

2022-2023 Consolidated Financial Statements of the Province of Alberta

Report of the Auditor General
December 2023

**Auditor
General**
OF ALBERTA

Introduction

We prepared this chapter to help readers of the Province's Consolidated Financial Statements understand our audit and the audit matters or items that in our professional judgement were most significant to the audit of the Province's Consolidated Financial Statements. These include accounting for environmental liabilities, and the implementation of the new public sector accounting standards related to asset retirement obligations, financial instruments, and foreign currency.

Treasury Board and Finance is responsible for preparing the Province's Consolidated Financial Statements and ensuring that transactions and events are fairly presented in accordance with Canadian Public Sector Accounting Standards (PSAS). It is our responsibility to express an independent opinion that provides reasonable assurance that the consolidated financial statements are free of material misstatement and are fairly presented in accordance with PSAS.

We issued a clean (unqualified) audit opinion for the Province's Consolidated Financial Statements. Based on our work, we have concluded the 2022–2023 financial statements are fairly presented in accordance with PSAS.

Background

The Province's Consolidated Financial Statements account for the financial affairs and resources of the province. It includes the financial results of departments; regulated funds; agencies, boards, and commissions such as schools, universities, colleges, and health entities such as Alberta Health Services; the Legislative Assembly, and offices of the legislature; and government business enterprises such as ATB Financial and the Alberta Petroleum Marketing Commission. The financial statements provide a comprehensive view of the revenues that the province recognized, its spending on various programs for 2022–2023, and its financial position at March 31, 2023.

The Office of the Controller is responsible for preparing the financial statements in accordance with PSAS. These standards ensure the financial information is presented fairly and on a comparable basis to prior years and to other governments. Departments, provincial agencies, and crown-controlled organizations are responsible for:

- implementing internal controls related to the collection and disbursement of money and safeguarding of assets
- ensuring transactions comply with applicable legislation and regulations
- ensuring transactions are properly recorded in financial systems to reflect the substance of the transactions in accordance with the applicable financial reporting frameworks

Management also uses judgement to prepare estimates included in the consolidated financial statements. The significant estimates include, for example, income taxes and asset retirement obligations.

Understanding the financial statements

The Province's Consolidated Financial Statements provide information for Albertans and Members of the Legislative Assembly. They tell an important story about the province's financial position and the financial results for the year ended March 31, 2023. They show how much revenue the government recognized, and the sources and degree of uncertainty in estimating some of those revenues such as income taxes. The financial statements also provide accountability information to show how money was spent compared to approved budgets and in which areas, such as healthcare and education. The financial statements further provide information about the province's financial assets, liabilities, capital assets, and which departments exceeded its budget appropriation.

The *Government of Alberta Annual Report 2022–2023* includes a Budget 2022 Key Results section that supplements the financial statements. The government also publishes the *2022–2023 Final Results—Year-end Report*² with the annual report. These reports provide additional explanations for significant variances from budgets and prior years' financial results.

In addition, ministry annual reports³ include more detailed financial results of ministry revenues and expenses, comparing actual results to the budget approved by the Legislative Assembly and to prior-year results. The ministry annual reports also include financial information about significant programs and information required by legislation, such as reporting payments under agreements.

² <https://open.alberta.ca/dataset/7714457c-7527-443a-a7db-dd8c1c8ead86/resource/e700b94a-bf65-49d1-bdac-af4915338c2c/download/tbf-go-2022-2023-final-results-year-end-report.pdf>.

³ <https://www.alberta.ca/government-and-ministry-annual-reports.aspx>.

Audit Opinion on 2022-2023 Consolidated Financial Statements

The Office of the Auditor General, under the *Auditor General Act*, is responsible for the annual audit of the Province's Consolidated Financial Statements. The objective of our audit is to provide reasonable assurance that the consolidated financial statements are free of material misstatement and are presented fairly in accordance with PSAS.

