Report of the Auditor General

to the Legislative Assembly

for the year ended March 31, 1992

Ottawa, Ontario
K1A OG6

The Honourable Michael Ballantyne, MLA
Speaker of the Legislative Assembly
of the Northwest Territories
Legislative Assembly
Yellowknife, NWT

Dear Mr. Ballantyne:

I hereby transmit a report to be laid before the Legislative Assembly in accordance with the provisions of section 30 of the Northwest Territories Act, R.S.C. 1985, C.N-22.

The report deals with "other matters" arising from my examination of the accounts and financial statements of the Government of the Northwest Territories for the year ended March 31, 1992 that, in my opinion, should be brought to the attention of the Legislative Assembly. The report also includes my recommendations and the related management responses.

Cordially yours,

L. Denis Desautels, FCA
Auditor General of Canada

Report of the Auditor General
For the Year Ended March 31, 1992

Introduction

We audited the accounts and financial statements of the Government of the Northwest Territories in order to express an opinion on the Government's 1992 consolidated financial statements.

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

This office also audited the following Agencies of the Government and issued reports during the past year:

Audit	Year End	Reported to
Workers' Compensation Board	December 31, 1991	Minister
Northwest Territories Housing Corporation	March 31, 1992	Minister
Northwest Territories Power Corporation	March 31, 1992	Minister
Northwest Territories Liquor Commission	March 31, 1992	Minister
Legislative Assembly Retiring Allowance Fund	March 31, 1992	Chairman, Management and Services Board
Arctic College	March 31, 1992	Minister
Petroleum Products Revolving Fund	March 31, 1992	Minister
Northwest Territories Development Corporation	March 31, 1991	Minister
Northwest Territories Business Credit Corporation	March 31, 1992	Minister

Management provided us with full access to all vouchers, records, documents and files, and all explanations and information requested during the audit of the above accounts. We thank the staff of Departments and Agencies for their cooperation.

This report is part of the Auditor General's Report on the 1992 financial statements of the Government of the Northwest Territories, as required by Section 30 of The Northwest Territories Act. The Act requires the Auditor General to provide a report on "other matters" within his audit scope which he feels should be reported to the Legislative Assembly. Accordingly, we report various items of concern, with our recommendations and management's responses.

Included in Chapter 1 of this report are comments on the financial statements of the Government.

The remainder of Chapter 1 and the rest of this report contain comments on other items we believe will be of interest to Members of the Legislative Assembly, but are not, individually or collectively, significant enough to require a reservation of opinion in the Auditor General's report on the Government's 1992 financial statements.

TABLE OF CONTENTS

Chapter 1

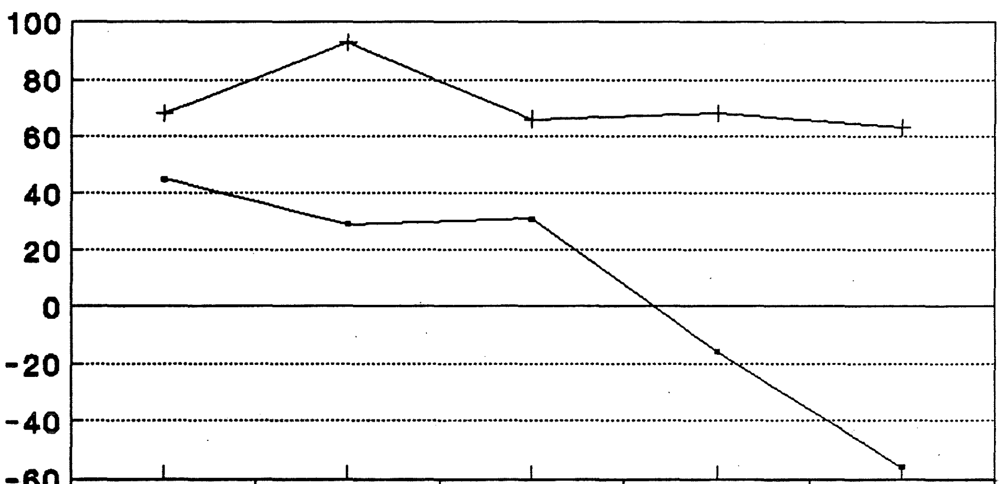
Financial Statement Issues

1.1 The Government's Cash Position

Exhibit 1 illustrates the trend of the Government's cash and surplus balances on March 31 for the last five years, excluding those of the Crown corporations and Agencies.

This Exhibit illustrates that the Government's surplus has remained relatively constant; however, the cash position has decreased steadily each year.

Exhibit 1
Trend of Government's Cash and Surplus
(Millions)



	1988	1989	1990	1991	1992
Net Cash	45	29	31	-16	-56
Surplus	68	93	66	68	63

Net Cash   Surplus

Impact of Cash Balance on Interest Expense

The Government pays interest on any overdraft balance determined by the bank and not on the cash balance reported in the Government's books. One would expect the two balances to be different because of the time lag between when the Government records an item and when the bank receives the item.

For example, when the Government issues a cheque, it deducts the amount from the bank balance in the bookkeeping system. The bank will not deduct the amount from the bank account until after the payee has received and deposited the cheque in his or her own bank account.

The reverse could also be true. The Government records cash when the funds are received. The bank would not increase the Government's account balance until the bank receives the deposit.

The difference between the Government's and the bank's cash balances can be quite large. On March 31st, 1992, for example, the Government's records showed an overdraft of $38,523,999 in one of its bank accounts, the consolidated revenue account. The bank's records indicate the overdraft for this particular account was $20,238,329.

Despite the large cash overdrafts shown in Exhibit 1, the Government has been able to avoid significant interest expense to date. Borrowing expense (excluding the interest on the loan for the Power Corporation transaction) for 1991-92 was $296 thousand. Management projects the 1992/93 overdraft expense will be $178 thousand. Unless the Government either increases its revenue or reduces its spending, it will continue to face the problem of funding significant interest expenses.

Ability to Repay Debt

If the Government borrows money to meet its cash requirements, it must pay interest charges as well as the amount of the loan. The Government's ability to raise additional revenue to make such payments is limited as approximately 81 percent of the Government's revenue comes from Canada. For illustration purposes only, if the Government raised personal and corporate income taxes rates to generate a 10 percent increase in tax revenue, total Government revenue would increase by less than 1 percent.

Canada's Payments to the Government

Canada is trying to reduce the federal deficit and has taken a stringent approach in its funding of other governments. Here are three examples of this trend which affect the Government:

i) Hospital Care for Indians and Inuit

The continuing dispute over funding hospital care for Indians and Inuit is a major contributor to the Government's current cash difficulties. During the 1991-92 fiscal year, the Government's cash balance decreased by $40 million. The hospital care dispute accounts for $26 million of this decrease.

