A REVIEW OF SCHOOL DIVISION FINANCIAL ACCOUNTING AND REPORTING



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Executive Summary

School divisions in Manitoba receive substantial monies from the Province and citizens (taxpayers, ratepayers and residents). To ensure that school divisions are held accountable for the funds they receive, citizens need to receive appropriate financial reporting and be confident that objective and recognized accounting standards are used. An understandable and accurate picture of a school division's financial position and operations enables both the Province and citizens, as well as the trustees and other stakeholders, to obtain assurance that public monies are being utilized in an appropriate and transparent manner.

The questions researched in this review were concluded on as follows:

- What legislation governs school division accounting and what are the required school division accounting standards in Manitoba?
    - As per Section 41(11.2) of The Public Schools Act, Manitoba school divisions are required to follow accepted accounting principles for school divisions. Accepted accounting principles for school divisions are outlined in the Financial Reporting and Accounting in Manitoba Education Manual (FRAME Manual) as those developed by the Department of Education, Citizenship and Youth (Department) through the Schools' Finance Branch (Branch).
- Are current Manitoba school division accounting policies in accordance with Generally Accepted Accounting Principles (GAAP)?
    - There are several areas where the accounting policies of Manitoba's school divisions do not comply with GAAP. These areas are highlighted in **Figure 1**.
- Is compliance with GAAP as issued by the Canadian Institute of Chartered Accountants (CICA) required in legislation across Canada and are CICA accounting recommendations being applied by other Provinces?
    - The accounting for school divisions in Canada is varied and appears to be in transition with a direction of movement toward compliance with GAAP as specified by PSAB recommendations, or alternatively the Not-for-Profit – deferral method.
    - Four Canadian Provinces have implemented, or have taken steps to implement, new accounting policies in accordance with either the Not-for-Profit – deferral method or Public Sector Accounting Board (PSAB) recommendations; British Columbia and Alberta have adopted Not-for-Profit deferral recommendations and Saskatchewan and Nova Scotia have adopted PSAB recommendations. Ontario, Prince Edward Island, and Newfoundland acknowledge that accounting policies for school divisions in their provinces need to be overhauled, but have made no decision as to which form of GAAP to adopt. Quebec has no plans to change current accounting policies. New Brunswick's school

districts do not prepare financial statements. All financial reporting is prepared by the provincial government.

- What is the Branch doing to ensure that the school divisions in Manitoba are in compliance with Sections 41(11) through 41(14) of The Public Schools Act?
    - The updated supplementary report (June 2003) is now providing a higher level of assurance. The report is no longer derivative in nature and the expectation gap has been closed as a result of the new process implemented by the Branch.

The preparation of financial statements in accordance with GAAP is fundamental to meaningful reporting. These principles are designed to provide for financial reporting that is readily understandable and consistent. They are intended to support transparency and accountability. We believe that citizens are not receiving the quality of financial reporting from their school divisions to which they are entitled, and their ability to hold divisions accountable is thereby impaired.

RECOMMENDATIONS FOR THE DEPARTMENT

As a result of this review, the following recommendations are provided:

- That the Department of Education, Citizenship and Youth update the FRAME Manual to ensure that school divisions account and report in accordance with GAAP. GAAP is defined for this purpose as being either accounting recommendations as defined by the PSAB Handbook or Not-for-Profit – deferral method accounting recommendations as defined by the CICA Handbook. However, we believe that there is merit in seriously considering the PSAB model because it is consistent with the government reporting models for local, provincial and federal governments. The following accounting policies should be incorporated into the method of GAAP chosen by the Department:
    - the consolidation of all funds reported in the financial statements;
    - the amortization of capital assets in a systematic manner over their useful life;
    - the recording of all school generated funds with supplementary note disclosure (to facilitate understanding by users, supplementary disclosure in the notes to school board financial statements should describe the nature of schools-generated funds and any limitations or restrictions of the use of such funds);
    - the full recording of employee future benefits;
    - the reporting of trusts and endowments;
    - the accrual of interest on outstanding debenture debt;
    - the retroactive restatement of the financial statements to reflect changes in accounting policies;

  - the segregation of current and long-term assets liabilities;
  - as a minimum, a statement of financial position, a statement of financial activities and a statement of cash flow; and
  - the incorporation of notes to the financial statements that are in accordance with GAAP.

- If GAAP is not followed, that the audit opinion on a school division's audited financial statements contain a fourth paragraph, as per Section 5600 of the CICA Handbook, indicating the financial statements are not prepared in accordance with GAAP.

1.0 Introduction

In performing this review, we explored the following questions:

1. What legislation governs school division accounting and what are the required school division accounting policies in Manitoba?
2. Are current Manitoba school division accounting policies in accordance with generally accepted accounting principles (GAAP)?
3. Is compliance with GAAP recommendations required by legislation across Canada, and are Canadian Institute of Chartered Accountants (CICA) accounting recommendations being applied by other Provinces?
4. What is the Schools' Finance Branch (Branch) doing to ensure that the school divisions in Manitoba are in compliance with Sections 41(11) through 41(14) of The Public Schools Act?

1.1 SCOPE

This review was conducted from October 2002 to December 2002. Information on the Supplementary Report and the impact of recent changes to the CICA Handbook to April 2004 has been reflected in this report. Our work consisted of such examinations, documentation review and procedures that we deemed necessary, including the following:

- Review of the Canadian Institute of Chartered Accountants (CICA)/Public Sector Accounting Handbook recommendations;
- Review of the Financial Reporting and Accounting in Manitoba Education Manual (FRAME Manual) published by the Department of Education, Citizenship and Youth (Department);
- Review of The Public Schools Act (Act);
- Review of the accounting manuals prepared by Departments of Education of other provinces of Canada (British Columbia, Alberta, Saskatchewan, Quebec and Nova Scotia);
- Review of *"Financial Reporting by Canadian School Boards"* 1996 publication by the CICA;
- Analysis of financial statements for various year-ends between August 31, 2000 and June 30, 2002 from selected school divisions in Canada:
    - We reviewed the financial statements of nine school divisions in eight provinces. It should be noted that our review of school division financial statements did not include New Brunswick as they do not prepare financial statements on a divisional basis;
- Analysis of financial statements for the year ended June 30, 2001, for ten Manitoba school divisions:
    - Our sample included four large divisions (instructional budget over $45M), two intermediate divisions ($10M - $45M) and four small divisions (less than $10M); and

- Interviews with staff of the Branch of the Department.

This report was reviewed by a representative of the CICA. Suggestions received were incorporated in this document.

2.0 Background

2.1 SCHOOL DIVISION FINANCIAL REPORTING

All school divisions in Manitoba are formed and dissolved by the Lieutenant Governor in Council, or the Minister, under the Act. The Minister of Education, Citizenship and Youth has statutory responsibility for the Act.

Under the Act, a school division is defined as *"having the responsibility of providing for elementary and secondary public school education and includes a remote school district"*. The Minister can establish, alter or dissolve school divisions and school districts by regulation.

Under the Act, School Divisions must submit certain information, including annual audited financial statements, to the Minister of Education, Citizenship and Youth. A school division's financial statements are a measure of the division's accountability to its stakeholders, and provides stakeholders with the opportunity to scrutinize the financial performance of the school division.

As required under Section 41(8) of the Act, the annual financial statements must be audited by an external auditor who must meet certain professional qualifications. Although an external auditor attests to the financial statements, the statements are the responsibility of management. This responsibility is stated in the first paragraph of the standard auditor's report. This responsibility is further emphasized in the statement of management responsibility, which is generally included in an annual report before the auditor's report and the financial statements. An example of the auditor's report can be found in **Appendix A**.

Section 41(11.2) of the Act states that an auditor's report *"shall include the auditor's opinion as to whether the financial statements present fairly the financial position of the school division at the end of the preceding fiscal year and the results of its operations for the preceding fiscal year, in accordance with accepted accounting principles for school divisions"*.

Manitoba school divisions are given direction as to the format and content of financial statements and other financial information by the FRAME Manual. The FRAME Manual states, *"A school division must follow the standards set out in this manual including accounting principles, fund accounting, and object and function/program definitions"*.

The FRAME Manual defines accepted accounting principles for school divisions in Manitoba. It provides direction and guidance for specific accounting procedures and also for financial statement presentation.

FRAME provides a standardized accounting and reporting system for school divisions in Manitoba.

FRAME is generally based on Generally Accepted Accounting Principles (GAAP) with two major exceptions. Amortization and interest on debt are not reflected in school division audited financial statements. As well, financial statement presentation varies from GAAP in a number of areas. **Figure 1** in this report highlights differences from GAAP.

The FRAME Manual was developed by the FRAME Committee in 1982. The FRAME Committee is made up of representatives from the education community and meets about four times a year to discuss the FRAME Manual and other school accounting issues. The FRAME Manual was overhauled in 1992 and is currently updated annually. Accounting principles are evolving rapidly and accounting policies and procedures need to be monitored and changed on an ongoing basis. The Department, through the Branch and the FRAME committee, has recognized the need for a change to the current School Division accounting practices in Manitoba.

The FRAME Report is published twice annually from the FRAME system to provide financial accountability to the public on school division revenues and expenditures. The first report is based on budget figures and the second reports shows financial statement figures. The FRAME Report consolidates data from all of the school divisions in Manitoba, facilitating comparison between the divisions.

2.2 CURRENT PRINCIPLES AND RECENT CHANGES IN SCHOOL DIVISION LEGISLATION

Accounting Standards are developed by The Canadian Institute of Chartered Accountants - Accounting Standards Board and the Public Sector Accounting Board (PSAB). These standards evolve as the need for more directive or specific information is required and when the ever increasing complexities of financial transactions warrant new standards. The Departments of Education of a number of Canadian provinces have recognized the need for changes to current accounting standards for school divisions, and have implemented, or have begun to implement, new accounting policies for their school divisions. There are two generally accepted accounting principles (GAAP) options for school divisions, Not-for-Profit deferral accounting recommendations, or PSAB recommendations. The two methods are very similar in the way transactions are accounted for, with distinctively different reporting recommendations. In examining accounting policies for school divisions across Canada, one GAAP method does not dominate. Saskatchewan and Nova Scotia have recently implemented PSAB accounting recommendations, British Columbia and Alberta have implemented Not-for-Profit deferral accounting recommendations, Manitoba, Ontario, Prince Edward Island and Newfoundland have not made a decision on changing their accounting policies and New Brunswick's school divisions do not prepare financial statements. Quebec has no plans to change from its current accounting policies.

2.3 RECENT CHANGES TO THE CICA HANDBOOK

Effective October 1, 2003, Section 5600, Auditor's Report on Financial Statements Prepared Using a Basis of Accounting Other than Generally Accepted Accounting Principles, applies. This section recommends that where an audit opinion is provided on

financial statements that are prepared using a basis of accounting other than GAAP, a paragraph be added to the auditor's report alerting users to this fact. This fourth paragraph will indicate to users that the financial statements are not, and were not intended to be, prepared in accordance with Canadian GAAP and are for the information and use of the intended users. An example of the resulting audit report appears in **Appendix A.1.**

Until school divisions have adopted accounting policies that result in full GAAP compliance, this additional paragraph will need to appear in all school division auditors' reports. When full GAAP accounting has been adopted by the school divisions, a GAAP audit opinion can be provided. An example of a GAAP opinion appears in **Appendix A.2**.

2.4 PROVINCIAL FINANCIAL ASSISTANCE TO SCHOOL DIVISIONS

School divisions receive financial assistance from the Public Schools Finance Board in the form of conditional and unconditional grants for operating assistance and capital assistance. Provincial support is based on a set of calculations that take into consideration student enrolment and expenditures for the current and preceding years, as well as a variety of other factors. The financial assistance provided by the Province to school divisions for the fiscal year ended June 30, 2002 totaled approximately $789.9 million. This funding is detailed in **Appendix B.**

3.0 What Legislation Governs School Division Accounting And What Are The Required School Division Accounting Standards In Manitoba?

Findings

- Section 41(11.2) of the Act in Manitoba directs that an Auditor's Report should indicate whether the division's financial statements are in accordance with accepted accounting principles for school divisions.
- The Department of Education, Citizenship and Youth, through the Branch has the responsibility to develop accounting principles for school divisions in Manitoba.
- The FRAME Manual prepared by the Department of Education, Citizenship and Youth is the directive for school board accounting standards.
- The financial statement package is prepared by completing forms which are issued by the Department
- The FRAME Manual specifies the following accounting policies:

Reporting

- Required reporting for school divisions consists of:
  - Operating Fund - Statement of Financial Position;
  - Operating Fund - Statement of Revenue, Expenditures and Accumulated Surplus;
  - Capital Fund Statement of Financial Position;
  - Capital Fund – Capital Financing; and
  - Capital Fund – Capital Invested.

(An example of each statement can be found in **Appendix C**).

Revenue Recognition

- All revenue is accrued with the exception of endowments, trust funds and school generated funds, which are not reported in the financial statements.

Contributions Receivable

- Not specifically mentioned, however, all grants from the Province are recorded as revenue and set up as a receivable.

Capital Assets

- Capital assets are defined as identifiable assets that are held for use in the provision of services, for administrative purposes or for the maintenance, repair, development or construction of other capital assets. Capital assets are recorded in the Capital Fund. The FRAME Manual establishes a threshold of $20,000 for the recording of capital assets. Amounts below this threshold are recorded in the Operating Fund.
- There is no amortization recorded on capital assets.

School Generated Funds

- The Department has issued a policy on school funds. Not all school funds are recorded in the financial statements.

Trust Funds

- Trust and endowments are not included in Manitoba school division financial statements.

Employee Future Benefits

- There is no directive for Employee Future Benefits in the Manual.

Fund Accounting

- The FRAME manual directs that a Capital Fund and an Operating Fund must be maintained.

Modified Accrual Accounting

- Defined by the FRAME Manual as full accrual except for the treatment of debenture and other long-term debt. Interest on debentures and other Provincially financed debt is recorded as an expenditure when paid. All other revenue and expenditures, except for amortization and employee future benefits, are accrued.

Changes in Accounting Policies

- Changes in accounting policies or principles are to be accounted for retroactively with no prior year restatement. Corrections of prior period errors are to be reported as a prior year adjustment.

Commitments

- The FRAME Manual states that annual financial statements should not include commitments

Presentation

- There is no segregation of the current portion of long-term liabilities.

Conclusions

- *As per Section 41(11.2) of the Act, Manitoba school divisions are required to follow accepted accounting principles for school divisions. Accepted accounting principles for school divisions are outlined in the FRAME Manual as developed by the Department of Education, Citizenship and Youth through the Branch.*
- *Accepted accounting principles for School Divisions vary in a number of cases from GAAP.*

4.0 Are Current Manitoba School Division Accounting Policies In Accordance With Generally Accepted Accounting Principles (GAAP)?

The Canadian Institute of Chartered Accountants (CICA) Accounting Handbook or the Public Sector Accounting Board (PSAB) Handbook defines Canadian GAAP. School divisions can be classified as Not-for-Profit entities and would fall under the Not-for-Profit accounting recommendations of the CICA Accounting Handbook. School divisions may also report under accounting recommendations as prescribed by the PSAB Handbook. There are few differences in accounting between the two methods, however, there are significant differences in reporting between the two methods.

Findings

Reporting

- Under Not-for-Profit deferral method accounting, the following statements are recommended:
    - a statement of financial position, which should present the following:
        - net assets invested in capital assets;
        - net assets subject to restrictions requiring that they be maintained permanently as endowments;
        - other restricted net assets;
        - unrestricted net assets; and
        - total net assets.
    - a statement of operations, which should present:
        - for each financial statement item, a total that includes all funds reported; and
        - total excess or deficiency of revenues and gains over expenses and losses for the period.
    - a statement of changes in net assets which presents the changes in the following for the period:
        - net assets invested in capital assets;
        - net assets subject to restrictions requiring that they be maintained as endowments;
        - other restricted net assets;
        - unrestricted net assets; and
        - total net assets.
    - a statement of cash flows which reports the total changes in cash and cash equivalents resulting from activities of the organization during the period.
- Under PSAB accounting the following statements are recommended:
    - a statement of financial position, which at a minimum reports all financial assets and liabilities at the end of the accounting period. (Note: financial assets do not include inventories of supplies and other acquired physical assets);
    - a statement of financial activities that accounts for the combined change in the balances of funds in the accounting period; and
    - a statement of changes in financial position.

Revenue Recognition

Not-for-Profit

- Restricted contributions for which the related restrictions remain unfulfilled are accumulated as deferred contributions.

- Endowment contributions should be recognized as direct increases in net assets in the current period.
- Restricted contributions for expenses of one or more future periods should be deferred and recognized as revenue in the same period as the related expenses are recognized.
- Restricted contributions for capital expenses should be deferred and recognized over the same period the respective assets are amortized.
- Unrestricted contributions should be recognized in the current period.

PSAB

- Externally restricted inflows should be recognized as revenue in the period in which the resources are used for the purpose or purposes specified.
- Externally restricted inflows received before the specified use has occurred should be reported as a liability until the resources are used for the purpose or purposes specified.
- Revenues should be accounted for in the period in which the transactions or events occurred that gave rise to the revenues.

Contributions Receivable

Not-for-Profit

- A contribution should be recognized as an asset when it meets the following criteria:
  - the amount to be received can be reasonably estimated; and
  - ultimate collection is reasonably assured.

PSAB

- Receivables should be recognized by the recipient for those grants authorized by the transferring government prior to the end of the accounting period but not yet received, if eligibility requirements have been met.

Capital Assets

Not-for-Profit

- Not-for-Profit accounting recommends that capital assets be recorded on the statement of financial position at cost. For contributed capital assets, cost is considered to be fair value at the date of contribution. In unusual circumstances when the fair value cannot be reasonably determined, the capital asset should be recorded at a nominal value.
- The cost, less any residual value, of a capital asset with a limited life should be amortized over its useful life in a rational and systematic manner appropriate to its nature and use by the organization.

Amortization should be recognized as an expense in the organization's statement of operations.

PSAB

- PSAB recommends that capital assets be accounted for and reported as assets on the statement of tangible capital assets. Tangible capital assets should be recorded at cost.
- The amortization of the costs of the tangible capital assets should be accounted for as expenses in the statement of operations.

School Generated Funds

- GAAP does not specifically mention school generated funds as they are unique to school divisions, however, all transactions should be recorded in the financial statements. One assertion of financial statements is the assertion of completeness – that there are no unrecorded assets, liabilities or transactions.
- Revenues should generally be recognized when performance is achieved and reasonable assurance regarding measurement and collectibility exists.

Trust Funds

Not-for-Profit

- Again, the Handbook does not specifically mention trusts. An organization should include in its financial statements, all areas of activity. Trust funds should be reported in a school division's financial statements if controlled by the school division.
- The completeness assertion also applies here – that there are no unrecorded assets, liabilities or transactions.

PSAB

- PSAB recommends that trusts not be recorded on the financial statements, but rather they be disclosed in the notes to the financial statements.

Employee Future Benefits

- Both Not-for Profit and PSAB require that an entity recognize the cost of retirement benefits and certain post-employment benefits over the periods in which the employees render service to the entity in return for the benefits.

Notes to the Financial Statements

- Review of financial statements for school divisions in Manitoba indicates that there is considerable variation in the notes currently included in the financial statements.
- The number of notes varied from one to ten depending on the school division.

- The Handbooks indicate the required disclosure for each financial statement item depending on the accounting method with which they are prepared.

Benefits of GAAP Prepared Statements

Financial statements that are prepared in accordance with GAAP will be beneficial to School Divisions for a number of reasons:

- *Comparability* – statements, including notes, can be compared to other school divisions in Manitoba.
- *Full disclosure* – statements will present a full accounting of a school division's costs.
- *Fundraising* – statements that present a full accounting of a school division will assist the school division in reporting fundraising conducted.
- *Note consistency* – the Handbooks provide the required disclosure for each financial statement area. Statements prepared under GAAP will result in consistent notes across the Province.
- *Consolidation into Public Accounts* – a PSAB exposure draft on the Government Reporting Model indicates that school divisions may be included in the government reporting entity. As a result, school division results may need to be consolidated into the Public Accounts statements. Financial statements prepared in accordance with PSAB recommendations will facilitate this consolidation.
- *Unqualified audit opinion* – the CICA has issued Section 5600 on non-GAAP auditor's reports. This requires that an audit report issued on financial statements prepared using a basis of accounting other than GAAP should *"in a paragraph following the opinion paragraph, state that these financial statements, which have not been, and were not intended to be, prepared in accordance with Canadian generally accepted accounting principles, are intended for the information and use of (the intended users) and may not be appropriate for any other purpose"*.

CICA Exposure Draft - *"Auditor's Report on Financial Statements Prepared Using a Basis of Accounting Other Than Generally Accepted Accounting Principles"*, October 2002.

Conclusion

- *While FRAME was developed around GAAP, with certain exceptions, there are several areas where the accounting policies in FRAME result in school divisions not being fully in compliance with GAAP. These areas are highlighted in* ***Figure 1***.

Handbook Section	Not-for-Profit Accounting (Deferral Method)	PSAB Handbook Section	PSAB Accounting	Current Manitoba Accounting	Impact of Difference of Manitoba Current Accounting	
					Not-for-Profit	PSAB
Financial Statement Presentation						
4400.05	Financial statements normally include: a) a statement of financial position; b) a statement of operations; c) a statement of changes in net assets; and d) a statement of cash flows.	1800.07	Financial statements should include, as a minimum, a) a statement of financial position; b) a statement of financial activities; and c) a statement of changes in financial position.	a) Statement of financial position for operating and capital funds; b) Statement of revenues, expenditures and accumulated surplus for the operating fund; and c) Various prescribed financial statements (i.e., Operating Fund - Revenue Detail).	No information summarizing changes in net assets provided. No 2 year comparative information in specific instances.	No information summarizing changes in financial position provided. No 2 year comparative information in specific instances.
4400.18	For each financial statement item, the statement of financial position should present a total that includes all funds reported.	1300.40 1300.44	Trusts administered by a government or government organization should be excluded from the government reporting entity. Government financial statements should disclose, in a note or schedule, a description of trusts under administration by a government or government organization, and a summary of trust balances.	Statement of financial position for the capital and operating funds but no consolidated total.	No consolidation; incomplete financial picture.	No consolidation; incomplete financial picture.
4400.19	Statement of Financial Position should present the following: a) net assets invested in capital assets; b) net assets subject to restrictions requiring that they be maintained permanently as endowments; c) other restricted net assets; d) unrestricted net assets; and e) total net assets.	1800.13 1800.16	The statement of financial position should, as a minimum, report all financial assets and liabilities at the end of the accounting period. Financial assets do not include inventories of supplies, equipment and other acquired physical assets.	Trusts and endowments are not reported in the financial statements. There is no disclosure of restrictions, if any.	No information provided for restrictions on net assets, if any.	All financial assets are not reported (trusts and endowments not reported).
4400.33	The statement of operations should present: a) for each financial statement item, a total that includes all funds reported; and b) total excess or deficiency of revenues and gains over expenses and losses for the period.	1800.36	The statement of financial activities should account for the combined change in the balances of funds in the accounting period.	Statement of revenues, expenditures and accumulated surplus for the operating fund; Capital fund reserve accounts; and Capital fund equity.	No consolidation; incomplete financial picture.	No consolidation; incomplete financial picture.
4400.41	The statement of changes in net assets should present changes in the following for the period: a) net assets invested in capital assets; b) net assets subject to restrictions requiring that they be maintained permanently as endowments; c) other restricted net assets; d) unrestricted net assets; and e) total net assets.	1800.63	No statement of change in net assets. Financial statements should disclose changes to current, capital and reserve fund balances in the accounting period.	No statement of changes in net assets.	No statement provided summarizing changes in net assets.	No statement provided summarizing fund balance changes.
4400.44	The statement of cash flows should report the total changes in cash and cash equivalents resulting from the activities of the organization during the period. The components of cash and cash equivalents should be disclosed.	1800.50 1800.51 1800.52	Statement of changes in financial position should: a) report the changes in cash and cash equivalents; b) classify cash flows by operating, investing and financing activities; and c) report significant non-cash items.	It is disclosed in the notes that no statement of cash flows is presented as it would not be meaningful.	No information showing cash flow provided.	No information showing cash flow provided.

FIGURE 1

FIGURE 1 (CONT'D.)

Handbook Section	Not-for-Profit Accounting (Deferral Method)	PSAB Handbook Section	PSAB Accounting	Current Manitoba Accounting	Impact of Difference of Manitoba Current Accounting	
					Not-for-Profit	PSAB
Financial Statement Presentation (cont'd.)						
4400.45	Statement of Cash Flow should distinguish at least the following: a) cash from operations....; b) components of cash flows resulting from financing and investing activities, not included in (a) above.		See above.	No statement of cash flows presented.	No information showing cash flow provided.	No information showing cash flow provided.
Contributions - Revenue Recognition						
4410.29	Under the deferral method, restricted contributions for which the related restrictions remain unfulfilled are accumulated as deferred contributions.	3100.11	Externally restricted inflows should be recognized as revenue in financial statements in the period in which the resources are used for the purpose or purposes specified. An externally restricted inflow received before this criterion has been met should be reported as a liability until the resources are used for the purpose or purposes specified.	FRAME manual does not specifically address this, however financial statements do contain an unearned revenue figure.	Direction not clear.	Direction not clear.
4410.29	Endowment contributions should be recognized as direct increases in net assets in the current period.		Endowments are not addressed by PSAB. Where PSAB makes no mention of a particular item, referral should be made to the CICA Handbook.	Endowments are not reported in the financial statements.	Not recording endowments does not give full information.	Not recording endowments does not give full information.
4410.31	Restricted contributions for expenses of one or more future periods should be deferred and recognized as revenue in the same period or periods as the related expenses are recognized.	3100.11	See above.	FRAME manual does not specifically address this, however financial statements do contain an unearned revenue figure.	Direction not clear.	Direction not clear.
4410.33	Restricted contributions for the purchase of capital assets that will be amortized should be deferred and recognized as revenue on the same basis as the amortization expense related to the acquired capital assets.	3410.48	Government transfers received before revenue recognition criteria have been met should be recorded in the recipient government's financial statements as a liability until those criteria have been met.	Grants received from the Province for capital assets are recorded as revenue in the capital fund.	Revenue overstated, Liability understated.	Revenue overstated, Liability understated.
4410.47	Unrestricted contributions should be recognized as revenue in the current period.	1500.83	Revenues should be accounted for in the period in which the transactions or events occurred that gave rise to the revenues, items not practicably measurable until cash is received would be measured at that time.	Recognized as revenue in the current period.	Practise is same.	Practise is same.
Contributions Receivable						
4420.03	A contribution should be recognized as an asset when it meets the following criteria: a) the amount to be received can reasonably be estimated; and b) ultimate collection is reasonably assured.	3410.39	Receivables should be recognized by the recipient for those grants authorized by the transferring government prior to the end of the accounting period but not yet received, if the recipient government has met eligibility criteria, if any, prior to the end of that period.	Grants due from province are recorded as revenue and set up as receivable.	Practise is same.	Practise is same.

FIGURE 1 (CONT'D.)

Handbook Section	Not-for-Profit Accounting (Deferral Method)	PSAB Handbook Section	PSAB Accounting	Current Manitoba Accounting	Impact of Difference of Manitoba Current Accounting	
					Not-for-Profit	PSAB
Capital Assets						
4430.06	A capital asset should be recorded on the statement of financial position at cost. For a contributed capital asset, cost is considered to be fair value at the date of contribution. In unusual circumstances, when fair value cannot be reasonably determined, the capital asset should be recorded at nominal value.	3150.09	Tangible Capital Assets should be accounted for and reported as assets on the statement of tangible capital assets.	a) land, buildings and vehicles are recorded at cost; b) site and building betterments with a value in excess of $20,000 are considered capital expenditures; c) equipment with a useful life greater than three years, and a unit value greater than $20,000 is considered a capital expenditure.	Complete financial picture not shown without full capitalization.	Complete financial picture not shown without full capitalization.
4430.13	The cost, less any residual value, of a capital asset with a limited life should be amortized over its useful life in a rational and systematic manner appropriate to its nature and use by the organization. Amortization should be recognized as an expense in the organization's statement of operations.	3150.23	When an entity reports expenses in its financial statements, the amortization of the costs of tangible capital assets should be accounted for as expenses in the statement of operations.	No amortization of capital assets.	Overstated value for capital assets.	Overstated value for capital assets.
School Generated Funds						
5300.17	Financial statement assertion of completeness - that there are no unrecorded assets, liabilities or transactions.	1400.29	Financial statements should provide an accounting of the full nature and extent of the financial affairs and resources for which the entity is responsible including those related to the activities of government agencies and enterprises.	Certain school generated funds are not recorded on the financial statements of school divisions in Manitoba.	Does not show complete financial picture.	Does not show complete financial picture.
Trust and Endowments						
1000.30	Not specifically addressed by the Handbook. However, assets are defined as having the following characteristics: a) they embody a future benefit that involves a capacity, singly or in combination with other assets...in the case of not-for-profit organizations to provide services; b) the entity can control access to the benefit; c) the transaction or event giving rise to the entity's right to, or control of, the benefit has already occurred.	1300.40 1300.44	Trusts administered by a government or government organization should be excluded from the government reporting entity. Financial statements should disclose, in a note or schedule, a description of trusts under administration, and a summary of trust balances.	Trusts and endowments are currently not recorded or disclosed on school division financial statements in Manitoba.	Does not show complete financial picture. Should be recorded in financial statements.	Does not show complete financial picture. Should be disclosed in notes to financial statements.
Employee Future Benefits						
3461.001	Section requires an entity to recognize the cost of retirement benefits and certain post-employment benefits over the periods in which the employees render the service to the entity.	3250.009	The accounting objective is to measure and report the obligation for employee retirement benefits and to attribute the costs of those benefits to the periods in which the related services are rendered.	Employee Future Benefits are not completely recorded by school divisions in Manitoba.	Does not present a true picture of liabilities.	Does not present a true picture of liabilities.

