
7 Review of Agency Financial Statements and Management Letters

Summary

Under Section 17 of the Auditor General Act, we conduct a review of the audit opinions and related management letters of agencies which comprise the government reporting entity (GRE) that are audited by private sector auditors. We consider those results, as well as results from our audits of agencies 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.

Although the majority of audits conducted on agencies within the GRE resulted in unqualified audit opinions, there were also a number of qualified opinions. 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. In our view, these qualified opinions do not diminish the usefulness of the related financial statements, however, we have suggested the Department of Education work with the boards to develop appropriate systems and controls to ensure the accuracy and completeness of this significant revenue, and to obtain unqualified audit opinions.

During our review of management letters we found auditors had identified numerous internal control and information technology deficiencies. Many deficiencies identified by auditors in the prior year still existed in 2009-10. We noted that approximately 33% of the recommendations made in 2009-10 were repeated from 2008-09, and of these, over half had been reported in 2007-08. Deficiencies were also identified in two provincial loan funds regarding documentation to support financial statement balances.

Control weaknesses will continue to be identified as auditors increase their awareness of the control environment in these agencies. Management should address the deficiencies identified by their auditors to ensure the integrity of their financial systems and financial reporting processes.

7 Review of Agency Financial Statements and Management Letters

Background

- 7.1 The audits of financial statements of crown corporations and agencies, funds of the Government of Nova Scotia, and trusts administered by the government of Nova Scotia, are mostly conducted by private sector auditors licensed under the Public Accountants Act. The Office of the Auditor General is the legislated auditor for the remaining entities.
- 7.2 Section 17 of the Auditor General Act permits this Office to conduct additional reviews of those agencies where financial statements are reported on by private sector auditors. This Chapter includes 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 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, 2010 statements are noted in Chapter 5 of this Report.

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

Review of Audit Opinions

Conclusions and summary of observations

We noted qualified audit opinions were issued in several agencies due to the inability of their auditors to audit completeness of certain revenues. We also noted an instance where a qualified opinion was issued because the auditors were unable to determine if the opening balances for assets and liabilities were free

of material misstatement and because there was insufficient evidence to indicate whether expenses were complete.

7.5 *Background* – 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, in accordance with Canadian generally accepted accounting principles. 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.

7.6 *Qualified audit opinions* – Several agencies 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. The audit opinions for these agencies are therefore qualified. This is a standard qualification for entities with these types of revenues.

7.7 Qualified audit opinions can also result from insufficient evidence to support financial statement balances or disclosures. The audit opinion of the Nova Scotia Farm Loan Board contained two qualifications. The auditors were unable to satisfy themselves that the opening balances for current year's assets and liabilities were free of material misstatement. Furthermore, there was insufficient evidence to indicate whether expenses of the Board were complete.

7.8 Qualified audit opinions were also issued by the auditors of the following agencies. The opinions are identical to those issued in 2008-09.

- Cape Breton Victoria Regional School Board, South Shore Regional School Board, Strait Regional School Board, Conseil scolaire acadien provincial, and Tri-County Regional School Board – due to the inability to verify the completeness of school-based funds
- Nova Scotia Power Finance Corporation – due to insufficient evidence of the historical cost and effective interest rate of investments
- Public Trustee – due to insufficient evidence to indicate whether trust income and assets are complete
- Art Gallery of Nova Scotia – due to insufficient evidence to indicate whether revenue is complete
- Nova Scotia Agricultural College Foundation – due to pledges not being recognized as revenue
- Nova Scotia E911 Cost Recovery Fund – due to insufficient evidence to indicate whether expenses of the fund were complete

- Nova Scotia Health Research Foundation – due to the inappropriate application of an accounting policy related to grants payable

- 7.9 The March 31, 2010 financial statements of the Province’s eight school boards indicate school-based funds total \$43.5 million. Five of the eight boards have received a qualified audit opinion with respect to the completeness of this significant revenue. We suggest the Department of Education work with the boards to develop the appropriate controls to ensure the accuracy and completeness of this revenue, and to remove the qualification from their audit opinions.
- 7.10 *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.
- 7.11 A qualified audit opinion was issued for the Sherbrooke Restoration Commission. The Commission’s financial statements were prepared using accounting principles for museum boards in Nova Scotia as prescribed by the Department of Tourism, Culture and Heritage. This opinion is consistent with prior years.

