

Auditor General of Canada

**2001 Report to the
Legislative Assembly of
Nunavut**

240 Sparks Street
Ottawa, Ontario
K1A 0G6

13 November 2001

The Honourable Kevin O'Brien
Speaker of the Legislative Assembly of Nunavut
Legislative Assembly
Iqaluit, NU

Dear Mr. O'Brien,

This is my first annual report to the 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 am proud to be the auditor of the new Territory, and I thank the Government of Nunavut for their efforts in preparing the first consolidated financial statements, and the collaborative way in which we resolved issues as they arose during my first audit.

This report comments and makes recommendations on issues my Office noted while auditing Nunavut's March 31, 2000 consolidated financial statements. It also includes Nunavut management responses to these issues.

Yours sincerely,

Sheila Fraser, FCA

Table of Contents

	Page
Chapter 1 – 1	
Introduction	1
About our first audit report	1
Our first annual report.....	1
Reviewing progress.....	2
Comments on first consolidated financial statements	2
Contact Information	3
Recommendations	3
Chapter 2 – 5	
Accountability: reviewing government operations	5
What does accountability mean?.....	5
How the government is organized.....	5
How the Legislative Assembly controls the government’s revenues and expenses	6
Is the government collecting and spending money properly?	7
How well is the government reporting to the Assembly?	8
Recommendations	9
Chapter 3 – 11	
Government financial health	11
Introduction.....	11
What is good financial health?.....	11
Are Nunavut's finances healthy?.....	12
Is the government living within its means?.....	12
Tough decisions lie ahead	14
Chapter 4 – 15	
Building good financial management.....	15
Introduction.....	15
What does good financial management mean?	15
What are Nunavut's financial management challenges?	15
Recommendations	18
Chapter 5 – 21	
The environment.....	21
Need to assess environmental damage	21
Recommendation	22
Chapter 6 – 23	
Lease or buy?.....	23
Introduction to long term leases	23
Leasing principles	24
Normally governments try to get the best possible deal.....	25
Lease or buy decisions are important to Nunavut	25
Recommendations	26
Appendix A – Our staff	27
Appendix B – A Reader's Guide to Nunavut's March 31, 2000 Consolidated Financial Statements	28
Appendix C – Glossary	29

Chapter 1 – Introduction

This chapter discusses our audit work and comments on the government's first consolidated financial statements.

About our first audit report

1. By law, the Auditor General of Canada is responsible for auditing the Government of Nunavut's financial transactions and financial statements. We give an opinion on whether these statements meet *accounting standards for governments*¹. Our opinion also says whether the government has followed important financial rules set by federal and Nunavut laws.
2. Our first audit report to the Legislative Assembly of Nunavut is included in the government's *Public Accounts March 31, 2000*. Our opinion deals only with the consolidated financial statements in Volume 1 of that report. Volume 2 of the *Public Accounts* includes other information that we haven't audited.²
3. Nunavut's Minister of Finance—with staff from his department—prepares and publishes the government's consolidated financial statements. Our audit opinion adds to the credibility of financial statements because it is an independent view of whether management has prepared the financial statements using government accounting standards. Clearly, managers of the Department of Finance and Administration worked hard to make sure the government's first consolidated financial statements met these standards.
4. When our audit shows that a set of financial statements meets accounting standards and that the government is following important financial laws, we give a "clean" audit opinion. Otherwise, we qualify our opinion. *Exhibit 1* shows that we gave a clean opinion on the government's consolidated financial statements for Nunavut's first year of operations, and on all but one of the other Nunavut government organizations.

Our first annual report

5. Each year we supplement our audit reports with an annual report on issues that we note during our audits. Since this is our first annual report to the Nunavut Legislative Assembly, it discusses a number of ideas that are important to this report and our future reports. Chapter 2 discusses accountability and how the Legislative Assembly approves the government's plans and describes some ways the government reports to the Assembly so that the Assembly can review how well the government performed. Chapter 3 discusses how an MLA could assess the government's financial health. Chapter 4 explains the "nuts and bolts" of making sure the government has the quality financial management it needs.
6. Chapters 5 and 6 turn to more specific issues. Chapter 5 discusses the environment, and chapter 6 explores how the government can make informed decisions about leasing or buying a building.
7. Our observations and recommendations to the government throughout this report are based on our audit of the government's consolidated financial statements for 1999-2000.

¹ This and other key words and phrases used in this report are defined in the glossary in Appendix C

² If you are unfamiliar with the structure of financial statements, you might find it helpful to read Appendix B, "A Reader's Guide to Nunavut's March 31, 2000 Financial Statements."

Reviewing progress

8. In the future we will look again at the recommendations in this report to see if the government is making adequate progress. We will report what we find to the Legislative Assembly.

Exhibit 1 – Summary of our Nunavut audit opinions

Entity	Financial Statement Date	Date of our Audit Report	Our audit report was addressed to	Clean opinion?
Government of Nunavut (consolidated)	March 31, 2000	February 16, 2001	Legislative Assembly of Nunavut	Yes
Nunavut Arctic College	June 30, 2000	November 1, 2000	Minister of Education	Yes
Nunavut Housing Corporation	March 31, 2000	October 31, 2000	Minister of the Nunavut Housing Corporation	Yes
Nunavut Development Corporation	March 31, 2000	August 3, 2000	Minister of Sustainable Development	No (2)
Nunavut Business Credit Corporation	March 31, 2000	June 9, 2000	Minister of the Nunavut Business Credit Corporation	Yes
Nunavut Petroleum Products Revolving Fund	March 31, 2000	June 23, 2000	Minister of Public Works and Services	Yes
Northwest Territories Power Corporation (1)	March 31, 2000	May 19, 2000	Ministers responsible for the Northwest Territories Power Corporation (1)	Yes
Workers' Compensation Board of the Northwest Territories and Nunavut (1)	December 31, 2000	March 31, 2001	Ministers of the Workers' Compensation Board of Northwest Territories and Nunavut (1)	Yes

(1) Operated in both Nunavut and the Northwest Territories.

(2) Our observations on the Nunavut Development Corporation are in Chapter 2.

Comments on first consolidated financial statements

9. We have the following comments and recommendations on two aspects of the government's first financial statements for 1999-2000.

