
7 Review of Financial Statements and Management Letters

Summary

In the private sector, financial statements are used by investors and potential investors to evaluate performance. In the public sector, financial statements are used not only to evaluate performance, but also to determine government's ability to continue providing key services to the public.

Schedule 9 of the Province's consolidated financial statements details the various entities included in the government reporting entity (GRE). Several of these entities are audited by this Office. The majority are audited by private sector auditors.

Under Section 17 of the Auditor General Act, we conduct a review of the audit opinions and related management letters of those entities audited by private sector auditors. We consider those results, as well as results from our audits of entities within the GRE, when auditing the consolidated financial statements of the Province. The purpose of this Chapter is to highlight matters of interest as a result of this review.

The majority of audits conducted on entities within the GRE resulted in unqualified audit opinions. We note that the audit opinion of one of the Province's loan funds was qualified due to insufficient support for management's estimate of provisions on asset impairment. In addition, the audit opinions for several of the school boards were qualified due to the inability of the auditors to verify the completeness of school-based funds.

Auditors are required to provide management and oversight bodies with information regarding internal control weaknesses. This information is provided in management letters. Our review of these management letters indicated that issues related to information technology infrastructure are pervasive throughout entities in the GRE. Deficiencies were also identified in two provincial loan boards regarding documentation to support financial statement balances. Management should address the deficiencies identified by their auditors to ensure the continued usefulness of their financial statements.

7 Review of Financial Statements and Management Letters

Background

- 7.1 The financial statements of crown corporations and agencies, funds of the government of Nova Scotia, and trusts administered by the government of Nova Scotia, are in some cases audited by the Office of the Auditor General and in other cases by private sector auditors licensed under the Public Accountants Act.
- 7.2 Section 17 of the Auditor General Act permits this Office to conduct additional reviews of those entities where financial statements are reported on by private sector auditors. This Chapter contains comments on our review of the results of financial statement audits by private sector auditors, as well as comments on audits performed by this Office.
- 7.3 As noted in Chapter 6 of this Report, the Auditor General is responsible for the annual audit of the consolidated financial statements of the Province of Nova Scotia. Comments and observations on our audit of the Province's March 31, 2007 statements are noted in that Chapter.

Chapter Objective

- 7.4 The objective of the review of financial statements and management letters is to identify matters of interest to the users of public sector financial statements.

Significant Observations

Financial Statement Audit Results

- 7.5 *Conclusions and summary of observations* – In our review of the results of financial statement audits, we noted several instances where qualified audit opinions were issued. The majority of these were anticipated due to the nature of the entity's operations. In our view, these qualified opinions do not diminish the usefulness of the related financial statements. However, a qualified opinion was also issued in one instance where there was insufficient support for the provision for impairment in one of the loan funds. This reduces the usefulness of these financial statements in assessing the recovery of financial assistance.

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- 7.6 In addition to our review of audit opinions, we also review the management letters that auditors provide to oversight bodies. We are concerned with the number of deficiencies identified in these letters, particularly in the area of information technology (IT) infrastructure. Inadequate financial controls, and deficiencies in IT infrastructure pose risks to the integrity of financial statements.
- 7.7 *Qualified audit opinions* – The result of an audit is an opinion on whether financial statements present fairly the financial position of the entity at its fiscal year end and the results of its operations for the year then ended. Where there are qualifications of an audit opinion or situations in which it is not possible to render an opinion, we believe it appropriate to report on such matters.
- 7.8 Qualified audit opinions can result from insufficient evidence to support financial statement balances or disclosures. The audit opinion of the Nova Scotia Farm Loan Board was qualified because of insufficient satisfactory evidence relating to management’s estimate of provisions for loan and real estate impairment. The audit opinion of Nova Scotia Power Finance Corporation was qualified because the Corporation was unable to provide historical cost and effective interest rate of investments.
- 7.9 Several entities included in the consolidated financial statements of the Province derive revenue from donations or other contributions, the completeness of which is difficult to verify during an audit. This is a standard qualification for entities with these types of revenues.
- 7.10 Qualified audit opinions were issued by the auditors of the following entities.
- Cape Breton Victoria Regional School Board, South Shore Regional School Board, Strait Regional School Board and Tri-County Regional School Board, due to the inability to verify the completeness of school-based funds.
 - Conseil Scolaire Acadien Provincial due to the exclusion of school-based fund activity in the financial statements.
 - Public Trustee due to insufficient evidence to indicate whether trust income and assets are complete, which is consistent with the prior year.
 - Art Gallery of Nova Scotia, Nova Scotia Talent Trust and Atlantic Provinces Special Education Authority, due to insufficient evidence to indicate whether revenue is complete, which is consistent with prior years.
 - Nova Scotia Agricultural College Foundation because pledges were not recognized as revenue.

