OFFICE OF THE
AUDITOR GENERAL
MANITOBA

The Auditor General Act, Section 10 Annual Report

Accounts and Financial Statements

1

Web version

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Highlights of this chapter

The Auditor General Act (the Act) requires us to report to the Assembly by December 31st each year about the examinations and audits conducted under Section 9 of the Act. This section of the Act relates to audits of the Public Accounts and other financial statements included in the Province of Manitoba's Public Accounts. Section 10(2) of the Act requires us to indicate anything resulting from this work that we consider should be brought to the Assembly's attention.

We are pleased to report that for 2012/13, we once again issued a clean audit opinion on the government's Summary Financial Statements, which means that the summary statements are presented fairly in accordance with Canadian public sector accounting principles. We are also pleased to report most organizations consolidated into the Summary Financial Statements received clean audit opinions.

Understanding Manitoba's financial reporting is important in order to evaluate the government's financial affairs. As a result, in **section 1** we discuss how financial information is presented in the Summary Budget and the Summary Financial Statements. We have drawn attention to the difference between focusing on information at the core versus the summary level. And we have described considerations necessary for understanding accountability at the summary level.

In **section 2**, we discuss various measures representing different aspects of the Province's debt. We provide information to help understand Manitoba's borrowings, net debt, accumulated deficit and debt servicing costs. In **section 3**, we discuss the Province's pension liability. We provide information on the types of pension plans in the Province, how the liability is estimated, discount rates and the accounting for the various pension plans in the Province.

In **section 4**, we list the significant matters that arose from our financial statement audits.

We report that:

- the Province's public sector compensation disclosure accounting policy is inconsistent.
- the statement of payments over $5,000 is out of date and incomplete.
- the Province does not release its quarterly reports promptly.
- the Manitoba Floodway and East Side Road Authority did not promptly provide information on assets it transferred to the Department of Infrastructure and Transportation.
- more policies are needed for the report of amounts paid or payable to Members of the Legislative Assembly.
- the Northern Affairs Fund's financial statements were not completed promptly.
- the Financial Institutions Regulation Branch was transferred to Manitoba Securities Commission before the transfer was approved or due to take effect.

Section 5 provides status updates on our prior year recommendations.

Understanding the public accounts and matters from other financial statement audits

1. Understanding Manitoba's financial reporting

1.1 Financial reporting responsibilities

Our responsibility and auditor's report

The Auditor General Act requires us to audit the provincial government's Summary Financial Statements and issue our auditor's report to the Legislature.

We conduct our audit in accordance with Canadian generally accepted auditing standards (GAAS). The standards outline the processes and procedures an auditor should follow to perform the audit appropriately. Our auditor's report on the Province's Summary Financial Statements as at March 31, 2013 presents a clean opinion. This means that we found the statements were fairly presented in accordance with Canadian accounting standards.

Responsibility for preparing the Summary Financial Statements

Section 65(1)(a) of *The Financial Administration Act* requires the Comptroller to prepare for each fiscal year, under direction of the Minister of Finance, public accounts that include Summary Financial Statements. At the direction of the Minister of Finance, the Provincial Comptroller prepares the Summary Financial Statements following Public Sector Accounting Standards (PSA standards).

To prepare financial statements, the Provincial Comptroller has to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. The Provincial Comptroller is also responsible for internal controls, to the extent they are necessary to prepare Summary Financial Statements free from material misstatement. The Provincial Comptroller confirms this by signing the "statement of responsibility" before our audit report. It is in Volume 1 of the Public Accounts.

In organizations governed by an independent board of directors, the board approves the financial statements on the recommendation of the audit committee. This governance structure does not exist for the Province's Public Accounts. Instead, it has an audit committee equivalent, consisting of the Minister of Finance, Deputy Minister of Finance, Secretary to the Treasury Board, Associate Secretary to the Treasury Board and the Assistant Deputy Minister of Finance. While these people are not independent of management or the government, they do review the results of our audit and the Summary Financial Statements. The Minister of Finance provides the final approval of the Summary Financial Statements.

1.2 Public Sector Accounting Standards

The Public Sector Accounting Board (PSAB) is an independent body that establishes Public Sector Accounting (PSA) standards. The PSA standards allow comparison of the financial results of public sector entities in Manitoba and across Canada. Because public sector entities do not typically aim to maximize profit or answer to shareholders, they have different measures of financial accountability. The PSA standards recognize these differences.

Entities that report under PSA standards

PSAB issues standards and guidance with respect to matters of accounting in the public sector. This means that entities in the public sector will either follow the PSA standards or will be directed to use another set of accounting standards by the PSAB guidance. Public sector refers to federal, provincial, territorial and local governments, government organizations, government partnerships, and school boards. Government organizations are entities controlled by the government. The PSA standards define control *as the power to govern the financial and operating policies of another organization with expected benefits or the risk of loss to the government from the other organization's activities*[1]. A government can govern financial and operating policies in several ways, including the ability to:

- establish an organization's fundamental purpose and eliminate or significantly limit the organization's capability to make future decisions by determining the financial and operating policies of the organization;
- direct the financial and operating policies of an organization on an ongoing basis; or
- veto or modify financial and operating policies established by an organization.

Controlled entities consolidated into the Province's Summary Financial Statements are listed in Schedule 8 of the financial statements, entitled *Funds, Organizations and Business Enterprises Comprising the Government Reporting Entity*.

Governments are directed to use PSA standards. There are a number of types of government organizations and PSAB guidance directs each type differently in determining which accounting standards they should follow. The three types are government business enterprises, government not-for-profit organizations, and other government organizations**.**

Government business enterprises

PSA standards define a government business enterprise as an organization with the following characteristics:

a. It is a separate legal entity with the power to contract in its own name and that can sue and be sued.
b. It has been delegated the financial and operational authority to carry on a business.

[1] Public Sector Accounting Handbook – section 1300.08 (PS 1300.08)

c. It sells goods and services to individuals and organizations outside of the government reporting entity as its principal activity.
d. It can, in the normal course of its operations, maintain its operations and meet its liabilities from revenues received from sources outside of the government reporting entity.

Although as public sector entities, government business enterprises (GBEs) are directed initially to the PSA handbook, they do not follow the PSA standards because their stakeholders' needs differ substantially from the needs of other public sector entities. GBEs focus on generating profit and sustaining operations. Other public sector entities do not. As a result, the PSA standards require GBEs to follow International Financial Reporting Standards (IFRS), the accounting standards for publically accountable enterprises outside of the public sector.

Government non-for-profit organizations

Government not-for-profit organizations are defined by PSAB as entities, normally without transferable ownership interests, organized and operated exclusively for social, educational, professional, religious, health, charitable or any other not-for-profit purpose. A not-for-profit organization's members, contributors and other resource providers do not, in such capacity, receive any financial return directly from the organization.

For purposes of their financial reporting, government not-for-profit organization must follow the PSA standards however they have a choice. They can either follow the general PSA standards used by governments or they can follow the PSA standards along with a special set of standards for government not-for-profit organizations; the government not-for-profit specific standards are similar to standards used by not-for-profit organizations outside the public sector.

Other government organizations

There are other entities that are controlled by the government which do not meet the definition of government business enterprise or government not-for-profit organizations; these are classified as other government organizations.

The standards in the CICA PSA Handbook generally meet the needs of users of general purpose financial statements of other government organizations. When these standards do not meet these users' needs, IFRS, the standards applicable to publicly accountable enterprises should be considered. In Manitoba all other government organizations use PSA standards.

Figure 1: Manitoba's public sector entities and their accounting standards

1. Governments Follow PSA standards Example – Province of Manitoba	**2. Government not-for-profits** Follow PSA standards Examples – universities, health authorities
3. Government business enterprises* Follow International Financial Reporting Standards Examples – Manitoba Liquor and Lotteries, Worker's Compensation Board and Manitoba Public Insurance	**4. Other government organizations** Follow PSA standards Examples – Manitoba Agricultural Services Corporation and funding entities such as the Manitoba Health Services Insurance Plan and Public Schools Finance board

* Manitoba Hydro follows Canadian generally accepted accounting principles and currently uses rate regulated accounting. The Canadian accounting standards board will require rate regulated entities to apply IFRS effective January 1, 2015. IFRS has issued an interim standard for first time adopters when the entity has rate regulated activities. Certain deferrals will still be permitted until the final IFRS standard is issued.

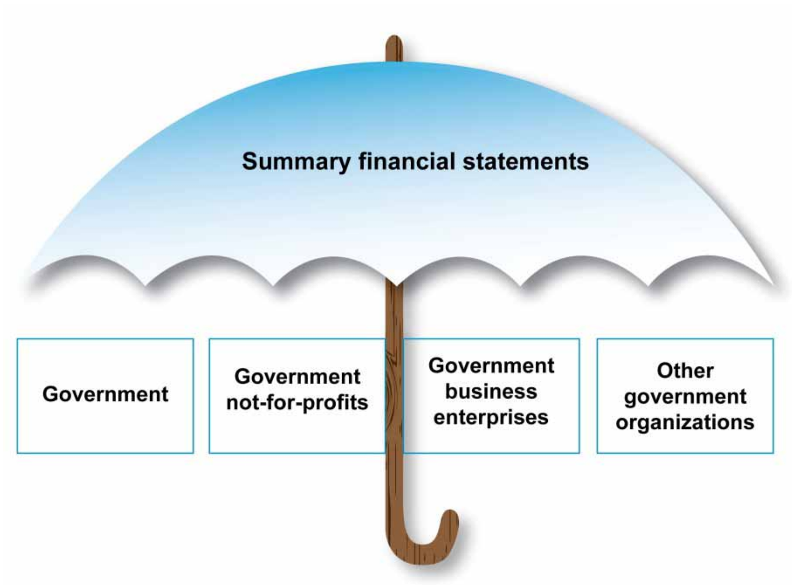
Because public sector entities all follow the PSA standards, their financial results can be compared. This is important so the government and other users can better evaluate the needs of public sector organizations more consistently when making financing, investing and operating decisions.

1.3 Summary versus core reporting

Summary reporting

The PSA standards require summary financial reporting. Summary reporting consolidates the results of the government and the entities it controls. The Summary Financial Statements for the Province of Manitoba consolidate the results of nearly 200 sets of financial statements. Some of these statements already include the consolidated results of a number of other separate entities. This provides a more complete picture of the government's financial status (than core reporting does) because the Summary Financial Statements include all the assets and liabilities and all sources of revenue and expenses of these entities. If the Summary Financial Statements do not include all controlled government entities, they provide an incomplete picture of the Province's financial status.

Figure 2: Type of entities consolidated in the summary financial statements



Core government reporting

Core reporting is essentially the reporting of government department activities only—not the activities of all the other entities that government controls. For example, in Manitoba the Department of Health is included in core government, the Regional Health Authorities (RHAs) are not. Department of Health grants to the RHAs would be included in the core government expenditures but other sources of revenue and expenditures of the RHA's are excluded and grant expenditures are not broken down into useful categories.

Reporting only on core government does not provide a full picture of a government's financial status. Core reporting can show the financial status of internal government operations, but it is incomplete. Entities outside core government provide many public services and are controlled directly or indirectly by government.

Manitoba has made many improvements to report more on summary results. But there are still areas where the financial reporting at the summary level could be improved. These include:

- Volume 1 (Public Accounts – Other Financial Reports) – Consolidated Details and Reconciliation to Core Government Results – although the schedule does reconcile to the Summary Financial Statements, the Consolidations Impacts column is difficult to understand and provides little information in understanding the adjustments.
- Volume 2 (Public Accounts) – payments in excess of $5,000 and compensation paid are disclosed only for the core government.
- Volume 3 (Public Accounts) – various schedules that contain only core government information.
- Quarterly Financial Reports – more detailed information on revenue and expenses and capital investment information is provided for only the core government.

We have made recommendations in the past on providing disclosure beyond the core government in Volumes 2 and 3. In our January 2012 Report to the Legislature (RTL), we recommended that the Province review its reporting of core information in Volume 3. In our December 2009 RTL, we recommended that the Province make the compensation disclosure available on its website for all organizations in the government reporting entity (GRE). But it has made only limited progress in these areas. In **section 4**, we recommend that the Province provide disclosure of payments by all entities in the GRE. Core government information can be useful, but it should be consistent with—and in addition to—the summary financial reporting.

1.4 Improving accountability

Summary budget - operating surplus or deficit

The Province of Manitoba Summary Budget is prepared on the same basis as the Summary Financial Statements. Budgeted revenue and expense figures are included in the Summary Financial Statements where they are compared to actual. This provides key accountability information, producing a complete financial picture of the Province.

