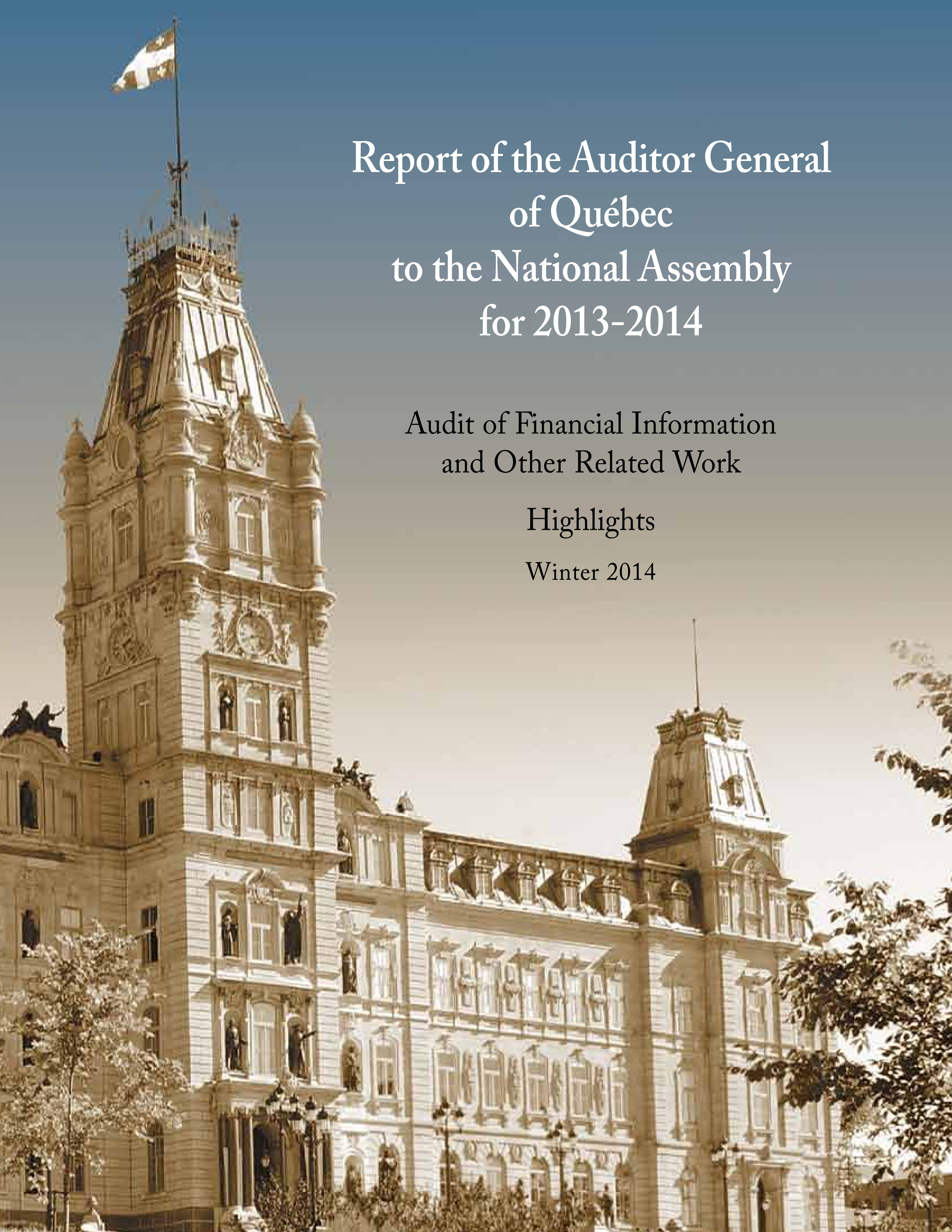

Report of the Auditor General of Québec to the National Assembly for 2013-2014

Audit of Financial Information and Other Related Work

Highlights

Winter 2014

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1 Introduction

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

2 Historically, this report presents the principal findings and recommendations arising from my financial audits. In addition, it informs parliamentarians about different subjects related to financial information. In fact, the provisions of the *Auditor General Act* make it possible for me to make comments that I deem appropriate with respect to:

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

3 A little over 40% of the Auditor General's annual budget is allocated to the audit of financial statements and other financial information. The aim of this report's is to make it possible for parliamentarians to benefit from the expertise of my staff in this sector.

4 In the last year, parliamentarians expressed to me their interest towards this separate report. I am therefore continuing the work in the same way as in previous years with the addition, this time, of a separate chapter presenting the results of my work following the analysis of the economic and financial update that the Minister of Finance and the Economy presented last November. This chapter constitutes the cornerstone of this report.

5 I am still of the opinion that it is important to properly inform parliamentarians on various subjects related to financial information. This report aims to meet the expectations that were expressed by parliamentarians.

2 Analysis of Québec's Economic and Financial Situation

6 On September 24, 2013, the National Assembly passed the following motion: [Translation] "THAT the National Assembly instruct the Auditor General of Québec to analyze the economic update that will be presented by the Minister of Finance and the Economy in respect of 2013-2014." I notified it shortly thereafter, through its president, that I planned on following up on that motion. I also met, on November 4, 2013, the members of the Committee on Public Finance to explain to them in detail the fundamental reasons that had motivated my decision.

7 Of those reasons, two deserve to be mentioned. First, the Auditor General is an institution devoted to the service of parliamentarians. The National Assembly, including the parliamentary committees, constitutes our one and only client. From this perspective, my staff and I are committed to listening to its needs in order to assist it in its function of controlling government action. Second, the *Auditor General Act* confers on me the powers needed to legitimately undertake this mandate. Thus, it is useful to remember that the object of that act is "to foster, through audit, parliamentary control over public funds and other public property."

