

## **GOVERNMENT-WIDE ISSUES**

**2.****ACCOUNTABILITY INFORMATION AND REPORTING****BACKGROUND**

**2.1** In recent years, the Report of the Auditor General has included chapters dealing with accountability to the House of Assembly, including comments on the action taken or planned by government and suggestions for improving the quality of information and reporting provided to the House.

**2.2** The purpose of this chapter is to provide updated and additional summary comments on the quality of accountability information and reporting to the House of Assembly, including the Province's financial statements.

**2.3** Significant change continues or is planned in a number of programs and areas of the Provincial public sector. Adequate information and reporting on government's plans and performance (i.e., results or outcomes) are required, so the House can satisfy itself as to the effectiveness of these changes and the subsequent quality of performance or service levels in key areas.

**2.4** Accountability, including the definition of basic accountability requirements in legislation, is a current topic of consideration in other jurisdictions. The need for quality accountability information and reporting is a significant issue in the public sector virtually everywhere.

**2.5** In its simplest terms, accountability means the obligation to answer for an assigned responsibility. An accountability relationship involves at least two parties, one who allocates or assigns responsibility, and one who accepts it, with an understanding to report upon results or outcomes.

**2.6** Exhibit 2.1 on page 24 provides a relatively simple two-dimensional overview of the key elements of an accountability relationship, including the role the audit function serves within it. This overview or model can be used when considering accountability at various levels within Provincial operations. For example:

- government's accountability to the House of Assembly;
- departments' and crown agencies' accountability to government;
- deputy head's or board's accountability to a Minister; and
- management's accountability to a deputy head.

**2.7** Exhibit 2.2 on page 24 provides an overview of the accountability organization with respect to the Provincial public sector. It is not intended to present all parties or relationships involved, but rather to emphasize the various levels that exist and the fact accountability to the public is relevant at all levels.

## RESULTS IN BRIEF

**2.8** The following are the principal observations from this year's review.

- 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 should be considered by government.
- Over the past 2-3 years, improvements made to the Province's financial statements have resulted in the Province's surplus/deficit and liabilities being accounted for and reported more completely and understandably than in the past. There are certain issues or concerns raised by this Office which have not yet been fully dealt with, including the need for full consolidated financial statements.
- The annual deficit of \$201,102,000 reported in the Province's March 31, 1996 financial statements includes \$50,913,759 of capital commitments as net capital expenditures. Although this one time adjustment is disclosed in the notes and supporting schedules to the financial statements, the capital commitments do not represent expenditures "incurred" during fiscal 1995-96, and reporting them as such is inappropriate. Further, reporting them as 1995-96 expenditures materially affects the reported results for that year, and in comparison to other years. As a result, the Province's results of operations for the year ended March 31, 1996 are not presented in accordance with the disclosed basis of accounting, nor are they reported consistently with the preceding year.

## AUDIT SCOPE

**2.9** The objective of this assignment was to review the status of action taken or planned to improve the quality of accountability information and reporting to the House of Assembly.

**2.10** In addition to considering the planning and accountability initiatives undertaken by government, we have also reviewed and provide commentary on the Province's non-consolidated financial statements to be included in the *Public Accounts* for the fiscal year ended March 31, 1996.

## PRINCIPAL FINDINGS

### *Significant Progress Being Made*

**2.11** For the House of Assembly to hold government to account, and for government to hold departments and agencies accountable, there must be an adequate standard framework in place requiring the provision of sufficient, appropriate, understandable and timely information or reports. Such a standard has now been defined. The *Planning and Accountability Framework*, which builds on certain initiatives that evolved from the integrated planning and budgeting process first used for the 1994-95 fiscal period, is a government-wide initiative being coordinated through the Priorities and Planning Secretariat. Government is continuing efforts to implement the various aspects of the framework and make necessary improvements, including an increased focus on defined outcomes at an overall government level as well as at the entity or program levels.

**2.12** The improvements in place, coupled with those in progress or planned, put Nova Scotia in much more of a leadership role in relation to public sector accountability. It is acknowledged that the effective implementation of such improvements represents a significant challenge, requiring a sustained commitment. Based upon the information available to us, we believe the level of commitment in this regard is stronger than it has ever been in the past.

**2.13** In 1995, the Public Accounts Committee (PAC) established a Sub-Committee to consider a number of topics relating to accountability. The Minister of Finance indicated support for the PAC's efforts in this regard. The Department of Finance, the Priorities and Planning Secretariat, and this Office provided staff support to the Sub-Committee. The PAC's report for 1995-96, which was tabled in the House in December 1996, included the Sub-Committee's report. While recognizing the improvements that had been made or were in progress, that report included a number of significant recommendations relating to the quality of accountability information and reporting to the House, including support for continued improvements to the Province's financial statements.

**2.14** Appendix 2A on page 29 is a summary of the PAC's recommendations to the House of Assembly as a result of the deliberations of the PAC and its Sub-Committee. As part of its continuing efforts to implement improvements, we urge government to consider the various recommendations included in the PAC Sub-Committee report, including the further expansion and enhancement of statutory requirements associated with ensuring that the House of Assembly will receive quality accountability information and reports.

**2.15** Certain significant accountability-related statutory amendments or provisions have been put in place in recent years which support the provision of improved and more timely information and reports to the House in selected areas. Further, the *Planning and Accountability Framework* initiatives will span a number of years and will support the provision of improved information and reporting on the plans and performance of government, including at the department or agency level.

**2.16** There are various documents and reports currently available which can either directly or indirectly be utilized for accountability purposes. The timing of certain of these reduces their value to support an effective accountability review by the House of Assembly or its Public Accounts Committee. Further, some of these are not required by legislation, and as such are available at the government's discretion.

