



Report of the Auditor General
of Québec
to the National Assembly
for 2014-2015

Audit of Financial Information
and Other Related Work

Highlights

Winter 2015

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1 Introduction

1 For the sixth consecutive year, the Auditor General of Québec is publishing a separate report covering the audit of financial information and other related work.

2 The provisions of the *Auditor General Act* make it possible for me to make comments that I deem appropriate with respect to:

- the financial statements of the government and its public bodies, as well as the accounting principles or policies according to which these statements were prepared;
- the form and content of financial information documents, such as the Expenditure Budget and the Public Accounts, tabled before the National Assembly or a Committee, as a basis for supervision over the use of public funds and other public property.

3 Nearly 50% of the Auditor General's annual budget is allocated to the audit of financial statements and other financial information. This report is being published to inform parliamentarians on subjects specifically related to financial information and to make them benefit from the expertise of my staff in this sector.

4 Note that since deadlines were extremely tight, the results of my work following the analysis of the government's latest economic and financial update, namely the December 2014 Update, are included in a separate report. This work was carried out in response to the motion unanimously passed by parliamentarians on November 28, 2014, which read as follows: "THAT the National Assembly instruct the Auditor General of Québec to analyze the economic update that will be presented by the Minister of Finance in respect of 2014-2015. THAT for the purpose of this analysis, the Auditor General of Québec have access to the same sources of information from the Ministère des Finances and the Secrétariat du Conseil du trésor as he did for the publication of his report dated 3 June 2014."

2 Québec's Economic and Financial Situation

2.1 Pre-Election Report

5 On February 5, 2015, as part of the study of Bill 28, *An Act mainly to implement certain provisions of the Budget Speech of 4 June 2014 and return to a balanced budget in 2015-2016*, I was invited to meet with members of the Committee on Public Finance. My intervention dealt only with the section on the pre-election report.

6 Bill 28 sets out the expectations of parliamentarians towards the work that the Auditor General must carry out with regard to the financial information produced in a pre-election period.

7 I mentioned to parliamentarians that this legislative measure is likely to promote better planning and more structured organization of my work. Indeed, over the last year, my institution was asked three times to carry out audit work on financial information documents. It is highly desirable that the conduct of audits as critical as these be more predictable.

8 Therefore, I favourably welcome the contents of Bill 28. If parliamentarians would like me to express an opinion on the contents of the next pre-election reports, I will work actively on this as I have done up until now.

2.2 Work on the December 2014 Update

9 On November 28, 2014, the National Assembly unanimously passed a motion to entrust me again with the mandate of analyzing the latest economic update, which was published on December 2, 2014.

10 It is important for me to state again that a forecast is a look into the future. Therefore, it depends on several factors. One thing is certain: there will be differences between forecasts and reality, and those differences may be significant. Moreover, the further forecasts go forward in time, the more the differences are likely to be considerable.

11 My work made it possible for me to find that the forecasts included in the December 2014 Update are reasonable for the years 2014-2015, 2015-2016 and 2016-2017, except for forecasts on debt service, which are pessimistic for those same years, and the forecast on expenditures from the general fund, which is ambitious for the year 2016-2017.

12 The reasonableness of the consolidated forecasts is based mainly on two elements. First, the December 2014 Update presents a fairly specific plan for achieving a balanced budget in 2015-2016 since measures were identified and concrete actions were taken. Second, the forecasts in the Update include prudence margins that make it possible to compensate for the risks that I identified.

13 Achieving a balanced budget therefore rests on the government's ability to sustainably maintain low growth of program expenditures from the general fund, notably by carrying out the planned measures. Some measures require changes in the governance of entities or changes to administrative practices, or arise from the negotiation of certain agreements. The government estimated the effects of those measures. However, this estimate involves risks. On the one hand, it is possible that the measures will be carried out late or that the desired results end up to be less than expected. The objective of my work was not to assess the probability that they will be carried out or the estimate made for each of the measures.