In the *Manitoba Estimates of Expenditure and Revenue,* core government revenues and expenses are reconciled to the summary budget. **Figure 3** summarizes this reconciliation.

Figure 3

All numbers in $ 000's

Estimates of expenditures of core government (voted appropriations) - Part A Operating	**($11,437,506)**
Estimates of revenues of core government	**$11,158,878**
Consolidation impacts on revenues of other government reporting entities	**$2,692,520**
Consolidation impacts on expenses of other government reporting entities	**($2,128,964)**
Debt servicing costs	**($857,584)**
In-year adjustments/lapse	**$112,500**
=	
Summary Budget Deficit	**($460,156)**

Source: 2012 Estimates of Expenditure and Revenue for the fiscal year ending March 31, 2013

Estimates of expenditures of core government (voted appropriations)—Part A operating

This portion of the Summary Budget includes budgeted expenses for all departments in the core government (also known as *Part A Operating*). The amounts are for direct expenses to fund government operations as well as grants and transfers to other government organizations and external agencies.

Members of the Legislative Assembly (MLAs) specifically vote on and approve this portion of the Summary Budget. However, the MLAs don't vote and approve the other adjustments explained below and outlined in **Figure 3** above.

Estimates of revenues of core government

This portion of the Summary Budget includes budgeted revenues received by the government primarily through taxes, transfer payments from the federal government, and income from Manitoba Liquor and Lotteries.

MLAs do not vote on the budgeted revenues of the core government. Although budgeted federal transfers payments are generally close to actual, budgeted revenues from taxes and income from government business enterprises can differ significantly from actual.

Consolidation impacts on revenues and expenses of other reporting entities

These adjustments are required to include all other non-core government reporting entities consolidated into the Summary Financial Statements. But they do not include enough information to explain what they relate to.

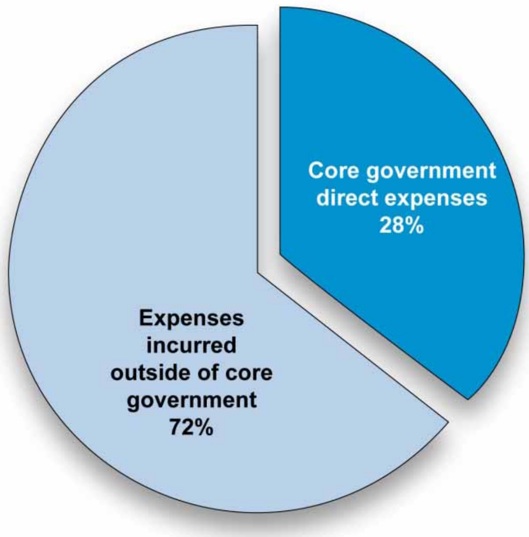
The consolidation impacts contribute additional revenue of $2,692,520,000 in the 2012-13 budget. This includes revenues from additional sources such as, for example, tuition and fees - and property taxes in the education sector. There is no information on which public sector entities are earning the revenues. The revenue consolidation impacts also include accounting adjustments such as grossing up sinking fund and other investment earnings of the core which have been shown on a net basis in the core.

The consolidation impacts also bring in additional expenses of $2,128,964,000 in the 2012-13 budget. This represents expenditures incurred by other reporting entities in excess of grant levels. It also includes accounting adjustments such as the gross up of the debt servicing expenses.

At the end of the day, the summary budget reflects net revenues of $563,556,000 with no clear link to where it comes from and what this represents. All entities as well as adjustments are grouped together in one column.

When the core results are adjusted by the consolidation impacts, all transactions between the core government and other reporting entities are eliminated. The consolidated summary revenues represent amounts coming from outside the government reporting entity (GRE). The consolidated summary expenses represent expenses that were paid outside the GRE. After consolidation, 28% of the summary expenses were incurred directly by the core government for items such as personnel costs, social assistance, and debt servicing. The remaining 72% were incurred by other reporting entities or were grants to organizations outside the GRE. This is shown in **Figure 4**.

Figure 4: Province of Manitoba breakdown of actual summary expenses for the year ended March 31, 2013 (in millions)



Core government direct expenses	$ 3,972
Total core government expenses less grants/transfer payments. Consists of operating expenses, social assistance related costs and debt servicing.	
Expenses incurred outside of core government	$ 10,394
Includes the costs incurred by the OREs for their operations and grants to entities outside the GRE.	
Total summary expenses	$ 14,366

Source: Compiled by OAG from information supplied by the Department of Finance

Because the majority of summary expenses are incurred outside the core, understanding the consolidation impacts of the other government entities is important. The responsibility for appropriate management of the grants and transfers payments rests not only with the boards, management and staff of these other government entities, but also with the Province who controls the entities. We urge the government to continue to improve the summary budget to make it easier for MLAs and the public to understand these adjustments.

Debt servicing costs

This portion of the Summary Budget relates to the interest paid on debt. It includes interest paid for the debt of the core government and for other government reporting entities (such as universities). It is important to note that voted appropriations do not include the debt servicing costs.

In-year adjustments/lapse

In-year adjustments/lapse represents unspecified cost savings or revenue increases that the government expects departments to find during the year. Accountability for this amount is not attributed to any specific reporting entity or business area within core government. And actual results are not explicitly reported on (actual results are only implicitly reported through increases/decreases in revenue and expenditures).

Summary budget deficit

The budgeted surplus or deficit is important to stakeholders—it allows them to better understand the Province's financial plan for the upcoming fiscal year. And MLAs can compare appropriations they vote on to the full context of the summary results. As well, the Summary Budget is compared to actual in the Summary Financial Statements showing whether the Province met its budget.

Summary budget: Capital investment

Within the Manitoba Estimates of Expenditure and Revenue document is the budget for capital investment for core government. Part B summarizes the total capital investment planned by departments for the fiscal year. MLAs vote on and approve this part of the Summary Budget. For the fiscal year 2013, budgeted capital investments were $751 million. The actual spent was $568 million, as shown in the *Summary of Departmental Appropriations and Expenses Part B- Capital Investments* in Volume 3 of the Public Accounts.

The budget does not provide equivalent information on planned capital investments for the other reporting entities, but does provide an estimate of the total capital investment on a summary level for the year. Using this available information, the additional capital investment outside the core government can be estimated. The summary budget discloses capital investment of $1.719 billion in the 2013 fiscal year. Since $751 million is related to core government, the total capital investment of other reporting entities can be estimated at $968 million.

Funding for capital investments related to the other reporting entities is generally provided through capital grants from the Province, loan advances from the Province, or the issuance of debt. Schedule 7 (Consolidated Statement of Tangible Capital Assets) in the Summary Financial Statements reports total capital additions of $1,273 million. Since $568 million relates to the departmental appropriations as shown above, actual additions of the other reporting entities were $705 million. This is summarized in the following chart:

	Budget	Actual
Core	$ 751 M	$ 568 M
Other entities	968 M	705 M
Summary – Capital investments	$ 1,719 M	1,273 M

In reviewing part B, it is important to understand how capital investments affect the annual net income of the Province. The cost of capital investment is not expensed to net income when it is incurred. Instead, it is amortized into net income. Amortization means the costs are allocated over the useful life of the related capital investment item. This is done to ensure the cost of the capital investment matches the period in which its benefits are expected to occur. For example, if the government bought a building for $40 million, it would not expense the full cost in one year. Rather, if it expects the building to last 40 years, a $1 million amortization expense ($40m divided by 40 years) would affect net income for the next 40 years. In other words, each year there would be a $1 million expense, for 40 years.

The amortization expense for all government assets is shown in Part A of the Summary Budget. In addition, Appendix B to the Manitoba Estimates of Expenditure and Revenue document details the useful life and the amortization method used by asset class.

Other financing mechanisms

Another vehicle for spending money not captured by the Summary Budget is *The Loan Act*. MLAs vote on *The Loan Act*, outlining the authorized borrowing limits to fund capital projects and government programs. Each fiscal year, the government votes on and authorizes new borrowing limits, including those authorized to Manitoba Hydro. The limit lapses each fiscal year and may be re-authorized the following fiscal year.

In addition, when the authority to make a loan under any other act (such as *The Loan Act*) is insufficient, Section 63(1) of *The Financial Administration Act* allows the Minister of Finance to make loans to non-government entities. *The Loan Act 2013* sets the maximum that the Minister of Finance can authorize under Section 63(1) as $200 million.

Payment of these funds is not reflected in the Province's Summary Budget. The Minister of Finance is responsible to table a report outlining loans made under Section 63(1) of *The Financial Administration Act.* While Volume 3 has a schedule of loans and advances, it does not specify the actual loans made during the year under *The Loan Act.* But the Government issues Orders in Council which publicly disclose loans as they are made.

1.5 No accountability for lapses or PPMR savings

The 2012-13 Summary Budget includes amounts for in-year adjustments/lapses and Program Portfolio Management Review (PPMR) savings. In-year adjustments/lapses are budgeted for annually and represent unspecified expected savings or increased revenue but are not allocated to a specific expense sector or revenue source. PPMR savings is an initiative from the 2012-13 Summary Budget to reduce government costs.

Amounts from the 2012-13 Summary Budget are presented in the 2012-13 Summary Financial Statements as an accountability measure for users to assess if each sector exceeded or met its budgeted expenditure levels. However, in-year lapses and PPMR savings are reported differently in the Summary Budget than they are in the Summary Financial Statements. It is difficult to compare information that is presented differently. **Figure 5** compares the presentation of budgeted amounts by expense sector in the Summary Budget and Summary Financial Statements.

The first column shows the total expenses budget by sector from the Summary Budget. The in-year lapses and PPMR savings are each presented as a single line item.

The second column shows the budgeted figures in the Summary Financial Statements. The in-year adjustment/lapses amount is netted against the Justice and Other expense sector and the PPMR savings is netted against the Community, Economic and Resource Development expense sector.

Figure 5

Expenses	Budget amounts	
	2012-13 Summary Budget	2012-13 Summary Financial Statements
	in $ millions	
Health & Healthy Living	$ 5,547	$ 5,546
Education	3,710	3,710
Family Services	1,064	1,064
Community, Economic and Resource Development	2,445	2,317
Justice and Other Expenditures	928	817
Debt Servicing	857	857
Program Portfolio Management Review	(128)	n/a
In-Year Adjustments/Lapses	(113)	n/a

Web version

In-year adjustments/lapses

Accountability for this amount is not attributed to any specific government entity or department in core government. And actual results are not explicitly reported—they are only implicitly reported through increases in revenue and decreases in expense. Because there is no publically disclosed plan for achieving these results and no clear method of public accountability or reporting on the results, it is hard to tell if the Province has achieved or is likely to achieve these budgeted targets.

In the Summary Financial Statements, the in-year adjustments/lapse amount has been combined with the budget of Justice and Other Expenditures. This presentation suggests that the Justice and Other sector overspent more than it did. This makes the comparison of actual versus budget misleading. There is no reporting elsewhere on whether these savings were achieved.

Program portfolio management review

The Province introduced a program portfolio management review process in its 2012-13 budget for the 2013 fiscal year. The budget cites examples of cost-cutting reforms already identified through this review, including reductions in the number of:

- regional health authorities.
- crown corporations (by merging Manitoba Liquor Control Commission and Manitoba Lotteries Corporation).
- government-appointed agencies, boards and commissions.

Expected cost savings of $128 million for the 2013 fiscal year were included in the printed budget estimates. As with the in-year lapses and adjustments, these changes were expected to take place within more than one sector and were not allocated to any one sector or in the budget.

For comparative purposes in the Summary Financial Statements, the savings were combined on the Community, Economic and Resource Development sector line of the Province's budget (see **Figure 5** above). Reporting of actual cost savings under the review is not publically available. So it is hard to tell if the Province achieved its budgeted cost savings. And this presentation in the Summary Financial Statements makes it appear that the Community, Economic and Resource Development sector overspent, when it was actually under budget.

Increasing significance of these areas

As the dollar value of in-year lapses and adjustments has increased significantly over the past few years, the financial reporting of this amount is important to users of the Summary Budget and Summary Financial Statements.

