

Chapter 4

Auditor General Concerns: New Brunswick's Fiscal Decline Continues

Contents

List of Concerns.....	125
Summary of AG Concerns.....	125
Recommendations.....	125
Continuing Provincial Deficits.....	128
Releasing the Province's Audited Financial Statements Before the Next Election.....	132
Delayed Financial Reporting by Economic Development Agencies.....	132
Governments Spending Before Obtaining Legislative Approval.....	133
AG Review of Long-Term P3 Contracts.....	135
Appendix I - Information from the 2017 Auditor General's Report, Volume IV.....	137
Appendix II – Supplementary Estimate Details.....	139

Auditor General Concerns: New Brunswick's Fiscal Decline Continues

List of Concerns

- 4.1** In this chapter, I am reporting on a number of important concerns. Some concerns are new findings while others relate to matters from past reports. My concerns include:
- continuing provincial deficits;
 - releasing the Province's audited financial statements before next election;
 - delayed financial reporting by economic development agencies;
 - governments spending before obtaining legislative approval; and
 - government is not effectively managing all its long-term P3 contracts.

Summary of AG Concerns

- 4.2** A summary of the Auditor General's concerns is presented in Exhibit 4.1.

Recommendations

- 4.3** A summary of recommendations can be found in Exhibit 4.2.

Exhibit 4.1 – Auditor General's Main Concerns

Auditor General Concerns: New Brunswick's Fiscal Decline Continues

Main Concerns:

- continuing provincial deficits and increasing Net Debt;
- releasing the Province's audited financial statements before next election;
- delayed financial reporting of economic development agencies;
- governments spending before obtaining legislative approval; and
- government is not effectively managing all its long-term P3 contracts.

What We Found

Province to Have 11th Consecutive Deficit

- Net Debt has increased \$7 billion in last 10 years.
- Bond rating agencies give negative outlook
- New Brunswick has highest Net Debt among comparable provinces.
- New Brunswick ability to address fiscal decline is more limited than other provinces.
- No immediate plan to address fiscal decline, nor Net Debt reduction target.

Release the Province's Audited Financial Statements Before Next Election

- This will allow New Brunswickers to judge how the government has managed public money and resources.
- These were released in advance of the last two elections.

Governments Spending Before Obtaining Legislative Approval

- In five of last ten years, governments overspent budgets before obtaining legislative approval.
- Approval is obtained sometimes over a year later.
- Amendments to the *Financial Administration Act* are needed.
- Made recommendations to Treasury Board.

Management of Long-term P3 Contracts

- \$17 million saved by obtaining lower interest rates on three existing P3 contracts.
- Cabinet allowed a significant school buy-out option to expire.
- Government is not effectively managing all its long-term P3 contracts.

Exhibit 4.2 - Summary of Recommendations

Recommendation	Department's response	Target date for implementation
4.33 We recommend Treasury Board prepare and submit Supplementary Estimates or Special Warrants before departments overspend their approved budgets.	<i>Supplementary estimates and special warrants are obtained in accordance with the Financial Administration Act.</i>	N/A
4.34 We recommend Treasury Board pursue legislative amendments to the <i>Financial Administration Act</i> to align with current accounting practices.	<i>Treasury Board, Office of the Comptroller will review the Financial Administration Act and make appropriate recommendations based on our findings.</i>	2019

Continuing Provincial Deficits

Negative outlook from bond rating agencies

4.4 Continued deficits, increased spending, and government's delayed plan to balance the books has resulted in a negative outlook by bond rating agencies.

4.5 This negative outlook could eventually affect the Province's ability to raise cash (issue bonds), as New Brunswick bonds may be less attractive to investors. The reaction of the rating agencies should be a major concern to government.