We discuss this dispute further in Section 1.2 Hospital Care for Indians and Inuit Dispute.

ii) Formula Financing Agreement

The Government and Canada are disputing one specific calculation in the complex Formula Financing Agreement (FFA). Canada believes the Government has overstated its claim by $4.7 million. The FFA revenue shown in the Government's financial statements includes the disputed $4.7 million.

We understand that subsequent to our audit work, the Government has abandoned its claim against Canada for the $4.7 million. This will require reducing FAA revenue in the Government's future financial statements to recognize that the $4.7 million will not be collected.

iii) Arctic Airports

The Government has a $435,000 receivable from Canada dating back to 1989-90. This was the last year the Government operated "Arctic B&C" airports for Canada under contract. The Government maintains Canada owes the money. We understand that subsequent to our audit work, the dispute was settled when Canada agreed to pay half of the claim (approximately $217,000).

Cash Management

With funding cutbacks and high demands for spending, all public entities are under pressure to make the best use of their available cash. Managing cash involves many different techniques including collecting receipts as promptly as possible, and paying bills as late as possible to avoid overdrafts and the resulting interest costs. On the one hand, organizations and people who owe money to the Government are reluctant to pay early. On the other hand, the Government's own suppliers and funding recipients all want their cash as early as possible. How could the Government best manage its cash resources? In Chapter 3 we discuss the problems we observed and recommend action that would improve the Government's cash management practices.

Total Government expenditures for 1991-92 increased by $94 million. Total Government revenue, however, increased by only $64 million. Since the Government no longer has large cash balances to act as a buffer between annual cash receipts and annual cash expenditures, good cash management practices are required.

1.2 Hospital Care for Indians and Inuit Dispute

As discussed in our report to the Legislative Assembly last year, there is a major dispute between the Government and Canada over financial responsibility for the costs of hospital care for Indians and Inuit.

Last year the disputed amount from Canada was $32 million. By March 31st, 1992, the disputed amount had grown to $51 million against which the Government has recorded a $19 million allowance. The allowance is an indication that the Government is being conservative in its accounting policies. The recording of an allowance is not an indication that the Government will not be pursuing full settlement of the account. In November 1992, the Government commenced legal action against Canada to recover the full disputed amount plus interest.

Our 1992 audit opinion does not contain a reservation of opinion as was the case in 1991. However, this year's audit opinion does comment briefly on the dispute and refers the reader to this report for further comments.

Readers of the financial statements and this report should not misinterpret the change in our opinion from a reservation in 1991 to a unqualified opinion in 1992. The change in our opinion reflects our satisfaction with the

Government's disclosure of the dispute in notes 3 and 24(a) to the financial statements. Readers of the financial statements are informed adequately of the dispute.

Chapter 2

Compliance with Authorities Issues

Our audit opinion on the Government's financial statements includes an opinion on whether the Government complies with all significant authorities. We noted the following two areas of non-compliance which will be of interest to the Legislative Assembly:

2.1 Over Expenditures

Section 32(1) of the Government's Financial Administration Act (FAA) states that:

Subject to subsection (2), no person shall incur an expenditure that causes the amount of the activity set out in the Estimates on which the appropriation is based to be exceeded.

As in previous years, there were unauthorized activity over expenditures in 1991-92. Exhibit 2 summarizes the over expenditures for 1991-92, and Exhibit 3 summarizes the trend of over expenditures for five years.

The activity over expenditures also caused the **Department of Health (Health)** to over expend its entire operations and maintenance vote by $11,311,710.

Exhibit 2
Summary of Activity Over Expenditures

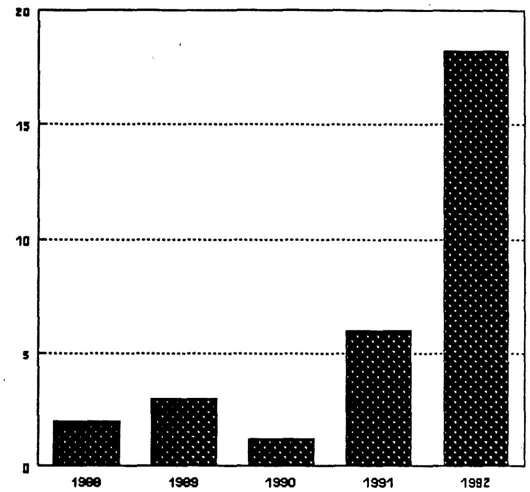
DEPARTMENT	ACTIVITY	OVER EXPENDITURE
Transportation	Arctic Airport	$711,113 (7.7%)
Renewable Resources	Field Operations	$14,687 (0.17%)
Health	Territorial Hospital Insurance Service	$15,317,110 (12.3%)
Health	Supplemen-tary Health Programs	$152,278 (1.03%)
Social Services	Community and Family Support Services	$857,659 (2.3%)
Economic Development and Tourism	Business Development	1,217,159 (6.7%)
Total		$ 18,270,006

As discussed in Section 1.2, the 1991-92 financial statements contain an allowance of $19 million for the disputed receivable for hospital care for Indians and Inuit. This $19 million allowance was recorded by the **Office of the Comptroller General (OCG)** and charged against Health's "Territorial Hospital Insurance Services" activity.

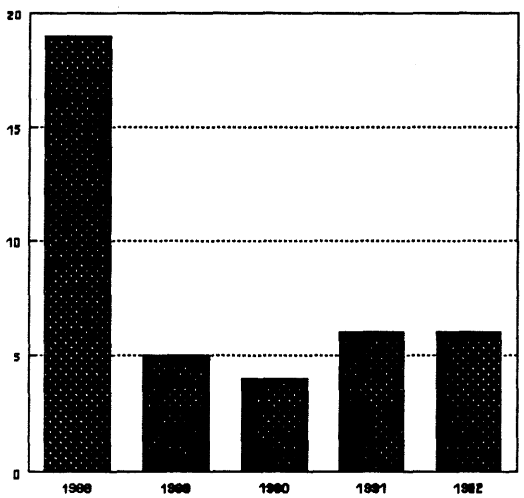
Section 36 of the FAA allows the **Comptroller General** to record allowances for doubtful accounts, even if there is no budget available against which to charge the expense. Therefore, the over expenditure by **Health** resulting from the provision of the $19 million allowance was within the statutory powers of the Government.

