OFFICE OF THE
AUDITOR GENERAL
MANITOBA

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The Auditor General Act, Section 10 Annual Report

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Accounts and Financial Statements

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Highlights of this chapter

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

We are pleased to report that for 2011/12, we once again issued an unqualified audit opinion on the government's Summary Financial Statements, which means that the summary statements are presented fairly in accordance with Canadian public sector accounting principles. We are also pleased to report most organizations consolidated into the Summary Financial Statements received unqualified audit opinions.

Understanding the purpose of the Summary Financial Statements and the Summary Budget is important in order to evaluate the government's financial affairs. As a result, we have explained in **section 1** the Summary Budget and the Summary Financial Statements. In light of these comments, we provided commentary on our office's current audit mix.

In order to help legislators understand the results of the Summary Financial Statements, in **section 1** we have defined net debt, total borrowings, the accumulated and annual surplus or deficit, the change in net debt and the cash position and cash flow. As well, we have explained the difference between the 3rd quarter forecast and the final 2011/12 actual results and have explained the variance between the actual deficit versus the budgeted deficit for 2011/12.

In **section 2**, we have listed significant matters that arose from our financial statement audits. We report that:

- additional information about personal income tax revenue is available but is not being used to estimate the year-end revenue figures.
- healthcare liabilities recorded by the government are not reconciled to those recorded by the Regional Health Authorities.
- environmental liabilities are not revalued.
- the International Polar Bear Conservancy Centre is recorded as an asset but should be expensed.
- Leaf Rapids Town Properties Ltd. is not financially viable.

Section 3 provides status updates on our prior year recommendations. **Section 4** contains a listing of our recommendations provided in this report.

Financial statement matters and recommendations

1. Summary Financial Statements

1.1 Our responsibility and auditor's report

Our responsibility is to audit the Summary Financial Statements, form an opinion based on our audit and issue our auditor's report. We conduct our audit in accordance with Canadian generally accepted auditing standards (GAAS). The standards outline the processes and procedures an auditor should follow to ensure the audit is carried out appropriately.

Our auditor's report on the Summary Financial Statements as at March 31, 2012 presents an unqualified opinion. The unqualified opinion indicates that we found the statements were fairly presented in accordance with Canadian accounting standards.

1.2 Responsibility for the preparation of the Summary Financial Statements

Section 65(1)(a) of *The Financial Administration Act* requires that the Comptroller must prepare for each fiscal year the public accounts that include Summary Financial Statements. At the direction of the Minister of Finance, the Comptroller has prepared and presented fairly the Summary Financial Statements in accordance with generally accepted accounting principles (GAAP). In the case of governments (Canada, Provinces and Municipalities), GAAP is established by the Public Sector Accounting Board (PSAB) of the Canadian Institute of Chartered Accountants (CICA) after broad consultations with stakeholders.

To prepare financial statements in accordance with GAAP, the Provincial Comptroller is required to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. The Provincial Comptroller is responsible for preparing the Summary Financial Statements, including related notes and schedules. The Provincial Comptroller is also responsible for internal controls, to the extent she deems them necessary to prepare Summary Financial Statements that are free from material misstatement whether due to error or fraud. The Provincial Comptroller confirms this by signing the *Statement of Responsibility* preceding our audit report which is included in the Province of Manitoba Annual Report.

In organizations which are governed by an independent board of directors, generally the board approves the financial statements on the recommendation of the audit committee. This governance structure does not exist for the Province as a whole, but PSA standards require that an audit committee equivalent approve the financial statements. In Manitoba, the audit committee equivalent consists of the Minister of Finance, Deputy Minister of

Finance, Secretary to the Treasury Board and Associate Secretary to the Treasury Board. While these individuals are not independent, as would be the case in a public company, having an audit committee equivalent provides the opportunity for greater scrutiny. The main responsibility for the audit committee equivalent is to review the Summary Financial Statements and address recommendations issued by our office.

1.3 Why Public Sector Accounting Standards?

The Province follows the accounting standards set by the Public Sector Accounting Board (PSAB) of the Canadian Institute of Chartered Accountants (CICA). PSAB has 12 board members who are appointed as individuals, not as representatives of governments. Task forces are created to address specific issues. The Board and task force members may include government representatives and auditors consisting of Deputy and Assistant Deputy Ministers of Finance and Municipal Affairs, comptrollers, legislative and municipal auditors, budget directors and municipal treasurers, as well as academics, bond-raters and other experts in government accounting and auditing.

PSA standards are a high quality set of accounting standards designed specifically to meet the needs of the users of government's financial statements in Canada. The accounting standards are set nationally and developed using a rigorous process that encourages input from all stakeholders. New standards or changes to existing standards are proposed by the PSAB in the form of exposure drafts. The exposure drafts are then made public and stakeholders are invited to send comments on the proposed changes. Stakeholders include governments, auditors, and the users of government financial statements. This process creates fair, reasonable standards that will allow for consistent reporting of governments across Canada to allow for comparison and evaluation of results. The process helps to eliminate arbitrary selection of rules.

1.4 What are the Summary Financial Statements and Summary Budget?

The Summary Financial Statements reflect the financial position and annual results of all organizations in the Government Reporting Entity (GRE). The GRE consists of government departments, special funds and all organizations the government controls. PSA standards define control as the power to govern the financial and operating policies of an organization.

The list of organizations in the GRE is in Schedule 8, pages 108-111, of the government's 2012 Annual Report. The organizations in the GRE include Government Business Enterprises (GBEs), Public Schools, Government Not for Profit Organizations, and Other Government Organizations.

Under PSA standards, a summary reporting model is the only appropriate reporting model for governments. A government's Summary Financial Statements should provide the accounting for the full financial affairs and resources, including those of its agencies and enterprises. The Summary Financial Statements are important as they provide the results of how the government has managed its financial affairs and resources. Summary Financial Statements recognize that, even though separate legal or organizational entities make up the GRE, together they make up a single economic unit. Combining the results of all entities in the GRE ensures that the Summary Financial Statements reflect only transactions and balances with third parties and helps users of the statements gain an overall understanding of the government's financial results.

Summary Budget

The Summary Budget outlines the estimated expenditures and revenues for all entities in the GRE. The Summary Budget is an important part of the financial reporting and comptrollership process because comparisons of budgeted to actual financial results provide key information of how the government has achieved its spending plans.

The Summary Budget includes the detailed estimates of revenues and expenditures for what is referred to as the "core" operations. It also includes the adjustments that are necessary to arrive at the Summary Budget amounts.

Estimates of Core Revenue

The estimates of core revenue includes all forms of taxation, other fees charged by the government, and government transfers. It also includes net revenues from liquor sales and lottery operations, even though these organizations are outside of the core.

