Special report of the Auditor General of Quebec tabled in the National Assembly at the time of the publication of the Public Accounts of the Government of Québec for the fiscal year ended on March 31, 2008

SCHEDULE

Observations of the Auditor General

5. The government has tabled in the National Assembly its consolidated financial statements for the 2007-2008 fiscal year. They report an annual surplus of $1.7 billion, $173.3 billion in liabilities, a net debt of $124.3 billion and an accumulated deficit of $94.2 billion as at March 31, 2008.

Opinion on the consolidated financial statements for the 2007-2008 fiscal year

6. My first observation concerns the consolidated financial statements. For a second year in a row, at the end of my audit, I conclude that the government's consolidated financial statements have been prepared in accordance with Canadian Public Sector generally accepted accounting principles (GAAP) and the government's accounting policies.

7. Indeed, in light of the implementation by the government, since 2006-2007, of the large majority of the recommendations made by the Task Force on Government Accounting, the consolidated financial statements were prepared on the basis of GAAP-compliant accounting policies. Once again this year, I congratulate all of the stakeholders, including the government: they made the necessary efforts allowing me to issue this opinion on the quality of the financial information included in the financial statements.

8. Within the context of the work that I carried out over the last year, I was able to see firsthand the scope of the progress accomplished thus far in connection with the aforementioned reform and also the work that still needs to be done within the next fiscal year. Indeed, beginning in 2008-2009, the entities of the networks as well as the entities that revolve around the networks will have to be consolidated line-by-line. For this purpose, the government will first have to survey all of the entities working on the periphery of the networks. Afterwards, the government will have to evaluate whether it controls these entities. Finally, it will have to evaluate the accounting policies of the entities that it controls and, where necessary, adjust their financial data to include them in its own financial statements.

9. I am monitoring the unfolding of this major undertaking very closely. The action plan, although realistic, is ambitious. It requires the full collaboration of numerous individuals from various entities of the government and the networks, within a restrictive time frame. For my part, I will continue to offer the government my collaboration for this important work. For the benefit of parliamentarians, I have included in this report a follow-up on all of the recommendations ensuing from the reform of government accounting. This follow-up makes it possible to understand the main initiatives currently underway to achieve the objectives sought in the consolidation field for the upcoming year.

10. In addition, I wish to recall that the inclusion of the entities of the networks in the government's reporting entity should in no way alter the autonomy of their managers or prevent them from fulfilling their reporting obligation. Consequently, I will continue to make sure that they comply with *An Act to provide for balanced budgets in the public health and social services network*. In so doing, I intend to contribute to the improvement of parliamentary control over the substantial expenses incurred in this crucial sector of the public administration.

Public debt

11. My second observation concerns the question of the public debt. The tabling of the Public Accounts in the National Assembly is a high point in the exercise of parliamentary control over the State's finances. Consequently, I feel that this is the ideal time to present my remarks on this question, which sparks real interest for parliamentarians. Indeed, Québec is one of the most indebted provinces in Canada based on the information published by the Ministère des Finances[1]. A high level of indebtedness can considerably limit a government's leeway. Indeed, as the share of the State's revenues required for servicing the debt increases, there is less money left over to fund program expenditures. Moreover, the level of indebtedness of a government can make it vulnerable to major fluctuations in interest rates.

12. My concern about meeting the needs of parliamentarians has prompted me to carefully monitor the government's reporting on Québec's indebtedness. I feel that it is important to make sure that parliamentarians have all of the information needed to give them the possibility to adequately evaluate the risks in this field and thus to permit the holding of a more enlightened public debate.

Measurements of the indebtedness

13. There are several ways of expressing the public debt, which can take more than one form. This situation makes measuring, understanding and evaluating the public debt complex. Due to this great complexity and its importance, the government produces information in order to explain the factors that influence the indebtedness of Québec's public sector as well as the various elements taken into account for the calculations of this indebtedness by the many interested parties, such as credit rating agencies. Last year, I had the

1. *2008-2009 Budget Plan*, p. D.15.

opportunity to present to the Committee on Public Administration (CPA) and to the Committee on Public Finance (CPF) my calculation of the indebtedness based on my own hypotheses. This calculation was intended to be the most inclusive possible. The prime objective was to bring together in one document the great majority of elements that may be considered as constituting a debt by the various interested parties and to clarify the different notions of indebtedness presented to parliamentarians by the government.

14. At the time of my presentation, parliamentarians asked me if it was possible to produce historical data based on my calculation. Unfortunately, such an operation was not possible with reasonable effort. Nevertheless, given the interest shown, I decided to update this calculation for the fiscal year ended on March 31, 2008. In addition, this year, I have added tables making it possible to follow the evolution of the contractual obligations presented in note 10 of the consolidated financial statements, given their significant growth. These obligations represent an implicit debt that will limit the government's budgetary leeway in the years to come much like the other debts already recognized on its balance sheet.