Note: The CICA Study Group of 1996 advocate the consolidation of "funds" for financial statement purposes and conclude that "fund accounting" should not be used as the basis for financial reporting by school boards.

The CICA Study Group of 1996 indicates that financial statements should report a comparison of actual results with the Budget and the Budget information should be presented on a basis consistent with that used for actual results.

5.0 Is Compliance With GAAP Recommendations Required By Legislation Across Canada And Are CICA Accounting Recommendations Being Applied By Other Provinces?

We compared accounting rules for school divisions in Manitoba with accounting rules in other Canadian provinces.

We then examined nine audited financial statements from eight provinces (Alberta, Saskatchewan, Ontario, Quebec, Nova Scotia, Prince Edward Island, Newfoundland and two from British Columbia) to determine the terminology used in indicating the accounting policies the statements were prepared in accordance with. Also, ten audited financial statements were reviewed from within the Province of Manitoba.

Findings

- Alberta requires the Not-for-Profit – deferral method of accounting be used for all school divisions in the Province. The reporting in Alberta is fully in compliance with Not-for-Profit GAAP as recommended by the CICA.
- British Columbia requires the Not-for-Profit - deferral method of accounting be implemented for the June 30, 2003 school division fiscal year.
- Saskatchewan has undertaken steps to implement PSAB accounting. Reporting in Saskatchewan has been changed to accommodate PSAB recommendations. Accounting issues such as school generated funds and employee future benefits have not been addressed in Saskatchewan accounting policies for school divisions.
- Nova Scotia has mandated that accounting policies for school divisions be in accordance with PSAB accounting and reporting recommendations as of March 31, 2003.
- School divisions/board accounting policies in Ontario, Quebec, Prince Edward Island and Newfoundland are currently not in accordance with either Not-for-Profit or PSAB GAAP as a whole. The policies in these provinces vary with respect to whether or not they are GAAP compliant. For example, Prince Edward Island amortizes capital assets, Quebec amortizes furniture and equipment only, and New Brunswick and Ontario do not amortize capital assets.
- In examining the most recently available financial statements from nine school divisions across Canada (one from each province, not including New Brunswick and two from British Columbia), there were no

qualifications issued. However, there were different authorities that the financial statements were in accordance with. The specific wording of the audit opinions were:

- "in accordance with the accounting principles disclosed in note 1 to the financial statements" (British Columbia, Ontario, Prince Edward Island, Newfoundland);
- "in accordance with generally accepted accounting principles" (Alberta);
- "in accordance with Canadian generally accepted accounting principles" (British Columbia);
- "in accordance with generally accepted accounting principles for Quebec school boards, as described in the Manuel de normalisation de la comptabilite scolaire." (Quebec);
- "in accordance with the accounting principles prescribed by the Department of Education" (Saskatchewan);
- "in accordance with accounting principles generally accepted for school boards" (Nova Scotia).

- The wording used on the auditor's report for school divisions in Manitoba is "in accordance with generally accepted accounting policies for school divisions as described in note 1".
- In discussing school division accounting with personnel from the various provinces, there was, for the most part, acknowledgement that, current accounting and reporting policies were not sufficient. Ontario is undertaking a study to determine what changes would be required to current policies to adopt PSAB recommendations. Quebec has no plans to change current school accounting policies.

Conclusions

- *The accounting for school divisions in Canada is varied and appears to be in transition with a direction of movement toward compliance with GAAP as specified for Not-for-Profit – deferral methods and PSAB recommendations.*
- *Four Canadian provinces have implemented or have taken steps to implement new accounting policies in accordance with either the Not-for-Profit – deferral method or PSAB local government recommendations (two Not-for-Profit and two PSAB). Three provinces acknowledge that accounting policies for school divisions in those provinces need to be overhauled, but have made no decision as to which recommendation to adopt. One province has no plans to change current accounting policies. One province has abolished school divisions.*

6.0 What Is The Schools' Finance Branch Doing To Ensure That The School Divisions Are In Compliance With Sections 41(11) Through 41(14) Of The Public Schools Act?

Findings

- Sections 41(11) through 41(14) of The Public Schools Act state the following:
  - 41(11) An auditor for a school division or school district shall, not later than October 31 in each year, make a report to the school board on the annual financial statements that the auditor has examined as at the end of the preceding fiscal year.
  - 41(11.1) Repealed
  - 41(11.2) A report made under subsection (11) shall
    a) be in accordance with the standards of the CICA for an auditor's standard report; and
    b) shall include the auditor's opinion as to whether the financial statements present fairly the financial position of the school division at the end of the preceding fiscal year and the results of its operations for the preceding fiscal year, in accordance with accepted accounting principles for school divisions.
  - 41(12) The auditor shall submit to the school board a supplementary report on his or her examination of the annual financial statements and the report shall contain any information required by the regulations.
  - 41(12.1) For the purpose of subsection 12, the minister may make regulations respecting information to be contained in the auditor's supplementary report.
  - 41(13) The auditor shall furnish one copy of each report to the minister.
  - 41(14) Not later than October 31 in each year, each school board shall furnish to the minister, in the form and manner that the minister requires, a duly audited financial statement showing the revenues, expenditures and other financial information relating to its school division or school district for the immediately preceding fiscal year, and the financial position of the school division or school district at the close of the immediately preceding fiscal year.

- The Branch provides a FRAME Manual to all school divisions. The FRAME Manual sets out standards, including accounting principles, fund accounting, and object and function/program definitions that must be followed by all school divisions. The FRAME Manual was originally produced in 1982. The entire manual was reissued 1992. Through the FRAME Committee, the Branch updates and revises the manual on an ongoing basis.
- Under the Act, the following information is to be submitted to the Minister, in care of The School's Finance Branch by October 31 in each year:
    - audited financial statement;
    - auditor's report; and
    - supplementary audit report.
- The Branch maintains a log of all the required submissions that have been received from school divisions and follows-up with those school divisions that have not submitted the required information.
- The Branch reviews the audit reports for all school divisions. All deviations from an unqualified opinion are followed up. The school divisions are contacted and the Branch ensures that changes are implemented to ensure that the reasons for qualifications or reservations in the Auditor's Report are corrected.
- The Branch is responsible for the prescribed form used by the school divisions for financial statement preparation. The Branch electronically sends each school division the prescribed annual financial statement forms, in which the audited statements are to be prepared. Included with the financial statement forms are the Legislative Requirements for the Completion of Financial Statements of School Divisions/Districts of Manitoba and Sections 41(9) through 41(13) of the Act. Also included is a requirement for a supplementary audit report. The Branch provides instructions for the completion of the forms and has a dedicated staff person which specifically deals with school division accounting.
- The Auditor's Supplementary Report Regulation, required under Section 41(12) of the Act (see **Appendix D** for the complete list of requirements), requires the auditors to give an opinion on:
    - the appropriateness of internal controls regarding the school division's assets;
    - the appropriateness and functionality of internal controls regarding the school division's reporting on enrolment;
    - the appropriateness of controls regarding school funds;
    - the appropriateness of the completed Schedule 8 (Calculation of Allowable Expenditures);
    - whether the funds of the school division have been paid and disbursed only under authority of the Act, or authority of a resolution, or by-law of the division; and

  - any significant matters or irregularities or discrepancies in the administration of the school divisions affairs that the auditor feels the school board or minister should be aware of.

- As at December 2002, there were slight variations in the wording of supplementary reports for the school divisions in Manitoba. However, all reports contained the information required by the Regulation. An example of a supplementary report is presented in **Appendix E**.
- The Branch relies on the supplementary report to provide assurance on the compliance with Section 41(12) of the Act.
- The Branch reviews all supplementary reports and notes any significant issues. To follow up on any issues noted in the report, the Branch sends a standard form letter to the chairperson of the school board. Included in the letter are the significant issue(s) noted. Additionally, there are two sections that require responses from the chairperson, a plan of action to resolve the issue(s), and the expected date of resolution.
- This report would be defined by the CICA Handbook (CICA HB AuG-13 Special reports on regulated financial institutions) to be a derivative report, as noted in the following sections:
  - Section 11 - A derivative report is a by-product of the financial statement audit. The auditor is required to communicate in writing transactions or conditions encountered during a financial statement audit that are relevant to the matters specified in legislation.
  - Section 12 - The derivative reporting responsibility does not require the auditor to provide any form of assurance on the matters specified in the legislation. Accordingly, no auditing procedures in addition to those carried out in the normal course of the financial statement audit would be carried out.
- AuG-13, section 14 notes that a derivative reporting requirement would not change the scope of a financial statement audit, because the nature, extent, and timing of auditing procedures performed during a financial statement audit are not changed.
- Inconsistencies in reporting resulted because regulators and auditors likely had different expectations and understandings of what can be reasonably expected from a derivative report. As noted in AuG-13, section 22:

  "When there is no comprehensive and precise interpretation of the matters on which derivative reports are required, there will likely be inconsistencies with respect to the types of transactions or conditions identified and reported by different auditors."

- Beginning with the 2003 school year, the Branch has changed the supplementary report that is required to be submitted by all school division auditors. Auditors must indicate in their engagement letter that the necessary procedures are being performed to issue the supplementary

report. An example of the updated supplementary report is presented in **Appendix E.1**. The updated supplementary report is drafted by the Branch and, as a result, all reports received should contain consistent wording.

Conclusions

- *The supplemental report provided by the external auditors provided a low level of assurance due to its derivative nature. However, the Branch relied solely on this report to assess compliance with Section 41(12) of the Act. Thus there was an expectation gap between what the external auditors were providing and what the Branch required.*
- *The updated (June 2003) supplementary report is now providing a higher level of assurance. The report is no longer derivative in nature and the expectation gap has been closed as a result of the new process implemented by the Branch.*
- *The Branch maintains an effective process for monitoring and ensuring compliance with Sections 41(11) through 41(14) of the Act.*

7.0 Recommendation for the Department of Education, Citizenship and Youth

- That the Department of Education, Citizenship and Youth, in consultation with the FRAME Committee and other stakeholders, update the FRAME Manual to ensure that school divisions move to full accounting and reporting in accordance with GAAP. GAAP is defined for this purpose as being either accounting recommendations as defined by the PSAB Handbook or Not-for-Profit – deferral method accounting recommendations as defined by the CICA Handbook. However, we believe that there is merit in seriously considering the PSAB model because it is consistent with the government reporting models for local, provincial and federal governments. The following accounting policies should be incorporated into the method of GAAP chosen by the Department:
    - the consolidation of all funds reported in the financial statements;
    - the amortization of capital assets in a systematic manner over their useful life;
    - the recording of all school generated funds with supplementary note disclosure (to facilitate understanding by users, supplementary disclosure in the notes to school board financial statements should describe the nature of schools-generated funds and any limitations or restrictions of the use of such funds);
    - the full recording of employee future benefits;
    - the reporting of trusts and endowments (where required);

- the accrual of interest on outstanding debenture debt;
- the retroactive restatement of financial statements to reflect changes in accounting policies;
- the segregation of current and long-term assets and liabilities;
- as a minimum, a statement of financial position, a statement of financial activities and a statement of cash flow; and
- the incorporation of notes to the financial statements that are in accordance with GAAP.

- If GAAP is not followed, that the audit opinion on a school division's audited financial statements contain a fourth paragraph, as per Section 5600 of the CICA Handbook, indicating the financial statements are not prepared in accordance with GAAP.

Departmental Response

The FRAME system of accounting and reporting for school divisions in Manitoba provides meaningful, relevant and comparable financial information on school division revenue and expenditures for the benefit of school boards, the department and the public. The department has received many positive comments on the value of FRAME.

FRAME accounting policies were developed to be consistent with generally accepted accounting principles with some exceptions which have been noted in the Auditor General's report. As the Auditor General has noted, school division accounting is in a state of change nationally which is reflective of changing information needs and expectations of public sector bodies. The department is aware of this environment and, through the FRAME Committee, had already taken steps to examine revisions to FRAME that may be necessary. For example the FRAME Committee has examined the reporting of trust funds under the control of school divisions and a trust fund reporting policy was implemented for the 2004/05 reporting period. The FRAME Committee had also established a sub-committee to examine the continued need for a separate capital fund and related asset amortization issues.

In June 2005, the Province of Manitoba announced a commitment to be fully compliant with summary budgeting and reporting standards related to the government reporting entity (GRE) requirements in the PSAB handbook by fiscal year 2007/08. The announcement included the consolidation of school division financial information in the GRE. During the summer of 2005, the department and the FRAME sub-committee evaluated this requirement in discussions with the government Steering Committee for summary budgeting and reporting and developed a broad framework that will lead to compliance with PSAB for local government by

2007/08 for school division accounting and financial reporting. It is expected these changes will address concerns identified in this report.

The Auditor General's recommendations, and in particular the comparisons between PSAB versus not-for-profit accounting standards for school divisions provides useful information for the department and the FRAME sub-committee to consider while continuing its work to meet this requirement.

The department will undertake further consultation with stakeholders to ensure that accounting changes do not result in unintended impacts for school divisions and taxpayers. In particular the recommendation to consolidate school generated funds requires a much closer examination of related audit requirements (and potential cost) and the administrative effort (and training requirements) to collect, compile and report the financial data.

Appendix A

AUDITOR'S REPORT

To the Chairperson and Board of Trustees of XYZ School Division

We have audited the Operating Fund and the Capital Fund Balance Sheets of XYZ School Division as at June 30, 20__ and the Statements of Revenue and Expenditures, Surplus (Deficit) Account for the Operating Fund and Capital Financing and Capital Invested Account for the Capital Fund for the Year then ended. These financial statements are the responsibility of the School Division's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of XYZ School Division as at June 30, 20__ and the results of its operations and the changes in its financial position for the year then ended in accordance with the basis of accounting required by the Schools' Finance Branch as disclosed in Note 1 to the financial statements.

Further, in our opinion, the other schedules and exhibits, when considered in relation to the aforementioned financial statements, present fairly the supplemental information shown.

City

Date

CHARTERED ACCOUNTANTS

Appendix A.1

AUDITOR'S REPORTS (CONT'D.)

AUDITOR'S REPORT

To the Chairperson and Board of Trustees of XYZ School Division

We have audited the Operating Fund and the Capital Fund Balance Sheets of XYZ School Division as at June 30, 20XX and the Statements of Revenue and Expenditures, Surplus (Deficit) Account for the Operating Fund and Capital Financing and Capital Invested Account for the Capital Fund for the Year then ended. These financial statements have been prepared to comply with the basis of accounting directed by the Manitoba Department of Education. These financial statements are the responsibility of the School Division's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of XYZ School Division as at June 30, 20XX and the results of its operations and the changes in its financial position for the year then ended in accordance with the basis of accounting described in Note 1 to the financial statements.

These financial statements, which have not been and were not intended to be, prepared in accordance with Canadian generally accepted accounting principles, are solely for the information and use of the Board of Trustees and the Minister of Education of Manitoba. The financial statements are not intended to be and should not be used by anyone other than the specified users or for any other purpose.

City
Date

CHARTERED ACCOUNTANTS

Appendix A.2

AUDITOR'S REPORT

To the Chairperson and Board of Trustees of XYZ School Division

We have audited the Statement of Financial Position of XYZ School Division as at June 30, 20XX and the Statements of Financial Activities and Changes in Financial Position for the Year then ended. These financial statements are the responsibility of the School Division's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of XYZ School Division as at June 30, 20XX and the results of its operations and the changes in its financial position for the year then ended in accordance with Canadian generally accepted accounting principles.

City
Date

CHARTERED ACCOUNTANTS

Appendix B

FUNDING THROUGH PSFB BY SCHOOL DIVISION

TOTAL PROVINCIAL FUNDING

No.	Division/District	Total Education and Training	Other Provincial Revenue	Total Provincial Revenue
1	Winnipeg	$134,490,056	$1,773,245	$136,263,301
2	St. James - Assiniboia	32,951,523	130,595	33,082,118
3	Assiniboine South	22,466,470	-	22,466,470
4	St. Boniface	23,476,944	4,217	23,481,161
5	Fort Garry	24,692,272	42,692	24,734,964
6	St. Vital	36,463,160	239,263	36,702,423
9	River East	52,258,177	65,368	52,323,545
10	Seven Oaks	38,003,777	102,235	38,106,012
11	Lord Selkirk	19,579,701	14,129	19,593,830
12	Transcona - Springfield	32,278,559	-	32,278,559
13	Agassiz	12,112,410	6,128	12,118,538
14	Seine River	16,375,826	26,938	16,402,764
15	Hanover	24,262,662	103,066	24,365,728
16	Boundary	3,768,612	10,138	3,778,750
17	Red River	2,686,139	-	2,686,139
18	Rhineland	6,230,236	47,652	6,277,888
19	Morris - MacDonald	10,255,255	3,479	10,258,734
20	White Horse Plain	4,728,712	-	4,728,712
21	Interlake	15,320,409	8,607	15,329,016
22	Evergreen	6,858,266	143,140	7,001,406
23	Lakeshore	7,388,782	20,968	7,409,750
24	Portage la Prairie	14,703,673	1,487	14,705,160
25	Midland	6,912,491	13,745	6,926,236
26	Garden Valley	11,763,794	8,485	11,772,279
28	Mountain	4,371,710	5,153	4,376,863
30	Pine Creek	6,429,280	1,295	6,430,575
31	Beautiful Plains	7,192,305	880	7,193,185
32	Turtle River	4,784,366	-	4,784,366
33	Dauphin - Ochre	8,535,747	27,880	8,563,627
34	Duck Mountain	4,357,571	-	4,357,571
35	Swan Valley	9,257,232	57,235	9,314,467
36	Intermountain	4,643,962	7,436	4,651,398
37	Pelly Trail	4,293,962	-	4,293,962
38	Birdtail River	5,380,002	-	5,380,002
39	Rolling River	9,791,791	5,547	9,797,338
40	Brandon	27,867,618	2,959	27,870,577
41	Fort la Bosse	7,001,538	-	7,001,538
42	Souris Valley	4,887,192	23,437	4,910,629
43	Antler River	3,482,503	23,646	3,506,149
44	Turtle Mountain	6,003,092	3,140	6,006,232
45	Kelsey	8,988,152	1,874	8,990,026
46	Flin Flon	6,567,646	-	6,567,646
47	Western	6,103,647	16,974	6,120,621
48	Frontier	28,172,876	136,239	28,309,115
49	D.F.S.M.	22,706,669	116,386	22,823,055
50	Prairie Spirit	9,239,975	17,486	9,257,461
2264	Churchill	1,348,175	-	1,348,175
2309	Snow Lake	1,406,761	7,076	1,413,837
2312	Lynn Lake	1,338,064	-	1,338,064
2355	Mystery Lake	16,181,596	-	16,181,596
2439	Sprague Consolidated	944,920	-	944,920
2460	Leaf Rapids	1,836,078	119,156	1,955,234
3000	Winnipeg Technical College	3,388,487	-	3,388,487
	Provincial Total	$786,530,823	$3,339,376	$789,870,199

REQUIRED FRAME REPORTING SCHEDULES

Appendix C

Manitoba
Education,
Training
and Youth



Schools' Finance Branch
511-1181 Portage Avenue
Winnipeg, Manitoba
R3G 0T3

SCHOOL DIVISION NAME AND SCHOOL DIVISION NO.
Address1
Address2

AUDITED FINANCIAL STATEMENTS

AND SUPPLEMENTARY INFORMATION

June 30, 2002

Appendix C (cont'd.)

REQUIRED FRAME REPORTING SCHEDULES

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REQUIRED FRAME REPORTING SCHEDULES

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AUDITOR'S SUPPLEMENTARY REPORT

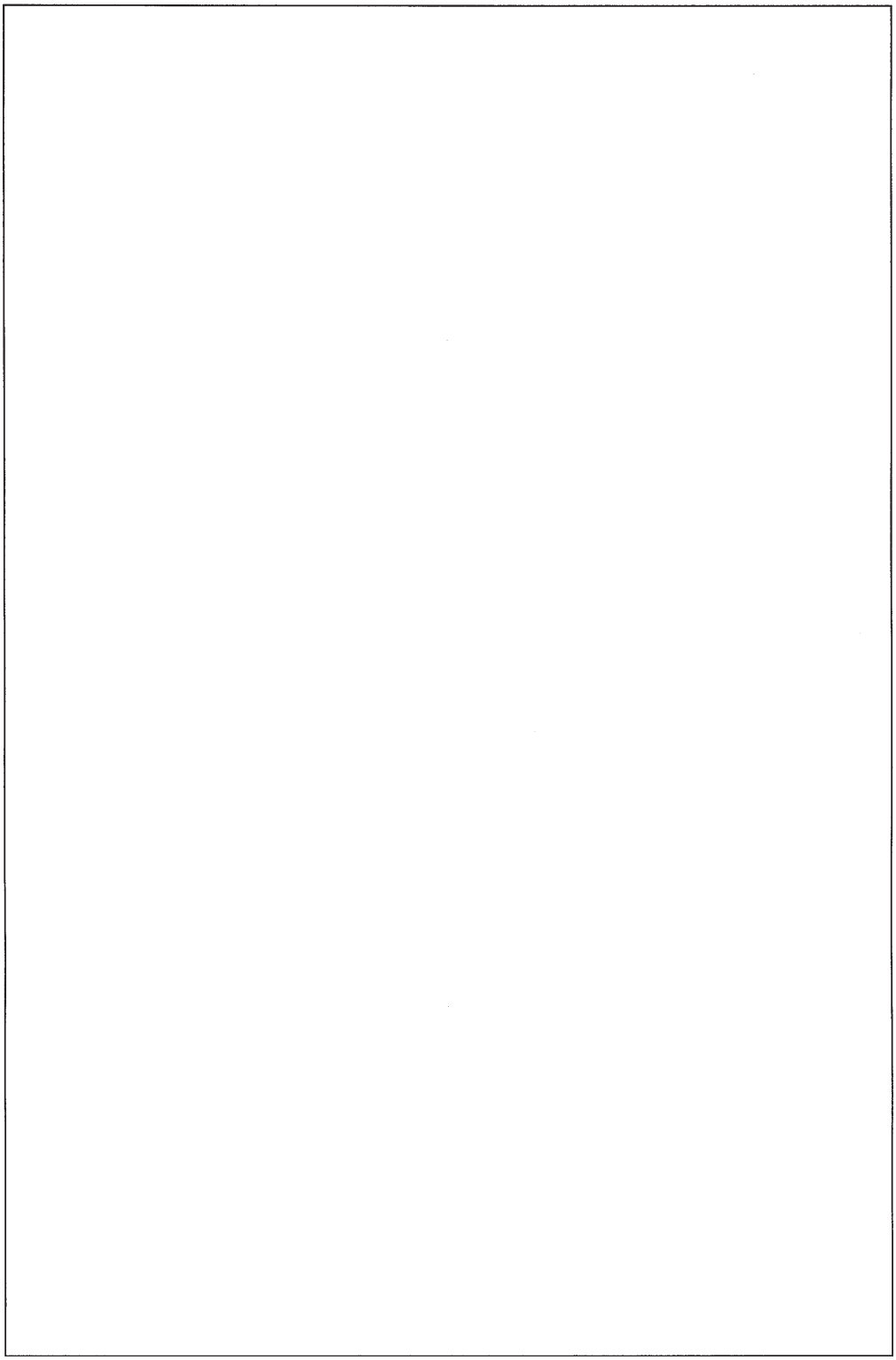
DATE	AUDITOR
DATE	CHAIRPERSON

Appendix C
(cont'd.)

REQUIRED FRAME REPORTING SCHEDULES

School Division Name and No.

NOTES TO THE FINANCIAL STATEMENTS



REQUIRED FRAME REPORTING SCHEDULES

Appendix C
(cont'd.)

School Division Name and No. 17-Apr-03

OPERATING FUND - STATEMENT OF FINANCIAL POSITION

As at June 30

	2002	2001
ASSETS		
Cash	-	-
Short Term Investments	-	-
Due From Provincial Government	-	-
Due From Municipal Government	-	-
Due From Federal Government	-	-
Due From Other School Divisions	-	-
Due From Other Funds	-	-
Accounts Receivable	-	-
Inventories	-	-
Prepaid Expenses	-	-
	0	0
LIABILITIES		
Overdrafts	-	-
Short Term Financing	-	-
Accounts Payable	-	-
Accrued Liabilities	-	-
Due To Provincial Government	-	-
Due To Municipal Government	-	-
Due To Federal Government	-	-
Due To Other School Divisions	-	-
Due To Other Funds	-	-
Unearned Revenue	-	-
	0	0
Accumulated Surplus (Deficit)	0	0
	0	0

Appendix C (cont'd.)

REQUIRED FRAME REPORTING SCHEDULES

School Division Name and No. 17-Apr-03

OPERATING FUND
STATEMENT OF REVENUES, EXPENDITURES AND ACCUMULATED SURPLUS

For the Year Ended June 30

	2002 Actual	2002 Budget	2001 Actual
REVENUES			
Provincial Government	-	-	-
Federal Government	-	-	-
Municipal Government	-	-	-
Other School Divisions	-	-	-
First Nations	-	-	-
Private Organizations and Individuals	-	-	-
Other Sources	-	-	-
	0	0	0
EXPENDITURES			
Regular Instruction	-	-	-
Exceptional	-	-	-
Adult Learning Centres	-	-	N/A
Community Education and Services	-	-	-
Divisional Administration	-	-	-
Instructional and Pupil Support Services	-	-	-
Transportation of Pupils	-	-	-
Operations and Maintenance	-	-	-
Fiscal	-	-	-
	0	0	0
Current Year Operating Surplus (Deficit)	0	0	0
Less: Net Transfers to Capital Fund	0	0	0
Net Current Year Surplus (Deficit)	0	0	0
Accumulated Surplus (Deficit) Beginning of Year	0		0
Adjustments: _____	-		
_____			-
Accumulated Surplus (Deficit) End of Year	0		0

REQUIRED FRAME REPORTING SCHEDULES

Appendix C
(cont'd.)

School Division Name and No. 17-Apr-03

OPERATING FUND - REVENUE DETAIL
PROVINCE OF MANITOBA
For the Year Ended June 30, 2002

Schools' Finance Program		
Base Support		
Support for Recognized Expenditures	-	
Curricular Materials	-	
Information Technology	-	
Library Services	-	
Level I Special Needs	-	
Counselling and Guidance	-	
Professional Development	-	
Occupancy	-	0
Categorical Support		
Transportation	-	
Board and Room	-	
Special Needs: Coordinator/Clinician	-	
Special Needs: Level II	-	
Special Needs: Level III	-	
Technology (Vocational) Education	-	
English as a Second Language	-	
Aboriginal Academic Achievement	-	
Heritage Language	-	
French Language Programs	-	
Small Schools	-	
Students at Risk	-	
Increasing Enrolment	-	
Remoteness Allowance	-	
Early Behaviour Intervention	-	
Early Childhood Development	-	
Early Identification	-	
Early Literacy	-	
Programme d'accueil	-	0
Supplementary Support		-
Adjustment for Days Closed		-
Other Program Support		
School Buildings Support: "D" Projects	-	
Vocational Equipment Replacement	-	
Environmental Assistance Program	-	
Air Quality Program	-	
Other Minor Capital Support	-	
Prior Year Support		
Finalization of Previous Year Support	-	
Curricular Materials	-	
School Buildings Support: "D" Projects	-	
Vocational Equipment	-	
Environmental Assistance Program	-	0
		0

Appendix C (cont'd.)

REQUIRED FRAME REPORTING SCHEDULES

School Division Name and No. 17-Apr-03

OPERATING FUND - REVENUE DETAIL
PROVINCE OF MANITOBA (CONT'D)
For the Year Ended June 30, 2002

Other Department of Education, Training and Youth

Non-Resident	-	
Special Needs	-	
Institutional Programs	-	
Adult Learning Centres	-	
Nursing Supports (URIS)	-	
Evening School	-	
Substitute Fees	-	
General Support Grant	-	
Red River Vocational Area Co-ordinator	-	
New Schools	-	
Other:	-	
		0

Other Provincial Government Departments

English as a Second Language (Adults)	-	
Driver Training	-	
Employment Programs	-	
Other:	-	
		0

Schools' Finance Program (previous page)	0
TOTAL PROVINCIAL GOVERNMENT REVENUE	0

REQUIRED FRAME REPORTING SCHEDULES

Appendix C
(cont'd.)

School Division Name and No. 17-Apr-03

OPERATING FUND - REVENUE DETAIL
NON-PROVINCIAL GOVERNMENT SOURCES
For the Year Ended June 30, 2002

Federal Government		
Tuition Fees	-	
Transportation of Pupils	-	
French Language Monitor	-	
Other:	-	
		0
Municipal Government		
Special Requirement	-	
Other:	-	0
Other School Divisions		
Transfer Fees	-	
Residual Fees	-	
Transportation of Pupils	-	
Other:	-	
		0
First Nations		
Tuition Fees	-	
Transportation of Pupils	-	
Other:	-	
		0
Private Organizations and Individuals		
Regular Tuition	-	
Continuing Education	-	
Driver Education	-	
Other Tuition:	-	
Food Service	-	
Other:	-	
		0
Other Sources		
Interest	-	
Donations	-	
Other:	-	
		0
TOTAL NON-PROVINCIAL GOVERNMENT REVENUE		0

Appendix C
(cont'd.)