Estimates of Core Expenditure

The estimates of core expenditures include two sections: Part A – Operating and Part B – Capital Investment. Part A Operating relates to the cost of operating core government programs including the amortization of capital assets and interest on public debt. Capital Investment relates to the cost of acquiring tangible capital assets.

The core expenditures include direct expenses of government departments as well as grants to agencies, boards, commissions and outside organizations or individuals, but may be incomplete. It may not include all expenses if organizations in the GRE incur deficits; or may include appropriated amounts that exceed the actual costs incurred by the organizations.

Adjustments

The adjustments consist of numerous impacts, in particular for the overall results of government business enterprises that are completely outside of the core such as Manitoba Hydro (Hydro), Manitoba Public Insurance (MPI) and Workers' Compensation Board (WCB). As well, adjustments are made for other revenue sources and associated expenses from public sector organizations such as regional health authorities, school divisions, universities and colleges that are directly or indirectly controlled by the government.

It is important to understand that while the core information is interesting, it cannot stand alone. Only the Summary Budget tells the complete picture of anticipated revenues and what government is planning to spend.

The Summary Budget is tabled in the legislature each fiscal year. However, only the core government budgeted amounts are approved by vote via *The Appropriations Act.*

Similar to summary financial reporting, summary budgeting allows users of the budget to gain an overall understanding of the government's financial plan. And, Members of the Legislature can see the difference between the amounts they are voting on as compared to the total budget controlled by the government.

Summary Financial Statements – Flow of Grants and Transfer Payments

It is important to understand the flow of grant and transfer payments paid by government to other government entities in the GRE to appreciate the complexity behind combining all of these organizations into the summary financial statements. The diagram below illustrates the flow of a grant provided to other government entities using an example from the health sector.

Based on this diagram, the grant that has been voted on by the Legislative Assembly for the purpose of long term care flows to three other government entities before it is spent on its intended purpose. As a result, when preparing the Summary Financial Statements, careful attention must be placed on determining the impact of inter-entity transactions and adjusting summary accounting records to ensure expenses or revenues are not recorded multiple times.

To illustrate this point using an example, if $10 million in funding was voted on by the Legislative Assembly for long term care administered by a personal care home, the $10 million would be paid from the core government to the Manitoba Health Services Insurance Plan who would transfer it to a Regional Health Authority who would pay it to a Personal Care Home who would ultimately be expected to expend the funds for their intended (voted) purpose. As a result, when compiling the summary financial statement impact, simply adding together the $10 million in expense at each government entity level would result in $40 million, obviously an overstatement of expenses in the Summary Financial Statements. Therefore, when preparing the Summary Financial Statements, amounts are eliminated using a series of accounting journal entries and processes to ensure only one $10 million expense is reflected at the summary financial statement level.

Following this logic, funding provided directly from the government to a third party outside the GRE does not require elimination as the expense is not paid to an intermediary government entity and is only reported once (through government) in the Summary Financial Statements.

The Loan Act

Another vehicle for disbursing funds not captured by the Summary Budget is *The Loan Act*. Members of the Assembly vote on *The Loan Act*, outlining the authorized borrowing limits to fund capital projects and government programs. For 2012, the government voted on and authorized new borrowing limits of $1,419 million, including those authorized to Manitoba Hydro and authorized existing loans of $1,647 million for a total authorized limit of $3,066. The limit lapses each fiscal year and may or may not be re-authorized the following fiscal year.

In addition, when the authority to make a loan under any other act (i.e., *The Loan Act*) is insufficient, Section 63(1) of *The Financial Administration Act* provides the means for the Minister of Finance to disburse loans to non-government entities. *The Loan Act 2012*, established the maximum amount that the Minister of Finance can authorize under section 63(1) to be $200 million.

The disbursement of these funds is not reflected in the government's budget as they are not considered expenditures. The Minister of Finance is responsible for tabling a report outlining loans provided for under the authority of Section 63(1) of *The Financial Administration Act*. While Volume 3 contains a schedule of loans and advances, it does not specify the actual loans disbursed during the year as authorized under *The Loan Act*.

1.5 Key elements in the financial reporting model for the Summary Financial Statements

The reporting model for the Summary Financial Statements prescribed by PSAB includes five key elements:

- net debt.
- accumulated surplus or deficit.
- annual surplus or deficit.
- change in net debt for the year.
- cash position and cash flow for the year.

Each element helps users understand how the government managed its financial resources for the year, plus understand what its financial position is at year-end. The following discussion refers to page numbers in the Province's Annual Report.

Net debt is calculated as total liabilities less financial assets (financial assets are assets which can be used to pay off liabilities). Net debt is an important indicator of the government's financial condition. Net debt represents the future revenue requirements needed to pay for existing liabilities (past transactions and events). Net debt of $14,511 million (2011 - $12,525 million) is reported in the Consolidated Statement of Financial Position on page 73 of the 2012 Annual Report.

It is important to distinguish net debt from total borrowings and borrowings as reported in the Consolidated Statement of Financial Position. Total borrowings represents all debt issued, including debt issued on behalf of Hydro and any debt the government has bought back to hold as sinking fund investments. Schedule 4 on page 103 of the 2012 Annual Report, illustrates how debt issued on behalf of Hydro and sinking fund investments are then deducted from total borrowings in determining borrowings for the Consolidated Statement of Financial Position. Debt issued for Hydro is reflected in that organization's financial statements and is summarized for information purposes in Schedule 3 to the Summary Financial Statements shown on page 102 of the 2012 Annual Report.

Figure 1 illustrates how borrowings, as reported on the Consolidated Statement of Financial Position, compares to total borrowings and distinguishes net debt from borrowings.

Figure 1: Borrowings and net debt (in $ millions)

	2010	2011	2012
Total Borrowings (includes Debt Issued on behalf of Hydro)	$25,101	$26,273	$29,297
(Less) Debt Issued on behalf of Hydro included in Total Borrowings	(8,289)	(8,467)	(9,095)
(Less) Debt Adjustments[1]	(701)	(656)	(599)
Borrowings as reported on the Statement of Financial Position	16,111	17,150	19,603
Add Other Liabilities[2]	5,341	5,306	5,536
(Less) Total Financial Assets[3]	(9,642)	(9,931)	(10,628)
Net Debt	**$11,810**	**$12,525**	**$14,511**

