2007

Report of the

AUDITOR GENERAL

to the

Legislative Assembly

Prince Edward Island

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INTRODUCTION

REPORT OVERVIEW

The Audit Act requires the Auditor General to report annually to the Legislative Assembly. This Annual Report 2007 provides observations, recommendations and information pertaining to the audits and examinations of government operations conducted by the Office during the year. The purpose of this report is to assist the Legislative Assembly in carrying out its responsibility to hold the government accountable for the management of public resources.

This Annual Report deals mainly with matters pertaining to the 2005-2006 fiscal year, however, many of the issues identified remain current and are still being addressed by government.

It is not possible to audit all government programs and entities each year, however, the Office strives to provide reasonable audit coverage on a cyclical basis. A large portion of the audit work is determined by statutory requirements which name the Auditor General as auditor. These requirements include the annual audit of the Public Accounts of the Province. The remainder of our resources are devoted to special audits and examinations.

This report includes information and discussion on the **Province's Finances**. The section on **Special Audits and Examinations** includes the results of various examinations conducted during the year including; Property Taxation, PEI Energy Corporation, Workforce Incentive Programs, and PEI Business Development Inc. - Lending Activities. The **Financial Statement Audits** section provides information on significant issues arising from the financial statement audits conducted by the Office.

Each year we contact departments and agencies to obtain follow-up information on the status of any outstanding recommendations from previous years. This information is included in a separate section of the report, **Update on Previous Recommendations.**

The **Standing Committee on Public Accounts** reviews the Auditor General's Annual Report and plays an important role in holding government accountable for the management of public resources. Information on the role of this Committee, and its proceedings during the past year, is provided in a separate section of the report.

The section on the **Office of the Auditor General** provides information on the mission and mandate of the Office, as well as the responsibilities of the Auditor General. Background information is provided on the objectives and accomplishments of the Office and the resources used to achieve them.

ACKNOWLEDGEMENTS

Cooperation of Ministers, Deputy Ministers, heads of Crown agencies and their staff is important. To carry out our work it is imperative that we receive the necessary information, reports and explanations. I wish to acknowledge that my Office received cooperation in the completion of the audits covered in my Annual Report.

The preparation of this report and recommendations as well as the statutory audits conducted by the Office is a result of the support and dedication of my staff. I would like to thank them for their effort, input and professional manner in which they conduct themselves and perform their work. Their continued support is essential to the work and continued success of this Office.

INTRODUCTION

APERÇU DU RAPPORT

L'Audit Act (loi sur la vérification des comptes publics) stipule que le vérificateur général doit déposer un rapport devant l'Assemblée législative tous les ans. Le présent rapport annuel de 2007 fournit les observations, recommandations et renseignements liés à la vérification et à l'examen des activités gouvernementales effectués par le Bureau du vérificateur général pendant l'exercice 2005-2006. Ce rapport vise à aider l'Assemblée législative à veiller à ce que le gouvernement rende des comptes aux contribuables quant à sa gestion des fonds publics.

Le présent rapport annuel traite principalement de questions propres à cet exercice, bien que de nombreuses questions soulevées demeurent d'actualité et doivent être traitées par le gouvernement.

Il n'est pas possible de vérifier l'ensemble des programmes et organismes gouvernementaux chaque année, quoique le Bureau du vérificateur général s'efforce de fournir une vérification raisonnable et cyclique de ceux-ci. Une partie importante du travail de vérification est établie par des exigences réglementaires, en vertu desquelles le vérificateur général est nommé. Ces exigences comprennent la vérification annuelle des comptes publics du gouvernement provincial. Le reste des ressources du Bureau sont consacrées aux vérifications et examens spéciaux.

Le présent rapport comprend des renseignements sur les **finances du gouvernement provincial** et une analyse de celles-ci. La section sur les **vérifications et examens spéciaux** comprend les résultats de divers examens effectués en cours d'exercice, notamment : les impôts sur la propriété foncière, la Société de l'énergie de l'Î.-P.-É., les programmes d'incitatifs pour les travailleurs, et l'Expansion des Affaires Î.-P.-É. – section des prêts. La section consacrée à la **vérification des états financiers** contient quant à elle des renseignements sur des questions importantes soulevées dans le cadre de la vérification de divers états financiers menée par le Bureau.

Chaque année, le Bureau communique avec les ministères et organismes gouvernementaux afin d'obtenir des renseignements de suivi sur l'état de toute recommandation des exercices précédents restée en suspens. Ces renseignements sont inclus dans une section distincte du rapport offrant une **mise à jour sur les recommandations précédentes.**

Le **Comité permanent des comptes publics** étudie le rapport annuel déposé par le vérificateur général et joue un rôle majeur dans le processus en vertu duquel le gouvernement est tenu de rendre des comptes quant à sa gestion des fonds publics. Des renseignements sur le rôle de ce comité et sur ses réunions au cours du dernier exercice sont fournis dans une section distincte du rapport.

La section sur le **Bureau du vérificateur général** fournit des renseignements sur la mission et le mandat du Bureau, de même que sur les responsabilités du vérificateur général. On y trouve aussi des renseignements généraux quant aux objectifs et réalisations du Bureau, de même qu'aux ressources utilisées pour y parvenir.

REMERCIEMENTS

La collaboration des ministres, des sous-ministres, des dirigeants des sociétés d'État et de leur personnel est importante. Pour que le vérificateur général puisse effectuer son travail, il est primordial qu'il reçoive les renseignements, les rapports et les explications nécessaires. Je souhaite souligner la collaboration générale de ces personnes avec mon bureau dans le cadre des vérifications présentées dans le présent rapport annuel.

La préparation du présent rapport et des recommandations qu'il contient, ainsi que les vérifications légales menées par le Bureau sont le résultat du soutien et du dévouement des membres du personnel. Je souhaite leur exprimer toute ma reconnaissance pour leurs efforts et leurs observations, et pour le professionnalisme de leur conduite et de leur travail. Le travail et le succès continu du Bureau reposent sur leur sur leur soutien appuyé.

1. THE PROVINCE'S FINANCES

OVERALL COMMENTS

1.1 To assist members of the Legislative Assembly, we provide an update each year on the Province's finances. The financial information is important because it indicates where we are financially and what decisions will be required to ensure programs and services will be provided in the future.

1.2 The Consolidated Financial Statements are the primary source of information to assess the financial condition of the Province. In the past year, the net debt decreased by $6.8 million. This represents a significant change from the increases in net debt of $16.9 and $134.1 million in the preceding two years.

1.3 While the net debt decreased by .5 percent the Provincial gross domestic product (GDP) increased by 3 percent. However, because of the deficits in recent years, the Province's net debt of $1.3 billion still remains a concern.

BACKGROUND

1.4 The Public Accounts record the Government's financial activities in accordance with the recommendations of the Canadian Institute of Chartered Accountants. The statements combine the financial activities of many diverse Government programs and entities with total expenditures of approximately $1.2 billion.

1.5 As in previous years, we are providing information to help put the numbers into perspective. The presentation is made in a format that focuses on key information to assist the Legislature and the public in obtaining a better understanding of the Province's financial condition. The Province's finances have a significant impact on the Provincial economy.

1.6 This discussion of the Province's finances is based on the Consolidated Financial Statements, which include departments, Crown corporations, school boards, and other organizations which are part of the overall Government reporting entity.

FINANCIAL MEASURES

1.7 Some of the common terms used to describe the Province's financial condition are presented below.

1.8 The **annual surplus or deficit** is the difference between a government's revenue and expense. This measure shows the extent to which revenues raised in the year were sufficient to cover expenses in that year. For the year ended March 31, 2006 the Province had a surplus of $.7 million.

1.9 The **total debt** is the amount owed by the Government. Government's debt includes outstanding debentures, pension obligations, and other accounts payable. The total debt of the Province as of March 31, 2006 was approaching $2 billion.

1.10 **Financial assets** are cash and other assets which could provide resources to pay liabilities or finance future operations. Total financial assets at March 31, 2006 were $643 million.

1.11 The **net debt** is equal to the difference between the Government's total liabilities and its financial assets. The net debt of the Province as of March 31, 2006 was $1.3 billion.

1.12 **Non-financial assets** include tangible capital assets such as buildings, roads, and equipment as well as prepaid expenses and inventories. The book value of tangible capital assets increases as they are acquired and is reduced over a period of time through amortization. At March 31, 2006 non-financial assets had a book value of $547.4 million.

1.13 The **accumulated deficit** represents the Province's liabilities net of the assets the Province has acquired, both financial and non-financial. It is calculated based on the surpluses and deficits incurred over the years. The accumulated deficit at March 31, 2006 was $775.3 million.

1.14 The **interest charged on borrowings** is the amount required to service the debt and must be taken from revenues before any expenditures can be made on Government programs.

1.15 The **gross domestic product (GDP)** is a measure of the value of the goods and services produced in the Province in a year. The Province's GDP is measured and reported by Statistics Canada.

1.16 **Exhibit 1.1** shows a summary of some key financial measures for the Province over the past three years.

EXHIBIT 1.1
PROVINCE OF PRINCE EDWARD ISLAND
SUMMARY OF FINANCIAL INFORMATION
(Millions)

	2006	Restated 2005	2004
Surplus (Deficit)	$ .7	$ (33.6)	$ (125.1)
Increase (decrease) in Net Debt	$ (6.8)	$ 16.9	$ 134.1
Net Debt	$1,322.7	$1,329.5	$1,312.6
Non-Financial Assets	547.4	552.9	582.7
Accumulated Deficit	$ 775.3	$ 776.6	$ 729.9
Debt Charges	$ 110.2	$ 104.9	$ 106.5
GDP	$ 4,142	$ 4,023	$ 3,858

Financial Highlights

1.17 **Exhibit 1.2** shows the change in the surplus (deficit) from 2004-05 to 2005-06.

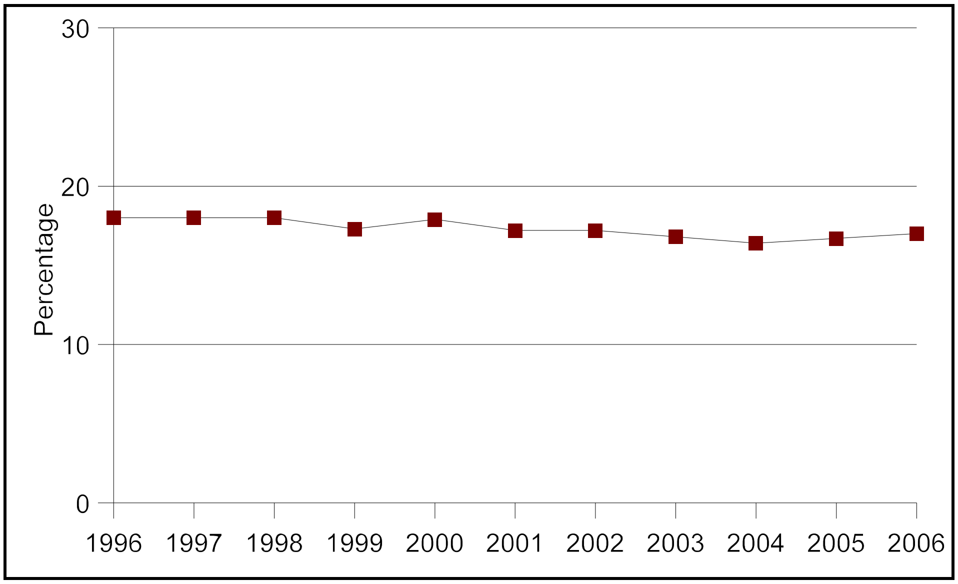
EXHIBIT 1.2
PROVINCE OF PRINCE EDWARD ISLAND
CHANGE IN SURPLUS (DEFICIT)
(Millions)

	Revenue	Expense	Surplus (Deficit)
2004/05 Surplus (Deficit)	$1,116.1	$1,149.7	$(33.6)
Increased Tax Revenue	56.7	-	-
Increased Federal Transfers	.9	-	-
Decreased Government Business Entities	(1.3)	-	-
Decreased other Government Revenue	(2.5)	-	-
Increased Health/Social Services Spending	-	11.3	-
Increased Education Spending	-	3.4	-
Increased Other Program Spending	-	14.7	-
Increased Interest	-	5.2	-
Decreased Other	-	(15.1)	-
2005/06 Surplus (Deficit)	$1169.9	$1169.2	$ .7

1.18 The growth in revenue for 2005-06 resulted from an increase in provincial tax revenue of $56.7 million. Of this amount $38.6 million was the result of an increase in personal and corporate income tax. Federal revenue increased marginally by $.9 million. Equalization, which comprises 62 percent of federal revenue received, decreased by $4 million while health and social transfers which comprise 28 percent of federal revenue increased by $15.8 million. The balance of federal revenues decreased by approximately $10.9 million.

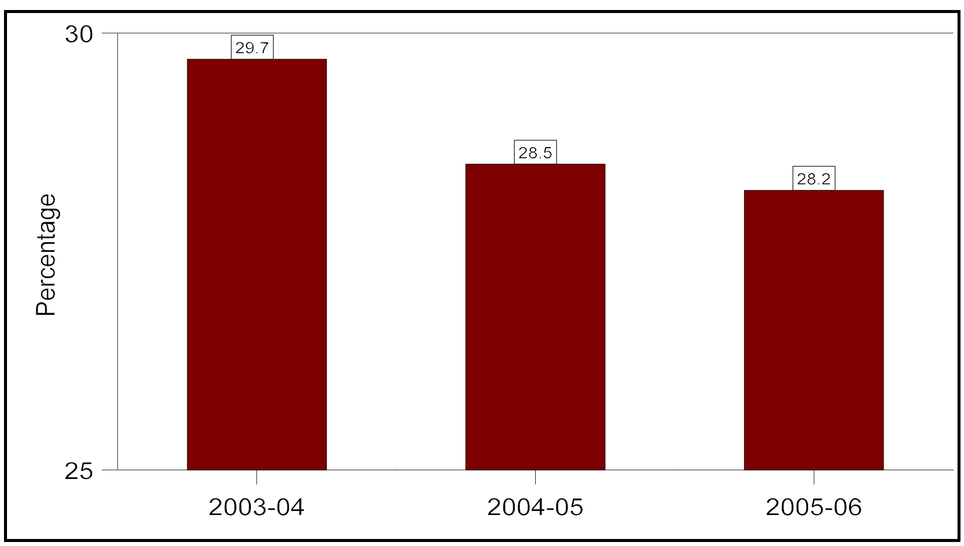
1.19 **Exhibit 1.3** shows the ratio of provincial revenue to GDP for the years 1996-2006. The trend between 1996 and 2004 was downward indicating that government was not increasing its own source revenue at the same rate as the growth in the Province's economy. However, in 2005 and 2006 there was a slight upward change in the trend.

EXHIBIT 1.3
PROVINCIAL REVENUE AS A PERCENT OF GDP



1.20 **Exhibit 1.4** shows that Government spending as a percentage of GDP decreased slightly in 2004-05 and has remained relatively constant in 2005-06. This indicates that the growth in the economy was sufficient to maintain additional spending.

EXHIBIT 1.4
EXPENDITURES AS A PERCENT OF GDP



1.21 Gross domestic product (GDP) per capita is a measurement of the year to year changes in the Province's economy and can be used to compare to other jurisdictions. It shows the average output per person as an indicator of wealth. **Exhibit 1.5** compares the growth in the GDP per capita in the Province to the other provinces and Canada since 2001. The Province still has the lowest GDP per capita but it has grown at a faster rate than five of the other provinces and Canada.

EXHIBIT 1.5
GROWTH IN GDP PER CAPITA
2001-2006*

	2001	2006	% Increase
Newfoundland	$26,367	$41,733	58.3
Alberta	48,184	66,279	37.6
Saskatchewan	33,566	42,742	27.3
Nova Scotia	26,403	33,533	27
Prince Edward Island	24,659	29,993	21.6
British Columbia	32,516	39,490	21.4
Manitoba	29,682	35,609	20
Quebec	30,573	36,175	18.3
New Brunswick	26,762	31,552	17.9
Ontario	37,719	42,866	13.6
Canada	35,080	42,498	21.1

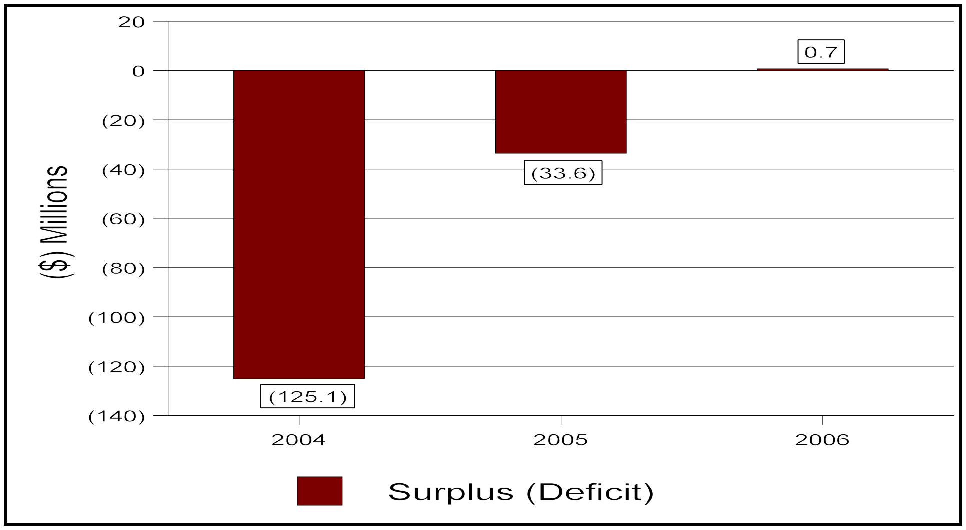
*Source: Statistics Canada

Sustainability

1.22 Sustainability indicates whether the Province can maintain programs and meet existing creditor requirements without increasing the debt burden on the economy. A comparison of the Government's annual surplus or deficit, net debt and the Provincial GDP provides insight into the sustainability of a government's practices of incurring expenditures and generating revenues.

1.23 The annual deficit or surplus indicates the extent to which a government spends more or less than what is raised in revenue in a particular year. It basically shows whether a government is living within its means. **Exhibit 1.6** shows the annual surplus (deficit) for the last three years. For these years the deficits have totalled $158.7 million. For the current year the Government recorded a small surplus.

EXHIBIT 1.6
THE GOVERNMENT'S SURPLUS (DEFICIT)
2004-2006

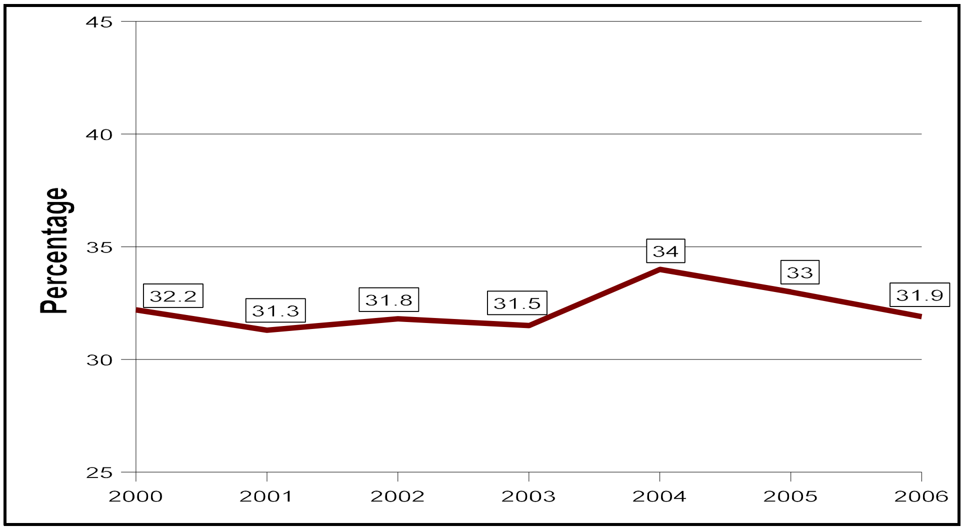


1.24 The net debt is the difference between Government's total liabilities and its financial assets. Since 2003 the net debt increased by $144.2 million or 12.2 percent and totalled $1.3 billion at March 31, 2006.

1.25 The GDP of the Province indicates the size of our economy. The Province's economy supports Government operations through taxes and fees. While the net debt has increased by 12.2 percent since 2003, the GDP of the Province increased by 10.5 percent. If this trend continues, the Province will have a reduced capacity to maintain programs and services without increasing the tax burden on the economy.

1.26 **Exhibit 1.7** shows the net debt to GDP ratios since 2000. The 2003-04 deficit of $125.1 million caused the net debt to GDP ratio to increase significantly but with the lower deficit of $33.6 in 2005 and the small surplus in 2006 the rates have returned to the 2000 level.

EXHIBIT 1.7
NET DEBT AS A PERCENT OF GDP



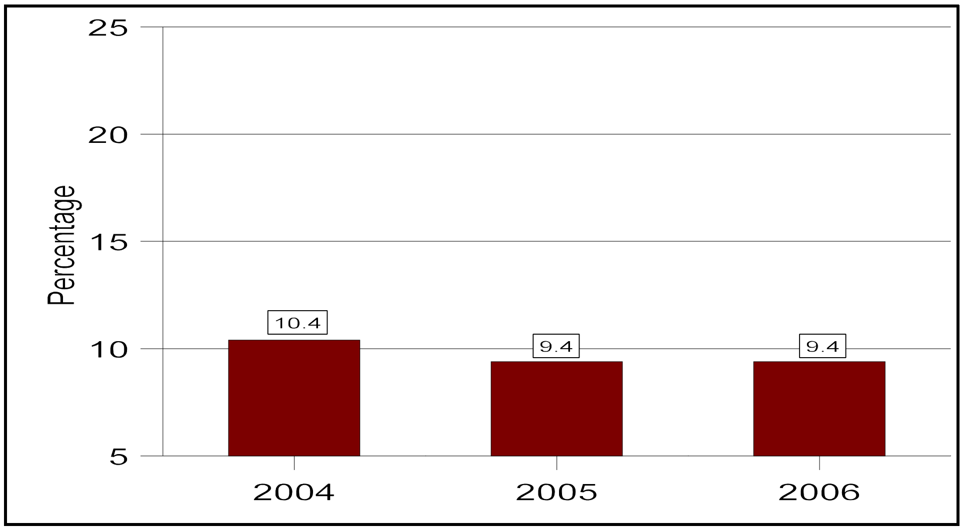
Flexibility

1.27 Government's flexibility is the degree to which it can increase its financial resources to respond to rising commitments by either expanding its revenues or increasing its debt. A government meets the test of flexibility when it can respond to changing economic conditions such as a recession or higher interest rates without making substantial changes to the way it operates.

1.28 A government's net debt and debt charges provide insight into whether it can respond to rising commitments without increasing its revenues. A rising debt burden and debt charges indicate there are fewer resources to allocate to programs and services.

1.29 One measure of a government's flexibility is the interest costs as a percentage of total revenues. This is sometimes referred to as the "interest bite". In 2005-06, debt charges on government borrowings were $110.2 million. The trend in the interest bite is shown in **Exhibit 1.8.**

EXHIBIT 1.8
INTEREST COSTS AS A PERCENT OF REVENUE



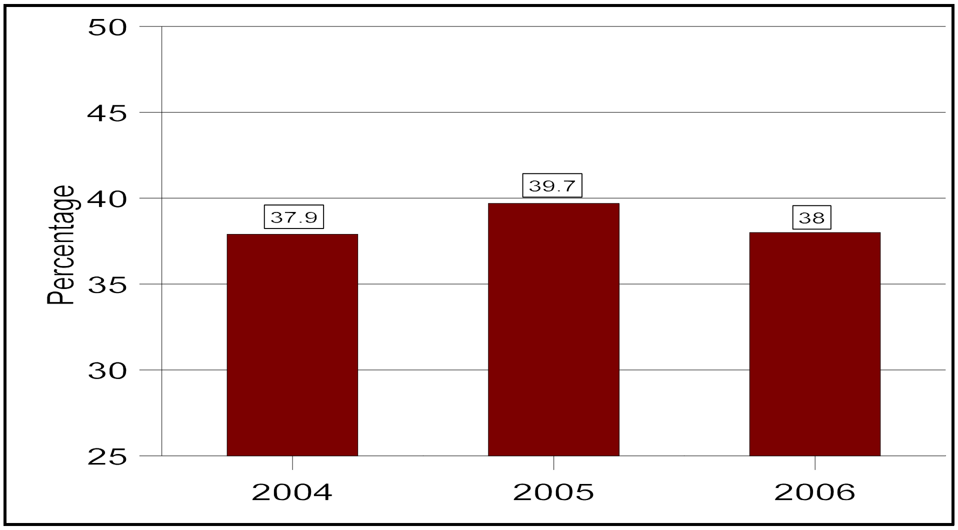
1.30 As indicated in **Exhibit 1.8**, the interest bite has not changed from 2005. Our net debt is over a billion dollars and the first $110.2 million must be earmarked to pay interest costs and is unavailable for government programs. Recent debenture issues have been for 30 year terms at comparatively low interest rates.

1.31 The total amount of interest expense for pension and other related obligations was $13.7 million for 2005-06. As in previous years, this amount was not included in debt charges.

Vulnerability

1.32 Vulnerability is the degree to which a government is dependent on, and therefore vulnerable to sources of funding outside its control or influence. In 2005-06, the federal government provided approximately $444 million to the Province, an increase of $.9 million from 2004-05. The trend in federal revenues relative to total revenues for the last three years is shown in **Exhibit 1.9.** This exhibit shows that approximately 38 cents of each dollar of revenue received by the Province in 2005-06 came from the federal government.

EXHIBIT 1.9
FEDERAL REVENUE AS A PERCENT OF TOTAL REVENUE



1.33 Revenue from provincial sources is more controllable through measures such as Provincial tax legislation or adjustments in user fees. Federal transfers are subject to different variables such as federal fiscal policies and the performance of other provincial economies. Any federal fiscal policy change impacts the Province.

SUMMARY

1.34 It is important for Members of the Legislative Assembly to have a regular update on the financial condition of Government. This section provides summary information using indicators recommended by the Canadian Institute of Chartered Accountants. The indicators provide useful insight into Government's ability to sustain its programs, the flexibility it has to respond to economic changes, and its vulnerability to sources of outside funding. The indicators help to put the finances of Government into perspective and assist Members to understand and interpret the information.

1.35 Further to the above discussion, we recognize that there are other relevant non-financial matters which have to be taken into consideration by Members of the Legislative Assembly in making budgetary decisions and setting Government policy direction.

