The Alberta Financial Review Commission

Report to Albertans

March 31, 1993

ALBERTA FINANCIAL REVIEW COMMISSION

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March 31, 1993

TO ALL ALBERTANS

The Alberta Financial Review Commission was established by the Provincial Treasurer, the Honourable Jim Dinning, to inquire into the current financial position of the province and to make recommendations as to what actions should be taken to improve the province's management and reporting systems, so that they more clearly communicate the province's financial situation to its citizens.

In establishing this Commission, the Minister made it quite clear that our responsibility was to report directly to all Albertans, and not to him or the government. He directed that all government officials of all departments, agencies and funds should make available to the Commission any information we required to carry out the review in accordance with our terms of reference.

In the Commission's restricted time frame of slightly more than two months, there was only time to conduct a general overview of the province's financial situation. No audit work was carried out and information requested and received from government sources was accepted and relied on. The Commission expresses no opinion on, and makes no representation with respect to, the accuracy or completeness of the information that it has accepted and relied on. This report is not intended to be, nor should it be construed or relied on as advice with respect to investment strategies either by the province or others.

The prompt and helpful response to our questions by government officials greatly assisted our work. The Commission would like to express its appreciation to the Deputy Provincial Treasurers, the administrative officials of the province and the Auditor General who provided the required information.

The Commission also solicited input from the public and consulted with other knowledgeable professionals.

The Commission's report does not review in detail the history of the province's financial situation. Neither does it propose any solutions to eliminate the province's annual deficit and net debt. These matters were considered to be beyond the Commission's terms of reference.

However, the nature of our review and the process which was followed naturally led the Commission to suggest a number of changes to the government's management and financial systems which are needed if we are to successfully address the current serious financial position of the province.

It must be recognized that many of the present systems were designed to serve the province during an era of abundance, and that the current times of economic difficulty necessitate major changes. There are many positive aspects of the current systems which the Commission has not commented on in this report. It appears to the Commission that there are many strengths, including the professional competence and dedication of government officers, a good cash management system and a number of well managed individual departments, agencies and funds.

The views expressed in this Report are those of the Commission.
The Commission hopes that this report will assist the Government and Albertans to successfully address the very serious financial situation faced by all Albertans.

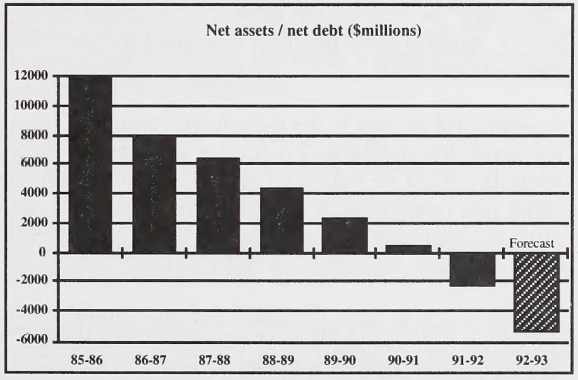
Yours truly,
ALBERTA FINANCIAL REVIEW COMMISSION

Marshall Williams
Chairman

Financial Highlights
(in millions)

Results of Operations for the year ended	March 31, 1992 (as reported)	March 31, 1993 (as forecast)
CONSOLIDATED DEFICIT	$2,629	$3,170

Financial Position as at	March 31, 1992 (as reported)	March 31, 1993 (as forecast)
CONSOLIDATED PROVINCIAL DEBT	17,403	19,830
CONSOLIDATED FINANCIAL ASSETS -- NET	15,238	14,495
CONSOLIDATED NET DEBT	$2,165	$5,335



Pro Forma Financial Position	March 31, 1993 (as forecast)
NET DEBT (after giving effect to unfunded pension liabilities and the province's share of school boards' debt)	$11,000

Understanding the Terms Used

To understand the financial position of the province, readers need to understand certain basic terms and concepts. Frequently, different meanings given to terms commonly used -- and misused -- in describing the province's financial position lead to misconceptions and dispute.

Here are some terms used in this report and how they are defined.

Deficit

"Deficit" is a term that is commonly misunderstood. "Deficit" means the excess of expenditure over revenue for a given year. In this report, we sometimes refer to the annual deficit as *"overspending"* .

Provincial debt

"Provincial debt" refers to the total amount outstanding that the province has borrowed for a period of time which it must repay to third parties.

Amounts borrowed by one provincial fund or agency from another are not part of the provincial debt, for example, amounts borrowed by the General Revenue Fund from the Heritage Savings Trust Fund,

Net debt

Provincial debt by itself is not a fair measure of the financial position of the province. The province also owns financial and other assets. The proceeds from the sale of any of these assets can be used to reduce the provincial debt, so that movements up and down in the provincial debt are not exclusively tied to annual overspending. Of more significance is net debt.

"Net debt" represents the excess of recorded liabilities over recorded assets. Annual overspending increases net debt and annual surpluses decrease net debt.

Structural deficit

A structural deficit is the deficit that would continue to occur even when the economy recovers. To correct a structural deficit, revenue and program spending must be balanced and in a way that enables them to grow at the same rate over time. A solution which balances revenue with expenditure without matching growth rates of those revenues and expenditures on a ongoing basis will result in deficits reappearing.

Consolidated Financial Statements

The easiest way to understand the province's whole financial picture is to examine the "consolidated" financial statements. These present the result of putting together as a single entity:

- the revenues and expenditures, assets and liabilities of government departments, funds and agencies; and
- the net results of operations of provincially-owned commercial enterprises.

Transactions and balances between provincial departments, funds and agencies are eliminated.

Budget

The "budget" or "budget estimates" refer to anticipated revenues and expenditures adopted by the Legislature as the financial plan for a given year.

General Revenue Fund

The budget presented to the Provincial Legislature each year in the Budget Address is that of the General Revenue Fund, which is also referred to as the government's *"budgetary revenues and expenditures"*.

This contains most -- but not all -- provincial revenues and expenditures. It contains the revenues and expenditures of government departments and the cost of providing many funds and agencies with financial support. It also receives income from other agencies, most notably the Heritage Savings Trust Fund and the Alberta Liquor Control Board. However, it does not include:

- the expenditures of the Capital Fund and the Capital Projects Division of the Heritage Savings Trust Fund;
- those revenues and expenditures of regulated funds and agencies which do not flow to or from the General Revenue Fund, such as the Lottery Fund; and
- the retained profits or losses of provincially owned commercial enterprises.

Forecast

A "forecast" is the latest estimate of the most likely outcome for the fiscal year, in this report, the year April 1, 1992 to March 31, 1993,

Projection

A "projection" illustrates the effect of certain assumptions which may or may not occur. Since the budget for the 1993-94 year has been delayed, Alberta Treasury prepared two projections for the Commission's use, one assuming flat revenues, the other a growth scenario, both assuming no change in current programs.

Guarantees and indemnities

Guarantees given by the province with respect to borrowing by others, and indemnifications against the risk of loss do not form part of the provincial debt. They do represent a risk to the province. If and when it is determined that the province will likely be called upon to make payments under a guarantee or indemnity, the amount becomes a liability and is added to the net debt and to the expenditures for the year.

GAAP

Generally Accepted Accounting Principles (GAAP) are primarily the accounting recommendations published by the Canadian Institute of Chartered Accountants (CICA).

PSAAC

The Public Sector Accounting and Auditing Committee (PSAAC) was established in 1981 by the Canadian Institute of Chartered Accountants (CICA). Its members include government chief financial officers, legislative auditors and treasury officials, among others. It has issued a number of statements on accounting by governments. Generally, its recommendations conform with GAAP with one major exception -- PSAAC is still considering the issue of whether governments should record and depreciate capital assets.

Table of Contents

Appendices

1. Summary

The Alberta Financial Review Commission

On January 21, 1993, Provincial Treasurer Jim Dinning announced the appointment of a nine-member commission made up of key Alberta business executives and financial experts to begin immediately to review the government's financial position and reporting procedures.

Marshall Williams, Director and past Chairman of the Board of TransAlta Utilities, was named chair of the Alberta Financial Review Commission. Three public members and senior partners from five chartered accountant firms were named to the Commission.

The Commission was given the authority and responsibility to inquire into and report on the following by March 31, 1993:

- The appropriateness of the accounting principles used to prepare the province's financial statements and methods to improve the usefulness, clarity and timeliness of the financial reports.

- The financial position of the province as at March 31, 1992 and forecasts of provincial revenue, expenditure, deficit and debt for 1992-93 and 1993-94, based on current programs.

The review was also to include, but not be limited to, the following areas:

- all government owned and controlled corporations, funds and agencies, including the Alberta Heritage Savings Trust Fund;
- loans, investments, guarantees and indemnities;
- provisions for material losses for the above and any other provincial asset or liability;
- the measurement and reporting of provincial revenue, expenditure, annual deficit and debt;
- any other provincial revenue, expenditure, asset or liability the Commission may consider necessary; and
- any other matter the Commission may deem relevant, as a result of information coming to its attention.

The Need for Albertans to Support Change is Urgent

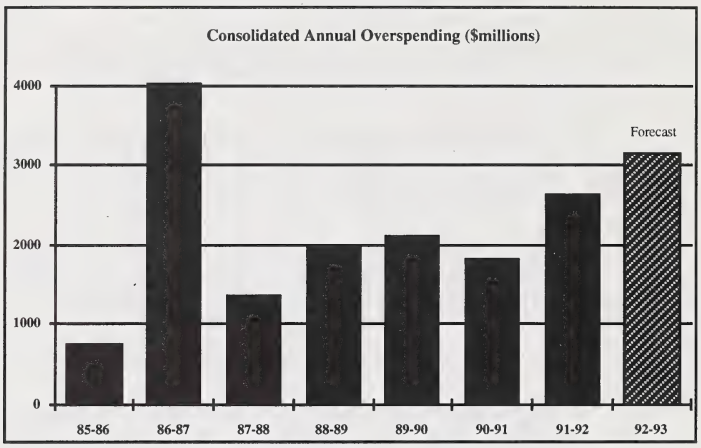
If the province's financial problems are to be resolved, it will only be as a result of Albertans first recognizing and understanding them, and then supporting government's efforts to address them. This report is designed to contribute to that process.

Following is a summary of the issues which must be addressed:

1. The annual deficit is serious and it is getting worse

The province is spending more than it can afford, has done so every year for the last eight years, and the rate of overspending is increasing.

The latest forecast obtained from Alberta Treasury shows that our overspending for the year ending March 31, 1993 -- the annual consolidated deficit -- will be $3,170 million. It would be even higher if more conservative approaches to valuing assets were used and if the accounting policies recommended in this report were adopted.



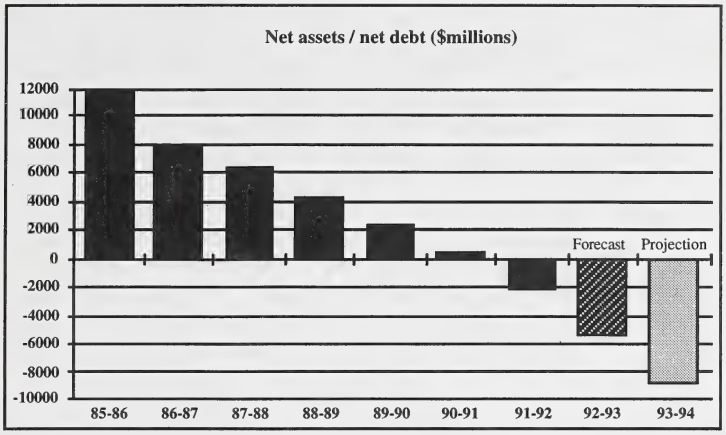
We cannot support this level of spending

Our current revenue base simply cannot support our current spending programs. The projected growth in the economy will not reverse this condition, nor can we expect revenues from oil and gas to increase sufficiently in the short term, and they will inevitably decline over the longer term. Without significant changes, expenditures will continue to grow at a faster rate than revenues.

We have spent our savings

Since 1985-86, the total of our annual deficits has exceeded $17,000 million. Our net assets, which stood at $12,000 million at March 31, 1986, have been spent and we have a net debt of over $5,000 million. We have effectively used up all the savings of the Heritage Fund and more.

Projections for 1993-94 indicate that the deficit will be higher than forecast for 1992-93 and that the net debt will exceed $8,500 million, as at March 31, 1994, unless we take action.



Can't we just go on borrowing?

We can continue to borrow as long as lenders have confidence that we can repay, perhaps through higher taxes. However, as our debt grows, that confidence will decline, eventually to a point where lenders may decide that our economic prospects cannot support further borrowing. Furthermore, as lenders' confidence declines, we will be charged higher interest rates. Ultimately, every dollar we overspend now could cost our children two dollars in only 10 years time, and three dollars in 15 years.