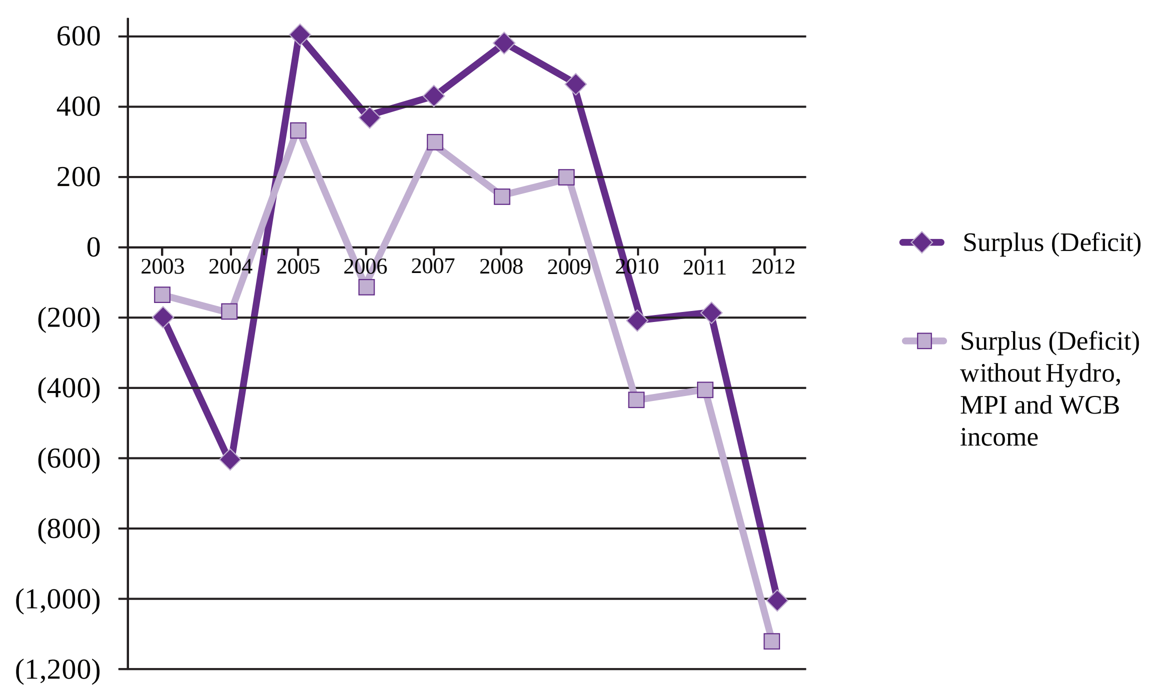
1 Debt adjustments include: unamortized debt issue costs; unamortized foreign currency fluctuations; unamortized gains/losses on derivative contracts; and, debentures issued by the Province that are subsequently repurchased (or held) by the Province as investments.
2 Other liabilities include: accounts payable, accrued charges, provisions, unearned revenue and pension liability as reported on the Statement of Financial Position.
3 Financial Assets are assets that could be used to discharge existing liabilities or finance future operations.

The **accumulated surplus or deficit** represents the difference between the government's total assets (includes non-financial assets such as tangible capital assets) and total liabilities. Accumulated deficit reflects the government's entire net economic shortfall meaning the government's liabilities are greater than their assets. As a result, the government has been financing their annual operating deficits by borrowing. It also reflects the sum of all the annual surpluses and deficits ever reported by a government. The accumulated deficit of $5,305 million (2011 - $4,237 million) is shown on the Consolidated Statement of Financial Position on page 73 of the 2012 Annual Report.

The **annual surplus or deficit** represents the difference between total revenues from operations during the year and total expenses (costs) incurred during the year. It indicates whether a government has raised sufficient revenues to pay for its expenses for that fiscal year. The expenses reported include the cost of using existing and new capital assets which is referred to as amortization expense. The annual deficit for 2011/12 is shown as $999 million (2011 - $179 million) on the Consolidated Statement of Revenue and Expense on page 74 of the 2012 Annual Report.

The annual deficit includes the net income generated by GBEs as revenue. The net income recorded by GBEs is presented on schedule 3 on page 102 of the 2012 Annual Report. The net income generated by Manitoba Liquor Control Commission and Manitoba Lotteries Corporation is normally transferred to government departments to pay for public programs. However, the net income generated by Hydro, MPIC, and WCB is normally retained by those entities to finance their future operations. As such, this revenue is not expected to be used to finance other current or future programs of the Province. Calculating the impact of removing this revenue from the annual deficit may provide useful information to users of the Summary Financial Statements. A 10 year graph is provided below (**Figure 2**), illustrating the annual surplus (deficit) as reported in the Consolidated Statement of Revenue and Expense, and for comparative purposes, the annual surplus (deficit) is presented less the surplus (deficit) of Hydro, MPIC and WCB.

Figure 2: Annual surplus (deficit) (in $ millions)



The **change in net debt** for the year represents the extent to which sufficient revenues were raised during the year to support government spending for both operating and capital purposes. The level of net capital spending may also be compared to the planned (budgeted) level of capital spending. An increase in net debt indicates that more future revenues will be required to pay for past transactions. The Consolidated Statement of Change in Net Debt is on page 76 of the 2012 Annual Report.

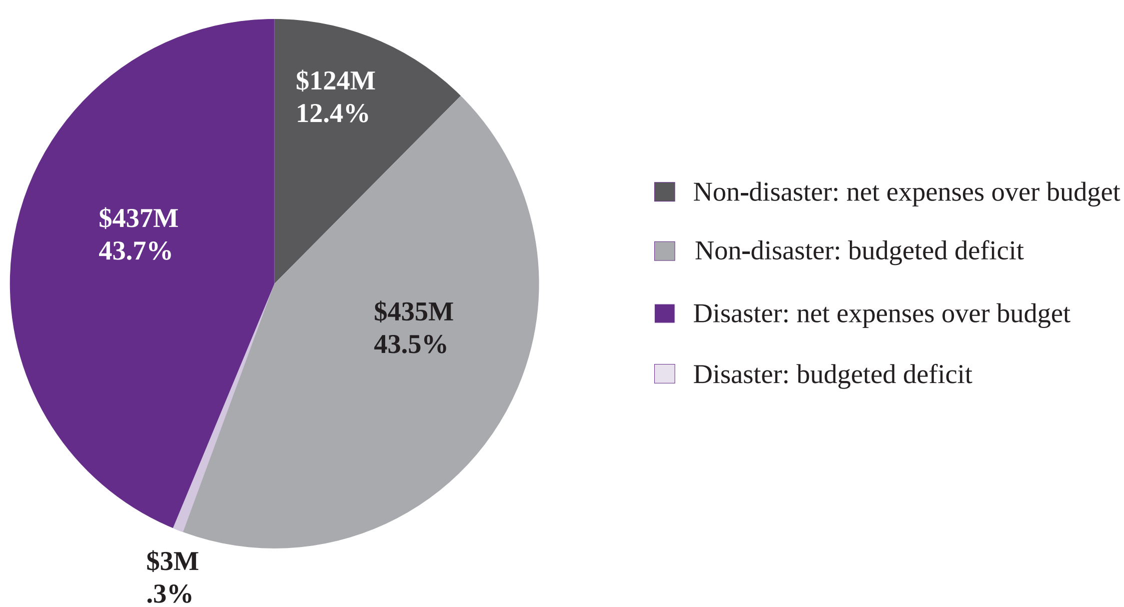
The **cash position and cash flow** provides information on how the government has managed its cash during the year and its sources of cash flow and use of cash resources through operating, investing and financing activities. It also highlights net capital spending and how cash was used to acquire capital assets. The Consolidated Statement of Cash Flow is on page 77 of the 2012 Annual Report.

