

Chapter 3

Matters Arising from our Financial Statement Audits

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Matters Arising from our Financial Statement Audits

Introduction

3.1 This chapter covers three separate, but related, topics:

- Matters arising from our audit of the financial statements of the Province

This section provides information on matters arising from our 2007 audit of the Province's financial statements.

- Compliance with PSAB recommendations

This section discusses the recommendations of the Public Sector Accounting Board of the Canadian Institute of Chartered Accountants. It focuses on those recommendations with which the Province is not in compliance in its summary financial statements.

- Other audit work in departments and Crown agencies

This section summarizes issues related to departments and Crown agencies arising from our financial statement audit work.

Background

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

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

Agencies included in the Public Accounts:

- Advisory Council on the Status of Women
- Kings Landing Corporation
- Lotteries Commission of New Brunswick
- 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 Legal Aid Services Commission
- New Brunswick Municipal Finance Corporation
- 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

Other Agencies:

- Le Centre communautaire Sainte-Anne

Scope

3.4 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.

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

3.6 It is our practice to report our findings to senior officials of the departments concerned, and to ask for a response. Some of these findings may not be included in this Report, because we do not consider them to be of sufficient importance to bring to the attention of the Legislative Assembly, or because public attention to weaknesses in accounting controls before they are corrected could possibly result in loss of government assets.

3.7 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.

Matters arising from our audit of the financial statements of the Province

Responsibilities of the government

Responsibilities of the Office of the Auditor General

3.8 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.

3.9 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.

3.10 The government is responsible for the preparation and the content of the Province's financial statements. The Statement of Responsibility at the front of Volume 1 of the Public Accounts is signed by the Minister of Finance on behalf of the government. The Comptroller is responsible for preparing the financial statements in accordance with the government's stated accounting policies. When preparing the financial statements, the government must make significant estimates, as not all information is available or determinable at the time of finalizing the statements. Examples of where estimates are used include: the set up of tangible capital assets as only limited records were kept for prior years; the pension liability and pension expense for the public service and other groups; and allowances for loss on loans felt to be uncollectible.

3.11 Our Office is responsible for auditing the financial statements. An audit provides reasonable, but not absolute, assurance that the Province's financial statements are free of material misstatement. Material misstatement refers to an item or group of items that, if omitted or misstated, would alter the decisions of reasonably knowledgeable financial statement users. The tolerable level of error or misstatement is a matter of judgment.

3.12 We obtain reasonable assurance on the financial statement figures because it would not be cost effective to obtain absolute assurance - our auditors cannot test every transaction. By applying audit procedures to test the accuracy or reasonableness of the figures appearing in the financial statements, we achieve our desired level of assurance. We use audit procedures such as tracing samples of transactions to supporting documents, testing the effectiveness of certain internal controls, confirming year-end balances with third parties and reviewing the reasonableness of estimates.

Our opinion on the financial statements

3.13 In our opinion, the financial statements present fairly, in all material respects, the financial position and results of operations of the Province of New Brunswick in accordance with the stated accounting policies of the Province, which are in accordance with Canadian generally accepted accounting principles.

Matters arising from our audit

3.14 In almost every audit, there are matters arising that need to be discussed with management. These matters, although significant, are not sufficiently large in dollar terms to affect our opinion on the financial statements. The following is a summary of significant issues raised with the Office of the Comptroller related to our 2007 audit.

Early Learning and Child Care Trust Fund

3.15 Last year we reported that we did not feel that the Early Learning and Child Care Trust Fund (ELCC) was a separate entity from the Province for the year ended 31 March 2006. There were no board members, by-laws, or operating principles in place at that time. The three applicants named on the application of incorporation were all staff of the Department of Family and Community Services (FCS).

3.16 At the end of March 2007, three board members were appointed by the Minister of FCS. The by-laws of the board that existed at the time stated that the board will appoint future members from a list of nominations provided to them by FCS. As a result, we feel that this fund was still being controlled by the Province at 31 March 2007.

3.17 **We recommended the Office of the Comptroller review and document the structure of such trust funds when they are created to ensure they are outside the provincial reporting entity.**

3.18 The Comptroller responded:

..... the by-laws for the ELCC Trust Fund have recently been changed, so that future appointees will come from nomination lists provided by existing Board members (two of which are non government), and not from a list provided by the Department of Family and Community Services as had previously been stated.

As per your recommendation, my Office will attempt to review and ensure proper documentation of the structure

of such trust funds when they are created so as to ensure they are outside of the Provincial reporting entity.

3.19 Furthermore, in our opinion, the establishment of and announcements surrounding this \$8 million trust have caused confusion. Even though this expenditure was recorded by the Province in the fiscal year ended 31 March 2006, with a June 2006 press release announcing the spending, as at 31 March 2007 the money was still in the Trust's bank account and none of it had been spent on improving child care in New Brunswick. A second announcement was made in June 2007 announcing the "implementation of the \$8 million Early Learning and Child Care Trust Fund". This essentially announced the same spending for a second time.

Payment of grants

3.20 Last year we noted that the one-time payment to the universities through Maritime Provinces Higher Education Commission (MPHEC) of \$60.0 million was recorded as an expense of the 2005-2006 year. This payment was for use by the universities in the 2006-2007 year. Normal grant payments were suspended in the first few months of 2006-2007 up to this amount. Late in 2006-2007, a further \$68.0 million payment was made to MPHEC that was for 2007-2008 operations.