REQUIRED FRAME REPORTING SCHEDULES

School Division Name and No.

17-Apr-03

OPERATING FUND - EXPENDITURES BY FUNCTION AND BY OBJECT

For the Year Ended June 30

OBJECT \ FUNCTION	100 Regular Instruction	200 Exceptional	300 Adult Learning Centres	400 Community Education and Services	500 Divisional Administration	600 Instructional and Pupil Support Services	700 Transportation	800 Operations and Maintenance	900 Fiscal	2002 TOTALS	2001 TOTALS
Salaries	-	-	-	-	-	-	-	-		0	-
Employees Benefits and Allowances	-	-	-	-	-	-	-	-		0	-
Services	-	-	-	-	-	-	-	-		0	-
Supplies, Materials and Minor Equipment	-	-	-	-	-	-	-	-		0	-
Short Term Loan Interest and Bank Charges									-	0	-
Transfers	-	-	-	-	-	-	-		(PAYROLL TAX) -	0	-
TOTALS	0	0	0	0	0	0	0	0	0	0	0

School Division Name and No.

OPERATING FUND - EXPENDITURE DETAIL: FUNCTION 100

For the Year Ended June 30, 2002

17-Apr-03

FUNCTION 100: REGULAR INSTRUCTION	10	SINGLE TRACK SCHOOLS *			80	90	
		20 ENGLISH	50	70 FRENCH	DUAL TRACK	SENIOR YEARS TECHNOLOGY	
CODE OBJECT \ PROGRAM	ADMINISTRATION	LANGUAGE	FRANÇAIS	IMMERSION	SCHOOLS **	EDUCATION	TOTALS
3XX SALARIES							
320 Executive, Managerial and Supervisory							0
330 Instructional - Teaching							0
350 Instructional - Other							0
360 Technical, Specialized and Service							0
370 Secretarial, Clerical and Other							0
390 Information Technology							0
Total Salaries	0	0	0	0	0	0	0
4XX EMPLOYEES BENEFITS AND ALLOWANCES							0
5-6XX SERVICES							
510 Professional, Technical and Specialized							0
520 Communications							0
540 Travel and Meetings							0
560 Tuition							0
570 Printing and Binding							0
590 Maintenance and Repair Services							0
610 Rentals							0
630 Advertising							0
640 Dues and Fees							0
650 Professional and Staff Development							0
680 Information Technology Services							0
Total Services	0	0	0	0	0	0	0
7XX SUPPLIES, MATERIALS AND MINOR EQUIPMENT							
710 Supplies							0
740 Curricular and Media Materials							0
760 Minor Equipment							0
770 Inventory Adjustment							0
780 Information Technology Equipment							0
Total Supplies, Materials and Minor Equipment	0	0	0	0	0	0	0
95X-99 TRANSFERS							
960 School Divisions							0
980 Organizations and Individuals							0
Total Transfers	0	0	0	0	0	0	0
TOTALS	0	0	0	0	0	0	0

* 90% or more of enrolment is in one of the following instructional programs: English Language, Français, French Immersion.

** includes multi-track schools.

Appendix C (cont'd.)

School Division Name and No.

OPERATING FUND - EXPENDITURE DETAIL: FUNCTION 200

For the Year Ended June 30, 2002

17-Apr-03

FUNCTION 200: EXCEPTIONAL	10	20	30	40	50	60	
CODE OBJECT \ PROGRAM	ADMINISTRATION /CO-ORDINATION	GIFTED EDUCATION *	CLINICAL AND RELATED SERVICES	SPECIAL NEEDS CLASSES	STUDENTS WITH SPECIAL NEEDS IN REGULAR CLASSES	OTHER RESOURCE SERVICES	TOTALS
3XX SALARIES							
320 Executive, Managerial and Supervisory							0
330 Instructional - Teaching							0
350 Instructional - Other							0
360 Technical, Specialized and Service							0
370 Secretarial, Clerical and Other							0
380 Clinician							0
390 Information Technology							0
Total Salaries	0	0	0	0	0	0	0
4XX EMPLOYEES BENEFITS AND ALLOWANCES							0
5-6XX SERVICES							
510 Professional, Technical and Specialized							0
520 Communications							0
540 Travel and Meetings							0
560 Tuition							0
570 Printing and Binding							0
590 Maintenance and Repair Services							0
610 Rentals							0
630 Advertising							0
640 Dues and Fees							0
650 Professional and Staff Development							0
680 Information Technology Services							0
Total Services	0	0	0	0	0	0	0
7XX SUPPLIES, MATERIALS AND MINOR EQUIPMENT							
710 Supplies							0
740 Curricular and Media Materials							0
760 Minor Equipment							0
770 Inventory Adjustment							0
780 Information Technology Equipment							0
Total Supplies, Materials and Minor Equipment	0	0	0	0	0	0	0
95X-99 TRANSFERS							
960 School Divisions							0
980 Organizations and Individuals							0
Total Transfers	0	0	0	0	0	0	0
TOTALS	0	0	0	0	0	0	0

* Does not include enrichment activities undertaken by the School Division.

School Division Name and No.

OPERATING FUND - EXPENDITURE DETAIL: FUNCTION 300

For the Year Ended June 30, 2002

17-Apr-03

FUNCTION 300: ADULT LEARNING CENTRES	10 ADMINISTRATION	20	
CODE OBJECT \ PROGRAM	AND OTHER	INSTRUCTION	TOTALS
3XX SALARIES			
320 Executive, Managerial and Supervisory			0
330 Instructional - Teaching			0
350 Instructional - Other			0
360 Technical, Specialized and Service			0
370 Secretarial, Clerical and Other			0
390 Information Technology			0
Total Salaries	0	0	0
4XX EMPLOYEES BENEFITS AND ALLOWANCES			0
5-6XX SERVICES			
510 Professional, Technical and Specialized			0
520 Communications			0
530 Utility Services			0
540 Travel and Meetings			0
560 Tuition			0
570 Printing and Binding			0
580 Insurance and Bond Premiums			0
590 Maintenance and Repair Services			0
610 Rentals			0
620 Taxes			0
630 Advertising			0
640 Dues and Fees			0
650 Professional and Staff Development			0
680 Information Technology Services			0
Total Services	0	0	0
7XX SUPPLIES, MATERIALS AND MINOR EQUIPMENT			
710 Supplies			0
740 Curricular and Media Materials			0
760 Minor Equipment			0
770 Inventory Adjustment			0
780 Information Technology Equipment			0
Total Supplies, Materials and Minor Equipment	0	0	0
95X-99 TRANSFERS			
960 School Divisions			0
980 Organizations and Individuals			0
Total Transfers	0	0	0
TOTALS	0	0	0

Appendix C (cont'd.)

School Division Name and No.

OPERATING FUND - EXPENDITURE DETAIL: FUNCTION 400

For the Year Ended June 30, 2002

17-Apr-03

FUNCTION 400: COMMUNITY EDUCATION AND SERVICES	10	20	30	40	
CODE OBJECT \ PROGRAM	CONTINUING EDUCATION	ENGLISH AS A SECOND LANGUAGE	COMMUNITY SERVICES AND RECREATION	PRE-KINDERGARTEN EDUCATION	TOTALS
3XX SALARIES					
320 Executive, Managerial and Supervisory					0
330 Instructional - Teaching					0
350 Instructional - Other					0
360 Technical, Specialized and Service					0
370 Secretarial, Clerical and Other					0
380 Clinician					0
390 Information Technology					0
Total Salaries	0	0	0	0	0
4XX EMPLOYEES BENEFITS AND ALLOWANCES					0
5-6XX SERVICES					
510 Professional, Technical and Specialized					0
520 Communications					0
540 Travel and Meetings					0
560 Tuition					0
570 Printing and Binding					0
590 Maintenance and Repair Services					0
610 Rentals					0
630 Advertising					0
640 Dues and Fees					0
650 Professional and Staff Development					0
680 Information Technology Services					0
Total Services	0	0	0	0	0
7XX SUPPLIES, MATERIALS AND MINOR EQUIPMENT					
710 Supplies					0
740 Curricular and Media Materials					0
760 Minor Equipment					0
770 Inventory Adjustment					0
780 Information Technology Equipment					0
Total Supplies, Materials and Minor Equipment	0	0	0	0	0
95X-99 TRANSFERS					
960 School Divisions					0
980 Organizations and Individuals					0
Total Transfers	0	0	0	0	0
TOTALS	0	0	0	0	0

School Division Name and No.

17-Apr-03

OPERATING FUND - EXPENDITURE DETAIL: FUNCTION 500

For the Year Ended June 30, 2002

FUNCTION 500: DIVISION ADMINISTRATION	10	20	30	50	
CODE OBJECT \ PROGRAM	BOARD OF TRUSTEES	INSTRUCTIONAL MANAGEMENT & ADMINISTRATION	BUSINESS AND ADMINISTRATIVE SERVICES	MANAGEMENT INFORMATION SERVICES	TOTALS
3XX SALARIES					
310 Trustees Remuneration					0
320 Executive, Managerial and Supervisory					0
360 Technical, Specialized and Service					0
370 Secretarial, Clerical and Other					0
390 Information Technology					0
Total Salaries	0	0	0	0	0
4XX EMPLOYEES BENEFITS AND ALLOWANCES					0
5-6XX SERVICES					
510 Professional, Technical and Specialized					0
520 Communications					0
540 Travel and Meetings					0
570 Printing and Binding					0
580 Insurance and Bond Premiums					0
590 Maintenance and Repair Services					0
610 Rentals					0
630 Advertising					0
640 Dues and Fees					0
650 Professional and Staff Development					0
680 Information Technology Services					0
Total Services	0	0	0	0	0
7XX SUPPLIES, MATERIALS AND MINOR EQUIPMENT					
710 Supplies					0
740 Curricular and Media Materials					0
760 Minor Equipment					0
770 Inventory Adjustment					0
780 Information Technology Equipment					0
Total Supplies, Materials and Minor Equipment	0	0	0	0	0
95X-99 TRANSFERS					
960 School Divisions					0
980 Organizations and Individuals					0
Total Transfers	0	0	0	0	0
TOTALS	0	0	0	0	0

Appendix C (cont'd.)

School Division Name and No.

OPERATING FUND - EXPENDITURE DETAIL: FUNCTION 600

For the Year Ended June 30, 2002

17-Apr-03

FUNCTION 600: INSTRUCTIONAL AND PUPIL SUPPORT SERVICES	10 CURRICULUM CONSULTING &	20 LIBRARY / MEDIA	30 PROFESSIONAL AND STAFF	40	50 HEALTH SERVICES AND	60 FOOD	70	
CODE OBJECT \ PROGRAM	DEVELOPMENT	CENTRE	DEVELOPMENT	COUNSELLING AND GUIDANCE	ATTENDANCE	SERVICES	OTHER	TOTALS
3XX SALARIES								
320 Executive, Managerial and Supervisory								0
330 Instructional - Teaching								0
350 Instructional - Other								0
360 Technical, Specialized and Service								0
370 Secretarial, Clerical and Other								0
390 Information Technology								0
Total Salaries	0	0	0	0	0	0	0	0
4XX EMPLOYEES BENEFITS AND ALLOWANCES								0
5-6XX SERVICES								
510 Professional, Technical and Specialized								0
520 Communications								0
540 Travel and Meetings								0
570 Printing and Binding								0
580 Insurance and Bond Premiums								0
590 Maintenance and Repair Services								0
610 Rentals								0
630 Advertising								0
640 Dues and Fees								0
650 Professional and Staff Development								0
680 Information Technology Services								0
Total Services	0	0	0	0	0	0	0	0
7XX SUPPLIES, MATERIALS AND MINOR EQUIPMENT								
710 Supplies								0
740 Curricular and Media Materials								0
760 Minor Equipment								0
780 Information Technology Equipment								0
Total Supplies, Materials and Minor Equipment	0	0	0	0	0	0	0	0
95X-99 TRANSFERS								
960 School Divisions								0
980 Organizations and Individuals								0
Total Transfers	0	0	0	0	0	0	0	0
TOTALS	0	0	0	0	0	0	0	0

Appendix C (cont'd.)

School Division Name and No.

OPERATING FUND - EXPENDITURE DETAIL: FUNCTION 700

For the Year Ended June 30, 2002

17-Apr-03

FUNCTION 700: TRANSPORTATION OF PUPILS	10	20	70 ALLOWANCES IN LIEU OF TRANSPORTATION	80 BOARDING OF STUDENTS/ DORMITORIES	90	
CODE OBJECT \ PROGRAM	ADMINISTRATION	REGULAR			OTHER	TOTALS
3XX SALARIES						
320 Executive, Managerial and Supervisory						0
350 Instructional - Other						0
360 Technical, Specialized and Service						0
370 Secretarial, Clerical and Other						0
390 Information Technology						0
Total Salaries	0	0	0	0	0	0
4XX EMPLOYEES BENEFITS AND ALLOWANCES						0
5-6XX SERVICES						
510 Professional, Technical and Specialized						0
520 Communications						0
540 Travel and Meetings						0
550 Transportation of Pupils						0
580 Insurance and Bond Premiums						0
590 Maintenance and Repair Services						0
610 Rentals						0
630 Advertising						0
640 Dues and Fees						0
650 Professional and Staff Development						0
680 Information Technology Services						0
Total Services	0	0	0	0	0	0
7XX SUPPLIES, MATERIALS AND MINOR EQUIPMENT						
710 Supplies						0
740 Curricular and Media Materials						0
760 Minor Equipment						0
770 Inventory Adjustment						0
780 Information Technology Equipment						0
Total Supplies, Materials and Minor Equipment	0	0	0	0	0	0
95X-99 TRANSFERS						
960 School Divisions						0
980 Organizations and Individuals						0
999 Recharge						0
Total Transfers	0	0	0	0	0	0
TOTALS	0	0	0	0	0	0

Appendix C (cont'd.)

School Division Name and No.

OPERATING FUND - EXPENDITURE DETAIL: FUNCTION 800

For the Year Ended June 30, 2002

17-Apr-03

FUNCTION 800: OPERATIONS AND MAINTENANCE	10	20	50	70	80	
CODE OBJECT \ PROGRAM	ADMINISTRATION	SCHOOL BUILDINGS MAINTENANCE	SCHOOL BUILDINGS REPAIRS AND REPLACEMENTS	OTHER BUILDINGS	GROUNDS	TOTALS
3XX SALARIES						
320 Executive, Managerial and Supervisory						0
360 Technical, Specialized and Service						0
370 Secretarial, Clerical and Other						0
390 Information Technology						0
Total Salaries	0	0	0	0	0	0
4XX EMPLOYEES BENEFITS AND ALLOWANCES						0
5-6XX SERVICES						
510 Professional, Technical and Specialized						0
520 Communications						0
530 Utility Services						0
540 Travel and Meetings						0
580 Insurance and Bond Premiums						0
590 Maintenance and Repair Services						0
610 Rentals						0
620 Taxes						0
630 Advertising						0
640 Dues and Fees						0
650 Professional and Staff Development						0
680 Information Technology Services						0
Total Services	0	0	0	0	0	0
7XX SUPPLIES, MATERIALS AND MINOR EQUIPMENT						
710 Supplies						0
740 Curricular and Media Materials						0
760 Minor Equipment						0
770 Inventory Adjustment						0
780 Information Technology Equipment						0
Total Supplies, Materials and Minor Equipment	0	0	0	0	0	0
TOTALS	0	0	0	0	0	0

REQUIRED FRAME REPORTING SCHEDULES

Appendix C
(cont'd.)

School Division Name and No. 17-Apr-03

OPERATING FUND - DETAIL OF TRANSFERS TO (FROM) CAPITAL FUND

For the Year Ended June 30, 2002

TRANSFERS TO CAPITAL FUND		
Category "D" School Buildings	-	
Environmental Assistance Program	-	
Bus Reserve	-	
Bus Purchases	-	
Other: _____	-	
_____		
_____		
_____		
_____		
_____		
_____		
_____		0
LESS: TRANSFERS FROM CAPITAL FUND		
_____		
_____		
_____		
_____		
_____		0
NET TRANSFERS TO (FROM) CAPITAL FUND		0

Appendix C (cont'd.)

REQUIRED FRAME REPORTING SCHEDULES

School Division Name and No. 17-Apr-03

CAPITAL FUND - STATEMENT OF FINANCIAL POSITION

As at June 30

	2002	2001
ASSETS		
Current Assets		
Cash	-	-
Short Term Investments	-	-
Due From Provincial Government	-	-
Due From Federal Government	-	-
Due From Other Funds	-	-
Accounts Receivable	-	-
	0	0
Capital Assets		
Land	-	-
Buildings	-	-
Equipment	-	-
Vehicles	-	-
	0	0
	0	0
LIABILITIES, RESERVE AND EQUITY		
Current Liabilities		
Overdrafts	-	-
Short Term Financing	-	-
Accounts Payable	-	-
Accrued Liabilities	-	-
Due To Provincial Government	-	-
Due To Federal Government	-	-
Due To Other Funds	-	-
	0	0
Debenture Debt	-	-
Other Long Term Debt	-	-
Total Liabilities	0	0
Reserve Accounts	-	-
Equity	-	-
	0	0

School Division Name and No. 17-Apr-03

CAPITAL ASSETS

For the Year Ended June 30

	TOTAL ASSETS at June 30, 2001	ADDITIONS	DISPOSALS AT ORIGINAL COST	TOTAL ASSETS at June 30, 2002	PROCEEDS FROM SALES	
Schools						
Land	-			0		(1)
Buildings	-			0		(1)
Equipment	-			0		
Administrative Facilities						
Land	-			0		
Buildings	-			0		
Equipment	-			0		
Residences and Dormitories						
Land	-			0		
Buildings	-			0		
Equipment	-			0		
Garages, Repair Shops and Warehouses						
Land	-			0		
Buildings	-			0		
Equipment	-			0		
Vehicles						
School Buses	-			0		
Other Vehicles	-			0		
TOTALS	0	0	0	0	0	

Note (1): Gross proceeds on sale of Land and School building(s)	-
Less transfers to Province of Manitoba	-
Net proceeds	0

Appendix C (cont'd.)

REQUIRED FRAME REPORTING SCHEDULES

School Division Name and No.

17-Apr-03

CAPITAL FUND - RESERVE ACCOUNTS

For the Year Ended June 30, 2002

	BUSES	OTHER	TOTAL
OPENING BALANCE	-	-	0
Adjustments			
Transfers from Operating Fund	-	-	0
Other: _____	-	-	0
_____			0
_____			0
_____			0
CLOSING BALANCE	0	0	0

CAPITAL FUND - EQUITY

For the Year Ended June 30, 2002

OPENING BALANCE		-
Adjustments for prior year		-
ADDITIONS:		
Contributed by Provincial Government	-	
Contributed by Federal Government	-	
Investment Income	-	
Gifts or Donations	-	
Transfers from Operating Fund	-	
Transfers from Reserve	-	
Other: _____	-	
_____		0
DEDUCTIONS:		
Debenture Debt Interest	-	
Adjustments to Asset Values due to Losses and Obsolescence	-	
Transfers to Operating Fund	-	
Transfers to Reserve	-	
Other: _____	-	
_____		0
CLOSING BALANCE		0

REQUIRED FRAME REPORTING SCHEDULES

Appendix C (cont'd.)

School Division Name and No. 17-Apr-03

CAPITAL FUND - CAPITAL FINANCING

For the Year Ended June 30, 2002

FINANCES ACQUIRED		
Current Assets as at June 30, 2001		-
Provincial Government		
Capital Projects	-	
Debt Servicing - Interest	-	
- Principal	-	
Other Department of Education, Training and Youth	-	
Other Provincial Government Departments	-	0
Federal Government		
Indian Affairs	-	
Other Federal:	-	
	-	0
Investment Income		-
Insurance Proceeds		-
Gifts or Donations		-
Other:	-	
	-	-
Proceeds from the sale of Capital Assets		-
Transfers from Operating Fund		-
Long Term Debt		
Debentures	-	
Other	-	0
Current Liabilities as at June 30, 2002		-
TOTAL FINANCES ACQUIRED		0
FINANCES APPLIED		
Current Liabilities as at June 30, 2001		-
Additions to Capital Assets		-
Debt Services		
Debenture Debt Interest	-	
Debenture Debt Principal	-	
Other Long Term Debt	-	0
Transfers to Operating Fund		-
Current Assets as at June 30, 2002		-
TOTAL FINANCES APPLIED		0

Appendix C (cont'd.)

REQUIRED FRAME REPORTING SCHEDULES

School Division Name and No.

17-Apr-03

STUDENT ENROLMENTS (FRAME) AND TRANSPORTATION STATISTICS (UNAUDITED)

ENROLMENTS BY PROGRAM		F.T.E. Enrolment September 30, 2001
REGULAR INSTRUCTION		
English Language - Single Track		-
Francais - Single Track		-
French Immersion - Single Track		-
Dual Track		
- English Language	-	
- Francais	-	
- French Immersion	-	
- Other Bilingual	-	0.0
Senior Years Technology Education		-
TOTAL REGULAR INSTRUCTION		0.0
EXCEPTIONAL : Special Needs Classes		-
TOTAL NUMBER OF FULL TIME EQUIVALENT K - S4 STUDENTS		0.0
ADULT LEARNING CENTRES		-

TRANSPORTATION OF PUPILS	
TRANSPORTED STUDENTS	-
TOTAL KILOMETERS - LOG BOOK	-
TOTAL KILOMETERS - BUS ROUTES	-
LOADED KILOMETERS	-

School Division Name and No. 17-Apr-03

FULL TIME EQUIVALENT PERSONNEL (UNAUDITED)

September 30, 2001

CODE OBJECT \ FUNCTION	FUNCTION 100	FUNCTION 200	FUNCTION 300	FUNCTION 400	FUNCTION 500	FUNCTION 600	FUNCTION 700	FUNCTION 800	TOTALS
320 Executive, Managerial, & Supervisory									0.00
330 Instructional - Teaching									0.00
350 Instructional - Other									0.00
360 Technical, Specialized And Service									0.00
370 Secretarial, Clerical And Other									0.00
380 Clinician									0.00
390 Information Technology									0.00
TOTALS (excluding Trustees)	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00

310 TRUSTEES		

Appendix C (cont'd.)

School Division Name and No. : 2001/2002 FRAME Financial Statements

17-Apr-03

CALCULATION OF ALLOWABLE EXPENDITURES

FUNCTION / PROGRAM	TOTAL EXPENDITURES	ADJUSTMENTS TO EXPENDITURES	REDUCTIONS TO EXPENDITURES: CATEGORICAL AND BASE SUPPORT	REDUCTIONS TO EXPENDITURES: OTHER PROGRAM SUPPORT	REDUCTIONS TO EXPENDITURES: OTHER PROVINCIAL GOVERNMENT REVENUE	REDUCTIONS TO EXPENDITURES: NON-PROVINCIAL SOURCES: TUITION, TRANSFER AND RESIDUAL FEES	REDUCTIONS TO EXPENDITURES: NON-PROVINCIAL SOURCES: OTHER	ALLOWABLE EXPENDITURES
		<<<<< *(from Appendix A)* >>>>>			<<<<< *(from Appendix B)* >>>>>			
100 Regular Instruction	0	0	0		0		0	0
200 Exceptional (1)	0	0	0		0		0	0
300 Adult Learning Centres	0	0			0		0	0
400 Community Education and Services	0		0		0		0	0
500 Administration	0	0	0		0		0	0
600 Instructional & Pupil Support Services								
610 Curriculum Consulting	0	0	0		0		0	0
620 Educational Media	0	0	0		0		0	0
630 Professional and Staff Development	0	0	0		0		0	0
640 Counselling and Guidance	0	0	0		0		0	0
600 Health/Food Services and Other	0	0	0		0		0	0
700 Transportation of Pupils	0	0	0		0		0	0
800 Operations and Maintenance	0	0			0		0	0
900 Fiscal	0							
SUBTOTAL (ALLOCATED)				0	0	0	0	
UNALLOCATED REVENUE/FUNDING					0	0	0	
TOTAL	0	0	0	0	0	0	0	

(1) To determine Allowable Expenditures for Level I.

Appendix C (cont'd.)

School Division Name and No. : 2001/2002 FRAME Financial Statements

17-Apr-03

APPENDIX A

CALCULATION OF ALLOWABLE EXPENDITURES (refer to "Allow Guide")

ADJUSTMENTS TO EXPENDITURES: (enter deductions as negative amounts)	Function/ Program	Amount
Capitalized Energy Mgmt. Systems Costs (add) (1), (2)	800	
Capitalized Section "D" School Bldgs. Costs (add) (1)	800	
Lease costs paid to other School Divisions (deduct)	800	
Transfers from Capital Fund (deduct)	800	0
Leased Non-School Space (deduct)	800	
Other Capitalized Items (2) (please specify item and Function/Program)		
Total Adjustments to Expenditures		0

(1) Net of all related revenues.

(2) For capitalized energy management systems costs and other capitalized items, lease and loan payments for eligible equipment may be included.

CATEGORICAL AND BASE SUPPORT TO BE ALLOCATED:		ELIGIBLE SUPPORT
Curricular Materials		0
Information Technology		0
Special Needs: Coordinator/Clinician		
(A) Maximum Support		
(B) Eligible Expenditures		
(C) Less related revenues		
(D) Allowable Expenditures (B) - (C)	0	
Eligible Support (lesser of A or D)		0
Special Needs: Level II and III		0
Technology (Vocational) Education		0
English as a Second Language		0
Aboriginal Academic Achievement		0
Heritage Language		0
French Language		0
Small Schools		
(A) Maximum Support		
(B) Program Expenditures		
Eligible Support (lesser of A or B)		0
Students at Risk		0
Early Behaviour Intervention		0
Early Identification		0
Early Literacy		0
Programme d'accueil		0
Total amount to be allocated on page 22 (Allowable Expenditures)		0

OTHER PROGRAM SUPPORT:

School Buildings Support: "D" Projects	0
Vocational Equipment Support	0
Environmental Assistance Program	0
Air Quality Program	0
Other Minor Capital Support	0
Curricular Materials Prior Year Support	0
Finalization of Previous Year's support	0
Sub-total	0
LESS: Environmental Assistance transferred to Capital	0
Amount carried forward to Allowable Expenditures	0

CALCULATION OF ALLOWABLE SECTION "D" EXPENDITURES:

Program 850 School Building Repairs & Replacements		0
PLUS: Capitalized Section "D" Expenditures (net)		0
Grounds		
LESS: Air Quality Program		0
E A P Support less transfers		0
Related revenue other than "D" Support		
Allowable Section "D" Expenditures	**(C)**	0
< OR >		
Expenditures to be used for calculating "D" Grant if different from above (cannot be more than amount on line C)	**(D)**	

Refer to page 2 of the Allowable Expenditures Guide when completing this section.

Appendix C (cont'd.)

School Division Name and No. : 2001/2002 FRAME Financial Statements

17-Apr-03

APPENDIX B

CALCULATION OF ALLOWABLE EXPENDITURES

OTHER PROVINCIAL GOVERNMENT REVENUE:

	Allocated	Unallocated	Total
Other Department of Education, Training & Youth			
General Support Grant		0	0
All other	0		0
Other Provincial Government Departments	0		0
Total Revenue	0	0	0

NON-PROVINCIAL SOURCES:

	Allocated	Unallocated	Total
Federal Government			
Tuition Fees	0		0
All other	0		0
Municipal Government			
Special Requirement		0	0
Other	0		0
Other School Divisions			
Transfer Fees	0		0
Residual Fees	0		0
All other	0		0
First Nations			
Tuition Fees	0		0
All other	0		0
Private Organizations and Individuals			
Tuition Fees	0		0
Ancillary Services	0		0
Other Sources			
Interest		0	0
Donations	0	0	0
Other	0		0
Total Revenue	0	0	0

ALL REVENUES REPORTED ON THIS PAGE, EXCEPT THOSE SHADED, MUST BE DEDUCTED FROM TOTAL EXPENDITURES ON PAGE 22 UNLESS THERE ARE SPECIAL CIRCUMSTANCES WHICH WOULD MAKE AN ALLOCATION IMPRACTICAL OR INAPPROPRIATE. **IN THOSE LIMITED CASES, REASONS FOR NOT ALLOCATING MUST BE PROVIDED BELOW.**

TOTAL FEES 0
(to agree with total tuition, transfer and residual fees on page 22)

TOTAL OTHER REVENUE 0
(to agree with total other revenue on page 22)

AUDITOR'S SUPPLEMENTARY REPORT REGULATION

Appendix D

THE PUBLIC SCHOOLS ACT
(C.C.S.M. c. P250)

Auditor's Supplementary Report Regulation

Regulation 149/2000
Registered November 6, 2000

Auditor's supplementary report

1 The supplementary report that an auditor for a school board must submit under subsection 41(12) of the Act must state the following:

(a) whether, in the auditor's opinion, appropriate internal controls exist for the school division assets outlined in section 9 of the *Financial Reporting and Accounting in Manitoba Education* (FRAME) manual;

(b) whether, in the auditor's opinion, an appropriate system of internal control existed and functioned effectively for reporting school division enrolment for the purposes of calculating provincial funding according to the definitions and reporting requirements set out in sections 1.1 and 1.2 of the annual Enrolment Reporting Requirements document issued by the Schools' Finance Branch;

(c) whether, in the auditor's opinion, appropriate controls exist for Type A and Type B school funds as outlined in the Policy on School Funds issued by the Schools' Finance Branch on November 15, 1993;

LOI SUR LES ÉCOLES PUBLIQUES
(c. P250 de la C.P.L.M.)