1.6 2012 Summary deficit

Overview

The government reported a $999 million deficit for the 2012 fiscal year in the Summary Financial Statements. **Figure 3** shows a breakdown of this amount.

Figure 3: Breakdown of deficit



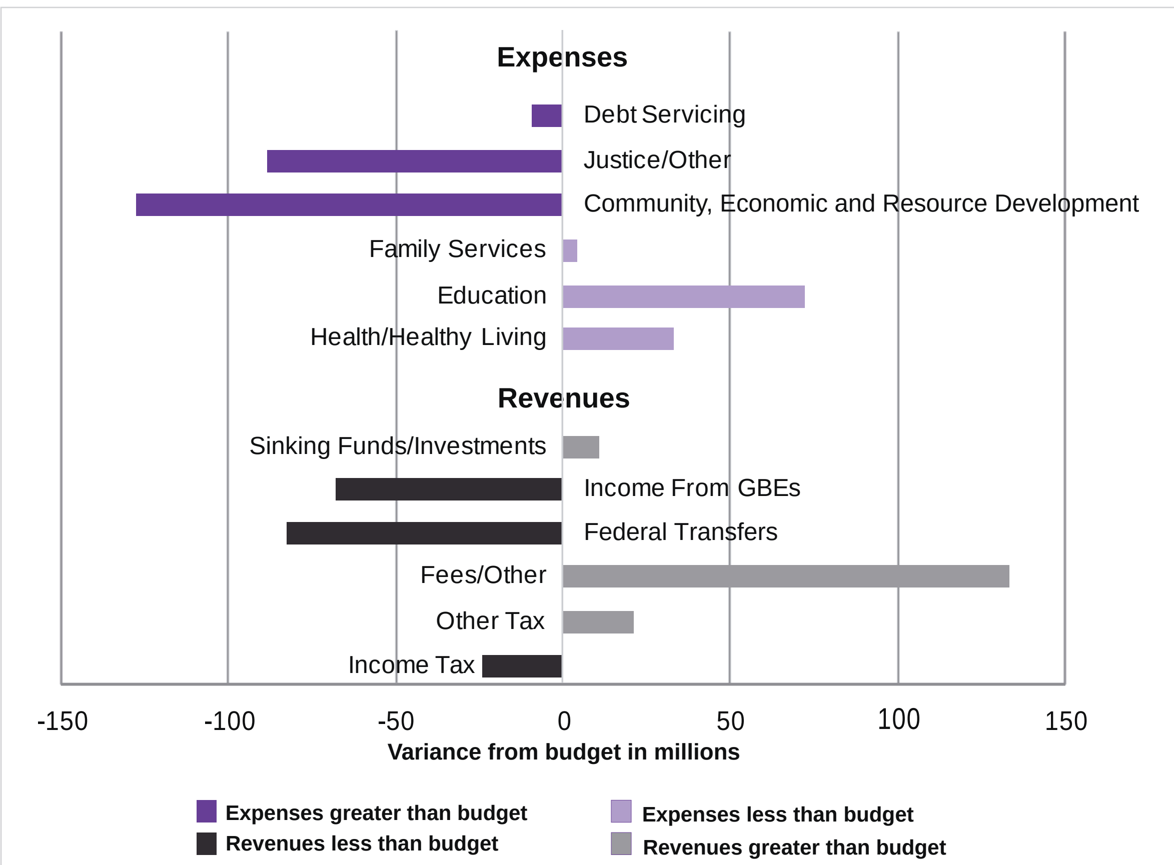
The government's expected deficit based on the 2011 budget was $438 million, made up of $435 million for the portion of the budget which was non-disaster related and $3 million related to disaster/agricultural assistance. The actual deficit was $999 million which is $561 million greater than budget. This difference is comprised of a $437 million net loss related to unbudgeted disaster costs, net of recoveries, and a $124 million net loss related to unbudgeted non-disaster costs.

Actual to Budget 2012

As noted above, the actual deficit for 2012 as reported in the government's Summary Financial Statements was $999 million, or $561 million greater than initially budgeted. Of this amount, $437 million was disaster-related, leaving $124 million related to non-disaster expenditures and revenues.

This $124 million is due to the combination of several offsetting variances from budget as detailed in **Figure 4**.

Figure 4: $124 million non-disaster actual to budget variances



Budget and third quarter forecast to actual

Figure 5 shows the fiscal 2012 budget, third quarter forecast and actual results.

Figure 5: Net income - budgeted, forecasted, actual (in $ millions)

	Budget 2012	Third quarter forecast 2012 (excluding disaster)	Third quarter forecast 2012 (including disaster)	Year end actual 2012
Revenue	$13,421	$13,378	$13,823	$13,855
Expense	13,859	14,007	14,943	14,854
Net deficit	$ (438)	$ (629)	$ (1,120)	$ (999)

Actual to third quarter forecast

The third quarter financial report, released by the government on March 9, 2012, reflected the unaudited year to date actual summary results and the projected summary revenues and expenses for the balance of the fiscal year.

The report included a forecast deficit of $629 million for 2011/12 before considering the impact of disaster costs. The report did not clearly state what the forecasted deficit would be, including disaster costs net of expected recoveries. This is confusing for users of the report. However, a forecast deficit of $1.12 billion, including disaster costs, can be calculated by using information contained in the report. The difference between the calculated forecasted deficit of $1.12 billion and the reported forecasted deficit of $629 million is equal to $491 million. The $491 million figure is made up of expected disaster costs of $936, net of $445 in expected recoveries.

The actual deficit of $999 million is $121 million less than the calculated forecasted deficit including net disaster costs of $1.12 billion.

Considerations in interpreting the deficit

As noted in our auditor’s report, the $999 million deficit shown in the Summary Financial Statements presents fairly, in all material respects, the government operations for the year ended March 31, 2012 in accordance with Canadian public sector accounting standards.