- Halifax Regional School Board due to insufficient evidence to ascertain the completeness of school-based funds and due to the use of cash basis in accounting for school-based funds.
- 7.11 A qualified audit opinion was also issued for the audit of E911 Cost Recovery Fund due to insufficient evidence to indicate whether expenses of the fund are complete.
- 7.12 *Disclosed basis of accounting* – Auditors can no longer provide an unqualified opinion on general purpose financial statements prepared on a basis of accounting other than generally accepted accounting principles.
- 7.13 The financial statements of the Sherbrooke Restoration Commission were prepared using accounting principles for museum boards in Nova Scotia as prescribed by the Department of Tourism, Culture and Heritage.
- 7.14 *Financial controls and records* – During financial statement audits, situations were noted where accounting and control systems or procedures were deficient. These weaknesses in internal controls were reported by the auditors in management letters to the crown corporations or agencies.
- 7.15 The results of our review indicated a significant number of deficiencies in information technology infrastructure. A recurring deficiency was in the area of access to systems. In many instances, access was granted to individuals who did not require access to a system to perform their duties, or access privileges created a lack of segregation of duties. This could impact the completeness, accuracy and authorization of recorded amounts. Other deficiencies related to controls over the general IT environment, such as program change-management, and disaster recovery. Deficiencies in application controls were also noted.
- 7.16 Although they were not of a magnitude to require reservation of an audit opinion, the auditors of the following entities have recommended improvements regarding the deficiencies noted to ensure financial records provide complete and accurate information on a timely basis.

Regional School Boards, Nova Scotia Community College and Atlantic Provinces Special Education Authority

- 7.17 *Annapolis Valley Regional School Board* – Cheque requisitions for expenses did not have the supporting invoices and the cleared cheque attached to them. This was also a weakness in the prior year. The SAP payroll system record of Master File Changes was not reviewed by senior management or payroll managers on a regular basis.

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- 7.18 *Conseil Scolaire Acadien Provincial* – The auditors recommended that the Conseil determine a system for processing school-based funds. The Conseil should also adopt a formal procedure for evaluating internal controls, which should then be under the direction of the Audit Committee.
- 7.19 *South Shore Regional School Board and Tri-County Regional School Board* – There was no formal process for documenting, testing and evaluating internal controls at the Boards, except for work that had been performed to date on controls related to school-based funds. The information technology function did not have explicit plans and objectives that were aligned with the Boards’ plans and objectives. Also system event logs and activity reports for the server at the Finance Department were not being reviewed and evaluated, and no security policies and procedures were in place for setup of new user or termination of existing user accounts.
- 7.20 *Halifax Regional School Board* – The following comments relating to school-based funds result from audit procedures conducted at six schools. Receipts were not consistently issued for funds received nor were receipts reconciled to school deposits on a consistent basis. The 68% refund of HST was not claimed on a consistent basis. Not all documentation was being reviewed and cancelled when the reviewer signed a cheque. The preceding were consistent with the prior year. One school was noted as having written a cheque to cash. There were a number of errors noted on bank reconciliations even though the bank reconciliation had been reviewed. Finally, a number of issues and errors relating to the conversion of the Board’s payroll system to the SAP system hosted by the Province of Nova Scotia were outstanding and need to be resolved.
- 7.21 South Shore, Tri-County and Halifax Regional School Boards were audited by the same public sector firm. In addition to the specific findings noted for each board, the auditors noted the following for all boards.
- A formal process to identify and evaluate internal and external business risks should be put in place at each board.
 - Management at each of the boards should review findings – noted exceptions and absent control objectives and procedures – reported in the CICA Section 5970 audit of the SAP Customer Competency Center. (SAP is the accounting software used by all school boards and is maintained by the Province’s Corporate Information and Systems Division.) Management should assess potential risks to their individual financial reporting environments which may result from these findings.
- 7.22 *Strait Regional School Board* – The following comments relating to school-based funds result from audit procedures conducted at two schools. Bank reconciliations were not done consistently for school-generated fund

activities. Receipts were not issued for all funds received. Also, cheques were presigned with one signature and not kept in a secure location. The authorization process was not adequate. Invoices should be reviewed and initialled by the individual before signing cheques. In addition, the HST rebate application was not prepared on a regular basis. These comments are consistent with the prior year.