Figure 6: In year adjustment projected for the next four years

10 / BUDGET 2013

Summary Budget Outlook

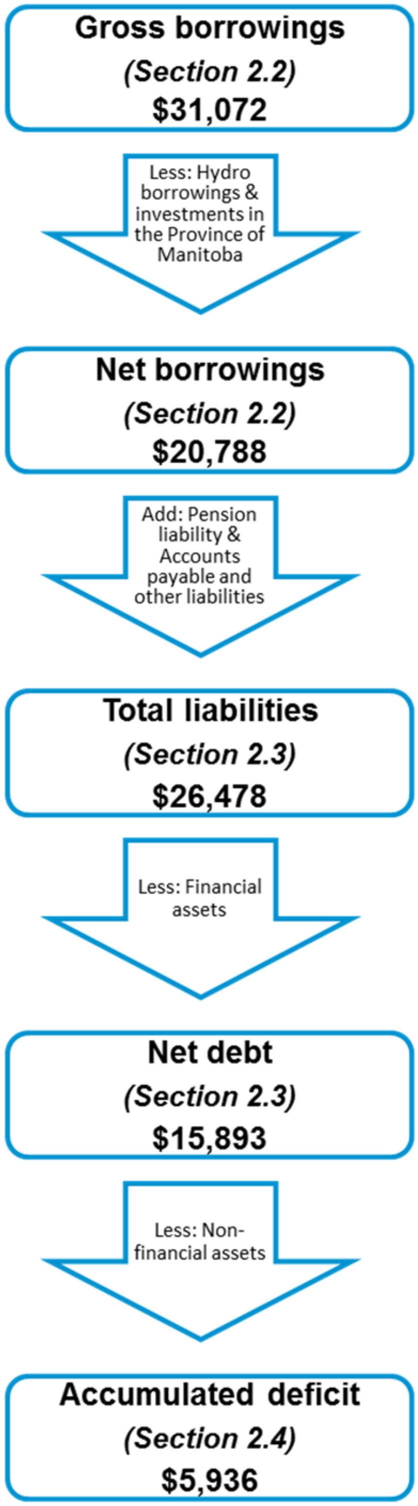
	2012/13 Forecast	2013/14 Budget	2014/15 Projection	2015/16 Projection	2016/17 Projection
			(Millions of Dollars)		
REVENUE					
Core Government[1]	11,143	11,524	11,977	12,449	12,937
Other Reporting Entities[2]	2,621	2,685	2,575	2,618	2,671
TOTAL REVENUE	13,764	14,209	14,552	15,067	15,608
EXPENDITURE					
Core Government Programs and Services[1]	11,825	12,099	12,371	12,639	12,912
Other Reporting Entities[2]	2,579	2,778	2,696	2,742	2,797
TOTAL EXPENDITURE	14,404	14,877	15,067	15,381	15,709
Re-statement Adjustment					
In-Year Adjustments/Lapse [3]	(57)	(150)	(150)	(150)	(150)
SUMMARY NET INCOME (LOSS)	(583)	(518)	(365)	(164)	49

1 Includes 2013 Spring Flood Contingency of $30 million in expenditures offset by $27 million in revenue.
2 Includes Consolidation Impacts.
3 In-Year Adjustments/Lapse could be an increase in revenue and/or a decrease in expenditure.

Source: Manitoba Budget 2012

Figure 6 shows that the in-year lapse is expected to be at $150M for the next 4 years. These savings will need to be achieved as part of the Province's planned return to an operating surplus in the 2016-17 fiscal year.

Figure 7



Source: Audited Summary Financial Statements for the year ended March 31, 2013

2. Understanding Manitoba's debt

In **Chapter 3** we report on our project findings that compare Manitoba's position to other jurisdictions in Canada and includes national and international research information.

2.1 Understanding Manitoba's debt position

Government debt is an area of concern for many people today, in Manitoba and Canada, and around the world. To understand Manitoba's financial position we need to understand Manitoba's debt. No single measure best represents the Province's debt; instead, several measures each represent a different aspect of the Province's financial position. When understood and looked at as a whole, these measures can give users an understanding of the Province's financial position and use of borrowing. This section summarizes these measures, plus current and historical data on Manitoba's debt and borrowings.

Figure 7 shows the significant measures related to debt and borrowings of the Province and the connection between them. The rest of this section discusses each measure in more detail.

2.2 Understanding borrowings

When people think of government debt, they often think of what is called (in the Province's Summary Financial Statements) borrowings—the formally issued securities the Province uses to pay for capital projects and to cover spending greater than revenues. Borrowings have also been used to pay the Province's share of its employees' pensions.

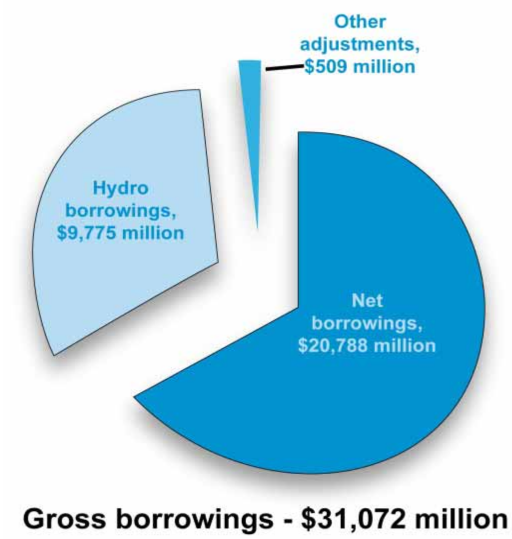
Nature of borrowings

The Province's borrowings include bonds and debentures payable in Canadian and US dollars, loans and mortgages payable to various financial institutions and the federal government, and short-term borrowings such as treasury bills.

Gross borrowings versus net borrowings

The Consolidated Statement of Financial Position (the balance sheet) shows borrowings of $20.8 billion at March 31, 2013. However, the Statement of Borrowings, a schedule to the financial statements, shows total gross borrowings of $31 billion for 2013. The difference is calculated on the Statement of Borrowings. **Figure 8** below shows how the gross “total borrowings” of $31 billion is broken down between the net borrowings in the balance sheet and the other adjustments.

Figure 8



Source: Audited Summary Financial Statements for the year ended March 31, 2013

The adjustments to reduce the gross borrowings to the net borrowings in the Province’s financial statements are as follows:

Manitoba Hydro borrowings

Manitoba Hydro (Hydro) is a government business enterprise (GBE). Because GBEs are profit oriented and expected to earn their own income rather than require funding from core government, they are accounted for in the same way an equity investment in a profit oriented company is. So the individual assets and liabilities of GBEs are not consolidated with those of the rest of the Province. The borrowings of Hydro are not included in the borrowings line on the Province’s balance sheet. Instead, the net equity (essentially total assets less total liabilities) of GBEs is included as an asset on the Summary Financial Statements representing the Province’s investment in them.

So Hydro's debt is not included in the net borrowings of the Province. Instead, Hydro's borrowings are netted against its assets and included through the "Equity in government business enterprises" line in the Summary Financial Statements. As a result, $9.8 billion of the Province's total borrowings are bonds the Province has issued for Hydro. Hydro receives the funds from the Province as a loan and agrees to repay the Province with the same interest and repayment terms as the debt has. The payments on these debts essentially flow through the Province and are payable by Hydro.

Other adjustments

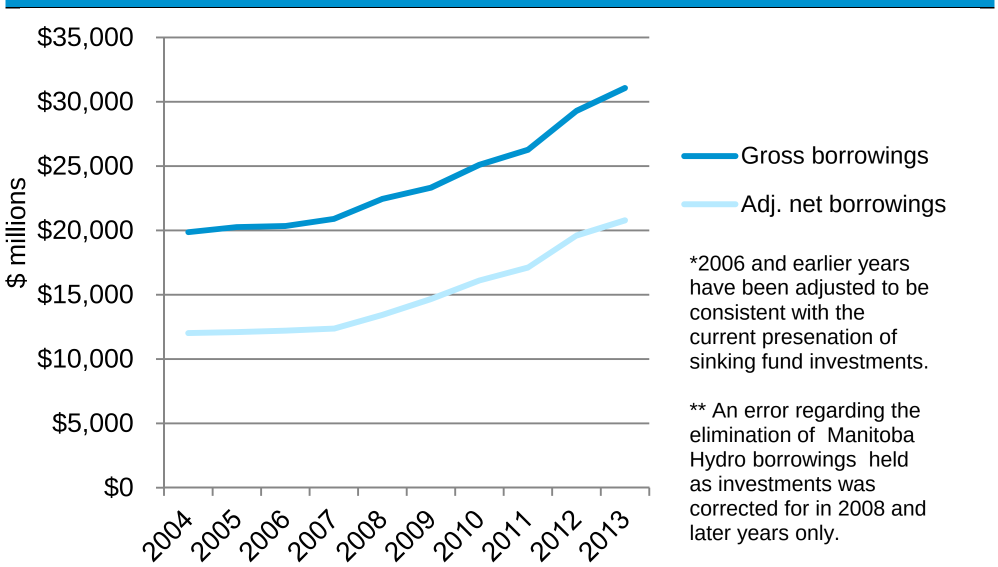
Several other adjustments are made to get net borrowings. The most significant one is to eliminate bonds and debentures the Province has bought back and holds as investments, as part of its debt-management strategy.

The remaining adjustments relate to how costs, gains, and losses related to borrowings are treated for accounting purposes.

Manitoba's gross and net borrowings over time

Figure 9 show the Manitoba's gross and net borrowings over the past 10 years.

Figure 9: Manitoba's gross & net borrowings

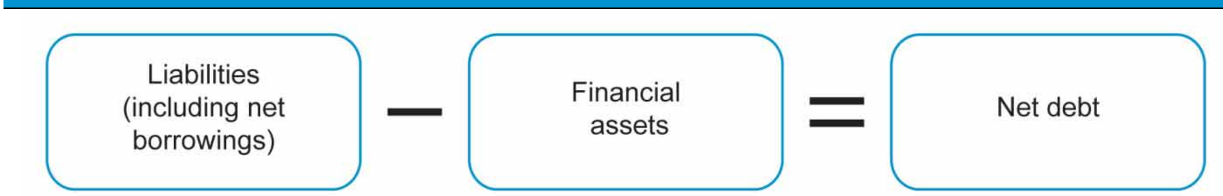


Source: Audited Summary Financial Statements for the years ended March 31, 2005 to March 31, 2013

2.3 Understanding net debt

Net debt is the next significant measure in looking at government's financial position. Net debt is the Province's total liabilities less its total financial assets. Financial assets (not total assets) are used to calculate net debt because financial assets can be used to pay liabilities. Non-financial assets excluded from this calculation are things like highways and buildings, which cannot be used directly to pay liabilities. They also do not generate income that the Province can use to repay liabilities. The logic is that financial assets can be used to extinguish liabilities or create cash flows to extinguish liabilities, so the net debt is the amount that liabilities exceed the assets that can be used to repay them. Net debt ultimately will be repaid by future revenues in excess of future cash expenditures. Since net debt is calculated using liabilities and financial assets, these balances will be discussed further.

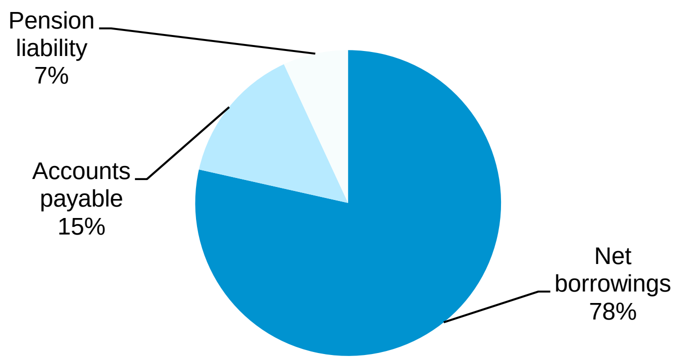
Figure 10: Calculation of net debt



Liabilities

The formula in **Figure 10** above shows that the net borrowings discussed in **section 2.2** above are included in the Province's total liabilities. **Figure 11** shows the composition of the current 2013 liabilities balance from the Consolidated Statement of Financial Position: 78% of the Province's liabilities are borrowings and 15% of liabilities are accounts payable, accrued charges, provisions and unearned revenue. This category includes amounts payable to suppliers, service providers, employees, deferred revenue, and estimates such as the amount to clean-up contaminated land and sites. It also includes the interest accrued and not yet paid on borrowings ($202 million in 2013). The final 7% of the Province's liabilities is the pension liability; see **section 3** for more on this. When the Province increases borrowings to pay its unfunded pension liability, this has no impact on total liabilities or net debt – the Province is just exchanging one type of liability, pension liability, for another type, borrowings.

