Looking Back and Moving Forward: Auditor General of Canada's First Report to the Second Legislative Assembly of Nunavut 2004

Auditor General of Canada
Vérificatrice générale du Canada

10 May 2004

The Honourable Jobie Nutarak, MLA
Speaker of the Legislative Assembly of Nunavut
Office of the Speaker
Legislative Assembly Building
Iqaluit, Nunavut
X0A 0H0

Dear Mr. Nutarak,

This is my first report to the Second Legislative Assembly of Nunavut, in Inuktitut, English and French. I have prepared my report in accordance with Section 46(2) of the *Nunavut Act (Canada).*

I thank the Government of Nunavut for the collaborative way in which we resolved issues as they arose during my audit work.

This report comments and makes recommendations on issues my Office noted during our audit work. It also includes Government of Nunavut management responses to these recommendations.

Yours sincerely,

Sheila Fraser, FCA

240 rue Sparks Street, Ottawa, Ontario K1A 0G6

Table of Contents

Chapter 1 – Looking back and moving forward

Main Points

We prepared this Report to raise issues that we feel are important and that we hope members of Nunavut's second Legislative Assembly will consider in shaping its priorities.

This chapter notes that our previous reports provide background to this Report and also explains a change in how we prepare our reports.

A snapshot of issues facing your government

1. We wrote our first Report to Nunavut's second Legislative Assembly with two objectives in mind.

2. First, we looked back at some of our observations from our earlier reports to the Assembly.

3. We acknowledge progress and highlight areas where we feel the government needs to take further action. We do not attempt to revisit every issue or recommendation from past reports. Rather, we raise those issues that are most relevant today.

4. Second, we raise new issues that we feel are important and need the attention of Nunavut's second Legislative Assembly.

5. We want to be clear. Much has been done already to build your new public government. At the same time, much work remains to be done. The first Legislative Assembly of Nunavut set out its objectives and vision in the *Bathurst Mandate* as a roadmap to its term of office. We hope that the issues noted in this Report will help members of the second Legislative Assembly (MLAs) and all Nunavummiut to chart the future of your government.

Building on previous reports

6. In this Report, we refer to previous reports that include more detailed explanations of the ideas discussed in this one. Our reports are designed to be used together to tell the story of the development of the government. In particular, our first, the 2001 Report to the Legislative Assembly, gives detailed explanations of several ideas important to the government.

7. All our Nunavut reports are available online at www.oag-bvg.gc.ca.

Change in how we report issues

8. Readers of this third Report to the Legislative Assembly of Nunavut may notice a change compared to previous years. Our first two reports were linked directly to each of the first two fiscal years and the government's public accounts for each of those years. We tabled these first two reports after the government's related public accounts were tabled. All three reports note that the government continues to experience delays in finalizing its public accounts.

9. Beginning with this Report, we will report issues as we become aware of them rather than waiting for the government to table the related public accounts. The cut-off for considering new information for this Report was generally around December 2003. Since as of December 2003, the government's 2002–2003 public accounts were not finalized, we may also have additional comments on the 2002–2003 fiscal year in our next Report.

10. This change of approach means that we will bring issues to the attention of the Legislative Assembly earlier than in previous reports. We expect that our future annual reports will be completed prior to the end of each calendar year and tabled in the Legislative Assembly at the first session thereafter.

Overview of this report

11. This Report contains 8 chapters in 4 general sections, plus appendices.

12. **Chapters 2 to 4** discuss issues within departments and also notes important issues to the government as a whole (departments and Crown corporations).

13. **Chapters 5 to 7** discuss issues in Nunavut's Crown corporations. We discuss these corporations separately because they operate under different rules and have different issues than departments.

14. **Chapter 8** includes other issues we noted during our audits. Specifically, we comment on two real estate transactions, and note problems charging expenses to the proper fiscal year.

15. The **Appendices** provide important background information to this Report.

Chapter 2 – Nunavut's finances

Main Points

This chapter highlights some trends in Nunavut's finances, and notes that there is no one method of assessing the state of Nunavut's finances. Instead it notes that Appendix C to this report shows a number of indicators which illustrate different aspects of Nunavut's financial health.

This chapter also explains the debt cap and why it is important to the government.

Government financial objectives and trends

16. **Our use of 2002–2003 amounts in this report.** Chapter 4 of this Report comments on the different ways in which the government prepares its estimates, interim financial report, and audited, consolidated financial statements.

17. Consolidated financial statements present a better view of the government's finances because they include the whole government. Unless a reader has a particular interest in departments only, readers should look to the audited, consolidated financial statements whenever possible. However, there is a timing problem with these statements.

18. Each year, the government first prepares its unaudited, unconsolidated financial statements, then converts them to consolidated statements, which we audit. On 22 October 2003, the government tabled an unaudited, unconsolidated interim financial report in the Legislative Assembly.

19. There are some important trends in the government's finances which are highlighted in the government's interim financial report. Ideally, we would like to refer to final consolidated and audited amounts in this Report, but the Report was finalized around December 2003, and the government had not yet completed its 2002-2003 consolidated statements. Consequently, any 2002–2003 financial information in this Report is unaudited and unconsolidated information from the interim financial report.

20. **Bathurst mandate: living within Nunavut's means.** One of the principles set out in the Bathurst Mandate is working within Nunavut's means. While this can be interpreted in different ways, we feel that the government has been successful in operating within this objective through 2002–2003. Below we highlight some important trends and issues related to living within Nunavut's means.

21. **Good revenue growth so far.** Nunavut's revenues have enjoyed good growth. Some 80 percent of consolidated revenues come from one source: a grant under the formula financing agreement with Canada. Based on unaudited information for 2002–2003, formula financing revenue has grown by some 23 percent over three years, or some 8 percent a year.

22. Part of this recent growth is due to deliberate changes to formula financing revenue from Canada.

23. Other parts of the increase are a result of the structure of the formula financing agreement. There are many factors in the agreement that can increase or decrease the grant automatically. For example, under the formula:

- if Nunavut's population grows, the grant can increase. This is one of the reasons for increases to the grant to date.

- the level of overall provincial and local spending across Canada also changes the formula financing grant to Nunavut.

- as Nunavut's workforce and economy grow, so should the income tax revenues collected. An increase in income tax revenues decreases the amount of the grant under the agreement.

24. The government should not assume that formula financing revenue will always increase as rapidly as in the past. In fact, under the formula, it is possible for revenue to decrease.

25. **Expenses also increasing rapidly.** At the same time that Nunavut revenues grow, there is never a shortage of initiatives on which the government could spend new money. In raising this, we are not advocating increased federal transfers to Nunavut. It is up to Canada and Nunavut to negotiate such transfers. Rather, we are pointing out that the government's expenses have increased rapidly over the last few years. The following are examples of increases:

- Increased salaries and benefits as the new government hired staff

  In the government's early days staff vacancies were high, but the government has been successful in staffing positions over time. According to the government's own information, which we did not audit, as at June 1999, 42 percent of positions were filled. That rate increased to 83 percent by March 2003. Since those positions do not include contract or casual workers, actual salaries will be even higher. As a result of increased staffing, the government's cost of salaries and employee benefits has risen rapidly.

- Health costs

  The government has seen rapid growth in program costs, such as health care expenses in medical travel and out-of-territory hospital services. Over three years, health operating expenses grew around 25 percent, or more than 8 percent a year.

- Capital spending

  As the result of deliberate policy decisions, the government has also increased capital spending for infrastructure, housing and health centres. Capital spending in 2002-2003 was 110 percent higher than in 1999–2000.

Assessing Nunavut's finances

26. **Different measures of a government's finances.** No one number can tell the whole story of a government's financial health. Appendix B to this Report is a reader's guide to the government's audited, consolidated financial statements. Appendix C discusses indicators of financial health identified by the Public Sector Accounting Board of the Canadian Institute of Chartered Accountants. It also shows how the government measures against each of the indicators.

27. Appendix C comments on the 2001–2002 audited, consolidated financial statements since the government has not yet finalized the 2002–2003 audited, consolidated statements. There are differences in how the government prepares its consolidated and unconsolidated statements beyond including Crown corporations or not. We caution readers that comparing the 31 March 2003 unaudited, unconsolidated statements to previous consolidated statements could lead to incorrect conclusions. We discuss these inconsistencies further in chapter 4.

The debt cap

28. One of the indicators discussed in Appendix C relates to debt. Chapter 3 of our 2001 Report discussed some of the issues that a government might consider in determining whether to borrow money. If any government wants to spend more cash than it has, it needs to convince a lender to lend it money. Borrowed money is called debt.

29. Each of the three northern territories also has another special consideration. Each of the federal acts setting up the territories states that the territories cannot borrow more than the amount set by the Governor in Council, that is, the Governor General acting on the advice of the federal cabinet.

30. Since Nunavut's creation, this limit has been $200 million. This limit is sometimes called the debt cap. Should Nunavut want to take on more than $200 million of debt, it needs to convince the federal government to increase the limit.

31. By the government's own calculations, by March 2003 it already had about $136 million of debt. Consequently, the government was within about $64 million of the debt cap. The $136 million includes debt issued by the Nunavut Power Corporation and the Nunavut Housing Corporation.

32. We feel that the government's calculation of the types of obligations that are considered debt, for the purposes of the debt cap, needs to be refined. In our view, money that is formally borrowed is just one form of debt. For example, the government itself has dozens of bank accounts, and Crown corporations have many more. In certain cases, bank overdrafts in these accounts are also debt.

Recommendation

2.1 The Department of Finance should review the government's financial affairs to ensure that it is aware of, and tracks all amounts which are debt for purposes of the debt cap.

Government response

The Department of Finance will undertake a review of the current approach it is using to track what could be considered direct and guaranteed debt under the provisions of the Nunavut Act. As part of this review the Department will also evaluate the definition of what it considers debt for purposes of the provision of the Nunavut Act.

Chapter 3 – Best bang for the buck: the case for good financial management and control

Main Points

"Financial management and control" is a group of activities designed to reduce the risk of wasting money or other assets through errors or bad decisions. New organizations need to take deliberate steps to build good financial management and controls into their daily activities.

Our 2001 and 2002 reports discussed in detail the need for Nunavut to take deliberate steps to strengthen this area as soon as possible. In 2001, the government predicted that it would have basic financial management and controls in place by 2004.

This has not yet been accomplished. This chapter notes that the government needs to maintain efforts to improve financial management and controls to help ensure that the government delivers the best bang for the buck for Nunavummiut.

A brief introduction to financial management and control

33. Both our 2001 and 2002 reports to the Legislative Assembly refer to the importance of good financial management and control (FMC). Chapter 4 of our 2001 Report describes FMC in detail. Exhibit 3.1 shows the three main characteristics of good FMC.

Exhibit 3.1

Three key characteristics of good financial management and control

Good controls over assets, liabilities, revenues and spending. The government must collect the money it is owed, and use its assets and spend its money wisely. Government employees need to understand and follow financial rules for both.

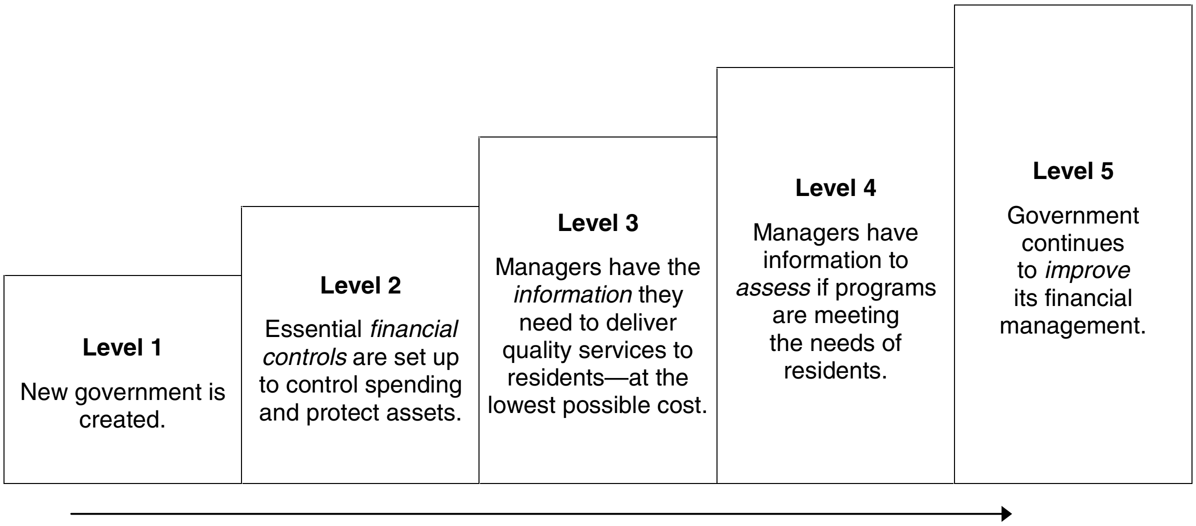
Good information for sound decisions. Poor information can lead to costly mistakes. Everyone who makes financial decisions needs good information to base them on. Accounting systems are an important source of this information.