Allowing the debt to increase will eventually lead to budget cuts that will impair our ability to maintain programs that Albertans believe are necessary, programs such as health care, social services and education. In addition, our ability to maintain and repair our current transportation network and infrastructure will also be impaired.

We must act now

We must adopt a plan to eliminate annual deficits completely. Just reducing the annual deficit is not enough, since that only reduces the rate at which the level of our debt is growing. Eliminating the deficit cannot happen overnight -- there are no quick fixes possible. However, every moment we delay increases the amount of debt and makes the solution more painful, as more and more of our income will be needed to pay interest.

2. Accounting and reporting must be improved

It is difficult for Albertans to understand the province's financial situation from the information currently provided by the government. The information needs to be more comprehensive and more timely.

Information needs to be more comprehensive

When the government speaks of the deficit, it is usually referring to only the deficit of the General Revenue Fund (GRF). However, a number of government transactions, such as those made by most government-owned and controlled agencies and funds, are outside of the GRF. We need to speak of the consolidated deficit that includes all government activities. The consolidated deficit is a higher, but a more accurate and comprehensive, number.

Information not timely

Financial information should be issued in a more timely manner. The 'Provincial Accounts' are issued approximately nine months after the fiscal year end. They are not accompanied by a report which compares actual consolidated results to what was planned and budgeted, and which explains them in simple, easy-to-understand terms. Neither does the government issue interim consolidated financial reports on a regular basis.

GAAP not consistently used

Generally Accepted Accounting Principles (GAAP) are not used in some important areas. Exceptions to GAAP can result in incomplete information. For example, the unfunded liability for pensions is not recorded. In fact, many of the exceptions to GAAP result in 'bad news' being deferred. If recommended changes in accounting were adopted, the net debt would more than double to approximately $11,000 million.

3. Management control and accountability systems should be more effective.

Financial reporting through the periodic preparation of financial statements is only part of the accountability process. To be effective, financial statements must operate in concert with an organization's goals and objectives. In this framework, financial reports can provide regular feedback on the results of the organization's efforts and more effective reporting to Albertans and the Legislature.

No apparent overall plan

One of the Commission's most significant concerns is the provincial government's apparent lack of an overall plan. Such plans may exist in part, but need to be drawn together in total. By establishing long-term goals and relevant program objectives, and then developing the required budgets and financial reporting systems, performance can be measured against the plan.

Review fiscal accountability

The Commission suggests that the government review its procedures to ensure fiscal accountability to Albertans and to the Legislature. The government should demand fiscal responsibility and accountability from all entities supported by government funding. The fiscal arm of the government should be appropriately involved in key financial decisions of certain funds and agencies that are currently run semi-autonomously. Senior financial officers need to have more input into the decision-making process.

4. Proliferation of agencies and funds can create confusion and reduce control.

The Commission has identified over 150 government-owned or controlled agencies, funds, boards and corporations. Many of these do business with each other, lending and borrowing funds or providing grants which are recorded as expenditures in one and revenue in the other. The number of these 'interfund transactions' can create confusion and makes it difficult to analyze the province's overall financial situation.

Mandates expand

It is questionable whether the existing number of agencies and funds is necessary. There is a strong tendency to create a new special agency in response to each new need. Once established, some continue indefinitely by expanding beyond their original mandate, long after demand for their

services has effectively ceased. The proliferation of these organizations results in increased administration costs for the province and the possible use of funds without regard to government-wide priorities.

Many are quite autonomous

A few of these organizations are quite large. They can have complex organizational structures and tend to be quite autonomous, without strong reporting controls. For example, most of the revenues from the Lottery Fund are distributed without input from the Treasury Department or approval by the Legislature.

Heritage Fund creates false sense of security

The existence of the Alberta Savings Heritage Trust Fund tends to create a false sense of security among Albertans. Since the government's level of debt exceeds the assets in the Fund, it can be said that there really is effectively no Heritage Fund. This does not imply that it should necessarily be liquidated, but rather that the Fund should be viewed as part of the consolidated entity.

5. Loans, guarantees and investments create risk.

Over the years, the government has made a series of investments, loans and guarantees for a variety of public policy reasons. In fact, since 1985, the Alberta Government has accelerated the use of loans, guarantees and investments as an economic diversification instrument as well as to support core industries that have been in financial difficulty. As of March 31, 1992, the government had outstanding loans, guarantees and investments in the amount of $12,210 million, compared to $7,070 million in 1981-82.

High risk

The energy, forestry and agricultural industries have been recipients of many of the transactions. These are cyclical industries that are exposed to volatile markets. The government has also been active in the high tech industry which also can be very risky.

The high degree of risk is illustrated by the fact that the government has written off or provided for $2,100 million in loans and guarantees since 1985. In fact, 10 transactions account for over 80 percent of this write-off.

Lack of adequate debate

Guarantees (which are all provided for by statute) are approved by a minister or by Cabinet and are not normally debated in the Legislature. Many of the loans and investments are or may be debated in the Legislature, but normally after the fact, and in the case of commercial loans and investments made by the Heritage Fund, they are never debated or considered by the Legislature in advance of the transaction; they are approved by Cabinet. In addition, the Commission is also concerned that the monitoring of loans, guarantees and investments is not consistent from one department or agency to another.

Concessionary terms not accounted for

The government occasionally provides loans with concessionary terms such as below-market interest rates. The province's financial statements do not account for these benefits, thus overstating the value of these assets.

Some loans receivable are not loans

Certain loans made by the province will only be repaid if the province makes grants in the future. These loans receivable are not really assets but expenditures; however, they are recorded as assets.

*The Commission's Recommendations **

Many of the recommendations we are making have already been made by others, including the Auditor General in his most recent report, most of which the Premier has publicly undertaken to adopt on a timely basis.

Our recommendations should not be viewed as criticism of past practices but as an opportunity to carry out change to cope with a much different financial and economic reality. Any structure that has evolved over time and during periods of prosperity is a prime candidate for change. This is an opportune time for government, as business has found, to restructure its organization and procedures in order to meet the challenge of radical changes to revenues and expenditures.

THE TIME FOR CHANGE IS NOW. The Commission recommends that the provincial government, with Albertans' support, implement the following actions:

1. Match spending with revenue

- Develop and adopt a workable and enforceable fiscal plan first to balance revenue and spending in a way that eliminates overspending on a sustainable basis, and, second, in the longer term, to generate a surplus to eliminate the net debt.

- Provide sufficient and timely information so that Albertans can understand and support the need for change. Albertans should encourage the government to address our financial problems and be prepared to accept solutions that may result in reduced services or increased taxes or both.

- Downsize the entire government infrastructure, at the same time, considering the full impact of any action. For example, a reduction in some programs may result in an increase in defaulted loans.

- Develop budget estimates for revenues and expenditures on the basis of realistic and conservative assumptions.

* Note: More detailed and comprehensive recommendations are contained in the Commission's detailed report.

2. Management control

- Develop, with the help of external expertise, a management control structure for all departments and government-owned, funded and controlled corporations, funds, boards and agencies (including those with 50 percent ownership or more and all educational and health care institutions). This structure should require the setting of goals for financial results, productivity and the protection of assets, and the measurement of actual performance against these goals.

- Develop an administrative arm of the government, headed by a 'Chief Administrative Officer' (CAO), to coordinate all government administrative activities, in particular, the operation of the management control structure. The CAO should be appointed for a fixed term of no less than three years.

- Provide greater technical and financial input to the Agenda and Priorities Committee by reverting to the previous practice of having a senior government official as a member of the committee. This would be an appropriate role for the CAO.

- Assure that there is clear delineation between ministers and their deputies, whereby ministers are responsible for making policy and deputy ministers assume more responsibility for reporting on the implementation of policy, including compliance with the goals and measures established for the government as a whole.

3. Agencies and funds

- Ensure that agencies and funds fill a role in achieving provincial goals. If they do not serve a purpose in the plan, they should be sold or wound up. Where duplication exists, they can be merged. Where they are to continue, establish clear controls and accountability.

- Transfer the investments of the Alberta Heritage Savings Trust Fund into the provincial government's main fund, the GRF. The investments can be soundly managed without a separate fund by Treasury as part of the management of other provincial funds.

- Include all the revenues which the province receives from the Lottery Fund in the consolidated budget and distribute them according to the priorities established in the consolidated budget.

- Before establishing any new agencies or funds, assess other methods of achieving government goals with input from various stakeholders. Agencies or funds should meet stringent justification requirements, be reviewed regularly, and provisions made for sunset clauses.

- When agencies or funds must continue, make appointments to the managing boards with the assistance of the Public Service Commission with emphasis on the required skills and experience.

- Consider the objectives and mandates of the financial institutions controlled by the province so that duplication, if any, can be eliminated. In addition, services offered should be reviewed to ensure that the institutions are competitive in meeting the needs of customers. Legislation should be

amended where necessary to include advisory boards and audit committees.

- Participate as a trustee of pension investment funds where the province assumes liability for shortfalls.

4. Loans & guarantees

- De-emphasize the use of loans and guarantees as instruments of public policy.

- Where they must be given, authorize in a consistent manner all significant loans, investments and guarantees. Such transactions should be approved either by the Legislature or by an all-party investment committee of the Legislature. In evaluating loans and guarantees, the government must consider the risk, security available, period of repayment and ways to minimize losses should circumstances deteriorate.

5. Accounting & reporting

- Develop a financial management reporting system that will compare actual results with the budget at an early stage, allowing program adjustments to keep spending within budget.

- Establish a dual reporting relationship for the senior financial officers in each department, government-owned and controlled corporation, fund, board or agency so that they have a responsibility both to the Treasury Department as well as to their own organization.

- Prepare the financial statements and budget on a consolidated basis to include the General Revenue Fund and all other government funds, agencies and corporations. These statements and budgets should be prepared in accordance with GAAP (with the possible exception of capitalizing capital expenditures and recording depreciation, pending a pronouncement from PSAAC). This would require, among other things, that unfunded pension liabilities and vacation pay be recorded and that the recent PSAAC pronouncement to recognize concessionary loans and inter-agency loans and grants be adopted. Related changes, excluding the capitalization of capital assets, would approximately double the forecast net consolidated debt at March 31, 1993.

- Undertake a study to determine how the province's capital assets should be recorded and valued.

- Provide additional information in the financial statements and budget about the risk of loss related to loans, guarantees and investments, and take a more conservative approach in valuing them.

- Issue annual consolidated financial statements, with an accompanying easy-to-understand explanation, on a timely basis (90-120 days after the fiscal year end) and interim consolidated reports on a semi-annual or quarterly basis.

And finally:

6. Follow up

- Charge the Audit Committee, established under the Auditor General's Act, with the responsibility of monitoring and reporting to Albertans on a yearly basis the government's progress in implementing these recommendations. The Auditor General would be requested to assist in this responsibility.

2. *The Alberta Financial Review Commission*

On January 21, 1993, Provincial Treasurer Jim Dinning announced that it was time for an independent and honest review of the province's financial situation.

He appointed a nine-member commission made up of key Alberta business executives and financial experts to begin immediately to review all aspects of the government's financial position and reporting procedures. The Commission was given the pressing deadline of completing its report by March 31, 1993.

Marshall Williams named Chairman

Marshall Williams, Director and past Chairman of the Board of TransAlta Utilities, was named Chairman of the Commission.

George Cornish, Faculty of Management, University of Calgary, and retired City of Calgary Chief Commissioner, was named Executive Director.

Members of the Commission

Marshall Williams, Director and former Chairman of the Board of TransAlta Utilities, Calgary

Gordon Barefoot, Partner, Ernst & Young, Edmonton

Gerald Burrows, Managing Partner, Deloitte & Touche, Calgary

James Cosh, Vice-Chairman, Western Region, Peat Marwick Thorne, Calgary

Susan Evans, Vice-President, Law and Corporate Affairs
Corporate Secretary, Encor Inc., Calgary

Justin Fryer, Partner, Coopers & Lybrand, Calgary

Henry Lawrie, Managing Partner, Price Waterhouse, Calgary

Brian MacNeill, President and Chief Executive Officer, Interprovincial Pipeline System Inc., Edmonton

Brian McCook, Senior Vice-President, Chief Financial Officer and Director, Nelson Lumber Company Ltd., Lloydminster

Terms of reference of the Commission

The Alberta Financial Review Commission was given the authority and responsibility to inquire into and report on the following:

1. The appropriateness of the accounting principles used in preparing the financial statements of the province.

2. The financial position of the province for the year ended March 31, 1992, or such later date as may be chosen by the Commission.

