

Department Audits

4 NOVA SCOTIA BUSINESS INC. - PAYROLL REBATES

BACKGROUND

- 4.1** Nova Scotia Business Inc. (NSBI) is a Provincial crown corporation which was created in April 2001; after the Nova Scotia Business Incorporated Act was given Royal Assent on November 30, 2000. Regulations governing NSBI activities were passed in November 2001. The Corporation has a 13 member Board of Directors comprised of individuals from various areas of the private sector.
- 4.2** NSBI's main goal is "to expand business activity in Nova Scotia." The corporation identifies four main lines of business: business attraction; business retention and expansion; trade promotion; and lending and finance. One way NSBI achieves its goals is through the use of payroll rebates. The payroll rebate program is "... a program funded through strategic investment funds, by which a portion of the taxes collected from a business, by the Province, are returned based on a percentage of the total payroll of the business." (NSBI Financial Assistance Regulations 2(1)(n))
- 4.3** Payroll rebates are paid from NSBI's Strategic Investment Fund. Payments are made in arrears after the company has demonstrated that they have achieved the terms and conditions set out in the signed payroll rebate agreement document. Typically, these arrangements cover periods from three to seven years. (See Exhibit 4.1 on page 38 for rebate payments by fiscal year.)
- 4.4** Rebate payments and accruals for 2003-04 totaled \$13.5 million. Additional rebate commitments of \$22.5 million to 13 companies were also approved during 2003-04. NSBI's 2003-04 Annual Report notes that these rebate commitments are expected to create between 2,297 and 3,327 jobs over the life of the agreements. Direct Provincial personal income tax revenues from those jobs are expected to total over \$37 million; resulting in a net positive impact on the Province's revenues. See Exhibit 4.2 on page 38 for estimated future direct tax recoveries and payroll rebate payments.
- 4.5** At March 31, 2004, NSBI had 28 approved payroll rebate agreements in place with maximum future payments of \$65.6 million. This was our initial broadscope examination of payroll rebates and of NSBI itself.

RESULTS IN BRIEF

- 4.6** The following are the principal observations from this audit.
- NSBI has adequate policies and procedures regarding the financial management of the payroll rebate program and demonstrates due regard for economy. Since NSBI's inception, improvements have been made to the payroll rebate program;

including a terms and conditions section in rebate agreements that typically addresses several areas such as number of jobs to be created and average salary.

NSBI management informed us that they are revising the standard terms and conditions for payroll rebate agreements. We have recommended that NSBI clarify what is required by the external auditor's certificate and develop wording to ensure these certificates will provide the desired level of assurance.

- Overall, NSBI's process for identifying, researching and approving potential rebate clients is well-managed. One area where we have recommended improvements is in the documentation of procedures for the risk assessment of prospective clients.

NSBI does not formally inquire whether all rebate clients are in receipt of additional government funding although repeat clients are asked to indicate non-NSBI sources of funding. We have recommended that NSBI include this information in rebate proposal documents to ensure its Investment Committee, Board and the Executive Council have a complete financial picture of prospective clients.

- NSBI's monitoring of payroll rebate agreements in progress was found to be appropriate. Improvements are required to longer-term monitoring of rebate clients once the agreements have expired. Management informed us they are implementing an account management system which will allow tracking of rebate clients and we encourage NSBI to continue working towards implementing this system.
- NSBI's verification and documentation of recipients' compliance with payroll rebate agreements was found to be adequate. No problems were noted with the disbursement process and NSBI staff involved had a good understanding of requirements. However, there are no written guidelines for rebate disbursements and we have recommended that NSBI formally document disbursement procedures.
- Overall, NSBI has policies and procedures in place to ensure compliance with legislation and regulations. We noted one area where NSBI was not fully compliant with regulations and recommended that NSBI comply in the future.