7.23 *Nova Scotia Community College* – There were instances where approved invoices were paid without supporting purchase orders and receiving reports attached. In addition, there were several instances of purchase orders approved in excess of the authorized level.

7.24 *Atlantic Provinces Special Education Authority* – There was no independent review of the bank reconciliation. Amounts receivable related to audiology sales were written off by management. This authority is given solely to Executive Council. This matter is discussed further in paragraph 7.59 below.

District Health Authorities and the IWK Health Centre

7.25 *Annapolis Valley District Health Authority, South Shore District Health Authority, and South West Nova District Health Authority* – Journal entries made by management were not subjected to the review process. The portion of construction costs related to holdbacks was not recorded. In terms of inventory valuation, there was no review of current price lists. Also, as in 2006, there was no formal, documented disaster recovery plan for recovery of the information processing environment although progress had been made in this area. There were concerns regarding user access, including continued access rights for former employees. In addition, South Shore District Health Authority did not set up a receivable for each claim submitted to the Department of Health. Finally, inventory counts or spot checks were not done periodically throughout the year at South West Nova District Health Authority. Parking lot revenue and ATM replenishments at this DHA were the responsibility of one individual but should have dual custody.

7.26 *Cape Breton District Health Authority* – A capital asset subsidiary ledger was not maintained. The DHA also continued to use two separate computer systems to produce information supporting purchasing and accounts payable. Several findings were noted relating to payroll: vacation carried forward from prior years was in excess of amounts permitted in the Authority's policies; timesheets were sometimes prepared and approved by the same person; and a large number of manual cheques were being processed by the payroll department each month. There were a number of journal entries without appropriate supporting documentation, and bank reconciliations were not always prepared on a timely basis. With respect to information

technology, back-up tapes were not stored off-site, and the DHA's disaster recovery plan is outdated.

- 7.27 *Colchester East Hants Health Authority* – Several findings were identified in the IT area. Security administration should be the responsibility of IT staff and certain finance management should not have access. In addition the controls surrounding passwords should be strengthened. Back-up tapes were not moved off-site daily and work on the disaster recovery plan should continue. A formal process was not in place for the review and follow-up of security incidents. A formal process should be developed for managing IT program changes. Finally, journal entries made by management were not subjected to the review process.
- 7.28 *Cumberland Health Authority* – Interim reporting to the Board would be improved through a review of the process for recording standard and non-standard accruals. A \$36,000 adjustment was required to reduce pharmacy inventory in the records to the results of the physical count. Purchase cards should be limited to one per institution in the Authority, and be controlled by the site manager. Several findings related to payroll: inadequate staffing levels; the need to monitor payroll master file changes; and review of payroll access privileges. HST remittances were not being filed on a timely basis. Finally, performance appraisals for Finance Department staff were not being performed.
- 7.29 *Guysborough Antigonish Strait Health Authority* – There were several instances where assets had not been received or projects started yet the asset had been capitalized and amortized; in addition, accounts payable had been set up for these items. There was no subsidiary ledger for capital assets. Consistent with 2006, several packing slips or invoice audit blocks were not initialled as evidence of receipt of the goods or services before payment was made. Inter-facility accounts receivable and accounts payable were not updated from 2006.
- 7.30 *Pictou County Health Authority* – Administrative level access for the network and for specific applications needs to be reviewed for both IT staff and other individuals to ensure there is appropriate segregation of duties. Access controls for both the network and applications need to be strengthened. Changes to the employee master file were not reviewed, nor were security logs. There was no formal, documented disaster recovery plan for recovery of the information processing environment, and a formal process for change management should be developed. Finally, the review of the bank reconciliation should be noted on that document.
- 7.31 *IWK Health Centre* – Certain users were allowed to emulate other users, that is access the system with all the rights of the other users. Such usage was tracked in a log that was not being regularly reviewed. The emulation

rights should be removed or the log reviewed on a regular basis. Also regular reviews of users' access to key applications was not being performed.