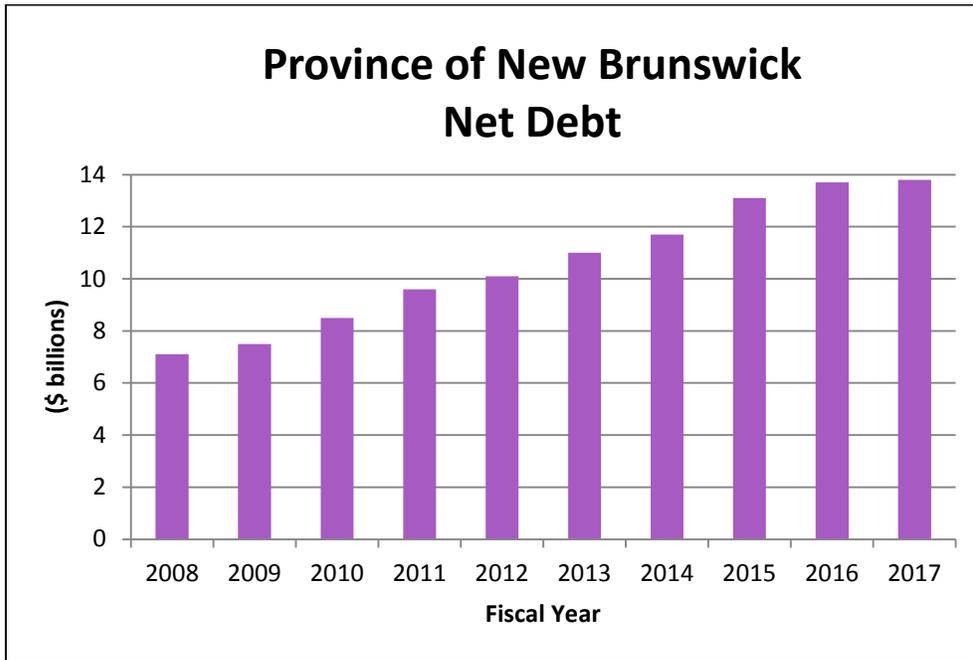
4.6 The Dominion Bond Rating Service (DBRS) recently downgraded the Province's rating trend from stable to negative. In a recent press release DBRS states, "*New Brunswick's 2018 budget once again delays the return to balance in favour of new spending ahead of the September 2018 provincial election.*"

4.7 Moody's Investor Service also recently stated "*...the stalled progression on deficit reduction is credit negative for the province which has not posted a balanced budget since 2007-2008 and is not planning a balanced budget until 2021-2022, resulting in one of the longest period of continued deficits among Canadian provinces following the 2008-2009 financial crisis.*"

Net Debt increased \$7 billion in 10 years

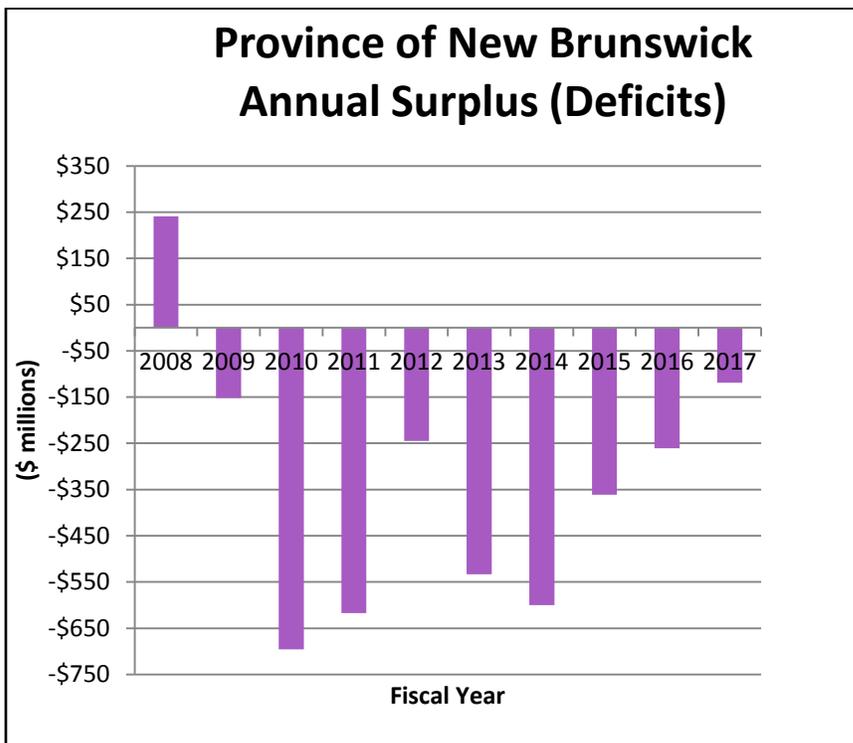
4.8 Over the past ten years, as shown in Exhibit 4.3, Net Debt has increased almost \$7 billion. This is as a result of current and past governments spending more than they collected. Exhibit 4.4 shows the Province's deficits in the last ten years. The Province's revenue and expenses in the last ten years is presented in Exhibit 4.5.