SPECIAL AUDITS AND EXAMINATIONS

2. INTRODUCTION TO SPECIAL AUDITS AND EXAMINATIONS

AUDIT PROCESS

2.1 Subsection 13(2) of the Audit Act states that the Auditor General may conduct any audit or examination he considers necessary to determine whether any agency of government is achieving its purpose, is doing so economically and efficiently and is complying with the applicable statutory provisions.

2.2 Given the size of the Office and the complexity and size of government operations, it is not possible to audit all Government programs each year. In determining the annual audit program for the Office, many factors are considered such as the results of previous audits, the total revenues and expenditures at risk, the complexity of operations of the entity, the significance of potential issues that may be identified by an audit, and the impact of the program on the public.

2.3 Special audits and examinations are conducted in accordance with standards established by the Canadian Institute of Chartered Accountants. These types of audits are conducted in a series of stages. During the planning phase information is gathered to gain an understanding of the program or entity, and an audit plan is prepared. Evidence is obtained and analyzed and observations and recommendations are developed in the implementation phase. In the reporting phase a draft report is issued to the auditee for discussion. At the conclusion of the audit, a final report is issued to the department or agency and a written response is requested.

2.4 Our work involves providing recommendations to management to address problems identified. We do not, however, infringe on management's right to select the most appropriate course of action to deal with the problems identified. We are primarily concerned that the issues raised are satisfactorily addressed.

2.5 Under Section 16 of the Audit Act, the Auditor General is required to call attention to any matters which he considers necessary to be brought to the attention of the Legislative Assembly. This report provides information on the following special audits and examinations: Property Taxation; PEI Energy Corporation; Workforce Incentive Programs; and PEI Business Development Inc. - Lending Activities.

3. PROPERTY TAXATION

BACKGROUND

3.1 Taxation and Property Records is a Division of the Department of the Provincial Treasury. The Division administers tax legislation and collects taxes and other revenues including sales tax, gas tax, health tax and real property tax. The Division's budget and actual expenditures are summarized in **Exhibit 3.1**.

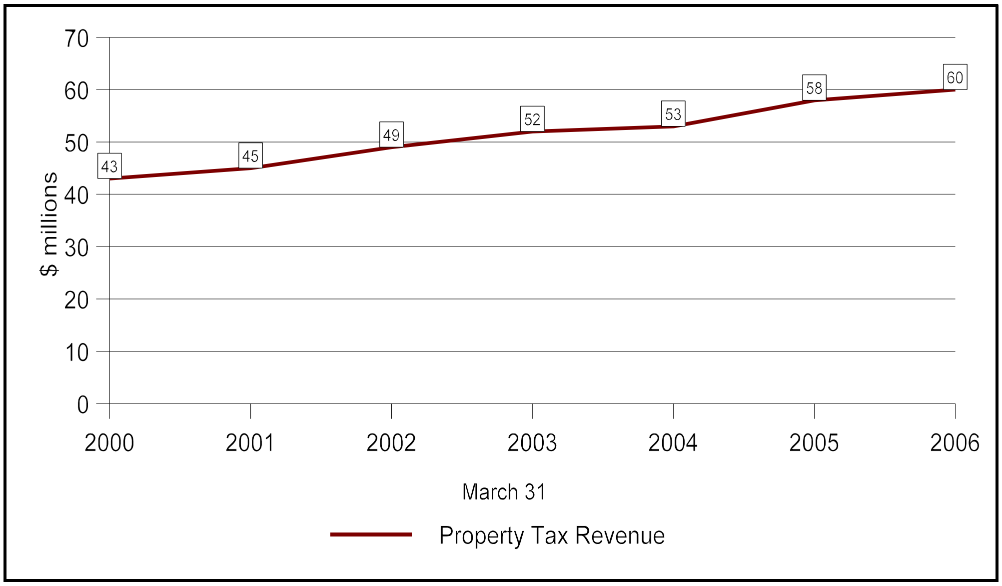
EXHIBIT 3.1
TAXATION AND PROPERTY RECORDS
DIVISION EXPENDITURES
(Millions)

	Budget 2006-07	Budget 2005-06	Actual 2005-06
Administration	$1.8	$1.7	$1.7
Tax audit, collection and inspection	1.3	1.3	1.2
Tax administration and client services	1.6	1.8	1.8
Information technology services	Note	1.0	.8
Property assessment services	1.1	1.1	1.0
	$5.8	$6.9	$6.5

Note: In 2006-07 information technology services were included within another division of the Department.

3.2 The Division is responsible for the Real Property Assessment Act and the Real Property Tax Act which provide the mandate for performing assessments on real property and the application and collection of taxes or fees for service. There are close to 100,000 property accounts, of which approximately 55,000 include residential assessments. Provincial property tax revenue for the year ended March 31, 2006 totalled $60 million. **Exhibit 3.2** shows comparative information on the provincial property tax revenues since 2000.

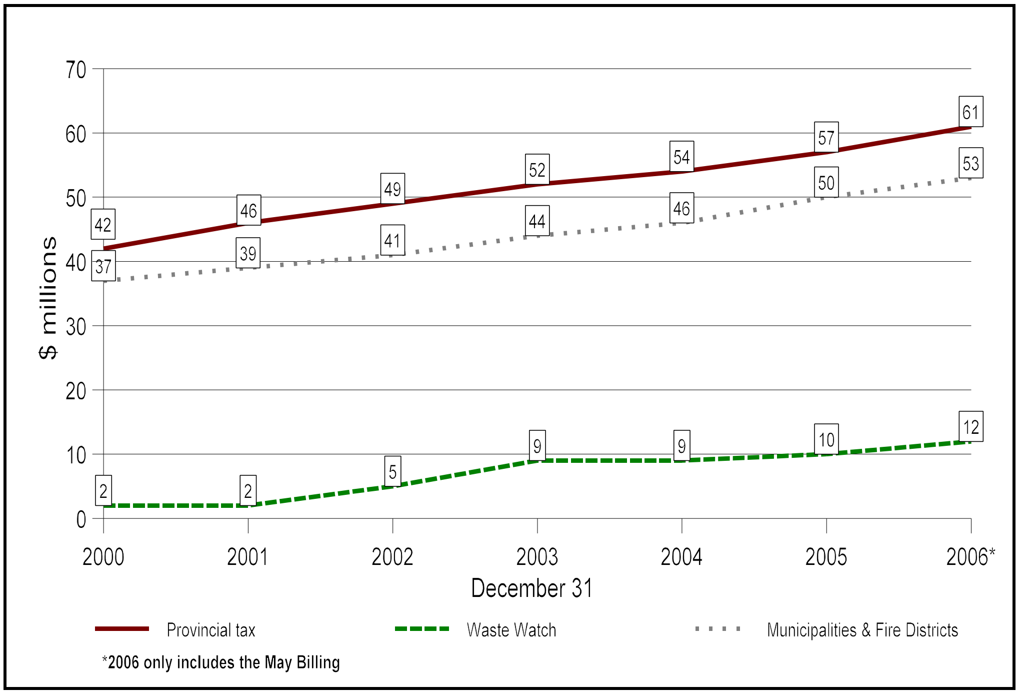
EXHIBIT 3.2
PROVINCIAL PROPERTY TAX REVENUES
($ Millions)



3.3 The Province's financial statements show that provincial property tax revenues have increased by $17 million or 40 percent since 2000. During that period the assessed values have increased by 53 percent. One reason taxes have not increased by the same percentage as assessed values is the owner occupied residential tax credit, introduced in 2003, which limits tax increases on residential properties to increases in the consumer price index (CPI).

3.4 The Division sends bills and collects taxes and other property related fees for municipalities, fire districts and the Island Waste Management Corporation. The annual billings are prepared on a calender year basis and are mailed in May of each year. The May 2006 billing was $126 million which included $65 million for municipalities, fire districts and the Island Waste Management Corporation. In addition to the annual billings, there may be partial billings issued throughout the year for property changes which affect taxes owing. **Exhibit 3.3** provides some comparative information on billings.

EXHIBIT 3.3
PROPERTY TAXES AND OTHER FEES BILLINGS
($ Millions)



3.5 In 2003, the Division began a process to replace its computer system. The old system was scheduled to be shut down in March 2004. This was a challenging time for the Division and the transition to a fully functioning system continued into 2006.

OBJECTIVES AND SCOPE

3.6 In accordance with Section 13 of the Audit Act, we conducted an examination of property taxation. Our objective was to assess the management practices in place over the billing of property taxes, the collection of property tax revenue and the assessment of residential properties. We did not examine commercial assessments.

3.7 Our audit focused on the year ended March 31, 2006 but also included a review of procedures in place over the conversion to the new property tax system in 2004.

3.8 We performed our examination in accordance with the standards for assurance engagements encompassing value for money, established by the Canadian Institute of Chartered Accountants and accordingly included such tests and other procedures as we considered necessary in the circumstances.

DETAILED AUDIT OBSERVATIONS

Tax Billings and Revenue

3.9 As part of our audit we looked at the requirements for property owners to be notified of their property assessment and taxes owing. The Real Property Assessment Act and the Real Property Tax Act outline certain requirements including:

- A notice of assessment is to be mailed to every person in whose name property is assessed;
- A notice of taxation is to be mailed to every person in whose name tax is levied; and
- The assessment roll and tax roll are to be open to public inspection.

3.10 Notices of assessment and taxation are mailed annually in May and additional tax levies are also mailed during the months of June to December. These notices are in a single document called the Summary of Property Charges. We observed that contrary to legislation, where a property is fully exempt from taxation, the owner is not notified of the property assessment.

3.11 There is no reconciliation prepared comparing the number of tax bills in the annual mailing to the number of property accounts in the system. This comparison would help ensure that a notice of taxation is sent to every property owner that owes tax.

3.12 At the time of our audit, the tax roll was not available for public inspection. The Division advised they plan to meet the public inspection requirement by using an electronic file, which is permitted under recent legislative amendments.

Recommendations

3.13 In accordance with legislation, all persons who own real property should be notified of their property assessment.

3.14 The Division should reconcile the number of tax bills mailed in the annual billings to the number of property accounts in its database.

3.15 To comply with legislation, the tax roll should be available for public inspection.

3.16 As part of our audit, we expected billings to be correctly calculated based on the assessed value of the property and relevant tax rates and credits. We also expected the Division to properly record and apply payments to property tax accounts. In addition, where taxes are owing we expected regular timely notification of amounts outstanding and a system in place to monitor and report on outstanding balances.

3.17 When the annual billings are mailed in May, the amounts billed include the new tax levy for the year plus any arrears as at March 31. Tax payments are due on May 31, August 31 and November 30. Partial billings are mailed monthly from June to December and result from new construction and other changes to accounts such as ownership transfers.

3.18 We selected a sample of properties and checked the calculation of the taxes payable based on the assessment. We checked the posting of payments and the calculation of any interest. We did not find any significant variances.

3.19 We noted that at March 31, 2006 there were 11,600 accounts with arrears over $100 totaling $16.6 million, an increase of $6 million from December 31, 2004. There were 450 accounts with arrears exceeding $5,000 at March 31, 2006 or $5.7 million in total.

3.20 Prior to 2004, a procedure had been in place to mail two statements of overdue taxes each year. The Division did not mail statements during the 2004 or 2005 calender years. In February 2006 statements of outstanding taxes were sent, however, no record was maintained of which accounts were mailed a statement.

3.21 We requested an aged tax receivable listing as of March 31, 2006. Division staff advised us the information is available within the system, and staff can access individual accounts and look at the billings and payments but a complete listing by account was not available. We were advised that the Division is having problems extracting this report from the new computer system and is working on this problem.

3.22 The Real Property Tax Act provides the Minister with authority to force the sale of a property and use the proceeds to pay property taxes in arrears. The timing of the notices of tax liability and tax sale are outlined in the Act and are tied to the accounts in arrears. When the arrears exceed 24 months a Notice of Liability to Tax Sale is to be sent and if unpaid after an additional 12 months, a Notice of Tax Sale is to be sent. The Division was unable to extract data from the system in order to mail these notices. At the time of our audit no notices had been mailed since 2004 prior to the conversion to the new computer system. The Division advised that they are working on this problem.

Recommendations

3.23 The Division should send statements of outstanding taxes to taxpayers on a regular, timely basis.

3.24 The Division should take action to ensure that regular tax receivable reports are prepared and reviewed.

3.25 The Division should send Notices of Liability to Tax Sale and Notices of Tax Sale in compliance with legislative requirements.

3.26 Property owners are entitled to several tax credits, which reduce their taxes payable. Entitlement to these credits is specified in legislation. Three major tax credit programs are the provincial tax credit, which applies to PEI residents, the owner occupied residential tax credit and the bona fide farmer tax credit. Tax credits, included in the annual May billings, for these three programs totalled $60 million in 2006 and $54 million in 2005.

3.27 We reviewed the procedures in place to monitor eligibility for the tax credit programs and examined the reports and documentation being used. Properties are normally only flagged for follow-up where there has been a change in ownership. Therefore, a risk of non-compliance exists when no ownership change occurs. An applicant who was eligible may cease to be eligible, for example when:

- They no longer satisfy the residence requirement; or
- The annual farm income does not meet the requirements for bona fide farmer status.

3.28 A report was prepared in 2005 containing over 1,000 properties that were flagged for bona fide farmer status review because of an ownership change. Letters were sent to request information and in some instances the credit was removed. A similar process was used to flag properties or owners regarding eligibility for the provincial tax credit and owner occupied residential tax credit.

3.29 The procedures in place do not ensure that eligibility for tax credit programs are sufficiently monitored. Limiting the review to changes in ownership could result in continued receipt of tax credits although the eligibility criteria are not satisfied.

Recommendation

3.30 The Division should confirm, on a test basis, continued eligibility for tax credits.

Real Property Transfer Tax

3.31 A new tax was introduced by enacting the Real Property Transfer Tax Act in May 2005. A one percent tax is applied to the greater of assessed value or consideration paid. The Division recorded tax revenue for the 2005-06 year of $2.4 million, relating to approximately 4,600 registered deeds.

3.32 To ensure that legislative requirements are being met there should be sufficient documentation filed and the documents should be reviewed on a test basis. When deeds are registered, some transactions are flagged at the registry office to indicate that additional research should be considered. From the time the tax was introduced until April 2006, there were approximately 500 transactions flagged for follow-up. This is mainly for exemptions and partial sales of properties. We were advised that there are no documented criteria for deciding which transactions should be flagged for additional verification. In addition, we noted that the transactions identified are not being followed up on a timely basis.

3.33 Under the legislation, first time home owners and family transfers are exempt from the transfer tax. The Division requires declarations to be filed for first time home buyers and family transfers. At the time of our audit the Division was not test checking declarations to ensure compliance with legislation.

Recommendations

3.34 Criteria should be developed and documented for flagging property transfers that require additional verification to substantiate compliance with the Real Property Transfer Tax Act.

3.35 To ensure the Real Property Transfer Tax legislation is being complied with, the Division should follow up on all transfers that are flagged for further review.

Assessments

3.36 The Real Property Assessment Act requires all real property in the Province to be assessed at its market value. To assess a property is to value a property for tax purposes, whether by an appraisal or by use of an adjustment multiplier. The Act defines market value as the most probable sales price indicated by consideration of the cost of reproduction, the sale price of comparable properties or the value indicated by rentals or anticipated net income.

3.37 These requirements provide the basis for the assessment activities of the Division. Our audit included a review of procedures for performing assessments on residential properties. In 2006, residential assessments totalled $4.6 billion. We expected policies, procedures and related documentation to be in place to support methodologies used by the Division to assess residential property at its market value.

3.38 During our last audit of property tax reported in 1998, there was a legislative requirement that all properties be appraised at least once every ten years. The Division was having difficulty meeting this target and was considering fundamental changes in the method of assessing properties. In 2002, the legislation was changed and the ten year requirement was removed. Individual physical property inspections are still carried out for new construction, referrals and as directed based on priorities of the Division, however, the Division now places greater emphasis on establishing market value by analyzing sales prices of properties in the same geographic area. On an annual basis, the Division compares the selling prices of properties in a geographic area or sales zone to their assessed values. The Division's goal is to have assessed values in the range of 90 to 110 percent of market value. Based on these comparisons and discussions with the assessment staff, a percentage increase is recommended for each work unit in the Province. The percentage increase is applied to an adjustment multiplier, which is a factor used to adjust the cost of properties from a base year of 1979. Work units are defined by geographic area and type of assessment and there are approximately 600 work units across the Province containing non-commercial assessments.

3.39 **Exhibit 3.4** provides a summary of property sales compiled by the Division for the 2.5 year period ending May 2005.

EXHIBIT 3.4
PROPERTY SALES DATA
FOR THE 2.5 YEARS ENDED MAY 2005

Geographic Area	Number of Sale Zones	Number of Sales	Sales price (millions)	Assessment at Sales Date (millions)
Summerside	1	490	$ 47	$ 39
Rural Prince County	7	870	49	36
Charlottetown to Stratford	1	1,520	177	140
Rural Queens County	5	1,280	94	66
Kings County	7	520	27	19
Total Province	21	4,680	$394	$300

3.40 The Division uses 21 zones or geographic areas to group sales. A large portion of sales occur in urban areas such as Charlottetown, Summerside and Stratford.

3.41 We examined the process used by the Division to recommend changes in the assessed values of properties, based on the analysis of property sales. We examined the sales analysis data compiled by the Division, which was used to increase the adjustment multipliers on residential properties. Our review was limited to 2,700 sales of residential properties. We found the number of sales for comparison purposes is low, especially in rural areas.

3.42 There has been a significant change in the methodology used by the Division to provide the annual assessments on properties. The current methodology is not documented. It is being used to support substantial increases in assessed values. Sales data is gathered as support for increases but because of the nature of some sales and the low volume in rural areas the data is limited. Division staff recognize these limitations and other information, including sales of similar properties in other sales zones, may be reviewed and considered, but this part of the process is not well defined and documentation is not always maintained to indicate what other information was considered in making decisions on assessment changes.

Recommendation

3.43 The Division should document its policies regarding the use of property sales data to increase annual assessments and the policy should provide guidance where the extent of sales data is limited.

3.44 Assessment staff have policy manuals which indicate the information to be recorded for each property and the various allowances and adjustments that are acceptable. Since conversion to the new computer system there have been changes in how the tasks are being accomplished, however, the assessment policy manual which had its last major update in 1990 is still applicable according to management.

3.45 The assessment manual includes rates for applying depreciation based on the age of the property. We reviewed a sample of properties to check for compliance with the depreciation policy.

3.46 In our sample, we found a number of properties where the depreciation rate applied was lower than the policy manual by at least five percent. The difference in assessed values per property ranged from $3,200 to $18,400. In our sample, 86 percent of the properties were inspected during the years 1989 to 1995 or from 10 to 16 years ago.

3.47 The Division's depreciation policy is not consistently followed because depreciation is normally only adjusted when an inspection is performed. Management has indicated that the new computer system does not have the capability, without extensive additional work, to annually adjust depreciation. Therefore, the depreciation applied is usually lower than what the policy manual allows. In addition, because the legislation no longer requires properties to be inspected on a cyclical basis, there is no mechanism in place to ensure all properties are adjusted for depreciation on at least a periodic basis.

3.48 **Exhibit 3.5** summarizes the assessments for three residential properties examined. These properties had their residential assessment calculated using various rates and methods established by the Division including:

- Application of a rate per square foot based on the type and size;
- Adjustments for the additional storey in the West Royalty properties and the relative grade or quality of each; and
- Application of the adjustment multiplier.

EXHIBIT 3.5
RESIDENTIAL ASSESSMENT EXAMPLES

	One storey split in Johnstons River	Two storey in West Royalty	Two storey in West Royalty
Year Constructed	1989	1988	1989
Reproduction Cost (Base year 1979)	$ 39,900	$ 91,300	$ 91,700
Adjustment Multiplier - 2005	2.16	2.04	2.04
2005 Value	86,300	186,300	187,100
Depreciation	(4,100)	-	(7,500)
Total Building	82,200	186,300	179,600
Total Land	21,200	43,300	43,600
Total Residential Assessment in 2005	**$103,400**	**$229,600**	**$223,200**

3.49 The Johnstons River property is assessed at $103,400 when the lot is included and depreciation applied. By comparison, one West Royalty property had depreciation applied and the other did not. All properties were constructed around the same time and according to the policy, nine percent depreciation should be applied. The Johnstons River property was inspected in 1995 and depreciation was applied at that time in accordance with the policy. One West Royalty property was inspected in 1989 following construction and no depreciation was applied. The other West Royalty property had depreciation applied as a result of a referral, where the property owner disagreed with the original assessment.

3.50 Division Management indicates that although the depreciation rate is not being regularly updated the adjustments to assessed values, based on sales analysis of properties, compensates for this. **Exhibit 3.5**, however, illustrates the impact on uniformity of assessments when depreciation is not applied on a consistent basis to all properties.

3.51 The Real Property Assessment Act provides taxpayers with an opportunity to question their assessment through a referral process. The taxpayer has 90 days from the date of notice to state the reasons for objecting and the Minister is obliged to reconsider and confirm or vary within 90 days. The Minister's decision can be appealed to the Island Regulatory and Appeals Commission. On average, 400 to 500 referrals have been registered annually over the past five years. This includes both commercial and non-commercial. The process to support a decision on referrals includes a review by the Assessment Supervisor and a visit with the taxpayer to obtain additional information. Based on a referral report related to the 2005 year, approximately 80 percent of residential referrals resulted in a change to the property assessment.

Recommendation

3.52 Approved policies on depreciation should be followed.

3.53 We reviewed the supporting documentation for a sample of properties. We expected to see rates and calculations from the policy manuals being used as well as explanations for adjustments.

3.54 A property card contains a picture taken at the most recent date of inspection and a sketch of the building elements including measurements. This is the only remaining paper record in the file. When the new system conversion occurred in 2004 we were advised that any additional records or notes were discarded or sent to storage.

3.55 The policy manual provides for obsolescence reductions or allowances to be considered and, where applied, the reason is to be briefly stated. Our sample noted some instances where the reasons were not stated. These instances reduced assessments by $229,000.

Division staff advised us that the supporting reasons are either in secondary storage or have been lost.

3.56 Our sample included 21 adjustments to the standard lot values and in some instances the reason was unclear. Division staff advised that adjustments to the standard lot values are the normal process whereby assessors will choose a standard for the work unit and adjust up or down based on comparisons. The policy manual does not identify this practice or provide guidance on the minimum level of documentation required. The database system allows assessors to add notes in the electronic file which automatically records a date and the assessor's name. We noted a few instances where this was used to explain or support a decision.

Recommendations

3.57 In accordance with policy, documentation should be maintained on the reasons for any allowances or reductions applied to property assessments.

3.58 The policy manual should be revised to include practices on standard lot adjustments. Where significant adjustments are made the reasons should be documented.

Information Technology Systems

3.59 In October 2003 the Division selected a replacement for the Property Assessment and Taxation System which was required due to system deficiencies and the government strategy to move away from mainframe systems.

3.60 The new system provides one integrated solution to maintaining over 100,000 property accounts including assessments, tax billings, accounts receivable and maintenance of tax credit programs. The system was selected through a competitive process. Proposals were evaluated based on ability to manage the business processes, add functionality and respond to the Division's challenges.

3.61 The contract with the system developer was signed in November 2003 for $1.2 million. Management of the project within the planned time frames was a significant challenge. The developer met with Division staff in December 2003 to define the project and develop a fast track migration plan. The old mainframe system was scheduled for shutdown in March 2004.

Outstanding Items

3.62 Some system components were still outstanding, as of the date we completed our audit. We were advised the Division agreed to defer some of these components, and wanted to focus on other aspects of the system. The main outstanding items include the Marshall swift functionality, which involves commercial assessments, and an income valuation module.

3.63 The previous system used a process whereby property changes were summarized into batches, entered in the system and then control reports were produced to check on the completeness and accuracy of the transactions processed. These control reports tracked assessed values, tax levies, accounts receivable and the number of property accounts. The new system enables real-time changes to be input by several staff on a daily basis. Division staff continue to work with the system developer to complete development of a number of control reports for the new system. At the date of our audit, these reports had not been completed and signed off by Division management.

Recommendation

3.64 Division management should continue to take action to ensure all outstanding system components and reporting capabilities are developed and provided by the system developer.

System Controls

3.65 As part of our audit, we assessed some of the computer system controls and reports. We expected that a well defined process would be in place to ensure that system access and data changes are well controlled.

System Access

3.66 We obtained a listing of all system users. There were 55 users, 26 of whom had extensive access rights. In general, access was assigned through groups with the intention of segregating incompatible functions, for example, the assessment function is separate from recording billings and payments. However, individuals can be granted additional access. Management advised that this sometimes occurred to facilitate the conversion to the new system. We noted, for example that one person had full assessment access as well as the capability to adjust account balances. In addition, we noted that there were a large number of individuals who had access that allowed them to put tax exemptions in place, thereby suppressing a tax calculation and billing. The system has been operating for a few years and the level of access needs to be re-examined.

3.67 The new system allows assessors to make changes on-line, however there is limited supervisory review of these changes. There is an audit trail report available for review which shows the details of the property changes and the assessor responsible, however this is not routinely reviewed. Instead reliance is placed on an annual quality control process, where, prior to annual billings, a series of reports are produced to identify exceptions or unusual items. We reviewed this process and found that the exceptions and unusual items are provided to assessors to follow up and correct or verify, however, there is no process in place to ensure that all items identified for follow-up are dealt with before the annual tax bills are mailed. In addition, the quality control process identifies unusual increases in assessments, but decreases in assessments are not flagged.

Recommendations

3.68 Division management should review user access to ensure that access approved provides adequate segregation of incompatible functions, and is limited to essential access related to job responsibilities.

3.69 Procedures should be implemented to ensure that all quality control exceptions are investigated and dealt with before the tax billings are processed.

3.70 The quality control process should include reports that flag decreases in assessments.

Property Changes

3.71 There are many changes processed during the year including changes such as new construction, new accounts and changes in ownership. Processing of these changes affects future billings and we expected to find a well controlled process to ensure all changes were processed properly, recorded in the system and resulted in accurate tax calculations and timely billings.

3.72 Many staff are involved in processing changes. For example, ownership changes begin in the Registry Office, assessment staff add information, the tax administration staff record the information in the property owner's account and other staff manage the printing and mailing of tax bills.

3.73 There are insufficient edits or checks to ensure that all changes which are created get properly completed. Division staff advised that a report exists to monitor changes that have been initiated but not completed. However, this report was deactivated during conversion because the system was backlogged. We were advised that the Division intends to reactivate this reporting capability.