On June 16, 2023, we issued a clean (unqualified) audit opinion on the Province's Consolidated Financial Statements for the year ended March 31, 2023. A clean audit opinion means that we concluded, based on obtaining sufficient and appropriate audit evidence, that the financial statements are free of material misstatement and are presented fairly in accordance with PSAS.

This year, requirements came into effect to report *Key Audit Matters* (KAMs) in the auditor's report that we decided to apply in our audit of the Province's Consolidated Financial Statements. KAMs are those matters that, in the auditor's professional judgment, were of most significance in the audit of the current period's financial statements. This includes areas of significant risks, or that require significant management or auditor's judgment. The purpose of communicating KAMs is to enhance the communicative value of the auditor's report by providing greater transparency about the audit that was performed. It also provides intended users a basis to further engage with management and those charged with governance about certain matters relating to the entity, the audited financial statements, or the audit that was performed.

We communicated KAMs in our auditor's report on the Province's Consolidated Financial Statements for the year ending March 31, 2023. We identified the adoption of the new PSAS standards on asset retirement obligations and financial instruments, and the accounting for environmental liabilities as KAMs. We discuss these in more detail below.

As part of our audit, we are required by Canadian Auditing Standards to:

- understand the entities and business activities included in the Province's Consolidated Financial Statements
- assess the risks of material misstatement
- perform appropriate audit procedures to obtain sufficient and appropriate audit evidence to support our conclusion
- evaluate and conclude whether the Province's Consolidated Financial Statements fairly present the financial position, results of its operations, its remeasurement gains and losses, its changes in net debt, and its cash flows

Our audit included consideration of internal control to design audit procedures, but was not for the purpose of expressing an opinion on the effectiveness of internal control, and is not designed to identify all matters that may be of interest to users. Internal control and other matters are limited to those we identified during the audit.

An effective and efficient internal control program that mitigates key financial and operational risks is an essential part of any organization. A key part of such an internal control program is evaluating the substance of transactions and events based on applicable accounting standards to ensure the complete, accurate and appropriate accounting and disclosures in financial statements. In an environment where financial and operational risks are continually changing and emerging, a structured program for internal controls can assist an organization in identifying, assessing, and responding when appropriate to the changing environment. Effective internal controls ensure reliable financial reporting; effective and efficient operations; and compliance with legislation and internal policies.

This year, agencies, boards and commissions, and departments who follow public sector accounting standards adopted the new accounting standard for asset retirement obligations (AROs). The Office of the Controller developed a new accounting policy for AROs and a guide for financial instruments. Departments also implemented the new financial instrument standards and were impacted by the government reorganization announced on October 24, 2022. The reorganization created some new ministries, dissolved some existing ministries, and transferred responsibilities for many government programs to new or existing ministries.

Management of each entity is responsible to implement systems to adopt new accounting standards and comply with the province's accounting policies. In general, we found most entities had effective processes and controls to adopt the new accounting standards. However, we initially identified weaknesses in some entities' processes to implement and comply with the new ARO standard. This included weaknesses to assess relevant legislation, identify assets with asset retirement obligations, estimate the costs to complete the work, and determine when to start amortizing the ARO asset. Management of the entities resolved the issues identified, and adjusted the ARO liabilities, ARO assets, amortization, and opening net assets in order for us to issue an opinion on the Province's Consolidated Financial Statements.

Several departments did not meet Treasury Board and Finance's timelines to prepare information required for the Province's Consolidated Financial Statements. Some departments also had significant staff turnover. The government reorganization required changes to the 1GX enterprise resource planning system to enable the Office of the Controller to prepare the Province's Consolidated Financial Statements based on the new government structure and responsibilities. While there were some automated tools used to transfer capital assets and related balances, most of the work required significant manual efforts from departments' finance staff. This together with the staff turnover in some departments created delays in preparing financial information needed to prepare the Province's Consolidated Financial Statements.

Included in the ministry chapters in this report are the recommendations that we made to individual entities in areas for improvement in their financial reporting processes.