14 Nevertheless, it is undeniable that demographic changes will create significant pressure on costs over the coming years. I am still of the opinion that considerable efforts and rigorous follow-up will be required.

2.3 Government's Consolidated Financial Statements

15 For a second year in a row, my auditor's report on the government's consolidated financial statements contains a qualification concerning the recognition of subsidies (government transfers). This qualification arises from a difference of opinion between the Auditor General of Québec and the Government of Québec concerning the interpretation of the accounting standard that came into effect on April 1, 2012. This difference can also be seen within the profession between different financial information preparers or different accounting firms. Chapter 2 presents this situation. The Public Sector Accounting Board (PSAB), the regulatory body responsible for this standard, undertook a consultation exercise to identify the difficulties related to the application of the standard. The Auditor General will attentively follow the PSAB's work.

16 My auditor's report also mentions a situation of non-compliance with the *Balanced Budget Act* for the fiscal year ended March 31, 2014. On November 26, 2014, Bill 28 was submitted in order to resolve the situation.

17 Finally, considering the importance of the consolidated financial statements for reporting on the province's public finances, I reiterate my invitation to entrust the responsibility of the Public Accounts' study to the Committee on Public Administration or another parliamentary committee.

3 Funds Allocated to Local Development Centres

18 In 2014, I undertook a value-for-money audit engagement on local development centres (CLDs). The transitional fiscal pact that the government and municipal representatives signed in last November provides for significant changes to the regional governance structure. Since then, some CLDs have ceased their activities, and others could follow suit over the next few months.

19 Considering these changes, I deemed it preferable to end this engagement. The work was not completed; however, it was far enough along to allow me to make some observations on the practices of responsible departments and CLDs. I consider that some of these observations remain relevant to the extent that the government will continue to entrust public funds to agents and will expect to see results in return.

20 That is why I present, in Chapter 6, the main observations made as well as the avenues for improvement for the entities concerned with the subject. These avenues for improvement notably deal with the need to clarify the terms and conditions of use of funds entrusted, to implement adequate management tools and control mechanisms and to rigorously monitor the results obtained. I hope that these avenues will contribute to the reflection of government authorities responsible for implementing financial support programs and improve the management practices of entities managing these programs.

Highlights

Work Objective

The preparation and audit of the government's consolidated financial statements require a great deal of effort.

The purpose of our work was to express an opinion on the financial statements in accordance with the *Auditor General Act* and Canadian Generally Accepted Auditing Standards.

This chapter constitutes a derivative communication under Canadian Auditing Standards arising from the financial statement audit performed according to the Canadian generally accepted auditing standards.

The Report is available at www.vgq.qc.ca.

Audit and Related Work Results

The following are the principal findings of our work.

From our point of view, the government's consolidated financial statements respect, with one exception, the Canadian Public Sector Accounting Standards for a second year in a row. The exception arises from a difference of opinion concerning the interpretation of the accounting standard on government transfers. According to our estimates, the net debt and accumulated deficits as at March 31, 2014, are understated by \$8.5 billion, and the annual deficit is understated by \$439 million. Considering the absence of information enabling the identification of the work performed at the end of the fiscal year for contractual obligations totalling \$3.1 billion, we have not been able to determine the additional adjustments to be made to these amounts.

As at March 31, 2014, the government contravened the *Balanced Budget Act* by recording an annual deficit of \$1,703 million, which exceeds the set objective by \$1,803 million. A comment on non-compliance with the Act was therefore added to our independent auditor's report on the consolidated financial statements as at that date. The government announced its intention to modify this Act in its June 2014 Budget. On November 26, the Minister of Finance submitted a bill to the National Assembly in order to resolve the situation.

In 2013-2014, the government adequately took into account the mortality tables and the life expectancy improvement scales, published in February 2014 by the Canadian Institute of Actuaries, in its obligations relating to pension plans; this resulted in an actuarial loss of about \$1.7 billion. This loss was included in the actuarial obligations of the concerned plans and will be amortized over the expected average remaining service life of participants.