10. **Accounting for long term leases.** Chapter 6 of this report discusses whether the government should lease or own building space. As background for that discussion, it's important to understand that financial statements can show leases as either capital leases or operating leases:

- A *capital lease* is similar to owning a building, but spreads the payments out over many years. Accounting rules require that financial statements show capital leases in the same way as if the government bought the building.
- All other leases are *operating leases*. Financial statements show operating lease payments as expenses when paid.

The government analyzed its leases as of March 31, 2000 and concluded that three were capital leases under accounting rules. For these three *capital leases*:

- The government's 1999-2000 consolidated statement of operations and accumulated surplus includes an expense of \$42 million in today's dollars for the future cost of these three leases even though the lease payments will be made in the future.
- The government's consolidated statement of financial position includes a liability for the leases in today's dollars. This is similar to borrowing money to build an asset. Each year the liability will be reduced as the government makes lease payments.
- The statement of tangible capital assets shows the leased assets. These assets will be amortized (depreciated) in the future as the buildings are used.

Unlike capital leases, liabilities for operating leases are not shown in the consolidated statement of financial position. We agree with the way the government classified its 1999-2000 leases between capital leases and operating leases. There is a need for the government to do a similar review of new leases each year.

11. Future financial statements. In government finances, as in everything else, the only certainty is that things will change. For this reason, the government needs to review each year how it will present its consolidated financial statements. Changes may be needed to adapt to new accounting rules, new events, or the new information needs of MLAs and others.

Contact Information

12. For comments or questions on this Report, please contact Dale Shier or Ron Thompson at (613) 995-3708.

Recommendations

The government should:

- 1. Review new long term leases each year to determine which ones need to be accounted for as capital leases and which ones need to be accounted for as operating leases.**

Management Response

The Department of Finance will work with government departments and Crown corporations to establish procedures to review all leases to determine which ones need to be accounted for as capital leases and which ones need to be accounted for as operating leases.

2. **Review the format of the government's consolidated financial statements each year to ensure that Members of the Legislative Assembly receive the best financial information possible, and that the financial statements meet any new government accounting standards.**

Management Response

The format of the consolidated financial statements will be reviewed each year, by the Department of Finance to ensure Members are receiving the best financial information and to ensure that the financial statements meet any new government accounting standards.

Chapter 2 – Accountability: reviewing government operations

This chapter describes how the Legislative Assembly gives the government authority to collect and spend money, and assigns duties to the government. It shows how the government reports on its operations to the Legislative Assembly so that the Assembly can decide how well the government is carrying out its duties.

The chapter also comments on several aspects of how the government is collecting and spending money. Finally, it gives two examples where the government needs to improve the information it provides to the Legislative Assembly.

What does accountability mean?

13. A person is *accountable* to someone else when he or she has to explain and justify (account for) actions to that other person. The same is true for governments. The Nunavut Legislative Assembly passes laws saying what the government can do, and that allow the government to collect and spend money. The Nunavut government is then *accountable* to the Legislative Assembly for how it carries out duties assigned to it by the Assembly. MLAs have the right to decide whether the government has done a good job in carrying out its duties.

14. The role of the Auditor General of Canada is to give objective and independent information on the government's operations. Our audit work is one of the tools for making sure that the Legislative Assembly can hold the government accountable for its actions. We don't work for the government or other MLAs. Instead, we report to the Assembly as a whole through a neutral person—the Speaker of the Legislative Assembly.

How the government is organized

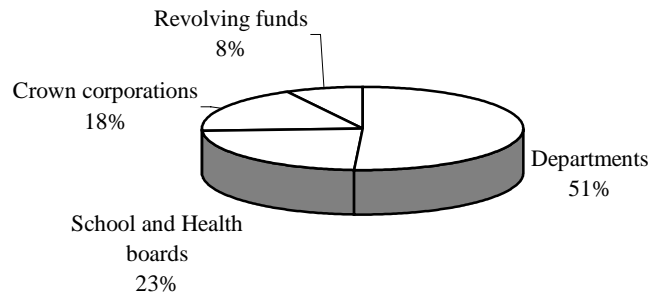
15. The Government of Nunavut has 11 departments (including the Legislative Assembly), as well as other public agencies that are accountable to the Assembly.

16. The government's financial statements on which we give our audit opinion include or '*consolidate*' the operations of other parts of the government. *Exhibit 2* shows the expenses of the different parts of the government. Some of these bodies, such as school and health boards, are audited by private auditing firms.

17. Each part of the government reports to Ministers, who in turn report to the Legislative Assembly. But there are important differences in how the different parts of government operate and how independent they are. While the government expects Crown corporations and public agencies to follow the government's financial policies, these bodies are more independent than departments. Crown corporations and other public agencies have boards of directors that look after normal operations.

Exhibit 2 – What makes up the Government of Nunavut?

Percent of spending



The school boards and health boards became a part of government departments after March 31, 2000. Their operations continue as part of the government.

How the Legislative Assembly controls the government's revenues and expenses

18. The government (departments, revolving funds, boards, and Crown corporations) needs the Legislative Assembly's approval before it can collect or spend money. The Legislative Assembly makes laws that:

- Give the government the power to *collect revenue (money)*.
- Require *departments* to get approval from the Legislative Assembly before spending money. The Assembly gives this approval each year when it votes to approve *main and supplementary estimates*. The government also needs the Assembly's approval to make *loans to others*.
- Set a limit on the amount that a revolving fund can get from the government, somewhat like a line of credit. The government sets up revolving funds to meet specific goals. The funds spend money, but they also get money back from the operations they are funding.
- Set up *boards and Crown corporations* under the direction of independent boards of directors, and allow them to operate without the kind of Legislative Assembly scrutiny that departments get. If a board or Crown corporation requires a subsidy or loan, this is approved through the Assembly's approval of government spending and loan plans.

Is the government collecting and spending money properly?

19. Some of the government's practices in collecting and spending money concern us because they do not meet legal requirements. Other practices are likely to make the Assembly's task of reviewing government operations more difficult.

20. The Department of Health spent more money than the Legislative Assembly approved. Nunavut's laws do not allow departments to spend more money than the Assembly approves in main and supplementary estimates each year. However, as we see in Note 19 to the government's March 31, 2000 consolidated financial statements, the Department of Health spent \$171,000 more than approved in its operating budget, and \$166,000 more than approved for its capital budget.