Règlement sur le rapport de vérification complémentaire

Règlement 149/2000
Date d'enregistrement : le 6 novembre 2000

Rapport de vérification complémentaire

1 Le vérificateur d'une commission scolaire doit, dans le rapport complémentaire qu'il doit déposer en vertu du paragraphe 41(12) de la *Loi*, préciser ce qui suit :

a) s'il existe, à son avis, des mécanismes de contrôle interne appropriés relativement aux biens de la division scolaire indiqués à l'article 9 du manuel du système comptable FRAME;

b) s'il existait, à son avis, un système de contrôle interne approprié et conforme aux définitions et aux exigences que prévoient les articles 1.1 et 1.2 du document intitulé *Communication des données sur les écoles publiques* qu'a produit la Direction des finances des écoles pour la communication des inscriptions des divisions scolaires aux fins du calcul des subventions provinciales;

c) s'il existe, à son avis, des mécanismes de contrôle appropriés relativement aux subventions d'écoles de type A et B ainsi qu'il est énoncé dans le document intitulé *Policy on School Funds* que la Direction des finances des écoles a produit le 15 novembre 1993;

Appendix D (cont'd.)

AUDITOR'S SUPPLEMENTARY REPORT REGULATION

(d) whether, in the auditor's opinion, Schedule 8 (Calculation of Allowable Expenditures) of the audited financial statements has been completed appropriately and in accordance with the Department's instructions included in the annual request for financial statements;

(e) whether the funds of the school division have, to the best of the auditor's knowledge and belief, been paid and disbursed only under authority granted by an Act of the Legislature, or under authority of a resolution or by-law of the division made under the authority of an Act of the Legislature;

(f) whether there are any other significant matters or irregularities or discrepancies in the administration of the school division's affairs that should be brought to the attention of the school board or the minister.

d) si, à son avis, le tableau 8 des états financiers vérifiés a été rempli convenablement et conformément aux recommandations que le ministère a indiquées dans la demande annuelle des états financiers;

e) si, à sa connaissance, les subventions ont été versées à la division scolaire uniquement en vertu d'une loi de la province ou d'une résolution ou d'un règlement administratif que la division a adopté en vertu d'une loi de la province;

f) si d'autres éléments importants, des irrégularités ou des erreurs dans l'administration des affaires de la division scolaire doivent être portés à l'attention de la commission scolaire ou du ministre.

Le ministre de l'Éducation et de la Formation professionnelle,

October 25, 2000 — Drew Caldwell, Minister of Education and Training

Le 25 octobre 2000 — Drew Caldwell

The Queen's Printer for the Province of Manitoba

L'Imprimeur de la Reine du Manitoba

Appendix E

AUDITOR'S SUPPLEMENTARY REPORT

To the Board of Trustees of the XYZ School Division

In accordance with the provisions of Section 41(12) of The Public Schools Act we have made a study of those internal accounting control and administrative control procedures of the XYZ school division that we considered relevant to the requirements of the Act. Our study was made in accordance Canadian generally accepted auditing standards, and accordingly included such tests and other procedures during the year from July 1, 20__ to June 30, 20__ as we considered necessary in the circumstances.

The administration of the Division is responsible for establishing and maintaining a system if internal accounting control. In fulfilling this responsibility, estimates and judgements by the administration are required to assess the expected benefits and related costs of control procedures. The objectives of a system are to provide the administration with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with administration's authorization and recorded properly to permit the preparation of financial statements in accordance with a described basis of accounting.

Because of inherent limitations in any system of internal accounting control, errors or irregularities may occur and not be detected. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions, or that the degree of compliance with the procedures may deteriorate.

Our study and evaluation was made for the limited purpose required by the provision of Section 41(12) of The Public Schools Act, and as such may not disclose all material weaknesses in the system. Accordingly, we do not express an opinion on the system of internal accounting control of the Division taken as a whole.

We report that in our opinion, during the year from July 1, 20__ to June 30, 20__ taken as a whole:

a) The appropriate internal controls exist for those School Division assets outlined in Section 9 of the FRAME Manual.

b) An appropriate system of internal control existed and functioned effectively for the School Division enrollment for the purpose of calculating provincial funding, per the definitions and reporting requirements established in section 1.1 and section 1.2 of the annual Enrollment Reporting Requirements document issued by the Schools' Finance Branch.

c) The appropriate controls exist for Type A and Type B school funds as outlined in the Policy on School Funds issued by the Schools' Finance Branch on November 15, 1993.

Appendix E
(cont'd.)

AUDITOR'S SUPPLEMENTARY REPORT

d) Schedule 8 (Calculation of Allowable Expenditures) of the audited financial statements has been completed appropriately and in accordance with the Department's instructions included in the annual request for financial statements.

e) The funds of the School Division have, to the best of our knowledge and belief, been paid and disbursed only under authority granted by an Act of Legislature or under authority of a resolution or by-law of the School Division made under the authority of an Act of the Legislature.

f) There are no other significant matters, or any irregularity or discrepancy in the administration of the affairs of the School Division, that should be brought to the attention of the School Board or the Minister. However, we have issued our standard internal control letter to the Board of Trustees under separate cover.

City, Province

Date

Chartered Accountants

AUDITOR'S SUPPLEMENTARY REPORT

Appendix E.1

AUDITOR'S SUPPLEMENTARY REPORT

TO THE BOARD OF TRUSTEES
SCHOOL DIVISION NAME

In accordance with the provisions of Section 41(12) of the Public Schools Act, we have made a study of those internal accounting control and administrative control procedures of School Division Name ("The Division") that we considered relevant to the requirements of the Act and related regulations. Our study was made in accordance with Canadian generally accepted auditing standards, and accordingly included such tests and other procedures for the year ended June 30, 2003 as we considered necessary in the circumstances.

The administration of the Division is responsible for establishing and maintaining a system of internal accounting control. The objectives of a system are to provide the administration with reasonable, but not absolute, assurance that transactions are executed in accordance with administration's authorization and recorded properly to permit the preparation of financial statements in accordance with a described basis of accounting.

Because of inherent limitations in any system of internal accounting and administrative control, only reasonable assurance can be obtained with respect to the adequacy of such internal control procedures.

Our study and evaluation was made solely for the purposes required by the provision of Section 41(12) of The Public Schools Act, and as such may not disclose all material weaknesses in the system. Accordingly, we do not express an opinion on the system of internal accounting control of the Division taken as a whole.

We report that, during the year ended June 30, 2003, taken as a whole:

(a) in our opinion, an appropriate system of internal control existed and functioned effectively for reporting school division enrolment for the purpose of calculating provincial funding, according to the definitions and reporting requirements set out in sections 1.1 and 1.2 of the document entitled "Public Schools Enrolment Reporting at September 30, 2002" issued by the Schools' Finance Branch;

(b) in our opinion, appropriate controls exist and are in use for Type A school funds as outlined in the Policy on School Funds issued by the Schools' Finance Branch on November 15, 1993;

(c) in our opinion, there are no other significant matters, or irregularities or discrepancies in the administration of the school division's affairs that should be brought to the attention of the school board or the minister.

Further, as result of our financial statement audit procedures and those procedures undertaken to allow us to report under Section 41(12) of the Public Schools Act, we report, to the best of our knowledge and belief, that the funds of the school division have been paid and disbursed only under authority granted by an Act of the Legislature or under authority of a resolution or by-law of the division made under the authority of an Act of Legislature.

_____ Date

_____ Auditor

I hereby certify that the preceding report has been presented to the members of the Board of School Division Name.

_____ Date

_____ Chairperson

Appendix F

SECTIONS OF PROVINCIAL ACTS RELATING TO FINANCIAL REPORTING FOR SCHOOL DIVISIONS

Manitoba

P250 – The Public Schools Act

41(11) Auditor's Report

An auditor for a school division or school district shall, not later than October 31 in each year, make a report to the school board on the annual financial statements that the auditor has examined as at the end of the preceding fiscal year.

41(11.2) Standards of the CICA

A report made in subsection (11) shall

a) comply with the standards of the Canadian Institute of Chartered Accountants for an auditor's standard report; and

b) include the auditor's opinion as to whether the financial statements present fairly the financial position of the school division as at the end of the preceding fiscal year and the results of its operations for the preceding fiscal year, in accordance with accepted accounting principles for school divisions.

41(12) Auditor's Supplementary Report

The auditor shall submit to the school board a supplementary report on his or her examination of the annual financial statements and the report shall contain any information required by the regulations.

41(14) Financial statement to minister

Not later than October 31 in each year, each school board shall furnish to the minister, in the form and manner the minister requires, a duly audited financial statement showing the revenues, expenditures and other financial information relating to its school division or school district for the immediately preceding fiscal year, and the financial position of the school division or school district at the close of the immediately preceding fiscal year.

Saskatchewan

E0.2 The Education Act, 1995

Reports to minister 282

A board of education or the conseil scolaire shall furnish to the minister copies of budget estimates, financial statements and other information in any form and at any times that the minister may consider necessary.

SECTIONS OF PROVINCIAL ACTS RELATING TO FINANCIAL REPORTING FOR SCHOOL DIVISIONS

Appendix F
(cont'd.)

Previous financial statements 283

1) On or before June 30 in each fiscal year, a board of education shall cause to be prepared and presented to the board of education a statement of the public accounts of the school division for the preceding year.

2) On or before June 30 in each fiscal year the conseil scolaire shall cause to be prepared and table at a public meeting of the conseil scolaire a statement of the public accounts of the conseil scolaire for the preceding fiscal year.

3) The public accounts prepared pursuant to subsection (1) or (2) shall:

    a) be open for inspection by any person during regular business hours;

    b) be printed in sufficient quantity and distributed in a manner to satisfy any requests for copies.

4) Subject to any limitations or requirements that may be prescribed in the regulations, the public accounts prepared pursuant to subsection (1) or (2) shall:

    a) in the case of a board of education, incorporate the audited financial statement of the school division prepared pursuant to clause 85(1)(s);

    b) in the case of a conseil scolaire, incorporate the audited financial statement of the conseil scolaire prepared pursuant to clause 86(1)(s);

    c) show clearly and fully the revenues, expenditures, assets and liabilities of the school division or the conseil scolaire as at December 31 of the preceding fiscal year;

    d) show clearly and fully the state of the operating and capital funds, and of any other funds provided for in this Act, of the school division or conseil scolaire as at December 31 of the preceding fiscal year;

    e) set forth all matters that are required to explain the financial transactions and position of the school division or the conseil scolaire during and at the close of the preceding school year; and

    f) show clearly and fully:

        i) the remuneration paid to each employee of the board of education or the conseil scolaire;

        ii) expenditures pursuant to any contract; and

        iii) expenditures, grants and contributions of goods and services made pursuant to section 87 in the case of a board of education, or pursuant to section 88 in the case of a conseil scolaire.

Appendix F (cont'd.)

SECTIONS OF PROVINCIAL ACTS RELATING TO FINANCIAL REPORTING FOR SCHOOL DIVISIONS

Alberta

The School Act Chapter S-3

Financial reporting 147

1) The fiscal year of a board of a district or division is September 1 to the following August 31.

2) The board of a district or division shall do the following:

   a) on or before November 15 in each year, prepare financial statements for the fiscal year ending on the previous August 31;

   b) on or before May 31 in each year, prepare and submit to the Minister a budget for the fiscal year beginning on the following September 1.

Auditor's report 149

1) An auditor shall perform the auditor's examination and prepare the auditor's report in accordance with generally accepted auditing standards on the financial statements prepared pursuant to this Act and submit the report to the board.

2) The auditor shall at all times be given access to all records, documents, books of account and vouchers of the board by board employees, and the auditor is empowered to request and receive from the board and any employee of the board any information and explanations that in the auditor's opinion may be necessary to enable the auditor to report as required by subsection (1).

3) The Minister may prescribe procedures to be used under this section that differ from generally accepted accounting principles.

British Columbia

School Act Part 8

Financial statements 157

1) The board must cause to be prepared each fiscal year by the secretary treasurer or other person authorized by it, financial statements of the school district respecting the preceding fiscal year.

2) The financial statements must be prepared on or before September 15 of each year, and must include for each fund a balance sheet, statement of income and expenditure and other information that the minister directs or the regulations prescribe.

3) The financial statements may include separate statements of special activities of the board so long as the items of account of a controlling nature appear in the statements referred to in subsection (2).

SECTIONS OF PROVINCIAL ACTS RELATING TO FINANCIAL REPORTING FOR SCHOOL DIVISIONS

Appendix F
(cont'd.)

4) The financial statements referred to in subsection (2) must be signed by the chair of the board and the secretary treasurer, and must be published for distribution to the public before December 31 together with the auditor's report submitted to the board under section 161(1)(d).

5) The secretary treasurer must, not later than September 30 in each year, forward to the minister a copy of the financial statements together with the auditor's report.

Duties of auditor 161

1) In addition to any terms of an auditor's appointment, the auditor

   a) must make an examination that will enable the auditor to report to the board as required under paragraph (d),

   b) has a right of access at all times to every record of the board other than a student record or a record referred to in paragraph (d) of the definition of "student record",

   c) may require from trustees or officers or employees of the board and from any other persons any information or explanation necessary to complete the audit, and

   d) must submit a report to the board respecting the annual financial statements referred to in section 157 and must state in the report

      i) whether his or her examination was made in accordance with generally accepted auditing standards including such tests and other procedures as he or she considered necessary in the circumstances, and

      ii) whether in the auditor's opinion the financial statements present fairly the financial position of the board as of the end of the fiscal year and the results of its operations for that year in accordance with section 156 (1) (b) applied on a basis consistent with that of the preceding fiscal year.

Ontario

Education Act Chapter E.2

Financial statements 252

1) Every year, the treasurer of every board shall prepare the financial statements for the board by the date prescribed under subsection (3) and, on receiving the auditor's report on the financial statements, shall promptly give the Ministry two copies of the financial statements and the auditor's report.

Appendix F (cont'd.)

SECTIONS OF PROVINCIAL ACTS RELATING TO FINANCIAL REPORTING FOR SCHOOL DIVISIONS

Minister's powers 252

3) The Minister may prescribe the date in each year by which the treasurer of a board shall prepare the financial statements of the board and forward them to the auditor.

Duties of auditor 253

4) An auditor of a board shall perform the duties that are prescribed by the Minister under paragraph 30 of subsection 8(1) and the duties that may be required by the board that do not conflict with the duties prescribed by the Minister.

Quebec

Education Act Chapter I-13.3

Auditor 284

For each fiscal year, every school board shall appoint from among the members of a professional order of accountants governed by the Professional Code (chapter C-26) an external auditor who shall file a report of his audit of the financial transactions of the school board.

The Minister may specify the mandate applicable to all auditors of school boards.

Financial Statements 286

Once the financial activities have been audited, the director general shall submit the financial statements of the school board and the external auditor's report to the council of commissioners at its first sitting following by at least 15 days the date of receipt of the report.

Financial Information 288

At the request of the Minister, the school board, either directly or through the financial institution with which it does business, shall furnish him with any information he may require on its financial position.

Newfoundland

Schools Act, 1997 Chapter 12.2

Accounts and audits 66

1) A board shall keep an accurate record of all receipts and expenditures and ensure that all funds received from the Crown are expended only for the purpose for which they are provided and prepare and submit to the minister at the end of each school year a detailed statement of its accounts audited by a person licensed under the Public Accountancy Act in the form and at a time that the minister may require.

SECTIONS OF PROVINCIAL ACTS RELATING TO FINANCIAL REPORTING FOR SCHOOL DIVISIONS

Appendix F
(cont'd.)

Nova Scotia

Education Act

Financial statements 83

Every school board for each fiscal year shall prepare financial statements in the form prescribed by the Minister and shall submit the statements to the Minister and to each municipality in the school district or school region before July 1st of the ensuing fiscal year.

Auditor 84

1) Every school board shall annually appoint a person who is a licensed public accountant or a firm in which a member is a licensed public accountant to be the auditor of the school board.

2) Where a school board does not appoint an auditor in accordance with subsection (1), the Minister may appoint one on behalf of the school board.

Audit 85

1) Within three months after the end of each fiscal year, the auditor of a school board shall examine and report on the financial statements of the board for the preceding fiscal year, including

    a) a statement of revenue and expenditure for the operating fund and any other fund of the board;

    b) a continuity of the surplus or deficit statement for the operating fund and any other fund of the board;

    ba) those matters that are required to be published pursuant to subsection 65(1);

    c) a statement of assets and liabilities for the operating fund and any other fund of the board as of the end of the fiscal year; and

    d) such other statement or information as may be required by law or by the school board.

2) The auditor shall perform the annual examination in accordance with generally accepted auditing standards.

3) The auditor shall attach to the financial statements a report which shall state

    a) whether the auditor has obtained all the information and explanations the auditor has required;

    b) whether the auditor's examination was made in accordance with generally accepted auditing standards, and accordingly included

Appendix F (cont'd.)

SECTIONS OF PROVINCIAL ACTS RELATING TO FINANCIAL REPORTING FOR SCHOOL DIVISIONS

such tests and other procedures as the auditor considered necessary in the circumstances; and

c) whether the statements present fairly the financial position of the school board as at the end of the fiscal year and the results of its operations for the preceding fiscal year in accordance with generally accepted accounting principles, as set out by the Minister in the financial management system approved by the regulations.

Prince Edward Island

School Act Chapter S-2.1

Annual Audited financial Statements 126(3)

Each school board shall provide the Minister with annual audited financial statements on the date set by Minister's directives.

INFRASTRUCTURE TANGIBLE CAPITAL ASSETS AUDIT REPORT



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APPENDICES

Appendix A: Infrastructure Recorded by Transportation and Government Services at April 1, 2004

Appendix B: Public Sector Accounting Standards

Appendix C: Infrastructure Project - Flowchart and Key Controls - Costs Accumulation at Transportation and Government Services

Appendix D: Infrastructure Project - Flowchart and Key Controls - Depreciation

Executive Summary

The objective of this audit was to confirm that the Province recognized infrastructure tangible capital assets in accordance with Canadian generally accepted accounting principles (GAAP) for senior governments as recommended by the Public Sector Accounting Board (PSAB), and to determine whether there are effective internal controls supporting the proper accounting for infrastructure.

The Province of Manitoba first began recognizing tangible capital assets in the Public Accounts in the 1999/00 fiscal year. That year the Province recognized all tangible capital assets except for land and infrastructure. In 2000/01, the Province recognized land. In the 2004/05 fiscal year, the Province completed its recognition of tangible capital assets with the recording of infrastructure with a net book value (cost less accumulated amortization) of $1.2 billion. Infrastructure tangible capital assets consist of such assets as provincial roads and highways, provincial bridges, provincial parks, the Red River floodway, and provincial dams.

The vast majority of infrastructure tangible capital assets was constructed by the Department of Transportation and Government Services. To a much lesser extent, infrastructure was also constructed by the Departments of Conservation and Water Stewardship and a very limited amount of infrastructure was built by the Department of Aboriginal and Northern Affairs.

Infrastructure is recognized in the Operating Fund, in all material respects, as at April 1, 2004 and for the year ended March 31, 2005, in accordance with GAAP as recommended by PSAB. However, there were certain misstatements related to the application of the Government's accounting policy. The material misstatements that we identified were adjusted in the 2004/05 Summary and Special Purpose Financial Statements.

We determined that Manitoba's infrastructure accounting policy is in accordance with GAAP. In addition, the key aspects of Manitoba's accounting policy and practices were consistent with the accounting policies and practices used in other provincial jurisdictions.

The Province's internal controls supporting the proper accounting for infrastructure were operating effectively for the year ended March 31, 2005 except for the internal control procedures related to the recognition of when new infrastructure is put in service. We recommended that the Province amend their procedures to record new infrastructure by September 30 of each fiscal year in order to permit the Asset Management Module of SAP to properly calculate the current year's amortization expense.

1.0 Introduction

The Province of Manitoba first began recognizing tangible capital assets in the Public Accounts in the 1999/00 fiscal year. That year the Province recognized all its tangible capital assets except for land and infrastructure. In 2000/01, the Province recognized land. In the 2004/05 fiscal year, the Province completed its recognition of tangible capital assets with the recording of infrastructure with a net book value (cost less accumulated amortization) of $1.2 billion. Infrastructure tangible capital assets consist of such assets as provincial roads and highways, provincial bridges, provincial parks, the Red River floodway, and provincial dams.

The vast majority of infrastructure tangible capital assets was constructed by the Department of Transportation and Government Services. To a much lesser extent, infrastructure was also constructed by the Departments of Conservation and Water Stewardship and a very limited amount of infrastructure was built by the Department of Aboriginal and Northern Affairs.

1.1 OBJECTIVES AND SCOPE

This examination formed part of our audit of the Public Accounts for the year ended March 31, 2005; we conducted this audit because the recognition of infrastructure is a material change in the accounting policies used by the Province in the preparation of the Public Accounts.

Sections of The Auditor General Act Granting Authority to Conduct the Audit

> ***"Audit of government accounts***
> *9(1) The Auditor General is the auditor of the accounts of the government, including those relating to the Consolidated Fund, and must make any examinations and inquiries that he or she considers necessary to enable the Auditor General to report as required by this Act.*
>
> ***Audit of the Public Accounts***
> *9(3) The Auditor General is responsible for examining and auditing the financial statements included in the Public Accounts under The Financial Administration Act, and any other statements the Minister of Finance presents for audit."*

Objectives

- To determine whether infrastructure tangible capital assets (infrastructure) are recognized in the Operating Fund, as at April 1, 2004 and for the year ended March 31, 2005, in accordance with Canadian generally accepted accounting principles (GAAP) for senior governments as recommended by the Public Sector Accounting Board (PSAB).
- To determine whether there are effective internal controls supporting the proper accounting for infrastructure.

The sources we used for the development of our audit criteria included:

- Recommendations of the Public Sector Accounting Board of the Canadian Institute of Chartered Accountants (CICA);
- CICA Research Report *"Accounting for Infrastructure in the Public Sector"*;
- Province of Manitoba's accounting policy related to infrastructure; and
- Annual reports of the Public Accounts of other provincial governments.

Our audit objectives and criteria were only applied to the examination of infrastructure. General tangible capital assets were excluded from this audit. Our examination of the internal controls did not include an examination of the general information technology (IT) controls. The general IT controls of the Province were examined separately in the audit of the Public Accounts.

Our examination included such tests and other procedures as we consider necessary in the circumstances.

Scope

The historical infrastructure recorded at April 1, 2004 does not include any fully amortized assets. With the exception of land infrastructure, the Province is not capitalizing any infrastructure costs incurred prior to April 1, 1964. The audit of the historical infrastructure balance at April 1, 2004 examined the 45 year period ending March 31, 2004. Our work was substantially conducted between January and February, 2005.

The audit of the internal controls examined the controls in place during the nine month period ending December 31, 2004. The construction "season" for highways ends on October 31st of each year. Therefore at December 31, 2004, over 80% of the department's infrastructure budget was already capitalized. Our audit work was substantially conducted between January and February, 2005 and was mainly performed at the Finance and Administration office of Transportation and Government Services.

The audit of the final infrastructure balances at March 31, 2005 was completed in June, 2005.

Our audit effort for Objective 1 was primarily directed at the infrastructure capitalized at April 1, 2004. Our audit effort for Objective 2 was primarily directed at the infrastructure capitalized since April 1, 2004.

Approach

Our audit procedures for the historical infrastructure of the three departments, Transportation & Government Services (T&GS), Conservation and Water Stewardship, identified with significant infrastructure, focused primarily on the verification of the existence and valuation of the assets. We reviewed the appropriateness of the methodology used by the three departments to identify and to ensure the completeness of their inventory of historical infrastructure.

The infrastructure constructed by the Departments of Water Stewardship and Conservation is not as significant to the Public Accounts and the net book value of infrastructure constructed by Aboriginal and Northern Affairs prior to April 1, 2004 was less than $1 million. For these three departments, our audit procedures were limited to minimum review procedures. We reviewed the nature of their historical infrastructure and the appropriateness of the amortization rates. For the year ended March 31, 2005, we performed substantive tests including analytical review procedures on the additions, disposals, write-offs and amortization expense recorded. However, we did not adopt a controls reliant approach related to controls affecting the proper accounting at these departments because of the relatively small dollar value of the 2005 fiscal year transactions.

For T&GS, the planned evidence gathering techniques beyond the basic approach of interview/discussion and related document examination were:

Objective 1

- Performance of substantive audit procedures for 100% of the infrastructure population at April 1, 2004. Our substantive tests included recalculating the accumulated amortization and verifying the construction costs to the annual reports of T&GS (1959/60) and the Construction Management System (CMS) (1993/94 to 2003/04).
- Adoption of a controls reliance approach for the audit of infrastructure for the year ended March 31, 2005. We also performed analytical review procedures on the additions, disposals, write downs of infrastructure assets and amortization expense recorded during the year. The key controls supporting this approach were documented and tested as part of our examination for Objective 2.

Objective 2

- Documentation and testing of the key controls at T&GS that ensure that infrastructure costs, capitalized since April 1, 2004 are complete, accurate, and valid.
- Documentation and testing of the key controls at T&GS that ensure amortization expense is complete and accurate.
- Documentation and testing of the key controls at T&GS that ensure that infrastructure is carried at the lower of net book value and the value of future economic benefits.
- Recalculation of the amortization expense at T&GS for the period ended December 31, 2004 for a sample of 16 infrastructure assets selected judgmentally.

2.0 Background

2.1 LEGISLATIVE AUTHORITY

Under the Financial Administration Act (Act) the Financial Statements of the Operating Fund [Consolidated Fund] are prepared using the Government's accounting policies and the Act also provides for the recognition of the amortization of tangible capital assets.

Excerpts from the Act are provided below:

> ***"Preparation of public accounts***
> *65(1) The Comptroller shall, in accordance with the directions of the Minister of Finance, prepare the public accounts in respect of each fiscal year that include*
>
> *a) the financial statements of the Consolidated Fund*
>
> *i) prepared in accordance with the accounting policies of the government as set out in the financial statements, and*
>
> *ii) accompanied by a report of the Auditor General concerning his or her examination of the financial statements;*
>
> ***Payment out of Consolidated Fund***
> *29 No money, other than trust money, shall be paid out of the Consolidated Fund without the authority of this or any other Act of the Legislature*
>
> ***Main estimates***
> *30(2) The main estimates of expenditure for a fiscal year shall*
>
> *(a) provide for expenditures that are incurred by the government in the course of business during the fiscal year and that are required to be voted on by the Legislature; and*
>
> *(b) include the amount of expenditures from statutory appropriations to be incurred in the fiscal year.*
>
> ***Amounts included for amortization of capital investment***
> *30(2.1) Despite clause (2)(a), amounts may be included in the main estimates in respect of the amortization of capital investments and may be charged to the Consolidated Fund in accordance with the accounting policies required to be stated in the public accounts, but shall not be paid out of the Consolidated Fund except to repay debt."*

2.2 ORGANIZATION

The Province of Manitoba, primarily through the Departments of T&GS, Water Stewardship, and Conservation, constructs infrastructure tangible capital assets on behalf of Manitobans and other Canadians.

Infrastructure tangible capital assets (infrastructure) are complex systems and structures needed in society to provide a wide range of goods and services.

Infrastructure is distinguished from general tangible capital assets based on:

- Consumption (use) of the assets; and
- Ability to control access to the asset.

Infrastructure is consumed by the general public and its access is generally not restricted. General tangible capital assets are consumed by the Province to provide services to the general public. Access to general tangible assets is usually restricted.

2.3 PROGRAM DELIVERY STRUCTURE

Capital projects including infrastructure projects are budgeted in the Estimates of Expenditure each year. The Estimates specify the expenditures under Part B – Capital Investment; General Assets and Infrastructure Assets are listed separately. The construction of infrastructure assets is the responsibility of the Departments of T&GS, Conservation and Water Stewardship, respectively.

TG&S uses a Construction Management System to manage its projects. It is a subsidiary system which tracks the different asset classes as well as aggregates the costs by project or by region.

The Departments of Conservation and Water Stewardship use the internal orders system within SAP to manage their projects except for the Red River Floodway expansion project which is being managed by the Manitoba Floodway Authority, a crown organization, on behalf of the Province.

2.4 PROGRAM COSTS

The net book value (cost less accumulated amortization) of infrastructure recorded at April 1, 2004 was $1,183 million. T&GS accounted for 92% of the recorded infrastructure with $1,086 million net book value (NBV). Infrastructure constructed by Water Stewardship amounted to 6% at $67 NBV and Conservation's share of the opening net book value of infrastructure was 2% or $29 million. Aboriginal and Northern Affairs also recorded infrastructure having a net book value of $1 million at April 1, 2004.

The capital investment budgeted for the 2005 fiscal year was $86 million with $79 million allocated to T&GS, $4 million allocated to Water Stewardship and $3 million allocated to Conservation. The Estimates of Expenditure also allocated $9 million (enabling appropriation) for the Red River Floodway Expansion.