8 To carry out my mandate, I formed an experienced team that promptly proceeded with the analysis of the document titled *Update on Québec's Economic and Financial Situation*. I am well aware that parliamentarians wish to have quick feedback and that the relevance of the findings and recommendations arising from our work is directly related to their delivery in a timely manner. In fact, the forecasts included in this update will be replaced by new ones when the next budget is tabled.

9 The time spent fulfilling my mandate was very short. In fact, to properly respond to the National Assembly's request, my objective was to produce my report in a timely manner, shortly after parliamentarians resumed work in February 2014, so that the report would be useful to them.

10 Carrying out such a mandate within these deadlines requires the collaboration of the stakeholders involved and access to information in a timely manner. The centralization of information made my staff's task laborious and delayed the advancement of the work.

11 The representatives of the Ministère des Finances et de l'Économie (MFEQ) took the care to send us complete and accurate documents. I recognize the quality of what was sent to us as well as the efforts made by the MFEQ's staff to provide us with as much as possible. However, given the constraints arising from this concern for quality, it was not possible for me to carry out all the work that I initially would have liked. Despite everything, I am able to draw conclusions about two of the three audit objectives I had set for myself, and to make several observations and recommendations to the MFEQ.

12 Chapter 3 of this report contains the findings and recommendations arising from this audit. Regarding that matter, it is important for me here to again make an important warning: a forecast is a look into the future. Therefore, it is dependent on several factors of which some are independent of the actions taken by the government. However, the government may, through its actions, influence the realization or non-realization of the forecast. One thing is certain: there will be differences between forecasts and reality, and those differences may be significant. Moreover, the further forecasts go forward in time, the more the differences are likely to be considerable.

13 The economic and financial update of November 2013 anticipates a return to a balanced budget in 2015-2016. This is an ambitious objective if we consider the significant efforts needing to be made to reduce the growth of expenditures and to eliminate the shortfalls to be offset as well as the small margin of prudence in the forecasts.

14 I recognize that the efforts in recent years to reduce the growth of expenditures have borne fruit. In fact, since 2010-2011, that growth has been less than the growth of the economy as measured by the nominal gross domestic product (GDP). The annual growth of consolidated expenditures excluding the debt service was 2.5% in 2012-2013, the lowest in the decade.

15 Achieving the 2.1% target starting in 2014-2015 after an increase to 3.3% in 2013-2014 will require further sustained efforts and rigorous follow-up. I consider that target to be ambitious. Returning to a balanced budget and reducing the growth of consolidated expenditures in the next years involves significant risks, as Chapter 3 illustrates. For example, the November 2013 update suggests major cuts to program expenditures and to expenditures by the education and health and social services networks for the three-year period ending in 2017-2018 compared to the March 2013 forecasts. The information made available to us does not make it possible to assess to what extent this assumption may become a reality. The government has given no indication in this regard. It plans to do so when the next budget is tabled. Nevertheless, it is clear that structuring measures, that is, measures of a recurring nature, must be put in place. In this respect, I invite the government to adopt an action plan that will be part of a medium- and long-term perspective.

16 My work aimed especially to ensure that parliamentarians had the best information possible to assess the quality of the forecasts presented in the economic and financial update. The Government of Québec is known for the quality of its forecasts and of its process. I invite it to continue in the direction it has taken to date, and it is my opinion that there is still room for improvements, more particularly with respect to the presentation of information and of analyses comparable to those published in its consolidated financial statements. I hope that my report is received with openness by the government, in a continuous improvement perspective, and that it constitutes an additional input to help parliamentarians play their role which is at the very heart of our democratic system.

3 Presentation of the Budget in Financial Statements

17 In the volume that covers the audit of financial information and other related work published in 2012, Chapter 7 dealt with the presentation of the financial statements of government organizations. That chapter discussed the need for those organizations to use the same presentation template as that employed by the Government of Québec. This requirement affected the government organizations that apply the Canadian Public Sector Accounting Standards (with the exception of non-profit organizations of the public sector). This template, prescribed by those same standards, requires in particular the presentation of the budget in financial statements.

18 In this respect, budget forecasts should:

- appear in the statement of operations and in the statement of change in net financial assets (or statement of change in net debt);
- be presented for the same scope of activities and in the same way as the actual results of the fiscal year;
- correspond to the results originally planned;
- be approved in a timely manner by those charged with governance.

19 Following the presentation by the government organizations of their budget, I made certain observations and recommendations to their managers and to those charged with governance.

20 In general, the organizations presented their budget in their financial statements. However, some deficiencies were noted:

- 18% of entities, namely 9 entities out of 51, did not have their budget approved in a timely manner, that is, in the three months following the start of the fiscal year;
- 16% of entities, namely 8 entities out of 51, neither prepared nor approved a budget according to the same scope of activities and in the same way as the actual results of the fiscal year, which resulted to adjustments during their inclusion in the financial statements;
- all the institutions of the network of health and social services as well as the school boards did not present their budget in the statement of change in net financial assets (or statement of change in net debt); rather, this information was included in the notes to their financial statements. This comes from the fact that these entities use a template produced by their respective department to prepare their financial statements. However, the template does not allow for the inclusion of budgetary data, and

therefore, it must be amended to enable the presentation of information in the form required by the accounting standards. These changes should be made in the course of 2014. In addition, for the institutions of network of health and social services, budgetary data is limited to the operating fund, although they should include data related to all funds.

21 Furthermore, in order to validate whether parliamentarians receive reliable information during the presentation of the government's budget, we compared the budgetary data of entities included in the government's 2012-2013 budget tabled on March 20, 2012, with the data appearing in the entities' own financial statements.

22 Therefore, the budget forecasts that the entities submitted to parliamentarians are, for all practical purposes, identical to those used by the entities in their audited financial statements. The results gathered show that the entities' budget forecasts are close to the forecasts submitted for the preparation of the government's budget.

Government's Consolidated Financial Statements and Other Elements of Interest

2

Highlights

Work Objective

The preparation and audit of the government's consolidated financial statements require a great deal of effort. The purpose of our work was to express an opinion on the financial statements in accordance with the *Auditor General Act* and Canadian Generally Accepted Auditing Standards.