21. The Nunavut Development Corporation needs to develop controls over spending, inventories, and money collection. The Government of the Northwest Territories set up a Development Corporation about 10 years ago. After division, the Corporation continued to operate as the Nunavut Development Corporation (DevCorp).

22. DevCorp operates several businesses as subsidiaries or joint ventures. The financial controls in these businesses are not strong. Their auditor has reported serious weaknesses in:

- collecting and recording the money they are owed
- paying for expenses without getting invoices
- inadequate control of inventory.

23. As a result of these weaknesses, we qualified our audit report on DevCorp's consolidated financial statements, and brought these serious matters to the attention of the Nunavut Legislative Assembly in our audit report dated August 3, 2000.

24. The approved limits for revolving funds in Nunavut need to be re-examined. Nunavut has a number of revolving funds, including the Petroleum Products Revolving Fund (PPRF), the Liquor Commission Revolving Fund, and others. As we have said earlier in this report, the Assembly sets a limit on the amount of money a revolving fund can get from the government.

25. The laws that set the limit for each revolving fund were copied from the Northwest Territories' laws at the time of the split. For this reason, they need to be re-examined to see if they are right for Nunavut.

26. If the approved limit is too low, revolving fund managers may not be able to do the job they are supposed to do. If the limit is too high, the Legislative Assembly is less able to control revenues and spending.

27. In the case of PPRF, most operations of the old Northwest Territories remained in Nunavut. Because of increased fuel prices, managers are reviewing whether the present limit of \$55 million is enough for it to operate.

How well is the government reporting to the Assembly?

28. The government gives the Legislative Assembly information it needs to review the government's plans for raising and spending money. The information is presented in the public accounts, annual reports of Crown corporations, and a variety of documents that are tabled in the Assembly. We noted two cases where this information can be improved.

29. Revolving fund financial statements leave out significant costs. This is true of all revolving funds. However, it is most important in the case of the Petroleum Products Revolving Fund because:

- it is the largest revolving fund in Nunavut
- it delivers an essential service to Nunavut residents
- its tank farms are worth a lot of money.

30. The PPRF's tank farms consist of equipment and tanks that store fuel for sale to residents. The tanks can last for many years, but each year as they get older they will lose some value. This is called *amortization*. The value the tank farms lose each year is part of the real cost of providing fuel, but PPRF does not include these amortization costs in its financial statements.

31. If it costs the government more to provide fuel than its fuel revenue, it loses money. It then has to use other government money to subsidize the loss. This money could be used for other purposes.

32. Fuel prices are vitally important to Nunavut residents. The size of the government's subsidy of PPRF prices is important to the public. PPRF's March 31, 2000 financial statements show that in 1999-2000 the Fund lost about \$300,000. This means that general government revenues subsidized fuel prices by \$300,000. However, the cost of the tank farms and the cost of financing inventory and tank farms (the interest cost) are paid by other government departments, and they are not shown as PPRF costs. These costs bring the actual subsidy to over \$3 million and this should be shown in PPRF's own financial statements.

33. In the fall of 2000, rising fuel prices world wide led the government to raise PPRF prices. We are not suggesting that the government increase PPRF prices further. That decision is up to the government. What we do suggest is that PPRF's accounting be changed to include all costs—including amortization—associated with the government's sale of fuel. This will show the Legislative Assembly the total cost of the fuel program.

34. The Nunavut Development Corporation has not collected information on jobs or costs per job. The Assembly has to make choices about spending on government programs. There is not enough money for everything. This means that the government should examine its programs regularly to see what works well and what doesn't.

35. The businesses that the Nunavut Development Corporation operates could fail if they don't continue to get subsidies from the government. In 1999-2000, these subsidies totalled about \$3 million. Thus, it is important to measure how successful these businesses are at meeting their objectives so the government can see if the money spent on them could be better used on something else. One simple way to measure is to count the number of jobs that the businesses created or maintained and assess their value to Nunavut. It is also important to decide what a 'job' is. For example, is a short-term or part-time job really a job? It will be important to thoroughly review these businesses that are DevCorp subsidiaries to get an overall view of their value.

Recommendations

1. **The Nunavut Development Corporation should correct the internal control weaknesses that led us to qualify our auditor's report. Since DevCorp is part of the government, the Department of Finance and Administration should ensure that DevCorp makes the appropriate changes.**

Management response

The Nunavut Development Corporation (NDC) was not fully established until the President and board members were appointed in the Fall of 1999. Once established, NDC personnel and subsidiary managers began to address financial deficiencies, especially control weaknesses.

The Department of Sustainable Development, in conjunction with the Department of Finance will continue to monitor the NDC to ensure that the appropriate financial controls are established, monitored and maintained.

The Financial Audit Division of the Department of Finance will follow up with NDC and include a review in our audit work plan.

2. **The government should review current revolving fund limits to see if they are appropriate in Nunavut's circumstances. If changes are needed, the government will need to recommend that the Legislative Assembly make the changes in the *Revolving Funds Act*.**

Management response

The Government of Nunavut will review all revolving funds including the Petroleum Products Revolving Fund and the Liquor Commission Revolving Fund. Once the review is complete the changes will be put forward to the Legislative Assembly.

3. **The government should consider recommending changes in the *Revolving Funds Act* to the Legislative Assembly so that financial statements of revolving funds can report the full cost of their annual operations.**

Management response

*The Government will review the *Revolving Funds Act* to ensure all costs associated with the funds are reported.*

4. The Nunavut Development Corporation should:

- **Develop a clear understanding of what a “job” is, and collect information on the number of jobs created and the cost to create each job.**
- **Provide information in its annual reports on the number of jobs created, the cost per job, and trends in each over the years.**

Management response

NDC is establishing funding guidelines tied to jobs created or maintained. NDC now provides information on jobs created or maintained in their Corporate Plan and will provide this information in annual reports.

5. The government should undertake a thorough review of the Nunavut Development Corporation and its subsidiaries to get an overall view of their value.

Management response

The Government will review NDC and its subsidiaries to determine their overall value.

Chapter 3 – Government financial health

This chapter notes that an important part of good government is to manage finances well. The chapter then discusses the government's financial health.