Exhibit 3
Trend of Over expenditures

Dollar Amount Over expended (Millions)



Number of Activities Over expended



Management's Comments:

i) *Department of Transportation*

The large portion of this over expenditure was actually the result of a disputed account with Transport Canada for $435,294. The Department was directed by the Department of Finance to establish a bad debt allowance for this full amount which increased the real over expenditure from $275,819 or 61% to the $711,113. This dispute has now been resolved and the Department has recovered the $217,647.

The Department was concerned with this over expenditure and is making every attempt to ensure that there are no reoccurrences. The Department engaged a consultant to review the financial management systems and organizational relationships of that division. The recommendations to prevent future occurrences are being implemented.

ii) Department of Renewable Resources

The over expenditure of $14,687 in field operations occurred when a FIS inquiry screen was read incorrectly and, as a result, a legitimate cost reallocation journal voucher was not posted prior to the year-end close.

iii) Department of Health

The year-end over expenditure in Supplementary Health Programs of $152,278 is attributable to an over expenditure in Noninsured Services. These expenditures are recoverable by way of contract with Health and Welfare Canada.

The Public Accounts also show an over expenditure in the Territorial Hospital Insurance Services activity of $15,317,110. Although the activity had a net surplus (after all other manual adjustments) for 1991-92 of $3,682,889. The $19 million valuation allowance for the DIAND receivable placed the activity in a deficit position.

iv) Department of Social Services:

The over expenditure was due to unanticipated increases in Social Assistance payments. The information system in use at the time did not provide reliable expenditure figures and, therefore, it was not possible to project year-end results accurately.

It is anticipated that with the implementation of the new Social Assistance System, effective April 1st, 1992, improvements in the projection of expenditures will occur.

v) Department of Economic Development and Tourism:

Under the <u>Financial Administration Act</u>, any losses incurred by a revolving fund must be charged to an appropriation in the fiscal year in which the loss was incurred. As of March 31, an amount of $1.827 million was charged to the Business Development activity representing the accumulated loss of Expo '92 to that date.

2.2 <u>Non-compliance with Investment Policy</u>

Section 57 of the FAA gives the **Minister of Finance** the authority to make short term investments. The **Minister of Finance** has delegated the setting of the investment policy to the **OCG.**

The policy sets out the maximum percentage of the Government's funds that may be placed in certain types of investments. The investment policy is unclear, however, whether the guidelines apply at the time of the purchase of an investment or whether the guidelines apply throughout the holding period of an investment.

We reviewed the "Government of the Northwest Territories Portfolio and Investment Pool Activity and Status Report" and noted there were 42 weeks when the investments exceeded the limits set out in the policy. This was the result of purchasing - and holding for a number of weeks - investments which caused the limits to be exceeded.

Recommendations

1. **The investment policy should be clarified as to whether the investment limits apply at the time of purchase or throughout the holding period of the investment.**

2. **The OCG should develop internal control procedures to detect and report on a timely basis any non-compliance with the investment policy.**

Management's Responses:

1. The investment manual has been redrafted to clarify what the policy is, that the limits apply at the time of the purchase only. Additionally, the limits are being amended to provide slightly increased limits for investing in authorized securities.

2. Weekly reports forecasting cash requirements for the ensuing six weeks are issued on Mondays and include a summary of investments on hand, together with a breakdown of the proportion of securities held. A review of these, at each month's investment meeting, should provide the necessary control and compliance with the policy.

Chapter 3

Cash Management

Significant cash management duties are delegated to the **Departments**. Other cash management duties are carried out by the **Office of the Comptroller General (OCG)**.

We audited the management of cash receipts, cash payments and cash on hand. Our focus was on the larger receipts and payments because of their significant effect on cash balances. We found many areas where cash management could and should be improved.

As discussed in Chapter 1, the Government's cash position has decreased. If the trend continues and the interest rates remain constant or increase, the Government's interest expense will escalate. Good cash management can help to minimize this. Also, at certain points during the year, the Government has surplus cash. Good cash management will maximize the interest income the Government could be earning.

There are three principles to good cash management:

i) Income should be collected as soon as possible.

ii) Bills should be paid as late as equitably possible.

iii) Any cash on hand should be used to pay down debt or invested to earn interest. Cash should be properly controlled.

3.1 Management of Cash Receipts

We used three criteria to evaluate how the Government manages cash receipts:

i) Management of cash receipts should comply with Government policies;

ii) The Government should negotiate contract terms that require amounts owing to the Government be paid within a reasonable period of time; and

iii) The Government should enforce its contractual rights, and ensure that payments owing to the Government are received by the due date.

We audited large sources of cash receipts, including the Formula Financing Agreement; other cost sharing agreements with Canada; projects for Canada and others ("Vote 4/5 Projects"); and services provided to Boards and Agencies for which the Board or Agency repays the Government.

Although the **OCG** provides support, individual **Departments** have primary responsibility for controlling cash receipts. They negotiate agreements, prepare invoices, maintain records of receivables, and have initial responsibility for collection of overdue accounts. When an account receivable is 61 days overdue, the account is transferred to the **Credit and Collections** section of the **OCG**.

Audit Findings

In general, we found poor adherence to the standards for good management of cash receipts. The following three examples illustrate typical opportunities for improvement:

Example 1: Projects for Canada and Others

The Government engages in various projects on behalf of third parties. These activities are called "Vote 4/5 Projects." In 1991-92, the Government spent $46 million on Vote 4/5 Projects.

Government Vote 4/5 policies as outlined in the Financial Administration Manual (FAM) 402[1] state:

i) Financing for such projects is to be provided by the sponsoring organization;

ii) Billings are to be issued either monthly or quarterly for agreements in excess of $100,000;

iii) No work under the agreement is to start until the first advance has been received. If this rule is not followed, the **Department of Finance** is required to authorize the commencement of the work, and interest is to be charged at the rate of prime plus one percent;

If these policies are followed, the Government will not bear the cash burden of financing the projects. The policies are not followed; consequently, the Government had a $17.7 million account receivable for Vote 4/5 Projects on March 31st, 1992.

We chose a sample of 20 accounts receivable for various Vote 4/5 Projects. We looked at when each invoice was supposed to have been paid and when the Government actually received the funds. We found that payments were late between 21 and 400 days.

For example, the **Department of Culture and Communications** was involved in two programs: Aboriginal Language Salaries and Language Bureau Enhancement. The amounts owing for these two programs on March 31st, 1992 were $2.8 million and $1.6 million respectively. Both agreements stated that Canada was to make the final payment by October 1st, 1991. Nevertheless, payment was not received until April 9th, 1992 -- a time lag of 192 days.