This number represents the net cost of the operating activities throughout the fiscal year. It includes costs and revenues related to both ongoing public programs (such as taxation, education and healthcare) and infrequently occurring activities (such as large-scale flood mitigation and remediation measures as required for the spring 2011 flood). It includes results from core government, GBEs, and other organizations considered to be part of the GRE. The deficit does not include costs related to construction of new capital assets or improvements to old ones, loans disbursed by the government (i.e., loans made to finance the construction of the new football stadium at the University of Manitoba), or the issuance or repayment of provincial debt. These are reflected in the borrowings, in the capital assets and shown in schedules 4 and 7 respectively of the Summary Financial Statements. Capital assets are expensed to the extent that they are used in the current year's operations through depreciation or amortization which represents only a percentage of the actual costs. For example, a road that is constructed will be depreciated over 20 years, and accordingly 1/20th of the original cost will be expensed for each of the next 20 years.

In providing our audit opinion on the Summary Financial Statements, we implicitly acknowledge that the deficit does not likely equal exactly $999 million. In order to understand why this number "presents fairly" the results of operations (as opposed to "presents exactly"), it is important to consider several factors inherent within auditing and general purpose financial reporting such as:

- The use of professional judgment in selecting and applying accounting policies (for example, determination of useful lives of capital assets which affects amortization expense).
- The unavailability of perfect information in calculating some balances in the financial statements (known as "measurement uncertainty"). In such cases, estimates are, by necessity, used to determine balances using the best information available (for example, the estimate of expected federal recoveries for 2011 flood costs).
- An audit is not designed to ensure that the financial statements are 100% accurate because it is not practical to test 100% of transactions. Audits use a concept known as materiality, which relates to the significance of transactions and balances contained in the financial statements. Information is material if its omission or misstatement could influence the decision of users taken on the basis of the financial statements. Therefore our audit is performed to gain reasonable -but not absolute- assurance that the summary financial statements are free from material misstatement.
- Immaterial errors and differences of opinion noted during our audit not adjusted for by the government are documented in our Schedule of Unadjusted Misstatements. We accumulate all errors or misstatements we note during our audit and make an assessment of whether they would individually or in aggregate cause financial statement balances to be materially misstated.

1.7 Framework of financial reporting for GBEs

As required by PSA standards, the revenues, expenses, assets and liabilities of all organizations in the GRE (except GBEs) are fully consolidated into the Summary Financial Statements.

GBEs are different from other organizations in the GRE because they are financially self-sustaining. This means they will experience annual profits and in some cases losses; but over the long-term, operate with the ability to maintain their operations and meet their liabilities without relying on government funding. GBE financial results are reflected in the Summary Financial Statements on the modified equity basis of accounting.

Under the modified equity basis of accounting, GBE net income is reflected on a single line in the Consolidated Statement of Revenue and Expense (p.74 of the 2012 Annual Report) and GBE equity (assets minus liabilities) is reflected on a single line in the Consolidated Statement of Financial Position (p.73 of the 2012 Annual Report). This accounting reflects the unique accountability relationship between the government and the GBEs. A GBE is recorded as a financial asset because a GBE can generate surpluses that may be available for the Province to use.

Under the modified equity method (unlike the full consolidation method) transactions between GBEs and the rest of the GRE are not eliminated on consolidation. And GBE equity and net income are not restated to conform to the government's basis of accounting for inclusion in the Summary Financial Statements.

During the 2012 fiscal year, the government performed a review of existing entities controlled by the government and obtained information regarding the Deposit Guarantee Corporation of Manitoba that supported the classification of this corporation as a controlled GBE. The Deposit Guarantee Corporation of Manitoba has guaranteed $18.8 billion (2011 – $16.2 billion) in credit union deposits at the end of their current fiscal year.

The net income and financial position for each GBE is reflected in Schedule 3 to the Summary Financial Statements (p.102 of the 2011 Annual Report). The net surplus (deficit) for each GBE is presented in **Figure 6**.

Figure 6: GBE surplus (deficit) (in $ millions)

Government Business Entity	2011	2012
Hydro-Electric Board	$ 150	$ 61
Workers Compensation Board	88	20
Manitoba Public Insurance Corporation	(29)	23
Manitoba Liquor Control Commission	250	254
Manitoba Lotteries Corporation	332	339
Deposit Guarantee Corporation	16	16
	$ 807	**$ 713**

1.8 Financial reporting by organizations within the GRE

Changing standards

As we noted in our prior year report, the accounting and auditing environment has been going through many changes in recent years. As a result, the financial reporting framework selected by organizations in the GRE will depend on their classification as outlined by PSAB.

Entities within the GRE are classified into one of three categories:

- Government Business Enterprises (GBEs) – GBEs are entities that sell goods or services to users outside of the government organization and are able to maintain their operations and extinguish their liabilities without assistance from the government. These entities follow International Financial Reporting Standards.
- Government Not For Profit Organizations (GNPOs) – A government not for profit organization is an organization that operates primarily for social, educational or other not for profit purposes, and that has counterparts outside the public sector. These entities follow public sector accounting standards (PSAB).
- Other Government Organizations (OGOs) – Other government organizations is the category that all other entities controlled by the government that are not considered GBEs or GNPOs fall into. These entities follow PSAB.

GBEs moved to IFRS

GBEs converged to International Financial Reporting Standards (IFRS) in the 2012 fiscal year with the exception of Manitoba Hydro.

Manitoba Hydro is required to adopt IFRS by April 1, 2014 for their 2014/15 fiscal year because it follows rate-regulated accounting policies. The CICA has given organizations that use rate-regulated accounting an additional time to move to IFRS because international standards are still evolving in this area.

OGOs moved to PSAB standards

All OGOs converged to public sector accounting standards for the 2012 fiscal year.

GNPOs moving to PSAB standards

In Manitoba, GNPOs have to adopt PSAB standards for the fiscal year beginning April 1, 2012. GNPOs include the Regional Health Authorities.

1.9 Financial instruments

In 2011, PSAB approved the new accounting standard sections PS 3450, *Financial Instruments*, PS 2601, *Foreign Currency Translation*, and PS 1201, *Financial Statement Presentation*.

These standards will be effective for fiscal years beginning on or after April 1, 2012 for government organizations and April 1, 2015 for governments. Early adoption is permitted; however, all new standards listed above must be adopted in the same fiscal year.

The new standards will result in some significant changes to the Summary Financial Statements for the Province of Manitoba which is why PSAB provided additional time to governments to implement these new standards. New processes, procedures and financial reporting systems may need to be changed to deal with these new reporting requirements and implementation issues. Additionally, *The Balanced Budget, Fiscal Management and Taxpayer Accountability Act* may need to be revised for the purpose of clarifying the year end balance of the GRE. We encourage the government to develop a planning strategy to facilitate the implementation of these standards.

Some highlights of these new accounting standards are outlined below.

