Office of the Provincial Auditor
500-330 Portage Avenue
Winnipeg, Manitoba R3C 0C4

March 2001

The Honourable Peter M. Liba
Lieutenant Governor of Manitoba
Room 235, Legislative Building
Winnipeg, Manitoba
R3C 0V8

Dear Sir:

I have the honour to submit herewith our March 2001 report on Compliance and Special Audits to be laid before Members of the Legislative Assembly in accordance with the provisions of Section 13 of The Provincial Auditor's Act.

Respectfully submitted,

Jon W. Singleton, CA, CISA

PROVINCIAL AUDITOR

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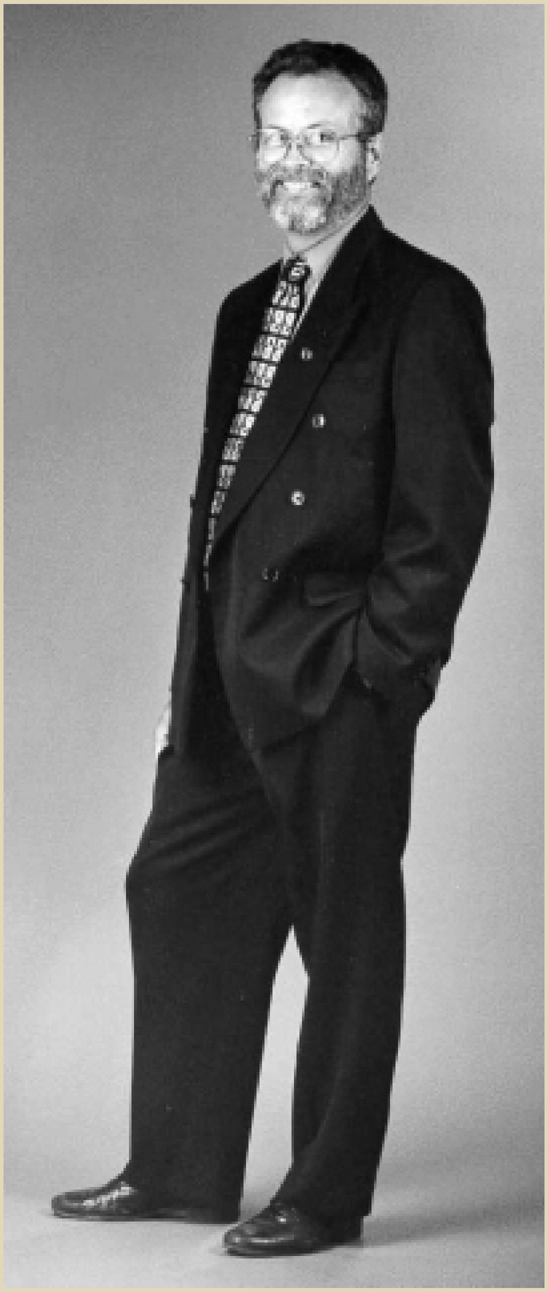
REFLECTIONS OF THE PROVINCIAL AUDITOR



This is the first Report to the Legislature devoted entirely to our compliance with authority and investigative work. We intend to issue such a report annually.

In all our work, from financial statement auditing to value-for-money auditing, compliance with authority is an important component. As legislative auditors, we design our work with a view to ensuring that the transactions we audit are conducted in accordance with applicable legislation, regulations and policies. However, because of the importance of legislation to government operations, we have decided to devote some of our resources specifically to this activity. In the Fall of 1999, we created the Compliance and Forensic Services Practice.

This report sets out the work of this Practice since inception. Most of the report deals with the investigative work of the Practice. We anticipate that future reports will emphasize the compliance with authority work of the Practice. This report also includes two chapters (Teacher's Retirement Allowances Fund and Revenue System Review) developed by the Financial Statement Services Practice.

In reviewing the chapters in this report, I noted a common theme…*the importance of good governance*. Lapses in governance practices are a contributing factor to many of the issues raised. It is apparent to me that good governance practices are an essential component of ensuring that an organization operates consistently with its legislation and in an efficient and effective manner. The absence of good governance practices creates a situation in which the risk that an organization will fail, or run into difficulties, increases significantly.

I hope that the readers of this report find useful lessons in it. The experiences of other organizations may assist them in improving the governance and operational practices of other organizations with which they are involved. If these organizations are in the public sector or the not-for-profit sector, the report will have served a particularly useful purpose.

Jon W. Singleton, CA, CISA

FINE OPTION PROGRAM

Department of Justice

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Introduction

The Fine Option Program (the Program) was enacted under Section 21(1) of The Summary Convictions Act. The Program is governed by Manitoba Regulation 17/83 and was revised through subsequent Manitoba Regulations 238/85 and 178/88.

The Program, which is administered by the Corrections Division of the Department of Justice, was established "to authorize an offender to perform certain unpaid community service work in lieu of the payment of a fine imposed on the offender."

The primary goals of the Program include:

- providing offenders who are unable to pay fines with an alternative through community work;
- reducing the cost of collecting fines and the incidence of arresting fine defaulters; and
- promoting community participation in the criminal justice system.

Community Corrections Coordinators are responsible to recruit Community Resource Centres (CRC) in their region for the placement of offenders registered in the Program. The Coordinators are Department of Justice staff. They provide ongoing training and support to CRC contact persons.

CRCs are non-profit organizations, local governments or First Nations Councils that enter into agreements with the Department of Justice to deliver the Program in their community. Each CRC appoints a contact person to perform the various duties and responsibilities required under the Program. The Province pays a work placement fee to each CRC for the services provided. There are approximately 150 CRCs located throughout the Province.

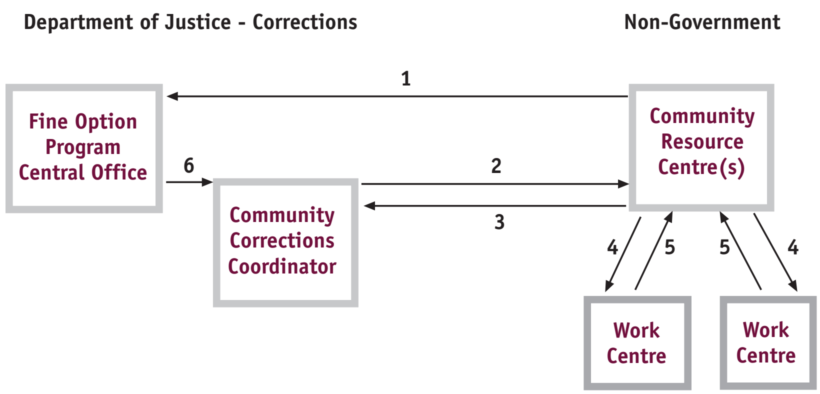
The CRC contact persons are responsible for recruiting a sufficient number of Work Centres, in their region, for the work placement of registered offenders. Non-profit organizations or branches of government are eligible to serve as Work Centres under the Program. The reporting structure of the Program is illustrated in Figure 1.

To participate in the Program an eligible offender must register in person at a local CRC. The CRC contact person immediately registers the offender by telephone with the Fine Option Program Central Office (Department of Justice). This is important so that the Central Office can notify the appropriate court that an offender has registered with the Program and ensure that no unnecessary action is taken by the court regarding the outstanding fines. The contact person subsequently mails the registration form and fine notice to the Program Central Office.

The CRC contact person arranges a work placement for the offender at a Work Centre. The hours of community work required to be performed by the offender depend on the amount of the fine imposed. Offenders are credited for hours worked at a rate equivalent to the Manitoba minimum wage rate. The Work Centre supervisor is responsible to ensure all work is adequately supervised and that work performance sheets and other forms are completed and returned to the CRC contact person when the offender has completed the required hours or withdraws from the Program. The offender is credited with the actual hours worked and the court is notified of the value of community work completed and the balance owing, if any. Statistical information on the Program is provided in Figures 2, 3 and 4.

FIGURE 1

Fine Option Program
Reporting Structure



Legend:

1. Community Resource Centre contact person registers offenders to the Program and calls in registrations to the Central Office. On completion or withdrawal from the Program by the offender documentation is forwarded to Central Office.
2. Community Corrections Coordinator provides training and ongoing support to the Community Resource Centre contact person.
3. Community Resource Centre contact person reports to the Community Corrections Coordinator regarding the status of offender files and work performance, etc.
4. Community Resource Centre recruits Work Centres for work placement purposes.
5. Work Centre supervisor reports to the Community Resource Centre contact person regarding work performance.
6. Central Office forward outstanding/overdue file reports to Community Corrections Coordinators for follow-up purposes.

About the Program

STATISTICAL INFORMATION

The following tables provide information on the Fine Option Program registrations and completions on a calendar year.

FIGURE 2

Fine Option Program Registrations Calendar Year

Region	1996	1997	1998
Winnipeg	1,248	673	598
Interlake	242	168	149
Eastman	154	126	118
Parklands	336	228	222
Norman/Thompson	1,216	666	597
Westman	362	276	264
Central	144	82	37
Dakota Ojibway	181	205	172
Out-of-province	6	6	4
Total	***3,889***	***2,430***	***2,161***

FIGURE 3

Completion Statistics Calendar Year

	1996	%	1997	%	1998	%
Successful completions:						
Completed all required hours	2,218	53.3	1,568	61.4	1,428	64.4
Completed some hours, to pay balance	318	7.6	194	7.6	187	8.4
Total successful completions	***2,536***	***60.9***	***1,762***	***69.0***	***1,615***	***72.8***
Unsuccessful:						
Failed to begin work	1,112	26.7	459	18.0	323	14.5
Failed to return to work	375	9.0	263	10.3	243	11.0
Unsatisfactory performance	17	0.4	10	0.4	9	0.4
In jail	21	0.5	10	0.4	12	0.5
Other	102	2.5	49	1.9	17	0.8
Total unsuccessful	***1,627***	***39.1***	***791***	***31.0***	***604***	***27.2***

Source: 1997/98 and 1998/99 Fine Option Program Annual Reports

Note: Total registrations on Figure 2 do not agree to total completions on Figure 3 each calendar year due to some offenders registering in a particular year, but not completing the Program until the following year.

FIGURE 4

Other Program Information Calendar Year	1996	1997	1998
Hours of community work completed	168,669	120,098	117,969
Value of fines worked off in the community	$901,569	$647,563	$637,030

Source: 1997/98 and 1998/99 Fine Option Program Annual Reports

Audit Objective, Scope and Approach

The purpose of our audit was to determine if the Fine Option Program is being administered in accordance with the current Regulation and policies governing the Program. Specifically, we examined those authorities relating to:

- establishment and administration of CRCs and Work Centres;
- registration and work placement of offenders; and
- monitoring of work performed by offenders.

We focused our audit on Fine Option Program registrations in the 1998 calendar year. We also visited five of the CRCs that are responsible for the placement of registered offenders.

We conducted our audit in accordance with generally accepted auditing standards which included a combination of interviews and a review of Program documentation, policies and procedures.

Summary Conclusion

As a result of our audit, we concluded that the Fine Option Program is being administered in accordance with the current Regulation and policies governing the Program, except for one area. The policy which requires the CRC contact persons to take special precautions when dealing with offenders who have a history of violence or sexual offences is not being effectively applied. There is no screening process in place, and relevant information on the history of offenders that would enable the contact person to take special precautions, is not readily available to the contact persons. Consequently, there is no practical means for the contact persons to identify these high risk offenders before assigning them to Work Centres.

During our audit we also identified opportunities to improve the training for CRC contact persons and the documentation and monitoring regarding offender registrations and work performance.

Detailed Findings and Recommendations

1. ESTABLISHMENT AND ADMINISTRATION OF COMMUNITY RESOURCE CENTRES AND WORK CENTRES

Our main concern in this area relates to the supervision and training provided for Community Resource Centres. Our examination focused on the following criteria:

- all CRCs should be governed by a signed community participation agreement with the Province (Manitoba Regulation 178/88, section 1);
- work placement fees paid to the CRCs should be accurate and supported by appropriate documentation (CRC Manual, section 13);
- CRC contact persons should be adequately trained (CRC Manual, section 1[1]);
- Community Corrections Coordinators should complete regular written reviews of all CRCs (CRC Manual, section 1[3]);
- only non-profit organizations or branches of government should be recruited as Work Centres (CRC Manual, section 8[4]); and
- Work Centre information sheets should be prepared for each Work Centre (CRC Manual, section 8[3]).

What We Found

Based on our sample of 19 CRC files and 25 CRC payments, we are satisfied that appropriate agreements are in place for each CRC and CRC payments are accurately calculated and adequately supported.

Although our examination indicates that only non-profit organizations or branches of government have been recruited as Work Centres, we have concerns regarding the training and reviews provided for CRCs and the use of Work Centre information sheets.

Based on discussions and interviews with Community Corrections Coordinators and CRC contact persons, we were advised that there is no formal training program in place for the contact persons. Training is provided on an ad hoc basis only.

From our sample of 19 CRC files, we identified 13 CRCs that had not been reviewed by Community Corrections Coordinators in the past three years. We also visited five CRCs and found that current reviews had not been performed at each of these locations.

Finally, based on our examination of 220 offender files, we identified 150 instances where Work Centre information sheets were not prepared. Work Centre information sheets provide information regarding the recruitment of Work Centres. They are important documents and provide a valuable source of information for new CRC contact persons, the Community Corrections Coordinators and the Manager of the Fine Option Program. During our visits to CRCs, three of the five contact persons we interviewed indicated that they were not aware of the Work Centre information sheets.

What We Concluded

It is very important for Community Corrections Coordinators to provide adequate training and support to the CRC contact persons to ensure they are fully aware of their duties and responsibilities under the Program. The Community Resource Centre Manual clearly indicates that Community Corrections Coordinators are responsible to ensure that contact persons receive adequate training prior to registering offenders in the Program. They are also responsible for completing regular reviews of CRC operations and providing written reports on their findings.

We recommend that the Manager of the Fine Option Program develop a cyclical schedule for reviewing CRCs across the Province. CRCs with a new contact person should be reviewed within a year of when the contact person received their initial training. Less frequent reviews would be appropriate for CRCs with more experienced contact persons.

Further, we recommend that the Manager of the Fine Option Program develop an orientation checklist for training new contact persons. A copy of the completed checklist should be sent to the Program Central Office prior to the contact person registering offenders in the Program.

COMMENTS OF OFFICIALS

A cyclical schedule for reviewing CRCs has been developed and is in place. Each Coordinator is expected to complete one CRC review every three months. We agree that CRCs with a new contact person should be reviewed within a year.

We agree with the Auditor's recommendation to develop an orientation checklist for training new contact persons. The checklist will be developed by June 30, 2001.

2. REGISTRATION AND WORK PLACEMENT OF OFFENDERS

We identified one significant concern in this area regarding the need to take special precautions when dealing with offenders who have a history of violence or sexual offences. We also identified several matters, involving the documentation of registrations that require attention. Our examination in this area focused on the following criteria:

- CRC contact persons should take special precautions when dealing with offenders who have a history of violence or sexual offences (CRC Manual, section 7[3]);
- only eligible offenders should be registered in the Program (Manitoba Regulation 178/88, section 2; CRC Manual, section 5);
- when registering for the Program, each offender should submit a fine notice from the courts (Manitoba Regulation 178/88, section 4; CRC Manual, section 6[2]);
- CRC contact persons should maintain appropriate information on the contact sheet for each offender who registers in the Program (CRC Manual, section 9[7]);
- CRC contact persons should notify the Fine Option Program Central Office on a timely basis, by telephone and in writing for each offender who registers in the Program (Manitoba Regulation 178/88, section 5[1]; CRC Manual, sections 6[7] and 6[8]);
- procedures should be in place to identify and follow up missing registration documents;

- community service work should not be performed by the offender until the Central Office has been notified of the registration (CRC Manual, sections 6[5] and 7[1]); and
- Central Office should prepare a court notification report after offenders have been registered in the Program (Manitoba Regulation 178/88, section 5[3]).

What We Found

Based on our interviews with Community Corrections Coordinators and CRC contact persons we found that there is not sufficient information available to the contact persons to enable them to take any special precautions regarding offenders who may be a high risk to the community. There is no screening process in place to identify high risk offenders when they register in the program. In addition, Fine Option Program staff do not have procedures to identify these types of offenders when the contact person calls in new offender registrations.

Based on our examination of 245 offender registration files, we found that all offenders registered in the Program meet the eligibility criteria and CRC contact persons notify the Central Office by telephone on a timely basis. We also found that a court notification report was prepared by Central Office for all offender registrations.

However, our audit tests indicate that in many instances fine notices are not forwarded to the Central Office with the registration forms. We found that a fine notice from the courts was missing for 27 of the 245 registration files examined. It is important that the fine notice be on file to ensure that questions regarding eligibility or other matters, can be resolved on a timely basis by Central Office staff.

We also found that contact sheets were not being initiated in many cases. Based on our interviews with five contact persons, we found that three contact persons were not familiar with contact sheets and did not use them. Contact persons should use contact sheets to document communications with Work Centre supervisors and offenders. Matters such as offenders not reporting to work and work performance problems should be documented.

Although we did not find any instances where the CRC contact person did not phone in a registration to Central Office, we identified many registration forms that were not submitted to the Central Office on a timely basis. The missing forms report dated April 20, 1999 lists 51 registrations that were outstanding longer than 60 days. Of these registrations, 27 were outstanding for more than 110 days. The missing forms report lists all offender registrations that have been phoned in to the Central Office by the CRC but the registration form has not yet been received by Central Office. The missing forms are identified but follow-up procedures need to be improved. It is important that contact persons forward all registration forms to Central Office on a timely basis.

Finally, from our sample of registration files, we found five instances where some community work was done prior to the registration date. No subsequent concerns were noted regarding these five instances, however these situations should not occur.

What We Concluded

We are greatly concerned that there is no procedure to ensure that violent or sexual offenders are not placed in Work Centres where they might have direct contact with vulnerable persons. It is possible for offenders with prior violent or sexual offences to register in the Fine Option Program with an unrelated offence. Since the CRC contact persons and Fine Option staff do not have access to the criminal records of offenders, it is not reasonable to expect the contact persons to identify such offenders.