The review was to include, but not be limited to, the following areas:

- all government owned and controlled corporations, funds, agencies and other entities;
- the Alberta Heritage Savings Trust Fund;
- loans, investments, guarantees and indemnities;
- provisions for material losses for the above and any other provincial asset or liability;
- the measurement and reporting of provincial revenue, expenditure, annual deficit and debt; and
- any other provincial revenue, expenditure, asset or liability the Commission may consider necessary.

3. Methods to improve the usefulness, clarity and timeliness of the financial reports of the government.

4. Forecasts of provincial revenue, expenditure, deficit and debt for 1992-93 and 1993-94, based on current programs.

5. Any other matter the Commission may deem relevant as a result of information coming to its attention.

Nature of work

In late January, the Commission placed a notice in the daily newspapers expressing an interest in receiving relevant information from Albertans. Six submissions were received and the suggestions put forward were considered and reviewed by the Commission in arriving at the recommendations contained in this report. No public hearings were held.

The Commission obtained information primarily by circulating questionnaires to various government departments and related organizations, and conducting personal interviews with present and former government officials.

3. *The Deficit*

Scope of Review

The Commission obtained a forecast of provincial revenue, expenditure, deficit and debt for 1992-93 from Alberta Treasury. A forecast for 1993-94 was not available and the Commission requested that a projection be prepared. Accordingly, Alberta Treasury prepared two projections for 1993-94 for the Commission's use, both assuming no change in current programs and one showing a growth scenario with more optimistic revenue than the other.

The Commission discussed the forecast and projections with officials from different sections of Alberta Treasury, as well as with senior financial officials of the largest government departments. In addition, specific questions related to future results were included in the questionnaires sent to the government funds and agencies.

Overview

Budgets and forecasts are prepared for individual funds and agencies, but the government does not consolidate them to reflect operations and balances in the same way as the annual financial statements are consolidated.

The largest fund, accounting for the major part of provincial revenues and expenditures, is the General Revenue Fund (GRF). The budget for this fund, together with those for the Heritage Fund, certain provincial corporations and other major funds, are presented individually in the annual Budget Address.

In this section, the revenues and expenditures discussed are those of the General Revenue Fund. However, in order to have a picture of what the deficit and net debt might be on a consolidated basis, the Commission requested Alberta Treasury to prepare a 'bottom line' consolidation, incorporating:

- the deficit of the General Revenue Fund;

- the net expenditure of the Alberta Capital Fund and the Capital Projects Division of the Heritage Fund; and

- adjustments to reflect the deficit or surplus of 22 other funds, agencies or commercial enterprises. These were selected on the basis of their having deficits or surpluses in excess of $5 million in any of the last five years. These adjustments eliminate the impact of interfund transactions on the consolidated deficit.

This consolidation is, therefore, approximate and the office of the Controller cautioned us that this consolidation method could result in an difference of ± $50 million.

Major Findings -- 1992-93

Forecast annual deficit

The following table sets out the forecast annual deficit for 1992-93.

	1991-92 Actual	($ millions)	1992-93 Forecast
General Revenue Fund			
Revenues	11,063		10,761
Expenditures	13,164		13,518
Deficit	2,101		2,757
Capital Funds	281		328
Other Funds and consolidation adjustments	247		85
Consolidated Annual Deficit	2,629		3, 170

Details of the General Revenue Fund's revenues and expenditures are presented in Appendix 1.

Forecast net debt

The forecast net debt, therefore, at March 31, 1993, is as follows:

	$ millions
Net debt at March 31, 1992	2,165
Forecast annual deficit for 1992-93	3,170
Forecast net debt at March 31, 1993	5,335

These numbers are computed according to the accounting principles currently followed by the province. They do not reflect the impact of changes to those accounting principles recommended elsewhere in this report. The most significant of these are accounting for:

- the province's pension liability, and its share of school boards' debt, which, if recorded, would increase the forecast consolidated net debt to approximately $11,000 million; and

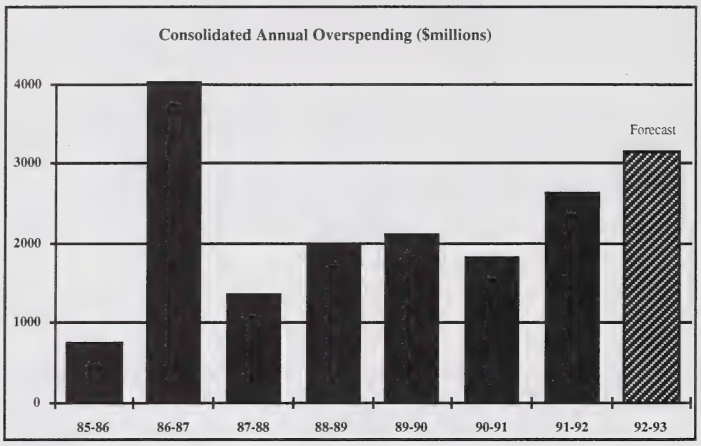
- the province's capital assets, less depreciation.

In addition, we have commented elsewhere in this report on the risks associated with the types of loans, guarantees and investments made by the government, particularly where they relate to industries which are cyclical in nature or where repayment may depend to some extent on continued support through other government programs. While the Commission did not identify the need for significant additional provision,

the scope of its work was not sufficient to provide comfort on this point. It seems inevitable, given the nature of the risks involved, that the full value of outstanding investments and loans will not be recovered, or the potential liability under guarantees expunged, without the need for some additional provision in the future.

Overspending continues

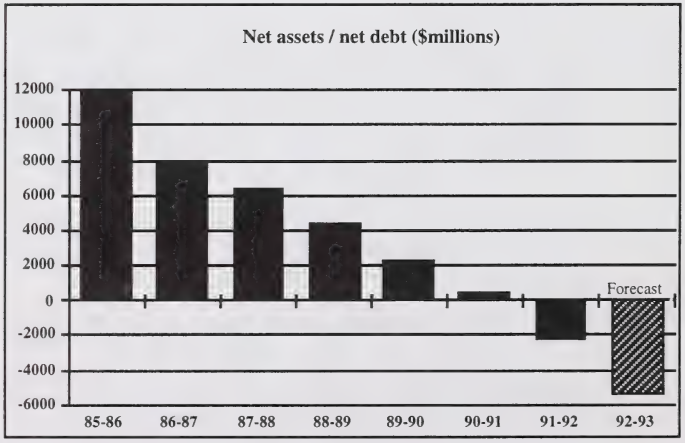
The province's annual deficit for 1992-93, forecast at approximately $3,170 million, continues a trend of increasing overspending on an annual basis since 1985-86.



Projections for 1993-94 show that, on the basis of current programs, this trend of increasing overspending will continue.

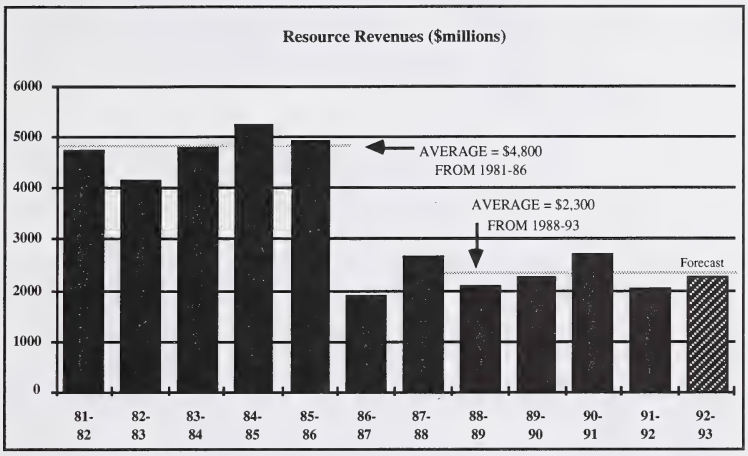
Total overspending has exceeded $17,000 million in last 7 years

From a net asset position of $11,817 million in 1985-86, the province's financial position has worsened to a forecast net debt position at March 31, 1993 of $5,335 million, as illustrated by the following bar graph.



Problem linked to drop in revenue in 1986

The problem can be linked to the dramatic drop of $3,040 million in resource revenue in 1986-87. Although there was a partial recovery in resource revenue in 1987-88, the downturn in oil and natural gas prices has kept resource revenues essentially flat, averaging approximately $2,300 million a year. The downturn in 1986 was not a cyclical move which can be expected to reverse. Indeed, it must be recognized that resource revenue will inevitably decline over the long term owing to the natural decline in the producing fields.



There was no reduction in expenditures corresponding to the dramatic drop in revenue and, in fact, they have grown at an average rate to 1991-92 of 5.1 percent. Although this rate has been below the combined rate of inflation and population growth, it has been from a higher base, and at a higher rate, than revenue growth.

Major Findings -- 1993-94

Basis of projections

Budget estimates for the 1993-94 year have been delayed while the government, under new leadership, completes a financial review and sets its fiscal strategy.

At the request of the Commission, Alberta Treasury prepared two projections for 1993-94 in order to estimate the effect of certain trends. These projections assume no changes in current programs or in the criteria for delivery of those programs. They demonstrate the potential effect on revenues and expenditures of current trends in population growth, the consumer price index, oil and natural gas prices and production, employment levels and economic growth.

The two projections were prepared on the following bases:

a) a "growing" economy based on a best estimate of energy prices and volumes for 1993-94 and a strong economic growth for Canada as provided by the Institute for Policy Analysis (University of Toronto) -- a 4.1 percent increase in real GDP and 3.6 percent increase in wages and salaries.

b) a "flat" scenario which reduces non-renewable resource revenue to equal the average of the last five years and reflects a weaker economic growth than the scenario used in the "growing" projection -- a 3.3 percent increase in real GDP and 3.1 percent increase in wages and salaries.

These projections do not reflect the estimates which might be presented in the 1993-94 Budget Address. The budget estimates for 1993-94 and actual results for the year will depend greatly on future policy decisions.

Some steps to control spending levels, which will have an impact on 1993-94 budget estimates, have been announced. These include:

- a government reorganization with a reduction in ministries;
- a voluntary separation allowance package for government employees;
- a salary freeze for government managers and an intention to negotiate a freeze for unionized staff; and
- no grant increases for hospitals, schools, post-secondary institutions and municipalities.

These decisions have not been taken into account in these projections.

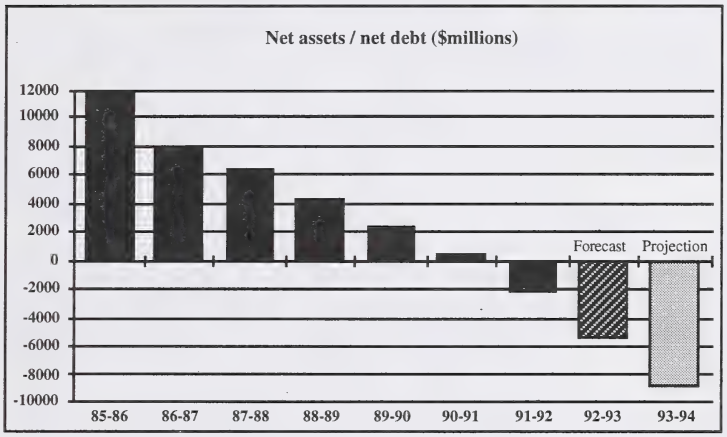
The results of the projections are as follows:

($ millions)		**1992-93 Forecast**	**1993-94 Projections**	
			Growing	**Flat**
General Revenue Fund	- revenues	10,761	10,920	10,607
	-expenditures	13,518	13,994	14,009
	- deficit	2,757	3,094	3,402
Capital Funds		328	345	345
Other funds & consolidation adjustments		85	(238)	(238)
Consolidated Deficit		3,170	3,201	3,509

Details of the General Revenue Fund's revenues and expenditures are set out in Appendix 1.

In both the growing and flat scenarios, the deficit is projected to increase in the absence of any program changes since revenue increases at a slower rate than expenditures. As a consequence, the net debt would increase on the same basis, as follows:

($ millions)	1992-93 Forecast	1993-94 Projections Growing	1993-94 Projections Flat
Opening net debt	2,165	5,335	5,335
Projected overspending for the year	3,170	3,201	3,509
Closing net debt at year end	5,335	8,536	8,844



Projections underline need for action

In both the growing and the flat projections, without any change to current programs (such as those recently announced), spending on programs (excluding interest) goes up by $431 million, an increase of 3.6 percent. Thus, if spending increases were completely eliminated, the effect would be to reduce the consolidated deficit only to between $2,770 million and $3,078 million. Revenues cannot be expected to rise to these levels, and in the meantime, each annual deficit adds to the following year's interest costs (between $245 million and $260 million in 1993-94, based on the above projections).

The province has a structural deficit

The inescapable conclusion, recognized by the Provincial Treasurer in his budget update in January 1993, is that the province has a structural deficit, a condition in which expenditures will continue to exceed revenues, even in an improving economy.