New section PS 3450, ***Financial Instruments*** provides guidance on the recognition, measurement, presentation and disclosure of financial instruments including derivatives. Items covered by this standard include:

- primary instruments (such as receivables, payables and equity instruments).
- derivative financial instruments (such as financial options, futures and forwards, interest rate swaps and currency swaps).

Derivative financial instruments and portfolio investments that are quoted in an active market are required to be measured at their fair value. A government may also choose to measure other financial instruments at their fair value. Changes in the fair value of financial instruments will be recognized in a statement of remeasurement gains and losses until settlement.

The new standard will have a significant impact on the Province's Statement of Financial Position. It will require that the government record the fair value of its derivative financial instruments on the statement of financial position. The government may elect to record its borrowings at fair value to offset the impact of recording the derivatives at fair value. For 2012, the net unrecognized liability associated with derivative financial instruments was $1.1 billion (2011 - $593 million) as shown in Note 12 to the Summary Financial Statements. The fair value of borrowings was not disclosed in the Summary Financial Statements so an estimate of the impact of recording both derivatives and borrowings at fair value cannot be made. The changes in the fair value of both the derivatives and borrowings will be recorded on the statement of remeasurement gains and losses.

New section PS 2601, ***Foreign Currency Translation*** replaces existing section PS 2600. Significant changes in this section include:

- elimination of the deferral and amortization of unrealized gains and losses arising from foreign currency translation before settlement.

- removal of hedge accounting.
- separating realized and unrealized foreign exchange gains and losses and reporting these in different statements.

The annual surplus or deficit will no longer include amortization of unrealized foreign currency exchange gains or losses. Rather, it will include the impact of the cumulative changes in the foreign exchange in the period of settlement.

New section PS 1201, ***Financial Statement Presentation*** replaces existing section PS 1200 and will include guidance on the new statement of remeasurement gains and losses. The statement will include:

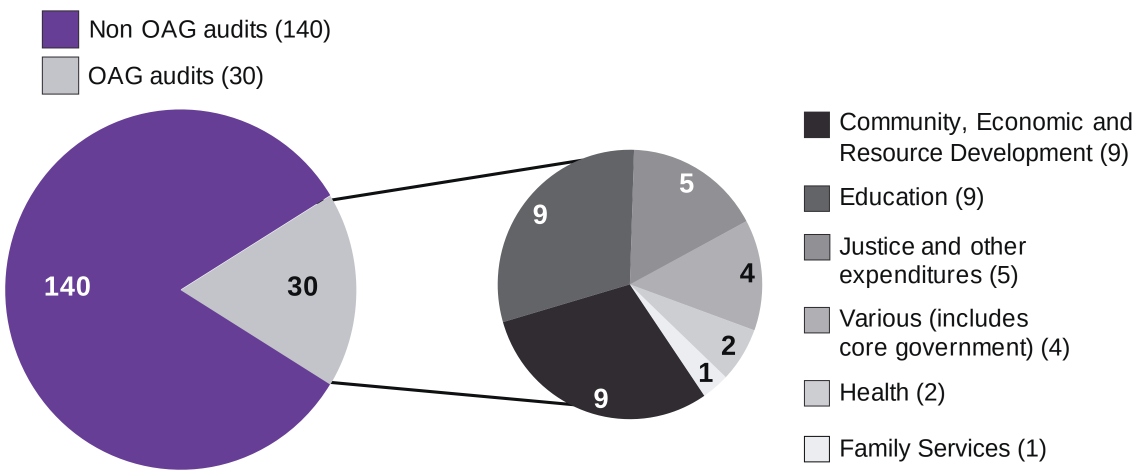
- unrealized gains and losses related to financial instruments in the fair value category.
- foreign currency exchange gains and losses related to monetary assets and monetary liabilities that have not been settled.
- amounts reclassified from to the statement of operations upon derecognition or settlement.
- other comprehensive income related to the GBE's.

1.10 Financial statements and compliance with legislative authority audits

Our office performs financial statement audits directly or uses a public accounting firm as our agent on our behalf. The remaining audits are conducted externally by a public accounting firm hired directly by the organization but are part of our external auditor review process. Many of the financial statement audits our office performs are the result of a legislative requirement.

Figure 7 illustrates our audit mix by sector. The result indicates that we audit approximately 30 of the 170 funds, organizations, pension plans and business enterprises associated with the government reporting entity.

Figure 7: OAG financial statements audits by sector



The figures below illustrate audits by significance for financial statement and pension plan audits. **Figure 8** shows our audits and external audits by expense significance for financial statements. **Figure 9** shows our audits and external audits by accrued benefit obligation for pension plans.

Of the seven financial statements audits we are responsible for (that have expenses in excess of $250 million), three are flow-through funding entities. These entities consist of the Manitoba Health Services Insurance Plan, the Public Schools Finance Board and the Council on Post-Secondary Education. We note this because the primary purpose of these entities is to fund other government entities and as a result the usefulness of these financial statements is limited.

Figure 8: Financial statement audit responsibility

Expenses (in $ millions)	**OAG audits**	**External auditor**
$0 to $5	9	34
$5 to $50	6	67
$51 to $250	2	25
> $250	7	2
Government Business Enterprises	0	6
Total	**24**	**134**

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Figure 9: Pension plan audit responsibility

Accrued benefit obligation (in $ millions)	OAG audits	External auditor
$0 to 1,000	3	6
> $1,000	3	0
Total	**6**	**6**

We also complete a number of federal claim, compliance with legislative authority and other audits.

Our audit mix is determined largely by legislation as opposed to a risk based approach. As a result, our office resources are used to audit entities that may be considered lower risk relative to other government entities.

Recommendation 1: We recommend that the government complete a review of the financial statement and other audits our office currently completes to ascertain an audit mix that maximizes the benefit to the Legislature.

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2. Matters arising from our audits

2.1 Additional information about personal income tax revenue not used

In 2012, the government reported $2.7 billion (2011 - $2.6 billion) of personal income tax revenue. This amount is an estimate and represents the largest revenue component (nearly 20%) reported in the Summary Financial Statements.

Personal income tax revenue is estimated because not all tax returns for the related taxation have been filed by the Province's year-end. The estimates are based on projections agreed to by the Province and the federal government. The projections are based on economic models and not actual tax returns filed.

Figure 10 illustrates that there are large fluctuations between the estimated balance reported in the Summary Financial Statements and the actual amounts reported on filed personal tax returns.

Figure 10: Personal income tax revenue (in $ millions)					
	2006	2007	2008	2009	2010
As reported in the Summary Financial Statements	$1,949	$2,130	$2,285	$2,455	$2,405
As reported in filed personal tax returns	2,012	2,146	2,314	2,389	2,430
(Under) Over - $	**(63)**	**(16)**	**(29)**	**66**	**(25)**
(Under) Over - %	(3.2)	(0.7)	(1.3)	2.7	(1.0)

The Province does not know the actual amount of personal income tax revenue until processing is completed by the CRA which can take up to two years following a given taxation year end.

