

Chapter 1

Introductory Comments

Contents

Introduction	3
Improving integrity and transparency in financial reporting	3
Financial indicators	8
Components of the Province's financial statements	8
Other financial audits we do	9
Acknowledgements	9

Introductory Comments

Introduction

1.1 Each year, we conduct two types of audits. Our financial audits result in us giving an opinion about the fairness of a set of financial statements. Our value-for-money audits result in us providing a report on the economy, efficiency and effectiveness of government programs.

1.2 We are including only our financial audit work in this volume of our 2007 Report. This includes information about our audit of the Province's financial statements, and our financial audits of other government organizations. We have also included comments about the Province's financial condition.

Improving integrity and transparency in financial reporting

1.3 I believe there are four things that the government should do to improve the integrity and transparency of its reporting of the Province's financial situation. I will discuss each of these in this chapter.

1.4 Our audit report on the Province's financial statements is included in Volume 1 of the Province's Public Accounts. 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 2007 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."

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

Report on a timely basis

1.6 The opinion is dated 6 September 2007. Last year our opinion was dated 28 July 2006. The Province issued the financial statements on 28 September 2007, which was within the deadline established by section 48.1 of the *Financial Administration Act*, although it was about six weeks later than last year.

1.7 One thing that the government can do to improve the integrity and transparency of its reporting of the Province's financial situation is to release the audited financial statements earlier. Alberta, Saskatchewan and British Columbia all issue their audited financial

statements before the end of July. New Brunswick has released its financial statements within six months of the year end in each of the past two years. This is an improvement on previous years, however the Province should be able to release its financial statements before the end of July. This would send a message that it takes financial reporting to its citizens seriously.

1.8 For the year ended 31 March 2007, the Province reported a surplus of \$236.8 million and a reduction in its net debt position of \$136.3 million. These were achieved even after accruing \$60 million for credit union stabilization and support, recording \$26.6 million for Saint John Harbour clean-up and advancing \$68.0 million to the Maritime Provinces Higher Education Commission as an acceleration of their 2007-2008 funding.

1.9 The surplus is not the same as the reduction in net debt because of the method of accounting for capital assets. Out of a surplus of \$236.8 million, the Province used \$136.3 million to pay down its net debt and the other \$100.5 million was used to increase the Province's stock of capital assets. These assets will provide service in future years.

1.10 I have heard it said that since the Province generated such a large surplus both in 2007 and 2006, the government took too much money from the taxpayers and should therefore give some back in a tax reduction. I am a believer that high taxes are a disincentive and a drag on the economy. However, even though the Province has paid down its net debt by about \$250 million over the past two years, there is still over \$6.5 billion of net debt owing. Furthermore, the Province's 2007-2008 Budget estimates that net debt will increase by about \$356 million during the current fiscal year. This increase will primarily be caused by the opening of the new four-lane highway.

Provide future oriented information

1.11 So, the second thing the government can do to improve the integrity and transparency of its reporting of the Province's financial situation is to produce more future oriented information. This would provide citizens with information to assess the government's long term plans. There are three items that should be included in these long-term future plans. They are; net debt management, operations forecasts and self-sufficiency financial statement targets.

1.12 I believe the Province should produce a long-term net debt plan that explains to citizens the level of net debt that the government expects to have over the next five to ten years, as well as a discussion about what level of net debt is appropriate. In chapter 2 of this volume of our Report we have included a twenty-year history of the

Province's net debt. It shows that, on a comparative basis, net debt has increased from \$4.2 billion at 31 March 1987 to \$6.6 billion at 31 March 2007. It also shows that net debt reached a high of \$7.1 billion at 31 March 2000.

1.13 The information about the history of net debt also shows that at 31 March 1987 the net debt to Gross Domestic Product (GDP) ratio was 40.1% while at 31 March 2007 it was at 26.1%. But what about the future? We know that the 2007-2008 Budget forecasts a significant increase in net debt, but does the government have plans to reduce net debt, or is there a ceiling that the government intends to put on the absolute amount of net debt?

