Auditor General
MANITOBA

Report to the Legislative Assembly

Understanding our Audit Opinion on Manitoba's March 31, 2018 Summary Financial Statements

– September 2018 –

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To focus our attention on areas of strategic importance to the Legislative Assembly, and to provide Members of the Legislative Assembly with reliable and efficient audits.

Our mission includes easy-to-understand audit reports that include discussions of good practices within audited entities, and recommendations that, when implemented, will have a significant impact on the performance of government.

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September 2018

The Honourable Myrna Driedger
Speaker of the House
Room 244, Legislative Building
450 Broadway
Winnipeg, Manitoba R3C 0V8

Honourable Ms. Driedger:

It is an honour to provide you with my report titled, *Understanding our Audit Opinion on Mantioba's March 31, 2018 Summary Financial Statements,* to be laid before Members of the Legislative Assembly in accordance with the provisions of Sections 10(1) and 28 of *The Auditor General Act*.

Respectfully submitted,

Norm Ricard, CPA, CA
Auditor General

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AG Comments

Issuing a qualified audit opinion is not something I took lightly. It is the single most important communication an auditor can have with the users of financial statements. A qualification highlights where users need to be cautious when relying on the financial statements it is attached to.

My staff and I care deeply about ensuring the public sector financial statements we audit comply to both the letter and the spirit of the applicable accounting standards. In so doing we believe we are having a strong impact in ensuring public sector entities provide the Legislative Assembly with meaningful, comparable, consistent and fairly presented financial statements. Our recently minted vision, mission and values statements speak to this passion.

It is very important that users of audited financial statements (and with respect to the opinions my Office issues, the Legislative Assembly and the public at large) understand that an audit opinion is not simply a casual point of view, as the word opinion may suggest. Rather, it is based on a rigorous evidence based process, conducted by experienced designated accountants. My office adheres strictly to Canadian Auditing Standards developed by the Chartered Professional Accountants of Canada. And in addition to our internal supervisory and quality assurance processes, we participate in external peer reviews. All this to say that an audit opinion issued by my Office, whether it is signed by me personally, as is the opinion on the Province's Summary Financial Statements, or as "Office of the Auditor General" as are most other audit opinions issued by my Office, the Members of the Legislative Assembly and the general public can be confident that the "opinion" represents a strong, evidence based conclusion on the reliability of the referenced financial statements. When we say the statements comply with public sector accounting standards or that certain aspects don't comply with the standards, know that such statements are made by an independent office of the Legislative Assembly and are supported by an objective, unbiased and demanding process.

It should be no surprise to anyone that the government is taking exception to our qualification, as is evidenced by their comments which I have attached. Nevertheless, we remain committed to working in a proactive and collaborative manner with the Comptroller's office in assessing the appropriateness of proposed accounting solutions to ensure continued or enhanced transparency and accountability within the areas in question, and that accounting standards are well understood and applied.

I would like to express my sincere thanks and appreciation to all my team members for their exceptional work.

Norm Ricard, CPA, CA
Auditor General

1 Background

1.1 What does a qualified opinion mean?

THE STANDARD AUDITORS REPORT – AN UNQUALIFIED OPINION

At the conclusion of every financial statement audit, an auditor issues a report containing the auditor's opinion on whether the financial statements are presented fairly. The standard audit opinion is an unqualified opinion which concludes that, in the auditor's opinion, the financial statements present fairly, in all material respects, the financial position and results of the entity being audited in accordance with the accounting framework they were prepared under.

Essentially, an unqualified audit opinion indicates the financial statements are reliable, and that they are prepared based on the relevant Generally Accepted Accounting Principles (GAAP) or accounting standards.

CANADIAN PUBLIC SECTOR ACCOUNTING STANDARDS

For governments in Canada, the relevant GAAP is Canadian Public Sector Accounting Standards (PSAS). PSAS are a set of standards specifically designed for the Canadian public sector by an independent standard setting body, the Public Sector Accounting Board.

Adhering to independently set financial reporting standards is critical to promoting public confidence in the financial statements prepared by public sector entities. Standards help ensure consistent reporting of financial transactions which allows for comparability of results – from period to period and between jurisdictions.

QUALIFIED AUDIT OPINIONS

When an auditor has significant concerns about an entity's compliance with GAAP, a qualified audit opinion is issued. Qualified opinions explain the concerns an auditor has with the quality and accuracy of financial reporting.