Analyses are required to determine the impact of applying the new accounting standard relating to contaminated sites on the government's consolidated financial statements as at March 31, 2015. We encourage the Comptroller of Finance to continue and complete the analyses undertaken as soon as possible.

Highlights

Work Objective

Each year and pursuant to his mandate, the Auditor General of Québec audits the financial statements of several public-sector entities. This work deals with the financial statements of the government, public bodies and government agencies, as well as the financial statements or reports of some institutions in the health and social services and the education networks.

This chapter presents the modified opinions, emphasis of matter paragraphs, cases of non-compliance as well as the related recommendations arising from our work over the past year that deserve to be brought to the attention of the National Assembly.

This chapter constitutes a derivative communication under Canadian Auditing Standards arising from the financial statement audit performed according to the Canadian generally accepted auditing standards.

The Report is available at www.vgq.qc.ca.

Audit Results

The following are the findings of our work.

Health and social services network. The qualification toward inadequate accounting of the buildings leased from the Société québécoise des infrastructures was again present where the situation applied as at March 31, 2014. Furthermore, the independent auditors of the financial statements of 55 agencies and institutions (16 as at March 31, 2013) formulated modified opinions that involve qualifications other than the above-mentioned qualification. Out of these 55 entities, 45 received a report that contained a qualification concerning inadequate accounting of government transfers relating to fixed assets (2 as at March 31, 2013). The increase in the number of modified opinions is a source of concern.

Education network. As at June 30, 2014, reports from the independent auditor of eight institutions (two institutions as at June 30, 2013) contained a qualification concerning inadequate accounting of government transfers relating to fixed assets.

Commission de la construction du Québec. According to the Commission, the application to the supplemental pension plan of the solvency deficiency amortization period provided for by law would have resulted in an employer contribution for past services of \$3.80 per hour worked in 2014 for an apprentice or a journeyman instead of the established contribution of \$1.925. A \$3.80 contribution per hour worked would have amortized the \$2.8 billion solvency deficiency as at December 31, 2013, \$1.4 billion of which is not covered by the contribution for past services that is planned for the next five years.

Conservatoire de musique et d'art dramatique du Québec. The Conservatoire contravened the provisions of its incorporating act by presenting an accumulated deficit in its financial statements as at June 30, 2013. The accumulated deficit increased by over 40% in the period then ended, reaching \$10.2 million (\$7.2 million as at June 30, 2012).

Institut de la statistique du Québec. The \$1.4 million accumulated deficit as at March 31, 2014, demonstrates that the Institut contravened its incorporating act by making payments or assuming obligations whose costs exceeded the amounts at its disposal.

Recommendations

The Auditor General has made recommendations to the audited entities and the concerned entities. All of them are shown to the right.

The audited entities and concerned entities had the opportunity to comment on the report; their comments can be found in the *Commentaires de l'entité auditée* or *Commentaires de l'entité visée* sections.

We want to point out that they accepted all of the recommendations.

Recommendations reiterated to the Ministère de la Santé et des Services sociaux

- 1 Provide public agencies and institutions with all the information they need to be in compliance with the standards to which they are subject for the preparation of their financial statements.**
- 2 Carry out a follow-up with entities in the health and social services network to ensure they put in place appropriate measures to solve the problems that led to qualifications in the auditors' reports.**

Recommendation reiterated to the Ministère de l'Enseignement supérieur, de la Recherche et de la Science

- 3 Take the steps needed to ensure that the universities produce their financial statements within the allotted time and, in the case of the Université du Québec, in time for consolidation with the government's consolidated financial statements.**

Recommendation reiterated to the Commission de la construction du Québec

- 4 Respect the provisions of the *Supplemental Pension Plans Act* to which it is subject.**

Recommendation reiterated to the Conservatoire de musique et d'art dramatique du Québec

- 5 Take the steps necessary to respect section 57 of its incorporating act.**

Recommendation to the Institut de la statistique du Québec

- 6 Take the measures required to respect its incorporating act.**

Highlights

Work Objective

Each year, work dealing with sensitive information is carried out in certain entities. This type of information mainly concerns expenditures related to administrators and managers as well as expenditures related to contracts awarded.