Figure 11: Composition of the province's total liabilities



Total liabilities - $26,478 million

Source: Audited Summary Financial Statements for the year ended March

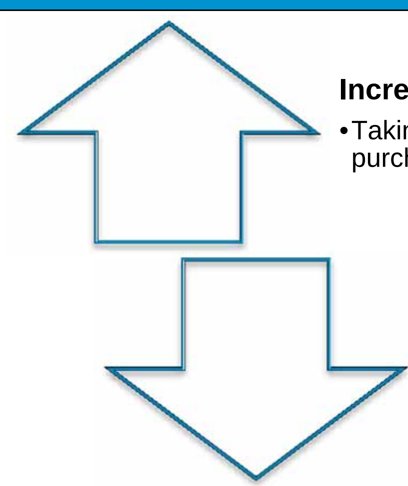
Financial assets

Financial assets are assets that could be used to discharge existing liabilities or finance future operations. They are not for consumption in the normal course of operations. [2] They include cash, investments, accounts receivable, loans and advances receivable, and inventories that will be sold to generate revenue. They also include equity in GBEs such as Hydro, discussed in **section 2.2** above.

Statement of changes in net debt

The equation in **Figure 12** shows the 2 ways that net debt can increase—increases in liabilities or decreases in financial assets.

Figure 12: Causes of increases in net debt



Increases in liabilities

- Taking on debt to fund operating expenses or purchases of non-financial assets

Decreases in financial assets

- Cash flows from net income are negative
- Non-financial assets are purchased using financial assets (such as cash)

[2] PS 1000.39

The *Consolidated Statement of Changes in Net Debt* in the Summary Financial Statements has more detail on causes of increases or decreases in net debt during the year.

Figure 13: Consolidated Statement of Changes in Net Debt
For the year ended March 31, 2013

	in millions
Net loss for the year	$ (580)
Tangible Capital Assets	
• Acquisition of tangible capital assets	$ (1,273)
• Amortization of tangible capital assets	511
• Disposal of tangible capital assets	17
Net Acquisition of Tangible Capital Assets	$ (745)
Other Non-Financial Assets	
• Decrease in inventories	$ 4
• Increase in prepaid expense	(10)
Net Acquisition of Other Non-Financial Assets	$ (6)
Other Comprehensive Income	(12)
Increase in Net Debt	$ (1,343)
Net Debt, beginning of year, as restated	(14,550)
Net Debt, end of year	**$ (15,893)**

Source: Audited Summary Financial Statements for the year ended March 31, 2013

Some parts of this statement are easy to understand, while others require more explanation.

The starting point for the change in net debt is net income or net loss for the year. A net loss (meaning expenses above revenues) will increase net debt. If expenses are higher than revenues, financial assets have to be spent to cover the expenses; alternatively, liabilities will have to be taken on to cover the expenses. Both scenarios increase net debt.

Alternatively, if there is a net income or surplus for the year, revenues exceeded expenses. The revenue in excess of expenses will be retained as financial assets (such as cash or investments). Consistent with **Figure 12**, an increase in financial assets decreases net debt.

The next item that affects the change in net debt is the acquisition of tangible capital assets and other non-financial assets. This includes acquisition of infrastructure such as highways and bridges and other capital assets such as buildings, universities, hospitals, aircraft, equipment and vehicles. Again, the impact on net debt is simple: non-financial assets are not included in the net debt calculation so when financial assets or debt are used to acquire non-financial assets, the net debt increases.

The next biggest impact on the change in net debt is the amortization of tangible capital assets. This amount appears to decrease net debt. This impact is less straightforward than the first 2 and requires more explanation.

Amortization is the accounting expense that is recognized as tangible capital assets are used up over their useful life. The amortization expense does not represent a cash flow in the current year – rather, the cash flow occurs in the year the asset is purchased or constructed. Instead of being recognized when the cash is paid, the expense is included in net income over time to recognize the usefulness of the asset being used up. As it is expensed, the value of the asset decreases, which means non-financial assets decrease.

So this non-cash expense has been included in net income but it does not actually have any impact on the financial assets or the liabilities – it affects only the non-financial asset balance. The amortization expense needs to be added back to net income because it is an expense that has no impact on the net debt.

The equation below simplifies the change in net debt.

Figure 14: Calculation of the change in the net debt

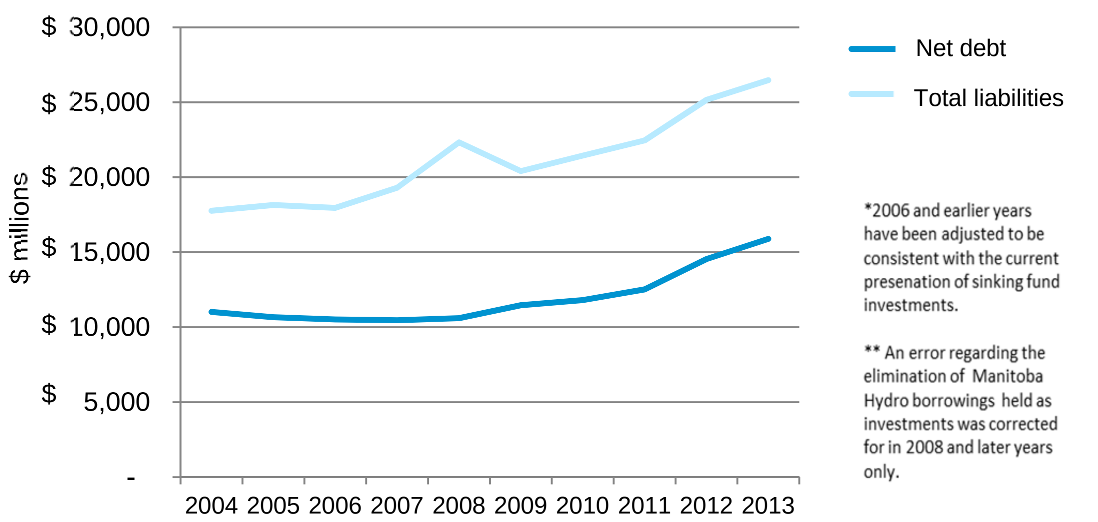
Change in net debt = Acquisition of non-financial assets + Net Income (or loss) adjusted for amortization + Other comprehensive income (or Loss) from GBE

Figure 14 shows that each year's change in net debt can be broken down between the increase due to the purchases of tangible capital assets and other non-financial assets, the impact of net income or loss adjusted for the non-cash expense of amortization, and the impact of government business entities' (such as Hydro's) other comprehensive income. Other comprehensive income is an accounting measure that includes unrealized foreign exchange and market value related gains and losses. These are excluded from net income because they are volatile and not yet realized. These items don't affect the net income of the Province during the year, but they do affect the equity of government business entities, which is part of the Province's financial assets, so other comprehensive income from government business entities must be included in the calculation of the change in net debt.

Changes in net debt over time

Figure 15 shows the trends in net debt and total liabilities over the past 10 years.

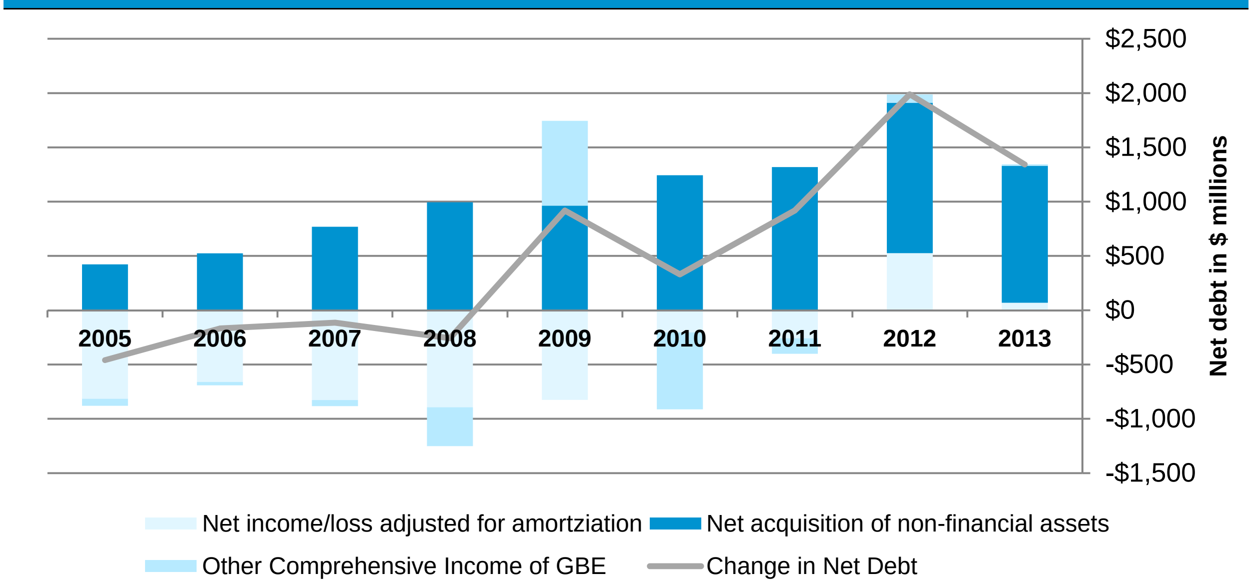
Figure 15: Manitoba's net debt and liabilities



Source: Audited Summary Financial Statements for the years ended March 31, 2005 to March 31, 2013

Figure 16 shows what drove the change in net debt over the past 10 years.

Figure 16: Drivers for the change in net debt



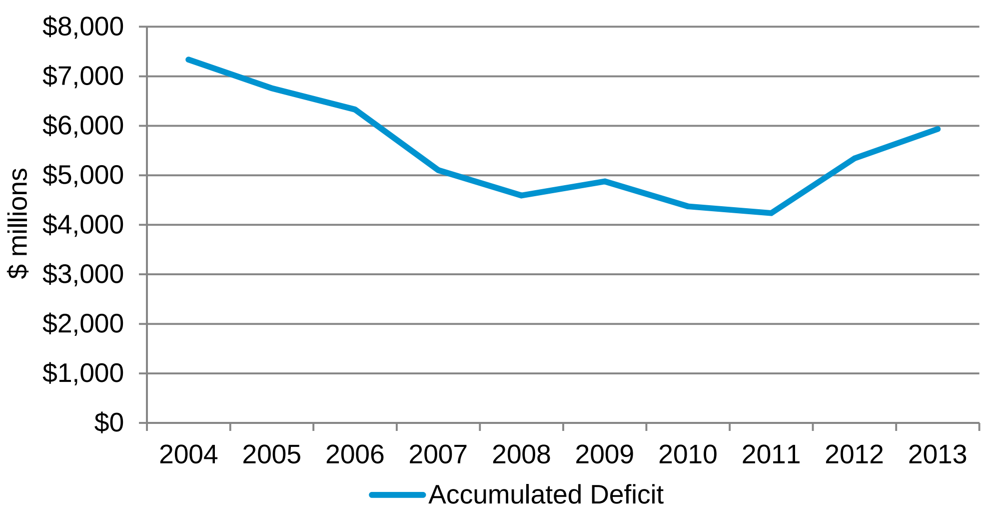
Source: Audited Summary Financial Statements for the years ended March 31, 2006 to March 31, 2013

The line in the chart in **Figure 16** represents the net change in net debt (a positive number indicates an increase in net debt and a negative number represents a decrease in net debt). The bars show the drivers that either increase or decrease the net debt during that year. The net total of the bars in the chart is equal to the line or the net change in net debt.

Every year, acquisition of non-financial assets (such as buildings and roads) increases net debt. Net debt will then increase if the cash flows from net income or deficit (after removing the effects of amortization) are higher than the acquisition of net assets during that year. During 2005-2008, cash flows from net income and the other comprehensive income of the GBEs were higher than the net investment in capital assets. This decreased net debt. During 2009-2011, cash flows from net income after removing the effects of amortization were positive even while the government was running a budget deficit during 2010 and 2011; however they weren't high enough to offset the amount of new investment in tangible capital assets. And in 2012 and 2013, the Province continued to run larger deficits so even after removing the impact of amortization, their cash flows from net income were negative; therefore both these negative cash flows and the investment in tangible capital assets had an impact on net debt.

2.4 Understanding the accumulated deficit

Figure 17: Manitoba's accumulated deficit



Source: Audited Summary Financial Statements for the years ended March 31, 2005 to March 31, 2013

Manitoba's accumulated deficit for the past 10 years is shown in **Figure 17.** The accumulated deficit is the difference between the total liabilities and the total assets of the Province. The difference between the net debt and the accumulated deficit is that the accumulated deficit also includes the non-financial assets. Non-financial assets are assets that do not normally provide resources to discharge existing liabilities. Instead, they are normally used to deliver government services; they may be consumed in the normal course of operations and are not for sale. They are primarily tangible capital assets such as infrastructure, buildings, vehicles and aircraft, but they also include inventory that will be used but not sold and prepaid expenses.