3.21 Payments made late in the year for ongoing programs which are offset by immediate changes in funding in the next fiscal period create confusion in regard to the ongoing level of funding for the program. It appears through the financial statements that funding for universities is fluctuating, when that is not necessarily the case.

Accounting differences with Crown agencies/service provider

3.22 Last year we reported that, during the audit of Provincial Holdings Limited (PHL), we found a loan guarantee for \$15 million that was in place at 31 March 2006 that was not on the list of guarantees prepared by the Department of Business New Brunswick (BNB). This year during our audit of PHL we found that a loan had been fully provided in the books of the Province by BNB, but it was not fully provided in the books of PHL.

3.23 During our audit of the student loans receivable, we noted that there were unexplained differences between the amounts recorded by the Province, and the balances reported by the service providers that administer the loans.

3.24 There were also unexplained differences between amounts that were recorded by the Province and those on the financial statements of the Regional Health Authorities.

3.25 We recommended the Office of the Comptroller ensure Departments perform reconciliations each year on a timely basis and discrepancies are investigated and resolved.

3.26 The Comptroller responded:

We agree that Departments must perform reconciliations each year on a timely basis. We will make every effort to ensure departmental staff complete these reconciliations by the requested deadlines and ensure discrepancies are investigated and resolved.

New Brunswick Power Holding Corporation (Holdco) audited financial statements

3.27 Last year we reported that New Brunswick Power Holding Corporation financial statements are required, by legislation, to be submitted to the Minister of Energy by September 30th of each year. This is the same date that the Province's financial statements, which include the results of Holdco, are to be laid before the Legislative Assembly according to the *Fiscal Responsibility and Balanced Budget Act*. We may require audited financial statements for Holdco be presented to us before we can issue an auditor's report on the Province's financial statements.

3.28 We recommended the legislated date of the Holdco financial statements be changed to ensure that we can issue an audit report to meet the September 30th deadline set out in the *Fiscal Responsibility and Balanced Budget Act*.

3.29 The Comptroller responded:

In a letter from the Deputy Minister of Finance to the President of the New Brunswick Power Holding Corporation (HOLDCO) it was formally requested that HOLDCO provide its audited financial statements well in advance of the September 30th deadline set out in the Fiscal Responsibility and Balanced Budget Act. HOLDCO has agreed to provide the audited financial statements in a timely fashion.

It has also been requested that the Department of Energy amend the Electricity Act to provide for an earlier

requirement for HOLDCO to provide their audited financial statements. This request has been agreed to in principle and the Department of Energy will bring this recommendation forward as part of any future amendment to the Electricity Act.

Public Sector Accounting Standards

3.30 If reference could be made in note 1 to the financial statements that the Province is following the CICA Public Sector Accounting Standards, this would allow for a less complicated auditor's report to the Legislature.

3.31 We recommended the Province include, in note 1 to its financial statements, a clear statement that the financial statements are prepared in accordance with the recommendations of the CICA Public Sector Accounting Board.

3.32 The Comptroller responded:

Although we had agreed to include the requested sentence to Note 1 of the financial statements in our response to the 2005-06 management letter, upon further consideration, we noted the need to review the wording of the Financial Administration Act to ensure that both the Act and the potential change to the financial statement note coincide.

Actuarial valuations

3.33 Note 14 (a) to the Province's financial statements shows that actuarial valuations for accounting purposes have not been done for the *Members' Superannuation Act* and *Members' Pension Act* since April 1996 and for the Early Retirement/Workforce Adjustment Program since April 1999. As a result, the liability in the financial statements may need to be adjusted.

3.34 We recommended actuarial valuations be done on the pension plans noted above.

3.35 The Comptroller responded:

A valuation is currently in progress for the Early Retirement/Workforce Adjustment program, which should be finished before the 2007-08 financial statements are prepared. As well, a valuation has been completed for the Members' Superannuation Act and Members' Pension Act. This valuation was completed in

April 2005, but the actuarial valuation date has not been updated in the notes. We will ensure it is updated for the 2007-08 financial statements.

Business continuity plan

3.36 Last year we reported that there was no business continuity plan in place for the financial information system. A business continuity plan outlines the procedures to follow and the resources needed to ensure systems continue to operate if an interruption or disaster occurs. Business continuity planning includes such things as a business impact analysis, emergency response procedures and an information technology recovery plan. Without such a plan, there is an increased risk of a disruption of government programs or services in the event of a disaster. It is our understanding that a business continuity plan is now being worked on, but is not complete.

3.37 **We recommended the Office of the Comptroller complete the development and documentation of a complete business continuity plan to help ensure that government programs are not seriously affected if an interruption or disaster affects the financial information system.**

3.38 The Comptroller responded:

In last year's response to your management letter, I responded that my Office was committed to commence work on the development of a business continuity plan. We have worked on the development of a plan during the 2006-07 year and the project is still in progress. It is an extensive undertaking but we are working on the project with a goal to completing the development and documentation of a business continuity plan.

Metallic mineral tax audits

3.39 Metallic mineral tax audits are not up to date. Returns for the past six years have not been verified for accuracy, therefore adjustments may be required. For the 31 March 2007 year end, this resulted in the Province recording an estimate of metallic mineral tax revenue without having verification of recent tax returns on which to base the estimate.

