



Office of the Ombudsman  
Final Report

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Municipal Loan Guarantees  
File #50268

May 2011

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## **Introduction**

This is the final report of the Nova Scotia Office of the Ombudsman into a complaint initiated by the Ombudsman, on his own motion, pursuant to Section 11 of the Ombudsman Act. This investigation focused on whether the Town of Shelburne, Municipality of the District of Argyle, Municipality of the District of Barrington, Town of Clark's Harbour, Town of Lockeport, Municipality of the District of Shelburne, Municipality of the District of Yarmouth, Town of Yarmouth, and the Municipality of the District of Clare granted loan guarantees and loans to the former regional development authority South West Shore Development Authority (SWSDA) contrary to the Municipal Government Act (MGA). The investigation also examined Service Nova Scotia and Municipal Relations' (SNSMR) oversight of, and advice to the municipal units in this matter.

On March 10, 2011 in keeping with the requirements under Section 20(5) of the Ombudsman Act, this Office released a consultative document to the nine (9) municipal units and the Deputy Minister of SNSMR.

This consultative document outlined the evidence gathered during the investigation and provided findings based on the evidence to date. The respondents were given 30 days to review the document and provide any new information, or provide clarity around material to assist the Ombudsman in this investigation. A response was provided by SNSMR and has been incorporated in this report. The municipal units did not respond to the consultative document.

## **The Investigation**

In February 2010, this Office released a report examining issues raised by concerned citizens regarding SWSDA. This report noted issues outside the scope of the original investigation which alleged municipal units may have granted loan guarantees and/or other financial assistance to SWSDA that were not in keeping with the authority provided under the MGA.

In July 2010, notification, in accordance with Section 15 of the Ombudsman Act, was provided to the CAOs of the nine (9) municipal units involved with SWSDA. In November 2010, subsequent notification was provided to the Deputy Minister of SNSMR.

## **Relevant Legislation**

Ombudsman Act  
Municipal Government Act  
Financial Reporting and Accounting Manual

## **Background**

SWSDA was incorporated under the Societies Act on August 11, 1995. It was recognized as the regional development authority for the Town of Shelburne, Municipality of the District of Argyle, Municipality of the District of Barrington, Town of Clark's Harbour, Town of Lockeport, Municipality of the District of Shelburne, Municipality of the District of Yarmouth, Town of Yarmouth, and the Municipality of the District of Clare.

SWSDA, like other regional development authorities, was created at the request of the municipalities and was the municipal vehicle responsible for economic development in the community. SWSDA was directed by a Board of Directors, which consisted of municipal and community representatives, as outlined in the organization's bylaws. Core and project funding were provided by federal, provincial, and municipal levels of government. Each funding partner was responsible for one third of the core funding. Project funding was separate and did not necessarily have contributions from each funding partner.

Currently SWSDA is no longer operational and has filed a notice of intention to make a proposal under the Bankruptcy and Insolvency Act.

## **Municipal Guarantees**

SWSDA had obtained an operating line of credit through the Royal Bank of Canada (RBC) in the amount of \$500,000.00 prior to 2004. In 2004, the CEO of SWSDA requested eight (8) of the municipal units (Municipality of the District of Clare was not a member until 2005) to guarantee the existing line of credit. SWSDA's reasons for having the municipalities secure this existing line of credit are not clear as this Office was denied access to the files at RBC.

Documentation provided indicates SWSDA wanted access to bridge financing for the various projects it was undertaking. The line of credit provided SWSDA with additional funds to move projects forward while waiting for project funding from the respective funding partner(s).

SWSDA proposed the amounts for each municipal unit to guarantee, following a funding formula similar to the one that was used to determine individual municipal core funding to the organization. The proposed guarantees totaled three times the amount the municipalities provided collectively for yearly core funding.

Each respective municipal unit discussed the request. The municipalities of Argyle, Clark's Harbour, Lockeport, Barrington, Shelburne, Town of Yarmouth, and Yarmouth passed motions of Council in support of providing guarantees for the existing line of credit. The Town of Shelburne adopted the minutes of its finance committee. Loan guarantees were signed by the Chief Administrative Officers (CAOs) or Clerks and Mayors or Wardens of each municipality.

Letters were sent to SWSDA advising approval from the various Councils on the matter. Copies of the signed loan guarantees were provided by RBC. With the exception of the Municipalities of the Districts of Barrington and Yarmouth, the remaining municipal units did not have copies of the documents for their records.