AUDIT SCOPE

- 4.7** The objectives for this assignment were to:

- document the payroll rebate process and assess the adequacy of NSBI's policies and procedures regarding the financial management of the payroll rebate program;

- assess whether NSBI demonstrates due regard for economy in the financial management of the payroll rebate program;
- assess the adequacy of NSBI's verification and documentation of recipients' compliance with payroll rebate agreements; and
- assess whether NSBI has policies and procedures in place to ensure compliance with legislation and regulations.

4.8 Our approach was based on interviews, review of payroll rebate agreements, disbursements and other documents. Criteria were developed from recognized sources including Office of the Auditor General of Canada's Financial Management Capability Model Application Guide, Treasury Board of Canada Secretariat's Policy on Transfer Payments and NSBI Act and Regulations.

PRINCIPAL FINDINGS

Financial Management

4.9 **Summary** - We assessed the adequacy of NSBI's policies and procedures regarding the financial management of the payroll rebate program and whether NSBI demonstrates due regard for economy. We noted that overall, roles and responsibilities are well understood. All approved rebates have written agreements which clients must sign in order to receive funds. NSBI's Board of Directors receives appropriate information to monitor rebate clients over the life of the agreements. We have recommended formal documentation of procedures in certain areas as well as improvements to long-term monitoring of rebate clients.

4.10 **Payroll rebate process** - Exhibit 4.3 provides information on NSBI's governance and organization which may be useful in gaining an understanding of divisions involved in the payroll rebate process. We reviewed five recent payroll rebate files with maximum rebate payments of \$25.6 million over the life of the rebate agreements. Based on this review, as well as discussions with staff at NSBI, we noted NSBI uses the following process in identifying, researching and approving payroll rebate clients.

- **Identification of potential client** - NSBI has Business Development Executives (BDEs) who research potential clients and begin negotiations that may lead to payroll rebates being awarded. In some cases BDEs contact prospective clients. Alternatively, interested companies may contact NSBI and be referred to the Business Development division.
- **Risk assessment** - A risk assessment is completed for each payroll rebate client. The assessment reviews risk in five areas: industry, management, financial, ability to access funds and environment. Assessments were typically completed by Financial Services staff. At the time of our audit, there was confusion among NSBI staff regarding whether future responsibility for this task would remain

with Financial Services or move to Business Development. Management informed us that responsibility is staying with the Financial Services division since they have the expertise to complete the necessary procedures.

Management noted that they are confident a full risk assessment is completed for all clients. However, there is no documented process for the preparation of risk assessments. Certain staff utilize checklists and scoring while others do not. Formal documentation of required procedures would help ensure that the risk assessment process is completed consistently for each client.

- **Economic impact** - NSBI provides the Nova Scotia Government's Department of Finance (DOF) with information on the number of jobs rebate clients expect to create and anticipated salary levels. DOF determines expected economic impact, both direct and spin-off. BDEs utilize economic impact data to calculate return on investment for the proposed rebate. This information forms part of the proposal which the Investment Committee and Board of Directors review prior to making their decision.
- **Proposal preparation and review** - Business Development Executives with NSBI prepare rebate proposals for presentation to the Investment Committee of the Board. Proposals include information on the prospective client, suggested terms and conditions of the agreement and return on investment to the Province.
- **Approvals** - The Investment Committee of the Board reviews rebate proposals and makes recommendations to the Board for approval, rejection or approval with amendments. All Investment Committee decisions must be ratified by the Board. Once a rebate proposal has been approved by the Board, the proposal and supporting documentation are reviewed and approved by the Minister of the Office of Economic Development and submitted to Executive Council for final approval via Order in Council.

Recommendation 4.1

We recommend that NSBI develop written procedures for the risk assessment process to ensure it is completed consistently for each payroll rebate client. Consideration should also be given to whether staff should be required to utilize common checklists to ensure consistency in assessing the risk of each potential client.

