

Government-Wide Issues

2

GOVERNMENT FINANCIAL REPORTING

BACKGROUND

- 2.1** For Members of the Legislative Assembly (MLAs) to hold government accountable for its use and control of public funds and resources, they need adequate information on the Province's financial plans, performance and condition.
- 2.2** The Minister and Deputy Minister of Finance are, under the provisions of the Provincial Finance Act, assigned various authorities and responsibilities related to the role of a chief financial officer for the Province. Certain of these assignments include the need for Governor in Council (i.e., Executive Council) approval or ratification of planned actions.
- 2.3** The Provincial Finance Act defines a number of financial reporting requirements for the Minister or Deputy Minister of Finance to meet on behalf of government. These include the following requirements.
- Annual estimates (Section 7A)
 - Interim reports on state of public finances (Section 8B, see also Section 77)
 - Annual public accounts (Sections 9 and 10)
 - Remission of tax, penalty or other debts (Section 19B)
 - Additional appropriations (Section 28, see also Section 75)
 - Special warrants (Section 29, see also Section 59D)
 - Redemption or purchase of securities (Section 54)
 - Financial transactions (Section 59B)
 - Financial obligations (Section 59C)
 - Consolidated fiscal plan (Section 82)
 - Report on outcomes for fiscal year (Section 83)
- 2.4** Further, Section 73 of the Provincial Finance Act requires that crown corporation business plans, any proposed public financing and audited financial statements be tabled in the House of Assembly each year.
- 2.5** As a foreign registrant of the Securities and Exchange Commission (SEC) in the United States, or its equivalent in other countries, government must file required documents in order to be able to access financing or financial markets.
- 2.6** In addition to required financial reporting, government can and has periodically, at its discretion, released other financial information or reports (e.g., debt reduction plan) publicly.

RESULTS IN BRIEF

2.7 The following are our principal observations in this chapter.

- The Auditor General's opinion on the government's 2004-05 revenue estimates was qualified for the same reasons as the previous year. It was tabled April 22, 2004 as part of the Nova Scotia Budget publication (page A2). A management letter on this year's review was issued on May 10, 2004.
- As in prior years, our audit of the Province's March 31, 2004 consolidated financial statements will be completed in two phases. The target deadline for the completion of our audit work is September 23, 2004. The scheduled date assumes year-end accounting and audit readiness requirements are met.
- The April 22, 2004 Budget Address and supporting documents disclosed information on accounting and other changes planned. This additional information is a significant improvement over last year, and should assist users to better understand the comparative information provided on government's fiscal plans and performance.
- In light of the updated net debt projections included in the April 22, 2004 Budget Address which include the retirement health benefit obligations, the June 11, 2003 debt reduction plan information on the government's website should be updated or removed. In its current form, the plan on the website is incomplete, not compliant with generally accepted accounting principles (GAAP), and could be misleading.
- Additional appropriations for 2002-03 of \$65,928,537 for program expenses and \$3,093,000 for sinking fund installments and serial retirements were approved on January 23, 2004 by Order in Council 2004-13. No special warrants have been approved since our last Report.

SCOPE

2.8 The Auditor General Act provides broad mandates for the Office to examine and report on use and control of public funds or resources by government, its controlled entities, and recipients of financial assistance. Further, Sections 9 and 9B of that Act provide for specific annual coverage and reporting by the Auditor General on government's financial statements (audit - high assurance) and revenue estimates (review - moderate assurance), respectively. The Office is also required to review the Province's annual U.S. SEC filing documents.

2.9 The annual financial statements of various crown entities and trusts are, depending on statutory or other arrangements, audited and reported upon by the Auditor General or a public accounting firm. We consider these financial statement audits, as well as other government financial reporting, where appropriate during the conduct of the Office's discretionary broad scope assignments in selected areas each year.

- 2.10** The purpose of this chapter is to provide summary comments and observations on government's financial reporting, including information on the planning or results of the Office's examination of government's financial statements and revenue estimates.