Qualified opinions should be a rare occurrence and should be taken seriously.

MANITOBA PREVIOUSLY RECEIVED UNQUALIFIED AUDIT OPINIONS EVERY YEAR SINCE 2008

We have issued an unqualified audit opinion on the Province of Manitoba's Summary Financial Statements every year since 2008. In 2006 and 2007, we issued a qualification based on the non-consolidation of the public school divisions. We noted that this was a temporary departure from PSAS that was disclosed in the summary financial statements, and that it was due to the time required for the school divisions to change their accounting systems. In 2008 the school divisions were consolidated and an unqualified opinion was issued.

1.2 Government's focus on reducing volatility in financial results

The public sector accounting standards are designed to ultimately show a government's performance and financial position by accounting for the full nature and extent of the resources and programs it controls. We emphasize the importance of summary financial reporting for governments, because whether a government department directly provides a program, or a government agency or board controlled by government delivers the program, it is ultimately part of the government's resources and should be considered in its financial results. Financial statements for the Government Reporting Entity (GRE) should be prepared to provide an understandable overview of the full nature and extent of the financial affairs and resources which the government controls. A focus on the GRE rather than core government (departments) ensures the bottom line cannot be impacted by decisions on where to house programs (inside or outside of departments) and their funding structure.

The Manitoba government has been reporting exclusively on a summary basis since 2007, and has recently begun to more actively manage on a summary basis. However, government officials, in the 2018 Budget document and in discussions with our office, expressed a concern that financial volatility in some components of government (particularly components managing restricted purpose funds where monies are not available to government for other purposes) can have a significant impact on the government's annual results. As a result, the government is looking for ways to reduce the GRE's exposure to this type of volatility. The qualifications as discussed below are both due to accounting decisions taken by government to reduce the volatility of reported results.

Summary reporting should be based on all resources the government controls. Consistent application of the criteria for control under PSAS is important. A government cannot add or delete entities or programs from its summary reporting unless changes are made in its relationship with these entities (to either give up control or gain control of the entity). Changes to the legal form of a relationship do not necessarily change the substance of the relationship. The exclusion of entities from the government reporting entity that are still controlled by the government does not provide a complete picture of the financial position and results of government.

We understand the government's desire to better segregate the impact of activities within restricted purpose funds from general operations. But eliminating their impact on the summary deficit or surplus must be given careful consideration to ensure continuing transparency and accountability for the funds in question, and that accounting standards are not compromised.

2 Our 2018 audit opinion contains 2 qualifications

For the first time since 2007, the Auditor General has issued a qualified audit opinion on the Province of Manitoba's summary financial statements. In the qualified opinion, we note that:

> *In our opinion,* ***except for the effects of the matters described in the Basis for Qualified Opinion paragraphs,*** *the consolidated financial statements present fairly, in all material respects, the financial position of the Province of Manitoba as at March 31, 2018, and the results of its operations, the changes in its net debt, and its cash flows for the year then ended in accordance with Canadian public sector accounting standards.*

Our qualifications on Manitoba's summary financial statements relate to the government not complying with Generally Accepted Accounting Principles (GAAP) and highlight that there are material misstatements in the summary financial statements. However, these errors are isolated to certain areas, which we have described in our "basis for qualified opinion" paragraphs and are explained further below. We were able to provide assurance that, other than the matters described in our audit opinion, the summary financial statements are not materially misstated.

2.1 Removal of Workers Compensation Board from the government reporting entity

During 2018, government reassessed whether they controlled the Workers Compensation Board (WCB). As described in Note 18 of the summary financial statements, control was reassessed based on "*a review of other jurisdictions accounting policies and legislation on their workers compensation boards*". Government concluded that they did not control the WCB.

Public sector accounting standards include criteria for evaluating whether an entity is controlled by government. Control is the power to govern the financial and operating policies of another organization with expected benefits or the risk of loss to the government from the other organization's activities. A government may choose not to exercise its power; nevertheless, control exists by virtue of a government's ability to do so.

ASSESSMENT OF CONTROL SHOULD BE BASED ON THE CRITERIA FOR CONTROL

Note 18 of the summary financial statements indicates that government reassessed its control of WCB based on a review of other jurisdictions' accounting policies and legislation on their workers compensation boards or equivalents. Whether a control relationship exists between a government and a public sector entity should be determined based on the substance of the relationship between the 2 parties, considering the criteria for control, and not based on how similar entities in other provinces are accounted for. The relationship between a government and its workers compensation board will not necessarily be the same as that found in other jurisdictions.

