

INTRODUCTION

1.

OVERVIEW AND SIGNIFICANT ISSUES

INTRODUCTION

1.1 This Report contains the results of the audit work carried out by my Office during 1996. My objective is to provide information to the House of Assembly to aid its members in carrying out their responsibility to hold the government to account for the management of public funds.

1.2 In conducting these audits we adhere to the standards promulgated by the Canadian Institute of Chartered Accountants. We are also guided by the recommendations of the Institute's Public Sector Accounting and Auditing Board.

1.3 This chapter provides a summary of the most significant findings outlined in the Report. The individual chapters provide the results of all our audit activity and identify other issues requiring attention. Those chapters also provide significantly more background and analysis of the findings discussed in this chapter and I caution readers that a fuller understanding would be obtained from reading them. In addition, two, more detailed, special reports were issued during the year, one on Atlantic Lottery Corporation to its shareholder, the Nova Scotia Gaming Corporation, and the second, on the Teachers' Group Insurance Plans, to the Minister of Education and Culture. The chapters in this Report dealing with those are summaries of the detailed reports.

1.4 The Report contains positive commentary on a number of government initiatives, many of which respond to recommendations and observations made in previous Reports. However this year's audit effort identified a number of significant matters warranting further action.

AUDIT MANDATE

1.5 The need to issue Special Reports, as discussed above, both as a result of the need to bring matters forward on a timely basis and in order to respond to specific requests, led me to seek clarification of my reporting mandate under the Auditor General Act. The legal opinion obtained indicates that I have greater flexibility than previously understood with regard to the tabling of both Special Reports and the Annual Report. I intend to use this flexibility in a cautious, responsible manner with the overriding objective of providing important information in a timely manner.

1.6 The legislated structure for the audit of the Province's financial statements, which calls for a chartered accountant appointed under the Provincial Finance Act to perform an audit and report to the Minister of Finance, is inconsistent with the traditional view that the Legislature should be the client for this audit. This matter was discussed extensively by the sub-committee of the Public Accounts Committee in preparing a report that recommends legislative improvements to the accountability structure, but no recommendation was made in this regard.

1.7 I will continue to review the financial statements and provide commentary. The comments on the financial statements for the year ended March 31, 1996 are contained in Chapter 2 and are summarized below.

ACCOUNTABILITY INFORMATION AND REPORTING

1.8 Significant progress is being made to improve the quality of accountability information and reporting by government. The improvements put in place - some supported by specific statutory provisions - coupled with those in progress or planned, put Nova Scotia in much more of a leadership role in relation to public sector accountability. In its 1995-96 report to the House of Assembly the Public Accounts Committee included a number of significant accountability-related recommendations which I encourage government to consider.

ANNUAL FINANCIAL STATEMENTS

1.9 Over the past 2-3 years, improvements made to the Province's financial statements have resulted in more complete and understandable reporting of the surplus/deficit and liabilities than in the past. There are certain issues that have been raised by my Office which have not yet been fully dealt with but are being considered. These include the need for full consolidated financial statements as the primary financial report.

1.10 The annual deficit reported in the Province's financial statements for the year ended March 31, 1996 was \$201,102,000. Net capital expenditures, which form part of this deficit, have been increased by \$50,913,759 of capital commitments. The notes to the financial statements and the supporting *Schedule of Net Capital Expenditures* provide disclosure of this matter. Further, we understand the adjustment was discussed during the public release of the 1996 *Financial Report* on August 8, 1996. We have held various discussions with Department of Finance officials and others with respect to the accounting treatment of these capital commitments. We have been provided with general background information on the discussions leading up to the decision to account for these items in 1995-96 (i.e., see Department of Finance's response to Chapter 2). However, we have not been provided, nor been able to determine, an appropriate basis upon which to justify accounting for the capital commitments as expenditures for 1995-96.

1.11 The \$50.9 million of capital commitments do not represent expenditures "incurred" during fiscal 1995-96, and reporting them as such is inconsistent with the Province's stated basis of accounting. Furthermore, comparisons between fiscal periods (1994-95 to 1995-96 to 1996-97) are affected significantly. Since these commitments would most likely result in expenditures in 1996-97 the effect is compounded.