Key Audit Matters

Our audit of the 2022–2023 *Consolidated Statements of the Province of Alberta* focused on the following key risks—or those matters that, in our professional judgement, were of most significance—during our audit:

- environmental liabilities
- adoption of the public sector accounting standard for asset retirement obligations
- adoption of the public sector accounting standards for financial instruments and foreign currency translation

The communication of key audit matters does not alter in any way our opinion about the consolidated financial statements, taken as a whole, and we are not, by communicating the key audit matters below, providing separate opinions about the key audit matters or the accounts or disclosures to which they relate.

Environmental Liabilities

Overview of risk

At March 31, 2023, the Province’s Consolidated Financial Statements included \$117 million for environmental liabilities (Schedule 12 of the Province’s Consolidated Financial Statements). This represents future funding required to comply with environmental legislation. During the year, the province reclassified \$215 million for the reclamation costs for the Swan Hills treatment plant and sand and gravel pits from environmental liabilities to Asset Retirement Obligations.

Under environmental legislation, the province is responsible to clean up contamination on sites that it owns and operates. The government has also accepted responsibility to clean up contamination on some orphan sites created by industrial activity over the last century before and after current environmental laws and standards existed. There is also a significant number of sites across various industries (such as coal mines and wood treatment) where, in government’s capacity as a regulator, environmental liabilities can exist due to care and custody work required to ensure a site does not pose an undue risk to Albertans and the environment.

We identified accounting for environmental liabilities as a key audit matter since:

- there are a significant number of sites where responsibility for who will do the work and/or costs of required work to protect people and the environment have not been established
- our *Processes to Provide Information about Government’s Environmental Liabilities, Report of the Auditor General—June 2021*,⁴ describes weaknesses related to the processes to provide information about environmental liabilities
- it requires significant interpretation of environmental law and standards to determine who is responsible to do the work when private operators will not do the work or no longer exist
- it requires significant expertise to assess the nature and extent of contamination and the work required to remediate and reclaim sites, and then to estimate the costs to do that work

⁴ <https://www.oag.ab.ca/reports/oag-governments-environmental-liabilities-fs-june-2021/>.

What we examined

Where the province recorded environmental liabilities in the Province's Consolidated Financial Statements, we audited those liabilities by reviewing engineering reports, assessing, and verifying if management's estimates and assumptions are reasonable.

We also audited a sample of sites across various entities where management did not record a liability and reviewed management's assumptions and explanations.

We also assessed the appropriateness of the disclosures in the consolidated financial statements against the standards for disclosures required by PSAS.

What we found

We conclude that management's estimates of environmental liabilities in the Province's Consolidated Financial Statements are reasonable, and the disclosures comply with public sector accounting standards. We have identified areas where processes to provide information on environmental liabilities and financial statement disclosures can be improved. These areas are discussed further below.

Context

Public Sector Accounting Standards⁵ require management to prepare a best estimate of the costs necessary to remediate and reclaim a site to an appropriate level for its specific use as well as the costs for any post-remediation operations, maintenance, and monitoring activities. This includes sites that the government owns and operates (e.g., highway maintenance yards), sites where a statutory environmental inspector determines additional reclamation work is necessary after certain legislative warranty periods expire from the date a reclamation certificate was issued, and other sites where the government accepted responsibility to manage, remediate and reclaim the site. This provides decision makers with information about the future funding required to comply with environmental legislation to protect people and the environment.