There are various reasons for the delays in the receipt of Vote 4/5 funds; for example:

i) Failure of a **Department** to invoice the project's funder on a timely basis;

ii) Failure of a **Department** to provide all the information required under the contract on a timely basis; or

iii) Failure to enforce collection once the Government has met all the conditions entitling it to payment.

Management's Comments:

The Canada-NWT Cooperation Agreement for French and Aboriginal languages in the NWT was signed on August 17th, 1991. The first payment under this agreement did not take place until the fall of 1991.

In light of the late signing into the fiscal year, all of the required steps under the Agreement were delayed. Many of the activities funded under the Agreement were not carried out prior to August 17. The interim report pertaining to these activities was completed January 6th, 1992. Prior to this report being submitted and approved by Canada, the second payment could not be released.

Example 2: Cost Shared Agreements with Canada

Canada has agreed to reimburse a portion of the Government's expenses under cost shared agreements.

Legal Aid

Canada agreed to pay $1.6 million towards the $5 million cost of the Legal Aid program for 1991-92. The Agreement calls for one mid-year advance. The balance is payable after year end, once the Government has satisfied various conditions.

We noted that Canada's final payment was late. For the 1990-91 year, the audited claim was submitted in November 1991. Nevertheless, Canada did not make the final $1.4 million payment until May of 1992.

Thus there seems to be a two-fold problem in receiving the funding under the program: the Government's delay in submitting the audited claim and Canada's delay in paying the account.

Management's Comments:

After receiving the audited financial statements from the Legal Aid Clinics, the Department of Justice prepared the draft 1990/91 Legal Aid claim and forwarded it to the Audit Bureau on August 2nd, 1991. The Department was subsequently advised that due to a lack of staff resources within the Audit Bureau, the Legal Aid claim was not completed and submitted to the Federal Government by the September 30th, 1991 due date.

The final audited claim was forwarded to the Federal Government by the Audit Bureau on November 25th, 1991 and the Federal Government did not pay the account until May 8th, 1992.

Example 3: Services to Boards and Agencies

The Government:

i) Is the major funder of most large Health and Education Boards and Agencies; and

ii) Collects funds from the Boards and Agencies to which it provides services.

Under the Government's 1988 transfer policy, the Government provides payroll, accounting and facility management services to certain Boards and Agencies. The exact services provided depend on the type of Board or Agency, and whether it was set up before or after the transfer policy.

The Government bills and receives payment for the direct cost of the services from the Boards.

Based on the Government's records, we estimate that the Government receives approximately $88 million a year for these direct costs. Payroll costs are a major component of the $88 million. The agreements state that the Government will receive payroll funds from the Education Boards and Agencies prior to payday. The Government will then issue the payroll cheques. On March 31st, 1992, the Government's receivable for these services exceeded $7 million when in fact there would not have been any receivable if the arrangement had been managed as set out in FAM 402.

We examined 15 invoices under the payroll agreements with the Education Boards. We noted that for the 15 items, it took between 35 and 90 days for the Government to collect cash for the payroll. The average was 55 days. On the other hand, the Government paid its contributions when required by the contribution agreements.

Management's Comments:

The Department of Education, Culture and Employment Programs will determine the extent and cause of the late payments. Once this information is available, the Department will work in concert with the Department of Finance and Boards to ensure timely payments of invoices.

In previous years, we reported on contributions in advance of need. The key principle is that contribution payments should be timed so that the recipient receives the funds when needed, and not before. The Government responded by changing many major contribution payments from quarterly to monthly. However, this still does not establish the relationship of need with receipt.

For example, we reviewed the interest income and cash balances of Arctic College and of the 18 Education and Health Boards for which we had both 1991 and 1992 financial statements. (One Education Board did not exist in 1991.) As summarized in Exhibit 4, we found that Boards continue to have significant cash balances and interest income. If the Government had delayed its payments to the Boards and Arctic College, the Government could have reduced its own interest expense.

One method of correcting the payment problem is for the Government to deduct the cost of its services from the contributions to the Boards and Agencies.

Management's Comments:

i) Department of Health

Interest earned by Boards was significantly reduced during 1991-92. It is true that the Boards did earn interest. However, some of this interest was due to delays in billing of major services to the Health Boards. A change in operating procedures during 1992/93 has affected these contractual arrangements. We will continue to review the Boards' cash on hand.

ii) *Department of Eduction, Culture and Employment Programs*

Effective April 1st, 1992, the Department changed from quarterly contributions to monthly contributions to Boards of Education, Divisional Boards of Education, the Board of Secondary Education and to Arctic College. The amount of the monthly contribution was based upon actual historical cash flows. As a result, the Department expects to see a significant reduction in the interest revenue earned by the Boards this school year. As payments are made monthly in advance, some interest will continue to be earned on contributions as well as on accumulated surpluses.

Exhibit 4
Examples of Boards and Agencies Cash Balances and Interest Incomes

	1992 Cash at end of Year	1992 Interest Income for Year	1991 Cash at end of Year	1991 Interest Income for Year
Total Net Cash and Interest Revenue for 18 Boards and Arctic College	$22,195,947	$4,915,420	$15,853,191	$5,960,110

Role of Departments

In addition to the above three examples of weak cash management, we have a general observation about the management of cash receipts. The **Departments** are given responsibility for negotiating contracts, invoicing and collecting accounts. However, the **Departments** have no incentive to manage revenue well, since any benefits derived would go directly to the central account. Nor is there any process to hold **Departments** accountable for their cash management performance.

Role of Departments Versus the Credit and Collections Section of the OCG

Departments have responsibility for the collection of accounts receivable until the accounts are 60 days overdue. During this period, the Government's Financial Information System automatically produces two reminder notices which are mailed to the debtor.

We reviewed various **Departments'** files to determine what collection efforts they made prior to transferring the accounts to **Credit and Collections (C&C)**. In general, we found no documented evidence of any specific collection efforts.

In discussions with management of C&C, we were advised that in many cases, files transferred to C&C did not involve a collection problem, such as a debtor who was unable to pay. Rather, the debtor was refusing to pay because of a dispute with the Department. In these situations, C&C was forced to play a mediation role rather than a collection role.

Recommendations

1. **When revenue agreements do not specify the timing of cash receipts, or those terms are not reasonable, the Government should negotiate payment terms when renewing the agreements.**

2. **Departments should ensure they satisfy the conditions for receiving payment. The Departments should then follow up to ensure payment is received promptly.**

3. **Departments should actively monitor overdue accounts, make serious attempts to collect the funds, and document the action they took prior to transferring the account to C&C. This would include determining whether there is a true collection problem, or a dispute with the debtor.**

4. **Procedures should be developed to measure and hold Departments and managers accountable for their cash management.**

Management's Responses:

Departments agree with the recommendations. Departments will be advised to review payment schedules when reviewing agreements and following up to ensure that the payment schedules are met.