Risk management. Organizations such as the Government of Nunavut need to identify risks, determine how significant the risks are, and take steps to manage them. This involves more than buying insurance. Organizations need to design steps to keep risks from becoming problems.

34. Our Office developed a five-step financial management and control model that shows the typical evolution of controls from a new organization through an established, high-functioning organization (Exhibit 3.2).

Exhibit 3.2

Five stages in building good financial management



Financial management normally improves over time, but management needs to take steps to make the improvements happen.

35. Additional information on financial management and control is found in chapter 4 of our 2001 Report and chapter 3 of our 2002 Report to the Legislative Assembly.

Financial management and control: what are the benefits?

36. Financial management and control and our five-step model can seem abstract. How do they help this government?

37. Mistakes happen. Poor decisions happen. Fraud can happen. As financial management and controls improve, the risk of expensive problems decrease. The government wants to deliver the best possible services to Nunavummiut. By avoiding costly problems, good financial management and control can help give the government and Nunavummiut the best bang for the buck, particularly where there are limited resources.

38. **Government's prior commitments to improvements.** The government will need many years to move through the model. Even large mature organizations may not be at level five. An important step is getting to level 2 in the model as quickly as possible.

39. In response to recommendations made in chapter 4 of our 2001 Report, the government indicated that it would have essential financial management and controls in place in government departments within three years or, in 2004.

40. In our 2002 Report, the government indicated that it was still working to meet that commitment.

41. **Government progress.** In 2003, the government began newly focussed efforts to improve financial management and controls. Although there are a variety of approaches it could have taken, the government adopted our Office's model and its detailed guidance to help guide efforts for improvements.

42. As part of the 2003 efforts, the government evaluated its overall state of financial management and identify areas that most need improvement.

43. **Improvements noted.** It is important to acknowledge improvements to the government's financial management. These improvements include the following:

- Internal audit

  Internal audits have expanded significantly since 2001, which is important for this decentralized government. However, there are some internal audit activities that need attention.

  There are always more possible areas for internal audit than there are staff to do the work. Internal audit planning should be improved to help ensure that it provides the best coverage possible. An audit committee made up of senior management from across the government would help to identify areas that most need internal audit attention. Government officials note that such a committee was approved by the Financial Management Board in November 2003. We have not yet audited how effectively that committee oversees internal audit efforts.

  In addition, chapter 5 of this Report notes the urgent need to extend internal audit to Crown corporations.

- Cost recovery

  Chapter 6 of our 2002 Report notes that Nunavut was unable to collect some $32 million from the federal government under a cost-share agreement for hospital and physician services. This was because the government could not submit the required claims to the federal government. By September 2003, Nunavut had taken steps to submit the claims and had received the cash. Further, the Government of Nunavut is now in the position to receive payments on a regular basis.

44. **Further work required.** Nunavut's 2003 review of necessary improvements to financial management shows many areas that require attention.

45. As of this writing, the level 2 target date for implementing essential financial management and controls that the government set in 2001 is about a year away. In our view, there is a risk that the government's target of 2004 may not happen. Potential difficulties include the following:

- Attracting specialist staff

  The government requires a variety of specialists such as doctors, nurses, teachers, engineers, lawyers and accountants, to deliver services. Here, we focus on the difficulties attracting accountants.

  The government provides on-the-job training and courses to help Nunavummiut process accounting transactions.

  On the other hand, an organization as complex and decentralized as the Government of Nunavut requires some highly trained professional accountants. Professional accountants have many years of formal education in accounting and business, and practical training. They develop and oversee areas such as internal controls and oversee the preparation of financial statements.

  The government has ongoing problems competing with the rest of the country for highly trained professionals.

- Current government finances

  Improving financial management will probably cost money. In the long term, we view this as a case of spending money to save money. But in the short term, will there be resources to continue the improvements?

- Crown corporations need to be included

  Recent efforts to improve financial management focus on departments. Chapter 5 of our Report notes that Crown corporations are important parts of the government, and that they also need improvements.

46. **Signing authorities need to be followed.** Chapter 7 of our 2002 Report explains why setting up proper signing authorities and following them is essential to good financial management. It also notes that we found many cases where transactions lacked proper approvals. We continued to find similar problems in our 2002–2003 audit as well.

47. Following the proper signing authorities may seem like unnecessary paperwork, but it is necessary to sound financial management. Chapter 8 of this Report gives an example of what can go wrong when an important contract lacks proper approvals.

Recommendations

3.1 The Department of Finance should measure its recent efforts to determine where in departments financial management and control most needs to be improved. It should update plans, budgets and deadlines to get to level 2 (Exhibit 3.2), and then monitor progress to ensure that the deadlines are met.

Government response

The Department of Finance will continue its efforts to strengthen the financial management capacity of the government. The Department is aware that, to be able to move to level 2 where essential financial controls are set up to control spending and protect government assets, further capacity building is required. In order to identify where departments' financial management is in most need of improvement, an assessment across departments of current capacity will be carried out.

3.2 The Department of Finance should include Crown corporations in its efforts to improve financial management and control in the government.

Government response

The Department of Finance will continue to include Crown corporations in efforts to strengthen financial management of the government. Through the efforts of the Crown Agency Council these initiatives will be enhanced.

Chapter 4 – Controlling the public purse

Main Points

The Legislative Assembly delegates responsibilities to the government, and the government is accountable back to the Assembly for how it carries out its duties.

This chapter notes problems in how the government reports its financial results. These problems make it harder for members of the Legislative Assembly to oversee the government's operations.

Delegation and accountability

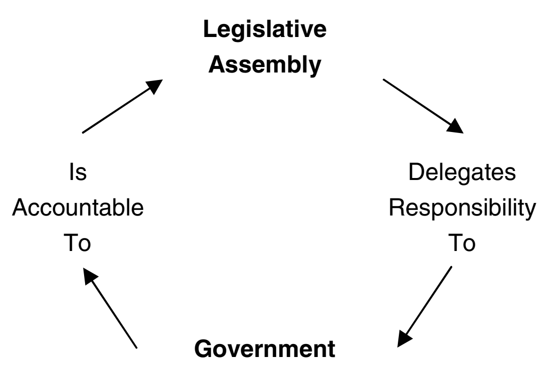
48. Nunavut's own laws requires that all revenues and expenses be approved by the Legislative Assembly.

49. The Assembly delegates the responsibility to collect and spend money to ministers and officials within their departments. Ministers are accountable to the Legislative Assembly.

50. The public accounts contain important financial information. Members of the Legislative Assembly (MLAs) can use that information to hold the government accountable for duties that the Assembly delegates to them (Exhibit 4.1).

Exhibit 4.1

Government is accountable to Legislative Assembly



51. This accountability back to the Assembly is a key principle of parliamentary democracies. Nunavut's current financial pressures add to the importance of the duties delegated to ministers and government officials by the Assembly.

52. During our audit work, we noted problems with a number of the components needed to make this delegation and accountability work well. This chapter discusses these problems.

Budgets and actual results are difficult to compare

53. If we look at accountability for the government's finances, there are currently three important sets of documents which members of the Legislative Assembly can use to help them determine how well the government has carried out the duties delegated to it (Exhibit 4.2).

Exhibit 4.2

Important documents for financial accountability

1. Main estimates, budget address, and supplementary appropriations

   In a typical year, the government signals its plans for collecting and spending money with a set of main estimates accompanied by a budget address. If additional spending is necessary later, the government asks the Assembly to approve supplementary appropriations.

2. Interim financial report

   The *Financial Administration Act* requires that the government provide an interim financial report to the Legislative Assembly by 30 September each year. The interim report for the 2002–2003 fiscal year was tabled 22 October 2003, which was the first time the Legislative Assembly sat after 30 September.

3. Audited, consolidated financial statements

   Both the federal *Nunavut Act* and Nunavut's *Financial Administration Act* require the government to provide an annual financial report to the Legislative Assembly. The entire report is called the public accounts.

   An important part of the public accounts is the audited, consolidated financial statements. Appendices B and C to this Report suggest ways that readers can use the audited, consolidated financial statements to assess the government's financial health. These appendices are based on the 31 March 2002 statements because, as of this writing, the government had not finalized the 31 March 2003 financial statements.

54. One way to check the government's financial management of Nunavut is to compare the financial statements to the main estimates.

55. Government accounting standards actually call for budgets to be shown in financial statements to make it easy for readers to make this comparison. However, Nunavut's consolidated financial statements (and interim financial report) omit budget amounts. This is because of an 'apples and oranges' problem. The way the consolidated financial statements are prepared is so different from the main estimates that comparisons of budgets to actuals is meaningless.

- The consolidated financial statements are prepared in accordance with Canadian accounting standards for government.

  These financial statements include, or consolidate, all parts of the government, departments and Crown corporations. In addition, the purchase cost of capital assets (buildings, tank farms, etc) is spread out, or amortized, over the life of the asset.

- The main estimates are unconsolidated. In addition, the entire cost of purchases of capital assets is shown as an expense in the year of purchase.

- The interim financial report is similar to the consolidated financial statements, but the interim report is unconsolidated.

56. How can this inconsistency be fixed to allow the meaningful comparison of budget amounts and financial statements? There are two options:

- Prepare the three documents in the same way

  Nunavut's audited, consolidated financial statements need to keep their current format to comply with Canada's requirement to follow the Public Sector Accounting Board's standards. So if changes are made, they will be to the other documents. Some governments in Canada prepare budgets as they do financial statements—Nunavut could do the same.

  Chapter 3 notes that Nunavut needs to work hard at improving its financial management. Should Nunavut revise its budget process, it should not divert attention away from improving other parts.

- Restate budget amounts in later documents

  An easier option might be to restate budget amounts in the financial statements. This could require additional information on capital assets and the plans of Crown corporations, but is much simpler than changing the entire budget process.

57. Legislative assembly members cannot get a clear picture of government operations when they cannot compare budget amounts to financial statements.

The government operates mainly on a cash basis throughout the year but is accountable to the Legislative Assembly for more than just cash

58. Nunavut's laws on spending money are complicated. But in general, managers are not allowed to spend more money than is available in a department's total operations and maintenance, or total capital budget for the year.

59. In addition, laws require that managers also consider amounts owing at year-end, which are called accounts payable. For example, if the government buys and takes delivery of a truck during the year but did not pay for it until after year-end, the cost of that truck is still counted as a purchase for the year.

60. Throughout the year, the government tends to consider only cash paid and not all payables which may exist. At year-end the government adds up their payables and adds them to expenses. This can show that a department has spent more than it realized, and, in some cases more than approved by the Legislative Assembly.

The government is consistently asking the Assembly to approve money after year-end, after it has already been spent

61. Nunavut's laws only allow the government to spend money which is authorized by the Legislative Assembly. At the same time, the requirements of Nunavut's *Financial Administration Act* may confuse the situation.

62. On the one hand, the government must produce accurate financial statements that include all expenses. The Act allows the comptroller general[1] to make accounting entries to record all expenses and all payables, even if they are more than the amount approved by the Legislative Assembly. If more money is spent than is in a budget, the Act then requires the government to submit a supplementary appropriation to the Legislative Assembly, after the money has been spent.

63. On the other hand, the law still requires that managers spend no more than they have in their budgets.

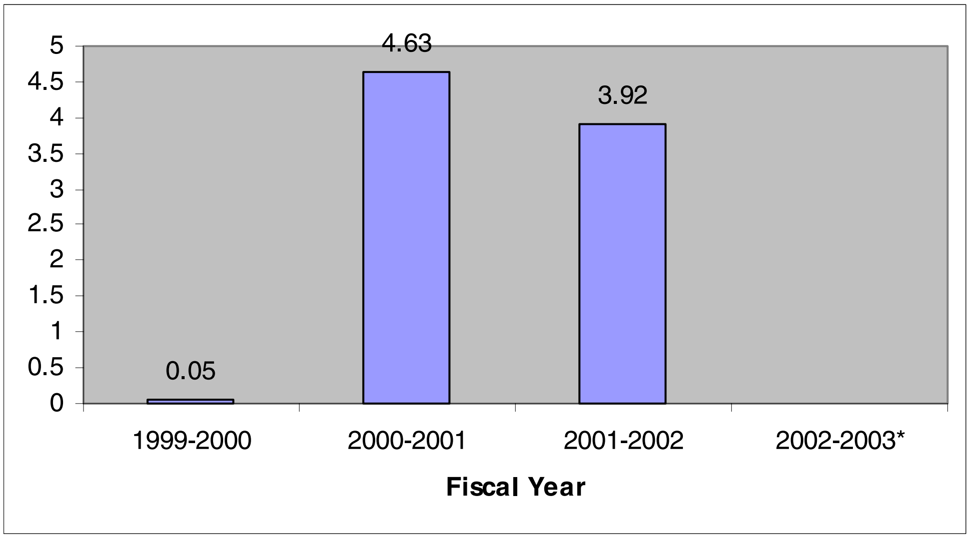
64. In our view an unusual and unfortunate trend has emerged. For the last two years of its operations, the government asked the Assembly to approve large amounts of spending after the fact (Exhibit 4.3).