Exhibit 4.3 - Province of New Brunswick Net Debt



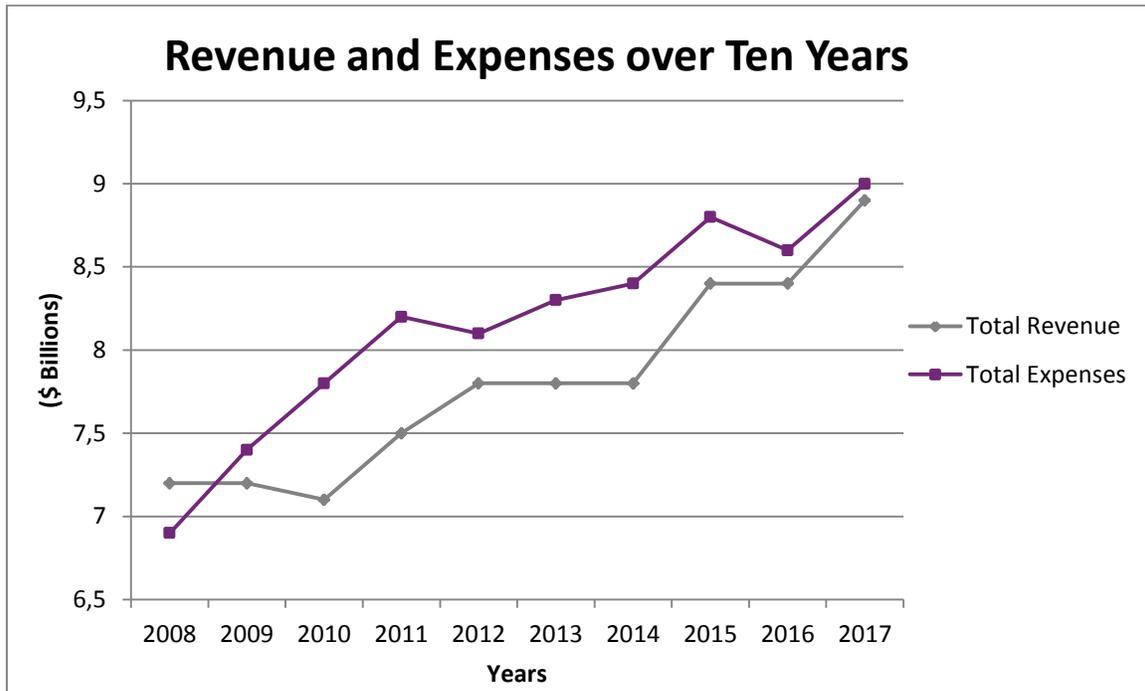
Source: 2017 Auditor General Report Volume IV, Chapter 2, Exhibit 2.3

Exhibit 4.4 – Annual Surplus (Deficits)



Source: 2017 Auditor General Report Volume IV, Chapter 2, Exhibit 2.1

Exhibit 4.5 – Revenue and Expenses over Ten Years



Source: AGNB

4.9 Despite governments actions (such as tax increases, program changes and reducing civil service benefits), deficits and increases to Net Debt continue. Government's budget for 2019 plans for \$14.5 billion in Net Debt, with a deficit of \$189 million. This will be the eleventh year of consecutive deficits.