DEBT MANAGEMENT

1.12 My last two annual reports have included chapters dealing with the results of our review of the government's debt management systems and practices. Due to other audit priorities and pending the availability of formal policies with respect to the use and control of derivatives by Finance, we have not completed a formal audit review in this area for 1996.

1.13 Government, through the Department of Finance, has taken and continues to take action to enhance its policies and practices for the ongoing management and control of the Province's debt and debt-related costs. In this regard, we note that statutory provisions passed in 1996 establish a specific target of 20% foreign debt. However, there were key areas where more detailed plans and specific policies and procedures needed to be established or finalized, including with respect to the use of alternative financial instruments (e.g., derivatives).

1.14 At a Public Accounts Committee meeting in early 1996, Finance undertook to have policies with respect to the use of derivatives drafted by the end of the year. These policies were in the

process of being finalized at the time that this Annual Report was completed. Once they are available to us, we will determine the nature and extent of our future audit work with respect to the management of the Province's debt and debt-related costs.

GOVERNANCE

1.15 The matter of "Governance" including the roles, responsibilities and relationships of governing bodies has been the subject of much discussion and research in recent years. Thus we decided to make it a theme for a number of the audits conducted this year, including a major survey of members of Boards of Governors in the Province's university system. The results are outlined in the various chapters but some common issues were identified.

1.16 Several of our audits resulted in findings from which we concluded that the relationship between the governing body (generally a Board) and the government was either unclear or not well understood. This was particularly true of the relationship between university boards and the Nova Scotia Council on Higher Education which is discussed in Chapter 6. As well these issues are the subject of ongoing efforts to define roles, responsibilities and accountability relationships as Regional and Community Health Boards are established. This is discussed in Chapter 8.

1.17 Strategic and program policy direction should be provided by government to organizations engaged in carrying out government programs. Government has established its priorities in terms of its four pillars, economic renewal, redesigned government, social responsibility, and fiscal recovery, and has communicated these through *Government By Design*. However, it would appear appropriate that organizations should receive more specific direction regarding these. As an illustration of this, the audit of Atlantic Lottery Corporation revealed that its Board and management could benefit from more specific government direction. It would seem appropriate for government to be more explicit regarding the balancing of fiscal versus social aspects of its priorities with respect to lottery activities in the Province from an operational perspective.

EDUCATION AND CULTURE - TEACHERS' GROUP INSURANCE PLANS

1.18 I had planned an audit of these plans in 1994 but was denied access by the Nova Scotia Teachers Union. As a result of amendments to the Education Act in 1995 my access was made more specific and I was granted access in 1996. The audit identified that, for a variety of reasons, primarily related to lack of clarity in the terms of negotiated agreements and absence of formal accountability reporting requirements, funds in excess of \$10 million plus earned interest over a number of years were accumulated by the NSTU Group Insurance Trustees. These funds were remitted by the Province, school boards and teachers and were not required to finance premiums. At the time of writing this Report negotiations were underway between the government and the NSTU related to the ownership of these surplus funds.

DEPARTMENT OF TRANSPORTATION AND PUBLIC WORKS - HIGHWAY 104 WESTERN ALIGNMENT PROJECT

1.19 This project was the government's largest venture into public/private partnering and represents our first attempt to audit the process. Although we were able to conclude that the initial stages of the process were competitive, in compliance with procurement policies and therefore open and fair, we could not conclude on the final result because of the negotiation process. Auditing these arrangements offers some unique challenges.

1.20 Based on our analysis, if the Province had borrowed the funds for the highway project directly, instead of Highway 104 Western Alignment Corporation, the debt service charge for the borrowing would have been significantly lower. However, if the Province borrowed the funds it would have assumed a greater amount of risk on the project, and we have been told by a representative of the company that designed and purchased HWAC's bonds that additional debt on the Province's books at this time could affect its credit rating and increase its average cost of borrowing. We cannot express an opinion on whether or not additional borrowing by the Province of this magnitude would change the Province's average borrowing rate. The financial markets determine interest rates, and it is very difficult to forecast the activity and demands of the market.

