

Third Session - Thirty-Ninth Legislature
of the
Legislative Assembly of Manitoba
Standing Committee
on
Public Accounts

Chairperson
Mr. Leonard Derkach
Constituency of Russell

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MANITOBA LEGISLATIVE ASSEMBLY
Thirty-Ninth Legislature

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LEGISLATIVE ASSEMBLY OF MANITOBA
THE STANDING COMMITTEE ON PUBLIC ACCOUNTS

Wednesday, October 21, 2009

TIME – 7 p.m.

LOCATION – Winnipeg, Manitoba

CHAIRPERSON – Mr. Leonard Derkach (Russell)

VICE-CHAIRPERSON – Ms. Jennifer Howard (Fort Rouge)

ATTENDANCE – 11 QUORUM – 6

Members of the Committee present:

Hon. Ms. Wowchuk

Mr. Borotsik, Ms. Braun, Messrs. Derkach, Dewar, Ms. Howard, Messrs. Jha, Lamoureux, Maguire, Ms. Selby, Mrs. Stefanson

APPEARING:

Hon. Peter Bjornson, MLA for Gimli

Hon. Andrew Swan, MLA for Minto

Ms. Carol Bellringer, Auditor General of Manitoba

Mr. Gerald Farthing, Deputy Minister of Education, Citizenship and Youth

Mr. Hugh Eliasson, Deputy Minister of Competitiveness, Training and Trade

MATTERS UNDER CONSIDERATION:

Auditor General's Report – Special Audit: Property Transactions in the Seven Oaks School Division, August 2007

Auditor General's Report – Examination of the Crocus Investment Fund, May 2005

* * *

Mr. Chairperson: Good evening, ladies and gentlemen. Will the Standing Committee on Public Accounts please come to order.

The meeting tonight has been called to consider the following Auditor General's reports: the Special Audit: Property Transactions in the Seven Oaks School Division, August 2007; and Examination of the Crocus Investment Fund, May 2005.

Before we get started this evening, I would ask that the committee concur that we only sit until 9 o'clock. Is that agreed? *[Agreed]*

Are there any suggestions as to the order in which we should consider the reports?

Mr. Rick Borotsik (Brandon West): Yes, as identified in the agenda.

Mr. Chairperson: Thank you very much.

And, I would like to also remind all members that when you are speaking tonight to move the microphone closer to yourself because I am told that there's been a little bit of difficulty in picking up the conversations because sometimes the mikes are somewhat distant from you. So please keep that in mind as we go forward because it helps *Hansard* to ensure that the—that the transcripts are accurate.

Before we get to our regular agenda, as always, we have always a few housekeeping duties to deal with, and I want to thank the committee members and the Auditor for the in camera sessions that we have because they do provide an opportunity for all of us to look at the issues before us, and tonight we have one that the Auditor General would like to make a comment about, and then we will move on to the report.

So, Madam Auditor General, I turn it to you.

Ms. Carol Bellringer (Auditor General of Manitoba): Mr. Chair, I, in the in camera session, spoke to the members of the committee about the situation of the Hydro special audit that we've been requested to conduct. I wanted to put on the record a few pieces of information to provide some clarification around it.

First of all, in July, we issued our operations report, and in that report I identified that we had received a whistle-blower complaint, and I also identified in that report that we were conducting an audit of Manitoba Hydro with respect to risk management. And, until today, I have not connected those two situations, but I'm now doing that publicly. While we won't name the whistle-blower, I will say that the complaint and the audit are one and the same.

We had intended to do a fairly broad audit of risk management at Hydro, but we've decided, based on recent media reports, that it would be wise to first

address the complaint, report on that and then decide if we need to do a broader audit of other risk-management issues. And, if that's the case, we'll conduct those later.

We are starting the audit immediately. The director of special audits is in charge of that audit, and we have other assistance through the office, and we will be hiring external assistants, which I'll get into in a second.

There has been an issue raised about the potential that I myself have a conflict with respect to that audit. I just want to have it on the record I was indeed a member of the board of directors of Manitoba Hydro prior to my appointment as Auditor General. I was on the board from September 15th, 2004, until my appointment in July of 2006. I was chairing the audit committee, and I was on the board. I therefore signed off on the financial statements for the '05 and '06 fiscal years. There has been a reference to my signing off on the '03-04 drought year, which was not the case.

And, also, there was the involvement of a consultant which has triggered certain of the allegations, and my understanding is she was actually hired while I was on the board in '06. But her—any reports that she—that she, and I'm using "she" because that's the gender that's referred to in the media, they were received by Manitoba Hydro after my involvement on the board, and we will be acquiring a lot of that information and verifying it.

For those reasons, I don't actually believe that I do have a conflict, but we do acknowledge and accept the fact that there could be that perception with the public and, as a result, the office has implemented a number of safeguards that we believe will—certainly we're hoping that they will alleviate any concerns.

We've had discussions with the Institute of Chartered Accountants of Manitoba around what kind of safeguards we might implement and what kind of disclosure would be appropriate. The safeguards we're putting into place, we have a number of senior staff in the office and our entire management team that will be involved in a management capacity, although I will be issuing the final report which will be referred to the Public Accounts Committee and delivered to the Legislative Assembly when it's completed.

The Auditor General Act will be the act that the— that the audit will be conducted under, but we—I am in the process of finding an external auditor from another jurisdiction. My preference is for that to be a former auditor general of another jurisdiction who will oversee the entire process, but I haven't yet made that appointment, so I can't fill you in with any further details at this point.

We will also be needing to engage other external auditors or consultants as necessary for technical expertise, and I've asked the Ombudsman—the whistle-blower complaint, I'm just—I'm gonna backtrack slightly and just explain the process.

* (19:20)

The whistle-blower complaint came in under the act that governs that, which is—it's a complaint that's made to the Ombudsman. In the event that she believes the subject matter is better followed up by our office, she refers that complaint to me, and that was the case with this complaint. I have asked the Ombudsman if she would play an ongoing role throughout the audit and she's agreed to do so, and so we're going to discuss with her exactly what that will mean, and I will be updating the Assembly when I know all of the various details with regards to this.

Thank you, Mr. Chair.

Mr. Chairperson: Thank you, Madam Auditor General.

Mr. Borotsik: Mr. Chairman, if I may, and again I thank the Auditor General for her comments on the perceived conflict. And in order to protect the integrity of an individual I have an awful lot of respect for and for the integrity of the office of the Auditor General, I'd like to put forward a motion if I could, Mr. Chairman, that we ask the Lieutenant-Governor-in-Council to appoint an independent audit authority based under The Manitoba Hydro Act and clause 42–44(2) of the act.

Mr. Chairperson: Mr. Borotsik, I want to inform you that this motion is problematic in a couple of ways. One, it is out of the scope of this committee, we think, but that is something that we will have to research, and I would ask that this motion be taken under advisement and then we will come back at a subsequent meeting and report on it. We need to do some research on this because there are a couple of areas within the intent of the motion that we need to do some research on. So to that extent, I will take

this motion under advisement and will have to report back to this committee.

Mr. Borotsik: Mr. Chairman, I respectfully disagree. I believe that this PAC committee has every opportunity and every right to put forward a motion to PAC. This committee is master of its own destiny and it can certainly put forward motions with requests to government, and in this particular case, the Lieutenant-Governor-in-Council, to react to a suggestion and motion of this committee. So I respectfully disagree, and as the Clerk has indicated, I can't discuss this motion to the point that I can't even discuss a motion that I think the committee has every right to put forward.

Mr. Chairperson: Mr. Borotsik, a couple of points. Number 1 is this is a very unusual motion in terms of the fact that it refers to Lieutenant-Governor-in-Council, and whether or not Public Accounts can actually have the power to direct Lieutenant-Governor-in-Council is something that we need to research. I'm not saying we can't, but I'm not saying we can. Now, you and I can't debate this, but on the other hand, you can challenge my ruling and then we'll move from there.

Mr. Borotsik: Well, Mr. Chairman, challenging your ruling isn't going to solve the problem, believe me, and if you're prepared to take it under advisement, I'm prepared, certainly, to listen to the advisement, but, as you'll recall in the motion, it's not that we're directing the Lieutenant-Governor-in-Council, we're simply asking the Lieutenant-Governor-in-Council to perform an independent audit. So we're not demanding that they do it, we're simply asking that they look at that possibility. So, again, non-debate, non-debatable, I'll accept that. Challenging the Chair, I don't suspect that there's much opportunity of getting any type of satisfaction at this time, so I will let you take it under advisement.

Mr. Chairperson: I thank you for that, Mr. Borotsik. I do have to consult with the Clerk of this committee to ensure that, in fact, if we move ahead, we do it in accordance with the rules established for this committee, and so I have no alternative but to say, at this point in time, that this motion will be taken under advisement and will be reported back to this committee at the subsequent sitting, but I can't do any more with it than that at this point in time. That puts an end to the matter, I'm sorry, unless you wish to challenge the Chair.