The Fine Option Program Manager has advised us this concern will be partially resolved when Central Office staff obtains access to the Corrections Offender Management System. This system will automatically flag sexual offenders who are being registered in the Program. CRC contact persons can then be advised accordingly and make the appropriate work placement based on this information. Access to this information is scheduled to be in place by May 2001.

We recommend that the Manager of the Fine Option Program develop an appropriate screening process for all contact persons to follow when registering new offenders.

We also recommend that the Manager remind the contact persons of the importance to take special precautions when dealing with offenders who have a history of violence or sexual offences.

In addition, we concluded that documentation standards for offender registrations could be improved.

We recommend that Central Office follow-up missing registrations on a timely basis and initiate corrective action whenever necessary.

We also recommend that Community Corrections Coordinators issue reminder notices to CRC contact persons regarding their responsibilities for submitting fine notice documents, preparing offender contact sheets and ensuring offender work placements do not start work prior to registering in the Program. These responsibilities also need to be monitored on an ongoing basis and corrective action taken as necessary.

COMMENTS OF OFFICIALS

We agree with the Auditor's recommendation and we should have a formal screening process in place by June 30, 2002 or no later than one year after the Fine Option Program is integrated into the Corrections Offender Management System.

The majority of the contact persons are performing their duties very well with few problems. However, we acknowledge that timely corrective action needs to be more focused to the CRCs requiring attention.

3. MONITORING OF WORK PERFORMED BY OFFENDERS

Although we are satisfied that there is evidence of work performed by persons registered in the Program, we are concerned about the quality of documentation of work performance and the lack of follow-up by CRC contact persons. Our examination in this area focused on the following criteria:

- work performed by offenders registered in the Program should be supported by work performance sheets that clearly indicate the nature of work performed (Work Centre Handbook);
- work performed should be adequately supervised by Work Centre supervisors (Work Centre Handbook);

- offenders should be credited with the value of work performed at a rate equivalent to the minimum wage rate (Manitoba Regulation 178/88, section 8; CRC Manual, section 6[5]);
- CRC contact persons should prepare the necessary completion documents for offenders when they either complete their work placement or withdraw from the Program (Manitoba Regulation 178/88, sections 9[2] and 9[3]; CRC Manual, section 12[6]); and
- completion documents should be sent on a timely basis to Central Office and the appropriate Courts for every offender who completes or withdraws from the Program (Manitoba Regulation 178/88, sections 9[2] and 9[3]; CRC Manual, section 12[7]).

What We Found

We examined 220 offender registration files and found 27 instances of work performance sheets that did not adequately support the work performed or did not clearly indicate the nature of the work performed. Following are several examples of the deficiencies we observed:

- work description not provided or too vague to be substantiated;
- daily work performance not reflected;
- work performed for private individual, however specific individual not identified;
- an offender credited for 92.5 hours of work, however the work performance sheet indicates only two days worked; and
- an offender credited for double time although there is no provision for double time.

We found that offender work is being adequately supervised and offenders are credited accurately with the value of work performed. We also found that completion documents were being completed appropriately and forwarded to Central Office and the Courts on a timely basis when offenders complete or withdraw from the Program.

What We Concluded

It is essential that the work performance sheets be completed sufficiently since this is the documentation that supports the hours credited to offenders. Work Centre supervisors should be reminded to complete the work performance sheets on a daily basis. For each day worked, the date, hours worked (from/to), total hours and a meaningful description of the work performed should be indicated on the work performance sheet. Further, the Work Centre supervisor should approve the work performance sheet on a daily basis.

We recommend that Community Corrections Coordinators initiate periodic reviews of the quality of work performance sheets and initiate corrective action whenever errors or deficiencies are identified.

COMMENTS OF OFFICIALS
As previously indicated, timely corrective action will be focused to the CRCs requiring attention.

AGASSIZ SCHOOL DIVISION

Department of Education and Training

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Report Overview

In response to the sudden resignation of their Secretary-Treasurer in August 1999, the Board of Trustees (Board) of the Agassiz School Division (ASD) expedited the completion of the 1999 annual financial statement audit of the Division. The audited financial statements of ASD for the fiscal year ended June 30, 1999 reported a net operating deficit of $1.15 million.

In November 1999 the Chairperson of ASD, through the Minister of Education and Training, requested that the Office of the Provincial Auditor (OPA) conduct a review of the circumstances that led to the deficit.

Our review concluded on three questions:

1. WHAT WERE THE CONDITIONS CONTRIBUTING TO THE ASD DEFICIT FOR THE FISCAL YEAR ENDED JUNE 30, 1999?

The combination of an operating budget that was unrealistic, a serious lack of expense and monitoring control, and poor communication resulted in an ineffective financial system that culminated in a significant deficit.

2. WHAT IS THE FINANCIAL CONDITION OF ASD FOR THE FISCAL YEAR ENDED JUNE 30, 2000?

ASD succeeded in eliminating the prospect of a significant deficit for the fiscal year ended June 30, 2000.

3. HOW EFFECTIVE WAS THE GOVERNANCE PROCESS AT ASD?

The ASD Board relied heavily on the quality of information provided to it by the former Secretary-Treasurer and did not effectively monitor the actions of its administration. Improvements can be made in the role clarity and decision-making processes of the Board.

Our comments and recommendations appear at the end of this review and are accompanied by responses from the ASD Board.

Introduction

In late August 1999 the Secretary-Treasurer of ASD resigned. As a result, the Chairperson of the Board of ASD requested that the Division's external auditor expedite the completion of the annual audit. The audited financial statements of the ASD for the fiscal year ended June 30, 1999 reported a net operating deficit of $1.15 million.

In November 1999 the Chairperson of ASD, through the Minister of Education and Training, requested that the OPA conduct a review of the circumstances that led to the deficit. While limitations in our resources preclude us from responding to all requests, we decided, in the circumstances prevailing at the time, to conduct this review.

We would like to thank the members of the Board and staff of ASD for their cooperation and assistance during the course of this review.

Objective, Scope and Approach

We conducted a review rather than an audit. Our objective was to obtain an understanding of the circumstances that led to the financial crisis at the ASD. We focused our review to respond to three questions:

1. WHAT WERE THE CONDITIONS CONTRIBUTING TO THE ASD DEFICIT FOR THE FISCAL YEAR ENDED JUNE 30, 1999?

2. WHAT IS THE FINANCIAL CONDITION OF ASD FOR THE FISCAL YEAR ENDED JUNE 30, 2000?

3. HOW EFFECTIVE WAS THE GOVERNANCE PROCESS AT ASD?

Our review was conducted in accordance with standards for assurance engagements recommended by the Canadian Institute of Chartered Accountants. However, it is important to note that the scope of our review was limited in one significant respect. The school division was unable to locate and provide us with supporting documents to substantiate the master budget approved for the fiscal year June 30, 1999.

Our review was conducted from February 2000 to August 2000 and involved a combination of interviews, review of budgets and accounting records, review of Board policy and provincial legislation, review of Board minutes and a survey of Board governance.

Our interviews included all 11 members of the ASD Board, the current and former Secretary-Treasurer, the Superintendent and the Supervisor of Transportation and Maintenance.

Our approach to addressing Questions 1 and 2 consisted primarily of financial analysis. Our findings are presented as information only. We did not perform an audit and consequently do not express an audit opinion concerning the information we gathered.

Findings and Conclusions

1. WHAT WERE THE CONDITIONS CONTRIBUTING TO THE ASD DEFICIT FOR THE FISCAL YEAR ENDED JUNE 30, 1999?

On March 11, 1998 the ASD Board approved the final budget for the fiscal year ending June 30, 1999. The budget approved expenses of $17,366,204 and provided for an operating surplus of $331,296. The operating surplus was reduced by $204,040 for bus purchases resulting in a net surplus of $127,256.

The audited financial statements for ASD for the year ended June 30, 1999 reported a net deficit for the year of $1,151,584, resulting in a negative variance of $1,278,840 from the approved budget.

Exhibit A provides an analysis of this deficit and is presented as information only.

Our review indicated that the deficit occurred as a result of several factors, involving weaknesses in the budgeting, expense control, monitoring, and administration processes.

Budgeting

A budget is a plan of financial operation embodying an estimate of proposed expenses for a given period and the proposed means of financing them. Provincial school division budgets are required to be prepared approximately 18 months prior to the end of their fiscal year ends. Although this time frame presents forecasting difficulties the process can be accomplished by employing a combination of reasonable estimates and historical data.

The operating budget for the ASD for the fiscal year ending June 30, 1999 incorporated $584,000 of new spending with no program reductions from the previous year's budget. Despite this fact the level of expenses was set $76,490 below the June 30, 1998 fiscal year actual expenses. While, in the absence of substantiating documentation, we were unable to assess the rationale for this decrease in overall budgeted expenses, the situation strongly suggests that the budget was incomplete.

According to ASD policy 4.02, the responsibility for budget preparation at ASD is assigned to the Secretary-Treasurer with input from division administrators, trustees and schools, including principals, staff, parental groups and the community at large. The budget is to be approved by the Board.

In addition to the above, the following evidence suggests the budget process at ASD was not effective.

The audited financial statements for the June 30 1999 fiscal year contain an accrual for wages payable of $218,283. This amount related to retroactive pay for teachers resulting from the signing of a new agreement in October 1999. The agreement provided a 2% increase retroactive to September 1, 1998. There was no provision for this possibility incorporated into the budget for the June 30, 1999 fiscal year. The Board maintains that the exclusion was made on the advice of the former Secretary-Treasurer. It was suggested to the Board that any inclusion could have influenced the settlement of the ongoing contract process.

ASD followed a policy of allowing schools and Adult Learning Centres to use any previous years' operating surpluses, subject to certain conditions, for needed current year expenses. The budget did not recognize the potential expense related to prior year operating surpluses, amounting to approximately $466,700, and they were not included in the budget figures.

The Board approved the adoption of a benefits package, developed by the former Secretary-Treasurer for divisional staff, effective July 1, 1998. The costs associated with this package were not included in the budget.

The Department of Education and Training requires school divisions to use a standardized accounting system known as *Financial Reporting and Accounting in Manitoba Education* (FRAME). This system records expenditures by operational functions. The audited financial statements of ASD are prepared in the FRAME format.

ASD prepares and approves its operating budget on a line by line basis within the overall FRAME format. However, the line by line budget does not mirror FRAME exactly. During our review, we noted that several versions of the line by line budget existed. Although all versions had the same final operating result each contained certain variances within the detailed numbers. We were unable to determine which version was used to transfer the budget figures into the FRAME format as none of the versions completely agreed to the final FRAME submission to the Department of Education and Training.

The FRAME requirements present some complexities and several changes have been made to the structure during the last few years. The former Secretary-Treasurer did not have prior experience working in a FRAME environment and may not have been familiar with the required structure within the reporting requirements. As a result, the FRAME budget has significant differences in certain areas from the line by line version. This may have contributed to budget variances in these areas.

Expense Control

ASD policy 4.02 assigns the responsibility for budgetary control to the Secretary-Treasurer. Within any business entity the accounting system should provide the basis for appropriate budgetary control. On the advice of the former Secretary-Treasurer, ASD implemented a new accounting software package for the June 1999 fiscal year. However, this accounting system, as implemented, did not effectively support expense control.

The new software would not allow the input of the budgeted amounts into the system making line by line tracking difficult. ASD staff was required to use another accounting package to create worksheets in order to monitor operations. The transferring of information between differing software was inefficient and increased the risk of error.

On a number of occasions throughout the year unbudgeted revenue was received from the province to fund unanticipated increased activity in specific ongoing programs. While the revenue was recorded as received, no process was established to monitor the resulting expense. This situation may have given rise to circumstances where forecasted results were overly optimistic.

From time to time it may be appropriate for an organization to initiate an analysis of the merits of making unbudgeted expenditures or increasing a particular expenditure beyond the budgeted amounts. Even if the analysis shows that, considered in isolation, the benefits of the expenditure outweigh the costs, it is still important to consider the impact of the expenditure on the overall financial position of the organization.

We noted several examples at ASD where additional expenditures were incurred either in the absence of a cost/benefit analysis, or without due regard to the overall financial impact of the expenditure. In some of these instances, the budget does not appear to have been considered when authorizing the expenditure.

- Expense for technology services and equipment was budgeted at $175,000. Actual expenses in this area were approximately $861,500, representing a 490% negative variance.
- Photocopiers were purchased for approximately $98,800. These purchases were not included in the budget and were not so identified in the minutes.
- A contract was signed with a company for an energy savings project. Payments made during the fiscal year ended June 30, 1999 totalled approximately $187,000. There was no amount budgeted for this project. Also, no long-term financing was arranged to take advantage of funding from Provincial Grants.
- Educational programs were approved by the Board with no dollar amounts included. Although these programs were not intended to add additional costs to the division, in several instances significant additional costs did arise.
- Expenditures for certain unbudgeted purchases were made by means of corporate credit cards. Payments for these items were made by bank debit memo. The Board was not aware of these expenditures.

Monitoring

By policy, ASD Board meetings are held on the first and third Tuesday of every month. At the latter of these meetings the former Secretary-Treasurer would present to the Board a report detailing the financial operations of ASD for the previous month and year-to-date.

The information provided in these reports was, for the most part, verbal in nature, and would detail the various revenue and expense activity during the month. The reports would indicate the status of revenue and expense by functional area by means of a percentage of the budget figure. Also, a 'Projected Financial Position – By Function' analysis would accompany the verbal information. This analysis would detail actual expense-to-date and projected expense for future months by functional area.

There is some dispute as to whether the practice of including a 'Projected Financial Position – By Function' analysis in the reports was discontinued in July 1998, at the beginning of the June 1999 fiscal year. The Board claims that they did not receive the projections during the period in question. The former Secretary-Treasurer contends that the projections were provided. The procedure was reinstated for the April 1999 report. During our review, we were unable to locate copies of any such reports for the months of July 1998 to March 1999.

The 'Projected Financial Position – By Function' report for April 1999 revealed a projected deficit for the June 30, 1999 fiscal year of $385,530. The May 1999 report revealed a projected deficit for the June 30, 1999 fiscal year of $465,625.

Our interview process revealed two conflicting versions of the events that occurred subsequent to the release of the April and May reports.

The Board maintains that when presented with this information they inquired of the former Secretary-Treasurer as to the reason for the deficit position. The Board stated that the former Secretary-Treasurer provided a plausible explanation for the deficit and told the Board that ASD was not in financial difficulty. No further follow up by the Board took place.

The former Secretary-Treasurer maintains that she advised the Board that ASD was in some financial difficulty and that revisions to plan should be considered. The former Secretary-Treasurer also stated that the Board did not act on her advice.

The June 1999 report was not provided by the former Secretary-Treasurer to the Board at the regular July meeting. The reason offered was that it was due to the crashing of the accounting system and other related problems. It had still not been provided when the former Secretary-Treasurer resigned her position in August 1999.

No entity can sustain itself where a vacuum of information exists. Whether ASD could have acted on the April 1999 'Projected Financial Position - By Function' report to significantly reduce the deficit is indeterminate, but unlikely. However, the Board should have been more diligent in its monitoring function. The Board indicated that they stopped receiving the monthly 'Projected Financial Position - By Function' reports in July 1998. The Board should have insisted on reinstating the reports immediately.

Coordination - Superintendent and Secretary-Treasurer

The administration leadership of ASD consists of two senior positions, each reporting directly to the Board. The Secretary-Treasurer is responsible for the financial operations of ASD. This includes producing and monitoring the operating budget as a whole and responsibility for the Divisional Transportation and Maintenance functions. The Superintendent is responsible for all educational matters including the staffing within divisional schools.

When one branch of an organization is not fully aware or informed concerning the operations of another and the branches are mutually dependant on the same resources, problems may develop. In such circumstances, senior administrators must be clear on their roles within their own administrative areas as well as the division as a whole.

During the course of our interviews, it became evident that communication issues may have existed. It appears that the incumbents were not appropriately apprised of issues in the other person's area of responsibility. This lack of communication may have contributed to the financial difficulties at ASD.

Conclusion

It was the responsibility of the former Secretary-Treasurer to ensure that procedures were in place within ASD to provide the necessary accountability of funds. As per ASD policy 4.02, the former Secretary-Treasurer was responsible for budgetary control. The Board trusted the former Secretary-Treasurer to carry out that responsibility. The Board maintains that it did ask the former Secretary-Treasurer for relevant information, but that the information it received was not accurate or complete. We acknowledge the difficulty faced by the Board to properly oversee operations under conditions of mis-information.

Nevertheless, the budgeting, expense control, monitoring and co-ordination processes that were in place at ASD for the fiscal year ended June 30, 1999 were weak. The combination of an operating budget that was unrealistic, a serious lack of expense and monitoring control and poor communication resulted in an ineffective financial management system that culminated in a significant deficit.

2. WHAT IS THE FINANCIAL CONDITION OF ASD FOR THE FISCAL YEAR ENDED JUNE 30, 2000?

As a result of the deficit recorded for the June 30, 1999 fiscal year, ASD staff completed a review of the probable financial condition of ASD for the June 30, 2000 fiscal year. Projections, based on anticipated revenue and actual expenditures for the fiscal year ended June 30, 1999, revealed a further deficit of $1,128,475 was likely for the fiscal year ended June 30, 2000.

In November 1999, at the request of the Provincial Department of Education and Training, ASD developed a ten-point deficit recovery plan. The plan provided for spending reductions in numerous areas totalling $1,032,534 resulting in an anticipated reduced net operating deficit of $95,942.

Actual audited expenses for the fiscal year ended June 30, 2000 disclose that expenses exceeded the November projection by $440,664. However, actual audited figures for revenue and capital fund transfers for the same period exceeded the November projection by $753,453 and $48,771, respectively. This resulted in a net surplus of $168,076.