3.74 In addition, at the time of our audit there was no reconciliation prepared or comparison done to ensure that any partial billings resulting from the changes were reconciled to the postings to taxpayer accounts and tax bills mailed. Staff advised that at one point the system showed that it was processing 100 transactions, but only 80 were posted to the accounts. The Division acknowledges that improvements are needed in this area and is working on a solution.

Recommendations

3.75 The Division should reactivate the report for monitoring outstanding changes to properties. The reports should be reviewed on a regular basis to ensure all initiated changes are properly processed.

3.76 The Division should reconcile partial billings to the accounts receivable postings and tax bills mailed.

Disaster Recovery

3.77 As part of our audit we expected the Division to have a disaster recovery plan. The Division does have a disaster recovery disk which includes the operating systems and it can be used to restore the system in the event of a failure. In addition, data is backed up. However, the Division does not have a documented disaster recovery plan outlining for example, responsibility for various procedures, access to hardware, and a location to start up operations.

Recommendation

3.78 The Property Tax Section should establish a disaster recovery plan which sets out the requirements to re-establish the property tax system in the event of a disaster. The disaster recovery plan should be tested periodically to ensure it is operational.

MANAGEMENT RESPONSE

3.79 Our report was discussed with management and a written response will be prepared.

4. PEI ENERGY CORPORATION

BACKGROUND

4.1 Unlike many other provinces, Prince Edward Island currently does not have accessible deposits of oil and natural gas or the capacity to develop hydroelectric power for energy production. The acquisition, production and cost of energy is a significant concern of Islanders. The accessibility and cost of energy has a major affect on both the cost of living as well as the ability to attract economic development to the Province. Reliance on imported fossil fuels has made the Province vulnerable to price instability and more recently has lead to increased concerns over long-term environmental impacts.

4.2 In 1978 the Energy Corporation Act was passed which established the PEI Energy Corporation. The Corporation has a broad mandate and corporate objectives are set out in the Act as follows:

- To develop and promote the development of energy systems and the generation, production, transmission, and distribution of energy in all its forms on an economic and efficient basis;
- To provide financial assistance for the development, installation, and use of energy systems; and
- To coordinate all government programs in the establishment and application of energy systems in the Province.

4.3 Initially, the Corporation developed a number of projects which were largely related to biomass energy generation. In 2000, after an extensive period of involvement in wind energy through its subsidiary, the Atlantic Wind Test Site, the Corporation began the development of the first wind farm on PEI. The North Cape wind farm was a 5.28 megawatt (MW) development which was later expanded.

4.4 In 2004, the Province in conjunction with the Corporation developed the *PEI Energy Framework and Renewable Energy Strategy* which outlines a plan to access a secure and competitively priced energy supply. The strategy focuses on investigating the feasibility of a number of sources of renewable energy as well as further development of wind energy and broader strategies for transportation and demand side management. This framework led to the establishment of the Renewable Energy Act which legislates, among other things, a renewable portfolio standard that 15 percent of the Province's electricity requirements are to come from renewable sources by 2010.

4.5 As illustrated in **Exhibit 4.1**, with the development of wind energy within the Province, the growth in capital investment through the Energy Corporation has increased significantly since 2001.

EXHIBIT 4.1
PEI ENERGY CORPORATION
TOTAL ASSETS
YEARS ENDED MARCH 31
($000)

	2001	2002	2003	2004	2005	2006
Current Assets	$1,617	$ 1,500	$ 2,330	$ 1,792	$ 2,065	$ 3,078
Long Term Investment	-	-	-	200	200	200
	1,617	1,500	2,330	1,992	2,265	3,278
Net Capital Assets						
North Cape Phase I	-	8,719	8,274	7,829	$7,384	$6,957
North Cape Phase II	-	-	-	7,396	7,176	6,811
Norway Transmission Line	-	-	115	198	188	178
East Point	-	-	-	-	-	5,641
	-	8,719	8,389	15,423	14,748	19,587
Total Assets	$1,617	$10,219	$10,719	$17,415	$17,013	$22,865

4.6 In 2006, a new energy target was announced committing the Province to produce 30 percent of its total energy needs from renewable, local sources by 2016. This new target incorporates transportation and heating fuels into the strategy and not simply electricity. Transportation fuel accounts for 40 percent of the Island's energy requirements. The production of renewable fuels will be key to reaching this new target.

OBJECTIVES AND SCOPE

4.7 In accordance with Section 13 of the Audit Act, we conducted an examination of the PEI Energy Corporation to assess the governance and management practices in place to meet its expanded role in the development and administration of wind energy production as well as other corporate expectations under the Renewable Energy Strategy.

4.8 The audit focused on the development and construction of the North Cape wind farms, both Phase I and Phase II, as well as the development and construction of the East Point wind farm up to September 2006. In addition, we reviewed the role and process followed by the Energy Corporation in examining the feasibility of certain renewable energy initiatives as referred to in the Renewable Energy Strategy.

4.9 We performed our examination in accordance with the standards for assurance engagements encompassing value for money, established by the Canadian Institute of Chartered Accountants and accordingly included such tests and other procedures as we considered necessary in the circumstances.

DETAILED AUDIT OBSERVATIONS

Wind Farm Development and Construction

4.10 The PEI Energy Corporation has focused on the development of wind energy as its primary source of renewable energy within the Province. At the time of our audit, the Corporation had a wind farm in operation producing 10.56 MW of energy located at North Cape and a 30 MW wind farm under construction at East Point.

4.11 We reviewed the management controls in place over the development and construction of the wind farms. We expected the Energy Corporation to demonstrate that an adequate analysis had been conducted to support the technical and financial feasibility of each wind farm prior to construction. The development and construction of a wind farm is a major capital project, and we expected the Corporation to comply with the requirements of the Treasury Board policies on Capital Projects Management and Professional Services Contracts, particularly with regards to employing a competitive process for awarding contracts, obtaining appropriate approvals, and reporting on project management.

4.12 The development and construction of a wind farm involves a number of stages. We reviewed the management of these projects at each stage. There were limited staff at the Corporation and projects of this nature and financial magnitude presented a significant challenge. A thorough technical feasibility analysis was conducted on the wind farms, and both North Cape Phase I and Phase II were completed within budget. East Point was still under construction at the time of our audit. **Exhibit 4.2** shows the comparison of budget to actual for North Cape Phase I, North Cape Phase II and the budget for East Point broken down by main components.

EXHIBIT 4.2
PEI ENERGY CORPORATION
WIND FARM DEVELOPMENT
COMPARISON OF BUDGET TO ACTUAL COSTS
($000)

	North Cape Phase I		North Cape Phase II		East Point
	Budget	Actual	Budget	Actual	Budget
Turbines	$5,938	$5,878	$5,800	$5,985	$35,761
Design and Project Management	195	183	160	128	710
Construction	2,892	2,766	1,335	1,414	15,855
Other	340	97	300	35	3,666
Total	**$9,365**	**$8,924**	**$7,595**	**$7,562**	**$55,992**

Project Management

4.13 North Cape Phase I, North Cape Phase II, and East Point wind farms are each major capital projects. Together they represent an increase in government investment of over $70 million. We expected a clear, concise set of procedures to manage the design, implementation, cost control, and commissioning of these projects in order to ensure government objectives are realized and risks are controlled and mitigated. We looked for the Board of Directors to provide oversight, and support to the project management team.

4.14 Treasury Board has established a Capital Projects Management policy which sets out a framework for authorization and project management. For each capital project, approval in principle to proceed is required from Treasury Board or Executive Council. The policy requires Treasury Board approval prior to release of Request for Proposals (RFPs) and again prior to awarding the contracts. Further, in the case of Phase I, the submission to Executive Council on which approval in principle was granted, specifically stated that the Energy Corporation would come back to Executive Council for approval of major contracts.

4.15 We found that approval in principle was obtained from Executive Council and/or Treasury Board for each wind farm development. However, a number of the contracts were not approved by Treasury Board or the Board of Directors.

Planning and Contracting

North Cape Phase I

4.16 In 2000, the PEI Energy Corporation began development of the 5.28 MW wind farm located at North Cape near the Atlantic Wind Test Site (AWTS). There was no wind atlas data available at the time, but extensive experience had been gained from the operation of the AWTS over the years, and the wind data at the location was widely documented. This information was used to help determine the project's feasibility.

4.17 The design and project management was conducted by an employee of AWTS who, in conjunction with senior management of the Energy Corporation, managed the project. We reviewed the contracting for Phase I for both professional services and construction contracts. We found that one of the technical engineering firms was hired without a competitive process, and there was no signed contract setting out the terms and conditions of the engagement.

4.18 When assessing the options for turbines, a $5.9 million expenditure representing 65 percent of the project's cost, the project manager from AWTS prepared a detailed evaluation of the different options including a variety of suppliers and models. Quotes were sought and an assessment of both quantitative and qualitative factors was conducted. Energy Corporation entered into negotiations with the turbine supplier and signed a Turbine Purchase Agreement.

North Cape Phase II

4.19 When Phase I was constructed, the land acquisition allowed for a future expansion of the wind farm. In designing and building the supporting infrastructure, the Energy Corporation built in the capacity to support a 100 percent expansion. When the Federal Government announced a Wind Power Production Incentive (WPPI), which provided $.01 per kilowatt hour produced, the government decided it was time to consider expanding. We found the economic feasibility analysis submitted for approval was not as comprehensive and thorough as it had been for Phase I. The analysis did not present alternative results by varying key assumptions such as interest rate and energy generation. This was a major capital construction project with a cost of $7.6 million, but with the introduction of the WPPI incentive, the favorable operating results of Phase I, and the constrained time budget for construction, limited attention was directed at the financial feasibility analysis for Phase II.

4.20 As in our review of Phase I contracting, we reviewed the process used for acquiring professional services for Phase II. The design of Phase II was managed first internally by an AWTS manager, the same person who managed the planning and construction of Phase I. During the preliminary stages, the manager left AWTS to start his own consulting company. Energy Corporation engaged this company to complete the design and project management for Phase II. Although this consulting company was engaged without a competitive process, the Treasury Board policy allows for sole sourcing in the situation where there is risk of serious loss of continuity, time or economy by going back to a competitive process. We found there was no signed contract with this consulting company setting out the terms and conditions of the work.

4.21 The Energy Corporation acquired the services of another engineering firm regarding site access for Phase II. We found there was no signed contract with this consultant.

4.22 We reviewed the contracts awarded for the construction phase of the wind farm development. In Phase II the construction of the foundations was awarded without a competitive process. The contractor had carried out the work on Phase I and the Energy Corporation was satisfied with the work. However, the cost of the foundation construction was in excess of $600,000 and should have been open to competition. In addition, there was no signed contract for this work.

4.23 When assessing the turbine model, the AWTS project manager prepared an evaluation of three options. Based on the results of the analysis of financial and non-financial data, the Energy Corporation chose to use the same turbines for the North Cape Expansion. The Energy Corporation negotiated and signed a Turbine Purchase Agreement.

East Point

4.24 In 2004 the Renewable Energy Strategy was developed and was subsequently followed with a legislated renewable portfolio standard (RPS) of at least 15 percent of electricity to come from renewable energy sources by 2010. At the same time, the Strategy called for a monitoring program to systematically appraise the wind profiles of the Island. This wind atlas had confirmed that the wind regime at East Point had at least as much potential as North Cape.

4.25 The renewable portfolio standard meant that the public utility was required to obtain more energy from renewable sources. We were advised that the Energy Corporation worked with the public utility to identify a realistic RPS given the intermittent nature of wind energy. This constraint, coupled with the fact that energy would also be purchased from a 9 MW privately owned wind farm, resulted in the decision to limit the proposed wind farm's capacity to 30 MW.

4.26 In February 2005, Executive Council approved the Energy Corporation's request allowing management to examine the feasibility of constructing a 30 MW wind farm at East Point. In May of that same year, Executive Council approved the Corporation's request to proceed with a request for proposal for the services of a project manager for the pre-development design/costing; and subject to government approval, the development and commissioning of the wind farm.

4.27 We reviewed the Corporation's processes for acquiring design and other engineering services. An RFP was issued for the preliminary and detailed design of the wind farm project. The responses were evaluated by a three member team consisting of the CEO of the Energy Corporation and two engineers employed by the Department of the Environment, Energy, and Forestry. A recommendation was made to Executive Council which resulted in the approval to hire the winning bidder, the same consulting firm which was involved in North Cape Phase II. At the time of the RFP process, the Energy Corporation had a preferred share investment in the winning company. Although the firm that won the bid clearly has significant experience and expertise in design and construction management of wind farms, an independent evaluation team should have been used to guard against any perception of a conflict of interest.

4.28 The RFP and the resulting contract covered only the design services required for the project. We noted that the same firm was then hired to carry out the project management for the construction of the wind farm and this phase of the work did not go back to an RFP. The professional contract services policy allows for selection without competition where going to another RFP would result in a serious loss of continuity, time or economy. We noted that there was no contract signed for the construction management services. Where arrangements are not documented in a contract, there is no record of the agreed upon terms of the work to be performed.

4.29 We also noted that during the construction phase of East Point, a contractor was hired for site clearing activities without a competitive process or a signed contract.

4.30 During the planning phase, the consulting firm prepared a detailed analysis of the different turbine options based on quotes obtained from suppliers. The results indicated the best alternative was a newer turbine model from the same supplier used at North Cape. In December 2005, Executive Council granted the Energy Corporation approval to enter into negotiations with the supplier for the turbines.

4.31 When the Energy Corporation began negotiations to establish an agreement for the sale of energy from East Point, a private sector developer came forward expressing interest in constructing a wind farm to sell energy to the public utility. Based on Executive Council approval, the Energy Corporation entered into an agreement to buy all the power produced by the private sector developer and resell it along with all power produced at the East Point wind farm to the public utility. This arrangement between the Energy Corporation and the private sector developer was not open to a competitive process, allowing other interested parties to participate.

Recommendations

4.32 As required by Treasury Board Policy, major construction contracts should be submitted to Treasury Board at the request for proposal stage and the approval stage.

4.33 Contractual arrangements should be documented, including at a minimum the terms and conditions of the services acquired and the agreed upon cost. The contract should be signed by both parties.

4.34 Significant contractual arrangements should be open to a competitive process.

Power Purchase Agreements

4.35 At the date of our audit, North Cape Phase I and Phase II were in operation while East Point was still under construction. The results of operations of North Cape Phase I and Phase II are illustrated in **Exhibit 4.3**.

EXHIBIT 4.3
WIND FARM OPERATIONS
NORTH CAPE - PHASE I AND PHASE II
AS OF MARCH 31
($000)

	2006	2005	2004	2003
Revenues				
Utility	$2,556	$2,551	$2,255	$1,942
Other	229	205	91	17
	2,785	2,756	2,346	1,959
Expenditures				
Operations	114	129	151	76
Interest	827	884	657	594
Amortization	841	834	576	445
Service and Warranty	224	228	140	112
Other	85	89	75	71
	2,091	2,164	1,599	1,298
Net Income	**$ 694**	**$ 592**	**$ 747**	**$ 661**

4.36 Wind farm development is a capital intensive undertaking with the ability to generate revenues over the long term. Typically, wind farm development is entered into only with a long-term agreement in place for the sale of the power that will be generated. This is called a Power Purchase Agreement (PPA). We expected the price and duration of the Power Purchase Agreements in place for each of the wind farms to be reasonable compared to other jurisdictions, while acknowledging Government's strategic objective to stabilize energy prices. Based on our comparisons, we found that most agreements are from 15 to 25 years. The PPAs negotiated by the Energy Corporation are all 20 year agreements. Prince Edward Island's current legislated rate of $77.50 per megawatt hour is within the range of prices established in other agreements that we reviewed.

4.37 North Cape Phase II was commissioned in 2003. The Energy Corporation negotiated a 20 year Power Purchase Agreement with the public utility for Phase II. We noted that although a separate PPA was negotiated and followed, the Agreement itself had never been signed until we brought it to management's attention.

Recommendation

4.38 The Energy Corporation should ensure that power purchase agreements entered into are signed by both parties.

Wind Farm Financing

4.39 We examined the financing in place for the wind farm projects. We expected management to consider alternatives and to seek out opportunities that would result in the lowest borrowing cost, and where applicable, would allow the Province to meet its broader goals as outlined in the Renewable Energy Strategy.

4.40 The government employed a formal request for proposal process to finance Phase I of the North Cape wind farm where proposal requests were sent to financial institutions. Proposals were evaluated, and an agreement was entered into with a major bank for the loan of $9.36 million at 6.6 percent. The loan is guaranteed by the Province.

4.41 To finance Phase II, the government again began with a formal request for proposal process. This time, another major bank was the successful proponent. However, during negotiations, the Province decided to finance the project internally with a loan from Provincial Treasury to the Corporation for up to $6.8 million at 5.39 percent.

4.42 The Renewable Energy Strategy specifically sets out an action item for the government to "pursue a method of enabling Prince Edward Island residents to invest in local wind energy projects." To this end, the Energy Corporation worked with different consultants to research financing alternatives that would allow Islanders to invest in the East Point wind farm. As well, in May of 2005, the government issued an RFI (Request for Information) for the financing of the East Point wind farm from the banking community.

4.43 In December 2005, the turbines had to be ordered to allow sufficient lead time for delivery in accordance with the project timing. Approval was obtained from Executive Council for financing of this $56 million project in the form of a loan from Provincial Treasury.

4.44 On September 12, 2006 Executive Council approved an investment strategy for private sector investment which included the formation of a wholly owned subsidiary of the Energy Corporation and the sale of bonds, which could be purchased by Islanders and their companies.

4.45 The sale of bonds began on December 11, 2006. There will be additional financing costs for the funds raised through the bond program because the bonds are at five percent and government's cost of borrowing at the time was marginally lower. As well, there are added costs of administering the bond program.

4.46 We noted that at the date of first issuance of the bond program the East Point Wind Farm was essentially complete. The financing through the Provincial Treasury was in place. There was reference in Executive Council submissions as to whether the proceeds raised through the private sector bond issue would be used to pay down the debt on the East Point wind farm or used for future renewable energy projects. At the date of issuance, the decision of Energy Corporation which was endorsed by Executive Council was to review the success of the bond program following the 2006 RRSP season and seek direction on the disposition of the proceeds at that time. We noted that the press release on the sale of the bonds states that these bonds will allow Islanders to invest in the Eastern Kings wind farm.

Recommendation

4.47 The Energy Corporation should ensure that the proceeds from the sale of the PEI Energy Savings Bonds are used as described to investors.

Governance

4.48 Under the Energy Corporation Act, the affairs of the corporation are to be conducted by a Board of Directors of not less than five and not more than seven directors appointed by the Lieutenant Governor in Council. The Act provides that the Minister is a director. We noted at the time of our audit that besides the Minister there were five other members who were all deputy ministers or senior civil servants.

4.49 In fulfilling its responsibility to manage the affairs of the Corporation, we looked for the Board of Directors to provide leadership and oversight in four broad areas:

- establishing the corporation's strategic direction;
- safeguarding the corporation's resources;
- monitoring corporate performance; and
- reporting to the Legislative Assembly.

4.50 There is no corporate strategic plan approved by the Board. The Renewable Energy Strategy was approved by Government in 2004 and identified a number of initiatives for government. The strategy is not a detailed plan and, therefore, does not indicate which government entity will be responsible for each initiative or which initiatives are priorities at any point in time. We noted that the Energy Corporation has taken action on a number of initiatives. However, the Corporation is only one organization that has a mandate allowing it to implement initiatives under the Renewable Energy Strategy. Others include the Department of Development and Technology and the Department of Environment, Energy and Forestry.

4.51 The Corporation in recent years has been charged with the administration of several major capital construction projects. We expected that the Board of Directors would perform an oversight role providing direction for the project management and accountability to Treasury Board and Executive Council. We found that the Board did not approve the tender packages or the awarding of major construction contracts. In many instances, it appears that the Board is brought together to approve actions after the fact. For example, at a meeting in January 2006, the Board approved the East Point wind farm project that had been approved in principle by Executive Council in September of 2005. Even the approval of the purchase of turbines for East Point, an acquisition contract valued at $36 million was approved as a formality by the Board after the contract was approved by Executive Council.

4.52 One area of responsibility of the Board is the monitoring of corporate performance. We reviewed minutes of Board meetings from 2003-04 to 2005-06. We found that the Board met on July 2004 and not again until July 2005. Since the late fall of 2005, with the construction of East Point wind farm the Board is meeting more frequently. We were advised that monthly financial reports were provided.

4.53 In 2006, the Board approved a capital asset acquisition policy. Approval levels are established for the CEO, Deputy Minister, Minister and Treasury Board, however, there is no level of capital asset purchase that requires Board approval.

4.54 The Financial Administration Act requires all reporting entities to provide an annual report including an audited statement of accounts and a report on the goals and results achieved. We found the Board was not consistently reporting on corporate results. Annual reports for 1998-99 and 1999-00 as well as 2003-04 and 2004-05 each covered a two year period. In addition, they did not include a clear statement of goals and results achieved.

4.55 Although we were advised by management that a clear definition of the role of the Corporation and the role of the Ministry exists, we found in practice there is an overlap of programs and initiatives. The CEO of the Energy Corporation is also a Director of one of the Department's divisions. In addition departmental staff often work on Energy Corporation projects. We noted that the Corporation has taken on a number of new activities as a result of the Renewable Energy Strategy, but it does not have a documented business plan that outlines planned activities and resources required.

Recommendations

4.56 The Energy Corporation should develop a strategic plan that is linked to the renewable energy strategy and approved by the Board of Directors.

4.57 The Board of Directors of the Energy Corporation should fulfill its responsibility to conduct the affairs of the Corporation and provide direction and accountability for major corporate initiatives.

4.58 The Energy Corporation should prepare an annual report which provides information on goals and results achieved.

4.59 The Energy Corporation should prepare a business plan, linked to its strategic plan, that outlines planned activities and required resources.

Renewable Energy Initiatives

4.60 In recent years the Energy Corporation has been involved in research and assessment of a number of potential renewable energy development projects. Many of these concepts are referred to in the Renewable Energy Strategy. Because of the nature of these projects, there are overlapping effects and sometimes competing objectives for a number of government entities including the Department of Environment, Energy and Forestry, the Department of Development and Technology, PEI Business Development Inc., and the Department of Agriculture, Fisheries and Aquaculture.

4.61 Under the Energy Corporation Act, the mandate of the Corporation is broad and includes the development and promotion of energy systems and coordination of all government programs in the establishment and application of energy systems in the Province.

4.62 We reviewed the involvement of the Corporation in the assessment of a number of initiatives including biodiesel, biogas, and ethanol development. In some cases the findings indicated a potential for successful development but in all cases the project did not go forward to the development stage. In April 2006, Executive Council directed the establishment of a Committee, with the Department of Development and Technology as the lead, to assess the potential and establish a policy framework for evaluating development projects in renewable energy. At the time of our audit, a consultant had been hired to assist the Committee in this regard.

4.63 In 2003-04 the Energy Corporation made an investment of $200,000 in preferred shares in a private company involved in energy system development. Prior to approving the investment, the Board of Directors obtained a letter of guarantee from PEI Business Development Inc. (BDI) to protect the interests of the Corporation. The shares were not redeemed when they came due in July 2006, and BDI did not pay out its guarantee. We have been advised that the private company has been in contact with BDI regarding financial arrangements.

Recommendation

4.64 A process should be put in place to review and prioritize potential renewable energy projects to ensure opportunities are not lost.

MANAGEMENT RESPONSE

4.65 Our report was discussed with management and a written response will be prepared.

5. WORKFORCE INCENTIVE PROGRAMS

INTRODUCTION

5.1 Since 2002 the Province has offered two different workforce incentive programs. These programs were designed to provide enhanced benefits to specified groups of employees to retire or leave their employment. The intention was to save salary dollars and facilitate a restructuring of the workforce.

5.2 We examined the Workforce Renewal Program 2005 and the Workforce Adjustment Program 2002. For both programs we observed that the process for assessing eligibility and providing benefit payments was well managed. We observed that there was no overall final report prepared on either program showing the program results compared to the original program objectives. In addition, sufficient information was not readily available on changes in positions and full-time equivalents during the period the programs were offered.

OBJECTIVES AND SCOPE

5.3 In accordance with Section 13 of the Audit Act, we conducted an examination of the Workforce Renewal Program 2005 and the Workforce Adjustment Program 2002. Our objective was to assess the management practices in place over the planning of these workforce incentive programs, to determine if payments were made in accordance with approved program requirements, and to examine the process used for measuring and reporting on program results. We did not audit the Program Renewal process carried out in 2004-05 that resulted in a number of changes to government operations and the identification of staff reductions.

5.4 We reviewed program guidelines, as well as submissions to Treasury Board and approvals of Executive Council. We interviewed managers responsible for planning and coordinating the programs. In addition, we tested documentation maintained on employees who received benefits under the programs and obtained information on program results.

5.5 Our examination was conducted in accordance with the standards for assurance engagements encompassing value for money, established by the Canadian Institute of Chartered Accountants and accordingly included such tests and other procedures as we considered necessary in the circumstances.

WORKFORCE RENEWAL PROGRAM 2005

5.6 In March 2005 Executive Council approved the Workforce Renewal Program 2005 to streamline the public service and provide opportunities to realign staff resources based on future program delivery requirements. Unlike the previous Workforce Adjustment Program 2002, this program was available to the Health Sector and School Boards, as well as the civil service and other specified entities.

5.7 During 2004-05 government engaged in a comprehensive program review process known as Program Renewal. Through Program Renewal the government was seeking improved fiscal responsibility by reviewing programs and reducing expenditures. The Workforce Renewal Program was designed to create flexibility in the workforce so government could respond to program delivery requirements identified under Program Renewal.

5.8 The key components of the program were as follows:

- an enhanced retirement benefit package;
- an enhanced voluntary severance package; and
- an unclassified workforce incentive.

5.9 Initially the program was approved with the requirement that interested employees had to retire or leave as of April 30, 2005, for employees of school boards it was June 30, 2005. A Phase II of the Program was approved in June 2005 which would see employees leave as of August 26, 2005. A further program offering was approved in October 2005, referred to as Phase II Extension, to allow employees to leave as of April 30, 2006 which was then extended to June 30, 2006. **Exhibit 5.1** summarizes the dates and the employee groups to which each phase applied.