The financial statements of a for-profit business do not have an equivalent measure to the government's net debt. Instead they measure equity, calculated in the same way as accumulated deficit (total liabilities less total assets). The main reason a for-profit entity uses this measure instead of net debt is that a for-profit entity uses all assets to produce income. So while non-financial assets are less liquid, eventually they will increase revenues over their life. Governments are different from for-profit entities in providing many services without any related revenue. The non-financial assets of government will not create any future revenues that can repay liabilities. This is why the net debt measure is used in addition to accumulated deficit (the equity equivalent) for governments.

Accumulated deficit is still relevant to the Province's financial position as it is the accumulated balance of all of the Province's annual operating surplus and deficits; it shows how the Province has been managing all its resources, both financial and non-financial.

2.6 Debt servicing costs

The Consolidated Statement of Revenue and Expense (or income statement) shows the Province's debt servicing expenses as a separate line item. In 2013, debt-servicing expenses were $839 million, or 5.8% of total expenses in the year. This consists of:

- $233 million reported as core debt servicing expenses in its unaudited schedule of the consolidated details and reconciliation to core government results.
- $442 million in gross up adjustments (amounts netted against debt servicing costs in the core) made up of:
  - $100 million, core investment income (primarily on sinking funds)
  - $94 million, Hydro guarantee fee
  - $69 million, interest on debt used to finance plan assets of the Teacher's Pension Plan
  - $179 million, interest on debt used to finance capital assets
- $164 million incurred by other reporting entities.

Following Canadian accounting standards, the $839 million does not include the debt servicing costs of Manitoba Hydro; their debt servicing expenses are included in determining the net income from government business enterprises, which is a revenue item for the Province.

Debt servicing costs are influenced by two factors: the total amount of borrowings and the interest rate the government must pay.

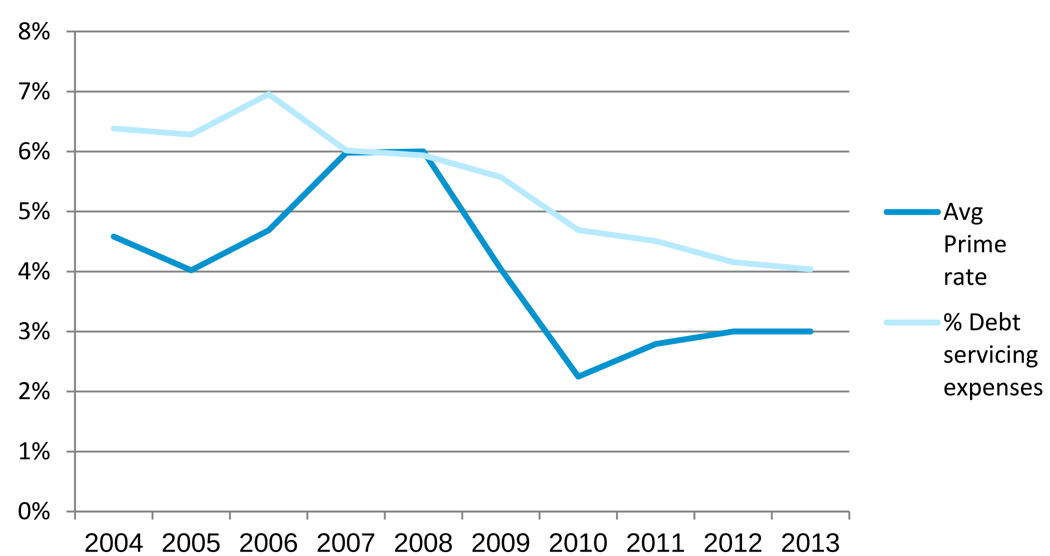
Total amount of borrowings—debt servicing costs are more closely correlated to borrowings than to total liabilities or net debt. This is because the other elements of liabilities (see **section 2.3**) do not directly incur debt servicing costs. The accounts payable, accrued liabilities, provisions and unearned revenue are typically shorter-term liabilities that don't incur interest. Pension liability does incur interest expense, but this amount is included in the pension plan expense, not the debt servicing expense. During 2013, the interest cost on pension benefit obligations was $448 million. **Section 3** discusses pension liability and expense.

Debt servicing costs are based on net borrowings, not gross (**section 2.2** distinguishes the two). This is because the gross borrowings include Hydro debt and since Hydro pays the interest on this debt, it is not an expense of the Province. Hydro's debt servicing costs do factor into the Province's net deficits, as they are included in the net income from government business enterprises, which is a revenue item for the Province.

Interest rate the Province must pay—this rate is influenced by both external market factors and the Province's debt-management strategy.

The Province's average interest rate can be calculated by dividing the net borrowings by the debt servicing expense. **Figure 18** shows the trends of the Province's average interest rate and the prime rate (representing market interest rate trends). Over the past decade, the Province's debt servicing expense rate has moved in the same general direction as market rates (the prime rate is an indicator of market rates).

Figure 18: Manitoba's debt servicing costs and the prime rate



Source: Bank of Canada for prime rates; debt servicing expense % calculated by OAG based on audited Summary Financial statements for the years ended March 31 2005 to 2013

Currently, market interest rates are at historically low levels. The prime rate has been at 3% since 2010, creating low market interest rates and relatively low debt servicing costs. Market rates (represented by the prime rate) have, over the last 40 years, averaged 8.27% – almost 3 times the current prime rate. When market rates rise again, the Province's borrowing rates, and thus cost of borrowing, will also increase.

While the Province cannot influence market rates, it has a debt-management strategy to manage its borrowing costs to some degree by using derivatives and sinking funds. With these tools, the Province can try to manage its interest rates and still maintain its desired balance of fixed and floating rate debt. The majority of the Province's interest costs are fixed rate as of March 31, 2013, about 12% of its debt had floating rate exposure, and was therefore impacted directly by market interest rates. This floating rate percentage is disclosed in the Province's audited financial statements. The disclosure indicates that this percentage takes into account the use of derivatives to manage interest rate risk as well as the returns on sinking funds held to extinguish debt. It does not include the exposure on debt issued for Manitoba Hydro. While not required by accounting standards, this information could be useful to the users of the financial statements.

3. Understanding Manitoba's pension liability

3.1 Manitoba's pension liability

In 2013, Manitoba had a pension liability of $1.8 billion shown in its Summary Financial Statements. This section will explain the pension liability, how it is determined, what it does and does not include, and what factors may influence it.

Figure 19: Calculation of the Province's pension liability

Accrued benefit obligation $7.6 billion	–	Plan assets $5.1 billion	–	Unamortized actuarial gains and losses $0.7 billion	=	Pension liability $1.8 billion

Source: Audited Summary Financial Statements for the year ended March 31, 2013

Figure 19 shows the formula for calculating the Province's reported pension liability. In simple terms, the pension liability is the estimated amount needed to pay for the pension benefits earned by current and past employees (the *accrued benefit obligation*) less the assets set aside to pay for pension benefits (the *Plan assets*). The adjustment for *unamortized actuarial gains or losses* is an accounting method used to smooth out fluctuations in the liability. It is explained in detail below.

Pensions plans included in the pension liability

When considering the *accrued benefit obligation*, it is important to understand which pension plans are included in this obligation and whether it represents the government's share or both the government's and employees' share of each plan's obligation. This is explained in **sections 3.2** and **3.7** below.

3.2 Types of pension plans

There are 2 basic types of pensions—defined benefit and defined contribution.

Defined benefit—employees receive a fixed (or defined) pension benefit when they retire based on a formula that typically uses the number of years worked and salary earned.

Defined contribution—employees and employers contribute a fixed amount to these pension plans and employees receive a benefit when they retire based on the amount contributed throughout their career and the actual investment return it has earned.

Defined contribution pensions create no liability because the province is responsible only for its required contribution to these plans. Benefits these plans pay are limited to the contributions by employees and the employer plus any return on investments. When investments suffer losses, employees simply have fewer assets available for benefits.

For defined benefit plans, in theory, payments by the employees and the employer will cover the estimated future pension payments; however, many factors can cause these plans to have a surplus or liability. Sometimes, an employer chooses not to fund future benefits in advance. This is called an unfunded pension liability, which forms part of the pension liability. But even if an employer province fully funds its portion of employee benefits when they are earned, it may still have a liability for a defined benefit plan if the actual results are not consistent with the assumptions used in calculating the liability in the long term. For example, investments may not earn the return expected or pensioners may start living longer and earning more pension benefits than expected.

The table below shows which of the Province's pension plans are defined benefit and defined contribution; most are defined benefit.

Defined benefit pension plans *(Included in pension liability)*	**Other pension plans** *(Not included in the Province's pension liability)*
• Civil Service Superannuation Plan • Teachers' Pension Plan • University of Manitoba Pension Plan* • University of Winnipeg Pension Plan* • Brandon University Retirement Plan • The Winnipeg School Division Pension Fund for Employees Other Than Teachers • Retirement Plan for Non-Teaching Employees of the St. James-Assiniboia School Division • Retirement Plan for Employees of Frontier School Division • Legislative Assembly Pension Plan • Members of the Legislative Assembly Plan • Judges' Supplemental Pension Plan • Winnipeg Child and Family Services Employee Benefits Retirement Plan	**Defined contribution plans** • University of Manitoba Pension Plan* • University of Winnipeg Pension Plan* • 35 school divisions have defined contribution pension plans for non-teaching staff. **Defined benefit plans not included in the Province's pension liability** • Healthcare Employee Pension Plan

***** University of Manitoba and University of Winnipeg have both defined benefit and defined contribution pension plans.

3.3 How the pension liability is estimated

To estimate the pension liability, the 3 areas shown in **Figure 19** must be considered.

The *accrued benefit obligation* is the estimate of the present value of pension benefits earned to be paid out for all current and past employees. It is calculated by an actuary using complex formulas and assumptions. Some of the significant assumptions are the discount rate used to calculate the present value of the liability, the inflation rate, mortality rates of the plan members, expected years of work and future salary increases. Each assumption affects the amount of the obligation.

The *plan assets* are the amounts that have been contributed by the employer (the Province) and, in some cases, the employees. They are invested by the pension plans to earn a return, but they can also incur a loss during market downturns.

The *unamortized actuarial gain or loss* is an accounting adjustment; the balance of these gains and losses is an off-balance sheet account that reduces the net value of the pension liability. It is used to "smooth" the pension expense recorded each year to account for period-over-period fluctuations between the actuary's expectations and the actual results. These results vary over time and would have an unstable impact on net income each year. There can be actuarial gains and losses for both the accrued benefit obligation and the plan assets.

As **Figure 20** illustrates, the actuarial gain or loss on the plan assets is the difference between the actual market value of the assets and the value of the assets if they had earned the "expected return". The expected return is the long-term return assumption used in the valuation by the actuary. So when the actual return is greater than the expected return, there is an actuarial gain and when the actual return is less than the expected return, there is an actuarial loss. The actuary's model is based on the expectation that, over time, the average return will equal the expected return, so over time, the actuarial gains and losses related to the plan assets will net to zero.

Figure 20: Calculation of an actuarial gain or loss on plan assets

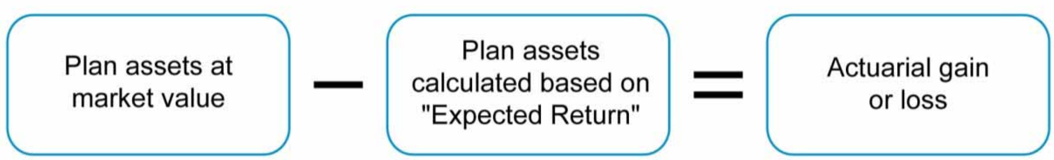


Figure 21 illustrates the calculation of the actuarial gain or loss on the accrued benefit obligation. An actuarial valuation of the obligation for each pension plan is not usually performed every year. It is often performed once every 3 years. To calculate the obligation in a year when a valuation is not performed, the actuary uses a formula that "rolls forward" the obligation based on the assumptions in their latest valuation. When a new valuation is finally prepared, the obligation calculated in it usually differs from the obligation calculated using the formula. This difference is the actuarial gain or loss.