- 4.11** **Typical payroll rebate agreement** - Since its inception in 2001, NSBI has made improvements to the terms and conditions for new payroll rebate agreements. At the time of our audit, NSBI management informed us that they were revising the standard rebate agreement to ensure there are certain standard clauses for all agreements as well as areas which could be edited based on the particular client.
- 4.12** Typical rebate agreements include a letter of offer and terms and conditions which clients must sign and return to NSBI to finalize the rebate agreement. In our review of payroll rebates, we noted that more recent agreements included:

- definition of full time equivalent (FTE) hours;
- minimum number of FTEs which must be employed to qualify for the rebate, and, where applicable, maximum FTEs for which a rebate can be paid out;
- period of the agreement and percentage rebate;
- minimum annual salary, including benefits;
- supporting documentation clients must provide to demonstrate compliance with the agreement; and
- requirement for an external auditor's certificate certifying gross payroll, number of employees and hours worked (this is discussed further in paragraphs 4.22 to 4.24 of this Chapter).

4.13 **Review of pre-NSBI rebate agreement file** - We reviewed one older payroll rebate agreement which was approved prior to NSBI's inception. We noted that documentation requirements for newer rebate agreements were more stringent than those in the older file. For example, the older agreement did not include any performance conditions such as number of jobs to be created in order to qualify for a rebate.

4.14 **Monitoring** - Monthly reports to the Board include information on forecast payments by rebate agreement for that fiscal year, jobs created and total expected rebates. Since rebates are paid in arrears, this level of monitoring is appropriate.

4.15 At the time of our audit, NSBI did not have a process to follow up completed rebate agreements. However, management informed us that they are implementing an electronic account management system which will allow electronic documentation of all clients and include tracking of long-term success of rebate clients.

4.16 We suggest NSBI continue with its plans to improve long-term tracking of rebate clients to provide better information on the overall success of payroll rebates as a tool for business attraction and retention in Nova Scotia. Further, NSBI should consider including longer-term reporting requirements in payroll rebate agreements requiring clients to submit information to NSBI beyond the rebate period.

4.17 **Government assistance** - With the exception of repeat clients, we noted that NSBI does not formally inquire whether potential clients are also receiving other sources of government funding. This could potentially result in an incomplete financial picture. In some cases, rebate approval might be contingent on the client receiving funding from other sources, including other government sources. NSBI staff indicated that in these situations, they require confirmation of other funding.

Recommendation 4.2

We recommend that NSBI determine whether potential rebate clients are in receipt of or will receive other forms of government assistance for the same project and verify funding where applicable. This information should be provided in rebate proposal documents to ensure NSBI's Investment Committee, Board and the Executive Council have a complete financial picture of prospective clients.

Compliance

- 4.18** **Summary** - We assessed NSBI's verification and documentation of recipients' compliance with payroll rebate agreements and found its processes to be adequate. There was evidence of review of supporting documentation and approval by NSBI staff prior to disbursements being made.
- 4.19** Overall, NSBI appears to have policies and procedures in place to ensure compliance with legislation and regulations. We noted one area where NSBI was not fully compliant with regulations and recommended that NSBI comply in the future.
- 4.20** **Disbursement process** - Payroll rebate disbursements are paid in arrears following a request for payment by the rebate client. NSBI staff review the original rebate agreement terms and conditions and verify that the client has provided the required supporting documentation. The Director of Corporate Services reviews the request for payment as well as the supporting documentation and must approve the request prior to a disbursement being made. Payments are made based on the terms and conditions which the Investment Committee and the Board approved at the time the rebate agreement was implemented. Generally, an NSBI staff member delivers the cheque to the rebate client. This provides an opportunity for an informal review of the company's operations.
- 4.21** NSBI does not have any formal, written procedures for rebate disbursements. Although staff demonstrated a good understanding of the steps in the disbursement process, written guidelines would help promote consistency among staff.

Recommendation 4.3

We recommend that NSBI formally document procedures for payroll rebate disbursements.

- 4.22** **Supporting documentation** - For pre-NSBI rebate agreements, disbursement requests were typically accompanied by client-generated documents noting numbers of jobs created and associated salaries. Rebate agreements under NSBI have terms and conditions which require an external auditor's certificate. We reviewed three disbursements on rebate agreements signed since NSBI's inception. We

noted that two files included audit reports on total payroll and employees while the remaining file had a special purpose, specified procedures report, signed by a public accountant, stating payroll information had been agreed to the pay register.