This chapter deals with the work on sensitive information that we carried out at the École nationale des pompiers du Québec during the period ended June 30, 2014, as well as other findings arising from our audit of the Université du Québec à Montréal's (UQAM's) financial statements for the year ended April 30, 2014.

This chapter constitutes a derivative communication under Canadian Auditing Standards arising from the financial statement audit performed according to the Canadian generally accepted auditing standards.

The Report is available at www.vgq.qc.ca.

Work Results

The following are the principal findings of the work that we carried out at the École nationale des pompiers du Québec and the UQAM.

By not launching a public call for tenders to choose a print service provider, the École contravened its policy on supply and service contracts as well as applicable opening of public procurement intergovernmental agreements. It paid a print service provider over \$1.8 million to print training manuals over an eight-year period, whereas the threshold for a public call for tenders for these services is \$100,000.

The UQAM disbursed lump sums to managers that are not in compliance with section 6 of the *Act to implement certain provisions of the Budget Speech of 30 March 2010, reduce the debt and return to a balanced budget in 2013-2014.* Indeed, during the fiscal year ended April 30, 2014, the UQAM disbursed to 85 managers, other than members of the senior administrative personnel, lump sums totalling \$352,767 over the maximum amount of salary scales.

Recommendation

The Auditor General has made a recommendation to the École nationale des pompiers du Québec. It is shown to the right.

The audited entities had the opportunity to comment on the report; their comments can be found in each *Commentaires de l'entité auditée* Section. However, some of them have generated a reaction from us, which follows those comments.

We want to point out that the École accepted the recommendation.

Recommendation to the École

1 Supervise the contract awarding process:

- **by respecting its policy on supply and service contracts by the launch of a public call for tenders, whenever required, and by complying with applicable opening of public procurement intergovernmental agreements;**
 - **by appropriately documenting this process.**
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Highlights

Work Objectives

On the one hand, this chapter gives an overview of the recommendations contained in the reports to those charged with governance and management produced from November 1, 2013, to October 31, 2014, except for one, and the recommendations that the Auditor General sent to the entities and that are published in his report to the National Assembly entitled *Audit of Financial Information and Other Related Work* (Winter 2014), excluding the recommendations from Chapter 3. This section constitutes a derivative communication under Canadian Auditing Standards arising from the financial statement audit performed according to the Canadian generally accepted auditing standards.

On the other hand, the chapter provides the results of the follow-up on two recommendations made to the Secrétariat du Conseil du trésor (SCT) in Chapter 10 of the report entitled *Audit of Financial Information and Other Related Work* (Winter 2012).

The Report is available at www.vgq.qc.ca.

Work Results

The following are our principal observations concerning the recommendations included in the reports to the National Assembly and the reports to those charged with governance and management, and we make conclusions about the two recommendations made to the SCT in Chapter 10 of the winter 2012 volume on financial audits.

Overall, in 2013-2014, the recommendation application rate (65%) increased; it was near 60% for the three previous periods. The recommendation application rate rose for the governance and responsibility of financial information category as well as the management and disclosure of financial information category, rising from 57% in 2012-2013 to 72% in 2013-2014. However, the application rate for the information technology management category fell (50% in 2013-2014, compared to 61% in 2012-2013).

Non-respect of policies, directives and procedures as well as deficiencies in the management of access rights and profiles are the deficiencies in internal control that the entities showed most frequently in 2013-2014. New recommendations, of which there were 150, were made to 50 entities in 2013-2014; 3 of the entities received 25% of the new recommendations.