Figure 1 below illustrates the circumstances noted above:

FIGURE 1

Agassiz School Division Financial Condition
For the year ended June 30, 2000

	November Projection	*June Actuals (Audited)*	*Variance*
Revenue	$ 19,187,217	$ 19,940,670	$ 753,453
Expense:			
Regular instruction	12,300,565	12,206,413	(94,152)
Exceptional	2,030,539	2,352,924	322,385
Technology education	61,337	-	(61,337)
Divisional administration	502,094	577,060	74,966
Instructional and pupil support	768,889	727,409	(41,480)
Transportation	1,282,190	1,336,029	53,839
Maintenance	1,640,421	1,801,583	161,162
Fiscal	454,420	479,701	25,281
Total expense	$ 19,040,455	$ 19,481,119	$ 440,664
Operating surplus(deficit)	146,762	459,551	312,789
Capital Fund transfers	242,704	291,475	48,771
Net surplus(deficit)	$ (95,942)	$ 168,076	$ 264,018

Revenue

The audited financial statements for the fiscal year ended June 30, 2000 disclosed that revenue exceeded the November projection by $753,453. Increased funding from the Provincial Government ($220,027), other school divisions/opted out Native Bands ($292,435) and ancillary revenue ($184,015) was the main reason for the increase.

In all of these areas there are numerous programs that are funded on a per capita basis. A portion of the increase is due to an underestimation of enrolment. Some of the increase is due to the introduction of new programs during the year.

Expense

Although expenses for the fiscal year June 30, 2000 were higher than the November 2000 projections by $440,664, they were managed properly in relation to the additional revenues the ASD received. It should be noted that increased program revenue has an associated expense side. Much of the overbudget expenses noted above are the result of new programs or increased programming levels for which matching funding exists. The ASD was also, within this context, able to achieve expense savings in various administrative areas.

Capital Fund Transfers

The $48,771 cost of the land for the new Tyndall School was not included in the November projection.

Conclusion

The ASD Board made a strong commitment towards controlling the division's finances for the fiscal year ending June 30, 2000. Despite the burden of a possible second consecutive million-dollar deficit, ASD has managed its financial affairs sensibly. The deficit reduction plan implemented by ASD succeeded in eliminating the prospect of a significant deficit for the fiscal year ended June 30, 2000.

3. HOW EFFECTIVE WAS THE GOVERNANCE PROCESS AT ASD?

In October 2000, the OPA released a Report to the Legislative Assembly entitled, *An Examination of School Board Governance in Manitoba*. This report introduced a governance model developed by our Office.

This model, based on a review of leading research, perspectives and practices on board governance, establishes that an effective board should:

- Be accountable for the effectiveness of the organization achieving a set of agreed upon priorities, based on clearly understood goals;
- Be clear on who it is the board represents;
- Be clear on board responsibilities;
- Have members on the board who are committed to the organization;
- Have the appropriate information to make decisions;
- Be organized as a board;
- Maintain appropriate linkages with other organizations;
- Define clear relations with senior administration;
- Make policy decisions for the organization and, as necessary, change the recommendations made to the board by staff.

In general, the more a board fulfils each of the attributes, the more effective it will be.

Based on this model, and utilizing information gathered through our review process and interviews, our assessment of the effectiveness of governance practices at ASD is as follows:

- The composition of the ASD Board did not consist of members with specific financial expertise and experience. Under our democratic system of election of school trustees it is impossible to predict the composition of any school board. This lack of financial expertise may have contributed to the Board's undue reliance and trust in the financial information provided by the administration. When questioning the administration on financial matters, the Board may have accepted explanations without challenging the reliability of the information it was receiving.

- Debating goals and agreeing to shared priorities are two of the key activities that help a board govern effectively. While the Board appeared to have a good understanding of and commitment to the goals and objectives of the division, they did not have a clear vision of how these objectives would be achieved. Our interviews revealed some concern from Board members that goals were not adequately discussed and that the Board was often unable to resolve conflicting positions.

- Role clarity is also an important contributor to effective board governance. Board members need to be clear on board responsibility and whom it is they represent. Our interviews revealed that while there was strong agreement among Board members that they were expected to reflect the values and priorities of the community from where they were elected, they were divided as to which members of the community they represented. Also, Board members may not have been clear on their role and responsibility in monitoring management performance in achieving the Board's objectives.

- The quality of a board's decision-making is of greatest importance to a board's ability to have an impact on its organization. Our interviews revealed that the Board's decision-making process may not have been effective. Board members indicated they felt somewhat overwhelmed by the amount of information they received for review prior to board meetings and that decision-making may have been hampered by some trustees who lacked understanding of the issues. To this end, the Board tended to rely on administration personnel to determine the merit and financial feasibility of division programming. As a result, some Board members indicated that they felt that the Board had often acted as a "rubber stamp" for management decisions.

- Board organization can also contribute to effective governance. During our review, we noted that copies of the minutes of Board and committee meetings were lacking in detail and, in some cases, were missing. In most cases, records of meetings did not contain copies of meeting agenda packages, and the recording of discussions of issues was minimal if present at all. Many of the minutes were unsigned.

Conclusion

It is clear that issues existed in the governance process and practices of the ASD Board. While we do not question the commitment nor the ability of the current members of the Board, we believe that improvements can be made in the role clarity and decision-making processes of the Board. Further, the Board failed to effectively monitor the actions of its administration.

It is our belief that the governance issues that existed at ASD may have arisen at any school board in a similar set of circumstances. Effective school board governance takes hard work and sustained effort. As with most human enterprises, it can always be improved. The result of that effort is improved organizational effectiveness, and clearer accountability processes.

Comments and Recommendations

FINANCIAL CONTROL

An organization prepares a budget to set out the plan to be utilized in achieving its goals and objectives. The accounting system records the progress made toward the accomplishment of the goals and objectives, and provides the control mechanism to keep the plan on track. The Board and its administration have the responsibility to monitor the operations of the division.

When the individuals within the organization do not uphold their responsibilities the system may fail. This would appear to be what happened at ASD. The Board may not have possessed the necessary financial expertise to fully appreciate the fiscal situation that existed at ASD. Also, the former Secretary-Treasurer may not have fully presented to the Board the seriousness of the financial situation.

We recommend that the Board direct the Superintendent and the current Secretary-Treasurer to work cooperatively to develop a report setting out their recommendations for strengthening the budgeting and expense control processes. Upon receipt of this report, the Board should challenge the recommendations, and then direct management to implement those recommendations it agrees with. At the same time, it should arrange for regular progress reports to be provided to the Board until all the recommendations have been fully implemented.

BOARD RESPONSE
The Agassiz School Division Board agrees with this recommendation. This recommendation will be implemented after discussing format during the pre-budget meetings of the Finance Committee.

GOVERNANCE

Effective governance can contribute significantly to organizational effectiveness and stronger accountability processes. Our review indicated that ASD would benefit from improvements in its governance practices.

A shared aim is vital for effective governance. It is important that Board members take the time to adequately discuss and clarify their role and responsibilities in achieving divisional goals and objectives.

The Board's relationship with the administration must be clearly delineated and roles clearly defined. The Board should maintain a professional distance from the administration. While the Board exercises ultimate authority they should not be overly involved in the day to day operational decisions. However, they need to ensure that they do not simply "rubber stamp" administration decisions.

The Board relies on the information provided to it by the administration. Nevertheless, the Board has the right and the responsibility to challenge the information presented by the administration and to seek further clarification when they do not fully understand the issues.

We recommend that the Board set aside some time to discuss governance issues specifically. The use of a professional facilitator may be beneficial. This could be the start of an ongoing dialogue around the best practices and solutions that suit this Board's unique situation.

BOARD RESPONSE

The Board agrees that this is an excellent recommendation and trustees have made some preliminary moves to ascertain availability of MAST staff to facilitate a workshop early in the new year.

SITE-BASED MANAGEMENT

The present system of operation at ASD requires the Board to micro-manage the financial affairs of the division. They are responsible and involved in the process of budget development and approval, budget monitoring, program approval and division policy. Based on our review of the ASD policy manual, it is our assessment that it may not be appropriate for the Board to administer all these functions.

Presently schools have control over only their supply budgets. They are authorized to move funds as needed between budget categories provided the budget total is not exceeded. Surpluses from one year may be carried over and used in the following year.

Beginning in October 1999, when the deficit was uncovered, the Finance Committee of the Board was required to approve all purchase orders. This system would seem to be too restrictive and may lead to delays in the receipt of goods and possible loss of promotional and sales pricing.

We recommend that the Board consider the merits of site-based management for its schools. Such a system allows the decision for the expenditure to be made at the level where the need for the expense is best understood.

In conjunction with the above recommendation, we also recommend that the division consider the formation of a purchasing department to take advantage of block purchasing opportunities by all division schools. Such a department should have a means of monitoring expenditure versus budget amounts to prevent unwarranted overages.

BOARD RESPONSE

The Board has created a steering committee with two representatives from the Board of Trustees, two principal representatives along with the Superintendent and Secretary-Treasurer. This steering committee has been given the mandate to *develop a draft policy on site-based management for the Division. This draft is expected by December 31, 2000.*

FUNDING COMPLEXITY

ASD receives its funding from a variety of sources. In excess of 90% of this funding comes from the Provincial Government and the various municipalities of the division. Within the Provincial umbrella there are over 20 separate funding categories. Some of this Provincial funding is to be allocated to specific division programming.

Our review indicated that control over the apportionment of Provincial and other funding may be lacking. There does not appear to be any process to match funding to programs and thus prevent possible double budgeting of revenue.

We recommend that the Board direct the Superintendent and Secretary-Treasurer to include this issue in their report on ways to improve the budgeting and expense control processes.

BOARD RESPONSE
The Board has agreed this too is an important recommendation.

BOARD MINUTES

Board minutes should provide important details of a board's decision-making process. During our review, we noted that the minutes of Board and committee meetings lacked sufficient detail. Additionally, the information packages provided to Board members for use at Board and committee meetings were not regularly retained as supporting material. Without adequate detail in the minutes the rationale for Board decisions is not clearly defined.

We recommend that the Board assign responsibility for the recording and retention of board and committee meeting minutes. It should establish policies around this issue and then take steps to ensure that the policies are implemented.

BOARD RESPONSE
The Board has agreed and will address this recommendation after the November reorganization meeting.

Exhibit A

The Department of Education and Training requires school divisions to use a standardized accounting system know as *Financial Reporting and Accounting in Manitoba Education* (FRAME). This system records expenditures by operational functions. The audited financial statements of ASD are prepared in the FRAME format.

Figure 2 summarizes the variance of actual expense from the operating budget for revenue and expense functions as per the audited financial statements of ASD for the fiscal year ended June 30, 1999.

FIGURE 2

Agassiz School Division Financial Statement
Fiscal year ending June 30, 1999

	ACTUAL	*BUDGET*	*VARIANCE*
Revenue	$ 18,746,751	$ 17,697,080	$ 1,049,671
Expense:			
Regular instruction	12,241,038	11,136,560	1,104,478
Exceptional	2,151,372	1,640,056	511,316
Technology education	75,540	84,000	(8,460)
Divisional administration	677,773	508,687	169,086
Instructional and pupil support	789,175	552,864	236,311
Transportation	1,319,264	1,301,885	17,379
Operation and maintenance	1,842,500	1,808,711	33,789
Fiscal	385,411	333,021	52,390
Total expense	$ 19,482,073	$ 17,365,784	$ 2,116,289
Operating surplus/(deficit)	(735,322)	331,296	(1,066,618)
Less: Net transfers to Capital Fund	416,262	204,040	212,222
Net surplus/(deficit)	$ (1,151,584)	$ 127,256	$ (1,278,840)

Within the functional structure, FRAME divides expense into five broad categories: salaries; employee benefits and allowances; services; supplies, materials and minor equipment; and transfers.

We conducted an examination of the variance in each function using the FRAME program categories. Our analysis is presented below:

Exhibit A
(cont'd.)

Revenue

ASD received revenue from various sources including the Provincial, Federal and Municipal governments; other school divisions; opted out Indian Bands; private organizations and individuals; and other miscellaneous sources.

Actual revenue exceeded budget figures by $1,049,671. The variance was mainly due to the following:

FIGURE 3

Explanation and Analysis of ASD Revenue Variance Fiscal Year Ended June 30, 1999	*Amount in Excess of Budget*
Variance for which we obtained an explanation:	
An increase in enrolment in the Adult Learning Centre by 150 in excess of budget contributed to an increase in funding from the Provincial Government	$ 528,500
Other variances:	
Provincial Government Supplementary Support	132,600
Other school divisions	150,600
Private organizations and individuals	129,300
Other	108,671
	$ 1,049,671

Regular Instruction and Technology Education

In accordance with FRAME, Technology Education expenses are recorded within the Regular Instruction function.

Regular Instruction encompasses expenses within all Division schools for the salaries of principals, teachers and support staff as well as instructional services and supplies. Technology Education encompasses expenses relating to vocational computer programming.

Combined expense for Regular Instruction and Technology Education exceeded budget figures by $1,096,018. The variance was mainly due to the following:

Exhibit A

(cont'd.)

FIGURE 4

Explanation and Analysis of ASD Expense Variance Fiscal Year Ended June 30, 1999	*Amount in Excess of Budget*
Regular instruction and Technology Education	
Variances for which we obtained an explanation:	
An increase in enrolment in the Adult Learning Centre by 150 in excess of budget contributed to an increase in teacher salary and benefit expense	$ 215,000
Budget for substitute teachers was set well below recent experience	73,600
No amount was budgeted for services to the Adult Learning Centre	57,500
No amount was budgeted for Home Care Assistant program expenses	38,500
No amount was budgeted for Information Technology Services expenses	158,400
No amount was budgeted for Information Technology Equipment expenses for the Adult Learning Centre	145,000
No amount was budgeted for the Native Language Enrichment program expense for the Ultimate Knowledge Pak	52,000
The number of students who would choose an option under the Schools of Choice program was higher than budgeted which contributed to additional costs	144,000
Other variances:	
Reading Recovery Program	123,000
Supplies	(121,000)
Information Technology Equipment for the school	74,000
Other	136,018
Total Variance	***$ 1,096,018***

Exceptional

Exceptional encompasses expense for the salaries of a co-ordinator, teachers and support staff engaged in the instruction of special needs children and the cost of programs designed specifically for these children.

Expense for Exceptional exceeded budget figures by $511,316. The variance was mainly due to the following:

Exhibit A
(cont'd.)

FIGURE 5

Explanation and Analysis of ASD Expense Variance Fiscal Year Ended June 30, 1999	*Amount in Excess of Budget*
Exceptional	
Variances for which we obtained an explanation:	
No amount was budgeted for the Mrs. Lucci Program	$ 34,500
No amount was budgeted for contract services and travel for the Northern Lights Program and the NETTING Program	62,700
No amount was budgeted for a counselling service	17,000
No amount was budgeted for information technology	105,700
Other variances:	
Talent Development salaries and benefits	51,700
Special Needs salaries and benefits	155,200
Supplies	66,000
Other	18,516
Total Variance	***$ 511,316***

Divisional Administration

Divisional Administration encompasses expense for board trustees, the Superintendent, Secretary-Treasurer and office staff. Expense for Divisional Administration exceeded budget figures by $169,086. The variance was mainly due to the following:

FIGURE 6

Explanation and Analysis of ASD Expense Variance Fiscal Year Ended June 30, 1999	*Amount in Excess of Budget*
Divisional Administration	
Variances for which we obtained an explanation:	
Portion of the salaries and benefits for the Secretary-Treasurer and clerical staff within the Business and Administrative Division allocated to this category, but budgeted in the Transportation and Maintenance Division	$ 64,100
No amount was budgeted for a new staff benefit package which took effect July 1, 1998	19,600
Purchase and installation of computers and software that were not included in the budget	75,900
Other variances	9,486
Total Variance	***$ 169,086***

Exhibit A
(cont'd.)

Instructional and Pupil Support

Instructional and Pupil Support encompasses library services, guidance counselling services, teacher professional development and sundry student activities. Expense for Instructional and Pupil Services exceeded budget figures by $236,311. The variance was mainly due to the following:

FIGURE 7

Explanation and Analysis of ASD Expense Variance Fiscal Year Ended June 30, 1999	*Amount in Excess of Budget*
Instructional and Pupil Support	
Variances for which we obtained an explanation:	
A professional development seminar was funded that was not included in the budget. The costs were offset by revenues earned.	$ 23,200
No amount was budgeted for the Drivers Education Program. These costs were offset by revenues from the Manitoba Public Insurance Corporation.	17,400
No amount was budgeted for Library Automation	19,600
Other variances:	
Salaries and benefits for Library staff	115,300
Salaries and benefits for Guidance and Counselling staff	19,500
Fees paid to instructors for professional development	(18,200)
Other professional development expenses	45,300
Other	14,211
Total Variance	***$ 236,311***

Transportation

Transportation encompasses the administrative and operational costs of busing students to division schools. Expense for Transportation exceeded budget figures by $17,379. The variance was mainly due to the following:

FIGURE 8

Explanation and Analysis of ASD Expense Variance Fiscal Year Ended June 30, 1999	*Amount in Excess of Budget*
Transportation	
Variances for which we obtained an explanation:	
Portion of the salaries and benefits for the Secretary-Treasurer and clerical staff within the Business and Administrative Division budgeted in this category, but which were actually charged to the Divisional Administration category	$ (34,900)
Other variances:	
Salaries and benefits for bus drivers	82,300
Services and supply	(32,000)
Other	1,979
Total Variance	***$ 17,379***

Exhibit A
(cont'd.)

Operation and Maintenance

Operation and Maintenance encompasses the administrative and operational costs for maintaining divisional buildings and grounds. Expense for Operation and Maintenance exceeded budget figures by $33,789. The variance was mainly due to the following:

FIGURE 9

Explanation and Analysis of ASD Expense Variance Fiscal Year Ended June 30, 1999	*Amount in Excess of Budget*
Operation and Maintenance	
Variances for which we obtained an explanation:	
Portion of the salaries and benefits for the Secretary-Treasurer and clerical staff within the Business and Administrative Division budgeted in this category, but which were actually charged to the Divisional Administration category	$ (29,200)
No amount was budgeted for the new staff benefit package	4,400
Salaries and benefits expense for school maintenance personnel	42,500
Services and supply	12,900
Other	3,189
Total Variance	***$ 33,789***

Fiscal

The Fiscal expense overage of $52,390 resulted from the following:

FIGURE 10

Explanation and Analysis of ASD Expense Variance Fiscal Year Ended June 30, 1999	*Amount in Excess of Budget*
Fiscal	
Variances for which we obtained an explanation:	
Additional interest costs associated with carrying more debt than budgeted	$ 26,796
Payroll taxes associated with higher than budgeted salaries	25,594
Total Variance	***$ 52,390***

Exhibit A
(cont'd.)