This chapter constitutes a derivative communication under Canadian Auditing Standards arising from the financial statement audit performed according to the Canadian Generally Accepted Auditing Standards.

The Report is available at http://www.vgq.qc.ca.

Audit and Related Work Results

We present here the principal findings of our work.

From our point of view, the government's consolidated financial statements respect, with one exception, the Canadian Public Sector Accounting Standards. The exception arises from a difference of opinion concerning the interpretation of the new accounting standard on government transfers. According to our estimates, the 2012-2013 annual deficit is understated by $626 million. As for the net debt and accumulated deficits, they are understated by $8.1 billion.

In our opinion, the government's budgetary practice leads to a parliamentary control that is not exercised in a timely manner. The government records its subsidy expenditure and submits it to the annual appropriations vote following the subsidy payment schedule, regardless of the fact that the subsidized fixed asset has already been acquired or entirely constructed.

Almost all entities in question complied with the *Act respecting subsidies for the payment in capital and interest of loans of public or municipal bodies and certain other transfers* (the Act). In our opinion, not accounting receivable subsidies does not give a fair presentation of their financial position and is not in compliance with the Canadian Generally Accepted Accounting Principles. Accordingly, with regard to the entities for which we were the independent auditor, we have expressed qualifications in our reports.

The concept of "payability" included in the Act is not interpreted uniformly in the various activity sectors. Therefore, the amount of receivable subsidies calculated according to the Act's provisions may be different from one recipient entity to another.

The information presented in the contractual obligations was the subject of important improvements. However, additional analyses are still needed concerning certain agreements.

In 2012-2013, the government reduced the value of its fixed assets without sufficient justification by withdrawing the amounts related to the work performed for free by the municipalities on its road network. This situation leads to an understatement of fixed assets and an overstatement of accumulated deficits of $255 million in 2012-2013 ($248 million in 2011-2012).

Recommendations

The Auditor General has made recommendations to the Comptroller of Finance and the Agence du revenu du Québec. All of them are shown to the right.

These entities had the opportunity to comment on these recommendations; their comments can be found in the *Commentaires des entités visées* Section.

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

Recommendation to the Comptroller of Finance and to the Agence du revenu du Québec

1 **Carry out additional analyses concerning the accounting policy for corporate taxes to demonstrate and support the fact that the tax base is unstable or to develop a method allowing for an estimate of the unaccounted amounts.**

Recommendation to the Comptroller of Finance

2 **Analyze the contracts or written agreements to ensure that the presentation in the financial statements of ensuing obligations respect the Canadian Public Sector Accounting Standards and to improve, if needed, their presentation in the consolidated financial statements.**

Analysis of the November 2013 Economic and Financial Update

3

Summary

Work Objective

The role of the Ministère des Finances et de l'Économie du Québec includes advising the government on budget, taxation, economic, financial and accounting matters. Out of a concern for transparency, it has presented, since 2006, an economic and financial update that gives an up-to-date view of budget execution including a revised forecast of budget results.

The audit work had the following objectives:

- obtain the assurance that the economic and financial update is prepared according to an efficient and rigorous process;
- obtain the assurance that forecasts related to financial framework and debt are reasonable;
- obtain the assurance that the information presented is accurate and sufficient, and that it adequately informs users.

The Report is available at http://www.vgq.qc.ca.

Audit Results

We present here the principal findings of our audit concerning the November 2013 economic and financial update.

Context and work scope

This auditing mandate dealt with the November 2013 Update following a motion passed by the National Assembly on September 24, 2013. This motion reads as follows: [Translation] "THAT the National Assembly instruct the Auditor General of Québec to analyze the economic update that will be presented by the Minister of Finance and the Economy in respect of 2013-2014."

The work was articulated around three axes, namely: review of the process used by the Ministère des Finances et de l'Économie du Québec (MFEQ) to prepare the economic and financial update, analysis of the forecasts it has established with respect to the economy, revenues, expenditures and the government's debt, and assessment of the information disclosed in the Update.

Our work was limited to making a conclusion on the forecasts pertaining to the first three years of the forecasting horizon, namely the years 2013-2014 to 2015-2016. We analyzed the reasonableness of economic forecasts and forecasts related to revenues, expenditures, gross debt, debt representing accumulated deficits and budgetary balance. However, we did not assess the quality of forecasts related to the revenues of government enterprises, nor those related to non-budget-funded bodies and special funds. We also did not analyze the budgetary process specific to each of those entities, which are independent and accountable for their forecasts.

Our work aimed to ensure that parliamentarians have the best possible information to assess the quality of the forecasts presented in the economic and financial update.

Inherent limits of our analysis

Forecasts are based on assumptions concerning future events. Therefore, actual results will be different from the information presented, and the differences could be significant.

Responsibility for the process of developing assumptions falls on the MFEQ, which is also responsible for ensuring that those assumptions are appropriate. The quality of forecasts depends in large part on the completeness and reasonableness of assumptions. As assumptions are often interdependent, they have to be coherent.

The goal of our auditing mandate was not to express an opinion on the possibility or probability that assumptions and forecasts will be correct.

Process of preparing the economic update

Obtaining documents is one of the validation steps of a process. The auditor must then confirm the accuracy of the descriptions obtained and ensure the process worked as it was described.

The documents that were given to us by the MFEQ describe a rigorous process with regard to the establishment of economic and revenue forecasts. However, considering the late receipt of the documentation on processes and the restricted access to people, systems and data in a timely manner, we were unable to ensure that the steps of the process described by the MFEQ were, in fact, all carried out. As a result, we cannot reach a conclusion on the efficiency and rigour of the process used by the MFEQ to prepare the November 2013 Update.

Government forecasts

The table under the following paragraph (table 2 in the report) presents the summary result of our work regarding the qualification of forecasts included in the November 2013 Update. The forecasts were qualified as reasonable or, when they were not reasonable, as pessimistic or ambitious, depending on the situation.

