PRESS RELEASE

AUDITOR GENERAL - O'CONNELL DRIVE ELEMENTARY SCHOOL LEASE

Auditor General Roy Salmon today issued a special report under Section 15 of the Auditor General Act on the O'Connell Drive Elementary School Lease. The Minister of Education and Culture requested the Auditor General to perform this audit on June 5, 1998.

The Auditor General indicates in today's report that the government has made a public policy decision with respect to school construction - schools will be built without adding to the debt of the Province. The government has also indicated that this will be accomplished through operating leases. The mandate given to the Auditor General under the Auditor General Act does not extend to assessment of public policy. He, therefore, does not express an opinion on whether schools should be built through P3 arrangements but focuses primarily on the accounting issues associated with these arrangements.

Today's report focuses primarily on the accounting treatment for the first school lease signed by the Province - O'Connell Drive Elementary School in Porters Lake which was opened in September 1997. The Auditor General indicates that accounting decisions are a matter of professional judgement and that professional accountants, looking at the same transactions, may sometimes reach different conclusions on accounting treatment.

The lease was signed by the Province and the private sector consortium which built the school on March 12, 1998. The Auditor General indicates that, in his opinion, the original lease did not meet the Canadian Institute of Chartered Accountants (CICA) quantitative tests for classification as an operating lease when he began his audit in June. He conveyed his concerns to the Department of Education and Culture and the Department decided to undertake negotiations with the consortium to modify some of the terms of the arrangement. On July 14, 1998 an agreement was signed which amends the lease to meet the quantitative tests included in the CICA Handbook for classification as an operating lease.

However, the Auditor General concluded that while it is acceptable to account for the arrangement as an operating lease it would be more appropriate to account for it as a capital lease because the majority of the risk remains with the Province. The CICA's recommendations are based on the premise that the substance, rather than the form, of transactions should be considered and the Auditor General indicates that classification as a capital lease would be consistent with the CICA recommendations. For example, the risks related to capital improvements, operating costs, and technology refreshment all remain with the Province. The major risk transferred to the private sector is residual value but because the private sector will have recovered more than 88% of its investment in the property at the end of the lease, the residual value risk is limited.

The Auditor General previously made comments on public-private partnerships (P3s) for school construction in his 1997 Report which was tabled in the House of Assembly early in 1998. With respect to value-for-money, his earlier report indicated that the government had not performed adequate analysis prior to the decision to enter into P3 arrangements for school construction and this limited his ability to comment on the related value-for-money considerations. In today's report, the Auditor General states that the private sector consortium obtained financing for the lease through a pension fund which operates in a tax-free environment. The end result for the Province is that the financing for the school is at approximately the same rate as the Province would have incurred if it had borrowed.

The Province will not own the school at the end of the lease term unless it decides to purchase it at that time. If the Province was to acquire the school in 20 years, at the end of the lease term, the present value to the Province for use of the school for its full economic life under the lease arrangement would be $8.3 million (excluding operating and maintenance costs) as opposed to $8 million if the Province owned the school and financed it with debt. (Note that this assumes that the Province acquires ownership at the end of 20 years. Alternatively, the Province could decide to renew the lease or "walk away".)

The Auditor General also states that any observations and conclusions included in today's report are related only to the lease for O'Connell Drive Elementary School and should not be generalized to other schools being constructed, or to be constructed in the future, under arrangements involving the private sector. However, he states that the O'Connell Drive lease demonstrates the potential accounting and value-for-money issues associated with lease agreements where services, in addition to the basic net lease, are acquired. These issues relate to the difficulty in assigning gross lease payments to individual services and the appropriate valuation of those services.

Finally, the Auditor General reports that the Province has made significant, positive changes to the public-private partnership process which should benefit future school construction projects.

Copies of the special report are available at the Nova Scotia Government Bookstore, 1700 Granville St., Halifax, 1-800-526-6575. It can also be viewed at http://www.gov.ns.ca/legi/audg/ on the Internet.

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