Capital Fund Transfers

The budget allocated the $204,040 Vehicle Support Grant to the Capital Fund. The Vehicle Support Grant was to be transferred to a separate bank account to ensure the money was used for bus purchases only. Actual Net Capital Fund transfers totalled $416,262 or $212,222 over the budgeted amount. The variance in this area was due to the following:

FIGURE 11

Explanation and Analysis of ASD Expense Variance Fiscal Year Ended June 30, 1999	*Amount in Excess of Budget*
Net transfers to the Capital Fund	
Variances for which we obtained an explanation:	
Five photocopiers were purchased that were not budgeted	$ 98,826
A contract was entered into with a company to upgrade lighting and heating systems that was not included in the budget	145,062
The purchase of Old Green church was not budgeted	35,974
Unbudgeted receipts from the Province	(67,640)
Total Variance	***$ 212,222***

MANITOBA CROP INSURANCE CORPORATION

Department of Agriculture and Food

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About the Program

INTRODUCTION

In September 1999 a former employee of the Manitoba Crop Insurance Corporation (MCIC) brought forward a complaint to the Office of the Provincial Auditor and Crown Corporations Council (CCC). The complainant made a number of allegations concerning management practices at MCIC and the processing of crop insurance claims.

Our Office and Crown Corporations Council decided to conduct a review of the allegations.

OBJECTIVE AND APPROACH

The purpose of our review was to determine the validity of the allegations.

We conducted the management practices review by interviewing 21 current and former employees and senior managers of the Corporation. We also interviewed the Chair of the Board. These interviews were conducted jointly by our staff and staff of CCC. We did not audit the management practices allegations identified in these interviews.

Our initial plan was that CCC would take responsibility for following up in more detail the management practices allegations. However, during the review, we determined that CCC did not have the legislative authority to conduct such a follow up at MCIC. Accordingly, we amended our planned approach to one in which details of the allegations were provided to the Chair of the Board and the General Manager in such a way as to protect the identity of the individuals we interviewed.

Our Office conducted an audit of five crop insurance claims which employees alleged had not been handled in accordance with MCIC policies and procedures.

Findings

Our audit of the five identified claims revealed that in four instances policies and procedures were followed. The fifth claim was resolved in the absence of a specific policy at the time.

With respect to management practices, we found significant differences of opinion between the management team and the employees interviewed. Since we did not conduct an audit of these differences and since we did not survey all employees of the Corporation, we are not in a position to express an opinion on these allegations. However, we believe that the existence of these differences of opinion indicates a need to give consideration to the likely causes.

Recommendations

We recommend that the Board direct the General Manager to review the allegations made by employees and the significant difference in perspectives of the management team. It would be useful for management to include the employees in this review. The need for expert advice to facilitate the review should also be considered. After this review, the Board should receive a report setting out the results of the review and recommended actions, if any, to be taken.

We recommend that MCIC review its internal communication practices with a view to enhancing employee understanding of organization goals, policies and procedures, together with the implementation of these policies and procedures.

Position of the Board of Directors

The Board of Directors of the Manitoba Crop Insurance Corporation is very pleased that only five claims were identified for review out of more than 100,000 claims processed by the Corporation over the period of time spanned by the five claims identified. Four of the five claims were found to have been settled as per MCIC policy, while the fifth claim involved an unusual situation that was not covered by existing policy. The Board is pleased to report that a policy was developed and implemented to deal with the situation which led to the fifth claim, prior to this review being undertaken.

The Board has been advised of the views raised through the review in respect of staff relations and communications matters. The Board is aware of the differences of opinion that exist between the current and former staff that were interviewed and management of the Corporation. Given the number of permanent and part-time staff employed by the Corporation, it is to be expected that some differences of opinion will exist. The Board further recognizes that an audit of these differences of opinion was not conducted, and that a select and limited number of staff were interviewed. The Board is giving serious consideration to the views that have been raised, and has directed the Corporation's executive management to develop a plan to identify and improve on any significant staff relations and communications issues that are found to exist.

The Board would like to take this opportunity to reiterate the Corporation's commitment to ensuring quality service to Manitoba's farmers and to the fostering of a respectful workplace for all of its staff.

Update - Corporation Response

The following update was provided by Manitoba Crop Insurance Corporation to our Office in February 2001:

> *"Measures have been taken to enhance communications and to discuss with staff how the operations of the Corporation can continue to be improved."*

MANITOBA LOTTERIES CORPORATION

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Introduction

In May 2000 we issued a report on an Investigation of Manitoba Lotteries Corporation (MLC) to the Minister responsible for Manitoba Lotteries Corporation. The full report is reproduced here to formally bring the results of this investigation to the attention of the Members of the Legislative Assembly. As well, MLC has provided us with the following update which highlights the actions that have been taken since the report was issued last year.

We would like to take this opportunity to thank the MLC Board, the Acting President and Chief Executive Officer of the MLC and his staff for their cooperation and steadfast dedication to ensuring that the recommendations in our report are fully addressed. The update that follows confirms the significant progress the Corporation has made in addressing the issues raised in the original report.

Update from the Manitoba Lotteries Corporation

The Provincial Auditor's report on his investigation of the Manitoba Lotteries Corporation (MLC) was received in May 2000. Since that date, the Corporation has vigorously pursued the changes required to address the inadequate policies and practices identified in the report and to restore public confidence in the level of accountability practiced at the Corporation.

The following summarizes the Corporation's response to recommendations for change made in each section of the report:

CASINO CONSOLIDATION PROJECT

- The report recommended that a post-expansion review of casino operations be undertaken to assess the impact of casino consolidation on future cash flows and profit levels of the Corporation. A comprehensive review of post-expansion operations is being conducted and progress has been made in many areas:

  a) Casinos are destination facilities that attract visitors from inside and outside the Province. Action has been taken to estimate the economic impact of group tour, convention and leisure visitors on the Manitoba economy as a direct result of the Manitoba Lotteries gaming operations at the casinos. A study done with the assistance of Tourism Winnipeg's research department, shows that a post-expansion increase in visitors in fiscal year 2000/2001 will increase gross economic activity some 68% over the previous year. This will contribute to higher employment and related spinoffs as well as increase taxes collected by all three levels of government.

  b) In addition to the economic impact that resulted from the construction that took place at the casinos, employment at the casinos has increased by approximately 700 employees since the consolidation and expansion occurred.

  c) Procedures that allow the Board to monitor and assess cash flows and profit levels on a monthly basis are in effect. Recently released quarterly results for the first nine months of the 2000/2001 fiscal year show satisfactory results. Net revenues at the two casinos have increased by 24% over the same period in the previous year. When the net revenue from the Crystal Casino, which ceased operations on July 19, 1999, is factored in, the increase is an average of 15%.

d) The post-expansion review has also led to a number of important initiatives by the Corporation to improve various aspects of the Corporation's operations:

i) A strategic and business planning initiative has been undertaken.

ii) The Corporation is reviewing its annual budget process as well as financial monitoring and reporting systems to ensure the Board is informed of the Corporation's performance on a timely basis.

iii) An internal audit undertaken of the approval process for consolidation costs identified a number of control weaknesses that are being addressed.

iv) The Internal Audit reporting relationship within the Corporation has been changed so that Internal Audit reports to the Board of Directors.

v) A comprehensive review of the Corporation's purchasing function has been undertaken to ensure that it operates efficiently and effectively.

- The recommended assessment of the current loan arrangements with the bank was done and, as a result, the Corporation's debt resulting from consolidation and expansion has been refinanced on a long-term basis with the Province of Manitoba. A plan has been approved to repay the debt over the projected life of the assets acquired with this debt.

EXECUTIVE TRAVEL AND ENTERTAINMENT COSTS

- The recommendations resulting from the investigation related to executive travel and entertainment costs have been fully addressed:

a) New corporate guidelines have been developed to govern the submission of expense accounts, the approval of entertainment expenses and the use of airline rewards and business class travel. All claims for reimbursement must be fully supported by receipts and be directly related to MLC business. Restrictions are placed on the approval of entertainment expenses and the use of business class travel. Employees are expected to use airline rewards earned on MLC business to reduce the future cost of travel on MLC business.

b) Internal Audit has conducted a review of the related accounting procedures to ensure that controls are adequate regarding travel and entertainment expenses.

c) Travel and entertainment costs are summarized quarterly for review by the Board.

d) As suggested in the report, consideration was given to a review of executive expense claims from prior periods. This was deemed not cost justified because of the previous practice of not retaining supporting documents for these claims. Without the details provided by these documents, there can be no meaningful conclusions regarding the propriety of the expenses.

EXECUTIVE VEHICLES

- The report recommendations regarding the provision of vehicles to the Corporation executive group have been addressed as well:

a) In future, the President will be required to adhere to the policy applicable to all executive vehicles.

b) A comprehensive policy for providing corporate vehicles to executives has been developed. Included in this policy is the replacement of leased vehicles with a monthly vehicle allowance. During the transition to the monthly allowance, employees currently leasing vehicles will be permitted to purchase their vehicles at fair market value on the approval of the Board of Directors.

c) The question regarding the legality of the purchase of leased vehicles at a price significantly less than retail value has been referred to the Winnipeg Police for investigation. They will submit a report to the Minister of Justice in due course.

d) Lease payments are reported as taxable benefits in accordance with The Income Tax Act. The related question of the purchase of the vehicle has been referred to Canada Customs and Revenue Agency.

e) The operating costs of leased vehicles are now categorized and monitored in the accounting section.

f) Capital leases for executive vehicles are recorded in accordance with generally accepted accounting principles.

g) The Board of Directors intends to arrange future employment contracts with the President.

CORPORATE PROMOTIONS

- Changes made in response to recommendations concerning corporate promotions include the following:

  a) A marketing plan that defines clear strategies and provides guidelines for corporate sponsorship activities was presented as part of the 2001/2002 budget process recently undertaken at the Corporation.

  b) When tickets are not required for attendance by a corporate representative(s), event tickets received through corporate sponsorships are distributed by Corporate Communications through a raffle in which all employees of the Corporation are able to participate.

  c) The practice of purchasing event tickets for employee use has been discontinued.

Purpose and Scope of Investigation

As a result of numerous allegations from current and former employees of the Manitoba Lotteries Corporation (MLC), regarding inappropriate spending at MLC, the Provincial Auditor decided to conduct an investigation. The allegations we decided to investigate involved the areas of casino consolidation, executive travel and entertainment, executive vehicles and corporate promotions. The investigation was conducted to assess the validity of the allegations. This report summarizes the findings and conclusions of the investigation team.

Our authority for this investigation is contained in both The Provincial Auditor's Act (PA Act) and the Manitoba Lotteries Corporation Act (MLC Act). Section 17(2) of the PA Act says,

> *"The Provincial Auditor may request an agency of the government to obtain and furnish to him such information and explanations from its present or former directors, officers, employees, agents and auditors or those of any of its subsidiaries as are, in the opinion of the Provincial Auditor, necessary to enable him to fulfil his responsibilities as auditor of the accounts of the government".*

Section 25(2) of the MLC Act says,

> *"...the Provincial Auditor may at any time order an audit of or investigation into the accounts or affairs of the corporation...".*

Our investigation was conducted from February to May of the year 2000 and included extensive interviews, detailed review and analysis of supporting documentation and independent confirmation of transactions, as we considered necessary. The scope of the work varies in each area of investigation, as we deemed appropriate in the circumstances.

During our investigation, we interviewed senior management and a former Board member, as well as several other current and former employees of MLC. The former Chair of the Board declined to be interviewed.

Summary Conclusions

MLC is a Crown corporation created for the benefit of the citizens of Manitoba. As such, its assets and profits accrue to the benefit of Manitobans. During our review of the Casino Consolidation Project, we noted comments in the records of the Corporation that suggested public funds were not affected by the costs of this Project. We do not agree with this proposition.

Public disclosures of casino consolidation costs were incomplete and misleading. MLC should have taken greater care to ensure that media information included full disclosure of the scope of capital plans and use of public funds.

In addition, we concluded that the policies were inadequate and the controls ineffective with respect to the administration of executive vehicle leases, executive travel and entertainment and items purchased for corporate promotions.

Casino Consolidation Project

THE ALLEGATIONS

We received the following allegations with respect to the recently completed Casino Consolidation Project:

- The cost of the project was much higher than had been publicly disclosed.
- The cost of the project was much higher than originally planned.
- Certain costs of the project had been recorded as expenses rather than being capitalized as part of the project costs.

THE SCOPE OF OUR INVESTIGATION

We limited our investigation in this area to interviews and a review of preliminary proposals, project approvals and MLC accounting records regarding capital expenditures. We did not audit the capital balances disclosed in MLC records.

FINDINGS

To address concerns regarding declining revenues and an expiring lease for the Crystal Casino, MLC proposed in June 1996 to expand two other casinos which it owns, Club Regent and McPhillips Street Station. The goal of these expansions was to ensure the long-term viability of Manitoba casino sites as tourist destinations, maintain the facilities' existing market share, attract tourism and encourage Manitobans to stay in Manitoba for gaming activities.

This proposal was portrayed as a comprehensive expansion and renovation project that would include expanding both of these facilities as well as enhancing the entertainment experience of the patrons. This proposal included several elements of a business plan and projected total costs of approximately $50 million.

In May 1997, the Government officially announced an initiative to consolidate the Crystal Casino with existing facilities at a cost of $50 million. This announcement included enhancements to the existing facilities and indicated,

> *"that food, licensed beverage services and entertainment should be part of the enhanced facilities",*

and

> *"to accommodate these additional services, along with the table games that will be transferred from the Crystal Casino, renovations of approximately $25 million for each site will be undertaken, with completion expected prior to the 1999 Pan Am Games".*

The intended scope of the project referred to in this government announcement was not clear. However, MLC officials have advised us that the "renovation" related only to building construction costs and that they have characterized this initiative as a consolidation project.

On November 20, 1997, the Board of MLC approved "the Casino Consolidation Project budget of $55 million plus taxes". On October 20, 1998, the Board approved an increase to the budget of $11 million plus taxes. These approvals relate to the construction components of the project. The final budget for construction costs related to casino consolidation amounted to $76.5 million including taxes of $10.5 million.

Also in November 1997, the external project manager who was hired to manage the casino project prepared a project implementation plan. This plan included amounts for construction costs to expand the existing facilities, as well as for office renovations, stage additions, air quality improvements, the Millennium Theatre at McPhillips Street Station and a new front facade at Club Regent. The base budget for the implementation plan was set at $92.5 million. Subsequent to the implementation plan, the external project manager processed project change orders for $22.1 million. We were advised that a business plan supporting these higher levels of expenditure and analyzing potential impacts on overall operations of the Corporation was not prepared.

During 1998 and 1999 MLC was involved in negotiations with the Federal government with respect to the implications of Goods and Services Tax on the gaming industry. Taxes are a very significant component of capital costs. The tax impact on the Board approved construction costs of $55 and $11 million is over $10 million. Information provided to the media in 1998 and 1999 disclosed only the pre-tax amounts regarding budget approvals for construction costs.

Figure 1 sets out the approved budget and capital costs incurred by MLC regarding the Casino Consolidation Project. This table includes the direct casino construction costs, as well as the costs of three other capital projects directly related to the Casino Consolidation Project. Taxes are included for all items.

FIGURE 1

Capital Costs Disclosed by MLC in March 2000	*Approved Budget*	*Cost*
	(in millions)	
Direct casino construction costs	$ 76.5	$ 84.8
Land and road relocation	2.3	2.6
Millenium Theatre	6.3	9.2
Equipment	14.8	15.9
	$ 99.9	***$ 112.5***

It is important to note that there were other MLC capital projects undertaken during the period of casino consolidation. These are not reflected in the above Figure.

Because MLC has arranged commercial financing for all capital projects of the Corporation, there are suggestions in MLC records that public funds were not affected by the costs of the Casino Consolidation Project. In the Board minutes of March 17, 1998, we were surprised by the following comments, which were made in the context of the status of the Casino Consolidation Project. The Board minutes state,

> *"There is, however, a need to get the message out re private sector funding, not taxpayers' dollars."*

Also, in the original June 1996 proposal document prepared by MLC, it states,

> *"And, as the MLC is financing the entire project through the Royal Bank of Canada ...... it's not taxpayers' money!"*

At the time of our investigation, long-term debt had grown to $170 million, whereas prior to the expansion, it was less than $55 million. No plans were available to show how this loan will be repaid.

During their audit for the year ended March 31, 1999, the external auditors did not identify any significant capital expenditures that were incorrectly recorded as operating costs. Also, during our review of maintenance costs from April 1999 to February 2000, we did not identify any capital items that had been incorrectly recorded.

CONCLUSIONS

MLC is a Crown corporation created for the benefit of the citizens of Manitoba. As such, its assets and profits accrue to the benefit of Manitobans. We do not agree with the proposition in the records of the Corporation, that public funds were not affected by the costs of the Casino Consolidation Project.

Public disclosures of the costs of the Casino Consolidation Project were incomplete and misleading, and the scope of the project was not clearly defined or communicated. In our view, piecemeal disclosure of capital plans increases the risk of confusing the public regarding capital activities of the Corporation.

Capital costs related to the construction component of the Casino Consolidation Project exceeded budget approvals by $8.3 million ($84.8 less $76.5).

Increasing corporate debt by over $115 million without a plan in place to show how the renovations would finance this debt is inappropriate.

The capital costs have been appropriately recorded in the records of the Corporation.

RECOMMENDATIONS

MLC should publicly disclose its operating and capital budgets in its annual report. Segmented reporting of the capital costs of each casino should be considered.