An Honourable Member: I just had a question.

Mr. Chairperson: Question, yeah.

An Honourable Member: Yeah, just a question of clarification—

Mr. Chairperson: Mrs. Stefanson.

Mrs. Heather Stefanson (Tuxedo): I just had a question of clarification. If it was the will of the committee to move forward with this, like, could we do that, or is that out of scope as well? Just a question of clarification.

Mr. Chairperson: Once the matter is taken under advisement, I'm informed that that is, sort of, puts the end to that kind of debate or discussion until the ruling comes back to this table.

Okay, I'm sorry—

An Honourable Member: A point then, a point of clarification. Comes back to this—

Mr. Chairperson: Mr. Borotsik.

Mr. Borotsik: It comes back to this table, comes back to this committee. Is there a time line that's been placed on that, Mr. Chairman, because we obviously got direction from government going forward with respect to an audit. If this is three months or four months down the line, then this is a moot point. You shouldn't even take it under advisement at that point.

Mr. Chairperson: Mr. Borotsik, I indicated that I would come back with—to this committee with a ruling at the next sitting. That is no different than any other Chair in this Legislature taking a matter under advisement, and there is no debate as to whether or not this matter is going to be taken under advisement or whether it's going to be reported. It will be reported but it will not be reported until the next sitting. Okay?

Thank you very much. We will be moving on.

We now move on to the—Mr. Maguire, unless it's on a different topic, this topic is closed.

Mr. Larry Maguire (Arthur-Virden): Well, Mr. Chairman, I guess my point was not to this motion. It's to the Auditor General's statement, and I see by a press release that she was asking for input from this Public Accounts Committee meeting on the 16th of October and I have, indeed, seen some risks, risk reports that management produced each year and I'm somewhat familiar with some of the related issues and is asking for a Public Accounts Committee of the Legislature to provide some opinion Wednesday,

which is today. I assumed we were going to come here and discuss this at least, a little bit anyway, and provide, perhaps, the Auditor General with our concerns or get some advice from her as well or have some discussion on it at least. But, and I—you know, obviously, from the motion that was raised, there is a concern and I just feel that maybe we can set this aside to bring it back at another time but there should be an opportunity to have a few questions.

Mr. Chairperson: Mr. Maguire, I gave this committee an opportunity to do that in the in camera session. Number 2, I indicated that the Auditor General would be able to report on this in the open session which is not something that's on the agenda of the meeting but, as practised in the past, we have always reported housekeeping duties to this committee and allowed some discussion.

* (19:30)

I've allowed for Mr. Borotsik to move a motion. Unfortunately, because of the type of motion that it is, I've been advised by our experts that this motion has to be considered. And so, it is for that reason that I'm taking it under advisement and, unfortunately, I have to cut off the discussion of this item, at this point, because it is not even on our agenda, the formal agenda. And if we start to move on this, I think there is a risk in terms of how this committee conducts itself. So, with respect, I certainly want to assure you that I'm cognizant of the sensitivity of this issue, but I think that we have to schedule it for a different period of time. Thank you.

Okay, so now we're into matters under consideration, and first of all we are going to consider the Special Audit: Property Transaction in the Seven Oaks School Division, August 2007. And I would like to welcome the Minister of Education (Mr. Bjornson) and the Deputy of Minister of Education to the table.

Okay, I welcome the Minister of Education to the table and the Deputy Minister of Education. As well, in the past meeting, we also invited the other officials of the department to the table, which we do today as well, and we begin this process by asking whether or not the Auditor General has an opening statement.

Ms. Bellringer: Thank you, Mr. Chair. I will summarize just the overall findings of this audit report.

The Seven Oaks School Division was created under The Public Schools Act and is governed

directly by an elected board of trustees. The Seven Oaks School Division receives its funding through the Public Schools Finance Board, which is directly accountable to the Minister of Education.

What we saw in the audit, it's obvious with multiple stakeholders, comes the need for additional effort at clear communication. In the case of the property development activities at the school division, it is my opinion, and I wrote this in the introduction to the report in the transmittal letter, that the trustees did what they believed was in the best interest of their school division.

With respect to the disposition of vacant surplus land in Swinford Park, the school division acting as a land developer had subdivided, serviced and sold residential lots, but The Public Schools Act does not specifically permit school divisions to develop land. The school division did indicate to us that they believed the act was sufficiently vague in that area to permit the activity. The Public Schools Finance Board indicated to us that they were not aware that the development—development activity was taking place until after the lots had already been sold.

We reported the end result of the activities was a net income to the school division of 512,000 related to the land sales that remained invested in surplus land which was still owned by the school division at the time of the audit, with a total cost of over 800,000.

We had recommendations in the report relating to our seven audit objectives, and many amendments had been made to The Public Schools Act and The Public Schools Finance Board Act which addressed most of our concerns. And, in addition to the recommendations included in the report, we, at that time, and I would—I would suggest it's always healthy to add this as a reminder, we urge the Public School Finance Board and the school divisions to continually seek ways to improve communications in the mutual interests of the students and communities they serve. Thank you, Mr. Chair.

Mr. Chairperson: Thank you very much, Madam Auditor General.

I would now ask the Minister of Education to introduce his staff that are with him and then I will be asking the deputy minister to make an opening statement.

Hon. Peter Bjornson (Minister of Education, Citizenship and Youth): Mr. Chair, Deputy

Minister Dr. Gerald Farthing from PSFB board as well and PSFB director Rick Dedi and Claude Fortier.

Mr. Chairperson: Thank you very much.

Now I turn to Mr. Farthing. Welcome. And I'm gonna ask you for an opening statement, please.

Mr. Gerald Farthing (Deputy Minister of Education, Citizenship and Youth): Thank you, Mr. Chair.

I am pleased to have the opportunity to speak on the 2007 office of the Auditor General's report on Property Transactions in the Seven Oaks School Division. Before I start, however, I'd like to share some information about the Public Schools Finance Board and the PSFB capital program.

The Public Schools Finance Board is a provincial statutory agency responsible for financing major capital projects in Manitoba—in Manitoba school divisions and managing the annual public schools capital program. The PSFB is governed by The Public Schools Finance Board Act and The Public Schools Act.

The Public Schools Finance Board consists of three deputy ministers appointed by the Lieutenant-Governor-in-Council. The chairperson of the board is the Deputy Minister of the Department of Education, Citizenship and Youth. The mandate of the PSFB as stated in legislation is, and I quote: The board is responsible for administering the capital support program and must provide for the effective and equitable allocation of the resources of that program in order to meet the needs of schools—or meet the needs of students and school divisions.

The duties and powers of the board are as follows. The board shall receive all monies paid to the fund; administer the capital support program and, under that program, make payments out of the fund at such times to such school divisions and in such amounts as the board may determine and in accordance with the regulations; make payments out of the fund at such times to such school divisions and such amounts as the minister, under the operational support program, may determine and in accordance with the regulations; consult with school divisions on a regular basis about their capital requirements priorities; develop and maintain a multiyear operating plan and a multiyear capital plan; evaluate board policies and procedures on a regular basis; develop and adopt conflict-of-interest guidelines; and finally, perform any other duties and exercise any

other powers imposed or conferred on the board under this or any other act.

In administering the capital support program the board must consider the following factors. First, the curriculum and instructional needs of programs offered by school divisions, particularly as they pertain to students in kindergarten to grade eight; second, the requirements of students with special needs; third, the community use of schools and the role of schools in their local communities; fourth, the influence of the design and maintenance of school buildings on the health and safety of students and other school users; fifth, energy efficiency; sixth, sustainable design in building practices; seventh, the life-cycle cost of school buildings; eighth, the long-term maintenance and renewal of school buildings and infrastructure; ninth, heritage preservation; tenth, the geography of school catchment areas; and finally, the efficient use of school lands and buildings within a school division and across school divisions.

The Manitoba public school infrastructure consists of 28 million square feet of school buildings and facilities. Capital planning of the school divisions is structured by a five-year capital plan submission and review process, which is undertaken annually. In March of 2009, the government announced a capital program of \$310 million over four years in support of the construction of five new schools and over 400 revitalization projects. This investment will be rolled out as \$85 million in the first year of the program and \$75 million for each of the following three years.

The Auditor's report notes that the 2006 amendments to The Public Schools Act and The Public Schools Finance Board Act, as enacted through Bill 35, The Public Schools Finance Board Amendment and The Public Schools Amendment Act, addressed most of their concerns. The Auditor did, however, recommend that the following additional areas be addressed and of which there are four. The first recommendation was that the department review and update The Public Schools Act to clearly define and specifically set out the activities that a school board can engage in and clearly specify that other activities are not permitted. In 2005, a letter was sent to school boards to remind them, quote: that the Public Schools Act provides a defined list of powers to school boards. Please note that the development and sale of fully serviced residential lots does not qualify as an eligible activity. I'm still quoting: School division are prohibited from acting as property developers under

the power granted them in The Public Schools Act. That letter was sent in 2005 from the former chair of the PSFB.