No documentation was provided to this Office to support that the Councils sought advice from SNSMR or municipal solicitors prior to adopting motions to approve the loan guarantees for SWSDA. Each municipal unit captured this contingent liability as a note in their audited financial statements. These audited financial statements were submitted annually to SNSMR. During the course of the investigation, municipal units acknowledged to this Office that there was no authority under the MGA to provide these guarantees, and that in essence the guarantees are not valid. SNSMR advised they are of the same opinion.

The following indicates amounts each municipality agreed to guarantee:

| <b>Municipality</b>                         | <b>Amount Guaranteed</b>     |
|---|------------------------------|
| Municipality of the District of Yarmouth    | \$116,750.00                 |
| Municipality of the Argyle                  | \$100,750.00                 |
| Municipality of the Town of Yarmouth        | \$95,750.00                  |
| Municipality of the District of Barrington  | \$92,250.00 *                |
| Municipality of the District of Shelburne   | \$84,105.00 & \$61,500.00 ** |
| Municipality of the Town of Shelburne       | \$22,500.00                  |
| Municipality of the Town of Clark's Harbour | \$12,000.00                  |
| Municipality of the District of Lockeport   | \$8,500.00                   |
| Municipality of the District of Clare       | Not a member until 2005      |
| <b>Total</b>                                | <b>\$594,105.00</b>          |

\* RBC documents signed by the Municipality of the District of Barrington are for \$92,250.00, however Council approved \$82,250.00. When asked about the discrepancy, Ombudsman Representatives were advised it was an error at time of signing that was not captured.

\*\* The Municipality of the District of Shelburne signed a previous loan guarantee for SWSDA in 2003 in the amount of \$84,105.00 which is tied to the former military base, CFS Shelburne.

The MGA is explicit in its authority for municipalities to grant guarantees and only permits it in four (4) cases:

- Section 60(4)(b) – municipality can guarantee the borrowings of an inter-municipal services corporation;
- Section 89 – municipality can guarantee the borrowings of a village located partly or wholly within the municipality;
- Section 294(6) – municipality may grant a guarantee to a fire department for capital or operating expenses; or
- Section 295(6) – municipality may grant a guarantee to an emergency services provider for capital or operating expenses

Also, Section 88 of the MGA does not authorize a guarantee without Ministerial approval:

88 (1) No money shall be borrowed by a municipality, village, committee created by an intermunicipal services agreement or service commission pursuant to the provisions of this Act or another Act of the Legislature until the proposed borrowing has been approved by the Minister.

88 (3) A guarantee by, or on behalf of, a municipality, village or service commission of a borrowing or debenture is not effective unless the Minister has approved of the proposed guarantee.

In February 2011, RBC sent notification to all the municipal units demanding repayment of the line of credit by March 23, 2011 as SWSDA had defaulted on its obligations.

## **Findings**

Councils in question approved guarantees to an existing operating line of credit for SWSDA, which are outside the authority permitted within the MGA. As well, the Municipality of the District of Shelburne's guarantee to SWSDA pertaining to CFS Shelburne is outside the permitted authority of the MGA. Elected officials and senior municipal staff have a responsibility to understand the legislative authorities and corresponding parameters guiding them in the exercise of their duties. Operating outside of these parameters compromises public confidence, and raises issues of accountability, responsibility, and reporting obligations. I find these municipal units and individuals have administered the law wrongly and contrary to law as contemplated under Section 20(1)(c) & (d) of the Ombudsman Act. Furthermore, I am of the view payment of these loan guarantees would constitute another breach of the MGA.

## **Loans**

In 2006, the acting CAO for the Municipality of the District of Shelburne questioned the authority municipalities had to grant certain types of guarantees. He brought forward his concerns to the area's Municipal Advisor and his municipal solicitor. Ongoing dialogue occurred between the parties and on May 31, 2007, the area Municipal Advisor sent correspondence and Bulletin no.19 (Appendix A) to all the municipal units associated with SWSDA. He advised them the MGA did not permit loan guarantees for the regional development authority.

In 2008, the CEO of the regional development authority approached the municipal units on behalf of SWSDA requesting an increase in the line of credit to \$700,000.00. The Municipality of the District of Barrington requested advice from SNSMR on the matter. Municipal Advisors from SNSMR further advised the municipalities that without Ministerial approval (Section 88 of MGA), there was no authority to grant this type of guarantee, however, the municipalities may still attract liability for the previous guarantees of 2004. Also, the provisions of the MGA would not permit such Ministerial approval to be granted. SNSMR indicated the only way to have authority to grant such guarantees to SWSDA would be to have amendments made to the MGA. Municipal Relations staff provided briefings regarding the matter to the Deputy Minister and Minister of SNSMR as well as the Premier. No documentation was provided to suggest SNSMR or the Province took corrective action in this matter.

