Finance

9A

Executive summary

In this chapter, we report the results of the audit of the Department of Finance (Department) and the entities it controls. Overall, the Department does a good job managing its responsibilities for safeguarding and controlling its assets and ensuring compliance with the law. However, we have significant concerns with the General Revenue Fund (GRF) and the planning and budgeting process.

The GRF's financial statements are not reliable. The financial statements do not record its pension liability of $4 billion, and understate pension costs by $39 million. Also, the financial statements inappropriately record a $280 million transfer from the Fiscal Stabilization Fund as revenue. As a result, the Department's accounting practices are not in accordance with The Canadian Institute of Chartered Accountant's accounting standards for the public sector.

We also report that the budgeting information provided in the budget Estimates needs improvement. For example, the Department does not include the GRF's total expected pension costs for the year in the budget Estimates. Including these costs is important because the Government uses the GRF's budgeted surplus or deficit as a key economic indicator.

However, in Volume 1 of our 2002 Fall Report we discuss a larger issue with the planning and budgeting process. Currently, the Government's public financial plan focuses on the GRF. That plan is not sufficient to have an informed public debate on whether Saskatchewan can afford new and existing programs. Also, a plan focused on the GRF is not sufficient to inform people if the Government plans to live within its means.

We also report that the Department's processes to ensure that investments held by pension plans comply with the law and the investment objectives need improvement.

Introduction

The Department of Finance (Department) helps the Government and the Legislative Assembly manage and account for public money. It controls spending from the General Revenue Fund (GRF) and ensures that the GRF receives all revenue due to it. The Department prepares the Government's summary financial statements. Also, the Department prepares an annual report that includes important accountability information about its activities, goals, and challenges.

The Department of Finance:

- prepares the annual Budget Address, Estimates, and Public Accounts;
- arranges Government financing, banking, investing, and borrowing;
- provides policy and financial analysis to Treasury Board and Executive Council;
- develops tax policy alternatives;
- administers various tax, grant, and refund programs;
- provides economic forecasting and economic, social, and statistical data;
- administers public sector pension and benefit plans;
- operates a central financial and human resources system for government departments; and
- leads the Government's accountability project.

Special purpose funds and Crown agencies

The Department is responsible for the following special purpose funds and Crown agencies.

Year end December 31

Extended Health Care Plan
Extended Health Care Plan for Certain Other Employees
Municipal Employees' Pension Commission
Public Employees Deferred Salary Leave Fund
Public Employees Disability Income Fund
Public Employees Dental Fund
Public Employees Group Life Insurance Fund
Saskatchewan Pension Plan
SaskPen Properties Ltd.[1]

Year end March 31

General Revenue Fund (GRF)
Fiscal Stabilization Fund[2]
Members of the Legislative Assembly Superannuation Plan
Public Employees Benefits Agency Revolving Fund
Public Employees Pension Plan
Public Service Superannuation Plan
Saskatchewan Pension Annuity Fund

[1] This office is denied access to this Crown agency; therefore, we could not audit the agency (see Chapter 8 1999 Fall Report-Volume 2 for further discussion of the matter)
[2] The Department does not prepare financial statements for this Fund. As required by *The Fiscal Stabilization Fund Act*, a schedule of transfers and accumulated balance appears in Public Accounts Volume 1.

Financial overview

The following is a list of the Department's major programs and spending: for the year ended March 31, 2002. The financial information is from *Saskatchewan Estimates 2001-02*, *Public Accounts 2001-02: Volume 1: Main Financial Statements* (Public Accounts 2001-02 – Volume 1) (to view a copy of this report, see http://www.gov.sk.ca/finance/paccts), and Saskatchewan Finance's *Annual Report 2001-2002*.