In April 2006, a news release was issued to inform school divisions and the public that changes would be made to The Public Schools Finance Board Act. Now I'm gonna quote from that news release. It says, that would strengthen existing accountability and reporting procedures, clearly outline the board's mandate and revamp its structures to increase co-ordination with stakeholders. End of quote.

* (19:40)

In August 2007, a news release was issued that told school divisions and the public that the Manitoba government had enacted new legislation as promised. Since that time, the department, along with legal counsel, has reviewed the current legislation to ensure that the intent is explicit and not subject to misunderstanding. We are satisfied that the existing provisions of the PSA with respect to the powers and duties of school boards are quite clear.

When school divisions are unclear, however, about what they can and cannot do under the PSA, they are expected to consult with the department for clarification, which they have done from time to time, and sometimes they even seek their own legal counsel for advice.

The second recommendation was that the department update the policy statement governing the disposition of surplus public school properties to ensure that the policy for the disposition of all school board-owned property is in compliance with the PSA. The update should include specific procedures for the disposition of school buildings and sites, vacant land and all other school division buildings not used for educational purposes.

The acquisition and disposition of all school board property must be approved by the PSFB or the minister, and that is now in legislation. In 2005, school boards were required to report on current landholdings, and so they gave us a snapshot of what was going on at that time, and then to report—and to report on land acquisitions. They were also notified that, henceforth, from that time on, that they would be required to submit annual updates on their vacant landholdings and acquisitions.

Therefore, every year as part of the five-year capital planning process, school divisions are required to complete something called the vacant landholdings acquisition report. A copy of this is

provided to the schools finance branch and checked to the capital fund financial statements for land acquired or disposed transactions. The schools finance branch also reviews capital fund financial statement transactions with the PSFB staff. So there's kind of double-check on what school divisions are sending to us via this report that I just mentioned.

A revised and expanded policy statement is currently being developed by the PSFB, and a draft of the revised policy will be made available to school divisions sometime during this school year, hopefully before the end of January, for their review and comment. The policy will be supported by specific written procedures and practice requirements. That's two of the four recommendations.

The third recommendation was that the department clarify the policy statement governing a disposition of surplus public school properties—clarify that this policy is, in fact, a policy rather than a guideline. This could be done by incorporating the policies of regulation to The Public Schools Finance Board Act.

The PSFB has clarified, actually, many times, that the current policy statement is, in fact, policy rather than a guideline, and is to be followed as a policy. A letter to school boards in 2005, for example, stated that the disposition of school division property must be undertaken in compliance with the policy governing the disposal of surplus school properties.

Since that time, this requirement has been reinforced through numerous conversations, consultations, discussions with school divisions, and school divisions are required—and they know that they are required—to seek approval prior to the acquisition or disposition of land. And they have come—and they do come to us from time to time to ask for permission to either buy land or sell land and buildings.

Finally, consideration will be given to incorporating the policy as a regulation to The Public Schools Finance Board Act as recommended by the Auditor General's office.

The fourth and last recommendation was that the Public Schools Finance Board develop a formal process to ensure that board motions are followed up and reported back to the board on a timely basis. The department and the PSFB have indeed established and implemented a formal process to ensure that board motions are, in fact, followed up and reported back on a timely basis. This is done by recording in

the PSFB minutes when items are deferred, pending, and will require further follow-up.

Thank you very much for your attention.

Mr. Chairperson: Thank you, Mr. Deputy Minister.

Now, the floor is open to questions.

Mrs. Stefanson: Thank you, Mr. Farthing, for your statements and for the Auditor General for her statement.

Mr. Farthing, you just went through all of the four additional areas that the Auditor General had brought forward in terms of recommendations, suggested recommendations, for your department. And I guess I would just like to ask the Auditor General right now: This report is from 2007, I believe—and I know that at some point you will be following up this report three years hence—and I'm wondering, if you could just indicate for us today, you've listened to some of the answers that the deputy minister has given, are you satisfied with the answers that your additional recommendations have been sufficiently followed through on?

Ms. Bellringer: Yes, I'd say that everything that they've outlined would address the recommendations. When we do the follow-up, we actually look for—we actually say, show us, so we would look for the backup for that, just to be able to provide that assurance to you that what they're saying they did is indeed what they've done.

The communications is clearly something that is not always just a snap, you know, a point in time; it's an ongoing thing. It's very difficult for us to really look at whether or not it's effective, and that's the piece that would be almost impossible to follow-up. But even given the information that the deputy minister's provided, the ongoing reminder to school divisions what they may and may not do is certainly going to satisfy the concerns we had at the time of the audit.

Mrs. Stefanson: Thank you very much for that. And, Mr. Farthing, just to follow-up on the—as I understand, there was an excess of, roughly, 500,000—I don't have the numbers in front of me right now—500,000 from the sale of the lands, of some of the land that was acquired. And I'm just wondering what happened to the proceeds. Would that have shown up—I guess it would have shown up in the financial statements that came forward to you? 'Cause we just had a bit of a concern, I guess, also,

because, as we—as we know, the tax rates—the Seven Oaks School Division continue to raise the taxes in the area, and I'm just wondering if anywhere it was indicated what happened with the sale proceeds of the land.

Mr. Farthing: Sorry. I don't know what was done with the proceeds of the land. I don't know what Seven Oaks did with the proceeds. I'm assuming that it went into the general revenue of Seven Oaks and I'm assuming that they used it for various educational purposes.

Mrs. Stefanson: Okay, and I guess I would just—if—what sort of follow-up is done? I think you mentioned the vacant land acquisition report, and so that goes out to all of the—or that is something that comes into the department annually, is it?

Floor Comment: Annually, that's right.

Mrs. Stefanson: Obviously, annual updates. But what—have you found anything unusual from those reports? And if you have, what steps would you take to ensure that this type of thing doesn't happen again? And what procedures does your department follow if you find something out of the ordinary?

Mr. Farthing: Okay, so far, we haven't found anything out of the ordinary. I can tell you that school divisions are being very careful about this. They call us—not all—not—you know, from time to time. I was going to say regularly, but that's a bit of an exaggeration, but they do call us from time to time to check as to whether or not they can be doing something under the PSA. And so they are being very careful. And what we're doing is monitoring, and what I was talking about is a monitoring process. If we were to find something out of the ordinary or irregular or something that we didn't understand, we would call them, and we would ask them what was going on and we would probably get to a situation like the Auditor General just referenced, which would be show me or show us if we had further concerns.

So, basically, what we would do is call them and ask for an explanation, and we would continue the conversation with them until we've got an explanation that can—allowed us to say that we clearly understood what was going on and could make a judgment as to whether what—whether what they were doing was appropriate or not.

Mrs. Stefanson: Just one other question. As I understand, the original land was purchased for around 3 million and they sold off about 2.2 of that—

Floor Comment: Something like that.

Mrs. Stefanson: —which they made some money on, I gather. And they kept another—the other 800,000 in inventory, as I understand.

Is that land still in inventory or have they—have they, subsequently, sold that?

Mr. Farthing: They sold all of—except the small—a couple of small parcels, which they are keeping for school purposes.

Mr. Borotsik: Yeah, and following up on Mrs. Stefanson's questions, they—they've kept these couple of parcels for school purposes. Have they identified any time line as to when the schools may well be developed on that piece of property, or is just contiguous with existing properties?

*(19:50)

Mr. Farthing: These parcels, they've been identified as future school sites, but there isn't a time line at this—at this point.

Mr. Borotsik: Just out of curiosity, the value placed on that property as of January 31st, 2006, the book value, was 819,000. Has your department confirmed the fact that that isn't a reasonable valuation of the lands for the Seven Oaks School Division?

Mr. Farthing: No, we haven't done that: if that's a reasonable evaluation.

Mr. Borotsik: I take it that's a function of the school division itself and that your department does not get involved.

Mr. Farthing: A function of the school division.

Mr. Borotsik: You made a comment that in 2005 you sent out a defined list of activities that were—that school divisions were capable of providing when land development was not one of those activities. Are there any other activities on that list in 2005 that perhaps you have some concerns with school divisions currently, perhaps either divesting themselves of interest of land or acquiring land?

Mr. Farthing: At this point in time there is no list of things that school divisions can't do. That could be developed in the future. There could be something like that in the future, an amendment to legislation, but at this point in time there isn't.

What The Public Schools Act does is it tells school divisions what they can do, and anything that they want to do they have to be able to see that they can do it as per The Public Schools Act. If they can't find a provision in The Public Schools Act that says they can do it they can't do it, and we have legal opinion to that effect and that's what we tell school divisions, and if they have a different opinion than us we suggest to them that they seek independent legal advice, and then we carry on the conversation after that. But it's not a list of things they can't do, it's a list of things they can do. That's what the PSA is.

Mr. Borotsik: Thank you. Are there any grey areas on that list? Are there negotiable areas on the list that the school divisions can go to the public finance school board and suggest that if they can do it that they could expand and be somewhat flexible on that list?