3.40 **We recommended metallic mineral tax audits be performed on a timely basis.**

3.41 The Comptroller responded:

This issue is now being addressed as the [Department of Finance] is carrying out plans to accelerate the completion of audits on the remaining older years while concurrently performing audits as current-year returns are filed. Within two years, the department will have completed all prior year audits.

Oracle financial information system

Disabling user accounts

3.42 User accounts are not disabled in a timely manner:

- We found 62 user accounts that were not disabled after 90 days of inactivity.
- The number of days that user accounts were inactive ranged from 100 to 2,230 days.
- The average number of days that the 62 user accounts were inactive was 247.

3.43 Failing to disable a user's account increases the risk of unauthorized access to the system and makes it harder to track software licenses.

3.44 In March 2003, the government released "Password Standard for User Accounts" which outlines baseline security for all user accounts. This policy requires that inactive user accounts be disabled after ninety days of inactivity.

3.45 Comptroller's Office staff said that they are aware that they are past due in terminating inactive user accounts. They had started a project in January to review inactive accounts but the project was not completed. Also, disabling user accounts that belong to other departments makes the process more difficult as departments want their users to be left alone.

3.46 We recommended the Office of the Comptroller disable Oracle user accounts that have been inactive for more than ninety days.

3.47 The Comptroller responded:

We have completed two improvements in this area since the time of your audit.

First, we moved all of our Oracle users to Single Sign On in late June 2007. This means that user names in Oracle Financials are now tied to network user names and passwords. When employees leave government or change departments, the network administrators are much more likely to keep their departmental network information up to date. Without a network login, there is no Oracle access.

In addition, we have automated a process that looks at the last date logged in for all users, and automatically end dates them if they have not accessed the system in more than 100 days.

Service requests

3.48 There is also a lack of documentation to support changes made to the Oracle system. In our testing of nine service requests, we found the following:

- six service requests did not have evidence that the Director of Accounting Services authorized the request.
- five service requests did not have evidence of testing.
- seven service requests did not have evidence that the Director of Accounting Services authorized the request to be put into production. However in two of these cases, other members of Accounting Services authorized the requests.

3.49 Lack of documentation to support program changes increases the risk that unauthorized system changes could be made. Also, if untested changes are accidentally put into production, the system could produce inaccurate results or be unable to process information.

3.50 The Office of the Comptroller has a service request policy that requires:

- the Director of Accounting Services to approve all service requests before they are made;
- Accounting Services to sign off on the testing of service requests before they are put into production; and
- the Director of Accounting Services to authorize service requests to be put into production.

3.51 The Director of Accounting Services indicated that she is aware of all system changes as they are discussed in their regular meetings. The errors that we found are more from a lack of

documentation than from unauthorized or untested system changes being made.

3.52 We recommended the Office of the Comptroller improve the process for documenting service requests. In particular the Office of the Comptroller should ensure documented evidence exists for all service requests to ensure that they are approved, tested and authorized for production.

3.53 The Comptroller responded:

We have enhanced the process since the time of the audit, reminding FIS Support and Accounting Services staff of the need for good documentation and director sign-off before anything goes into production. As well, we are in the process of acquiring some helpdesk software which will be used to not only log help desk calls, but also to document a knowledge base and service requests/ approvals.

Compliance with PSAB recommendations

Summary of compliance

3.54 The Public Sector Accounting Board (PSAB) of the Canadian Institute of Chartered Accountants, the national body that establishes accounting standards, issues accounting standards for provincial governments.

3.55 In volume 1 of our 2006 Report, we reported on the Province's compliance with the accounting standards for provincial governments issued by the Public Sector Accounting Board (PSAB). We concluded that the Province had complied with 165 of 187 applicable recommendations for a compliance rate of 88.2%. We also made recommendations that would result in the Province complying with 15 of the 22 PSAB recommendations that they were not complying with. This year we are pleased to report that the Province has implemented many of our recommendations. The following table shows the progress made in the 15 areas:

Complied with in the year ended 31 March 2007	9
Partially complied with in the year ended 31 March 2007	3
Situation did not occur during the year ended 31 March 2007	1
Not complied with in the year ended 31 March 2007	2

3.56 The specific PSAB accounting recommendations under consideration were:

PSAB Reference	2006 Report of the Auditor General Vol. 1 Reference	31 March 2007 Compliance	31 March 2007 Financial Statement Reference
1200.061	2.54	Yes	Note 9
1200.129	2.58	Yes	Statement of Change in Net Debt
2600.48	2.63	Yes	Note 1 (c) Foreign Currency Translation and Risk Management
3030.04	2.67	Yes	Note 6
3050.38	2.79 2.80	No	
3050.54	2.85	Partially	Note 1 (c) Accrual Accounting
3060	2.88	Yes	
3070.56	2.91	N/A	
3070.60	2.99	No	
3100.24	2.103	Partially	Note 5
3230.03	2.107	Yes	Note 1 (c) Sinking Funds
3250.084	2.113	Yes	Note 14 (c) Summary Pension Information
3250.093	2.117	Yes	Note 14 (c) Summary Pension Information
3310.29	2.121	Yes	Note 1 (c) Allowances
3310.31	2.125	Partially	Note 15 (b) New Brunswick Credit Union Deposit Insurance Corporation