EXHIBIT 5.1
WORKFORCE RENEWAL PROGRAM 2005

PROGRAM	APPLIES TO	APPROVED	LEAVE
Phase 1	Civil Service	March 2005	April 30, 2005
	School Boards		June 30, 2005
	Health Sector		April 30, 2005
Phase II	Excluded Employees	June 2005	August 26, 2005
	*UPSE in Civil Service and Health		August 26, 2005
	**IUOE local 942		August 26, 2005
Phase II Extension	Excluded Employees	October 2005	June 30, 2006
	*UPSE in Civil Service and Health		June 30, 2006
	**IUOE local 942		June 30, 2006

*** Union of Public Sector Employees**
**** International Union of Operating Engineers**

5.10 The program applied to permanent civil servants and unclassified employees. Members of the Senior Compensation Plan are not permanent employees but were also eligible for enhanced benefits.

5.11 Initially the program was offered on a voluntary basis to interested employees. At the same time the Program Renewal and Health Sector restructuring were taking place and later the Information Technology (IT) Optimization occurred. Through these processes government identified positions at various points which were not required under the new structure. Employees in specific positions received a notice of layoff and were declared “affected.”

5.12 As job competitions were completed a number of affected employees were placed. Variations of the Workforce Renewal Program were approved to be extended to different groups to allow these affected employees to access the program if they were not successful in job competitions.

5.13 Exhibit 5.2 illustrates the total number of participants and the dollars paid out in enhanced retirement and severance pay over the course of the program.

EXHIBIT 5.2
WORKFORCE RENEWAL PROGRAM 2005
PARTICIPANTS BY PHASE
($ Millions)

	Number of Participants	Voluntary Retiring Pay	Voluntary Severance Pay	Unclassified Workforce Incentive	Total
Phase I	780	$12.8	$ .7	$.8	$14.3
Phase II	42	.6	.5	-	1.1
Phase II Extension	47	.9	.3	.1	1.3
	869	$14.3	$1.5	$.9	$16.7

DETAILED AUDIT OBSERVATIONS

Enhanced Retirement

5.14 The eligibility requirements for early retirement under each phase of the program were consistent. Participants were required to be permanent employees, to have been working for their employing authority for at least two years prior to their termination date, to be 53 years of age, and to be vested in their applicable pension plan. The participants were required to notify their Deputy Minister or equivalent by the date specified in that phase of the program, as well as agree to terminate by the date specified. Phase II of the program had a requirement that non-affected employees could only participate if their position could be backfilled by an affected employee, abolished, or have equivalent dollars sequestered from the Department's budget.

5.15 Each participant of the retirement program was eligible to receive the regular retirement pay equal to one weeks salary per year of service to a maximum of 26 weeks as well as the voluntary retirement pay equal to 26 weeks salary regardless of years of service. The voluntary retirement pay was to be prorated for part-time employees.

5.16 There were a total of 608 employees who retired under this enhanced program. The total cost of the enhanced retirement pay for the program was $14.3 million for these employees. A total of 553 employees participated under Phase I of the program, 25 under Phase II and 30 under the Phase II Extension.

5.17 We tested a sample of files of program participants to determine if the employees who were approved for retirement met the eligibility requirements, the amounts were accurately calculated, and where required, the position was backfilled by an affected employee, abolished or equivalent dollars were sequestered from the department budget.

5.18 We noted that for the items we tested, all participants met the eligibility requirements and retirement benefits were appropriately calculated. We were advised that when each participant was approved, the salary dollars in the budget were sequestered and were not released unless the position was approved by Treasury Board to be backfilled, and if that approval was not obtained, the positions were abolished. Public Service Commission indicated that a process was in place to ensure positions required to be backfilled with an affected employee were followed up.

Enhanced Severance

5.19 The Workforce Renewal Program included a voluntary severance component. Under this option, employees could terminate their employment with their employing authority and receive voluntary severance pay equal to 26 weeks or one-half years salary.

5.20 In order to meet the eligibility requirements, participants were required to be permanent employees and to have been working for their employing authority for at least two years prior to their termination date. Under the program a condition of eligibility was that the position or a similar position could either be abolished, backfilled with an affected employee, or equivalent dollars would be sequestered from the department's budget. In some situations, only affected employees were eligible. Participants were required to forward a request to their Deputy Minister or equivalent by a specified date and agree to terminate by the stated date.

5.21 A total of 63 employees participated in the voluntary severance aspect of the program. These employees terminated employment at a cost of $1.5 million which consisted of $1.3 million voluntary severance pay and $.2 million for pay in lieu of notice. The breakdown of participants by phase is 34 participants in Phase I, 17 participants in Phase II and 12 participants in the Phase II Extension.

5.22 We tested a sample of employees who took the voluntary severance option to determine if they met the eligibility requirements, calculations for severance were correct, and the position or a similar position was abolished, backfilled with an affected employee or equivalent dollars were sequestered from the departmental budget. The cases we examined were all in compliance with the rules of the program.

Unclassified Workforce

5.23 The Workforce Renewal Program 2005 provided an incentive for unclassified or casual employees in the civil service to terminate employment. These employees could be eligible for an incentive equal to 50 percent of their annual salary if they worked full-time. Seasonal employees were eligible for an incentive equal to 50 percent of their earnings during their last term of employment. The calculations were to be prorated for part-time employees.

5.24 To be eligible for the program, employees had to be unclassified employees of the civil service. Seasonal employees were required to have been employed in each of the two previous fiscal years and temporary employees were required to have had continuous service for a two year period. The participants were required to forward their request to the Deputy Head by the date specified in the program and agree to terminate by the specified date. The request would be approved if the Deputy Head agreed that the employee would not be replaced.

5.25 A total of 198 employees participated in the unclassified workforce incentive. Of these, 193 participated under Phase I of the program and 5 participated under the Phase II Extension. There were no participants under Phase II of the program. The total cost of this part of the program was $.9 million.

5.26 We tested a sample of the participants to determine if each met the eligibility requirements, the incentive was accurately calculated and the employee was not replaced. For all the participants in our sample, the benefit amounts were correctly calculated. We were advised by the human resource managers in the respective departments that the employees selected in our sample were not replaced.

Return to Work

5.27 Each phase of the Workforce Renewal Program had essentially the same restrictions on a subsequent return to work after accepting enhanced retirement or severance benefits under the Program. Within five years of the date of retirement or severance, any return to employment or a professional service contract was required to be approved by Treasury Board. In addition, any employees who became employed either directly or through an incorporated company within the civil service, the Department of Health, the Department of Social Services and Seniors, any school board, or any board, agency, institution, authority or commission established by or pursuant to an Act of the Legislature, within five years of their separation under this program were required to refund the benefit based on a sliding scale.

5.28 In the planning stages of the program, it became apparent that special consideration would be required in the applicability of the program to certain positions where market shortages were known to exist. These were primarily in the health care sector where government had been challenged to fill existing positions. The health care sector had designated certain positions into groups where market shortages were known to exist, and these designations were used in determining the applicability of the program.

5.29 Group I included those positions where there was a history of difficulty in filling positions such as salaried physicians, pharmacists, speech language pathologists, psychologists, radiation therapists, and specialty medical radiation technology positions. This group was not eligible for the Workforce Renewal Program.

5.30 Group II included positions where there was some known market shortages. Some of these positions included nurses, medical laboratory technologists, respiratory therapists, physiotherapists, occupational therapists and physicists. This group was allowed to participate in the program if approved by the employing authority on a case by case basis.

5.31 Executive Council approved that nurses and medical laboratory technologists would be permitted to access the program and return to work on a casual basis without the requirement to repay enhanced benefits received under the program.

5.32 We obtained information from the Department of Health. Thirty-six nurses who were members of the PEI Nurses Union retired under the Workforce Renewal Program. Of these, 25 have returned to work on a casual basis after having received enhanced retirement benefits of $580,000. Three of these had casual remuneration of over $25,000 in a fiscal year.

5.33 Similar to Health, in the Education sector it was fully anticipated that many of the positions vacated under Workforce Renewal would have to be backfilled in order to maintain staffing ratios. In total 159 teachers participated in the program and the net reduction in teaching positions was 30. Executive Council provided approval for teachers who participated in the program to return to work on a casual basis in certain situations where a severe shortage of substitute teachers existed. Some examples provided to Executive Council included french immersion, french first language and high school math and science. We obtained information from the Department that indicated 29 teachers have returned to work on a casual basis.

5.34 In addition to these broad groups, we noted Executive Council approval was obtained for a number of individuals to return to work on a limited basis to fulfil specific duties. In the approvals, the requirement for these individuals to repay enhanced retirement benefits was waived.

5.35 In support of the budget process, each department is required to submit a detailed salary spreadsheet. We were advised that budget analysts review these sheets in detail and any individuals who return as an employee without approval would be identified.

Program Results

5.36 When the Workforce Renewal Program was initially approved, overall responsibility for administration was not specifically assigned to one government organization. Budgetary issues are regularly handled through Provincial Treasury, and human resource management for the public service is administered through the Public Service Commission. Both organizations were involved in different aspects of the program and it was very difficult to obtain program information, particularly salary savings and the net change in the workforce over the duration of the program.

Program Objectives

5.37 The objective of the program was to realign staff resources with future program delivery requirements and to maximize savings in the public sector. In the fiscal year 2004-05 Budget Forecast, $5,000,000 was included as the estimated cost of the program and a savings of $7,750,000 was included in the 2005-06 Budget Estimates. These amounts were based on a target of 200 participants at an average cost and savings of $25,000 and $38,750 respectively per participant for a net savings of $13,750 per participant.

5.38 Although the initial costs and savings included in the Estimates were based on 200 participants, the initial voluntary response to the program was much greater. In addition, with consideration of Program Renewal, government was seeking a much larger reduction in the size of the work force. The budget highlights released in April 2005 referred to a figure of 500 employees. We were advised that the annual savings target was $25 million.

Program Costs

5.39 We found that the total cost of the enhanced retirement and severance benefits was $16.7 million and the total number of participants was 869. Of the 869 participants, 608 took retirement, 63 took severance and 198 took the unclassified workforce incentive. The average cost per participant, broken down by program is $23,610 for retirement, $24,188 for severance and $4,511 for the unclassified workforce incentive.

5.40 The participants of the program are members of one of four pension plans. Three of these plans reported an additional liability relating to the Workforce Renewal Program 2005 in the actuarial assessment following the program. For the three pension plans which separately identified the amount related to the Workforce Renewal Program, the additional liability totalled $9.1 million. **Exhibit 5.3** provides a breakdown of these costs.

EXHIBIT 5.3
WORKFORCE RENEWAL PROGRAM 2005
PROGRAM COSTS
($ Millions)

PROGRAM PAYMENTS	PARTICIPANTS	COSTS
Enhanced Retirement	608	$14.3
Voluntary Severance	63	1.5
Unclassified Workforce	198	.9
	869	16.7
ESTIMATED INCREASE IN PENSION LIABILITY		
Civil Service Superannuation Fund		6.5
Teachers Superannuation Fund		1.1
Uniform Pension Plan for Employees of Health and Community Services System		1.5
		9.1
Estimated Costs		$25.8

5.41 Additional program costs were incurred where retirees opted to receive their retirement benefit over a period to bridge the time to age 55 when they can draw a regular pension. These costs include the employer’s share of pension contributions and group insurance benefits.

5.42 In some cases the program created a shortage of staff in work units which had to be filled by contracting, for example in financial services. We are aware that in the health sector, accounting work was contracted to the private sector because a number of qualified staff left the system, under the Workforce Renewal Program. In these cases, as well as where participants subsequently returned to work, additional costs were incurred because the enhanced benefit was paid and costs were also incurred to fill the vacated positions.

Estimated Program Savings

5.43 At the time of our audit there was no final report on the program showing the estimated salary savings achieved. Although budget reductions related to Workforce Renewal were made, there were also new initiatives, restructuring, and budget reductions related to Program Renewal during the same time period. A projected savings was calculated at November 2005 which showed an estimated budget reduction of $21.5 million in 2006-07 based on estimated reductions in positions. The program, however, was not complete in November 2005.

5.44 The estimated budget reduction of $21.5 million included a reduction of $9 million for the health sector salary budgets. We were advised that health sector salary budgets were reduced by $6 million in 2005-06 and an additional $3 million in 2006-07. The Phase II Extension of the program occurred after November 2005 and we were provided with estimated salary savings of $2.8 million in 2006-07 for IT Optimization.

5.45 The projected program savings were based on reductions in positions. Although budget dollars were sequestered when individuals were approved to retire or take severance, some positions were approved for backfilling on a case by case basis.

5.46 We selected one department and examined the budget support for the change in number of positions and the estimated salary savings. Supporting budget information showed an estimated salary savings of $2.3 million for 2006-07, while the document compiled by the Public Service Commission showed an estimated salary savings of $2.8 million for 2006-07.

5.47 We obtained information on the classified full time equivalent positions (FTEs) at March 31, 2005 and at March 31, 2006 from the Public Service Commission and looked at the change in the number of positions. For the classified civil service we received information that 186 classified positions, or 169.3 FTEs, were abolished in May 2006 after fiscal year end. We were advised that positions in the school boards and former health regions did not require Treasury Board approval for their abolishment and most of the reduction in these sectors were reflected in staffing levels by March 31, 2006.

5.48 We requested the total number of new positions created by the Public Service Commission with Treasury Board approval since the Workforce Renewal Program was announced and found a total of 115.88 FTEs were created up to January 2007. Of these, 71.65 FTEs were created after March 31, 2006.

5.49 **Exhibit 5.4** summarizes the change in classified full time equivalent positions for the period March 2005 to January 2007, based on information provided by the Public Service Commission and the Department of Education. This Exhibit does not include information on the PEI Lending Agency and PEI Business Development Inc., which were also part of the program.

EXHIBIT 5.4
WORKFORCE RENEWAL 2005
CHANGE IN CLASSIFIED FULL TIME EQUIVALENT POSITIONS (FTEs)

	FTEs March 31/05	FTEs March 31/06	Change In FTEs	FTEs Abolished May 17/06	FTEs Created	Change in FTEs
Other Civil Service	2,053.1	2,072.3	19.2	(169.3)	50.25	**(99.85)**
School Boards	2,389.7	2,343.8	(45.9)	-	-	**(45.90)**
Health/Social Services	3,580.6	3,383.6	(197.0)	-	21.40	**(175.60)**
	8,023.4	7,799.7	(223.7)	(169.3)	71.65	**(321.35)**

5.50 In addition to the actual reductions of classified FTEs, the Public Service Commission provided information indicating that 64.4 FTEs were reduced in the unclassified workforce.

Recommendation

5.51 The Public Service Commission should prepare a final report on the Workforce Renewal Program including the impact on the size of the public service, the direct costs and estimated savings. The report should be provided to Executive Council.

Reporting on Results

5.52 The Workforce Renewal Program 2005 was approved by Executive Council in March 2005 and the final participants had left their positions by the summer of 2006. The majority of participants retired or left employment between March and August of 2005. The Phase II Extension occurred after this date but involved a much smaller number of people. During this period, Treasury Board and Executive Council were involved in decisions regarding applications under the program, sequestering of budget and release of sequestered funds for backfilling positions. Numerous updates were provided on staffing within various departments.

5.53 The administration of this program was more complex than previous workforce incentive programs for a number of reasons. The number of participants far exceeded previous workforce incentive programs, there were various collective agreements and pension plans involved, and the program duration continued over an extended period.

5.54 We expected a final report to be provided to Executive Council on the overall results of the program. In addition, given the magnitude of the program and the extensive impact on the public sector workforce we expected information to be included in the Annual Report of the Public Service Commission which would be provided to the Legislative Assembly. At the time of our audit, the 2006 Annual Report of the Public Service Commission was not available. It is important for decision makers to have information available which compares the original goals of the program to the actual results achieved.

Recommendation

5.55 The Annual Report of the Public Service Commission should include information on the Workforce Renewal Program showing the program objectives and the results achieved.

WORKFORCE ADJUSTMENT PROGRAM 2002

5.56 In response to budget constraints a Workforce Adjustment Program was developed in 2002 with the objective of reducing the civil service by up to 200 full time equivalent positions. The Public Service Commission indicated at that time that there were approximately 2,100 permanent employees and 2,000 casual employees (at peak season) employed under the Civil Service Act. The civil service under this program, did not include most Crown corporations, the health regions or the school boards but included all government departments and some selected entities.

5.57 The key components of the program as recommended by Treasury Board and approved by Executive Council included the following:

- an enhanced retirement benefit package;
- an abolished position to result from each approved retirement;
- a voluntary reduction in hours of work;
- an examination of the casual/seasonal workforce for possible savings; and
- a program service review to facilitate further reductions if possible.

DETAILED AUDIT OBSERVATIONS

Early Retirement Participants

5.58 To be eligible for the early retirement portion of the program the employee had to be a permanent employee of the civil service, at least 53 years of age and had to have a vested pension contribution in the Civil Service Superannuation Plan. The eligible employees that intended to participate were required to notify the applicable Deputy Minister by March 15, 2002 and retire by March 31, 2002. However, a number of extensions to the retirement date were granted based on work load issues. Each eligible retiree was entitled to receive regular retirement pay equal to one week per year of service to a maximum of 26 weeks plus enhanced retirement pay equal to 26 weeks salary regardless of years of service.

5.59 We tested a sample of files for program participants to determine if the employees who were approved for retirement met the eligibility requirements and the amounts were appropriately calculated. Retirees under the program received regular retirement pay and enhanced retirement pay in accordance with the program. However, for part time employees the enhanced retirement pay was not prorated as required by the program and there was no documented approval for the program change.

Recommendation

5.60 Revisions to the terms and conditions of an early retirement program should be authorized at the level at which the original program was approved.

Voluntary Reduction of Hours

5.61 The Workforce Adjustment Program had a component that allowed employees to voluntarily reduce their hours of work. For a specified time period, employees could reduce the number of hours worked or go on full leave without pay.

5.62 An employee requesting reduced hours would be approved provided operational requirements permitted because under the program the position could not be backfilled. There were 47 employees who were approved for full leave without pay under the Workforce Adjustment Program. Under this aspect of the program the employer was required to continue to pay the employer's share of benefits not including pension contributions during the period of absence. We determined that employees who took the leave without pay option received benefits in accordance with the program.

Return to Work

5.63 Where employees, who opted to retire under this program, subsequently returned to work as an employee or under a professional services contract, the Department was required to seek approval of Treasury Board. In addition, there was a requirement that if employment was approved, employees would be required to refund program benefits on a pro rata basis depending on the length of time since retirement.

5.64 The return of retirees to work was not tracked by the Public Service Commission or Treasury Board, therefore, we could not review information on all employees that returned to work to determine if the program requirements were met.

Recommendation

5.65 To ensure all program requirements are adhered to, a process should be in place for the Public Service Commission to identify all retirees who return to the civil service after receiving retirement benefits under an early retirement program.

Program Results

5.66 The overall objective of the program as stated in the approved program documents was "to assist government in meeting its corporate objectives through a reduction in the size of the civil service." The Workforce Adjustment Program was approved with the intention of reducing the workforce by up to 200 full-time equivalent positions. The documents submitted to Executive Council in support of the program indicated estimated net savings in the range of $1.6 million to $3.3 million based on 100 to 200 employees taking the early retirement offer. This was calculated based on an estimated average salary of $38,000 which would be saved going forward with the abolishment of an offsetting position for each person who accepted retirement. From this amount the additional cost of the enhanced retirement pay was deducted to arrive at a net savings.

5.67 To review the program goal of reducing the size of the civil service we looked for information summarizing full-time equivalent positions. Information on full-time equivalent positions was not available from the Public Service Commission for 2002 and 2003. A computerized management information system is used to record basic employment information, but reports are not produced and maintained on an annual basis. We did, however, obtain information on the size of the civil service including both classified and casual positions. This information is presented in **Exhibit 5.5**, and shows that the total number of approved positions in the civil service increased by 161 positions between 2002 and 2003, the first year the program was in effect.

EXHIBIT 5.5
SUMMARY OF CIVIL SERVICE ESTABLISHMENT

	Classified (vacant & filled)	Casual	Executive	Total
2002 Positions (March 31, 2002)	2,432	662	19	3,113
Less: 2002 Abolished - unfunded	(61.5)	-	-	(61.5)
Less: 2002 Abolished - funded	(71.5)	-	-	(71.5)
2002 Positions after abolishments	2,299	662	19	2,980
2003 Positions (March 31, 2003)	2,267	855	19	3,141
Increase (Decrease)	(32)	193	-	161

Source: Public Service Commission Annual Reports

5.68 The Program was approved with the expectation that each retirement would result in an offsetting abolished position. A total of 138 people took early retirement but only 68.83 funded full-time equivalent positions were abolished. Treasury Board approved the abolishment of 123.94 full time equivalent positions, however, 55.11 of these positions were unfunded. In other words, there was no budget approved to allow departments to fill these positions and, therefore, their abolishment did not contribute to any cost savings under workforce adjustment.

5.69 We found that the early retirement aspect of the program did not result in savings as predicted but resulted in a net cost of $54,000 in year one. This net cost of $54,000 is based on the salary savings for funded abolished positions less the enhanced retirement benefits paid out. There was no subsequent report prepared on salary savings that may have been achieved in later years.

5.70 In the initial approval of the program it was indicated that the unfunded liability of the civil service pension plan was estimated to increase by $2.3 million. We were advised that this was based on discussions with the actuary. An actuarial calculation of the unfunded pension liability was completed as of April 1, 2002, however, it did not identify the increase as a result of the 2002 Workforce Adjustment Program.

5.71 Another component of the program not specifically related to retirement was the option to voluntarily reduce the number of hours worked, including leave of absence for a specified time period. The initial approval of the program did not include an estimate of salary savings. The actual savings achieved totalled approximately $980,000.

Recommendation

5.72 The Public Service Commission should maintain a record of the full-time equivalent positions at each fiscal year end.

Reporting on Results

5.73 The Workforce Adjustment Program was approved by Executive Council with a specific objective and within a defined period. We expected a report to be provided to Executive Council on the results achieved by the program compared to the original program goals.

5.74 There was no final report provided to Treasury Board or Executive Council on the results achieved by the program. An update on the program was prepared and provided to Treasury Board in October 2002 which cited a savings of $2.9 million resulting from the program. This $2.9 million was based on the salaries and benefits related to the funded positions that were abolished at that time. This figure did not include the cost of the additional retirement benefits paid out under the program nor did it include the cost savings achieved from voluntary reduction of hours and voluntary leave of absence. The information provided indicated the total number of positions abolished as a result of the program but it didn't provide information on the total size of the civil service.

5.75 **Exhibit 5.6** summarizes our calculations of the direct costs and savings resulting from the program. It does not include any increase in the unfunded liability of the pension plan.

EXHIBIT 5.6
WORKFORCE ADJUSTMENT PROGRAM 2002
FINANCIAL SUMMARY
($000)

	Costs	Savings	Total
Enhanced Retirement (138 Participants)			
• abolished positions		$2,870	$ 2,870
• enhanced retirement pay	$(2,924)		(2,924)
			(54)
Voluntary Reduction in Hours (18 Participants)			
• reduced salaries		169	169
• pension benefit top up	(10)		(10)
			159
Voluntary Leave of Absence (47 Participants)			
• reduced salaries		817	817
			817
Total Net Savings	$(2,934)	$3,856	$ 922

Recommendation

5.76 When a program is established by government with a defined duration and objective, a report should be provided to Executive Council at the conclusion of the program comparing the goals and results achieved.

MANAGEMENT RESPONSE

5.77 Our reports on the Workforce Adjustment Program 2002 and the Workforce Renewal Program 2005 were discussed with the Public Service Commission. A written response will be provided.

6. PEI BUSINESS DEVELOPMENT INC. - LENDING ACTIVITIES

BACKGROUND

6.1 PEI Business Development Inc (BDI), a Crown corporation, is the primary organization charged with carrying out economic development activities on behalf of the Province. It fulfills its mandate through offering a variety of programs covering a range of services from client advice to financial assistance including loans, guarantees, grants, and tax rebates.

6.2 At March 31, 2006, the Province had net loans receivable outstanding of $204 million. At that date the net loans outstanding at BDI were $42 million or 21 percent of the total provincial loans receivable.

6.3 The lending portfolio at BDI has increased dramatically in recent years. **Exhibit 6.1** shows the loans receivable at BDI since 2002, broken down by industry sector. Although BDI's portfolio is $42 million, 83 percent of the total dollars outstanding are receivable from two major clients.

EXHIBIT 6.1
BDI LOANS RECEIVABLE
($000)

	Year Ended March 31				
	2006	2005	2004	2003	2002
Working capital and craft loans	$ 9,743	$ 2,884	$ 7,712	$2,454	$2,456
Shipbuilding	21,600	-	-	-	-
Manufacturing/processing	14,991	34,087	18,827	1,012	6,438
Tourism	113	45	300	400	700
Small business	2,012	2,306	2,487	284	401
Technology	4	14	20	29	101
Other	181	134	173	211	262
	48,644	39,470	29,519	4,390	10,358
Less: Allowance for Possible Losses	(6,277)	(3,333)	(2,157)	(945)	(4,819)
Net Loans Receivable	**$42,367**	**$36,137**	**$27,362**	**$3,445**	**$5,539**

6.4 Loan guarantees for the Province amounted to $157 million at March 31, 2006. Of this, $9.4 million or six percent were loan guarantees provided by BDI. In addition a $13.4 million guarantee for a lease was provided to a landlord for a private sector tenant. **Exhibit 6.2** shows guarantees provided by BDI since 2003.

EXHIBIT 6.2
BDI GUARANTEES
FOR THE YEARS ENDED MARCH 31
($000)

	2006	2005	2004	2003
Loan Guarantees	$ 8,305	$10,720	$12,077	$7,385
Entrepreneur Loan Program Guarantees	1,120	1,327	1,681	1,634
Lease Indemnification	13,393	12,633	-	-
Total Guarantees	22,818	24,680	13,758	9,019
Allowance for Possible Losses	(1,459)	(1,565)	(1,665)	(1,765)
Net Guarantees	$21,359	$23,115	$12,093	$7,254

OBJECTIVES AND SCOPE

6.5 In accordance with Section 13 of the Audit Act, we conducted an examination of the lending activities at PEI Business Development Inc. Our objective was to assess the management practices used in providing financing through BDI for both loans and loan guarantees. We looked for sufficient project assessments, appropriate authorization, adequate monitoring, and collection action when necessary. In addition, we looked for overall portfolio performance to be monitored and information reported at various levels.

6.6 We interviewed managers responsible for planning and providing lending activities through BDI. We tested a sample of loans and loan guarantees outstanding at March 31, 2006. Although we did not audit the loans outstanding at Island Investment Development Inc. (IIDI), we reviewed the instances of intercompany loans provided by IIDI to BDI.