	Original Estimates	Actual
	(in millions of dollars)	
Interest-GRF debt	641	617
Interest-Crown corporation debt	308	320
Total interest on debt	949	937
Pensions and benefits	175	174
Administration	37	37
	1,161	1,148

The following is a list of the Department's major revenue sources:

	Original Estimates	Actual
	(in millions of dollars)	
Individual Income Tax	1,185	1,196
Interest-Crown Corporations	308	320
Sales Tax	796	771
Transfers Equalization	377	492
Transfers CHST	594	609
Fuel Taxes	368	354
Corporation Taxes	641	509
Tobacco Taxes	125	120
Income-Government Entities	538	542
Motor Vehicle Fees	113	118
Other	112	114
	5,157	5,145

Key risks

It is important that Members of the Legislative Assembly (MLAs) and the public know the key risks facing a department. Also, they should receive information on these risks to understand and assess a department's performance. We think sharing our understanding of the Department's key risks with MLAs and the public will help them better understand and assess the Department's performance.

Information on how a department is managing its key risks can increase public confidence. Annual reports provide this information to MLAs and the public.

We identified the following key risks the Department must manage well to be successful. It must:

- give Treasury Board accurate and useful information to enable it to develop, manage, and evaluate the Government's fiscal plan;
- publish useful planning and performance reports;
- manage the Government's debt;
- manage investments;
- collect revenues due to the Department;
- manage several government pension and benefit plans; and
- ensure designated government entities comply with Treasury Board's directives.

To identify these key risks, we reviewed *The Financial Administration Act, 1993* and other legislative authorities. We also reviewed the Estimates, the Public Accounts, the Budget Address, the Department's annual report, and prospectus documents. In addition, we discussed these risks with key Department officials.

Our audit conclusions and findings

This chapter contains our audit conclusions and findings on the Department, its special purpose funds, and Crown agencies for the fiscal years ending on or during the year to March 31, 2002, except for the Municipal Employees' Pension Commission. We will report our results in a future report, when we complete our work on this pension plan.

Our Office worked with Deloitte & Touche LLP, appointed auditor for the Saskatchewan Pension Plan, and KPMG LLP, appointed auditor for the Public Employees' Pension Plan and the Municipal Employees' Pension Commission. We used the framework recommended by the *Report of the Task Force on Roles, Responsibilities, and Duties of Auditors* (to view a copy of this report, see our web site at http://www.auditor.sk.ca/rrd.html).

Our Office, Deloitte & Touche, and KPMG formed the following opinions.

In our opinion:

- **the Government's summary financial statements included in the Public Accounts 2001-2002 – Volume 1 are reliable;**

- **the financial statements for the special purpose funds and Crown agencies listed above that were audited are reliable except for the GRF;**

- **the GRF financial statements included in the Public Accounts 2001-2002 – Volume *1* are reliable except that the transfer from the Fiscal Stabilization Fund is not properly recorded and some pension costs are not recorded.**

- **the Department, its special purpose funds, and Crown agencies, that we audited, had adequate rules and procedures to safeguard and control their assets except for the matters described in this chapter;**

- **the Department, its special purpose funds, and Crown agencies, that we audited, complied with authorities governing their activities relating to financial reporting, safeguarding assets, revenue raising, spending, borrowing, and investing except where we report otherwise in this chapter; and**

- **in KPMG's opinion, the Public Employees Pension Plan had adequate rules and procedures to safeguard and control its assets and the Public Employees Pension Plan complied with authorities governing their activities.**

We did not rely on KPMG's opinion on the adequacy of the Public Employees Pension Plan's rules and procedures to safeguard and control its assets or KPMG's opinion on the Public Employees Pension Plan's compliance with authorities governing its activities.

The Provincial Auditor Act requires us to do additional work when we are unable to rely on the reports of appointed auditors. Our additional work consisted of reviewing *The Pension Benefits Act, 1992*, the statement of investment objectives, the investment managers' compliance reports, and discussions with management.

We also report on special warrants.

Our auditor's report on the GRF financial statements

Our auditor's report on the GRF financial statements for the year ended March 31, 2002 warns readers that the financial statements do not include all of the Government's financial activities. Therefore, readers should not use the GRF statements to understand and assess the Government's overall performance. The appropriate financial statements to use for that purpose are the Government's summary financial statements.