**2.17** Annual reporting standards and practices of departments and agencies need to be updated, expanded and strengthened to support the provision of sufficient, understandable and timely information on the results or outcomes achieved in comparison to plans. Further, responsibility for monitoring compliance with annual reporting requirements needs to be clearly assigned. This is a point that has been made by our Office a number of times in the past, and we understand it is now being actively reviewed by government through the continued efforts of Priorities and Planning Secretariat staff as one of the *Planning and Accountability Framework* initiatives.

**2.18** There are costs associated with such changes or improvements. However, the benefits of the effective implementation of improvements to the accountability process should outweigh the costs. In this regard one need only ask, *if previous governments had provided quality information on plans and performance, including complete and understandable consolidated financial statements, would we have started to face today's fiscal and related challenges earlier, or at least been better prepared to deal with them?*

**2.19** Some may suggest this is hindsight. However, that notwithstanding, many of the fundamental challenges government now faces existed for some time and were created over many years, but the information and reports provided in the past did not effectively account for or disclose these matters.

### ***Audit of the Province's Financial Statements***

**2.20** Section 65 of the Provincial Finance Act creates an audit reporting relationship which is unique in Canada. Nova Scotia is the only jurisdiction in Canada where the legislative auditor does not audit and provide an opinion on the financial statements. The Province's financial statements are audited by a public accounting firm and the auditors' report (opinion) is addressed to the Minister of Finance. The audit opinion in other jurisdictions is addressed to the House of Assembly (or its equivalent).

**2.21** This Office has and will continue to place appropriate reliance on the audit of the financial statements as it relates to our mandate defined under the Auditor General Act. We will continue our efforts to monitor the results of this audit function and provide commentary on the overall completeness and adequacy of the Province's financial statements which are included in the *Public Accounts*.

**2.22** In recent years we have made reference to the annual *Management Report* issued by the external firm appointed under Section 65 of the Provincial Finance Act. A draft of the *Management Report* resulting from the audit of the Province's March 31, 1996 financial statements was provided to us in March 1997, and will be considered during our audit planning for 1997. We are encouraged that Finance in collaboration with other departments has formally responded to the *Management Report*, which we understand will form the basis of an action plan.

### ***Commentary on the Province's Annual Financial Statements***

**2.23** *Introduction and overview* - The Members of the House of Assembly (and the public) require financial information on and reporting of the Province's financial position and results - both plans and performance - on a complete, understandable and timely basis. This view is consistent with the recommendations made by the PAC's Sub-Committee in its report which was tabled in the House in December 1996. Among other things, that report provides recommendations dealing with improvements to the Province's financial statements, including consolidation and timely release.

**2.24** Since 1993, the Report of the Auditor General has included commentary on the Province's annual financial statements, one of government's primary financial accountability documents. We have previously identified concerns relating to the completeness and adequacy of the Province's financial statements which are published in the *Public Accounts*. Over the past 2-3 years, improvements made to the financial statements have resulted in the Province's annual surplus or deficit and its liabilities being accounted for and reported more completely and understandably than in the past.

**2.25** There are certain issues or concerns previously raised by this Office which have not yet been fully dealt with by Finance. Among these are the issues of full consolidated financial statements and certain costs and other adjustments being charged directly to the *Statement of Net Direct Debt* rather than being reported on the *Statement of Revenue and Expenditures* as part of the annual surplus or deficit. We acknowledge Finance has taken certain action with respect to these and, as we understand, intends to go further. Nothing short of full and complete accounting for and reporting of the Province's surplus or deficit and its liabilities should be considered acceptable.

**2.26** Finance now includes a *Consolidated Financial Summary* in the *Public Accounts*. This represented an initial step toward full consolidated financial statements. However, until full consolidated financial statements are prepared, the Province's financial position and results of operations will not be reported completely. Finance has indicated that it wants to have consolidated budget information in place prior to moving to full consolidated financial statements. However,

we note that most other Canadian jurisdictions now issue consolidated financial statements without having implemented consolidated budgeting.

**2.27** The timeliness of financial reporting by government has been less of an issue, to some extent, due to the Minister of Finance releasing the annual *Financial Report* (which has included the traditional non-consolidated statements for the Province) in August in recent years. In previous Annual Reports we have noted that the release of the *Financial Report* is discretionary (i.e., not required by statute), and that the *Public Accounts* cannot be released on a timely basis, due to the provisions of the Provincial Finance Act.

**2.28** With respect to understandability of the Province's financial statements, by their very nature, the statements are a summary resulting from the selection of alternative accounting policies and disclosure practices. The impact or implication of these selections may not be fully understood or appreciated by other than a well-informed reader. This notwithstanding, one attribute of understandability that readers should be assured of is that of consistency. In situations where the government elects to change accounting policies, the onus is on it to ensure that such changes are appropriate, as well as fully and adequately disclosed in the notes to the financial statements themselves. In most instances, such changes should result in a retroactive restatement of the prior year's comparative data, so the financial statement readers are still presented with information on a consistent and comparable basis.

**2.29** *Consolidated financial statements* - As previously recommended, full consolidated financial statements for the Province should be a primary financial accountability report for government. There is currently no legislative requirement for Finance to provide consolidated financial information. However, since 1993, the *Public Accounts* tabled in the House have included a separate *Consolidated Financial Summary*.

**2.30** Note 1 to the March 31, 1996 financial statements indicates that the "*Province separately prepares consolidated financial information including the assets, liabilities, revenues and expenses of government entities; such consolidated information forms part of the Public Accounts as supplementary information.*"

**2.31** We have previously acknowledged Finance's initiatives in this regard, and provide the following comments for consideration as efforts continue to improve the overall quality of the consolidated financial information available to the Members of the House of Assembly.