The Department of Finance will develop reports which show the amount of revenue and expenditure for third party projects on a monthly basis.

A review of methods to hold Departments accountable for their cash management will be done.

3.2 Management of Cash Payments

It is the Government's policy to pay northern suppliers twenty days after receipt of either the invoice or the goods or service. Other suppliers are paid after thirty days. This payment structure reflects the Government's conscious decision to assist northern businesses.

In our audit, we examined whether the management of cash payments complied with Government policy. We examined large cash payments, particularly "Other Operations and Maintenance" expenses.

Payments are made with computerized cheques. The person requisitioning payment inputs the date the goods or services were received, and the computer automatically produces a cheque using the 20/30 day rule. It is also possible for the person to override this feature, and request payment on a specific date.

We selected 20 payments which appeared to have been made early. The due date on all 20 payments had been overridden to allow the early issuing of a cheque. There was no documented explanation for 17 of these overrides.

Specifically, we noted that the typical payment date for lease agreements is the first of the month. Cheques for the leases were being printed 10 to 19 days early and were clearing the bank an average of 6 days before the payment was even due. Management of **Government Services and Public Works** advised us this was necessary to allow for unpredictable mail delivery in the Northwest Territories.

We note that the Government already uses electronic funds transfer - rather than cheques - to pay certain large bills.

Recommendations

1. **Due dates for regular payments should not be overridden without a valid reason. The reason for the override should be documented on the payment voucher.**

2. **The Government should consider expanding its use of electronic funds transfers to include more large, routine payments that have to be paid by a specific date.**

Management's Responses:

1. *In accordance with the terms of lease agreements, rent is payable "in advance on the first day of each and every month." To meet this requirement, the practice has been to print cheques 10 days in advance for payments issued in Yellowknife and 15 days in advance for payments issued in the Regions to allow for delivery on time through the mail. There is no facility within the FIS to post date cheques. The Department of Government Services and Public Works is currently discussing with the Department of Finance the feasibility of using electronic transfer of funds for lease payments.*

   Departments occasionally override dates to process early payments to contractors. When done, it is based on a request by the contractor. Normally requests are made when the contractor has a cash flow problem, and the approval of the Comptroller General is obtained.

2. *The Department of Finance currently uses electronic funds transfers for certain payments. The Department will continue to review the use of electronic fund transfers.*

3.3 Management of Cash on Hand

We used two criteria to audit the Government's management of cash on hand:

i) Cash on hand should be invested in accordance with the Government's investment policy.

ii) There should be proper controls over cash.

Higher risk investments generally provide higher yields. This is called a risk/return trade off. The Government assesses its tolerance for risk, develops an investment policy, and manages its cash on hand in accordance with its policy.

From time to time, the Government has surplus cash. The **Banking and Investments** section of the **OCG** invests the surplus. In addition, **Banking and Investments** invests the surplus cash of Education and Health Boards and Agencies which belong to the Investment Pool.

We have three observations:

i) **Investment Strategy**

The Government has an investment committee, chaired by the Comptroller General, which determines the strategy for managing investments. The committee has been inactive since December 1991.

ii) **Investment Pool Agreement**

Members sign an investment agreement which sets out, for example, how the revenue earned on investments is to be shared.

There is no provision, however, in the agreement for the allocation of any income loss realized on an investment. The agreement is also silent on the issue of allocating capital gains and capital losses.

iii) **Bank Reconciliations**

The **OCG's Corporate Reporting and Control Section** is in charge of bank reconciliations. The actual reconciliations are prepared by the individual **Departments**. Bank reconciliations are important as they may detect unauthorized expenses.

Management advised us there is no signed banking agreement which stipulates the number of days the Government has to notify the bank of errors on the bank statements. The Department has an unsigned agreement on file which suggests the Government has 15 days. Management has advised us that this document governs only nine of its bank accounts.

We reviewed the bank reconciliation process during our 1991 and 1992 financial statements audits. During the 1991 year-end audit, we noted the following:

- There were two instances of a trust account being in overdraft. (An overdraft in a trust account is a violation of Government policy.)
- For eight of the nine bank accounts covered by the unsigned bank agreement, there was always at least one month when the bank reconciliation had not been finalized within the stipulated period.
- There were two examples of bank reconciliations being approved even though they contained arithmetic errors.

Similar problems were noted with the 1992 bank reconciliations.

Recommendations

1. **The Investment Committee should be active. It should be given a mandate to:**

    i) **Determine both investment and debt strategies; and**

    ii) **Monitor compliance with both strategies.**

2. **The Investment Pool agreements should be amended to provide for the allocation of income losses, capital gains and capital losses to Pool members.**

3. **Bank reconciliations should be:**

   i) **Prepared promptly; and**

   ii) **Properly reviewed and approved.**

Management's Responses:

1. *Investment committee meetings were held in December of 1992, and have been maintained on a monthly basis since then, and will continue each month. Meeting dates will be arranged in advance to ensure that this committee remains active. Attention will be given to reviewing compliance with investment and borrowing strategies set at previous meetings. Borrowing to meet short term cash requirements was limited to approximately one month at the end of the fiscal year and is expected to be of shorter duration and for less in the current fiscal year. Copies of all meeting records will be signed and dated by the Comptroller General.*

2. *Investment Pool Agreements currently provide for the division of investment earnings. This has always been assumed to be net earnings taking into account capital gains and losses. Income losses do not occur. In order to make the agreements more specific, they will be amended to provide specific reference to the distribution of capital gains and capital losses in addition to interest income and other expenses that might be incurred.*

3. *The Department agrees that bank reconciliations should be prepared promptly and properly reviewed and approved. Procedures have been developed to review long outstanding items and stale-dated cheques. As well, we will be developing a reconciliation checklist to ensure thorough and proper review of all reconciliations.*

Chapter 4

Purchasing

We examined the Government's purchasing process in order to determine:

i) The major types of contracts used by the Government; and

ii) Whether the policies and procedures governing the contracts were being followed.

We noted there were several recurring compliance issues or deficiencies with contracts:

i) The Financial Administration Manual (FAM) 808 requires the **Department of Justice (Justice)** to review all nonstandard contracts over $50,000. Individual **Departments** are responsible for bringing these contracts to the attention of **Justice**.

   This is not being done consistently. For example, in our sample of 110 service contracts, we observed 24 contracts were over the threshold. There was no evidence that any of the 24 contracts had been sent to **Justice** for their review.

