

# Chapter 3

## Matters Arising from Our Financial Statement Audits

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# Matters Arising from Our Financial Statement Audits

## Background

3.1 Our audit work encompasses financial transactions in all government departments. 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
- New Brunswick Agricultural Insurance Commission
- New Brunswick Electric Finance Corporation
- New Brunswick Highway Corporation
- New Brunswick Legal Aid Services Commission
- New Brunswick Lotteries and Gaming Corporation
- New Brunswick Municipal Finance Corporation
- New Brunswick Securities Commission
- Premier's Council on the Status of Disabled Persons
- Regional Development Corporation

### Other Agencies:

- Le Centre communautaire Sainte-Anne
- New Brunswick Research and Productivity Council
- Office of the Public Trustee

## Scope

3.2 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.

3.3 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.

**3.4** 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.

**3.5** 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.

**3.6** 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.

**3.7** 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.

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

### ***Responsibilities of the government***

**3.8** 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 pension liability and pension expense for the public service and other groups, and allowances for loss on loans felt to be uncollectible.

### ***Responsibilities of the Office of the Auditor General***

**3.9** 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.

**3.10** 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***

**3.11** 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 Canadian generally accepted accounting principles.

***Matters arising from our audit***

**3.12** 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 2010 audit.

HST rebate claim

**3.13** During the audit we found the HST receivable was almost double the amount from the prior year. The usual practice of the Province is to claim the HST rebate every two weeks. While we have never found problems with the HST claim process in the past, this year there were two claims that had been missed around year end. The proper claims were made in May and the rebate was received in June. Not claiming HST on a timely basis results in interest expense for the Province.

**3.14** **We recommended the Office of the Comptroller ensure that HST rebate claims are made on a timely basis.**

**3.15** The Comptroller responded:

*I wish to note that the incident referred to in your letter was an isolated case and that such a filing delay has never before been identified in all the years my Office has been*

*filing HST rebate claims. The issue arose over this year end when staff members were in transition to New Brunswick Shared Services Agency. As a result, the claims were not filed on time. Our office has retained responsibility for filing the HST claims and assigned the function to an individual.*

## Regional Development Corporation

**3.16** There have been issues with the consolidation of Regional Development Corporation (RDC). In the year we audited, there was some confusion over a grant that was given by RDC to the Fundy Trail Development Authority Inc. to construct a connector road. There was uncertainty as to whether this road was an asset of the Province. If the road belongs to the Province, an asset would have to be set up and the grant expense of \$4 million would have been eliminated.

**3.17 We recommended the Province determine if this road is an asset of the Province and make the necessary adjustments to the financial statements.**

**3.18** The Comptroller responded:

*My Office is investigating the matter and will make any required adjustments to the provincial accounts when the matter is resolved.*

**3.19** Under the Building Canada Fund agreement, RDC disburses grants to provincial government departments and Crown agencies. Transactions such as this lead to complex consolidating issues, as the grants are often spent on capital assets. The recipients of grants, as well as what the grant was used for, must be considered when the consolidation entries for RDC are made.

**3.20 We recommended the Office of the Comptroller ensure that consolidating entries properly reflect the substance of transactions between Crown agencies and the Province.**

**3.21** The Comptroller responded:

*My Office will continue to work closely with RDC and departmental staff to identify transactions between departments and other entities in the government reporting entity in order to properly eliminate inter-company*

*amounts and accurately reflect the overall substance of transactions.*

**3.22** During our audit of the RDC financial statements we found that accounts receivable under some federal agreements remain uncollected. Some of these accounts receivable date back to 2006-2007. As the administrator of several federal-provincial agreements, we feel that RDC has the responsibility to ensure that receivables are collected in a timely manner.

**3.23** Untimely collection of accounts receivable raises questions about the ability to collect the receivable. As well, the Province incurs interest expense.