- Consolidated financial information, and preferably full consolidated financial statements, should be available publicly at the same time as the traditional non-consolidated statements. Reasonable effort should be taken to focus increased and appropriate attention on such consolidated financial information since it provides the "totals" as opposed to just part - albeit a significant part - of the Province's financial position and results of operations.
- In the *Consolidated Financial Summary*, the Workers' Compensation Board of Nova Scotia (WCB) and Halifax-Dartmouth Bridge Commission have not been accounted for as part of the Province's consolidated reporting entity. Both entities have significant liabilities which, in the case of the latter, are directly guaranteed by the Province.
- Significant adjustments recorded directly to net direct debt for purposes of the non-consolidated statements, have not been included in the consolidated (i.e., total) surplus or deficit of the Province reported in the *Consolidated Financial Summary*.

**2.32** *Reporting of the annual deficit* - The Province's financial statements include a *Statement of Revenue and Expenditures* which now presents the annual surplus or deficit for a fiscal period in a more complete and understandable manner, more consistent and comparable to other jurisdictions. However, charges continue to be recorded directly to the *Statement of Net Direct Debt*, certain of which should more appropriately be included in the calculation of the annual surplus or deficit of the Province. Those charges for the 1995-96 fiscal period net out to only \$515,000, so the impact of reporting those items in the calculation of the annual deficit would not have been significant for that year. For the first time in many years the annual deficit reported essentially represents the changes to the Province's net direct debt.

**2.33** Exhibit 2.3 on page 25 summarizes the changes to net direct debt as reported in the Province's financial statements in recent years. For purposes of the analysis we have used the same presentation of deficit used for the March 31, 1996 financial statements. However, we have not adjusted previous years' deficits for the improvements in accounting policies implemented since 1993.

**2.34** Finance had previously indicated that since items such as pension valuation adjustments do not lend themselves to accurate and reliable budgeting, it is appropriate for them to be recorded to net direct debt rather than in the calculation of the surplus or deficit on the *Statement of Revenue and Expenditures*. We agree such items are more challenging to determine, both from a budgeting and an accounting perspective, than many other items. However, they still represent items that must be considered when assessing the financial position and fiscal performance of the government. Further, there are already a number of other revenue and expenditure items recorded to the *Statement of Revenue and Expenditures* for which estimation and accounting is relatively challenging or complex.

**2.35** Finance needs to clearly define its accounting policy on what will be recorded directly to the *Statement of Net Direct Debt*. In this regard, we strongly recommend that, in the absence of extraordinary or retroactive adjustments due to changes in accounting policies, the annual surplus or deficit should be the only factor causing a change in the Province's net direct debt. All other items should flow through the *Statement of Revenue and Expenditures*, and be included in the determination of the reported surplus or deficit for a fiscal year. We acknowledge that implementing such a policy would represent some further challenges to the Province's annual budget preparation process. Finance has indicated that this is the reporting basis it intends to move towards over time.

**2.36** *Completeness of reported liabilities* - There continue to be specific liabilities which have not been accounted for in the Province's financial statements or the *Consolidated Financial Summary*. For example, the following items have not been accounted for in the March 31, 1996 financial statements.

- *Workers' compensation liabilities* - The December 31, 1995 financial statements of the Workers' Compensation Board of Nova Scotia reported a significant unfunded actuarial liability. The WCB is a crown agency, but this liability is not reported in the Province's financial statements. The notes to the Province's *Consolidated Financial Summary* indicate the WCB is not considered part of the Province's reporting entity for financial statement purposes.

The financial statement accounting policies and disclosure practices for workers' compensation by governments vary significantly across the country. We will continue to monitor reporting practices in other jurisdictions in this regard.

In addition to the general unfunded liability, there are certain specific liabilities of the Province relating to workers' compensation which should be, but have not, been accounted for in the Province's financial statements. These included the Province's liability as a self-insurer, which has been estimated at \$25.5 million. This liability has not been accounted for in the March 31, 1996 financial statements of the Province, although it is disclosed in the notes to the financial statements.

- *Long-term disability* - We previously recommended Finance ensure its liability for long-term disability is appropriately accounted for or disclosed in the Province's financial statements. The notes to the March 31, 1996 financial statements disclose that *"the Long-Term Disability plan, which is funded on an equal basis by the Province and its employees, has an estimated unfunded liability as at March 31, 1996 of approximately \$45,000,000. The Province is not contractually committed to fund this shortfall; therefore, no liability is recorded in these financial statements."*

**2.37** *Timeliness of financial reporting* - The Province's March 31, 1996 non-consolidated financial statements were released publicly August 8, 1996 as part of the Minister of Finance's *Financial Report 1995 - 1996, Hitting the Targets, Government by Design in Action*. This represents timely reporting, and would be even more noteworthy if there were consolidated financial statements provided at that time. Further, we acknowledge that under new provisions of the Provincial Finance Act the government is now required to provide quarterly financial reports to the House of Assembly on a timely basis. This is an important enhancement in the reporting process which will substantially improve the timeliness of financial information.

**2.38** However, the Provincial Finance Act does not require (or allow for) the timely release of the *Public Accounts*. Section 10 of the Act requires that they be tabled or deemed tabled before March 31 but not before January 1 of the year following the fiscal year end to which they apply. The earliest they could be tabled is nine months after the year end to which they apply, which is not timely reporting. Ideally, the *Public Accounts* should be released at the same time as the annual *Financial Report*. Finance has indicated its support for changes such that the *Public Accounts* would be released prior to December 31.

**2.39** On another matter regarding the timing of the release of the Province's March 31, 1996 financial statements, we note they were finalized and released despite the fact that spending authority for certain overexpenditures was still pending. The necessary spending authority for these expenditures was not received until November 1996 after a resolution under the Expenditure Control Act was approved by the House.

**2.40** The notes to the Province's statements dealt with this matter as follows.

*"An Additional Appropriation to authorize program expenditures to the extent of \$53.3 million for the fiscal year 1995-96 is required and planned to be obtained in the fall (1996) sitting of the Legislative Assembly. The majority of this expenditure was by the Department of Health (\$51.7 million). Authority for this spending is required from the House as per the Expenditure Control Act."*

**2.41** *March 31, 1996 adjustment for capital commitments (\$50.9 million)* - A significant issue was identified with respect to the Province's traditional non-consolidated financial statements which form part of the *Public Accounts* which will be tabled or deemed tabled prior to March 31, 1997. The matter relates to the decision to account for \$50,913,759 of capital commitments as liabilities as at March 31, 1996, and include them in the net capital expenditures reported for the year ended March 31, 1996. The reason for this treatment was identified in the notes to the



financial statements as being the result of a change in authority for capital spending from a two-year vote to a one-year vote.