3.57 The following table outlines the nine recommendations that the Province agreed with and implemented.

2006 Report of the Auditor General Volume 1 Reference	Recommendation	2007
2.54	The Province should include in its note to the financial statements on tangible capital assets the additions in the year, the disposals in the year, the amount of any write downs in the year and the amount of amortization for the year for each class of tangible capital asset.	Yes
2.58	We recommend the Province report the budgeted change in net debt figures with a comparison to the actual change in net debt for the year.	Yes

2006 Report of the Auditor General Volume 1 Reference	Recommendation	2007
2.63	We recommend the Province include note disclosure of its policy for managing foreign currency risk, and a brief sensitivity analysis of the impact of fluctuations in exchange rates.	Yes
2.67	We recommend the Province report the market value of its short term investments.	Yes
2.88	We recommend the Province review whether it is a member of any government partnerships, with specific emphasis on the Atlantic Provinces Special Education Authority, Canadian Blood Services and the Council of Atlantic Premiers.	Yes
2.107	We recommend the Province include in its notes to the financial statements a brief explanation about how the sinking fund is used to retire funded debt.	Yes
2.113	We recommend the Province disclose the actual amount of benefits paid out of its pension plans and the actual annual return on plan assets for each plan.	Yes
2.117	We recommend the Province disclose the financial status of its two defined benefit plans with fixed employer contributions in the notes to the financial statements.	Yes
2.121	We recommend that the note to the financial statements that summarizes the Province's accounting policies should include information about the Province's accounting policy for recording and changing the amount of provision for losses on loan guarantees.	Yes

3.58 Recommendation 2.88 did not result in any change to the Province's financial statements. It recommended that the Province review whether it is a member of any government partnerships, with specific emphasis on the Atlantic Provinces Special Education Authority, Canadian Blood Services and the Council of Atlantic Premiers. It is our understanding that the Province reviewed its possible government partnerships and determined that no change was required.

3.59 The following table outlines the three recommendations that the Province agreed with and partially implemented.

2006 Report of the Auditor General Volume 1 Reference	Recommendation	2007
2.85	We recommend the Province's note on significant accounting policies should include the policy for the recognition of interest revenue.	Partially
2.103	We recommend the Province disclose information about the purpose of the CMHC Funding Special purpose account, and information about the assets and liabilities of this account. The Province should establish a policy to make such disclosure for any account that exceeds a certain value, for example \$20 million.	Partially
2.121	We recommend the Province provide a brief description of the general terms and conditions of loans guaranteed under its significant loan guarantee programs.	Partially

3.60 The reasons we concluded that these recommendations have been partially implemented are as follows.

3.61 The new note disclosure on interest revenue contained in note 1 (c) Accrual Accounting, does not indicate under what circumstance interest would cease to be recorded on doubtful interest bearing receivables.

3.62 Note 5 to the 2007 financial statements on Special Purpose Accounts now includes descriptions of two significant special purpose accounts, the CMHC Funding account and the School District Self Sustaining Accounts. However, the description of the CMHC funding account could be improved by more fully explaining the types of programs that fall under the administration of the Social Housing Agreement, and the rate of return that is being earned on the account's \$54.1 million in assets.

3.63 Note 15 (b) to the 2007 financial statements on Contingent Liabilities related to the New Brunswick Credit Union Deposit Insurance Corporation has been added. However, there is still no description of the general terms and conditions of the \$723.5 million of loan guarantees listed in note 15 (a) Guaranteed Loans.

3.64 The following table outlines the three recommendations that the Province has not implemented; these three recommendations relate to two PSAB recommendations.

2006 Report of the Auditor General Volume 1 Reference	Recommendation	2007
2.79	We recommend the process for writing off uncollectible accounts receivable be changed to allow departments to write off certain receivables themselves.	No
2.80	We recommend that annually, all loans and other receivables for which there is no realistic prospect of recovery should be written off.	No
2.99	We recommend the Province consider if there are any significant transactions and balances involving government business enterprises and other organizations that are part of the Province's reporting entity and report them in the note to the financial statements on government business enterprises.	No

3.65 We are again recommending that the Province make these changes.

Financial statement discussion and analysis

3.66 The public sector accounting board (PSAB) has established a statement of recommended practice for financial statement discussion and analysis (SORP-1).

3.67 The recommended practices do not form part of generally accepted accounting standards but do offer guidance for governments to better communicate their financial condition and performance to the public.

3.68 The government of New Brunswick does not specifically state that Volume 1 of the Public Accounts includes financial statement discussion and analysis (FSD&A). However, the government does prepare "results for the year" and "major variance analysis" discussions which immediately precede the audited financial statements in Volume 1 of the Public Accounts.

3.69 The Province has made progress in the discussion and analysis of its financial statements that it presents in Volume 1 of

the Public Accounts. In 1997, there was no discussion or analysis accompanying the financial statements. The major variance analysis was added to the Public Accounts in 1998. The “results for the year” section was added in the 2004 Public Accounts, and it was expanded in 2005.

3.70 As they appear in the 2007 Public Accounts, the two sections “results for the year” and “major variance analysis” contain some components of PSAB’s recommended practices for FSD&A. As the following analysis shows, we believe that further improvements could be made which would further explain and highlight information underlying the Province’s financial statements.

Summary

3.71 SORP-1 contains six main recommendations. The following table provides a summary of our assessment of the Province’s current financial statement discussion and analysis.