PRINCIPAL FINDINGS

Review of Revenue Estimates

- 2.11** The Auditor General's reporting required under Section 9B of the Auditor General Act on the 2004-05 revenue estimates was tabled in the House on April 22, 2004 along with the supporting information for the 2004-05 Nova Scotia Budget. Exhibit 2.1 on page 14 is a copy of the Auditor General's Report on the 2004-05 Revenue Estimates. The Report is qualified for the same reasons as the previous year (i.e., non-consolidated basis, unable to determine impact of personal income taxes being estimated based on federal assumptions).
- 2.12** Subsequent to the conclusion of our review of the revenue estimates, we issued a management letter to Finance on May 10, 2004. That letter provided additional observations and comments from our review of the 2004-05 revenue estimates and other related information included in the Minister of Finance's April 22, 2004 Budget Address and supporting documents.
- 2.13** The following is a summary of selected matters and recommendations in the management letter.
- The summary of possible differences identified during our review net to an average understatement of \$19.8 million, or 1/3 of 1% of the total ordinary revenue reviewed.
 - The economic assumptions and the revenue line item estimates were developed by staff without direct knowledge of or information on government revenue and spending plans for 2004-05. Subsequently, once the 2004-05 revenue and spending plans were finalized, Finance senior management assessed their impact on significant transfer and taxes revenue line items received from the federal government.
 - The government's values for economic assumptions were not used directly to estimate all revenue line items which should have used those values. In all such instances, except for the personal income tax revenue line, the impact of using other than government's values for economic assumptions could be assessed.
 - Since 1994-95, net prior year adjustments (PYAs) totalling \$740 million have been reported by government (approximately 1.5% of the total ordinary revenue reported for that timeframe). It must be acknowledged that PYAs will most likely be identified during 2004-05 for prior years and, with respect

to 2004-05 in future years, and that they could be significant individually or collectively. In this regard, further adjustments may be necessary to the PYAs for 2003-04 included in the budget documents as a result of new updated information that becomes available prior to the finalization of the Province's March 31, 2004 consolidated financial statements.

- This year's revenue estimates management letter included the following recommendations.

Recommendation 2.1

We recommend the economic assumptions and estimated revenues for each line item be developed after the Executive Council has approved planned revenue and spending decisions for the coming year and the impact of those decisions be incorporated into the development of the economic assumptions and the revenue line items.

Recommendation 2.2

We recommend all assumptions used in the development of the revenue estimates be approved by the Executive Council.

Recommendation 2.3

We recommend that the processes and practices for measurement and recognition of tax and other revenue transfers from the federal government be reviewed to ensure they are the most appropriate.

- 2.14** As part of our revenue estimates review, we refer to pronouncements of the Canadian Institution of Chartered Accountants (CICA), including those directed to management preparers of future-oriented financial information (FOFI). Each year, we notify Finance that the Department should ensure appropriate compliance with those pronouncements when preparing and presenting the revenue estimates. Comments raised in the House and at recent meetings of the Public Accounts Committee (PAC) lead us to suggest that not only should these pronouncements be more specifically considered by government with regard to revenue estimates, but also for other budget information provided by government. In this regard, we recommend the following in Chapter 3 (paragraphs 3.38, 3.41-3.43) of our 2001 Report.

3.38 *Information presented with or supporting the Estimates should be verifiable and free from material error or bias. Users of the information should be able to depend upon it to faithfully represent what it purports to represent and the information should be linked to and consistent with economic and program-related assumptions.*

3.41 The information provided to the House along with the Budget Address could more completely identify the nature and extent of program changes or adjustments made as a result of decisions in the budget process. Financial budget information should be clearly linked and cross-referenced to program plans, including information provided on outcomes or targets.

3.42 We believe it is imperative for readers of the business plans and budget information to be able to clearly identify significant changes that result in the plans and budget being presented on a basis different than prior years. Government has an obligation to ensure sufficient, appropriate supporting information is available to MLAs, as a matter of course, to support the substance of budget debate in the House.

3.43 However, it is not possible for the Auditor General or government to anticipate all significant information needs of MLAs. In this regard, one option to consider could be an all-party committee of MLAs to identify basic requirements.

2.15 In addition, we note that the inclusion of debt reduction provisions in the determination of the budgeted surplus for 2004-05 is not compliant with generally accepted accounting principles (GAAP). Such allocations or transfers do not represent program expenses or other charges to be included in the measurement of annual operating results under GAAP financial reporting.

Audit of Government's Financial Statements

2.16 Under Section 9 of the Auditor General Act, the Auditor General is mandated to examine and report on the government's annual consolidated financial statements. The government released the Province's March 31, 2003 consolidated financial statements on November 13, 2003 as part of Volume 1 of the Public Accounts. The Auditor General's opinion on those statements was unqualified.