4.10 As I have reported repeatedly, this trend is not sustainable. If this continues, eventually governments will not be able to provide the same level of programs and services such as health care, education, roads, schools and hospitals.

4.11 Action is required to address this problem and I again encourage government to set targets to eliminate deficits and reduce Net Debt.

What is the impact to New Brunswickers?

4.12 An even higher demand will exist on future generations to pay for past expenses.

4.13 We found in our November 2017 report, the Net Debt per New Brunswicker is higher than other provinces with similar populations or economies.¹ Each New Brunswicker's share of the Net Debt is expected to grow to \$19,000 by 2019. The table from our November 2017 report is in Appendix I.

4.14 New Brunswick's ability to reduce Net Debt is more limited than other Provinces given challenges such as aging and declining population, high unemployment rates and slow economic growth.

4.15 New Brunswick also had the highest Net Debt as a percentage of Gross Domestic Product (GDP)² among comparable provinces,³ which indicates high net debt and low activity in the economy. This percentage (41%) has increased since 2008 outpacing other provinces such as Nova Scotia, Manitoba, and Saskatchewan. The table from our November 2017 report shows this trend in Appendix I.

Province paid \$700 million in interest in 2017

4.16 In 2017, the Province paid \$700 million in interest on its overall funded debt⁴ of \$16.5 billion. If this interest cost was a department, its budget would be larger than the Department of Transportation and Infrastructure.

What happens when interest rates increase?

4.17 If the interest rate goes up by 1%, the Province estimates in three years, the annual interest expense would increase by \$60 million. Such an increase would further restrict government program spending.

¹ Volume IV November 2017 Chapter 2, Exhibit 2.11 comparing New Brunswick, Manitoba, Nova Scotia, Saskatchewan.

² Gross Domestic Product (GDP) measures the value of all final goods and services produced in an economy in a given period of time.

³ Volume IV November 2017 Chapter 2, Exhibit 2.13 comparing New Brunswick, Manitoba, Nova Scotia, Saskatchewan.

⁴ The Province's overall funded debt is referred to as 'Funded Debt' in its financial statements. Funded Debt is the total amount the Province is legally required to repay and make interest payments to creditors. This differs from Net Debt, which is an accounting calculation presented as total liabilities less financial assets.

Reversing the fiscal decline will be difficult especially in New Brunswick

4.18 I remain concerned the Province has no immediate plan to address the continuing fiscal decline. The longer the decline continues, the harder it will be to reverse, especially in New Brunswick.

Releasing the Province's Audited Financial Statements Before the Next Election

Release the audited financial statements before next election

4.19 I encourage the timely release of the Province's audited financial statements in advance of the upcoming September 2018 election. The audited results are important to allow New Brunswickers to judge how the government has managed public money and resources. The audited financial statements should be available before the next election.

4.20 As I stated in my November 2017 report, the Province's audited financial statements were released in advance of the last two elections. Recent discussions with government audit committee⁵ indicate its intention to publish its audited financial statements prior to the election. We continue to work with the Office of the Comptroller and will make every effort to make sure this happens.

Delayed Financial Reporting by Economic Development Agencies

Delayed reporting by ONB, RDC, and PHL is disappointing

4.21 The lack of timeliness of financial reporting by economic development Crown agencies including Opportunities New Brunswick (ONB), Regional Development Corporation (RDC), and Provincial Holdings Ltd. (PHL) is disappointing. Ongoing delays result in outdated and less relevant information for decision-makers and New Brunswickers.

4.22 ONB published its 2017 annual financial report almost a full year after the financial year was over. The other two agencies still have not posted their 2017 reports as of

⁵ The audit committee is a group established to meet and discuss significant audit matters. The committee is chaired by the Minister of Finance and includes six other members.

May 16, 2018, the date of writing this report.

PHL has not reported financial information since 2014

4.23 I am particularly concerned that PHL has not published its financial information since 2014. I feel it is inappropriate for a provincial agency to go three years without public reporting. This is especially important given PHL's investment in the New Brunswick Naval Centre located in Bas-Caraquet.