The Board of MLC should arrange for a post-expansion review of casino operations and consider the impact of all capital expenditures and long-term debt on future cash flows and profit levels of the Corporation.

The Board of MLC should arrange for an assessment of the current loan arrangements with the bank with a view to determining the most cost effective way to manage and pay off this debt. This should include determining whether it would be more cost effective to finance the loan with the Province of Manitoba.

Executive Travel and Entertainment Costs

THE ALLEGATIONS

We received the following allegations with respect to executive travel and entertainment costs:

- Some of the expenses claimed by the executives were of a personal nature.
- Many of the business expenses incurred by the executives were extravagant.
- Supporting documentation for executive expense accounts was not provided to the accounting department.
- Significant airline rewards were being accumulated and used for personal purposes.

THE SCOPE OF OUR INVESTIGATION

We examined the expense account claims for the President, Vice-Presidents and several senior managers for the nine month period from April 1, 1999 to December 31, 1999. These expenses amounted to $224,490.

The criteria we used to assess the allegations are as follows:

- The Corporation's documented policies on travel expenses, entertainment and airline rewards should be followed (see Exhibit A).
- Procedures should be in place to ensure compliance with corporate policies.

Whether a particular expenditure is extravagant is a subjective matter. In lieu of making a determination as to whether expenditures were extravagant, we have compared certain items to MLC's documented policy guidelines, to other Crown corporations and to the Government's General Manual of Administration. While the latter two items are not binding on MLC, they do provide a framework within which the Board can review the appropriateness of MLC policies and practices. On the other hand, the President advised us that he supported a liberal travel and entertainment expense practice, as a reward for extraordinary efforts by the executives.

At the outset of our investigation, we were surprised to find that MLC had adopted a practice of not retaining supporting documentation for executive expense claims. (Certain executives, however, had retained their receipts in separate files.) We were advised that this practice was initiated on direction from the President. As a result, the scope of our investigation was limited and we were unable to investigate these expenses to the extent we believe appropriate. We advised the Chair of this practice as soon as it came to our attention. The Chair subsequently issued instructions to the Acting President to end this practice and to comply with the existing documented corporate policy.

During our investigation, those executives who had retained their receipts in separate files provided them for our review. In addition, we asked the executives to contact some of the hotels where they had stayed to obtain copies of their hotel bills for our review. We subsequently received 10 of the 14 hotel bills that we requested. We also contacted the Corporation's travel agency directly to obtain additional supporting documentation for transactions included in our investigation.

FINDINGS

Figure 2 shows the extent of unsupported payments at the end of our investigation. Unsupported payments include instances in which no receipt was provided and instances in which the receipts provided inadequate information. In our opinion, credit card statements do not provide adequate documentation of expenditures.

FIGURE 2

Summary of Unsupported Payments	*Amount Paid*	*Amount Unsupported*	*%*
Transportation	$ 114,942	$ 12,972	11
Entertainment	49,298	44,655	91
Hotel charges	46,886	22,060	47
Miscellaneous supplies, gifts, dues	13,364	8,355	63
Totals	***$ 224,490***	***$ 88,042***	***39***

We identified several claims for minor items that were of a personal nature and others where we were not able to clearly determine the appropriateness of the item. Details of these will be provided to the Chair of the Board for further review.

During our investigation, we examined the costs incurred during 1998 and 1999 relative to a gaming conference that is held in Las Vegas each year. Attendance at each conference was approved and documented on MLC travel authorization forms (T/A's). In 1998, the Corporation approved the attendance of eight executives at an estimated cost of $3,200 each or $25,600 in total, and in 1999, nine executives were approved at an estimated cost of $3,000 each or $27,000 in total. The conference in 1998 involved four nights of accommodation and 1999 involved three nights. The total costs incurred for each of these conferences significantly exceeded the estimated levels. We were advised by some executives that the estimates recorded on the T/A forms were not intended to provide any restriction over the level of expenditure on these trips. The costs for these trips are summarized in Figure 3:

FIGURE 3

Conference Costs Incurred During 1998 and 1999	***1998***	***1999***
Registration	$ 5,280	$ 4,895
Hotel	10,671	6,636
Meals and entertainment (no receipts)	9,370	9,320
Car rental and taxis	1,201	2,558
Airfare	17,660	33,676
Total	***44,182***	***57,085***
Recoveries from Executives	-	(4,832)
Net cost to Corporation	44,182	52,253
Estimate from T/A forms	25,600	27,000
Amount in excess of T/A estimate	***$ 18,582***	***$ 25,253***

In November 1999, recoveries of $4,832 were made at the request of the President. There were no recoveries initiated for 1998 or any prior trips.

Business class travel is used to a greater extent than appears to be contemplated by MLC's documented policy requiring the most economical method of travel. The Corporation does not have a documented policy regarding the use of business class airfare.

While provincial guidelines are not binding on the Corporation, they provide that a Minister or Deputy Minister (and equivalents) and accompanying persons may travel business class. In the absence of a clear MLC documented policy on business class travel, we compared current MLC practice with the provincial guidelines. We identified 22 instances, or 61% of our sample, where business class airfare was purchased relative to trips not involving the President. In addition, the Corporation purchased business class airfare for the President and six Vice-Presidents attending the 1999 Las Vegas conference (1998 - eight executives). The President advised us that he had authorized the Corporation's practice with respect to business class travel.

During our investigation, we determined that the Corporation does not maintain records to monitor compliance with its documented airline promotion policy. We further noted that this policy does not deal with airline rewards accumulated through the use of corporate credit cards. In 1999 the executives earned an aggregate of 400,567 airline reward points through the use of corporate credit cards, with one executive earning 177,133 airline reward points.

Because it was not practical to distinguish airline rewards earned from business activities from rewards earned from personal activities, we did not attempt to assess whether airline rewards were inappropriately used. However, some of the executives we interviewed indicated that they had used airline rewards earned from business activities for personal purposes. The President advised us that he had authorized the practice of using airline rewards for personal purposes.

The process in place for paying executive expense accounts is administered differently than all other accounting transactions. Each executive initiates his/her own expense claim which is forwarded to the Administrative Officer of the Finance and Administrative Division for processing. The expense claim forms forwarded to the President for approval were supported primarily with credit card statements. However, some executives retained their receipts in separate files. A cheque requisition is then prepared and approved by the Vice-President, Finance and Administration. No documentation, other than the summary totals of all executive expense claims, are provided to the Corporate Controller's department to support the payments.

We noted that the Board had not been provided with meaningful information on executive expense claims or entertainment expenses.

Section 6(1) of the Crown Corporations Public Review and Accountability Act indicates that:

> *"The council shall .... ensure consistent practices among two or more corporations where appropriate...."*

CONCLUSIONS

The practice of not obtaining and retaining supporting documentation for executive expense accounts is clearly inappropriate. It indicates a lack of due care over the management of public monies.

Controls over entertainment expenses are essentially nonexistent.

The lack of control over expenses contributed to the Corporation incurring some minor expenses on behalf of the executives that were of a personal nature. Given the lack of documentation we were unable to determine whether there were other expenses of a personal nature claimed by executives.

In our view, there was little or no attempt to constrain the costs incurred on the Las Vegas trips and stay within the estimated levels of expenditure. In 1999 the airfare alone exceeds the estimated levels.

In the absence of a documented policy on business class travel, it is difficult to assess MLC's practices. It is not uncommon to provide the right to travel business class to certain individuals in the public sector.

Business class travel can be a useful perquisite to provide to executives, especially in circumstances where mandated salary levels make it difficult to recruit. The Board needs to consider the extent to which it believes access to business class travel should be permitted and adopt a documented policy accordingly.

Those executives who told us that they used airline rewards earned for business activities for personal benefit have clearly not been following the documented corporate policy. However, they were following the practice authorized by the President.

With respect to the personal use of airline rewards, some organizations have developed a philosophy, that supports personal use of the airline rewards earned because an employee is giving up personal time or is required to be away from their family. In any case, one needs to be practical in any policy developed. Recognizing the numerous ways in which individuals can earn airline rewards today, the policy should focus on major items and be relatively simple to administer.

The role of the Corporate Controller's department in ensuring that expenditures of the Corporation are for bona fide business purposes and appropriately supported was weakened by the process followed for paying executive expense accounts and credit card charges.

Effective procedures are not in place to ensure compliance with corporate policies.

RECOMMENDATIONS

The Board of MLC should consider whether it would be appropriate to review executive expense account claims from prior periods that were not included in our investigation. In addition, the Board should consider whether it would be appropriate to initiate recovery of payments to executives for any personal or other expenses without a clear business purpose.

The Board of MLC should clarify, in cooperation with Crown Corporations Council, the corporate policy for expense accounts, entertainment, and use of airline rewards, and develop an appropriate policy for business class travel. The aim should be to ensure that these policies reflect a prudent use of public monies and a respect for employees who are required to travel on personal time, away from their families.

After the Corporation has revised its policies, the Board of MLC should involve the Internal Auditor in a review of the accounting procedures to ensure that controls are adequate regarding travel and entertainment expenses.

The Board should establish an independent reporting process that captures all travel and entertainment related costs on a summarized basis for periodic review by the Board. We suggest the Board consider having these reports periodically audited by the Internal Auditor.

Executive Vehicles

THE ALLEGATIONS

We received the following allegations with respect to executive vehicles:

- Some executives purchased vehicles leased by MLC for nominal amounts without appropriate authorization.
- Significant repair costs were incurred by MLC shortly before being purchased by executives.
- Some of the vehicles leased by executives at MLC expense were extravagant.

THE SCOPE OF OUR INVESTIGATION

We reviewed the terms and conditions of all executive vehicle leases currently in force. We also reviewed the disposition of all vehicles under previous MLC lease contracts. The criteria we used to assess these allegations are as follows:

- The terms of the employment contract between the President and the Province of Manitoba should be adhered to. This contract provides for,

  "...an automobile or an allowance in accordance with the policy applicable to Deputy Ministers....".

- The corporate policy over leased vehicles should be designed to provide reasonable control over the level of benefit provided to executives.
- Corporate authority should be provided for employees purchasing leased vehicles at the end of the lease term. Such vehicles should be purchased at fair market value unless an employment contract or corporate policy indicates otherwise.
- When lease arrangements transfer substantially all of the benefits and risks of ownership to the Corporation, the lease should be recorded in the accounting records of the Corporation as a capital lease. In these situations the vehicle should be recorded as an asset of the Corporation and the amounts payable should be shown as an obligation of the Corporation to the leasing company.
- The costs of operating a leased vehicle should be supported with receipts and appropriately monitored to ensure compliance with operating standards established by the Corporation.

With respect to whether the vehicles leased were extravagant, we have limited our assessment to comparing the values of MLC leased vehicles to government policy.

We contacted the Corporation's leasing company directly to obtain additional supporting documentation and clarification for transactions included in our investigation.

FINDINGS

The contract with the President and CEO indicates that he is entitled to a vehicle equivalent to that to which a Deputy Minister is entitled. Current guidelines for Deputy Minister vehicles call for a purchase price limit of $27,000. The cost of the vehicle currently leased for the President and CEO is $32,000 as indicated by the leasing company.

The current corporate policy on the leasing of corporate vehicles spells out a maximum monthly lease payment amount for the President and CEO and Vice-Presidents. These limits are $975 for the President and $700 for the Vice-Presidents. All lease arrangements were consistent with the policy. However, the policy does not place any restrictions on deposits, prepayments or vehicle options and does not provide any limitations on the capital cost of the vehicle, the length of each lease or on extensions and renewals. The policy does not address vehicle ownership at the end of the lease term or deal with residual values of leases and executive buyout options.

Two executives arranged either directly or indirectly for the purchase of MLC leased vehicles at the end of the lease for amounts significantly below market value and for use by their spouses. We asked Manitoba Public Insurance to provide us with the approximate retail value of these vehicles. One vehicle had an approximate retail value (excluding taxes) of $16,049 and was purchased by the executive for $456. The other vehicle had an approximate retail value (excluding taxes) of $14,735 and was purchased for $1. We have found no corporate authorization for these transactions. No taxable benefit was reported to Canada Customs and Revenue Agency (CCRA) with respect to these transactions.

Significant repairs were made to the vehicles at MLC expense shortly before the expiration of the lease. In one case, repair costs of $5,593 were charged in December 1996 and January 1997. The executive then purchased the vehicle in January 1997. In the other case, repair costs of $2,484 were charged two months prior to the expiration of the lease and the executive purchasing the vehicle.

Executive vehicles under capital lease arrangements are not recorded in MLC records as capital assets. They should have been so recorded. The Canadian Institute of Chartered Accountants (CICA) provides clear guidance regarding the accounting treatment of lease transactions in order to comply with generally accepted accounting principles (GAAP). Section 3065 of the CICA handbook provides definitions that distinguish between capital and operating leases and outlines criteria for applying the definitions in order to comply with GAAP (see Exhibit B).

We found that no attempt was made to manage the operating costs of the leased vehicles. We did an analysis of the gasoline costs associated with these vehicles and found that in several instances, the costs exceeded standard consumption (for city use) by a considerable margin. We determined standard consumption by referring to the ratings provided by Natural Resources Canada. The variances from standard consumption ranged from an underconsumption of 7% to an overconsumption of 84%.

In addition, we found that $14,177 or 39% of the operating costs of these vehicles were supported only by a monthly credit card statement.

CONCLUSIONS

While the vehicle leased for the President exceeds the value provided for in the contract of employment, it is consistent with the policy adopted by the Board of Directors. Neither the employment contract nor the Board policy indicates which one should take precedence. This makes it difficult to assess the appropriateness of the arrangements.

The current policy with respect to leasing vehicles for executives is ineffective in controlling the value of the benefit to the executives. This policy is of limited utility because it does not address a number of other significant variables to ensure that benefits received by the executives are controlled and equitable. The limitations of MLC's policy is amply demonstrated by the fact that the vehicles leased by MLC executives range in value from $28,500 to $49,000. All of these values are higher than that specified in the President's employment contract and that specified for Deputy Ministers.

We believe it was inappropriate for two executives to arrange directly or indirectly for the purchase of MLC leased vehicles for personal use by their spouses, at amounts significantly below market value without corporate authority. Further, we believe that an unreported taxable benefit may have been incurred.

We believe that making major repairs to a leased vehicle shortly before a lease expires, unless there is clear evidence that such repairs are required under the terms of the lease agreement, is an inappropriate use of public money.

The operating costs of leased vehicles are not effectively managed.

The President's employment contract is a contract between the President and the Province of Manitoba. Such an arrangement can contribute to ambiguity in the relationship between the Board of Directors and the President. It suggests that the President is primarily accountable to the Province rather than the Board of Directors. In our opinion, it is generally preferable for such employment contracts to be between the Board of Directors and the President.

RECOMMENDATIONS

The Board of MLC should take steps to resolve the conflict between the President's employment contract and its policy on the leasing of executive vehicles.

The Board of MLC should develop a comprehensive policy for providing corporate vehicles to executives. The policy should be designed to ensure equity and provide reasonable control over the value of the benefit provided to the executives. One test of reasonableness is that the value provided to Vice-Presidents should normally be less than that provided to the President.

The Board of MLC should seek legal advice on the appropriateness of the purchase of the leased vehicles at significantly less than retail value without corporate authority. The Board should also seek tax advice to ensure that appropriate taxable benefits with respect to these transactions have been reported to CCRA.

The Board of MLC should arrange for an effective process to be developed to monitor the operating costs of leased vehicles. We suggest that Fleet Vehicles Agency be consulted in the development of this process.

Capital leases of executive vehicles should be recorded in accordance with generally accepted accounting principles.

The Board of Directors should arrange for future employment contracts with the President and CEO.

Corporate Promotions

THE ALLEGATIONS

We received the following allegations with respect to this area:

- Event tickets for major concerts and season tickets for professional sports teams are frequently used for the personal benefit of favoured individuals in the Corporation.
- $18,000 worth of golf equipment purchased in 1997 was used for the personal benefit of certain executives.
- The controls over items purchased for corporate promotions were weak.

THE SCOPE OF OUR INVESTIGATION

The criteria we used to assess these allegations are as follows:

- Use of event tickets and other items such as golf equipment purchased for corporate promotions should be supported by a corporate marketing plan.
- There should be meaningful criteria for the distribution of event tickets and other items, such as golf equipment, to employees.

FINDINGS

We found that the Corporation had purchased, for use and distribution across all divisions of MLC, a combined total of 150 season tickets for the Winnipeg Blue Bombers, Winnipeg Goldeyes and Manitoba Moose franchises in 1999/2000. We also found that the Corporation had purchased a combined total of 340 tickets for concerts by Shania Twain, Elton John and Ricky Martin. These tickets were intended to be used as prizes, promotional items and employee recognition awards.

There is no policy governing the distribution of any of these tickets to employees.

Concerning tickets retained at head office for executive use and distribution, we were advised that checkoff sheets were used to ensure all tickets got distributed. However, these checkoff sheets were not retained in MLC files for future reference or audit purposes.

Prior to January 2000, records tracking the distribution of tickets by each casino to MLC customers as prizes or for the personal use of casino employees were inadequate. Subsequently, distribution records have been improved at the casinos to provide adequate documentation of the distribution of tickets.

We found that adequate records are maintained regarding tickets distributed through the Video Lotto Division.

In June 1997, MLC purchased various items of golf equipment for over $18,000. MLC officials advised us that this golf equipment was used for prizes at golf tournaments sponsored by MLC, and that several items still remained in inventory. However, distribution records do not provide adequate descriptions of prizes awarded and of items remaining in inventory to link back to the original purchase order.

We selected a number of golf equipment purchases from 1999 and traced these to casino promotional records or to the inventory records. All items we selected from 1999 were adequately recorded.

CONCLUSIONS

There was essentially no control over the distribution of event tickets by head office and the casinos. This is clearly inappropriate. It exposes the Corporation to a significant risk that items purchased for business purposes may, in fact, be used inappropriately for the personal benefit of employees.

Because of deficiencies in the records, we were unable to determine the distribution of some of the golf equipment purchased in 1997 for over $18,000. However, one executive advised us that executives and staff utilized golf clubs on occasion at corporate sponsored events over the past few years. He advised that these clubs were either given out as prizes or returned to the Corporation.