Of the 53 entities for which recommendations were the subject of a follow-up in 2013-2014, 29 (55%) achieved the recommendation application rate of 70%, which is the target application rate given in the Auditor General's *Strategic Plan for 2012-2015*, compared to 19 entities out of 43 (44%) in 2012-2013. The 24 entities that did not achieve the 70% target application rate had received 55% of the 232 recommendations that were followed up. Of these entities, 19 did not achieve the 70% recommendation application rate in last year's portrait. Note also that 25 entities (47%) reported a recommendation application rate of 100% in 2013-2014, compared to 14 entities out of 43 (33%) in 2012-2013.

The recommendation application rate varies greatly depending on the year of origin; in general, the further back in time the recommendation was made, the lower the application rate is. The rate drops from 86% for recommendations made to entities in 2013 to 35% for recommendations made from 2005 to 2008.

Follow-up on two recommendations made to the SCT. Our work led us to conclude that there was satisfactory progress for one of the recommendations.

Highlights

Work Objectives

In 2003, responsibilities for local development and entrepreneurship support were transferred to regional county municipalities (RCMs). They were then obligated to entrust these responsibilities to a local development centre (CLD).

The transitional fiscal pact that the government and municipal representatives signed on November 5, 2014, provides for the termination of this obligation.

Considering the significant changes proposed to the governance structure and the cessation of activities of some CLDs, continuing the audit engagement that we had undertaken in the matter was no longer relevant.

However, we believe it would be useful to identify some of the non-optimal management practices we observed and to propose avenues to improve management of public funds.

In this chapter, we discuss the following subjects: monitoring by the responsible departments, governance and management of funds allocated to CLDs, and management of financial support.

The Report is available at www.vgq.qc.ca.

Observations

The following are the principal observations of our work concerning funds allocated to CLDs.

Sums from Local Investment Fund (LIF) were not used for their intended purposes. In 2013, 51% of the CLDs used LIF's assets to pay for expenses that should have been covered by their operating budgets. Between 2011 and 2013, 43 CLDs used sums from the LIF to fund expenses related to day-to-day administration. Thus, about \$3 million per year was not available to help businesses.

Despite the data collected by the responsible departments, there is no up-to-date picture of the CLDs' main characteristics, their performance or the economic benefits of their interventions.

The LIF's assets were not used optimally, particularly with respect to results related to investment rate and rate of return, as well as the distribution of amounts allocated to CLDs for the LIF. In 2013, the LIF's investment rate was 53%; therefore, \$80.4 million in liquid assets were not invested in businesses. Furthermore, over half of the CLDs had negative cumulative rates of return.

In the three CLDs that were visited, key administrative policies or control mechanisms were absent. Consequently, expenses were paid without authorization at the appropriate level or adequate justification, while others did not comply with policies in effect.

LIF loans were not always granted according to the terms and conditions of the CLD's investment policy, the loan agreement and the management agreement. None of the 18 loan files that we analyzed complied with all the terms and conditions of the management agreement. In addition, for half of those files, the CLDs did not comply with one or more of the terms and conditions listed in their investment policy.

For most of the LIF loan files that we analyzed, the LIF management conditions or good practices were not complied with systematically. The lack of management tools, the absence of documented procedures or even their incomplete nature compromised the adequate processing of the files.

Avenues for Improvement

The Auditor General has provided avenues for improvement intended for government entities that entrust public funds to agents as well as for the latter. All of them are shown to the right.