To assess the reasonableness of forecasts, we considered a combination of quantitative and qualitative factors. The factors considered vary according to the type of forecast. Table 34 found in appendix 4 of the report presents these factors for economic, revenue budget, as well as expenditure and debt forecasts.

Qualification of forecasts in the November 2013 Update

	2013-2014	2014-2015	2015-2016
Overall economic forecasts	**Reasonable**	**Reasonable**	**Reasonable**
Real GDP	Reasonable	Reasonable	Reasonable
Price increase	Reasonable	Reasonable	Reasonable
Nominal GDP	Reasonable	Reasonable	Reasonable
Revenue (A)	**Reasonable**	**Reasonable**	**Reasonable**
Personal income tax	Reasonable	Reasonable	Reasonable
Health Services Fund	Reasonable	Reasonable	Reasonable
Consumption taxes	Reasonable	Reasonable	Reasonable
Corporate taxes	Note 1	Note 1	Note 1
Government enterprise revenue	Note 2	Note 2	Note 2
Federal transfers			
▪ Equalization	Reasonable	Pessimistic	Pessimistic
▪ CHT and CST	Reasonable	Reasonable	Reasonable
Expenditures (B)	**Reasonable**	**Ambitious**	**Ambitious**
▪ General fund	Reasonable	Ambitious	Ambitious
▪ Non-budget-funded bodies and special funds	Note 2	Note 2	Note 2
▪ Networks	Reasonable	Ambitious	Ambitious
▪ Debt service	Reasonable	Reasonable	Reasonable
Budgetary balance (A-B)	**Reasonable**	**Ambitious**	**Ambitious**
Debt forecasts			
Gross debt	Reasonable	Reasonable	Reasonable
Debt representing accumulated deficits	Reasonable	Ambitious	Ambitious

1. The work carried out for this report did not make it possible to reach a conclusion on the quality of this forecast, as explained in the relevant section.
2. Due to the scope of our work, which is presented in appendix 1, we cannot make a conclusion on the quality of this forecast.

Economic forecasts

To ensure it reaches its budgetary objectives, and considering the uncertainty involved in developing forecasts, the government must establish short and medium-term forecasts that correspond to the most likely perspectives while adopting a prudent approach. This prudence is even more justified given that Québec is exposed to several risks associated with the behaviour of the global and U.S. economies, as pointed out in the November 2013 Update.

The MFEQ's overall economic perspectives are reasonable because they fall within an acceptable range. Only a third of them can be qualified as prudent when we compare them to private-sector forecasts.

History of real GDP and nominal GDP

The GDP forecast for the coming year constitutes a short-term perspective and reflects the basis for revenue budget forecasts at the time of publication of the budget or the economic and financial update. This forecast has a determining effect not only for the year concerned, but also for the coming years, as it impacts the level of revenue growth of subsequent years.

In the past 10 years, forecasters – those of both the private sector and the government – have shown an optimistic bias in establishing their economic forecasts with regard to real GDP and nominal GDP for the coming year.

Over that decade, the MFEQ overestimated the annual growth of real GDP for the following year by 0.6 percentage points (p.p.) on average. As for the private sector, it overestimated growth by 0.7 p.p. With regard to nominal GDP, we observed an optimistic bias in the forecasts presented by the MFEQ of 0.4 p.p. for the following year.

An overly optimistic forecast of those economic variables has the effect of overestimating own-source revenue. For example, according to the sensitivity analysis published by the MFEQ in the Update, a bias of 0.4 p.p. in the forecast relating to nominal GDP, corresponding to the one found over the past years, would have an impact of $200 million on the government's own-source revenue in 2013-2014.

Revision of the economic scenario

The nominal GDP makes it possible to adequately measure the government's own-source revenue potential, since it better represents the base that is taxable by the government.

The private sector reduced its nominal GDP forecasts for the year 2013 much more quickly than the MFEQ did, namely in the fall of 2012 and the spring of 2013. The government waited until the fall of 2013 to recognize the situation.

The late adjustment of the forecasts established by the government explains the severity of the downward revision of the economic assumptions presented in November 2013 and their impact on budget forecasts for 2013-2014. The downward revision of 1.5 p.p. of the nominal GDP had an impact of $750 million on the government's own-source revenue.

Spending Control

In modern economies, governments are important actors and have a significant influence on a territory's economic activity. Thus, important decisions related to a government's investments and expenditures must be taken into consideration in the economic assumptions used for developing budget forecasts.

The MFEQ did not take into consideration the impact that expenditure restrictions outlined in the Update will have on the growth of the economy (GDP). In fact, these cuts could slow down economic activity.

Several modifications were made to the forecasts with regard to consolidated expenditures for the fiscal years 2013-2014 to 2017-2018 in the November 2013 Update. In addition, new expenditures identified in November 2013 will have to be funded by the government from the new reduced expenditure objectives starting in 2014-2015.

Economic prudence margin

Good practices in this area recommend that decision makers take into consideration an economic prudence margin in their forecasts in order to compensate for errors in this regard.

A prudence margin can be explicit, like the one the federal government integrated into its most recent update of economic and budget forecasts: its nominal GDP forecast was reduced by $20 billion (1%) starting in 2014 to take into consideration the risks associated with the forecast, which translated into a $3 billion reduction of its revenue forecast. The prudence margin can also be implicit, for instance by adopting a conservative approach, without more specifics.

The MFEQ is not consistent on whether or not to establish an implicit margin of economic prudence. It does not establish clear directives in this regard and does not give any information in the Update on how it wishes to integrate this type of margin into its economic forecasts.

Revenue forecasts

We analyzed the forecast for the most important revenues, namely personal income tax (PIT), the Health Services Fund (HSF), corporate taxes, consumption taxes, government enterprise revenue, as well as certain federal transfers.

