
6 Government Financial Reporting

Summary

An audit opinion provides independent assurance on the financial results of an entity. An unqualified audit opinion provides assurance that the financial statements present fairly, in all material respects, the financial results of an entity. The Minister of Finance tabled the Province's audited consolidated financial statements on August 9, 2007. The Auditor General's opinion on those statements was unqualified. This release date is significantly earlier than the release date closer to the end of September in prior years. We commend the efforts of Department of Finance staff in preparing and releasing more timely financial results.

Several findings and observations resulting from this audit were reported in a management letter issued to the Minister of Finance in January 2008. We noted accomplishments in financial reporting during the year such as the disclosure of budget information, as necessary, throughout the financial statements, and the disclosure of expenses at gross values.

The most significant of our findings related to an accounting change and its retroactive restatement in the financial statements. We believe an additional adjustment of \$27.5 million was required to the accumulated deficit of the Province at April 1, 2006. Although this finding and others identified were neither individually, nor cumulatively, significant enough to affect the opinion on the consolidated financial statements, each impacted on the integrity of financial results, and reduced the usefulness of these statements to users.

We made several comments with respect to systems and controls. We noted the need to document roles and responsibilities for controls, including internal controls, and government's continued efforts to fulfill this need. We also noted our continued concerns with respect to IT access issues, and have made a recommendation to reduce access to certain IT functions to select individuals.

We are required under Section 9 of the Auditor General Act to report any appropriations that were exceeded during the year. Two additional appropriations were approved totaling \$222.4 million to cover budget overruns for 2006-07. The most significant amount of the total additional appropriations related to capital purchase requirements which exceeded the approved budget by \$75.6 million. We noted, as we have several times over the past years, that the current process to approve additional appropriations reduces accountability to and control by the House of Assembly. The debate and challenge that are integral to the budget process are absent from the approval for additional appropriations.

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Background

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- 6.1 The Provincial Finance Act establishes the roles and responsibilities of the Minister and Deputy Minister of Finance. Key among these are financial reporting requirements including the preparation of estimates, public accounts and forecasts. These reporting requirements are a significant component in the accountability framework between the Department and the House of Assembly. The framework also includes:
- the annual tabling of crown corporations' business plans, audited financial statements and proposed public financing in the House of Assembly;
 - the filing of required documents as a foreign registrant of the Securities and Exchange Commission in the United States (or its equivalent in other countries);
 - other discretionary financial information or reports released to the public;
 - the oversight responsibility of the Executive Council; and
 - the role of the House of Assembly itself, including the Public Accounts Committee in holding government accountable for the use and control of public funds.
- 6.2 As an independent audit office, the Office of the Auditor General's role in the accountability framework is established through the Auditor General Act. The broad mandate of the Act provides for the Office to examine and report to the House of Assembly on the use and control of public resources by government and its controlled entities, as well as recipients of financial assistance. Further, Sections 9 and 9B of that Act provide for specific annual reporting by the Auditor General on the Province's consolidated financial statements (an audit engagement, with a high level of assurance provided by the audit opinion), and government's revenue estimates (a review engagement, providing a moderate level of assurance).
- 6.3 The Auditor General's opinion on the 2007-08 revenue estimates was tabled in the House of Assembly on March 23, 2007 along with the government's budget documents. The results of that review were reported in Chapter 7 of the June 2007 Report of the Auditor General.

Chapter Objective

- 6.4 The purpose of this Chapter is to provide summary comments and observations on our audit of the Province's March 31, 2007 consolidated financial statements. A draft management letter including detailed comments and suggestions was issued to the Minister of Finance in October 2007. Management's responses were included in the final letter dated January 31, 2008.

Significant Observations

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Results of the March 31, 2007 Audit

- 6.5 *Conclusions and summary of observations* – The Minister of Finance tabled the Province's audited consolidated financial statements on August 9, 2007, well in advance of the legislated deadline of September 30. The Auditor General's opinion on those statements was unqualified.
- 6.6 The Province's Government Accounting Division is responsible for the preparation of the Province's consolidated financial statements. We commend the efforts of the Division in preparing and releasing more timely financial results. Several findings resulted from the audit and these were reported in a management letter issued to the Minister of Finance in January 2008. While our findings were neither individually nor cumulatively significant enough to affect the opinion on the consolidated financial statements, each impacts on the integrity of financial results, and reduces the usefulness of these statements to their users.
- 6.7 Professional standards require that an auditor review, prior to their release, any information or other documents to be released concurrently, or in combination, with financial statements upon which the auditor has or will be providing an opinion. We reviewed, but did not audit, the information in the Financial Discussion and Analysis section of Volume 1 of the March 31, 2007 Public Accounts.