We acknowledge that the worker's compensation boards or equivalents of most other Canadian provinces are not considered controlled and therefore excluded from the summary financial statements of those provinces. We did not do a detailed analysis of the circumstances in each of these other provinces that led decision makers and auditors (several years ago) to determine that the entities were not controlled.

Rather, we performed an analysis based on the criteria for control in PSAS, and the relationship between the Province and the WCB as defined in the Workers Compensation Board Act (the Act). We believe the following factors indicate that government controls the WCB:

- All WCB board members are appointed by government. While the government must consult with relevant stakeholder groups for the purpose of making board appointments, the ultimate authority and discretion in appointment lies with government.
- The WCB may make regulations on many areas impacting its operations, as described in section 68(1) of the Act. However government can disallow within 30 days any regulation that the Board makes, ultimately providing government with the power to control these areas of operations.
- Government controls the scope of WCB and its revenue generating capacity through the regulation it enacts to control which types of employers must pay premiums into the accident fund. In Manitoba, the Act covers 76%[1] of the workforce, while in other provinces and territories, the percentage of the workforce covered varies from 74% to 100%, with many provinces in the 90% range, so control over the scope can have a significant impact on WCB's reach.
- WCB must provide a grant to government from its accident fund to cover expenses incurred by government in its administration of the Workplace Safety and Health Act. In the year ended December 31, 2017, WCB paid $8.7 million to the Province for this purpose.

[1] Workforce coverage ratios from: http://awcbc.org/wp-content/uploads/2013/12/Industries_Occupations_Covered.pdf

NO CHANGE IN CIRCUMSTANCES TO TRIGGER CHANGE IN ASSESSMENT OF CONTROL

As defined by PSAS, control of an entity by government is a question of fact, but it is not always clear and may require the application of professional judgement. Once a determination of control is made, it should not be changed unless there are identifiable changes to the relationship or the criteria used for assessing if control exists. If a government was able to change its assessment of control, from time to time, without any changes in the underlying relationship, this would lead to inconsistent financial reporting, potentially influenced by the desire to achieve new or revised financial objectives of government.

WCB has been considered a part of the government reporting entity since it was first defined in 1988. The criteria for control under PSAS were last revised in 2005. At that time the Department of Finance assessed the relationship between government and the WCB against the new criteria and came to the conclusion that government controlled WCB, and we agreed.

There have been no significant relevant changes in the Workers Compensation Act since 2005 to trigger a reassessment of control.

In the 2018 Summary Budget, government discussed its objective of reducing volatility. WCB's 5-year plan covering 2016 to 2020 shows that because of a build-up in assets over the years, the WCB was projected to decrease assessment rates and revenue, and begin to incur operating deficits in the year ended December 31, 2018. As such, removing WCB from the GRE would also remove this volatility of the reported summary results. The government's desire to reduce volatility in the summary results may have influenced their assessment of control.

2.2 Unauthorized government transfer recorded

The Government recognized an expense as at March 31, 2018 for a $265 million transfer from Manitoba Agricultural Services Corporation's (MASC) insurance reserve funds to 2 trust accounts they had not yet created. We have 2 main concerns with this transaction. First, the transfer was not authorized before March 31, 2018, and as such there was no liability to record at March 31, 2018. Secondly, it is not clear whether these insurance trust accounts should be accounted for outside the government reporting entity.

TRANSFER NOT AUTHORIZED BEFORE MARCH 31, 2018

A government transfer occurs when a government provides funds to another organization. A transfer is not to pay for a specific good or service, and has no expectation of future repayment or return on investment.

Under PSAS, a government transfer should be recognized by a transferring government as an expense in the period the transfer is authorized and all eligibility criteria of the recipient have been met by the recipient. Regarding the transfer to the MASC trust accounts, there are no eligibility criteria so recognition is based on when the transfer is authorized. PSAS provides criteria that must be met in order for a transfer to be considered authorized. There are 2 possible situations that can support authorization.

The first situation where authorization occurs is when (emphasis is ours):

(a) There is evidence that both of the following have occurred by the financial statement date:
(i) The enabling authority to provide a transfer is in place, which is conveyed through approved legislation, regulations or by-laws of the transferring government, and
(ii) **an exercise of authority** under that approved legislation, regulations or by-laws **has occurred**. In essence, a decision has been made by the transferring government under the approved legislation, regulations or by-laws that **clearly demonstrates that it has lost its discretion to avoid proceeding with the transfer**.