The actuarial gain or loss may result from:

- Differences in actual results when compared to assumptions used by the actuary (for example, salary increases, mortality, etc.).
- Changes in actuarial assumptions used to estimate the obligation.

Figure 21: Calculation of actuarial gains and losses on accrued benefit obligation

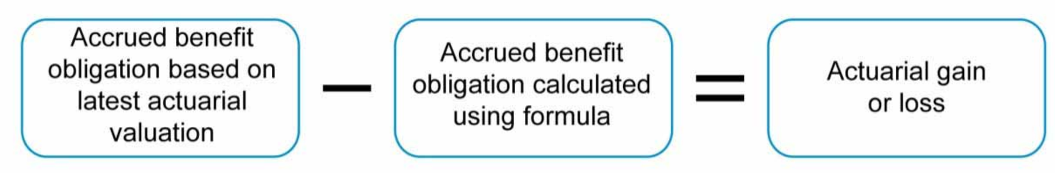
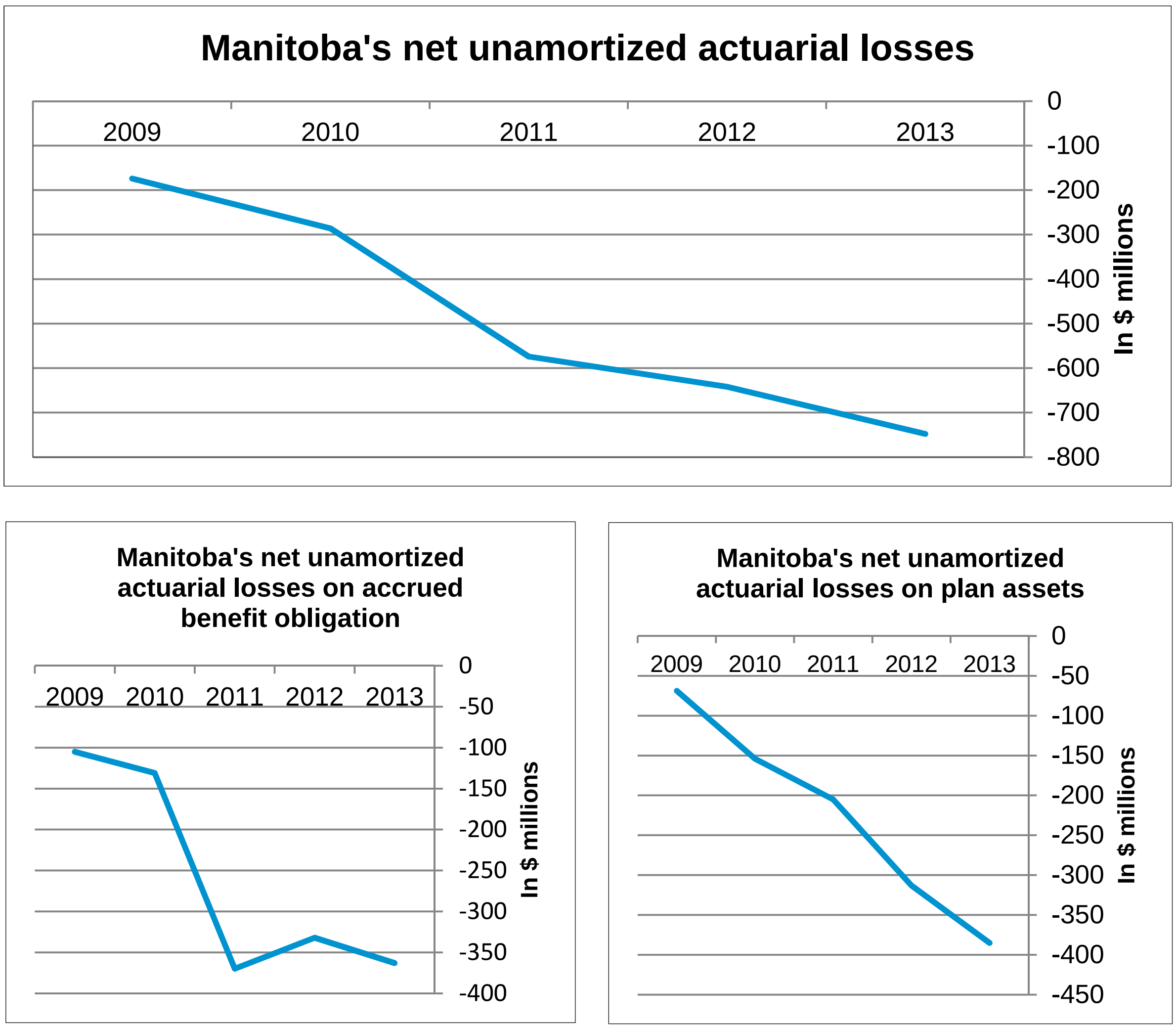


Figure 22



Source: Compiled by OAG using information obtained from the Department of Finance

The Province's unamortized actuarial losses can be further broken down between the unamortized losses on the pension plan assets and the unamortized losses on the accrued benefit obligation. As **Figure 22** shows, the unamortized actuarial losses on the plan assets have been steadily increasing over the past 5 years, from a net loss of $69 million in 2009 to a net loss of $385 million in 2013. Under PSA standards, the assets are recorded at their "market related value" rather than market value. This means that any difference between expected return and actual return is first deferred and amortized over a 5-year period into the unamortized actuarial gains and losses on plan assets balance. Despite this smoothing mechanism, the accumulated unamortized loss balance has continued to increase steadily.

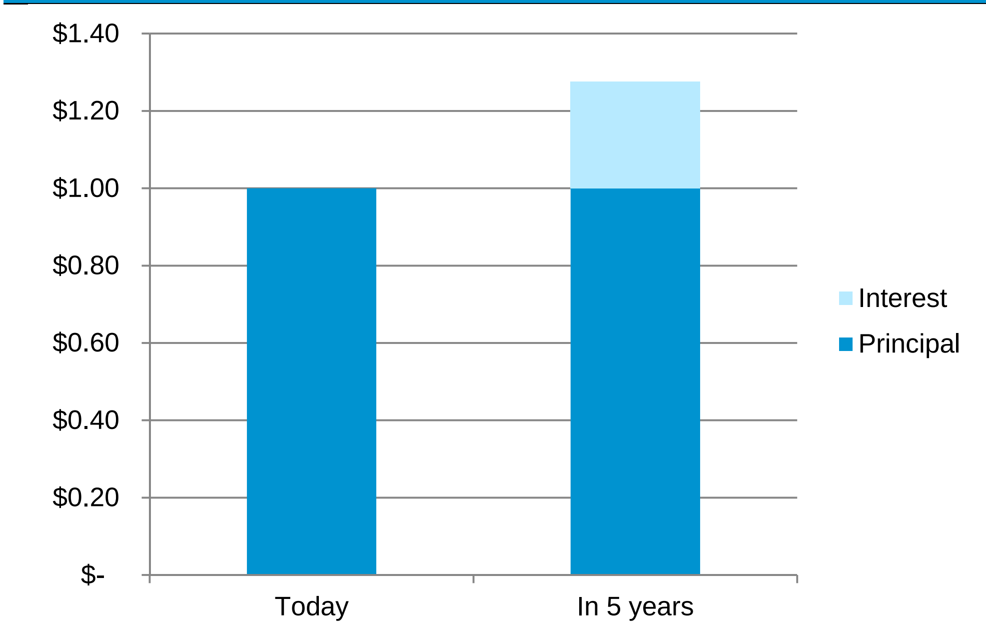
The unamortized actuarial losses on accrued benefit obligations show less of a trend over the past 5 years. However, these are not measured for each plan each year—they are measured only when a new actuarial valuation is obtained (typically every 3 years).

3.4 How discount rates affect liability

The *accrued benefit obligation* is an estimate by an actuary of the present value of pension benefits to be paid out to current and future pensioners based on service to date. The estimate relies on several assumptions—one of the most significant is the discount rate.

Discount rates are used to calculate the present value of a liability. The present value considers the time value of money. The time value of money recognizes that $1 today is more valuable than $1 in 5 years. You could invest $1 today and earn interest on it, so that in 5 years it will be worth more. For example – if you invest $1 today and it earns 5% annually, in 5 years you would have $1.28. The rate used to calculate present value is the discount rate. So the present value of $1.28 using a discount rate of 5% is $1.00. The present value of a liability is calculated in much the same way. A dollar owed now differs from a dollar owed in 5 years. By not paying $1 now, you can do other things with it—invest it and earn interest or repay other debt and save the related interest expense; so $1 owed in the future must also be discounted back using a discount rate to get the present value of the liability.

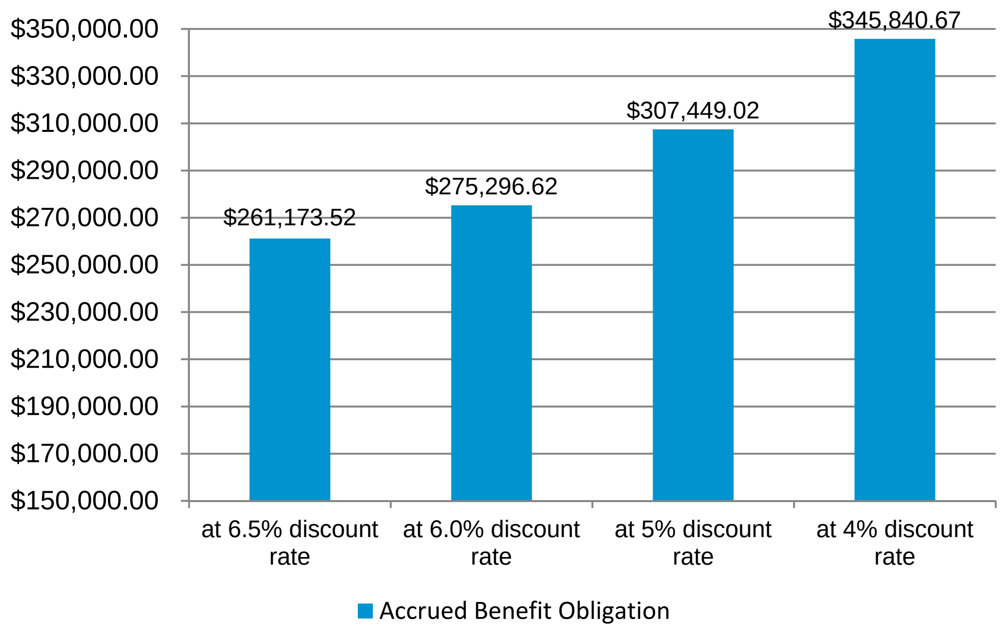
Figure 23: Time value of money



Manitoba's pension plans use various discount rates to calculate the obligation, ranging from 5% to 6.5%. The higher the discount rate used, the lower the current obligation is and the higher the future expenses relating to the current pension liability are.

Figure 24 is a simplified illustration of the effect of the discount rate on the *accrued benefit obligation*—which directly affects the pension liability. It shows just one person's pension benefits—a pensioner who will receive $20,000 a year over 30 years, starting now. Decreasing the discount rate significantly increases the obligation.

Figure 24: An illustration of discount rates' effect on accrued benefit obligation



Decreasing the discount rate from 6.5% to 4.0% increases the obligation by 32% in this case.

PSA standards do not specify what discount rate to use—they require only that assumptions be internally consistent. They provide examples of discount rates based on either the return-on-plan assets or its cost of borrowing.

Because the standards don't specify a discount rate, and because the rate significantly affects the valuation of liability (and as a result, the Province's net debt and accumulated deficit balances) management must carefully choose an appropriate discount rate.

The Department of Finance gave us documentation supporting its discount rates for several significant pension obligation calculations and for several other liabilities that are actuarially determined. The PSA standards indicate that actuarial assumptions should be based on the government's best estimates of expected long-term experience and short-term forecasts[3]. So assumptions used in the actuarial valuations should be forward looking. But the support for the discount rates does not consider future expectations. Instead, the discount rates chosen are supported by historical borrowing costs and historical return on assets. While it may be appropriate to consider historical data when estimating future oriented rates, Finance could better document how it used historical data to estimate future expected rates and document any other future projections or estimates it considered when calculating the discount rate.