The forecast related to the government's consolidated revenue is reasonable. However, it involves risks that are not clearly presented in the Update.

For example, the three main government enterprises mentioned risks to the MFEQ when they sent their forecasts. Those risks were not reproduced in the Update. Among them, there is the fact that Hydro-Québec was unable to provide forecasts for the year 2015-2016 and subsequent years.

Corporate taxes

Upon reviewing the processes used by the MFEQ to establish the forecast for revenues from corporate taxes, it appears to us that it does serious work. However, in the time that was allotted to us to carry out our work, it was impossible for us to deepen our analyses. We note that the forecast for corporate taxes involves a considerable level of uncertainty. Several economic factors have an influence on the profit level of corporations. In addition, depending on the activity sector (construction, retail sales, service company, etc.) and the presence of activities related to external trade (import and export), these factors can have a greater or smaller influence on their profits.

Given the historic volatility of corporate profits, the difficulty of predicting the behaviour of corporations with regard to their tax strategy including the use of their carryforward tax losses and the risk associated with the debt collection rate arising from tax recovery activities, we are unable to express an opinion on the reasonableness of the forecast made by the MFEQ regarding corporate taxes.

Federal transfers

With respect to federal equalization transfers, the estimate of the fiscal capacity of each of the other provinces involves high risks given the number of variables to be considered and the diversity of the economies of the Canadian provinces.

The forecasts related to federal equalization transfers are pessimistic, except for the one established for the 2013-2014 fiscal year, which is reasonable. The underestimation of $548 million relating to the forecast made for the 2014-2015 fiscal year, highlighted following the new estimate established by the federal government in December 2013, explains this qualification. This new estimate will also lead to a difference in the forecast made for the year 2015-2016.

Expenditure forecasts

The consolidated expenditure growth objectives were determined without taking into consideration the expenditure forecasts prepared by government departments and budget-funded bodies. The MFEQ considers as marginal the differences between the needs expressed by government departments and budget-funded bodies in their detailed forecasts and the targeted level of expenditures. The latter forecasts were incidentally not communicated to us. The MFEQ considered that this information was not relevant for our work, an opinion that we obviously do not share. Thus, the information available does not make it possible to assess the scope of actions that will have to be taken to reduce the growth of overall expenditures.

While we were limited in our work, we are able to conclude that consolidated expenditure forecasts are reasonable for 2013-2014, but ambitious for the following two years. Therefore, respecting the forecasts for 2014-2015 and 2015-2016 will require considerable efforts and rigorous follow-up.

Consolidated expenditures will increase from $83.4 billion in 2013-2014 to $90.9 billion in 2017-2018. This increase in expenditures corresponds to average annual growth of 2.4%. The growth rate anticipated for the next five years is much lower than the average growth rate for the years 2006-2007 to 2012-2013, which is 4.6%.

The following table (table 25 in the report) presents the revisions related to consolidated expenditure forecasts and the total effort required in the Update for the fiscal years 2013-2014 to 2017-2018.

Revisions related to consolidated expenditure[1] forecasts (in millions of dollars)

	2013-2014	2014-2015	2015-2016	2016-2017	2017-2018	Total
March 2013 Update	83,034	85,154	87,418	89,838	92,371	437,815
November 2013 Update	83,372	85,142	86,930	88,435	90,854	434,733
Revisions related to the consolidated expenditure objective	**338**	**(12)**	**(488)**	**(1,403)**	**(1,517)**	**(3,082)**
Retirement plans of public and parapublic sector employees	(404)	(394)	(399)	(400)	(400)	(1,997)
Economic policy	(52)	(607)	(651)	(690)	–	(2,000)
Solidarity policy	–	(80)	(89)	(95)	–	(264)
Assistance to the community of Lac-Mégantic	(60)	–	–	–	–	(60)
New expenditures funded from the consolidated expenditure objective	**(516)**	**(1,081)**	**(1,139)**	**(1,185)**	**(400)**	**(4,321)**
Total effort required to control consolidated expenditures	**(178)**	**(1,093)**	**(1,627)**	**(2,588)**	**(1,917)**	**(7,403)**

1. These expenditures exclude those of the debt service.
Source: Ministère des Finances et de l'Économie du Québec.

General fund

Expenditures from the general fund, namely program spending, represent 30.4% of expenditures for all sectors.

The significant reduction in the growth of program spending and the considerable efforts required to meet their growth objective for the years 2014-2015 and 2015-2016 lead us to conclude that forecasts for expenditures from the general fund are ambitious for those two years.

To determine the overall level of expenditures for the subsequent fiscal years, the MFEQ applied an increase percentage to expenditures of the year 2013-2014. This growth percentage was reduced from the March 2013 forecasts. In addition, the MFEQ determined additional expenditures that will be funded from the program spending objective. Therefore, government departments and budget-funded bodies will have to make considerable efforts to respect the desired growth objective. This effort represents nearly $2.0 billion starting in the 2015-2016 fiscal year. It should be recalled that this exercise was carried out without taking into consideration the needs expressed by government departments and budget-funded bodies.

Measures of a temporary nature were taken to reach the 2013-2014 spending objective. However, the significance of the reductions expected in the following years calls for measures that are clearly more structuring.

Health and social services and education networks

The expenditures of the health and social services and education networks represent 43.3% of expenditures for all sectors. The anticipated growth of expenditures in the two networks for the 2014-2015 and 2015-2016 fiscal years is one of the lowest of all the sectors. In addition, the networks will see a significant reduction of transfer revenues from the general fund starting in 2014-2015. For example, for the 2015-2016 fiscal year, the networks' transfer revenues were reduced by nearly $1.3 billion, a decrease of 3.8%. Yet, services to the population in the health sector are faced with increasing demand.

The forecast is reasonable for 2013-2014 and ambitious for the following two years. The pressure exerted on the expenditures of the health and social services and education networks accentuated by a significant reduction in transfer revenues from the general fund starting in 2014-2015 explains our assessment.