4.24 Once again, we encourage these agencies to publish timelier reports in the future. Ongoing public reporting delays makes it difficult for people to assess what and how the provincial agencies are doing. Publically funded agencies have a duty to be transparent (open) and accountable (answerable) to the public as well as the Crown Corporations Committee.

Governments Spending Before Obtaining Legislative Approval

4.25 We found in our work, governments have not been consistently following the proper process when spending public funds. Governments need to obtain approval from the Legislative Assembly prior to spending public funds.

4.26 In five of the last ten years, governments have over spent their budgets before obtaining this approval. In some years, governments obtained legislative approval well over a year later. In one instance, in 2015, this was for \$357 million. Our findings are in Appendix II.

Why is this happening?

4.27 The *Financial Administration Act* (the FAA) describes the process for how government can spend money. The Act states “*no payment is to be made out of the Consolidated Fund without the authority of the Legislature.*”

4.28 The word “payment” does not represent today's accounting practices and is outdated. It could be misinterpreted because accounting information is recorded when a financial transaction occurs, not just when cash (“the payment”) is paid.

4.29 For example, if you buy something but do not pay for it until later, the financial transaction already exists even though you have not made the cash payment.

4.30 In my view, the intent and spirit of the FAA is to obtain approval from the Legislative Assembly before the

financial transaction occurs, not just when cash is paid.

4.31 Throughout the year, governments can obtain Legislative Assembly approval with a 'Supplementary Estimate' or a 'Special Warrant.' This can be obtained for unexpected overspending not known when the budget was set.

What should they do?

4.32 If governments require more funding due to end of the year accounting adjustments or other unforeseen circumstances, then a final Supplementary Estimate can be obtained after year-end. This was the practice from 2008 to 2011 as shown in Appendix II, when governments obtained timely approval during and after the year ended. It appears since 2011 there has been a change in what is considered appropriate.

Recommendations

4.33 We recommend Treasury Board prepare and submit Supplementary Estimates or Special Warrants before departments overspend their approved budgets.

4.34 We recommend Treasury Board pursue legislative amendments to the *Financial Administration Act* to align with current accounting practices.

AG Review of Long-Term P3 Contracts

Lower interest rates obtained on three contracts saved over \$17 million

4.35 We reviewed four recent financial decisions for existing public-private partnership⁶ (P3) contracts. We wanted to see whether the long-term P3 contracts were being well managed with the taxpayer in mind.

4.36 I am pleased to report the Province was proactive in saving over \$17 million (present value in today's dollars) by obtaining a lower interest rate for:

- Eleanor W. Graham Middle School in Rexton ;
- Moncton North School; and
- Moncton Court House.

4.37 In these cases, Cabinet approval was not needed to change to a lower interest rate.

Cabinet allowed a significant school buy-out option to expire

4.38 In the case of the Leo Hayes High School in Fredericton, however, Cabinet direction was needed regarding a time-sensitive option to buy the school. We found, in this case, Cabinet knowingly allowed the option to purchase the school to expire.

4.39 According to the financial analysis and options prepared by the Departments of Education and Early Childhood Development and Transportation and Infrastructure, the lowest cost option was to purchase the school in 2019.

4.40 The analysis presented four more options including different combinations of extending the contract term, purchasing or building a new school in the future. Among the options, it was evident there was a wide range in the tens of millions of dollars, thus indicating the significance of the decision.

⁶ A public-private partnership (PPP or P3) is a contract between a public sector entity and a private sector entity that outlines the provision of assets and the delivery of services. Examples of public-private partnerships in New Brunswick include highways, schools, court houses and health facilities.

Government is not effectively managing all its long-term P3 contracts

4.41 Cabinet opted not to make a decision, and withdrew the Departments' proposal from the Cabinet agenda. The option in the contract to purchase the school has since expired.

4.42 We found the options were presented to Cabinet a month before the expiry date. We were informed this was not enough time to allow Cabinet to consider alternatives and evaluate options of this decision involving tens of millions of dollars for a project that was not in government's multi-year capital infrastructure plan.

