

**Deloitte &
Touche**



Province of Manitoba Financial Review

Interim Report

*Prepared for Hon. G. Selinger
Minister of Finance
Government of Manitoba*

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TABLE OF CONTENTS

EXECUTIVE SUMMARY	1
I. INTRODUCTION.....	5
II. HIGHLIGHTS OF SIGNIFICANT FINDINGS.....	6
III. FINANCIAL MANAGEMENT MATTERS.....	7
IV. FINANCIAL REPORTING MATTERS.....	17
V. SUMMARY SITUATION.....	20
 APPENDIX A: TERMS OF REFERENCE AND STATUS	

EXECUTIVE SUMMARY

The new Government of Manitoba wants to have a comprehensive picture of its financial position. The Government also wants to have a clear understanding of what this means for 1999/2000 and for the future. With this information, the Government will be better able to set its budgetary and financial management course.

INTRODUCTION

In late October, the Government asked Deloitte & Touche LLP to frame the financial picture facing the Province and identify the implications of this situation. An additional focus of the review will be to examine how budgets are developed, how to improve the accuracy of future budgets, and how the Government might better ensure performance to budget. This is a financial review and is not an audit of the Government of Manitoba or any of its entities, and so is not directed to questions of performance of programs in meeting their objectives.

This interim report presents our preliminary findings respecting the financial situation facing the Government. Focused on the issue of 1999/2000 operations and the anticipated financial results for the year, the review efforts to date have been directed to learning the status of the Province's expenditures and revenues, compared to the approved operating budget for the current fiscal year.

OVERVIEW OF 1999/2000 FINANCIAL POSITION

The 1999/2000 published Estimates for the Consolidated Fund indicated an anticipated deficit, after debt repayment, of \$163.3 million, offset by a planned \$184.7 million allocation from the Fiscal Stabilization Fund to produce a net surplus of \$21.4 million for the 1999/2000 fiscal year. It now appears that assuming the debt repayment contemplated in the published Estimates and allocation of the same \$184.7 million from the Fiscal Stabilization Fund, the result for the year will be a deficit in the range of \$262 million to \$417 million, rather than the forecasted surplus level of \$21.4 million. Details of this financial position are set out in Exhibit 1.

The variances for this year are the result of the added costs for the operations of existing programming already underway, for commitments entered into before the end of the second quarter, for emergencies and \$10 million in new health spending to address the new government's promise on "hallway medicine".

The current 1999/2000 forecast contemplates certain anticipated revenue adjustments. These adjustments do not include the impact of the final revenue estimates that will be made by Manitoba Finance once updated economic and financial forecast data is provided by the Federal Government.

Exhibit 1 (in millions of dollars)

	<i>Variances</i>			<i>Current 1999/2000 Forecast</i>
	<i>99/00 Published Estimates</i>	<i>Approved</i>	<i>Additional/ Anticipated</i>	
<i>Revenue</i>	\$5,897.5		41.7	\$5,939.2
<i>Expenditures</i>	5,985.8	81.5	243.7	6,311.0
Deficit Before Transfer from the Stabilization Fund and Debt Retirement Payments	(88.3)	(81.5)	(202.0)	(371.8)
Debt Retirement Payment	(75.0)			(75.0)
Deficit Before Transfer from the Stabilization Fund	(163.3)	(81.5)	(202.0)	(446.8)
Planned Transfer from the Stabilization Fund	184.7			184.7
Surplus (Deficit) for the Year	\$21.4	(81.5)	(202.0)	(262.1)
Additional Potential Variances				(155.0)
				\$(417.1)

The majority of the approved and anticipated expenditure variances that have been identified are centred in two major departments, namely Health and Education & Training, as well as in emergency expenditures related to flood and fire suppression costs. Much of the more recent flood-related costs are compensation for unseeded rural farm land. For these three areas alone, findings based on review to date indicate a significant departure from the established expenditure levels, with variances totalling in the order of \$306 million, which represents the majority of the \$325 million change in expenditures from the published estimates.

The difference between the original estimated surplus of \$21.4 and the low end of the range forecast deficit of \$262.1 million is set out in Exhibit 2.

Exhibit 2 (in millions of dollars)

Original Estimated Surplus		\$21.4
Additional Revenue		41.7
Additional Expenditures		
Health:		
<i>Health Authority Deficits</i>	73.5	
<i>Wage Settlements During the Year</i>	63.2	
<i>Additional Contribution to Canadian Blood Services</i>	9.4	
<i>Effect of Manitoba Medical Association Arbitration Award</i>	16.2	
<i>Increased Pharmacare Benefits</i>	10.8	
<i>New Government Election Commitments</i>	10.0	
<i>Other</i>	6.6	(189.7)
Education		(22.5)
Justice		(4.2)
Family Services		(5.2)
Emergency Expenditures (Re: Flood Assistance and Fire Suppression)		(93.9)
Agricultural Income Disaster Assistance Program		(9.0)
Increases		
Other Departments		(0.7)
Forecasted Deficit as at November 17, 1999		\$(262.1)

This forecasted deficit could increase to as high as \$417.1 million by the end of this fiscal year by virtue of as much as \$155.0 million more being required for the following types of items:

POTENTIAL ADDITIONAL ONE-TIME COSTS

- Additional valuation allowances for specific investments (e.g., \$56 million if the total investment in SmartHealth and Faneuil was written off).
- Additional costs for 1999 flood-related relief and support programs (e.g., up to \$28 million).