Accounting for environmental liabilities is complex and requires significant judgements and reliance on experts and the province's environmental regulatory systems. Our *Processes to Provide Information about Government's Environmental Liabilities, Report of the Auditor General—June 2021*,⁶ describes weaknesses related to the processes to provide information about environmental liabilities. We found:

- within Environment and Protected Areas and the Alberta Energy Regulator (AER) there is a lack of clarity about who is responsible for certain sites, and in cases where the province has accepted responsibility or is responsible, who will do the work for certain sites
- there is a lack of clarity around funding sources available to AER to manage, and where needed, clean up (remediate and reclaim) sites for which they are responsible in the oil and gas and coal industries
- Environment and Protected Areas and AER need to improve processes to prioritize sites and maintain up-to-date cost estimates to manage and clean up sites
- Transportation and Economic Corridors needs to improve its processes to account for environmental liabilities related to its sand and gravel pits and highway maintenance yards
- Transportation and Economic Corridors must improve its processes to comply with environmental legislation at its highway maintenance yards

⁵ PS 3200—Liabilities, PS 3260—Liability for contaminated sites, and PS 3300—Contingent liabilities.

⁶ <https://www.oag.ab.ca/reports/oag-governments-environmental-liabilities-fs-June-2021/>.

Improvements to these processes are necessary to ensure government decision-makers, Members of the Legislative Assembly and Albertans are supplied with important and current information about the government's environmental liabilities. As a result in 2021, we recommended that:

- Environment and Protected Areas develop guidance to determine who is responsible for cleanup work
- Environment and Protected Areas and AER complete case-by-case assessments of sites to determine who is responsible and what work is required
- Transportation and Economic Corridors improve its processes to assess, estimate, and account for its environmental liabilities
- Transportation and Economic Corridors improve its processes to ensure compliance with environmental legislation

The respective entities are in the process of making improvements, but further work remains to fully implement the recommendations. Given the importance of these recommendations, we plan to assess the implementation of these recommendations in the upcoming year.

Based on the polluter pay principle, private operators and the industry-funded Orphan Well Association (OWA) are responsible to clean up sites they are responsible for. However, there are a significant number of sites where responsibility for who will do the work and/or costs of required work to protect people and the environment are unknown. It requires interpretation of environmental law and standards to determine who is responsible to do the work when private operators will not do the work or no longer exist. For example, the OWA is not responsible to clean up “legacy” sites left behind by oil and gas activity that took place before current environmental laws and standards existed.

As we reported on page 21 of our *Liability Management of (non-oil sands) Oil and Gas Infrastructure, Report of the Auditor General—March 2023*,⁷ the Alberta Energy Regulator (AER) was awaiting policy direction from the provincial government regarding administration and funding for legacy sites. There are also legacy sites from other industries like coal mines, wood treatment sites and sand and gravel pits where operators no longer exist and where no backstop exist, like the OWA to clean up orphan and legacy sites. Environment and Protected Areas and the AER (as regulators of environmental legislation) are responsible to monitor these sites and to identify a responsible party to complete the required work. In some cases, they may not be able to identify a responsible party.

Accounting for environmental liabilities requires the work of specialists like engineers, to determine the type and extent of contamination, the work required to remediate and reclaim sites, and the estimated costs to do that work. It also requires an assessment of who is responsible to do that work. As a result, a liability estimate to remediate and reclaim sites may not be determinable if key information is lacking. Over time, as more information (like an environmental assessment) is obtained through effective environmental management systems, it is more likely a reasonable estimate can be made. PSAS recognizes all the information needed may not be immediately available; as a result, there is a requirement to disclose the reasons why the province did not record a liability and that it may need to record a liability in the future.

⁷ <https://www.oag.ab.ca/reports/oag-liability-management-of-non-oil-sands-oil-and-gas-infrastructure>.

PSAS requires the province, when it has not recorded a liability, to disclose if the responsible party is unknown or a reasonable cost estimate cannot be made. This informs readers of the province's financial statements there is a risk that the use of public money may be necessary to cover the costs to clean up and restore certain sites in the future. Note 8(e) of the Province's Consolidated Financial Statements discloses information where the province did not record a liability and the reasons why.