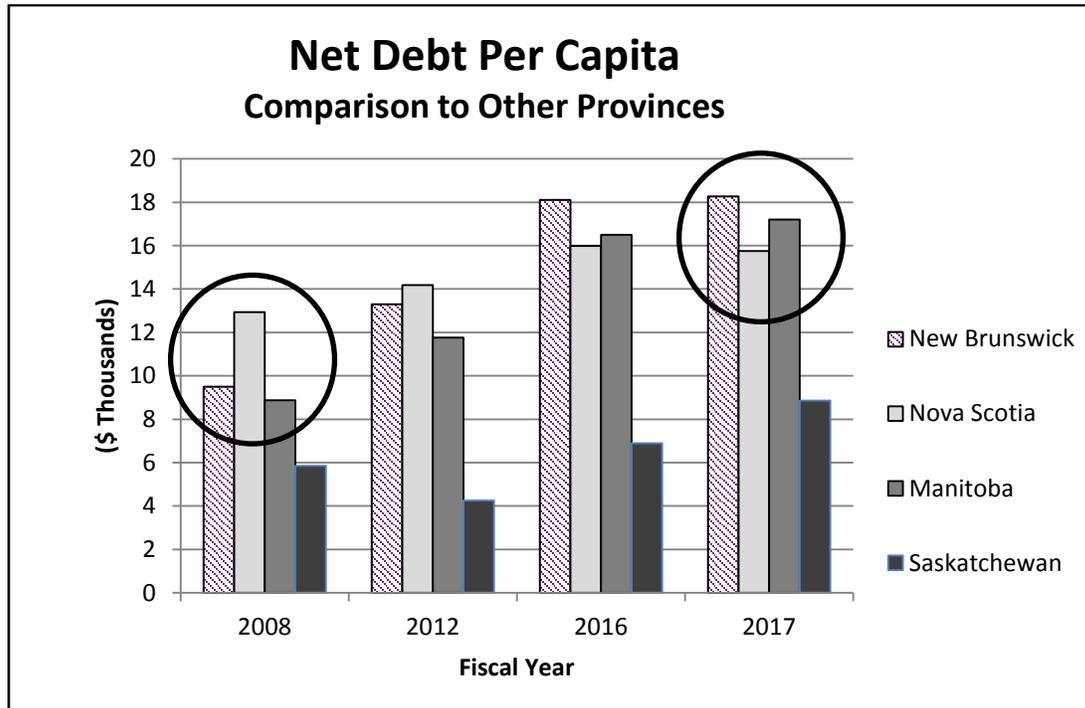
4.43 Cabinet decided more information was required (such as demographic and aging infrastructure analyses) to make such a significant budget decision, as it related to the long-term educational and public infrastructure needs in the community. In addition, Cabinet had to consider the impact of displacing other capital projects included on the multi-year capital infrastructure plan.

4.44 Overall, we found Cabinet allowed the school buy out option to expire as there was very little time to evaluate options and arrive at a decision for a significant item not on the government's multi-year capital infrastructure plan. We have therefore concluded government is not effectively managing all its long-term P3 contracts.

4.45 Without proper tracking and management of long-term P3 contracts, government may end up making significant decisions that are not always in the public interest.

Appendix I – Information from the 2017 Auditor General's Report, Volume IV

The following information was presented in the 2017 Auditor General Report Volume IV, Chapter 2.



Source: 2017 Auditor General Report Volume IV, Chapter 2, Exhibit 2.10 (modified)