65. As of this writing, the government was still working on its financial statements for 2002–2003, so we cannot include a similar percentage for that fiscal year.

[1] The deputy minister of Finance

Exhibit 4.3

Percentage of total spending approved by Legislative Assembly after it was already spent (approved after year-end)



* unknown as of this writing.

Source: Government of Nunavut estimates and scheduled of expenses included the government's unaudited, unconsolidated financial statements

66. We want to be clear that it is not normal for a government to ask a Legislative Assembly for approval to spend money after the money is already spent. For this reason, the government needs to resume asking for approval in advance.

Public accounts continue to be late

67. Legal requirement. Both our previous reports to the Nunavut Legislative Assembly note that the government was significantly late in meeting deadlines for tabling its public accounts. The *Nunavut Act* requires that the public accounts be tabled each year by 31 December. If the Assembly is not sitting on December 31, then they must be tabled earlier.

68. Another good reason for timely financial statements: they are important. Equally important, the need for timely public accounts is critical information for MLAs. In our view, the government's audited, consolidated financial statements, which are included in the public accounts, should be the official starting point for discussions of both the government's financial results and Nunavut's financial health. But for the past few years, public accounts were tabled so late (Exhibit 4.4) that other, less relevant, financial information, such as the interim financial reports took on greater importance than they should.

69. Elsewhere in this chapter we note that information in the interim financial report is not prepared in accordance with accounting standards for governments, and differs from information included in the audited, consolidated financial statements. It is urgent to make the public accounts available sooner. Exhibit 4.4 shows that the government is not having much success in meeting its deadlines.

Exhibit 4.4

Dates the government tabled its public accounts

Fiscal Year	Date Public Accounts tabled in Legislative Assembly (1)	Tabled how long after year end	Tabled how long after deadline (2)
1999-2000	May 2001	13 months	5 months
2000-2001	May 2002	13 months	5 months
2001-2002	June 2003	14 months	6 months
2002-2003	Not yet tabled as of April 2004	--	--

(1) Public accounts include the audited, consolidated financial statements and is a key document in assessing Nunavut's finances.

(2) Based on Canada's *Nunavut Act*.

70. **Why so late?** The audited, consolidated financial statements included in the public accounts require information from all parts of the government (departments and Crown corporations).

71. If any of the key information is late, then the public accounts will be late. Until every one of dozens or hundreds of people in the government complete year-end procedures assigned to them, then the public accounts cannot be completed.

72. We note that some of the information needed for the audited, consolidated financial statements is now being prepared earlier. Despite the improved timeliness in some areas, not all information is available on a timely basis, and there continues to be delays in the preparation of financial statements. The result is that the date the public accounts are tabled in the Legislative Assembly is not improving.

73. The public accounts need to be tabled on time. For that to happen, the government needs to become more aggressive in ensuring that all its departments and Crown corporations meet their deadlines.

Recommendations

4.1 The Department of Finance should provide adjusted budget information in its financial reports so that MLAs and others can compare budget amounts to actual.

Government response

The Department of Finance has completed preliminary research with respect to the implementation of accrual-based budgeting, including the amortization of its tangible capital assets. This work will continue in the 2004-05 fiscal year and implementation will occur as soon as is practical.

4.2 All departments should seek the Legislative Assembly's approval to spend money before it is spent.

Government response

The Department of Finance agrees that prior approval should be sought before departments incur expenses, and is working with all departments across the government to ensure full compliance with this requirement of the Financial Administration Act.

4.3 The Department of Finance needs to improve the timeliness of the tabling of the public accounts.

Government response

The Department of Finance is working towards producing timely financial statements. Through the creation of the Crown Agency Council, the Department expects more timely annual reports from the Crown Corporations.

Senior management in the Department of Finance will be monitoring the year-end procedures in all departments to ensure that all the reporting deadlines agreed upon for financial reporting are adhered to by all departments. Any delays or missed deadlines will be identified and addressed at an earlier stage. This in turn will ensure that the government's own reporting is more timely.

Chapter 5 – Crown corporations need some special attention

Main Points

Crown corporations are an important part of the Government of Nunavut. They just happen to operate differently than departments.

There are significant issues with Nunavut Power Corporation and Nunavut Business Credit Corporation. We discuss these in chapters 6 and 7 in detail.

This chapter looks at some problems which impact many of Nunavut's Crown corporations, and in part contribute to the problems we found in Nunavut Power Corporation and Nunavut Business Credit Corporation.

The chapter concludes that the current state of Crown corporations creates risks for the government, and recommends areas that need action to reduce these risks.

74. Nunavut has five Crown corporations, excluding the Workers' Compensation Board, which is currently under joint Northwest Territories and Nunavut control (Exhibit 5.1).

75. Crown corporations are a significant part of the government. During 2001–2002, they spent about $200 million, or 25 percent of total government spending, excluding transfers between different parts of the government. The size of the Crown corporation sector could become much larger because the government is considering the transfer of its $80 million annual petroleum products operations from a revolving fund within the Department of Public Works and Services[2] to a subsidiary of Qulliq Energy Corporation.

Exhibit 5.1

Nunavut Crown corporations

- Nunavut Arctic College
- Nunavut Business Credit Corporation
- Nunavut Development Corporation
- Nunavut Housing Corporation
- Nunavut Power Corporation (*)

(*) became Qulliq Energy Corporation on 1 April 2003

[2] Now Department of Community and Government Services

76. Beyond the dollars they spend and collect, Crown corporations are an important part of the government, and, like departments, deliver government programs important to Nunavummiut. However, they operate differently from departments. The *Financial Administration Act* outlines how these corporations are governed. Under the Act, the government's relationship with Crown corporations is not as close as it is with departments.

77. While deputy ministers and their staff report directly to ministers, each Crown corporation, except for the Nunavut Housing Corporation, has a board of directors that oversees its management.

78. Despite the greater independence, the Legislative Assembly, ministers and the government can influence the activities of Crown corporations in several ways.

- Each Crown corporation has its own enabling act that determines what it is allowed to do. The Legislative Assembly can influence corporations through this legislation.

- The *Financial Administration Act* requires Crown corporations to submit annual corporate plans and budgets for ministerial approval. Although those sections of the Act are complex, in general they require Crown corporations to operate in accordance with the corporate plan and budgets approved by the Government of Nunavut.

- The Act allows the minister of Finance to issue formal directives to Crown corporations in unusual circumstances. In addition, enabling legislation for each corporation sometimes gives that authority to the minister responsible for the corporation. Chapter 7, on the Nunavut Business Credit Corporation, describes an example of this.

Important issues facing many Crown corporations

79. The many issues facing Nunavut's Crown corporations, particularly the Nunavut Power Corporation and the Nunavut Business Credit Corporation, concern us. Generally, the issues described in this chapter apply to all the corporations.

80. **Difficulty recruiting staff with special experience.** Chapter 3 outlines the need for good financial management and control in all parts of government. For Crown corporations, this requires recruiting staff to oversee financial management and prepare annual financial statements. Chapter 3 further notes problems the government has in competing with other parts of Canada for staff with this kind of experience.

81. This problem is particularly difficult for Crown corporations because most are based in smaller Nunavut communities. Each corporation needs at least one professional accountant with a lot of experience to develop and oversee internal controls and prepare financial statements.

82. We are not questioning the government's decentralization policies, however, with the current high demand throughout Canada for trained accountants, it is difficult for

Nunavut Crown corporations in smaller communities to compete for trained staff – see case study below, Nunavut Artic College.

83. Nunavut Arctic College without permanent financial leadership for two years. For example, Nunavut Arctic College's headquarters moved from Iqaluit to Arviat in fall 2001. For the next two years, the College did not have a full-time bursar (vice president of finance). The bursar's duties were split between staff and contracted help.

84. A prolonged lack of financial leadership makes it difficult to ensure that a Crown corporation has the level of financial management and control that it needs.

85. At present, the Department of Finance has the government's highest concentration of technical staff needed to implement good financial management and control. In response to our past reports, the Department created advisor positions to help other departments with financial issues. However, this is not the case for Crown corporations.

86. Lack of internal audit. Chapter 3 outlines how internal audit is an important part of good financial management in the government. However, at present there is no internal audit function within any Crown corporation.

87. Training for boards of directors needed. The *Financial Administration Act* imposes many serious responsibilities on the boards of directors of Crown corporations. For example, directors are responsible for establishing financial controls in their corporations and ensuring that they prepare appropriate financial statements.

88. Recent problems with some well known corporations around the world have focussed attention on corporate financial management and the need for good controls. These problems have also highlighted the need for boards of directors to oversee management in meaningful way. This is called corporate governance.

89. Effective directors need to work with management. They also need experience, training, and independence to ask management tough questions and, as a board, truly govern the Crown corporation.

90. In addition, best practice calls for a professional accountant to head the committee of the board that is responsible for overseeing a corporation's finances. Such committees are typically called audit committees.

91. We have not audited how new directors are selected or trained for their duties. We note that at least one Crown corporation has orientation activities for new directors.

92. We note that the government has no co-ordinated training for directors. It may be expensive for individual Crown corporations to go it alone with training for their boards since they may be re-inventing similar material. The cost to provide this training may be quite significant in relation to their operating budget.

93. But more importantly, the roles of these directors are so important that they warrant consistent training. Of course, they also require separate orientation on their particular Crown corporations.

94. Do government policies apply to Crown corporations? We raised this issue in chapter 5 of our 2002 Report to the Legislative Assembly. This issue has not yet been addressed, and we still do not know which government policies apply to Crown corporations.

95. In recent discussions, management of the Department of Finance indicated that they felt that all government policies should apply to Crown corporations unless there is a good reason for an exemption for a particular corporation. However, as of December 2003, steps had not been taken to make this happen.

96. Crown corporation financial statements: late and holding up the government's own statements. Our Office gives opinions on annual financial statements prepared by Crown corporations. Nunavut's laws are clear that management, under the board of directors, is responsible for preparing accurate financial statements. In this respect, Nunavut's laws for its Crown corporations are consistent with laws in other parts of North America and much of the world.

97. Chapter 4 includes an update on efforts to improve the timeliness of the government's own financial statements. Delays by Crown corporations in finalizing their own financial statements contribute to delays in the government's own financial reporting.

98. To be clear, we have noticed improvements in individual corporations' ability to prepare financial statements. But only two had their annual reports for 2002–2003, including audited financial statements, tabled promptly in the Legislative Assembly. Also, the Nunavut Business Credit Corporation has had extraordinary problems in preparing its statements for the past three years (chapter 7).

Nunavut Crown corporations: significant risks to the overall government

99. The nature of the problems discussed in this chapter tend to compound each other. Purely for illustration, if there is a significant problem with financial management and control in a Crown corporation, who would find it?

- There are problems recruiting staff with appropriate technical training. It is possible that management may not find the problem.

- Boards of directors may not have the training or current information needed to catch problems through their oversight.

- There is no internal audit in Crown corporations.

100. All of this is to point out that there are significant issues in the overall structure and management of Crown corporations. The issues and risks noted in these chapters need to be addressed by the government as a whole to ensure that appropriate financial management exists in Crown corporations.

Crown Agency Council: positive recent development

101. For some time now we have been discussing our Crown corporation concerns informally with senior Department of Finance staff. They have been receptive to our concerns and are beginning to take corrective action. In fall 2003, the government established a Crown Agency Council to deal with Crown corporation issues. The Council has two levels: a political level chaired by the minister of Finance and a bureaucratic level chaired by the deputy minister of Finance.

102. By December 2003, each committee had met formally twice. We support the objectives of the Council and hope that it will continue to develop under the new Cabinet.

Nunavut Power Corporation and Nunavut Business Credit Corporation: lessons for future transfers

103. Most of Nunavut’s Crown corporations were created on 1 April 1999. However, Nunavut Power Corporation was created on 1 April 2001. The Government of Nunavut took over responsibility for the administration of Nunavut Business Credit Corporation on 1 April 2000.

104. On the one hand, it would be easy to dismiss the problems with these two Crown corporations which we raise in chapters 6 and 7 as start-up problems that come along with new responsibilities. On the other hand, the problems are serious and could have been avoided.

105. The problems with Nunavut Power Corporation and Nunavut Business Credit Corporation should be taken as cautionary tales with a view to preventing future problems when new Crown corporations are set up in Nunavut.

106. The government made a deliberate policy decision to put some government operations into Crown corporations, and to locate some Crown corporations outside of Iqaluit. We need to be clear that we are not questioning these decisions. At the same time, we are concerned that there are significant problems with Nunavut’s Crown corporations which need attention. Our recommendations below are designed to respect the government’s key decisions on Crowns, but at the same time address some critical problems. Our recommendations may require a closer relationship between Crown corporations and the government than is typically the case. In our view, this is consistent with the government’s own decision to use the Crown Agency Council to give more attention to Crown corporations.