The Nunavut government has little financial flexibility, mostly because it receives so much of its revenue from the Government of Canada. Because it lacks flexibility, it is important for Nunavut to stay financially healthy by not getting into more debt than it can afford. At the end of its first year of operations, Nunavut had a large surplus. However, current plans call for spending all of this surplus, and going into debt by the end of 2002.

The pressures to spend more are strong. The government will have to make tough choices to maintain the territory's financial health.

Introduction

36. Good government means many things, including good leadership, good employees, and a vision for the future. Good government also means good financial health and good financial management. This chapter looks at Nunavut's financial health. Chapter 4 looks at its financial management.

What is good financial health?

37. Good financial health means that a government has financial flexibility and that it can live within its means.

- A government has *financial flexibility* if it can adapt to changes outside of its control without having to cut spending on its programs.
- A government *can live within its means* if it can meet its financial obligations. If a government borrows, it has to pay interest and repay the loan. Together, the interest and repayments are “debt costs.” Borrowing is not a problem if future government revenues increase enough to pay the debt costs. However, if the government can't pay these costs it may find that it has to cut programs.

38. MLAs can assess the government's financial health by looking at its total *surplus* or total *deficit* at the end of the financial year. A government has a *surplus*³ if its revenues over the years have been higher than its spending. This is a sign of financial health. A government has a *deficit* if it spends more than it takes in. This is a sign that finances are less healthy.

39. If Nunavut begins to accumulate debt, then MLAs should carefully watch the relationship between spending and revenues. Circumstances can arise that force a government to borrow in order to meet urgent needs. However, if it can't pay the debt costs it may have to cut programs later.

³ The government's March 31, 2000 consolidated financial statements call this “accumulated surplus”.

Are Nunavut's finances healthy?

40. We'll look at financial flexibility first. *Nunavut has little financial flexibility.* In 1999-2000, about \$630 million, or 86 percent of its revenue, came from the Government of Canada. Little revenue came from sources that Nunavut itself can control, like taxes or fees. This makes Nunavut vulnerable to changes in revenue from Canada.

Is the government living within its means?

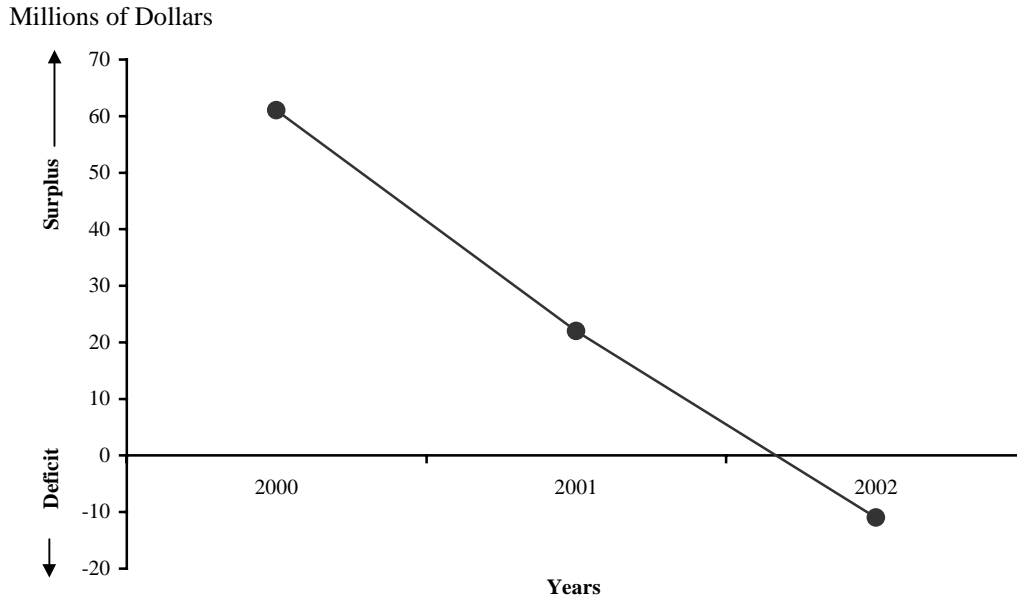
41. The *Bathurst Mandate* calls for Nunavut to work within its means. Assessing whether it is doing that means both *looking back* to actual results and *looking forward* to financial plans.

42. **Looking back.** Ideally, MLAs and others should be able to compare the original budgets for the year with the consolidated financial statements at the end of the fiscal year. If there are significant differences between budgets and actual results, MLAs can call for explanations from the government. It is possible to make this comparison for 1999-2000 only by using unconsolidated financial statements of departments. The consolidated financial statements do not include budgets for the whole government because they were not available.

43. **Looking forward.** MLAs can use the government's estimates to look to the future, but they need to keep in mind that the estimates are for departments only and do not include all parts of government (*Exhibit 2*). Also, the estimates are plans only, and actual financial results may be different.

44. Since the government is young, it does not have information from several years that would show a pattern or trend of surpluses or debt. The information it does have is for departments only (*Exhibit 3*). This shows that Nunavut plans a deficit of about \$12 million by 2002. Consolidated information (for the whole government) or actual information may be different. For example, management notes that budgets for 2000-2001 and 2001-2002 did not include an estimate for one-time expenses for new capital leases (Chapter 1).

Exhibit 3 – Trend of unconsolidated, surplus or debt



Information in Exhibit 3 is unconsolidated and unaudited.

1999-2000 information is actual. 2000-2001 and 2001-2002 information is from the government's 2001-2002 Main Estimates.

45. Looking beyond the numbers. The possibility that Nunavut could move into debt is not necessarily bad. But there are financial pressures and other matters that MLAs should consider when looking forward at financial plans. Together, these point to uncertainty. For example:

Ability to repay any future debt	<ul style="list-style-type: none"> • If the government moves into a debt position but its revenues do not increase enough to pay the debt costs, it could have to spend less on programs.
The government already has significant future financial commitments	<ul style="list-style-type: none"> • Note 16 to the consolidated financial statements shows future commitments of over \$700 million, including \$476 million for lease payments over the next 20 years or so.
High staff vacancies may hide the true cost of government operations	<ul style="list-style-type: none"> • Some staff vacancies are normal: people quit or retire, and it takes time to replace them. But the vacancies in 1999-2000 were high because Nunavut had not yet recruited staff for its new government. In fact, one third of all positions were vacant at March 31, 2000. • When Nunavut succeeds in staffing the vacant positions, the costs of salaries and employee benefits will be higher.
A young and growing population will put pressure on government services	<ul style="list-style-type: none"> • This growing pool of people can help Nunavut increase Inuit employment levels in the future. But there will also be pressures on programs such as education, housing, and health care.