Entities Providing Financial Assistance

- 7.32 *Nova Scotia Farm Loan Board* – As in 2006, inadequate monitoring of loans, lack of documentation to support the loan valuation process, and weaknesses in business processes and internal controls resulted in the inability to conclude on the accuracy of provisions for real estate impairment.
- 7.33 *Nova Scotia Fisheries and Aquaculture Loan Board* – The Board's books of accounts did not report all transactions and the balances of these accounts do not equal the amounts in the financial statements. The loans subledger and general ledger were not reconciled. There was inadequate documentation supporting the allowance amount for impaired loans. These findings were all noted in the previous year. In addition, it was noted that interest accrued prior to declaring a loan to be impaired was not being included in the allowance for loan impairments.
- 7.34 *Nova Scotia Film Development Corporation* – There were several incidents where cheques had only one signature, instead of the two required by the Corporation, and there was no documentation to authorize the single signature.
- 7.35 *Nova Scotia Business Inc.* – Existing purchase order policies were not consistently applied. Controls over payroll transactions should be strengthened. All journal entries should be independently reviewed or approved by an authorized individual and supporting documentation for manual journal entries should be maintained. The Corporation should obtain current financial statements as specified in related agreements, for the annual loan review process. Management should consider an actuarial valuation for the public service awards liability.

Government Business Enterprises

- 7.36 *Halifax Dartmouth Bridge Commission* – There were instances where suppliers were paid twice and refunds of duplicate payments were requested and received. A review process should be established for commissionaires' payroll. Finally, holdbacks should be recorded in accounts payable to ensure the total amount of the asset is recognized.
- 7.37 *Highway 104 Western Alignment Corporation* – The agreement with the service provider for the facility requires a full operational audit performed at least once per year. An audit was not completed during the year. Also, the Corporation should consider having unique user profiles and passwords in its new tolling system as the current system does not provide for these.

Finally, the Corporation needs to develop journal entry policies, including related limits.

- 7.38 *Nova Scotia Liquor Commission* – Access to systems remained intact for employees who changed duties or who had been terminated. Changes to IT applications should be tested, reviewed and approved before implementation. Vendor account reconciliations for key suppliers should be performed on a quarterly basis, and be reviewed by management.

Pension Funds

- 7.39 *Nova Scotia Teachers' Pension Fund* – There were internal control weaknesses in physical security, confidentiality and safeguarding of information, application software development and maintenance, computer operations and change management.
- 7.40 *Nova Scotia Public Service Superannuation Fund* – Accounts payable included \$7.8 million related to an error found in 2004 on the commuted value of pensions paid from 1994 to 1999. These amounts should be paid to avoid further interest charges to the Fund.
- 7.41 *Member's Retiring Allowances Act Accounts* – A pensioner's death was not detected by NSPA. In addition, procedures used to allocate items between the registered and supplementary fund were not formally documented.

Regional Development Authorities

- 7.42 *Antigonish Regional Development Authority* – Credit card slips were used to support a number of expense claims. These should be supported by restaurant tabs, and the purpose for and participants at the meal should be noted. A written policy should be established regarding staff meals.
- 7.43 *Cape Breton County Economic Development Authority* – Cheques on hand that will not be used should be voided. Invoices should be approved in accordance with the approval policy. A capitalization policy should be developed.
- 7.44 *Colchester Regional Development Authority* – Financial reporting duties and administration of the accounting system should be segregated.
- 7.45 *Lunenburg Queens Regional Development Authority* – There was inadequate segregation of duties within the finance department. In addition, it is not certain that interim financial statements were being prepared using GAAP. There was no formal disaster recovery plan. Also, computers were not in a secure environment and systems and security event logs were not reviewed.