As we indicated last year,⁸ although the disclosures comply with PSAS, we believe that management can further improve the disclosures to provide more comprehensive information about current and potential future environmental liabilities. This includes providing additional information about the total number of sites, the number of sites for which it has not recorded a liability, the number of sites where the responsible party are still unknown, and the undiscounted value of recorded liabilities. This will provide better information to readers about the risks that the province is exposed to.

Adoption of the New Public Sector Accounting Standard for Asset Retirement Obligations

Overview of risk

The province adopted a new accounting standard for Asset Retirement Obligations that prescribes how the province should account for liabilities arising from legal obligations to retire tangible capital assets. At March 31, 2023, the province recorded \$2.3 billion in asset retirement obligations (Schedule 12 of the Province's Consolidated Financial Statements). The majority relates to removing asbestos in the province's buildings.

We identified this as a key audit matter since adopting this new standard and estimating these liabilities are complex and requires significant judgements, assumptions, and inputs. It includes identifying legal requirements to retire tangible capital assets, determining the nature and extent of the asset retirement activities required, estimating the costs to complete the work, and determining when that work will be completed.

What we examined

We:

- tested management's processes to identify the nature and extent of what work the province must do to retire its tangible capital assets
- evaluated management's methodology, data, and assumptions to estimate the costs to complete the work. This included evaluating management's assessment and conclusions on the use of present value techniques
- verified the reasonableness and accuracy of management's estimated costs to retire its tangible capital assets by comparing its data and assumptions to engineering reports and other supporting documents
- verified that management implemented the standard in accordance with the standard's transitional provisions

⁸ *Report of the Auditor General—November 2022*, page 19.

What we found

We conclude that management's estimates of asset retirement obligations in the Province's Consolidated Financial Statements are reasonable, and the disclosures comply with public sector accounting standards.

Context

The province adopted the new PS 3280—Asset Retirement Obligations (ARO) on a modified retroactive approach, with restatement of the 2022 comparative results. The new standard requires the province to account for liabilities arising from legal obligations to retire a tangible capital asset. At March 31, 2023, ARO liabilities are estimated to be \$2.3 billion, with the majority related to removing asbestos from government buildings. It also includes \$215 million that were previously recorded under environmental liabilities such as the estimated reclamation costs for the Swan Hills treatment plant and sand and gravel pits.

Key changes under the new standard include the following:

- a liability is recognized for assets with a legal obligation to incur retirement costs. Legal obligations can arise from legislation, contracts, and promissory estoppel.
- asset retirement costs are included in the carrying amount of the related asset when they are in productive use and amortized to expense over the assets' useful life, and expensed when not in productive use
- an accretion expense is recorded for any change in the liability from the passage of time when present value techniques are used
- adjustment to the opening balance of the accumulated surplus / deficit in the year the standard is adopted

The adoption of the new standard required entities consolidated in the Province's Consolidated Financial Statements to:

- identify legal requirements to retire tangible capital assets. This involves federal and provincial legislation, regulations as well as contracts such as lease contracts
- determine the nature and extent of the asset retirement activities required. This required use of specialists such as engineers to determine the nature and extent of asset retirement activities. For example, entities had to determine if there are hazardous materials such as asbestos and lead in buildings, the type of hazardous materials and the extent of it. Based on this, entities had to then estimate the costs to complete the required work and determine when that work will be completed. As a result, there are significant judgments and estimates on the nature and extent of hazardous materials and the estimated costs to remove those materials.

We found most entities had effective processes and controls to adopt the new accounting standards. However, we initially found weaknesses in some entities' processes to implement and follow the new asset retirement obligations standard. This included weaknesses to comprehensively assess relevant legislation, identify assets with asset retirement obligations, estimate the costs to complete the work, and determine when to start amortizing the ARO asset. Management of the entities resolved the issues that we found, and adjusted the ARO liabilities, ARO assets, amortization, and opening net assets in order for us to issue an opinion on the Province's Consolidated Financial Statements.