   If this control is ignored, the Government may enter large contracts which do not adequately protect its interests.

ii) FAM 808-1 requires contracts in excess of $5,000 be submitted for tender. This is not always done. In our sample of service contracts we found 70 contracts were over the threshold. Nonetheless, there was tendering evidence for only eight contracts.

iii) Manuals are not being kept up to date. For example, FAM 808 section 3(a) has not been amended to include the **Department of Transportation (Transportation)** in the list of Departments authorized to enter into construction contracts.

iv) Any **Department** may purchase goods costing less than $1,000 by using a "Local Contract Authority" (LCA). The spending limit is being circumvented by using more than one LCA to acquire a particular good or service. In our sample of ten LCAs, we noted two examples where multiple LCAs had been used. In both incidents the LCAs had been issued by **Transportation**.

Management's Comments:

The Auditor General points out that multiple LCAs have been used to circumvent the spending limit. The Department of Transportation has reviewed this matter and has discussed the misuse with the appropriate people. Staff have been reminded of the rules respecting LCAs. Additionally, the Department of Transportation will ensure that future contract training seminars deal clearly with this matter.

contracts being issued to people whose functions were equivalent to those of regular employees.

We reviewed 34 contracts issued to "self-employed" contractors. Our sample was drawn from 10 **Departments** in several regions. We used the FAM guidelines and standard Revenue Canada tests to determine whether there was an employer/employee relationship.

We observed the following:

i) Five of the contracts were contracts for services. In our opinion, the employee versus self-employed status of the contractors in the remaining 29 contracts is open to debate.

ii) Only 8 of the 29 contracts had clauses limiting the Government's exposure for not remitting UIC, CPP or tax. Only 4 of the 29 contracts had clauses limiting the Government's liability for Worker's Compensation premiums.

Recommendations

1. **Contracts for services should not be issued to people who are equivalent to employees.**

2. **Contracts for services should contain clauses limiting the Government's liability for unremitted source deductions and Workers Compensation premiums.**

Management's Response:

The Department of Finance has conducted a review to determine the nature and extent of the problem. A committee with representation from the Department of Finance, Personnel, Justice and several program Departments has been established to review this situation and develop recommendations for guidelines in this area.

4.2 <u>Contracts for Computer Goods and Services</u>

The Government has delegated responsibility for computer purchases to the **Department of Government Services and Public Works (GS&PW)**. The decision to centralize the major responsibility for computer goods enables the Government to maintain control over the quality and cost of goods acquired.

In some cases, individual **Departments** acquire computer goods and services themselves by using LCAs and service contracts.

We observed the following:

i) Contracts Overpriced and Equipment Did Not Meet Government Standards

We selected a sample of 50 payments for computer goods and services made by the individual Departments. The total value of our sample was $124,449. The sample items included payments for computer hardware and software, maintenance contracts and equipment rental. We reviewed the purchases and the associated costs in conjunction with **GS&PW**. Approximately $25,000 (that is 25%) more was spent than necessary. Lower prices might have been obtained if the Departments had drawn upon the

v) Contracts do not routinely contain confidentiality and conflict of interest clauses.

Recommendations

1. **The Government should keep its manuals and policies up to date.**

2. **The Government should review its contracting policies to ensure spending limits and authorizations are reasonable and practical. The policies should be enforced.**

Management's Responses:

i) Department of Finance

Agreed. Certain components of the FAM will be reviewed during the current year to ensure it is up to date.

A review of the contract regulations and signing authorities will be done during the current year.

ii) Department of Justice

All contracts submitted for review by Justice will be dealt with accordingly. The large number of contracts in this category could not be reviewed by present Justice staff assigned to this function. This concern has been raised in the past and efforts have been made to standardize contracts by type, with input from Justice in drafting same. Therefore, if a standard approved tender or contract has been adapted for use in the purchase of heavy equipment, for example, it is not necessary to have each individual document reviewed. This process is permitted by the FAM.

4.1 "Employment" Contracts

Background

Only the **Department of Personnel (Personnel)** has the authority to enter into employment contracts. In this way, the Government ensures its hiring policies and priorities are being obeyed; its human resource practices are being followed; and its restraint programs are being honoured.

Departments sometimes contract for the services of "self-employed" people. These people would not be treated as employees of the Government. The contracts would be entered into directly by the individual **Department** and **Personnel** would not be involved.

We found the use of "self-employed" contractors was widespread. For example, the Department of Municipal and Community Affairs advised us that it spends approximately $500,000 a year for these types of contracts.

Using contracts can be advantageous when the Government has either a short-term staffing need or requires the services of an expert.

However, there can also be disadvantages to using contracts. The expertise gained on a particular project does not stay within the Government and the Government can become dependent on the contractor. Secondly, continuously contracting for a service may lead to the establishment of an employer-employee relationship. This would result in the Government being liable for not having made the appropriate payroll deductions, Workers' Compensation premiums etc.

Audit Work and Observations

The Corporate Reporting and Control Section of the **Department of Finance** has examined this area and found numerous examples of experience and expertise of **GS&PW** staff.

Moreover, in our sample we found 11 examples of equipment not conforming with Government standards. These standards had been implemented to ensure only compatible, high quality equipment is acquired.

ii) **Equipment was being Rented at Rates that Exceeded Purchase Price**

There is always a trade-off between buying or leasing equipment. Short term computer leases tend to be expensive and may exceed the cost of buying the equipment.

On the other hand, purchasing equipment may involve future maintenance and disposal costs.

The **Department of Transportation** leased some computer equipment for a period of four months. At the end of the lease, the equipment was returned to the supplier. The total cost of the lease was approximately $15,000. **Transportation** could have bought equivalent equipment for about the same cost. We found no evidence that management had weighed the costs and benefits of leasing versus purchasing this equipment.

Management's Comments:

The Department of Transportation concurs with the recommendations of the Auditor General. Program staff will be reminded to be more diligent in coordinating the acquisition and leasing of computer equipment through our Information Technology Coordinator, who will ensure that the Government's policy is followed and a proper cost-benefit analysis is part of the decision process.

Recommendations

1. **Departments should follow the Government's policy regarding contracts for computer goods and services.**

2. **Departments should analyze the costs and benefits of leasing versus buying before acquiring capital items. The most economical route should be followed.**

Management's Response:

It is the understanding of the Department of Government Services and Public Works that generally Departments do follow the Government's policy regarding contracts for computer goods and services. The Department of Government Services and Public Works will advise other Departments of the services that they provide. Additionally, all Departments will be reminded of the current policies and processes that are to be adhered to in acquiring computer goods and services.