Tough decisions lie ahead

46. *Nunavut will have to make hard choices to stay in good financial health.* The territory's resources are limited, and it doesn't have the financial flexibility to adapt easily to unfavourable economic changes. In the face of pressures to increase spending, Nunavut will need to carefully consider which programs are most important, and which ones it cannot afford.

Chapter 4 – Building good financial management

This chapter explains good financial management. The Nunavut government needs to build good financial management in all parts of government; this includes boards, Crown corporations and revolving funds, as well as departments.

There are several specific financial management issues that Nunavut needs to address. The government needs to recruit trained financial managers, including accountants. It also needs to ensure that Nunavut residents have the opportunity to obtain the education and training needed for senior financial management jobs.

Finally, Nunavut's internal audit and evaluation functions need prompt attention.

Introduction

47. Nunavut is justifiably proud of what it has achieved since the territory was established. The start-up challenges that a new government faces are huge. This chapter looks at the financial management challenges that need Nunavut's attention in the near future.

What does good financial management mean?

48. Some of the key characteristics of good financial management include the following:

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

Good information for good decisions. Poor information leads to a waste of money. Everyone who makes financial decisions needs good information first. 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 important risks from becoming actual problems.

49. The Auditor General has prepared a *Financial Management Capability Model* that shows a new government or organization the different stages in building good financial management. *Exhibit 4* shows how financial management should develop as a government or organization matures.

What are Nunavut's financial management challenges?

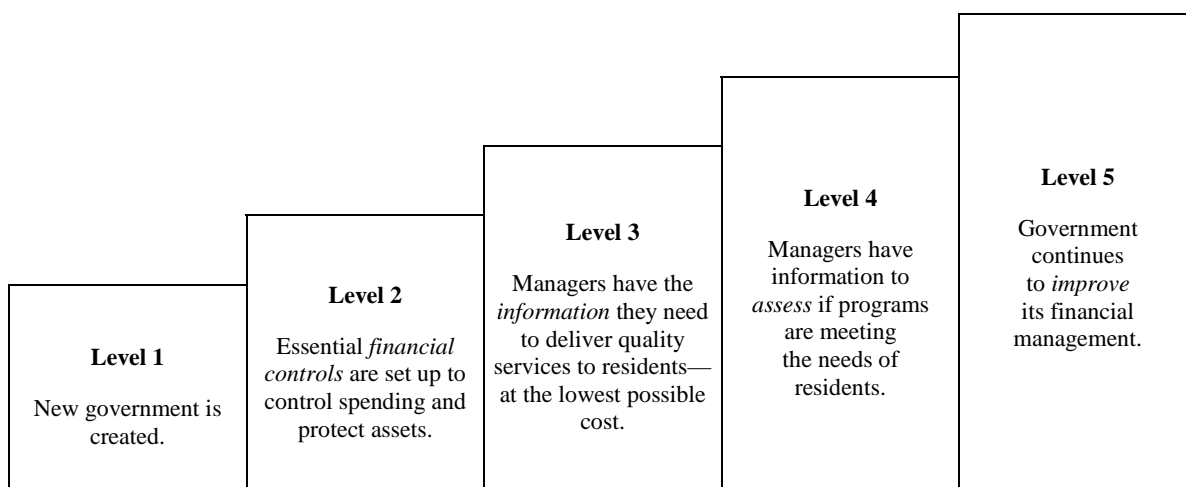
50. The improvements in financial management shown in *Exhibit 4* are not automatic. Management must make these improvements happen. For Nunavut, this means that all government organizations (boards, Crown corporations, revolving funds and departments) face similar challenges.

51. At present the government is generally at Level 1 in the Model (the beginning), and working towards implementing the essential controls needed for Level 2. In our view it is important for the government to develop a timetable to move fully to Level 2 and beyond.

52. **Not having enough trained accountants, makes it hard to build good financial management.** Nunavut has a lot of financial management positions that are vacant because there are not enough people who have the skills and qualifications that the jobs require.

53. All government employees have a role to play in financial management. However, some employees are needed who have extensive technical training in accounting. The title “accountant” is broad, and may include people with very different training and skills. At one extreme, *accounting clerks* with some training can enter financial information into computers. At the other extreme, *trained accountants* design and maintain complex accounting systems and prepare monthly reports and financial statements for an organization’s own use, and annual financial statements that are made public. These accounting systems are important for making sure that decision-makers have the best information available. Trained accountants and senior financial managers usually have university degrees, professional accounting courses, and practical experience. To be called a professional accountant, they must pass examinations. It usually takes several years to become a professional accountant.

Exhibit 4 – Five stages in building good financial management



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

Source: Adapted from Office of the Auditor General of Canada’s financial management capability model.

54. Right now, Nunavut doesn't have enough trained people to fill senior accounting jobs in the government. The Department of Finance notes that the government currently needs many more trained people for these jobs.

55. The government may wish to find residents who are interested in becoming trained financial managers and accountants, and arrange for them to get the necessary training and experience they need. In the long term, this will open up senior employment opportunities for Inuit. However, until Nunavut has residents who have taken formal training as senior financial managers and accountants, it will have to compete with other employers elsewhere in Canada to hire the people it needs. At present there is a shortage of trained accountants throughout Canada, and Nunavut will have difficulty getting the right people. Until it has the right kind of trained accountants throughout Nunavut, the government’s financial management systems and processes will be at risk.

56. Departmental Operations. During our audit we noted several areas where departments need to improve their financial management. They include:

- ensuring that the government collects all the money to which it is entitled
- ensuring that necessary accounting reviews and reconciliations are complete and up to date
- improving the quality of monthly budgetary reviews.

Accounting reviews and reconciliations are needed to ensure the accuracy of information in the government's financial systems. Monthly budgetary reviews are needed to ensure that the government's progress towards expected surpluses or deficits are controlled. Without good budgetary reviews, there is a greater risk of failing to collect money or spending more than is approved by the Legislative Assembly.