- 4.23** We were informed that NSBI is revising standard agreement sections for rebate terms and conditions. These standard sections should address whether audit level assurance is required or if specified procedures reports are acceptable. If management determines that specified procedures reports are sufficient, the specific procedures required should be clearly stated. This would allow NSBI to ensure it has a consistent level of assurance for all rebate disbursements. NSBI may wish to consult with its external auditor for assistance in determining the appropriate level of assurance.
- 4.24** During our audit, NSBI management identified a recent disbursement that was made without an audit certificate. Although the terms and conditions required an “auditor’s certificate certifying gross wage or payroll bill...and the number of employees and hours worked”, the client’s understanding was that an internal report was sufficient. The Board and Investment Committee were not consulted prior to the disbursement being made. This payment represented the initial disbursement on an agreement. No further disbursements had been made at the time of our audit. The client has requested a renegotiation of the terms and conditions. NSBI management informed us that any amendment to the original agreement will clearly state that an external audit certificate is required.

Recommendation 4.4

We recommend that NSBI finalize revised wording for standard rebate terms and conditions. The level of assurance required from an external auditor or procedures to be performed to verify a company has met the terms and conditions necessary for rebate disbursement should be clearly stated.

- 4.25** **Testing results** - We tested five recent rebate disbursements totaling \$4.7 million. Maximum rebate payments over the life of these five agreements total \$29 million. We noted that supporting documentation was provided as specified in the original terms and conditions for each rebate agreement and NSBI staff signed off on the disbursements as required.
- 4.26** **Financial statement audit** - As part of our work, we reviewed the files of NSBI’s financial statement auditors for background information purposes. The auditors tested controls for rebate disbursements and concluded that those controls were operating properly. There were no significant findings reported from that audit.
- 4.27** **Legislation and regulations** - We reviewed NSBI’s policies and procedures regarding compliance with legislation and regulations. For the most part, NSBI is in compliance with legislation and regulations. We noted one exception: rebate

policies and guidelines are not included in the annual business plan as required by NSBI Regulations.

Recommendation 4.5

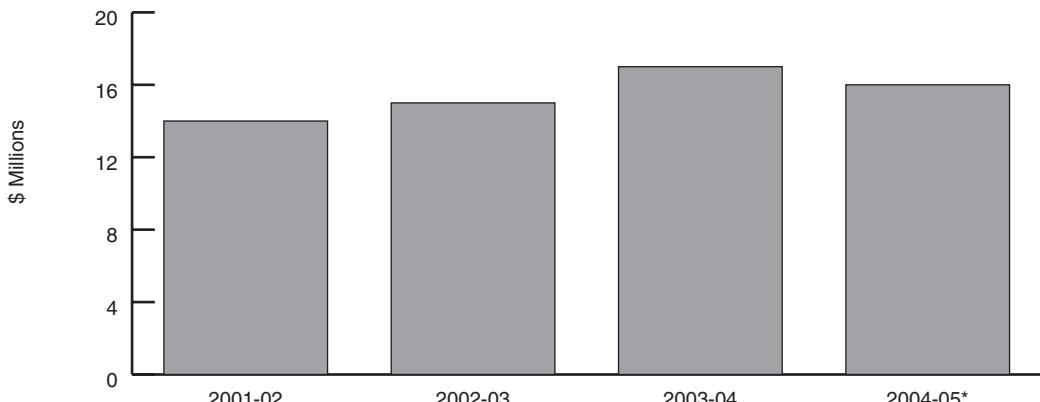
We recommend that payroll rebate guidelines and policies be included in NSBI's annual business plan as required by Regulations.