**2.42** As a result, net capital expenditures reported for 1995-96 were overstated in various departments as follows.

| <b>Department</b>   | <b>Capital Commitments</b> |
|---------------------|----------------------------|
| Municipal Affairs   | \$12,305,400               |
| Supply and Services | 14,474,800                 |
| Transportation      | 16,531,887                 |
| Health              | <u>7,601,672</u>           |
|                     | <u>\$50,913,759</u>        |

**2.43** We understand that the decision to make this change in authority was based on the objective of achieving improved accountability and greater discipline in the management of capital projects. While we agree with this objective, we do not believe that deviating from the stated basis of accounting was appropriate.

**2.44** Note 1 of the Province's financial statements titled *Financial Reporting and Accounting Policies*, includes a section titled *Basis of Accounting* which indicates "these accounts are maintained on an accrual basis, revenues recorded when earned and expenditures recorded when incurred."

**2.45** The \$50.9 million adjustment is inconsistent with the Province's stated accounting policies, and is fundamentally wrong from an accounting principles perspective. The capital commitments do not represent expenditures "incurred" during fiscal 1995-96, and reporting them as such is inappropriate. Further, reporting them as 1995-96 expenditures materially affects the reported results for that year, as well as comparability to other years. As a result, the Province's results of operations for the year ended March 31, 1996 are not presented in accordance with the disclosed basis of accounting, nor are they reported consistently with the preceding year.

**2.46** Exhibit 2.4 on page 26 summarizes the impact of the decision to account for the capital commitments in the manner chosen, including a focus on what the reported financial results would have been had the commitments been accounted for in a manner consistent with the "basis of accounting" and previous years. We have also included 1996-97 totals, based on the *Estimates* and assuming all the related capital projects will be completed in 1996-97 (i.e., the related expenditures will be incurred in 1996-97).

**2.47** It is important to observe that if Finance had accounted for the \$50.9 million of capital commitments consistently and appropriately, the Province still would have reported progress towards government's stated goals of a balanced budget. Exhibit 2.5 on page 27 provides a graph showing the impact of the adjustment in this regard.

**2.48** We have been provided with information and analysis of the capital projects making up the \$50.9 million. However, we have not been provided sufficient and appropriate support for recording the \$50.9 of capital commitments as liabilities as at March 31, 1996 or as capital expenditures for the 1995-96 fiscal period. The information received from Finance indicated that the recording of the capital commitments "does not materially misstate the province's financial position."

**2.49** A decision as to what constitutes a material amount for the financial statements of the Province requires judgement and consideration of the interests and understanding of the users of the statements. For example, would a \$50.9 million change in the reported surplus or deficit significantly affect a financial statement reader's assessment of the Province's financial position or performance? In our view, the \$50.9 million of net capital expenditures being reported in 1995-96 as opposed to 1996-97 is material, and could affect a reader's assessment.

**2.50** Further, it was indicated that the adjustment was disclosed in the supporting notes and schedules to the statements. Exhibit 2.6 contains extracts of the disclosure of the adjustment in the financial statements and the *Financial Report*. We also understand the adjustment was highlighted during the public release of the *Financial Report*. However, it is generally accepted that disclosure in the notes to financial statements is not a substitute for the use of appropriate accounting policies and practices.

**2.51** Further, we understand that the impact of this adjustment on the forecast information for 1995-96 and the estimates for 1996-97 is reflected in the expenditure totals included in the 1996-97 *Estimates* tabled in the House, but there is insufficient explanation of the adjustment or its impact from a consistency or comparability perspective in the *Estimates*.

**2.52** The implementation of a change in spending authority for capital from two years to one should more appropriately have been handled through the annual *Estimates* for 1996-97. Such would have preserved the consistency and comparability of the Province's financial reporting, while avoiding the use of an inappropriate accounting adjustment to the Province's liabilities and results for 1995-96.

## CONCLUDING REMARKS

**2.53** An effective accountability framework should provide or result in an appropriate balance of information and reports to the House of Assembly on the plans and performance of government overall and individual departments and agencies, both from a financial and a program delivery or service perspective. The goal is better information and reports, not just more.

**2.54** There have been a number of significant initiatives undertaken to improve the quality and timeliness of information and reports available to the House and the public with respect to government's plans and priorities. The Department of Finance and the Priorities and Planning Secretariat have taken, and are still planning to take, steps to improve the nature and quality of the information and reports available, including an expanded focus on results and outcomes of departments and agencies in key areas.

**2.55** An adjustment to record \$50.9 million of capital project commitments results in overstating the Province's liabilities as at March 31, 1996 and its expenditures for 1995-96. As a result, 1996-97 expenditures have been reflected in the annual deficit reported for 1995-96. This one time adjustment is inconsistent with the Province's stated accounting policies, affects comparability from year to year, and is fundamentally wrong from an accounting principles perspective.

**2.56** As is my normal practice, Finance was offered the opportunity to respond to this chapter, as they have the responsibility for the financial statements. Their response, in the form of a letter from the auditors appointed under Section 65 of the Provincial Finance Act, is reproduced at page 31.

**2.57** Contrary to the disclosure in the notes to the financial statements, the response states that the Province's basis of accounting has been changed and that capital commitments will be accrued

as expenditures in future years. This is contrary to generally accepted accounting principles and generally accepted accounting practices in the provincial and federal public sector.