Paragraph	Area	Assessment
.12	Reference to the financial statements	Needs improvement
.14	Government responsibility	Not done
.30 a)	Summary of significant events	Needs improvement
.30 b) i)	Information on risks and uncertainties	Not done
.30 b) ii)	Variance analysis	Needs improvement
.30 b) iii)	Trend analysis	Not done

3.72 We address each of these areas in the remainder of this section.

Reference of the financial statements

3.73 Paragraph .12 of SORP-1 Financial statement discussion and analysis recommends:

Financial statement discussion and analysis should be clearly referenced to the related summary financial statements.

3.74 The Province prepares summary financial information which was taken directly from audited financial statements, and its discussion and analysis immediately precedes the financial statements in Volume 1 of the Public Accounts. However, no clear reference is made to the financial statements.

Government responsibility

3.75 Paragraph .14 of SORP-1 Financial statement discussion and analysis recommends:

Financial statement discussion and analysis should include a statement acknowledging the government's responsibility for its preparation.

3.76 The Province prepares a Statement of Responsibility acknowledging the government's responsibility for the preparation of the financial statements. However, a Statement of responsibility for the preparation of FSD&A is not included in Volume 1 of Public Accounts.

Presentation

Summary of significant events

3.77 Paragraph .30 subsection (a) of SORP-1 Financial statement discussion and analysis recommends:

Financial statement discussion and analysis should include:

.30 (a) highlights section that provides a brief, concise summary of the significant events affecting the financial statements.

3.78 The SORP provides a further explanation of the purpose of the highlights section in paragraph .35 which says that "The purpose of the highlights section is not to simply reiterate the information that is presented in the financial statements, but to add value by providing an executive overview of those statements and the significant in-year activities that have affected them."

3.79 The Province presents summary financial information for fiscal year 2006 and 2007 which highlights the financial position of the Province, its Statement of Operations and its Statement of Change in Net Debt. Additionally, a brief explanation of the surplus is included in the General Comments section. However, the Province does not provide a concise summary of other significant events affecting the financial statements.

Information on risks and uncertainties

3.80 Paragraph .30 subsection (b) (i) of SORP-1 Financial statement discussion and analysis recommends:

Financial statement discussion and analysis should include:

(b) an analysis section that:

- (i) *includes information on known significant risks and uncertainties inherent in the government's financial position and changes in financial position, and briefly outlines the strategies, policies and techniques adopted to manage those risks and uncertainties;*

3.81 The Province's financial statement discussion and analysis does not provide an identification, description and discussion of risks and uncertainties inherent in the government's financial position and changes in financial position, and it does not explain government's policies to mitigate those risks and uncertainties.

Variance analysis

3.82 Paragraph .30 subsection (b) (ii) of SORP-1 Financial statement discussion and analysis recommends:

Financial statement discussion and analysis should include:

(b) *an analysis section that:*

(ii) *identifies and explains:*

significant variances between current year actual results and budget;

significant variances between current year actual results and prior year actual results; and

changes that have occurred but are not readily apparent from the quantitative analysis;

3.83 The Province provides brief explanations for major budget-to-actual or previous-year-actual-to-current-year-actual variances. However, we believe that a better format could be used to make the explanations more understandable. For example, the explanations could be preceded by a summary table of the variances as follows:

Revenue

2007 Budget to Actual (\$ million)				
Item	Budget	Actual	Change	% change
Provincial sources				
Taxes	2,879.1	3,120.2	241.1	8.4
Investment income	232.2	308.5	76.3	32.9
Other provincial revenue	276.5	339.1	62.6	22.6
Federal sources				
Fiscal equalization payments	1,432.2	1,450.8	18.6	1.3

Taxes

- Metallic minerals tax is up \$112.2 million primarily due to significant increases in world zinc prices, and prior-year adjustments.
- Personal income tax is up \$70.4 million and corporate income tax is up \$39.2 million both due to positive prior-year adjustments related to the 2005 taxation year.
- Harmonized sales tax is up \$57.8 million due to increased federal payments and the elimination of the home energy HST rebate.
- Gasoline and motive fuels tax is \$21.1 million lower than budget largely due to a 3.8-cent per litre tax reduction in October 2006.
- Tobacco tax is \$11.1 million lower due to lower-than-anticipated volumes.

Investment income

This increase is mainly due to a \$64.7 million improvement in net income for the New Brunswick Electric Finance Corporation (NBEFC). NBEFC net income was higher than budget as a result of NB Power experiencing an above-average year in 2006-2007 with warm winter weather, high water levels and increased exports. The above-average results for NB Power more than offset the impact of an 8% cap on electricity rate increases.

Other provincial revenue

This reflects increases in various sales of goods and services and other miscellaneous revenue as well as new public sector accounting guidelines to report the amortization of deferred capital contributions of \$23.2 million.

Fiscal equalization payments

This increase reflects the fixed payment announced in the 2006-2007 federal budget.