CONCLUDING REMARKS

- 4.28** Since NSBI's inception, improvements have been made to the Province's payroll rebate program. NSBI has adequate policies and procedures in place to support the financial management and control of the rebate program. We have made recommendations that certain of these processes should be more formally documented.
- 4.29** NSBI is required to submit a performance report in late 2006 against its five-year strategic plan (2002-07). The performance of its payroll rebate program will need to be a significant element of that report.
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Exhibit 4.1

Annual Payroll Rebate Expenditures

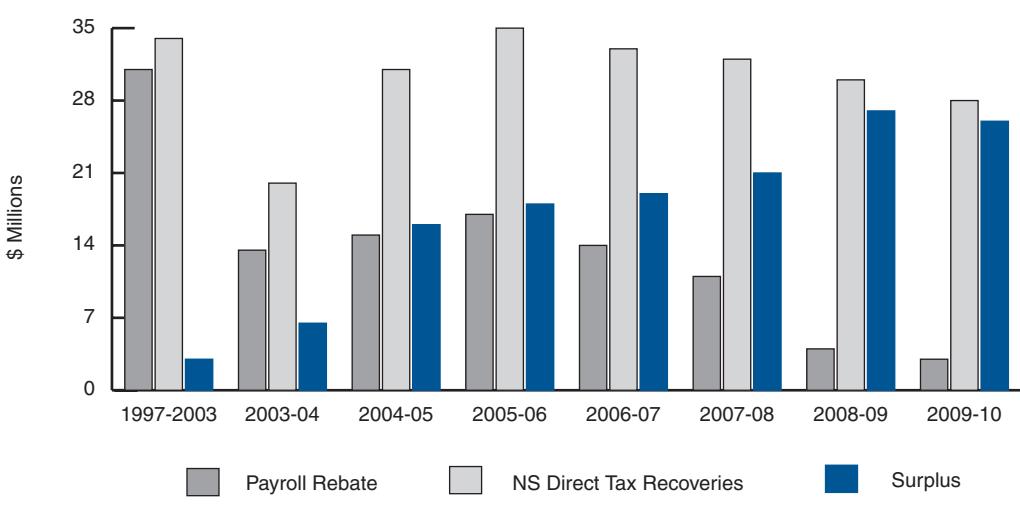


*Estimate

Source: Nova Scotia Business Inc.