The nine (9) municipalities agreed that a request would go forward to the Union of Nova Scotia Municipalities (UNSM) for amendment to the MGA providing for guarantees to regional development authorities. Pending resolution of the proposed amendment, Municipal Councils collectively approved and forwarded \$200,500.00 to SWSDA. Seven (7) of the nine (9) municipalities capture this as a repayable grant or repayable contribution. Clark's Harbour and the Town of Yarmouth have captured this money as an advance and both have clarified with this Office that the money would have been deducted from the following year's core funding to SWSDA. Documentation reviewed has not shown these two municipal units reduced SWSDA's core funding in the 2009 - 2010 fiscal year.

Municipal expectations were that SWSDA would repay the money once the proposed amendments to the MGA were approved allowing for them to secure an increase in the line of credit. The proposed amendments were not accepted by SNSMR.

Municipalities captured these amounts on their audited financial statements as receivables and submitted them annually to SNSMR.

The following indicates amounts each municipality provided to SWSDA:

| <b>Municipality</b>                         | <b>Amount Provided</b> |
|---|------------------------|
| Municipality of the District of Clare       | \$116,600.00           |
| Municipality of the District of Yarmouth    | \$20,000.00            |
| Municipality of the District of Argyle      | \$16,600.00            |
| Municipality of the District of Barrington  | \$14,700.00            |
| Municipality of the Town of Yarmouth        | \$14,200.00            |
| Municipality of the District of Shelburne   | \$10,000.00            |
| Municipality of the Town of Shelburne       | \$4,200.00             |
| Municipality of the Town of Clark's Harbour | \$2,500.00             |
| Municipality of the District of Lockeport   | \$1,700.00             |
| <b>Total</b>                                | <b>\$200,500.00</b>    |

Sections 57 and 65 of the MGA set out the authority in which a municipality is able to provide grants:

Section 57 (1) A municipality may: (c) pay grants to a body corporate for the purpose of promoting the municipality or any part of the municipality and the surrounding areas as a location for institutions, industries and businesses; or

Section 65 The council may expend money required by the municipality for (au) a grant or contribution to (i) a society within the meaning of the Children and Family Services Act, (ii) a mental health clinic in receipt of financial assistance from the Province, (iii) an exhibition held by an educational institution in the municipality, (iv) a club, association or exhibition within the meaning of the Agriculture and Marketing Act, (v) any charitable, nursing, medical, athletic, educational, environmental, cultural, community, fraternal, recreational, religious, sporting or social organization within the Province, (va) a day care licensed under the Day Care Act, (vi) a registered Canadian charitable organization, and the municipality shall publish annually a list of the organizations and grants or contributions made pursuant to this clause in a newspaper circulating in the municipality.



## **Findings**

Councils in question expended public dollars to SWSDA outside the authority provided in Sections 57 and 65 of the MGA. Municipalities identified these financial contributions as grants, however, once the term repayable is used it ceases to be a grant and becomes a loan. The Towns of Yarmouth and Clark's Harbour captured these expenditures as advances of core funding, however, did not show how the monies were recouped during the next fiscal year and still show them as receivables owing to date.

I find these municipal units have made loans to SWSDA outside of the authority provided in the MGA. Municipal Councilors are custodians of public funds and have a responsibility to ensure spending is within the legislative authority provided. Taxpayers naturally expect elected officials to ensure funds are administered according to law and in the best interest of the public. I find these municipal units and individuals have administered the law wrongly and contrary to law as contemplated under Section 20(1)(c) & (d) of the Ombudsman Act. This money was expended outside the authority provided in the MGA and should be recovered.

This situation identifies a gap within the structure of SNSMR. SNSMR has an embedded oversight role within the MGA and currently there is no structure to adequately address issues as they arise.

## **Audited Financial Statements and Registered Municipal Auditors**

Section 451 of the MGA provides the Minister of SNSMR the authority to prescribe the accounting methods municipal units are required to administer. Section 457 requires municipalities to engage registered municipal auditors and sets out the procedure for this registration. These municipal auditors are required to complete the annual audited financial statements of municipalities. While there is no requirement for these individuals to have an understanding of the MGA, the Finance Reporting and Accounting Manual (as set by Regulation) sets out the obligations of the registered municipal auditor, as well as the municipal audit committees.

Section 5.4 of the Finance Reporting and Accounting Manual states:

The auditor should adhere to examination standards as outlined in the CICA [Canadian Institute of Chartered Accountant] Handbook.