Compliance with legislation

15. My third observation deals with the government's compliance with legislation. Once again this year, more than one quarter of the health and social services institutions do not comply with *An Act to provide for balanced budgets in the public health and social services network*. This situation has continued for eight years now. I am concerned about this phenomenon, the effect of which is to trivialize compliance with this Act. This concern is all the more important since the planned adoption of GAAP by these institutions could accentuate the budgetary imbalance situation.

16. In other respects, three other laws are the subject of remarks about compliance in this report, namely *An Act to establish a budgetary surplus reserve fund, An Act to reduce the debt and establish the Generations Fund and the Balanced Budget Act*. The non- adoption of Bill no. 85, namely *An Act to amend the Balanced Budget Act and other legislative provisions* explains this non-compliance situation. Indeed, in my opinion, the government took steps within the context of this Bill and not in the spirit of the current Acts. However, I feel that it is important to reiterate that, with all due respect for the National Assembly, it is my duty to continue passing judgment on the government's actions based on the legislation currently in force. Finally, I urge the government to take the necessary steps to ensure strict compliance with all of the laws.

Balanced Budget Act

17. Like most other Canadian governments, the Government of Québec went into debt over a period of several years to meet day-to-day needs. These operating deficits, commonly referred to as "déficits d'épicerie" in French, stood at $94.2 billion as at March 31, 2008. They appear in the consolidated financial statements under the heading of "accumulated deficit".

18. To limit recourse to indebtedness to fund operating deficits, the Québec National Assembly adopted the *Balanced Budget Act*. Consequently, for more than a decade now, there has been a mechanism making it possible to annually report on compliance with the balanced budget requirement.

19. Over the last few years, I have repeated that this mechanism should be revised, given the fact that the cumulative deficits have continued to grow despite this Act. The indicator provided by the *Balanced Budget Act*, which reflects the attainment of a budgetary balance as calculated by the government, is not a fair reflection of reality because the government has chosen advantageous accounting methods, has posted expenses or revenue reductions directly in the accumulated deficits of the government's financial statements without taking these expenses or reductions into account for the purposes of the Act and finally, has recognized revenues twice in its calculation of the balance for the purposes of the Act. Consequently, I have made my own estimate of the balance for the purposes of the Act by using rigorous accounting in keeping with the spirit of the Act. At the request of parliamentarians and following the tabling of Bill No. 85 to amend the *Balanced Budget Act*, I updated my estimate of this balance as at March 31, 2007.

20. In this report, I have updated my calculation of the balance for the purposes of the Act currently in force given the fact that the Bill was not adopted. For the year ended on March 31, 2008, I note a real decline in the accumulated deficits both for the purposes of the *Balanced Budget Act* and for accounting purposes due to the surplus achieved in 2007-2008. In addition, the weight of the accumulated deficits in relation to the Gross Domestic Product (GDP) also declined. In fact, this ratio was 31.6 percent as at March 31, 2008, as compared to 34.0 percent at March 31, 2007.

21. Despite this encouraging decline, the monitoring of the annual budgetary balance is at the heart of the concerns of parliamentarians and rightly so, since the financial outlook points to a deficit for 2008-2009[2]. The government mentioned that it intends to offset this deficit with a portion of the surpluses of the last two years which the government designated as its budgetary reserve. I therefore reiterate my invitation to the government to continue its steps aiming to revise the *Balanced Budget Act* so that parliamentarians have a reliable indicator of the measurement of the budgetary balance, and hence of the existence of operating deficits.

Follow-up on the recommendations of the Committee on Public Administration

22. My last observation concerns the follow-up on the recommendations made by the CPA. In November and December 2007, there were hearings involving the Deputy Minister of Finance, the Comptroller of Finance and Government Accounting, the Secretary of the Conseil du trésor and myself. These hearings were held within the framework of the following mandate from the National Assembly: "Clarify, beginning on November 1, 2007, the application of the *Balanced Budget Act* and propose, as the case may be,

2. *2008-2009 Budget Plan*, p. C. 38.

by December 20, 2007 recommendations aiming to correct the artificial budgetary balance." [free translation] Following the hearings, the members of the CPA unanimously made six recommendations.

23. In the last section of this report, I take stock of these six recommendations. That way, parliamentarians will be able to evaluate the extent to which the government has satisfactorily followed up on their concerns.

Asset-backed commercial paper

41. […] the investments made in ABCP [asset-backed commercial paper] by all of these entities [the ones included in the reporting entity of the government] totaled $3,306.6 million as at March 31, 2008. The losses in value attributable to these investments stood at $506.4 million, namely 15.3 percent.

52. […] It should be noted that the government does not decide the investment policies of these fiduciary bodies. […] they [the entities falling within the jurisdiction of the Auditor General but excluded from the reporting entity] suffered $1,435.4 million in losses in value, namely a decline in value of 14.7 percent, on $9,740.2 million in investments in ABCP, held almost entirely by the CDPQ [Caisse de dépôt et placement du Québec].