Annual overspending results not from a cyclical downturn in provincial revenues, which might be expected to reverse, but from an inherent imbalance between revenues and expenditures which must be addressed. In addition, we are facing reduced payments from the federal government and the compounding effect on interest costs of borrowing to finance our annual deficits.

Failure to address this imbalance will mean that borrowing to finance the government debt will increase in cost and, at a certain debt level, the province will be unable to borrow additional funds.

Recommendations

Adopt a fiscal plan

- The government should develop and adopt a workable and enforceable fiscal plan, first to balance revenues and spending in a way that eliminates overspending on a sustainable basis, and second, in the longer term, to generate surpluses to eliminate the net debt.

Prudent budgeting

- The government should base budget estimates for revenues and expenditures on realistic and conservative assumptions.

Planning and budgeting must recognize 'lurking expenditures'

- The existence of 'lurking expenditures' should be recognized and their potential effect taken into account in developing future plans. These expenditures are attributable to such factors as environmental issues, our aging population, advances in health care technology, deferred maintenance and looming replacement of properties and infrastructure.

Provide information

- The government must provide sufficient and timely information so that Albertans can understand and support the need for change. Albertans should encourage the government to address our financial problems and be prepared to accept solutions that may result in reduced services or higher taxes or both.

4. Accounting and Reporting

Scope of Review

The Commission's terms of reference included an inquiry into the appropriateness of the accounting principles used to prepare the financial statements of the province and methods to improve the usefulness, clarity and timeliness of financial reports to the government.

Major Findings

It is difficult for Albertans to understand the province's financial situation from the information currently provided by the government. The information is not complete, it is not timely and, by not following GAAP in all areas, does not clearly present the risk of loss associated with a number of government activities and tends to defer 'bad news' into the future.

Information not complete

A consolidated budget is not prepared. Thus, when talking about the provincial deficit, the number referred to by the Treasury is the deficit of the General Revenue Fund (GRF). The GRF excludes a number of government transactions, such as those made by most government-owned and controlled agencies and funds. When all activities and transactions are included, the deficit is considerably higher.

Information not timely

Provincial financial information is not issued in a timely manner. The 'Provincial Accounts' are issued approximately nine months after the fiscal year end. They are not accompanied by a report which compares the actual results to what was planned and budgeted, and explains them in simple, easy-to-understand terms. Neither does the government issue interim consolidated financial reports on a regular basis.

GAAP not used in all areas

The Generally Accepted Accounting Principles (GAAP) followed by the private sector are not used in some important areas as follows:

- Cost of capital assets is written off in the year of acquisition, rather than being capitalized and depreciated.
- Personal, corporate and capital tax revenues are recorded on a cash, rather than on an accrual basis.
- Provincial hospitals, universities and colleges are not consolidated. Under GAAP, they would need to be consolidated if they are controlled or are ultimately controlled by the province. Entities which are 50 percent or less owned and over which the government exercises 'significant influence' are not equity accounted; under GAAP they would be, under PSAAC they need not be.

- The present value of future unfunded pension liabilities is not recorded. Contributions made currently for pensions are reflected as expenditures. Under GAAP, such liabilities must be recorded and total estimated pension costs must be recognized each year over the service lives of employees.

- Liabilities for vacation pay, sick leave and the present value of long-term disability costs are not recorded. Payments made currently are reflected as expenditures. Under GAAP, such liabilities must be recorded and the related costs must be reflected on an accrual rather than a cash basis.

- Realized gains and losses from portfolio investments are deferred and amortized. Under GAAP, they would need to be recognized immediately.

- Foreign exchange translation gains and losses on borrowings in foreign currency are amortized on an other than an equal annual basis over the remaining term of the debt.

- Legal costs related to outstanding claims are not recognized until they become payable.

- The extent of disclosure of contingent losses should be expanded and the CICA has issued proposals in this regard. Losses which are likely (but for which amounts cannot be determined) and losses which are less than likely (but greater than unlikely) must be disclosed under GAAP.

- It is likely that new PSAAC accounting rules will require that loans made to other entities (which will require the province to make appropriations in the future so that those entities may repay the loans) be treated as expenditures, for example, the province's portion of school boards' debentures. Forgiveable portions of loans are to be recognized as expenditures as well, and concessionary loans are to be recorded at net present value with the discount treated as an expenditure at the time the loan is made.

'Bad news' deferred

We recognize that each of the above exceptions to GAAP is based on long-standing practices followed by many governments. However, many of them result in the recognition of 'bad news' being deferred and in the possibility of decisions being based on incomplete information.

The argument is made that governments are different than private sector enterprises. And that their "GAAP" should reflect these differences. This argument was recognized by the Canadian Institute of Chartered Accountants when it established PSAAC. Its members include government chief financial officers, legislative auditors and Treasury officials, among others. The accounting standards they have established for government generally conform with GAAP for the private sector, with only one major exception -- the question of recording and depreciating capital assets -- which PSAAC is still considering.

Adherence to GAAP by government agencies

A large number of government-owned and controlled agencies and other organizations reported that their accounting policies were in accordance with GAAP. For organizations where there was a departure from GAAP, primarily those in the health and educational fields, most differences related to the expensing of capital assets and the failure to accrue vacation pay liabilities.

Recommendations

Consolidated budget

- The province's budget should be prepared on the same consolidated basis as the Public Accounts and include all government funds, agencies and corporations, as recommended by the Auditor General. Reporting could still be done on a segmented or divisional basis, but the segments and divisions would always be seen as part of the whole and the totals would equal the consolidated accounts. It is not practical to prepare a consolidated budget for the next Budget Address, so for 1993-94, the government should proceed on an unconsolidated basis. However, budgets should be obtained from all entities and a consolidated budget for 1993-94 should be prepared by August, 1993.

Conservative estimates

- Budget estimates for revenues and expenditures should be based on realistic and conservative assumptions. The volatility of this area exposes planning on the basis of optimistic forecasts to the risk of significant overspending. We endorse an approach suggested by Treasury of reducing annual resource revenue expectations to an amount equal to an average of the previous five years (in the absence of a perceived downward trend). If resource revenue exceeds this amount, the difference should not be regarded as available for current year's spending, but should be allocated to debt reduction.

Reporting should be timely

- An annual report, presenting the consolidated financial statements with an accompanying easy-to-understand explanation, should be issued on a timely basis (90-120 days after the fiscal year end). Year ends of all government-owned and controlled agencies, funds and corporations should conform to the government's year end, wherever possible.

- The government should issue interim reports which present condensed financial results and position compared to budget, along with easily readable commentary by management. Interim financial reports should be issued on a semi-annual or quarterly basis within 60 days after the quarter end.

Reporting should be more useful

- The province should issue an annual report that would replace the Public Accounts' as the financial report to Albertans. It could contain 'user-friendly' information such as budget and prior period comparisons and feature a forward-looking, forthright 'Management Discussion and Analysis'. It would contain much of the analytical information currently found in Section 3 of the Auditor General's report. This information should be reviewed, not prepared, by the Auditor General,

GAAP adherence

- The government should adopt GAAP now, with the possible exception of capitalizing capital expenditures and providing depreciation. The Commission endorses the Auditor General's recommendation that a study be undertaken to determine how the province's capital assets should be recorded and valued.

If all the exceptions, but for the one dealing with capital assets and depreciation were eliminated, (pending a pronouncement by PSAAC), the accounting principles used to prepare the province's financial statements would be considered 'appropriate' in that they would be in accordance with GAAP. The province would also be a leader in Canada in the adoption of GAAP.

5. *Management Control and Accountability*

Scope of Review

It was not part of the Commission's direct mandate to review how the government is managed. However, during the Commission's research it became apparent that similar findings and concerns regarding the management process were arising in all areas under review. The general consensus of the Commission is that government must develop a more effective management process.

Major Findings

Financial reporting through the periodic preparation of financial statements is not on its own an accountability process. To be effective, financial statements must operate in concert with an organization's goals and objectives. In this framework, financial reports can provide regular feedback on the success of the organization's efforts and more effective reporting to Albertans and the Legislature.

Apparent lack of overall plan

One of the Commission's most significant concerns is the provincial government's apparent lack of an overall plan for establishing long-term goals and program objectives, and then developing the required budgets and financial reporting systems to measure performance against the plan.

Review fiscal accountability

The government needs to review its procedures to ensure fiscal accountability to Albertans and to the Legislature. The fiscal arm of the government is not involved in all financial decisions -- many of the government's funds and agencies are run autonomously, such as the Workers' Compensation Board and the ACCESS Network. Senior financial officers should have more input into the decision-making process.

Recommendations

Develop a management plan or strategy

- The first step in developing a management framework is for government to determine what services it wants to provide, what goals should be pursued and how performance will be measured. Once goals have been identified, they must be clearly communicated to those responsible for their execution.

Drawing on external expertise, the government should develop a consistent and effective management control structure for all departments and government-owned, funded and controlled corporations, funds, boards and agencies (including provincially-owned educational institutions and hospital boards).

This system should identify goals and measure performance not only through the financial statements, but also by reporting on the achievement of intended results, productivity and the protection of assets.

- There is also a need to develop a financial management reporting system that will compare actual results with the budget at an early stage, allowing program adjustments to keep spending within budget.

Strengthen administration

- There should be clear delineation between ministers and their deputies, where ministers are responsible for making policy and deputy ministers assume full responsibility for implementing policy.

- The government should develop an administrative arm, headed by a 'Chief Administrative Officer' (CAO), to coordinate all government administrative activities, including the responsibility for implementing the strategies to meet objectives, developing the consolidated budget and coordinating activities of agencies, funds and government departments. The CAO should be appointed for a fixed term of no less than three years.

- The government should provide for greater technical and financial input to government decision-making committees (like the Priorities Committee) by reverting to the previous practice of having an appropriate senior government official, for example, the CAO, be a member and full participant of such committees.

- The government should establish a dual reporting relationship for the senior financial officers in each department, government-owned and controlled corporation, fund, board or agency so that they report both to their own organization as well as to the Treasury Department.

- The government could request the Auditor General to 'audit' the budget systems and processes and make recommendations to improve them. The budget is the key to managing operations and the Auditor General can bring added discipline and objectivity to the activity.

6. Government-owned and Controlled Corporations, Agencies and Funds

Scope of the Review

The Commission sent questionnaires to over 120 out of the 150 identified agencies, corporations and funds operated by the government. The review was intended to identify how the current reporting and accountability framework functions for these organizations.

Because of time restrictions, most of the information in this review was obtained by questionnaire, although certain organizations were contacted for a more in-depth interview.

Overview

Many different types of agencies & funds

Government-controlled agencies included a range of different entities with very different mandates:

- *departmental agencies*, which act as extensions of a government department, such as the Alberta Racing Commission and the Alberta Petroleum Marketing Commission;
- *operational agencies*, which deliver services, such as the Alberta Agricultural Development Corporation;
- *asset disposal agencies*, such as the Alberta Government Telephone Commission;
- *proprietary agencies* which are actively involved in commercial trade, such as Gainers Inc. and Northwest Trust Company; and
- *provincial bodies*, such as colleges, universities and technical institutes.

These agencies represent billions of dollars in assets, millions of transactions and employ thousands of Albertans. Certain agencies generate significant revenues for the province, such as the Alberta Liquor Control Board. On the other hand, others consume a significant amount of the province's financial resources.

The Commission found that there was a proliferation of agencies involved in a range of different operations. It also found a number of agencies that offer financial services. For example, Northwest Trust, the Alberta Opportunity Company and Treasury Branches all lend money and, may therefore appear to compete with the private sector, as well as with each other.

Government funds include:

- *regulated funds*, generally constituted for a specific purpose or program and funded by transfers from the General Revenue Fund. Unexpended fund balances at year-end may be required to be returned to the General Revenue Fund.

- *revolving funds*, created primarily to provide services or materials within the government sector and to the public, and funded initially by a draw from the GRF together with receipts generated from sales activities;

- *Treasury Branches Deposits Fund* is a major financial institution in the province with assets of over $7,000 million.

Major Findings

Number of agencies & funds is excessive

Many of the 150 government-owned or controlled agencies, funds, boards and corporations do business with each other, lending and borrowing funds or providing grants which are recorded as expenditures in one and income in the other. The number of these 'interfund transactions' creates confusion and makes it difficult to analyze the province's overall financial situation.

Mandates expand

It is questionable whether the existing number of agencies and funds is necessary. There is a strong tendency to create a new special agency in response to each new need. Once established, they continue indefinitely by expanding beyond their original mandate, long after demand for their services has effectively ceased. The proliferation of these organizations results in increased administration costs for the province and the possible application of funds in an inappropriate priority.