Recommendations

5.1 As part of its efforts to improve financial management and control in the government, the Department of Finance should extend its detailed review of areas for improvement from departments to Crown corporations as well.

Government response

As indicated under recommendation 3.2, the Department of Finance will continue to include Crown corporations in efforts to strengthen financial management of the government. This will be affected through the efforts of the Crown Agency Council.

5.2 The Department of Finance should:

a. ensure that all Crown corporations have the adequate technical staff needed for proper financial management and control;

b. extend internal audit to Crown corporations;

c. extend Department of Finance support to Crown corporations;

d. ensure that boards of directors have adequate training to carry out their duties for overseeing Crown corporations on behalf of the government, the Legislative Assembly and Nunavummiut;

e. resolve how government policies apply to Crown corporations;

f. ensure that Crown corporations are able to generate timely financial statements; and

g. ensure that Crown corporations are able to monitor their own finances and report problems so that there is no unexpected bad financial news to the government as a whole.

Government response

The Department of Finance is aware of the concerns in a number of the specific areas mentioned in this recommendation. The Department is confident that the Crown Agency Council will to help ensure that some of the specific concerns itemized will be improved as a result of the operation of this new oversight agency.

5.3 If the Government of Nunavut creates new Crown corporations, the creation should be carefully planned and monitored to avoid the kinds of problems encountered with Nunavut Power Corporation and Nunavut Business Credit Corporation.

Government response

The Government notes the recommendation concerning the formation of Crown corporations. A recent decision to delay the formation of the Qulliq Fuel Corporation indicates that the government is taking steps to ensure that the formation of new Crown corporations have sufficient time to be carefully planned and carried out successfully.

Chapter 6 – Nunavut Power Corporation

Main Points

Nunavut Power Corporation is a territorial Crown corporation created under the Nunavut Power Utilities Act. It is responsible for the safe, economical, and reliable delivery of electricity in Nunavut.

The Corporation is important due to its size and economic significance, but also because it is the sole supplier of power to the people of Nunavut. The Corporation is supposed to be self-financing through billings to its customers, but since it was created on 1 April 2001 it has had major financial problems. This chapter details some of those issues.

107. The governments of Nunavut and the Northwest Territories (NWT) divided most of their programs and activities on 1 April 1999. But they waited for another two years before dividing the Northwest Territories Power Corporation between them. They split the NWT Power Corporation on 1 April, 2001 and Nunavut's portion, called the Nunavut Power Corporation has been operating since then.

108. During that time, many of those involved made some mistakes but also learned valuable lessons.

109. Looking back, several things could have been done much better. The IKUMA Report prepared for the Government of Nunavut offered a plan for power generation and distribution in Nunavut, but the decision to split the NWT Power Corporation was the crucial decision that started things off. The split was not uneventful and to date some financial aspects have not been finalized.

Challenges for the Nunavut Power Corporation

110. The challenges facing the Corporation include becoming financially viable, recruiting and retaining professional staff, serving a small population that is spread over a large territory, and the difficulty of achieving any real cost efficiencies through economies of scale.

111. Because of distances between communities, and the often difficult terrain, electrical generation plants are not connected by a grid. Each community has a stand-alone generation plant and local distribution. At present, the Corporation uses mostly diesel power generators. Diesel fuel costs are about 40 percent of the Corporation's annual operating expenses, and fuel is subject to market price fluctuations.

Senior staff positions

112. The Corporation initially employed many former NWT Power Corporation managers for its senior staff, including the president and all the vice-presidents. More recently, there have been significant changes at the senior management levels.

Offices in different locations separated management and staff

113. The government decided to locate the Corporation's head office in Baker Lake, where there were few experienced local staff for administrative positions. It also kept an office in Iqaluit where most senior managers lived and worked. This added difficulties by not having all management and administrative staff in one location.

114. Training local staff has been challenging and the separate Iqaluit office for management has added costs for travel, communications, and accounting.

It is not clear what was expected of the Nunavut Power Corporation

115. Senior management and the board of directors did not meet the challenge of managing the financial affairs of the Corporation well during its first three years.

116. Even before the Corporation was legally formed, the transition funding provided by the government was seriously overspent by $1.0 million.

117. Crown corporations are somewhat independent of day-to-day government operations, but are still subject to direction from the responsible minister. We did not see any specific policy expectations or policy directives to management or the board of directors on key issues such as profit expectations, etc., as shown below.

118. The Corporation is subject to the Nunavut *Power Utilities Act* and the Nunavut *Financial Administration Act,* but these Acts are not enough to set policy direction.

119. The Government of Nunavut had been in place for two years (1999 to 2001) when the Corporation started on 1 April 2001. Given the two years of experience, we expected that the Corporation's board of directors would have agreed with the minister on several key policies:

- Does the government expect the Corporation to make a profit or break even? Is it expected to pay dividends of a certain amount each year, in the same way that the Northwest Territories Power Corporation does? (The *Nunavut Power Utilities Act* allows for dividends to be paid from time-to-time.)

- What are the government's goals for the Corporation when it makes certain decisions, such as consolidating its offices in Baker Lake?

- The minister responsible for the Corporation appoints members to the board. What mix of expertise should be on the board of directors, and what qualities should managers possess?

- What is the government's tolerance for increasing rates when revenues no longer cover costs? For example, although it is set up to be financially self-sufficient by charging its customers for power at rates that would cover costs and make a profit, according to the Ikuma Report, the government pays about 80 percent of the

Corporation's billings one way or another. The Corporation bills the remaining 20 percent to private customers.

120. Clearer policies from the government may have helped prevent some of the problems experienced by the Corporation in its first three years. These problems resulted in major financial losses and recent changes at the board level and senior management levels.

121. Although it is not clear if there were specific policy objectives on profits, in each of the fiscal years 2002 and 2003, the government budgeted $3.9 and $2.3 million of expected dividends from the Corporation. No dividends have been paid by the Corporation.

The financial situation today

122. The Corporation has lost about $13 million since it began and is financially vulnerable, as discussed below. Management knew, or should have known, about this deteriorating situation and should have taken action.

Governance, the board of directors

123. A board of directors should include outside members who have expertise in financial management and a good understanding of accounting matters.

124. The Corporation's board of directors has had a combination of Nunavummiut and non-residents, some of whom were appointed because they had specialist experience or qualifications.

125. However, the Corporation has been weak overall in financial management and accounting expertise. The senior people who should have been aware of the Corporation's health were not. They failed to identify or take action on important indicators of the deteriorating fiscal situation.

126. For example, in their first two years, the Corporation's board of directors approved projected profits of $2.7 million and $1.6 million, based on management projections. Instead, the Corporation lost $13.1 million.

127. This huge discrepancy needs to be examined and understood. What is clear is that management was too optimistic in its forecasts and failed to take into account revenue shortfalls, poor spending habits and over-budget capital spending. It is not clear whether the board of directors was aware of the poor management projections or if they seriously challenged the assertions.

Alerts from the auditors

128. Our Office issued severe warning letters to management with copies to the board of directors, plus separate reports to the board. On the last set of financial statements for

Nunavut Power Corporation, as at 31 March 2003, our audit report included the following paragraph:

> "I wish to draw to your attention that the Corporation has incurred significant operating losses and has increased its debt by approximately $29 million since it commenced operations on April 1, 2001. Reasons for these losses included utility rates charged that were insufficient to cover operating costs and inadequate control over spending resulting from significant weaknesses in financial management practices. The Auditor General's next report to the Legislative Assembly will discuss these matters further."

129. This Report addresses these important issues. Its objective is to help improve the accountability of the Corporation's management to the board of directors, and the board to the minister and the Legislative Assembly.

130. The Corporation faced two critical challenges in its first years of operation. It had to bill and collect the right amount of revenues to be self-sustaining, and it had to control its costs within its ability to pay. It did neither.

Problems with insufficient revenue

131. In the Nunavut Power Corporation, good revenue management should follow a simple process:

- Set rates sufficient to cover costs and review them regularly (see exhibit 6.1).
- Read all meters accurately and regularly.
- Issue timely and accurate billings.
- Collect from customers according to the terms of business.

Rate rider discontinued too quickly

132. Initially, the Nunavut Power Corporation had a rate rider in place to cover excess fuel costs. This rate rider was added to the first year bills of all Nunavut customers. Based on the advice received from management, the Minister approved the termination of the rate rider and the Corporation stopped billing it on 31 March 2002. This occurred when the Corporation still had over $4 million in extra costs un-recovered from previous years, and did nothing to request a new general rate.

133. In March 2003, the Corporation made a request to the Minister for a rate rider to cover the excess fuel costs. The request was reviewed by URRC and it recommended a lesser amount for the rate rider to the Minister. On 3 June 2003, the Minister rejected both requests and stated that the Corporation will develop a general rate application during 2003-04.

134. High fuel prices have continued and the Corporation continues to pay additional extra fuel costs. None of these costs have been charged to customers since 31 March 2002.

Exhibit 6.1

A note about electricity pricing

The Nunavut Power Corporation and the Northwest Territories Power Corporation are rate-regulated utilities. This means that, unlike many companies in the private sector, they cannot set their own rates for electricity sales. They are subject to government laws that set out a process for pricing electricity.

The Nunavut Power Corporation's initial prices for electricity were approved by the NWT Public Utilities Board based on the costs incurred by the NWT Power Corporation and the rate of return (profit) allowed. After an exhaustive study of costs by the Board, in a process known as a "general rate application", the rates are set for several years. The Nunavut Power Corporation has collected those same rates since. The Corporation can charge those prices to its customers until the minister approves the next general rate application.

However, the Corporation has to keep aware of whether current rates are enough to cover its costs and make a profit. If they are not, the Corporation can submit an application for review and request for change.

Nunavut pricing process is a little different

When the two governments divided in 1999, the Nunavut Legislative Assembly created the Nunavut Public Utilities Board.

After division, the government repealed the *Nunavut Public Utilities Act* (which was similar to the *Northwest Territories Public Utilities Act*) and replaced it with a simplified process under the *Utility Rates Review Council Act*.

The Act created a Utility Rates Review Council (URRC), which is responsible for reviewing requests for rate changes by the Corporation and making recommendations to the minister who has final approval authority.

Excess costs and how these are recovered

From time-to-time, some costs turn out to be higher than forecast and approved by the Public Utilities Board in setting rates. The cost that changes most often is the price of diesel fuel. When this happens (usually due to higher prices), the increased fuel cost is calculated and added up until it reaches a certain level. The Board can allow the Corporation to increase its bills to collect these higher costs. This is known as a rate rider.

A rate rider usually lasts for a certain period until the Corporation has recovered its increased costs.

Continuing extra costs were not known by the Corporation

135. At the time of our 2002 audit of the Corporation (its first year-end), we asked management to calculate the additional fuel costs paid but not recovered. Until that point, management did not know the amounts, or that they had excess costs before stopping the rate rider billings.

136. At 31 March 2002, the uncollected costs were more than $4.5 million. A year later they had grown to $9 million. If the Corporation had kept the rider in place, it could have billed the $9 million to customers and avoided serious losses by 31 March 2003. Management estimates the uncollected extra fuel costs will be $14 million by 31 March 2004.

Revenues do not cover costs

137. For the Corporation to be self-sustaining and be able to pay dividends to its owner, the Government of Nunavut, it must earn more revenue than it pays in expenses.

138. This has not happened. In a utility business, the revenue needed to be self-sustaining must cover the total operating costs (such as fuel, wages, supplies, and rent), capital assets depreciation, and interest costs, plus allowed profit (rate of return).

139. As noted, the Utility Rates Review Council reviews rate applications from the Corporation and makes recommendations to the minister who approves them. But the Council does not suggest changes on its own.

140. The rates charged by the Corporation have not changed since 1997. But the costs of operating the business have changed so much since then, that the "old" rates don't cover the Corporation's current and extra costs.

141. At division, the Nunavut Public Utilities Board (now replaced by the Council) directed the Corporation to submit a rate application, to determine if existing rates covered the operating costs. Even though its costs had changed (Exhibit 6.2) the Nunavut Power Corporation did not submit the application.

Exhibit 6.2

Examples of increased costs

- Before division, NWT Power Corporation had computer systems and administrative processes to cover both the NWT and Nunavut. Since division, Nunavut Power Corporation has had to develop and pay for its own.
- A new head office in Baker Lake (with all new staff), new engineering department, new computer systems, etc., all added to the Corporation's costs.
- The Corporation borrowed $61 million to pay off its share of long-term borrowings, at a reduced interest rate. The former lenders charged a large premium for the refinancing. The revised debt also changed future interest costs.
- Since division, the Corporation has upgraded several plants at a significant cost.
- The price of fuel has changed.
- Government expansion and the growth in the city of Iqaluit have increased power sales and have cost the Corporation money to provide extra service.
- Inflation since the last rate increase has added to costs.
- Hiring and training new staff continues to be expensive.