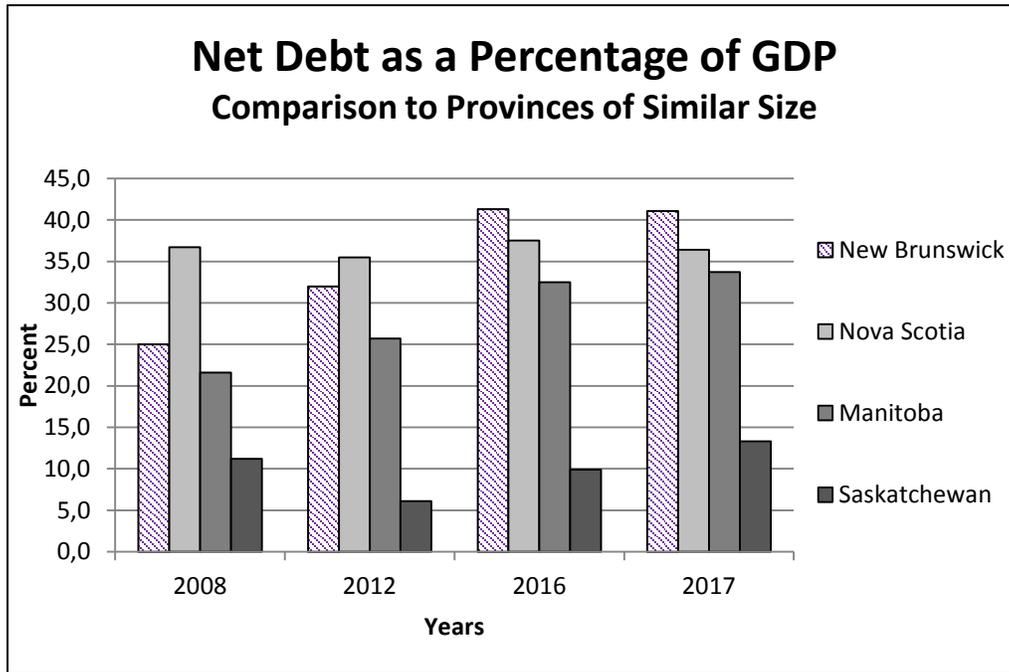
Net Debt Per Capita Comparison to Other Provinces*				
(\$ thousands)				
Province	2008	2012	2016	2017
New Brunswick	9.5	13.3	18.1	18.3
Manitoba	8.9	11.6	16.5	17.2
Nova Scotia	12.9	14.2	16.0	15.8
Saskatchewan	5.8	4.2	6.9	8.8

Source: 2017 Auditor General Report Volume IV, Chapter 2, Exhibit 2.11

*Amounts from provinces' 2017 financial statement discussion and analysis where available. For those provinces where this indicator was not published in the same format, information was obtained on population from Statistics Canada as of July 1 within the fiscal year (i.e. 2017 was July 1, 2016 population). Numbers have been rounded for presentation purposes.

Appendix I – Information from the 2017 Auditor General’s Report, Volume IV (continued)

The following information was presented in the 2017 Auditor General Report Volume IV, Chapter 2.



Source: 2017 Auditor General Report Volume IV, Chapter 2, Exhibit 2.12

Net Debt as a Percentage of GDP Compared to Other Provinces (percent)					
Province	2008	2012	2016	2017	% Increase (Decrease) from 2008 to 2017
New Brunswick	25.0	32.0	41.3	41.1	64.4%
Manitoba	21.6	25.7	32.5	33.7	56.0%
Saskatchewan	11.2	6.1	9.9	13.3	18.8%
Nova Scotia	36.7	35.5	37.5	36.4	(0.8%)

Source: 2017 Auditor General Report Volume IV, Chapter 2, Exhibit 2.13

Appendix II – Supplementary Estimate Details

Supplementary Estimates that have received approval from Legislative Assembly since 2008

Year ended March 31	During Year		After Year Ended		
	Approval Date	Estimate Amount (\$ millions)	Approval Date	Estimate Amount (\$ millions)	# Months
2017	*	*	16-Mar-18	65	12
2016	*	*	05-May-17	57	14
2015	*	*	28-Jun-16	357	15
2014	06-Jun-13	16	*	*	*
2013	*	*	21-May-14	209	14
2012	*	*	20-Dec-12	92	9
2011	17-Dec-10	124	21-Dec-11	166	9
2010	26-Feb-10	198	17-Dec-10	67	9
2009	19-Dec-08	299	26-Feb-10	101	11
2008	20-Dec-07	64	19-Dec-08	99	9
	28-Mar-08	202			

Source: Legislative Assembly web site, Date Supplementary Appropriates Acts received Royal Assent

*Blank indicates no Supplementary Estimate obtained.