Under its legislation, MASC has the authority to make payments from the insurance funds. But in our view, the authority had not been exercised as of March 31, 2018, because the trust account agreements and the contribution agreements were not signed until September 2018. Government officials stated that Treasury Board had approved the creation of the trust accounts before March 31, 2018 and as a result had lost discretion to avoid the transfer. We concluded there was no loss of discretion when it came to making this transfer because the agreements had not yet been signed. We see no reason why the decision to proceed with the transfer could not be reversed up until the time all agreements were signed.

The second situation that can support authorization is when:

(b) There is evidence that both of the following have occurred:
(i) Actions and communications of the transferring government by the financial statement date clearly demonstrate that it has lost its discretion to avoid proceeding with a transfer and thus the government is demonstrably committed to approving the enabling legislation, regulations or by-laws for the transfer and proceeding with the transfer; and
(ii) Final approval in the stub period of the enabling legislation, regulations or by-laws confirms that the transferring government was demonstrably committed to approving and proceeding with the transfer at the financial statement date.

There were no actions and communications prior to March 31, 2018 which indicated a loss of discretion. There was no clear communication of this plan to the public or stakeholders (MASC's insurance policy holders) that would imply the government was committed to this transfer during fiscal 2018.

In our view, the criteria for authorization of a government transfer were not met at March 31, 2018. As such the transaction should not have been recorded in fiscal 2018.

WE ARE CONDUCTING AN IN-DEPTH ANALYSIS OF THE TRUST ARRANGEMENT

The government worked on the specific details of the trust and contribution agreements well into September 2018. As a result, the terms of the trust agreements were not finalized until mid-September. Given this timing, we have not yet completed our analysis of whether the trusts should be accounted for outside the government reporting entity.

Our future assessment of the trusts does not impact this year's qualification because regardless of whether the trusts are included in the GRE or not, the authorization for the transfer was not in place at year end.

3 Going forward

A qualified audit opinion is a serious matter as it indicates a significant departure from the proper application of Canadian public sector accounting standards. We are prepared to work in a proactive and collaborative manner with the Comptroller's office in assessing the appropriateness of proposed accounting solutions to resolve identified concerns with summary reporting.

3.1 Workers Compensation Board

Based on the current legislation, in our view, the WCB is controlled by the government and should be included in the government reporting entity. In order to change the relationship of control, there must be some change in the legal structure of the relationship. As long as the government maintains the powers noted in section 2 of this report, the government controls WCB. Continuing to exclude the WCB from the summary financial statements in future years without any changes in the relationship will, by necessity, result in an ongoing qualification to our audit opinion.

3.2 Manitoba Agricultural Services Corporation Trusts

As noted in section 2.2, we are reviewing whether the trust accounts should be accounted for outside the government reporting entity. This assessment will impact next year's audit.

Response from officials

RESPONSE FROM THE GOVERNMENT OF MANITOBA

Our government was elected on a solemn commitment to bring transparency and accountability back to the Manitoba Legislature. That commitment – restoring honesty in government -- is the foundation for all that we do as a government. It is what guides us in each of our decisions and, in particular, the manner in which we report on the finances of our province. We also committed to reduce structural deficits and move towards a balanced budget. One of those decisions was the commitment to clean up the books we inherited from the previous government, by removing assets that are not government property; and by valuing assets and liabilities more accurately.

That is exactly what we have done in the public accounts for the 2017/18 fiscal year. Improperly claiming the money of the Workers Compensation Board (WCB) as a government asset, and showing the fluctuations in the stability and insurance funds in the Manitoba Agricultural Services Corporation (MASC), painted a misleading picture of the structure of Manitoba's finances. Funds held by the WCB is not our money and should not be treated as such for financial reporting purposes. For MASC, the past practice of growing or draining an insurance fund, and then reporting the associated income or losses as part of the government's finances, could materially misrepresent the overall financial position of the Province.

These decisions were not motivated by self-interest. In fact, the necessary adjustments we have made are adverse to our own financial results.

The Office of the Auditor General has expressed concern with these professional judgements, but they were made in a manner wholly compliant with Public Sector Accounting Standards (PSAS). With respect to WCB, we are now taking the exact same accounting position as has been taken by eight other provinces and their respective Auditors General. With respect to MASC, the decision to fully isolate its insurance funds from government was irrevocably made by our government's Treasury Board several weeks prior to the end of the fiscal year.