Another executive indicated that golf clubs were sometimes tested by an executive to make sure they were of adequate quality. Controls over golf equipment purchases in 1999 were adequate.

It is important to establish strong controls over all promotional items, especially high value items.

RECOMMENDATIONS

The Board should direct management to develop a current marketing plan that defines clear strategies and provides clear guidelines for all corporate sponsorship activities of MLC. The Board may wish to seek guidance from the Government on this issue.

The Board should re-evaluate the practice of providing event tickets to employees. If the practice is to be continued, management should develop appropriate criteria compatible with other employee recognition policies of MLC and establish appropriate controls to monitor employee participation.

Exhibit A

A - 20

MANITOBA LOTTERIES FOUNDATION

POLICY MANUAL

SUBJECT: AIRLINE PROMOTIONS

1. POLICY

   1.1 Employees who earn benefits from airlines accumulated as a result of travelling on government business, will only utilize such benefits while on government business.

   1.2 Violation of this policy will result in disciplinary action.

2. APPLICABILITY

   2.1 All Manitoba Lotteries Foundation staff.

Exhibit A
(cont'd.)

MANITOBA LOTTERIES FOUNDATION

POLICY MANUAL

SUBJECT: EMPLOYEES IN TRAVEL STATUS

1. POLICY

1.1 Approval for out-of-town travel is required as follows:

a) Away from home base - Supervisor/Director

b) Out-of-Manitoba - General Manager,

c) Out-of-Canada/U.S.A. - Minister Responsible for Lotteries

1.2 Travel arrangements can be booked well in advance to take advantage of reduced rates.

a) Only when there is a net cost saving to M.L.F.., will employees be permitted to stay additional days to benefit from lower rates.

1.3 Dependant upon availability, M.L.F. employees will stay at hotels which provide discount rates to government employees travelling on business.

1.4 The General Manager must be notified in all instances where a spouse or second party who is not on M.L.F. business will accompany the employee.

a) The M.L.F. will only reimburse expenses incurred by the employee.

b) The M.L.F. will reimburse the accommodation on a single occupancy rate and only that rate must be shown on the employee's expense account.

1.5 Manitoba Lotteries Foundation employees who are eligible, may claim the actual cost of purchased meals up to the maximum amounts allowed under the General Manual of Administration – AE-25-03 AppendixÊÊ"A" and PA-30-25 Paragraph 3.3.4.

1.6 Manitoba Lotteries Foundation employees travelling out of province may claim the actual cost of meals in excess of the maximum amounts allowed under the General Manual of Administration provided that:

a) The M.L.F. deems that the amount claimed is reasonable.

b) No alcoholic beverages are included in the claim.

c) Receipts are provided for the meals claimed.

1.7 Other miscellaneous expenses incurred during travel status, must be consistent with those outlined in the General Manual of Administration – AE-25-06.

SUBJECT: EMPLOYEES IN TRAVEL STATUS (Continued)

2. APPLICABILITY

2.1 All Manitoba Lotteries Foundation staff in travel status.

A - 23

Exhibit A
(cont'd.)

MANITOBA LOTTERIES FOUNDATION

POLICY MANUAL

SUBJECT: EXPENSE CLAIMS - ENTERTAINMENT

1. POLICY

1.1 The General Manager and/or Directors may entertain business associates at their discretion.

1.2 All other employees must obtain their respective Director's approval prior to entertaining business associates.

1.3 All employees who entertain business associates should do so in a cost efficient manner.

1.4 The original receipt is required for reimbursement of expenses incurred. Duplicate receipt from credit card slip will be accepted:

a) Purpose of meeting, names and occupations of persons in attendance must be included.

1.5 Reimbursement will not be provided without prior approval of the General Manager for:

a) Entertainment of another employee;

b) Payment of another employee's meals while in travel status;

c) Alcoholic beverages;

2. APPLICABILITY

2.1 All Manitoba Lotteries Foundation staff.

Exhibit A
(cont'd.)

MANITOBA LOTTERIES FOUNDATION

POLICY MANUAL

SUBJECT: EXPENSE CLAIMS - PARKING AND MISCELLANEOUS

1. POLICY

1.1 Manitoba Lotteries Foundation will reimburse only actual expenses accompanied by a receipt.

1.2 Claims for parking expenses other than meter parking must be substantiated by receipts:

a) Claims for meter parking will be paid if deemed reasonable. A daily record of meter parking should be kept.

1.3 Claims for telephone calls will be paid if deemed reasonable. A daily record should be kept.

1.4 Claims for business lunches will be paid provided that the employee's Director authorized the expense prior to the lunch taking place:

a) All claims for business lunches must be supported by receipts.

b) All claims must indicate the purpose of the meeting and the names of the persons in attendance.

1.5 Claims for expenses incurred as part of an employee's normal coffee break will not be paid.

2. APPLICABILITY

2.1 All Manitoba Lotteries Foundation staff.

Exhibit A
(cont'd.)

Excerpts: CICA Handbook, Section 3065

Definitions

.03 The following definitions have been adopted for purposes of this Section:

(a) Capital lease is a lease that, from the point of view of the lessee, transfers substantially all the benefits and risks incident to ownership of property to the lessee.

(d) Operating lease is a lease in which the lessor does not transfer substantially all the benefits and risks incident to ownership of property.

(e) Bargain purchase option is a provision allowing the lessee, at its option, to purchase the leased property for a price which is sufficiently lower than the expected fair value of the property, at the date the option becomes exercisable, that exercise of the option appears, at the inception of the lease, to be reasonably assured.

.06 From the point of view of a lessee, a lease would normally transfer substantially all of the benefits and risks of ownership to the lessee when, at the inception of the lease, one or more of the following conditions are present:

(a) There is reasonable assurance that the lessee will obtain ownership of the leased property by the end of the lease term. Reasonable assurance that the lessee will obtain ownership of the leased property would be present when the terms of the lease would result in ownership being transferred to the lessee by the end of the lease term or when the lease provides for a bargain purchase option.

(b) The lease term is of such a duration that the lessee will receive substantially all of the economic benefits expected to be derived from the use of the leased property over its life span. Although the lease term may not be equal to the economic life of the leased property in terms of years, the lessee would normally be expected to receive substantially all of the economic benefits to be derived from the leased property when the lease term is equal to a major portion (usually 75% or more) of the economic life of the leased property. This is due to the fact that new equipment, reflecting later technology and in prime condition, may be assumed to be more efficient than old equipment which has been subject to obsolescence and wear.

(c) The lessor would be assured of recovering the investment in the leased property and of earning a return on the investment as a result of the lease agreement. This condition would exist if the present value 1(1), at the beginning of the lease term, of the minimum lease payments, excluding any portion thereof relating to executory costs, is equal to substantially all (usually 90% or more) of the fair value of the leased property, at the inception of the lease.

.09 A lease that transfers substantially all of the benefits and risks of ownership related to the leased property from the lessor to the lessee should be accounted for as a capital lease by the lessee and as a sales-type or direct financing lease by the lessor. [JAN. 1979]

.10 A lease where the benefits and risks of ownership related to the leased property are substantially retained by the lessor should be accounted for as an operating lease by the lessee and lessor. [JAN. 1979]

.15 The lessee should account for a capital lease as an asset and an obligation. [JAN. 1979]

LIONS CLUB OF WINNIPEG HOUSING CENTRES (LHC)

Department of Family Services and Housing

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Introduction

In January, 2001, we issued a Special Audit Report on Lions Club of Winnipeg Housing Centres to the Minister of Finance under Section 15(1) of The Provincial Auditor's Act. The following report overview has been excerpted from the full report and represents a summary of our findings, key conclusions and key recommendations. The full report was made public by the Government on February 5, 2001 and is available from our Office on request.

The purpose for including a summary in this Report to the Legislature is to formally bring the results of this Special Audit to the attention of the Members of the Legislative Assembly and to provide an opportunity for the Government to set out the initial actions it has taken in response. The Government acted swiftly as indicated in their response which follows this summary.

Background

In early 2000, the former Executive Director of the Lions Club of Winnipeg Housing Centres (LHC) approached the Province requesting financial assistance (corporate structure and entity descriptions are included in Figures 1 and 2).

Pursuant to the Social Housing Agreement with Canada Mortgage and Housing Corporation (CMHC) dated September 3, 1998, Manitoba Housing and Renewal Corporation (MHRC) assumed responsibility for CMHC programs. The Province assumed administrative responsibilities over CMHC agreements with LHC effective April 1, 1999.

Due to MHRC concerns that were beginning to be raised since this transition, the former Executive Director was advised that a comprehensive review of all LHC operations, involving both the Department of Family Services and Housing and the Department of Health would be required before further support would be contemplated.

Subsequently, in April 2000, at the request of the Department of Family Services and Housing, LHC provided financial information, along with a request for additional funding support. LHC requested the following:

- $1.0 million toward debt reduction attributable to the 333 Maryland Project;
- $175,000 for capital refurbishment in Lions Manor;
- That the Province replace West Broadway Housing financing with funding from Governmental Inner City Housing Initiatives;
- That the Province postpone LHC's required contribution of $525,000 on the PCC for up to five years; and
- The option of using over $900,000 of monies (that LHC was at one point eligible to receive under a Contribution Agreement with the Province for the construction of the Personal Care Centre (PCC) to use for Lions Manor refurbishment) to cover operating deficits and debt.

This information, along with additional Provincial follow-up suggested that LHC was experiencing financial difficulties and may be in breach of Provincial agreements.

The Province subsequently offered assistance to the LHC Board in the summer of 2000 conditional on a proposal that LHC enter into an agreement to establish, on an interim basis, a management committee made up of a majority of Provincial representatives together with LHC representatives.

The intent was that this committee would provide the Province with a temporary monitoring role. The Province also proposed engaging a professional management consulting firm to provide assistance and direction until the financial and management difficulties could be resolved to the Province's satisfaction. As well, the Province indicated that the Office of the Provincial Auditor would be engaged to perform a Special Audit. The LHC Board refused to accept these conditions as a basis for additional funding. The Province determined that a Special Audit was appropriate under the circumstances.

On July 14, 2000 the Office of the Provincial Auditor was requested by the Minister of Finance to perform a Special Audit of the Lions Club of Winnipeg Housing Centres (LHC) to:

- Determine the financial well-being of LHC as a whole; and
- Examine the appropriateness of financial transactions over the last three years.

FIGURE 1

Lions Club of Winnipeg Housing Centres (LHC) Corporate Structure
(Compiled by PAO)

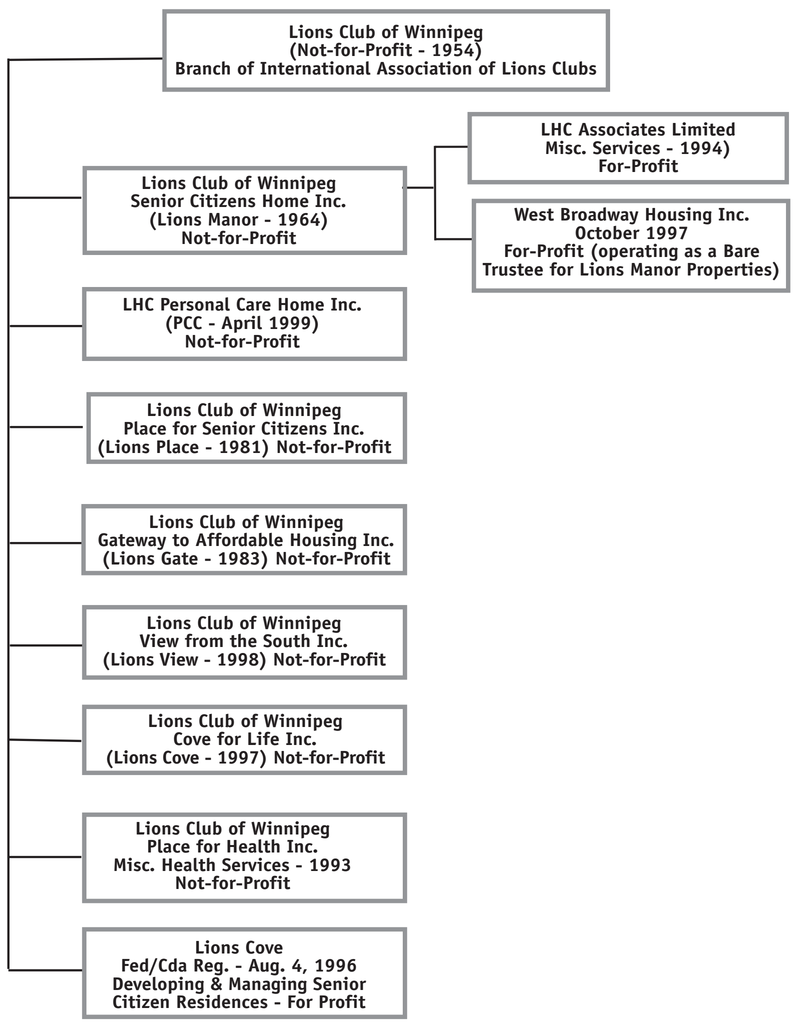

FIGURE 2

LHC Entity Descriptions		
Legal Entity	***Operating Name***	***Nature of Business***
Lions Club of Winnipeg Senior Citizens Home (Not-for-profit)	Lions Manor	• Operation of residential low income seniors complexes, including Lions Manor North and South Towers (320 Sherbrook Street), providing care and housing with 317 suites. • Operation of the Alzheimer Residence (32 suites) & Research Centre (333 Maryland Street). • Operation of four separate Adult Day Club Programs. • Owner of LHC Associates Limited.
Lions Club of Winnipeg Place for Senior Citizens Inc. (Not-for-profit)	Lions Place	• Operation of a residential low-income seniors complex at the Lions Place building with 287 suites (610 Portage Avenue).
Lions Club of Winnipeg Gateway to Affordable Housing Inc. (Not-for-profit)	Lions Gate	• Operation of a 72-unit low-income townhouse complex at 1321 Beaumont Street in Fort Garry for low-income families. Included within this operation is the Lions Gate Day Care for pre-school and before and after-school children.
Lions Club of Winnipeg View From the South Inc. (Not-for-profit)	Lions View	• Operation of a 32-unit low-income housing project for special needs individuals living on assistance or low income (311 Furby Street).
Lions Club of Winnipeg Cove for Life Inc. (Not-for-profit, Life-Lease)	Lions Cove	• Operation of a 48-unit mid-income seniors life lease project on Valhalla Drive in East Kildonan.
LHC Associates Limited (For-Profit, Share Capital Entity owned by Lions Manor)	LHC Associates	• Provision of property management and consulting services. • Operation of LHC Associates building (677 Portage Avenue)
West Broadway Housing Inc. (Share Capital Entity owned by LHC Associates operating as a Bare Trustee)	West Broadway Housing	• Operation of West Broadway house purchase, renovation, and sale projects and the Wilson House Project.
Place for Health Inc. (Also known as George Thomson Health Centre) (Not-for-profit)	Place for Health	• Provision of geriatric care as an independent medical center (located in Lions Place).
LHC Personal Care Home Inc. (Not-for-profit)	PCC	• Operation of a Personal Care Centre with 116 beds (320 Sherbrook).
Lions Cove Inc. (For-Profit, Share Capital)	Trademark	• Established for the sale of the Cove Trademark in Canada.

Scope

A Special Audit, as provided for in Section 15(1) of The Provincial Auditor's Act is comprised of such examinations and procedures as we determine are necessary to address the issues raised in the request from the Minister of Finance, and any other issues that arise during the audit.

This Special Audit was conducted from September 2000 to December 2000 and included extensive interviews, detailed review and analysis of supporting documentation, and independent confirmation of transactions. The scope of the work varied in each area of review, as we deemed appropriate in the circumstances. We interviewed past and present LHC Board members; past and present senior management; and a number of past and present employees.

We have not performed an audit of the financial records of LHC, but have performed various procedures we considered necessary in these circumstances. The scope of our work was negatively affected by numerous inadequacies in the financial records of LHC, absence of key documentation in certain cases and the inability of staff to provide us with the rationale for certain transactions. As a result, while we have made our best efforts to validate and substantiate the numbers used in this report, further adjustments to the reported results of LHC may be warranted. However, we are confident that any adjustments made would not affect our fundamental conclusions.

This Special Audit generally covered the period from April 1, 1997 to September 30, 2000.

Summary

LHC is an organization in trouble. Unfortunately, its difficulties have been self-inflicted. Through poor and questionable management, an organization that was in excellent financial health a few short years ago, finds itself close to financial failure. This is most unfortunate because most of the activities of LHC are valuable to our community. Many of our citizens are provided with a safe, secure and affordable place to live through initiatives carried out by LHC and financed largely by the Province of Manitoba.

We would like to indicate at the outset, that the troubling findings and conclusions contained in this report should not be attributed to everyone involved with LHC activities. Many members of the Board and staff are contributing selflessly and performing a valuable service as well.

Why should the citizens of Manitoba care about the situation that has unfolded at LHC? In our view, there are two fundamental answers to this question. One is that significant amounts of public monies have been put at risk. The other is that the deteriorating financial results have placed the ability of LHC to continue to deliver its services at risk.

We believe that those of us charged with managing public monies owe a special duty of care to the citizens of Manitoba. There is a duty of care to utilize such monies with transparency, due diligence, and with an appreciation of the accountability to government and donors of private funds. The special duty of care arises because citizens are compelled to provide government with most of its revenues. In this circumstance, it is incumbent on anyone with access to public monies to be particularly prudent in managing the use of these monies.

Throughout the full report, we cite examples where public monies have been mismanaged. We cite other examples where public monies have been put at an unacceptable risk and used for purposes other than those for which they were intended.

Perhaps one quote from a former senior member of the staff we interviewed would help to illustrate why we are so concerned about LHC. With respect to the creation of numerous separate entities to conduct LHC affairs, the individual advised us that *"the entities were set up to keep the Provincial, Federal governments at bay"*. Other findings in our report suggest that the desire to "*keep…governments at bay*", may have influenced many of the decisions and accounting transactions entered into by LHC entities.