Other Entities

- 7.46 *AgriPoint International Inc.* – There was inadequate segregation of duties. An individual who had signing authority also reconciled the bank, had access to accounting records, the signature stamp and received the bank statements.
- 7.47 *AgriTECH Park Incorporated* – The entity needs to record capital assets in accordance with GAAP, and maintain an inventory of these assets. Also, cut-off procedures for accounts payable need to be reviewed.
- 7.48 *Insured Prescription Drug Plan Trust Fund* – The auditors recommended that the Department of Health ensure the new contract with the service provider for the Plan includes certain internal controls related to the IT environment.
- 7.49 *Nova Scotia Gaming Foundation* – All disbursement amounts were not subjected to independent review and there was no indication of board approval for contract changes. The Nova Scotia Gaming Foundation should ensure the independent review and approval processes occur. The terms and conditions and any changes to its contract agreements should be formally documented. In addition, the Memorandum of Agreement between the Department of Health Protection and Promotion and the Foundation should be updated to address situations where there is a need to reallocate funding.
- 7.50 *Nova Scotia Health Research Foundation* – The financial records should record investment income of the Foundation on a regular basis.
- 7.51 *Nova Scotia Legal Aid Commission* – The accounts payable subledger was out of balance with the general ledger again this year.
- 7.52 *Nova Scotia Government Fund* – Management should develop a process to ensure that interest and principle amounts are included in the financial statements on a timely basis.
- 7.53 *Nova Scotia School Boards Association* – The audit committee should conduct periodic testing to monitor compliance with Board policies and procedures. A written policy should be established for investing surplus funds. Internal controls over cheque signing and access, and invoice approval processes should be strengthened.
- 7.54 *Resource Recovery Fund Board* – Several deficiencies were identified in access to applications and data, including continued access for terminated users. An audit trail is required to support amounts transferred from one subledger system to the software used for the general ledger. Several deficiencies were

noted in the review of internal controls and processes for approved program funding.

- 7.55 *Sherbrooke Restoration Commission* – The auditors recommended that the Commission should have at least one member with financial expertise. Controls over the inventory count and related pricing should be strengthened. Also, the Commission should maintain a detailed fixed asset schedule.
- 7.56 *Other matters* – In addition to the above control deficiencies, we also reviewed management letters for other matters of interest. The following are the most significant noted.
- 7.57 *Canada-Nova Scotia Offshore Development Board* – The auditors recommended that the Board establish a funding plan for their unfunded pension and other retirement obligations. In addition, the Board needs to determine whether its employees are eligible for service awards and, if so, recognize these as liabilities on the financial statements.
- 7.58 *Nova Scotia Harness Racing Incorporated (NSHRI)* – Consideration should be given to discontinuing the operations of NSHRI as the entity exists only to act as the conduit through which funds flow between the government and the harness racing industry.
- 7.59 *Nova Scotia Innovation Corporation (InNOVAcorp)* – Approximately \$5.4 million of investments in the Nova Scotia First Fund were written off during the current year. Although management of the Corporation was informed Executive Council approval (OIC) was not required for this write-off, we noted as auditors of InNOVAcorp that we believe write-offs of crown entities require OIC approval under the Provincial Finance Act. We recommended to the Department of Finance that the Act be clarified in this matter – see Recommendation 6.4 in Chapter 6 of this Report.
- 7.60 *Cape Breton Victoria Regional School Board* – The operating results for the year included an excess of revenue over expenditures of \$1,606,213. These operating results include \$2,163,520 of last year's surplus.

Timeliness of Financial Reporting

- 7.61 *Conclusions and summary of observations* – The usefulness of financial information is impacted by its timeliness. As noted in Chapter 6, the usefulness of the Province's Public Accounts was enhanced this year due to their early release on August 9, 2007, well in advance of the late September release date in prior years. Management of all entities within the government reporting entity need to ensure their financial statements are released as required by legislation. Timely financial results are important for decision-making purposes.



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- 7.62 *Compliance with deadlines* – The Provincial Finance Act requires that financial statements for government business enterprises and governmental units be submitted to the Minister of Finance by June 30 following the fiscal year end (usually March 31).
- 7.63 There continue to be problems with receiving submissions by the deadline. This year, 24 entities (2006 – 20) were not successful in providing audited financial statements and requested information by June 30. This delay results in using unaudited information for planning and monitoring purposes in the current year.
- 7.64 The Province’s March 31, 2007 consolidated financial statements were released on August 9, 2007 meeting the reporting requirement set out in the Provincial Finance Act.