Significant Accounting Policies

- 6.8 *Prior and current recommendations* – The June 2007 Report of the Auditor General identified certain areas in which the Province's March 31, 2006 consolidated financial statements were not yet fully in compliance with generally accepted accounting principles (GAAP). We recommended steps be taken to ensure fuller compliance for the March 31, 2007 consolidated financial statements, the audit of which had just begun. We are pleased to acknowledge that significant steps have been taken to address many of these areas. Accomplishments during the year include the following.

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- Budget information is now included on the Statement of Change in Net Direct Debt. This completes the required disclosure of budget information under Public Sector Accounting Board (PSAB).
 - PSAB requires that expenses be disclosed at gross values. Management began the process of recording user fees, chargeables and recovery account balances as revenues in 2005-06, and continued improvements during the current year. The March 31, 2007 Statement of Operations and Accumulated Deficits now reflects all significant revenues and expenditures at gross value.

6.9 We believe further improvements to the consolidated financial statements are needed, as noted below.

- There remains one entity (Canadian Blood Services) for which there is disagreement between the Department of Finance and the Office of the Auditor General as to whether it is a Government Partnership Arrangement. The results of operations of this entity have not been consolidated. This matter will be resolved prior to next year's audit.
- PS 2500.07 of the Canadian Institute of Chartered Accountants (CICA) Public Sector Accounting Handbook notes that as part of the consolidation process, the accounting policies of government units must be adjusted to conform with the government's accounting policies. We disagree with Government Accounting's interpretation of this recommendation. While Government Accounting understands this recommendation to mean that overall accounting policies are conformed, we have interpreted this recommendation to require that the specifics of the policies conform as well. For example, not only must a government unit capitalize its assets as central government does, it must also capitalize its assets using the same threshold limits.

6.10 The example of asset capitalization noted above was selected as it represents the most significant matter for discussion during the process of ensuring government unit accounting policies conform to those of government. This is for two reasons.

- We have had a concern with the high level of the tangible capital assets (TCA) thresholds used by government for certain classes of assets for the past several years, and have communicated this to management both in our audit results communication and in previous Reports of the Auditor General.
- Accordingly, adjusting the TCA thresholds of all entities consolidated to the Province's thresholds would reduce the amount of TCA balances which would be capitalized. Given the high TCA threshold limits of the

Province, compliance with the GAAP requirement could actually impair the fair presentation of the TCA balances on the consolidated financial statements.

- 6.11 During the current year's audit, we refined our analysis of the Province's threshold limits and focused our discussions on those TCA classes where the threshold appears to be higher than the anticipated individual cost of an asset in that TCA category. Our concern is that there could be a significant balance of transactions related to the acquisition of TCA, as defined by GAAP, which are expensed rather than capitalized since the balances fall below the government's threshold for capitalization.
- 6.12 There is a need to further research and review the Province's TCA threshold limits to ensure they allow for the fair and consistent presentation of the TCA balance on the consolidated financial statements. Government Accounting has agreed to review these threshold limits when they conduct their next review of all threshold limits.