Many are quite autonomous

A few of these organizations are large, have complex organizational structures and tend to be quite autonomous, without strong budgeting and legislative controls. For example, most of the revenues from the Lottery Fund are distributed without input from the Treasury Department or approval by the Legislature.

Wide latitude

They have various reporting and approval processes, with varying degrees of government control. Some organizations have a very wide latitude to make decisions, for example, entering into lease commitments and other long-term obligations without Treasury approval. NovAtel is a good example of this type of autonomous decision-making. Most organizations reviewed do not have any specific guidelines for the selection of directors.

Difficult to get an overall picture

The proliferation of agencies and funds also results in significant revenues and expenditures outside of the General Revenue Fund, so that it is again difficult to get an overall picture of the government's finances. The agencies have not been organized into categories of activity with a common control apparatus applied to them.

Privatization is slow

Efforts are currently underway to privatize a number of existing agencies, including Gainers, Northern Lite Canola and Intermodal Services Limited. However, progress is slow.

Lack of management objectives

Few of the organizations identified objectives with actions and time frames specific enough for measurement. There was only limited reference to three or five year goals, strategic planning, focus on the customer's needs or managing change to improve service. In addition, there were few specific references to provincial objectives the agencies should serve.

Incomplete accounting in a number of funds

The Commission found that the financial statements of many funds do not include all administrative costs, such as personnel and accommodation costs, which are absorbed by the GRF. Thus it becomes difficult to measure whether a financial objective is being met, when all costs are not included in the financial statements. On the other hand, the interest income of some funds is credited directly to the GRF, rather than reflected as income of the fund, thus understating the fund's revenue. Some funds do not conform to GAAP.

Pension Fund assets

The book value of the Pension Fund's assets at March 31, 1992 amounted to $6,358 million (market value -- $6,812 million). The pension assets are controlled and administered by Treasury rather than by a trustee, as would more normally be the case in commercial practice. There is proposed pension legislation that would result in a move to a trustee arrangement.

The unfunded Teachers' Retirement Fund is a separate fund. However, the province has no influence on the trust concerning investments, even though the province has a liability for any unfunded pension shortfalls.

It would be a normal practice once a trustee arrangement is in place, for a significant stakeholder to act as one of the trustees of such a plan.

Pension Fund liability

The government's Pension Fund assets are insufficient to meet the actuarial estimated liability for accrued pension obligations. The latest estimate of this shortfall is $4,462 million.

Lottery Fund

The Lottery Fund is being administered within the terms of its governance. However, as the Auditor General recommended, greater accountability for the operation of the Fund should be vested in the Legislature including approval of how revenues are distributed.

Alberta Heritage Savings Trust Fund

From its inception in 1976, the Heritage Fund had three basic objectives:

- To save for the future;
- To strengthen and diversify Alberta's economy, and
- To improve the quality of life in Alberta.

Since 1976, $3,300 million has been spent on facilities ('deemed assets') to enhance the quality of life of Albertans. At March 31, 1992, over $4,000 million was invested in agriculture, small businesses and social programs.

Even given these initiatives, retention of the Heritage Fund in its present form may be creating a false sense of security among Albertans. These funds are no longer available for a "rainy day"; the assets of the Heritage Fund have been effectively mortgaged. Eliminating intergovernmental borrowings, the book value of the Fund's assets was $7,665 million at March 31, 1992, compared to a total provincial debt of $17,403 million.

This, combined with the decision in 1982 to transfer all the Fund's investment earnings to the GRF (stopping the growth of the Fund), and the need to include the spending from the Fund in the overall provincial spending priorities, challenges the need for the Heritage Fund being retained as a separate and distinct entity.

Treasury Branches Deposits Fund

The Treasury Branches Deposits Fund, an extension of the provincial Treasury, concentrates its activities in Alberta and operates with a net deficiency of about $100 million, as compared to normal capital of $500 million for an institution of this size. Thus, about $600 million of the free capital of the province are needed to meet the liquidity and potential financial demands of this institution.

Enabling legislation which brought the Fund into existence in 1938 does not provide for governance through an advisory board or the operation of an audit committee. Now that the Treasury Branches are a major financial institution, governance and review are more important than ever.

Unlike other financial institutions, the Treasury Branches have not expanded their services to include brokerage, trustee and insurance services. In light of the rapid changes occurring in the financial services industry, the long-term outlook of the Treasury Branches could be adversely affected by not keeping pace with these changes.

The province also has control over the following financial institutions:

- Alberta Agriculture Development Corporation
- Alberta Mortgage and Housing Corporation
- Alberta Opportunity Company
- North West Trust Company

These, together with the Treasury Branches Deposits Fund, provide a variety of financial services. In addition, the province makes loans and investments and issues guarantees through the General Revenue Fund. All these activities suggest the opportunity to reconsider the objectives and mandates of all the institutions involved.

Recommendations

Reduce number of funds and agencies

- Efforts should continue to reduce substantially the number of government-owned and controlled corporations, funds, boards and agencies by selling, merging, downsizing or winding up.

Review need for agencies

- The need for all government entities should be reviewed regularly or ensure that they have sunset clauses in their agreements.

Look at other ways to achieve goals

- Other methods of achieving government goals should be assessed with input from various stakeholders before establishing any new agencies. New agencies or funds must be required to meet stringent justification requirements.

Record capital expenditures

- The government should consider recording capital expenditures as capital assets. In this way, a number of funds could be eliminated as it appears that a number have been created to facilitate asset management.

Strengthen control over agencies and funds

- The regulation and accountability of all government-owned, funded and controlled corporations, funds, boards and agencies (including those with 50% ownership or more and all educational and health care institutions) should be made consistent. The financial activities of these organizations should be controlled and coordinated wherever possible through the Treasury Department.

Pension liability should be recorded

- We concur with the Auditor General's recommendation that the liability associated with various pension plans administered or guaranteed by the province be recorded in the financial statements. Moreover, if the government funds all or a portion of pension plans and is responsible for their liabilities, it should share control over how the funds are invested.

Transfer Heritage Fund

- The investments of the Alberta Heritage Savings Trust Fund should be transferred into the provincial government's main fund, the GRF. The investments can be soundly managed without a separate fund.

  The accounting for 'deemed assets' reported in the balance sheet of the Fund, but excluded from the total assets of $12,039 million reported earlier, must be reviewed. Undoubtedly, they are of value, and should a general decision be made to capitalize the government's capital assets as opposed to expensing them, consideration should also be given to capitalizing the cost of certain of these 'deemed assets'. In the meantime, however, to avoid confusion, the 'deemed assets' of the Heritage Fund should be removed from the balance sheet and the appropriate information disclosed in a note to the financial statements.

Include lottery funds in consolidated budget

- All the revenues which the province receives from the Lottery Fund should be included in the consolidated budget and distributed according to the priorities established in the consolidated budget.

Financial institutions

- Consider the objectives and mandates of the financial institutions controlled by the province so that duplication, if any, can be eliminated. In addition, services offered should be reviewed to ensure that the institutions are competitive in meeting the needs of customers. Legislation should be amended where necessary to include advisory boards and audit committees.

Appointments on merit

- All agency, fund or board appointments should be made on the basis of merit and through the Public Service Commission.

7. *Loans, Guarantees and Investments*

Scope of the Review

The Commission reviewed the process of initiating, authorizing, valuing, monitoring and acting upon the loans, investments, guarantees or indemnities issued by the province through the GRF and the Heritage Fund.

Limited inquiry was also made into loans and guarantees issued through specific programs. While the Commission's findings relate to the financial statements for fiscal 1991-92, we also attempted through inquiry to identify any activities occurring since March 31, 1992, which would have an impact on our analysis.

Major Findings

Loans and investments have accelerated in recent years

Over the years, the government has made a series of investments, loans and guarantees for a variety of public policy reasons. In fact, since 1985, the Alberta Government has accelerated a program of using loans, guarantees and investments as an economic diversification instrument, as well as to support core industries that have been in financial difficulty. As of March 31, 1992, the government had outstanding loans, guarantees and investments in the amount of $12,210 million, compared to $7,070 million in 1981-82.

	1981-82	**1985-86**	**1991-92**
		$ millions	
Loans & investments less deposits	6,610	9,180	8,430
Guarantees	460	530	3,780
Total	**7,070**	**9,710**	**12,210**

The energy, forestry and agricultural industries have been recipients of many of the transactions. These are cyclical industries that are exposed to volatile markets. The government has also been active in the high tech industry which can also be very risky.

The high degree of risk is illustrated by the fact that the government has written off or provided for $2,100 million in loans and guarantees since 1985. In fact, 10 transactions account for over 80 percent of this write-off. If these transactions are considered, it is apparent that the government has been very active in the economy, but with mixed success.

By the very nature of these transactions, the government's role has been as a 'lender of last resort', taking on risk that the private sector was not prepared to, or could not, take on. The Commission is concerned that such risk may not be fully reflected in the financial statements.

An issue for the future will be whether Alberta can realize the book value on some of its major investments, should the government implement a liquidation strategy to reduce its debt.

Departments originate transactions

Most loans, guarantees, investments and indemnities originate from a specific government department, usually Economic Development and Tourism, Agriculture and Energy. The Treasury Department reviews proposals and makes a recommendation to the Treasurer. The Treasury Department is later involved in monitoring the transaction, if it is granted.

The proposal is then submitted to Cabinet. If the proposal is approved, more detailed negotiations take place involving Treasury, the sponsoring department and the proponent.

Lack of consistent procedures

The Commission is concerned that the monitoring of loans, guarantees and investments is not consistent from one department or agency to another.

Lack of adequate debate

Guarantees, which are all provided for by statute, are approved by a minister or by Cabinet and are not normally debated in the Legislature. The recent proliferation of guarantees may be due to the flexibility offered by this approach. However, this tool involves increased risk as well as offering increased flexibility. The use of guarantees can be compared to co-signing a relative's loan -- for which you will be responsible if he/she defaults -- at a time when you are struggling to meet your own debt payments.

Many of the loans and investments are or may be debated in the Legislature, but normally after the fact, and in the case of commercial loans and investments made by the Heritage Fund, they are never debated or considered by the Legislature in advance of the transaction; they are approved by Cabinet.

More monitoring tools should be used more consistently

The Auditor General confirms that the monitoring process for loans, investments and guarantees has been formalized over the years and has seen marked improvement in recent years. A manual which lists standard authorization procedures appears to be in use.

In order to monitor loans, investments and guarantees, the general tools are:

- Financial statements, e.g., annual, semi-annual, quarterly, monthly;
- Business plans;
- Financial projections and cash flows;
- Management meetings;
- Appraisals or valuations.

It appears that while financial statements are always reviewed and contact with management is made, the other information may not be prepared or available in every case.

Recognize losses as early as possible

Loans and investments are recorded by the government at the time when the funds are advanced. Guarantees and indemnities are noted in the financial statements when they are issued. A guarantee is recorded as a liability when it is apparent that a payment is likely to be required under the guarantee.

Long-term investments are recorded at cost. On construction projects, interest is capitalized until completion of the project in accordance with GAAP. When there is a loss in value of the investment, a write down occurs by way of a valuation adjustment.

In addition, the government has issued a number of concessionary loans and investments, which offer special terms such as low interest rates, extended repayment schedules and forgiveness clauses. The government's financial statements do not account for these benefits, thus overstating the value of these assets.

The accounting policy concerning asset valuation developed in 1990-91 has been a significant aid in reducing the chances of unexpected large valuation adjustments. The Commission applauds this change as a significant step in managing future risk. Treasury should continue to develop policies and systems to make allowances for and recognize losses as early as practicable.

Recommendations

More conservative valuation principles

- The government should use more conservative valuation principles for loans, guarantees and investments for current and subsequent years which recognize the uncertainty and risk associated with these transactions.

Recognition of significant commercial risk

- The government needs to convey better to the financial reader the significant commercial risk within the loan, investment and guarantee portfolio through extended disclosure policies that clearly highlight the future potential risk of loss inherent in the portfolio.

The Commission believes that there is significant risk in the government's investment portfolio and that the need for additional provisions for losses is likely over the next 2-3 years. In addition, the reporting of concessionary elements of loans and investments would provide a fairer picture of government activities.

De-emphasize loan guarantees

- The use of loan guarantees as a public policy instrument should be de-emphasized, given the fiscal condition of Alberta. If the government wants to provide long-term support for certain projects, it should consider other mechanisms such as tax policy, regulatory changes and infrastructure support. These may be more appropriate instruments for policy development than direct investment or loan guarantees.

It might be argued that guarantees have some practical advantage, as no funds are required up front and if it is a good investment, the funds will never be required -- that's good resource management. If the government is not prepared to invest in a project because it doesn't have the available resources, it should not provide a guarantee to the project through which a liability may arise in the future.