Mr. Farthing: It's only grey in the sense of everything that they—the way that we interpret The Public Schools Act is that whatever they want to do it has to be educational. It has to be in support of the education of the students that they have responsibility for, and it has to be pretty clearly like that, and if it's not pretty clearly like that, then what we tell them is that they can't be doing that. Some school divisions have wanted to get into, for example, partnering with private companies to offer Internet service, and they make the argument that they can provide better service—educational service to their kids by doing that. We have said no, because it's not clear that they can do that under The Public Schools Act, and it's one step removed from providing an educational service, which is the way we interpret The Public Schools Act.

Mr. Borotsik: Just for my own curiosity. You get a list on an annual basis as to the surplus lands of all the school divisions. Do you corroborate those surplus lands? Are there—and I'm not suggesting that school divisions would try to put forward reports that aren't correct, but do you go out and do an audit on any of those school divisions on a random basis just to make sure that those reports that are coming forward are in fact factual?

Mr. Farthing: No, we haven't gone out and actually done an audit. What we're relying on is the regular audit—their reporting and the regular audit process, and we check what they give to us against their financial statements and we look for irregularities. If we saw an irregularity and if they couldn't explain it, as I indicated earlier, then we might do something

like what you're talking about, but we do try to monitor it very closely to look for anything that looks out of the ordinary, odd, irregular, that might trigger us asking questions, and perhaps even going as far as you're talking about. But to date that hasn't happened.

Mr. Borotsik: I don't want you to think that I'm suggesting that school divisions would consciously try to suggest that they falsify any reports. I don't think they would, but in fact in the Seven Oaks School Division they did a function of land development that was totally contrary to what the policy of the department was, so in fact it has happened in the past, and I suspect that it's your hope that it doesn't happen in the future. Therefore, there has to be more due diligence, if you will, with respect to the reports coming in, and, as Mrs. Stefanson started to ask what the remedies would be if in fact you did identify some anomaly, what are the remedies from your department at that point in time to that specific school division? Should you identify an issue like the one with Seven Oaks School Division?

Mr. Farthing: Well, a couple of things. First of all, we're monitoring it very closely and it's not just because—you know, there's always a possibility that somebody's going to deliberately do something they shouldn't, but it's more likely a possibility that if somebody's going to be doing something that they shouldn't be doing and they don't know that. And so we're looking for that so that we can all make sure that we're all onside with what's allowed and what isn't under The Public Schools Act and under policy.

Second of all, we are doing due diligence, and we learnt from the situation that we're talking about. And we've taken steps and actions based on that learning to be doing a lot more due diligence than we were before. And we're pretty confident that we're monitoring the situation closely, and we're very likely to see anomalies as they arise.

With regard to your last point, if we found that someone was doing something similar to what Seven Oaks was doing, we would tell them that they couldn't do that. We would tell them to stop doing that. We would tell them that this is not allowed under The Public Schools Act, and then we would expect them to cease and desist.

But, as I indicated earlier, we haven't got to that point with anyone else because school divisions are being very careful, and if they're doing anything that

they think might be outside of—well, that's me; I can't know that for sure. But quite often we get calls where they ask us, is this allowed under The Public Schools Act, and we will give—we will then look at what they might want to do and give them an opinion. But, if someone was doing something like Seven Oaks was doing, we would immediately contact them and point out that they can't do that, they shouldn't be doing that.

Mr. Kevin Lamoureux (Inkster): Seven Oaks is the reason why we have this particular report. What I'm interested in knowing is to what degree is this something that happens with any sort of frequency, where a school division is outside of what The Public Schools Act would be expecting a school division to be, whether it's investing in or spending tax dollars. To what degree is that an issue, or is it just an anomaly?

Mr. Farthing: It's very rarely an issue. It does not happen very often at all. It's an anomaly.

Mr. Lamoureux: I can appreciate why there would be a no list, a no list for things that you cannot do because I think the things that you cannot do would be virtually unlimited—

Floor Comment: Right.

Mr. Lamoureux: —and there would always be things that would be created.

The list of what you can do, how often is that—is that like updated periodically? Can you just tell me a bit about that list?

Mr. Farthing: In my experience, while I've been in the department, not very often. Once in a—it's happened a couple of times but not very often because the list from the start was fairly long and fairly comprehensive, because it's through the public schools—the school divisions are empowered as school divisions by The Public Schools Act and school divisions manage schools, which means that they have a lot of—there's a lot of things they have to be able to do in order to manage schools and offer programs for kids. So the list was already pretty comprehensive from the point of view of empowering school divisions to be able to do things that are—educational things that kids need.

Mr. Lamoureux: I guess the rule of thumb is, if in doubt, contact the Department of Education.

Mr. Farthing: Absolutely, and our experience to date has been that that is what they do.

Mr. Lamoureux: In terms of acquisition, future acquisition, is it correct in terms of, in listening to your opening remarks, any future acquisition of property, the board has to be notified prior to its acquisition?

Floor Comment: Yes. The board has to—the board has to approve—

Mr. Chairperson: Dr. Farthing.

Mr. Farthing: Sorry, Mr. Chair. I keep—the board has to approve the acquisition and the disposition of lands. The board or the minister.

An Honourable Member: And/or the minister.

Mr. Farthing: Right.

Mr. Chairperson: Mr. Lamoureux.

Mr. Lamoureux: Yeah, just kind of threw you off at the very end.

The board and/or the minister, or the board and the minister?

Mr. Farthing: The board and/or the minister.

* (20:00)

Mr. Lamoureux: Now, would it not be more appropriate that the board would have to be made aware of it?

The minister, you know, has a fairly sense of responsibility in terms of attending numerous meetings, and a school trustee could, in passing, say to the minister, oh, by the way, we're going to be doing this and then feel, well, the minister nodded his head in affirmation, and who knows what it is that actually was said. It becomes his word, my word.

Can you just explain what that would be?

Mr. Farthing: Well, in practice, what happens is the boards always come to the—the school boards come to the Public Schools Finance Board, in practice. I'm sure that if they went to the minister first, the minister would defer the matter to the Public Schools Finance Board for consideration and advice.

Mr. Lamoureux: But, you know, one of the things that we're talking about, and you even said it yourself, is that this is an anomaly. It doesn't happen very often, right, and, you know, given that, in terms of being able to prevent it into the future, that wouldn't it be better—or maybe I would look to the provincial Auditor to provide comment—would it be

better that any acquisition or disposition of the land be referred for, at the very least, some sort of written document, whether it's from the minister or from the board?

Ms. Bellringer: It's my understanding that that is the case. I think the deputy will have to confirm that, but that was one of the changes, I believe, when the act—originally, land could be acquired without the Public School Finance Board's approval, but I believe that was changed, and that would, indeed, address the major concern that, you know, if a school division was acquiring without that approval, that obviously it opened up the door to how are you going to dispose of it if you're not given the approval to go forward with building a school. So—but the deputy will have to confirm that, but I'm pretty sure that that has indeed changed since the audit.

Mr. Lamoureux: So then, I've looked to the deputy minister. My understanding, listening to the Auditor then, would be that any sort of decision to acquire or dispose of property would require something in, in essence, writing, because it's a formal decision from the school board.

Mr. Farthing: Absolutely. I mean, none of this could happen without there being something in writing, a formal request in writing. None of—there would be no approval given based on a conversation or a nod or anything of that nature. This is a formal process and it's documented and we're very careful about that, very formal—may I? Formal, documented, and transparent.

Mr. Lamoureux: And the last question, and it's just more so just to provide comfort to myself. I know the Auditor had looked at the potential of conflict of interest, citing this specific report, the Seven Oaks only, in terms of owners or school trustees, making sure that there was no conflict. To what degree did the department look at individuals that would have acquired the property, like had purchased lands? Is that something that you would have done to find out, to ensure that there was no conflict, like a sister-in-law to a trustee or something of that nature that had purchased land? Was there anything done in regards to that?

Mr. Farthing: Well, when we did the study in June of 2005, the internal review, and we did that with the Internal Audit and Consulting Branch in the Department of Finance, and it is this report that was made public, we looked at everything and we did not find any conflict of interest and neither did the Auditor General find any conflict of interest, and

that's in the Auditor's report. We haven't looked to see if there was anything of the nature you're talking about thereafter, because I think what you're suggesting is that the land might have been sold to somebody's spouse or friend or something like that, and we haven't looked to see if anything like that has happened, but with regard to the whole Swinford Park subdivision situation, we looked at all of the files and we didn't find any conflict of interest.

Mr. Lamoureux: So, again, I don't want to imply things in regards to the integrity of school trustees and so forth. I just think that would be kind of a natural thing in terms just looking where there could have been conflict and making sure that the taxpayers' interests were, in fact, protected and that's what was meant in the question itself. So, suffice to say that the lots that would have been sold were—would have been sold at a fair market value, and from the department's perspective, they're confident that that was the case.