142. Replacing the Public Utilities Board with the URRC did not excuse the Corporation from knowing its costs and obtaining approval for updated rates. The Corporation's lack of action in this regard resulted in its large losses in its first two years.

143. As noted previously, the Corporation compounded the problem by discontinuing the rate rider to cover additional fuel costs. The Corporation stopped collecting this additional rider on 31 March 2002 without fully understanding the financial implications.

The bottom line

144. The Corporation has not yet billed $9 million in extra costs to 31 March 2003 and a likely further $5 million to 31 March 2004. These are a major part of the large losses that the Corporation has suffered.

145. It is also unclear why the Corporation did not prepare and submit a new general rate application to the Council, even though management knew, or should have known, that it was not charging enough to recover current costs.

146. The Corporation also had problems with regular accurate meter readings, inaccurate billings and late billings to customers. Worse still, there was little or no effort to collect from customers.

Managing accounts receivable

147. At division, the Corporation had accounts receivable of $11 million. A year later, they had grown by some 233 percent to $25 million. At 31 March 2003, the Corporation had reduced its accounts receivable to just under $19 million, but this is still 175 percent higher than at division.

148. By not collecting its bills on time the Corporation has to finance its operations by borrowing. It ran out of cash in its first year, borrowed from the bank, and paid interest on its overdraft. This added up to about $1 million over the first two years.

149. The longer the Corporation's bills remain outstanding, the more difficult they are to collect. This means higher bad debts, about $857,000 in its first two years of operations. Bad debts for a well-run utility company should be small.

150. The cost of these errors is hard to measure precisely but includes lost credibility by the Corporation with its customers, increased risk of non-collection and additional interest costs.

Financial management

151. In our two previous reports to the Legislative Assembly, we noted our concerns about several basic financial management issues for the government as a whole, summarized below in Exhibit 6.3. In many respects, these issues also apply to the Nunavut Power Corporation.

Exhibit 6.3

Messages from past reports

The government should define and build day-to-day relationships with Crown corporations. Many of Nunavut Power Corporations' problems are a result of the lack of such a relationship.

Other issues previously reported include:

The importance of good financial management and budgetary controls over spending. The Corporation has poor spending controls and has never produced timely and accurate financial information

Good financial controls are even more important in a decentralized organization. The Corporation has split its billing, collections and other functions between Baker Lake, Iqaluit and other locations. Decentralized functions between the locations require even stronger controls.

Improving revenue management. The Corporation's main revenue is from electricity sales. It has had problems in issuing timely, and accurate bills, and serious problems collecting from customers. The Corporation had to borrow money to pay its bills instead of collect from customers.

Improving payment management. The Corporation's purchases and payments controls have been weak.

Corrective action is needed

152. The Corporation is financially unhealthy and needs major effort to put it back on a solid foundation.

153. The cost of continued poor financial health affects the Corporation in several ways:

Financial instability. By 31 March 2003, the Corporation was unable to meet its short-term financial commitments without borrowing. This situation has worsened since then.

Growing debt. Total debt has increased by over $29 million since division. By 31 March 2003, the Corporation had borrowed $19 million more than it was legally allowed to under its Act.

Capital investment plan needed. The Corporation has invested over $20 million in property, infrastructure and equipment since 1 April 2001. A capital investment plan should, in the long-term, be funded from internally generated profits. The Corporation does not generate enough internal cash to buy capital assets, (it has to borrow), and its capital spending has exceeded internal budgets.

Other financial management control problems

154. Other financial management and cost control weaknesses have contributed to the Corporation's financial problems.

Previous audit reports to management and the board of directors have identified problems with poor spending controls

155. We have issued four reports to the board of directors and four reports to its management. No significant action has been taken on the various problems we identified until recently. Exhibit 6.4 details the most costly and significant issues.

Monitoring and control of spending

156. The large overspending of capital and operating budgets raise a number of concerns including how budgets were determined, how payments were authorized and how spending was monitored by management and by the board of directors. Spending should be controlled using standard general principles as shown in Exhibit 6.5.

157. There were many cases where monitoring and accounting controls did not exist or were completely ineffective. In addition to the items noted earlier, we noted that

- The Corporation paid a supplier more than $800,000 under a verbal agreement. The written agreement was drafted but not finalized.
- Managers without sufficient spending authority approved purchases.
- Staff made purchases that did not comply with the Corporation's purchasing policy.
- The Corporation did not tell the bank that certain employees had left and so their names were still on the cheque signing authority.
- The Corporation issued "sole source" contracts without the president's written approval as required.

Exhibit 6.4

Significant findings of prior years

Capital budgets

The Nunavut Power Corporation overspent its capital budgets by $2.8 million in 2002 and $2.1 million in 2003 on completed jobs because management:

- did not properly monitor projects during construction.
- systems could not produce timely and accurate financial information for management purposes.
- revised capital projects without getting proper approval.
- approved some capital projects that were not in the budget.

The *Nunavut Power Utilities Act* requires the Corporation to submit capital budgets to the minister responsible. Management informed us that the 2003 capital budget was not submitted to the minister because they were not aware of the legal requirement. Senior management needs to know the legislation under which they are required to manage the Corporation.

Penalties for late payments

The Corporation, (like all businesses) has to pay employee tax withholdings and the goods and services tax (GST), to Canada Revenue Agency on time, otherwise it will be charged significant penalties. During the 2002 fiscal year, the Agency charged the Corporation $110,000 in late filing penalties. The Corporation also paid a fuel supplier penalty of $130,000 because of late payments.

Additional pension costs not recovered

Prior to division, the employer's share of basic pension costs increased by 114 percent. While the NWT Power Corporation was paying the employees' salaries, the federal government was subsidizing the increased pension costs. This subsidy was to last until 2004. While in effect, the pension subsidy reduced NWT Power Corporation's costs which had an impact on its rates.

On division, no additional funding was negotiated for pension costs for Nunavut Power Corporation employees when they transferred to Nunavut. Without the subsidy, additional pension costs to the Corporation for the two years totalled over $800,000.

Consulting costs for year-end accounting

The Corporation has struggled with a lack of experienced accounting professionals. In its first two years, management had to hire consultants at a cost of over $400,000 to correct accounting, billing and other errors and to reconcile its accounts before we could audit them.

Billing errors

During the 2002 fiscal year, the Corporation issued many incorrect bills to customers. The mistakes were due to

- poor data input,
- incorrect billing set-up of customers,
- misread electrical meters, and
- errors in the way the computer system calculated bills.

The problems were most significant during the first six months of operations, however management still has not fixed some of them.

Operating and computer systems

The Corporation bought and implemented some new computer systems. Operational problems continued for a long time. Many of the problems could have been avoided if initial systems had been set up correctly. Many other problems could have been avoided if the Corporation had effective controls to ensure that all meters were read, that readings were accurate, and that billings were accurate, complete and timely.

Exhibit 6.5

General principles for spending

- Develop realistic budgets and clear purchasing authorities
- Approve purchases that are within those budgets
- If purchase is not within budget, higher level of approved required
- Record purchases accurately and in a timely manner
- Compare spending against budget on a regular basis
- Revise budgets periodically with board of directors approvals

The role of senior management in monitoring payments

158. One of the most important controls is the regular monitoring by senior management of the Corporation's finances. We saw little evidence of this. Indeed, because of serious problems in controls, we question whether management was aware of the developing problems. For example, management and staff

- failed to prepare bank reconciliations in 2001-02;
- recorded purchases and payments months after they occurred;
- did not correct major errors until year-end;
- failed to record the majority of opening balances transferred from NWT Power Corporation in Nunavut Power Corporation's books until after 31 March 2002;
- did not reconcile sub-ledgers to control accounts (accounts receivable, capital assets, customer deposits, accounts payable, construction work in progress);
- recorded expenses in the wrong accounts;
- did not prepare clearing account reconciliations, or prepared them late;
- did not prepare and review monthly accounting results;
- produced significantly incorrect periodic financial reports.

159. Because of these problems, the Corporation never produced accurate accounting data during its first year. Only after our first audit, which required many year-end accounting adjustments to correct errors, did management know that by 31 March 2002, its predicted profit was reduced by over $5 million.

160. Since division, the Corporation has learned much about what to do and what not to do. However, some of the decisions have cost the Corporation a lot of money (see Exhibit 6.6).

Exhibit 6.6

Summary of unique costs for the first two years

Financing increased accounts receivable	$ 1,000,000
Increased bad debts	857,000
Extra fuel costs not collected	9,000,000
Capital overspending	4,900,000
Late payment penalties	240,000
NWT pension subsidy not obtained	800,000
Consulting costs to complete basic accounting	400,000
Management bonuses	670,000
Total	$ 17,867,000

Management Bonuses. The Corporation paid performance bonuses of over $670,000 in its first two years to managers. These bonuses were approved by the president and were based on evaluations of how each employee measured up to their individually set annual objectives.

The annual objectives did not include how well the Corporation was doing financially. The employee evaluations did not take into account many of the significant problems mentioned in this Report.

The board of directors did not, at the time, have a compensation committee and did not review or approve management bonuses. Normally, bonus plans are dependent on how well the company is doing financially.

Recent developments

161. 2003 direction from the government. In 2003, Corporation management told us that it had received a directive from the government to control spending. We have not evaluated whether the directive was complied with.

162. In June 2003, the Corporation made some major changes. Several senior staff, including the president and vice presidents left. The government approved a new corporate structure and the Corporation has changed its name to Qulliq Energy Corporation on 1 April 2003.

163. The Corporation hired a new president from outside. He initiated new, strict rules on spending and strengthened accounting and controls. However, in early 2004, this “new” president also left and an acting President was appointed. At the time this report was written it was not clear who would be appointed permanently to run the Corporation.

164. The government replaced two former outside directors (when their contracts expired), with two former senior employees of the government.

165. The government plans further restructuring and a rationalization of the business. The petroleum products division of the government will be incorporated under the name Qulliq Fuel Corporation, as a subsidiary of Qulliq Energy Corporation. A new corporation to be named Nunavut Power Corporation, will take over the power generation and distribution assets from Qulliq Energy Corporation.

166. To strengthen the role of the board of directors, the board has agreed to form an audit committee with its own terms of reference.

Conclusion

167. The first two years of Nunavut Power Corporation's operations have been challenging. Setting realistic goals and priorities, hiring the appropriate calibre of staff, and implementing sound financial management practices are needed for the Corporation to run properly.

Recommendations

6.1 The Government of Nunavut (as sole shareholder) and Qulliq Energy Corporation should work together to develop a corporate culture that is consistent with the goals of the government. The Corporation should receive clear directives from the minister, the board of directors should be more knowledgeable of financial matters and management should be basing their plans on the realities of Nunavut.

Government response

The Government of Nunavut will work with the Qulliq Energy Corporation to help develop a corporate culture consistent with government goals. The Department of Finance will continue to include Crown corporations such as the Qulliq Energy Corporation in efforts to strengthen financial management. This will be affected through the efforts of the Crown Agency Council.

The board of directors now receives accurate and timely financial information on a regular basis. Management planning processes have been amended to include the realities of Nunavut.

6.2 To ensure its long-term financial health, the Corporation should develop a realistic rate structure that covers its expected costs for an agreed period.

Government response

To ensure its long-term financial health, the Corporation is preparing a general rate application.

6.3 The Corporation needs to review its rate structure regularly and apply for rate riders or general increases when it needs them.

Government response

The Corporation is reviewing its rate structure and revenue requirement on an annual basis. The requirement for a fuel stabilization rate rider is being reviewed quarterly.

6.4 The Corporation should develop and implement a plan to deal with its immediate financial problems which include losses, borrowing exceeding its limit, cash crisis and violation of borrowing conditions on long-term debt.

Government response

The Corporation is developing a plan to resolve the present financial situation. The general rate application, re-establishing the fuel rider, the consolidation of existing short-term debt into a new long-term debt issue, and an understanding of the Corporation's requirement to earn an adequate return on equity are integral to the resolution.

6.5 The capital planning process should take into account the financial capacity of the Corporation as well as the needs for reliability and safety. (As a general guideline, capital spending should not exceed annual amortization expense over the long-term if the Corporation is to be self-sustaining). This process must be done in conjunction with rate setting.

Government response

The capital planning process is presently based on reliability, safety, efficiency and the environment. The general rate application will reflect the Corporation's capital expenditure requirements for a specified period.

6.6 Management and the board of directors should take stock of its human resource needs and ensure that it has the appropriate calibre and number of people on staff.

Government response

The Corporation regularly reviews human resource requirements in order to ensure sufficient and appropriately qualified personnel are employed on an on-going basis. Priority hiring, succession planning, and training programs are in place to ensure the Corporation will be adequately and properly staffed in the future.

6.7 Management should promote a culture that supports fiscal responsibility and long-term stability. Incentives that recognize overall corporate performance and individual efforts should replace existing plans.