OTHER POTENTIAL ADDITIONAL COSTS

- Further over-expenditures in certain program areas where expenditures are based on the volume of claims by applicants and the number of claims may grow beyond volumes currently projected (e.g., certain social services, education and health costs).
- Settlement of certain litigation matters.
- Additional emergency expenditures.
- Unanticipated required additional spending by departments.
- Finalization of management estimates used in recording all costs payable by the Province at March 31, 2000 to ensure that all year end accruals are complete.

POTENTIAL POLICY DECISIONS

Proposals supporting additional expenditures of approximately \$37 million on 1999 flood assistance have been prepared by the civil service. To date, the government has not approved any expenditures on these programs. Any future approval by the government to proceed with these programs would further increase the forecasted deficit. Provision for these programs has not been made in the current 1999/2000 forecasted deficit range.

FISCAL PRESSURES FOR FUTURE YEARS

Comprehensive forecasts of the Province's operating fund budget for the next two fiscal years have not yet been compiled by Manitoba Finance. Nevertheless, information which is currently available suggests that the nature of the pressures felt in managing the current year's financial situation will probably become more pronounced in subsequent fiscal years. Pressure is evident in both revenue and expenditure areas.

In moving towards completion of this review, a key consideration will be the implications of both the 1999/2000 financial picture and the pressures for future years as the Government prepares its first budget and shapes its long term approach to financial management and reporting.

I. INTRODUCTION

This document is the interim report of Deloitte & Touche LLP to the Government of Manitoba on the Financial Review started in late October 1999 and ending in January, 2000.

Appendix A provides the terms of reference for the review, including review of 41 entities, and an indication of the status of the work to November 17, 1999. In this chapter, we highlight a number of considerations that we believe are particularly important in reviewing this report on our preliminary findings.

A. MATERIALITY

Given the urgency of the Government's need to come to conclusions quickly about the current financial situation, the terms of reference for the review established a materiality provision as follows:

For purposes of this review, transactions or programs should be considered to be material if they have the potential to result in adjustments in the \$10 million range for 1999/2000 or any prior period, where this is justified. In addition, consideration should be given to potential adjustments which during the present fiscal year may be less than this, but which represent a material potential cost in future years.

B. FOCUS ON FINANCIAL RESULTS

Strictly speaking, this is a financial review and is **not an audit** of the Government of Manitoba or any of its entities, and **is therefore not directed to questions of performance of programs in meeting their objectives**. The review is focused on understanding the current year's projected financial results compared to the approved budget for 1999/2000, and is not intended to assess the value provided by specific revenues and expenditures.

C. RELIANCE ON INFORMATION PROVIDED BY PROVINCIAL OFFICIALS

To establish the picture of the Government's financial position, we have reviewed and analyzed information provided by provincial officials, looking at multiple sources where possible in order to ensure consistency and completeness. Within the time constraints imposed by the interim reporting date, we have sought corroboration regarding information provided by provincial officials. However, we have not conducted a verification process with respect to expenditure or revenue projections for individual Departments and programs.

In the following chapters, we describe our preliminary findings.

II. HIGHLIGHTS OF SIGNIFICANT FINDINGS

The substance of this review can be characterized as relating to either financial management or financial reporting. The distinction between these two functions is important, as are the implications of the current financial position on the Government's ability to address issues in each of these areas.

A. FINANCIAL MANAGEMENT

Financial management encompasses a range of activities, from defining revenue/expenditure options to making revenue/expenditure choices to implementing those choices within defined parameters. In the context of this review, the financial management focus is on the latter function – specifically, the variance between the defined spending parameters, as approved in the Province's budget, and the actual financial results for the year. Additional considerations related to planning and making expenditure decisions will be addressed in the second phase of the review.

For this interim report, the significant findings related to financial management centre on the variance between the published Estimates and forecast expenditures for 1999/2000; the translation of this variance into a deficit that is larger than earlier anticipated for the Province this fiscal year; expected areas of expenditure and revenue pressures in the following two years; and the status of the Fiscal Stabilization Fund.

B. FINANCIAL REPORTING

Financial reporting encompasses the process of accounting for the execution of the Province's financial plan. This reporting function is a key component of the accountability framework, and is central to the Government's characterization of a year's financial results.

From the historical and current year perspectives, the potential issue is whether the treatment accorded particular valuations, obligations and expenditures conforms to Generally Accepted Accounting Principles, including the pronouncements of the Public Sector Accounting Board (PSAB) of the Canadian Institute of Chartered Accountants (CICA). For future years, consideration must be given to ways to further improve Government financial presentation and reporting, including full, accurate and plain public disclosure over the long term.