Mr. Farthing: We are confident that that was the case. We haven't looked into it, but we are confident that was the case.

Ms. Erin Selby (Southdale): My question's for the deputy, and I'm just wondering if you have a sense of how much time will be available for review and comment by the school divisions on the revised and expanded policy statement.

Mr. Farthing: Yes. We would like to have the revised policy statement to school divisions no later than the end of January. Then we plan on giving them at least six weeks, possibly two months, to provide comment and feedback, and then we hope to have the policy finalized by the end of the school year. So it'd be end of June next year.

Mr. Borotsik: Mr. Chairman, with respect to the Seven Oaks School Division and its land development itself, to the Auditor General: I'm trying to piece this together. It seems there was a surplus of \$512,118, and then you said with the additional \$307,000, which was equity, obviously, they show that as a book value—the total thing, the book value and the land of \$819,000.

Was there an, actually, a cash surplus, a net cash surplus of the land development that Seven Oaks School Division undertook, that showed on its balance sheet, it showed on its financial statements?

Ms. Bellringer: The financial statements would have shown a net income of the 500, and then on—that would have been in the, like, in the income

statement, and on the balance sheet, you would have seen 800 as the investment in the land. I mean, there were a lot of other transactions within the, you know, that that was within the context of. So I, you know, I don't recall. I'll just check with the director, but I don't recall what the overall numbers were looking like.

Mr. Borotsik: Before you check with the director, there were other costs. They actually did a land development. There were costs that they entered into. There was arrangements for sewer, water, drainage, roads. Those are very expensive items when doing a land division or a land subdivision and, certainly, a development.

Did you as the Auditor General go in and actually look at the costs associated to the land development and if, in fact, there was a net surplus, cash surplus that came out from that land development?

Ms. Bellringer: The costs that were associated with the development activity were allocated partly to the property that was sold and partly to the property that was retained at the end. And so we looked at the allocation process that they followed. They had a formula that they used as to how they applied it to the various components, but we didn't go further than that. Like, we didn't—in fact, those numbers were provided to us through audited financial statements that had been provided by an outside firm of chartered accountants.

Mr. Borotsik: The reason I asked the question is, if it was shown as net income on the financials of the school division, Mr. Farthing, is there not a requirement that, should there be a disposition or an asset value there, that a portion of that should then be submitted to the Public Schools Finance Board, and did you not ask for any of those net returns that came from that particular land division?

Mr. Farthing: No. That's not the case here because we're talking about land that the school division bought, and other school divisions do that. Not—they don't buy land to develop it for housing, but they buy land and hold it for future schools, and then when they dispose of that land, they keep the proceeds.

What you're talking about is when they sell a school building. When schools—when schools are sold, then the Province has the option of holding or keeping some of the proceeds, but not in this case because this was just land, it wasn't a school building.

Mr. Borotsik: If the Auditor General has a comment on that—and I have to admit, I'm fairly confused. This is an anomaly. This is something that never happened and should never happen again, where school divisions get into land development. Land development is fairly, fairly risky. You could lose a lot of money in the land development, and I can tell you that from some experience.

However, this particular school division did that. I'm told that there was a net value of some \$512,000. You're suggesting that the Public Schools Finance Board had no opportunity of getting any of those surplus dollars, those net dollars. They all went into, I assume, and maybe I can ask the Auditor General, that all went into if there's—if there was cash there, but there's not. As I understand it, that's asset value of land. There's no cash. There's asset value to land only and no cash. So there was no opportunity to offset any of the costs to the school division at that point in time with their own operations. Madam Auditor General.

* (20:10)

Ms. Bellringer: That first—we did point out in the report, and I would reiterate, that the school division did enter into something that put public funds at risk because it is outside of the normal operation of a school division. The—and, as you point out, it's a—it's a one-off. It's not something that there probably is a policy around. You know, and I think—but, having said that, the extent to which we would look at it is to provide you with the information, and you're correct, that there's no—500,000 is not sitting in a bank account somewhere.

In terms of cash flow, the—it's tied up, if you will, in the investment in the land that they retained. But, whether or not they are required to provide any kind of funding back to the department or back through the Public School Finance Board is purely a policy decision that we make no comment on, and I think that's where the deputy is trying, you know, providing the answer as to—in what cases do they have a policy where they're asked to submit funds when there's sales of schools, for example, and in what cases are they permitted to retain it. And those are decisions that are made by the department. We don't—we don't have any comments in the report on that.

Mr. Borotsik: One last question.

This was not necessarily a secret. As a matter of fact, there were some public meetings that were held.

There was—there was plans of subdivision that had to be approved, there were other departments that were involved, we talk about infrastructure that had to be put into place. This was not a secret. When did the department find out that, in fact, the Seven Oaks School Division was doing a land development and when you find out—found out, what was your response at that point in time?

Mr. Farthing: We're just checking on the exact dates, but I believe it was in May of 2004 that the department became aware of this situation, and, as the Auditor has pointed out, the Public Schools Finance Board could've—should've known about it earlier. The documentation wasn't perfectly clear, but there was documentation with the Public Schools Finance Board that, if it had been looked at more closely, one could have seen what was going on earlier.

With regard to your earlier statement, this is a one-off, and this should not have happened, and we have taken steps to make sure that it doesn't happen in the future. We've taken a lot of steps, actually, to make sure that it doesn't happen in the future.

Mr. Maguire: I just had a few questions around that vein, as well, Mr. Farthing—Dr. Farthing, as well, and I guess it was just to confirm with the Auditor General, the—without any of the investments that my colleague from Brandon West was talking about for land development, the purchase of the land was \$3 million, that was a value paid for by the school division?

Mr. Chairperson: I'm sorry, Mr. Maguire, I missed who you're asking the question of.

Mr. Maguire: Oh. Madam Auditor General.

Ms. Bellringer: The 3 million would include the initial purchase of the land, plus all of the development costs that were invested, as well, into the property prior to the subdivision and sale.

Mr. Maguire: And then, Dr. Farthing, and the subsequent split off and sale of that land, and I understand was 2.2 was split off, was subsequently sold for 2.7, somewhere in there, about a \$500,000 profit on that—capital gains, I assume, and then there's the other—of course, the other \$800,000 of land that was split off, that was left as an inventory.

You indicated earlier that you don't follow that \$800,000 worth of inventory land. Is that correct?

Mr. Farthing: No, that's not correct. We do follow it; we know it's there; we're watching what's going on. They have to report that to us. If they want to sell that land, they have to come to us to get approval to do so. So, your statement wasn't completely accurate.

Mr. Maguire: Okay, I could—I could have been very wrong, and I appreciate your answer. I just picked that up from your comments in the statements that you were making earlier in your—in your statement.

Floor Comment: Maybe I wasn't clear.

Mr. Maguire: I must have misheard that.

But, I guess the point that I wanna make is that if that land is still there, there's that development. That was \$800,000 worth of land in 2001, I believe, when it was purchased or—what year would that 800,000 value be placed on? Is it '01 dollars or '04 dollars or—

Floor Comment: I would have to defer to the Auditor—

Mr. Chairperson: Dr. Farthing.

Mr. Farthing: I would defer to the Auditor General, but I believe it was more like 2006-7.

Mr. Chairperson: For clarification, the Auditor General.

An Honourable Member: When the split—I guess it would—

Mr. Chairperson: Just a moment, please. The Auditor General is recognized.

Ms. Bellringer: The figure of the 800,000 was from the 2006 financial statements.

Mr. Maguire: Okay, thank you. The—at that rate, even if there was a \$2.7-million sale of that purchase of land, that school division, in my estimation, with a \$3-million investment would still be \$300,000 short in cash then.

Floor Comment: Well—

An Honourable Member: Is that correct?

Floor Comment: But they're holding some of that—

Mr. Chairperson: I'm sorry, Dr. Farthing, just a moment. Mr. Maguire to complete.

Mr. Maguire: I was just asking if that's correct.

Mr. Farthing: Yeah, but some of the—some of the proceeds—some of the realization, the gain from these transactions is being held in land, that land that I referred to earlier. And some of the—so what Seven

Oaks has realized as a gain is tied up in the land that they're still holding.

Mr. Chairperson: Mr. Maguire.

Floor Comment: Can I—

Mr. Chairperson: Dr. Farthing, to complete.

Mr. Farthing: And let me clarify one other thing. The reason why we don't take a part of the proceeds when school divisions sell land is because we don't help them buy it. With schools, we build the schools, and that's why when the schools are sold, we reserve the right to receive some of the proceeds.

Mr. Maguire: I have no problem with that at all. I certainly understand and agree with that, Dr. Farthing. I guess my point here is then you're saying that of the \$800,000 that was split off, part of that 800,000 is represented in some of the 500,000 capital gain that was made on the 2.2 that was split off?

Mr. Farthing: I'm sorry. Could you repeat the question? Sorry about that.