Government response

Management has established an environment within the Corporation that promotes a culture of accountability, fiscal responsibility and long-term stability. Plans that did not adequately recognize overall corporate performance and individual efforts have been discontinued.

6.8 **The Corporation should strengthen and develop its financial management systems, and senior management and the board of directors should monitor carefully all financial aspects of the Corporation on an ongoing basis. Management, with the approval of the board, should develop internal controls to prevent errors from happening in the first place, as well as monitoring and detection controls.**

Government response

The Corporation continues its efforts to strengthen and develop its financial management systems. Senior management regularly monitors the financial aspects of the Corporation and the board of directors is presently provided with quarterly financial reports.

6.9 **An outside director with strong knowledge of financial management and accounting would be a useful addition to the board of directors.**

Government response

The Government of Nunavut will take into account the appointment of a board member with strong knowledge of financial management.

Chapter 7 – Nunavut Business Credit Corporation

Main points

Nunavut Business Credit Corporation is a small corporation with only three employees. It provides loans to Nunavut businesses.

We observed significant problems in several areas, including controlling operations in such a small organization and approving loans. This chapter describes these problems and recommends changes.

The chapter closes with a discussion of extraordinary problems that the Corporation has had in finalizing its financial statements. The good news is that it appears that the Corporation is beginning to be able to finalize financial statements faster.

Background information

168. A small Crown corporation that has moved around. There are different ways to gauge the size of a Crown corporation, but Nunavut Business Credit Corporation is probably Nunavut's smallest Crown corporation. As of January 2004, it had only three employees: an acting chief executive officer (CEO)[3], a comptroller (head of accounting), and one support staff. An investment manager position has been vacant for many months.

169. The Corporation was created on 1 April 1999, but for the first year of its operations, administration was contracted back to the NWT Business Credit Corporation. When its administration was first brought to Nunavut, it was handled by the Department of Sustainable Development[4] in Iqaluit. Around mid- 2001, the Corporation's staff took over its administration, including accounting, in its new headquarters in Cape Dorset.

170. Mandate. The law that set up the Corporation, allows its board of directors to loan money to Nunavut businesses, if the board concludes that an applicant for a loan can succeed and cannot obtain necessary financing from a bank.

171. Loan portfolio. On 31 March 2002, the Corporation had a portfolio of some 51 loans totalling about $7.9 million before allowances. For 2001–2002, it received regular repayments (principal and interest) of $1.4 million.

172. Accounting rules require that any corporation with loans receivable from others review its portfolio annually, estimate the amount that will not be collected and establish an allowance for doubtful accounts. As of 31 March 2002, management's allowance for doubtful accounts was $618,000, or about 8 percent of total loans.

[3] The title chief executive officer is set by the Nunavut law which sets up Nunavut Business Credit Corporation. Readers may be more familiar with the title "President" which tends to be used by most of Nunavut's Crown corporations.
[4] Now Department of Economic Development and Transportation

173. Letters of instruction from Minister of Sustainable Development. The law that set up the Corporation allows the minister responsible (the minister of Sustainable Development) to provide the Corporation with directives.

174. The Minister of Sustainable Development issued two letters of instruction (Exhibit 7.1).

Exhibit 7.1

Key points from letters of instruction from the Minister of Sustainable Development to Nunavut Business Credit Corporation

Letter dated 16 March 2001

- Direction to take an active role in the operations of Nunavut's business development centres

Letter dated 20 May 2003

- Direction to withdraw responsibility for business development centres;
- Detailed direction on the board of directors' governance of the corporation and such matters as strategic planning; and
- Direction on the reporting relationships between the CEO and the chair of the board of directors and between the CEO and deputy minister of Sustainable Development.

Relationship of Nunavut Business Credit Corporation to the Department of Sustainable Development

175. Generally the head of a Crown corporation reports to a board of directors or the board's chair.

176. During our early audit work, we noted that both the Department of Sustainable Development and the Corporation's CEO understood that the CEO had a "dotted line" reporting relationship to the deputy minister of the Department, in addition to the CEO reporting to the chair.

177. This relationship was formalized by the May 2003 letter of instruction which described the arrangement. This relationship seems to have allowed the Department to provide some support to the small Crown corporation. In addition, the Department has helped resolve some of the problems we identified in the Corporation.

Problems we identified with Nunavut Business Credit Corporation

178. Reservations in audit reports. Both our 2000–2001 and 2001–2002 audit reports contain reservations designed to draw readers' attention to issues that we feel are important. As of this writing, our audit work on the Corporation's 2002–2003 fiscal year was continuing, so we have not issued our opinion for that year.

179. Exhibit 7.2 recaps the issues that caused our reservations. It is important to note that it is rare for our Office to express a reservation in an attest audit report. We hope this helps readers understand that issues within Nunavut Business Credit Corporation are serious.

Exhibit 7.2

Extracts of issues highlighted by reservations to our Nunavut Business Credit Corporation audit reports

2000–2001 audit report

- By the time we signed our audit report, the Corporation had missed its deadline for submitting its annual report to the Minister of Sustainable Development by 18 months. Reasons for the delays included:
    - the transfer of accounting functions from the Department of Sustainable Development in Iqaluit to staff at the new NBCC headquarters in Cape Dorset
    - problems preparing financial statements
    - problems providing our Office with the information we needed to complete our audit

2001–2002 audit report

- Four of six new loans issued during the year lacked proper approval
- The Minister of Sustainable Development directed the Corporation to take an active role in the management of business development centres. While the direction was valid, we have concerns about the informal manner in which NBCC took control of operations
- By the time we signed our audit report, the corporation had missed its deadline for submitting its annual report to the Minister of Sustainable Development by 13 months

2002–2003 audit report

- Not yet issued

180. Other issues we reported to the board of directors. By January 2004, we had issued several reports to the Corporation's board of directors. Some of these reports discussed our audit plans or the role of a board. Many also noted important issues for the attention of the board.

Good financial management and control—normal methods do not work properly in small organizations

181. Small size makes controls difficult. Good financial management and controls reduce the risk of bad decisions, errors, or fraud. However, good controls require that the organization or work unit have at least several people. This is necessary so that no one person has too much access to assets or accounting records.

182. The Government of Nunavut is highly decentralized, with many small work groups. The Nunavut Business Credit Corporation, for example, has only three employees.

183. We are not in any way commenting on the skills or integrity of Corporation employees. However, if an organization is below a certain size, setting up good controls to help prevent problems is difficult.

184. Lack of a proper accounting system for many years compounded problems. Another complication is that through the 2002–2003 fiscal year at least, the Corporation did not have a proper accounting system. Instead, it used a general purpose computer spreadsheet package. This further increased the risk of errors and other problems since proper accounting systems contain various error checks and audit trails that are not included in a spreadsheet.

185. Management now indicates that they use a standard, inexpensive computer accounting package for 2003–2004, but we have not yet audited that year. In our view, waiting three years to put a simple, inexpensive accounting package into place was unnecessary.

186. Compensating for the Corporation's small size. What can be done to deal with risks created by the small size of the Corporation's staff? If controls to prevent problems do not work, then it is important to strengthen controls to detect problems. All the types of issues we discuss for Crown corporations in general in chapter 5 also apply to Nunavut Business Credit Corporation, but with even greater importance.

187. Good governance by board of directors is key. The board of directors needs to be aggressive in its governance of the Corporation. But up until December 2003, the board did not receive basic information such as regular financial reports from management. We note that the Minister of Sustainable Development's May 2003 letter of instruction gave the board detailed instructions on governance, which appear designed to strengthen board supervision of management. We agree that this is essential.

188. As an update, in February 2004 we participated in a Nunavut Business Credit Corporation board of directors meeting by teleconference. During our discussions, the chair indicated that, starting with that meeting, the board was beginning detailed scrutiny of the Corporation's transactions. While we have not audited this new process, we are encouraged by the board's recent efforts.

189. Internal audit is also key. Chapter 5 recommends that internal audit be extended to all Nunavut Crown corporations. This is vital for Nunavut Business Credit Corporation.

190. This chapter does not contain any new recommendations on governance and monitoring of the Corporation. Our recommendations in chapter 5 stand. Our objective in this chapter was to underscore the importance of these issues to the Corporation.

Loan approvals

191. During our audit we identified two important issues associated with loan approvals: loans made without proper approval and interest rates on loans.

192. Loans made without proper approvals. The *Nunavut Business Credit Corporation Act* requires the Corporation to approve new loans by a majority vote of its board of directors. There were six new loans issued during 2001–2002. For three of these loans, management used e-mails and faxes to poll the directors for approval. In those three cases, not all directors responded, and there was no majority vote of approval for each loan. In a fourth case, management did not obtain the board of directors' approval for the loan.

193. Consequently, four of the six new loans issued during the year did not have proper authority under the *Nunavut Business Credit Corporation Act*. This lack of proper approvals is a fundamental internal control and governance issue. It is essential that steps be taken so that this does not happen again.

194. Interest rates. The Corporation borrows money from the Government of Nunavut, and it pays interest on this loan. Then it lends this money to Nunavut businesses. Thus, interest rates are important to both the Corporation and its borrowers.

195. Interest rates are important to the Corporation. It needs to set its lending rates high enough so that the combination of interest income and contributions from the government combined are sufficient to cover its costs, including interest expense on the money it borrows from the government, bad debts, and administrative expenses.

196. Interest rates are also important to borrowers. They want the lowest rate possible, and as a government lender, we would expect that borrowers also expect to receive fair rates compared with other borrowers. Not all borrowers receive the same interest rate from Nunavut Business Credit Corporation. The Corporation charges higher interest rates to higher—risk borrowers to help cover the risk of bad debts. This is a normal business practice among lenders.

197. Management developed, and the board approved, an interest rate policy that lists 12 different levels of risk, which can lead to 12 different interest rates charged to borrowers. The interest rate charged to the poorest credit risks is up to 2 percent higher than that charged to the best risks.

198. However, the policy provides little guidance on assessing the risk of a loan application. Such decisions require a great deal of judgement, and it is unclear to us how management assesses risk with so many choices.

199. We note that recent regulations for the NWT Business Credit Corporation define only two levels of risk: "normal" and "greater than normal". Borrowers assessed with greater than normal risk are charged an interest rate that is one percent higher than normal risk borrowers. The NWT system is both simpler and more transparent for borrowers.

200. Finally, the law that established Nunavut Business Credit Corporation calls for regulations setting key lending terms. At the time of the creation of Nunavut, such regulations were in place at the NWT Corporation. The Nunavut Business Credit Corporation needs to work with the government to develop its own regulations.

Involvement with business development centres

201. Nunavut's three business development centres, were set up several years ago. The three separate organizations are not part of the Government of Nunavut. Their activities include lending money to businesses.

202. Since the centres are not part of the government, we are not their auditors. As a result, this section is not based on audit work. Rather, it is based on our discussions with Corporation management, with key facts confirmed in writing.

203. By 2001, the government determined that two of the three centres had operating deficiencies, and was concerned that Nunavut businesses had less access to loans and services. In his first letter of instruction (Exhibit 7.1), the minister of Sustainable Development directed the Corporation to take an active role in the centres. In our view, the minister was within his power to do and the Corporation had the authority to take on this role.

204. Corporation management indicated that their involvement in the two previously inactive centres included taking control of their bank accounts and writing cheques on their accounts. Corporation management also confirmed that they did not take any legal steps to get authority to take over these organizations which were not part of the government.

205. We have concerns about the manner in which the Corporation carried out the Minister's direction. Even if a private organization is inactive, an arm of the government, such as Nunavut Business Credit Corporation, has no right to just step in and take over operations. The Corporation's actions did not demonstrate an understanding of the limits of the reach of government.

206. In February 2004, management indicated that one of the two formerly inactive centres had begun operating without the Corporation's involvement, but that it still operated the other centre. Given the Minister's May 2003 direction to end this involvement (Exhibit 7.1), we were surprised that the Corporation was still involved seven months later. We discussed this with Corporation management, who indicated that they wanted to end their involvement but that it was not practical to do so until the second centre was also in a position to operate on its own.

207. We discussed this situation with management at the Department of Sustainable Development. They were aware of the ongoing involvement and, while hoping that it would end soon, were supportive of it for the time being.

Important operating issues

208. **Monitoring loans.** Loan agreements require repayment over time. Often, the loan agreement requires the borrower to renegotiate the loan before its full term.

209. While it is the borrower's responsibility to renegotiate or repay the loan at the end of the term, it is the lender's money that is at risk. Good controls require lenders to monitor loans to ensure that borrowers are up-to-date with their repayment responsibilities.

210. During our audit we noted that the Corporation was not monitoring its loans. The terms had expired for 27 of 51 loans by 31 March 2002.

211. Commercial loan agreements often impose conditions on borrowers beyond just making payments on time, and loan agreements typically indicate that if the borrower violates conditions then the lender may have the right to demand repayment. Conditions vary for different loans. They can include a requirement to submit annual financial statements, to retain a certain level of financial health, or to maintain insurance on assets held as collateral.