1.14 The *Fiscal Responsibility and Balanced Budget Act* does include an objective to reduce the ratio of net debt to GDP. I believe that this target is not sufficient on its own. The net debt to GDP target can improve even when net debt is growing – a potentially dangerous situation.

1.15 The second type of multi-year plan that the government should produce is future operations forecasts. The Grant Thornton report issued in December 2006 included forecast information for three years into the future. However, when the Province produced its 2007-2008 budget, it did so in the normal fashion. The budget did not include estimates of operations beyond the 2007-2008 budget year. If three year forecasts could be produced as part of Grant Thornton's review of the Province's financial position, similar three-year forecasts should be able to be produced and included with each year's budget.

1.16 The final type of future-year forecast that should be prepared is related to the government's self-sufficiency plan. The government's goal of achieving self-sufficiency is one that I support. I believe that there needs to be a concise definition of self-sufficiency in order to assess when it has been achieved. I also believe that the Province should prepare forecasts of its financial position and operating statements against which progress can be measured. If the Province will be self-sufficient in 2026, what will its statement of financial position look like in 2026? How much net debt will there be in 2026? What will its statement of operations look like in 2026? How much equalization revenue will there be? What will the surplus be? Not only should these forecast statements be prepared for 2026, but also for 2021, 2016 and 2011 to gauge progress.

Year-end grant payments

1.17 The third thing the government can do to improve the integrity and transparency of its reporting of the Province's financial

situation is to stop making large grant payments at year end to manage the amount of surplus reported.

1.18 Even though our audit opinion on the Province's financial statements was unqualified, we did bring some items to the government's attention that we were concerned about during the course of our audit. These items are discussed in chapter 3 of this volume.

1.19 One of the items that caused us concern was the accelerated payment of operating grants to the Maritime Provinces Higher Education Commission. This was a year-end grant that did not have to be paid in 2007. It was paid to reduce the surplus in 2007 and provide budget room in 2008. We raised the same issue in our 2006 Report, and we were surprised that the current government used the same approach in 2007. After the previous government announced their intention to accelerate \$60.0 million in funding to MPHEC in 2006, we received a document from the then office of the opposition that included the opinion that such a move "defies financial logic." In 2007 the current government accelerated a payment of \$68.0 million. We continue to believe that altering the timing of regular operating grants creates confusion and makes it difficult to assess the government's performance.

1.20 Readers of the Province's financial statements have to remember that the \$68 million is not additional funding to the universities; it is offset by a reduction in the budgeted funding the universities will receive in the 2007-2008 fiscal year. This is obvious from looking at the 2007-2008 Main Estimates, in which the government goes through some contortions to try to explain this. Page 134 of the Main Estimates tries to explain to readers that even though the revised expenditure amount for MPHEC in 2007 is \$215.5 million, and the estimated expenditure for 2008 is \$163.8 million, this does not represent a reduction.

1.21 The Main Estimates say that "The 2007-2008 estimate of \$163.3 million does not represent a reduction in Assistance to Universities. There has been a corresponding \$68 million increase in assistance in 2006-2007 to reflect an additional grant of \$68 million over and above the original 2006-2007 estimate which will be paid by 31 March 2007." The underlining is in the original document, presumably to provide emphasis for the reader.

1.22 The point here is that the money did not have to be paid in 2007. It was paid to reduce the 2007 surplus and create budget room in 2008. By accelerating these grants the government is obscuring its

operating results and not being transparent. The surplus of \$37.1 million forecast in the 2007-2008 budget was created, not through a structural adjustment of revenues or expenses, but by using the 2007 results as a quick fix. If the grant was not paid in 2007, the money would not disappear. There would have been a larger surplus in 2007, and a projected deficit in 2008 – a more accurate picture.