In the interim, the Province receives tax sharing statements (TSS) from the CRA which provide information including volume and dollar value of tax returns that have been filed to date. This information is not used by the Province to determine or evaluate the reasonableness of the estimated personal income tax revenue in the Summary Financial Statements.

Recommendation 2: We recommend that the Department of Finance consider the most current tax sharing statements information when determining or evaluating the reasonableness of their estimate for personal income tax revenue before finalizing the Summary Financial Statements.

2.2 Healthcare liabilities not reconciled

Impact on the Manitoba Health Services Insurance Plan financial statements

Some collective bargaining agreements for health related unions include a component to increase wages to achieve a standardized level across organizations and within professions. The associated expenses when agreements are settled are estimated and voted on through the Department of Health appropriations. Payments are made to Manitoba Health Services Insurance Plan (MHSIP) which then funds the Regional Health Authorities (RHAs). The RHAs submit funding requests to MHSIP with details to support the wage standardization calculations.

For the year ended March 31, 2012, MHSIP estimated that the remaining payments for wage standardization settlements were $58.5 million. The RHAs recorded only $4.5 million in receivables from MHSIP related to this estimate. MHSIP could not explain the difference between these estimates, but adjusted the accrual at year end by $21 million.

Recommendation 3: We recommend that the Department of Health, MHSIP and the RHAs reconcile the wage standardization accruals to ensure that actual amounts owing are properly recorded in MHSIP's financial statements.

Impact on the Summary Financial Statements

There is a total discrepancy of $120.3 million between liabilities recorded by MHSIP and receivables recorded by other health entities. Prior to 2012, the Comptroller Division was not aware of the significant differences between MHSIP's payables and the other health entities' receivables when preparing the Summary Financial Statements. Without a reconciliation of these balances in previous years, improper consolidation entries caused healthcare expenses to be double counted in the Summary Financial Statements.

The government adjusted their 2012 Summary Financial Statements to correct healthcare expenses that were overstated by $133 million in previous years. In determining the $133 million adjustment, the Comptroller Division made substantial assumptions. The assumptions were necessary due to a lack of sufficient detail of the differences between the MHSIP's payables and other health entities' receivables. For our audit, we concluded that the adjustment was reasonable; however, a further difference of approximately $20 million could not be confirmed.

Recommendation 4: We recommend that the Comptroller Division, Department of Health, MHSIP and the RHAs determine the exact nature of the differences between the Plan's liability and the RHAs receivable to enable appropriate consolidation entries to avoid misstatements in the Summary Financial Statements.

2.3 Environmental liabilities not revalued

In 2012, the government reported environmental liabilities of $467 million (2011 - $487 million). The liability is for contaminated sites where the government is responsible for the remediation costs due to reasons of public health and safety, contractual arrangements, or compliance with environmental standards. The liability is based on estimated costs to return the sites to a level appropriate of the site's current or intended use.

In follow-up to our prior year environmental liability recommendation (see **Figure 12** below), we note the government has made efforts in coordinating departments to accurately evaluate and report on outstanding environmental liabilities; however, this recommendation has been largely unaddressed.

In addition, PSA standard 3260 – Liability for Contaminated Sites, comes into effect for years ending March 31, 2015. This is a new standard that specially addresses the recognition and measurement criteria for recording these liabilities. The Province's current environmental liability may change under this new standard.

2.4 International Polar Bear Conservancy Centre recorded as an asset but should be expensed

The government has committed $31 million to support the development of an International Polar Bear Conservancy Centre (IPBCC) located at the Assiniboine Park Zoo and managed by the Assiniboine Park Conservancy (APC). The centre is located on City of Winnipeg land that is leased by the APC. The APC will pay the Province nominal rent of $1 annually.

During the 2011/12 fiscal year, the government concluded that its commitment towards this project should be recorded as a tangible capital asset in the Summary Financial Statements. We reviewed the supporting analysis and did not reach the same conclusion.

The APC has the authority to independently operate and earn revenue from the IPBCC. By having the right to hold and use the property to provide the services it desires, APC is benefitting directly from the asset and can deny or regulate access to the services. As a result, the IPBCC does not meet accounting criteria for recognition as an asset of the Province. Related funding should therefore be recognized as a grant expense in the year payments are provided.

As the government is recording this as their asset, they are recognizing the costs over the life of the asset (40 years). We believe that the funding should be recorded as a grant in the current year. Because we disagreed with the government's accounting treatment, we placed the current 2011/12 project balance of $8 million on our Schedule of Unadjusted Misstatements.

Recommendation 5: We recommend that the Department of Finance adjust the Summary Financial Statements to appropriately record the funding for the IPBCC as a grant.

2.5 Leaf Rapids Town Properties Ltd. not financially viable

The closure of the Ruttan Mine in May 2002 created doubt that Leaf Rapids Town Properties Ltd. (the Company) can operate as a going concern and be able to realize its assets and discharge its liabilities in the normal course of business.

The Company previously acquired funding from the Mining Community Reserve Fund over a four year span starting in the March 31, 2008 fiscal year that secured the financial viability of the Company for the time period.

In addition to this source of funding, during March 31, 2010 fiscal year, the government utilized existing Loan Act Authority to provide a loan of $500,000 to the Company. During March 31, 2011 the government wrote off their loan receivable and the Company recorded this unusual item as a gain on forgiveness of the debt the Company had.

For March 31, 2012 fiscal year the government again used existing Loan Act Authority to provide a second loan of $500,000 to the Company. The government has provided a full allowance against their loan receivable for March 31, 2012 fiscal year. No amount has been written off as of November 2, 2012.

We continue to point out that this is not a long term solution to the continuing operations of the Company and further action is required.

2.6 Changes in The Civil Service Superannuation Act

Last year in our RTL we reported that changes to *The Civil Service Superannuation Act* removed the specific requirement for the Auditor General to audit the financial statements of the Civil Service Superannuation Fund. While this had been considered in an early draft, in fact, the changes in the final Act did not remove this requirement.

3. Follow up of prior years' recommendations

Each year, in our report to the Legislative Assembly on the Audit of Public Accounts, we provide recommendations to the government where we identify opportunities for improvement.

The status of implementation for our prior years' recommendations is presented in **Figures 11** and **12**.