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Exhibit 2.1

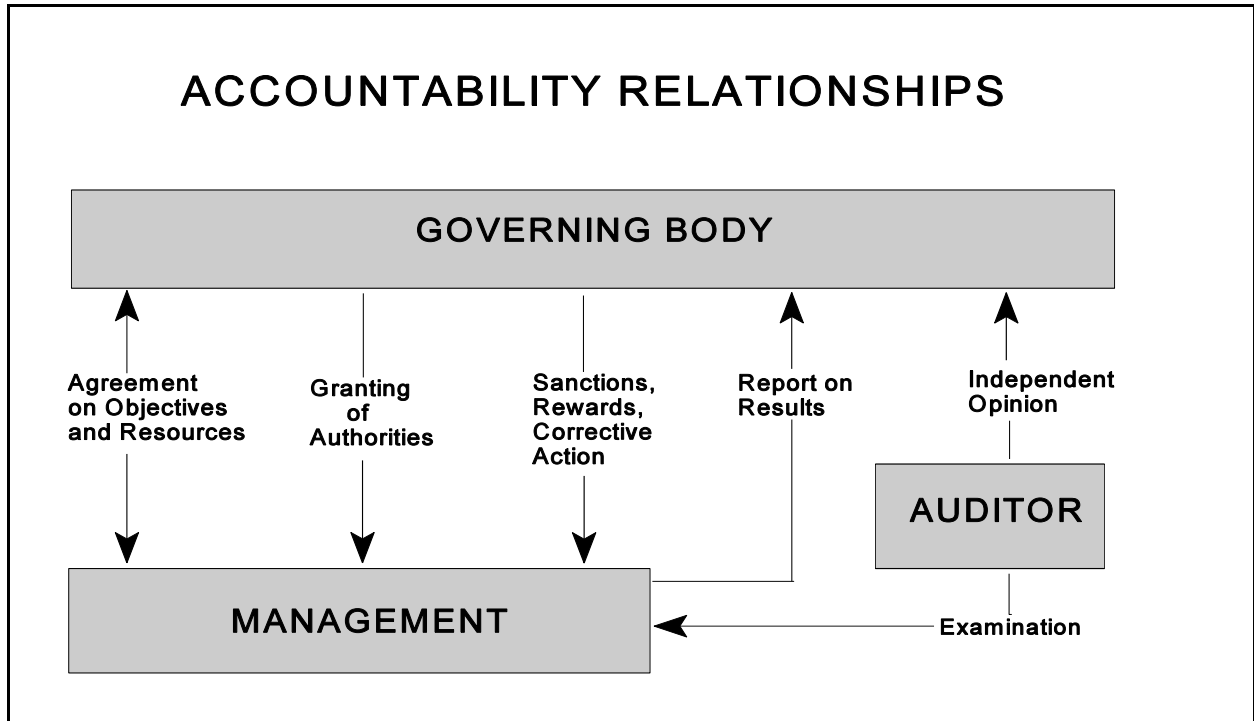


Exhibit 2.2

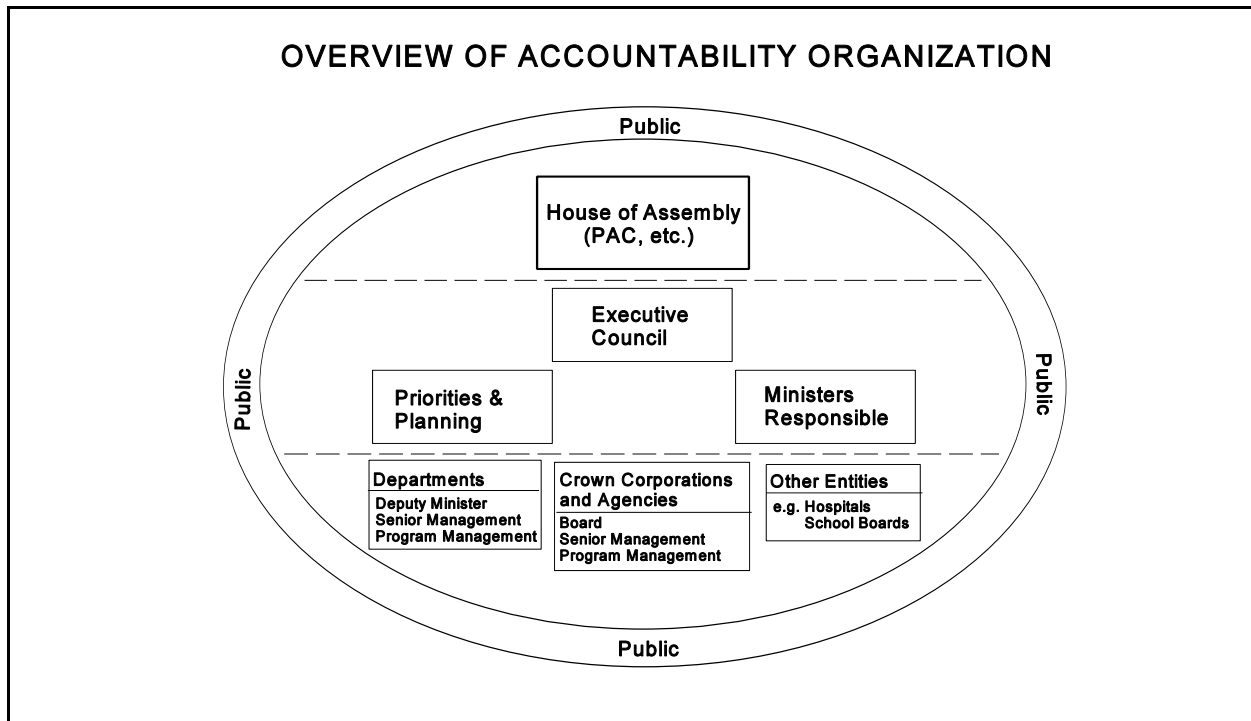
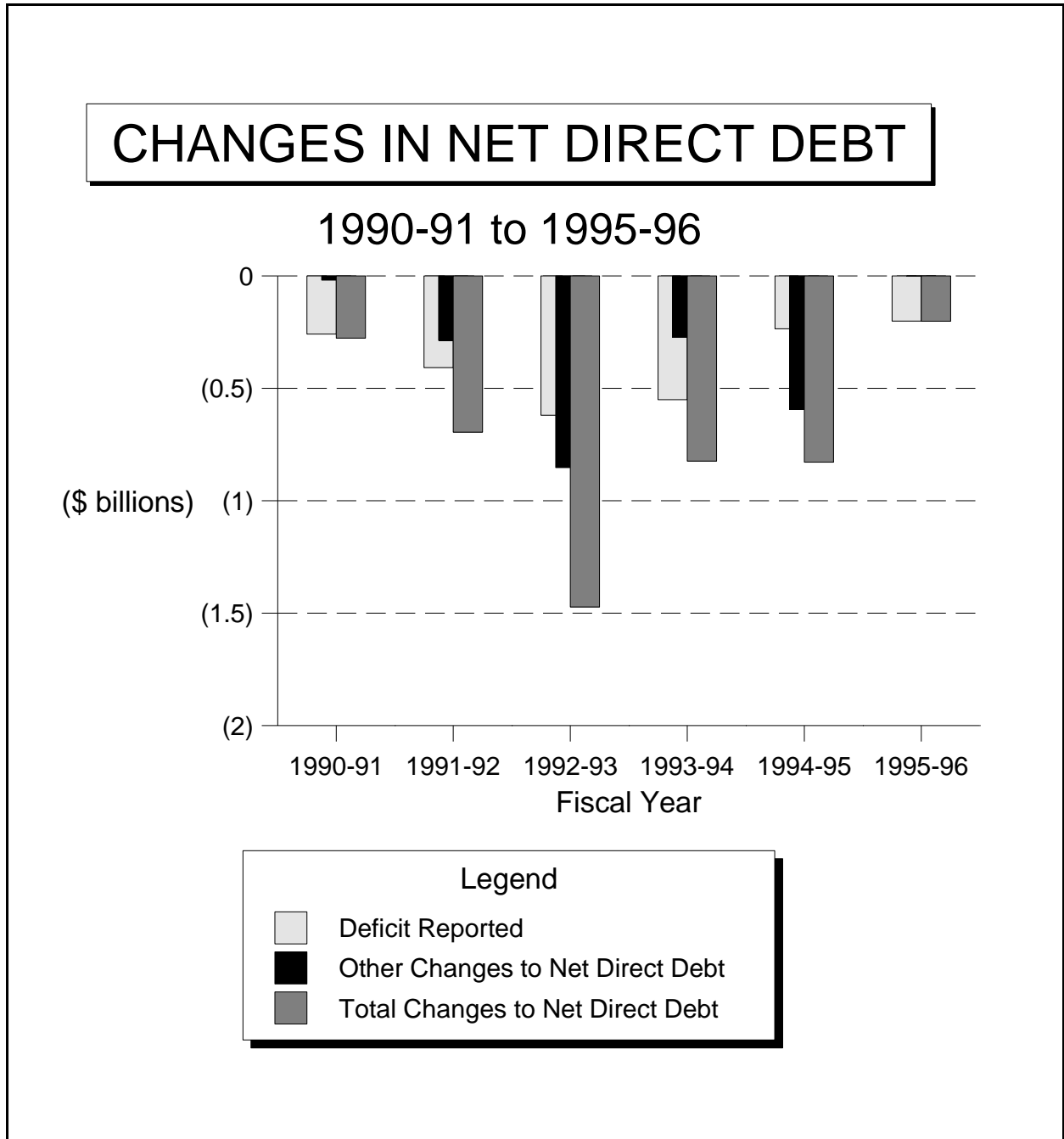


Exhibit 2.3



*Exhibit 2.4*

**March 31, 1996 Capital Commitment Adjustment  
Analysis of Effect  
(thousands of Canadian \$)**

**Summary of the Province's Financial Results Reported\***

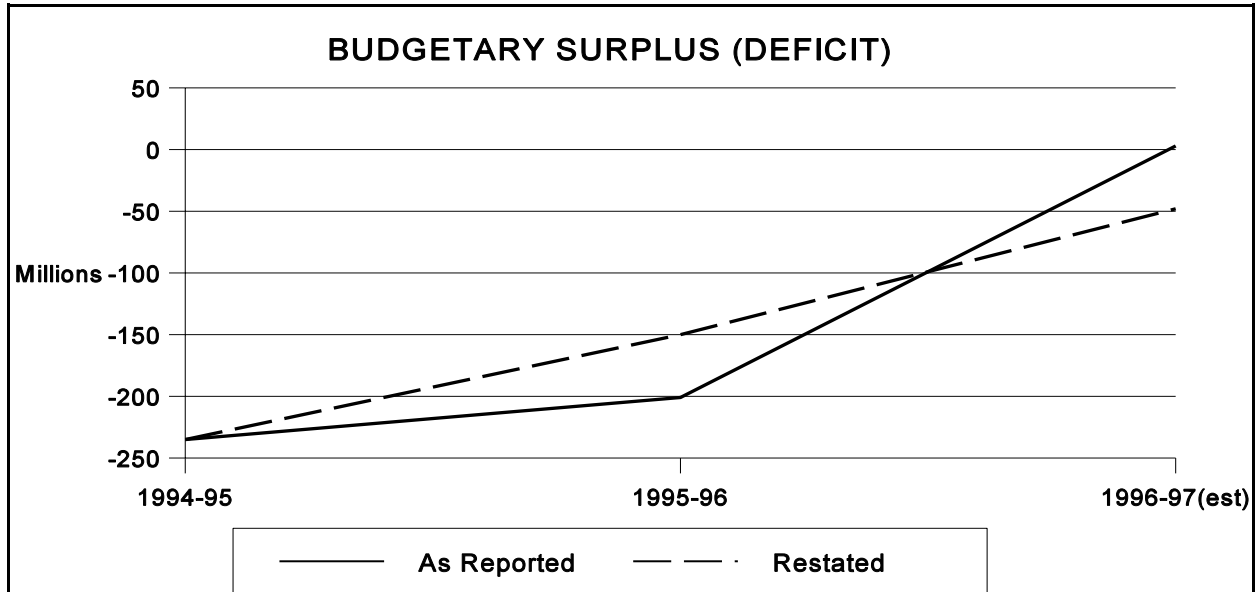
|                                      | 1994-95            |                    | 1995-96            |                 | 1996-97 |          |
|--------------------------------------|--------------------|--------------------|--------------------|-----------------|---------|----------|
|                                      | Actual             | Estimate           | Actual             | Estimate        | Actual  | Estimate |
| Current Account Surplus<br>(Deficit) | \$ (84,745)        | \$ (28,083)        | \$ 101             | \$ 40,076       |         |          |
| Net Capital Expenditures             | (260,196)          | (284,980)          | (317,603)          | (159,175)       |         |          |
| Sinking Fund Earnings                | <u>109,870</u>     | <u>129,800</u>     | <u>116,400</u>     | <u>121,900</u>  |         |          |
| Budgetary Surplus (Deficit)          | <u>\$(235,071)</u> | <u>\$(183,263)</u> | <u>\$(201,102)</u> | <u>\$ 2,801</u> |         |          |