212. The lender is responsible for monitoring borrowers' compliance with the terms of the loan agreement in order to protect its loan. While we did not have overall statistics, we noted that monitoring of loans is not always up-to-date in some cases and, in others, not done at all.

213. The Corporation's investment manager position has been vacant for some time, which may be the cause for the failure to monitor loans. However, lack of monitoring greatly increases the risk of loan losses. It is essential that monitoring improve.

214. **Bid bond security letters.** The law that set up the Corporation allows it to issue "bid bond security letters". These letters are often required as conditions to bidding on large capital projects. While bid bond security letters are a small part of the Corporation's business, we noted two issues in the management of these letters that need improvement.

215. First, the bid bond security letters we reviewed lacked expiry dates of any kind. Risks to the Corporation could be reduced if the letters included expiry dates that were acceptable to the organization calling for bids.

216. Second, at the beginning of our work, the Corporation's records of bid bond security letters issued and outstanding were incomplete and records had to be recreated. Records need to be kept up to date.

Toward more timely financial statements

217. **Extraordinary delays.** Our 2000–2001 and 2001–2002 audit reports (Exhibit 7.2) noted serious delays in sending annual reports, including audited financial statements to the minister responsible for Nunavut Business Credit Corporation. The combined 2000–2001 and 2001–2002 annual report was not tabled in the Legislative Assembly until December 2003—some two years after year-end for 2000–2001, and more than one year after year-end for 2001–2002. What went wrong?

218. The transition of management and accounting records from the Department of Sustainable Development in Iqaluit to the Corporation in Cape Dorset occurred around the time someone should have been working on the 2000–2001 financial statements. This probably caused some delays, but is not the main problem. The underlying cause is the difficulties the Corporation had preparing the financial statements and providing us with the information we needed to do our audits.

219. Problems accounting for bad debts. The Corporation needs to record an allowance for its risky accounts to allow for bad debts. Canadian accounting standards for "impaired loan" accounting are complex, and the Corporation had difficulty applying the rules to its loan portfolio. Our Office also audits some large financial institutions in Canada. While we did not perform any impaired loan accounting work for the Corporation, we used our Office's experience to advise management on how to apply impaired loan accounting in accordance with Canadian standards.

220. Information not always available. Throughout our 2000–2001 and 2001–2002 audits, there were simply long delays in receiving information we needed to complete our work. By the fall of 2003, we were in the unusual position of working on three audit years at once (2000–2001, 2001–2002, and 2002–2003) while we waited for information to complete the earlier audits.

221. By March 2003, delays in receiving information had become such a problem that we gave the Corporation a list of 78 items for which we needed documents or explanations to complete our 2000–2001 and 2001–2002 work. This achieved some results. By June 2003, the Corporation had provided much of the information we needed. However, we cannot complete an audit until we receive all necessary information.

222. The goods and services tax (GST) rebates illustrates one extraordinary delay. In April 2002, we told management that the Corporation might be eligible for GST rebates; a receivable that would affect the financial statements. We included this issue in our list of 78 outstanding items in March 2003. However, the Corporation did not even file a GST claim until 10 October 2003—18 months after we first asked them about it.

223. Recent developments seem positive. Recently, we noted that the Corporation has become much faster in providing us with the information we need to do our audits. As a result, at this writing we were nearly finished our 2002–2003 audit, only a few months after we finished our 2000–2001 and 2001–2002 audits.

224. Management told us that all information needed for our field work for the 2003–2004 audit would be available by May 2004, less than two months after year-end. We agreed to do our field work in May, provided that we would be able to confirm in advance that all the information was ready.

Recommendations

As discussed in this chapter, some general recommendations made in chapter 5 are also directly applicable to Nunavut Business Credit Corporation. The following recommendations are for the Corporation alone:

7.1 The Corporation should ensure that its board has properly approved all loans as required by law. (Loans over $500,000 also require approval by the minister responsible for the Corporation.)

Government response

The Corporation will circulate a draft loans policy at the May 2004 board meeting.

7.2 The Corporation should work with the government to develop its own lending regulations. It should consider including a simple system of assessing risk and setting interest rates, perhaps with as few as two levels of risk and two interest rates.

Government response

The Corporation will work with the government to develop lending regulations. The matter will be brought forward for discussion at the May 2004 board meeting.

7.3 The Corporation should improve its monitoring of loan terms and conditions.

Government response

A draft policy to deal with improved monitoring of loan terms and conditions will be circulated at the May 2004 board meeting.

7.4 The Corporation should keep up-to-date records of bid bond security letters. If possible, bid bond security letters should include expiry dates or other ways that would allow cancellation.

Government response

A policy regarding bid bond security letters has been formulated and approved by the board at the February 2004 meeting.

Chapter 8 – Other observations

Main Points

Other observations are issues we noted during our audits that we want to bring to the attention of the Legislative Assembly, but that do not fit into the themes of our other chapters. This year we have two other observations.

First, we observed significant issues with two real estate transactions which we reviewed, including lack of documentation for costly decisions. The government needs to review its contracting practices as part of its overall efforts to improve financial management.

Second, financial reporting is not always as accurate as it should be. We observed that on multi-year capital projects the cost of work is sometimes charged to the year with money left in its budget rather than the year that the work was done. The government needs to stop this practice.

Observation 1—Real estate transactions

Introduction

225. As part of our regular audit of the government's consolidated financial statements, we reviewed two real estate transactions: the purchase of the Sivummut building, and a lease for a new medical boarding home in Winnipeg.

226. This observation discusses issues we noted with these two transactions.

Purchase of the Sivummut building

227. In March 2003 the government purchased the Sivummut building[5] a building that it had previously been leasing. There were originally two leases for this building: a 20 year lease for the building itself (building lease), and a separate lease with the same landlord for tenant improvements (tenant improvement lease).

228. Why did the government agree to increase the purchase price by $175,000? The building lease agreement gave the government the right of first refusal to purchase the building on the terms and conditions of any arm's length offer from another prospective buyer. In May 2002, the government received evidence of such an offer.

229. The government did an analysis of the possible purchase price compared to the future costs of the lease, and concluded that buying the building was a good deal for the government. We reviewed the government's analysis, and concur with its conclusions.

[5] formerly called the Nova building

230. The building lease agreement indicated that the government had the right of first refusal on other offers to buy the building. The government obtained Financial Management Board (a committee of cabinet) approval to buy the building, based on the purchase price offered by the other prospective buyer: $7,325,000.

231. In the end, the government paid an additional $175,000, described as an "agreed adjustment to purchase price" in legal documents. Considering the unusual nature of this additional expense, we would have expected that the rationale for the $175,000 would have been clearly set out in writing in departmental records. However, the government has not provided us with such a written analysis.

232. **Initial leases.** There are two basic approaches the government can take in calling for bids on large contracts. If the government knows exactly what it wants, it may issue a tender where normally the low bidder gets the contract.

233. If the government is less sure of what it wants, or feels that the private sector could provide innovative alternatives, or feels that bids should be evaluated on more than just low cost, it can issue a request for proposals. A request for proposals approach was used for the original building lease.

234. While our focus was on the 2003 purchase, we have the following observations on the original leases.

- The Department of Public Works and Services[6] was unable to locate important documents readily

  As background, we asked to see the original proposals submitted in response to the request for proposals. Even though these documents are only a few years old, at the time of our audit the department was unable to produce these documents.

- Tenant improvement lease

  In October 2000, a separate tenant improvements agreement was signed whereby the landlord agreed to finance improvements to the interior of the building at a cost of $2 million. Under this agreement, the government agreed to pay the landlord some $19,600 per month for 20 years for these tenant improvements.

235. It is important to note that while the government has now purchased the Sivummut building itself, it did not purchase the tenant improvements. Thus, the government continues to lease the tenant improvements on the building it owns.

236. We asked the government to provide us with documents related to the separate tenant improvement lease. In particular, we asked for documentation related to the decision to issue the lease for tenant improvements. The main document provided to us was a brief note from the Deputy Minister of Public Works which stated that the prime contractor had been told to "go ahead with the TI" (tenant improvements) and that the

[6] real estate services are now a part of the Department of Community and Government Services

cost would be amortized over 20 years. We expected more documentation and analysis for a decision that would, overall, cost the government at least $3 million.

237. The landlord financed the tenant improvements; the government committed to pay off the $2 million cost of these improvements over 20 years at 10% interest. This interest rate is high compared to rates at which the government itself might have been able to borrow.

238. The tenant improvement lease provides that on the fifth anniversary of the agreement (fall 2005), the government has the option to payout the remaining balance of the lease at that time. If the government exercises this option, it will cost $1.8 million to terminate the agreement, in addition to the $1.2 million it will have already paid in monthly instalments. As a result, the improvements will cost the government at least $3 million of which over $900,000 is interest. No documentation was provided to us to explain why the government would choose such an expensive method of paying for the leasehold improvements.

Winnipeg boarding home lease

239. Why would the government replace a lease with a more expensive one? In May 2002, the government entered into a twenty-year building lease for a new medical boarding home in Winnipeg. In October 2002 and then again in May 2003, the contract was replaced with completely new leases for facilities at the same address.

240. The acting Deputy Minister of Health and Social Services signed the first two of the three leases. On the one hand, the acting Deputy Minister was delegated 'full' signing authority for his department. On the other hand, the government's contract regulations govern all signing authorities. These regulations state that only the Department of Public Works and Services has the authority to sign lease transactions. Thus, the first two of the three leases did not have proper approval within the government.

241. In our view, problems with roles and responsibilities between departments contributed to the unusual situation where three different leases were signed for the same facility. We note that there was an e-mail from staff of the Department of Health and Social Services to staff of the Department of Public Works and Services in May 2002—before the first lease was signed—asking for Public Works' comments on the first lease. To date, we have not seen any documents which show that Public Works replied at that time.

242. We noted that the first lease called for the landlord to pay for the cost of utilities and repairs, while the second lease required the government to pay separately for these costs.

243. Generally a contract can only be renegotiated if both parties agree. Given the fact that a deal is a deal and that the second lease was more expensive to the government, we were unable to understand why the government would have agreed to set aside the earlier lease and replace it with a second, more expensive lease. To date, the government has not provided us with any written analysis of why it did this.

244. By spring 2003 officials within the departments of Public Works and Services and Finance became aware of the Winnipeg boarding home situation, and were concerned with the cost.

245. In May 2003, a third lease was signed, and the Department of Public Works and Services had an active role in negotiating this lease. On a more positive note, while it is different from both of the earlier two leases, it appears that the costs of this lease will be considerably less than under the second lease, and somewhat similar to costs under the first lease.

246. Documents not available to us. The government also used a request for proposals to select a firm to build this facility. Government records show that three firms submitted proposals, and as background we asked to review all three. To date, the Department of Health and Social Services has been unable to locate the proposal made by one of the three applicants.

Lessons learned

247. Real estate transactions. There are common issues in these two transactions that suggest that the government needs to take action to improve contracting. These include

- **Missing documents**

  The government's own reports note that three firms submitted proposals for the Winnipeg boarding home. However at the time of our audit it was unable to locate one of the proposals. The government was unable to locate any of the proposals for the original lease of the Sivummut building.

- **Documentation of important decisions**

  We would expect that the government should document the rationale for costly or unusual decisions in writing at the time the decisions were made.

  Thus, we would have expected the government to be able to provide us with written explanations for both the $175,000 "agreed adjustment to purchase price" paid for the Sivummut building, and why the government agreed to replace the first lease for the Winnipeg boarding home with a second more costly one.[7]

  Our 2002 Report to the Legislative Assembly notes that we observed that the government was having difficulty filing important information in ways that allowed staff to retrieve the information readily. Are there documents somewhere that would

[7] As noted above, the second lease for the boarding home was later replaced with yet a third lease, similar to the first lease, and less expensive than the second.

answer these key questions, but the government just cannot find them? We have no way of knowing.

- **Signing authorities**

  All of our Reports to the Legislative Assembly have noted problems with transactions which did not have proper approval under the government's signing authorities. Signing authorities are designed to refer transactions to people with appropriate understanding and experience to reduce risks to the government. Failure to comply with signing authorities can lead to costly mistakes. In our view, the unusual series of leases for the Winnipeg boarding home demonstrate what can go wrong when signing authorities are not followed.

248. **Other contracting.** This observation focuses on real estate transactions. At the same time, government departments and Crown corporations enter into other types of expensive contracts on a regular basis. For example, the Department of Health and Social Services estimates that it spends some $40 to 50 million annually under various contracts.

Conclusion

249. Getting the best bang for the buck in contracting is critical to delivering quality services to Nunavummiut since the dollars being spent under contracts are large.

250. Given our observations on these two transactions, we encourage the government to include contracting in areas which receive attention as part of its efforts to improve its financial management and control within the government.

Recommendations

8.1 All departments should review their practices to ensure that:

a. there is appropriate approval of significant financial transactions
b. reasons for key decisions in large or unusual transactions are documented
c. government contracting procedures are understood and followed
d. the manner in which contracting is handled provides the best value to the government, unless other policy objectives take precedence
e. specialists in other departments are involved in contracting when required
f. key documents of all types are filed and indexed in a manner which allow them to be located and retrieved readily.