Below is a more detailed explanation as to why it is our opinion that the OAG has erred in issuing a qualified audit opinion in this instance. This explanation is wholly consistent with our government's commitment to transparency and accountability. It is a commitment we will neither retreat from nor apologize for.

RESPONSE FROM THE PROVINCIAL COMPTROLLER

2.1 Removal of Workers Compensation Board from the government reporting entity (GRE)

The Department did perform a jurisdictional scan and found that Manitoba and Saskatchewan are the only jurisdictions in Canada that consolidate their equivalent of the Workers Compensation Board (WCB), despite the similarities in legislation.

A review of control indicators at the WCB was not performed for a number of years. The only review the department could locate went back to 2005. Based on the age of the previous assessment, and the fact that Manitoba was an outlier, an updated control assessment was required by the department. Our updated analysis indicated the "government's had no ongoing access to the assets of the organization, and the ability to direct the ongoing use of those assets". We discovered that what we previously viewed as a persuasive indicator was not considered by other provinces to be a persuasive indicator of control. The Lieutenant Governor in Council appoints the board; two thirds of the board are nominees of the employers and employees. In fiscal 2017/18, we removed the WCB from Manitoba's GRE based on these findings. The prior inclusion of the WCB was an error that required a correction through a restatement of past financial statements.

Regulations of WCB Board of Directors 68(1):

Section 2.1 of the OAG report also discusses the regulatory environment of the WCB. Under section 68(1) of the WCB Act, the WCB directors may make regulations concerning minimum annual earnings, deductions, benefits, and benefit programs. However the government can disallow within 30 days any regulation that the board makes, thereby indicating that the government has the power to control these areas of operations.

As per PSAS, a government's ability to regulate an organization, does not in and of itself, constitute control. Government may establish the regulatory environment in an industry or sector within which organizations operate and impose conditions or sanctions on their operations. The governing bodies of those regulated organizations make independent decisions within the regulatory framework.

The government regulates safety and health at all workplaces in Manitoba but does not consolidate them into the Province's Summary Financial Statements. There are many other examples such as daycares and child welfare agencies that are regulated but not controlled. The WCB makes its own regulations, much like any other board in the Province, but the WCB regulations must comply within the regulatory framework of the Province. This is not the same as saying that the Province controls their operations. The WCB is free to make whatever decisions it chooses over its own operations.

Changes within the Government Reporting Entity (GRE):

Section 2.1 of the OAG report suggests, that once a determination of control is made, the decision cannot be reversed, unless there are identifiable changes to the relationship or criteria used for assessing control. To suggest that governments cannot review their application of PSAS is an extraordinary claim that we can find no support for in PSAS.

Further, there are no recommendations in the standards that would prohibit the government from reviewing the entities that are in the GRE. The fact is that the Province has added multiple entities into the GRE over prior years and the OAG has agreed with those additions. This has led to the inclusion of Deposit Guarantee Corporation of Manitoba, the not-for-profit personal care homes, and a number of smaller reporting entities in the past.

If it is possible to add entities to the GRE, then it must also be possible based on an analysis of the entities, to remove entities from the GRE. The PSAS standards do however provide for the correction of an error. Not restating the financial statements impairs the fairness and comparability of prior periods. The correction of the error is reported retroactively, as we have done. After the error was discovered in 2017/18, the financial statements of prior period were restated in accordance with PSAS. Our conclusion was that our assessment of control over the WCB needed to be revised, to produce reliable and relevant results for the public, creditors and other stakeholders.

2.2 Unauthorized government transfer recorded

In fiscal 2017/18, the Province established two trusts for the benefit of agricultural producers with the authorization of Government of Manitoba. The authorization occurred in February 2018. The approval of government was in place but there were still additional details of the trust arrangements to complete that required due diligence on the part of the trustee. These details were resolved during the "stub period" from April 2018 to September 2018. The agreements were executed in September 2018.

It is the position of Manitoba that the standard for authorization of a government transfer is met under both of the two situations outlined in the accounting standards. The department of Agriculture had sufficient enabling authority by way of surplus and reserve balances and operated within the existing legislation to effect the transfer. The decision direction and authority, to recognize a transfer to the trusts was made by cabinet in February 2018, well in advance of the year end date.