4.3 Contracts for Legal Services

Only the **Department of Justice (Justice)** has the authority to enter into contracts for legal services.

We reviewed 20 payments to law firms to determine if **Justice** had authorized or approved the legal services. Twelve of these payments were for legal services engaged by a **Department** other than **Justice**. There was no evidence that **Justice** had been consulted or advised about the contracts. Two of these contracts were for legal services involving litigation matters.

Unless the policy for engaging legal services is followed by all **Departments**, the Government could be party to a law suit without **Justice** being aware of the fact.

Recommendation

1. **The Government should review its policy for the contracting of legal services. If the review indicates the current policy should be maintained, the policy should be enforced.**

Management's Response:

The Department of Justice believes there is no need for the Government to review its policy for the contracting of legal services. The current policy must be enforced, given the wording of the Department of Justice Act. The Act states both that the Attorney General is the official legal adviser and that the Attorney General shall have conduct of all litigation for or against the Government.

4.4 Construction Contracts

In the mid 1980's **GS&PW** had a policy which stated performance evaluations were to be made for all contractors awarded contracts over $500,000.

A new directive was subsequently issued which makes evaluations optional at the manager's discretion. Evaluations are to be performed when a contractor has performed either exceptionally well or exceptionally poorly.

Transportation has advised us that it has adopted the new directive produced by **GS&PW**.

While an evaluation of every contract would be excessively bureaucratic, such evaluations done in accordance with meaningful criteria can be a useful tool in helping government determine whether the best value has been received for its investments.

We reviewed 10 large construction contracts initiated by **GS&PW** and fifteen initiated by **Transportation**. We found no evidence that evaluations had been performed. Given that there is no objective criteria for when evaluations should be performed, we cannot comment on whether evaluations should have been performed.

Recommendation

1. **Objective criteria (for example dollar limits) should be established to clarify when managers are required to perform job evaluations.**

Management's Responses:

i) Department of GS&PW

The Department considers that the Directive on Consultants and Contractor Performance Evaluation (20-7) is no longer appropriate as it is too brief to provide meaningful information. Furthermore, in its attempt to be brief, it may be misleading and result in the GNWT taking action that is not in the best public interest. A decision to rescind this directive will be made in conjunction with the Department of Transportation.

In accordance with the Contract Administration Manual, the Department undertakes a thorough technical and administrative review of a low tenderer prior to the award of a *contract. This review is based on desk research as well as personal contact with other purchasing agents and clients who have done work with the tenderer in the recent past. The Contracts Division maintains a file on the majority of contractors who have worked with the GNWT which is available for this review. In addition, the Department has access to Dun and Bradstreet on an annual basis in order to obtain a corporate and financial profile on each company. As well, complete files from previous projects are available. These files are exhaustive and include minutes of meetings, correspondence and comments on the performance of the contractor including any information related to claims or litigation.*

ii) Department of Transportation

Contractors are under continuing evaluation through the contract award process, onward through contract supervision and management, contract closure and even through the warranty period. These evaluations are documented through technical evaluation during the contract award reviews, daily journal entries, letters to contractors, progress claims, northern and local involvement reports, final project reports, etc., and retained on the project file.

The performance evaluation report contemplated in the directive could not reasonably consider all factors that cause "perceived" good or bad performance. It would be more subjective than the continuing evaluation contemplated as an integral part of the contract management process and may become perfunctory in nature. The Department with the Department of Government Services and Public Works, will further review the requirements to complete these evaluations and make a final decision on whether to delete this directive, as it appears to add no value to the process.

Chapter 5

Other Audit Observations

This chapter contains observations on various matters that came to our attention during the course of our audit work.

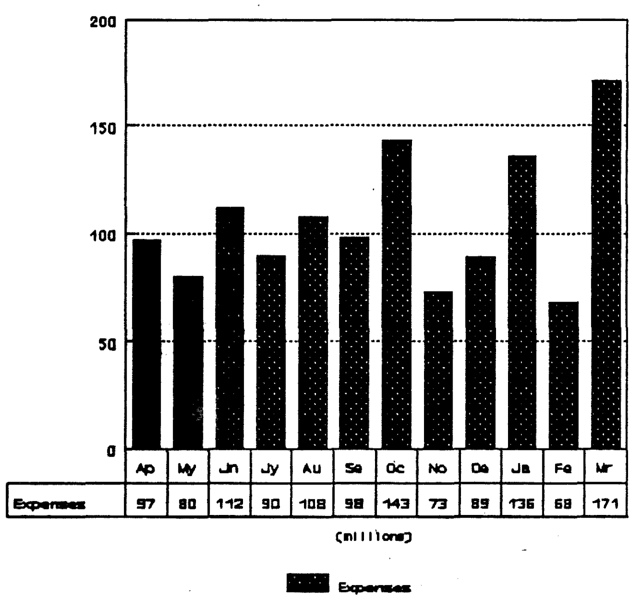
5.1 <u>Year-end Spending</u>

In November 1991, the Government introduced a restraint program for the balance of the 1991-92 fiscal year. The program emphasized maintaining services to the public, while imposing a hiring freeze and restrictions on most expenditures.

We noted the dollar value of the expenditures charged to the month of March was unusually high compared with the other months. This pattern is shown in Exhibit 5.

We reviewed a sample of the March expenses (excluding payroll) to determine why they were so high. Our review indicated that the increase in expenditures related to year-end adjustments being posted in March. We did not observe any significant violations of the Government's restraint program in the March expenditures.

Exhibit 5
Spending Pattern



5.2 Micro Computer Purchases

In our 1991 Report to the Legislative Assembly, we noted that the Government made 31 percent of its 1990-91 micro computer purchases in March.

We repeated our test for 1991-1992. We found there was no year-end spending bulge for computers. We then reviewed microcomputer purchases for the first few months of the 1992-93 fiscal year to determine whether or not large computer purchases were made once the restraint program was lifted. We found no such trend.

5.3 Delays in Financial Statement Preparation

The Financial Administration Act requires the **Office of the Comptroller General (OCG)** to prepare interim financial statements by September 30th. The Public Accounts are due December 31st. The deadlines have been met. The **Public Accounts Committee**, however, has expressed its concern over the length of time required to provide it with financial information.

We share the Committee's concern. We did not receive balanced consolidated financial statements until October 22nd, 1992. As a result, our audit work was delayed.

Two factors which contributed to the delay in finalizing the statements were:

i) Inefficiencies in the financial statement process; and

ii) A lack of communication amongst the various parties involved in preparing the statements.