In addition, our auditor's report on the GRF financial statements for the year ended March 31, 2002 includes two reservations. The financial statements are significantly misstated because the GRF's pension costs and the transfer from the Fiscal Stabilization Fund are not reported properly.

The combined effects of these two reservations are as follows:

- the GRF's surplus is overstated by $319 million;
- the transfer from the Fiscal Stabilization Fund of $280 million overstates revenue by $280 million;
- pension expenditures are understated by $39 million; and

- pension liabilities are understated by $4.0 billion, assets are understated by $495 million, and accumulated deficit is understated by $3.5 billion.

Fiscal Stabilization Fund reservation

The Government records transactions between the GRF and the Fiscal Stabilization Fund as revenues or expenditures of the GRF. The substance of the transactions between the GRF and the Fiscal Stabilization Fund are that amounts owed by the GRF to the Fiscal Stabilization Fund must be repaid to the GRF by the Fiscal Stabilization Fund. Canadian generally accepted accounting principles for the public sector do not allow the GRF to record changes in the amounts due to the Fiscal Stabilization Fund as revenues or expenditures of the GRF.

The 2002 GRF financial statements show a liability of $495 million owed to the Fiscal Stabilization Fund. This amount is a reduction of $280 million from 2001. This reduction is recorded as revenue from the Fiscal Stabilization Fund. It is not appropriate to record the $280 million as revenue because it is not revenue earned by the GRF. Instead of recording revenue of $280 million, the GRF should show an asset of $495 million owed from the Fiscal Stabilization Fund.

The effects of not properly reporting this asset are as follows:

- GRF revenue is overstated by $280 million;
- the GRF's surplus is overstated by $280 million;
- assets are understated by $495 million; and
- accumulated deficit is overstated by $495 million.

The Fiscal Stabilization Fund was created in April 2000. The stated purpose of the Fiscal Stabilization Fund is to stabilize the fiscal position of the Government from year to year. However, making transfers from one fund to another, and back again, has no effect on the Government's overall financial position. The Government's total net worth for 2002, which amounts to an accumulated deficit of $8.7 billion, is unaffected. Therefore, the only consequence of recording these transactions in the

GRF financial statements is that the actual amount of the GRF surplus is changed to another amount chosen by the Government. This is worrisome because the Government uses the amount of the GRF's surplus or deficit as one of its key performance indicators.

Last year, we recommended that the GRF financial statements should record transfers to the Fiscal Stabilization Fund as an asset, not as an expenditure. In addition, the GRF financial statements should record any transfers back to the GRF as a reduction of that asset, not as revenue.

In February 2002, The Standing Committee on Public Accounts (PAC) considered this matter and disagreed with our recommendation.

We continue to recommend that the General Revenue Fund financial statements should record transfers to the Fiscal Stabilization Fund as an asset, not as an expenditure and any transfers back to the General Revenue Fund as a reduction of that asset, not as revenue. Canadian generally accepted accounting principles for the public sector do not allow the General Revenue Fund to record changes in the amount due to the Fiscal Stabilization Fund as revenues or expenditures of the General Revenue Fund.

Pension costs reservation

The GRF is responsible for the liabilities of several pension funds. However, the GRF financial statements do not record these liabilities. Therefore, the Assembly and the public are unable to properly assess pension costs because the financial statements do not include the GRF's total pension costs for the year or the unfunded pension liability. The financial statements only include the amounts the Government actually paid retired members or contributed to a pension fund that year. The effects of not properly recording pension costs are as follows:

- pension expenditures are understated by $39 million;
- the GRF's surplus for 2001-2002 is overstated by $39 million; and
- pension liabilities and accumulated deficit are understated by $4.0 billion.

In previous years, we recommended that the Department account for pension costs in the GRF financial statements in accordance with The Canadian Institute of Chartered Accountants (CICA) accounting standards for the public sector.

In February 2002, PAC considered this matter and disagreed with our recommendation.

We note that Manitoba is the only other provincial government in Canada that publishes financial statements that do not follow CICA accounting standards for pensions.