Mr. Maguire: Yeah, I'm just saying that from your answer, I'm taking—and I could be wrong—that the—of the 500,000 capital gain from the sale of the original 2.2 for 2.7, the \$500,000 capital gain, that you're saying that part of that \$800,000 split-off part is some of the five—or all of the 500,000 in capital gain?

Floor Comment: What I'm saying is, is that some of the—

Mr. Chairperson: Dr. Farthing.

Mr. Farthing: —some of the—I'm gonna defer to the Auditor. I'm getting signals here.

Ms. Bellringer: It has a number the Auditor must know. The way you described it when you started asking the question was right on. The—if this—let's imagine this was the only transaction that had occurred in the—in the school division that year. If they had purchased the land, sold off a portion and retained the rest, and that was the only thing they did, they would have been short 300,000 in cash on a cash-flow basis. But from an income perspective, they made 500; from an asset perspective, they retained an asset of 800.

Now, this is all within the context of other aspects of the operations; it isn't the only transaction that took place. And so I am—and, again, I don't have the statements in front of me, so I don't know what

other transactions appear in those financial statements that year, but there would have been, obviously, sufficient cash from other sources from, you know, from the division, I mean, that otherwise would have been put into a surplus or whatever, if they, you know, they used that. The cash flow worked somehow, or they would have had to have asked for additional cash resources.

So, I just—I guess what I'm—what I'm trying to do is make a distinction between the—the income and the investment is different from the cash flow, and you are absolutely correct, and on a cash-flow basis, there is—there is a—well, you don't call it a loss when it's a cash-flow shortage, but there is more money invested than available in a bank account.

Mr. Maguire: Yeah, it's a cash—like it's a cash flow or cash shortage on the ledger for that particular year, yeah.

And so, I guess just for clarification, then, if there was 3 million invested and 2.2 was split off, there's still an 800,000 there in investment of a—of a nature in '06 dollars, which we don't have a—you know, I guess, today, the school PSFB, I guess—to go back to the deputy minister—has refused to allow a school to be built in that area, or at least, I understand that. Or is there—has there since been a school okayed to be built on this property?

* (20:20)

Mr. Farthing: Well, they haven't asked for a school to be built in that, in Swinford Park. We built a school not far from there—West Kildonan—a very nice school.

Mr. Chairperson: Well, isn't that nice? A very nice school.

Mr. Maguire.

Mr. Maguire: Have no problem with that, but it wasn't built—but it wasn't built on the \$800,000 piece of property, is what I'm getting at.

Floor Comment: No, it wasn't. It was different property.

Mr. Maguire: So, has the—do you have any—you don't have any right or ability, then, to tell the school division to sell that piece of property?

Mr. Farthing: No, but they have to get approval from us if they do want to sell it, and we are in discussions with Seven Oaks and other school divisions about the land that they have and the land they might need for future schools. That's an ongoing

conversation, and an ongoing issue because, you know, there's some risk assessment that has to be done when you buy a piece of land as to whether or not you're going to need it, when you're going to need it and what do you do if in the future you don't need it. But that's an ongoing conversation, not only with Seven Oaks, but with a whole bunch of school divisions.

Mr. Maguire: Just a few more, Mr. Chairman. I guess I'm just wondering then, I know that they've got this parcel of land, and it probably has appreciated somewhat since even then. I don't know if the school board is going to look good in the end out of that one, But, you know, I guess I would ask the Auditor General if she feels that the—I guess, the speculative nature of a land sale as described by my colleagues, whether this is—I mean, this was purchased with public school board—Public Schools Finance Board funds, school division funds, school division funds to purchase this particular land. And so, you know, it could well be a liability if our economic crisis had worsened and land sales had gone down anymore. We've seen that happen with many properties in the United States, particularly right now, and I guess I'm wondering, is there any protection from the school division in regards to that happening to the taxpayers of that area?

Ms. Bellringer: That's exactly why we pointed out there was a risk. I would attach the speculation not to the sale of the land, but to the development of the land. And just to point—I mean, not—the remaining land that's in the inventory is fully serviced, but to what end? So, I mean, it's only at the point at which it's either sold or used that that value is truly realized.

Mr. Maguire: Well, I just—then to the deputy minister, I just wanted to wonder whether or not the—you know, it appears as if the land has been developed for housing, why would the school division still be—have they come forward to you to ask for it to be sold, or to them to have it released to be sold into development? For residential.

Mr. Farthing: A couple of comments—

Mr. Chairperson: Yes, go ahead, Dr. Farthing.

Mr. Farthing: A couple of comments. One is, one of the ways that you minimize the risk is if you make sure that school divisions aren't holding more land than they should be. I mean, that's one of the ways to minimize the risk. And so that's why we're monitoring it in discussions with school divisions about what they might and might not need.

With regard to this specific situation, we will have to wait and see whether they'll need that particular land for a school or not. If they don't, then they will sell it and have to purchase other land, or they could exchange that land for land somewhere else that they would need for a school. And we know from the five-year capital plan that Seven Oaks has submitted that they're looking at those options and those possibilities. So they're trying to keep their options open.

So there's two things. Minimize the risk by only having them hold as much land as they might need for a school and then keep their options open about what they would do with the land in the future if they're not going to build a school specifically there.

Mr. Maguire: Are there any other land developments that school divisions would own that are developed for housing projects, as this one is, or is this one developed for a potential—for a school to go onto?

Mr. Farthing: This is for a potential school, and no other school division that we know of is holding land that's going to be, or intended to be, developed for residential use or any other use other than for a school.

Mr. Chairperson: Ms. Braun—Mr. Borotsik.

Mr. Borotsik: I'm okay. No, I'm fine. I'm fine.

Mr. Chairperson: Okay, seeing no other questions, Auditor General's Report – Special Audit: Property Transactions in the Seven Oaks School Division, August 2007—pass.

Thank you, Minister. Thank you, Deputy Minister and staff.

Now we call forward the minister responsible and the deputy minister for the Crocus Fund, and the report we'll be considering is the Examination of the Crocus Investment Fund, May 2005.

Does the Auditor General wish to make an opening statement?

Ms. Bellringer: No, Mr. Chair, I just—I'm noting there the report's been here six times previously, so I'll dispense with an opening statement.

Mr. Chairperson: Thank you, Madam Auditor General.

Does the deputy—pardon me. First of all, I would like to ask the minister to introduce his staff, please.

Hon. Andrew Swan (Minister of Competitiveness, Training and Trade): Yes, thank you, Mr. Chairperson.

With me, of course, Hugh Eliasson, the Deputy Minister of the Department of CTT. I'm also joined by Doug Fyfe, who's a manager in the Financial Services branch of CTT. To the far left is Richard Groen, who's the manager in the business taxation department of the Department of Finance, as well as Eleanor Andres, who's Crown counsel in Civil Legal Services.

Mr. Chairperson: Thank you very much, Mr. Minister.

Does the deputy minister have an opening statement?

Mr. Hugh Eliasson (Deputy Minister of Competitiveness, Training and Trade): Yes, I do.

Mr. Chairperson: Thank you. Proceed, Mr. Eliasson.

Mr. Eliasson: Thank you for this opportunity to provide the Public Accounts Committee with an update on the recommendations from the office of the Auditor General as a result of its examination of the Crocus Investment Fund.

The report contained a total of 142 recommendations, 120 of which were issued to Crocus. Of the remaining 22 recommendations, 15 have been fully implemented and seven are no longer relevant due to changes in circumstance.

The lead or primary recommendation to the Province acts as a starting point for all of the other recommendations.

The first recommendation to the Province is that, in light of the current challenges facing the fund and the observations contained in this report, the Province establish a review process to consider (1) the impact of this situation on the Province's monitoring role; and (2) whether there are any beneficial changes to The Crocus Investment Fund Act and The Labour-Sponsored Investment Fund Act that may be required.

The Province acted expeditiously to implement the points in this recommendation. First, on June 1st, 2005, the Province tabled Bill 51, The Labour-Sponsored Investment Funds Act (Various Acts Amended), which addressed recommendations regarding board governance, accountability of senior management and the board, and the completeness of

information provided to shareholders and prospective shareholders.

Second, the Province appointed a Crocus Investment Fund Implementation Team co-chaired by John MacDonald, a former senior partner in a major firm of chartered accountants, and Winston Hodgins, the current CEO of the Manitoba Lotteries Corporation. The implementation team report was tabled by the minister at the December 8th, 2005, Public Accounts Committee meeting.

The implementation team's report recommended a number of legislative amendments to implement the recommendation of the Auditor General's report. These amendments were tabled and passed in Bill 37, The Labour-Sponsored Investment Funds Act, 2006, which received royal assent on June 13th, 2006.

The principal amendments in Bill 37 transferred the monitoring and compliance function for labour-sponsored venture capital funds—the function along with relevant legislation to the Department of Finance, and it established the position of the independent administrator. The bill also provided that the independent administrator has the authority to issue an assessment to a fund, imposing a penalty for non-compliance with the legislation.