While a significant focus for entities was the adoption of the new standards, we encourage entities to also ensure that they maintain effective processes to comply with ongoing requirements in the standards, such as updating and maintaining information about the nature and extent of ARO requirements, the work required, and updating cost estimates.

Adoption of the New Public Sector Accounting Standards for Financial Instruments and Foreign Currency Translation

Overview of risk

Effective April 1, 2022, the province adopted the new public sector accounting standards for financial instruments and foreign currency translation. The new standards included significant changes to the measurement and disclosures for financial instruments in the Province's Consolidated Financial Statements. The significant measurement impacts to the recording of financial instruments included increasing the opening net assets of the province by \$2.8 billion, mostly due to the difference in the book value and fair values of portfolio investments, and separately recording \$1.1 billion in derivative financial assets and \$1.9 billion in derivative financial liabilities on the statement of financial position. Key definitions related to financial instruments are included in the glossary within the Government of Alberta Annual Report 2022–2023.

We identified the adoption of the new standards as a key audit matter since there are significant changes to the way financial instruments are measured and disclosed in the Province's Consolidated Financial Statements. This requires significant judgements and assumptions to determine the fair values of private equities, inflation sensitive and alternative investments.

What we examined

We:

- examined the opening and closing balances for the statement of remeasurement gains and losses and the calculation of unrealized gains and losses on translation of foreign debt, valuation of derivatives and portfolio investments
- evaluated management's processes for valuing and disclosing derivatives on the statement of financial position
- verified the existence and valuation of derivatives by examining derivative contracts, inputs used in valuation calculations and counterparty balances
- reviewed the appropriateness and accuracy of quantitative and qualitative disclosures of the nature and extent of risks associated with debt, loans, derivatives and portfolio investments
- verified that management appropriately implemented the standard's transitional provisions

What we found

We found that the province appropriately accounted for and disclosed financial instruments in the consolidated financial statements. We concluded that the valuation of derivative financial instruments, portfolio investments and foreign currency translation and the financial instrument disclosures were reasonable.

Context

Effective April 1, 2022, the province adopted a new set of accounting standards to account for financial instruments and foreign currency translation. The new standards included significant changes to the measurement and disclosures for financial instruments in the Province's Consolidated Financial Statements.

Key differences in the province's financial statements prior to and after adoption of the new financial instruments' standards are as follows:

	Prior to the Adoption of the New Financial Instruments Standards	After Adoption of the New Financial Instruments Accounting Standards
Portfolio investments	- recorded at amortized cost, with book value of \$33.4 billion - fair value of \$36.3 billion was only disclosed in Schedule 6 of the financial statements	- recorded at fair value when managed on a fair value basis - unrealized gains and losses recorded in the consolidated statement of remeasurement gains and losses - investments recorded at \$36.3 billion
Debt	- recorded at amortized cost - foreign debt translated at the exchange rate established by hedging derivative financial instruments	- recorded at amortized cost - foreign debt translated at year-end exchange rates - unrealized foreign exchange translation gains and losses recorded in the consolidated statement of remeasurement gains and losses
Derivative financial instruments	- recorded and accrued only as payments were due - derivatives used to hedge foreign currency risk recorded together with debt as one financial instrument based on the foreign exchange rate established by the derivative financial instrument	- recorded at fair value - derivative financial instrument assets and liabilities recorded separately on the consolidated statement of financial position
Net assets	net assets on the consolidated statement of financial position included accumulated operating surpluses (deficits) but did not include remeasurement gains and losses	- net assets on the consolidated statement of financial position split between accumulated surpluses (deficits) and accumulated remeasurement gains and losses - new statement of remeasurement gains and losses shows the change in accumulated remeasurement gains and losses for the year
Fair value hierarchy disclosures	no disclosure	financial instruments recorded at fair value categorized into three levels that are based on the level of subjectivity involved in estimating the fair values
Financial risk management disclosures	limited requirements for disclosure	extensive requirements for disclosing qualitative and quantitative information about the nature, extent and management of financial risks related to each financial instrument