Public-private partnerships

55. In 2007, the Ministère des Transports reached a partnership agreement with a private enterprise concerning the design, construction, financing, operation and maintenance of the completion of Autoroute 25 in the Metropolitan Montréal Region.

60. During the fiscal year ended on March 31, 2008, the government posted in its books $79 million in assets in relation to this project, an amount that corresponds to the cost of the work done as of that date. A debt for the same amount was also recorded since no sum had been paid to the partner as of that date. The difference between the total costs of the project [estimated at $502 million] and the recorded assets, namely $423 million, is presented in the government's financial statements as contractual obligations. Indeed, the government has undertaken to pay out this sum over the next 35 years.

61. We are of the opinion that posting such assets and such a debt resulting from this partnership in the government's books complies with GAAP.

Université du Québec à Montréal

64. In the financial statements of UQAM [Université du Québec à Montréal] for the fiscal year ended on May 31, 2007, two reservations are expressed by the external auditor. […]

65. In the case of the first reservation, the government made an adjustment to eliminate the grant to be received in the financial statements of UQAM. In the case of the second reservation, the government added a provision of $200 million to the annual deficit of UQAM presented in its financial statements of May 31, 2007 to cover future devaluations that might occur concerning Îlot Voyageur. […]

Société nationale du cheval de course

71. According to the government's interpretation, the control that the government exercises is temporary. As a result, SONACC [Société nationale du cheval de course] was not included in the government's consolidated financial statements as at March 31, 2008. Certain elements argue in favour of a revision of the position adopted by the government as regards the control that it exercises over the Société.

73. Consequently, there is no doubt that the government has the power to govern the financial and operating policies of SONACC in such a way that its activities procure advantages for the government or expose it to a risk of loss. Moreover, given the fact that the provisions that confer the control are enshrined in a law, it is our opinion that this control will most likely not be temporary.

Balanced Budget Act

85. A sum of $1.3 billion was appropriated for the budgetary reserve in 2006-2007, including $1.1 billion to maintain the budgetary balance in 2008-2009 and $200 million for the purposes of the Generations Fund. For 2007-2008, an additional sum of $717 million was added to the reserve intended to maintain the budgetary balance.

86. For our part, we made a new update of the accumulated balance as at March 31, 2008 for the purposes of the *Balanced Budget Act* currently in effect, without taking into account these appropriations for the budgetary reserve and the Generations Fund […].

87. […] the annual surplus for 2007-2008 established for the purposes of the *Balanced Budget Act* stands at $1,201 million. […] the accumulated balance for the purposes of the Balanced Budget Act was $3.3 billion in deficit as at March 31, 2008.

An Act to provide for balanced budgets in the health and social services network

94. […] the deficits totaled $127 million in 2007-2008 and concern 55 institutions. These deficits stood at $137 million in 2006-2007, $139 million in 2005-2006 and $223 million in 2004-2005. Among the 55 institutions in deficit in 2007-2008, 47 of them have had a deficit for at least 5 years.

95. It is hard for us to understand why […] the budgetary balance sought by this Act has not been achieved. […]

Québec's indebtedness

Measurement of the indebtedness by the Auditor General

105. The total indebtedness of Québec's public sector, as calculated by the Auditor General, is made up of the debt supported by the government, the self-financed debt of commercial enterprises and the debt supported by the municipal and university sectors.

106. […] the total indebtedness stood at $208.3 billion as at March 31, 2008, a sum representing 69.9 percent of the GDP. […]

113. […] the debt supported by the government reached $158.8 billion as at March 31, 2008, which represents 53.3 percent of the GDP. […]

138. The self-financed debt of commercial enterprises […] totaled $34.4 billion as at March 31, 2008. […]

142. […] the debt supported by the municipal and university sectors reached $15.1 billion as at March 31, 2008. […]

Fiduciary operations

143. Fiduciary operations do not appear in the government's results because the entities that carry out such operations are not part of its reporting entity. […]

144. […] we deemed that it was relevant to draw the attention of parliamentarians to the fiduciary operations of the Fonds d'assurance-stabilisation des revenus agricoles. The Fonds posted negative net equity of $780 million as at March 31, 2008 […]. A portion of this negative net equity represents […] an implicit debt for the government.

Contractual obligations

149. The commitments contracted by the government were up by $1.9 billion as at March 31, 2008. […]

Measurement of the indebtedness by the Government of Québec

152. The Government of Québec uses different indicators to measure Québec's indebtedness. They include the net debt, the accumulated deficits, the total debt for the purposes of *An Act to reduce the debt and establish the Generations Fund*, the gross debt and the long-term debt of the public sector. […]

169. The long-term debt of the public sector is presented by the government in its budget plan. It totaled $197.3 billion as at March 31, 2008 […] Given the fact that the calculation of the total indebtedness of the public sector made by the Auditor General stood at $208.3 billion as at March 31, 2008, there is a difference of $11.0 billion […].