1.23 An example of a problem with these year-end grant payments is the grant for the Early Learning and Child Care Trust that was recorded as an expense in the year ended 31 March 2006. As we say in chapter 3 of this volume of our Report, this money was still in the Trust's bank account at 31 March 2007. So the government in 2006 took credit for spending \$8.0 million on early learning and child care, when in reality none of it had been spent even a year later. In fact a second announcement was made in June 2007 about the implementation of this trust fund. This essentially announced the same spending for a second time.

Discuss the financial results

1.24 The fourth thing the government can do to improve the integrity and transparency of its reporting of the Province's financial situation is to provide a full discussion of the results for the year. In chapter 3 we compare the information contained in Volume 1 of the Public Accounts under the headings "results for the year" and "major variance analysis" to the recommended practices for preparing a financial statement discussion and analysis as issued by the Public Sector Accounting Board. We evaluated six areas of recommended practice and found that the government is not doing three of them and needs to improve on the other three.

1.25 To summarize, there are four things that the government should do to improve the integrity and transparency of its reporting of the Province's financial situation, they are:

- release the audited financial statements earlier;
- produce more future oriented information, specifically, a long-term net debt plan, future operations forecasts, and self-sufficiency related pro-forma financial statements for 2011, 2016, 2021 and 2026;
- stop making large grant payments at year end to manage the amount of surplus reported; and
- provide a full discussion of the results for the year.

1.26 None of these should be particularly difficult to do, with the possible exception of preparing pro-forma financial statements related to the self-sufficiency vision.

1.27 The Province has made some steps to improve its financial reporting. As I noted earlier, the audited financial statements for each of the past two years have been released within six months of the year end. Also, as we report in chapter 3, the Province made significant progress in improving its compliance with the accounting recommendations of the Public Sector Accounting Board during 2007.

1.28 In this volume, we are also reporting on other items that resulted from our financial audits.

Financial indicators

1.29 In chapter 2 we report the six financial indicators that we have tracked for a number of years. These show that since 31 March 2000, the Province has made significant improvements in its net debt to GDP ratio; in keeping its change in net debt below the increase in GDP; in the amount of annual revenue that is dedicated to the “interest-bite”; and to its exposure to foreign currency risk. The areas without any significant change since 31 March 2000 are related to the sources of the Province’s revenue.

Components of the Province’s financial statements

1.30 Chapter 2 also contains our comments on the components of the Province’s financial statements. This is a detailed breakdown of the numbers contained in the financial statements, and it is aimed at the reader who wants to drill down an extra level to understand the Province’s financial position and results of operations.

1.31 In the comments on the components of the financial statements, there are three things I want to highlight.

1.32 The first is that we are still concerned about the level of the Province’s doubtful accounts, and believe there is an opportunity to better manage these accounts.

1.33 The second comes out of our comparison of the Province’s net debt position to other provinces. We think that it is relevant to the self-sufficiency vision to recognize that even though Nova Scotia has a population that is 25% larger than New Brunswick and an economy that is 33% larger, it has net debt that is more than 80% larger than New Brunswick. This means that, depending on your definition of self-sufficiency, a larger economy and larger population are not guarantees of success.

1.34 The third is the growth of income tax revenue. Personal income tax revenue is increasing at a rate that is significantly above what the economic data would suggest it should be. This appears to

be a national phenomenon for which there is not a definite explanation.

Other financial audits we do

1.35 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 3. For most of these organizations, legislation directs us to perform an audit.

1.36 As I noted last year, auditing these organizations consumes a significant portion of our resources. New assurance standards issued by the Canadian Institute of Chartered Accountants 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. This has led to an increase in our financial audit time, causing us to look for new ways to accommodate the extra time requirements.

1.37 We continue to believe that some of the organizations we audit do not need audits, although they are required by legislation to have audits. Some of the organizations we audit are small, and the government has access to all the information it needs to hold them accountable even without an audit. We would like to have government remove the legal requirement for us to audit some organizations.

Acknowledgements

1.38 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.

1.39 I want to thank all of the staff of the Office of the Auditor General for their fine work during the year. We continue to look for ways to do our work better, and the staff of the Office has embraced this challenge



Michael Ferguson, CA
Auditor General