3.0 Findings and Conclusions

OBJECTIVE 1

To determine whether infrastructure tangible capital assets (infrastructure) are recognized in the Operating Fund, as at April 1, 2004 and for the year ended March 31, 2005, in accordance with Canadian generally accepted accounting principles (GAAP) for senior governments as recommended by the Public Sector Accounting Board (PSAB).

Findings

3.1 The accounting policies used by the Province to capitalize infrastructure are in accordance with GAAP.

- Manitoba has adopted the practice of setting minimum threshold amounts for the capitalization of assets. We reviewed this practice in other provincial jurisdictions. We found that setting minimum thresholds for capitalization is an accepted practice in five other provinces, British Columbia, Quebec, Alberta, Nova Scotia and Newfoundland and Labrador. Saskatchewan and Ontario do not use thresholds. New Brunswick has not recorded infrastructure in its financial statements.
- The thresholds used by the Province of Manitoba (listed below) are reasonable in comparison to other jurisdictions:

  - land $0
  - traffic/lighting facilities and equipment $10,000
  - roads, bridges, dams and water structures $100,000

  British Columbia also uses $100,000 as the threshold for roads, bridges, dams and water structures. Quebec and Nova Scotia use a $500,000 threshold for roads and bridges.
- We compared the asset classes used by Manitoba to those of other jurisdictions and found that most provincial governments define five major classes, road/trunk highway surface, road/trunk highway grade, bridges, and dams/water structures.
- We also evaluated whether the estimate of the useful life of the respective asset classes and the amortization methods used by the Province are appropriate to the nature and use of the asset. The Province indicated that the rates used were in accordance with industry standards but did not provide any documentation specifically supporting their assertions. We compared the Province's amortization

policies and rates to other jurisdictions. We observed that several key areas of the Province's amortization policies were consistent with other jurisdictions:

- All provincial governments, with the exception of Nova Scotia, use the straight line method to amortize their infrastructure assets;
- Four provincial governments, British Columbia, Quebec, Newfoundland and Labrador and Manitoba, amortize their bridges as a single asset over 40 years;
- All provincial governments, with the exceptions of Alberta and Newfoundland and Labrador, amortize their roads and highways on a component basis rather than as a single asset;
- Four provincial governments, British Columbia, Saskatchewan, Ontario and Manitoba, amortize their road beds over 40 years;
- With the exception of Alberta and Newfoundland and Labrador, the provinces amortize their road surfaces faster than Manitoba; and
- All provincial governments, including Manitoba, amortize their dams and water structures over 40 years or longer.

3.2 Infrastructure properly included only direct construction or development costs, indirect costs, overhead costs and capitalized interest directly attributable to the construction or development activity; however, the Government's calculations required adjustment as at April 1, 2004 for overstatement of $6.1 million.

The net difference between the $26.4 million understatement for survey and design cost, and the $32.5 million overstatement due to the use of incorrect CMS data, is $6.1 million NBV (cost - $37.9 million, accumulated amortization - $31.8 million) overstatement of the total $1.1 billion NBV of T&GS's infrastructure at April 1, 2004 (**Appendix A**).

- The Department of Finance made a presentation to senior financial officers of all the departments on the nature of infrastructure and the eligible costs. Each department was then responsible for identifying its infrastructure at April 1, 2004. Only four departments, T&GS, Conservation, Water Stewardship, and Aboriginal and Northern Affairs reported that they had infrastructure at April 1, 2004.
- In order to develop a methodology to determine the historical cost of infrastructure constructed before April 1, 2004, T&GS analyzed the costs incurred during the fiscal years from 1994 to 2002. T&GS used the information from their Construction Management System (CMS) to arrive

at an average percentage for their maintenance (Part A) and construction (Part B) programs for that period. Using CMS information, they were able to further determine an average expenditure rate for each of the major transportation infrastructure classes. The total construction and maintenance costs for the fiscal years 1960 to 1993 were derived from the departmental annual reports. The Part B rates for each infrastructure class were multiplied by the total construction costs to arrive at the historical cost of the various infrastructure asset classes.

Incorrect CMS Data Used

- Based on that methodology, T&GS were not able to use minimum capitalization thresholds as set out in the Government's accounting policy. However, we found that the cost of most T&GS projects exceeded the minimum thresholds and therefore the cost of the infrastructure recorded would not be significantly overstated.
- In applying that methodology, T&GS incorrectly combined Part A with Part B costs to arrive at the percentages of costs incurred for each of their major infrastructure classes. Part A costs should have been excluded. We recalculated the percentages for each infrastructure class using the appropriate CMS data and then recalculated the infrastructure balances for fiscal years 1960 to 1993. The effect of this error resulted in an overstatement of $32.5 million in the net book value (NBV) of T&GS's infrastructure (cost - $82.2 million, accumulated amortization- $49.7 million).
- For fiscal years 1994 to 2004, the actual CMS data was used to determine the amounts capitalized for each major transportation infrastructure class. T&GS properly calculated the infrastructure balances for fiscal years 1994 to 2004.

Survey and Design Costs

- T&GS did not capitalize any survey and design costs as part of their historical infrastructure at April 1, 2004. The data in the CMS did not make a distinction between survey and design cost which should be capitalized and the portion which should be expensed. Survey and design costs are often incurred for capital projects which would not proceed for several years or could be eventually cancelled. Survey and design costs must be incurred within two years of the start of project to be treated as part of the cost of infrastructure according to the Province's accounting policy. A historical analysis of survey and design cost was considered difficult by T&GS because of the number of work orders involved and the difficulty in determining if the survey and design cost related to a capital project which was started within two fiscal years of the costs being incurred.
- Based on the results for the year ended March 31, 2005, 54.4% of survey and design costs were incurred for infrastructure projects which will commence within two fiscal years. Using a capitalization rate of 54.4%,

T&GS estimated that the NBV of survey and design costs at April 1, 2004 was $26.4 million (cost - $44.3 million, accumulated amortization-$17.9 million). We estimated, based on our sensitivity analysis, that a 1% change in the capitalization rate used for the survey and design costs only has a $0.5 million effect on the NBV of the infrastructure.

- Conservation and Water Stewardship also used their annual reports to identify and cost their historical infrastructure as at April 1, 2004. A lack of information in their annual reports for the period from 1960 to 1980 impaired their ability to properly recognize the cost of all the infrastructure assets constructed during that period. They recorded the larger and highly visible infrastructure assets constructed during that period such as the Red River Floodway, the Shellmouth Dam and the Portage Diversion.
- At April 1, 2004, the cost of the existing Red River Floodway, net of the federal government contributions, was $32.8 million and the accumulated amortization was $19.3 million. The assets under construction for the floodway expansion at April 1, 2004, net of the federal government contributions, amounted to $2.1 million. The total net book value was therefore $15.6 million. This information was reported in the audited financial statement of the Manitoba Floodway Authority for the year ended March 31, 2004.
- The Departments of Conservation and Water Stewardship used a threshold of $500,000 for the capitalization of their historical infrastructure assets. This cut-off was done to reduce the amount of work required to identify and cost their historical infrastructure assets. The thresholds used by the Departments of Conservation and Water Stewardship are significantly higher than the amounts prescribed by the Province's accounting policies for infrastructure. The Province's threshold for the recognition of land improvements, dams and water structures is set at $100,000.
- We selected judgmentally a small sample of infrastructure assets recorded by Conservation and Water Stewardship; we vouched the records of the historical cost of the infrastructure to the departmental annual reports or other supporting documentation. We found that all the amounts recorded were valid infrastructure assets and there was adequate support for their historical cost.
- We reviewed the Estimates of Expenditures for the Departments of Conservation, Water Stewardship, and Aboriginal and Northern Affairs (or former departments) for the period from 1964 to 1980 and found no evidence of significant spending on projects than those already identified such as the Red River Floodway and the Portage Diversion.
- In the case of Aboriginal and Northern Affairs' Estimates, we also found reference to a federal -provincial government cost sharing agreement for infrastructure constructed in northern Manitoba. We found that this infrastructure was constructed on behalf of northern Community Councils (local governments) and is held in trust by the Province for the

Community Councils. This infrastructure, with an estimated cost (replacement cost) of $ 53 million (the $53 million figure also includes certain buildings), was not reflected in the Public Accounts as a trust liability.

- We found that because no fully amortized assets are recognized as April 1, 2004 and because of the misapplication of the Government's accounting policy regarding recording one half of annual amortization expense in the year of acquisition/construction, which resulted in the overstatement of accumulated amortization at April 1, 2004 noted below, assets in the amount of $47 million were not properly reflected in the cost of infrastructure reported as at April 1, 2004. These assets were treated as fully amortized at April 1, 2004 and therefore not reported.
- We found that all the capitalized costs met the definition of infrastructure according to the Government's accounting policy and infrastructure at April 1, 2004 properly includes direct construction or development costs, and overhead costs directly attributable to the construction or development activity. We also found that infrastructure was properly classified in accordance with the asset classes established in the Government's accounting policy.
- The infrastructure costs recorded by T&GS properly did not include any indirect overhead such as salaries and wages from the Finance and Administration branch of the department or the Minister's salary.
- It is the Province's accounting policy to capitalize interest where the projected cost of a project is expected to exceed $20 million before the asset is ready for productive use. There was no past or current project at T&GS that exceeded or was expected to exceed the $20 million threshold.

  We also found that the only project at Water Stewardship where it is likely that interest will be capitalized is the Red River Floodway expansion. Major construction and borrowings to finance the construction are expected to start in the summer of 2005.

Cost of Infrastructure properly recorded for the year ended March 31, 2005

- Starting April 1, 2004, T&GS capitalized survey and design costs for capital projects that will commence within two years. Survey and design costs were capitalized as assets under construction (AUC). Survey and design costs in the operating budget (Part A) were recovered from the capital assets - infrastructure budget (Part B).
- Based on our analytical review procedures, we found that the cost of infrastructure was properly recorded during the year ended March 31, 2005.

3.3 Infrastructure, with a limited life, is properly amortized over its useful life in a rational and systematic manner appropriate to its nature and use by the Province; however, the Province's calculations required adjustment.

Accumulated amortization recorded at April 1, 2004 required adjustment for an increase of $17 million

- We recalculated the accumulated amortization of 100% of T&GS' infrastructure assets recorded at April 1, 2004. For each asset class, we vouched the total accumulated amortization calculated to the balances recorded in general ledger accounts in SAP. We also selected a sample of 24 infrastructure assets and vouched the accumulated amortization at April 1, 2004 to the posted amounts in the Fixed Asset Management System module (SAP).
- We found that the accounting for the calculation of accumulated amortization as April 1, 2004 did not reflect the half year rule in the year of acquisition. The Province's accounting policy is to take one-half of the annual amortization in the year of acquisition. As a consequence, accumulated amortization as at April 1, 2004 was estimated to be understated by $13 million ($15 million for assets recorded by T&GS offset by $2 million for assets recorded by Conservation, Aboriginal and Northern Affairs and Water Stewardship).
- The errors we found regarding the cost of T&GS infrastructure also affected the calculation of accumulated amortization at April 1, 2004. The accumulated amortization overstatement (net of the effects for understatement for survey and design cost, and the overstatement due to the use of incorrect CMS data) was estimated at $31.8 million.
- For several historical infrastructure assets recorded by Conservation and Water Stewardship, we observed that the capitalization date used was often several years after the costs had been incurred. Conservation's and Finance's position is that these assets were under construction and thus amortization should commence only after the project was completed. However, we found that the nature and circumstances of the infrastructure assets involved indicated that the extended asset under construction period was likely not warranted. Examples include:
    - The Whiteshell Provincial Park land improvements was a project that began in 1982, however amortization did not begin until the year ended March 31, 1988.
    - One hundred percent of the capitalized cost for the Shellmouth Dam was incurred in 1969; however amortization of the asset did not begin until the 1973 fiscal year.
    - The Valley Town Dikes, which were betterments to the existing dikes of several communities, have capitalized costs from 1983 to 2002. The recorded date for the capitalization of the Valley Town Dikes was March 31, 1991.

- Information at Conservation and Water Stewardship as to the date when an asset was put in service was difficult to obtain and was often not available. Based on the results of our testing, we estimated the extrapolated error to be a $4 million understatement of accumulated amortization related to the infrastructure recorded by Conservation and Water Stewardship at April 1, 2004.

Amortization expense recorded for the year ended March 31, 2005 required adjustment for increase of $2 million

- We found that T&GS not recorded amortization expense on new infrastructure. (Conservation and Water Stewardship did not complete any new infrastructure in 2004/05). T&GS's construction period ends in October; however, the department did not record any amortization expense on these assets for the year ended March 31, 2005. This understatement of amortization expense is estimated at $1 million.
- In addition, the impact of the overstatement of the accumulated amortization of infrastructure recognized as at April 1, 2004 is that the amortization expense for the 2005 fiscal year is understated. We estimate the understatement at $1 million.

3.4 The financial statement presentation and disclosure of infrastructure are in accordance with GAAP.

- We reviewed the recommendations of the PSAB and of the CICA Research Report "Accounting for Infrastructure in the Public Sector" regarding financial statement presentation and disclosure (**Appendix B**).
- PSAB's standards related to infrastructure include a recommendation for the disclosure of deferred maintenance. Our value for money report on *Planning for Highway Construction, Rehabilitation and Maintenance* (Highways) issued in 1998 stated, *"Deferred maintenance, a.k.a. infrastructure deficit, is the difference between expenditures required to maintain the normal operating capacity of infrastructure and any lesser amount of maintenance and replacement actually incurred".*
- Based on the findings of the 1998 Highways report and the level of spending on maintenance and replacement since then, we found that it is likely that there is a significant deferred maintenance balance.
- We also noted that the Research Report included three recommendations which are not included in PSAB's standards. They are as follows:
    - Disclosure of the current depreciated [amortized] reproduction costs;
    - Information about a government's infrastructure management plan should be provided; and
    - Information about infrastructure condition should be provided.

- The Research Report defined current depreciated [amortized] reproduction cost as an inflation adjusted valuation using the cost to reproduce the asset reduced by accumulated depreciation (amortization) to reflect the remaining useful life of the asset. Reproduction cost is different from replacement cost in that replacement cost usually includes the impact of technological improvements affecting service potential and/or cost as supposed to reproduction cost which is defined as the cost to reproduce the asset in substantially the identical form.
- The Research Report also indicated that the infrastructure management plan (IMP), which includes information about infrastructure condition, should be made available for each major network of assets. An IMP is fundamental for providing information as to the effects of government decisions are having on the stock of infrastructure. An IMP would include:
    - the government's strategy that sets out the overall objective related to infrastructure;
    - an extensive description or inventory [of infrastructure];
    - life cycle needs and costs of the infrastructure network;
    - preventative strategies;
    - description of condition assessment models; and
    - overall condition of the infrastructure network.
- We compared all of these recommendations to the Province's revised financial statement presentation and disclosure and found that information regarding deferred maintenance, current depreciated [amortized] reproduction cost and the infrastructure management plan was excluded.
- The Government participated in a shared cost program with the Federal Government to construct infrastructure and other tangible capital assets for northern Community Councils. The Province holds title to these assets in trust for the northern communities until the Community Councils become municipalities. These trust assets were not disclosed in the Public Accounts.

Conclusions

- Infrastructure is recognized in the Operating Fund, in all material respects, as at April 1, 2004 and for the year ended March 31, 2005, in accordance with GAAP as recommended by the PSAB. However, there were certain misstatements related to the application of the Government's accounting policy which were adjusted when brought to the Province's attention.
- The combination of the following errors in the application of the Province's accounting policies results in a $24 million understatement of the net book value of infrastructure as at April 1, 2004.

- T&GSs' estimate of the cost of their infrastructure at April 1, 2004 was overstated by $38 million based on the $1.8 billion cost of assets capitalized. T&GS's estimate of the accumulated amortization of their infrastructure at April 1, 2004 was overstated by $32 million based on $792 million of accumulated amortization recorded. As a result of these errors, the net book value of infrastructure as at April 1, 2004 was overstated by $6 million.
- Conservation and Water Stewardship understated accumulated amortization (overstated net book value) by an estimated $4 million because of the use of inappropriate dates (year) marking when the infrastructure constructed before April 1, 2004 was first put in service.
- All four departments further understated both the cost of infrastructure by $47 million and accumulated amortization of infrastructure at April 1, 2004 by an additional $13 million (T&GS - $15 million, offset by the $2 million overstatement by Conservation, Water Stewardship and Aboriginal and Northern Affairs). This overstatement occurred because the calculation of accumulated amortization as April 1, 2004 did not reflect the half year rule in the year of acquisition. The Province's accounting policy is to take one-half of the annual amortization in the year of acquisition. This error results in the understatement of the net book value of infrastructure by $34 million.
- Furthermore, amortization expense for the year ended March 31, 2005 was also understated and the net book value was overstated because no amortization was taken in the 2005 fiscal year on new infrastructure. This incorrect application of the Province's accounting policy understated the 2005 fiscal year amortization expense and overstated net book value by $2 million.

- Manitoba's infrastructure accounting policy is in accordance with GAAP. Key aspects of Manitoba's accounting policy and practices are consistent with the accounting policies and practices used in other provincial jurisdictions and that the Government's accounting policy was appropriate regarding:
  - the cost components of infrastructure assets capitalized;
  - the major asset classes prescribed; and
  - the estimate of the useful life of the various asset classes and amortization methods used in relation to the nature and use of the key infrastructure.

  Furthermore, in accordance with the Government's accounting policy, capitalized assets also met the definition of infrastructure and were properly classified according to the prescribed asset classes.

OBJECTIVE 2

To determine whether there are effective internal controls supporting the proper accounting for infrastructure.

Findings

3.5 Internal controls and procedures are sufficient to ensure that infrastructure costs recorded are complete, accurate, and valid.

- We documented and tested the key processing controls at T&GS that ensure infrastructure costs are complete, accurate (valuation) and valid (exists) (**Appendix C**). We found that the internal controls and procedures are sufficient to ensure infrastructure costs are complete, accurate, and valid.

3.6 Internal controls and procedures to ensure that amortization expense is complete and accurate, need improvement.

- We documented and tested the key controls at T&GS that ensure amortization expense is complete and accurate (measurement) (**Appendix C**). Key controls include management and monitoring controls as well as processing controls. We found that internal controls and procedures are sufficient to ensure that amortization expense is complete and accurate for existing infrastructure.
- We found, however, that the internal controls regarding the recognition of the date(s) new infrastructure assets were put in service did not address the need to record new infrastructure by September 30 of the fiscal year. Their procedures need to ensure that all new assets put in service in the current year are recorded in the Asset Management Module by September 30. T&GS's procedures failed to ensure that roads and highways completed in the 2005 fiscal year (the costs were incurred and the work completed prior to October 31, 2004) were reflected as in service effective September 30 in accordance with the Province's accounting policy to record one-half of the annual amortization in the year of acquisition.

  The use of an inappropriate date recognizing when the assets were put in service resulted in the understatement of amortization expense for the 2005 fiscal year by an estimated $1 million.

3.7 Internal controls and procedures are sufficient to ensure that infrastructure is carried at the lower of net book value and the value of future economic benefits.

- We discussed the controls over write-downs/write-offs with management at T&GS. We found that the circumstances which would require the write off of an infrastructure asset are considered to be rare. A write off would happen only if a road was taken out of service or transferred to a local government (for nil proceeds). In either case, this event would only likely happen with infrastructure assets that were fully amortized and would also require ministerial approval. If a write off was required, the net book value of the infrastructure asset would be estimated. The cost and accumulated depreciation for the asset class by year would be adjusted in the Asset Management System module of SAP. We found that there were no write-downs/ write offs during the 2005 fiscal year.

Conclusions

- The Province's internal controls supporting the proper accounting for infrastructure were operating effectively for the year ended March 31, 2005 except for the internal control procedures related to the recognition of when new infrastructure is put in service.
- The internal controls related to the determination of amortization expense on new infrastructure were not effective. Amortization expense for the 2004/05 fiscal year was complete and accurate on existing infrastructure but was not properly calculated on new infrastructure because the dates used to reflect when the assets were put in service were incorrect. This failing resulted in no amortization expense being recorded on new infrastructure for the 2005 fiscal year. Transportation and Government will need to amend their procedures to properly record amortization expense on new infrastructure assets.
- For the year ended March 31, 2005, T&GS's internal controls and procedures were operating effectively to ensure that:
    - infrastructure costs recorded are complete, accurate, and valid; and
    - infrastructure is properly carried at the lower of net book value and the value of future economic benefits.

4.0 Recommendations

The following recommendations were implemented in the 2004/05 Summary and Special Purpose Financial Statements. Therefore no response from officials was needed.

- That the Operating Fund as at April 1, 2004, the cost of infrastructure estimated at $47 million which was treated as fully amortized and therefore not properly reported in the opening balances be adjusted to the opening April 1, 2004 balance.
- That the calculation of accumulated amortization of infrastructure as at April 1, 2004 incorporate the Province's accounting policy to take one-half of the annual amortization in the year of acquisition and that the $13 million overstatement of accumulated amortization be adjusted accordingly.
- That the calculation of amortization expense of infrastructure for the year ended March 31, 2005 be adjusted to reflect the Government's accounting policy to take one-half of the annual amortization in the year of acquisition and that the accumulated amortization is also adjusted accordingly. This cumulative adjustment is estimated at $2 million.
- That the disclosure of accounting policies for tangible capital assets be improved. The significant accounting policy note should be expanded to disclose what costs are capitalized and the basis of valuation of the assets.
- That the presentation of the tangible capital asset schedule be improved. Smaller (dollar value) asset classes should be combined together to accommodate expanded disclosure of the large transportation infrastructure classes.

The following recommendations have been put forward for the 2005/06 fiscal year:

- That note disclosure on deferred maintenance be added to the financial statements.
- That information on the infrastructure management plan (IMP) is included in the financial statements or in text of the annual report of the Public Accounts.
- That the infrastructure constructed on behalf of the northern Community Councils, estimated $53 million, be disclosed as a trust asset and liability in the Public Accounts for the year ended March 31, 2006.
- That T&GS as well as Conservation and Water Stewardship amend their procedures to record new infrastructure by September 30 of each fiscal year in order to permit the Asset Management Module of SAP to properly calculate the current year's amortization expense.

Response from Officials

The Government acknowledges that while deferred maintenance has been addressed in a Canadian Institute of Chartered Accountants (CICA) Research Report and that the Public Sector Accounting Board (PSAB) has encouraged the measurement of deferred maintenance, there is no requirement under GAAP to record or note disclose these amounts in the Public Accounts. As noted in the PSAB Handbook, section PS3150.43, "Governments may want to consider providing this information ... as supplementary disclosure in the notes or schedules to the financial statements." The recommendation will therefore be reviewed considering the needs of financial statement users and best practices in other jurisdictions.

This recommendation will be reviewed and any decision to implement or not will be made after considering the needs of financial statement users and best practices in other jurisdictions.

We will review the treatment of infrastructure constructed on behalf of northern Community Councils and, if appropriate, will reflect the amounts as trust assets and liabilities.

For the March 31, 2005 fiscal year, the application of the accounting policy was amended under the recommendation of the Auditor General and all new infrastructure assets were subject to six months amortization regardless of when it was put into service. As a result, this issue has been effectively addressed.

Appendix A

INFRASTRUCTURE RECORDED BY TRANSPORTATION AND GOVERNMENT SERVICES AT APRIL 1, 2004

Comparative Findings

	Total Land	Buildings	Traffic	Bridges	Weighscales	Surfaces	Grade	Survey & Design	Total Grade	Airstrips	Total
T&GS - Per GL											
Cost	133,875,594	150,000	12,429,545	289,512,082	396,220	785,320,092	615,618,970	-	615,618,970	8,929,000	1,846,231,503
Accumulated Depreciation	-	(52,500)	(5,952,356)	(115,138,365)	(188,569)	(403,636,432)	(260,924,552)	-	(260,924,552)	(6,524,868)	(792,417,632)
NBV	**133,875,594**	**97,500**	**6,477,189**	**174,373,727**	**207,651**	**381,683,660**	**354,694,418**	**-**	**354,694,418**	**2,404,133**	**1,053,813,871**
OAG											
	Total Land	**Buildings**	**Traffic**	**Bridges**	**Weighscales**	**Surfaces**	**Grade**	**Survey & Design**		**Airstrips**	**Total**
Cost	131,566,192	150,000	10,896,180	289,148,263	396,220	761,329,303	561,618,605	44,321,606	605,940,211	8,929,000	1,808,355,369
Accm Depreciation	-	(52,500)	(4,777,027)	(114,936,844)	(188,569)	(385,254,459)	(230,990,510)	(17,886,390)	(248,876,900)	(6,524,868)	(760,611,167)
NBV	**131,566,192**	**97,500**	**6,119,153**	**174,211,419**	**207,651**	**376,074,844**	**330,628,095**	**26,435,216**	**357,063,311**	**2,404,133**	**1,047,744,203**
Differences (T&GS - OAG)											
	Total Land	**Buildings**	**Traffic**	**Bridges**	**Weighscales**	**Surfaces**	**Grade**			**Airstrips**	**Total**
Cost	2,309,402	-	1,533,365	363,819	-	23,990,789	54,000,365	(44,321,606)	9,678,759	-	37,876,134
Accumulated Depreciation	-	-	(1,175,329)	(201,511)	(0)	(18,381,973)	(29,934,042)	17,886,390	(12,047,652)	-	(31,806,465)
NBV	**2,309,402**	**-**	**358,036**	**162,308**	**(0)**	**5,608,816**	**24,066,323**	**(26,435,216)**	**(2,368,893)**	**-**	**6,069,669**
NBV %	**1.76%**	**0.00%**	**5.85%**	**0.09%**	**0.00%**	**1.49%**	**7.28%**	**-100.00%**	**-0.66%**	**0.00%**	**0.58%**

Appendix B

PUBLIC SECTOR ACCOUNTING STANDARDS

Section PS 3150

Paragraph 41:

"Financial statements should also disclose the following information about tangible capital assets:

(a) the amortization method used, including the amortization period or rate for each major category of tangible capital asset;

(b) the net book value of tangible capital assets not being amortized because they are under construction or development or have been removed from service;

(c) the nature and amount of contributed tangible capital assets received in the period and recognized in the financial statements;

(d) the nature and use of tangible capital assets recognized at nominal value;

(e) the nature of the works of art and historical treasures held by the government; and

(f) the amount of interest capitalized in the period."

Paragraph 42:

"If a government has an accounting policy of capitalizing interest, disclosure of the amount of interest capitalized would assist readers of the financial statements to assess the impact of that policy on the government's reported results."

Paragraph 43:

"Governments are encouraged to measure the extent to which maintenance has been deferred on their material and complex network assets, such as highways. Governments may want to consider providing this information in their financial statements because it can add to the picture given of the financial condition of a government. Deferred maintenance information, like information on contractual obligations and contingencies, is useful for understanding and assessing future revenue requirements and could be presented as supplementary disclosure in the notes or schedules to the financial statements."

Section PS 1200.061

"The financial statements should disclose, for each major category of tangible capital assets and in total:

(a) cost at the beginning and end of the accounting period;

(b) additions in the period;

(c) disposals in the period;

(d) the amount of any write-downs in the period;

Appendix B
(cont'd.)