Consistent authorization

- Where they must be given, the government should authorize in a consistent manner all significant loans, investments and guarantees. Such transactions should be approved in advance either by the Legislature or by an all-party investment committee of the Legislature. In evaluating loans and guarantees, the government must consider the risk, security available, period of repayment and an exit strategy, i.e., ways to minimize losses in unfavorable circumstances. If there is little chance of exiting or if there is significant risk, such transactions might be considered more as 'contributions' than investments.

8. *In conclusion*

The Alberta Financial Review Commission wishes to express its appreciation for having the opportunity to comment on the serious deficit and debt problems facing Albertans.

We hope that this report will enable Albertans to gain a more complete understanding of the issues facing us all. We urge Albertans to support the recommendations contained in this report.

We sincerely hope that, in response to this report, the government will promptly initiate a program and develop an effective infrastructure to resolve these problems.

And finally we recommend:

Follow up

- The Audit Committee, established under the Auditor General Act, should be charged with the responsibility of monitoring and reporting to Albertans on a yearly basis the government's progress in implementing these recommendations. The Auditor General would be requested to assist in this responsibility.

DETAILS OF THE 1992-93 FORECAST AND 1993-94 PROJECTIONS

Cautionary Note

The 1992-93 consolidated forecast and the 1993-94 projections have been prepared at the Commission's request by Alberta Treasury.

- Actual results for 1992-93 may vary from the information presented. For example, the evaluation of loans and investments in the preparation of the consolidated financial statements for the year ended March 31, 1993 or the adoption of accounting principles recommended by the Commission and the Auditor General could have a material effect on the deficit and net debt.

- The projections for 1993-94 are designed to demonstrate the effect on revenues and spending of current economic and other trends **assuming no change in current programs.** They do not reflect the estimates which might be presented in the 1993-94 budget address, which will depend greatly on future policy decisions. For example, they reflect projected increases of 2.5% in grants for schools, post-secondary institutions and hospitals. After the projections were prepared, it was announced that there will be no such increases.

The Commission has not audited the forecast or the projections.

1993-94 PROJECTIONS

The following table presents the revenues and expenditures of the General Revenue Fund, together with the capital expenditures of two other major funds and the consolidation adjustments required to present the annual deficit on a consolidated basis.

	1993-94 Projections		1992-93	1991-92
	Growing	Flat	Forecast	Actual
			($ millions)	
General Revenue Fund				
Revenue				
Personal Income Tax	3,021	3,003	2,790	3,057
Corporate Income Tax	675	650	630	731
Non-renewable Resource Revenue	2,565	2,314	2,250	2,021
Federal Government	1,622	1,629	1,657	1,577
Investment Income (Heritage Fund)	965	965	1,020	1,382
Other	2,052	2,046	*2,414	2,295
	10,900	10,607	10,761	11,063
Expenditures				
Health	3,695	3,695	3,497	3,352
Education	2,872	2,872	2,711	2,570
Family and Social Services	1,732	1,732	1,643	1,500
Debt Servicing Costs	1,480	1,495	1,235	1,136
Other	4,215	4,215	*4,432	4,606
	13,994	14,009	13,518	13,164
Budgetary Deficit	**3,094**	**3,402**	**2,757**	**2,101**
Alberta Capital Fund	**252**	**252**	**240**	**197**
Heritage Fund - Capital Projects	**93**	**93**	**88**	**84**
Consolidation Adjustments	**(238)**	**(238)**	**85**	**247**
Consolidated Overspending	**3,201**	**3,509**	**3,170**	**2,629**

* Other revenue includes a transfer of $300 million from the Alberta Municipal Financing Corporation, $200 million of which was paid to municipalities to support infrastructure improvements and increase employment and is charged in other expenditures.

Economic Indicators

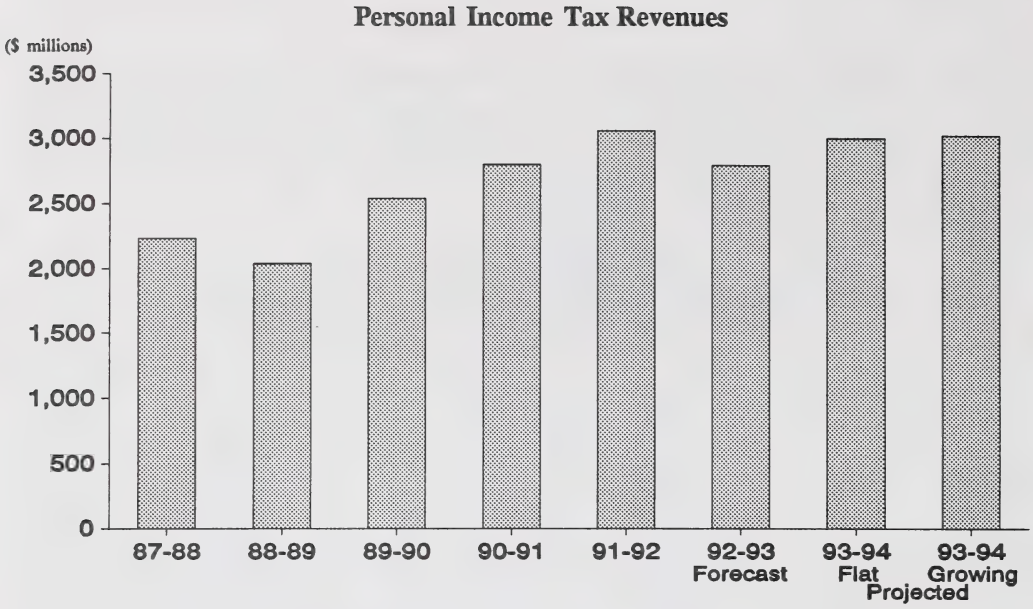
All forecasters predict a recovery in Canada's economy in 1993. Alberta Treasury shares this view but sees a bigger turnaround for other provinces than for Alberta particularly in employment, other provinces (particularly Ontario) having suffered a deeper recession than Alberta. The economic indicators used in the projections, compared with those of other forecasters and previous years, are as follows:

	1993						
	Projections		Other Forecasters			Calendar Years	
	Growing	Flat	Low	Median	High	1992	1991
					(% change)		
Canada							
Nominal GDP	5.5	5.2	4.0	5.2	6.0	2.1	1.0
Real GDP	4.1	3.3	2.2	3.1	4.1	1.0	-1.7
Population	1.3	1.3				1.5	1.5
CPI	2.6	2.3	1.8	2.5	2.8	1.5	5.6
Employment	2.1	1.2	0.8	1.3	2.1	-0.8	-1.8
Wages and Salaries*	3.6	3.1				1.6	2.8
Alberta							
Nominal GDP	6.9	6.1	4.2	5.2	5.7	3.6	0.3
Real GDP	3.8	3.0	2.5	3.2	4.6	2.3	0.6
Population	1.5	1.5				1.7	2.0
CPI	2.5	2.5	2.0	2.4	2.7	1.5	5.9
Employment	1.3	0.9	0.7	0.9	1.3	-0.5	1.2
Wages and Salaries*	3.3	3.0				2.4	6.1

* including the effects of increased employment

Personal Income Tax Revenue

Personal income taxes (PIT) are the largest single source of revenue for the Province, representing slightly over a quarter of all provincial budgetary revenue. PIT is collected by the Federal Government and Alberta's share is remitted to the Province. PIT is budgeted by the Province on a cash basis so that the 1992-93 forecast includes approximately 10¼ months of the 1992 tax year's estimated PIT and 1 3/4 months of the 1993 tax year's estimated PIT.



1992-93 Forecast

In the budget update of January 1993, a reduction in budgeted PIT for 1992-93 was announced. It turns out that the Federal Government overestimated income for the 1991 year. It is not yet clear what caused the overestimate. Since PIT for the 1992 and 1993 tax years, included in the 1992-93 budget, was based on growth projections which used the 1991 year as a base, when that base declined so did the estimates for the portions of 1992 and 1993 included in the 1992-93 budget. The economic recovery in 1992 in Canada has been weaker than expected at the time the 1992-93 budget was prepared. Altogether the result was to reduce the original 1992-93 budget by $475 million.

The impact of this overestimate was reduced by the counter effect of the workings of Established Programs Financing payments from the Government of Canada. This reduction in PIT leads to an increase of $135 million in payments from the Federal Government to Alberta for health-care and post-secondary education - see page 9.

1993-94 Projections

Personal income taxes are projected to increase by $213 million (7.6%) in the flat projection, $231 million (8.3%) in the growing projection. Because of the different years involved, however, and the time lag in the final adjustment for a particular year, these numbers need further analysis as follows:

	1993-94 Growing Projection	1993-94 Flat Projection ($ millions)	1992-93 Forecast
Amount included in personal tax revenue in respect of:			
1994 Tax Year	473	460	
1993 Tax Year	2,584	2,579	437
1992 Tax Year			2,474
	3,057	3,039	2,911
Adjustment for 1992 Tax Year	(36)	(36)	
Adjustment for 1991 Tax Year			(121)
	3,021	**3,003**	**2,790**

Ignoring prior year adjustments, therefore, personal income tax revenues for 1993-94 increase over the previous year by between 4.4% and 5.0%. This reflects a view that the economic recovery will not, in the short term, see significant growth in employment or wages.

Non-Renewable Resource Revenue

The major components are royalties from oil and gas, by-products and sales of Crown leases. Oil and gas are commodities with seasonal and cyclical price fluctuations typical of commodities, and the royalty formula structure, being more tied into prices following the changes announced in October 1992, has made resource revenue even more volatile. The US$ exchange rate also has an impact on revenues derived from oil and gas.

Oil and gas prices have proved successful in eluding the grasp of both private and government forecasters. Natural gas prices have consistently been forecasted to increase since 1984. Just as consistently they have fallen, so that predictions of price increases have been made from an ever lower price. Since 1986-87 oil prices have fluctuated between US$16.50 and US$24.50 a barrel. The numbers used in the "growing" projection, compared to prior years, are set out below (the flat projection uses the same numbers but reflects a downward adjustment in resource revenues to the level of the average of the last five years):

	1993-94 Projection Growing	1992-93 Forecast	1991-92 Actual	1990-91 Actual
Oil				
Price (US$ per barrel)				
• West Texas Inter.	20.25	20.50	20.77	24.49
Production (1000 barrels/day)				
• Conventional	937	932	904	918
• Synthetic and Bitumen	386	345	342	353
	1,323	1,277	1,246	1,271
Gas				
Price (Cdn$/1000 cubic feet)				
Weighted Average Price	1.55	1.39	1.34	1.53
Sales (billion cubic feet)	3,882	3,569	3,289	3,144

Other forecasters predict oil prices for 1993-94 from a low of US$19.88 to a high of US$22.04, with a median of US $20.69, and gas prices to range from a low of $1.31 to a high of $1.60 with a median of $1.43. Alberta Energy has a more bullish view of gas prices in the short term and is at the high end of the range.

The exchange rate for the Canadian dollar is projected to average US 78.0¢, compared to US 81.0¢ forecast for 1992-93. Other forecasters project rates from US 77.4¢ to US 81.1¢, with a median of US 78.0¢.

Crude Oil and Equivalent Production and Prices

Generally, production is seen by the Energy Resources Conservation Board to decline over the next ten years by 1.8% to 3.1% per year, with real prices (ie: not adjusted for inflation) being in a band between $16.50 and $22.00 with a mid point of $19.25, increasing by $2.00 over the next ten years.

Gas

The general thesis is that gas prices will rise to a level above replacement cost but below the level at which alternate fuels become attractive, and that volumes will generally increase as additions are made to pipeline capacity. A range for prices over the longer term is seen between $1.50 and $2.50, with a sense that the low end of the range is more likely and that prices may remain flat for some time.

Sensitivity

The sensitivity of resource revenues to changes in oil and gas prices has increased significantly with the changes to the royalty system in October 1992. An increase of US$1.00 per barrel of oil affects resource revenues by approximately $200 million (a decrease in price affects revenues by less than $200 million because of other factors), while a change of 10¢ per 1000 cubic feet of gas affects resource revenues by approximately $109 million. Thus the impact on projected resource revenues for 1993-94 of using the low and high price projections of other forecasters are:

	Low	($ millions)	High
Oil	-75		+360
Gas	-261		+54

Resource revenues are less sensitive to production and sales variances than to price variances. A change in oil production of 10,000 barrels a day (0.75% of projected production) affects revenues by approximately $17 million. Thus a change in production of 5% would affect revenues by approximately $110 million. A change in gas sales of 100 billion cubic feet (2.5% of projected sales) affects revenues by approximately $23 million. Thus a change in gas sales of 5% would affect revenues by approximately $46 million.