6.7 Our examination was conducted in accordance with the standards for assurance engagements encompassing value for money, established by the Canadian Institute of Chartered Accountants and accordingly included such tests and other procedures as we considered necessary in the circumstances.

DETAILED AUDIT OBSERVATIONS

Lending Activity

6.8 The loan portfolio of BDI has grown significantly in recent years. In addition BDI lending officers also manage the IIDI loan portfolio. Island Investment Development Inc. is a Crown corporation separate from BDI which receives immigrant investor funds through several programs. At March 31, 2006, IIDI had loans receivable of $57.6 million of which $34.2 million was receivable from BDI and its subsidiaries. As well, the PEI Lending Agency is the Province's primary lender with a portfolio of $129 million at March 31, 2006. Although the Lending Agency and BDI both provide loan financing, they are intended to provide different types of loans to different target sectors.

6.9 We were advised that BDI is a developmental lender for high risk situations where there is economic development potential. Many of the clients we reviewed met this criteria and in some instances clients were referred to BDI from PEI Lending Agency after refusal.

6.10 We expected the Lending Division at BDI to have approved policies in place addressing key aspects of lending that would be consistent with normal lending practice within the industry and revised to address the type of client, level of risk, and industry sectors which would be typical for BDI. A draft policy manual was developed in 2003 and has not been approved. We were informed in 2004 when we were updated on previous recommendations, that loan policies had been approved. When we commenced our audit the policies were still in draft, and some sections of the policy manual were not being followed.

6.11 There is no approved format for a project assessment, however, each file includes background information on the financing request. For larger loans this assessment was comprehensive and normally included a detailed assessment of the industry, economic factors, historic financial performance of the client, and projected financial results laid out in a submission to Treasury Board and Executive Council. For smaller clients the extent of the project assessment was not consistent.

6.12 PEI Business Development Inc. is the primary economic development organization within the Province. We expected the assessment of financing applications to include a consideration of the projected economic development impacts. We were advised that BDI has several models in place for projecting the impacts of job creation over a period of years into the future. A key consideration in providing financing is the economic development potential of the project.

6.13 We noted that a risk rating system was included in the draft policy manual but was never implemented. A risk rating process would include consideration of all factors in the project assessment and an assignment of a rating based on an assessment of the risk of the project and the security in place under the letter of offer. For example, if a loan has little or no security it may require approval at a higher level of authority. Loans of a certain risk rating may have a template of expected monitoring for example, monthly financial information rather than annual. A risk rating system provides support for variations in interest rates on term loans. We noted that interest rates on the term loans we reviewed varied from 4.5 percent to 12 percent. The recommendation for a risk rating process to be implemented was also made by the external financial auditors of BDI.

6.14 We reviewed the authorization levels in place for loan approvals. We found a separate Lending Board was established in 2001 made up of senior civil servants at the Deputy Minister level. This Lending Board reviews loan recommendations as presented by the lending officers and provides approvals. In 2003, BDI provided its loan authorization policy to Treasury Board. Under the policy the Director can approve loans up to $25,000, the CEO up to $250,000 and the Deputy Minister of Development up to $500,000. Anything over $500,000 must be approved by the Lending Board and over $1 million by Treasury Board.

6.15 In 2005, the Regulations to the PEI Business Development Inc. Act were amended to require the approval of the Lieutenant Governor in Council for the advance of a loan or a loan guarantee to a person if the total indebtedness of that person to the Corporation including the guarantees exceeds $2.5 million in the aggregate. Amounts which bring the total indebtedness to between $1 million to $2.5 million may be approved by Treasury Board. Amounts which bring the indebtedness up to $1 million may be approved by the Board, which is defined in the Act as the Board of Directors of the Corporation. We noted, however, that the Board of Directors of the Corporation does not review or approve loans. We were advised by BDI that when the Regulations were established it was the intention that the authorization levels would apply to the Lending Board and not the Board of Directors of the Corporation. However, the way the Regulations are currently written, the Lending Board does not have authority under the Regulations.

6.16 We were advised by management that the Board of Directors of BDI directs policy and the Lending Board functions as a decision making body for the Lending Division. We noted that the Board of Directors does not have an audit committee in place. Given the magnitude of the operations of the Corporation, the need to monitor risk management practices, and considering the growth in the lending portfolio, an audit committee is necessary to provide oversight for the financial management of the Corporation. The external financial auditors of BDI have also recommended the establishment of an audit committee of the Board.

Recommendations

6.17 The draft policy manual for lending activities should be revised where necessary and approved.

6.18 PEI Business Development Inc. should develop and implement a risk rating process to be used on its loan portfolio.

6.19 The decision making authority of the Lending Board within BDI should be clarified under the PEI Business Development Inc. Act Regulations.

6.20 An audit committee should be established for BDI.

6.21 We expected loan files to contain information to demonstrate a review of the proposed management team, the applicant's financial commitment, projected earnings of the project, security, projected economic benefits as well as a risk assessment. We looked for the loan to be authorized in accordance with the Lending Board Policy and Regulations to the BDI Act. In addition we looked for terms and conditions set out in the letter of offer to be monitored and the loan to be reviewed in accordance with the level of risk, but at a minimum, on an annual basis.

6.22 We selected a sample of clients with loans outstanding at March 31, 2006. Many of these had numerous loans with BDI in recent years. For each of these clients we reviewed the recent lending activity with that client.

6.23 Standard practice requires a letter of offer to be drawn up for each loan provided. A letter of offer is a contract with the client setting out the terms and conditions of the financing including for example, interest rate, repayment dates, security required and extent of financial reporting required. We noted some loans where there was no letter of offer signed by the client indicating acceptance of the terms and conditions of the loan. In most cases promissory notes were obtained when the funds were disbursed. However, these do not provide agreement between BDI and the borrower on all the conditions attached to the loan such as financial reporting, other security, and monitoring requirements.

Recommendation

6.24 For each loan a letter of offer should be in place setting out the terms and conditions of the financing as agreed to by the client.

Disbursement of Funds

6.25 For each of the loans in our sample we reviewed the disbursements of the loan proceeds. We found several cases where we had concerns about the cash disbursements. In some of these cases the cash was disbursed to the client prior to acceptance of the letter of offer. In other cases, the letter of offer was in place but the required security or contingent conditions specified in the letter of offer were not in place prior to disbursement, and for one no security was taken. In another instance, funds were not disbursed in accordance with the requirements set out in the letter of offer.

Shipbuilding Facility

6.26 One client that operates a shipbuilding facility approached government seeking financing arrangements that would allow the facility to continue full operations and, therefore, maintain jobs in a rural area. A loan was provided by BDI in the amount of $21.6 million to a company related to the shipbuilding facility to purchase three tugs to be constructed at the shipbuilding facility.

6.27 The terms and conditions of the letter of offer stated that the loan would be drawn down based on achievement of agreed milestones to a maximum of $7.2 million per vessel. The security was promissory notes for the amount of the loan proceeds advanced from time to time and a first fixed security by way of a marine mortgage in respect of each vessel. We found that the promissory notes were issued for the total amount of $21.6 million but the breakdown by vessel was $8.8M, $8.1M and $4.7M.

6.28 The total loan exposure by the Province to the shipbuilding industry is substantial. Loans have been made to several clients by BDI as well as IIDI. The loans include direct financing of vessels, financing of production of vessels at the shipyard, and top-up financing provided to clients of the shipyard to assist them to purchase vessels with IIDI sharing the risk of loss on the loan with the shipyard. PEI Business Development Inc. prepared a schedule of the total approved loan exposure as of August 2006 which is summarized in **Exhibit 6.3**.

EXHIBIT 6.3
SHIPBUILDING LOAN ACTIVITY
APPROVED FINANCING AS OF AUGUST 2006
(Millions)

Borrower	Approved BDI	Approved IIDI	Total Approved Loan Exposure
Shipbuilding Facility			
line of credit	$ 4.0	$ -	$ 4.0
top-up loan for customer 2003	-	4.1	4.1
top-up loan for customer 2004	-	3.8	3.8
top-up loan for customer 2004	-	1.9	1.9
	4.0	9.8	13.8
Related Company			
financing of vessels	21.6	-	21.6
Customer of Shipbuilding Facility			
top-up loan 2006	-	3.6	3.6
	$25.6	$13.4	$39.0

Source: PEI Business Development Inc.

Harness Racing Loans

6.29 In 2004, Executive Council approved Atlantic Lottery Corporation's (ALC) business plan whereby ALC would make a $25 million investment in gaming and racing infrastructure at the race park in Charlottetown and a $14 million investment at the race park in Summerside.

6.30 As a result of these investments, the business plan projected profits after expenses of $5.3 million in Charlottetown and $1.3 million in Summerside. For the years ended March 31, 2006 and 2007, the government did not budget for the financial assistance it had historically given the harness racing industry. Information on file indicated the intention was to double the race purses which would become self-funded through gaming revenues instead of being subsidized by government.

6.31 In June 2005, BDI was authorized to provide a term loan of $2 million to an external not-for-profit organization which would then disburse the cash to the Charlottetown and Summerside race parks for 2005 race purses. These funds were to be temporary in nature until such time as the gaming profits were realized later that year. The gaming funds would then be used to pay back the loan to BDI. BDI provided the loan under these conditions and obtained written confirmation that funds from the gaming operations would be used to pay down the debt. We noted that $500,000 of the $2 million was disbursed prior to the borrower accepting the terms and conditions of the letter of offer and a further $250,000 was disbursed prior to any security being in place.

6.32 The Atlantic Lottery Corporation opened the entertainment centre in Charlottetown in August 2005, and reported a net loss of $2.4 million for the fiscal year ended March 31, 2006. This net loss was allocated to the Province through the PEI Lotteries Commission. Since the anticipated profits did not materialize, there were no funds with which to pay back BDI's loan. In June 2006, Executive Council authorized the Lotteries Commission to use its allocated revenue from ALC to pay back BDI's loan plus accrued interest. Although the Lotteries Commission did not pay out its usual grant to the harness racing industry which had been funded at $934,000 in 2003-04 and 2004-05, it did end up absorbing the entertainment centre's net loss of $2.4 million and paying back BDI's loan of $2.1 million, including accrued interest.

6.33 In June 2006, Executive Council authorized BDI to make another loan, $2.1 million to the same not-for-profit organization for 2006 race purses. Instead a loan was provided by IIDI to the Lotteries Commission. PEI Business Development Inc. did not have documented approval from Executive Council for this change. Before it was decided that IIDI would provide the loan, BDI had advanced $450,000 to the not-for-profit entity without a letter of offer or security in place. The $450,000 was repaid by IIDI when it provided the financing.

Recommendations

6.34 A letter of offer should be issued and signed by the client before disbursement of the loan proceeds.

6.35 Security and contingent conditions should be satisfied prior to the disbursement of loan proceeds.

6.36 PEI Business Development Inc. should ensure that the draw down of funds as outlined in the terms and conditions in the letter of offer are followed.

6.37 Significant changes to loans should be approved at the same level of authority as the original loan.

Loan Collections

6.38 We looked for BDI to have a systematic approach to collection procedures with documentation on file to support the collection efforts including any decisions regarding legal action, extension of due dates, and write-offs. We reviewed a sample of files which were reported as impaired loans by BDI.

6.39 We were advised that there is no approved collection process but rather collections are managed on a case by case basis. For the files we examined, there was evidence in the file of ongoing monitoring, and action was taken where necessary to realize on the security.

6.40 The Treasury Board policy on Loans and Guarantees requires that a Central Default Registry be maintained containing information on clients where the debt is written off or otherwise deemed uncollectible. For the loans written off in the last five years, three of the clients were not added to the Central Default Registry and had not otherwise satisfied the default.

Recommendation

6.41 In accordance with Treasury Board policy, where a client is in default to government, they should be added to the Central Default Registry.

Guarantees

6.42 At March 31, 2006 BDI had loan guarantees outstanding of \$9.4 million of which \$1.1 million related to guarantees under the Entrepreneur Loan Program and \$8.3 million related to other loan guarantees. In addition, BDI had guaranteed lease payments to a landlord on behalf of a private company which at March 31, 2006 was valued at \$13.4 million.

6.43 We examined a sample of loan guarantees provided by BDI. For each guarantee we looked for a project evaluation in support of the decision, appropriate approval, security in place, and monitoring of terms and conditions as required by the letter of offer.

6.44 For the guarantees we reviewed we found that the authorization was made at the appropriate level. However, in one case a loan guarantee was approved for \$1.7 million for a crab fisherman to obtain a fishing boat and license which would increase the product available for processing on PEI. The approval by Executive Council was conditional on all product being processed on PEI. This condition was not included in the letter of offer or the guarantee agreement, and there was no further documented approval from Executive Council to alter this condition of approval.

6.45 We reviewed the monitoring carried out for loan guarantees in accordance with the terms and conditions set out in the letter of offer. In one case we found a restriction had been put in place that the owner could not receive more than $70,000 per year from the company while the guarantee was in place but the financial information obtained by lending officers did not provide sufficient detail to determine if the owner was abiding by this condition.

6.46 In another case, a loan guarantee of $2.9 million required the owners to each contribute equity of $1,000 per year. This condition is not being followed. Lending officers at BDI are aware and plan to address it when the guarantee comes up for renewal.

6.47 Treasury Board policy requires that an administration fee of one percent per annum be charged for all loan guarantees provided by the Department of Provincial Treasury. The draft policy manual of BDI states that a minimum guarantee administration fee of one percent per annum be charged. We noted a wide variation in the fees charged ranging from fees being waived to 2.50 percent per annum. A risk rating system would assist in providing support for the variation in fees charged.

6.48 PEI Business Development Inc. has provided guarantees on preferred share investments made by other government agencies in the amount of $695,000. The Corporation was asked to provide these guarantees because preferred share investments are high risk and there is no security taken. By providing these guarantees the risk is being transferred from one government organization to another but this does not enhance the security of the investment overall.

Beef Processing Plant

6.49 As indicated, BDI guaranteed lease payments to a landlord valued at $13.4 million. We reviewed the extent of financing between BDI and this client. In 2003, the Province decided to partner with Maritime beef producers and a grocery cooperative to build a beef processing plant on PEI. Two processing plants in the Maritimes had ceased to process beef in 2002 and 2003.

6.50 The ownership and original investment in the facility was established as follows:

Common Shareholders:	
Producers Cooperative	$1,550,000
Grocery Cooperative	510,000
Preferred Shareholders:	
Province (BDI)	1,480,000
Total share capital	$3,540,000

6.51 Of the $1,550,000 invested by the beef producers, $420,000 came from BDI in the form of a preferred share investment in the producers cooperative. Taking into account the $420,000, the Province contributed just over 50 percent of the required cash for the initial investment.

6.52 Construction of the plant began in November 2003 and it opened in January 2005. A private company constructed the plant, purchased most of the equipment, and leased it back to the entity at an annual lease payment of $1.3 million per year. These annual lease payments were guaranteed by BDI for the 20 year term of the lease.

6.53 From the beginning, the processing plant was confronted with several obstacles. The BSE crisis coupled with construction cost over-runs and start-up operational problems have contributed to the plant's current situation, which is one of persistent negative cash flows.

6.54 The original business plan developed in 2002-03 included forecasted capital costs and working capital requirements. The actual cost to build and equip the plant amounted to $16.5 million, $5.5 million above what had been budgeted. A waste treatment facility was built at a cost of $4.75 million, $1.75 million over budget, and finally, working capital requirements amounted to just over $13 million whereas the original budget had estimated a need of $5 million.

6.55 The Province has funded the majority of these cost overruns and continued operating losses through various loans, grants, and a second injection of equity in the form of preferred shares. The Federal government has contributed funds to assist with capital costs. A summary of funding sourced through the Province is provided in **Exhibit 6.4**.

EXHIBIT 6.4
BEEF PROCESSING PLANT
PROVINCIAL INVOLVEMENT
AS OF JANUARY 3, 2007
(Millions)

	Province
Capital Costs:	
Waste Treatment Grant	$ 3.0
Equipment Grant	1.0
Traceability Equipment	-
Share Investment:	
Start-up	1.9
Second Equity Injection 2006	3.0
Working Capital:	
Loans	6.0
Grant	.6
Guarantees:	
20 year lease	13.4
Total	**$28.9**
Percentage of total financing	*85%*

6.56 As reported in **Exhibit 6.4**, there was a second injection of equity in February 2006. Both BDI and the beef producers contributed $1.5 million. However, the PEI Lending Agency loaned the beef producers cooperative $1.5 million for their investment.

6.57 As of January 3, 2007 the Province has contributed 85 percent of the total financing of this project, and the Federal government has contributed 10 percent. The security on BDI's advances is limited to a first charge on accounts receivable, inventory, and the traceability equipment and any equity in the land, building and other equipment if it is required to honour its guarantee.

6.58 The Province continues to seek financial support from other Maritime provinces and from the Federal Government. Consultants reviewed the plant's operations in late 2006, and developed a strategy to achieve a gross margin in line with industry norms. We were advised that the Board of Directors of the processing facility and plant management are implementing the recommendations from that report.

Recommendations

6.59 Conditions established by Executive Council should be included in the letter of offer for the guarantee.

6.60 Sufficient information should be obtained by lending officers to monitor compliance with terms and conditions of the guarantee.

Intercompany Loans

6.61 Island Investment Development Inc. is a separate Crown corporation established under an act of the Legislative Assembly. Island Investment Development Inc. administers venture capital funds received under various immigration programs and invests in active business operations directly or through BDI. The portfolio at IIDI is managed by the lending officers at BDI.

6.62 At March 31, 2006 IIDI had total notes receivable outstanding of $45 million of which $20.3 million was receivable from BDI. An additional $1.3 million was receivable through subsidiaries of BDI. In addition, IIDI had a demand loan receivable of $12.6 million from BDI for a total of $34.2 million receivable from BDI and its subsidiaries.

6.63 One of the loans outstanding at March 31, 2006 from IIDI to BDI was loaned by BDI to a company in the process of expanding their manufacturing plant. The client requested additional financing for a further plant expansion and Executive Council approved a loan of

$23.75 million through IIDI. The amount of $13.75 million was to pay out the existing loan to BDI, which BDI had sourced from IIDI, and an additional $10 million was to finance the expansion. During negotiations on the terms and conditions of the loan, management at BDI tried to obtain additional security by way of an assignment of intercompany receivables but the client would not agree. The security obtained was a first charge on the land and buildings, a first charge on the new equipment and a second charge on existing equipment. Notes on the file indicate there was a shortfall on the security of $12 million but because of other factors, including the strong financial performance of the client, the loan was approved.

6.64 Immigrant investor funds are received by IIDI through a subsidiary, the PEI Century 2000 Fund. This Fund receives allocations through Citizenship and Immigration Canada's (CIC) Immigrant Investor Program. This program was redesigned a number of years ago with the objective of eliminating some of the complicated rules governing the use of investors' funds. In 2005, CIC provided some guidance to the provinces on what would be considered acceptable use of these funds. This document indicates that providing the funds to another Provincial organization for subsequent private sector investment is not consistent with the program.

6.65 We were advised by management at BDI that when they became aware of this guidance they stopped any further direct transfer of funds to provincial organizations including BDI. We noted, however, that a loan was approved to the Lotteries Commission from IIDI in July 2006 for funding of the 2006 race purses. In addition, at the same date a loan was approved to BDI for funding of a building to be leased to a private sector company.

6.66 In addition to the term loans which were advanced subsequent to the guidance, IIDI had also advanced a revolving line of credit to BDI to a maximum of $15 million with the balance at March 31, 2006 of $12.6 million. We were advised that these funds were not sourced from the Century 2000 Fund but rather from good faith and language proficiency deposits made to IIDI under the Provincial Nominee Program. We found that these deposits of $25,000 and $20,000 for each immigrant nominee were made "in trust" to the Province under the terms of the deposit agreement as provided by IIDI to the immigrants and signed by them. The agreements do not indicate how the deposits are to be invested. We noted that these funds are deposited in a separate account, which provides further evidence that a trust arrangement has been created. We acknowledge that BDI intends to return investors' deposits as agreed if all conditions are met. However, it would be prudent for BDI, IIDI and the Province to provide more clarity in the arrangements with immigrant nominees.

Recommendations

6.67 In accordance with guidance provided by Citizenship and Immigration Canada, funds should not be advanced to provincial organizations from the PEI Century 2000 Fund Inc. to be used for private sector investment.

6.68 PEI Business Development Inc., IIDI and the Province should clarify the financial arrangements with immigrant nominees regarding good faith deposits and language proficiency deposits.

MANAGEMENT RESPONSE

6.69 Our report was discussed with management and a written response will be provided.

FINANCIAL STATEMENT AUDITS

7. INTRODUCTION TO FINANCIAL STATEMENT AUDITS

INTRODUCTION

7.1 Section 13 of the Audit Act establishes the Auditor General's mandate to perform financial audits of the Public Accounts, Crown controlled or owned corporations, and the trusts and funds held by any agency of government insofar as they are not subject to financial audit by an external auditor.

7.2 Financial statements are management's responsibility and reflect management's assertions. They provide information that is used to make important economic decisions. It is imperative that the reader has confidence in the quality of that information.

7.3 The auditor is independent of management and can objectively assess the accounting principles used and the estimates and other decisions made by management as reflected in the financial statements. An examination of the entity's accounts is carried out in accordance with generally accepted auditing standards. These standards have been established over time and continue to evolve with the changing economic environment. The result of the examination is the auditor's opinion as issued in the Auditor's Report.

7.4 In addition to issuing an Auditor's Report on the financial statements, the auditor may also identify problems in the financial controls and accounting records. In these cases, findings and recommendations are reported in a management letter addressed to the department or agency.

7.5 For the majority of the financial statement audits we performed, management letters were issued. We brought to management's attention any problems noted during the audits and made recommendations for improvements. These recommendations are at various stages of implementation.

7.6 In the following sections we provide summary information on our audits of the Public Accounts and Appropriations.

8. PUBLIC ACCOUNTS

BACKGROUND

8.1 The Public Accounts include the annual financial statements of government and are the primary source of information on government's stewardship of public funds both to Islanders and to the Legislative Assembly.

8.2 The Public Accounts are prepared by the Comptroller and tabled by the Provincial Treasurer as required by the Financial Administration Act. According to the Act, the Public Accounts must contain the Financial Statements of the Operating Fund and the Consolidated Financial Statements of the Province, along with any other statement required by Act to be presented. The Consolidated Financial Statements provide the most complete information about the operating results and financial position of the Province as they consolidate the accounts of the Operating Fund with those of the Crown corporations and agencies.

8.3 The Public Accounts for the year ended March 31, 2006 consist of two volumes:

- Volume I contains the consolidated audited financial statements.

- Volume II contains the audited financial statements of the Operating Fund, Crown corporations and agencies.

OBJECTIVES AND SCOPE

8.4 In accordance with the Audit Act, we performed an audit of the Public Accounts of the Province for the year ended March 31, 2006. The objective of our audit was to express an opinion on the financial position and operating results of Government. Our audit reports on the Consolidated Financial Statements and the Operating Fund Financial Statements for the year ended March 31, 2006 did not contain any qualifications or reservations.

8.5 Under Section 17 of the Audit Act, the Auditor General is not required to audit or report on the accounts of any agency of government where another auditor has been designated to audit its accounts. In these instances, the Auditor General relies on the Auditor's Report for each of these entities when performing the audit of the Public Accounts.

8.6 This report contains comments and observations arising from our audit of the Public Accounts for the fiscal year ended March 31, 2006.

FINANCIAL HIGHLIGHTS

8.7 The following schedule provides a summary of the consolidated results for the last three years.

	Year Ended March 31 (Millions)		
	2006	**2005**	**2004**
Provincial Revenue	$ 725.5	$ 672.6	$ 634.5
Federal Revenue	444.4	443.5	386.9
	1,169.9	1,116.1	1,021.4
Expense	1,169.2	1,149.7	1,146.5
Annual Surplus (Deficit)	$ .7	$ (33.6)	$(125.1)

DETAILED AUDIT OBSERVATIONS

Financial Statement Presentation

8.8 The Consolidated Financial Statements provide a complete picture of Government operations by including the activities of Crown corporations and government agencies. Volume I of the Public Accounts contains the audited Consolidated Financial Statements. To avoid confusion and to ensure the Consolidated Financial Statements receive their proper attention, audited statements of the Operating Fund have been included in Volume II of the Public Accounts.

Outstanding Debentures and Related Accounts

8.9 The largest single liability on the Province's financial statements is its outstanding debentures, which account for $1.37 billion of the Province's $1.96 billion liabilities. All of these debentures have been issued in Canadian dollars. The outstanding debentures can be broken down into public issues of $1.23 billion and Canada Pension Plan issues of $140 million. The public issues have a sinking fund requirement. The Canada Pension Plan issues are for a 20 year period and do not contain sinking fund requirements.

8.10 The Province issued $100 million in public debentures in September, 2005. These debentures carry an interest rate of 4.65 percent and will mature in November 2037. The contributions to the sinking fund for these issues are 1.25 percent per annum.

8.11 At March 31, 2006, the Sinking Fund for debentures held net assets of $265.9 million.

8.12 In 2005-06, in addition to regular required contributions, a special contribution of $48.7 million, was made to the Sinking Fund from the Province's Operating Fund.

PEI Master Trust

8.13 Investments of the Civil Service Superannuation, Teachers' Superannuation and MLA Pension Funds are consolidated into the Province of PEI Master Trust. Individual funds receive units in the Master Trust based on the net contributions and allocated shares of income and expense. The investments are managed by investment managers external to government and an external custodian is responsible for accounting and record keeping. An Investment Advisory Committee, with representation from government and plan members, provides assistance to Provincial Treasury with the investment of the fund assets. The Fiscal Management Division of Provincial Treasury is responsible for overseeing the Master Trust.

8.14 A revised policy framework for investment of fund assets was developed and approved by Executive Council in September 2006. The revised policy retains asset mix targets of a 65/35 split between equities and fixed income investments and a target of 40 percent investment in non-Canadian equities. The revised policy expands the range of acceptable investments to include investment vehicles such as units of income and real estate investment trusts, foreign debt issues traded on a recognized exchange and mortgage backed securities.

8.15 At March 31, 2006, the pension fund assets as reported by the custodian were $930 million. The following table provides a breakdown of the Master Trust investments as of March 31, 2006 with comparative information at March 31, 2005. The balance includes amounts invested with the investment managers and amounts held in individual accounts of the participants.