In addition, the auditor must ensure that the municipality has performed its duties in accordance with the particular Act(s) and special legislation under which it is governed, including, but not limited to, the following:

- (a) the approval of the Minister of Service Nova Scotia and Municipal Relations for:
  - (1) borrowings by a municipality other than borrowing for the purpose of providing for payment of part of the annual expenditures, a guarantee of a borrowing or a long-term commitment that exceeds \$100,000.00;

- (2) the issuance of debentures or other term debt; . . .
- (e) the verification that all expenditures incurred (capital and operating) were spent on items for which the municipality had authority;
- (f) the approval of municipal council for commitments and expenditures incurred by the administration on behalf of the municipality.

Municipalities are required to provide audited financial statements annually to SNSMR. Our investigation showed the nine (9) municipal units involved submitted the required financial statements and recorded the guarantees as contingent liabilities in the notes of their statements, and the repayable grants as receivables. All financial statements were completed by registered municipal auditors as contemplated in the MGA.

Generally, these audited financial statements are submitted to SNSMR for:

- preparation of annual municipal statistical reports;
- preparation of municipal indicator ratios;
- Stats Canada reporting
- report to the NS Department of Finance;
- data used for calculation of grants, such as equalization; and
- debt ratio calculations.

Ombudsman Representatives were advised by SNSMR that these financial statements are not reviewed through a lens to ensure compliance with the MGA.

## **Findings**

Ombudsman Representatives were not provided any evidence to indicate any of these registered municipal auditors advised CAOs or Councils of these potential breaches or provided management letters regarding concerns regarding compliance with the MGA.

I believe it is reasonable to conclude that the purpose of having a list of registered municipal auditors, which municipalities are required to use, is to provide another level of financial control. Without SNSMR requiring or providing annual training regarding the MGA for these individuals I question the merit of the system as it is currently designed. Review of the purpose of having this selected list and how the application of the MGA applies to the financial statements is required.

Also, there appears to be a gap in the system with respect to municipal compliance with the MGA. SNSMR requires municipalities provide annual audited financial statements, but does not review them through a compliance or enforcement lens. In this instance, nine (9) municipal units were reporting violations in the loaning and guaranteeing of public dollars, submitting these violations to SNSMR yearly and the Department has no systems in place to identify these compliance infractions. A review of SNSMR's role in this matter is required.

## **Conclusion**

Elected officials of the municipalities identified in this report approved the expenditure of public dollars to SWSDA outside the authority provided in the MGA. As a result, taxpayers have lost \$200,500.00 to loans and there is a demand to pay in excess of \$590,000.00 which Councils guaranteed with no authority. The municipal units showed a lack of due diligence in the stewardship of this money and administered funds contrary to law as contemplated in the MGA.

Nova Scotians have the right to expect that elected officials and staff, both provincially and municipally, will administer and oversee public funds appropriately, and have an understanding of the authorities that govern their duties. Elected officials are accountable for the decisions they make, and a lack of knowledge of the MGA is not a defense for mal-administration of the law or public funds.

I am of the position the municipalities have no authority to pay the demands on the line of credit. As well, public funds loaned improperly should be recovered. Individual liability, through error and omission insurance may be an avenue to explore, or remedies through the courts. While the relationship between the Province and municipalities is such that municipalities are fairly autonomous, the MGA provides a framework for municipalities to operate and provides certain ministerial responsibilities.

More training and awareness of the MGA is required at the CAO, CFO, and Council levels of municipal government. As well, an identified need for training of registered municipal auditors on the provisions of the MGA is required. This situation saw at least three (3) potential levels of control fail in capturing violations of the MGA. This diminishes public confidence in government.

A re-evaluation, by SNSMR, of the intent of the annual audited financial statements being submitted is required. The infraction of these guarantees were duly noted every year by the municipal units, but never actioned by SNSMR. There appears to be a gap in the enforcement and compliance applications of the Act and requires further examination.

## **Recommendations**

In keeping with Section 20 of the Ombudsman Act I recommend:

1. The loan guarantees not to be paid from public funds;
2. The municipalities recover money expended in 2008 to South West Shore Development Authority relative to the line of credit;
3. Service Nova Scotia and Municipal Relations examine the intent of annual financial audited statements;

4. Service Nova Scotia and Municipal Relations examine the intent of registered municipal auditors;
5. Service Nova Scotia and Municipal Relations provide annual training regarding the Municipal Government Act to chief administrative officers, chief financial officers, municipal elected officials, and registered municipal auditors; and
6. Service Nova Scotia and Municipal Relations examine the identified gap in the oversight role provided within the Municipal Government Act.

Respectfully,

Dwight Bishop  
Ombudsman

# Appendix A

[http://www.gov.ns.ca/snsmr/muns/manuals/pdf/mga/mga\\_info\\_bulletin.pdf](http://www.gov.ns.ca/snsmr/muns/manuals/pdf/mga/mga_info_bulletin.pdf)

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