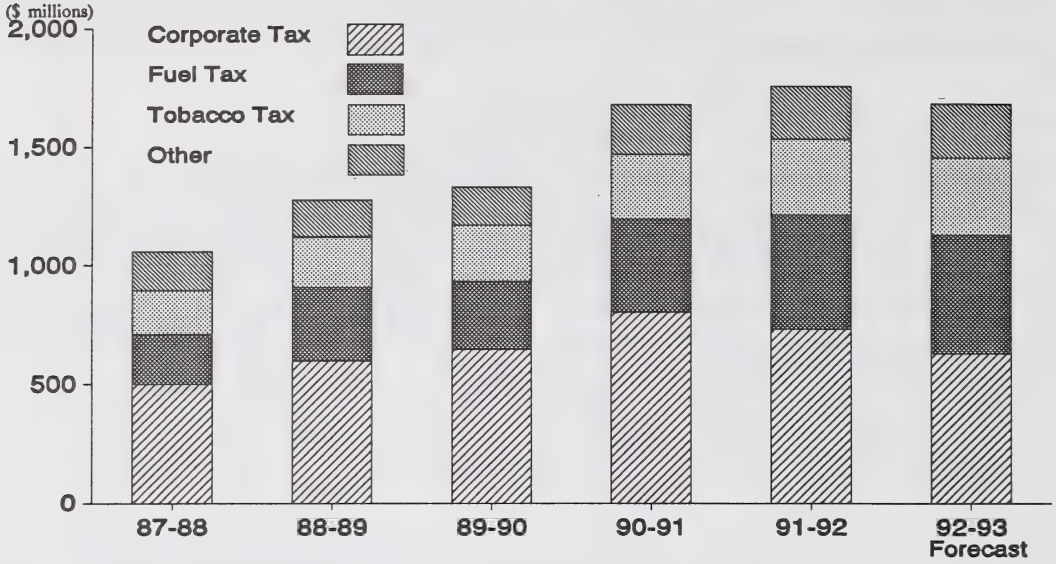
The value of the Canadian dollar not only affects resource revenue but, inversely, the cost of servicing US dollar debt (paying interest and principal). To a certain extent, therefore, the Province's US dollar borrowing serves to offset the result of fluctuations in resource revenue caused by movements in the value of the Canadian dollar against the US dollar. The net effect is that for each 1¢ US decrease in the value of the Canadian dollar the Province's net income increases by approximately $11 million (and vice-versa), the precise amount being subject to both the average rate for the year and the year-end rate.

Conclusion

While the "growing"projection appears conservative in projecting resource revenues, it is not without downside risk. The Commission supports the approach advocated by Alberta Treasury in its "flat" projection of reducing projected resource revenue to the average level of the previous five years, a downward adjustment of $251 million. This seems a prudent basis on which to budget and plan fiscal policy in such a volatile area. Any excess of actual revenues over those budgeted should not be seen as available for spending under current programs but should be applied to reduce the year's overspending or to debt reduction, in

a similar way to the allocation in the past of a proportion of non-renewable resource revenue to the Heritage Savings Trust Fund.

Corporate Income Tax, Fuel, Tobacco and Other Taxes



Projections for 1993-94 indicate tht these taxes will increase above 1992-93 forecast levels but fall short of 1991-92 in total.

Increases in fuel and tobacco taxes in 1991-92 and in 1990-91 were due in part to rate increases.

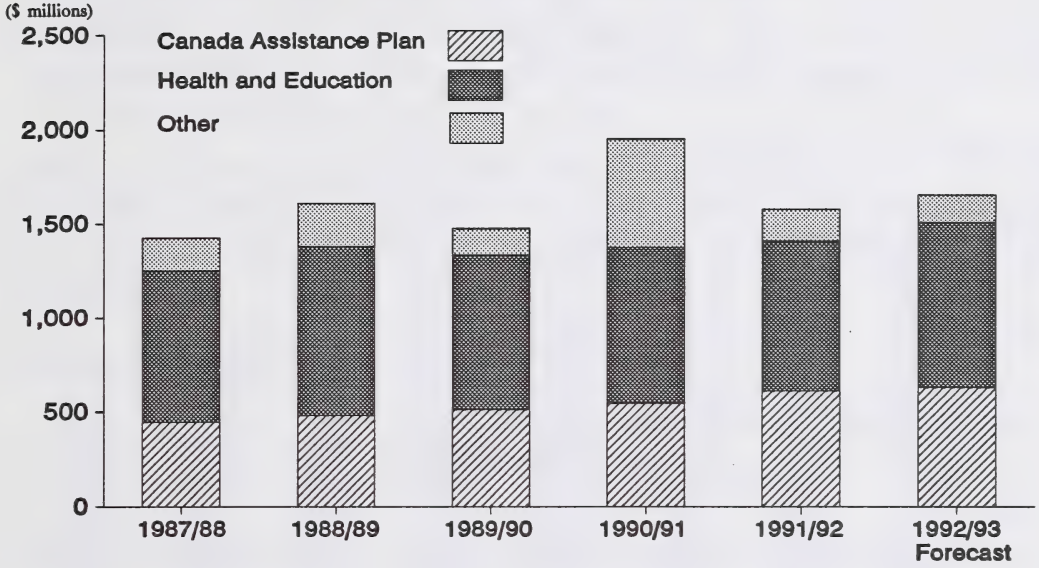
Significant growth is not seen from these sources of revenue for 1993-94. The impact of economic growth on corporate profits does not translate immediately into a comparable growth in corporate taxes since these are reduced on application of prior years' losses.

Payments from the Government of Canada

The major programs are:

- Canada Assistance Plan;
- Established Programs Financing which includes Hospital Insurance, Post-Secondary Education, and Extended Health Care.

Payments From the Government of Canada



Projections for 1993-94 indicate that payments from the Government of Canada will fall between the levels of 1991-92 and the 1992-93 forecast.

The Canada Assistance Plan

The Canada Assistance Plan is a sharing of eligible expenditures for social assistance on a 50/50 basis with the Federal Government. However, in 1989-90, a 5% annual compound growth limit was imposed on certain provinces, including Alberta, until after the 1994-95 year. Eligible expenditures under this program in 1992-93 are budgeted at $1,366 million. The maximum contribution from the Federal Government is $610 million, falling short of a full 50% share by $73 million. Thus, all additional expenditures are costing the Alberta Government a full 100 cents on the dollar.

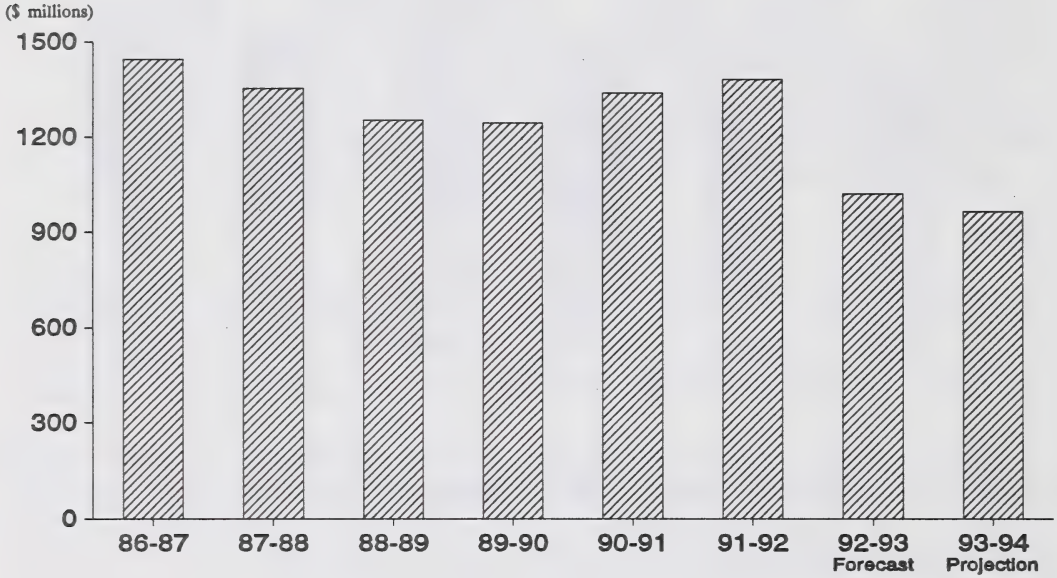
Established Programs Financing

Payments from the Government of Canada for two programs, health care and post-secondary education, are computed by a reference to a formula which takes into account the value derived by the Province from the tax points transferred to the provinces in 1977. The

formula applies a dollar amount (currently $701) to the provincial population, from the result of which is deducted the current value of the tax points transferred to the Province to give the cash payment amount. The proportion is approximately 1/3. Thus, when there is an adjustment upward or downward in the Province's Personal Income Tax revenue, the value of the tax points changes resulting in an adjustment of approximately 1/3 in the other direction to the cash payment the Province will receive under established program funding. The eligible funding of $701 per person is fixed until after the 1994-95 year.

Payments for extended health care are computed at $51 per capita and are frozen until after 1994-95. After the 1994-95 year, the announced plan of the Federal Government is for the amount to increase by GNP less 3%, but will not be less than the rate of inflation. However, as personal income tax revenue increases, it results in a higher value to the tax points of the Province, resulting in a lower cash payment from the Federal Government.

Investment Income (Heritage Fund)



Investment income from the Heritage Fund is declining as a result of:

- lower interest rates, the impact of which is felt currently on short-term investments but which will continue into the future as long-term investments mature and are reinvested or rolled-over at lower rates;

- the expenditure of the capital projects division reduces the base of income-producing assets by approximately $100 million a year;

- approximately $400 million (since written down by $88 million) has been invested in the Lloydminster Bi-Provincial Upgrader, which is not projected to earn income before 1994-95.

In 1991-92 capital gains were realized of $340 million, offset in part by a write down in investment values of $100 million.

Expenditures

Expenditures, excluding interest, are projected to increase by $431 million, an overall increase of 3.6%. Major category increases are as follows:

	% increase
Health	5.7
Education	6.9
Advanced Education	4.5
Family & Social Services	5.4

These are commented on in more detail below. It is important to note that these expenditures are those of the departments and do not represent all the expenditures for a particular function. For example, health care costs below do not include the amounts spent by the Health Care Insurance Fund out of premiums and contributions from the Federal Government.

Department of Health

	1993-94 Projection	1992-93 Forecast	1991-92	1990-91	1989-90
	($ millions)				
Department Expenditures	3,695	3,497	3,352	3,177	2,946
% Change from Previous Year	5.7	4.3	5.5	7.8	

The department employs 1,894 fulltime equivalent employees. It provides health care insurance coverage, financial assistance for acute and long-term care and community and mental health services.

Over 95% of the department's expenditures is in the form of grants which it pays out. The components of the 1992-93 forecast are:

	$ millions
Departmental Support Services	26
Health Care Insurance	639
Financial Assistance for acute care	2,043
Financial Assistance for long-term care	476
Community Health Services	258
Mental Health Services	55
	3,497

The department has developed several techniques for controlling health care costs. In the area of fee-for-service payments to physicians, it has negotiated a cap on the increase in payments to physicians at 5.5% ($50 million in 1992-93) and 4.5% ($40 million) in 1993-94. The capped increase is intended to fund new procedures, inflation and volume increases. Should it appear, at the end of any quarter, that the cap may be exceeded for the year, then fee rates will be reduced accordingly to eliminate such excess. Prior to 1992-93, the fee agreements addressed only price with the department funding all utilization increases.

The department has also instituted an acute care funding plan which compares the productivity of hospitals in terms of cost and rewards the efficient hospitals.

The department has the responsibility for administration of "Equity Agreements" for 24 hospitals that are not owned by the Province. Under the agreements, the Province is obligated to buy out the owners of the hospitals at an equity amount determined based on 1959 values plus certain permissible increases. Although there appears to be some dispute with owners as to the total potential liability, it was at least $46 million at March 31, 1991. Under the provisions of the agreements, this liability continues to increase. Until the buy-out occurs, the department must pay 3% per year on the equity amount to the owners of these hospitals.

It is projected that if current programs are continued, the budget for the department would increase by $198 million in 1993-94, an increase of 5.7% of which $67 million is represented by an assumed grant rate increase of 2.5% in grants to hospitals.

Department of Education

	1993-94 Projection	1992-93 Forecast	1991-92	1990-91	1989-90
			($ millions)		
Department Expenditures	1,750	1,637	1,531	1,465	1,387
% Change from Previous Year	6.9	6.9	4.5	5.6	

The department had 681 full-time equivalent employees in 1992-93. The department's major funding program is financial assistance to support early childhood programs and grades 1 to 12 education.