(e) the amount of amortization of the costs of tangible capital assets for the period;

(f) accumulated amortization at the beginning and end of the period; and

(g) net carrying amount at the beginning and end of the period. [APRIL 2005]"

CICA Research Report "Accounting for Infrastructure in the Public Sector" (2002) excerpt:

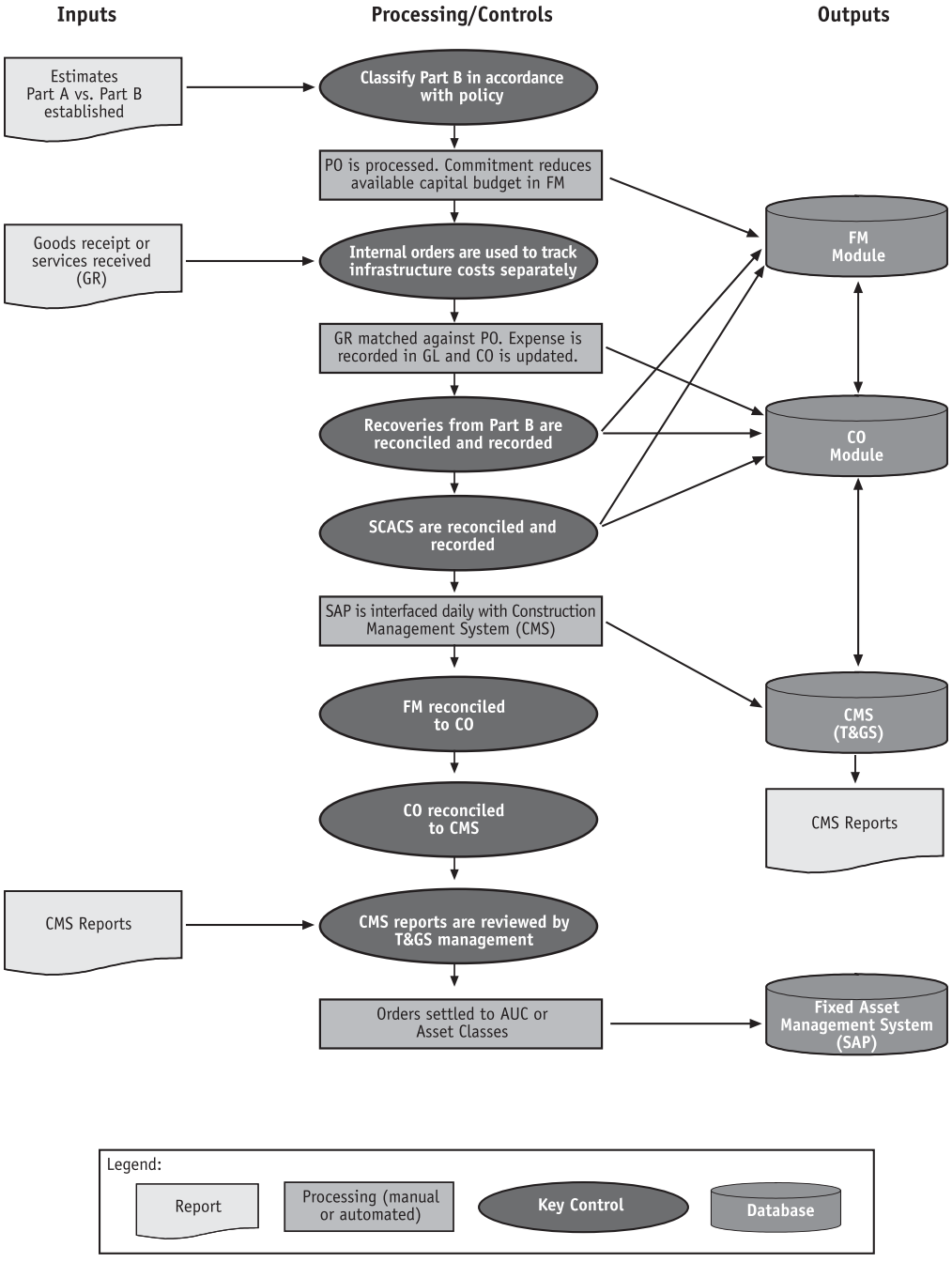
"Summary of Findings

The Study Group concluded that

- *Financial information about infrastructure should be provided;*
- *Infrastructure should be reported as an asset;*
- *Infrastructure acquired in lieu of developer charges or other fees, and other "acquired" infrastructure should be included in the stock of infrastructure;*
- *The cost of using infrastructure should be reported;*
- *Information about the stock of infrastructure should be accounted for on a component basis;*
- *Infrastructure should be depreciated over its useful life;*
- *At acquisition, acquired or self-constructed infrastructure should be measured at cost;*
- *At acquisition, "contributions" of infrastructure should be measured at estimated cost;*
- *Subsequent to acquisition, infrastructure should be measured at current depreciated reproduction cost. Until the issue of accounting for inflation is addressed for all assets and liabilities, however, measurement subsequent to acquisition would remain on a historical cost basis with disclosures of current depreciated reproduction costs;*
- *Information about infrastructure condition should be provided;*
- *Information related to deferred maintenance should be provided as part of the infrastructure condition information; and*
- *Information about a government's infrastructure management plan should be provided."*

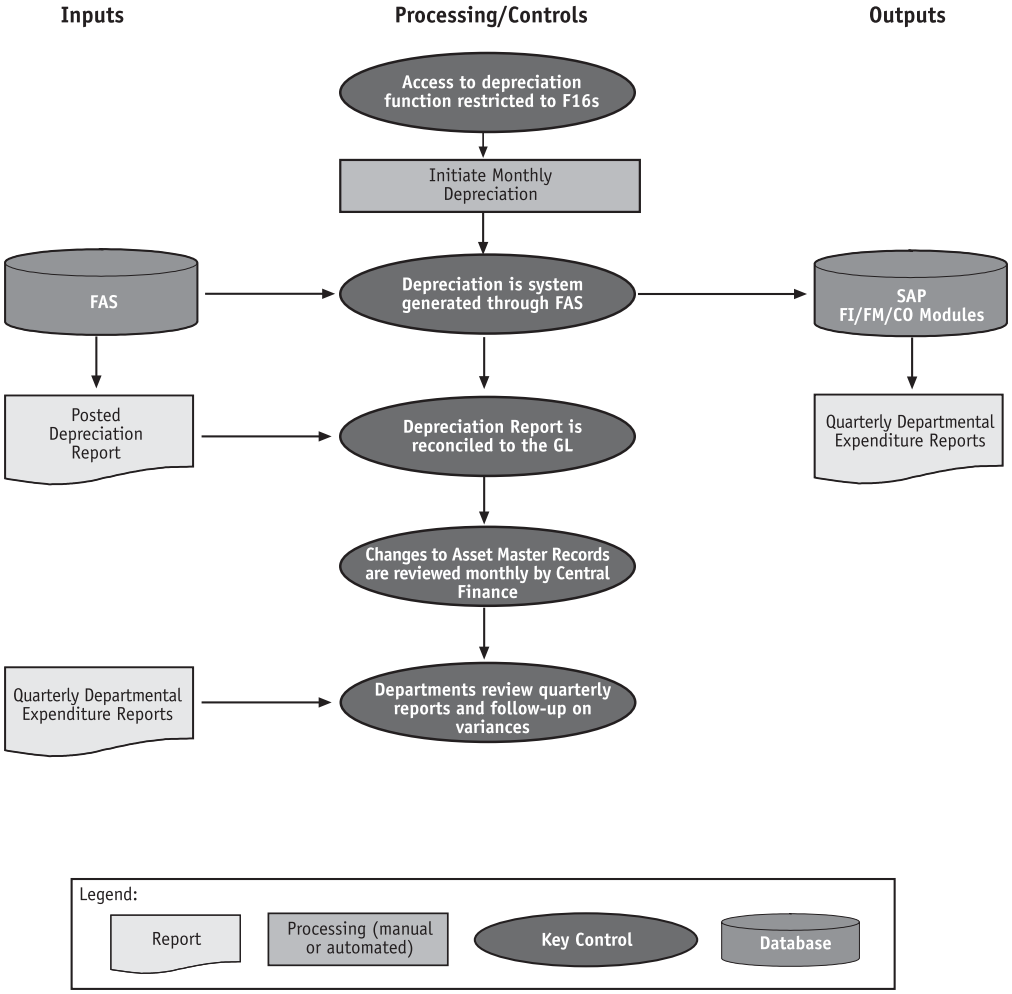
Appendix C

Infrastructure Project
Flowchart and Key Controls - Costs Accumulation at T&GS
December 31, 2004



Appendix D

Infrastructure Project
Flowchart and Key Controls - Depreciation
December 31, 2004



THE USE OF DERIVATIVE FINANCIAL INSTRUMENTS IN THE PROVINCE OF MANITOBA



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Executive Summary

DERIVATIVE FINANCIAL INSTRUMENTS

Derivative financial instruments are *"financial arrangements between parties whose payments or value is derived from the performance of some agreed-upon, underlying benchmark. Derivative financial instruments (derivatives) can be issued based on currencies, commodities, government or corporate debt, home mortgages, stocks, interest rates weather, or any combination."* Some examples of derivatives include swaps (currency and interest rate) and forward contracts (see Glossary of Terms - **Appendix B**).

Derivatives can be used to increase the return on an investment and/or to hedge against (reduce) the risk of loss. The Province of Manitoba (the Province) uses derivatives in managing the Province's debt (borrowings) and investment portfolios.

OBJECTIVE OF REVIEW

The focus of our review was to determine whether the Province has a risk management process (derivative risks include management, market, legal, credit, and operational risk) in place, and whether that risk management process used by the Treasury Division with respect to derivatives (with respect to debt and investments) is consistent with industry best practices.

Our review of the risk management process regarding the use of derivatives was a review of only one component of the overall risk management process used by Treasury Division and the Department of Finance.

BEST PRACTICES OUTLINED

In broad terms, industry best practices define the risk management process as involving a number of activities and assigned responsibilities including:

- The strategic identification of objectives, along with the risks in achieving those objectives (Management in conjunction with, and approval by an Oversight Body);
- The development and action on a strategy to address the identified risks (Management);
- The development of policies and procedures for the conduct of its activities (Management);
- The establishment of benchmarks against which to measure its performance (Management in conjunction with, and approval by an Oversight Body);
- Monitoring of performance and compliance with policies and procedures (Management); and
- Oversight of management's activities (Oversight Body).

BACKGROUND

The Treasury Division of the Department of Finance manages the use of derivatives. In July, 2003, the Division began a reorganization process to realign their operational structure in accordance with industry best practices. The reorganization created a **front office, middle office** and **back office**. Generally speaking, the offices are assigned responsibilities as follows:

- **Front office** is responsible for market analysis, and recommending and executing trading activity related to debt and investments including master agreements with derivative counterparties.
- **Back office** is responsible for the settlement and confirmation of the trades as well as the accounting and financial reporting functions.
- **Middle office** is responsible for policy development, monitoring and reporting compliance with policies and procedures, and risk and performance measurement and reporting.

GENERAL CONCLUSIONS

The Province has a risk management process for derivatives in place, but as indicated in the general conclusions below, and in the details contained in this report, there are areas that need to be addressed to ensure that this process is operating consistent with industry best practices with respect to management, market, legal, credit, and operational risks.

- The Department of Finance and its Treasury Division **have not formally documented their overall strategic objectives, a strategy on how to achieve those objectives, the strategy on how to identify the risks (risk identification), and the risk of achieving the strategic objectives (risk management strategy)**. Nevertheless, the Division has a working definition of its objectives, risk identification and risk management strategy. The Department and the Division use derivative financial instruments as one mechanism to implement that strategy.
- The **Treasury Division's objectives, risk identification and assessment, and risk management strategy have not been approved**. While there is a Derivative Policy statement, it also has never been approved. We believe that an oversight body should be involved in that approval process.
- **Treasury Division developed a risk management policy referred to as the Derivative Policy. The Derivative Policy is part of the Division's overall Risk Management Policy which is still under development.** We determined that the risk management process to address key risks involving the use of derivatives which include management, market, legal, credit, and operational risks, was generally consistent with industry best practices. However, we have a number of recommendations regarding the controls and procedures addressing operational risk as well market and credit risks.

- We believe that **what constitutes acceptable levels of risk and risk limits need to be documented in a risk management policy statement**. Similarly, there is a need for more documentation of the due diligence process regarding the deliberations and decisions to use derivatives. Additional documentation would provide more adequate audit trails of transactions.
- Because the **Middle Office is still under development and therefore not fully functional**, the risk management process for the Treasury Division as a whole is not fully developed. We recommended that the Department of Finance consider allocating more resources in order to complete the development of the Middle Office's functionality in the near term.
- We believe that the **oversight function should be expanded**. There is no governance equivalent to a board of directors in place to establish the strategic objectives and to set out a broad framework for management to work within and provide oversight. An oversight committee should receive timely and sufficient information to oversee the Treasury Division's activities. In the current organizational structure, the Capital Markets Committee is the senior committee overseeing the risk management process regarding the use of derivative financial instruments. No minutes are recorded at the Committee's meetings and therefore there is no audit trail documenting the Committee's deliberations and decisions.

1.0 Introduction

Derivative financial instruments are *"financial arrangements between parties whose payments or value is derived from the performance of some agreed-upon, underlying benchmark. Derivative financial instruments (derivatives) can be issued based on currencies, commodities, government or corporate debt, home mortgages, stocks, interest rates weather, or any combination."* Some examples of derivatives include swaps (currency and interest rate) and forward contracts.

Derivatives can be used to increase the return on an investment and/or to hedge against (reduce) the risk of loss. The Province of Manitoba (the Province) uses derivatives in managing the Province's debt (borrowings) and investment portfolios. We conducted this review because of the nature and extent of the Province's use of derivative financial instruments and because of the risks associated with the use of derivatives.

Sections of the Auditor General Act Granting Authority to Conduct the Audit

> ***Audit of Government Accounts***
> *9(1) The Auditor General is the auditor of the accounts of the government, including those relating to the Consolidated Fund, and must make any examinations and inquiries that he or she considers necessary to enable the Auditor General to report as required by this Act.*
>
> ***Audit of the Public Accounts***
> *9(3) The Auditor General is responsible for examining and auditing the financial statements included in the Public Accounts under The Financial Administration Act, and any other statements the Minister of Finance presents for audit.*

1.1 OBJECTIVE, SCOPE AND APPROACH

Objective

The objective of our review was:

> To determine whether the Province has a risk management process (derivative risks include management, market, legal, credit, and operational risk) in place, and whether that risk management process used by the Treasury Division with respect to derivatives (with respect to debt and investments) is consistent with industry best practices.

Our review of the risk management process regarding the use of derivatives was a review of only one component of the overall risk management process used by Treasury Division and the Department of Finance.

Scope

We examined the risk management process regarding the use of derivatives that was in place during the period of April 1, 2003 and December 31, 2004, and also included an examination of all types of derivative instruments used by the Province during the period of April 1, 2003 and December 31, 2004.

Our work was substantially conducted between January and March, 2005. The fieldwork took place at the Treasury Division offices of the Department of Finance.

Our review did not include an examination of:

- The risk management process that relates specifically to other activities of the Treasury Division such as investing or financing activities.
- The general information technology controls. The general information technology controls of the Province are examined as part of the audit of the Public Accounts; and
- The human resource processes of recruitment, remuneration, training, and evaluation of staff. Our examination of human resources was limited to a review of the organizational structure and an evaluation of the segregation of duties.

Internal Audit and Consulting Services of the Department of Finance had not conducted any audits on the use of derivatives and therefore this review did not consider any reliance on their work.

Approach

Our work included such tests and other procedures as we consider necessary in the circumstances. We conducted research, reviewed documentation, and conducted interviews as follows:

- obtained information on industry best practices on the risk management process for the use of derivatives by engaging a consultant;
- reviewed the work flow analysis resulting in a process flowchart;
- reviewed minutes of Capital Markets and Risk (Credit) Committees' meetings;
- reviewed Treasury Division files and records relating to derivative transactions (one transaction per quarter for the period under review);
- performed an internal control system walkthrough;
- tested the effectiveness of internal controls in a sample of derivative transactions;
- tested the accuracy and completeness of information included in a sample of management reports; and
- interviewed various Treasury Division staff.

We developed our review criteria using the following sources:

- COSO Internal Control-Integrated Framework - Committee of Sponsoring Organizations of the Treadway Commission 1992.
    - Internal Control Issues in Derivatives Usage: An Information Tool For Considering the COSO Internal Control-Integrated Framework in

Derivatives Applications - Deloitte and Touche LLP.

- The IIA Handbook Series - The Institute of Internal Auditors.
  - Auditing Derivative Strategies - Barbara Davison, CIA, CISA, FLMI.

We engaged a consultant to assist us in developing a review program, and in researching and understanding what constitutes industry best practices regarding the risk management process involving the use of derivatives.

In July 2003, Treasury Division of the Department of Finance was reorganized into a front-middle-back office structure: **Front Office** –trading; **Back Office** - processing of transactions accounting, and reporting; and **Middle Office** - risk management.

A report issued in February 2004 by the consultant hired by the Province to review its organizational structure made recommendations regarding the implementation of a middle office. Treasury Division is in the process of implementing the recommendations from that report. The resulting changes that affect the derivatives risk management process have been considered in our review. Recommendations that did not directly relate to the risk management program concerning derivatives were not considered during our review.

2.0 Background

2.1 LEGISLATIVE AUTHORITY FOR THE USE OF DERIVATIVES

The Financial Administration Act (Act) provides the authority to borrow on the credit of the government and provides for the use of derivatives under section 10(1). Excerpts of the Act follow:

> ***Authority to raise money***
> *50(1) When this or any other Act of the Legislature confers on the government the power to raise money on the credit of the government, the Lieutenant Governor in Council may by Order authorize the Minister of Finance or may designate and authorize an officer of the Department of Finance to raise money to a specified maximum amount on the credit of the government.*
>
> ***Manner of raising money***
> *50(2) An Order of the Lieutenant Governor in Council under subsection (1) authorizes the Minister of Finance or designated officer to raise money by way of loan in any of the following ways:*
>
> *(a) by the issue and sale of provincial securities;*
> *(b) from a bank, trust company, credit union or other financial institution;*
> *(c) in any other manner.*
>
> ***Powers re raising money***
> *50(3) When the Minister of Finance or designated officer raises money by the issue and sale of provincial securities, he or she may determine*
>
> *(a) the principal amount of the provincial securities to be issued;*
> *(b) the rate of interest payable and the rate of any premium or discount*

applicable on the provincial securities;

(c) the currency in which the principal amount of the provincial securities and any interest or premium are payable;

(d) the sale price of the provincial securities;

(e) the form, denomination and dates of issue and maturity of the provincial securities; and

(f) any other terms and conditions of the provincial securities.

Terms and conditions of securities

50(4) The terms and conditions of provincial securities may include any provision that in the opinion of the Minister of Finance or designated officer is necessary or advisable to facilitate the sale of the provincial securities, including, without limiting the generality of the foregoing, a provision that

(a) the interest rate payable on the provincial securities or the amount of principal payable at maturity be calculated and paid with reference to the value of a share or commodity or with reference to an index or some other basis;

(b) the provincial securities may be redeemed before maturity at the option of the government or the holder; or

(c) the holder of the provincial securities be reimbursed by the government for withholding taxes, duties, assessments or charges imposed by law on or with respect to a payment under the provincial securities by the government to the holder.

Financial agreements

10(1) The Minister of Finance may enter into and execute agreements or engage in activities of a financial nature respecting the investment of public money or the management of the public debt including, without limiting the generality of the foregoing, agreements for management of risks relating to currency, interest rates and other matters, swap agreements, futures agreements, option agreements and rate agreements.

2.2 TREASURY DIVISION MANDATE/MISSION

Treasury Division Mandate and Vision/Mission Statements are currently in draft form (pending approval) as follows:

Treasury Division's *Mandate* is:

- *Manage the borrowing programs of the government and its agencies;*
- *Develop and maintain the debt management program of the government;*
- *Manage the cash resources and investment activities of the government and its agencies;*
- *Service the debt of the government; and*
- *Manage the banking operations of the government.*

Treasury Division's *Vision/Mission* is:

- *Maintaining the exceptional reputation of the Province of Manitoba in the global marketplace is the primary goal of the Treasury Division, and,*

therefore, that of each of the employees within the Division.

- *Employees fulfill that responsibility in their regular contact with financial institutions, regulatory and rating agencies as well as the general public in order to ensure the Province's integrity and reputation is maintained.*

2.3 TREASURY DIVISION PROGRAM SERVICES

Treasury Division manages and administers the cash resources, borrowing programs, and all investment and debt management activities of the government. It also manages the borrowing programs and investment activities for all of its Crown corporations and government agencies. Treasury Division assists in the financing of municipalities, schools and hospitals and it is the Division's responsibility to ensure that such financing is arranged.

The Treasury Division uses derivatives to support the achievement of Treasury Division strategies and objectives. Treasury Division will execute derivative transactions consistent with the specific liability and investment objectives approved by management.

2.4 PROGRAM DELIVERY STRUCTURE

Treasury Division, under the Deputy Minister of Finance, is divided into four functional areas:

- **Administration** - Responsible for the general management of the Division and for providing advice to the Minister and Deputy Minister on all policy and program matters of a financial nature.
- **Capital Markets (designated Front Office)** - Responsible for managing and administering the cash resources, borrowing programs, and all investment and debt management activities of the government including managing the borrowing programs and investment activities for all of its Crown corporations and government agencies.
- **Risk Management and Banking (designated Middle Office)** - Responsible for the effective measuring, monitoring and reporting on the Division's market, credit, operational and liquidity risks ensuring compliance with predetermined rules and regulations.
- **Treasury Services (designated Back Office)** - Responsible for servicing & administering the public debt of the Province as well as servicing and safekeeping the investments of the Province and certain Crown corporations and government agencies.

In addition to the functional areas, Treasury Division has five committees with different responsibilities:

Executive Management Committee

- Meets monthly to discuss matters relating to personnel, operations, planning, budgeting, information technology, legislation and administrative matters so as to maximize the use of all resources

provided to the Treasury Division, prioritize activities and ensure effective and efficient delivery of treasury functions.

Capital Markets Committee

- Meets weekly to review world capital markets, investment and foreign currency markets and ensures that Treasury management and professional staff are conversant with current events and expectations respecting these markets. The Committee is responsible for the tactical execution to achieve Treasury Division's risk management objectives.

Risk Committee (formerly Credit Committee)

- Meets quarterly to review the financial status and exposure to individual financial institutions, establishes approved lists of financial counterparties as well as limits for exposure to individual financial institutions, reviews documentation standards for financial agreements, and assesses the risks related to investment classes and transactions. Responsible for the risk oversight function of the Treasury Division ensuring that policies, processes, procedures and controls are properly documented and that they are consistently communicated to staff and understood by everyone responsible for their implementation and monitoring.

Operations Committee

- Responsible for implementing processes and procedures to minimize operational risk and ensure the smooth running of the day to day operations of the Division. Meets monthly to discuss matters relating to operational policies and procedures, business and staff continuity planning, and, system and reporting issues. This Committee addresses issues affecting the daily operations of the Treasury Division and proposes solutions leading to an efficient and effective workplace. It is responsible for monitoring and coordinating all processes and procedures relating to treasury operations.

2.5 SIGNIFICANT RECENT CHANGES TO THE PROGRAM

In July 2003, Treasury Division was reorganized into a front-middle-back office structure. This resulted in the amalgamation of all trading activities and the development of a segregated middle office with new roles and responsibilities to measure, monitor, and report on the Treasury Division's financial risks and exposures.

To assist the Treasury Division with the design and implementation of the middle office, the Province engaged a consultant to provide a 'middle office blueprint' indicating appropriate structure, practices, controls, and information flows. The report was provided to the Division in February 2004 and the implementation of the recommendations is ongoing.

The number of derivative financial instrument agreements administered by the Treasury Division has increased since 1999. **Figure 1** indicates the approximate number of debt issues and investments which had associated derivative financial instrument agreements outstanding in each fiscal year.

FIGURE 1

	1999	2000	2001	2002	2003	2004
Debt issues	125	160	About 150	About 250	266	270
Investments	130	162	>150	About 150	150	122
Total	255	322	300	400	416	392

3.0 Conclusions and Findings

THE OBJECTIVE

To determine whether the Province has a risk management process (derivative risks include management, market, legal, credit, and operational risk) in place, and whether that risk management process used by the Treasury Division with respect to derivatives (with respect to debt and investments) is consistent with industry best practices.

WHAT WE CONCLUDED

The Province has a risk management process for derivatives in place, but as indicated in the conclusions below, and in the details contained in this report, there are areas that need to be addressed to ensure that this process is operating consistent with industry best practices with respect to management, market, legal, credit, and operational risks.

The Treasury Division has a working definition of its objectives, risk identification and a strategy to address the risks faced by the Division in achieving its goals, in accordance with industry best practices. The implementation of their strategy incorporates the use of derivative financial instruments (derivatives). However, Treasury Division of the Department of Finance has not documented their objectives, risk identification and strategy using that terminology or framework.

- The Treasury Division's Derivative Policy identifies the key risks associated with the use of derivatives. This Derivative Policy is modeled after an illustrative policy example in the publication Internal Control Issues in Derivatives Usage: An Information Tool For Considering the COSO Internal Control-Integrated Framework in Derivatives Applications - Deloitte and Touche LLP.
- The Derivative Policy clearly defines intent and activities; it also generally specifies the types of authorized derivatives and inappropriate uses of derivatives are identified. However, the Division needs to establish more clearly within the Derivative Policy the acceptable levels of risk and specify risk limits.
- It is management's intention that the Derivative Policy will form part of the Division-wide Risk Management Policy which has not yet been completed. This Risk Management Policy will outline the Division's

structure, controls, roles and responsibilities, measurement and reporting guidelines. Accompanying the Division-wide Risk Management Policy is the restructuring of the Division including the implementation of a middle office function. We noted that the implementation of the middle office is also not complete. That functionality is integral to the full development of an effective Division-wide risk management process which includes the risk management process affecting the use of derivatives.

- Risk management procedures and controls over the use of derivatives need improvement in certain areas. The procedures and controls addressing operational risk could be enhanced for the initiation of transactions and the execution of transactions. Risk management procedures and controls related to market risk could be expanded as well by developing sensitivity analysis to separately evaluate market risk for derivatives. Risk management controls and procedures effectively address legal risk and generally address credit risk.
- Certain key controls were in effect during the period under review which also included the period in which the Treasury Division began its reorganization to a front office, middle office and back office structure. However, monitoring controls need strengthening and exception reporting should be standardized.
- Governance practices in the risk management process should be enhanced. The oversight function at an oversight level needs to be expanded and the Risk and Capital Markets Committees could enhance their risk management processes as well. The Risk Committee could consider meeting monthly instead of quarterly and Capital Markets Committee should record minutes of the weekly meetings. Both Committees should maintain formal records of meeting agendas and material submitted for review.

WHAT WE FOUND

3.1 OBJECTIVES, RISKS AND STRATEGY IDENTIFICATION - The Division's objectives are established, key risks are identified and a risk management strategy is developed

- In the absence of an approved document stating the objectives of Treasury Division, we were unable to directly link documented objectives of the Department of Finance to documented objectives of the Treasury Division. However, based on our review of Treasury Division's operations including interviews with senior management, we determined that their implied objectives are:
    - Ensuring sufficient cash resources are available to meet the financing needs of the government reporting entity through the management of the borrowings program and investment activities; and

- Managing public debt expense within the budgeted amounts set out in the annual Estimates of Expenditure.

Both of these implied objectives are linked to the objectives set for the Department of Finance and the Government.

- The risks that the Treasury Division faces in achieving its objectives are interest rate risk, exposure to foreign currency fluctuations and to some extent, the capacity of capital markets. The Treasury Division developed a strategy to address these risks, which is to use both fixed and variable interest rate debt instruments and to eliminate exposure to foreign currency fluctuations. The Treasury Division addressed the risk of the capacity of capital markets by developing the strategy of maintaining its presence in the capital market place including using both short-term and long-term strategies. Treasury Division implemented these strategies partly through the use of derivative financial instruments. As well, there are risks associated with derivative financial instruments.
- The risks associated with using derivative financial instruments (derivatives) include:
  - **Credit risk** - the risk of counterparty defaults on the derivative contracts. This risk is addressed through identifying a minimum credit rating acceptable for dealing with a counterparty, and by setting counterparty credit limits to establish the maximum exposure for a counterparty.
  - **Legal risk** - the risk that the counterparty's performance obligations (legal contracts) are unenforceable. This risk is addressed through the use of agreements developed in accordance with the standards set by the International Swaps and Derivatives Association (ISDA).
  - **Market risk** - the risk associated with a change in a derivative contract value due to an adverse movement in price, index or interest rate; the risk that changes in the market will adversely affect the value of a derivative. This risk is addressed by monitoring counterparty exposures against acceptable limits.
  - **Management risk** – the risk that management is ineffective in overseeing the risks associated with the use of derivatives. This risk is addressed by the setting of objectives, strategies, policy and procedures, and performing the oversight function-monitoring of compliance with policy and procedures and measuring the achievement of objectives and the effectiveness of the strategies employed to achieve the objectives.
  - **Operational risk** - the risk that errors occur in the processing of transactions as a result of deficiencies in the system of internal controls. This risk is addressed by establishment of appropriate policies and procedures, segregation of duties between the initiating/authorizing of transactions, and the settlement, processing and recording of transactions.

3.2 OBJECTIVE LINKAGE -

The Treasury Division's objectives are linked to the Department of Finance's objectives

- As a result of the restructuring of Treasury Division and the implementation of the consultant's recommendations, the Treasury Division is drafting a document which will state its mandate, vision/ mission, role/objective, new organizational chart, accountabilities/ responsibilities, activities, and committees. For the period under review, this document had not been finalized. According to the minutes of the March 17, 2005 management meeting to discuss the ongoing implementation of the consultant's report, finalization of this document is receiving immediate priority.

- We reviewed the Department of Finance's 2004 annual report and noted the overall responsibilities of the Minister and the Department included:

    - Managing daily cash requirements, the public debt, the investment of public money, and of loans and advances made, and guarantees given, by the government.
    - Insuring government assets and managing risk; and
    - Fostering business and consumer confidence in the marketplace and administering a regulatory framework that contributes to a competitive Manitoba economy.

- We also reviewed the Treasury Division's Derivative Policy to determine if strategies, operating plans and policies are linked back to the broad objectives. We found confirmation that there is a linkage as follows:

    - The Division's Derivative Policy states that, "Treasury Division will execute derivative transactions consistent with the specific liability and investment objectives approved by Management".

3.3 RISK IDENTIFICATION -

Risk identification and measurement is an ongoing process

- We reviewed the Division's Derivative Policy to evaluate the adequacy of the Division's identification and understanding of risks resulting from business activities. We found that in the Derivative Policy, business risk is defined as "*...the quantifiable or identifiable risk relating to normal Capital Markets operations and to activities that are a by product of the normal activities of the Province that relate to the management of provincial debt including financing and debt servicing. Such risk is necessary to the management of provincial debt of the Province and cannot be avoided without the Province incurring substantial economic disadvantage to the province".*

- The Derivative Policy contains a section on risk identification which states that the capital markets and risk management (formerly credit) committees are charged with ensuring the procedures are in place to identify and assess all risk exposures to the Province and to manage those exposures within tolerable limits. Business exposures that have been identified but are not limited to:

- Interest rate risk inherent in maintaining the debt portfolio;
- Foreign currency risk from financing activities outside Canada;
- Credit risk;
- Transactional risk;
- Legal risk;
- Liquidity risk; and
- Operational risk.

