

Chapter 1

Introductory Comments by the Auditor General

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Introductory Comments by the Auditor General

Introduction

1.1 In this performance audit volume of our 2017 Report, we include our special examination which details findings and work performed to address remaining unanswered questions from my 2015 Report “*Financial Assistance to Atcon Holdings Inc. [Atcon] and Industry.*” The 2015 Report was prepared in response to a June 2013 unanimous motion of the Legislative Assembly requesting we undertake an audit in this area.

Significant findings in 2015

1.2 The focus of my 2015 Report was on events surrounding government’s decision making process in granting \$63.4 million of financial assistance to Atcon for the period from 2008 to 2010, as well as how to improve the performance of the Department of Economic Development. Significant conclusions and findings from this 2015 Report included:

- a) *Cabinet disregarded the advice of senior public servants;*
- b) *The decision to amend security terms was a critical decision which cost taxpayers millions of dollars;*
- c) *Cabinet displayed a very troubling disregard for taxpayers’ money;*
- d) *The legislative authority to amend security was unclear;*
- e) *A similar situation could happen again;*
- f) *Nothing we saw would support a conclusion that the decisions made were reasonable in the circumstances;*
- g) *There was no central monitoring of financial assistance to a single company;*
- h) *Only 29% of 2010 AG recommendations in this area have been implemented; and*
- i) *The Department does not report performance results.*

Unanswered questions remained

1.3 Subsequent to release of this Report in March 2015 my Office continued to receive numerous phone calls, letters and emails regarding this file. After completing our initial 2015 Report questions remained such as:

- where did the \$63.4 million of taxpayers' money go;
- who benefited from the financial assistance provided by government; and
- which vendors were paid in connection with the assistance and loan guarantees granted by government.

Further Atcon work announced in 2015 (with government support)

1.4 In December 2015 I announced my intention to pursue further work on the Atcon file. My decision was made after having received June 2015 correspondence from the Clerk of the Executive Council and Secretary to Cabinet indicating *“If, from your perspective, further review of the matter is required to determine the final disposition of the financial assistance monies associated with the Atcon file, government has indicated that it will be both supportive and cooperative.”*

Responses to Unanswered Questions

1.5 This 2017 Report has been prepared to respond to these remaining unanswered questions regarding government financial assistance provided to Atcon.

Where did \$63.4 million of taxpayers' money go?

1.6 When Atcon defaulted on its loans in March 2010, the guarantees were called and the Province was required to pay \$50 million to the Bank of Nova Scotia. Also, in October 2010 a further \$13.4 million was paid to the Government of the Northwest Territories in relation to a guarantee on a letter of credit regarding a bridge contract.

1.7 This is the simple answer to the question “where did the money go?” However, we wanted to know what Atcon did with the money that was subject to the guarantee prior to default.

Which vendors were paid in connection with the assistance and loan guarantees granted by government?

1.8 While we had some significant data limitations, we were able to review numerous Atcon records and source documents as detailed in the following chapter. In summary, \$63.4 million in provincial financial assistance was used in the following ways:

- \$21.4 million to pay off high interest loans;
- \$14.6 million to pay down operating line of credit;

- \$13.4 million paid to the Government of Northwest Territories for the Deh Cho Bridge guarantee;
- \$9.9 million to fund ongoing operations of Atcon;
- \$2.9 million to pay other fees and taxes; and
- \$1.2 million to pay liens and judgments from creditors.

Funds provided to Atcon were used for business related activities

1.9 We found based on the information we were able to obtain, the funds provided to Atcon were largely used for business related activities.

Questionable Atcon operating and financial reporting practices

1.10 However, we found several questionable Atcon operating and financial reporting practices, which are detailed in the following chapter. Some examples include:

- poor management of Atcon’s assets and liabilities such as work in progress, accounts receivables and accounts payable;
- poor cost control on jobs and poor project management practices;
- poor strategic management in balancing corporate growth, financing and cash flow needs;
- questionable application of accounting policies in the audited financial statements which improved Atcon’s results (in appearance); and
- questionable linkage from Atcon’s Statutory Declaration of payments made to New Brunswick suppliers to Atcon’s available financial records.

Unresolved legal and professional conduct matters

1.11 There are also unresolved matters in connection with the Atcon file including:

- PNB’s legal action against Atcon’s auditor;
- PNB’s legal action to pursue personal guarantee of Atcon’s President; and
- PNB’s professional conduct complaint filed with the Chartered Professional Accountants of New Brunswick.