57. Financial statements and annual reports are not timely. Chapter 2 notes that MLAs need information to determine if the government is doing a good job carrying out the duties assigned to it. Documents tabled in the Legislative Assembly provide much of this information.

58. The *Public Accounts* includes the government's audited consolidated financial statements and other unaudited information. The laws of Canada require Nunavut to table its annual consolidated financial statements in the Legislative Assembly by December 31 each year. Nunavut's first Public Accounts were tabled on May 29, 2001.

59. Nunavut laws require each Crown corporation to give its *annual report* (including audited financial statements) to its Minister within three months of year end, or within five months if the Minister of Finance approves the extra time. The Minister responsible for the Crown corporation is to table the annual report in the Legislative Assembly as soon as possible. However, there have been considerable delays in tabling annual reports of Nunavut's Crown corporations.

60. Delays in tabling information for new entities may be inevitable. However, it is important to shorten these reporting delays in the future, first to meet the deadlines set by law, and second, to provide MLAs with more current information so they can assess the government's operations and its financial health.

61. The Assembly may wish to consider allowing documents to be tabled even when it is not sitting. This "back door" tabling could allow MLAs and legislative committees to consider more up-to-date information between the Assembly's sessions.

62. An expanded audit and evaluation function is needed. Internal audit and evaluation are also essential parts of financial management. Their roles are different from the Auditor General's role. The Auditor General reports once a year to the Legislative Assembly. Internal auditors and evaluators report to management more often to help the government improve its operations. Audit and evaluation units perform a variety of important tasks. These include reviewing whether the government has complied with financial rules and controls, investigating possible frauds, advising managers about financial issues, and evaluating the government's programs to see if they are achieving their objectives.

63. At various times both the Department of Executive and Intergovernmental Affairs and the Department of Finance have had responsibility for certain types of audit and evaluation work, but overall, little work has been done. The lack of audit and evaluation work has been at least in part related to the government's overall staffing problems. It is now important to give audit and evaluation the attention it deserves as a part of good financial management.

64. Management informs us that the Department of Finance is now responsible for audit. It recently hired a Director of Internal Audit within the Department of Finance and Administration, and it is also staffing other auditor positions. We also understand that the government is beginning a review of its programs. This review is headed jointly by the Department of Executive and Intergovernmental Affairs and the Department of Finance. Management of the Department of Executive and Intergovernmental Affairs informs us that it also has two other evaluation projects in progress.

Recommendations

The government should do the following things:

- 1. Recruit financial managers and accountants with the necessary training and experience.**

Management response

The Department of Finance will hire six additional senior accountants. These individuals will provide assistance to all government departments.

- 2. Develop a long term strategy for allowing Nunavut residents to get the education and experience to fill more senior financial management and accounting jobs.**

Management response

The government has approved in principle the Inuit Employment Plan. Included in this plan are many initiatives that will help Nunavummiut to obtain the education and experience required to assume senior finance jobs.

Some of these initiatives already have been started, however, it will take many years before the full benefits of these initiatives are realized.

In addition, the government is developing more specific accounting and financial management programs, which will lead to more individuals obtaining an accounting designation.

- 3. Assess its current level of financial management capability, and develop a strategy and deadline to get all parts of the government (departments and other) to “Level 2” (Essential financial controls) in the financial management capacity model and beyond.**

Management response

As a result of a review of the financial management capabilities of the government six senior accountants will be hired in the Department of Finance. This will assist us in achieving our goal of having essential financial controls in all government departments, within the next three years.

During the coming year we will be setting specific goals and targeting areas of greatest need.

4. Ensure that the internal audit and evaluation functions operate fully as soon as possible.

Management response

The financial audit function within the Department of Finance is now 66 percent staffed and will be fully operational this year.

Evaluation projects are underway and the first reports are expected in December of 2001. Draft Terms of Reference for an Evaluation Planning Committee to develop multi-year work plans and methodologies are under consideration.

Chapter 5 – The environment

This chapter calls on the government to find out what it will cost to clean-up environmental damage that it is responsible for cleaning up, and include these environmental liabilities in future financial statements.

Need to assess environmental damage

65. Accounting for environmental liabilities is one area where we feel the government can improve its consolidated financial statements.

66. For years, society has been leaving behind waste and contamination. In some cases, the impact is only in appearance, and little clean-up is needed. In other cases, specific sites have to be cleaned up to protect the environment and the health of residents. Finally, there may be pollution in water or air from thousands of miles away, and clean-up may not be feasible.

67. Note 17(b) to the first consolidated financial statements describes a "*contingency*" (uncertainty) about the government's environmental liabilities. The uncertainty is that the new government does not yet know how much it will cost to clean-up environmental damage for which it is responsible.

68. We believe that the government should do three things:

- Make an inventory of contaminated sites in Nunavut and determine which ones need to be cleaned up.
- Determine who is responsible for the clean-up. If someone else is responsible, the government should encourage the other party to do the work.
- Estimate the cost of cleaning up contaminated sites that no one else is responsible for, and make a long term clean-up plan. Based on these cost estimates and plans, the government should record liabilities for its clean-up responsibilities in its financial statements.

Completing these steps will be a complicated job. The government will have to negotiate responsibility for clean-up with other parties to settle on who is responsible for cleaning up what sites. It will take time, but is essential for protecting the environment and the health of residents. Also, when liabilities for clean-up costs are included in the government's financial statements, MLAs and others will be more able to assess the government's financial health.

Recommendation

- 1. The government should develop a plan with a specific deadline for identifying, evaluating and estimating the costs of cleaning up contaminated sites in Nunavut that are the Nunavut Government's responsibility.**

Management response

The Government of Nunavut is aware of the issue and the importance of the environment and is starting to inventory contaminated sites in Nunavut. This project is expected to take over five years to complete.

The issue of responsibility is not a straightforward one, as most lands in Nunavut remain within the management and control of the Government of Canada.

Chapter 6 – Lease or buy?

Leasing buildings for a long term and buying buildings are two different ways the government can get the space it needs. The government is now committed to many long term leases involving large amounts of money. Leases may be more expensive than buying or less expensive than buying—it all depends on the details.