- We conducted interviews and discussions with management to determine what process was in place to identify and document identified risks. Based on discussions with management, during the period of our review, we found that the Treasury Division had begun the process of implementing the recommendations in their consultant's report.
- Risk evaluation and measurement were identified as key roles for the middle office in the consultant's report. The report recommended that the middle office develop risk evaluation frameworks and methodologies to identify and assess the risk within Treasury Division.
- Treasury Division has formed a committee to oversee the implementation of the recommendations in consultant's report which meets to discuss progress and priorities. At the meeting on March 17, 2005, the status of recommendations was discussed, and it was reported that information is being collected for inclusion in a Risk Management Policy which will outline structure, controls, roles and responsibilities, measurement and reporting guidelines.

3.4 RISK MANAGEMENT STRATEGY -
Risk management strategy employed addresses the identified risks

- Although the Treasury Division's risk management strategy is not documented and therefore not approved, we found that the strategy implemented does clearly address the identified risks. The overall strategy used to address interest rate risk and foreign currency fluctuation exposure is to have both fixed and variable interest rates on debt and investments and to eliminate the exposure to foreign currency fluctuations. This strategy is implemented by using derivatives and by maintaining the Province's position in the capital markets through refinancing a certain amount of debt annually.
- As identified in the Derivative Policy, the Treasury Division has defined its risks to achieve its objectives as interest rate risk and foreign currency fluctuation exposure. To address these risks, Treasury Division has implemented a risk management strategy whereby interest rates of the debt portfolio of the Operating Fund should be within a defined percentage of fixed and variable interest rates. The current strategy also requires the reduction of foreign currency fluctuation exposure to nil.
- Another risk that was not identified in the Derivative policy is the capacity of capital markets. The Division addresses this risk with short

and long term strategies such as maintaining a presence in the capital markets by refinancing $1.0 - 1.5 billion of debt annually.

- The strategy to manage interest rate and foreign currency risk is implemented using derivatives. As well, in part, maintaining an active presence in the capital markets also involves using derivatives.

3.5 RISK MANAGEMENT STRATEGY -
Risk Management Strategy is not documented

- For the period under review, Treasury Division did also not have an approved statement of activity level objectives. However, the middle office was developing a mandate document that would provide a clear statement of these objectives. This document will come into effect when it is approved by the Risk Committee.
- For the period under review, Treasury Division did not have formally documented strategies. However, through discussions with staff and management, it was apparent that there was a general understanding of strategies used. Having no documented strategies is contrary to their Derivative Policy which does address the need for clearly stated policies. The Derivative Policy states that the duties and responsibilities of the Capital Markets and Credit (Risk) Committees include: *"...ensuring that policies, strategies, procedures, and controls are fully documented in writing, clearly and unambiguously, and that they are consistently communicated to and understood by everyone responsible for their implementation and monitoring"*.

3.6 RISK MANAGEMENT POLICY -
Risks associated with using derivatives are identified in the Derivative Policy

- We reviewed the derivative policy to determine if risks associated with derivatives are identified.
- The Overview section states:

  "Risks associated with derivatives include market, credit, liquidity, as well as various other risks described below. In addition to these technical risks, there is the fundamentals risk that the use of these products may not be consistent with Divisional objectives.

  This Derivative Policy is intended to provide adequate assurance that necessary controls are in place and the derivative use will support the achievement of Divisional strategies and objectives."
- The Risk Identification section of the Derivative Policy includes:

  "In addition to the interest rate and foreign exchange risks associated with financing and investing activities, the risk identification area of the policy identifies credit risk, transactional risk, legal risk, liquidity risk, and operational risk as key risks. These key risks are applicable to the use of derivative financial instruments."

- Expectations of Treasury Division states:

  "Treasury Division is expected to understand fully the extent to which their decisions and actions expose the Province to risk. Any activities that are not related to the Province's normal business activities and have the effect or potential of increasing risk generally will be avoided."

- Counterparty Risk:

  "The Province will enter into a derivative agreement only with counterparties that are currently rated AA low or better or the equivalent rating by recognized rating agencies as approved by the Credit Committee or are Canadian Schedule A banks.

  Where the counterparty is rated AA mid or higher, no term restrictions will be placed on the counterparty. Should the counterparty have a credit rating of AA minus; the Province will require a one-way option to terminate at 5 years. Canadian Schedule A banks will not be required to agree to the one way termination clause.

  With the exception of the Canadian Schedule A [Schedule I] banks the Province generally will review any derivative transaction if the counterparty's credit rating is downgraded to A high. Appropriate steps will be taken to minimize risks if any counterparty's credit rating is downgraded below A high. Such steps may include obtaining collateral or some other acceptable form of credit enhancement, or terminating the transactions. The Credit Committee will be notified of all credit downgrades. The Credit Committee must approve the actions proposed to be taken with respect to a transaction in which any counterparty's credit rating is downgraded below A high.

  The Province will not enter into a new derivative transaction with a counterparty if the new transaction will result in credit exposure exceeding limits specified by the Credit Committee."

- The Derivative Policy, includes under the duties of the Credit Committee:

  "Ensuring that all personnel responsible for the Province's involvement with derivatives are suitably qualified by training and experience to fulfill their responsibilities."

3.7 DERIVATIVE POLICY -

Derivative Policy clearly defines intent and activities

- The first section of the Division's Derivative Policy provides an effective overview of the policy which clarifies the intent of the policy. The first section states that:

  "Derivatives are financial contracts that derive their value from the performance of underlying assets such as a stock, bond, physical commodity, interest or currency exchange rates, or a variety of indices.

  Derivatives include a wide assortment of financial contracts, including swaps, futures, forwards, options, caps, floors and collars, whose values are derived based on defined formulas that apply to notional amounts.

Derivatives can also include certain assets and liabilities whose value and cash flows are directly determined by an underlying instrument or index.

Risks associated with derivatives include market, credit, liquidity, as well as various other risks described below. In addition to these technical risks, there is the fundamentals risk that the use of these products may not be consistent with Divisional objectives.

This Derivative Policy is intended to provide adequate assurance that necessary controls are in place and the derivative use will support the achievement of Divisional strategies and objectives."

- The Derivative Policy contains a section which provides definitions of some key terms which are used in the policy. It provides the following definitions of terms: Risk Management, Business Risk, Speculative Risk, and Hedging. Consistent with the recommendation of the COSO report, the use of definitions will assist in avoiding possible misunderstanding and confusion about the intent of the policy and the use of derivatives.

3.8 RISK LEVELS AND LIMITS -
Risk levels and limits need to be clearly specified in the Derivative Policy

- We reviewed the Treasury Division's Derivative Policy to determine if the use of derivatives to manage risks is based on the assessment of risks, and is expected to manage the risks effectively.

- The Risk Management Objectives section in the Derivative Policy states:

  "Treasury Division will execute derivative transactions consistent with the specific liability and investment objectives approved by Management. For example the debt portfolio should be maintained with fixed - and variable - rate debt established by the Capital Markets Committee, to diversify the impact of interest rate changes on the public debt expenditure and on cash flows relating to interest payments. The Capital Markets Committee may also decide to give more weight to the effect on cash flow from potential changes in interest rates than on the changes in the market value of the portfolio."

- The Risk Measurement section in the Derivative Policy states:

  "Market risks that can be managed should be assessed at least monthly and in response to significant market movements and changes in activities that expose the Province to risk."

  During the period under review, the Treasury Division was performing a sensitivity analysis on a quarterly basis on the effect of market movements.

- The Derivative Policy broadly identifies risk areas and assigns the identification and assessment of risks to the Capital Markets and Credit (Risk) Committee. While the Derivative Policy states that derivative use is based on specific liability and investment objectives, the Policy does not clearly link the risks identified to derivative usage. The

implementation of the consultant's recommendations involves risk evaluation and measurement. Since the implementation of these recommendations was an ongoing process during our examination period, it is expected that a more defined link between the risks and derivative usage will form part of the risk management policy that will be developed from that process.

- We reviewed the Province's Derivative Policy and related policies to determine if maximum acceptable levels of risk are specified. We found that while the Derivative Policy identifies risks, it does not specify limits or maximum acceptable levels of risk. We noted that the Treasury Division does monitor certain risk exposures, but the tolerable limits are determined by the Credit committee. We also found that the Derivative Policy was integrated with the investment policy which sets limits on the mark to market exposure for a counterparty.

- The Risk Identification section of the policy indicates, *"The Capital Markets and Credit Committees are charged with ensuring that procedures are in place to identify and assess all risk exposures to the Province and to manage those exposures within tolerable limits"*. However, the policy does not specify what tolerable limits are.

- The Derivative Policy does not specify acceptable limits for credit or market risk. However, we noted that the Policy states, *"Treasury Division will execute derivative transactions consistent with the specific liability and investment objectives approved by Management. For example, the Capital Markets Committee may also decide to give more weight to the effect on cash flow from potential changes in interest rates than on the changes in the market value of the portfolio"*. This policy establishes a link between liability and investment objectives and the use of derivatives. While the Derivative Policy does not itself specify limits to address counterparty credit risk, we noted that the Treasury Division does specify limits for short and long term investments. Specific limits for a counterparty's mark to market exposure have been approved by the Credit Committee as part of the investment policy. All financial institutions that are approved for current derivative transactions are be approved to a maximum of $50 million in securities such as bonds and are subject to a $75 million limit including the mark to market exposure of the derivatives. This limit is not specified in the Derivative Policy but is documented in a Credit Committee submission which was approved in September 1997. No rationale or supporting documentation was found on the appropriateness of the limits. We discuss these limits in another section of the report.

- To address market risk, the Derivative Policy states, *"Sensitivity analysis could be used on an interim basis to expedite responses to effects of significant day-to-day market movements. Such analysis could assess the impact of outstanding derivative positions on the hedged items, showing results if interest rates and prices move up and down by 100, 200, and 300 basis points, or by such other factors as may be specified by the Credit*

Committee". However, the policy does not specify acceptable limits regarding the results of the sensitivity analysis.

- To address interest rate risk inherent in the maintenance of the debt portfolio, the Policy states that, *"the debt portfolio should be maintained with fixed - and variable - rate debt established by the Capital Markets Committee, to diversify the impact of interest rate changes on the public debt expenditure and on cash flows relating to interest payments"*. The Policy addresses the risk but does not specify an acceptable level. This decision is left to the discretion of the Capital Markets Committee. Based on discussions with senior management, we have determined that the Division's strategy is to maintain interest rates of the debt portfolio within a defined percentage of fixed and variable rates. Minutes are not kept for Capital Markets Meetings and we did not find any documentation supporting the appropriateness of the ratio. Therefore, we cannot determine whether the defined variable fixed interest rate strategy is within the Division's maximum acceptable level of risk.

3.9 AUTHORIZED DERIVATIVES - Types of authorized derivative financial instruments are generally specified

- We reviewed the Division's Derivative Policy to determine if it defines authorized types of derivative instruments.
- The policy states:

  "The Province may use derivative instruments authorized by the Capital Markets Committee, provided these can qualify as a hedge as defined in this policy and such use is not prohibited elsewhere by this policy. The following are examples of approved derivatives for use by the Province:

  - *Foreign currency derivatives:*
    - *Currency forwards.*
    - *Currency options.*
    - *Cross Currency swaps.*
    - *Combination foreign currency options, in which the notional amount and maturity date exactly match the underlying transaction being hedged.*
  - *Interest rate derivatives:*
    - *Interest rate swaps, options and swaptions.*
    - *Interest rate forwards, futures and options.*
    - *Interest rate collars and caps."*

- We noted that the policy effectively defines the types of authorized derivative instruments to be used. However, there is no specific reference in the Derivative Policy to distinctive characteristics such as liquidity and customization to be considered.

3.10 INAPPROPRIATE USE OF DERIVATIVES -

What constitutes inappropriate uses of derivatives is identified in the Derivative Policy

- We reviewed the province's Derivative Policy to determine if it has identified activities and strategies that might be considered controversial and provide a clear and formal interpretation of what they mean to the entity. We found that the Derivative Policy identifies prohibited uses of derivatives. The following excerpt from the policy outlines prohibitions and restrictions on derivative use:

  "General - Derivatives must be related to specific underlying liability or investment requirements and cannot be used for activities that increase risk to the Province, such as trading, speculation, or any other purpose in which the objective is solely to generate profits. Derivative activities are considered speculative if they increase risk, if their use has no relation to objectives specified by the policy, or if their use is not intended and expected to reduce business risks that have been identified.

  Unusual and complex transactions - Derivative instruments can become extremely complex when combinations of components and features are embedded in a single instrument. Complex derivative transactions are prohibited by this policy if they are not essential to accomplishing the objectives specified in the risk management policy or if they cannot be readily valued and determined to be effective in reducing risk. These transactions must be understood and approved by the Capital Markets Committee.

  Leverage - Derivative transactions are considered to be leveraged if they expose the Province to loss or gains higher than expected to be generated by the underlying transaction.

  Valuation - Use of any derivative is specifically prohibited if a market quotation cannot be obtained from more than one source or it cannot be valued internally by the financial staff, using available internal models that have been approved for use by the Capital Markets and Credit Committee."

3.11 OPERATIONAL RISK -

Risk management procedures and controls regarding the use of derivatives need improvement. The procedures and controls addressing operational risk could be enhanced.

3.11.1 Initiation of Transactions - Initiation of transactions require further documentation

- We found that according to Treasury Division policies, factors involved in entering into a derivative agreement with a counterparty include current exposure risk, swap spreads, sensitivity of the trade, strategy being employed, the type of instrument being used and consistency with the Treasury Division's Derivative Policy. Further, the decision to use a

derivative instrument is made by the Director and the Assistant Director of Capital Markets of Treasury Division based on discussions held with the Management Team at the weekly Capital Markets Committee (CMC) meetings. However, we found there was not an appropriate audit trail of the initiation of derivative deals to confirm that this policy was followed.

- The Capital Markets Committee meets weekly to review world capital markets, investment and foreign currency markets and ensures that Treasury Division management and professional staff is conversant with current events and expectations regarding these markets. They are responsible for the tactical execution of the Treasury Division's risk management strategies.
- We found that there was a lack of an appropriate audit trail for the initiation of derivative deals arising from the CMC meetings because no minutes are recorded at these meetings. The only documented evidence we could find from the CMC meetings was copies of the information that was presented for discussion. We examined this information for a sample of meetings held during the audit period. We found the information package that was prepared contained information on:
    - F/X rates and range;
    - Cash flow requirements for the province;
    - Balances of trust, portfolios, promissory notes;
    - Synopses of market activity for past few weeks;
    - The economic highlights of the previous week;
    - Movement of the Canadian dollar;
    - Money market interest rates;
    - Bond market activity;
    - Funding levels and LIBOR targets; and
    - FX and Fixed Income commentary.
- Management informed us that discussions regarding the potential use of a derivative take place during the CMC meetings. However, any decisions to initiate a deal are made by the Assistant Deputy Minister, Director and Assistant Director of Capital Markets. There are no records of these decisions or the exercise of due diligence regarding the decisions to use a derivative financial instrument.
- From interviews with management, we were informed that decisions regarding the type of derivative to be used are also made by the Director of Capital Markets and Assistant Deputy Minister. Considerations of the distinctive characteristics are part of the process of selecting type of derivative instrument.

3.11.2 Execution of Transactions - Authorization procedures and controls need strengthening

- We found the Treasury Division's documented risk management procedures for authorizing derivative financial transactions to be

appropriate. However, in the course of our audit we noted that the procedures were not always followed.

- Authority to enter into derivative financial transactions is granted under Section 10(1) of the Financial Administration Act and delegated to persons by the Minister of Finance.
- The Treasury Division Risk Management Procedures indicate that, "two authorized signing officers, one of which is the trader, signs the trade".
- We reviewed the Risk Management Sheets and Investment Trade Reports prepared for a sample of deals in the period under audit to test whether all the deals have been appropriately signed off in accordance with approval authority.
- In the sample selected, all deals had been appropriately signed off in accordance with the risk management procedures, with one exception. The Risk Management Sheet for one of the deals selected was signed on behalf of the trader by an employee who had not been delegated authority. The second signatory however did have delegated authority.

3.11.3 Trader's log book records need more detail

- We found the risk management sheets (RMS) and investment trade reports (ITR) contain the relevant details of the deals. However, the 'trader's log book' did not provide a reliable audit trail for derivative financial instrument agreements (derivative) transactions.
- For the sample selected, we matched the details of the deal to the RMS or the ITR. For every transaction selected, the deals were accurately recorded on the RMS or ITR.
- The RMS and ITR are prepared from the details of the derivate deal transacted by the trader. We obtained the trader's log book to compare the details of each deal to the trader's notes. We noted that an audit trail for the deal was not always apparent in the trader's notes.
- We noted four instances where the details of the deal did not match the trader's notes. In two instances, the swap was done when the debt was issued; therefore a term sheet is used for details and there were no trader notes. In another instance, the trader wrote the wrong date in the log and in the last instance, the trade dates did not match.
- We also noted that amendments are not recorded in the 'Trader's log book'. Minor changes to dates, rates are dealt with in the middle office. The Senior Treasury Officer makes changes on the confirmation before faxing the authorized confirmation back to the counterparty.

3.11.4 Risk Management Sheets should be pre-numbered

- Risk Management Sheets (RMS) record the details of all debt swaps. We found that we could not use the RMS to test for completeness of recorded debt swaps. We were also unable to determine the date the RMS was created or approved.

- A RMS is created for each debt swap by debt issue. The sheet details not only the most recent swap, but also the previous swaps and forward rate agreements done on the debt issue. The original signed RMS is kept on file in the front office. Copies are kept in a binder in the back office.
- We reviewed all Risk Management Sheets for the period under examination and noted the following:
    - Risk Management Sheets (RMS) are numerically sequenced with the exception of one number which was used twice and one number was missing.
    - None of the RMS was dated with either the creation or approval date.
    - Amended RMS was clearly identified as Amended with the amendments in bold if applicable.
    - Contrary to Treasury Division procedures, 4 RMS were not signed by a trader and 4 RMS were signed by someone other than an authorized signing officer.

3.11.5 Hedge Transactions are properly documented

- A hedge sheet is prepared for a debt issue which has several swaps on it. The hedge sheet calculates the net effect of all swaps.
- We found that there is appropriate documentation of swap transactions classified as hedges. For swaps with "hedge sheets" we vouched the details on the "hedge sheet" to the Risk Management Sheet. We recalculated the hedging to ensure that there is full coverage for the debt. No exceptions were noted in the vouching of the details or the recalculations.

3.11.6 Timing of the Recording of Transactions need improvement

- We found that derivative transactions were recorded accurately in the Treasury Manager System (TMAN). However, we noted that in several instances, the deal was entered into TMAN after the effective date.
- For the selected sample of derivative deals done during the period of examination, we tested to ensure that the deals were recorded in the TMAN system. We vouched the details of the derivative deal to the information. We also made note of the date the entry was created, by whom and dates of modification. We noted that the details of all deals tested matched the information recorded in TMAN. We also noted that entries were made by appropriate persons. However, in six instances the deal was entered into TMAN after the effective date of the trade.
- We also tested a sample of deals to determine that the date confirmation from the counterparty is received is before date entered into TMAN. We found that in five instances, the deal was entered to TMAN before the confirmation was received.

3.11.7 Confirmations of Trades need monitoring

- We found the Treasury Division has procedures to match all terms of the deals between the risk management sheet and the counterparty confirmation. We also noted that the confirmations were not received on a timely basis.
- We selected a sample to test to ensure that all terms of the deals between the risk management sheet and the counterparty confirmation have been appropriately checked and initialed as reviewed. We found that details on the Risk Management Sheet matched the confirmation sheets with no exceptions.
- For the sample selected, we also noted the date that the confirmations were received from the counterparty. We found that final confirmations were received from the counterparty anywhere from 1 to 123 days after the trade date, without any explanation of the delay(s), although 123 days following the trade date was not the norm.

3.11.8 Communications with Counterparties need monitoring

- We selected a sample of deals and reviewed documentation on file to find evidence that the confirmation has been appropriately communicated to the counterparty. We found that confirmations of trade were appropriately communicated back to the counterparty. All except one item had evidence of the confirmation being faxed back to the counterparty.
- Confirmations were faxed back to counterparty anywhere from the same day to 50 days later.
- For deals in the sample where there were discrepancies between the risk management ticket and the counterparty confirmation, we noted that the process includes verbal follow up with the trader and/or the counterparty. From discussions with the Treasury Division's management, this is usually sufficient to reach a resolution. An amendment is then made accordingly. There is no more formal process in place to deal with discrepancies.

3.11.9 Settlement of Transactions controls are operating effectively

- We found that the Treasury Division has instituted appropriate controls surrounding the payments and settlements required in derivative contracts.
- We selected a sample of payments and performed tests on the sample. As a result of our tests, we found that:
    - All payments tested had appropriate authorizations for both the amount of payment, as well as for the wire transfer of funds;
    - Floating rate resets for the payments tested were agreed with the counterparties;

- All payments tested accurately were recorded in the general ledger (SAP) and had appropriate supporting SAP documentation; and
- For all items tested, payment and settlement amounts were traced to the bank statement on a daily basis. Further all amounts paid and received per the bank were agreed to the amounts recorded in TMAN.

- Controls surrounding payments and settlements are needed to ensure the amount paid is authorized, accurately calculated, and recorded correctly. We found all such controls and procedures to be functioning as intended.

3.12 LEGAL RISK -

Procedures and controls effectively address legal risk

- Through interviews with management and a review of Treasury Division procedures we noted that to address legal risk, all counterparties are required to have a signed agreement in accordance with International Swap Dealer Association Inc. (ISDA) documentation standards. The Treasury Division uses the Civil Legal Services Special Operating Agency (Civil Legal Services) to provide legal counsel in the negotiation and finalization of ISDA agreements. Civil Legal Services and legal counsel for the counterparty prepare and sign separate legal opinions on the ISDA agreement. These opinions are exchanged with the counterparties and retained on file.

- We selected a sample of four counterparties and their ISDA agreements. For all samples, signed agreements conforming to ISDA documentation standards were on file. Three of the four files selected had legal opinions on the agreements signed by legal counsel from Civil Legal Services and the counterparty. We followed up with Civil Legal Services and determined that opinions had been prepared but were awaiting approval from the counterparty's legal counsel before the opinions were signed and exchanged.

- The involvement of Civil Legal Services and the use of ISDA documentation standards provide adequate controls and procedures to address the legal risk associated with the use of derivatives.

3.13 MARKET RISK -

Procedures and controls addressing market risk could be expanded

- We found that no sensitivity analysis was prepared by management to evaluate the effect of changes in foreign currency and interest rates on the mark to market value of derivative financial instruments. However, a sensitivity analysis is performed to determine the sensitivity of public debt expense to interest rates and foreign exchange rates which includes the effect of derivative transactions on debt.

- Analysis is performed to determine the effect that 1% change in interest rates would have on the public debt expense reported at year-end. All debt issues are included in the analysis. The sensitivity of each debt issue is calculated by including the effect of all derivative instruments on that debt. If the effect of the derivatives is such that it fixes the rate of the debt, that debt issue is not included in the analysis of the overall debt's sensitivity to interest rate and foreign exchange rates.
- Not all derivatives are in the sensitivity analysis because the analysis is actually on the sensitivity of public debt expense and not on mark to market values of derivatives. Therefore, only debt swaps are included in the analysis. No sensitivity analysis is performed for investment derivatives, because the interest rate risk is hedged by offsetting debt instruments.
- While Treasury Division does not report the sensitivity of derivative mark to market values, if a counterparty approaches the credit limit, they will look at the effect of changes in interest rates and foreign exchange rates on the value of the derivatives. The mark to market exposure to the majority of counterparties is a negative value. The negative exposure (the Province owes the counterparty) lowers the risk of counterparty default.

3.14 CREDIT RISK -
Procedures and controls generally address credit risk

3.14.1 Counterparties' credit ratings are monitored

- We found that Treasury Division does restrict dealings to only highly rated counterparties and the ratings are monitored on a regular basis. We noted that the Derivative Policy addresses counterparty credit ratings as follows:

  "The Province will enter into a derivative agreement only with counterparties that are currently rated AA low or better or the equivalent rating by recognized rating agencies approved by the Credit Committee or is a Canadian Schedule A bank. Where the counterparty is rated AA mid or higher, no term restrictions will be placed on the counterparty. Should the counterparty have a credit rating of AA minus; the Province will require a one-way option to terminate at 5 years. Canadian Schedule A banks will not be required to agree to the one way termination clause.

  With the exception of the Canadian Schedule A banks the Province generally will review any derivative transaction if the counterparty's credit rating is downgraded to A high. Appropriate steps will be taken to minimize risks if any counterparty's credit rating is downgraded below A high. Such steps may include obtaining collateral or some other acceptable form of credit enhancement, or terminating the transactions. The Credit Committee will be notified of all credit downgrades. The Credit Committee must approve the actions proposed to be taken with respect to a transaction in which any counterparty's credit rating is downgraded below A high."

3.14.2 Established Credit limits should be reviewed periodically

- Credits limits are used to manage the credit risk associated with single events or correlated credit events such as defaults or downgrades, by restricting the exposure to any one counterparty or group of counterparties. The setting of credit limits is determined from a Division-wide perspective using a top down approach. For example, the ceiling could be the maximum credit limit acceptable for the debt (borrowings) and investment portfolios taken as a whole. The total credit limit could then subdivided by geographic region and then within the geographic region by country and then by counterparty. The sum of the credit limits of the components should not exceed the overall maximum acceptable credit limit.

- The credit exposure related to a derivative counterparty is generally the current credit exposure plus a factor for the potential credit exposure after considering the impact of a netting (amount owed net of amount due) agreement and any collateral obtained. Current exposure is the replacement cost of the derivative transactions (positive mark to market value) and potential exposure is an estimate of the future replacement cost of the derivative using probability analysis over the remaining term of transaction. The probability analysis would reflect both an expected (likely) exposure and the maximum worst case scenario.

- We noted that Treasury Division has established a credit limit for all the financial institutions which are approved for derivative transactions. However, the limit has not been updated since it was approved in 1997. We noted that credit criteria were outlined for the purchase of securities in a Credit Committee Submission on Securities Investments and were approved by the Minister of Finance on September 15, 1997. The recommendations include limits for all financial institutions which are approved for current derivative transactions. These institutions are approved to a maximum of $75 million for the combined security and derivatives values. While the combined value is $75 million, the value of securities is limited to $50 million. From discussions with management, there has been no update or review of the appropriateness of these limits since that date.

3.14.3 Credit limits are monitored

- We found that the Treasury Division is monitoring the mark to market value of derivative (a measure of the credit exposure) dealings, for each counterparty, on a monthly basis, to ensure that no counterparty exceeds the credit limit established. During the period audited, the Treasury Department began producing a Derivatives Exposure Report each month which is provided to senior management of the Treasury Division. However, we noted that the Treasury Division is not calculating the value of all the derivatives but relying on the values provided by the counterparties.

- The Treasury Division is obtaining a mark to market valuation of its derivative financial instruments on a monthly basis. During the period

audited, the Treasury Division tested and implemented an in-house system to value derivatives called ConjecSure. We noted that after ConjecSure was implemented, it remains unable to calculate the mark to market value for certain derivatives. However, the values that are calculated by ConjecSure are reasonable compared to the values provided by the counterparties. For derivatives which are unable to be valued by ConjecSure, the Treasury Division uses the mark to market valuations provided from the counterparty to monitor counterparty credit limits.

- We looked at the Derivative Exposure Report prepared for November 30, 2004. We also obtained the spreadsheet where the ConjecSure values are compared to the values provided by the counterparties. We noted that counterparty confirmations were received from all derivatives counterparties except for one. For each counterparty, we traced the amounts reported on the Derivative Exposure Report to the client prepared spreadsheets which compares the mark to market value per ConjecSure and the counterparty.
- We noted that some of the values "per ConjecSure" on the spreadsheet had been overridden with the value provided by the counterparty. The values overridden were for derivatives that were unable to be priced in ConjecSure. ConjecSure is unable to price options. Therefore, swaptions are not priced by ConjecSure and ConjecSure cannot calculate the value of swaps with step up rates which is the option to increase rates. While there would be a cost for the implementation, Treasury Division may include optionality in pricing at a future date.
- We tested whether the values from the ConjecSure system are reasonable compared to the values reported by the counterparties. For derivatives that were valued by ConjecSure, we noted that there were some differences to the values provided by the counterparties but the values used were reasonable. Differences arise due to differences in assumptions and methods in the calculations by the counterparty. Except for one counterparty, all the differences are within 10% of the reported exposure. The exposure for the counterparty greater than 10% is insignificant as it represents .06% of the derivative exposure total reported.
- We tested the input data into the ConjecSure system for valuing the swaps to the underlying sources. We found that input data used agreed to rates provided by the Bloomberg System used by Treasury Division. We also found that the yield curve generated by Treasury Manager System (TMAN) agreed to curve used in ConjecSure for valuing derivative contracts. During the testing, we noted that the cash curve data for a 0 to 12 month timeline (CDOR or BA rates) is entered every month into TMAN. The amount is overridden every month but is used for the calculation price. As such, there is no audit trail in the TMAN for the rates used for that month.
- We tested input control to ensure that inputs into the ConjecSure system are appropriately validated. During the testing and implementation

phases of the ConjecSure system, one staff member would enter and check all amounts input into TMAN and ConjecSure to produce the mark to market values. This approach was also used for the November, 2004 report which was sampled above. We also noted that subsequent to the audit period, the amounts have been entered by one staff member and another checks the entries. However, there is no record maintained of preparer/reviewer or signoff.