The key question now is: Given the culture evident in LHC, and given the serious financial condition that LHC is in, what should the Government of Manitoba do? While we make a number of recommendations in the full report, we believe that there is one overriding recommendation that should be actively pursued:

We recommend that the Government, as one of its options, consider whether it would be appropriate to transfer control of all the housing and personal care facilities currently managed by LHC that are financed by the Province of Manitoba to another organization.

Key Conclusions

- Losses over the past three years have eroded the equity position of LHC and have placed a serious financial strain on the entities. LHC is in its current financial position for a number of reasons in addition to the fact that there have been significant operating losses in virtually all of the operating entities. Contributors to this current financial position include the following:

    - Incomplete and inaccurate financial information negatively impacted decision-making; and

    - Questionable decisions were made regarding the future direction of the organization (LHC Associates; West Broadway Housing; Wilson House; 333 Maryland Building; 677 Portage Avenue Building; Lions Cove).

  These issues along with others highlighted in the full report need to be addressed by this organization in the larger context of future corporate governance, strategic direction, financial management and accountability.

- The Projection that was prepared and submitted to the Province by LHC was incomplete, inaccurate and unreliable.

- New and non-core business initiatives have drawn over $2.9 million of cash from LHC core operations.

- Governance reviews that we have conducted indicate that it is not uncommon for a board, especially a not-for-profit board, to experience some of the issues noted in our full report from time to time. However, we believe it is unusual for such a wide range of governance issues to exist for such a considerable period of time, without being addressed. We believe that the poor governance practices contributed to poor decision-making. We also believe that a reasonable person would perceive that the significant business some Board members obtained from LHC activities may have contributed to a lack of concern with governance issues.

- Over the last four years transactions between various LHC entities and Board member companies, and between LHC entities and companies of former Board members have amounted to in excess of $2.0 million (we did not attempt to determine the amount of profit earned on these transactions). We believe that this is inappropriate. The culture of LHC has resulted in public monies being treated in a cavalier fashion.

- We found evidence that certain individuals placed themselves in either a real or a perceived conflict of interest position.

- Although, it is easy to see with hindsight, that the business plans for LHC Associates Limited were unrealistic, we believe that a prudent Board and management would not have embarked on this risky venture, nor have continued with it when it became apparent it was failing on all fronts. Some of the reasons we hold this view are:

    - The nature of the proposed business was so different from that normally conducted by LHC that the risks of adverse outcomes could have been anticipated to be high;

- As each year went by, the results were so much worse than planned that there were many missed opportunities to shut the organization down and stem the losses; and
- From the outset, it was clear that the resources of a not-for-profit entity would have to be put at risk to start up and maintain the operations of LHC Associates.

- A number of transactions, in our view, were specifically designed to mask the negative operating results of LHC Associates to the detriment of other not-for-profit LHC entities. Transactions with other LHC entities have had a material impact on the equity position of LHC Associates. All lines of business that did not involve other LHC entities accumulated losses on an annual basis.
- Given the extensive level of renovations that were planned, administration and carrying costs that were foreseeable and the reality that properties in the West Broadway area of the city have a limit on their maximum market value, the expectation to break even on the sale of West Broadway Housing properties was unrealistic. Estimated total losses on West Broadway Housing activities are $491,400 to date. When the grants received of $162,800 are taken into account, the amount of money actually lost on this initiative to date totals $654,200.
- As of December 31, 2000, Lions Manor and the WCB had made arrangements to defer the December 31, 2000 payment due of $600,000 to March 31, 2001.
- It is clear that Wilson House was acquired with no specific purpose or tenant identified.
- Since the LHC comingled bank account is in a negative position, with LHC carrying a line of credit, it is likely that approximately $490,000 of funds raised for the construction of PCC were initially used for other purposes.
- The comingling of funds has contributed to:
  - An inability of LHC to demonstrate that it has initially used government grants and charitable donations for the purposes intended;
  - Inadequate financial reporting to the Board;
  - Inadequate controls over the operation of LHC entities; and
  - A lack of transparency in LHC's financial reporting.

  This is especially critical because the funds of a for-profit entity are comingled with not-for-profit entities.
- It appears that public monies are being expended on administrative costs without due regard for economy or efficiency.
- In our opinion, costs allocated to LHC entities are questionable. In too many instances, LHC has not documented the basis for these allocations. It is possible that some of these allocations may have resulted in overpayments by the Province to the LHC entities affected.
- It was not possible for us to determine whether all donations have been used for the purposes intended. However, we believe that it is very likely that some donations have, in fact, been used for purposes other than intended.

- The confusing accounting system, combined with the comingled bank account, have contributed to LHC's inability to be transparent and accountable with respect to the use of donations received.
- Replacement reserve funds were not available for use at March 31, 2000 as required under the Lions Place, Lions Gate, Lions Manor and Lions View agreement with Manitoba Housing and Renewal Corporation (formerly a Canada Mortgage and Housing Corporation responsibility).
- Numerous breaches of funding agreements have occurred including:
  - Advances to related parties which contravene the prohibition against encumbrances and lending;
  - Audited financial and other statements not submitted when required;
  - Monthly financial information not provided to the Winnipeg Regional Health Authority;
  - Hypothecation of investment funds which were only to be used for MHRC (formerly CMHC) approved repairs and capital replacement; and
  - Reserve funds not being held in a special bank account as required.

Key Recommendations

- We recommend that the Government, as one of its options, consider whether it would be appropriate to transfer control of all the housing and personal care facilities currently managed by LHC that are financed by the Province of Manitoba to another organization.
- Additional adjustments as described in the full report are recommended to be made prior to LHC finalizing their draft financial statements of March 31, 2000 for Lions Manor, LHC Associates and Lions Cove.
- We recommended to the Province in October 2000 that additional monies not be advanced to LHC based on LHC Projections. No funds have been advanced to date. We continue to recommend that no additional funds other than those currently being advanced under existing service agreements be provided to LHC until the concerns in our report have been satisfactorily addressed.
- LHC should immediately cease the practice of awarding LHC business to Board member's companies and those of former Board members as long as they remain members of the Lions Club of Winnipeg.
- The Province should make it a condition of providing public monies to not-for-profit organizations, that neither individual board members nor their companies should benefit from the public monies.
- The Province should obtain legal advice to assess whether public monies were paid to individuals with a conflict of interest and to consider what, if any, action would be appropriate.
- The Province of Manitoba and the LHC Board should review all financing arrangements and security with a view to ensuring that these are appropriate and manageable.

- A business plan for the operation of 333 Maryland should be developed. If the business plan shows that the facility is not viable, an action plan should be developed in conjunction with the Province to minimize the loss of public monies in this venture.
- LHC should determine the least costly alternative to divest itself of Wilson House and act upon this plan expeditiously.
- LHC should establish separate bank accounts and lines of credit for each LHC entity together with separate bank accounts for restricted charitable donations and government grants to the extent necessary to enable them to demonstrate appropriate accountability for funds.
- The Province should consider requiring LHC to prepare a special audited report on the use to which public monies have been put. This could include assessing the appropriateness of cost allocations and the potential for past overpayments by the Province. The Province should subsequently consider whether it would be appropriate to recover public monies that have been spent for purposes other than those intended and whether actions to recover these overpayments would be practical.
- The Province should advise Canada Customs and Revenue Agency (CCRA) of our concern with respect to the appropriateness of the use of donated monies and request them to conduct an audit.
- LHC should take steps to satisfy Manitoba Housing requirements for providing an adequately detailed plan for proposed expenditures through the replacement reserves.
- Appropriately funded replacement reserves should be put in place for all LHC properties and funding deficiencies need to be addressed by LHC management. As well, capital plans should be prepared for all facilities.
- The Province should direct LHC to begin complying with its agreements immediately.

Government Response

The Provincial Auditor's report on the Special Audit of the Lions Club of Winnipeg Housing Centres was received by the Province on January 15, 2001. The Special Audit was completed at the Province's request as a result of growing concerns over the management, financial stability and long-term viability of the housing and personal care facilities operated by the Lions Club of Winnipeg. The Province considered the findings and recommendations of the Special Audit to be extremely serious and acted quickly to protect the significant investment of public monies and to ensure the continued well-being of the residents and participants of the several Lions Club of Winnipeg facilities.

Between the receipt of the Special Audit report on January 15, 2001 and the release of the report to the public on February 5, 2001, the following measures have been put in place:

- *The Boards of Directors of the Lions Club of Winnipeg and the Lions Housing Centres have entered into a Memorandum of Agreement with the Province of Manitoba and the Winnipeg Regional Health Authority, confirming their agreement that the Boards' management authority would be delegated to a Provincial Management Committee for an indefinite period of time while the Lions restructure their organization, and the Province and the Lions address the Provincial Auditor's recommendations;*

- *A Provincial Management Committee, comprised of senior staff from the provincial departments of Family Services and Housing, Health and Finance, as well as the Winnipeg Regional Health Authority, has been established to oversee the management and operation of the Lions Club of Winnipeg Housing Centres' several housing and personal care facilities, and to ensure that the Provincial Auditor's recommendations are appropriately addressed; and*

- *Bethania Mennonite Personal Care Homes Inc., a non-profit community based organization with experience operating both personal care and housing facilities, has been appointed as Interim Manager, reporting to the Provincial Management Committee, to oversee all day-to-day operations of the various Lions Club of Winnipeg facilities, for an interim period of at least six months.*

Work has begun to address the Provincial Auditor's findings and recommendations and to deal with the Lions Club of Winnipeg Housing Centres' financial difficulties. Provincial officials and the Lions Club of Winnipeg Housing Centres are working cooperatively in this regard.

TEACHERS’ RETIREMENT ALLOWANCES FUND

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Report Overview

This report highlights a situation that in turn gives rise to perplexing questions about the role of the Legislative Assembly of Manitoba as an institution, and the related subordinate roles of government, civil servants and the boards of public sector entities created by the Legislative Assembly. Our view is that the Legislative Assembly is the only institution in Manitoba with the power and authority to pass and amend legislation.

One of the roles of government, which is shared with all members of the Assembly, is to propose new legislation, or amendments to existing legislation, to the Legislative Assembly. But it is the Legislative Assembly, not the government, which ultimately decides whether to pass proposed legislation or amendments.

Another role of government is to conduct the operations of government in compliance with the laws passed by the Legislative Assembly. This is also expected of civil servants and the boards, officers and employees of boards, agencies and commissions created by the Legislative Assembly.

As a general rule, we believe that, where a government finds a particular Act is causing difficulties in administration or impacts new policy, it should arrange for the Legislative Assembly to amend the Act before adopting a changed practice that conflicts with the legislation. However, some might suggest that there may be circumstances in which complying with a particular Act causes such harm to the public good that it would be understandable for a government to change practices before amending the legislation. We worry, though, that if such a position were invoked frequently, it could undermine the authority of the Legislative Assembly, an institution which represents all the citizens of Manitoba.

Another argument, that some may put forth, is that when the government of the day has a majority of the seats in the Assembly, it will usually be able to ensure that the Assembly amends legislation retroactively so that its past actions will comply with the revised legislation. In this circumstance, what is one to think about the government actions in the time before the Act is amended? We believe that it is inappropriate to assume that the Legislative Assembly will agree to the amendments.

In any case, the role of the Provincial Auditor, as an officer of the Legislative Assembly, is to bring significant issues of non-compliance with legislation to the attention of the Assembly.

Background

During the course of the Office of the Provincial Auditor's audit of the financial statements of the Teachers' Retirement Allowances Fund (TRAF) for the year ended December 31, 2000, a subsequent event was brought to our attention. This is discussed in the section entitled "Findings".

Scope

Our procedures have been limited to a review of the Teachers' Pensions Act and correspondence regarding this subsequent event, as well as discussions with the President and Chief Executive Officer of TRAF and the Vice-President of Finance and Operations.

Findings

The following information was brought to our attention:

- Through correspondence dated January 22 (Exhibit A) and January 31, 2001 (Exhibit B), the Minister of Education and Training advised TRAF that Government representatives and the Manitoba Teachers' Society (MTS) had reached agreement on a cost of living adjustment (COLA) for retired teachers to be effective July 1, 2000. The Government agreed to commit an estimated $0.8 million of the amount set out in the Department of Education and Training's 2000/01 estimates, to cover the Government's portion of the costs of this COLA. The Pension Adjustment Account (PAA) of TRAF would pay $0.8 million as well.
- According to the report of the actuary dated May 2, 2000, each 1% granted as a cost of living increase in 2000 requires $7.4 million in the PAA as currently structured. Since the PAA as at December 31, 1999 was in a deficit position of $0.7 million, the payment of a 2% COLA as at July 1, 2000 will require the amount of $15.6 million to be transferred from the Basic Benefits Reserve (Account A) to the PAA.
- The Minister of Education and Training advised that it is his intention to introduce an amendment to the Teachers' Pensions Act authorizing the retroactive transfer of $15.6 million from Account A to the PAA.
- In correspondence dated January 22, 2001 and January 31, 2001, the Minister of Education and Training requested that TRAF accept his correspondence and his commitment to introduce the required legislative amendment during the Spring 2001 session, as authority for TRAF to immediately commence paying the agreed COLA to retired teachers.
- On January 31, 2001, the TRAF Board passed the following motion:

  > *"The payment of a 2% COLA effective July 1, 2000 be approved based on the receipt from the Minister of Education of a letter dated January 31, 2001 providing assurance that legislation will be introduced authorizing TRAF to transfer $15,621,010 from Account A to the PAA."*

- A Memorandum to the Board from the TRAF President and Chief Executive Officer dated January 31, 2001 given to the Board as background information stated the following:

> *"Time has become of the essence. If the payment is to be made within the context of the Province's current fiscal year ending March 31, 2001 the adjustment must be made on the February pension payroll. For TRAF to proceed with that we require your authorization at today's meeting."*
>
> *"Authorizing legislation is critical to this process. The TRAF Board does not have the authority to transfer assets from Account A to the PAA. Pursuant to Section 10(8) of the Act, the TRAF Board is not permitted to pay a COLA that would create an unfunded liability in the PAA. In the event the PAA does not have sufficient funds during any year to pay a full COLA, the COLA is to be actuarially reduced to the amount the PAA can afford to pay, hence the non-payment of a COLA at July 1, 2000. To pay a 2% COLA retroactive to July 1, 2000, the PAA must be put in the same financial position that would have been required to pay a 2% COLA on July 1, 2000. To accomplish this requires a transfer of $15,621,010 from Account A to the PAA effective January 1, 2000."*

- Draft legislation to amend the Teachers' Pensions Act is in progress. As at the time of this report, there is no confirmation as to when the draft bill will be put forward when the next session of the House opens.
- Payment of the arrears related to the retroactive cost of living adjustment, in the amount of $1.8 million, was included in the February 2001 monthly pension payments. TRAF has billed the Province for one-half of that amount. The Province paid TRAF on March 1, 2001.
- For March 31, 2001, the Province would increase its pension liability related to the retroactive cost of living adjustment by approximately $15 million.
- The increase in the monthly pension payment related to the 2000 COLA is $0.2 million (Provincial and TRAF portion combined).

Conclusions

- The Minister did not have the legislative authority to request that TRAF accept his letter of January 31, 2001 as authority to transfer $15.6 million from Account A to the PAA and to request that his letter be accepted as authority to immediately commence paying the agreed COLA to retired teachers. The Minister should not have provided direction to this Board to contravene their enabling legislation.
- Pursuant to Section 10(8) of the Act, the TRAF Board does not have the authority to grant or pay a new COLA that would create an unfunded liability in the PAA. The Board does not have the authority to approve the transfer of $15.6 million from Account A to the PAA. Without this transfer, the new COLA creates an unfunded liability.
- The Board did not meet its responsibility to act within the provisions of the Teachers' Pensions Act. We acknowledge that the current provisions of the Act are impractical. The Act limits the ability of TRAF to make cost of living adjustment to a greater extent than was likely intended when the relevant sections were originally drafted. We believe, however, that the Act should have been amended prior to providing the July 2000 COLA.
- Public monies (i.e., Provincial portion of the July 2000 retroactive COLA) have been disbursed without proper authority.

Recommendations

The Government should establish guidelines for Ministers advising them that boards, agencies and commissions are expected to abide by their governing legislation, and that it is inappropriate for a Minister to instruct them to do otherwise.

The TRAF Board should direct TRAF to cease paying the July 2000 COLA effective immediately. If the Legislative Assembly amends the legislation to permit these payments, they could be resumed retroactively. If the Legislative Assembly decides not to amend the legislation, TRAF should recover the payments made to pensioners from the pensioners and reimburse the Government of Manitoba for its share.

Comments of TRAF Officials

The TRAF Board maintains that it acted in a prudent manner in the administration of the Teachers' Pensions Act (the Act) and the Pension Benefits Act by giving effect to the intent of the Act and the agreement between the Province and The Manitoba Teachers' Society. Prior to approving its January 31, 2001 motion authorizing the payment of the 2% cost of living adjustment, it received advice about the nature and potential consequences of its action. Specifically, it considered the following information:

1. *The Pension Adjustment Account (PAA) was established to provide automatic cost of living adjustments for retired teachers. At the time of its establishment, the intent was to provide sufficient funds for that purpose by allocating to this account a portion of teachers' contributions and crediting it annually with a preferential, albeit arbitrary, rate of interest. As a consequence of changing demographics and economic circumstances, the PAA is no longer functioning as it was intended. If a more appropriate interest crediting mechanism were in place, the PAA could have supported a 2.49% cost of living adjustment in 2000. During 1999 the legislation required crediting a -2.3% to the PAA instead of the actual earnings of our investments of 10.5%, despite the fact that the funds allocated to the PAA are comingled with Account A for investment management purposes. As a consequence of the arbitrary interest crediting mechanism, the PAA has subsidized Account A to the extent of $25 million since 1995 as compared to crediting the PAA with the actual earnings on investments during that period.*

2. *An agreement was reached between the Province and The Manitoba Teachers' Society to pay a 2% cost of living adjustment using the funds set aside by the Province in estimates for that purpose and agreeing to transfer sufficient funds from Account A to the PAA to cover its increased liabilities ($15.6 million).*

3. *The Minister of Education, Training and Youth forwarded a letter to the TRAF Board advising them of his intention to introduce legislation authorizing the TRAF Board to transfer $15.6 million from Account A to PAA to cover the liabilities arising from paying a 2% cost of living adjustment. He requested*

the TRAF Board to accept the letter as authority to effect the transfer and also requested them to immediately commence payment of the 2% adjustment to pensioners.