Presentation Changes

- 6.13 *Accounting changes* – PS Section 2120 on Accounting Changes recommends that a change in an accounting policy be applied retroactively, and that prior period amounts appearing on the financial statements in the year of the change be restated accordingly. A cumulative restatement to opening accumulated deficits is made to reflect the impact of retroactive changes on prior years not presented for comparison.
- 6.14 Note 2 to the March 31, 2007 Public Accounts describes the impact of implementing a change in accounting policy on the current and prior years. This change was due to revisions to PS Section 3150 on Tangible Capital Assets. These revisions, which required assets be recorded at their gross cost, were released in September 2006 and were effective immediately. (Previously, assets could be recorded net of contributed amounts received, for example, under cost-sharing agreements with the Federal government.) An adjustment of \$10.4 million was made to the April 1, 2005 Accumulated Deficits. Comparative amounts for March 31, 2006 were restated.
- 6.15 During the audit of Note 2 to the March 31, 2007 consolidated financial statements, we determined that this change in policy was applied retroactively to April 1, 2004. We disagree with the time frame selected to effect this change. Retroactive restatement applies to all prior periods. While we recognize there is a cost in time and resources to determining the restatement, we believe this change in policy was significant to periods prior to April 1, 2004. In support of this, we obtained, with minimal effort, audit evidence indicating the TCA balance would have been approximately \$27.5 million higher had the change in accounting policy

been applied retroactively to April 1, 1999 – the date on which the Province first recognized tangible capital assets. Accumulated deficits at April 1, 2005 would have been reduced by a similar amount. This amount is not conclusive because we focused only on the more significant cost-sharing agreements. However, it is significant and indicates that a full analysis of the cost versus benefit of determining the extent of the adjustment was not completed.

- 6.16 *Changes to trust funds under administration* – Our management letter issued as a result of the March 31, 2006 audit of the Public Accounts recommended that government complete a detailed analysis of the appropriate accounting treatment for the Workers’ Compensation Board (WCB), an entity which had been included in Note 8 – Trust Funds under Administration. As a result of this analysis, it was determined that WCB did not meet the definition of entities to include in Note 8. We concur with this view. However, we feel this change in reporting should have been disclosed in the March 31, 2007 Public Accounts, preferably in the consolidated financial statements themselves, or at least as part of the Financial Statement Discussion and Analysis. This would have provided users of the Public Accounts with information on the decision to remove WCB from Note 8.

Other Required Communication on Audit Results

- 6.17 *Use of estimates* – Government’s preparation of the Province’s consolidated financial statements requires the use of significant accounting estimates, certain of which are particularly sensitive to future actual results differing from government’s assumptions upon which the accounting estimates are based. At the conclusion of this year’s audit there were no significant outstanding concerns with the estimated accounting balances used in preparing the March 31, 2007 consolidated financial statements. We do have a comment with respect to disclosure of the following matter.
- 6.18 The disclosure of changes in actuarial assumptions used to determine post-retirement benefits is considered desirable. PS Section 2120.28 notes “*Disclosure of the nature and effect on the current period may be desirable for a change in an accounting estimate that is rare or unusual and that may affect the financial results of both current and future periods.*” While we acknowledge that a change in an actuarial assumption is neither rare nor unusual, we suggest that its impact is significant enough to warrant disclosure in the financial statements. The impact of the change in the discount rate used to determine the actuarial value of the post-retirement obligations of the Province’s two most significant obligations was an increase of \$151.5 million.
- 6.19 *Misstatements in the financial statements* – During the audit of the March 31, 2007 consolidated financial statements, a number of accounting, disclosure

and audit issues arose, and were communicated to government staff at various points in the audit process. Some of these issues were resolved either by review of additional information provided to us or by adjustments made to the financial statements.

- 6.20 Generally accepted auditing standards require that all but trivial known errors or misstatements identified in the Province's consolidated financial statements during the year-end accounting or audit processes be corrected. This increases the accuracy of the financial statements. Any unresolved, unadjusted errors or differences are considered when preparing the auditor's report on whether the statements "*present fairly*" in accordance with GAAP. In their response to our management letter resulting from the March 31, 2007 audit, management indicated they agreed with our recommendation noted below.

Recommendation 6.1

The Government Accounting Division should ensure that all but trivial known and possible errors identified during the audit be corrected.

Audit Completion

- 6.21 This year Government Accounting set an aggressive target for release of the March 31, 2007 consolidated financial statements. Where previously these had been issued in late September each year, this year they were scheduled for release in early August. The actual release date was August 9, 2007.
- 6.22 We commend Government Accounting for undertaking this initiative and for their accomplishment. More timely financial statements increase their usefulness in decision-making and resource allocation.

Access to Information

- 6.23 When completing our audit work on the March 31, 2006 consolidated financial statements, we encountered difficulties in gaining access to certain information requested. No such difficulties were encountered during this year's audit.