- We tested whether the valuation has been carried out independently by the middle office and signed off. The only staff member doing the valuations for the period under review was a staff member in the Middle Office.
- We tested that the mark-to-market values have been appropriately reported to senior management. The Derivatives Exposure Report for November, 2004 was circulated to the Directors, Assistant Directors, and Assistant Deputy Minister. It was also discussed extensively at the Credit Committee meeting on December 14, 2004 as noted in the minutes.

3.15 MANAGEMENT RISK -

Procedures and controls address certain management risk

- While we noted a lack of formal management reporting, we also noted that the existing monitoring controls provide management the ability to supervise and oversee the activities relating to derivatives.
- We enquired whether there have been any breaches of credits limits and, if so, what action has been taken. We also reviewed minutes of the Risk (credit) Committee for documentation of action to be taken to avoid any potential breach of credit limits.
- We found that according to the November 30, 2004 Derivative Exposure Report, two counterparties were identified to have exceeded the established credit limit.
- The report was circulated to all senior management and was discussed at the Credit Committee meeting on December 16, 2004. Corrective action discussed at the meeting involved three options: unwind swaps, re-coupon the transactions (change the interest rates used for the related transactions) and capture positive mark-to-market, or sell investments in bonds.
- The decision was made to suspend bond purchases for those counterparties sell the bonds held at that time. Additionally, the Risk (Credit) Committee indicated that they want research to determine if they should change credit (exposure) limits.
- We followed up the action taken with the first counterparty and confirmed that the two bonds had been sold in December, 2004. Per a memo to management on December 20, 2004, the valuation of one counterparty's derivatives had decreased below the threshold. The sale of the bonds combined with increase in the value of the Canadian dollar

decreased the exposure within the specified counterparty credit limit. The memo also stated that this counterparty should be monitored by risk management every two weeks and further action would be necessary if the exposure started to increase.

- We followed up on the action to be taken with the second counterparty and determined that the Division was currently in negotiations with the counterparty to either provide additional collateral to the Province or to re-coupon the transactions at a lower rate and receive funds for the difference.

3.16 MIDDLE OFFICE -

Key controls were in effect throughout the period under review and key controls were in effect throughout the reorganization transition regarding the middle office function

- In July 2003, Treasury Division was reorganized into a front-middle-back office structure. The intended result was an amalgamation of all trading activities, and the development of a segregated, middle office, with new roles and responsibilities to measure, monitor and report on the Division's financial risks and exposures. However, while the reorganization was effective July 2003, the actual transition is taking place over a number of years. To assist the Treasury Division with the design and implementation of the middle office, a consultant was engaged to provide a 'middle office blueprint' indicating appropriate structure, practices, controls, and information flows. The report was provided to the division in February, 2004 and the implementation of the recommendations is ongoing.

- Through interviews with management regarding the reorganization and implementation of the consultant's recommendations we found that the reorganization is still in process and going at a slower pace than expected. The main priority throughout the reorganization is the continued operation of the Treasury Division. New positions have been created and new staff have been hired. The Division has also been training staff for the new positions. The Division has had to find a balance between implementing the consultant's recommendations, while at the same time, mentoring the back office where there are several new hires.

- During the development of the middle office processes, some of the controls became the responsibility of different areas or persons during this transition time. Additionally, Treasury Division is currently working on developing a new mandate, risk management policy, investment and debt policies.

- The mandate of the middle office includes new procedures and controls to address risk. Some of these controls were started during the period under review and some will commence after the review date. However, the operational controls and procedures surrounding the initiation, confirmation, and servicing of derivative agreements have existed

throughout the examination period (although the responsibility for the controls may have changed areas or persons).

- We tested whether operational controls surrounding the initiation, confirmation, settlement and recording of derivative transactions remained in effect for the period under review and during the reorganization. When selecting our sample to test operational controls, we included trade dates covering the whole examination period. The controls that tested to be effective were in place for the entire period of examination.
- We found that for the period under examination, the full role of middle office was not yet implemented. They are currently working on risk management: developing a new mandate as well as risk management, investment and debt policies. However, we determined that the key operational controls on the initiation, confirmation, recording and servicing of the derivatives remained in place during the period under examination.

3.17 MIDDLE OFFICE -
Monitoring controls over the use of derivatives needs strengthening and the middle office transition should be completed as soon as possible

3.17.1 Standardized exception reporting is needed

- We found that a number of monitoring activities and analysis were being performed to ensure the use of derivatives is effective and consistent with the divisional objectives. However we noted that there was a lack of standardized reports prepared for management and therefore a lack of documentation of the information provided for monitoring and analysis.
- We found that there are no minutes from the weekly Capital Markets Committee meeting, no standardized exception reports, and no reporting on derivative activity other than the derivatives exposure report. Much of the reporting is done on an ad hoc basis, so we were unable to obtain documentation of all the information considered by senior management for their monitoring activities. The only management information report relating specifically to derivatives that was prepared regularly was the monthly Derivatives Exposure Report. Also, minutes were kept for the Risk (Credit) Committee meetings and we were able to review them for decisions relating specifically to derivatives activity. The Division produces a weekly financial status report and a Treasury Services Report which do not include specific information relating to derivatives activities.
- We were unable to follow any audit trail for exception reporting. There is no standard process for exception reporting. Any exception noted is handled on an ad hoc basis by the Treasury Division. Examples of

exceptions handled in this manner are; counterparty credit limits exceeded, confirmations not received, and a change in credit rating.

- The Treasury Division's senior management indicated that because the Treasury Division consists of a small staff, monitoring is addressed through good communication among all levels of staff. Information is shared at the weekly Capital Markets Committee meetings and the less frequent Credit (Risk) Committee meetings. The former Assistant Deputy Minister stated that he always knew what was happening through his daily interaction with the staff and if there was a problem, he would know about it.

3.17.2 Full Implementation of Middle Office functionality is crucial

- The middle office is still under development. The middle office is responsible for a range of functions for the entire Treasury Division pertaining to risk management. The role of the middle office includes policy development, monitoring and reporting compliance with policy and procedures, risk performance measurement and reporting, risk limit calculations and monitoring, approval of valuations(models, methodologies and parameters),and approval of master agreements (with counterparties).
- We understand that there is considerably more effort needed to fully establish the full Middle Office functionality. The staff working in the middle office is in the process of redeveloping the Treasury Division–wide risk management policies, against which the current Derivative policy will be considered. Once the Division's risk management policy is revamped, roles and responsibilities must be reviewed as well as a review of other aspects of the Treasury Division's risk management process.
- Because of the key importance of the middle office functions, the Department of Finance should consider whether the time frame to complete the development of the Middle Office is appropriate as well as the level of assigned resources. We understand that the implementation process is taking longer than anticipated.

3.18 GOVERNANCE OVERSIGHT - Governance practices in the risk management process should be enhanced

- Industry best practices recommend an oversight body (a board of directors in industry) in conjunction with management establish Treasury Division objectives. This body would also set out a broad framework for management to work within and provide oversight. The oversight body should receive timely and sufficient information to oversee the Treasury Division's activities. We found that there is no such oversight body in place.
- In the current organizational structure, the Capital Markets Committee is the senior committee overseeing the risk management process regarding the use of derivatives. No minutes are taken at the Committee's

meetings, and therefore there is no audit trail documenting the Committee's deliberations and decisions.

- We also found that the Risk Management (formerly Credit) Committee did not meet quarterly throughout the period under review. They met three times during the period under review (April, 2003 to December 31, 2004). While there were minutes of the meetings held, consideration should be given to this Committee meeting monthly to consider exception reports and to document discussions and the decisions arrived at.
- In addition, we found that the record keeping of the operations of the Committees could be more formal in that meeting agendas and material submitted to the Committees for review and discussion should be retained for reference purposes.

4.0 Recommendations

Strategic Objectives for the Treasury Division and the Related Risk Management Strategy

- That the Division's objectives, risk identification and assessment, and risk management strategy be documented and approved. We also recommend that the Derivative Policy statement be approved.
- That the formulation and approval of the Treasury Division-wide Risk Management Policy statement be targeted as a key priority.
- That the risk management strategy be documented and approved by management and the Board of Directors (equivalent).
- That maximum acceptable levels of risk and risk limits be specified in the Derivative (Risk Management) Policy.
- That the Derivative Policy should document any distinctive characteristics such as liquidity and customization that may be used with the authorized types of derivatives.

Operational Risk

- That the exercise of due diligence regarding the decision to enter into a derivative financial instrument agreement be documented. We also recommend that the deliberation of the type of derivative financial instrument to be used and its distinctive characteristics should be documented.
- That the internal control procedures be adhered to in order to ensure that documents supporting the execution of derivative transactions are duly authorized by staff who has delegated authority.
- That the trader's log book maintains a complete and accurate account of the relevant details of each derivative financial instrument contract.

- That pre-numbered risk management sheets be used and accounted for to ensure the completeness of the records of derivative financial instrument agreements.
- That the derivative transaction in the Treasury Manager System be recorded after receiving the counterparty confirmation but before the effective date of the derivative financial instrument contract.
- That the internal controls regarding the confirmation of trades be strengthened by assigning responsibility to a staff person for the follow-up of outstanding confirmations.
- That the internal controls regarding the communication with counterparties following confirmation of trades be strengthened by assigning responsibility to a staff person for the monitoring of these communications.

Market Risk

- That Treasury Division expands their sensitivity analysis to separately evaluate the market risks associated with derivative financial instruments.

Credit Risk

- That a review of the current credit limits should be undertaken within the context of the Treasury Division-wide credit risks.

Management Risk

- That an audit trail be established for the preparation and review of the monthly mark to market (valuation of derivatives) reports.
- That the risk management reporting process being developed requires standard exception reports to be produced at defined intervals.
- That the Department of Finance strongly considers providing additional resources in the short-term to facilitate the full implementation of the Middle Office functionality.
- That the Department establishes an active and effective Board of Directors (equivalent) to determine Department-wide objectives set the framework for Treasury Division management to work within and to provide oversight of Treasury Division's operations and performance.
- That the Capital Markets Committee record minutes of their meetings in order to document their deliberations and risk management activities. That the Risk Committee consider meeting monthly to review exception reports and thereby document their governance activities. All meeting agendas and material submitted to the Committees should be retained for reference purposes.

Response from Officials

Treasury Division management has reviewed the report, and we are in general agreement with the recommendations. Since the completion of your audit, most of your recommendations have either already been implemented or are currently being worked on.

Your recommendations are valuable input into the ongoing development of the Department's use of Derivative Financial Instruments.

Appendix A

DETAILED CRITERIA

Objective: To determine whether the Province has a risk management process (derivative risks include management, market, legal, credit, and operational risk) in place, and whether that risk management process used by the Treasury Division with respect to derivatives (with respect to debt and investments) is consistent with industry best practices.

Main Criteria	Sub-Criteria	Expectation Discussion	Source
Is there a risk management policy on the use of derivatives?	Have Department of Finance objectives been linked to Treasury Division's operations?	The Department's objectives are linked to objectives set for Treasury Division. The Division's strategies, operating plans and policies can be linked back to the broad objectives.	COSO Internal Control-Integrated Framework in Derivatives Applications.
	Are risks clearly identified and measured?	A process should exist to assess and understand fully the nature and extent of risks that result from business activities before derivatives are used for risk management purposes. The risk management policy should specify that the use of derivatives to manage risks should be based on such assessment and is expected to manage the risks effectively.	COSO Internal Control-Integrated Framework in Derivatives Applications.
	Does the policy specify acceptable levels of risk or other measurable limits?	Policy should specify maximum acceptable levels of risk in terms that are clear and can be quantified. The policy concerning derivatives may also be integrated with policies dealing with related business activities, e.g., maintaining a balance between fixed and variable rate instruments in the management of the debt or investment portfolio.	COSO Internal Control-Integrated Framework in Derivatives Applications.
	Are risk management activities and the intent of the policy clear?	Definition of all key terms used to describe risk management activities to avoid possible misunderstanding and confusion about the intent of the policy and the use of derivatives.	COSO Internal Control-Integrated Framework in Derivatives Applications.
Is there a risk management strategy on the use of derivatives?	Does the risk management strategy address the identified risks?	The risk management strategy clearly addresses the identified risks.	Province of Manitoba Treasury Division Derivatives Policy.
	Is the risk management strategy documented and communicated?	A clear statement of objectives decreases confusion and misunderstanding of policies and provides a foundation for specifying control activities that govern their use. Activity-level objectives governing the use of derivatives should be clearly specified and documented in a policy to avoid confusion about the purpose for using derivatives.	COSO Internal Control-Integrated Framework in Derivatives Applications.
	Does the plan to implement the risk management strategy identify risks associated with the use of derivative financial instruments?	The risks associated with the use of derivative financial instruments are clearly defined and understood. A minimum level of expertise should be required within the entity dealing with derivatives. Management, credit, market, operational and legal risks are identified as the key risks.	Province of Manitoba Treasury Division Derivatives Policy. COSO Internal Control-Integrated Framework in Derivatives Applications.
	Are the types of authorized derivatives clearly identified?	Derivatives have distinctive characteristics that should be considered in the formulation of policies governing their use, e.g., leverage, liquidity, customization. Clear definition of what derivative instruments are authorized to be used, e.g., interest rate swaps, foreign exchange forward contracts.	COSO Internal Control-Integrated Framework in Derivatives Applications.

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Main Criteria	Sub-Criteria	Expectation Discussion	Source
Is there a risk management strategy on the use of derivatives? (cont'd.)	Are inappropriate uses of derivatives clearly identified?	A clear statement of objectives decreases confusion and misunderstanding of policies and provides a foundation for specifying control activities that govern their use. Activity-level objectives governing the use of derivatives should be clearly specified and documented in a policy to avoid confusion about the purpose for using derivatives. Derivatives have distinctive characteristics that should be considered in the formulation of policies governing their use, e.g., leverage, liquidity, customization. Clear definition of what derivative instruments are authorized to be used, e.g., interest rate swaps, foreign exchange forward contracts. The risks associated with the use of derivative financial instruments are clearly defined and understood. A minimum level of expertise should be required within the entity dealing with derivatives. Management, credit, market, operational and legal risks are identified as the key risks. Derivatives have distinctive characteristics that should be considered in the formulation of policies governing their use, e.g., leverage, liquidity, customization. Clear definition of what derivative instruments are authorized to be used, e.g., interest rate swaps, foreign exchange forward contracts. Policies should also clearly identify activities and strategies that might be considered controversial and provide a clear and formal interpretation of what they mean to the entity, e.g., classifying activities as "appropriate", "inappropriate' or require ad hoc consideration and specific approval.	COSO Internal Control-Integrated Framework in Derivatives Applications.
Are there risk management procedures and controls on the use of derivatives?	Do the risk management procedures and controls implement the risk management policies?	The procedures and controls are in place to implement the objectives and strategies of the risk management policy.	Province of Manitoba Treasury Division Derivatives Policy. COSO Internal Control-Integrated Framework in Derivatives Applications.
	Do the procedures and controls address credit risk?	In order to limit credit risk, dealings with counterparties are restricted to only highly rated counterparties. Moreover, limits are also established with counterparties to limit total exposure to individual counterparties.	COSO Internal Control-Integrated Framework in Derivatives Applications.
	Do the procedures and controls address operational risk?	An appropriate organizational structure with clear delineation of responsibilities is in place. Derivative instruments are transacted by authorized traders, appropriately authorized and recorded. Confirmations are received for all derivative deals and settlement amounts.	Documentation and understanding of system and processes relating to derivative transactions.
	Do the procedures and controls address market risk?	A sensitivity analysis should be prepared by management to to evaluate the effect of changes in foreign currency and interest rates.	Documentation and understanding of system and processes relating to derivative transactions.
	Do the procedures and controls address legal risk?	In order to reduce legal risks, all derivative contracts should conform to the ISDA documentation standards.	COSO Internal Control-Integrated Framework in Derivatives Applications. Documentation and understanding of system and processes relating to derivative transactions.

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Main Criteria	Sub-Criteria	Expectation Discussion	Source
Are the key controls in effect throughout the period under review?	Did the controls remain in effect during the reorganization?	During the period under review, Treasury Division implemented a middle office. As a result some processes and staff responsibilities may have changed. However, the key controls surrounding derivative transactions should be in effect during the reorganization.	Documentation and understanding of system and processes relating to derivative transactions.
Is the process of monitoring controls effective?	Are there monitoring controls in place?	Periodic monitoring activities and analysis is required to document that the use of derivatives is effective and consistent with the activity-level and entity wide objectives.	COSO Internal Control-Integrated Framework in Derivatives Applications.
	Do the monitoring controls address management risk?	Monitoring controls provide management the ability to supervise and oversee the activities relating to derivatives. Management information reports are prepared on a timely basis, are reviewed by appropriate levels of management and timely action was taken. Management should review the results against any limits established or against their overall financial positions.	COSO Internal Control-Integrated Framework in Derivatives Applications.
Are governance practices in the risk management process appropriate?	Are the governance practices consistent with industry best practices?	Entity-wide objectives are established by the Board of Directors or equivalent and senior management. An active and effective Board or equivalent provides the oversight and lays down the broad framework for management to work on. At the Board or equivalent and executive management levels, there should be a clear understanding and documentation of the purpose for using derivatives. Sufficient and timely information is provided to the Board or equivalent to assist them in their oversight role. An independent review of derivative activities is performed to determine whether the policies are being implemented in accordance with management objectives as well as there is compliance with control procedures and risk exposure limits.	COSO Internal Control-Integrated Framework in Derivatives Applications.
	Is there a risk management group or risk committee to establish policy and oversee management of risk?	The risk management group or risk committee is responsible for establishing the risk management policies and to over see the entity's management of risk and use of derivatives. The risk management group/risk committee's role may include: - Specifying authorized strategies and permitting uses of and limitations on derivatives. - Ensuring that policies, procedures and controls are fully documented in writing and communicated to everyone. - Establishing a general framework for monitoring results of derivative activities and compliance with policies and procedures. - Evaluating and approving new transactions and strategies. - Ensuring that approval of new transactions is based on an understanding of the underlying contracts and that the contracts have been read and approved and that accounting, credit, legal, and operational considerations have been fully documented before execution. - Approving all counterparties and specifying limitations on counterparty risks, such as minimum credit rating and credit exposure limitations. - Specifying reports to be prepared on a periodic basis for monitoring derivative activities, e.g., sensitivity analysis, analysis of the effectiveness of derivatives in accomplishing objectives. - Periodically reporting derivative activities and results, including both gains and losses and any deficiencies to the Board.	COSO Internal Control-Integrated Framework in Derivatives Applications.

Appendix B

GLOSSARY OF TERMS

Banker's Acceptance (BA)	A short-term credit investment created by a non-financial firm and guaranteed by a bank. Acceptances are traded at a discount from face value on the secondary market. Banker's acceptances are very similar to T-bills and are often used in money market funds.
Basis Point	A unit that is equal to 1/100th of 1%, and is used in denoting the change in a financial instrument. The basis point is commonly used for calculating changes in yield of a fixed-income security, interest rates and equity indexes. The relationship between percentage changes and basis points can be summarized as follows: 1% change = 100 basis points, and 0.01% = 1 basis point. So, a bond whose yield increases from 5.0% to 5.5% is said to increase by 50 basis points; or interest rates that have increased by 1% are said to have increased by 100 basis points.
Bond Rating	A specification of a bond issuer's probability of defaulting based on an analysis of the issuer's financial condition and profit potential. Bond rating service companies provide ratings for various debt and preferred stock issues for safety of payment of principal, interest, or dividends. Bond ratings start at AAA (denoting the highest investment quality) and usually end at D (meaning payment is in default).
Cap or Capped Option	An option with a pre-established profit cap. A capped option is automatically exercised when the underlying security closes at or above (for a call) or at or below (for a put) the Option's cap price. This can also be referred to as a capped-style option.
CDOR	The Canadian Dollar Offered Rate, named CDOR, is the recognized benchmark index for bankers' acceptances with a term-to-maturity of one year or less. CDOR serves both money and derivative markets: it is employed for the final settlement price for the over-the-counter (OTC) derivatives market synthetic instrument calculations like forward rate agreements (FRAs) and swaps. CDOR is determined daily from a survey of nine market makers in bankers' acceptances (BA). The daily survey of money market rates is derived from bid side prices provided by survey participants.

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Collar	A protective options strategy that is implemented after a long position in a stock has experienced substantial gains. It is created by purchasing an out of the money put option while simultaneously writing an out of the money call option.
Collateral	Something of value that is pledged for a loan or other financial obligation. The lender or holder of the collateral can repossess the collateral if the loan is repaid or the obligation fulfilled. When the obligation is fulfilled, the creditor must return the collateral. Also, collateralize – to provide collateral.
ConjecSure	Software used by Treasury Division to calculate the market value of derivatives. It was developed by the creators of the TMAN software.
COSO	The Committee of Sponsoring Organizations of the Treadway Commission. Members of COSO are: American Accounting Association, American Institute of Certified Public Accountants, Financial Executives Institute, Institute of Internal Auditors, and the Institute of Management Accountants.
Counterparty	The party on the other side of a transaction such as a swap agreement. The transaction is traded over the counter (not on a stock exchange).
Currency Forward	A forward contract that locks-in the price an entity can buy or sell currency on a future date. In currency forward contracts, the contract holders are obligated to buy or sell the currency at a specified price, at a specified quantity, and on a specified future date. These contracts cannot be transferred. Also known as "outright forward currency transaction".
Currency Option	A contract that grants the holder the right, but not the obligation, to buy or sell currency at a specified price during a specified period of time. An entity against foreign currency risk by purchasing a currency option put or call.
Currency Swaps	A swap that involves the exchange of an amount in one currency for the same in another currency.
Derivative	A security, such as an option or futures contract, whose value depends on the performance of an underlying security or asset. Futures contracts, forward contracts, options, and swaps are the most common types of derivatives. Derivatives are generally used by institutional investors to increase overall portfolio return or to hedge portfolio risk.

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Floor	Common name for an interest rate floor. Interest rate floors are agreements between two parties in which the seller, in return for a premium, agrees to limit the risk associated with a decline in interest rates. If interest rates fall below a specified level, known as the strike price, the floor buyer is entitled to receive cash payments equal to the difference between the market rate and the strike price multiplied by the notional principal amount. A floor is a type of option; therefore, the buyer has the right but not the obligation to exercise it.
Futures	A financial contract that obligates the buyer (seller) to purchase (sell and deliver) financial instruments or physical commodities at a future date, unless the holder's position is closed prior to expiration. Futures are often used by mutual funds and large institutions to hedge their positions when the markets are rocky, preventing large losses in value. The primary difference between options and futures is that options provide the holder the right to buy or sell the underlying asset at expiration, while futures contracts holders are obligated to fulfill the terms of their contract.
FX	The foreign-exchange market ("forex" or "FX") is the place where currencies are traded. The forex market is the largest, most liquid market in the world with an average traded value that exceeds $1.9 trillion per day. There is no central marketplace for currency exchange, rather, trade is conducted over-the-counter. The forex is open 24 hours a day, five days a week, with currencies being traded worldwide among the major financial centers of London, New York, Tokyo, Zurich, Frankfurt, Hong Kong, Singapore, Paris and Sydney - spanning most time zones.
Hedge	Making an investment to reduce the risk of adverse price movements in an asset. Normally, a hedge consists of taking an offsetting position in a related security. An example of a hedge would be if you owned a stock, then sold a futures contract stating that you will sell your stock at a set price, therefore avoiding market fluctuations. Investors use this strategy when they are unsure of what the market will do. A perfect hedge reduces your risk to nothing (except for the cost of the hedge).

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Interest rate swap	A deal between counterparties where borrowers switch floating-rate loan payments for fixed rate loan payments. These can be either the same or different currencies. The advantage to this is that one party may have access to lower fixed rates and another company may have access to lower floating rates... so they trade.
Interest rate swaption	The option to enter into an interest rate swap. In exchange for an option premium, the buyer gains the right but not the obligation to enter into a specified swap agreement with the issuer on a specified future date. The agreement will specify whether the buyer of the swaption will be a fixed-rate receiver (like a call option on a bond) or a fixed-rate payer (like a put option on a bond).
ISDA	The International Swaps and Derivatives Association is the global trade association representing participants in the privately negotiated derivatives industry, a business covering swaps and options across all asset classes (interest rate, currency, commodity and energy, credit and equity). ISDA was chartered in 1985, and today numbers over 650 member institutions from 47 countries on six continents. These members include most of the world's major institutions who deal in, as well as leading end-users of, privately negotiated derivatives. Since its inception, ISDA has pioneered efforts to identify and reduce the sources of risk in the derivatives and risk management business. Among its most notable accomplishments are: developing the ISDA Master Agreement; publishing a wide range of related documentation materials and instruments covering a variety of transaction types; producing legal opinions on the enforceability of netting and collateral arrangements (available only to ISDA members); securing recognition of the risk-reducing effects of netting in determining capital requirements; promoting sound risk management practices, and advancing the understanding and treatment of derivatives and risk management from public policy and regulatory capital perspectives.
Leverage	The use of various financial instruments or borrowed capital, such as margin, to increase the potential return of an investment. Leverage can be created through options, futures, margin and other financial instruments. The use of leverage increases risk because the potential losses are greater than they would have been without leverage - leverage magnifies not only gains but also losses.

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	Derivative transactions are considered to be highly leveraged if they expose the entity to loss in excess of gains expected to be generated by positions and transactions they modify.
LIBOR	The London Interbank Offer Rate is the rate of interest at which banks borrow funds, in marketable size, from other banks in the London interbank market. In other words, LIBOR is the international rate used when banks borrow from other banks. This is the most widely used benchmark or reference rate for short term interest rates.
Liquidity	The capability of ready conversion to cash.
Mark to market	The process of valuing (market value or fair value) derivative positions for purposes of determining accounting gains or losses.
Mark to market exposure (of a swap counterparty)	The net positive market value of all swap agreements with a given counterparty. Higher exposure indicates increased credit risk for that counterparty.
Notional Amount	A theoretical or stipulated principal amount, agreed upon by the counterparties, upon which many derivative contracts are based.
Option	An option is a contract whereby the contract buyer has a right to exercise a feature of the contract (the option) on or before a future date (the exercise date). The 'writer' (seller) has the obligation to honour the specified feature of the contract. Since the option gives the buyer a right and the seller an obligation, the buyer has received something of value. The amount the buyer pays the seller for the option is called the option premium.
Recoupon	To change the periodic payments required by a financial instrument. Usually this is done in exchange for a lump sum payment at the time of the recoupon.
Schedule A bank	A federally regulated Canadian bank as listed in Schedule I of The Bank Act.
Sensitivity Analysis	A technique for determining the outcome of a decision if a key prediction turns out to be wrong.
Speculation	An aggressive strategy designed to increase profits by accepting more market risk than generated by underlying business operations or financial instruments funding the company's capital structure. Highly leveraged derivatives also are signs of speculating activities.

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Step Up Bonds	A bond that pays an initial coupon rate for the first period, and then a higher coupon rate for the following periods (step up rates). In other words, the coupon "steps up". For example, a five-year bond may pay a 4% coupon for the first two years of its life and a 6% coupon for the final three years.
	The difference between the negotiated and fixed rate of a swap. The spread is determined by characteristics of market supply and creditor worthiness.
Swap	A periodic exchange (or swap) of payments between two counterparties for a specified period of time. The exchange of payments can be based on such things as Interest rates, currency rates, commodity prices, stock indices, temperature.
Swap Spread	The difference between the swap rate and the lending rate offered through other investment vehicles with comparable characteristics. Similar to equity spreads, the swap spread adjusts for every contract and the different participating parties.
Swaptions	A combination of a swap and an option. In its basic form, the swaption gives the buyer the right, but not the obligation to buy (call) or sell (put) a swap.
TMAN (Treasury Manager)	Software used by Treasury Division to track investment and debt activity and the resulting cash flows. Reports from TMAN are used to support amounts reported the G/L.
Unwind	To terminate or sell a derivative position, or achieve the same effect by entering into another derivative contract that offsets the first position.
Yield curve	The yield curve or the term structure of interest rates is the relationship between the cost of borrowing money and the amount of time the money is being borrowed for. The yield of a financial instrument is the amount of money to be made per year by investing in that instrument. For instance, a bank account that promises an interest rate of 4% per year has a 4% yield. In general the amount per year that can be made is dependent on the length of time that the money is invested. For example, a bank may offer a "savings rate" higher than the normal checking account rate if the customer is prepared to leave money untouched for five years. Generalizing, investing for a period of time t gives a yield Y(t). This function Y is called the yield curve. The nomenclature "curve" is used rather than

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"yield function" because when plotted on a graph, the function is a curve.

Y is often an increasing function, but that need not always be the case - yield curves are used by fixed income analysts, who analyse bonds and related securities, to understand conditions in financial markets and to seek trading opportunities. Economists use the curves to understand economic conditions.

The yield curve function Y is actually only known with certainty for a few specific periods of time, the other periods are calculated by interpolation (see Construction of the full yield curve from market data below).

Yield curves carry an implicit forecast of future short-term interest rates: for example if the annual yield on a 10-year bond is 5%, and on an 11-year bond is 5.5%, then the implicit yield in year 11 is a graphic line chart that shows interest rates at a specific point for all securities having equal risk, but different maturity dates. For bonds, it typically compares the two- or five-year Treasury with the 30 year Treasury.

Securities with longer maturities usually have a higher yield. If short term securities offer a higher yield, then the curve is said to be inverted.