gathered at the federal level by Statistics Canada and other government agencies. Finance NB participates in semi-annual workshops held by Statistics Canada. At these workshops, the economic input data is reviewed, but not audited; therefore, some risk exists that errors could occur in the input data.

**7.105** Staff at Finance NB asked whether sufficient sampling of the economic data was performed by Statistics Canada to ensure an accurate representation was made of the Province's economic activity. Statistically, each participating province's activity is very small relative to the national economy. Statistics Canada confirmed to our Office that they adjust their sample sizes to ensure they appropriately capture the economic activity of each province individually.

#### Distribution of revenues

**7.106** The fourth area of risk involves the distribution of the GST/HST revenue pool.

**7.107** Staff at Finance NB asked us to investigate whether the full amount of the GST/HST revenue pool was actually distributed to the participating provinces and the Government of Canada. They wondered if there could be balances accumulating from prior years which were not appropriately distributed.



**7.108** Finance NB may take assurance from the audit of CRA by the federal Auditor General. This audit shows that the combined GST/HST revenues are recorded by CRA and that information on HST revenues is reported to Finance Canada based on entitlements determined by the revenue allocation formula.

**7.109** The federal Minister of Public Safety and Emergency Preparedness is responsible for the operations of the CBSA. The revenues collected by CBSA are reported in the Public Accounts of Canada and audited by the Auditor General of Canada.

**7.110** Finance Canada, a department within the Government of Canada, is also audited by the federal Auditor General. The Public Accounts of Canada disclose details of the provincial HST revenues administered by Finance Canada. We confirmed with staff of the Auditor General of Canada that no balance carries forward to the benefit of the Government of Canada.

**7.111** The federal Auditor General also compares instalment payments to the Province with the entitlement estimates.

**7.112** At the provincial level, the Public Accounts of the Province are audited by this Office. We also review the HST revenue estimates, instalment payments, and balances receivable from Finance Canada. We confirm all transactions with Finance Canada.

### ***Analysis***

**7.113** We have noted numerous measures taken at the federal and provincial levels in response to the risks of misstatement of HST revenues to the Province. In summary, we believe the following actions are particularly relevant:

- CRA and CBSA have numerous internal controls and audit procedures designed to address the risks surrounding the completeness and accuracy of GST/HST assessments.
- Key economic data inputs to the HST revenue allocation formula are provided by Statistics Canada. Statistics Canada operates independently of Finance Canada.
- The work of the federal Auditor General provides assurance that HST revenues are properly estimated, recorded, and paid to the participating provinces.
- The HST review committees are a vital forum for all participants in the HST framework to challenge the entitlement calculations and to propose improvements to the revenue allocation formula.

Finance NB staff conduct a detailed review of every HST entitlement and freely communicate with their peers as part of the tax review committee process.

**7.114** We believe these are appropriate measures taken to mitigate the risks of misstatement of HST revenues.

## Department of Transportation

### Engineering Consulting and Road Construction Materials

**7.115** We conducted an audit of Engineering Consulting and Road Construction Materials in the Department of Transportation in 2000. One component of this audit was to review how the Department purchased engineering services from consultants and to determine if there might be ways the Department could reduce the costs (which were nearly \$10 million for the year ended 31 March 1999) associated with these services. Our objective for this component of the audit was:

*To determine if the Department can reduce costs while maintaining quality by adopting a more competitive process for the contracting of engineering services.*

**7.116** To support the objective we established three criteria, two of which were not met. The two criteria not met were:

- where it is cost effective to do so, all qualified firms should have an opportunity to compete for government contracts; and
- the method of selecting consulting engineers for projects should be cost effective.

**7.117** As the Department did not meet these criteria we made five recommendations. The Department responded to the recommendations by stating they would be “prepared to consider piloting the requesting of proposals for engineering contracts”.

**7.118** We have reviewed the actions taken by the Department in response to the recommendations and reported the results in our follow-up chapters beginning with our 2002 Report. We noted in our 2002 Report that the Department had piloted the use of a request for proposals process for one engineering services contract and was evaluating the results. The Department indicated it was planning on performing a second pilot project at the time of our review in 2002 but later decided not to proceed with it. Our third and final year of follow up was conducted last year, and as reported in our 2004 Report the Department reached the following conclusions:

- direct project costs for the pilot were similar to situations where no requests for proposal (RFP) were sought;
- design standards were maintained;

- there were additional administration costs; and
- the time frame was extended because of the use of the RFP.

**7.119** Normally we do not report on recommendations after the three updates. But this case was different because we found that the Department had not adopted any of the five recommendations, and that their decision was based on the results of just one pilot project.

**7.120** The Department requested proposals for an engineering contract estimated to cost \$50,000. We decided to evaluate the adequacy of the use of this pilot project to guide their decisions on the recommendations. And we have observations on how our recommendations were addressed by the pilot project. We also have comments on the conclusions drawn by the Department from their experience with the pilot.

***Examining how the recommendations were addressed***

**7.121** Following are the original five recommendations made in 2000 plus a summary of the Department's efforts to investigate the merits of the recommendations through the pilot project. The first recommendation ties into the criterion which stated that, where cost effective, all qualified firms should have an opportunity to compete for government contracts. The next four recommendations relate to the second criterion which stated that the method of selecting consulting engineers for projects should be cost effective.

**7.122 We recommended the Department publicly advertise each engineering consulting project so that all consulting firms have the opportunity to express their interest in the available work.**

**7.123** For the contract that the Department chose to pilot, they indicated there were a limited number of suppliers available for the service. In their opinion, they invited bids from all qualified firms available in the province. However, as there was no public advertising of the pilot project this recommendation was not addressed.