2.17 On November 14, 2003, we released a special report on the results of our audit of the Province's March 31, 2003 consolidated financial statements and other financial reporting practices of government. Subsequently, the 2003 Report of the Auditor General, released on December 17, 2003, provided further summary observations and recommendations on government's financial and other reporting. We also issued a detailed management letter to Finance dated February 13, 2004.

2.18 In May 2004, Finance provided a detailed response to the matters reported as a result of our 2003 audit work. This response was thorough, identifying specific action taken or planned to address our observations and recommendations.

2.19 Professional standards require that the auditor of an entity with public accountability, like the Province, communicate with those having oversight responsibility for the entity's financial reporting process. For the Province's financial reporting by government, oversight responsibility rests, to a significant extent, with the Executive Council. In addition, the House of Assembly, including its Public Accounts Committee, has an important role in the oversight and public accountability processes for the Province's financial reports issued by government.

- 2.20** In accordance with the professional standards referred to above, the Office of the Auditor General's 2003 Performance Report and 2004 Business Plan publication (issued March 31, 2004) included comments on the independence of the Auditor General position from government as well as on the professional conduct rules and standards adhered to by the Office.
- 2.21** We issued a letter to Finance on March 5, 2004 which included a list of information, schedules, documentation and other readiness requirements to be met by government management and accounting staff to facilitate the timely and cost-effective completion of the audit of the Province of Nova Scotia for the fiscal year ending March 31, 2004.
- 2.22** As in prior years, the audit of the consolidated financial statements is to be completed in two phases. Most of the work for the first phase, focusing on the core government consolidated fund accounting balances, is scheduled to start May 25th, with an interim exit meeting scheduled for July 15th. The second phase is the work on the draft consolidated financial statements, which are to be available for audit by August 16th.
- 2.23** Based on experience in prior years, certain areas have been identified where Finance's Government Accounting Division has agreed to focus additional attention. The Division will also increase quality assurance processes, on the information provided by departments and agencies, in order to reduce the risk of errors in the draft financial statements and improve the efficiency of the year-end accounting and auditing processes. These areas for increased attention include, for example:
- the federal-provincial accounts receivable/payables and accruals by revenue line item and by year;
 - the closure and clean-up provision balance(s) for SYSCO;
 - the year end accruals and accrued balances of departments;
 - the commitments and contingencies of departments; and
 - the restructuring costs and accruals.
- 2.24** The target deadline for the completion of our audit of the consolidated financial statements is September 23, 2004. The scheduled date assumes year-end accounting and audit readiness requirements are met on a timely and appropriate basis.
- 2.25** Generally accepted accounting principles (GAAP) are not static. Standard setters in Canada and internationally continue to develop new or revised pronouncements in important areas. This is true for the CICA Public Sector Accounting Board (PSAB) which is the primary body issuing recommendations on public sector accounting

in Canada. The following are the more significant matters in progress at PSAB or on which it has recently released final or draft pronouncements:

- financial statement discussion and analysis;
- government transfers;
- liabilities, contingent liabilities and contractual obligations; and
- GAAP hierarchy.

2.26 New formal recommendations or guidance in these areas could require changes to government's financial reporting in the future.

Recommendation 2.4

We recommend that government, where possible, identify required and planned accounting changes to the House in advance of the start of the fiscal year in which they will be implemented.

2.27 Government, primarily through management of the Department of Finance, is responsible for preparation of the Province's consolidated financial statements. This includes responsibilities related to internal control, such as designing and maintaining accounting records, selecting and applying accounting policies, safeguarding assets, preventing and detecting error and fraud, and being aware of circumstances that could result in fraudulent financial reporting.

2.28 The Auditor General's responsibility is to express an opinion on the consolidated financial statements. The opinion is based on our audit which is performed to obtain reasonable, but not absolute, assurance as to whether the financial statements are free of material misstatement. Due to the inherent limitations of an audit, there is an unavoidable risk that some misstatements of the March 31, 2004 consolidated financial statements will not be detected even though the audit is properly planned and performed.

2.29 In conducting our audit, we will obtain a sufficient understanding of the systems and controls to plan the audit. Where we intend to rely upon controls, sufficient audit evidence will be obtained to support that assessment. However, the scope of our review of government's systems and controls during the audit of the March 31, 2004 consolidated financial statements will not be sufficient to conclude on the adequacy of the overall level or quality of controls.

2.30 The financial statements of various crown corporations and agencies of government are audited by other auditors. As appropriate under generally accepted auditing standards, we will rely on the work and reporting of these other auditors.