Government response

The government will ensure that all departments review their practices to ensure that appropriate approvals are obtained, reasons for decisions are properly documented, contracting procedures are understood and followed and key documents are retained and filed.

In order to ensure a focus on proper financial controls and to emphasize the importance of the Contracting Section, the Department of Community and Government Services has recently moved the government Contracting Section under its Finance Division. Also this department will ensure that more emphasis is placed on providing support to all departments, on updating user manuals and guidelines, and on training in regard to contracting.

8.2 As part of its ongoing audit work, the government's internal audit division should periodically audit whether departments are complying with the government policies, and best practices noted above.

Government response

The Department of Finance will ensure that the internal audit services periodically audits whether departments are complying with government policies as they relate to contracting.

Observation 2—Financial reporting is not always as accurate as it should be

Cost of capital projects charged to the wrong fiscal year

251. During our review of department expenses, we found problems with which fiscal year an expense is recorded. The government has many contracts and projects that last for more than a single fiscal year, such as multi-year capital projects. To have accurate financial information for MLAs and others, it is essential that work be charged to the proper fiscal year. This is known as having proper cut-off of expenses between years.

252. During our audit, we found cases where expenses under multi-year projects were charged to the year that had money left in its budget rather than the year that the expense happened. An example is below (Exhibit 8.1).

Exhibit 8.1 **Example of cut-off of expenses between fiscal years for multi-year projects**
During 2002–2003, a contractor submitted a bill for $3,595,237.23 for work to date on a project. The contractor was asked to adjust the invoice downwards to $3,500,000; the amount of money left in the budget that year. In April 2003, the contractor submitted a second bill of $564,307.54 for work also performed in 2002–2003. A note to file indicated that, even though the bill indicated that work was done in 2002–2003, the payment would be recorded as an expense in the 2003–2004 fiscal year, as no money was left in the 2002–2003 budget.

253. It may be inevitable that the expenses for multi-year projects do not occur in the year planned. The pace of work can change. Sea-lift deadlines can be met or missed. Construction workers cannot work without materials.

254. Charging expenses to the year where budget is available is convenient. It can help avoid the need to move budget between years by asking the Legislative Assembly for supplementary appropriations to move money between years. However, it does not comply with Nunavut’s laws.

Conclusion

255. The examples we noted are not large enough to affect the government’s financial statements as a whole. However, the government needs to review and enforce procedures for ensuring that expenses are charged to the proper fiscal year.

Recommendations

8.3 The government should ensure that it has policies, training, and reviews in place to ensure that expenses are charged to the proper fiscal year, particularly for multi-year projects.

Government response

The Department of Finance will renew its efforts through training and education at the departmental level to ensure that all expenses are charged to the proper fiscal year.

8.4 Internal audit should add audits of cut-off of expenses between years to its ongoing audit plans.

Government response

The Department of Finance will ensure that the internal audit service includes verification of the appropriate cut-off date for expenses in its annual audit plan.

Appendix A – About our audits and The Office of the Auditor General of Canada

Our Vision

The Office of the Auditor General is an independent audit office serving the Legislative Assembly and the well-being of Nunavummiut and is widely respected for the quality and impact of our work.

We promote

- accountable government
- an ethical and effective public service
- good governance
- sustainable development
- the protection of Nunavut's legacy and heritage.

We do this by

- conducting independent audits and studies that provide objective information, advice, and assurance to the Legislative Assembly, Government of Nunavut and Nunavummiut
- working with other legislative auditors, federal and territorial governments, and professional organizations
- providing a respectful workplace in which our diverse workforce can strive for excellence and realize their full career potential

Our mandate

In accordance with the *Nunavut Act,* section 46(1), we audited the accounts and financial transactions of the Government of Nunavut, to express an opinion on the government's consolidated financial statements.

Our audits included reviews of certain operating, legislative and financial control systems, and financial management practices, with detailed tests as we considered necessary.

This *Report of the Auditor General to the Legislative Assembly of Nunavut,* also known as the Report on Other Matters, is part of our audit. In accordance with the *Nunavut Act,* section 46(2), the Auditor General is to report to on any "other matters" arising from the audit that should be communicated to the Legislative Assembly. Each of the significant matters reported in this report was examined in accordance with generally accepted auditing standards; accordingly, our examination included such tests and other procedures as we considered necessary.

Our audit work

This report contains comments on items that we believe will be of interest to Members of the Legislative Assembly; it also contains our recommendations and management's responses, where appropriate. The matters reported were noted during our financial and compliance audits of the consolidated financial statements and Crown corporations.

Readers should be aware that the primary purpose of our audits is to express an opinion on the financial statements. Consequently, our audits will not identify all issues which may be of interest to Members of the Legislative Assembly or others.

Exhibit A.1 shows where we have not been able to issue a clean audit opinion, either on the financial statements themselves, or on authorities. We discuss the audit qualifications elsewhere in this report.

Exhibit A.1

Our 2002 and 2003 Nunavut audit opinions

Entity	Year ended	Audit report date	Clean opinion?	Date tabled
Government of Nunavut (consolidated)	March 31, 2002	April 25, 2003	Yes	June 3, 2003
	March 31, 2003	not yet issued	N/A	
Nunavut Arctic College	June 30, 2002	October 22, 2002	Yes	June 4, 2003
	June 30, 2003	September 19, 2003	Yes	not yet tabled
Nunavut Business Credit Corporation	March 31, 2001	March 31, 2003	No (1)	December 4, 2003
	March 31, 2002	October 24, 2003	No (1)	December 4, 2003
	March 31, 2003	not yet issued (2)	N/A	
Nunavut Development Corporation	March 31, 2002	August 2, 2002	Yes	March 25, 2003
	March 31, 2003	June 13, 2003	Yes	December 4, 2003
Nunavut Housing Corporation	March 31, 2002	July 19, 2002	Yes	October 23, 2003
	March 31, 2003	October 31, 2003	Yes	not yet tabled
Nunavut Power Corporation	March 31, 2002	November 13, 2002	Yes	June 3, 2003
	March 31, 2003	August 1, 2003	No (3)	November 4, 2003
Workers' Compensation Board of the Northwest Territories and Nunavut	December 31, 2001	March 28, 2002	Yes	November 28, 2002
	December 31, 2002	March 28, 2003	Yes	not yet tabled
	December 31, 2003	not yet issued	N/A	

(1) refer to Chapter 7 – Nunavut Business Credit Corporation

(2) refer to Chapter 7 – Nunavut Business Credit Corporation

(3) refer to Chapter 6 – Nunavut Power Corporation

Our People

Many people with different skills and experiences carry out an audit. It is the sum of these resources that allows the Office to make a difference. Since Nunavut is large, our audit work involves staff from our Ottawa and Edmonton offices. Most of these staff work on Nunavut audits only as brief assignments.

Assistant Audit General
Ron Thompson
Principals
Dale Shier, Ottawa
Roger Simpson, Edmonton

Staff		
Christian Asselin	Tyleen Kearney	Denise Rita
Marie-Noelle Beauchamp	Stefanie King	Julie Salois
Kristine Coombs	Kathryn Kyle	Francis Seguin
Joanne Gorenstein	Guy Legras	Mila Simon
Roberto Grondin	Susan Meilleur	Michelle St-Jean
Kathleen Hobbs	Advit Nath	Grace Wilk
Darlene Holloway	Minh-Duc Nguyen	Peter Yeh
Mary-Jo Jacksic	Chris Polselli	Lena Zecchino
Catherine Johns	Marjorie Pound	

Reporting and management comments

Our Office policy is that audit observations and recommendations be referred to the management of the audited organizations for comment. Where appropriate, the Office obtains management's written responses to recommendations in audit chapters.

We provided our draft chapters to the Office of the Comptroller General, government departments, and territorial corporations, where appropriate. Management responses are included in the relevant chapters.

Our Thanks

Management provided explanations information, and access to documents requested during our audits. We thank the staff of the Government of Nunavut and its entities for their co-operation.

For comments or questions on this report, please contact our Office's Communications group at (613) 995-3708 or 1-888-761-5953 (toll free).

Appendix B – A reader's guide to Nunavut's audited consolidated financial statements

This Appendix describes the main parts of the government's consolidated financial statements. Appendix C of this report highlights some of the information in the consolidated financial statements that is important to assess the government's financial health.

Section	What this section tells you
Auditor's report	The report states the auditor's qualifications or other observations, if any, concerning the financial statements. A "clean opinion" means that the financial statements have been prepared in accordance with government accounting standards. It also means that the statements are credible and can be used to assess the government's financial health. On the other hand, if the audit report contains a "reservation", then there is a significant issue of which readers should be aware.
Consolidated financial statements.	Consolidated means that the financial statements include those of Crown corporations and agencies as well as government departments. This provides a more complete picture of the government's financial transactions and its financial health. Consolidated financial statements are the official accounting report of the Government of Nunavut and the ones on which we give our audit opinion.
Statement of financial position (sometimes called a balance sheet)	Provides a summary of the government's liabilities, financial assets, net debt, non-financial assets, and accumulated surplus. Liabilities are what the government owes to others. Assets are the things of value that the government owns, such as loans due from others. Financial assets can be used to pay liabilities, or provide services. Non-financial assets are those assets that are intended to be kept until used, such as buildings and equipment. If there are more liabilities than financial assets, there is net debt.
Statement of operations (sometimes called an income statement)	This statement provides a summary of revenues and expenses for the year and shows whether revenues for the year were enough to cover expenses. If revenues are greater than expenses, there is an annual surplus. If not, there is an annual deficit.
Statement of change in net debt	This statement explains the difference between a government's annual surplus or deficit reported on the statement of operations and the change in net debt. Net debt is an extremely significant indicator of government financial position and the affordability of future services. If a government is buying lots of capital assets, the statement will highlight the extent by which this spending has increased the government's net debt.

Statement of cash flows	This describes whether cash and temporary investments increased or decreased during the year, where the cash came from, and how it was spent.
Notes to the financial statements	These are explanatory notes setting out the Government of Nunavut's accounting policies and further analyses of various balances included in the statements. These notes help readers understand the summarized figures. They also help to explain the various risks taken by the government in its activities and help readers better understand the future spending commitments that have been made.

Appendix C – Indicators of government financial health

Recently the Public Sector Accounting Board of the Canadian Institute of Chartered Accountants developed a new government reporting model that shows how federal, provincial, and territorial governments should prepare their consolidated financial statements. The Government of Nunavut adopted this model with its 2001–02 consolidated financial statements.

The new model is designed to provide five indicators of government financial health. We have added an additional indicator for territorial governments: debt versus the borrowing cap (see chapter 2).

Unless otherwise noted, amounts below are from the government's 2001–2002 audited, consolidated financial statements. As of this writing, the 2002–2003 consolidated statements are not yet available.

Indicator	Description	Where is it found?	2001–2002 amount	Significance to the government
Net debt/net financial assets	If a government is in a net debt position, future revenues are needed to pay for past transactions; if the government is in a net financial asset position, it has resources that can be used to finance future operations.	Consolidated statement of financial position	Net debt = $62.4 million	This means that the government has "borrowed" $62.4 million from future revenues to pay for transactions that have already occurred.
Accumulated surplus/deficit	The total of annual surpluses/deficits since Nunavut was created.	Consolidated statement of financial position	Surplus = $807 million	Total resources of the government are $807 million. Much of this surplus is the value of Nunavut's capital assets, such as buildings and tank farms. While capital assets are valuable and provide services to Nunavummiut, they cost the government money to maintain and operate.

Indicator	Description	Where is it found?	2001–2002 amount	Significance to the government
Annual surplus/deficit	This number tells you if the revenue earned, covered the costs of services provided in the year. It includes the annual cost of using capital assets to provide services.	Consolidated statement of operations	Deficit for the year = $10.1 million	In 2002, the government spent $10.1 million more on services than the revenues it took in.
The change in net debt	This number tells whether revenues earned in the year were sufficient to cover the government's spending in that year.	Consolidated statement of change in net debt	Increase in net debt = $50 million	The government's revenues were not sufficient to cover its spending in the year, —by $50 million.
The change in cash and the cash flows that contributed to the change	The statement of cash flow is key to understanding the government's finances for the year because it describes where the government's cash has come from and what has been done with it.	Consolidated statement of cash flows	Increase in cash and temporary investments = $76.6 million	The government's cash balances increased by $76.6 million. (This trend reversed dramatically in 2001–2002. See chapter 2).
Debt to borrowing limit	This is a limit on the amount of debt or borrowings that the government may incur (see chapter 2). This comparison describes how much more debt the government can assume. The Government of Nunavut's borrowing limit is $200 million.		$119 million (1)	As at 31 March 2002, the government could only borrow $81 million (1). As at 31 March 2003, this was reduced to $64 million (1).

(1) unaudited