4. *Account A had a disclosed surplus of $43 million as at January 1, 1998. A valuation of Account A is currently being undertaken and the actuary has advised the TRAF Board to expect a significant increase in the surplus.*

5. *The Retired Teachers' Association of Manitoba had been consulted in the process of arriving at the agreement and had concurred with the agreement.*

6. *A verbal opinion had been provided by a representative of the Provincial Auditor's Office indicating that the consequences of taking such action would be that the Provincial Auditor would report such non-compliance to the Minister responsible.*

7. *A memorandum from the Department of Justice advising the TRAF Board that they had a duty to comply with the legislation under which it had been created and that failure to do so could result in personal liability for any losses that might result from such decision. The memorandum advised weighing carefully the risks of such action before proceeding. No potential losses or injured party could be identified.*

This information is provided to demonstrate that the Board did not act precipitously on this matter. It very carefully considered the situation, the solvency of the plan and the best interests of the beneficiaries it has been appointed to represent. Under the circumstances it took the action it deemed most appropriate and that fulfilled the intent of the Act, even though potentially not in compliance with a strict legal interpretation of the Act. It took this action to facilitate the wishes of the principals for whom the Act was promulgated, the Province and its teachers.

While this action may be viewed technically as not in compliance with the Act, it fulfills the intent of the Act. Section 10 of the Act was implemented in the late '70s to provide automatic cost of living adjustments to teachers. Prior to that date, all cost of living adjustments had been ad hoc; determined and paid for solely by government. To relieve the government of that onerous financial responsibility in light of the very high inflation of the day, the government proposed the establishment of the Pension Adjustment Account with the expectation that it would be able on average to fund an annual increase in pensions in excess of the actuary's assumed rate of inflation. To assure the ability of the PAA to support reasonable cost of living adjustments, it was credited with what was then the most favourable rate of return on investments. Now over twenty years later, the PAA is no longer functioning as intended by the parties when it was established.

It may be argued that the establishment of the PAA provides to pensioner members a legal commitment to provide a cost of living adjustment. The mechanism for determining that adjustment has become dysfunctional through the passage of time and the changing of economic and demographic circumstances never contemplated by the drafters of Section 10. The PAA is only a notional account to which is credited, solely for purposes of calculating a cost of living adjustment, a portion of teachers' contributions and an arbitrary rate of interest. Its current *dysfunction should not be used as an excuse to deprive pensioners of a reasonable cost of living adjustment to protect the value of their pensions, which they had been promised when they gave up their employment. The agreement between the Province and The Manitoba Teachers' Society gave a form for that intent to be honoured in the year 2000. The Board in implementing the agreement, at the request of the Minister of Education, Training and Youth and with the full consent of the Society, facilitated the honouring of that intent.*

The recommendation to cease payment of the COLA would create significant and unnecessary administrative cost and pose a hardship to pensioners. While we may concur that such action may become necessary should the Province not pass the authorizing legislation in the upcoming session of the Legislative Assembly, we suggest doing so in this pre-emptive fashion is not warranted.

Departmental Response

At the outset, it should be stressed that there was never any intention to undermine the authority of the Manitoba Legislature.

It is important to note that the transaction identified by the Provincial Auditor represents a continuation of a past practice as it applies to Manitoba's pension plans for teachers and public servants.

The direction provided by the Minister of Education to the Teachers' Retirement Allowances Fund (TRAF) Board was not a hasty decision. Early in 2000 it became apparent that some 6,500 retired Manitoba teachers would receive no cost of living adjustment effective July 2000, notwithstanding the fact that an overall surplus existed in the TRAF account. Retired Manitoba teachers had received an annual cost of living adjustment each year since 1977 when the pension adjustment account was first established.

Extensive negotiations on the issue of a cost of living adjustment took place between representatives of the Province and the Manitoba Teachers' Society. Negotiations were concluded in December 2000.

In order not to disadvantage Manitoba's retired teachers, the Minister of Education, on the advice of officials, provided direction to the TRAF Board to proceed with funding the negotiated cost of living adjustment.

The transaction in question authorized TRAF to transfer a surplus from one account to offset a deficit in another account. The issue in question is the authorization to transfer funds from one account to another.

What were the implications of not acting? The Minister of Education has clearly indicated that the amendment to legislation will be introduced during the spring session of the Legislature. Failure to provide retired Manitoba teachers with a cost of living adjustment for 2000, once an agreement was reached on this matter, would be an unfair and unnecessary action on the part of government based on past practice.

The decision to proceed with the identified transaction is not unique and does follow a past practice in addressing teacher and public servant pension plan matters.

By way of example, similar direction was provided by government to TRAF and the Civil Service Superannuation Fund (CSSF) in 1995 in the matter of a reduced work week service calculation. Legislative amendments reflecting the administrative decision followed at a later date.

Similarly, government direction was provided to CSSF Board in 1995 on a matter relating to a transfer of funds to the Province. As in the previous example, legislative amendments were introduced at a later date.

It is important to note that similar direction provided by government in previous years drew no comment by the Provincial Auditor at the time. Given past practice, it was not contemplated that the Provincial Auditor would find such transactions problematic.

It is an unfortunate truth that Manitoba's legislation in relation to the teachers' and public servants' pension plans is written in such a way as to include administrative matters which are not normally covered by legislation. The allocation of funds between accounts is clearly one such matter. It was deemed to be in the greater public interest to proceed with the negotiated agreement implementation consistent with an established past practice.

It is accepted that government and pension plan administrators may well have to take remedial action if the appropriate legislative amendments do not proceed at a future date as promised. To cease increased pension payments at this time, as suggested by the Provincial Auditor, would be an unnecessary and unwelcome action towards Manitoba's retired teachers, resulting in a backlash from this group, many of whom are on fixed incomes.

The Minister of Education's commitment and an established past practice is sufficient to continue the pension plan payments pending the legislative amendments.

In conclusion, it should be re-emphasized that there was no intention to undermine the authority of the Legislature. Rather, it was the belief of officials that it was in the greater public interest to implement a negotiated agreement at the earliest possible date, consistent with past practice and subject to future legislative amendments.

JANUARY 22, 2001 LETTER TO THE PRESIDENT/CEO OF TRAF FROM THE MINISTER OF EDUCATION

Exhibit A

MINISTER OF EDUCATION AND TRAINING

Room 168
Legislative Building
Winnipeg, Manitoba, CANADA
R3C 0V8

January 22, 2001

Mr. Tom Ulrich
President/CEO
Teachers' Retirement Allowances Fund (TRAF)
Room 330 Johnston Terminal
Winnipeg MB R3C 4S8

Dear ~~Mr. Ulrich:~~ Tom,

Re: Cost-of-Living Adjustment for Retired Teachers

I have been advised that Government representatives and the Manitoba Teachers' Society (MTS) have reached agreement on a cost-of-living adjustment (COLA) for retired teachers to be effective July 1, 2000. The Government has agreed to commit $836,000, the amount set out in the Department's 2000/01 estimates, to cover Government's share. MTS has agreed to support the transfer of $836,000 from Account A of the Teachers' Retirement Allowances Fund (Fund) to the Pension Adjustment Account (PAA) to cover the teachers' share of the cost of a COLA. I understand that the Government's $836,000, along with a matching amount transferred to the PAA from Account A, would be sufficient to provide retired teachers with a 2% COLA effective July 1, 2000.

I am advised that a legislative amendment to *The Teachers' Pensions Act* is required to accomplish a transfer of $836,000 from Account A to the PAA. It is my intention to introduce an amendment to that effect during the spring session of the legislature. Since all parties are in agreement and

.../2

Mr. Tom Ulrich
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wish to proceed as soon as possible, I am requesting that TRAF accept this letter and my commitment to introduce the required legislative amendment during the spring session, as authority to immediately transfer $836,000 from Account A to the PAA and commence paying the agreed COLA to retired teachers.

Thank you.

Yours sincerely,

Honourable Drew Caldwell
Minister
Education, Training and Youth

c. Dr. Ben Levin
Lawrence Grant
Brian Hanson

Exhibit B

JANUARY 22, 2001 LETTER TO THE MINISTER OF EDUCATION FROM THE PRESIDENT/CEO OF TRAF

TRAF

TEACHERS' RETIREMENT ALLOWANCES FUND

January 22, 2001

The Honourable Drew Caldwell
Minister of Education
Room 168, Legislative Bldg.
450 Broadway
Winnipeg, MB
R3C 0V8

Dear Drew:

Re: ***Cost of Living Adjustment for 2000 - Your letter of January 22, 2001***

I am in receipt of your letter of January 22, 2001 informing TRAF of the agreement between the Government of Manitoba and The Manitoba Teachers' Society to provide for a cost of living adjustment effective July 1, 2000. The adjustment is to be equal to that which can be supported by the Government providing $836,000 to pay its one-half share of the adjustment during the 2000-2001 fiscal year, with the Pension Adjustment Account (PAA) paying for the other half. As we had previously advised Larry Grant, that would provide for a 2% cost of living adjustment.

You advised me that it has also been agreed to permit the transfer of funds from Account A to the PAA to cover the projected cost of paying such adjustment, and that you will introduce an amendment to that effect. I need to clarify that the PAA is required to fund the additional liability created by the payment of the cost of living adjustment. According to the report of the actuary dated May 8, 2000, the liability created in the PAA as currently structured for each 1% granted as a cost of living increase in 2000 equals $7,479,259. Since the PAA as at December 31, 2000 was in a deficit position of $662,493, the payment of a 2% cost of living adjustment as at July 1, 2000 will require the amount of $15,621,010 to be transferred from Account A to the PAA.

The proposed amendment to the Teachers' Pensions Act authorizing the transfer of funds from Account A to the PAA should provide authorization for transfer of that amount. Please confirm that this is consistent with the agreement of the parties and with the proposed legislative amendment and we will commence payment of the 2% adjustment.

We await your reply.

Sincerely yours

Tom Ulrich
President/CEO

c. Dr. Ben Levin, Deputy Minister
Brian Hanson, Director, Administration & Professional Certification
Larry Grant, Director, Compensation Services, Civil Service Commission

Room 330 Johnston Terminal
25 Forks Market Road, Winnipeg, MB R3C 4S8
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JANUARY 31, 2001 LETTER TO THE PRESIDENT/CEO OF TRAF FROM THE MINISTER OF EDUCATION

Exhibit C

MINISTER OF EDUCATION AND TRAINING

Room 168
Legislative Building
Winnipeg, Manitoba, CANADA
R3C 0V8

January 31, 2001

Mr. Tom Ulrich
President/CEO
Teachers' Retirement Allowances Fund
Room 330 Johnston Terminal
Winnipeg MB R3C 4S8

Dear ~~Mr. Ulrich~~: Tom,

Re: Cost-of-Living Adjustment for Retired Teachers

This will acknowledge receipt of your letter dated January 22, 2001, which is in response to my letter to you on January 22, 2001, concerning the subject captioned above.

You have advised, that in order to pay the agreed Cost-of-Living Adjustment (COLA) to retired teachers effective July 1, 2000, a transfer of $15,621,010 from Account A in the Fund to the Pension Adjustment Account (PAA) is required. I understand that $15,621,518 is the sum of the additional liability ($14,958,518) which paying a 2% COLA would create in the PAA and an additional amount to cover the $662,493 deficit in PAA as at December 31, 1999.

I understand that the transfer of $15,621,518 from Account A to the PAA does not increase the Government's cost of the agreed COLA and is merely an administrative matter of moving money within the Fund to cover the teachers' share of the cost of the COLA payment. Based on this understanding, I can confirm that it is my

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Mr. Tom Ulrich
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intention to introduce the legislative amendment necessary to accomplish a transfer of $15,621,518 from Account A to the PAA and would request that you accept this letter as authority to immediately commence paying the agreed COLA to retired teachers.

Thank you.

Yours sincerely,

All the best!

Honourable Drew Caldwell
Minister
Education, Training and Youth

c. Dr. Ben Levin
Brian Hanson
Larry Grant

Exhibit D

JANUARY 31, 2001 MEMO TO THE TRAF BOARD FROM THE PRESIDENT/CEO OF TRAF

TRAF

TEACHERS' RETIREMENT ALLOWANCES FUND

MEMORANDUM

January 31, 2001

To: TRAF Board

From: Tom Ulrich, President & CEO

Re: **Pension Adjustment Account**

You have received a copy of the letter from the Minister and my response. Further discussions have ensued with the Province regarding the need to introduce legislation authorizing the transfer sufficient funds from Account A to the Pension Adjustment Account to give effect to the agreement between the Province and The Manitoba Teachers' Society. Today we received confirmation from the Province of their commitment to introduce appropriate legislation to accomplish the payment of a 2% Cost of Living Adjustment (COLA) for the year 2000 (copy attached).

Time has become of the essence. If the payment is to be made within the context of the Province's current fiscal year (ending March 31, 2001) the adjustment must be made on the February pension payroll. For TRAF to proceed with that we require your authorization at today's meeting.

Authorizing legislation is critical to this process. The TRAF Board does not have the authority to transfer assets from Account A to the PAA. Pursuant to Section 10(8) of the Act, the TRAF Board is not permitted to pay a COLA that would create an unfunded liability in the PAA. In the event the PAA does not have sufficient funds during any year to pay a full COLA, the COLA is to be actuarially reduced to the amount the PAA can afford to pay, hence the non-payment of a COLA at July 1, 2000. To pay a 2% COLA retroactive to July 1, 2000, the PAA must be put in the same financial position that would have been required to pay a 2% COLA on July 1, 2000. To accomplish that requires a transfer of $15,621,010 from Account A to the PAA effective January 1, 2000.

It is therefore recommended, assuming the TRAF Board wishes to facilitate the payment of the 2% COLA effective July 1, 2000, as agreed between the Province and The Manitoba Teachers' Society, that the TRAF Board pass the following motion:

That payment of a 2% COLA effective July 1, 2000 be approved based on the receipt from the Minister of Education and Training of a letter dated January 31, 2001 providing assurance that legislation will be introduced authorizing TRAF to transfer $15,621,010 from Account A to the Pension Adjustment Account.

Room 330 Johnston Terminal
25 Forks Market Road, Winnipeg, MB R3C 4S8
Phone: (204) 949-0048 Fax: (204) 944-0361 Toll Free: (800) 782-0714
Website: www.traf.mb.ca e-mail: info@traf.mb.ca

EXTRACT OF SECTION 10(8) FROM THE TEACHERS' PENSIONS ACT

Exhibit E

"Actuarial reduction in pension adjustment

10(8) If, in the opinion of the actuary, payment in any year of the total pension adjustments provided for under this section would result in an unfunded liability as at December 31st, of the preceding year, in the pension adjustment account established for the payment of the fund's share of such adjustments, the level of the Consumer Price Index for Canada at the end of the year in which the calculations under Sub Section (7) are based, shall be deemed to be at such a level as will, in the opinion of the actuary, result in no unfunded liability in the pension adjustment account."

REVENUE SYSTEM REVIEW

Table of Contents

Introduction

The Province of Manitoba receives revenue from three main sources: Taxation; Government of Canada; and Other Revenue. Included in Other Revenue is a myriad of systems for the collection of small and large revenue sources by the various departments within government. Revenue from Taxation, the Government of Canada and some larger Other Revenue sources are audited by our office through our audit of the Public Accounts.

Between October, 1999 and February, 2000, we conducted a review of departmental revenue systems. The review included 17 systems within six departments totalling approximately $14.5 million per the Manitoba Estimates of Revenue for the fiscal year ending March 31, 2000. The systems reviewed and their estimated revenue are as follows:

FIGURE 1

Revenue System Review

Department/System	*Estimates of Revenue March 31, 2000 (000s)*
Culture, Heritage and Citizenship	
Manitoba Film Classification Board	$ 338.5
Statutory Publications	793.8
Labour	
Elevator permits	400.0
Pension Commission	465.0
Boiler inspection fees	775.0
Gas and oil permit fees	920.0
Trade licence fees	92.0
Agriculture and Food	
Veterinary Diagnostic Services	673.4
Health	
Cadham Lab	200.0
Selkirk Mental Health Centre	1,859.8
Air Ambulance	1,000.0
Consumer and Corporate Affairs	
Commissioner for Oaths	135.0
Permits and licences	350.0
Insurance Act fees	762.0
Residential Tenancies fees	121.5
Family Services and Housing	
Child Tax Benefits	5,250.0
Post-adoption search and registration fees	370.0
	$ 14,506.0

Scope And Audit Approach

We planned our audit work in conjunction with our office's responsibilities to audit the Public Accounts of the Province of Manitoba. We chose a sample of departments based on the cyclical audit schedule determined for review as per our Public Accounts audit approach for the year ended March 31, 2000. Systems from the identified departments were selected after review of Other Revenue contained within the Manitoba Estimates of Revenue for the fiscal year ending March 31, 2000.

Our audit approach for each system included documentation of the system followed by the performance of a walkthrough test. We then performed substantive testing of the system as we considered necessary in the circumstances. Our testing also included a review of fees charged in compliance with applicable legislation.

Findings

We noted weaknesses in six of the systems that we tested. Many of the revenue systems that we audited are very small in terms of the dollar amounts involved and the number of employees administering the particular system. As a result, it is impractical to segregate duties in three of the systems. These included the Manitoba Film Classification Board, Veterinary Diagnostic Services and Commissioner for Oaths revenue systems. Three other systems, Cadham Lab, Air Ambulances and Post-Adoption Search and Registry fees had minor weaknesses of a procedural nature.

Recommendations

We recommended that certain compensating controls be implemented where segregation of duties was impractical and that the minor weaknesses be rectified.

In all instances, corrective action was implemented and all weaknesses have been rectified.