- 2.31** The Auditor General will express an opinion as to whether the financial statements present fairly, in all material respects, the financial position, results of operations and cash flows of the Province of Nova Scotia in accordance with Canadian generally accepted accounting principles for the public sector. Our audit will be carried out in accordance with Canadian generally accepted auditing standards.
- 2.32** The concepts of materiality and audit risk are implicit in the wording of the standard auditor's report. It is intended to communicate, amongst other items, that the amounts included in the financial statements are not necessarily precise and that the audit does not provide absolute assurance that the financial statements are not materially misstated. In this regard, as noted, we seek reasonable assurance that the financial statements as a whole are not materially misstated. Government is responsible for maintaining accurate books and records, and the expectation is that non-trivial errors will be corrected.

Other Matters

- 2.33** [Disclosure of accounting changes](#) - Our November 14, 2003 report on government's financial reporting practices raised significant concerns about Finance's adherence to generally accepted accounting principles (GAAP) when issuing non-financial statement financial reports and information.
- 2.34** Government's financial reporting in spring 2003, on required and planned accounting changes to account for pensions and retirement health benefit costs and obligations as at March 31, 2003 and beyond, was incomplete and inadequate. Budget documents released on April 3, 2003 and the debt reduction plan released on June 11, 2003 did not reflect all of the costs and obligations associated with these changes, or the comparative impact of changes on prior period information.
- 2.35** On June 30, 2003, after we formally communicated our concerns (which had previously been noted in April 2, 2003 correspondence to the Minister) to the Minister of Finance and the Premier's office, government announced its intentions to implement GAAP compliant accounting as at March 31, 2003 to recognize its retirement benefit costs and obligations.
- 2.36** In accordance with GAAP, those changes, including the retroactive impact on the prior period comparative information, were reflected in the Province's March 31, 2003 consolidated financial statements released by government on November 13, 2003.
- 2.37** In December 2003, government indicated that recommendations in our November 14th special report would be addressed. We acknowledge that on March 30, 2004, Finance announced that it was implementing changes to its tangible capital asset accounting effective for 2003-04. The announcement provided descriptive information on the various changes being implemented and their impact on the 2003-04 results. We will complete an examination of these changes as part of the audit of the March 31, 2004 consolidated financial statements.

- 2.38** We also acknowledge that the April 22, 2004 Budget Address and supporting documents disclosed information on accounting and other changes planned. This additional information - on page B4 of the Budget Address - is a significant improvement over last year, and should assist users to better understand the comparative information provided on government's fiscal plans and performance.
- 2.39** [Debt reduction plan](#) - When released on June 11, 2003, the debt reduction plan was not presented in accordance with GAAP. The total net direct debt of \$11.7 billion as at March 31, 2003 would have been \$12.2 billion had the government's retirement health benefit obligations been included in accordance with GAAP. This concern was brought to Finance's attention at various times, formally and informally, during 2003.
- 2.40** After comments made at the December 3, 2003 Public Accounts Committee meeting, the Deputy Minister of Finance undertook to ensure that the debt reduction plan was updated to reflect the additional obligations. Finance dealt with this undertaking by adding the following note at the end of the version of the plan on the government's website.
- "Addendum: Based on the 2002-2003 Public Accounts, released on November 13, 2003, the province's net direct debt is now at \$12.2 billion, up from the \$11.7 billion estimate in the April 3, 2003 budget."*
- 2.41** In light of the updated net debt projections included in the April 22, 2004 Budget Address which include the retirement health benefit obligations, the June 11, 2003 debt reduction plan information on the government's website should be updated or removed; since in its current form it is incomplete, not GAAP compliant, and could be misleading.
- 2.42** [Government news release](#) - While it is not normally the practice of this Office to comment on government news releases, representations made in a December 3, 2003 release titled *Nova Scotia Books Accurate and Fair*, issued subsequent to a PAC meeting on government's financial reporting, were very troubling to us.
- 2.43** For example, when commenting on our November 14, 2003 special report issue regarding accounting for retirement health benefit (RHB) costs and obligations, that release indicated the "Department did not become aware that the timing of the accounting change was a serious issue for the Auditor General until June of this year." This echoed comments made by Finance at the PAC meeting, but ignored the facts tabled at that meeting, including that on April 2, 2003 the Minister and Deputy Minister of Finance had been formally notified in writing that the decision to not fully account for RHB costs and obligations as at March 31, 2003 was not compliant with GAAP.
- 2.44** As a result, it is still our view that the government had been told, and should have known, that the net debt total of \$11.7 billion reflected in its June 11, 2003 debt reduction information should have been \$12.2 billion as at March 31, 2003 in order to be GAAP compliant as government had represented when the plan was released.