We continue to recommend that the Department account for pension costs in the General Revenue Fund financial statements in accordance with CICA accounting standards for the public sector.

Annual pension costs not included in Estimates

In previous reports, we reported that the Assembly and the public are unable to properly assess pension costs because the Estimates do not include the GRF's estimated total pension costs for the year. The Estimates only include the amounts the Government expects to pay retired members or contribute to a pension fund that year.

The effects of not including the GRF's total pension costs in the Estimates for the year ended March 31, 2002 are as follows:

- budgeted operating expenditures of $5.7 billion are understated by $42 million;
- the GRF's budgeted surplus of $3 million is overstated by $42 million; and
- the budgeted accumulated deficit of $7 billion is understated by $4.0 billion.

In previous years, we recommended that the Department include the GRF's total pension costs for the year in the Estimates.

In February 2002, PAC considered this matter and disagreed with our recommendation.

We continue to recommend that the Department include the General Revenue Fund’s total pension costs for the year in the Estimates.

This matter is important because the Government uses the GRF’s budgeted surplus or deficit as one of its key performance indicators. If the budgeted surplus or deficit does not include the total estimated pension costs, it is difficult for the Assembly and the public to assess the Government’s performance. As well, the Assembly makes decisions based on the belief that the “budget” is balanced. It might make different decisions if the budget included the correct amount of pension costs for the year.

In Volume 1 of our 2002 Fall Report, we discuss a significant concern with the Government’s budgeting process. We state that a budget focused only on the GRF does not provide sufficient information for the Assembly and the public to have an informed debate on issues such as the affordability of new or existing programs. This is because it excludes a significant amount of the Government’s revenue and spending.

Also, a plan focused on the GRF is not sufficient to inform people whether the Government plans to live within its means. For example, the Government’s public financial plan for 2002 says that the Government planned to raise $3 million more in revenue than it would spend. The actual results for 2002 for the GRF show that the Government raised $1 million more than it spent. Focusing only on the GRF could cause people to think that the Government had a plan for the entire Government to live within its means and that for 2002 it did so.

However, the financial results for the entire Government show that the Government did not live within its means in 2002. In 2002, the Government actually spent $483 million more than the revenue it raised. This is nearly a $1 billion turnaround from 2001, when the Government raised $461 million more than it spent. A published financial plan for the entire Government would improve the Government’s accountability by allowing legislators and the public to assess whether this financial performance is better or worse than what was planned. Accordingly, in

Volume 1 of our 2002 Fall Report, we recommend that the Government should publish a financial plan for the entire Government.

Special warrants

The law requires us to report when a special warrant approved the payment of public money. For the year ended March 31, 2002, the Government approved the spending of $89.6 million by special warrant. It later included these special warrants in an appropriation act.

Verification of investment manager compliance reports

The Department needs adequate rules and procedures to ensure that investments held by the Members of the Legislative Superannuation Plan, the Saskatchewan Transportation Company Employees Superannuation Fund, and the Public Employees Pension Plan comply with the law and the plans' investment objectives.

The Members of the Legislative Assembly Superannuation Plan is a defined benefit final average pension plan. In 2001-2002, this plan earned investment income of $0.9 million, and the market value of its investments increased by $0.1 million. At March 31, 2002, it held assets of $21.7 million and had liabilities of $48.4 million.

The Saskatchewan Transportation Company Employees Superannuation Fund is part of the Public Service Superannuation Plan. This fund is a defined benefit final average pension plan. In 2001-2002, it earned investment income of $1.0 million and the market value of its investments decreased by $0.2 million. At March 31, 2002, this fund held assets of $19.2 million and had liabilities of $28.5 million.

The Public Employees Pension Plan is a defined contribution pension plan. During the year, this plan earned investment income of $91.3 million and the market value of its investments increased by $55.9 million. At March 31, 2002, it held assets of $2.7 billion for the benefit of members.