PEI MASTER TRUST
INVESTMENTS
(Millions)

	Year Ended March 31	
	2006	**2005**
Accrued income	$ 4	$ 4
Short term investments	36	16
Canadian bonds, debentures and notes	298	274
Canadian equity securities	338	313
Foreign equity securities	252	219
Canadian real estate	2	5
	$930	$831

8.16 The investments include amounts which Master Trust fund managers have invested in their own pooled funds. The March 31, 2006 market values of pooled fund investments total $250 million.

8.17 The market value of the pension plan assets held by the Master Trust was $930 million at March 31, 2006 compared to a market value of $831 million at March 31, 2005. The following table illustrates the components giving rise to the change in assets as well as the rate of return on trust assets.

PEI MASTER TRUST
CHANGE IN TRUST ASSETS
(Millions)

	Year Ended March 31	
	2006	**2005**
Special contributions by Government	$ 19	$ 18
Interest and dividends	27	25
Market value gains(losses)	85	22
Plan withdrawals and expenses less contributions	(32)	(25)
Total increase	$ 99	$ 40
Plan asset rate of return	13.5%	5.9%

Tangible Capital Assets

8.18 Tangible capital assets are recorded in the Province’s financial statements in accordance with Public Sector Accounting Board (PSAB) recommendations. The Province first began recognizing tangible capital assets in the Public Accounts in 2003-04. That year the Province recognized all tangible capital assets but included an exception with regard to the completeness of land as follows: *“Under the transitional Provisions of PSAB Section PS 3150 historical cost is still being gathered for certain land parcels. Adjustments to costs may be required when more information becomes available.”* A similar note is disclosed in the 2005-06 schedule of tangible capital assets. Despite our continued recommendations to address this issue, the Province has not yet determined historical cost for all land parcels.

8.19 The 2005-06 Public Accounts includes an audited schedule of tangible capital assets. In the past we identified a number of issues regarding the tangible capital asset schedule which needed further examination by the Province. The Province has not yet responded to the points raised in our 2004-05 audit. Following are previous year issues that remain outstanding:

- We noted that a large number of land parcels owned by the Province were not included on the schedule of tangible capital assets. These properties were noted as being owned by the Government of PEI in the property tax system but are not included in tangible capital asset land schedules. Additional follow up is required in this area to ensure the land category is complete.
- An analysis of the change in the net book value of assets is not done to identify disposals of some Crown corporations. As a result disposal transactions are not being accounted for properly.
- The Province has included the cost of roads reported in the Public Accounts since 1959. Over the last 47 years, many of the roads have been rebuilt. In addition most of these roads would be fully amortized resulting in the cost and accumulated amortization balances for roads in the Public Accounts being overstated. It would be more appropriate to include costs over a shorter period of time.

8.20 The following issue has been identified during the 2005-06 audit:

- With the elimination of the five Regional Health Authorities in April 2005, capital assets of the Authorities have been transferred to the Province. The Province has reconciled asset balances transferred at April 1, 2005 to the March 31, 2005 audited financial statements of each Authority. However, a detailed listing of individual assets, their cost and accumulated amortization was not received. This detail is necessary in order to determine the useful life of each asset, to calculate amortization and to ensure only assets exceeding the Province's threshold for capitalization are included. During our audit we could identify assets from one Authority with a net book value of $663,000 which were included in the April 1, 2005 balances but were under the Province's capitalization threshold. In addition, an error was noted in the method used to calculate amortization on these assets resulting in a $3 million adjustment to amortization expense.

Recommendations

8.21 Historical cost information should be obtained for a number of land parcels.

8.22 The changes in net book value of assets should be analyzed in order to correctly record costs of disposals.

8.23 Consideration should be given to reducing the period of capitalization for roads.

8.24 A listing detailing the cost and accumulated amortization for all Health Authority assets should be obtained.

8.25 Only assets exceeding the Province's threshold values should be capitalized.

8.26 Amortization should be calculated on an individual asset basis based on net book value and remaining useful life.

Inventories

8.27 PSAB recommendations applicable for years beginning on or after April 1, 2005 require inclusion of inventories held for consumption or use as non-financial assets on the statement of financial position. For the 2004-05 fiscal year the Province implemented the PSAB recommendation for inventories in the operating fund but the recommendation had not been applied to Consolidated entities. For the 2005-06 fiscal year additional inventories, totalling $3.6 million, in the health and education sectors were recognized.

Consolidated Budget Estimates

8.28 In the past we have recommended that Government prepare Consolidated Budget Estimates rather than budgeting for the Operating Fund only. Since the Province's annual surplus or deficit is the main measure of financial performance, financial statement users should be given sufficient information to compare actual results to budget. The Consolidated Financial Statements with corresponding consolidated estimates are a more complete document for understanding and assessing trends in government financial operations and demonstrating public accountability for government's financial performance. Consolidated Budget Estimates were prepared for the first time for the 2003-04 year.

8.29 PSAB Standards set as a basic requirement the inclusion of consolidated budget data with the Public Accounts. To facilitate meaningful comparisons, consolidated budgets need to be prepared and reported on the same basis as that used to prepare the Consolidated Financial Statements. The 2005-06 Budget Estimates were prepared on a consolidated basis but we noted differences in the format used in the Budget and the basis used in the 2005-06 Consolidated Financial Statements. Budgets include the net deficits of Crown corporations as an expenditure in the Budget summary. Proper accounting in the Consolidated financial statements requires inclusion of each Consolidated entity's revenues and expenses rather than the net result. The absence of budgeted revenue and expense information of Crown corporations in budget documents creates difficulties in comparing budget and financial statement information.

Recommendation

8.30 The budget format should be revised to allow for better comparability to financial statements.

Timely Financial Statements

8.31 We continue to stress the importance of releasing the Public Accounts on a timely basis. Financial statements are an important source of information for decision makers. Their usefulness diminishes as time elapses and increased efforts are needed to have financial statements available on a more timely basis. The following schedule provides the dates that the Consolidated Financial Statements were released for Canada and the Provinces for the last three years.

CONSOLIDATED (SUMMARY) FINANCIAL STATEMENTS RELEASE DATES YEAR ENDED MARCH 31

Jurisdiction	2006	2005	2004
Newfoundland and Labrador	Dec. 13, 2006	Nov. 29, 2005	Nov. 30, 2004
Nova Scotia	Sept. 29, 2006	Sept. 28, 2005	Sept. 30, 2004
Prince Edward Island	Jan 31, 2007	Jan. 23, 2006	Feb. 03, 2005
New Brunswick	Aug. 16, 2006	Dec. 01, 2005	Nov. 03, 2004
Quebec	Oct. 24, 2006	Dec. 13, 2005	Mar. 22, 2005
Ontario	Aug. 24, 2006	Sept. 27, 2005	Sept. 27, 2004
Manitoba	Sept. 05, 2006	Sept. 08, 2005	Sept. 30, 2004
Saskatchewan	June 29, 2006	July 13, 2005	June 29, 2004
Alberta	June 26, 2006	June 29, 2005	June 29, 2004
British Columbia	July 17, 2006	June 29, 2005	June 29, 2004
Canada	Sept. 28, 2006	Sept. 29, 2005	Oct. 13, 2004

8.32 The Financial Administration Act requires each reporting entity to have audited financial statements completed within three months of year end and an annual report available to the public within six months of year end. Delays were noted in completion of some entity statements and in the provision of information required for consolidated financial statements.

Recommendation

8.33 The Public Accounts should be prepared and released on a timely basis.

Pension Obligation

8.34 A pension obligation arises when the pension entitlements owed to employees for services rendered exceed pension fund assets. During the 2005-06 fiscal year, Provincial Treasury issued a note payable to the Teachers’ Superannuation Fund of $160 million to provide additional funding of pension liabilities. The note is payable over a ten year period with interest at 4.345 percent. The pension obligation in this report is prepared based on the information presented in the Public Accounts.

8.35 The following schedule shows the total pension liabilities, assets and unamortized expense for the past five years:

	Year Ended March 31 (Millions)				
Date of Valuation	**2006**	**2005**	**2004**	**2003**	**2002**
Pension fund liabilities	$1,170.1	$1,048.8	$1,001.8	$955.6	$898.7
Pension fund assets	1,077.9	831.8	791.1	626.6	744.8
Unfunded pension liability	$ 92.2	$ 217.0	$ 210.7	$329.0	$153.9
Unamortized adjustments	(71.2)	(49.7)	(35.1)	(164.0)	26.5
Net Pension Obligation	$ 21.0	$ 167.3	$ 175.6	$165.0	$180.4

8.36 Unamortized adjustments noted above arise due to variances between assumptions applied in calculating actuarial estimates and actual results. These variances are initially recorded in the Province's statement of financial position and are amortized over future periods to pension expense on the Province's statement of operations.

8.37 A performance review report prepared by consultants for the Master Trust reported annualized returns of 8.6 percent over a 10 year period to March 31, 2006. Returns for 2006 were 13.5 percent while returns reported for the four year period of 2002-2006 were 6.5 percent, substantially below the reported 10 year rate. Investment returns are a key variable in the magnitude of the pension obligation.

8.38 Pension obligations are calculated on an actuarial basis every three years. During the interim period, liabilities are estimated by the Province by extrapolating the data from the most recent valuation. Actuarial valuations were carried out for the Teachers' Superannuation Fund and the Civil Service Superannuation Fund as of April 1, 2005 and for the MLA Pension Funds as of April 1, 2006. Actuarial valuations as of April 1, 2005 for Teachers' Superannuation Fund and Civil Service Superannuation Fund were completed January 16, 2007 and August 18, 2006. The late completion of the valuations prevented the use of the valuations in the March 2005 public accounts and resulted in significant delays in completion of audit procedures relating to pension liabilities for the 2006 public accounts.

8.39 The following values were reported by the actuary as of the valuation dates:

	(Millions)		
	TSF	CSSF	MLA
Date of Valuation	Apr.1/05	Apr. 1/05	Apr.1/06
Pension fund liabilities	$516.1	$575.8	$ 15.2
Pension fund assets	308.6	502.0	22.6
Unfunded pension liability	$207.5	$ 73.8	$ (7.4)

Recommendation

8.40 Actuarial Valuations for pension and retirement benefits should be completed on a timely basis.

Federal Revenue

8.41 During 2004-05 the Province received $18.2 million in federal funding related to the Wait Times Reduction Transfer Trust. The Province recorded $2.7 million as revenue in 2004-05 and recorded $15.5 million as deferred revenue when they initially received the money. For 2005-06, the Province recorded $2.7 million of revenue from the Trust. The Province plans to take the remaining $12.8 million into revenue over the next three years. We had concerns regarding the accounting treatment applied to the Trust receipts, based on application of criteria in the PSAB handbook and on inconsistences with accounting treatment applied to past federal transfers where trust agreements were similar. Our research on the issue noted variations among other provincial jurisdictions in accounting treatment for receipts under the Trust. PSAB is currently researching the area of accounting for government transfers.

8.42 We have reported over the past several years on problems with inaccurate recording of revenues and accounts receivable from the federal government, and with inadequate monitoring procedures to ensure that amounts due from the federal government are claimed and collected on a timely basis. This year, we found that this ongoing problem had actually worsened compared to what we encountered during previous years' audits. We identified adjustments to federal revenues in the net amount of $11.2 million, and these were subsequently adjusted by the Office of the Comptroller. In most cases, these were revenues not recorded by the departments as of late August 2006, nearly five months following the fiscal year end.

8.43 In addition, our audit work identified a $9.7 million increase to the amount receivable from the federal government for Provincial income tax revenues and the Office of the Comptroller adjusted for this item. The increase in income tax revenues for the 2005 and prior taxation years resulted from the federal government's revised estimates released in November 2006, but relates to revenues outstanding as at March 31, 2006.

8.44 We also identified other amounts which may have further increased federal revenues by the net amount of $1.9 million, but these were not adjusted by the Office of the Comptroller. These unadjusted amounts consisted of a $0.3 million reduction in transfer payments resulting from the federal government's revised estimates dated September/October 2006, for the Canada Health Transfer and Canada Social Transfer and a $2.2 million increase in Disaster Financial Assistance Arrangement revenues, comprised as follows:

September 2003 Hurricane Juan	$1.3 million
December 2004 storm surge	0.9 million
	$2.2 million

8.45 The outstanding adjustment related to Hurricane Juan is the difference between the estimate of the amount which will be received, and the amount which the Office of the Comptroller has set up as receivable. The outstanding adjustment related to the December 2004 storm surge is the entire amount estimated to be received, but in respect of which the Office of the Comptroller has not recorded any revenue. The Office of the Comptroller is reluctant to set up additional monies from Hurricane Juan in September 2003 and an amount from the storm surge from December 2004 until a claim is prepared.

8.46 The Public Accounts consolidated statement of financial position reports receivables from the federal government of $39.6 million as at March 31, 2006, including the aforementioned $9.7 million increase in income tax revenues for the 2005 and prior taxation years, resulting from the federal government's revised estimates released in November 2006. The remaining receivables totalled $29.9 million, down from the $31.7 million receivable as at March 31, 2005. The following table summarizes four programs having substantial balances receivable as at March 31, 2006 which were still outstanding as at December 31, 2006.

**LARGER FEDERAL RECEIVABLES AS AT MARCH 31, 2006
STILL OUTSTANDING AS AT DECEMBER 31, 2006
($000)**

	Balance Receivable Mar. 31/06	Cash Receipts Apr.1/06 to Dec. 31/06	Still Outstanding Dec. 31/06	
Official Languages in Education	$4,727	$1,179	$3,548	**Note 1**
Promotion of Official Languages	2,213	0	2,213	**Note 2**
Agriculture Policy Framework Agreement	1,329	48	1,281	**Note 3**
Infrastructure Programs	1,011	102	909	**Note 4**
	$9,280	$1,329	$7,951	

Note 1 FY2004-05: $1,081; FY2005-06: $2,467
Note 2 FY2004-05: $843; FY2005-06: $1,370
Note 3 FY2005-06: $1,281
Note 4 FY2005-06: $909

8.47 Discussions with departmental staff indicated that for three of the above four programs, the delay in collecting monies was due to claims still not submitted as of December 31, 2006. In the case of the fourth program, it appears the federal government is responsible for the delay. Due to the magnitude of federal revenues, delays such as these have a significant negative impact on the Province's cash flow.

Recommendations

8.48 Steps should be taken to ensure that all revenues from the federal government are identified and reported in the Province's financial statements.

8.49 All revenues from the federal government should be claimed and collected on a timely basis.

Guaranteed Debt

8.50 Over the past five years the Province has reported the following guaranteed debt balances on the Guaranteed Debt Schedule.

	Year Ended March 31 (Millions)				
	2006	**2005**	**2004**	**2003**	**2002**
Per Schedule	$156.6	$137.4	$99.4	$82.6	$47.2
IIDI Guaranteed Amounts*	-	-	-	13.4	8.5
	$156.6	$137.4	$99.4	$96.0	$55.7

***Not shown on the Guaranteed Debt Schedule in previous years.

8.51 Guaranteed balances increased by $19.2 million over the previous year. For 2006, balances of $74.8 million (2005-$50.5million) relating to Island Investment Development Inc.'s Century 2000 Fund notes payable to the Minister of Citizenship and Immigration have been included in the Guaranteed Debt Schedule. This guarantee was not included on the Guaranteed Debt Schedule prior to the 2004 year but was disclosed in a financial statement note.

8.52 In addition to an increase of $24.3 million in balances guaranteed on IIDI's Century 2000 Fund notes payable, other significant changes in guaranteed balances include an increase of $2.8 million in student loan balances, a decrease of $3 million in guaranteed debt of Summerside Regional Development Corporation and a decrease of $2.6 million in guarantees issued by PEI Business Development Corporation.

8.53 The Province has included provisions for losses of $3.9 million on the guarantees. Schedule 21 of the Public Accounts shows a continuity schedule for the Provision for Doubtful Accounts.

8.54 In addition to the balances noted above, note 7(c) and (d) to the Consolidated Financial Statements provides information on two additional guarantees. These guarantees have been disclosed in the Public Accounts notes but have not been included on the Guaranteed Debt Schedule in the Public Accounts. Note 7(c) indicates the PEI Business Development Inc. has indemnified lease payments to a landlord on behalf of a private company. In the case of default by the tenant, the maximum amount indemnified is $108,000 per month, pursuant to the lease ending February 2025. Note 7(d) provides information on the guarantee to the Credit Union Deposit Insurance Corporation. Based on unaudited information, Prince Edward Island Credit Unions held insurable deposits of $462.6 million at September 30, 2005.

Harness Racing PEI Inc.

8.55 In January 2005 Harness Racing PEI Inc. was established as a non profit corporation under Part II of the Companies Act. One of the objects of the company is to operate harness racing tracks in Prince Edward Island. The company is governed by a Board of Directors appointed by the Minister responsible for Harness Racing.
We have advised the Comptroller that this entity meets the criteria for consolidation. At the time of our inquiry, an audit of the financial statements of Harness Racing PEI Inc. had not been completed.

Recommendation

8.56 The financial results of Harness Racing PEI Inc. should be included in the Province's Consolidated Financial statements.

Cancellation or Discharge of Debt

8.57 Section 16 of the Audit Act requires the Auditor General to report the total amount of any claims, debts or monies due to the Province that have been discharged, cancelled, and released under Section 26 of the Financial Administration Act. In 2005-06, the amount cancelled or discharged under Section 26 totalled $395,047 and the amount written off under Section 26.1 was $1,112,225 as follows:

	Section 26(1)	Section 26.1(1)
Revenue Tax Act	$ 15,325	$1,111,806
Environment Tax Act	-	419
Long Term Care Subsidization Act	182,041	-
Social Assistance Act	168,335	-
Real Property Tax Act	29,346	-
	$395,047	$1,112,225

8.58 The total amount discharged, cancelled and released or written off owed by third parties to the Province was $1,507,272.

Surplus (Deficit) of Crown Agencies and Corporations

8.59 Section 16 of the Audit Act requires the Auditor General to include information in the Annual Report on deficits of agencies not covered by appropriations in the year in which they have been incurred, and any surpluses not paid into the Operating Fund in the year in which they are earned. For information purposes we have also included the cumulative surplus or deficit for each entity.

AGENCY	Annual Surplus(Deficit) For the Year	Cumulative Surplus (Deficit)
Advisory Council on the Status of Women	$ (1,211)	$ 35
Agricultural Insurance Corporation	4,642,901	13,711,481
Agricultural Research Investment Fund Inc.	(53,500)	733,433
Aquaculture and Fisheries Research Initiative Inc.	21,635	670,556
Business Development Inc.	(8,501)	1,604,482
Charlottetown Area Development Corporation	1,101,842	5,024,891
Energy Corporation	773,726	3,233,828
French Language School Board	1	26
Grain Elevators Corporation	(59,863)	478,224
Human Rights Commission	42,192	20,242
Island Investment Development Inc.	66,674	223,851
Island Waste Management Corporation	(1,352,185)	(1,385,788)
Lending Agency	(1,446,778)	(1,446,738)
Museum and Heritage Foundation	(55,357)	585,070
Self-Insurance Fund	59,935	7,262,296
Special Projects Fund	(175,387)	907,959
Summerside Regional Development Corporation Ltd.	4,013,331	3,464,550
Tourism P.E.I.	(892,066)	(2,122,041)
Western School Board	367	372
Workers Compensation Board	12,445,331	(286,492)

MANAGEMENT RESPONSE

8.60 These matters have been discussed with management.

9. APPROPRIATIONS

INTRODUCTION

9.1 Our audit of Appropriations for the year ended March 31, 2006 included a review of the systems and procedures for the administration of the Province's annual budget. This required an audit of appropriations approved by the Legislature and special warrants approved by Executive Council on the recommendation of Treasury Board.

9.2 The Appropriations Act provides the spending authority for government and is approved by the Legislative Assembly annually. Appropriations for 2005-06 were approved in the Appropriation Act 2005. If additional funds are required during the year, special warrants are issued by the Lieutenant Governor in Council.

9.3 In **SCHEDULE A** attached to this report, we provide a comparison of appropriations to actual expenditures in accordance with the classifications in the Appropriation Act 2005.

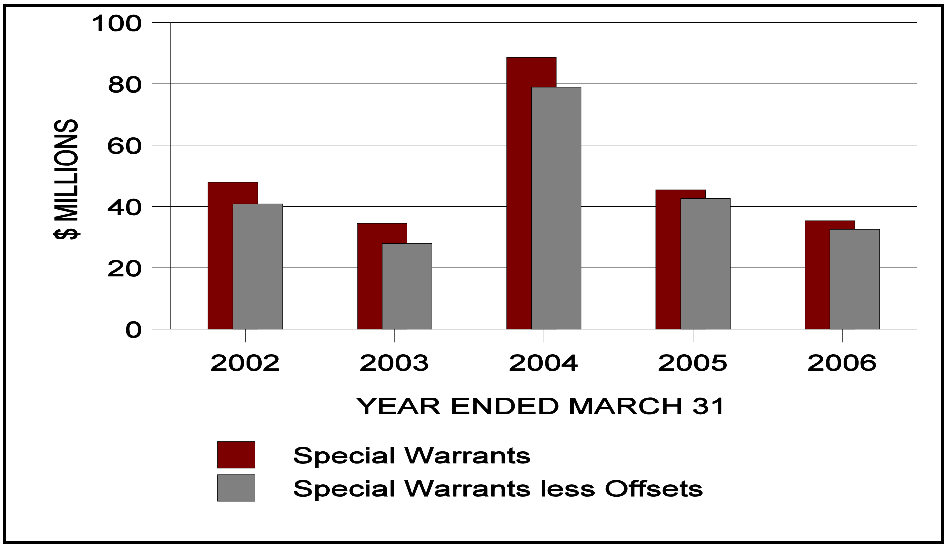
SPECIAL WARRANTS

9.4 Section 16(h) of the Audit Act requires the Auditor General to list in detail appropriations made by special warrant and the purpose of such appropriations. Details are shown in **SCHEDULE B** attached to this report.

9.5 For the 2005-06 fiscal year, special warrants totalled $35.3 million compared to $45.4 million in 2004-05. Of the special warrants issued for 2005-06, $2.8 million were offset by revenue. The result was a net increase in provincial appropriations of $32.5 million.

9.6 **Exhibit 9.1** indicates the gross special warrants and special warrants net of any offsets for the last five years.

EXHIBIT 9.1
SPECIAL WARRANTS



General Government Transfers

9.7 Section 37.2 of the Financial Administration Act provides for the transfer of salary increases from General Government to the various government entities. Section 37.2 states

> *(1) "When the Treasury Board has approved collective agreements which include salary increases for public sector employees, the Lieutenant Governor in Council may approve the transfer of monies appropriated to general government for such purposes and to such departments listed in Schedule A or to Crown corporations listed in Schedule B, as it considered appropriate."*

> *(2) "The Provincial Treasurer shall report all transfers of monies pursuant to subsection (1) to the Legislative Assembly as soon as practicable."*

9.8 We noted that transfers of $837,500 out of a total of $2.5 million were not approved by an Order In Council. This issue has been raised in our past reports. We noted that a proposed amendment to Section 37.2(1) of the Financial Administration Act was introduced at the 2006 Fall session of the Legislature where it received first reading.

Department of Health Expenditures

9.9 In 2005-06, the four Regional Health Authorities and the Provincial Health Services Authority were brought into the Departments of Health and Social Services and Seniors. In the past, the organizations mentioned above were recorded on a net appropriation basis when included in the appropriation for the Department of Health and Social Services. This has been the same practice that occurs with the other Crown corporations and agencies of the Province.

9.10 For 2005-06, we noted that in some cases, revenues were netted against expenditures for the former health entities and government appropriated a net amount for the Departments of Health and Social Services and Seniors. We noted in the Estimates of Revenue and Expenditure Book for the 2006-07 fiscal year that netting is still occurring for the former health entities within the Department of Health.

Recommendation

9.11 In future periods, appropriations for the Department of Health should be shown on a gross basis.

Transfers of Appropriated Amounts

9.12 The Financial Administration Act only allows appropriation transfers between departments in limited cases and in all cases an Order in Council is required. Generally transfers are allowed in three cases:

(a) When there is a transfer of functions from one department to another department.
(b) When one or more departments are reorganized, amalgamated or has a name change.
(c) When approved collective agreements which include salary increases for public sector employees, the Lieutenant Governor in Council may transfer monies from General Government.

9.13 We noted a transfer from General Government to Community and Cultural Affairs for $8.1 million which did not meet the criteria for a transfer under the Financial Administration Act and an Order in Council was not issued. The transfer did receive Treasury Board approval and is disclosed in Appendix III of the Estimates of Revenue and Expenditure Book for the 2006-07 fiscal year.

Recommendation

9.14 The Financial Administration Act should be adhered to.

MANAGEMENT RESPONSE

9.15 We have discussed our findings with management.

UPDATE ON PREVIOUS RECOMMENDATIONS

10. UPDATE ON PREVIOUS RECOMMENDATIONS

INTRODUCTION

10.1 At the conclusion of each special audit, we provide a report including recommendations designed to improve the management and administration of government operations and programs. It is management's prerogative to select the best course of action to address the problems identified. We are primarily concerned that all recommendations are being addressed by management.

10.2 Each year, we request information from departments and agencies on the status of action taken to address outstanding recommendations. Normally this information consists of correspondence from the Deputy Minister or Chief Executive Officer of the organization. We do not always further verify or check the information received, however, we do review the responses for reasonableness. In most cases it is more cost-effective to do detailed verification during the next scheduled audit.

10.3 Following is summary information provided to us on the status of recommendations from the special audits and examinations reported in the 2006 Annual Report of the Auditor General as well as outstanding recommendations from audits in the 2005, 2004, and 2003 Annual Reports.

STUDENT TRANSPORTATION - EASTERN SCHOOL DISTRICT

10.4 Following are the recommendations resulting from our examination of Student Transportation - Eastern School District as presented in the 2006 Annual Report of the Auditor General. The status of implementation of the recommendations is provided based on information received from management of the Eastern School District (ESD).

Auditor General's Recommendation	Status/Management Response
The Eastern School District should develop a process to ensure all bus drivers have a valid Class II license.	Driver's records are flagged and drivers are notified when licenses are set to expire.
Criminal record checks should be obtained for all bus drivers.	New bus drivers are required to provide a criminal record check.
Employment requirements for bus drivers established by regulation and job position should be followed.	All requirements included in the Minister's Directive, Eastern School District policy and regulations are being met.
The Eastern School District should establish a well defined process whereby each accident of a serious nature would be reviewed to determine if improvements are needed to busing procedures or crisis response.	The Transportation Manager and Transportation Safety Supervisor will monitor accidents. Drivers who have preventable type accidents are sent on a training course to review safe driving procedures.
In accordance with Eastern School District policy, a standard performance appraisal process should be implemented for bus drivers.	The evaluation process is to be determined. This will be a major responsibility of the Transportation Safety Supervisor.
The Eastern School District should ensure that the database of bus route information is updated each year on a timely basis.	Each driver is asked to update information on their student bus load and return it to the Eastern School District by Oct. 15.
The Eastern School District should evaluate the cost/benefit of adding an inquiry function to the Transportation Management Information System.	This will be discussed with software programmers.