For this interim report, the significant findings related to financial reporting are centered only on specific issues of valuation.

III. FINANCIAL MANAGEMENT MATTERS

In this chapter, we address a number of fundamental financial management issues facing the Government. We start with an overview of the estimated 1999/2000 results, move on to provide an indication of the significant variances that these results represent when compared to the 1999/2000 budget, note the fiscal pressures that appear to be on the horizon for the coming two years, and address the status of the Fiscal Stabilization Fund.

However, we first provide some general description of the terms we use throughout this discussion:

- We refer to the “*published Estimates*”. These are the Province of Manitoba Estimates of Expenditure and Estimates of Revenue for the year April 1, 1999 to March 31, 2000. We also refer to this as the approved budget for the year.
- We refer to “*1999/2000 forecast*”. This is the projected financial result (either revenue or expenditure) that is anticipated for the Department or program for the year. The actual number may be the same as that contained in the published Estimates, or it may be higher or lower.
- We refer to “*variances*”. These are the differences between the published Estimates for a Department or program and the forecast for the 1999/2000 year. We have made the distinction between “*approved*” variances and “*anticipated*” variances. We make this distinction because some of the variances have already been approved and/or provided for (e.g., through Special Warrant), while others have not.

The Province’s existing budget framework focuses on the Consolidated Fund of the Province of Manitoba. In addition, *The Balanced Budget, Debt Repayment and Taxpayer Protection Act* requires measurement of the Consolidated Fund results in order to determine whether the Legislative Assembly of the Province of Manitoba has met its statutory requirements for management of the Province’s fiscal resources.

Given the current and existing focus of the budgetary and statutory frameworks on the Consolidated Fund, this is the perspective that has been adopted for the purposes of producing a “quick snapshot” of the Province’s financial position requested by the Government for this interim report.

A. OVERVIEW OF ESTIMATED RESULTS OF THE OPERATING FUND TO MARCH 31, 2000

At the end of the first quarter for 1999/2000, the Government of the day noted that expenditure pressures were evident in the areas of Health and Justice, and indicated that a revised surplus/deficit projection would be provided in the second quarter financial report. At the end of the second quarter, preliminary results showed revenue recorded at \$2,789 million and expenditures at \$2,977 million, resulting in a preliminary reported deficit of \$187 million to the end of September, before allocation from the Fiscal Stabilization Fund.

Based on the information we have received and reviewed from provincial officials, the following table represents the current forecast financial position for the fiscal year ended March 31, 2000:

Exhibit 3 (in millions of dollars)

	<i>Variances</i>			
	<i>99/00 Published Estimates</i>	<i>Approved¹</i>	<i>Additional/ Anticipated</i>	<i>Current 1999/2000 Forecast</i>
Revenue	\$5,897.5		\$41.7	\$5,939.2
Expenditures				
Health	2,119.3		189.7	2,309.0
Education and Training	1,180.0	1.0	21.5	1,202.5
Family Services	701.7		5.2	706.9
Public Debt	480.8		-	480.8
Justice	208.0	2.8	1.4	212.2
Agriculture	113.0		9.0	122.0
Emergency Expenditures (Re: Flood Assistance and Fire Suppression)	23.5	79.0	14.9	117.4
Other	1,159.5	(1.3)	2.0	1,160.2
	5,985.8	81.5	243.7	6,311.0
Deficit Before Transfer from the Stabilization Fund and Debt Retirement Payments	(88.3)	(81.5)	(202.0)	(371.8)
Debt Retirement Payment	(75.0)			(75.0)
Deficit Before Transfer from the Stabilization Fund	(163.3)	(81.5)	(202.0)	(446.8)
Planned Transfer from the Stabilization Fund	184.7			184.7
Surplus (Deficit) for the Year	\$21.4	(81.5)	(202.0)	(262.1)
Additional Potential Variances				(155.0)
				\$(417.1)

Notes:

1. *Approved variances include Special Warrants and transfers between estimates.*

The forecast set out above includes all expenditures projected by the departments as required in order to continue their existing approved programming on an “as is” basis. However, we cannot, at this early stage in the review offer firm assurance that the final deficit for 1999/2000 will be greater than \$417 million. The “Additional Potential Variances” of \$155 million identified above include provisions for the following types of expenditures that may be incurred prior to March 31, 2000:

POTENTIAL ADDITIONAL ONE-TIME COSTS

- Additional valuation allowances for specific investments (e.g., \$56 million if the total for SmartHealth and Faneuil was provided for).
- Additional costs for 1999 flood-related relief and support programs (e.g., up to \$28 million).

OTHER POTENTIAL ADDITIONAL COSTS

- Further over-expenditures in certain program areas where expenditures are based on the volume of claims by applicants and the number of claims may grow beyond volumes currently projected (e.g., certain social services, education and health costs).
- Settlement of certain litigation matters.
- Additional emergency expenditures.
- Unanticipated required additional spending by departments.
- Finalization of management estimates used in recording all costs payable by the Province at March 31, 2000 to ensure that all year end accruals are complete.