\$50 million in financing was never going to have been enough to “save” Atcon

1.12 As a result of our review of Atcon’s records and their financial situation we believe \$50 million in financing was never going to have been enough to “save” Atcon. We believe Atcon’s financial problems were due largely to a history of poor working capital management and insufficient capital to support the rapid increase in business volume beginning in 2007. Overall, we found the government’s analysis of Atcon’s financial situation given

the significant amount involved and high risk nature of the file could have been strengthened in areas. Although officials repeatedly advised against approval, Cabinet was not informed that \$50 million would not be nearly enough to fix Atcon's problems.

1.13 It is impossible to determine at this time if any additional analysis would have changed the outcome of government's decision to proceed in providing the assistance with the loan guarantee or in giving up first position on secured Atcon assets. However, we have made recommendations in this Report to strengthen the financial analysis provided to Cabinet for future financial assistance decisions.

Who benefited from the financial assistance provided by government?

1.14 Given the volume of correspondence we received on the Atcon file and the significant amount of funding provided, we were interested in determining who benefited (possibly inappropriately) from the financial assistance provided by government.

Inappropriate benefit to certain Atcon personnel

1.15 To assist in determining a response to this question we reviewed numerous Atcon records. As explained in the following chapter, we did have some significant data limitations in our work, however, we did not find evidence of any inappropriate benefit to Atcon personnel other than the following:

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

1.16 It is my opinion that such benefits are inappropriate given the significant amount of financial assistance the Province was providing at the time. We have made recommendations in this Report to address these circumstances for future government financial assistance decisions.

Atcon's bank was the primary beneficiary of Atcon's government financial assistance

1.17 In more general terms regarding who benefited from the financial assistance provided by government, Atcon and its employees and suppliers may have benefited in the very short term from the financial assistance provided by government. However, it is clear with the benefit of hindsight Atcon's bank was the primary beneficiary of government financial assistance.

***Critical decision:
release of first position
on Atcon's secured
assets***

1.18 In all of the events that unfolded regarding Atcon's demise Cabinet made one very critical decision which caused the Bank of Nova Scotia to be the primary long-term beneficiary of Atcon's government financial assistance: Cabinet decided to release first security position on Atcon assets. Thus, when Atcon eventually defaulted and the Province had to pay \$50 million to the Bank of Nova Scotia to settle the guarantee, the Province then stood to receive significantly less through the receivership process than it would have previously because of this critical decision to give up first position on security in favour of the bank.

***The Province has only
recovered 4.5% of its
losses on \$63.4 million***

1.19 The benefits received by the Bank of Nova Scotia relating to Cabinet's decisions are again clear when reviewing the percent of funds recovered on losses. We estimate the bank has recovered up to 78% (\$77.2 million) of the amount it was owed by Atcon (\$99.2 million). The Province only recovered 4.5% (\$2.8 million) of \$63.4 million.

***This one Cabinet
decision could have
cost the Province in the
range of an additional
\$12-19 million to the
benefit of the Bank of
Nova Scotia***

1.20 Determining what the Province would have received had it remained in first position is very difficult to estimate with precision. However, we believe this one Cabinet decision could have cost the Province in the range of an additional \$12-19 million to the benefit of the Bank of Nova Scotia.

***Cabinet rejected the
change in security
position twice before
approving it***

1.21 The bank took action to mitigate its losses: it requested an independent review of Atcon's finances by another accounting firm. As well, the bank requested the Province give up first position on security in favour of the bank, in return for which Atcon's credit limit with the bank was increased by another \$10 million. As noted in our 2015 Report, Cabinet rejected this change in security position twice before approving it (rejected August 13, September 2 and approved September 11, 2009).

***Cabinet reversed
measures to protect the
Province from
substantial financial
losses***

1.22 Ultimately there were two very different reactions to Atcon's financial problems: the bank very astutely manoeuvred to mitigate its potentially substantial losses, while Cabinet ignored the advice of bureaucrats and essentially reversed measures to protect the Province in the face of Atcon's deteriorating financial health.

1.23 The bank had extended Atcon's financing to the point Atcon was in violation of (lending) debt covenants. Cabinet's approvals effectively allowed the bank to recover \$50 million and in addition obtain first position on the assets. Less than seven months later Atcon was placed into receivership. Upon liquidation of the assets the bank recovered another \$27.2 million.

No clear rationale was provided to support the decision to release security from the six Cabinet Ministers we interviewed

1.24 As part of our work in this area in 2017 we individually interviewed the six Cabinet Ministers who were also Cabinet Ministers at the time of the Atcon decision. While the Cabinet Ministers were cooperative in the interview process and gave a consistent rationale for providing the financial assistance, no clear rationale was provided for the decision to release security in favour of the bank.

Public expectation justifiably remains for elected officials to provide rationale for government decisions

1.25 In my view, public expectation justifiably remains for these elected officials to be transparent and give the rationale for this inexplicable multi-million dollar decision.