3.5 Manitoba's pension liabilities

Manitoba has a pension liability of $1.8 billion. This is sometimes referred to as the unfunded pension liability, which means it does not have enough assets set aside to pay for all the pension benefits earned by employees to date. Unfunded liability does not mean the Province is offside in making contributions to the pension. The Province has made changes in the past decade to improve the funding position of its largest pensions, the Civil Service Superannuation Plan (CSSP) and the Teachers' Pension Plan (TPP). The Province is not required to fund these pension plans ahead of time; when originally set up the Province funded these plans on a "pay as you go" basis only paying for the pension benefits as they were paid out to retired pensioners. In 2008 the Province voluntarily put funds set aside for paying the CSSP and TPP pension liabilities into irrevocable trust accounts; doing this the funds are legally set aside for paying the pension and therefore reduce the net pension liability. By setting these funds aside the province greatly reduced the "unfunded" liability.

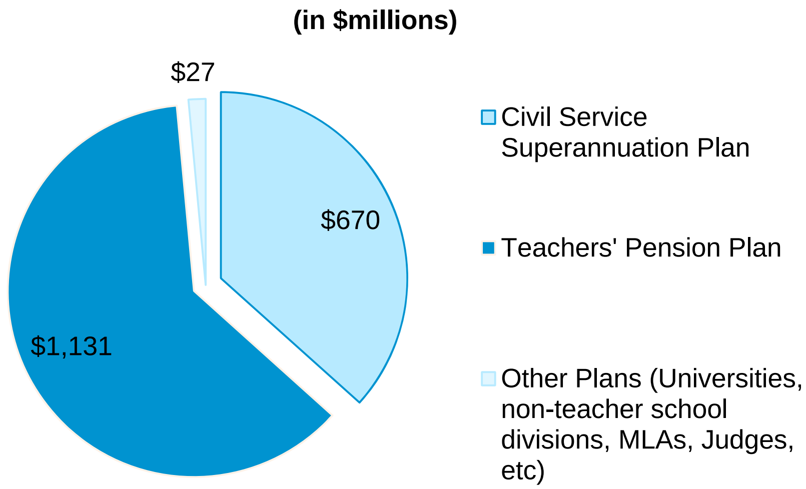
3.6 Pension plans included in the pension liability

The Province's total pension liability is $1.8 billion, and as **Figure 25** shows, the liability is primarily from the Civil Service Superannuation Plan (the plan for employees of the "core" government departments), and the Teacher's Pension Plan.

The other plans category includes the defined benefit pension plans of the University of Manitoba, University of Winnipeg and Brandon University, plans for school divisions' non-teaching employees and other small plans such as for MLAs and judges. The University of Manitoba and school division plans are currently fully funded and aren't in a pension liability position.

[3] PS 3250.42

Figure 25: Pension liability by plan



Source: Audited Summary Financial Statements for the year ended March 31, 2013

3.7 Employer share of pension liability

Figure 25 shows that the pension liability is mainly from the Civil Service Superannuation Plan (CSSP) and the Teachers' Pension Plan (TPP). The liability the Province records for these plans is based on only the employer's (the Province's) share of the liability.

For both the CSSP and TPP, the future pension benefits are to be funded equally by the Province and the employees through their contributions. Employees pay a percentage of their earnings bi-weekly. Their contributions plus the investment earnings on them should fund half of the benefits paid out in the future—the Province is then responsible for the other half of the benefits.

For both these plans, the Province considers that its risk is limited to its portion of the plan (50% of the accrued benefit obligation, the future pension benefits); therefore, it records only the plan assets and accrued benefit obligations for its half of the plan. This is required under PSA standards, which consider these plans joint defined benefit plans. In these plans, the Province shares the risks and rewards of the plan with plan participants. For CSSP and TPP, the Province does share the risks and rewards with the employees. For all other plans in the pension liability, the Province records 100% of the plan assets and accrued benefit liability (it includes the employee's share). This is because these are not joint defined benefit plans—there is no formal agreement establishing shared control of the plans.

The Province's pension liability does not include any assets or liabilities for plans of GBEs such as Manitoba Hydro, MPI, and Manitoba Liquor and Lotteries. These employers also participate in the CSSP, but their portion of plan assets and accrued benefit obligations is not included in the Province's pension liability. Instead, it is incorporated in the "Equity in government business enterprises" asset in the Summary Financial Statements, as discussed in **section 2.2**.

The following table illustrates what is, and is not, in the Province's reported pension liability.

Figure 26

Plan and employer	Employer's assets and accrued benefit obligation included	Employee's assets and accrued benefit obligation included
Teachers' Pension Plan	Yes	No
CSSP – Civil Service (government department employees)	Yes	No
CSSP – Government Business Enterprises (Hydro, MPI, Liquor, Lotteries, WCB)	No	No
CSSP – other entities in the government reporting entity (such as RHA admin staff, Red River College)	Yes	No
University Pension Plans	Yes	Yes
School Divisions non-teaching employee plans	Yes	Yes
Other plans (MLAs, Judges, etc.)	Yes	Yes
Healthcare Employees' Pension Plan	No	No

3.8 Healthcare Employees' Pension Plan

As the table above indicates, the Healthcare Employees' Pension Plan (HEPP) is not included in the Province's pension liability. Yet most health care employers in the Province participate in HEPP. And these employers are part of the government reporting entity and are consolidated in the summary financial statements. On a summary level, Manitoba is providing about 90% of the employer contributions for HEPP, however there are also some participating employers who are not part of the government reporting entity.

HEPP is a defined benefit plan but is accounted for in the same way as a defined contribution plan. Contributions by the Province are expensed during the year and no liability is recorded. The Province considers HEPP to be a *multiemployer plan*, as defined in the PSA standards, which requires this different accounting treatment.

The Province's reasons for this different treatment are:

- Multiple employers contribute to the plan and the assets of each employer are not segregated but go into one pooled fund.
- The Province does not consider itself or any of the entities in the summary umbrella as sponsors of the plan; this means they are not responsible to ensure that the defined benefits promised to employees are met.

4. Matters from our financial statement audits

We have noted several matters resulting from our work on financial statement audits for the year ended March 31, 2013, as follows.

4.1 Public Sector Compensation Disclosure accounting policy inconsistent

Each year, the Province prepares a *Schedule of Public Sector Compensation Payments of $50,000 or More* (the Schedule) under the *Public Sector Compensation Disclosure Act*. The Schedule's policy for disclosure of seconded provincial employees temporarily transferred to organizations outside of government departments states:

> The primary payroll system used by the Government also provides payroll services to certain Government organizations whose compensation information is not included in this report. When employees of Government Departments are seconded to these organizations, or from these organizations to Government Departments, their compensation is included in the report of the Department/organization that funded the compensation.
>
> This report also includes compensation paid to provincial employees who have been seconded to external employers whose employees are not paid through the primary payroll system and whose compensation is recovered from those employers, but does not report the compensation of employees of external organizations who are paid by that other body and whose compensation is recovered from the applicable Government Departments.

This policy is confusing and inconsistent: the reporting of seconded employees is different depending on the process of recovering the funds from the outside organization. The report excludes employees seconded to an outside organization that uses the Province's primary payroll, but it includes employees seconded to an outside organization that does not use the Province's primary payroll. Yet in both cases, the Province recovers the costs of the seconded employees—only the process differs.

Recommendation 1: We recommend that the Department of Finance account for seconded employees consistently—regardless of the cost recovery process.

Response of Officials: The Department will consider drafting a revised note to make the policy on secondments clearer to the general public. The Department agrees to consider whether the recommended change to the secondment policy is required and feasible to produce.

Since the Public Sector Compensation Disclosure Act was enacted in 1996 the Department of Finance has complied every year with the legislated requirements and has consistently applied its disclosed policy from year to year.

Web version

4.2 Statement of payments over $5,000 out of date and incomplete

The Province discloses total annual payments over $5,000 to any vendor in Volume 2 of the Public Accounts, in the *Statement of Payments in Excess of $5,000 to Corporations, Firms, Individuals, Other Governments and Government Agencies*. Reporting of people and entities receiving payments from government helps ensure both transparency and accountability for taxpayer money.

In our 2009 report on Public Sector Compensation Disclosure Reporting, we identified improvements that could be made in the *Statement of Payments in Excess of $5,000* to increase the relevance and quality of the report. These findings are still relevant today.

4.2.1 $5,000 threshold set in 1982

The practice of reporting vendor payments in the Public Accounts has existed for over 100 years and is widely followed by other provincial governments. All vendor payments of the core government were reported until 1935, when a threshold of $100 was implemented. The current $5,000 threshold has been in effect since 1982.

Recommendation 2: We recommend that the Province increase the threshold for the *Statement of Payments in Excess of $5,000* to reflect the Province's objectives of the disclosure. We also recommend that the Province set up a mechanism to regularly adjust the threshold.

Response of Officials: The threshold for the statement of vendor payments is set by administrative policy. The Department of Finance agrees to review the policy and determine if an increase in the threshold is appropriate.

4.2.2 Payments by other reporting entities not disclosed

Vendor payments by non-core-government entities (known as other reporting entities) are not disclosed in the Public Accounts. This creates a disparity between core government and other reporting entities in the government reporting entity. The former provides more complete and transparent information than the latter. The majority of public funds are spent outside of the core. Limiting disclosure to the core is not a transparent way to report to the legislature on how public funds are used.

Recommendation 3: We recommend that the Province provide disclosure of vendor payments by all entities in the government reporting entity.

Response of Officials: The Province agrees to consider the recommendation and will evaluate the administrative requirements to have a vendor payment report produced for all government reporting entities, including the Province, Crown corporations, school divisions, regional health authorities, universities and colleges, and will assess the related benefits of producing such a report.

The Province is not aware of any jurisdiction in Canada that produces a report of this nature.

4.3 The Province does not release its quarterly reports promptly

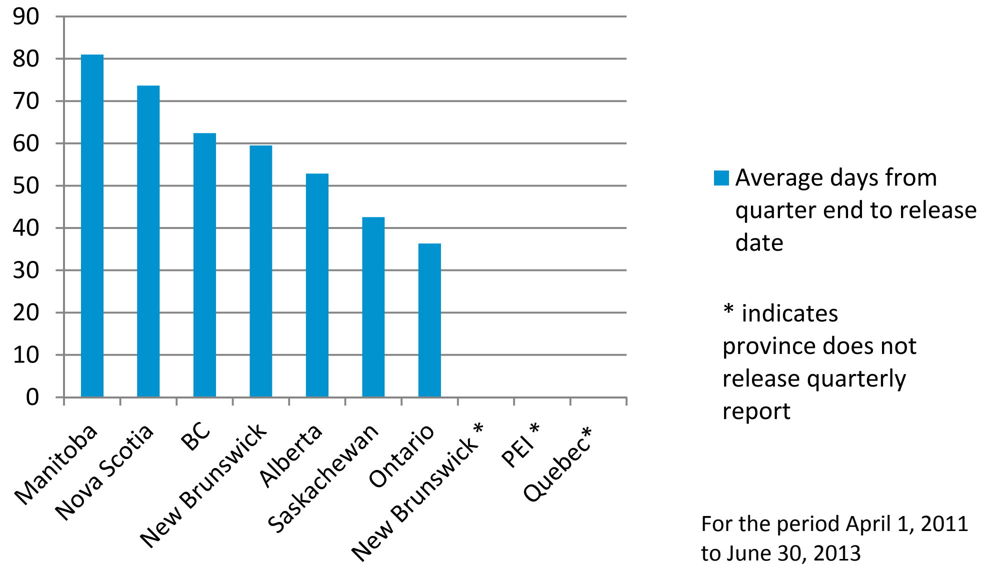
The Province releases quarterly financial reports for the first three quarters of each fiscal year. These reports are not required by legislation, but they provide useful financial information for the Province's stakeholders. In recent years, the Province has taken longer to release these reports: from an average of 65 days in fiscal year 2012 to an average of 93 days in fiscal year 2013.

Figure 27: Quarterly reports release dates

Quarter ending	Release date	Days to release
June 30, 2013	September 30, 2013	92
December 31, 2012	April 16, 2013	106
September 30, 2012	December 20, 2012	81
June 30, 2012	October 1, 2012	93
December 31. 2011	March 9, 2012	69
September 30, 2011	December 16, 2011	77
June 30, 2011	August 18, 2011	49

Most other provinces release quarterly reports. The content and complexity of the quarterly reports vary by province. Manitoba takes the longest average time (of provinces we reviewed) to release its quarterly reports.

Figure 28: Average days to release quarterly reports



The average time for Manitoba to release a quarterly report during the period we examined is 57 days, ranging from 49 to 106 days. The other provinces averaged 34 days, all with smaller ranges.

The usefulness of the quarterly reports diminishes as time passes. And if readers don't know when to expect quarterly reports, they cannot rely on up-to-date financial information to make informed decisions.