**3.24 We recommended RDC actively pursue collection of the accounts receivable.**

Segment note

**3.25** Note 16 of the financial statements is intended to provide supplementary information on the Province's revenue and expense by segment. One segment reported is the Regional Health Authorities (RHAs). While the Province uses audited financial statements of the RHAs to consolidate the income statement and balance sheet, the information presented in the segment note does not all come from the audited financial statements. The Department of Health obtains further breakdown of certain amounts for presentation in the segment note from the RHAs.

**3.26 We recommended the Office of the Comptroller ensure there is a process in place to obtain an appropriate level of confidence from the RHAs regarding the accuracy of the information disclosed in the segment note.**

**3.27** The Comptroller responded:

*Staff in my Office has spoken to officials in the Department of Health and are satisfied that their process to obtain the required information from the RHAs is sufficient and reliable. The department obtains the information from each RHA that is also used for national healthcare reporting. The categories used are similar to our primaries.*

Netting issues

**3.28** We have identified areas where we believe the Province is not accurately reflecting revenues and expenses, but is netting, or

offsetting some expenses against associated revenues. Netting results in revenues and expenses being understated. Under current Public Sector accounting standards, the items discussed below should be shown at their gross amounts.

**3.29** As noted in our 2008 Report, volume 2, timber royalty revenue reported by the Province is net of certain costs incurred by licensees in the management of the Crown forest. A Regulation to the *Crown Lands and Forests Act* allows revenues paid by licensees to be reduced “to offset the costs incurred by the forest industry in their management of Crown Lands.” The Province accounts for these costs as a reduction in the royalty revenue recorded. Rather than netting the reduction from the revenue, the Province should record the gross value of its royalty revenue and record an expenditure for the amount owed to the licensees for their management of Crown lands. If this reduction had not been netted, the Province’s timber royalty revenue and related forestry management expenditures would both have been higher by approximately \$22 million in 2009-2010, \$27 million in 2008-2009, and \$29 million in 2007-2008. As importantly, this expenditure would have been subject to the annual appropriation process of the Legislative Assembly.

**3.30** We recommended the Province record timber royalty revenue on a gross basis and record an expenditure for the amount deducted from royalty payments by licensees to cover the costs incurred in the management of Crown lands.

**3.31** The Comptroller responded:

*My Office will obtain the necessary information from the Department of Natural Resources to make the required adjustments in the summary financial statements for the year ending 31 March 2011 to properly report the costs incurred by licensees to manage Crown lands as expenses rather than netted against the royalty revenue.*

*Department of Natural Resources supports the presentation of the gross revenue and expenditure related to timber royalties and has indicated they will be taking the issue forward to the Department of Finance to have the budgeting adjusted as well. They intend to request a net budgeting appropriation which will provide full disclosure of the amounts but allow the department to manage the program on a net basis.*

**3.32** In our 2008 Report, volume 1, we highlighted that there are provincial rebate programs netted against personal income tax revenue. The tax revenue is collected annually by the federal government from New Brunswick individuals who file personal income tax returns. Two of the four programs noted in 2008 are no longer in existence.

**3.33** The Public Sector Accounting Board has finalized the accounting standard on Tax Revenue. Under this standard, there are guidelines establishing when a tax concession may be netted against tax revenue and when an expenditure must be recorded at the gross amount. This standard comes into effect for fiscal years beginning on or after April 1, 2012, but earlier adoption is encouraged.

**3.34** **We recommended the Office of the Comptroller review any expenditures that are netted against tax revenue to ensure those expenditures are properly accounted for and comply with the new accounting standards.**

**3.35** The Comptroller responded:

*We will work with the Department of Finance to identify expenditure amounts that are netted against tax revenues and make the required adjustments in the summary financial statements for the year ending 31 March 2011 to properly report the gross expenditures and revenues.*

**3.36** We have also identified netting of expenditure against revenue received from Canada Mortgage and Housing Corporation (CMHC) by the Department of Social Development. The full amount of revenue to be received under the agreement with CMHC is not being recognized in the financial statements.