Debt forecasts

The November 2013 Update presents forecasts over a five-year horizon for three concepts used in relation to debt: gross debt, net debt and debt representing accumulated deficits.

In all material respects, the forecast related to gross debt is reasonable, considering the size of the debt. However, significant unexplained differences in net capital investments could make gross debt vary.

The forecast related to debt representing accumulated deficits for the year 2013-2014 is reasonable. However, the cumulative effect of the risks associated with expenditure cuts and the shortfalls to be offset makes it such that we qualify the forecasts for the years 2014-2015 and 2015-2016 as ambitious.

Presentation of information

The publication of an economic and financial update is a good practice in terms of transparency that was adopted by the government. The MFEQ incidentally presents in the November 2013 Update a lot of useful information on the evolution of public finances between the two budgets.

The MFEQ improved the information contained in the November 2013 Update compared to the previous Update. However, further improvements are desirable. Indeed, the information presented does not allow the reader to fully assess the quality of forecasts and to understand the risks associated with them.

Assumptions

No assumption is published concerning expenditures. This situation is consistent with the fact that the MFEQ establishes the overall expenditure level in a residual manner based on anticipated revenues and the desired level of indebtedness, without a detailed analysis of historical trends according to the nature of expenditures, or even according to the State's main missions.

Details of revisions

Certain revisions made to the forecasts since the March 2013 Update are explained, while others are not. The explanations are particularly poor with regard to revisions concerning anticipated expenditures and investments.

For example, the anticipated $783 million increase in the networks' expenditures in 2013-2014 is no more documented than the $1 billion decrease in 2017-2018. While it may be understandable for modifications affecting a farther horizon to be not as well explained, those made for the year in progress should certainly be explained, which is not the case.

Risks

The Update identifies certain risks related to economic forecasts such as the factors that have an influence on the Canadian dollar, the price of raw materials and inflation. However, the risks related to financial forecasts, including forecasts for own-source revenue, are not presented or commented on. Information on the evolution of expenditures is rudimentary and does not make it possible to assess the risks associated with the forecasts.

Certain risks involve a medium to long-term perspective. This is the case for those associated with demographic changes. The Update does not present projections beyond 2017-2018. Yet, these changes will have a major impact on the evolution of public finances. It is important to situate forecasts within an economic cycle and to analyze them on that basis.

Comparability

The information and explanations of the Update are fragmented according to certain reporting areas, which complicates understanding and comparability. Contrary to the government's consolidated financial statements, the information presented in the Update does not show revenues by source and expenditures grouped together by mission or by supercategory. Thus, the forecasting data cannot be compared with the actual audited data.

The analysis prepared by the MFEQ that accompanies the government's financial statements presents very relevant information on the evolution of certain major components of public finances. Trend analyses are presented in it as well as several indicators of interest. The information presented in the Update does not make it possible to situate the forecasts that are contained in it in relation to the trends and indicators. For example, it is not possible to assess the anticipated average progression for expenditures related to the "Health and Social Services" mission in the horizon covered by the document. Undoubtedly, a parallel between the two documents would have brought added value in terms of information in the Update.

Balanced budget

In the November 2013 Update, the government announced that the return to a balanced budget would be delayed by two years, until 2015-2016.

Returning to a balanced budget in 2015-2016 is an ambitious objective if we consider the significant efforts required to reduce the growth of expenditures and to eliminate the shortfall to be offset as well as the small margin of prudence in the forecasts.

Shortfalls to be offset to reach a balanced budget

In the section dealing with expenditure forecasts, we demonstrated that limiting the growth of program spending to 2% in 2014-2015 and 2015-2016 is an objective that does not take into consideration the needs expressed by government departments and budget-funded bodies. In addition, this growth is considerably lower than the historic average growth observed. In itself, this objective presents a risk for the achievement of a balanced budget in 2015-2016.

Added to this risk is the presence of shortfalls to be offset to reach the anticipated surplus or deficit targets. Considering that the government announced that it would not increase taxes, it is reasonable to believe that these shortfalls will have to be offset particularly through an increase in service fees or an additional decrease in expenditures.

The following table (table 32 in the report) presents the evolution of shortfalls to be offset since the tabling of the November 2012 Budget for the 2013-2014 to 2017-2018 fiscal years.

Evolution of shortfalls to be offset (in millions of dollars)

	2013-2014	2014-2015	2015-2016	2016-2017	2017-2018
November 2012 Budget and March 2013 Update					
Shortfalls to be offset	–	430	430	430	430
November 2013 Update					
Reduction of FINESSS expenditures	–	(430)	(430)	(430)	(430)
New shortfalls to be offset	–	400	1,000	400	400
Shortfalls to be offset	–	**400**	**1,000**	**400**	**400**

Contingency reserve

In the November 2013 Update, the government eliminated from its financial framework contingency reserves for the years 2013-2014 and 2014-2015 ($200 and $300 million) and reduced by half the reserves of the last three years of the forecasting horizon to establish them at $200 million. It appears to us unjustified to reduce this margin of prudence, or even eliminate it, in the context where means have not been identified to reach an ambitious expenditure growth objective and where shortfalls to be offset persist.

Recommendations

The Auditor General has made recommendations to the Ministère des Finances et de l'Économie du Québec. All of them are shown to the right.

The audited entity had the opportunity to comment on these recommendations. Some of these required a reaction. The comments and reaction can be found in the *Commentaires de l'entité vérifiée* Section.