Auditor General's Recommendations	Status/Management Response
Enrollment projections should be used as one input in planning school bus routes.	Enrollment is one factor considered when planning bus routes.
The Eastern School District should establish guidelines for acceptable transit times, and for all students exceeding the guidelines adjacent routes should be examined to determine if there is a more appropriate arrangement.	Bus routes are reviewed on a regular basis to balance loads and time on buses. Action is taken where concerns are raised by parents and/or staff. Where parents feel the transit times are unacceptable, they can appeal to the Board. The Eastern School District is also working with the Department of Education to enlarge the bus fleet.
The Eastern School District should establish a policy on the acceptable number of students per bus based on student age.	The Eastern School District is reviewing each bus load to determine if there is over crowding. Where it exists action will be taken.
The additional transportation costs incurred for transporting students out of zone for each school should be calculated and provided to the Board for its consideration.	The Board is in the process of establishing an ad hoc committee to address school zoning and one objective is to examine the issue of transporting out-of-zone students.
The Department of Education should establish a long term plan for school bus acquisition which considers the cost/benefit of maintenance versus replacement as well as the optimum size of the bus fleet.	The Department of Education and school boards are preparing a fleet replacement submission for Treasury Board.
Routine maintenance checks should be carried out as scheduled.	Schedules are to be established as part of the responsibilities of the Department of Transportation and Public Works.
Given the age of the bus fleet, the Eastern School District should continue periodic inspections of the structural integrity of its older buses to confirm their safety.	A schedule will be determined in conjunction with the Department of Transportation and Public Works.

Auditor General's Recommendations	Status/Management Response
The Eastern School District should ensure that the weaknesses in division of duties at the depots, accuracy of the management information system, and control over parts inventory are addressed under the new government structure for bus maintenance operations.	Eastern School District will monitor bus maintenance with the Department of Transportation and Public Works.

EAST PRINCE HEALTH - SENIORS SERVICES

10.5 Following are the outstanding recommendations resulting from the audit of East Prince Health - Seniors Services presented in the Auditor General's 2006 Annual Report to the Legislative Assembly. The status of implementation of these recommendations is presented based on information received from management of the Department of Social Services and Seniors, and the Department of Health.

Auditor General's Recommendation	Status/Management Response
The Department of Social Services and Seniors in conjunction with the Department of Health should develop a long term strategy for seniors services which addresses the projected future needs and considers current best practices.	Executive Council approved the establishment of a Seniors Secretariat including roles and responsibilities, accountability and operational framework, and a work plan for 2006-2008.
The long term care policies should be followed and the comfort allowance should be consistent for all manors.	This issue has been rectified.
The regulations regarding the provision of a comfort allowance to persons in need should be followed.	This issue has been rectified.
The regulations regarding the use and application of comfort allowances should be reviewed. The billings to estates should be consistent for all nursing homes.	This issue has been rectified.
Residents' trust accounts at Stewart Memorial should be reconciled on a regular basis.	This issue has been rectified.

Auditor General's Recommendation	Status/Management Response
A workload measurement standard should be developed which defines minimum levels of care for residents of nursing homes. The standard should be supported by a breakdown of the extent of care to be provided by nursing staff and other staff. Staffing budgets should be established to meet this standard.	The long term care nursing managers are reviewing the continuing care reporting system.
The Department of Health should investigate the feasibility of computerization to reduce the duplicate manual entries required in staff scheduling.	This is being considered by the Director of Community Hospitals and Continuing Care in conjunction with the Public Service Commission and IT Shared Services.
The reporting process for incidents should be revised to ensure subsequent diagnosis of injuries is reported.	A process was presented and approved by the senior directors of the Department.
A capital replacement plan should be developed based on an assessment of the future needs for long term institutional care and the age and condition of existing facilities.	A capital program for manor replacement was announced in the 2006 Throne Speech.
The Department of Health should periodically verify the amounts billed by private nursing homes for residents' comfort allowances.	The Director of Community Hospitals and Continuing Care is working with Divisional personnel to establish a process for verification.
Policies for the Home Care Program should be formally approved and followed.	Policies have been approved.
Home care clients should be reassessed at least annually and more often where the service is temporary.	The provincial home care practice involves an annual reassessment or sooner if necessary.
Consistent service levels for home care should be provided across the Province.	Home support fees have been eliminated and services have been standardized across the Province.

Auditor General's Recommendation	Status/Management Response
A detailed plan should be developed for the seniors units in each community based on a needs assessment and taking into consideration the current availability of reasonably priced private sector housing in the area.	A comprehensive housing study has begun and will be completed by December 2007.
The plan for seniors housing should address whether the units should be put up for sale by tender or renovated and upgraded.	Further analysis will be completed on this issue.
A multi-year capital budget should be developed to provide for the renovations and capital repairs as approved in the detailed seniors housing plan.	A five year capital budget has been approved. Canada Mortgage and Housing Corporation will provide cost-matching dollars under certain federal-provincial agreements.
The Department of Social Services and Seniors should examine the current practice for placement in seniors housing units to ensure it still meets the program objectives.	Government is currently analyzing this issue.
When a capital project is carried out, a detailed submission including estimated cost and financing arrangements should be presented to Treasury Board.	Our capital budget allocation is approved by Treasury Board.

LIQUOR CONTROL COMMISSION

10.6 Following are the recommendations resulting from our examination of the Liquor Control Commission as presented in the 2006 Annual Report of the Auditor General. The status of implementation of the recommendations is provided based on information received from management of the PEI Liquor Control Commission.

Auditor General's Recommendation	Status/Management Response
The Commission Board should be updated on the achievement of plans on a timely basis.	Updates are now provided to the Commission Board on a timely basis.
The annual budgeted revenues and expenditures of the PEI Liquor Control Commission should be formally approved by the Commission Board.	The annual budgeted revenues and expenditures will be formally approved by the Commission Board before being sent to Budget Cabinet. If changes occur after Budget Cabinet review, it will be reviewed again by the Board for final approval.
In accordance with the Financial Administration Act, the Commission should include information in its Annual Report on goals and results achieved.	Information on goals and results achieved has been included in the Commission's 2006 Annual Report.
Inventory strategies in the warehouse should be reviewed to determine whether smaller, more frequent orders can be utilized to reduce inventory levels.	The Commission is working with all Atlantic Liquor Boards to have an Agency stocking program in place whereby all four locations would access a Halifax warehouse. This will allow access to imported products on an as needed basis, thereby reducing required lead times for imported inventory as well as inventory levels of imported products in the warehouse.
Inventory procedures in the stores should be reviewed with the objective of reducing inventory levels.	The Commission has initiated a new delisting procedure to reduce the number of products in its portfolio. The delisting procedure involves consideration of the profitability of products.

Auditor General's Recommendations	Status/Management Response
A documented marketing plan should be approved by the Commission Board, clearly communicated, and monitored to cover all elements of marketing addressed in the strategic plan.	The Commission's marketing plan was formally approved by the Commission Board in October 2006.
The location of stores should be reviewed before leases are renewed to ensure they provide the most economic options.	The Commission now reviews all leases prior to renewal to ensure that they provide the most economic options.
The facility plan should identify the justification for store location and size.	The Commission reviews each facility for store location and size prior to renovation or lease renewal.
The Commission Board should consider whether additional agency stores should be used to increase Commission profitability.	It is Government's philosophy to develop small rural communities, therefore the Commission will not be closing liquor stores or adding additional agency stores in the near future.
The Commission should comply with Treasury Board policies on travel.	The Commission requires that all travel claims be on the forms prescribed by Treasury Board.

PROFESSIONAL AND CONTRACT SERVICES

10.7 Following we present the outstanding recommendations resulting from the audit of Professional and Contract Services presented in the Auditor General's 2006 Annual Report. The status of implementation of these recommendations is presented based on information received from management of the Department of the Provincial Treasury.

Auditor General's Recommendation	Status/Management Response
In accordance with Treasury Board policy, departments should ensure that contracts are competitively bid whenever possible.	It is our policy and practice to advise all departments to follow a competitive process within the context of Treasury Board policy and regional and national agreements.
The Province should report exceptions as required under the Agreement on Internal Trade.	The Office of the Comptroller prepares a report in accordance with the Agreement on Internal Trade. Information contained in the report is obtained from line departments.
Significant aspects of contractual arrangements should be considered by Department staff and documented in contracts as required.	Department staff are advised to compare all contracts to the contract templates contained in the Treasury Board policy manual.
Contracts should be approved in accordance with Treasury Board policy.	The Treasury Board policy continues to be in effect and is part of our daily procedure.

PUBLIC TRUSTEE

10.8 Following are the outstanding recommendations resulting from our audit of the Public Trustee presented in the Auditor General's 2006 Annual Report. The status of implementation of these recommendations is presented based on information received from management of the Office of the Attorney General.

Auditor General's Recommendation	Status/Management Response
Additional effort should be made to contact beneficiaries of estates and where beneficiaries cannot be located the accounts over five years old should be closed.	The Public Trustee plans to review Part IV of the Public Trustee Act, because the present wording presents difficulties with respect to the release of dormant accounts.
Additional effort should be made to identify parties who are entitled to property tax trust funds and where they cannot be located balances over five years old should be closed.	The Public Trustee plans to review Part IV of the Public Trustee Act because the present wording presents difficulties regarding the release of dormant accounts. In addition, the practice of forwarding excess property tax funds to the Office of the Public Trustee has been discontinued.
Part IV of the Public Trustee Act should be reviewed and either be complied with or amended.	The Department agrees.
An investment policy should be documented for client trusts.	Discussions have been held on the issue, but a policy has not been documented. The Office plans to seek input from the Public Trustee Advisory Committee.
The Public Trustee should examine opportunities to increase investment yields.	The Public Trustee will undertake to explore opportunities to increase investment yields within a defined risk-free area.

KPMG LLP FORENSIC AUDIT OF POLAR FOODS INTERNATIONAL INC.

10.9 Following are the outstanding recommendations resulting from the KPMG LLP Forensic Audit of Polar Foods International Inc., which were included in the 2006 Annual Report of the Auditor General. The status of implementation of the recommendations is provided based on information received from the Deputy Provincial Treasurer.

Auditor General's Recommendation	Status/Management Response
Tax Loss Utilization KPMG LLP recommends that the Province direct BDI to request the Receiver to provide the 2004 income tax returns of Polar Foods and provide BDI with an analysis of the loss utilization planning considerations in order to ascertain if value from the accumulated losses in the subsidiary corporations could have been realized for the benefit of the Province.	The Receiver has examined the tax losses and informed PEI Business Development Inc. (BDI) that the tax losses are not recoverable under the Canadian Income Tax Act.
Dividend Payments KPMG LLP recommends that the Province seek legal advice in order to determine if remedies exist for recovery due to the contravention of the Companies Act of PEI.	PEI Business Development Inc. has received a legal opinion stating that any litigation would be lengthy, contentious and expensive, and the outcome is uncertain. Based on the advice received, Government has determined it will not pursue this matter.
Collection or Resolution of Disputed and Other Amounts KPMG LLP recommends that this matter be resolved by requiring BDI to request the Receiver's disclosure in a statement or reconciliation for accounts receivable and inventory which would include a resolution of the disputed amounts, including written explanations providing reasons for amounts not recovered.	The Receiver advised that attempts are still being made to resolve the disputed amounts. PEI Business Development Inc. advised the Receiver that if resolution is not reached by February 23, 2007, additional steps may be taken including legal action if necessary.

Auditor General's Recommendation	Status/Management Response
Marketing Agreement KPMG LLP recommends that the Province conduct sufficient due diligence and require that contractual arrangements contain the rights and remedies and include legal documentation on all commitments in order to ensure that the Province's investments are protected through remedies or recovery from parties benefitting from the Province's guarantee.	Where BDI approval is required before a client enters into an agreement with a third party, BDI will continue to review the agreements to determine if the terms are in the best interest of their client and the Province.

PROVINCIAL DRUG PROGRAMS

10.10 Following are the outstanding recommendations resulting from our examination of Provincial Drug Programs as presented in the 2005 Annual Report of the Auditor General. The status of implementation of the recommendations is provided based on information received from management of the Department of Social Services and Seniors.

Auditor General's Recommendation	Status/Management Response
Objectives for each drug program should be documented and clearly defined in measurable terms.	Work is currently underway to document measurable objectives.
Drug programs should be evaluated on a cyclical basis.	Program utilization data is currently reviewed on a monthly basis. The Department plans to seek guidance from the Evaluation Section of Provincial Treasury regarding an evaluation of the Seniors Drug Cost Assistance Plan.
The Department should determine whether standing offer contracts can be used to achieve cost savings.	Standing offer and group purchasing contracts are used for drug programs delivered through the Provincial Pharmacy. PEI is participating in work done through the National Pharmaceuticals Strategy that supports the assessment and purchasing power of all provinces.
The Department should further explore Reference Drug Pricing.	Preliminary work indicates that implementation of Reference Based Pricing is not acceptable. More acceptable and effective strategies for managing drug expenditures aim at encouraging appropriate, effective, and safe medication prescribing by physicians and use by patients.

Auditor General's Recommendations	Status/Management Response
The Department should monitor prescribing patterns to identify and follow up unusual practices. The Department should develop procedures to monitor and analyse drug use and take corrective action as necessary.	There are a number of strategies being explored including: • revising the mandate of the PEI Pharmacy Advisory Committee to review the prescribing and use of medications in PEI and recommend actions for improvement; • will be working with the PEI Seniors' Federation on an initiative to encourage regular medication reviews for Island seniors; • participating in the Canadian Optimal Medication Prescribing and Utilization Service (COMPUS), a national initiative to review the prescribing and use of medications across Canada and develop strategies and tools that can be used to encourage the optimal prescribing and use of medications within individual provinces; and • implementing a Drug Information System, where information can be used for monitoring prescribing practices and usage by patient, physician or drug.
The Department should conduct rotational audits of pharmacies on an annual basis.	The Department is working on a process for annual rotational audits of retail pharmacies.

ISLAND WASTE MANAGEMENT CORPORATION

10.11 Following are the outstanding recommendations resulting from our examination of the Island Waste Management Corporation (IWMC) as presented in the 2005 Annual Report of the Auditor General. The status of implementation of the recommendations is provided based on information received from management of the Corporation.

Auditor General's Recommendation	Status/Management Response
A long-term strategy should be developed to address the projected financial deficit of IWMC.	The accumulated debt of IWMC has been eliminated and direction has been given to balance future financial requirements through an application process to the Island Regulatory and Appeals Commission.
The IWMC should prepare and submit to the Department of Environment, Energy and Forestry an overall plan for the decommissioning and ongoing monitoring of currently used and closed landfills.	Island Waste Management Corporation has only one currently used landfill and annual monitoring reports are provided to the Department of Environment, Energy and Forestry. Work required on any closed sites has been identified and a multi-year plan has been put in place in conjunction with the Department of Transportation and Public Works to use excess fill created from highway construction for the decommissioning of former sites.
The management of IWMC should prepare a strategic plan for Board approval.	A strategic plan will be presented to the Board in 2007.

CELLULAR TELEPHONES

10.12 Following is an outstanding recommendation resulting from our examination of Cellular Telephones as presented in the 2005 Annual Report of the Auditor General. The status of implementation is provided based on information received from management of the Department of the Provincial Treasury.

Auditor General's Recommendation	Status/Management Response
In accordance with Treasury Board policy, ITMG should maintain an accurate inventory of cellular telephones for all government departments and agencies.	Information Technology Management Group (ITMG) has been amalgamated into IT Shared Services (ITSS) as part of the recent IT Optimization initiative. Treasury Board policies related to wireless devices are currently being updated to reflect that transition. ITSS maintains an inventory of cellular devices. ITSS is responsible for ordering devices, receiving equipment and recording it in inventory prior to sending the device to the department/agency.

CROWN AGENCIES - CONTROL AND ACCOUNTABILITY

10.13 Following are the outstanding recommendations resulting from our examination of Crown Agencies - Control and Accountability, as presented in the 2004 Annual Report of the Auditor General. The status of implementation of the recommendations is provided based on information received from management of the Department of the Provincial Treasury.

Auditor General's Recommendation	Status/Management Response
Each Crown agency board should develop and document guidelines on the desirable qualifications and attributes of prospective board members.	Treasury Board staff are currently reviewing all Treasury Board policies. The review will include the direction required for Crown agency governance.
Each CEO should have a formal performance evaluation conducted by the board of directors on a periodic basis.	Same as above.
Boards of directors should fulfil the responsibilities as set out in the enabling legislation of the Crown agency as well as the general responsibilities of corporate directors.	Same as above.
An audit committee should be appointed for each Crown agency or, where not appointed due to size, the board of directors should carry out the responsibility.	Same as above.
Treasury Board should develop requirements for corporate governance applicable to all Crown agencies.	Same as above.

Auditor General's Recommendation	Status/Management Response
Executive Council should establish a corporate planning process for all Crown agencies which includes at least the following: • a corporate plan approved by the board of directors; • endorsement by the Minister responsible; • review and approval by Treasury Board and/or Executive Council; • release to the Legislative Assembly in conjunction with the budget approval process; and • linkage to the corporate annual report.	Treasury Board staff are currently reviewing all Treasury Board policies. The review will include the direction required for Crown agency governance.
Information provided to the Legislature for Crown agencies should include budgets showing revenues and expenditures of the agency and its subsidiaries, arriving at a net revenue item or net appropriation required.	The budget estimates now include the budgeted bottom line results for consolidated Crowns. Consideration will be given during preparation of the next budget to include a schedule with a revenue and expenditure for each Crown agency.
In addition to budgets by program area for health authorities and school boards, the Budget Estimates should at a minimum provide supplementary information showing budgeted revenues and expenditures by health authority and school board.	Supplementary information for the budget estimates will be considered.
The creation of subsidiaries should require formal approval by Executive Council and the governance and accountability structures should be clearly defined when the subsidiaries are created.	Treasury Board staff are currently reviewing all Treasury Board policies. The review will include the direction required for Crown agency governance.

Auditor General's Recommendations	Status/Management Response
Treasury Board should establish standards for subsidiary corporations regarding reporting on program performance and financial results.	Treasury Board staff are currently reviewing all Treasury Board policies. The review will include the direction required for Crown agency governance.
Each Crown Agency identified in the Financial Administration Act should provide an annual report within six months of its financial year end in accordance with the requirements of the Act.	Agree that each Crown agency should provide an annual report in accordance with the Financial Administration Act.
Annual reports of Crown agencies should be referred to a Standing Committee for review of agency performance.	This would have to be considered by the Legislative Assembly.

INFORMATION TECHNOLOGY SECURITY REVIEW

10.14 Following are the outstanding recommendations from our Information Technology Security Review as presented in the 2004 Annual Report of the Auditor General. The status of implementation of the recommendations is provided based on information received from management of the Department of the Provincial Treasury.

Auditor General's Recommendation	Status/Management Response
Departments and agencies should develop information technology security policies and procedures which address their specific information technology applications.	The Program Management Division of IT Shared Services is in the process of creating a Government Information Security Policy.
Departments and agencies should follow the information categorization system required in Treasury Board policy.	Plans are underway to move this portion of the Treasury Board policy to the policy on Recorded Information Management.
Policies should be developed to ensure data shared with other departments and agencies is adequately protected.	The Government Information Security Policy will include a policy governing the sharing of data between departments and agencies.
The physical security over computer equipment and software should be reviewed to ensure the exposure to damage and loss is minimized.	Consultation between Risk Management and IT Shared Services is ongoing and various security measures have been implemented or are being considered. The Government Information Security Policy will include a policy on the secure housing of servers and telecommunications equipment.
Policies should be developed to ensure computer program changes are adequately controlled.	Processes relating to change and configuration management are being developed. The intention is to develop a policy which will be maintained and administered by a Change Management Committee.

Auditor General's Recommendation	Status/Management Response
A standard section relating to the security of data should be developed and included in all service level agreements with external service providers.	Security policies contained in the Government Information Security Policy will apply to third party vendors who access government data.
A formal policy should be developed and implemented regarding arrangements with external service providers. At a minimum, the policy should allow for the monitoring of service providers with access to sensitive information and provide for the review of security procedures by government staff.	The Government Information Security Policy will apply to all external service providers who have access to sensitive information. The Application and Data Security Policy mandates appropriate audit logging for each system and audit processes and procedures will be developed for situations where external service providers access sensitive information.
A process should be implemented to log all traffic between government entities and external service providers. These logs should be reviewed on a periodic basis to ensure access is appropriate.	A Network Security Policy is being developed which would mandate the monitoring of logs, relating to the Government's network infrastructure, to detect and investigate any suspicious activity.
The Information Technology Management Group should develop a formal service level agreement to clearly define its role and responsibilities in providing services to departments and agencies.	Development of Service Level Agreements is being undertaken in cooperation with client departments and agencies.
Departments and agencies should ensure that a contingency plan exists for all systems which are critical to their continuous operation. The plan should specify the acceptable recovery time for each system, indicate arrangements for replacement systems, identify a testing plan, indicate staff training requirements and indicate offsite storage for the plan.	An Information Integrity and Continuity Policy will be contained in the Government Information Security Policy. The purpose of the policy will be to ensure that the appropriate security controls are in place to protect the availability and integrity of the electronic information owned or maintained by the Government. Departments and agencies are responsible to ensure contingency plans exist for systems that are critical to their operations.

GOVERNMENT GARAGES

10.15 Following are the outstanding recommendations resulting from our audit of the Government Garages presented in the Auditor General's 2004 Annual Report. The status of implementation of these recommendations is presented based on information received from management of the Department of Transportation and Public Works.

Auditor General's Recommendation	**Status/Management Response**
The Government Garages should use the FleetAnywhere System to prepare standard management reports on a regular basis for each location.	Management agrees and maintains this as a priority initiative. Amalgamation of the bus fleet repair operations into the Department have caused some delays. It is anticipated that within the next 12 to 16 months standard management reports will be established and used as required on a regular basis.
The time spent doing work on assigned tasks should be separately identified from other time charged to shop work orders.	Some changes have been made to track time spent on specific activities that were previously charged to shop work orders and additional work is planned.
The Government Garages should reconcile the hours of work paid against time entered to FleetAnywhere.	The Division will continue to work towards tracking all types of work carried out. With the implementation of an updated reporting system, it is expected that the Government Garage will be able to reconcile hours of work against time entered to FleetAnywhere.

Auditor General's Recommendation	Status/Management Response
The Government Garages should update their mechanic staff formula. It should consider facility and equipment limitations, and the allocation of work to other garage locations.	As of June 2006, the Department has started providing maintenance and repairs to the Province's school bus fleet. Managing staff levels has been difficult because of workforce reduction incentives, losing trade staff to Alberta and hiring School Board staff who provided maintenance and repair services to the buses. The Department will continue to work towards having the most appropriate mechanic staffing arrangement to meet the demands of maintaining the fleet.

WATER MANAGEMENT DIVISION

10.16 Following is an outstanding recommendation resulting from our examination of the Water Management Division, as presented in the 2004 Annual Report of the Auditor General. The status of implementation is provided based on information received from management of the Department of Environment, Energy and Forestry.

Auditor General's Recommendation	Status/Management Response
The Strategic Plan should be updated and approved by the Department of Environment and Energy.	The Department is updating its strategic plan and it is expected to be completed by February 2007.

THE GOVERNANCE STRUCTURE OF THE CREDIT UNION DEPOSIT INSURANCE CORPORATION UNDER THE REGULATORY FRAMEWORK FOR CREDIT UNIONS

10.17 Following are the outstanding recommendations from our review of the Governance Structure of the Credit Union Deposit Insurance Corporation (CUDIC) under the Regulatory Framework for Credit Unions as presented in the 2003 Annual Report of the Auditor General. The status of implementation of the recommendations is provided based on information received from the Office of the Attorney General.

Auditor General's Recommendation	Status/Management Response
The Credit Unions Act should be revised to require Board members to hold office for a specified term.	Board polices of CUDIC include appointment terms for the three directors who are nominated by Credit Union Central.
Eligibility requirements for the appointment of members to the Board of Directors of the Credit Union Deposit Insurance Corporation should be established and should specifically exclude employees of credit unions, Credit Union Central and CUDIC.	Eligibility requirements are included in new CUDIC Board policies. Under these policies, employees of credit unions, Credit Union Central and CUDIC are not eligible for appointment to the CUDIC Board.
Guidelines on the desirable qualifications and attributes of prospective Board members should be developed and considered in the nomination process.	CUDIC, Credit Union Central and the Office of the Attorney General have had discussions and there is consensus on the need for well qualified nominees. The expectation is that guidelines will be articulated.
The Board of the Credit Union Deposit Insurance Corporation should document approved policies in a policy manual and update the manual as required.	The Board of CUDIC approved policies in July 2006.
The Credit Unions Act should be amended to provide an inspection function that is controlled by the Credit Union Deposit Insurance Corporation.	The inspector makes regular presentations to the CUDIC Board on all inspections conducted.

Auditor General's Recommendations	Status/Management Response
The Board of Directors of the Credit Union Deposit Insurance Corporation should develop a Board policy which sets out actions to be taken for certain categories of risk associated with deteriorating financial condition of a credit union.	The recently approved Board policy includes a section on Intervention, which outlines actions to identify and stabilize credit unions that are experiencing deteriorating financial performance.
Each credit union should be subject to an annual external financial audit. The Credit Unions Act should be amended to require a credit union auditor to be a public accountant as defined under the Public Accounting and Auditing Act.	Discussions are continuing on this issue.
The Board of Directors of the Credit Union Deposit Insurance Corporation should re-examine the investment policy for the deposit insurance fund and consider introducing diversification into the portfolio.	An Investment Policy was documented as part of the recently approved Board policies. Investment decisions will be made by resolution of the Board.
The annual report of the Credit Union Deposit Insurance Corporation should include additional information resulting from the monitoring of credit unions and the administration of the Deposit Insurance Fund.	CUDIC is working to provide more useful information in its Annual Report.