Although the department has a regulatory and significant funding role, it does not have direct responsibility for the cost of delivering education. By law, each child between the ages of 6 and 16 must attend school; however, for the most part, the school boards across the Province have the direct responsibility for funding the cost of schools. The school boards receive grants from the Province for each enrolment for the school year (September to June). Any deficiency a school board has must be requisitioned from the municipality. The municipality passes this requisition on to its taxpayers as a school tax levy. The municipality, by law, must pay this amount.

The main components of the 1992-93 forecast are:

	$ millions
• Departmental support services	15
• Financial assistance to schools	1,581
• Development and delivery of education programs	41
	1,637

During 1992-93, the department required supplemental funding of $18 million to cover enrolment increases. It appears that enrolment was forecast by the department to increase by 2.6% and a shortfall was caused by a reduction in funding allocation by the Treasury Board on the basis of 0.7% increase in enrolment. Actual enrolment increased by 2.3% and the department had an obligation to fund the additional enrolment.

The department is obligated to the school boards to pay an agreed portion of principal and interest payments on debentures issued by the school boards to fund building and equipment additions, obligations the province has guaranteed. Only the current payments on these obligations by the department are recorded in the Province's accounts. It is estimated that the department's portion of outstanding debentures is approximately $1 billion and the total amount of outstanding debentures is $2 billion.

It is projected that if current programs are continued, the budget for the department would increase by $113 million in 1993-94, an increase of 6.9%. This is represented by:

	$ millions
• Assumed grant rate adjustment - 2.5%	23
• Enrolment increase - projected at 2.0%	24
• Increased contributions to Teachers' retirement fund	24
• Increased building and equipment support to schools	11
• Other	31
	113

The majority of expenditures in the budget are grants to school boards. The school boards have the responsibility to control the costs of delivery or to seek additional funding from their municipalities. As education is mandated by law, a future issue may arise as to the responsibility for funding in areas where school tax increases can no longer be borne by the rate payers in that area. The department currently provides some additional funding to compensate the school boards in poorer areas; however, there may be an increased need for funding to these school boards in the future.

Department of Advanced Education

	1993-94 Projection	1992-93 Forecast	1991-92	1990-91	1989-90
			($ millions)		
Department Expenditures	1,122	1,074	1,039	1,019	1,002
% Change from Previous Year	4.5	3.4	2.0	1.7	

The department provides for the advancement of higher and further education through provincially funded and operated colleges and operating and capital grants to other educational institutions. The department also provides financial assistance through the Student Finance Board to Alberta students to enable them to participate in higher and further education programs.

The 1992-93 forecast consists of:

	$ millions
• Departmental Support Services	4
• Assistance to higher and further education institutions	980
• Financial assistance to students	90
	1,074

Of the above amounts approximately $990 million is in the form of grants and approximately $58 million is salaries, wages and employee benefits.

The department employs approximately 1,238 full-time equivalent employees of which approximately 818 are employed at four Alberta Vocational Colleges administered by the department.

Most major items in the budget can be easily forecast as they are subject to wage settlement agreements and government policy as to grant rate increases. The exception to this is payments through the Students Finance Board to provide financial support to needy Alberta students. The Students Finance Board provides grants and bursaries to Alberta's students who are pursuing post-secondary education, guarantees and pays interest on loans to such students, refunds a portion of these loans to borrowers who meet specific qualifications and pays the loans if the borrower defaults.

The 1992-93 budget increase over the previous year was caused primarily because of a grant value increase of 3%. Changes made in 1990-91 to Students Finance Board Programs resulted in proportionally more funding to students being provided in the form of a loan than a grant, reducing government costs initially. Costs have begun to rise as there is a higher default rate of student loans guaranteed by the province (24%). As well, the amount of grant assistance paid to students has risen for two reasons: more students have been unable to find good paying jobs during the summer to finance their education and are qualifying for higher levels of grant assistance and the province has increased the maximum

amount of loan/grant assistance a student can obtain so that the neediest students can obtain funding to pay the growing cost of tuition.

It is projected that, if current programs are maintained, the 1993-94 budget would increase by $48 million of which $21 million is attributable to an assumed grant increase of 2.5% and $17 million to increased payments by the Students' Finance Board.

Department of Family & Social Services

	1993-94 Projection	1992-93 Forecast	1991-92	1990-91	1989-90
			($ millions)		
Department Expenditures	1,732	1,643	1,500	1,320	1,260
% Change from Previous Year	5.4	9.5	13.6	4.8	

The department employs approximately 4,260 full-time equivalent employees. Its responsibilities include providing income support, social support and where appropriate, access to training and employment programs for individuals and families in financial need. It is generally the last resort source of funding after all other resources are exhausted, ie: unemployment insurance. Although most programs have restricted access based on asset or income test, some are not based on financial need, ie: for the severely handicapped. The programs are funded in the form of direct payments or subsidies to and on behalf of individuals and families, as well as payments to other organizations providing social support for those in need.

The 1992-93 original budget consisted of:

	$ millions
Departmental support services	36
Income support to individuals and families	1,104
Social support to individuals and families	427
	1,567

Of the above amounts, $1,140 million was in the form of grants.

During 1992-93, supplementary funding of $85 million was required to cover expenditures in excess of those budgeted because the estimated average monthly caseload increased to 89,000 for 1992-93 from 76,930 in 1991-92. The department had originally forecast an increase to approximately 87,000 in submitting its 1992-93 budget estimates but the Treasury Board had reduced that estimate to 82,000. A significant part of this budget shortfall was therefore predicted by the department but not provided for in the final estimates.

The main challenge of this budget is estimating the caseload and the average size of the case, ie: individual or size of family. The estimated caseload for supports for independence is partly based on projected unemployment figures, the availability of unemployment

insurance, and projected migration of those in need. The influence of these factors on caseloads is difficult to predict if there are significant changes in other programs such as the federal unemployment insurance program. In addition, migration can be a factor depending on the comparability of the Alberta support programs with those of other provinces.

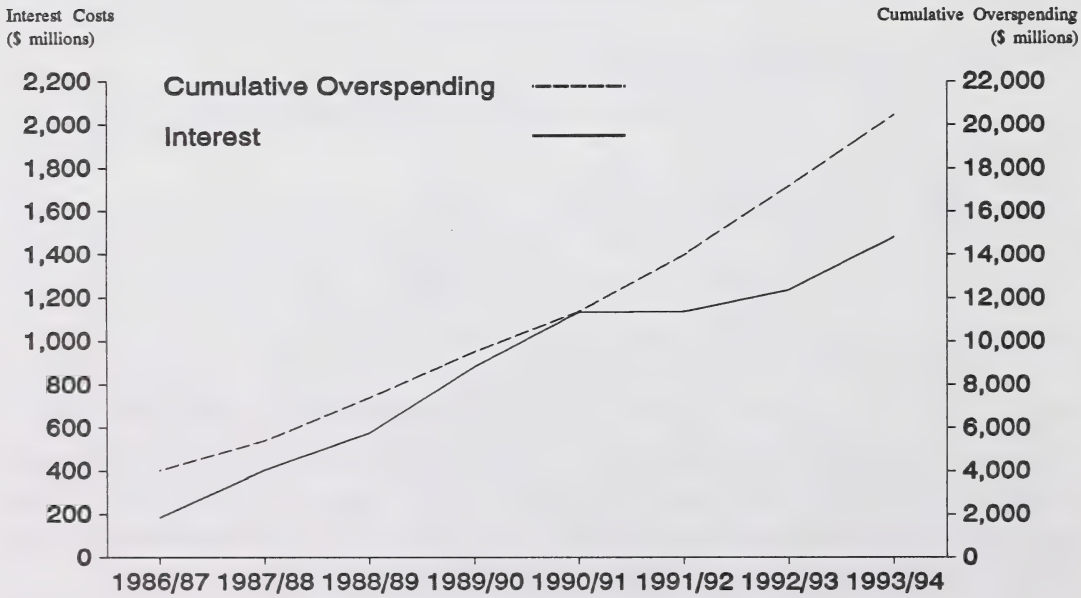
The main factor which will drive costs in the 1993-94 projections is caseloads as they affect over 84% of the department's budget. The average monthly caseload is projected to increase to 90,800 in 1993-94 from 89,000 in 1992-93.

It is projected that, if current programs are maintained, the department budget would increase to $1,732 million in 1993-94 from $1,643 million in 1992-93, an increase of 5.4%, the principal element being increase in support for independence (social allowance) program costs of $47 million.

Debt and Debt Servicing Costs

The forecast and projected cost of servicing the Provincial debt on a consolidated basis has not been computed. However, the interest cost in the General Revenue Fund debt (actually a higher number than the consolidated cost because some GRF debt is held by other funds and eliminated on consolidation) demonstrates the compound effect with which interest costs rise as annual overspending accumulates. Interest costs are projected to increase from $1,235 million for 1992-93 to between $1,480 and $1,495 for 1993-94. The following chart shows the rate of increase of annual interest costs compared to the cumulative amount of annual overspending since 1986-87.

General Revenue Fund Interest Costs



Consolidation Adjustments

The consolidation adjustments for the 1992-93 forecast are made up as follows:

	$ millions
Alberta Hail and Crop Insurance	174
Crop Reinsurance Fund of Alberta	23
Others	3
Alberta Mortgage and Housing Corporation	(57)
Workers' Compensation Board	(33)
Alberta Heritage Medical Research Fund and Scholarship Fund	(25)
Increase in Consolidated Overspending	85

The adjustment for Alberta Mortgage and Housing Corporation is mostly to reverse the cost of a funding payment by the General Revenue Fund which, in the consolidated accounts, was recognized in a prior year. For Alberta Hail and Crop Insurance as well as the Crop Insurance Fund of Alberta, significant losses are forecast for 1992-93 arising from the Revenue Protection Fund (Gross Revenue Insurance Program - GRIP).

In the case of the Workers Compensation Board, net profits are anticipated of $33 million in 1992-93 (and $51 million in 1993-94), arising from revisions to the actuarial basis of computing future claims, increased investment and assessment income and reduced administrative expenses.

Consolidation adjustments for the 1993-94 projections are made up as follows:

	$ millions
Alberta Hail and Crop Insurance	91
Crop Reinsurance Fund of Alberta	(23)
Alberta Mortgage & Housing Corporation	(123)
Workers' Compensation Board	(51)
Alberta Heritage Medical Research Fund & Scholarship Fund	(18)
Pension Fund Valuation Adjustments	(21)
Lottery Fund	(80)
Other	(13)
Reduction in Consolidated Overspending	(238)

The adjustment for Alberta Mortgage and Housing Corporation arises for the most part from proceeds from the sale of assets, the cost of which was accounted for as an expense in the Province's consolidated accounts.

The profits from the Lottery Fund are attributable to increased revenue from Video Lottery Terminals while grant expenditures are projected at approximately the same level as 1992-93.

Special Warrants and Supplementary Estimates

Special warrants are used to approve spending over budget appropriations approved by the legislature when the legislature is not in session. Supplementary estimates are used to approve additional spending when the legislature is in session. In the past, special warrants have been issued for substantial amounts. During 1992-93, the amount of special warrants has been reduced dramatically.

	1992-93	1991-92 ($ millions)	1990-91
Supplementary Estimates	141	-	-
Special Warrants	28	356	600
	*169	*356	600

* Excludes funding of amounts the cost of which was recognized in a previous year's financial statements.

The supplementary estimates for 1992-93 were presented in the budget update of January 1993. No further special warrants are expected for the 1992-93 year.

The Spending Control Act of 1992 will have the effect of limiting special warrants in the future, since spending from the General Revenue Fund in excess of the following limits over the previous year's forecast cannot be authorized without the prior consent of the Legislature.

1992-93	2.5%
1993-94	2.25%
1994-95	2.0%

Another consequence of the Spending Control Act, however, is likely to be a reduction in the level of lapsed expenditures each year. Because General Revenue Fund spending is monitored in relation to the amounts authorized, actual spending from the General Revenue Fund for a year almost always falls short of the budgeted amount. However, a feature of the Spending Control Act allows approved budgeted amounts not needed in one appropriation to be transferred to another appropriation in that department or to another department or agency controlled by the same minister with the consent of the Treasury Board.

APPENDIX 2

ALBERTA FINANCIAL REVIEW COMMISSION
REPORT TO ALBERTANS

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B.C. Financial Review Summary & Recommendations

B.C. Financial Review Issue of Treasury Function

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B.C. Financial Review Issue of Federal/Provincial Cost Sharing

B.C. Financial Review Issue of Disposal & Valuation of Assets

B.C. Financial Review Issue of Forecasting & Fiscal Planning

B.C. Financial Review Issue of Accounting Policies

B.C. Financial Review Issue of Financial Control

B.C. Financial Review Issue of Revenues and Recoveries

B.C. Financial Review Issue of Lurking Expenditures

B.C. Financial Review Issue of Loans, Invest. Accts. Rec. & Loan Guarantees

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