When the government plans to build, the Legislative Assembly reviews and approves the planned capital spending before the project starts. The Assembly does not review and approve the government's long term leasing plans in advance because planned new lease commitments are not shown in capital estimates, even though the lease costs may be as large as building costs. This means that the government could plan more total capital spending (building and leasing) than it can afford, and this fact could go unnoticed.

Space in buildings is expensive. That's why we believe that in most cases a government should decide whether to lease or buy based on the principle of economy—whichever option is the cheaper way of getting equivalent building space. If the government chooses to lease even if it will cost more, then it should know the additional cost in advance. The government should also be able to say what objective it achieves by choosing the more expensive option.

We feel that the government should review its extensive use of long term leases to see if there are any lessons to be learned.

Introduction to long term leases

69. Governments sometimes lease an asset so they can use it without having to buy it. There are many kinds of leases:

- *Short term leases* may be used for photocopiers or vehicles, or to rent a building temporarily.
- *Long term leases* can be used for assets which last longer such as buildings, bridges or roads.

This chapter discusses some of the issues surrounding the decision to use long term leases or to buy.

Leasing principles

70. All governments should consider the following leasing principles.

71. **Consider priorities and affordability first.** Long term leases have an obvious appeal since they are a form of "buy now, pay later." The government gets the use of a building for a long time, and spreads its payments out over the term of the lease. Sometimes accounting rules require the government to show a lease liability in its financial statements, and sometimes not (Chapter 1). Spending decisions on expensive buildings should be based on getting the best deal, not on the accounting treatment.

72. Usually there are more requests for capital projects than a government can afford. Before any government commits to getting a building, it needs to be sure it has picked the most important projects and that it can afford them.

73. There are three ways a government can pay for a capital project:

- Pay cash (if it has cash)
- Borrow (if it thinks it will be able to repay the principal and interest)
- Lease (if it thinks it will be able to make the lease payments for many years in the future).

74. **Leases may or may not be a better deal than buying.** Buying a building requires up-front cash or borrowing. Leasing allows payments to be spread over time. Making the right choice depends on the details of the situation. Both the conditions and costs of the lease need to be considered.

- *Lease conditions vary.* Not all leases are the same. If a government wants to lease a building, it has to negotiate lease conditions with the company that leases the building (the lessor). These conditions could be more favourable to the government or to the lessor. Some factors to consider are:

Flexibility	If a lease commits the government to lease payments for many years, it benefits the lessor.
Ownership at end of lease	Leases may let the government buy the building for a small amount (such as one dollar) at the end of a lease. Others may allow the government to buy the building at market value at the end. Still others may say nothing about sale to the government.
Risk of rising costs	There is a risk that the building's costs may go up. These costs include heat, water, electricity, repairs, and cleaning. In some cases the lessor just bills all these costs to the government. In other cases, the government could pay increases in these costs based on inflation.
Risks associated with leasing a building	There are a number of risks in leasing a building. These might be borne by the government or the lessor—it depends on the terms of the lease. The risks include: <ul style="list-style-type: none"> • Damage from fire, water or other causes. • Legal liability (for example, if a person is injured.) • Losing use of the space. (For example, if a building burns down, is the lease cancelled, or does the lessor have to find new space for the government?)

This chart illustrates different possible lease conditions. Readers should not assume that the Government of Nunavut's leases actually contain the full range of conditions shown here.

- *Everything has a cost.* If the government negotiates more favourable lease conditions, the lessor will usually want to charge more. For example, if the government leases a new building in a small community, the lessor may not have any other potential occupants for the building. In this case, the lessor may insist on a lease that commits the government for many years. In other cases the lessor may charge much more if the government wants the option of walking away at any time.

There are financial techniques that compare the cost of leasing with the cost of buying equivalent space. Once the government knows all the conditions and costs of a draft lease for a particular building, it can calculate whether it is cheaper to lease or own the building.

Normally governments try to get the best possible deal

75. A *lease premium* is the additional cost to lease rather than buy if the lease is more expensive. A government may decide that other benefits make the premium worth paying. But this situation is usually the exception and not the rule. If a government wants to set aside the principle of *economy*, it should understand the reason and the cost. Information on any instances of paying lease premiums should be tabled in the Legislative Assembly so MLAs can assess the trade-offs the government made between economy and other policy objectives.

Lease or buy decisions are important to Nunavut

76. We have not audited how Nunavut makes its decisions about building priorities, the affordability of its capital plans, or whether it should lease or buy. However, we have noted a number of issues that MLAs may want to consider when they review the government's capital plans.

77. Nunavut has a lot of long term building leases and the number is growing. The costs of these leases are significant. At March 31, 2000, the government was committed to making about \$476 million in lease payments, mostly for long term leases of up to 20 years.

78. Also, the government continues to enter into new long term leases as it builds infrastructure for the new territory. Final commitments as of March 31, 2001 are not yet available. But based on unaudited information there are about \$145 million of new commitments for leases which began in 2000-2001.

79. Total capital spending is not apparent, since capital estimates do not show the total cost of leases. Different types of information on buying and on leasing make it difficult for MLAs to tell whether the government can afford its total capital plans for the year.

80. Planned leases are not shown in the government's 1999-2000 capital estimates. Lease costs are included in the main estimates, but only as an operating expense for the total lease payments in a year. The government's plans for new leases are not highlighted in either the capital estimates or main estimates. This means MLAs cannot look as closely at new leases as they would at proposals to buy buildings. Lease payments could raise the total cost of capital projects to an unaffordable level, without anyone noticing the problem.

81. The government's reasons for choosing to lease are not clear. We wanted to understand how the government decides to lease a particular building rather than to buy or build it. We picked one recent long term lease to review, and noted the following:

- Management informs us that the government has not established any formal objectives for deciding whether to lease or buy buildings. We would therefore expect that it would apply the principle of *economy*, and decide to lease or buy depending on which is cheaper. This is based on the assumption that a government would be able to pay to build, whether with cash or by borrowing.

- For the particular project we reviewed, the government arranged for a calculation of whether it would be cheaper to lease or buy. The calculation suggests that the cost of this particular lease was 50 percent higher than it would have cost the government to build the building. Nevertheless, the government decided to pay this lease premium. The analysis is dated two days before government records indicate that the government wrote to the successful bidder to inform the bidder that it had the lease. Without explicit objectives that clearly say why the government might want to pay this large premium, it is unclear to us why the government decided to lease and not buy.