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

Recommendations to the Ministère des Finances et de l'Économie du Québec

1. **Ensure that the determination of the overall expenditure level is made in light of complete information, that is, by taking into consideration the evolution of current program costs and the impact of decisions made by the government until now, particularly to assess the risks related to the objectives set.**
2. **Present the health and social services and education networks separately in the financial framework.**
3. **Ensure coherence between the capital investments presented in the 2013-2023 Québec Infrastructure Plan and those used to make forecasts in budget documents, so these forecasts are well established.**
4. **Establish, for management and reporting purposes, intermediate targets for the reduction of gross debt as well as debt representing accumulated deficits to be achieved by March 31, 2026.**
5. **Explain all significant assumptions underlying the financial framework and the main risks related to financial forecasts to allow readers to assess the quality of forecasts and understand the risks associated with them.**
6. **Improve the sensitivity analysis of forecasts for the economic variables presented in the Update so that it integrates all significant variables and their impacts on detailed forecasts for the duration of the forecasting horizon.**
7. **Explain all significant revisions to the financial framework so that readers can assess their causes and recurring character.**
8. **Present forecasting data in a form comparable with the actual data published in the government's consolidated financial statements.**
9. **Improve the comparable information from other governments to help readers accurately assess the information.**
10. **Adopt a clear orientation concerning the margin of prudence to be integrated into the economic scenario and into budget forecasts, communicate it explicitly to the different stakeholders and explain this position in budget documents.**

Special Funds Budget

4

Highlights

Work Objective

In this chapter, we propose possible avenues for improving the information available in the *Special Funds Budget,* with a view to fostering parliamentary control.

This work was performed in accordance with section 43 of the *Auditor General Act* and does not constitute an audit based on the Canadian Auditing Standards.

The Report is available at http://www.vgq.qc.ca.

Work Results

We present here our principal observations concerning special funds.

Since April 1, 2012, special funds budgets are subject to parliamentary control. This change falls clearly within a perspective of improving parliamentary control and constitutes a step in the right direction.

The *Special Funds Budget* presents the information required by the *Financial Administration Act*. However, certain improvements should be made to facilitate parliamentary control.

The *Special Funds Budget* does not contain sufficient information on the source of revenues. This does not make it possible to know which type of financing the fund has recourse.

The information included in the *Special Funds Budget* does not make it possible to know that certain advances from the general fund of the Consolidated Revenue Fund are excluded from the *Balance of Advances from the General Fund* Rubric.

Activities related to special funds are not defined as programs. Expenditures and investments made by the funds are not detailed in the *Special Funds Budget*. Parliamentarians do not have an overall vision of the amounts to be approved and the appropriations to be voted according to the targeted results for a given program; they cannot judge the use of resources, nor can they assess the prioritization of projects, their implementation and the resulting risks.

The presentation of additional information dealing with, among other things, the nature of and reasons for probable overexpenditures as well as actual overexpenditures of previous years in the *Special Funds Budget* would make it possible for parliamentarians to better assess the overexpenditures and forecasts to be approved.

Recommendation

The Auditor General has made a recommendation to the Ministère des Finances et de l'Économie (MFEQ) and the Secrétariat du Conseil du trésor (SCT). It is shown to the right.

These entities had the opportunity to comment on this recommendation; their comments can be found in the *Commentaires des entités visées* Section.

We want to point out that they accepted the recommendation.

Recommendation to the Ministère des Finances et de l'Économie and to the Secrétariat du Conseil du trésor

1 **Improve and regroup the available information in the Special Funds Budget to further comply with good practices.**

Modified Opinions and Comments in the Independent Auditor's Report

5

Highlights

Work Objective

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

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

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

The Report is available at http://www.vgq.qc.ca.

Audit Results

We present here findings of our work.

Health and social services network. As at March 31, 2013, the independent auditors of the network's entities still had to make a "shared" qualification in their opinion on the financial statements of all institutions and agencies where the situation applied. Furthermore, 16 of them (14 as at March 31, 2012) have modified opinions that involve qualifications other than the shared qualification. The repeated presence of modified opinions is a source for concern.

Education network. We included an emphasis of matter paragraph in the independent auditor's report of the Commission scolaire du Chemin-du-Roy about the unknown financial impact of a pyrrhotite problem at the Complexe sportif Alphonse-Desjardins. In addition, four qualifications were included in the independent auditor's report of a CEGEP.

Agence du revenu du Québec. The last auditor's report on the financial statements of unclaimed property, administered by the Agence, covers the year ended December 31, 2009. This report was produced in November 2013. Due to the stated reservation on December 31, 2008, the 2009 financial statements include a reservation on the opening balance of the net assets of $4 million. Furthermore, a qualification in the independent auditor's report of the Agence mentions that the information concerning the unclaimed property presented in a note to its financial statements of the year ended March 31, 2013, could not be audited.

Société de l'assurance automobile du Québec (SAAQ). During the year ended December 31, 2012, the cost of certain activities previously supported by the SAAQ and totalling $20.2 million was charged to the Fonds d'assurance automobile du Québec (FAAQ). Given the important effect of this revision on the comparability of the SAAQ's financial results, we included an emphasis of matter paragraph in the independent auditors' report. This also reduced by $20.2 million the consolidated expenditures of the Government of Québec.

Société d'habitation du Québec. The inadequate application for the AccèsLogis Québec program of the new accounting standard for government transfers led to the formulation of a qualified opinion in the independent auditor's report of the Société. As at March 31, 2013, annual surplus is overstated by $46.6 million, and the accumulated surplus is overstated by $75 million. The Société declined our invitation to make the necessary adjustments to its financial statements. For its part, the Government of Québec made the required corrections in its consolidated financial statements as at March 31, 2013.

Recommendations

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

The concerned entities had the opportunity to provide their comments. One of those generated a reaction. The comments and the reaction can be found in each *Commentaires de l'entité visée* section.

We want to point out that they accepted all of the recommendations, except for the Ministère de l'Enseignement supérieur, de la Recherche, de la Science et de la Technologie for the recommendation pertaining to the establishment of terms of repayment for the subsidies payable to the institutions for sick leaves and vacations.