Additional expenditures to be recorded on account of these items could amount to as much as \$155 million. Therefore, the forecast deficit for the 1999/2000 year, after fiscal stabilization, is currently estimated to be between \$262 and \$417 million.

Two possible federal/provincial events could improve this financial outlook:

- Manitoba Finance receives revised estimates from the Federal Government based on the various factors that affect the determination of federal revenue accruing to the Province. Information that will be provided in late November will enable the Department to revise its revenue forecasts early in December. In the event that these revised forecasts show enhanced revenue, the forecasted deficit would be reduced accordingly. Manitoba Finance is currently of the view that that the revenue will not be eroded by this revised forecast, but may very well be increased beyond the \$41.7 million reflected in Exhibit 3.
- The Province of Manitoba continues to pursue the sharing of 1999 flood related costs with the Federal Government. To date, the Federal Government has not indicated any willingness to initiate cost sharing programs for any of the emergency expenditures that have been incurred by the Province. In the event that the Federal Government's position on this matter was to change, the recovery of certain of the flood related emergency expenditures would also reduce the deficit.

POTENTIAL POLICY DECISIONS

Proposals supporting additional expenditures of approximately \$37 million on 1999 flood-impact assistance have been prepared by the civil service. To date, the government has not approved any expenditures on these programs. Any future approval by the government to proceed with these programs would further increase the forecasted deficit. Provision for these programs has not been made in the current 1999/2000 forecasted deficit range.

B. SIGNIFICANT BUDGET VARIANCES IDENTIFIED TO DATE FOR THE YEAR ENDING MARCH 31, 2000

Understanding the variety of forces affecting specific expenditures has been a key consideration in reviewing the significant variances from budget. In some cases, the variance has been provided for through a Special Warrant and has in effect resulted in a revised 1999/2000 budget for the affected Department.

These variances essentially are related to meeting obligations inherent in existing government programs as contemplated in the published Estimates, as well as emergency expenditures approved throughout the year. The degree of choice available to the Government in authorizing or avoiding additional expenditures is variable. Our final report will provide our best indication of the degree of certainty that the particular additional expenditure is required and cannot be avoided by government. Based on the advice we have received from individual Departments, we understand that the following indication of variances is consistent with their best understanding of the impact on 1999/2000 revenue and expenditure.

For this initial period of the review, we have focused attention on the large expenditure programs, namely the Departments of Health, Education & Training, Family Services, and Justice. We also conducted a preliminary review of a number of other large expenditures, focusing on emergency and disaster-related expenditures and large technology investments.

We understand that of the variances identified to date, \$10 million can be attributed to policy decisions made by the new Government in the area of Health to deal with the issue of “hallway medicine”.

In the following paragraphs, we outline our preliminary findings.

1. MANITOBA HEALTH

The number contained in the 1999/2000 published Estimates for Manitoba Health was \$2,119.3 million. It now appears that the expenditure result for the year will be in the order of \$2,309.0 million, based on **variances totaling \$189.7 million** as follows:

<i>Area of Expenditure</i>	<i>Projected Variance (000,000)</i>
Deficits of Regional Health Authorities to be funded by Manitoba Health	\$73.5
Impact of wage settlements with the Manitoba Nurses Union, Canadian Union of Public Employees and other unions	63.2
Impact of an arbitration award on medical payments to be made to physicians under the terms of the Manitoba Health agreement with the Manitoba Medical Association	16.2
Increased costs for Pharmacare for increased claims volumes and increased drug costs	10.8
Required increase in the Province's contribution to the operations of Canadian Blood Services	9.4
New Government election promises re: "hallway medicine"	10.0
Other items	6.6
<i>Total Variance</i>	<i>\$189.7</i>

2. MANITOBA EDUCATION AND TRAINING

The number contained in the 1999/2000 published Estimates for Manitoba Education & Training was \$1,180.0 million. It now appears that the expenditure result for the year will be in the order of \$1,202.5 million, based on **variances totaling \$22.5 million** as follows:

<i>Area of Expenditure</i>	<i>Projected Variance (000,000)</i>
Additional costs that have been incurred as a result of unanticipated increases in adult education enrolment	\$12.0
Unbudgeted expenditure that will be incurred related to disbursements from the Millennium Scholarship Fund. <i>However, this amount will be fully funded by the Federal Government and therefore an additional \$11.3 million of revenue has been included in the revenue forecast for 1999/2000.</i>	11.3
Other items	(0.8)
<i>Total Variance</i>	<i>\$22.5</i>

3. MANITOBA FAMILY SERVICES

The number contained in the 1999/2000 published Estimates for Manitoba Family Services was \$701.7 million. It now appears that the expenditure result for the year will be \$706.9 million, based on **variances totaling approximately \$5.2 million** as follows:

<i>Area of Expenditure</i>	<i>Projected Variance (000,000)</i>
Funding the 1999/2000 operating deficit of Winnipeg Child & Family Services	\$5.2
<i>Total Variance</i>	\$5.2

4. MANITOBA JUSTICE

The number contained in the 1999/2000 published Estimates for Manitoba Justice was \$208.0 million. It now appears that the expenditure result for the year will be \$212.2 million, based on **variances totaling approximately \$4.2 million** as follows:

<i>Area of Expenditure</i>	<i>Projected Variance (000,000)</i>
Increased correctional staff	\$4.1
Increased Courts costs	1.5
Other items	(1.4)
<i>Total Variance</i>	\$4.2

5. MANITOBA AGRICULTURE

The number contained in the 1999/2000 published Estimates for Manitoba Agriculture was \$113 million. It now appears that the expenditure result for the year will be \$122 million, based on **variances totaling approximately \$9.0 million** as follows:

<i>Area of Expenditure</i>	<i>Projected Variance (000,000)</i>
Excess of actual 1998 AIDA (Agricultural Income Disaster Assistance) claims by producers over the initial estimate of \$12 million	8.0
Other items	1.0
<i>Total Variance</i>	\$9.0

6. EMERGENCY EXPENDITURE VARIANCES

A number of additional emergency expenditures have resulted in a **variance of \$93.9 million** from the published Estimates as follows:

<i>Area of Expenditure</i>	<i>Projected Variance (000,000)</i>
Forest fire suppression	\$12.8
Disaster Flood Assistance	12.2
1997 flood program	3.8
1999 flood emergency expenditures	\$66.0
Other items	(.9)
<i>Total Variance</i>	<i>\$93.9</i>

7. OTHER EXPENDITURE VARIANCES

Other expenditure variances identified but not reviewed individually in detail at this point total \$0.7 million and cross over a number of Departments.

8. REVENUE VARIANCES

Manitoba's strong economic performance is expected to result in increased corporate income tax and retail sales tax revenues. In addition, improvements in the mining sector specifically have resulted in an increase in mining tax income in excess of the original revenue estimates.

<i>Revenue Source</i>	<i>Projected Variance (000,000)</i>
Increased corporate income tax revenue	\$26.4
Increased retail sales tax revenue	4.0
Increased mining tax revenue	10.0
Federal revenue	
• Millennium scholarship fund (offset to expenditures)	11.3
• Decrease in federal flood proofing-related revenues	(12.6)
Other	2.6
<i>Total Variance</i>	<i>\$41.7</i>

C. OTHER MATTERS OF SIGNIFICANCE

In the course of completing the Phase I financial review, we will address other matters of significance. For example, questions have been raised with respect to the information technology investments and projects of the Province, and we will be examining this important area of expenditure.

D. FISCAL PRESSURES TO BE CONSIDERED FOR 2000/2001 AND 2001/2002

Comprehensive forecasts of the Province's operating fund budget for the next two fiscal years have not yet been compiled. Nevertheless, information which is currently available suggests that the nature of the pressures felt in managing the current year's financial situation will grow and become more pronounced in subsequent fiscal years. Pressure is evident in both revenue and expenditure areas. While some pressures relate strictly to the 1999/2000 year, others have future year implications as well.

1. REVENUE PRESSURE POINTS

To this point in the review, we have become aware of several major pressure points from a revenue perspective.

Federal Government Health Transfer

The 1999/2000 revenues include a \$131 million health program transfer from the federal government. This amount, attributed to the 1999/2000 year, represents funding for the three years 1999/2000 to 2001/2002. Manitoba chose to record the total transfer in the initial year rather than over the three-year period. Accordingly, this revenue will not be part of the revenue base for the Province going forward.

Personal Income Tax

A second revenue matter relates to Manitoba's personal income tax, which is determined as a percentage of the basic federal tax payable by each Manitoban. Consequently, any federal tax rate reductions would negatively affect cash advances received against personal income tax revenues and ultimately the amount of personal income tax revenues recorded in future years. This, together with other items, has affected the Manitoba Finance projection of income tax revenue for the 2000/2001 year, for which no increase is currently forecast.

2. EXPENDITURE PRESSURE POINTS

To this point in the review, we have become aware of several other major pressure points from an expenditure perspective.

Manitoba Health

While the variance anticipated for Manitoba Health is significant for the 1999/2000 year, it appears that the current situation for the Department is consistent with a developing trend. The gap between budgeted and actual expenditures for Manitoba Health increased from \$43 million in 1995/1996 to \$132 million in 1998/1999. Each year, much of the over expenditure became part of the following year's base expenditure. The 1999/2000 situation is a continuation of this established expenditure pattern.

The additional funding, from previous years as well as for 1999/2000, can be expected to continue having an impact on future years as the funding becomes part of the Department's base expenditures. We note that Manitoba Health has indicated that to maintain programming on an

“as is” basis would require increases above the current year forecast (\$2,309 million). The Department estimates that the increases in each of the next two years would be in the same order of magnitude as prior years’ variances.