**3.37** **We recommended the Office of the Comptroller determine if the accounting treatment of the CMHC revenue is correct.**

**3.38** The Comptroller responded:

*We have spoken to staff at the Department of Social Development and they are in agreement with the proposed presentation. They will work with the Department of Finance to properly reflect the gross amounts in the revenue and expenditure budgets. In addition they will provide our Office with the information to adjust the*



*revenue and expense amounts in the 2010-2011 summary financial statements.*

#### Retirement allowance

**3.39** The last actuarial evaluation of the retirement allowance programs happened in 2006. Actuarial evaluations are typically done every three years. A current actuarial evaluation is needed to ensure the liability reported by the Province is accurate.

**3.40** **We recommended the actuarial evaluation be done and the necessary adjustments made to the retirement allowance liability.**

**3.41** The Comptroller responded:

*An actuary has been engaged and the valuation for the retirement allowance liability is in progress.*

#### Pension issues

**3.42** We identified errors in the calculation of the current service cost for the Public Service Superannuation Plan and in the calculation of the valuation allowance for the Schools-GLTS Plan. We identified some minor spreadsheet errors in the calculation of expected earnings on assets for both the Teachers' Plan and the Judges' Plan.

**3.43** **We recommended the Office of the Comptroller ensure a process is put in place by relevant departments to perform a quality review of these calculations before making the pension journal entries.**

**3.44** The Comptroller responded:

*My Office put in place a mechanism of review for all pension calculations that involved other departments where expertise was available in this area. However, they were not able to meet our timelines at year end. We now have separate staff performing the pension expense calculations and the review.*

**3.45** We strongly believe that it is not appropriate to use a rate-of-return based discount rate for plans that do not have fund assets. Specifically, the discount rate for the Members' Plan and the Early Retirement Plan, as well as the retirement allowance estimate should all be based on the Province's borrowing rate. Because these plans have little or no investible assets, and only obligations, they are

fundamentally different than the funded plans. There is no return on plan assets.

**3.46 We recommended the Province have these plans re-valued using a borrowing rate based discount rate.**

3.47 The Comptroller responded:

*My Office has raised this issue with the Actuarial Valuation Committee who advises the Minister of Finance on pension related matters. Ultimately it is the Minister, as Chair of the Board of Management, who makes the final decision related to actuarial assumptions for the pension plan valuations.*

3.48 A large portion of the pension adjustments for the current year was due to changes in the assumptions used in valuing the pension asset or liability. The change in assumptions is not disclosed in the pension note. We believe that such disclosure is relevant to the readers of the financial statements.

**3.49 We recommended the Notes to the Financial Statements include a brief description of the changes to the assumptions used in valuing the pension asset or liability of the Province.**

3.50 The Comptroller responded:

*I believe there is sufficient detail contained in the note for most users of the financial statements. The pension plan note to the statements is currently seven pages long. I am concerned that adding more information would be confusing for many readers therefore adding no value. The few more sophisticated users who wish to delve into the actuarial assumptions can easily compare the assumptions listed in one year with the prior year and determine what changed.*

3.51 The Hospital CUPE and Hospital CBE plans are defined benefit plans with fixed employer contributions. We feel that disclosing the percentage of assets to liabilities for these two plans is relevant to the readers of the financial statements.

**3.52 We recommended the Notes to the Financial Statements include the percentage of assets to liabilities for the two defined**

**benefit plans that have fixed employer contributions: the Hospital CUPE and Hospital CBE plans.**

**3.53** The Comptroller responded:

*The funding position of both these plans is currently disclosed in the financial statements. My Office will consider whether increased disclosure is necessary for the 2010-2011 financial statements.*

**3.54** The treatment of some contributions to the Public Service Superannuation Plan should be reviewed. We identified that there were some organizations for which there were employee contributions but no employer contributions. Also, the treatment of employer contributions from the Regional Health Authorities was not consistent with the treatment of the contributions from Facilicorp.

**3.55** We recommended the Office of the Comptroller review the list of contributing organizations and look into any unusual contribution arrangements.