HIGHWAY MAINTENANCE

10.18 Following we present the outstanding recommendations resulting from the audit of Highway Maintenance presented in the Auditor General's 2003 Annual Report. The status of implementation of these recommendations is presented based on information received from management of the Department of Transportation and Public Works.

Auditor General's Recommendation	Status/Management Response
The Highway Maintenance Division should prepare a plan which sets out measurable objectives. The annual report should show the results achieved compared to the objectives.	As time and resources permit, the Division will continue to work towards establishing reporting methods which demonstrate measurable program objectives. The annual report will provide information about results achieved when meaningful measures have been established.
The Division's policy for half-ton rentals from employees should be submitted to Treasury Board for review and approval.	The Division has rented trucks based on direction from Treasury Board.

PUBLIC ACCOUNTS COMMITTEE

11. PUBLIC ACCOUNTS COMMITTEE

ROLE AND MANDATE

11.1 The Standing Committee on Public Accounts is a Committee of the Legislative Assembly. It provides an important link in the accountability process. Through Committee proceedings members of the Committee, as members of the Legislative Assembly, are given the opportunity to hold the administration accountable for the use of public funds and the stewardship of public assets.

11.2 The Committee currently consists of eight members and is chaired by a member of the Official Opposition. It is charged with matters concerning the Public Accounts of the Province and the Auditor General's Annual Report. The Committee holds public meetings and requires the Auditor General and other witnesses to appear and answer questions on matters raised in the Auditor General's Annual Report as well as other issues.

PROCEEDINGS AND RESULTS

11.3 During the year the Committee met to review my 2006 Annual Report. Since the date of my last Annual Report up to February 14, 2007, I appeared before the Committee on two occasions and assisted in their deliberations by providing further information, explanation and clarification on a number of issues.

11.4 Through its deliberations the Committee has an important role in contributing to improved accountability and effectiveness in government operations. I look forward to continuing to work with the Committee in fulfilling its mandate.

11.5 In September 2006 Prince Edward Island hosted the joint Canadian Council of Legislative Auditors (CCOLA) and Canadian Council of Public Accounts Committees (CCPAC) Annual Conference. This was the twenty seventh meeting for CCPAC and the thirty fourth meeting for CCOLA. The conference had both joint and separate business sessions allowing an exchange of information between the two groups and an opportunity to share knowledge and experiences with other jurisdictions.

11.6 The joint session included a presentation by CCAF, a Canadian research and education foundation, on their research into the effectiveness of Public Accounts Committees. CCAF also facilitated a panel discussion on maximizing the effectiveness of Public Accounts Committees.

OFFICE OF THE AUDITOR GENERAL

12. OFFICE OF THE AUDITOR GENERAL

MANDATE AND MISSION

12.1 The mandate of the Office is derived from the Audit Act. As a servant of the Legislative Assembly, the Auditor General is independent of government. Authority is given to carry out financial statement audits of the Public Accounts as well as any agency of government or Crown controlled or owned corporation.

12.2 Under the Act, the Auditor General has a broad mandate to conduct any audit or examination he considers necessary to determine whether any agency of government is achieving its purposes and is doing so economically and efficiently in compliance with the applicable statutory requirements.

12.3 The mission of the Office of the Auditor General is

- to conduct independent audits and examinations that provide objective information, advice, and assurance to the Legislative Assembly; and
- to promote best practices in government operations.

RESPONSIBILITIES AND FUNCTIONS

12.4 The Audit Act sets out the responsibilities of the Auditor General. The Auditor General is required to report annually on the results of the audits and examinations conducted by the Office. The work of the Office can be categorized into two main types of assignments - financial audits, and special audits and examinations.

12.5 The primary responsibility of the Auditor General is the audit of the Public Accounts of the Province. The Auditor General is also named in legislation as the financial auditor for a number of Crown agencies.

12.6 The mandate allows the Auditor General to conduct any audit or examination considered necessary to determine whether any agency of government is achieving its purpose, is doing so economically and efficiently and is complying with the applicable statutory provisions. Special examinations may include work on compliance with applicable authorities on a government-wide basis. In addition, the Act allows for special assignments or investigations at the request of the Lieutenant Governor in Council.

12.7 The Office performs an important service to the Legislative Assembly. In some cases, where government reports information about its performance, we comment on its completeness and accuracy and thus provide credibility and add value to that information. In other circumstances, we audit government programs directly and report our findings to the Legislative Assembly and the public. The reports resulting from these assessments include recommendations and advice which can assist government in identifying opportunities for improvement in the management and control of public funds.

OPERATING PHILOSOPHY

Independence

12.8 The Auditor General is responsible to the Legislative Assembly, not government. The Office is positioned to offer impartial opinions and recommendations on government operations and management practices. The Audit Act establishes the legal framework for an independent audit office. The key components in building that independence include:

- the existence of a Legislative Audit Committee which reviews the Office’s budget;
- the authority to carry out the audits and examinations which the Auditor General deems necessary;
- the right of access to records and information necessary to perform audit functions;
- the power to request and receive information or explanations required; and
- the requirement to report annually to the Legislative Assembly.

12.9 In addition, the independence of the Office is supported by an office code of conduct which includes, among other things, policy and guidance on integrity, impartiality, and potential conflict of interest situations.

Audit Planning

12.10 Each year an audit work plan is developed consistent with the audit priorities established by the Office and the resources available. The annual work plan includes a number of financial statement audits as well as special audits and examinations.

12.11 Special audits and examinations of government departments and Crown agencies are carried out on a cyclical basis. These audits can vary in scope from the entire organization to a specific division or program. Audits are sometimes carried out on a particular function on a government-wide basis.

12.12 Various factors are considered in establishing priorities for special audits and examinations. These include; materiality of revenues/expenditures, results of previous audits, the date of the last audit, and the impact on the public. Other factors considered in planning each audit include; our audit mandate, expected resources required to complete the audit, the quality of the financial and management controls in place for the entity, complexity of the operations, and possible matters of significance that may arise from the audit.

Professional Standards

12.13 Generally accepted accounting principles for government are established through the recommendations of the Public Sector Accounting Board (PSAB) of the Canadian Institute of Chartered Accountants (CICA). These recommendations are directed at the public sector and deal with numerous accounting issues. We rely on generally accepted accounting principles for the public sector in conducting our audits as well as other guidance provided by the CICA.

12.14 Our audits are conducted in accordance with generally accepted auditing standards. These standards relate to the professional qualifications of auditors, minimum examination requirements, and reporting responsibilities. They are designed to ensure that our audits are properly planned, conducted, and reported and that audit findings are based on well substantiated evidence.

12.15 The Office is subject to a periodic practice inspection carried out by the Institute of Chartered Accountants of Prince Edward Island. This process is designed to protect the public interest by ensuring the Office meets the standards required of the profession. The most recent practice inspection was completed in May 2005.

PERSONNEL, ADMINISTRATION AND AFFILIATIONS

Organization

12.16 The Office staff complement consists of two audit directors, twelve auditors and two administrative staff. Three other auditor positions remain vacant, due to lack of budgetary resources. With our limited staff we strive to provide audit coverage of significant areas of government on a cyclical basis.

12.17 Under the Audit Act, the Legislative Audit Committee, a standing Committee of the Legislative Assembly, is responsible for the administration of the Office of the Auditor General. The Committee consists of the Speaker of the Legislative Assembly, who is Chairperson; the Leader of the Opposition; and the Provincial Treasurer. On an annual basis, the Committee reviews the budget estimates of the Office.

12.18 For the year ended March 31, 2007 budgeted expenditures for the Office amounted to $1,446,800 as follows.

	2006-07 Budget Estimate
Administration	$ 38,800
Equipment	9,000
Materials, Supplies, and Services	11,300
Professional and Contract Services	64,500
Salaries	1,289,000
Travel and Training	21,800
Contribution - CCAF	12,400
Total	$1,446,800

Professional Affiliations

12.19 As an Office we strive to keep current in all aspects of legislative and other audit practices, as well as new developments within the profession. The Office maintains a close association with a number of professional organizations, and experience and methodology is shared with a view to contributing to the continuing development of legislative audit practices. Some of the key affiliations include the following:

- The Canadian Council of Legislative Auditors (CCOLA) - The meetings of the Council bring together legislative auditors from the federal government and the provinces and provide an opportunity for information exchange, discussion, development and enhancement of legislative audit practices. Members of the Office serve on various CCOLA committees. In September 2006 our Office hosted the Annual Conference of CCOLA.

- The Public Sector Accounting Board - The Office provides input and cooperates with the Board in its efforts to improve and harmonize public sector accounting practices across Canada. The Board conducts research and issues recommendations on public sector accounting issues.

- The Canadian Institute of Chartered Accountants and the Institute of Chartered Accountants of Prince Edward Island - The Office maintains an important professional relationship with these organizations and provides input and receives information on developments in the profession through membership on various committees.

- The CCAF - The Office has been a member and supporter of the CCAF since its inception in 1980. CCAF is a Canadian research and education foundation dedicated to building knowledge for meaningful accountability and effective governance, management, and audit.

OBJECTIVES AND ACCOMPLISHMENTS

12.20 In accordance with its mandate, the Office has established two broad goals:

(I) ***To promote improved accountability for, and management of, public funds.***

(II) ***To continuously update our knowledge and skills within our field of practice and to work to the highest standard of our profession.***

In support of these goals, the Office has developed a number of objectives. The following paragraphs provide information on each of these objectives and the accomplishments during the year.

(I) To prepare an Annual Report for the Legislative Assembly, as required under the Audit Act, on the results of the audits that have been carried out.

12.21 The Annual Report provides information on significant issues and recommendations resulting from our work. We expect that the Annual Report presented each year will act as a vehicle for positive change in the management and performance of the public sector. The deliberations and discussions on the Report that occur within the Legislative Assembly and by the Standing Committee on Public Accounts provide the impetus to bring about the improvements recommended in the Report.

12.22 The 2006 Annual Report of the Auditor General was tabled in the Legislative Assembly on March 31, 2006. The Report was referred to the Public Accounts Committee and the Auditor General appeared before the Committee to discuss the Annual Report and provide additional information and explanations to the Committee.

(ii) To express opinions on the financial statements of the Public Accounts of the Province and other Crown agencies subject to audit.

12.23 An unqualified opinion was provided on the Public Accounts for the year ended March 31, 2006. We continue to work closely with the Office of the Comptroller in improving the financial statement presentation and disclosure. In addition to the Public Accounts, we conduct a number of financial statement audits of Crown Corporations, Pension and Trust Funds, and other Agencies. This process provides assurance to the taxpayers, through the Legislative Assembly, on the fairness of information reported by government.

(iii) To perform selected special audits and examinations to determine whether departments and agencies are being managed with due regard for economy and efficiency and are in compliance with applicable statutory provisions.

12.24 The Office has a limited amount of resources to carry out its work. Many of the financial statement audits which we perform are required under legislation. The extent of special audit and examination work that we can undertake is determined by the resources available after the financial audit work has been assigned.

12.25 Our special audits and examinations provide information and assurance on the management of public resources in a number of areas. We provide advice and make recommendations to improve management controls and practices where problems are identified.

(iv) To perform other investigations as may be required from time to time.

Occasionally we are asked to investigate potential weaknesses in control or to follow up on specific observations from our report.

12.26 It has also been our practice to follow up on outstanding recommendations and provide information in our Annual Report on the status of implementation of the recommendations arising from our audits. This is part of the legislative audit function which provides important feedback to the Public Accounts Committee, and assists in its role of holding government accountable.

(v) To maintain technical competence in an evolving accounting and auditing environment.

(vii) To remain aware of and provide input to the development of public sector accounting standards.

(viii) To build leadership within the Office by providing professional development and training opportunities for staff.

12.27 Our Office maintains an affiliation with the Canadian Institute of Chartered Accountants which helps us to keep up to date on emerging accounting and auditing issues. Standards are promulgated by the Public Sector Accounting Board and the Assurance Standards Board. We regularly participate in this process by providing comments during the discussion stages of the development of government accounting standards. In addition we maintain professional affiliations with the Canadian Council of Legislative Auditors and the CCAF. This participation allows us to share knowledge and experience as well as receive information on newly developed methodology.

12.28 Audit staff within the Office have professional accounting designations. We strive to provide training and professional development opportunities to staff. Individual staff members attend various professional courses, conferences, seminars, and meetings.

12.29 For 2006 and subsequent years the Institute of Chartered Accountants of PEI requires members to take a minimum of 20 hours of professional development per year and not less than 120 hours in a three year period.

SCHEDULES

OPERATING FUND
APPROPRIATIONS

ORDINARY	APPROPRIATION ACT 2005	GOVERNMENT REORGANIZATION	SPECIAL WARRANTS	TRANSFERS	TOTAL BUDGET	APPROPRIATION ACT EXPENDITURES 2005/2006		OPERATING FUND EXPENDITURES 2005/2006
AGRICULTURE, FISHERIES AND AQUACULTURE	$ 28,384,000	$ -	$ 2,806,300	$ 405,200	$ 31,595,500	$ 31,301,164	**Note**	$ 31,248,207
OFFICE OF THE ATTORNEY GENERAL	32,663,900	-	117,600	256,500	33,038,000	32,428,726	**Note**	32,357,674
AUDITOR GENERAL	1,356,600	-	-	33,000	1,389,600	1,335,943		1,335,943
COMMUNITY AND CULTURAL AFFAIRS	23,088,300	-	333,200	8,410,300	31,831,800	30,591,438	**Note**	30,543,223
DEVELOPMENT AND TECHNOLOGY	5,368,500	-	871,600	39,700	6,279,800	6,073,872	**Note**	6,040,883
PEI BUSINESS DEVELOPMENT INC.	20,376,200	-	3,678,000	436,800	24,491,000	23,982,600		23,982,600
EMPLOYMENT DEVELOPMENT AGENCY	3,546,900	-	-	2,700	3,549,600	3,372,363		3,372,363
EDUCATION	226,339,100	-	75,000	531,700	226,945,800	224,602,392		224,602,392
ISLAND REGULATORY AND APPEALS COMMISSION	1,200,000	-	-	-	1,200,000	1,200,000		1,200,000
ENVIRONMENT, ENERGY AND FORESTRY	12,103,600	-	1,000,000	286,900	13,390,500	12,434,854	**Note**	12,353,226
PEI ENERGY CORPORATION	346,300	-	50,000	5,000	401,300	349,600		349,600
EXECUTIVE COUNCIL	4,159,800	-	136,400	(730,600)	3,565,600	2,987,153	**Note**	2,922,579
HEALTH (originally Health and Social Services)	445,278,000	(110,041,600)	2,983,200	1,662,100	339,881,700	337,235,075	**Note**	343,242,770
SOCIAL SERVICES AND SENIORS	-	110,041,600	1,850,000	15,000	111,906,600	109,875,920		109,875,920
LEGISLATIVE ASSEMBLY	3,614,900	-	401,500	76,700	4,093,100	3,920,261		3,920,261
PROVINCIAL TREASURY	21,237,100	-	-	(1,339,600)	19,897,500	18,009,350		18,009,350
GENERAL GOVERNMENT	26,420,900	-	-	(10,786,200)	15,634,700	7,424,869		7,424,869

See note on page 3

OPERATING FUND
APPROPRIATIONS

ORDINARY	APPROPRIATION ACT 2005	GOVERNMENT REORGANIZATION	SPECIAL WARRANTS	TRANSFERS	TOTAL BUDGET	APPROPRIATION ACT EXPENDITURES 2005/2006		OPERATING FUND EXPENDITURES 2005/2006
TECHNOLOGY ASSET MANAGEMENT	$ 2,721,800	$ -	$ -	$ -	$ 2,721,800	$ 2,481,628		$ 2,481,628
PEI LENDING AGENCY	1,715,900	-	4,750,000	-	6,465,900	6,405,300		6,405,300
COUNCIL OF ATLANTIC PREMIERS	123,500	-	-	-	123,500	123,500		123,500
PEI PUBLIC SERVICE COMMISSION	6,180,800	-	-	117,300	6,298,100	5,579,545	**Note**	4,913,112
EMPLOYEE BENEFITS	27,818,300	-	14,714,500	-	42,532,800	42,532,713		42,532,713
TOURISM PEI	18,386,800	-	200,000	566,700	19,153,500	13,272,471		13,272,471
TRANSPORTATION AND PUBLIC WORKS	80,419,900	-	-	10,800	80,430,700	75,900,470	**Note**	76,734,841
INTERMINISTERIAL WOMEN'S SECRETARIAT	304,200	-	-	-	304,200	287,297		287,297
INTEREST CHARGES ON DEBT	107,970,000	-	-	-	107,970,000	106,877,502		106,877,502
AMORTIZATION OF TANGIBLE CAPITAL ASSETS	-	-	-	-	-	-	**Note**	27,645,170
TOTAL ORDINARY	$1,101,125,300	$ -	$33,967,300	$ -	$1,135,092,600	$1,100,586,006		$1,134,055,394
CAPITAL								
TRANSPORTATION AND PUBLIC WORKS	26,095,000	-	1,318,000	-	27,413,000	27,204,341	**Note**	-
GRAND TOTAL	$1,127,220,300	$ -	$35,285,300	$ -	$1,162,505,600	$1,127,790,347	**Note**	$1,134,055,394

See note on page 3

OPERATING FUND
APPROPRIATIONS

Note : Appropriations and expenditures are presented in accordance with the classifications in the Appropriation Act 2005. During the year, expenditures were recorded on the same basis as the Appropriation Act 2005. This differs from the format used in the Operating Fund. For the fiscal year 2005-2006 the Province followed the Public Sector Accounting Board standards for the recording of tangible capital assets. As a result, amortization of tangible capital assets are recorded as expenses in the Operating Fund.

	Per Appropriation Act	Revenues/ Expenses Transferred	Tangible Capital Asset Adjustments	Per Operating Fund
Agriculture, Fisheries and Aquaculture	$31,301,164	$ -	$ (52,957)	$31,248,207
Office of the Attorney General	32,428,726	-	(71,052)	32,357,674
Community and Cultural Affairs	30,591,438	-	(48,215)	30,543,223
Development and Technology	6,073,872	-	(32,989)	6,040,883
Environment, Energy and Forestry	12,434,854	-	(81,628)	12,353,226
Executive Council	2,987,153	-	(64,574)	2,922,579
Health	337,235,075	6,650,920	(643,225)	343,242,770
PEI Public Service Commission	5,579,545	-	(666,433)	4,913,112
Transportation and Public Works	75,900,470	834,371	-	76,734,841
Amortization of Tangible Capital Assets	-	-	27,645,170	27,645,170
Transportation and Public Works - Capital	27,204,341	(834,371)	(26,369,970)	-
		$6,650,920	$ (385,873)	

In addition, capital expenditures from the health area were netted against capital revenues as described in Sections 9.9 to 9.11 of this report.

ORDER-IN-COUNCIL	LIST OF SPECIAL WARRANTS		
	AGRICULTURE, FISHERIES AND AQUACULTURE		
EC 2005-656	FISHERIES AND AQUACULTURE		
	Professional and contract services		$ 51,300
	Funding to conduct an economic analysis of lobster fishing enterprises.		
EC 2006-436	AGRICULTURE POLICY AND REGULATORY DIVISION		
	Grants		750,000
	To fund loan loss provisions for the hog industry.		
EC 2006-546	CORPORATE AND FINANCIAL SERVICES		
	Canadian Agricultural Income Stabilization		505,000
	To fund additional expenditures in the Farm Safety Net Program for 2005-06.		
EC 2007-40	AGRICULTURE POLICY AND REGULATORY DIVISION		
	Bad debt expense		1,500,000
	To fund loan loss provisions for the hog industry.		
	Total		$ 2,806,300
	OFFICE OF THE ATTORNEY GENERAL		
EC 2006-171	LEGAL AND JUDICIAL SERVICES		
	Computer equipment	$ 63,400	
	Salary	54,200	$ 117,600
	To fund overexpenditures identified in the 2005-06 Third Quarter Forecast.		

ORDER-IN-COUNCIL	LIST OF SPECIAL WARRANTS		
	COMMUNITY AND CULTURAL AFFAIRS		
EC 2006-173	CULTURE AND HERITAGE		
	Administration	$ 5,000	
	Computer equipment	20,000	
	Field supplies	15,000	
	Professional and contract services	28,000	
	Salaries	60,000	
	In-province travel	3,000	
	Out-of-province travel	9,000	
	Grants - Heritage Archaeology	180,000	
	PLANNING AND INSPECTION SERVICES		
	Professional and contract services	13,200	$ 333,200
	Funding for overexpenditures identified in the 2005-06 Third Quarter Forecast.		
	DEVELOPMENT AND TECHNOLOGY		
EC 2007-41	FINANCE AND ADMINISTRATION		
	Grants		$ 871,600
	Grant to the Charlottetown Area Development Corporation to adjust book value of land to market value.		
	PEI BUSINESS DEVELOPMENT INC		
EC 2006-172	BUSINESS DEVELOPMENT		
	Strategic Infrastructure Assistance Development Assistance	$ 200,000	
	Tax Incentives Development Assistance	1,158,000	$ 1,358,000
	To fund expenditures identified in the 2005-06 Third Quarter Forecast.		
EC 2006-630	BUSINESS DEVELOPMENT		
	Provision for possible credit losses		2,320,000
	To provide an allowance for possible losses on exposure risk.		
	Total		$ 3,678,000

ORDER-IN-COUNCIL	**LIST OF SPECIAL WARRANTS**		
	EDUCATION		
EC 2005-548	FRENCH PROGRAMS		
	Grants - Minority and Second Language	$ 38,000	
	Out-of-province travel	7,000	
	Wages	30,000	$ 75,000
	Funding for a Federal/Provincial literacy project for francophone students. The expenditure was to be offset 100 percent by revenue from the Council of Ministers of Education in Canada.		
	ENVIRONMENT, ENERGY AND FORESTRY		
EC 2005-657	ENERGY AND MINERALS		
	Administration	$ 27,000	
	Materials and supplies	429,000	
	Professional and contract services	542,000	
	In-province travel	2,000	$ 1,000,000
	Funding for the Residential Energy Assistance Program.		
	PEI ENERGY CORPORATION		
EC 2006-140	OPERATIONS		
	Administration	$ 3,000	
	Professional and contract services	47,000	$ 50,000
	Overexpenditure relating to the measurement, collection and interpretation of wind data from its thirteen meteorological towers. The expenditure was to be offset 100 percent by revenue from the sale of wind data.		
	EXECUTIVE COUNCIL		
EC 2006-174	ACADIAN AND FRANCOPHONE AFFAIRS		
	Administration	$ 2,200	
	Professional and contract services	130,100	
	Out-of-province travel	4,100	$ 136,400
	To fund the development of a website to promote best practices in the provision of french language services. The expenditure was to be offset 100 percent by revenue from the governments of Canada and New Brunswick.		

ORDER-IN-COUNCIL	**LIST OF SPECIAL WARRANTS**		
	HEALTH (originally Health and Social Services)		
EC 2005-505	HEALTH POLICY DEVELOPMENT		
	Professional and contract services		$ 98,300
	Funding for a mass media anti-smoking campaign directed at youth/young adults. The expenditure was to be offset 100 percent by revenue from Health Canada.		
EC 2006-175	HEALTH INFORMATICS		
	Professional and contract services	$2,400,000	
	CORPORATE SERVICES		
	Grants	408,800	2,808,800
	Funding for four initiatives related to health human resource planning and recruitment and retention initiatives. Also funding of $2,400,000 for the Clinical Information System. The expenditure was to be partially offset by $2,400,000 in federal revenue and revenue from the QEH Foundation.		
EC 2006-467	POPULATION HEALTH		
	Grants - Health Research Program		76,100
	To fund additional expenditures of the Health Research Program. The expenditures was to be offset 100 percent by revenue from the PEI Special Projects Health Research Fund.		
	Total		$ 2,983,200
	SOCIAL SERVICES AND SENIORS		
EC 2006-176	CHILDREN AND YOUTH SERVICES		
	Grants		$ 1,850,000
	To provide funding for the Early Learning and Child Care Agreement which was signed by the Province in November 2005.		

ORDER-IN-COUNCIL	**LIST OF SPECIAL WARRANTS**		
	LEGISLATIVE ASSEMBLY		
EC 2006-63	ELECTIONS		
	Salaries	$ 104,000	
	Administration	2,900	
	Materials, supplies and services	31,000	
	Professional and contract services	104,000	
	Travel and training	1,800	$ 243,700
	To cover the costs pertaining to the plebiscite for the Provincial Mixed Member Proportional System.		
EC 2006-141	COMMISSION ON PRINCE EDWARD ISLAND'S ELECTORAL FUTURE		
	Professional and contract services		114,900
	Expenditures for the Commission on PEI's Electoral Future.		
EC 2006-437	ELECTIONS		
	Administration	$ 1,000	
	Equipment	300	
	Materials, supplies and services	4,900	
	Professional and contract services	22,900	
	Salaries	13,300	
	In-province travel	500	42,900
	To cover costs pertaining to the Morell-Fortune Bay by-election.		
	Total		$ 401,500
	PEI LENDING AGENCY		
EC 2007-42	DIVISION MANAGEMENT		
	Operations - Crown corporations		$ 4,750,000
	To fund loan loss provisions.		

ORDER-IN-COUNCIL	LIST OF SPECIAL WARRANTS		
	EMPLOYEE BENEFITS		
EC 2007-76	EMPLOYEES' FUTURE BENEFITS		
	EI (VRP Leave)	$ 125,300	
	Group life (VRP Leave)	22,600	
	Health & Dental (VRP Leave)	126,800	
	CPP (VRP Leave)	218,900	
	Early Retirement Incentive	2,450,000	
	Retirement Pay Health Sector	1,044,800	
	UPP Pension (VRP Leave)	190,000	
	GOVERNMENT PENSION CONTRIBUTION		
	Interest on Unfunded Pension Liability	1,623,100	
	Civil Service Superannuation Fund Pension Contributions	6,824,500	
	Teachers Superannuation Fund Pension Contributions	2,088,500	$14,714,500
	To fund annual expenses in excess of the 2005-06 budget for increases in pension and retirement allowance costs arising from the April 1, 2005 valuations, interest costs on unfunded liabilities and costs associated with the 2004-05 Workforce Adjustment Program.		
	TOURISM PEI		
EC 2006-177	TOURISM MARKETING		
	Tourism Advisory Council		$ 200,000
	To provide for a shortfall pursuant to a special promotion for the East Coast Music Awards.		
	TRANSPORTATION AND PUBLIC WORKS - CAPITAL		
EC 2006-178	HIGHWAYS		
	Highway Reconstruction - Development costs		$ 1,318,000
	To provide funding for shoreline protection.		