Systems and Controls

- 6.24 *Conclusions and summary of observations* – The significance of a control framework, and processes that monitor it to ensure continued and effective operation, cannot be overemphasized. This framework should include a system of internal controls that provides for timely and accurate transaction processing and safeguarding of assets.

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- 6.25 Internal control systems should be documented in order to ensure continuity when staff and management changes occur. Documentation should also describe responsibilities and authorities by position to ensure accountabilities are clear. Government has indicated that it is in the process of documenting its system of internal controls.
- 6.26 We have continuing concerns in the area of IT security. It is critical that users have access only to those system functions which are necessary for them to perform their duties. The ability to access other data increases the risk of inaccurate transaction posting, thereby reducing the usefulness of financial results.
- 6.27 *Internal controls* – As part of our audit, internal controls were reviewed only to the extent necessary, under Canadian generally accepted auditing standards, to establish a basis for determining the audit coverage necessary to express an opinion on the Province’s consolidated financial statements. The audit work was not designed to determine whether internal controls are adequate for management’s purposes and will not necessarily disclose all conditions requiring attention by management.
- 6.28 Further, as it relates to the internal controls of the entities consolidated in the Province’s financial statement reporting entity, reliance has been placed on the audit work of public accounting firms appointed to report on the financial statements of those entities. Our comments on selected weaknesses in internal controls which were reported to those entities by their auditors are included in Chapter 7 of this Report.
- 6.29 In the past, we have made recommendations concerning internal controls, including their delegation throughout government. While the Provincial Finance Act includes general references to the roles and responsibilities of the Minister and Deputy Minister in this regard, additional guidance needs to be developed, and effectively communicated on a more comprehensive basis. This would include the roles and responsibilities of departmental and crown entity governing bodies and senior management in the design, implementation, operation and maintenance of internal controls.
- 6.30 The response to our March 31, 2006 management letter notes that departments are involved in documenting business processes and controls as part of the business continuity planning process. We are also aware that the Internal Audit and Risk Management Centre is facilitating departmental risk assessment processes. Departments are continuing to document processes, including documentation of internal controls. We await the results of these processes and hope they will address our concerns regarding the clear documentation and communication of responsibility for internal control.

6.31 *Access controls* – A standard audit procedure is to ensure that closing balances in the financial accounting records from one year become opening balances for the next year. While performing this procedure, we noted several instances where an entry had been posted to the prior year, during the current year, thereby changing the year-end balance in individual accounts in the general ledger. Some of these entries were made to reconcile sub ledger accounts to the general accounts. Other entries were made to allocate accumulated amounts to individual accounts.

6.32 The ability to post to a prior period should be limited to very few users, and not be a function for those who post routine transactions. This segregation of duties finding was also reported as a result of an audit of SAP application controls performed in June 2006 (reported in the December 2006 Report of the Auditor General). At that time, there were 15 users who were able to perform these incompatible functions. At the time of our audit (July 2007), this number had increased to 28 users.

Recommendation 6.2

The Division should ensure that adjustments to the general ledger be made as part of the year-end financial statement preparation process only, and not subsequently. In addition, the ability to post these entries should be limited to selected senior individuals.

6.33 *Audit of governance and control framework* – An audit of the governance and control framework of the Investment, Liability Management and Treasury Services and Capital Markets Administration Divisions of the Department of Finance was conducted by an external audit firm and completed in 2004. The resulting report, issued in December 2004, identified several control weaknesses which resulted in a denial of opinion.

6.34 We reported the results of this audit in Chapter 2 of the December 2005 Report of the Auditor General. At that time, we recommended government ensure a follow-up audit be conducted to determine the status of the identified weaknesses. We further recommended that this follow-up audit be completed by a private-sector firm with the necessary expertise.

6.35 During our current review of the status of recommendations made in the December 2005 Report of the Auditor General (see Chapter 8 of this Report), we were informed that the follow-up work was to be conducted by staff of the Internal Audit and Risk Management Centre.

6.36 Given the significance and complexity of the transactions processed by these Divisions, we again recommend that an audit by an external experienced private sector firm be conducted in order to determine whether the deficiencies have been remedied to the extent necessary for an unqualified audit opinion.