MGEU Contract

The expiration of the Manitoba Government Employees Union (MGEU) contract in March, 2000 will require the Province to enter into a collective bargaining process with the MGEU. The financial implications of a new agreement will have a direct impact on future year expenditures.

Infrastructure

A number of departments are pointing to the need for significantly enhanced funding to address the erosion of provincial infrastructure such as highways as well as aging primary and secondary schools and post-secondary institutions.

Pension Plan Requirements

As a result of the Province’s aging work force and the increasing number of people who are anticipated to retire in the next several years, the amounts which must be included in provincial budgets to fund the “pay as you go” pension plan requirements will continue to increase.

Information Technology

It is reasonable to anticipate that requests to fund the further development and operations of improved information technology systems will continue to increase.

Corrections

Increasing correctional facilities’ populations are likely to pressure expenditures on correctional staff levels.

Emergency Expenditures and Related Flood Proofing Costs

Commitments to provide or continue flood proofing or other disaster assistance programs will require funding. In particular, the province has an agreement with the federal government to fund up to \$75 million of flood proofing costs by 2004.

E. FISCAL STABILIZATION FUND

The following table provides a summary of the status of the Fiscal Stabilization Fund for the 1999/2000 fiscal year:

<i>Fiscal Stabilization Fund</i>	<i>1999/2000 Published Estimates (000,000)</i>
Fund balance, beginning of year 1999/2000	\$427.3
Add: Projected Interest Earnings	9.3
Less: Net planned amount allocated to 1999/2000 operating fund revenues	(184.7)
<i>Projected fund balance, end of year</i>	<i>\$251.9</i>

The Balanced Budget, Debt Repayment and Taxpayer Protection Act contains requirements with respect to the management of the Fund in deficit circumstances, with three clauses particularly relevant to the 1999/2000 financial results:

3(2) If expenditure exceeds revenues in a fiscal year, the government shall not be considered to be in contravention of this Act to the extent that the deficit is a result of one or more of the following: ... an expenditure required in the fiscal year as a result of a natural or other disaster in Manitoba that could not have been anticipated and affects the province or a region of the province in a manner that is of urgent public concern ...;

4(1) If there is a deficit in a fiscal year that is not authorized by the Act, the government is required to achieve at least an offsetting surplus in the next fiscal year; and,

4(2) If there is a general election and the party forming the government after the election is different from the party forming the government before the election, subsection (1) does not require the government after the election to achieve an off-setting surplus in connection with a deficit incurred in the fiscal year during which the election took place.

Application of the Act to the 1999/2000 circumstances is a legal matter. We believe that the Province would be well served to formally obtain legal advice in the form of a legal opinion on the application of these and other provisions of the Act to these current circumstances.

IV. FINANCIAL REPORTING MATTERS

In this chapter, we describe our interim findings related to financial reporting matters, focusing on the valuation of specific assets.

A. VALUATION OF SPECIFIC ASSETS

Valuation of a number of specific provincial government assets affects the completion of the 1998/1999 accounts as well as the current and future years. Decisions will have to be made shortly on the disposition of two investments, including the valuation of the investment and appropriate write-downs.

1. HEALTH INFORMATION NETWORK/SMARTHEALTH

In 1995, Manitoba Health entered into an agreement with SmartHealth for the development of a Health Information Network for Manitoba. The terms of the contract, a master agreement, were a maximum time period of five years or a maximum investment level of \$100 million, whichever limit was reached first. Project funding within these parameters was to be approved on an initiative by initiative basis. As the Department is currently discussing disengagement from this contract with SmartHealth, there is a reasonable basis to question the future benefit of these expenditures. The investment at the current date is \$33 million, which represents the maximum potential exposure of the Province on this initiative.

2. FANEUIL

The Province currently has an investment with a carrying value of about \$20 million in Faneuil ISG Inc. In addition, through its agreement with Vision Capital, the Province also has further exposure of approximately another \$3.2 million related to this company. Therefore, the maximum potential exposure of the Province on this initiative is about \$23 million.

Within the last several weeks, the current government confirmed an August 16, 1999 agreement with the other shareholders in Faneuil ISG Inc. to extend additional loan guarantees to the company. Concurrently, the repayment of the loan payable owing by the company to the Province was rescheduled. The new government did this after receiving advice from the accounting firm of Ernst & Young, which it had retained to review this investment. Manitoba Industry, Trade and Mines has begun the process of determining the net realizable amount of the loan in accordance with Generally Accepted Accounting Principles. It is anticipated that an allowance against the current carrying value of the investment will be required as a result of this process.

3. OTHER VALUATION ISSUES

The Government has an asset portfolio of both direct and indirect investments, including loans to operating entities. We will be reviewing policies and issues associated with these matters and will address them in our final report.

B. ACCOUNTING POLICIES

The Government of the Province of Manitoba has been challenged over the past 15 years and earlier regarding the degree to which its financial reporting complies with generally accepted accounting principles (GAAP). We note that since the financial review of 1988, the Province has made progress in dealing with some of the issues that were identified at that time, including, for instance, the amortization of a portion of capital expenditures over the effective life of the asset.