2006 Actual-to-2007 Actual (\$ million)				
Item	2006 Actual	2007 Actual	Change	% change
Provincial sources				
Taxes	2,817.6	3,120.2	302.6	10.7
Investment income	409.6	308.5	(101.1)	(24.7)
Other provincial revenue	317.4	339.1	21.7	6.8
Federal sources				
Fiscal equalization payments	1,348.0	1,450.8	102.8	7.6
Unconditional grants	698.2	708.8	10.6	1.5
Conditional grants	324.3	304.6	(19.7)	(6.1)

Taxes

- Personal income tax is up \$111.5 million due to prior year adjustments and strong growth in the tax base.
- Corporate income tax is up \$67.3 million due to prior year adjustments.
- Metallic minerals tax is up \$109.7 million due to significant increases in world zinc prices, and prior-year adjustments.
- The harmonized sales tax has increased by \$33.4 million as a result of economic growth.
- Provincial real property tax is \$10.5 million higher than the previous year as a result of the growth in the assessment base.
- Gasoline and motive fuels tax is \$16.9 million lower than the previous year largely due to a 3.8-cent per litre tax reduction in October 2006

- Tobacco tax is \$8.6 million lower due to lower volumes.

Investment income

The reduction is primarily due to a \$112.9 million decrease in net income for NBEFC. NBEFC net income was lower than the previous year as a result of the impact of a cap on electricity rate increases in 2006-2007 and an extraordinary fiscal performance for NB Power in 2005-2006.

Other provincial revenue

This reflects increases in various sales of goods and services and other miscellaneous revenue.

Fiscal equalization payments

Due to an increase in the fixed payment to the province.

Unconditional grants

Mainly due to increased federal funding for the Canada Health Transfer and the Canada Social Transfer.

Conditional grants

Mainly due to lower federal funding related to health and education.

3.84 The above information has been taken directly from Volume 1 of the Public Accounts and simply reorganized. We have not attempted to improve the explanations provided. However, we believe that the explanations could be improved. For example the explanation that Other Provincial Revenue in 2007 was higher than in 2006 because of “increases in various sales of goods and services and other miscellaneous revenue” does not really provide the reader with a useful explanation.

Trend analysis

3.85 Paragraph .30 subsection (b) (iii) of SORP-1 Financial statement discussion and analysis recommends:

Financial statement discussion and analysis should include:

(b) an analysis section that:

(iii) includes an analysis of significant trends related to financial assets, liabilities, net debt, tangible capital assets, net assets, revenues, expenses / expenditures, net revenues (expenses / expenditures), and cash flows.

3.86 Paragraphs .53 to .81 further explain what the assessment of trends should include.

3.87 The Province presents net debt and net debt as a percentage of GDP for eight years, as well as the surplus for three years. However, no assessment of other trends is provided. Other ratios and indicators recommended by the CICA are not included.

3.88 We have found examples of other jurisdictions that appear to be presenting a financial statement discussion and analysis that is closer to the practices recommended by PSAB. The 2007 Public Accounts of British Columbia contain a good example of a financial statement discussion and analysis.

PSAB projects in progress

3.89 PSAB is currently working on several projects. We have highlighted four below.

Government transfers

3.90 There is a PSAB Re-exposure Draft dealing with government transfers that was released in April 2007. This Re-exposure Draft recommends that a grant be recognized as an expense when the events giving rise to the transfer occur, as long as the transfer is authorized and the eligibility criteria, if any, have been met by the recipient. The recipient records the transfer as revenue unless there is an obligation associated with the transfer. In that instance, the recipient recognizes the transfer as a liability; however, as the terms are met the transfer is recognized as revenue.

3.91 In the re-exposure draft government transfers include monetary assets and tangible capital assets. The transfers can be made to individuals, organizations or other governments. The re-exposure draft states that for the expenditure to be recognized as a transfer the government making the transfer can not:

- i) receive any goods or services directly in return, as would occur in a purchase/sale or other exchange transaction;*

ii) *expect to be repaid in the future, as would be expected in a loan; or*

iii) *expect a direct financial return, as would be expected in an investment.*

3.92 If PSAB approves the new guidance on transfers, the accounting for some grants in the Province's financial statements will need to change.

Identifying and reporting performance indicators

3.93 In June 2007 PSAB approved the proposal for a project on *Identifying and Reporting Performance Indicators*. The project's objective "...is to provide guidance on the factors to consider for identifying and reporting performance indicators." This direction from PSAB will help enhance and will support the Statement of Recommended Practice (SORP-2), Public Performance Reporting. This guidance will allow performance indicators to be prepared using a consistent approach across governments.

3.94 PSAB expects to have the Final Statement of Recommended Practice (SORP) approved by March 2009.

3.95 We will encourage the Province to adopt the SORP on *Identifying and Reporting Performance Indicators* when it is in place.

Indicators of government financial condition

3.96 In September 2007 PSAB approved a *Statement of Principles for Indicators of Government Financial Condition*. The project's goal is to set a new Statement of Recommended Practice (SORP), which would propose indicators of financial condition for each tier of government.

3.97 A Research Report entitled *Indicators of Government Financial Condition*, was issued by PSAB in 1997 and will be the basis for the new SORP. The report will be used to help identify indicators of financial condition that will provide meaningful and useful information to users in assessing government's performance.

3.98 PSAB expects the Final Statement of Recommended Practice approval in September 2008.

3.99 We will encourage the Province to adopt the SORP on *Indicators of Government Financial Condition* when it is in place.

Segment disclosures

3.100 Government produces consolidated financial statements, which provides information to the public regarding financial affairs and resources of government. At times, it is more useful to separate out key financial information into segments that can be used for decision making purposes and to provide accountability.

3.101 As of April 1, 2007 a new standard on segmented reporting is in effect. This section provides a means for defining, identifying and disclosing segments, which are defined by PS 2700.07 as “distinguishable activity or group of activities of a government...”