Recommendation 6.3

Management should obtain an independent audit opinion on the governance and control framework of the Investments, Liability Management and Treasury Services and Capital Markets Administration Divisions. This should be conducted by a private sector firm.

- 6.37 *Internal audit* – The Internal Audit and Risk Management Centre (IARMC) was established in 2004. Its primary role is to determine whether management’s risk management, control and governance processes are functioning properly to ensure, among other priorities, that resources are spent efficiently and assets are protected.
- 6.38 In the December 2005 Report of the Auditor General we commented on the need for an effective internal audit function in government; one that assists management to ensure internal controls are effective and adequately monitored. We also noted the possible challenges now faced by government in maintaining an effective internal audit function given that the focus of IARMC extends beyond internal controls.
- 6.39 We are currently conducting an audit of internal audit functions across government, including those in crown corporations and other governmental units. While the objectives of that audit focus on compliance with policies and internal audit best practices, we expect that through our review of IARMC reports we will also note the extent to which the Centre is involved in monitoring internal controls.

Compliance with the Provincial Finance Act

- 6.40 *Conclusions and summary of observations* – Additional appropriations totalling \$222.4 million were approved for the fiscal year ended March 31, 2007. Although the timing of the approval for these additional appropriations was in compliance with the Provincial Finance Act, the Act itself reduces accountability and control by allowing approval of additional expenditures in exhausted appropriations for up to ninety days after the tabling of the Public Accounts. The Act needs to be clarified. It also needs to be clarified with respect to write-offs by crown corporations.
- 6.41 *Additional appropriations* – We are required under Section 9 of the Auditor General Act to report on any appropriations that were exceeded during the year. Executive Council approved Order-in-Council 2007-189 on March 30, 2007 approving additional appropriations of \$120.2 million for 2006-07. A second additional appropriation (OIC 2007-577) was approved on November 2, 2007 to cover further budget overruns in the amount of \$102.2 million. The most significant amount of the total additional appropriations related to capital purchase requirements which exceeded the approved budget by \$75.6 million.

6.42 The details of additional appropriations for the past five years are included in Exhibit 6.1 below. We note, as we have several times in past years, that the current process to approve additional appropriations reduces accountability to and control by the House of Assembly. The debate and challenge that are integral to the budget process are absent from the approval for additional appropriations.

Exhibit 6.1
Additional Appropriations

Year	Amount
2002-03	\$ 69,591
2003-04	\$ 99,017
2004-05	\$159,443
2005-06	\$110,761
2006-07	\$222,434

Source: Public Accounts – Volume 1

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6.43 *Timing of approvals* – According to Section 13 of the Provincial Finance Act, before a cheque can be issued, a sufficient balance must be available in the appropriation for the specified purpose and, where an appropriation is exhausted, no further contractual obligations or commitments may be charged to the exhausted appropriation. However, Section 28 of the Act allows up to ninety days after the tabling of the Public Accounts for the approval of additional appropriations related to the appropriations in the Public Accounts. There is an inconsistency within the Act. Management has acknowledged this inconsistency. We recommended last year that the Provincial Finance Act be amended and repeat this recommendation below.

6.44 *Write-offs* – Section 23 of the Provincial Finance Act notes

“Where a person has an obligation or debt due to the Province ..., the Governor in Council may direct the Minister, ... to negotiate and accept a settlement in payment and satisfaction of such obligation, debt or claim, or to determine that any such obligation, debt or claim is not collectable and to write off any loss incurred in any such settlement or determination and to charge it to the appropriation for the service in respect of which the loss was incurred or to the Consolidated Fund or to the appropriate reserve account.”

6.45 During this year’s audit, we noted that an entity included in the consolidated financial statements had written off an investment without Order-in-

Council approval as described above. Our interpretation of the Finance Act has always been that it extends to the government reporting entity, thereby including consolidated entities. We are aware the Act does not clearly address whether the requirement for Executive Council approval extends to crown corporations.

Recommendation 6.4

Department of Finance management should ensure that the Provincial Finance Act is amended to eliminate the existing inconsistency with respect to additional appropriations. Management should also ensure the Act is clarified regarding its applicability to certain entities with respect to the process to write off recorded amounts.