**Restated**

|                                      | 1994-95            |                    | 1995-96            |   | 1996-97 |          |
|--------------------------------------|--------------------|--------------------|--------------------|---|---------|----------|
|                                      | Actual             | Estimate           | Actual             | Estimate, plus<br>commitments<br>recorded as at<br>March 31, 1996 | Actual  | Estimate |
| Current Account Surplus<br>(Deficit) | \$ (84,745)        | \$ (28,083)        | \$ 101             | \$ 40,076   |         |          |
| Net Capital Expenditures             | (260,196)          | (284,980)          | (266,689)          | (210,089)   |         |          |
| Sinking Fund Earnings                | <u>109,870</u>     | <u>129,800</u>     | <u>116,400</u>     | <u>121,900</u>  |         |          |
| Budgetary Surplus (Deficit)          | <u>\$(235,071)</u> | <u>\$(183,263)</u> | <u>\$(150,188)</u> | <u>\$ (48,113)</u>  |         |          |

\* Based on non-consolidated financial statements and the support for the April 25, 1996 *Budget Address*.

*Exhibit 2.5*



**Exhibit 2.6****Extracts from 1995-1996 Financial Report  
Re: Capital Project Commitments****Extract from page 10 of the Financial Report for 1995-96 - Capital Spending**

*Net capital expenditures for 1995-96 of \$317.6 million exceed the budget level of \$285 million for an increase of \$32.6 million. This variance was caused by a change in budgeting authority, which requires capital items to be appropriated annually (versus a 2 year authority), commencing in 1996-97. This resulted in \$50.9 million of capital commitments being expensed in 1995-96, to facilitate the introduction of the new policy. Without this transitional adjustment, capital spending was underspent by \$18.3 million.*

**Extract from Note 5 to the March 31, 1996 financial statements re: Commitments**

*Due to the change in authority for capital spending commencing in the 1996-97 fiscal year, transitional funding has been provided whereby the province has incurred commitments to the extent of \$50,913,800, representing projects in progress as at March 31, 1996. This is in addition to the commitments referred to above.*

**Extract from footnote to Schedule 3 - Schedule of Net Capital Expenditures**

*Due to the change in authority for capital spending commencing in the 1996/97 fiscal year, the Province has expensed commitments to the extent of \$50,913,800, representing projects in progress as at March 31, 1996. These commitments have been recorded in the financial statements as capital expenditures for the year ended March 31, 1996 (see Note 5).*



**Appendix 2A****Sub-Committee on Public Accounts - Report - 1996  
Summary of Recommendations****Overall Accountability Information and Reporting**

- i. *The provision of sufficient, appropriate, understandable and timely (i.e. quality) accountability information and reports to the House of Assembly should be required by statute, but with the specific form and nature determined by government policy or other directives.*
- ii. *Accountability information and reports should be available to the House of Assembly on the plans and performance of government overall as well as individual departments and agencies, both from a financial and a program delivery or service perspective.*
- iii. *A comprehensive review and analysis of accountability related statutory provisions in place in other jurisdictions should be considered, and could support the development of draft statutory provisions/proposals for Nova Scotia.*
- iv. *Departments and crown corporations or agencies (including inter-provincial crown entities with head-office operations outside of Nova Scotia) should be required to provide accountability information and reports to the House through a responsible Minister. For inter-provincial crown entities with head-office operations outside Nova Scotia the application of the provisions of the Auditor General Act and other provincial statutes need to be clarified.*
- v. *If accountability information or reports will not be tabled when required, the House (i.e. to the Clerk of the Legislative Assembly) should be notified with a full and complete explanation, so Members will be made aware of the delay. This explanation should state an approximate date as to when the report requirement will be met.*
- vi. *The statutory framework or standard shall also provide for timely interim reporting by government against its overall plans and budgets. The sub-committee recognizes the May 1996 amendments to the Provincial Finance Act require quarterly financial reporting on the state of public finances.*
- vii. *Information in the Supplement to the Public Accounts, which traditionally has only included information about departments and agencies using Finance's central financial systems, should be required for crown corporations and agencies, and other Provincial public sector entities. Given the varied functions of such corporations, agencies and other entities, practical reporting requirement limits may vary from those required by government departments.*

**Estimates and Budgeting**

- viii. *Additional appropriations and special warrants need to be reviewed by the House of Assembly on a more timely and effective basis. Where a department or agency has been allocated an additional appropriation the appropriation should be tabled in the House of Assembly or if the House is not sitting it shall be deemed tabled with the clerk of the House. The amount of the appropriation must also be included.*