Exhibit 4.2

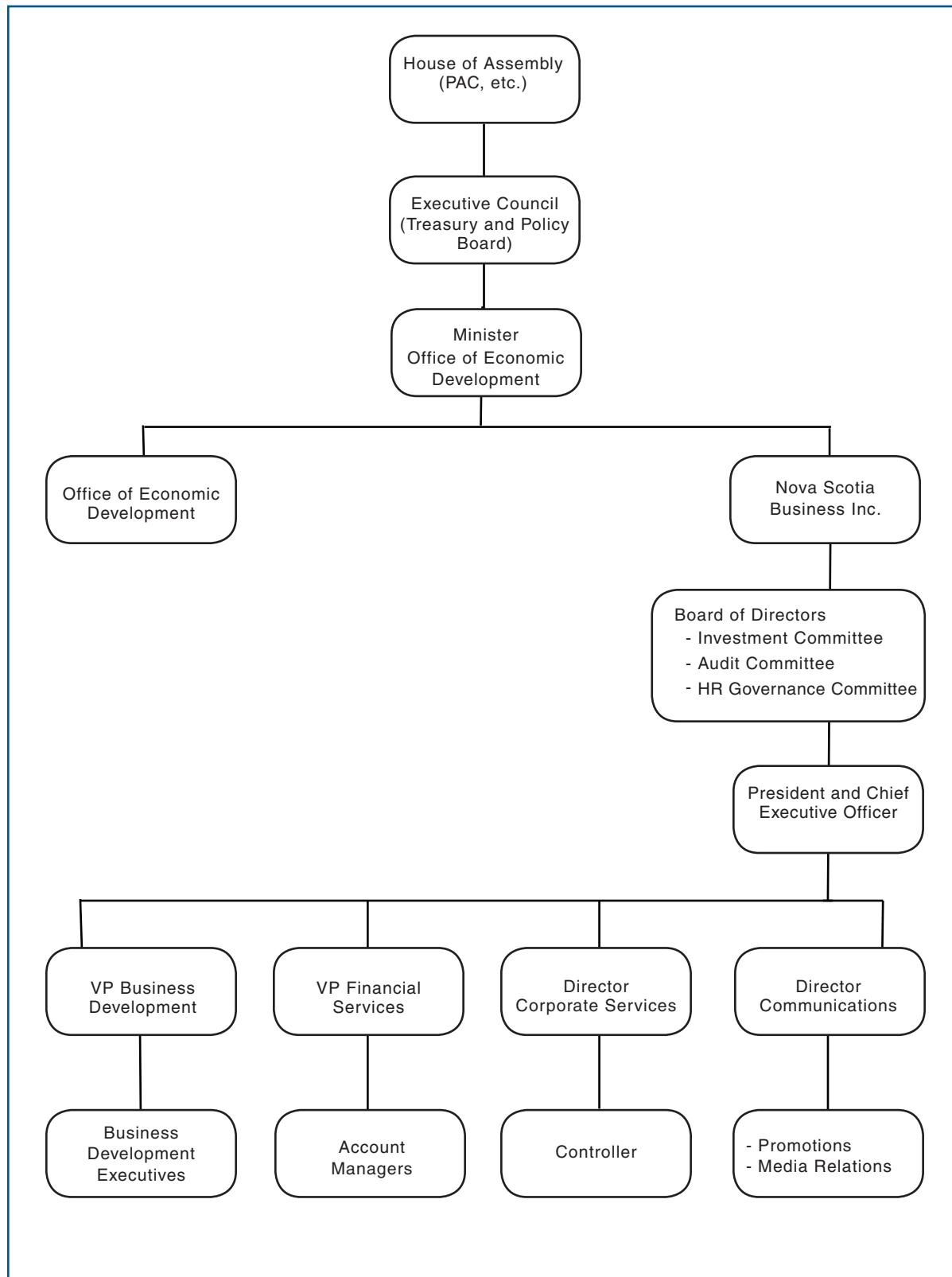
Payroll Rebate Expenses and Expected N.S. Direct Tax Recoveries



Note: Payroll rebate expenses are estimates for fiscal years 2003-04 to 2009-10. Expected direct tax recoveries and surplus are based on estimates for all fiscal years.

Nova Scotia Business Inc. - Governance and Organization Chart

Exhibit 4.3



NOVA SCOTIA BUSINESS INC.'S RESPONSE

Thank you for the opportunity to comment on the Payroll Rebate Audit report. Nova Scotia Business Inc. (NSBI) is supportive of the findings and recommendations. NSBI is pleased that the report indicates that the policies and procedures are adequate and that the changes implemented by NSBI have improved the delivery of the Payroll Rebate. We strive to continue to improve it and would like to comment on the recommendations.

Recommendation 4.1

We currently employ a process that ensures the relevant risk factors to a Payroll Rebate are considered. Credit risk is an important consideration for the Payroll Rebate, but the risk assessment is different than that for loans as it targets the opportunity cost of client non-performance. We agree that written procedures relating specifically to the Payroll Rebate would be beneficial and would distinguish the process from that which is outlined in the detailed risk assessment procedures for loans.

Recommendation 4.2

We agree that other forms of government assistance can be an important consideration when determining the risks associated with a Payroll Rebate client. While we have indicated other known government assistance in the past, NSBI will make a change to the current proposal format to ensure this factor is specifically identified. All known and relevant forms of government assistance relating to the same project will be documented.

Recommendation 4.3

NSBI will draft procedures outlining the steps currently used in the disbursement process. These procedures will

augment the Board approved disbursement policy and account manager checklist currently employed.

Recommendation 4.4

The recommendation to improve the wording of the level of assurance required from the external auditor is appreciated and NSBI has implemented the change.

Recommendation 4.5

The payroll rebate guidelines will be included in the upcoming NSBI annual business plan.

We would like to thank the team that provided the Payroll Rebate Audit report. Your advice on improving the Payroll Rebate is appreciated and we will continue to seek advice as more improvements are made.