The investment pacing test has been simplified and clarified.

The amendment's increase of funds' accountability to shareholders: A majority of the members of the board of directors must be elected by class A shareholders.

Bill 37 requires the board to approve an annual business plan.

* (20:30)

The legislation also introduced more flexibility for a fund to meet the business plan objectives and to increase its rate of return for the benefit of shareholders. The 15 percent reserve requirement was replaced with a reserve requirement that allows a fund to meet its cash-flow requirements.

The act requires a fund to file an annual information return to the independent administrator in a form approved by the administrator.

Bill 51 in 2005, and Bill 37 in 2006, in total contain at least 115 provisions to either amend, repeal or add new legislation to The Income Tax Act and The Labour-Sponsored Venture Capital

Corporations Act. Most of The Crocus Investment Fund Act was repealed. Through these amendments, the office of the Auditor General's recommendations that remain relevant have been implemented or resolved.

Thank you for the opportunity to outline the steps that we've taken.

Mr. Chairperson: Thank you, Mr. Eliasson.

The floor is now open for questions.

Mr. Borotsik: Thank you, Mr. Eliasson.

To the Auditor General, the deputy minister has indicated that 15 of the recommendations have been resolved; seven were not relevant. Do you agree—I believe that there is a follow-up report—do you agree with the deputy minister that the—that the recommendations have been identified and dealt with as he—as he has identified?

Ms. Bellringer: Yes, the 2009 report that we issued identifies that 15 were implemented and resolved. I just want to point out that when we do the follow-up reports, we don't do a full re-audit. We do ask the departments for their self-reporting to us and then we verify it on a test basis. So there hasn't been a full audit of those—of each of those recommendations, but we do concur with the summary that the deputy's provided.

Mr. Borotsik: Unfortunately, I have not been present at the other six times that this report has been dealt with at this table and I don't wish to—I don't—don't wish to continue too much longer on this, but just for my own purposes, Mr. Deputy Minister, I did have a chance to look at the figure 6, which is page 65 on the Auditor General's report and it's the income statements for Crocus that goes back from 1999 to 2004, and there was a net loss in 2001 of some \$12,600,000; in 2002, a net loss of nine million nine; in 2003, a net loss of five million three; and 18 million in 2004.

Was there no red flags in 2001 with respect to the loss of twelve million six at that point in time? Did your department not identify any red flags with the Crocus Investment Fund at that point?

Mr. Eliasson: Unfortunately, I have been here for the prior six.

I, you know, I think an investment fund like the Crocus Investment Fund produces the majority of its income through the gain on investments and the successful disposition of those investments, and so a

fund at a particular point in its maturity may well be incurring operating losses in the expectation of making gains on investment in the future.

Mr. Borotsik: That may well be true, but there has to be, certainly, an assessment of the asset value at that point in time in order to make sure that the fund in fact is being successful or not, but operating losses themselves should, I would suspect, show some red flags, especially when operating losses over a four-year period of time, and I do appreciate the fact that the fund was—or the securities were stopped—sale of the securities were stopped in 2004, but even just looking at this income statement would, I think, make somebody stand up and take notice and ask questions of that fund at that time.

However, I do find that back in the budget year of 2003 the then-Finance Minister was suggesting that the Crocus and ENSIS at that time were very successful. Was success—how was success identified at that point in time if there was no asset—or appraisal done of the asset value and showing a loss? In your department, Mr. Eliasson, how would you show that as being very successful?

Mr. Eliasson: Well, to start off with, Crocus was a privately run corporation responsible to its own board of directors. They provided annual financial statements that were provided to the shareholders. They filed an annual prospectus, so people who invested in the Crocus Investment Fund had an opportunity to make a decision on the success, or potential success in the future, based upon the information that was provided to them.

The operating losses that you referred to, the larger numbers that you referred to include losses on disposition of assets, and the operating losses were not quite as significant as you indicated in your first question.

Mr. Borotsik: Well, again, I don't want to flog a dead horse, and I apologize, but, as I said, I haven't been party to the other six meetings that followed this particular file. I do understand, however, that the Deputy Minister of Finance sat on the board of this—your words—private corporation. There were requirements of this private corporation to disclose to government what was happening at the time, and I find that in 2003, again, very positive statements being made by the former Finance Minister with respect to Crocus, and we do identify that in 2003, there were some serious difficulties.

With a Deputy Minister of Finance sitting on the board, were there no red flags? And I keep coming back to that. Was this just simply a surprise, come 2004, when they stopped the sale of Crocus shares?

Mr. Eliasson: Just to clarify, the Deputy Minister of Finance didn't sit on the board. There was a representative of government on the board from April 2000 to April 2001. I sat on the board. Following that, John Clarkson, who was an assistant deputy minister in the department at the time, sat on the board, and following that, Ron Waugh sat on the board.

In the changes in the legislation that I outlined that were in response to the Auditor General's report, no government representative sat on the board. While the government was represented on the board, the director's duty was to the shareholders of the corporation, and the director was not there to provide monitoring reports back to government.

Mr. Borotsik: Just on that, the duty of the shareholders certainly wasn't handled very well. The shares were stopped, and, as you're well aware, the initial payment, just recently, is well, well below what the original share price of the Crocus shares were at that point in time, so I would suggest that the board of directors certainly were deficient, if you will, in the valuation of this particular corporation.

Again, not to flog a dead horse, I find it somewhat difficult that you and your department, and, certainly, the Department of Finance weren't aware that there were some issues with the valuations back in the years of 2002, 2003. And that's not a question; it's simply a statement. And, as I said, this has been dealt with a number of times. We do know what the disposition of the shares have been just recently, so I guess it's a sad chapter in a long litany of errors and mistakes, so.

Thank you, Mr. Chairman.

Mr. Chairperson: Thank you, Mr. Borotsik.

Mr. Lamoureux: Just a couple of questions, I guess more so for clarification more than anything else. You indicated the Province's appointment to the board was more for the shareholders' interests as opposed to the Province's interests. Was there any obligation at all in terms of that representative reporting to the Minister of Finance?

Mr. Eliasson: The director did not have an obligation to report to the Minister of Finance. The director owed his duty—his or her duty—to the

shareholders of the corporation, and the actions of the director should have been in the best interests of the shareholders.

Mr. Lamoureux: So, there being no obligation, was there—or could you, as the deputy minister, indicate that the Minister of Finance, then, would not have been aware of the issues because there was no obligation, or could that individual still have informed the minister? Was there an obligation of confidentiality that that individual rep could not discuss issues from the board meeting with the Minister of Finance? If you could just kind of expand on that particular point.

* (20:40)

Mr. Eliasson: Crocus and the other labour-sponsored venture capital fund had reporting requirements to the government, but the reporting requirements were not through the directorate that the government appointed to serve on the board.

Mr. Lamoureux: So, in a real way, how would that work in terms of how would the government be kept abreast of what was taking place?

Mr. Eliasson: There was an annual information return that each venture capital corporation was responsible for filing with the government on an annual basis to report on the extent that they were meeting the public policy objectives for which the tax credit was given. And to sort of briefly summarize those: that was to make sure that 70 percent of the money that was raised in a given year was invested in Manitoba corporations within a reasonable period of time. There was an obligation that a percentage of the money that was raised had to be in the form of small investments to benefit—with the intent of benefiting smaller companies. There was an obligation to maintain a level of the investment in Manitoban companies. And so that was one means by which the corporations reported to the government.

The corporations also were required to provide their annual audited financial statements to the government, and those statements were then reviewed to monitor the extent to which obligations, like reserve requirements, were met. The government received copies of the annual prospectus that was filed by the corporation with the Manitoba Securities council commission and was available to investors and prospective investors in the corporations. So those were the primary means of reporting through to government.

Mr. Lamoureux: There was a component of promotion of the Crocus Fund in which many of the consumers or the stakeholders that acquired shares, because they believed that the government was, in essence, promoting the Crocus. They'd seen it as a government-sponsored fund.

When would have been the last time government would have actually, you know, paid for any sort of promotion of the Crocus? When would that have stopped?

Mr. Eliasson: To the best of my knowledge, the government never paid for promotion of Crocus. The prospectus filed by Crocus was very clear that the government passed no judgment on the value of an investment in Crocus. The government took action in part in the legislative change—changes that were made to restrict some of the marketing activities that Crocus had engaged in, in terms of marketing in the workplace and the utilization of mandatory payroll deduction for the purchase of shares.

So, in the two sets of legislative changes that I referenced earlier, there were restrictions that were put on all labour-sponsored venture capital funds that govern the way they could market themselves in the future.

Mr. Lamoureux: Maybe that then becomes the issue, right?

Many of the consumers of the Crocus actually believed that the government was somehow endorsing it, maybe through the tax benefits and the people that were selling it, were using the government fact that it's a tax break, it's something that the government's behind, and so forth. That's something in which the department would be fully aware of. I know, at one point, I believe, there was even promotional material that was put into paycheque stubs, giving the impression that the government was really behind this fund.