3.102 As a result of the new standard we expect to see segment disclosures in the Province’s 31 March 2008 financial statements.

Other audit work in departments and Crown agencies**Kings Landing Corporation*****New point of sales system (gift store and admissions)***

3.103 Kings Landing implemented a new point of sales system at the beginning of the year. We noted some areas of weak controls upon its implementation and throughout the year.

- Upon implementation of the new system, no reconciliation of the new system with the old system was done for inventory.
- Regular reconciliations between the general ledger and the system were not being performed for admissions and gift store revenue throughout the year.
- Cost of goods sold in the general ledger is adjusted using actual inventory counts. Comparisons were not performed between the general ledger balance and the point of sale system balance. Discrepancies of approximately \$8,000 were identified during the audit between the two balances. It appeared as though this inventory was missing, and staff was unable to explain the variance. Plausible reasons for the differences were eventually provided by staff. However, there is no evidence that the explanations account for all or most of the discrepancy.
- There is no formal process in place to transfer goods from the gift store to the Grant store.

3.104 These weaknesses increase the risk that Kings Landing does not identify areas of concern on a timely basis and does not take any corrective action to prevent problems from escalating. These weaknesses also increase the risk that fraudulent transactions go without notice by Kings Landing staff.

3.105 We recommended Kings Landing reconcile the point of sales system with the general ledger at least at the end of every month and any differences between the two systems be investigated immediately.

3.106 We also recommended a more formalized process be established in recording items taken from the gift store and transferred to other areas on site in order to ensure that proper sales are being recorded and that inventory is properly controlled.

3.107 The Board responded:

The recommendation of reconciling the point of sale system with the general ledger at the end of every month and investigating differences has been implemented. As well, a more formalized process of transferring items from one retail outlet to another has been put into effect. The items are recorded in the computer and these purchase orders are tallied and a journal entry completed to move the items from one retail area to another. Gross profit calculations are being prepared and reviewed monthly against budget and the previous month to ensure the retail area is on track.

Increased costs of food items

3.108 During our audit it came to our attention that Kings Landing had a significant increase in the cost of their food items. Kings Landing staff were unable to explain this increase to us and the increase did not appear to be in line with an increase in sales. It should also be noted that Kings Landing charges the same amount for a dinner regardless of the type of food ordered, despite there being a significant difference in the costs of the various items.

3.109 We recommended Kings Landing perform a detailed gross profit analysis on a monthly basis in order to ensure that issues are addressed on a timely basis.

3.110 We also recommended a detailed costing analysis be done to help Kings Landing determine the appropriate costs for their various dinners.

3.111 The Board responded:

..... we have implemented the recommendations of performing detailed gross profit analysis monthly, have

developed forms that are easier for recording the inventory, and data entry of the inventory items and tabulation of the COGS is done in a more timely fashion at the end of each month. The itemized data will be used to check variances against budget and running averages. In addition, Kings Landing has sought the assistance of industry experts to assist in determining theoretical food cost versus actual food cost such that we can analyze the difference and determine why and where the variance occurred. The staff have been retrained in utilizing the waste forms, recording spoilage and we are monitoring portions and have tightened portion controls at the various food outlets. As well, Kings Landing is calculating gross profit at the restaurants on a monthly basis.

Calculation of HST

3.112 During our audit we noticed several instances where Kings Landing was not properly recording HST on purchases. This oversight by Kings Landing staff resulted in them not receiving back the full amount of HST that they were eligible to receive.

3.113 We recommended Kings Landing staff abide by the CRA rules for claiming HST and take a more diligent approach to ensuring that invoices are properly coded for HST.

3.114 The Board responded:

..... Accounts Payable will be more diligent in checking invoices to ensure the HST has been coded properly.

New Brunswick Credit Union Deposit Insurance Corporation

Deposit Insurance Fund

3.115 The method of calculating the level of net assets to be maintained in the deposit insurance fund is determined using an adaptation of a model created by the Canadian Deposit Insurance Corporation. The adapted model accepted by the Board at the inception of the fund does not consider credit unions in unusually high risk situations. The current methodology creates a general allowance for payout of deposit insurance as opposed to a specific allowance for credit unions presenting an unusually high risk situation.

3.116 We recommended the Corporation revisit the methodology used to calculate the level of net assets to be maintained in the Deposit Insurance Fund.

3.117 The Board responded:

The Board identified the need to review guiding principles for the credit union deposit trust fund methodology and fund formula for calculating credit union assessments in its 2006 planning session. As a result of this exercise, the Board has recognized the need to engage an expert to complete a review of the trust fund methodology and fund formula and is in the process of doing so. The Board has established the goal of modernizing the trust fund methodology and fund formula to address the concerns identified in its 2006 planning session and audit.

Audit committee

3.118 Part II Section 23 (1) of the Corporation's By-laws indicates that *"The Board may establish a committee being the Audit Committee composed of*

(a) The Chairperson; and

(b) Two directors referred to in paragraph 4(b)."

3.119 Section 23 (2) requires *"The Chairperson of the Audit Committee shall be a director, other than the Chairperson, named by the Board."*

3.120 The audit committee provides independent oversight into the Corporation's accounting and financial reporting and oversees the Corporation's annual audits. The audit committee may oversee a broad range of areas under the blanket of this primary purpose. These areas include:

- governance;
- ethics;
- adequacy of internal controls;
- accuracy of records and reports presented to the board of directors;
- proper authorization of activities and expenditures; and
- protection of employees raising concerns about serious accounting or auditing irregularities.