Nevertheless, the Provincial Auditor continues to point out that some differences remain between the Province's financial reporting policies and GAAP. In particular, these relate to the way in which the following issues are dealt with in the compilation of the result for the consolidated fund, known as Volume I of the public accounts:

1. The existence of an un-funded pension liability of \$2.6 billion and the accounting for the annual increase in that liability.
2. The treatment of transfers between government accounts as though they were revenues and expenses.
3. The definition of what constitutes the complete government reporting entity. For instance, the Volume I financial statements exclude government operations such as Manitoba Hydro and Manitoba Public Insurance from the accounts.

These differences from GAAP are addressed in the Province's summary financial statements known as Volume III of the public accounts. Volume III does incorporate the consolidated fund and all other significant elements of government and its agencies, including significant government operations like Manitoba Hydro and Manitoba Public Insurance. However, the preparation of the summary financial statements in Volume III is also based on several policies that differ from GAAP. The following deviation from GAAP were noted in the Province's 1997-98 summary financial statements. This is the most recent year for which the Province's summary financial statements have been completed and released to the public:

- exclusion of the financial results and position of Regional Health Authorities from the summary financial statements;
- inconsistency in the accounting for certain capital costs during the Province's transition to the capitalization of long term capital onsets;
- non-accrual of severance benefits; and,
- non-restatement of prior year results when prior period adjustments are made.

The Province of Manitoba has adopted the practice of emphasizing the Volume I reporting as its primary financial reporting tool. However, the fact that the Volume III summary financial statements are produced is evidence that a more comprehensive picture of the Province's financial position is available. Therefore, we believe that the following two issues should be addressed by the Province:

1. The summary financial statements contained in Volume III are more consistent with the provisions of GAAP than Volume I. The issue is to determine what role the preparation of the Volume I financial statements should have in the Province's overall financial reporting process. This is not an easy question to resolve given the importance of the Volume I financial statements in determining the Province's compliance with *The Balanced Budget, Debt Repayment and Taxpayer Protection Act*.
2. Differences that have been identified by the Provincial Auditor in the preparation of the Province's summary financial statements in Volume III of the public accounts should be addressed to ensure that the Province is in compliance with all authoritative recommendations of the Canadian Institute of Chartered Accountants with respect to financial reporting. Addressing these issues, as is currently planned by the Department of Finance, could bring the government into conformity with GAAP.

The forecasted deficit figures referred to in this report have been determined using the same accounting policies as were used in the preparation of the Consolidated Fund published Estimates for 1999/2000. Any changes that might be made in accounting policies to bring them into greater consistency with the recommendations of the Provincial Auditor and GAAP could further change the amount of the forecasted deficit.

We ask that the Government consider the issues identified above. We note that in the past few months, two more Canadian jurisdictions (British Columbia and Nova Scotia) have considered similar issues, bringing to seven the total number of jurisdictions reporting in a manner which is consistent with the provisions of GAAP.

If the Government reaches a conclusion on how to address these issues prior to the completion of our final report, we will be able to take the planned changes into account in determining our final forecasts of the 1999/2000 results. These changes would also be considered in the formulation of recommendations for any suggested changes in the budget estimate preparation process and the government's processes related to expenditure management.

C. OTHER CONSIDERATIONS

Other financial reporting considerations will be addressed as the review progresses and we will report on them as appropriate in our final report.

V. SUMMARY SITUATION

For the current fiscal year, the Government of Manitoba is facing a potential deficit of \$262 million to \$417 million in the Consolidated Fund, after the presumed \$184.7 million transfer from the Fiscal Stabilization Fund. The Government will determine how to deal with this reality. In formulating its plan of action, the requirements of *The Balanced Budget, Debt Repayment and Taxpayer Protection Act* will have to be considered.

Regardless of the direction that the Government takes, the implications of the current financial picture will need to be considered when planning for the next and subsequent budget periods. In effect, the future financial capacity of the Government appears to be substantially constrained by the current financial position.

This report is a preliminary assessment of the situation. In the weeks ahead, we will explore the Government's financial management and financial reporting in more depth and will report our findings in greater detail in our final report.

APPENDIX A
TERMS OF REFERENCE AND STATUS

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The new Government of Manitoba wants to have a comprehensive picture of its actual starting position from a financial perspective. The Government also wants to have a clear understanding of the implications of its financial circumstances, both for this year and for subsequent years. With this information, the Government will be better able to set its budgetary and financial management course.

Following the issuing of a Request For Proposals on October 18, 1999 and the completion of a competitive process, the Government has engaged Deloitte & Touche LLP to undertake a two-phase review to establish the financial picture facing the Province.

PHASE I – FINANCIAL REVIEW

Deloitte & Touche LLP has been asked to estimate, with the greatest possible accuracy, those obligations which the Government must meet for the current year, the revenues it will have to do so, and the impact of the current year situation on the next two years.