Figure 11: Status of prior years' recommendations

Report	Recommendation	Status
January 2012 Report to the Legislature - Chapter 1	We recommend that the Province remove Schedule 10 and all references to core government from the audited Summary Financial Statements.	Implemented
	We recommend that the Department of Finance revise the information included in Volume 3 to provide relevant information to users that is consistent with the Summary Financial Statements.	Work in progress
	We recommend that the Province perform a valuation of the non-vested sick time liability to determine whether the current accounting treatment of this item is reasonable.	Implemented
	We recommend that the Province revalue its environmental liabilities each year to reflect known changes in the liability including the impact of the passage of time, interest rates and an appropriate margin of error.	Work in progress (See discussion in section 2.3 above.)
	We recommend that MHSIP implement a comprehensive IT risk assessment process.	Work in progress
	We recommend that the University of Manitoba implement a comprehensive IT risk assessment process.	Work in progress
	We recommend that the University of Winnipeg implement a comprehensive IT risk assessment process	Work in progress
	We recommend that the University College of the North implement a comprehensive IT risk assessment process.	Work in progress
	We recommend that the Department of Health implement a formal, comprehensive IT security policy.	Work in progress
Audit of the Public Accounts for the year ended March 31, 2010	We recommended that the Department of Finance review public quarterly reporting requirements for organizations in the GRE and prepare a plan to resolve any inconsistencies.	Work in progress
	We recommended that the Department of Finance review the requirement for the release of 4th quarter reports under *The Crown Corporations Public Review and Accountability Act* to determine if it is still appropriate.	Work in progress

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Figure 11 (cont'd)

Report	Recommendation	Status
	We recommended that the Province determine what steps are necessary for an earlier release date of the Public Accounts.	Work in progress
	We recommended that the Department of Finance do a cross-government review to assess the extent to which the Province currently requires supplementary audit reports and work with departments to revise the requirements to be consistent with GAAS while meeting departmental needs.	Implemented All supplemental reports issued by departments were in compliance with GAAS with the exception of the supplementary report required under section 190(2) *The Municipal Act*.

Figure 12: Status of prior years' recommendations Followed up as part of the 2012 Audit of IT Security Management Practices - Chapter 3

Report	Recommendation	Status
January 2012 Report to the Legislature - Chapter 1	We recommend that the Province analyze their IT security policies, standards, guidelines and procedures for completeness and appropriateness.	Work in progress (See chapter 3 section 3.4)
	We recommend that the Province implement a formal Disaster Recovery Plan for SAP.	Work in progress (See chapter 3 section 7.6)
Audit of the Public Accounts for the year ended March 31, 2010	We recommended that the Province implement a long-range IT strategic plan.	Work in progress (See chapter 3 section 2.1)
	We recommended that Business Transformation & Technology, in collaboration with relevant business stakeholders, implement a comprehensive IT security policy.	Work in progress (See chapter 3 section 3.2)
Audit of the Public Accounts for the year ended March 31, 2007	We recommended that the Provincial Comptroller's Office in collaboration with the CIO's Office ensure that a government wide disaster recovery plan is developed and tested to ensure that critical business functions can be continued by recovering computer processing capabilities in the case of an event which disrupts computer servicing services or facilities.	Work in progress (See chapter 3 section 7.6)

Summary of recommendations and response of officials

1. **We recommend that the government complete a review of the financial statement and other audits our office currently completes to ascertain an audit mix that maximizes the benefit to the Legislature.**

    Response - Department of Finance: Management agrees with the recommendation and would be willing to discuss with the OAG any potential changes in the audit mix which maximizes the benefit to the legislature. However any changes in the OAG's audit mix must consider the Province's current timelines for delivering the Summary Financial statements.

2. **We recommend that the Department of Finance consider the most current tax sharing statements information when determining or evaluating the reasonableness of their estimate for personal income tax revenue before finalizing the Summary Financial Statements.**

    Response - Department of Finance: The Province applies a consistent methodology in determining the estimate for the personal income tax revenue reported in the annual public accounts. Current practices result in a best estimate based on assumptions that reflect the most probable set of economic conditions.

    The Province uses the TSS to estimate the personal income tax revenue. The Province uses the first few months of TSS reports to identify possible errors in the data and as a preliminary indication that there may be unanticipated changes to the basic data, which are closely monitored as the Province receives subsequent, more reliable TSS reports. Early TSS reports are less reliable because it has been the Province's experience that a small number of taxpayers can appear to have a significant impact on revenues in the early reports.

    The Province uses the May TSS data for the year end estimate. Given our current reporting deadlines the May TSS is the latest available statement. However, the May statement only represents partial data for the prior taxation year.

    The Province uses the final data from two prior taxation years, adding in policy changes and economic indicators to estimate the personal income tax revenue reported in the Summary Financial Statements. In the past this has produced more consistent and reliable estimates.

3. **We recommend that the Department of Health, MHSIP and the RHAs reconcile the wage standardization accruals to ensure that actual amounts owing are properly recorded in MHSIP's financial statements.**

   Response - Department of Health: Since regionalization in 1998, the move to improve the standardization of wages across organizations and within professions, has had an effect where wage standardization settlements have become increasingly complex to administer.

   In the finding above, the OAG identified that Manitoba Health "could not explain the difference between the estimates." Following considerable dialogue regarding the complexity of establishing a wage standardization accrual, Manitoba Health made an adjusting entry to reflect a wage liability that the Office of the Auditor General would accept.

   In the interests of addressing this management comment, during 2012/13, the Department is in the process of funding the older wage standardization amounts owing.

4. **We recommend that the Comptroller Division, Department of Health, MHSIP and the RHAs determine the exact nature of the differences between the Plan's liability and the RHAs receivable to enable appropriate consolidation entries to avoid misstatements in the Summary Financial Statements.**

   Response - Department of Finance: Prior to 2012, the Comptroller's Division was aware of differences between the MHSIP payables and the RHA receivables during preparation of the Summary Financial Statements, and made adjusting entries accordingly. During a 2012 year end meeting, the Comptroller's Division confirmed the nature of some of the differences, advised the OAG of the impact on the Summary Financial Statements, and further adjustments were made.

   The Comptroller's Division agrees with the recommendation and has met with officials at the Department of Health and MHSIP to address the differences between the MHSIP liability and the RHAs receivables.

   Response - Department of Health: Manitoba Health remains committed to working with the Comptroller's Division to provide the information they require to address this recommendation.

5. **We recommend that the Department of Finance adjust the Summary Financial Statements to appropriately record the funding for the IPBCC as a grant.**

Response - Department of Finance: The Department of Finance disagrees with the OAG's analysis that led to their conclusion that the IPBCC is not a tangible capital asset of the Province and should instead be accounted for as a grant to APC.

The Province, as legal owner, is providing the base building and infrastructure to APC to operate as the IPBCC. The APC is restricted from using the building for purposes other than the IPBCC.

The Department of Finance views the IPBCC to meet all the requirements to be an asset of the Province in accordance with Canadian public sector accounting standards. The IPBCC embodies a future benefit to the public in the form of a recreational and educational facility on polar bears and their environment.