**7.124 We recommended the Department ask for proposals from several qualified consultants for each engineering contract.**

**7.125** Although the Department did not publicly advertise the pilot project, the Department did contact ten New Brunswick firms that it believed were capable of handling the contract and asked them to submit proposals. This is consistent with the practice we recommended.

**7.126 We recommended the process by which the Department chooses consultants to request proposals from be formalized and documented. The process, associated evaluation criteria and results of the process should be transparent to all consultants.**

7.127 The process by which the Department chooses which consultants to request proposals from was described verbally but was not documented. The decision to formalize and document the process was dependent upon departmental acceptance of our recommendations. Since the Department did not accept our recommendations, it was not done.

**7.128 We recommended that the Department require the cost of the project to be included in the proposals received from the competing consultants.**

7.129 A requirement for cost information was included in the request for proposals. The consultants provided estimates of what they felt the ultimate cost would be and an explanation of the charge-out rates used to prepare the cost estimate. But the quotes included in the RFPs were not binding.

**7.130 We recommended the process by which the Department chooses which consultant to hire be formalized and documented. Cost should be an important component of this. The methodology, associated evaluation criteria and results of the process should be available to all consultants.**

7.131 The process for choosing which consultant to hire was documented for the one pilot project only. The decision to formalize and document the process for all hiring was dependent upon the Department's acceptance of our recommendations. Since the Department did not accept our recommendations, this was not done.

7.132 Cost was one of the evaluation criteria used in selecting the successful contractor. However as mentioned above, the costs were not binding so the value of cost inclusion was diminished.

7.133 The Department made the details available to the consultants on how the successful proposal was chosen for the pilot.

7.134 We have several concerns with the process that was used to decide whether the recommendations would be adopted.

***Our concerns with the Department's follow-up initiative***

- The pilot project was not publicly advertised and we are unable to estimate the impact that this had on the nature and the number of bidders on the project.
- In our 2000 Report we pointed out that significant savings occurred in other provinces when two conditions were in place: cost was an important factor in the selection process and bids were solicited in a competitive environment. This pilot project was not conducted in a truly competitive environment. We say this because one engineering contract does not simulate how bidders would act if all contracts were awarded in a competitive market place. For example, with the knowledge that many engineering contracts will be available during the year and that most, if not all, of these would be awarded on a non-competitive, rotational basis, why would a firm be motivated to offer government its most competitive price in a pilot project involving just one contract? As a result we are not convinced that the pilot project generated the lowest cost that could be available to the Province from an RFP process conducted in a competitive environment.
- The Department reported that there were additional administration costs encountered and the time frame was extended when compared to the process that takes place when RFPs are not sought. However the Department did not keep formal records of the additional costs and time required. This would be necessary if the Department is to formally evaluate any new contracting process. We also point out that the outcome may have been different had the Department considered the internal efficiencies that would result from adopting this as a standard practice as opposed to using it in just one pilot project.

## **Conclusion**

**7.135** Based on the above factors, our opinion is the one pilot project done by the Department is not adequate to determine if the Department can reduce costs (while maintaining quality) by adopting a more competitive process for the contracting of engineering services. And the Department still does not meet the two criteria.

**7.136** The result is, companies that want to compete for engineering services contracts may not have the opportunity. And without competition, it is possible government pays too much for these services. Finally, the existing hiring process provides the Department with no evidence to support the decisions it makes in hiring engineering consultants.

**7.137** We are not satisfied that the actions taken by the Department were sufficient to allow an informed decision to take place on whether the methodology we recommended could be of benefit to the Province.

### ***Departmental comments***

**7.138** We provided our observations to the Department, which responded as follows:

*The results of our first pilot project led to the conclusion that costs outweighed the benefits of seeking requests for proposals for engineering services. Those results were that direct project costs were similar to the non-RFP process, there was additional administrative effort involved and the overall project timeframe was extended.*

*Although the results did not indicate that a change was warranted, the advantages of a more formal pilot are recognized. As a result we have decided to conduct such a pilot project.*

### **Compliance audits**

**7.139** We have recently committed additional audit resources to measure government's compliance with provincial legislation and with its accounting and other administrative policies.

**7.140** Our work on legislation will focus primarily on acts and regulations that have a relatively narrow application. This type of legislation would not normally receive in-depth audit attention from either our annual financial statement audits or our value-for-money audits.

**7.141** We will also examine government's level of compliance with accounting and other administrative policies. The intent will be to focus on policies that are important to the efficient operation of government. However we will also audit compliance with policy which has received little or no audit attention in recent years.

**7.142** Projects we have begun include the following:

employee travel claims;  
relocation expenses;  
safeguarding movable physical assets;  
lease or loan of assets outside of government;  
*Collection Agencies Act;*  
*Degree Granting Act;* and  
levy on motor vehicle insurers.

## Losses through fraud, default or mistake

**7.143** The results of these audits will be reported to the appropriate departments. Any items of significance will be included in our annual Reports to the Legislative Assembly.

**7.144** 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.

**7.145** 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 Education

- Missing equipment, money and supplies in various school districts \$27,096

### Department of Family and Community Services

- Cheques cashed by persons not eligible to receive the funds \$10,461

### Department of Health and Wellness

- Missing cash and equipment, and ineligible Medicare service claims \$4,210

### Department of Justice

- Missing cash \$1,912

### Department of Natural Resources

- Missing equipment in various regions \$12,495

### Department of Training and Employment Development

- Missing equipment and cash shortages in various community colleges \$20,730

### Department of Transportation

- Missing equipment and supplies in various districts \$2,855

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

**7.147** The Province reports in Volume 2 of the Public Accounts the amount of lost tangible public assets (other than inventory shortages).

**7.148** In 2005, the Province reported lost tangible public assets in the amount of \$139,981 compared to a loss of \$204,035 reported in 2004.