ATLANTIC LOTTERY CORPORATION (ALC)

1.21 This audit resulted from a request to me from the Nova Scotia shareholder, the Nova Scotia Gaming Corporation, to carry out an audit. The request was made pursuant to provisions of the bylaws of Atlantic Lottery Corporation. Previously plans had been made to conduct a regular audit under the Auditor General Act and to do it jointly with the Auditors General of the other Atlantic Provinces. Jurisdictional issues prevented that plan from going forward and I urge government to clarify the status of ALC so that such jurisdictional issues are avoided.

1.22 Staff from the Office of the Auditor General of New Brunswick participated in the 1996 shareholder's audit and the Auditors General of Prince Edward Island and Newfoundland and Labrador were consulted. An audit report was transmitted to the Nova Scotia Gaming Corporation on March 19, 1997 and provided to the Auditors General of the other Atlantic Provinces with permission to transmit it to the shareholders in their provinces. Chapter 12 in this Report is a summary of that more detailed report with some added focus on issues germane to Nova Scotia.

1.23 ALC is an established organization with procedures and systems in place to manage and control its activities. ALC has grown substantially since it was established in 1976, particularly with the growth of the video lottery program since 1991. Arrangements and agreements made in 1976 should be revisited and renegotiated by the shareholders and shareholder provinces. Issues such as public reporting, dispute resolution mechanisms and cost allocation methodologies need review.

1.24 We estimate that a more equitable basis of cost allocation would have benefited Nova Scotia by approximately \$5 million in 1995-96. Further, we estimate that under the current cost allocation methodologies and at the existing deployment levels, Nova Scotia would end up bearing approximately \$1 million more depreciation expenses over the next few years as a result of ALC's planned acquisition of new retail terminals for its regular lottery programs.

1.25 By majority vote of the Board in 1995, a long-term lease for a head office facility in Moncton was approved at the time that Nova Scotia was exploring alternative organizational arrangements. Given that Nova Scotia, under current cost allocation methodologies based on 1995-96 results, would bear approximately 40% of these accommodation costs, deferring such a decision until organizational issues were resolved would appear to have been more reasonable.

1.26 In my view, based on the results of our audit, Nova Scotia and Nova Scotia's ALC Board representatives need to ensure that interests and priorities of the Province are fully understood and adequately dealt with by ALC.

NOVA SCOTIA RESOURCES LIMITED

1.27 As a result of allegations made by members of the Legislature, media and public about the company's handling of certain negotiations and other business matters, I was requested to undertake an audit of the corporation.

1.28 All of the transactions, which were the subject of the allegations, were influenced by the government's decision, in early 1995, to dispose of the company and terminate its involvement in the oil and gas business. The audit determined that, once that decision was made, the government obtained expert assistance and commenced a process for the orderly disposal of the company's assets including its tax pools. Decisions had to be made that required balancing risks and rewards and the process is still not complete.

1.29 Given the uncertainty of future events and the potential risks that had to be considered, I concluded that decisions were made based on reasonable amounts of information and advice.

CONCLUDING REMARKS

1.30 During 1996 there was a continuation of previous initiatives designed to improve management processes, particularly in the area of planning and budgeting. However once again I raise the concern that such positive improvements may not be sustained in the absence of a legislated accountability framework.

1.31 The Public Accounts Committee made significant recommendations that if adopted would address much of this concern. I urge the government and the Legislature to give serious consideration to those recommendations.

1.32 This was an unusually difficult year for the Office, primarily due to the requests for special audits and the complexity of many of the matters addressed. I want to recognize the support of my staff and their willingness to accept new challenges and adapt to a rapidly changing environment.

1.33 The Office was also saddened when one of its longest serving employees, Tom Edwards, passed away suddenly on March 9, 1997. Tom was a dedicated professional who was also very active in community and charitable endeavours. He was looking forward to retirement in June and he will be sorely missed by his family, friends and associates.