**3.56** The Comptroller responded:

*The information referred to is maintained by the Office of Human Resources (OHR). My Office will work with OHR to determine if there are employer contributions in arrears from any employers. I would point out that employee contributions to the Public Service Superannuation Plan totalled \$51.71 million in 2009-10. The employer contribution rate is currently 144% of employee which would total \$74.46 million. Regular employer contributions totalled \$74.48 million. Therefore there is no apparent shortfall in employer contributions for 2009-10.*

*The treatment of contributions from Facilicorp and Fundy Linen for pension expense calculation purposes will be the same as that for the regional health authorities in 2010-11.*

**Other audit work in departments and Crown agencies**  
**Regional Development Corporation (RDC)**  
*Collection of accounts receivable*

*Building Canada federal-provincial agreement*  
*Observation on provincial funding*

*Communication of terms and conditions*

**3.57** As discussed earlier in this chapter, during our audit we found that accounts receivable under some federal agreements remain uncollected. Some of these accounts receivable date back to 2006-2007. As the administrator of several federal-provincial agreements, we feel that RDC has the responsibility to ensure that receivables are collected in a timely manner.

**3.58** Untimely collection of accounts receivable raises questions about the ability to collect the receivable. As well, the Province incurs interest expense.

**3.59** **We recommended RDC actively pursue collection of the accounts receivable.**

**3.60** The agreement as negotiated with Canada allowed the Province to include in its eligible costs in the initial year of the agreement (2008) provincial costs to implement projects which were non-incremental in nature (for example salaries of provincial employees working on the project). After that year these costs were no longer eligible to be included under the provincial funding of the agreement. Due to the late finalization of the agreement (May 2008) and the approval date of the initial project list (September 2008) no projects could be initiated in 2008 and the first projects for the 2008 annual capital plan were initiated in 2009.

**3.61** At first departments thought that these costs could be included as project costs for 2008 capital plan projects incurred in 2009. However, the Province was told by federal officials that these costs were not to be included as only non-incremental costs incurred in 2008 were eligible under the agreement.

**3.62** The effect of this is that the Province would have to include over \$3.5 million more in project costs to reach the maximum federal funding under the agreement. This means that approximately \$1.75 million more would have to be funded by the Province.

**3.63** As noted above, the 2009 projects were being implemented before the agreement and the approved project list were finalized. The terms and conditions of the agreement at the time we audited the expenditure reports of the three departments / agencies involved had not been communicated to them. In some cases this may have resulted in apparently ineligible expenditures being included in the

expenditure reports. We assume this was a result of the timing of the projects and the agreement.

**3.64 We recommended RDC communicate the terms and conditions of the Base Funding agreement to future recipients as projects are approved. Further, RDC should obtain a letter of confirmation from the recipients to ensure that the recipients have a clear understanding of the conditions attached to the funding.**

#### *Recipient reporting*

**3.65** Costs were not always tracked by recipients in accordance with the agreement. In some cases ineligible costs had to be separated from the gross totals. Recipients such as Village Historique Acadien and Kings Landing Corporation found it challenging to report costs precisely as required by the agreement. This may be a result of such entities not dealing with capital projects as extensively as some departments. The lack of precision in reporting resulted in unexpected delays during our audit.

**3.66 We recommended RDC communicate the reporting requirements to the recipients and ensure that the recipients commit to tracking costs as required by the agreement.**

#### **Losses through fraud, default or mistake**

**3.67** 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.

**3.68** 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**

- Loss of school raised funds  
(relates to 08-09 and 09-10) \$13,163

##### **Department of Environment**

- Missing equipment \$2,063

##### **Department of Local Government**

- Missing equipment \$5,850

**Department of Natural Resources**

- Missing equipment from various regions \$2,090

**Department of Social Development**

- Missing cheques \$13,514

**Department of Transportation**

- Missing equipment \$1,300

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

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

**3.71** In 2010, the Province reported lost tangible public assets in the amount of \$39,826 compared to a loss of \$89,365 reported in 2009.