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

1 **Provide institutions and public agencies with all the information they need to be in compliance with the standards to which they are subjected for the preparation of their financial statements.**

Recommendation to the Ministère de la Santé et des Services sociaux

2 **Carry out a follow-up with entities in the health and social services network to ensure they put in place appropriate measures to solve the problems that led to qualifications in the auditors' reports.**

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

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

Recommendation reiterated to the Ministère de l'Enseignement supérieur, de la Recherche, de la Science et de la Technologie and to the Ministère de l'Éducation, du Loisir et du Sport

4 **Determine terms of repayment (disbursement) for the subsidies payable to the institutions for sick leaves and vacations.**

Recommendations reiterated to the Agence du revenu du Québec (also called Revenu Québec)

5 **Strengthen the year-end closing process for financial statements covering unclaimed property and acquire the systems and tools needed to ensure the production of reliable and relevant financial information.**

6 **Meet the legal deadline for producing the financial statements for unclaimed property.**

Recommendation reiterated to the Commission de la construction du Québec

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

Recommendation to the Société d'habitation du Québec

8 **Put in place, at year end, the procedures needed to obtain the required information to allow for the accounting of government transfers, on the basis of work performed for the AccèsLogis Québec program.**

Portrait of the Reports to the National Assembly and of the Reports to Those Charged with Governance and Management

6

Highlights

Work Objective

This chapter gives an overview of:

- the recommendations contained in the reports to those charged with governance and management that the Auditor General produced from October 1, 2012, to October 31, 2013;
- the recommendations that he sent to entities under his authority and that are published in his report to the National Assembly entitled *Audit of Financial Information and Other Related Work* during this same period.

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

The Report is available at http://www.vgq.qc.ca.

Work Results

We present here the principal observations concerning the recommendations that are made in the reports to the National Assembly and the reports to those charged with governance and management.

Overall, in 2012-2013, the recommendation application rate (59%) stayed relatively stable, given that it was 58% in 2011-2012 and 60% for the two previous periods. From October 1, 2012, to October 31, 2013, 356 recommendations sent to 58 entities were presented in a report of the Auditor General to the National Assembly as well as in reports to those charged with governance and management. Among those recommendations, 124 were submitted for the first time in 2012-2013, whereas 232 others concerned earlier periods. The latter recommendations were the subject of a follow-up, which enabled us to determine to what extent the entities had applied our recommendations.

Of the 232 recommendations that were the subject of a follow-up in 2012-2013, 51% were made to 24 of 43 audited entities. These 24 entities did not achieve the 70% target application rate given in the Auditor General's *Strategic Plan for 2012-2015*. However, for 14 other entities, the application rate is 100%.

The recommendation application rate varies greatly depending on the year of origin. Thus, for the recommendations submitted before 2008, the rate is only 22%. The rates for the recommendations made in 2008 and 2009 are 61% and 79% respectively, while the rate for recommendations made in 2010 is 57%.

Régie de l'énergie: Sensitive Information and Other Findings

7

Highlights

Work Objective

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

This chapter deals with the work on sensitive information that we carried out at the Régie de l'énergie for the period from April 1, 2011, to March 31, 2012, as well as other findings arising from our audit of the Régie's financial statements for the years ended March 31, 2012 and 2013.

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

The Report is available at http://www.vgq.qc.ca.

Work Results

We present here the principal findings of the work that we carried out at the Régie de l'énergie.

The Régie has no internal policy governing entertainment expenses. Rules for using the amount allocated for this type of expense are not established. Furthermore, the supporting documents provided to justify entertainment expenses are generally credit card transaction receipts, which contain few details.

The former chair and another manager of the Régie approved themselves expenses that they incurred. However, a proper segregation of duties requires that expenses incurred by one person be approved by another person having the authority to do so, according to an expense approval policy.

The former chair of the Régie solicited sponsorships from entities regulated by the agency. As a public office holder and commissioner of the Régie, he failed to fulfill his obligations of reserve. In fact, the solicitation of sponsorships from entities with respect to which the Régie must render decisions free from all influence adversely affects the agency's independence and independence in appearance.

The Régie granted an advance to a non-profit organization. It is within neither the powers nor the functions of the Régie, which are stipulated in the *Act respecting the Régie de l'énergie*, to authorize and grant an advance of funds to another organization.

Recommendations

The Auditor General has made recommendations to the Régie de l'énergie. All of them are shown to the right.

The audited entity had the opportunity to comment on these recommendations; its comments can be found in the *Commentaires de l'entité auditée* Section.

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

Recommendations to the Régie

1. **Adopt an internal policy concerning entertainment expenses, which specifies their nature and the circumstances in which they may be incurred, the types of expenses not permitted as well as the supporting documents and information required.**
2. **Ascertain that entertainment expenses are justified and documented to ensure they are in accordance with the policy concerned, and require the necessary and relevant supporting documents.**
3. **Ensure that expenses incurred by one person are approved by another person having the authority to do so, according to an expense approval policy.**
4. **Ensure compliance with the *Regulation respecting the ethics and professional conduct of public office holders* and the commissioners' code of ethics and professional conduct.**
5. **Abstain from soliciting sponsorships from entities included within its field of jurisdiction.**
6. **Ensure that its financial transactions are carried out in accordance with the powers given to it by the *Act respecting the Régie de l'énergie*.**

VÉRIFICATEUR GÉNÉRAL
DU QUÉBEC

Significance of the Logo

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

Three dynamic lines, illustrating:

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

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

Acting Auditor General

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

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

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

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

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

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

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

A member of the Ordre des comptables agréés du Québec since 1984, which was brought into the Ordre des comptables professionnels agréés du Québec in May 2012, he holds a bachelor's degree in business administration and a licence in accounting sciences, both of which he received from Université Laval in 1981.

This publication
was produced by

VÉRIFICATEUR GÉNÉRAL
DU QUÉBEC

Québec
750, boulevard Charest Est, bureau 300
Québec (Québec) G1K 9J6
Tél.: 418 691-5900 • Téléc.: 418 644-4460

Montréal
770, rue Sherbrooke Ouest, bureau 1910
Montréal (Québec) H3A 1G1
Tél.: 514 873-4184 • Téléc.: 514 873-7665