The Pension Benefits Act, 1992 (Act) sets out the investment requirements that pension plans must follow. Pension plans may contract with investment managers to make investment decisions. However, management is still responsible to ensure that all investments comply with the law and with established investment objectives. Management can do this by verifying the investment manager's compliance reports or management could receive periodic independent assurance on the adequacy of the systems and practices the investment manager uses.

For the above plans and funds, contracts with investment managers require the investment manager to ensure that investments comply with the law and the established investment objectives. Management receives quarterly investment compliance reports from the investment managers.

However, for the Members of the Legislative Assembly Pension Plan and the Saskatchewan Transportation Company Employees Superannuation Fund, management does not verify those reports. To ensure that all investments comply with the law and the investment objectives, management should establish rules and procedures to verify the investment manager's compliance reports. Alternatively, management could get periodic independent assurance on the adequacy of the systems and practices the investment manager uses.

Management does not have rules and procedures to verify the investment manager's compliance reports. Nor does management receive independent assurance on the adequacy of the systems and practices the investment manager uses. As a result, we cannot determine if investments complied with the law and established investment objectives.

For the Public Employees Pension Plan, management established a policy requiring verification of the investment manager compliance reports relating to securities held directly, e.g. bonds and equities. The policy excludes pooled funds[3]. Securities held directly represent about 40% of the total investment portfolio.

As a result, management verifies only about 40% of the investment portfolio of $2.7 billion. To ensure that all investments comply with the law and the investment objectives, management should revise its policy to require verification of all manager compliance reports. Alternatively, management could receive periodic independent assurance on the adequacy of the systems and practices the investment manager uses.

[3] Pooled funds are typically trust funds that hold investments managed by a professional money manager and are similar to mutual funds.

1. We recommend that management establish policies and procedures to ensure that all investments held by the following plans comply with the law and the investment objectives: the Members of the Legislative Assembly Pension Plan; the Saskatchewan Transportation Company Employees Superannuation Fund; and the Public Employees Pension Plan.

Public Service Superannuation Plan

The Public Service Superannuation Plan (Plan) consists of the Public Service Superannuation Fund, the Anti-Tuberculosis League Employees Superannuation Fund, and the Saskatchewan Transportation Company Employees Superannuation Fund. The Plan is a defined benefit final average pension plan.

In 2001-2002, the Plan provided superannuation allowances, refunds, and transfers of $95.2 million. At March 31, 2002, it held assets of $20 million and had liabilities of $1.5 billion.

The Public Service Superannuation Board (Board) manages the Plan. The Board's primary objective is to provide superannuation allowances to employees who retire and to the dependants of deceased superannuates and employees in accordance with governing legislation including *The Public Service Superannuation Act*.

Retired members' pensions

The Board needs information about retired plan members who are receiving a pension and have returned to work for the Government. The Board needs this information to ensure that it pays pensions in accordance with the law.

Section 27 of *The Superannuation (Supplementary Provisions) Act* (Act) sets the requirements for stopping pensions when retired members, receiving a pension, are re-employed. The Act allows retired members, receiving a pension, to work for the Government as temporary, casual, or provisional employees for a period not exceeding six months in a fiscal year without any pension reduction. However, the Act requires the Board to stop the pension of a retired member who works for the Government more than six months in a fiscal year. The Act also requires the Board to stop the pension of a retired member re-hired by the Government as a permanent employee on the day the member starts work.

The Board does not have rules and procedures to know if retired members are working for the Government. The Board relies on retired members receiving a pension notifying the Board upon re-employment with the Government. As a result, the Board cannot ensure that all pensions paid comply with the law. Also, because the Board does not have rules and procedures to know if retired members are working for the Government, we cannot determine if the Board complied with section 27 of the Act.

We also reported this matter in our 2001 Spring Report.

In November 2001, the Standing Committee on Public Accounts considered this matter and concurred with our recommendation.

We continue to recommend that the Public Service Superannuation Plan's Board establish rules and procedures to ensure that all retired members receiving a pension, who have returned to work for the Government, are paid in accordance with the Act. Alternatively, the Board should seek changes to the Act.

Management told us it plans to seek changes to the Act.