Cabinet's poor decisions continue to cost taxpayers money

1.26 The decision by Cabinet to provide the \$50 million guarantee to Atcon and to release first position on secured assets has had ongoing financial consequences to the Province. We estimate the additional costs of this decision to be at least \$2.9 million, excluding other costs not included in our calculation, such as the countless hours spent on the file by civil servants both before and after the decision. Exhibit 1.1 estimates some of the additional costs related to the decision to provide \$50 million guarantee to Atcon.

Exhibit 1.1 - Estimate of some of the additional costs related to the decision to provide \$50 million guarantee to Atcon and to release first position on secured assets in 2009 (rounded to the nearest thousand)

Estimate of some of the additional costs* related to the decision to provide \$50 million guarantee to Atcon in 2009 (rounded to the nearest thousand)	
Conflict of Interest Commissioner's investigation regarding former premier, Hon. Shawn Graham	\$ 225,000 ⁽¹⁾
Legal bill for Hon. Shawn Graham following Conflict of Interest Commissioner's investigation	\$ 72,000 ⁽²⁾
Cost (to June 2017) of litigation: PNB vs. Grant Thornton (Atcon's auditors)	\$ 1,166,700 ⁽³⁾
RSM Richter report (Report prepared at request of PNB on Atcon's financial situation)	\$ 765,000 ⁽⁴⁾
Deloitte consultation for ONB assistance in implementing AGNB recommendations from Atcon I (at December 2016)	\$ 155,000 ⁽⁵⁾
AGNB Atcon I	\$ 131,000 ⁽⁶⁾
AGNB Atcon II	\$ 373,000 ⁽⁶⁾
Total additional costs paid for by the Province (PNB)	\$ 2,887,700

* In some cases the estimated costs represent a minimum cost figure.

Source:

- ⁽¹⁾ Information provided by the Office of the Clerk of the Legislative Assembly;
- ⁽²⁾ CBC news "Shawn Graham's lawyer billed \$72K for conflict probe", posted February 21, 2014;
- ⁽³⁾ Information provide by Office of the Attorney General;
- ⁽⁴⁾ Public Accounts – unaudited supplementary supplier lists of 2011 and 2012;
- ⁽⁵⁾ Information provided by Opportunities NB;
- ⁽⁶⁾ Totals as of March 31, 2017 - AGNB with existing budget resources and \$200,000 expenditures in excess of 2016-2017 budget; chart created by AGNB

ONB & ECO - Implementation of our Past Recommendations

***Only 4 of 19 (or 21%)
recommendations have
been implemented so
far by ONB***

1.27 As part of our testing we reviewed Opportunities New Brunswick (ONB) & Executive Council Office (ECO) implementation of our past recommendations.

1.28 In our testing we found only four of 19 recommendations or 21% had been implemented. This is contrary to what we had been expecting given ONB's self-assessment indicated 15 of 19 recommendations had been implemented.

1.29 Overall, it appears ONB is attempting to make positive changes in its policies and processes to address our recommendations, however, with only four of 19 recommendations implemented it is difficult to see significant improvements at this time.

1.30 We were also disappointed to note ONB intends to implement our recommendations regarding public performance reporting on the value and outcomes of financial assistance to industry on a go forward basis only.

Regardless, given ONB's efforts under way to date we remain hopeful to see future improvements in ONB's implementation of our past recommendations.

- 1.31** In addition, we found little effort by ECO to ensure our recommendations have been applied to all other entities providing financial assistance to industry. This is unfortunate given, since 2015, \$313 million has been spent on financial assistance to industry as seen in Exhibit 1.2.

Exhibit 1.2 – Financial Assistance to Industry since 2015 (\$ millions)

Financial Assistance to Industry since 2015 (\$ millions)			
Entity	2016	2017	Total
Opportunities New Brunswick	36.9	58.3	95.2
Regional Development Corporation	73.0	134.4	207.4
Provincial Holdings Ltd.	1.0	4.8	5.8
Other	3.0	1.7	4.7
Grand Total	113.9	199.2	313.1

Source: Created by AGNB

Conclusion

- 1.32** While two and a half years have passed since my prior Atcon Report, I unfortunately find it applicable and necessary to again state: *“The substantial financial loss to taxpayers in our opinion was totally unnecessary. Unless government sees fit to make changes to the way in which financial assistance to industry is approved at the Cabinet level, I believe a similar situation could happen again. At present, the only impediment for current and future governments is that they will ultimately be held accountable by the electorate for their decision-making.”*

Acknowledgements

- 1.33** Staff in my Office worked very hard with extremely limited resources in carrying out the large amount of work involved in preparing this Report. This Report is a reflection of their level of commitment, professionalism and diligence. I would like to express my appreciation to each for their contribution and continuing dedication to fulfilling the mandate of the Auditor General of New Brunswick.



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