Recommendations

1. **Information provided to the Legislative Assembly should allow MLAs to see the total cost of the government's capital plans for the next year, including planned commitments for long term leases.**

Management response

The government will provide the total cost of capital plans in the Capital Estimates and Budget each year. Any long-term capital leases impacting on that fiscal year will be included.

2. **If the government continues its long term leasing activities, it should establish formal objectives, and periodically evaluate whether those objectives are being met.**

Management response

The Government will establish clear objectives and standards for long term leasing activities, and will evaluate on an annual basis whether these objectives are being met.

3. **The government should compare the costs of leasing with the costs of buying before making a lease or buy decision.**

Management response

See below.

4. **The government should consider what lessons it can learn from its recent long term leases. It should assess the premiums it has paid in order to lease rather than buy, and any objectives that might justify the decision to pay these premiums.**

Management response

Before entering into new leases the government will compare the cost of leasing with the costs of buying in an effort to make the best business decision for the government. The government also considers factors in the overall decision making process other than straight cost, including the local work force, supporting the Nunavut economy and the Nunavummi Nangminiaqtunik Ikajuuti (Assistance for Nunavut Businesses) policy.

Many of the existing government leases were entered into before the creation of Nunavut, and their costs are covered by transfer payments from the Government of Canada for the next 20 years.

Appendix A – Our staff

Sheila Fraser, FCA	Auditor General of General
Michael J. McLaughlin, CMA	Deputy Auditor General
Ronald C. Thompson, CA	Assistant Auditor General
Dale Shier, CA	Principal, Nunavut audits
Roger Simpson, CA	Principal, Edmonton Office
John McCullough, CA	Principal, Winnipeg Office

Audit team

Since Nunavut is large, our audit work involves staff from our Ottawa, Edmonton, and Winnipeg offices. Most of these staff work on Nunavut audits only as brief assignments.

- Sophie Boudreau
- Yannick Brazeau
- Estelle Charette
- Monique Charron
- Doug Dheere
- Helene Demarcke
- Jeanette Fitzpatrick
- Shawn Frost
- Charles Gay
- Samantha Hazen
- Wendy Ho
- Dustin Hoshowski
- Mary-Jo Jacksic
- Guy Legras
- Susan Meilleur
- Chantal Montpetit
- Barry Naik
- Megan Picard
- Marjorie Pound
- Michel St. Amant
- Alain Sansregret
- Pascale Saulnier
- Donna-Lee Shaw
- Mila Simon
- Dan Stadlwieser
- Lise Tremblay
- Laura Wolanik
- Peter Yeh

Appendix B – A Reader's Guide to Nunavut's March 31, 2000 Consolidated Financial Statements

Section	What this section tells you
Auditor's report	<p>This tells you if there are any qualifications or other observations in the auditor's report. If there are none, it 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.</p> <p><i>(There is no qualification or other observation in our opinion on Nunavut's March 31, 2000 consolidated financial statements.)</i></p>
Consolidated statement of financial position	<p>This tells you whether the government has more financial assets than liabilities or whether it has more financial liabilities than assets. If there are more financial assets than liabilities, this is an accumulated surplus.</p> <p><i>(At March 31, 2000, the government's accumulated surplus was over \$25 million.)</i></p>
Consolidated statement of operations and accumulated surplus	<p>This tells you whether revenues for the year were enough to cover expenses. If so, this is an annual surplus. If not, it is an annual deficit.</p> <p><i>(The government had a surplus of over \$28 million for its first year of operations. The accumulated surplus on the statement of financial position is made up of the \$28 million surplus less the opening net debt transferred to Nunavut on April 1, 1999 of \$3 million.)</i></p>
Consolidated statement of cash flows	<p>This tells you whether cash and temporary investments increased or decreased during the year and why.</p> <p><i>(This statement shows that cash and temporary investments totalling \$29 million were transferred to Nunavut on April 1, 1999. Cash increased by \$90 million during the year, so the government had \$119 million in cash and temporary investments at 31 March 2000.)</i></p>
Consolidated statement of tangible capital assets.	<p>This gives you information on physical assets owned by the government.</p>
Notes to the financial statements	<p>These give you information you need to understand the sections of the financial statements described above. For example:</p> <ul style="list-style-type: none"> • Note 1(a) lists all the entities that are consolidated (included) in the financial statements • Note 16 lists commitments (we discuss commitments in chapters 3 and 6 of this report) • Note 17 lists important contingencies (uncertainties)

Appendix C – Glossary

Accountable	Responsible for explaining and justifying actions to someone else.
Accounting standards for government	Independent and objective accounting rules for the federal, territorial, and provincial governments. Published by the Public Sector Accounting Board of the Canadian Institute of Chartered Accountants.
Amortization	Spreading the cost of a long lived (capital) asset over its life. (Used to be called depreciation.)
Capital lease	A lease that transfers many of the benefits and risks of ownership to the party leasing an asset such as a building.
Consolidate	Include all parts of government in financial statements, not just Departments.
Contingency	A significant uncertainty at the time financial statements are prepared that affects the amounts reported in the statements. Typical examples include litigation or incomplete information. Significant contingencies are disclosed in a note to the financial statements.
Deficit	If a government's spending over the years has been more than revenues, then it has a deficit. Opposite of surplus.
Economy	The principle of not paying more for something than is necessary to get the good or service which is needed.
Lease	A contract to rent an asset from someone else.
Lease premium	There are financial techniques that can be used to determine if leasing or buying is a better deal for a particular need. If in a particular case, leasing is more expensive but the government decides to lease anyway, then the extra cost is the lease premium.
Long term lease	A lease for a long lived asset where the lease is for many years. Could be either an operating or a capital lease.
Operating lease	Any lease which is not a capital lease.
Public accounts	Annual public financial report published by the Government of Nunavut. Contains both audited and unaudited information.
Revolving Fund	A part of the government which has a specific goal and a maximum amount of money it can get. A revolving fund spends money but also gets money back from operations.
Short term lease	Any lease which is not a long term lease.
Surplus	If a government's revenues over the years have been more than spending, then it has a surplus. Opposite of deficit.