The firm has also been asked to identify the implications of this situation on (a) the Province's ability to meet debt repayment schedules under *The Balanced Budget, Debt Retirement and Taxpayer Protection Act* and (b) the ability to meet anticipated demand for public services.

The entities to be examined in the review are as follows:

Departments

- Aboriginal and Northern Affairs
- Agriculture and Food
- Civil Service Commission
- Conservation
- Consumer and Corporate Affairs
- Culture, Heritage and Tourism
- Education and Training
- Family Services and Housing
- Finance
- Health
- Highways and Government Services
- Industry, Trade and Mines
- Intergovernmental Affairs
- Justice
- Labour

Government Enterprises

- Manitoba Hydro-Electric Board
- Manitoba Liquor Control Commission
- Manitoba Lotteries Corporation
- Manitoba Public Insurance Corporation
- Workers' Compensation Board

Crown Organizations

- Child and Family Services Agencies
- Communities Economic Development Fund
- Council on Post-Secondary Education
- Criminal Injuries Compensation Board
- Economic Innovation and Technology Council
- Government Information Systems Management Organization (Man) Inc.
- Health Information Services of Manitoba
- Legal Aid Services Society
- Manitoba Agriculture Credit Corporation
- Manitoba Cancer Treatment and Research Foundation
- Manitoba Crop Insurance Corporation
- Manitoba Development Corporation
- Manitoba Health Services Insurance Plan
- Manitoba Housing and Renewal Corporation
- Manitoba Trade and Investment Corporation
- Manitoba Water Services Board
- Public Schools Finance Board
- Special Operating Agencies' Financing Authority

Special Funds

- Debt Retirement Fund
- Fiscal Stabilization Fund
- Mining Community Reserve

PHASE II – EXPENDITURE MANAGEMENT REVIEW

As a second and related phase of work, Deloitte & Touche LLP has been asked to examine the process by which budgets are developed and make recommendations on how to improve the accuracy of future budgets. The firm has also been asked to consider the process the Government uses to ensure performance to budget.

STATUS OF REVIEW

The Minister of Finance has appointed a Steering Committee of senior provincial officials and the Provincial Auditor, chaired by Ron Hikel, to oversee the review process. Deloitte & Touche LLP reports to this committee on a weekly basis.

For the Phase I financial review, the direction has been to work quickly to produce a preliminary snapshot of the situation in order to provide an interim report so that the Government has an early indication of its financial circumstances. The final report for this phase of work, due at the end of December, will contain a more in-depth review of matters covered in the interim report. As well, the final report will provide commentary on potential options that the government might pursue to address both the current financial situation and the preliminary forecasts of the Province's financial position for the next two fiscal years.

In the first three weeks of the review, Deloitte & Touche LLP has undertaken to establish the context for the review with the Steering Committee members, both collectively and individually, and to gather and review information relevant to the review process. This information has been provided from a number of sources, and includes Treasury Board analysis of individual department situations and the overall Government's financial position, as well as information from the government entities themselves.

In order to move quickly to an understanding of the current situation for purposes of completing an interim report by mid-November, priority areas were established for more substantive discussions and closer analysis of the detail provided. The priority areas were identified as Health, Education & Training, Justice, Family Services, revenue and public debt. Deloitte & Touche LLP met with individuals responsible for these priority areas to gain greater understanding of the significant variances between budget and anticipated levels for this fiscal year.

The focus of this first three weeks of the review has been on Phase I work. Phase II will commence in substantive form in late November. Given the tight timing, Deloitte & Touche LLP has relied essentially on information and records provided by Treasury Board staff and by senior officials from each entity. Information and advice from the Provincial Auditor and his staff were also key to the review process. As a result of this approach, and particularly the abbreviated examination that was necessary to be able to produce this interim report, the numbers referenced in this document have not been verified by a detailed analysis of individual program files.

As outlined in our proposal to the Province, we identified a number of entities with which we have had professional service relationships within the past two years. To be certain that the reviews of these entities are independent, we are engaging individual contractors to handle selected reviews. Wintemute Randle Kilimnik will do the review work related to Manitoba Lotteries Corporation, Manitoba Housing, and the Manitoba Housing and Renewal Corporation. Braha & Associates Ltd. will do the review work related to the Better Methods implementation.

Work between mid-November and the end of December will involve building on the initial work for priority areas through gathering additional information and follow-up meetings with provincial officials. For the remainder of the entities, Deloitte & Touche LLP will follow a similar process of requesting and reviewing materials and meeting with persons responsible. The findings from this process will be considered in the context of providing comprehensive advice to the Government on the current financial picture and the implications of the situation.

The financial position of the Province as identified in the Phase I work will be a key context-setting element as the Government shapes its financial management framework. For the Phase II work, Deloitte & Touche LLP will focus on advising the Province on an appropriate approach and process to guide its budget planning, decision-making, and performance management and accountability. The effectiveness of these internal processes will be a key success factor in helping the Government to ensure sound management of the Province's financial resources.