Changes in Accounting Standards

- 6.46 *Conclusions and summary of observations* – Accounting standards and pronouncements that comprise GAAP continue to evolve. Changes in presentation and disclosure are intended to improve the usefulness of financial statements for decision-making purposes. There are several new accounting pronouncements, and some in process, that will have an impact on the government's future financial reporting.
- 6.47 Significant matters on which PSAB has recently released final or revised pronouncements or is developing new or revised pronouncements, or issuing statements of principle, are described below.
- 6.48 *Segmented information* – PSAB has introduced PS 2700 - Segment Disclosures; the recommendations of which are effective April 1, 2007. A segment is defined as a distinguishable activity or group of activities of a government for which it is appropriate to separately report financial information. Effective for 2007-08, government will be required to disclose the following in its consolidated financial statements:
- the basis for identifying segments, the nature of the segments and the activities they encompass, and the method of significant allocations to segments;
 - segment expense by major object or category;
 - segment revenue by source and type;
 - the aggregate of the net surplus / deficit of government business enterprises and government business partnerships accounted for under the modified equity method for each segment, if applicable; and
 - a reconciliation between the information disclosed for segments and the consolidated information in the summary financial statements.

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- 6.49 Information on segments is already presented in the consolidated financial statements, by major functions such as health, education, community services and transportation and public works. Since segment totals are to be presented on a comparative basis, changes may be needed in the presentation of March 31, 2007 balances.
- 6.50 *Accounting for tax revenue* – PSAB’s Tax Revenue Project will address general recognition, measurement, reporting and disclosure principles of all types of tax revenues. An exposure draft is expected to be issued in due course and a new standard is anticipated in June 2008.
- 6.51 *Statements of principles and other standards* – Statements of principles suggest key principles and definitions that PSAB expects to propose in future recommendations. Three statements of principle have been issued recently by PSAB:
- assessment of tangible capital assets;
 - financial instruments; and
 - indicators of government financial condition.
- 6.52 In addition, amendments to existing standards are proposed in the exposure draft on government transfers.
- 6.53 New formal recommendations or guidance in such areas could require changes to government’s financial reporting in the future. The nature and impact of required or planned accounting changes should be disclosed as soon as practical, ideally no later than during the presentation of the budget for the fiscal year in which the changes will take effect.
- 6.54 We note that there are several accounting topics which impact crown corporations and other entities whose results are consolidated with those of the Province. These include several new pronouncements related to financial instruments; revisions to accounting for changes and estimates, and errors; and inventory. The impact of these changes on the financial statements of crown corporations will have to be considered during the consolidation process.
- 6.55 *International financial reporting standards* – Finally, the move to international accounting standards is fast approaching. Publicly accountable enterprises in Canada are to adopt International Financial Reporting Standards starting January 1, 2011. The Accounting Standards Board of the CICA is expected to issue an Omnibus Exposure Draft in early 2008 as a step to incorporating the international standards into the CICA Handbook. The scope and impact of this transition will likely be significant to the Public Accounts.



Other Matters

- 6.56 *Conclusions and summary of observations* – No special warrants have been approved by Executive Council since our last Report in June 2007. In addition, with respect to cash and other losses, an insignificant amount has been reported to us for 2006-07.
- 6.57 *Special warrants* – Section 9A of the Auditor General Act requires that we report whether any special warrants have been issued. A special warrant is issued under Section 29 of the Provincial Finance Act for expenses that have not been provided for by the Legislature and are immediately and urgently required for the public good. We note that since our last Report in June 2007, no special warrants have been approved by Executive Council under Section 29 of the Act.
- 6.58 *Cash and other losses* – Section 9A (1) (e) of the Auditor General Act requires that we report every case in which we have observed that “... *there has been a deficiency or loss through fraud, default, or mistake of any person*”.
- 6.59 There is no longer a requirement in the Management Manuals for departments and crown entities to report losses to this Office. However, as in prior years, some departments reported losses to our Office for 2006-07. Note that the list below may not include all losses as it details only those provided to us.

Exhibit 6.2 Cash and Other Losses – 2006-07

Department	Cash	Property
Justice	\$646.00	\$9,000.00
Service Nova Scotia and Municipal Relations	\$5.50	–