Avenues for improvement intended for government entities that entrust public funds to agents

- 1 Clarify the terms and conditions of use of funds made available to agents and adopt the necessary control mechanisms to ensure that the funds are used for their intended purposes.**
- 2 Ensure the optimal use of public funds invested in assistance programs, namely:**
 - by regularly monitoring the performance of agents and the benefits of funds made available to them to determine whether the objectives have been reached;
 - by periodically evaluating the adequacy between funding allocation, needs and results achieved, and by making the necessary adjustments, where applicable;
 - by checking whether obligations are being met.
- 3 Ensure that the agents have implemented adequate policies and control mechanisms for expenditures to manage public funds and that they rigorously apply them.**

Avenue for improvement intended for agents that are entrusted with managing financial support programs

Avenue which also concerns the responsible government entities that will need to ensure the implementation of these management practices

- 4 Implement tools and controls that promote the effective management of the funds they are entrusted with (grants, loans), namely:**
 - establish an investment policy that complies with government requirements and apply it;
 - ensure compliance with all the terms and conditions of the loan agreement, management agreement or any other document of this nature;
 - adopt adequate procedures for awarding grants or loans and managing related files, and apply them;
 - monitor compliance with the terms and conditions stated in the loan agreement with the business.
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Significance of the Logo

An easy-to-recognize building, the Parliament, where the National Assembly sits. It is this authority which has entrusted the Auditor General with his mission and to which he reports.

Three dynamic lines, illustrating:

- the three types of audits carried out by his staff, namely financial audits, audits of compliance with statutes, regulations, policies and directives, as well as value-for-money audits;
- the three elements that are examined during value-for-money work: economy, efficiency and effectiveness;
- the three fields—social, economic and environmental—related to the stakes concerning sustainable development.

A truly distinctive sign, the logo of the Auditor General clearly illustrates that this institution, which is in constant evolution, aims to assist elected members in their desire to ensure the sound management of public funds, for the benefit of the citizens of Québec.

Acting Auditor General



On November 29, 2011, the President of National Assembly appointed Mr. Michel Samson as Acting Auditor General of Québec.

Since January 1, 2008, Mr. Samson held the position of Assistant Auditor General. He was responsible for several teams of experts in charge of carrying out value-for-money audits with government entities, whose scope and vocation were highly varied. The projects that he conducted mainly concerns such areas as education, transportation, culture and finance. Moreover, since 2010, he supervised the general directorate that offers value-for-money audit advisory services for its staff.

It was in 1990 that Mr. Samson joined the staff of the Auditor General. He began by working as a professional for six years in Québec City, being mainly assigned to value-for-money audits. He went on to accept a senior management position at the Montréal office; the files on which he worked concerned both financial audits and management audits.

His commitment and versatility bore fruit. In 2003, he returned to Québec City where he would serve as senior director, overseeing some thirty employees up until 2005. He is credited with numerous reports, which take stock of the practices used in, and the financial information produced by the Administration. He was entrusted with key sectors, which allowed him to demonstrate his ability to successfully complete particularly demanding assignments. The main components of his mandate were related to education, justice, modernization of government management, and computer systems.

Over the last few years, Mr. Samson headed four auditing directorates specializing in value-for-money audits. He carried out a significant share of the audit engagements completed on behalf of the National Assembly. Moreover, since being hired, he has often participated in special audits or overseen their completion.

As for his other professional activities, this experienced manager has contributed to the efforts made by all Canadian legislative auditors to promote the quality of information on performance published in the public sector. In addition, he has hosted training sessions on value-for-money auditing (Institute of Internal Auditors, Morocco Audit Institution, etc.) on many occasions. Finally, he has been a member of numerous in-house committees, including the one responsible for the organization's strategic planning from 2000 to 2006.

Before joining the ranks of the Auditor General, Michel Samson worked for two accounting firms. As a partner, he carried out financial auditing work for small and medium-sized businesses in the manufacturing sector.

A member of the Ordre des comptables agréés du Québec since 1984, which was brought into the Ordre des comptables professionnels agréés du Québec in May 2012, he holds a bachelor's degree in business administration and a licence in accounting sciences, both of which he received from Université Laval in 1981. In other respects, the Ordre des CPA du Québec awarded in May 2014 the CPA Award of Excellence to Mr. Michel Samson. He also was presented on May 29, 2014 the CPA Émérite Award, bestowed by the Chaudière-Appalaches and the Québec City CPA Groups.

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