Both the **Departments** and **Regional Comptrollers** have extensive accounting responsibilities. However, they do not appear to make their financial responsibilities a priority. For example, we noticed many **Departments** missed the May 1st deadline for submitting normal year-end adjustments. The **OCG** was forced to process these adjustments manually. This obviously took more time, and it caused a bottleneck in the system when information on one financial section was needed to complete another.

It is the **OCG's** responsibility to identify important accounting issues and to decide how these issues will be presented in the financial statements. Even though many of these issues were known before year end, a decision on how to disclose them was not made until mid-summer. For example, the **OCG** knew the Government was involved in a pay equity dispute. The original drafts of the financial statements made no reference to the issue. The **OCG** decided on an appropriate presentation only after we raised the pay equity issue with them.

The communication between the **OCG** and the **Departments and Regions** needs to be improved. The **Departments and Regions** do not always advise the **OCG** of the accounting issues and problems they face. For example, the **OCG** had not been advised of the dispute between the **Department of Finance** and DIAND over a calculation in the Formula Financing Agreement. (This dispute is discussed further in Section 1.2 of this report.)

Recommendations

1. **Departments should be reminded of the importance of their financial responsibilities and the importance of completing financial reports on time.**

2. **The OCG should review the year-end account procedures and identify**

ways to process year-end adjustments as early as possible.

3. **The communication between the OCG and the Departments and Regions should be improved so that the OCG is aware of accounting issues and disputes as they arise.**

4. **The OCG should decide on the accounting treatment and disclosure of financial matters before year end.**

Management's Response:

Staff of the Comptroller General's Office are meeting individually with all Departments to emphasize the shared concerns of the Auditor General and the Public Accounts Committee and to solicit departmental cooperation. The meetings discuss the key financial deadlines and financial reporting issues. In addition, a letter addressing these issues was sent to all recipients of the section's "1992/93 Year-End Instructions". The time line for the preparation of the Public Accounts has been shortened with a view to completing the Public Accounts earlier than in prior years.

Additionally, the Department of Finance is reviewing the methods to provide unaudited interim financial reports earlier than the Public Accounts.

5.4 ED&T's Agreement with the Northwest Territories Development Corporation Does Not Link Contribution Payments to Cash Needs

The 1991-92 contribution agreement between the **Department of Economic Development and Tourism (ED&T)** and **The Northwest Territories Development Corporation (the Corporation)** called for a $10 million contribution. The funds were to be advanced in four instalments. The agreement expired on March 31st, 1992. On March 18th, 1992, the Government issued a cheque to the **Corporation** for $4.1 million, the balance of funds owing under the agreement. The **Corporation** cashed the cheque on March 24th, 1992.

Our comments on this contract focus on the Government having entered into a contract which did not link cash needs of the recipient with the timing of the payments. This issue was also raised in Chapter 3 from a cash management perspective.

The only documentation the **Corporation** provided to **ED&T** to justify the release of the final payment under the agreement was a letter stating:

> *At the NWT DevCorp's (the Corporation's) board meeting on January 22-23, 1992 approximately $4.0 Million in investments were approved including the 10% investment reserve.*

At March 31st, 1992, the **Corporation** had over $6 million in cash and short-term investments. In other words, at the time of receiving the final payment, the **Corporation** already had $2 million in cash and short-term investments.

The $4.1 million payment was charged against **ED&T's** capital budget. **ED&T** lapsed $1.1 million in capital funds in 1991-92. If the payment had not been made, **ED&T** would have lapsed $5.2 million.

If the agreement had allowed the Government to defer the final payment to the **Corporation**, the Government could have used the cash to pay down some of its debt.

Recommendations

1. **Future ED&T contribution agreements should allow it to consider the recipient's cash needs.**

2. **ED&T should monitor the cash position of recipients. ED&T should make contributions only when recipients have an actual, documented cash need.**

Although the above recommendations are directed at **ED&T**, other **Departments** may find the recommendations useful.

Management's Response:

The Department of Economic Development and Tourism does monitor the cash position of recipients, and generally speaking, contributions are made only when recipients have an actual, documented cash need. An exception is made in the case of the Northwest Territories Development Corporation for a number of reasons:

> *i) The NWT Development Corporation is now part of the GNWT investment pool;*
>
> *ii) The money is voted as a contribution to the NWT Development Corporation. It would seem inappropriate to have any funds lapse in so far as the money is committed in terms of approved projects.*

5.5 ED&T Expo '92 Forecast Prepared with Inadequate Information

The Expo '92 Revolving Fund Act was established to account for the Government's involvement in Expo '92. There is no requirement for a separate audit of the Expo '92 Revolving Fund. We noted one issue we feel should be brought to the Assembly's attention: due care was not exercised in preparing the revenue projections.

As part of the discussion on whether to participate in Expo '92, **ED&T** prepared a forecast of expected revenue and expenses. The forecast predicted Expo '92 would break even.

The final financial statements for Expo '92 have not been provided to us. The latest interim statements report a loss of $4.2 million. Exhibit 6 compares the forecast with these statements:

Expo '92 did not generate the revenue the Government had anticipated. As noted below, revenue was 68 percent lower than expected. We reviewed how **ED&T** had prepared the original forecast and what steps ED&T had taken to ensure reasonable revenue projections.

Expo '92 was held in Spain; Expo '86 in Vancouver. Consequently, one would expect different issues, problems and risks emerging with Expo '92. We asked the question, "Did **ED&T** consult with experts in European hospitality and international fairs before finalizing the revenue projections?"

Exhibit 6
Comparison of Expo '92 Budget and Interim Financial Statements

	Budget March 1991	Interim Financial Statements	Difference
Total Revenues	$ 5.6 million	$ 1.8 million	($3.8 million) 68%
Expenditures	5.6 million	6.0 million	($0.4 million) 7%
Net Loss	$ 0	($4.2 million)	($4.2 million)

ED&T advised us it did consult various people. The people consulted had experience mainly with the Canadian hospitality industry. We wonder if the Canadian experience is relevant for a world fair held in Spain.

ED&T does have contacts with consultants with expertise in the international hospitality industry. While **ED&T** engages this firm for survey work, **ED&T** did not make use of their expertise for the Expo forecast.

Recommendation

1. ED&T should develop and follow procedures to ensure the necessary expertise is acquired when budgets and forecasts for special projects are being developed.

Management's Response:

1. Although attempts were made to obtain the most relevant information available, it is acknowledged that the data in many cases proved to be unreliable. The Department agrees with the recommendation.

FOOTNOTE

1. FAM 402 was repealed in July 1992. Pending the finalization of the revised policy, there is no FAM direction on Vote 4/5 projects. However, FAM 402 was in effect for the year we audited.