Recommendation 2.5

We recommend that government news releases on its financial reports and reporting be factually correct, complete and accurate.

- 2.45** **Additional appropriations and special warrants** - Section 9A of the Auditor General Act requires, among other things, that we call attention to every case observed in which any appropriation is exceeded or a special warrant is authorized. Our last reporting under that section was in the 2003 Report of the Auditor General, chapter 16. We now provide the following updated comments.
- 2.46** Under the provisions of Section 28 of the Provincial Finance Act, on January 23, 2004 the Executive Council approved Order in Council 2004-13 putting in place additional appropriations for 2002-03 of \$65,928,537 for program expenses and \$3,093,000 for sinking fund installments and serial retirements. The tabling in the House, required within 15 days of the above OIC under that Section, was outstanding at the time this chapter was drafted in early May 2004.
- 2.47** As per the 2003-04 forecast information released with the Minister of Finance's April 22, 2004 Budget Address, subject to year-end accounting or audit adjustments, additional spending authority (additional appropriations) will need to be approved by OIC within 90 days of the government's release of the March 31, 2004 consolidated financial statements.
- 2.48** We note that since our last Report, there have been no special warrants approved by the Executive Council under Section 29 of the Provincial Finance Act.

CONCLUDING REMARKS

- 2.49** Government's decision to ensure generally accepted accounting principles are followed in all of its financial information and reporting is acknowledged. Appropriate and continued implementation of this decision should contribute significantly to the quality of government's financial reporting.
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Report of the Auditor General to the House of Assembly on the Estimates of Revenue for the Fiscal Year Ending March 31, 2005 used in the preparation of the April 22, 2004 Budget Address

Exhibit 2.1

I am required by Section 9B of the Auditor General Act to provide an opinion on the reasonableness of the estimates of revenue used in the preparation of the annual budget address of the Minister of Finance to the House of Assembly.

The estimates of revenue for the fiscal year ended March 31, 2005 (the 2004-05 revenue estimates) are the responsibility of the Department of Finance and have been prepared by departmental management using assumptions with an effective date of March 1, 2004. I have examined the support provided by the department for the assumptions, and the preparation and presentation of the 2004-05 revenue estimates of \$5,908,287,000 for total ordinary revenue. My opinion does not cover the budget address, the 2003-04 forecast, the 2004-05 spending estimates, sinking fund earnings, nor recoveries, user fees or other income netted for annual appropriation purposes. My examination was made in accordance with the applicable Auditing Guideline issued by the Canadian Institute of Chartered Accountants. I have no responsibility to update this report for events and circumstances occurring after the date of my report.

Commencing with the fiscal year ending March 31, 1999, the Government implemented consolidated financial statement reporting in accordance with Canadian generally accepted accounting principles for the public sector. Consistent with prior years, the 2004-05 revenue estimates have been presented including the total ordinary revenue of the Consolidated Fund established under the provisions of the Provincial Finance Act. As a result, sinking fund earnings and revenue of certain government organizations reported as revenue in the Province's consolidated financial statements are excluded from the 2004-05 revenue estimate for total ordinary revenue, but included elsewhere in the 2004-05 estimates, and have not been included in my examination.

The personal income taxes (PIT) revenue for 2004-05 was estimated based on national level taxable income and provincial share information determined by the federal government. The extent to which the economic and other assumptions used by the federal government to determine this information agrees to or differs from the Nova Scotia government's assumptions for 2004-05 has not been fully determined. As a result, the impact of any differences on the PIT estimate can not be adequately assessed.

Except for the effect of adjustments, if any, which might have been necessary as a result of the matters discussed in the preceding paragraphs, in my opinion,

- as at the date of this report, the assumptions used by the Department are suitably supported and consistent with the plans of the Government, as described to us by departmental management, and provide a reasonable basis for the 2004-05 revenue estimates; and
- the 2004-05 revenue estimates as presented reflect fairly such assumptions.

Since the 2004-05 revenue estimates are based on assumptions regarding future events, actual results will vary from the information presented and the variations may be material. Accordingly, although I consider, except for the matters discussed above, the 2004-05 revenue estimates to be reasonable, I express no opinion as to whether they will be achieved.

(original signed by)
E. R. Salmon, FCA
Auditor General

Halifax, Nova Scotia
April 19, 2004