3.121 **We recommended the Board establish an Audit Committee.**

3.122 The Board responded:

The Board recognizes the value of establishing an audit committee that would oversee the Corporation's

accounting and financial reporting, annual audits, and other important governance issues. The Board plans to establish an audit committee in the next year in response to your management letter recommendation.

Income tax issues

3.123 Investment income earned on the Deposit Insurance Fund has been distributed to the Office de Stabilisation de la Fédération des Caisses Populaires Acadiennes Limitée (l'Office) and Brunswick Credit Union Federation Stabilization Board Limited (BCUFSBL). We found during our audit that l'Office has been filing the appropriate tax returns while BCUFSBL filed up to 2004 but neglected to file for the 2005 and 2006 taxation years.

3.124 We recommended the Corporation consult with a tax specialist to determine the position of the Corporation should the requirements of the Income Tax Act not be complied with.

3.125 The Board responded:

..... the Corporation has to date identified a number of tax issues which it intends to address going forward with the assistance of tax experts. This will address the tax concerns you have raised.

New Brunswick Electric Finance Corporation

Payments in lieu of taxes

3.126 Section 37 of the *Electricity Act* requires the New Brunswick Power Holding Corporation and its subsidiaries (NB Power Group) to make special payments in lieu of income taxes to New Brunswick Electric Finance Corporation (NBEFC) each year. The Act requires the calculation of the payments to be made based on sections of the *Income Tax Act of Canada* and the *New Brunswick Income Tax Act*. For the 2005 to 2007 audit years the actual calculation was based on an agreement reached between NB Power Group and NBEFC. This agreement is not in compliance with the *Electricity Act*.

3.127 It is our understanding, based on correspondence received from the Corporation, that the Corporation is “seeking amendments to Section 37 of the *Electricity Act* in order to ensure full compliance with the Act regarding the calculation of special payments.” Nevertheless, for the year ended 31 March 2007, NBEFC is still not in compliance with the *Electricity Act* with respect to the method of calculating special payments in lieu of taxes.

**New Brunswick Research
and Productivity Council***Audit committee*

3.128 A key responsibility of the Board of Directors is to ensure the integrity of the Council's internal control and management information systems. This responsibility has also been described as a board's stewardship responsibility.

3.129 In order to act as good stewards, the board needs to assure themselves that management controls effectively reduce key risks to an acceptable level. They must also assure themselves that the management information systems that produce the information on which they base their decisions are reliable. Finally, they must assure themselves that the third-party information and assurances on which they are relying are truly being developed independent of management.

3.130 A tool used by many boards of directors in both the public and private sectors is the audit committee. In fact, the federal *Financial Administration Act* requires that most federal Crown agencies have an audit committee. Also, TSX listing standards require that all publicly-traded companies have an audit committee in place, and further that all members of that committee be "financially literate." An audit committee allows for a more in-depth review of the effectiveness of controls in place than is possible at meetings of the full board.

3.131 Consequently, we recommended the RPC Board of Directors establish an audit committee to provide additional focus on the boards' stewardship role.

3.132 The board responded:

... this will be discussed by the Board at our January meeting.

Transfers to the capital fund

3.133 A transfer from the operating fund to the capital fund of \$1,450,000 was approved by the board in June 2007 and recorded in the financial statements for the period ending 31 March 2007. Transfers for accounting purposes should be recorded in the year they are approved by the board.

3.134 We recommended that transfers between funds be recorded in the year they are approved by the board.

3.135 The board responded:

... we will revise the approval process or timing to accommodate your concern.

Pre-signing of cheques

3.136 It came to our attention that cheques were on occasion being pre-signed. This represents a significant weakness in control over disbursements.

3.137 We recommended all cheques be signed after they are printed and appropriate supporting documents have been reviewed.

3.138 The board responded:

... this will be the practice for all checks in the future.

Premier's Council on the Status of Disabled Persons

HST recoveries on behalf of Disability Awareness Week

3.139 The Council has significant involvement in the organization of the annual Disability Awareness Week. As part of this involvement the Council pays invoices for some DAW activities. The HST portion of these invoices is included as part of the Council's HST rebate claim from the Canada Revenue Agency (CRA). The overall result of this is that DAW receives back 100% of the HST it paid. While the Council is entitled to a rebate of 100% of its HST paid because of its status as a Crown agency, DAW is separate from the Council and so would not be entitled to a 100% rebate. While we recognize that this arrangement provides more funding to DAW, we are concerned that the Council may not be in compliance with the HST rebate rules as established by CRA.

3.140 We recommended the Council discuss the appropriateness of including amounts on behalf of DAW in the HST rebate claims with the provincial Department of Finance and with the Canada Revenue Agency.

Losses through fraud, default or mistake

3.141 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.

3.142 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 in various school districts and head office \$16,434

Department of Natural Resources

- Missing equipment and supplies in various regions \$14,478

**Department of Post-Secondary Education,
Training and Labour**

- Missing equipment in various community colleges \$11,790

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

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

3.145 In 2007, the Province reported lost tangible public assets in the amount of \$64,500 compared to a loss of \$105,600 reported in 2006.