Recommendation 4: We recommend that the Province set fixed dates to release its quarterly reports.

Response of Officials: Manitoba reports on a summary basis which includes core government departments as well as Other Reporting Entities which make up the Government Reporting Entity. Government agrees that the reports provide useful financial information for the province's stakeholders and will continue to take time to ensure quarterly reports contain complete and accurate information. Dates for the release of the quarterly reports must consider a balance between timely information versus more accurate information. Quarterly reports should not be released at the expense of their reliability.

As noted, the content and complexity of the quarterly reports varies by province which makes comparing release dates difficult. Manitoba has generally released its reports around the same time over the past several years however the compilation of the material does affect the date of the release and therefore Manitoba is not prepared to set fixed dates.

4.4 Manitoba Floodway and East Side Road Authority reporting problems

Manitoba Floodway and Eastside Road Authority (the Authority) is part of the government reporting entity. It builds and maintains the Manitoba Floodway and the East Side Road. The Authority builds these assets but transfers them to the Department of Manitoba Infrastructure and Transportation (MIT). The Authority must promptly provide information to MIT about the assets and their costs and expenditures so MIT can properly account for them.

During 2013, the Authority did not promptly provide the monthly information on assets it transferred to MIT. The Authority made classification errors in recording the assets that were transferred to MIT. As well, the errors were not identified and corrected on a timely basis because the Authority and MIT don't share information or communicate enough. We found the variances while auditing the Summary Financial Statements. The parties eventually resolved the variances, once we coordinated a meeting between them. But the delay caused another problem— the Authority is part of the GRE, and its financial results are consolidated with the Province's. The Authority's audit was not finalized by the reporting deadline, so it could not give Finance its draft financial statements.

Recommendation 5: We recommend that Finance, Manitoba Infrastructure and Transportation and the Manitoba Floodway and Eastside Road Authority improve their communication with each other to ensure information is promptly reported and reviewed by all parties to prevent errors.

Response of Officials: The Departments of Finance and Manitoba Infrastructure and Transportation and the Manitoba Floodway and Eastside Road Authority agree with the recommendation. Since the completion of the March 31, 2013 Public Accounts, the Department of Manitoba Infrastructure and Transportation and MFESRA have taken measures to improve the level of communication and timeliness of information.

4.5 More policies needed for report of amounts paid or payable to members of the legislative assembly

Members of the Legislature receive various allowances for expenses they incur as MLAs. Authorized expenses under *The Members' Allowance Regulation* include the constituency allowance, constituency office rent allowance, constituency assistants allowance, travel allowance, living allowance, moving allowance, commuter allowance, alternate living allowance, inter-sessional committee allowance, telephone privileges, and printing and mailing privileges. The nature of these expense categories is clearly laid out in the regulation. These allowance payments are reported annually on the *Report of Amounts Paid or Payable to Members of the Assembly* (Report).

The Report also includes payments made or amounts payable under the categories of "Reimbursement of Premier's and Ministers' Expenses" and "Reimbursement of Other MLAs' Expenses". Note 1(c) to the Report describes these as:

> Reimbursement of Premier's and Ministers' Expenses and Reimbursement of Other MLAs' Expenses reflect claims made by members for expenses incurred. They also reflect payments made directly to suppliers for expenses incurred by members, when this is clearly identifiable. Expenses claimed by a third party on the member's behalf are excluded.

Expenses paid directly by a Department on behalf of the Premier, Ministers, and MLAs are not always included in the Report. There is a difference between the amounts disclosed in the Report and the annual Ministers' expenses disclosed on the Departments' websites. So it is not clear what expenses to report here.

Recommendation 6: We recommend that the Province specify in a policy or regulation the type of expenses to include in the *Report of Amounts Paid or Payable to Members of the Legislative Assembly* for expenses that the *Members' Allowance Regulation* does not cover.

Response of Officials: The Province agrees to consider whether a policy or regulation is required beyond the legislation and policies currently in effect.

The report is prepared in accordance with Section 52.27(1) of *The Legislative Assembly Act*. In accordance with the Act the report shows all the amounts paid or payable to each person who has been a member of the Assembly for the fiscal year. The report is not meant to include expenses incurred by members that are paid directly to the suppliers unless specifically provided for in the Members Allowance Regulation.

The Province currently applies the policies as outlined in the General Manual of Administration in the approval and reimbursement of any Premier, Ministerial, and other MLA Expenses incurred on behalf of government business. The Province will consider additional wording to the note to clarify the policy being followed and the types of expenditures that appear in the report. In addition all Ministerial expenses are disclosed publically on each department's website.

4.6 Northern Affairs Fund financial statements not completed promptly

The Northern Affairs Fund (The Fund) administers funds for designated communities. It also administers the property tax system within the jurisdiction of the Department of Aboriginal and Northern Affairs.

Fund management prepares the draft financial statements annually. Our office audits the financial statements. The Auditor's Report and the financial statements are included in the Public Accounts of the Province.

Section 184(2) of *The Northern Affairs Act* states that, *at least once in each fiscal year, the Auditor General must conduct and report on an audit of the accounts of the Fund. The Auditor General's report must include audited financial statements of the affairs of the Fund for that fiscal year, including a balance sheet and a statement of receipts and disbursements.*

Section 184(2) also states that, *the report of the Auditor General and financial statements of the fund must be included in the Public Accounts of the government.*

The last completed audited financial statements were for March 31, 2011. The audit was substantially completed on March 15, 2012. The signed Auditor's Report was released on May 15, 2012.

For March 31, 2012 fiscal year, there was a draft financial statement but it was not converted to Canadian public sector accounting standards or another acceptable reporting basis. We understand the Fund had staffing vacancies that impacted day to day work. The conversion to an appropriate basis of accounting is still outstanding as at November 12, 2013.

The Fund is not meeting its financial reporting requirements promptly or complying with its act.

Recommendation 7: We recommend that the Northern Affairs Fund complete its financial statements in compliance with the Act.

Response of Officials: The Department of Aboriginal and Northern Affairs agrees with the recommendation. Arrangements have been made with the auditor to complete the March 31, 2012 financial statement. The Department will complete the March 31, 2013 financial statements immediately following the completion of the 2012 audit.

4.7 Financial Institutions Regulation Branch transferred to Manitoba Securities Commission before transfer approved or due to take effect

The government recently transferred the Financial Institutions Regulation Branch (Branch) from the Department of Finance to the Manitoba Securities Commission (Commission). In our view, the transfer did not comply with section 6(1) of *The Special Operating Agencies Financing Authorities Act.* The Act required the Lieutenant Governor in Council to approve of the Branch's transfer. Yet the transfer occurred on October 1, 2012—before it was approved on March 13, 2013 (and due to take effect on March 18).

While auditing the Special Operating Agency Financing Authority (SOAFA), we learned that on September 22, 2012, Treasury Board (TB) approved the Branch's transfer effective October 1, 2012. The transfer was later authorized by Order in Council (OIC) 77/2013, dated March 13, 2013. It was to take effect on the date the regulation changing the Commission's name took effect. Regulation 29/2013, dated March 18, 2013 changed the Commission's name to the Manitoba Financial Services Agency (MFSA). MFSA's financial statements reflect the transfer occurring on October 1, 2012.

We discussed the date discrepancy with SOAFA. It said that TB issued a Program Portfolio Management Review (PPMR) Minute on September 22, 2012, approving the Branch's transfer to the Commission effective October 1, 2012. SOAFA said this was not ideal, but the timing of the Treasury Board instructions meant it could not obtain both a regulation to amend the name and an OIC to approve a new operating charter and management agreement before October 1.

Treasury Board and the Controller's Division of the Department of Finance consulted with Civil Legal Services on this issue. Consistent with the legal advice received prior to the merger, they re-affirmed their position that they have complied with legislation. We disagree.

Date	Action
September 22, 2012	TB approved the Branch's transfer, effective October 1, 2012 (thru PPMR).
October 1, 2012	MFSA financial statements show the Branch's transfer effective this day.
March 13, 2013	OIC authorized the Branch's transfer, to take effect on same day the regulation changing the Commission's name to MFSA took effect (March 18).
March 18, 2013	Regulation changed the Commission's name to MFSA.

4.8 Healthcare financial reporting problems

Each year, the Province spends billions of dollars on healthcare. Most of this is funded through Manitoba Health Services Insurance Plan (MHSIP). MHSIP distributes the funds to other health entities such as the Regional Health Authorities (RHAs) that provide health services to people. MHSIP also directly funds medical and Pharmacare claims by third parties. In last year's report to the legislature, we made recommendations on the financial reporting on MHSIP financial statements and the Summary Financial Statements. The statuses of these recommendations are reported in **section 5** as "work in progress".

In the current year, we continued to note issues at the various levels of financial reporting.

Province of Manitoba Summary Financial Statements discrepancies

Our January 2013 report to the Legislature reported a material discrepancy between liabilities recorded by MHSIP and receivables recorded by RHAs that required an adjustment. We recommended that the Province, MHSIP and the RHAs determine the exact nature of the differences between MHSIP's liability and the RHAs' receivables to enable appropriate consolidation. This year we noted there are still unexplained differences between MHSIP's liabilities and the RHAs' receivables.

MHSIP does not report net assets in financial statements

MHSIP operates under *The Health Services Insurance Act*. Its mandate is to provide health related insurance for Manitobans by paying for qualified hospital, medical, personal care, and other health services. The Act requires MHSIP to prepare annual audited financial statements. We audit the MHSIP's financial statements.

MHSIP has no net assets. It maintains an annual break-even position by sending excess funds back to the Province or by receiving more funds from the Province. MHSIP is simply a flow-through entity of the Province. An accountability feature of public sector financial statements is that net assets are accounted for to determine the resources available to meet the needs of the entity. So reporting no net assets really diminishes the ability to assess accountability. In addition, there is no board or external governance oversight of the financial statements. The financial statements are simply prepared and reviewed by management.

5. Follow up of prior years' recommendations

Each year, in our report to the Legislative Assembly on the Audit of Public Accounts, we recommend improvements to the Government. **Figure 29** shows the status of our prior years' recommendations.

Figure 29: Status of prior years' recommendations

Report	Recommendation	Status
Audit of the Public Accounts for the year ended March 31, 2012	We recommend that the government complete a review of the financial statement and other audits our office currently completes to ascertain an audit mix that maximizes the benefit to the Legislature.	Work in progress
	We recommend that the Department of Finance consider the most current tax sharing statements information when determining or evaluating the reasonableness of their estimate for personal income tax revenue before finalizing the Summary Financial Statements.	Do not intend to implement
	We recommend that the Department of Health, MHSIP and the RHAs reconcile the wage standardization accruals to ensure that actual amounts owing are properly recorded in MHSIP's financial statements.	Work in progress (See **section 4.8** above)
	We recommend that the Comptroller Division, Department of Health, MHSIP and the RHAs determine the exact nature of the differences between the Plan's liability and the RHAs receivable to enable appropriate consolidation entries to avoid misstatements in the Summary Financial Statements.	Work in progress (See **section 4.8** above)
	We recommend that the Department of Finance adjust the Summary Financial Statements to appropriately record the funding for the IPBCC as a grant.	Work in progress
Audit of the Public Accounts for the year ended March 31, 2011	We recommend that the Department of Finance revise the information included in Volume 3 to provide relevant information to users that is consistent with the Summary Financial Statements.	Work in progress (See **section 1.3** above)
	We recommend that the Province revalue its environmental liabilities each year to reflect known changes in the liability including the impact of the passage of time, interest rates and an appropriate margin of error.	Work in progress

Figure 29 (cont'd)

Report	Recommendation	Status
	We recommend that MHSIP implement a comprehensive IT risk assessment process.	Work in progress
	We recommend that the University of Manitoba implement a comprehensive IT risk assessment process.	Work in progress
	We recommend that the University of Winnipeg implement a comprehensive IT risk assessment process.	Work in progress
	We recommend that the University College of the North implement a comprehensive IT risk assessment process.	Work in progress
	We recommend that the Department of Health implement a formal, comprehensive IT security policy.	Work in progress
Audit of the Public Accounts for the year ended March 31, 2010	We recommended that the Department of Finance review public quarterly reporting requirements for organizations in the GRE and prepare a plan to resolve any inconsistencies.	Work in progress
	We recommended that the Department of Finance review the requirement for the release of 4th quarter reports under The Crown Corporations Public Review and Accountability Act to determine if it is still appropriate.	Work in progress
	We recommended that the Province determine what steps are necessary for an earlier release date of the Public Accounts.	Implemented An earlier release is not being considered.