**Province's Financial Statements (i.e. the Public Accounts)**

- ix. *Full consolidated financial statements for the Province should be a primary financial accountability report for government, and there should be consolidated estimate or budget information against which the actual financial position and results can be assessed by the House of Assembly.*
- x. *In determining the reporting entity for purposes of the Province's financial statements, as well as other accounting policy and disclosure decisions, the government should adopt the public sector accounting recommendations issued by the Canadian Institute of Chartered Accountants.*
- xi. *The annual surplus or deficit, in the absence of extraordinary or retroactive adjustments due to changes in accounting policies, should be the only factor causing a change in the Province's net direct debt.*
- xii. *The Provincial Finance Act should be amended so that the full Public Accounts (including full consolidated financial statements) are released at the same time as the annual Financial Report, or at least within nine months of year-end.*
- xiii. *The Auditor General should provide an opinion on the Provinces's financial statements to the House of Assembly on a timely basis. If the House is not sitting the report should be deemed tabled with the Clerk of the House.*

**Annual Reporting**

- xiv. *Annual reports (i.e. whether for government overall, its departments, crown or other agencies) should be tabled or deemed tabled in the House of Assembly within six months after the end of the fiscal year to which the reports apply.*
- xv. *If an annual report is not tabled by a defined deadline, a full and complete explanation should be tabled or deemed tabled in the House of Assembly. (See recommendation v. for further details.)*
- xvi. *There must be adequate policy direction and provision of government guidelines provided by the government to departments, crown or other agencies including direction on format and content of annual reports and other information to be provided to the House of Assembly.*

**Auditor General's Mandate and Reporting**

- xvii. *The release of the Report of the Auditor General should not be restricted or tied to specific actions or events the timing of which are controlled by government. In this regard, changes should be made to the Auditor General Act allowing the Auditor General to report to the House (table or deemed tabled) at least once, but no more than three times, each year, with the timing to be established at the discretion of the Auditor General.*
- xviii. *The results of any independent professional standards and/or peer review functions of the audit activities of the Auditor General should be made available to the PAC on a timely basis, along with the Auditor General's comments on action taken or planned to address improvements necessary.*

## DEPARTMENT OF FINANCE'S RESPONSE

*In reply to your offer to respond to your Annual Report, I request that the attached letter from Deloitte & Touche be printed in your Annual Report, as a direct response to your comments on "capital", contained in Chapter 2.*

*Thank you for your ongoing cooperation.*

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## RESPONSE OF AUDITORS APPOINTED UNDER SECTION 65 OF THE PROVINCIAL FINANCE ACT

*With reference to our meeting on March 17, 1997 in which you allowed us to read (but not retain) a copy of Chapter 2 of your Draft Annual Report relating to various accounting information matters of the Province of Nova Scotia ("Province"), we wish to express our significant concern with respect to statements made in your report dealing, in particular, with the transition in the Capital Vote carryover provisions that were initiated during the 1995/96 year.*

*Deloitte & Touche, in our capacity as auditors of the Province, issued an unqualified audit report on the Province's financial statements for the year ended March 31, 1996. In our opinion, these financial statements, in all material respects, present fairly the financial position and results of operations of the Province for that year. We stand by our opinion.*

*You have taken the position that the accrual for capital commitments of \$50.9 million as at March 31, 1996 materially affects the financial results of the Province for that year. We do not agree.*

*We wish to reiterate our comments to you at our March 17th meeting, in previous discussions and in our Management Report dated July 10, 1996 as follows:*

- (a.) The accrual of \$50.9 million was a one-time transitional change, designed to facilitate improved accountability of the Province's financial affairs and reporting by moving from a two-vote system (operating and capital) to a single operating vote for all expenditures. This accrual reflects a more conservative accounting treatment by increasing the Province's deficit in 1995/96 by \$50.9 million. In future years, we have been advised by the Province, it is the Province's stated intentions to continue with this conservative accounting treatment and to accrue at year-end capital commitments which are verifiable and have received the requisite appropriations.*
- (b.) This change was clearly disclosed and noted in the financial statements along with the actual amount of the accrual so there was no question about the effect on the Province's financial position as at March 31, 1996; furthermore, this change was also specifically*

*highlighted in the Government's public announcements when releasing the financial statements.*

- (c.) The accrual of capital commitments was based on a detailed review of the projects at March 31, 1996 and included only those for which there were formal authorizations/signed contracts and/or purchase orders.*
- (d.) We performed a specific review of these projects, the resulting dollar amounts involved and the overall process as part of our examination of the Province's financial statements.*

*We then addressed the impact of this one-time change in assessing materiality within the context of the Province's overall financial position. Our firm has adopted the following definition from the International Standards on Auditing (ISA) 25, "Audit Materiality", paragraph 3:*

*"Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size of the item or error judged in the particular circumstances of its omission or misstatement. Thus materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic which information must have if it is to be useful."*

*We interpret the term "economic decisions of users" included in the preceding paragraph as referring to the judgments and decisions made by a "reasonable" user. It is fair to assume that a "reasonable" user who may rely on financial statements is knowledgeable about them, at least to the extent of understanding their meaning and limitations.*

*Section 1000.17 of the CICA Handbook, in its definition of materiality, states that "materiality is a matter of professional judgment in the particular circumstances".*

*Total expenditures of the Province in 1996 (program, debt service and capital) amounted to \$4.169 billion. The accrual under discussion represents 1.2% of total expenditures. Based on our professional judgment, an accrual representing 1.2% of total expenditures is not material and would not be considered material by, or influence economic decisions of, an informed reader of the financial statements.*

*After examining all of these matters, and after taking all factors into consideration, it is our professional opinion that the results of this accounting treatment did not materially misstate the financial position or results of operations of the Province, as reflected in the financial statements taken as a whole for the year ended March 31, 1996.*

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