Is that a fair assessment?

Mr. Eliasson: I think it's very fair to say that both the federal and provincial governments provided a tax credit to individuals who invested in labour-sponsored venture capital funds as an asset class. And the government certainly encouraged that kind of investment as an instrument of public policy to make venture capital available to industry businesses within their jurisdictions. And labour-sponsored venture capital funds operate in almost every jurisdiction in Canada with a federal government tax credit as well as a provincial government tax credit.

So it's very clear that governments, through the tax credit, are encouraging investment in that class of asset.

As far as the promotion of individual funds, actions were taken to restrict the ways in which funds could promote themselves through the legislative changes that I mentioned. And I think clearly one of the benefits of the Auditor's review of the Crocus situation were a series of recommendation that the government has acted on, and, in my mind, create a much stronger governance environment for the fund and a much clearer and simplified set of regulations governing the operations of the fund.

Mr. Lamoureux: Final question, then, would be is: when would have the—when, or if it happened, did the government first express to the public, or—that there are some issues with Crocus that people should be somewhat concerned, or any sort of warning to the public about investing in Crocus, or did—or would they have even done something of that nature prior to its collapse in November of 2004?

Mr. Eliasson: The regulatory regime with—in which Crocus operated, from a disclosure point of view, was primarily monitored by the Manitoba Securities Commission. When the Crocus board made a determination that they couldn't place a value on—they couldn't agree on a value, on the shares, they requested authority from the Manitoba Securities Commission to cease trading, and that was the notification to the public. That was in December of '04.

Mr. Maguire: Mr. Eliasson, thank you for your opening remarks tonight as well, and I guess I just wanted to go back to my colleague's question earlier in regards to the red flags that might have been around on this one, and you were talking about those earlier. The fact that you'd been in the department as well for a number of these—what is it—six or seven times you've been here in this review? And say that, you know, there's a—it's coming to a conclusion now. There are 34,000 Manitobans involved in this and I think there's been an expectation all along from them that some kind of payment be made to them. That seems to be going out to them right now, and many of them have told me that they've received their letters and funds in regards to this.

You know, I guess there was, with a \$100-million investment in some of those areas back in those days, we, you know, it first became public in much, I guess, many years after the Minister of

Finance in charge of Crocus found out about it, there's been many excerpts from the 2000 November report that the minister was involved in at that time, noting that there was many shortfalls in the Crocus Fund, in fact, that, perhaps, even there wouldn't be enough money to pay out persons if they all took their profits at that time. Also, at times, I think he's even indicated that they knew about the fact that people were still investing, being encouraged to invest in Crocus at that time, when, in fact, the funds that were coming in were hardly offsetting the amount that some of the previous shareholders, earlier, were taking out.

I wonder if you can just elaborate on any of those occurrences, in fact, confirm that, in fact, sometimes the funds coming in and being collected and still encouraged to be collected in that '04 period, some of the latter parts of it were, in fact, hardly covering what was going out.

Mr. Chairperson: Mr. Eliasson to answer. Mr. Swan—oh, sorry. Mr. Eliasson.

Mr. Eliasson: I believe the minister has a response.

Mr. Chairperson: The question is to the deputy. I'm sorry, the minister may add to your question later.

Mr. Eliasson: I'm trying to develop a—I'm trying to think of something specific, a specific way to respond to your question. In each and every year, the Crocus Investment Fund met its pacing requirements, and I think that that's reported in the Auditor's report, which means that each and every year, they were fully compliant in investing new funds that were raised in accordance with the guidelines that existed for them to do that.

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Mr. Swan: Yeah, I—the member may have more questions. I was just going to say perhaps if we could—if there were specific questions we could break down, it would be more fair for the deputy minister to try and answer. There were some pieces where I was, I was jumping ahead with a political answer which wouldn't actually help the work the committee is doing. So the more that—the more, Mr. Maguire, you can do just to shorten up the questions so that something that's fairly within the purview of Mr. Eliasson, the better off we'll be.

Mr. Chairperson: Mr. Swan, I'm the Chair of this committee, and if I feel that a question is out of order or is too long, I'll rule on that. It is not up to the minister to do that.

So I thank you for your intervention, but that is not appropriate.

Mr. Maguire: I guess I'll try and do the same, regardless, in the custom that we've grown accustomed to here in the committee and the good work that we've been doing, across both sides of the table. And I know that—I know you mentioned it earlier, I wonder if the deputy could just, the minister could just indicate to me again which years he was sitting on the board of Crocus.

Mr. Eliasson: I sat on the board of Crocus for one year from April of 2000 to April of 2001.

Mr. Maguire: Thank you. During that time, then, did you have discussions with the minister, because the minister's gone back into time and indicated that he knew about this in November of 2000?

Mr. Chairperson: Mr. Maguire, can I ask you to rephrase that question, please?

Mr. Maguire: Well, I just—

Mr. Chairperson: Just, I wasn't following it. I'm sorry.

Mr. Maguire: Okay. No. I just asked the deputy, if, because of his period of time when he was there, and I wasn't—I didn't catch it earlier. So it just come to my mind here that if he was there from—up till April of '01, I believe he said, that the minister in charge of Crocus at that time indicated that he knew about this in November of 2000, some of the shortfalls in Crocus didn't become public for many years after that. I just wondered if the deputy had had any discussions with the minister around that time in regards to advising him on some on these areas.

Mr. Eliasson: Crocus was formed in 1993 and there was always a representative of the government appointed to the board. It had been, prior to 1999, a senior official of the department, often the secretary of the Economic Development Board or the deputy minister of the department or an assistant deputy minister of the department.

When I came on the board and garnered some experience on the board, I could detect that there was conflicting duties. As I mentioned, the director of the corporation has a duty to the shareholders, and, as a deputy minister, I had a duty to government. And, as I gained experience on the board, I could perceive that those duties could be conflicting duties. And I began to seek legal advice as to what remedies could be taken, and there are several remedies that members of a board can take when they're presented

with a conflict, but none of them seemed sufficient to me to give me sufficient comfort to carry out both those duties simultaneously, which is why I resigned from the board in April of 2001.

And then the government then appointed Mr. Clarkson, who was not involved in any of the policy issues or anything related to Crocus. And so that separation continued up until the time when the government made the determination not to have a director on the board.

Mr. Maguire: And so it was Mr. Clarkson that came on the board to represent—well, you stayed then as a— you weren't on the board after that; you resigned, you're indicating. So that you were, then, separate from the—from the future circumstances, I assume, and Mr. Clarkson was there then to take your place in representing the government.

Mr. Eliasson: Mr. Clarkson was the director appointed by the government.

Mr. Maguire: And so it was Mr. Clarkson's responsibility then to report to the government after that period of time.

Mr. Eliasson: No. I think I sort of clearly outlined that the director is appointed by the government. The director is not the government's representative on the board, that the director appointed by the government, like any other director of a corporation, owes their duty to the shareholders of that corporation.

Mr. Maguire: And so you pulled yourself out because of the conflict of interest you felt because you were directly involved in the department in policy making? Am I correct there?

Mr. Eliasson: I wouldn't characterize it as a conflict of interest. I would characterize it as two duties that were in conflict or potentially in conflict.

Mr. Maguire: Yes, I would agree with you there. That's a better way of wording it, and I thank you for the clarification.

And so, Mr. Clarkson, then, would have been the person appointed by the government as the director. Who, then, was the person that was there in regards to reporting to the government directly, then?

Mr. Eliasson: The reporting by the venture capital corporations to the government came through the means that I outlined earlier for the member for Inkster (Mr. Lamoureux), and that was the annual

information return that reported on the extent to which each of the venture capital funds were meeting their public policy objectives in terms of the pace at which they were investing in eligible Manitoba investments, the percentage that was dedicated to small investments, their maintenance of a level of investment in Manitoba companies, the annual audited financial statements of each of the funds and the prospectus that was filed with the Manitoba Securities Commission.

Mr. Maguire: Just, I had asked a question earlier, and I guess, in just regards to that, and I fully agree with the path that the deputy has taken on in regards to the responsibilities. I think that is a very responsible action.

Would he be able to go back and answer the question that I asked? I'll just rephrase it. In regards to in his period of time, then, he would, you know, in—obviously, to be able to do this he must have had

discussions with the minister in regards to making the recommendation and resigning himself, the deputy would have had to know why you want to make a resignation from that. Can you just indicate to us what kind of discussions he had with the minister at that time?

Mr. Eliasson: It wasn't—there wasn't—it wasn't any particular issue. It was experience on the board that allowed me to identify the conflicting duties that a director had and a deputy minister had, and I came to the conclusion that there was no suitable remedy to those conflicting duties other than to remove myself from the board.

Mr. Chairperson: The hour being 9 o'clock, committee will rise, as we had agreed to in the past, and this report will remain on the books.

Committee Rise.

COMMITTEE ROSE AT: 9 p.m.

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