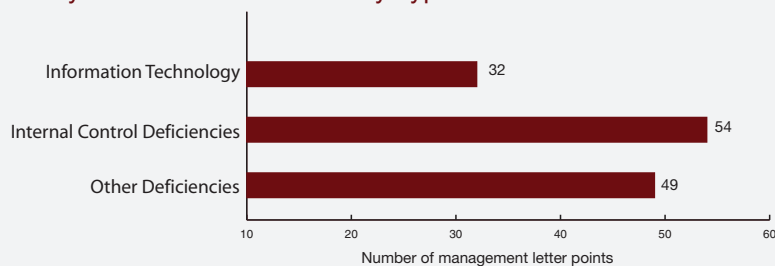
Review of Management Letters

Conclusions and summary of observations

Many of the findings noted in the management letters we reviewed were reported in prior years and management have failed to respond to auditors’ recommendations for improvement. Responding to audit recommendations is an indication of a strong overall control environment in an entity. A significant number of internal control deficiencies were reported in several agencies. Examples include improperly prepared and supported account reconciliations, and poor segregation of duties. In addition, there are numerous findings and recommendations related to information technology, including system access issues such as continuing access rights for terminated employees and access rights that are in excess of those needed to perform duties.

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- 7.12 *Information technology controls, and financial controls and records* – During financial statement audits, situations were noted where accounting and control systems or procedures, including those related to information technology systems, were deficient. These weaknesses were reported by the auditors in management letters to the crown corporations or agencies. Other deficiencies reported include matters related to governance, and other financial reporting matters. The exhibit below provides the number of weaknesses identified by type.

Summary of Recommendations by Type



Source: Management letters – Agencies in the government reporting entity.

7.13 Responding to audit recommendations is an indication of a strong overall control environment in an entity. The number of control recommendations that remain outstanding from one year to the next in several agencies is concerning, as is the number of new findings and recommendations. In fact, about 33% of the recommendations made in 2009-10 were repeated from 2008-09, and of these, over half had been reported in 2007-08. Management needs to address recommendations on a timely basis to ensure the integrity of their financial statements.

7.14 Although they were not of a magnitude to require reservation of an audit opinion, the auditors of several agencies recommended improvements to ensure financial records provide complete and accurate information on a timely basis. These recommendations are detailed below.

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

7.15 *Annapolis Valley Regional School Board* – The auditors noted that two of the schools sampled when testing expenses from school-based funds had purchased goods exceeding \$1,000 directly from the supplier, contrary to the funds' policies. All goods exceeding \$1,000 should be purchased through the school board's purchasing department. The auditors also found that honorariums were paid to school staff from school-based funds. All payments to staff should be made through the payroll department and should be included on the staff member's T4 slip.

7.16 *Cape Breton Victoria Regional School Board* – Recommendations reported in prior year's management letters were noted again in the current year.

- Management should determine if there is any obligation to provide future health retirement benefits to confidential employees.
- As noted in 2008-09, improvements in cash flow are still needed. The auditors recommended the Board collect on the March 31, 2010 accounts receivable balance due from the Province.

- Management should assess the impact of exceptions noted to control objectives in the service provider's audit report for physical access controls, logical access controls, and application software development and implementation.
- The auditors recommended that management develop a plan to enable audit verification of school-based funds by providing additional training to staff and implementing the use of accrual-based accounting.

7.17 The 2009-10 management letter noted that time sheets and bank reconciliations should be approved in a timely manner. Also, the Board should have the Province provide the necessary support to facilitate charging and collecting interest from the schools' developer, and the Board should pursue the Province for payment of the shortfall in funding related to the Provincial Agreement with certain First Nations.

7.18 *Conseil scolaire acadien provincial* – In the prior year, the auditors recommended that all accounts and transactions related to school-based funds be included in the accounting system. In the current year, the auditors recognized that improvements have been made over the prior year as all accounts have been included in the system and a manual has been developed. The auditors recommended that standard procedures be implemented in all schools to ensure consistency.

7.19 Consistent with 2007-08 and 2008-09, no internal audit function or formal documentation and proof of monitoring of controls has been put in place. The auditors noted that having an internal audit group in place will prevent errors from occurring and detect whether controls are working properly.

7.20 *South Shore Regional School Board and Tri-County Regional School Board* – Although the Boards have made significant efforts to develop internal audit functions for school-based funds in the past few years, there is still a need to establish procedures for documenting, testing and evaluating internal controls at the individual school level to ensure complete and accurate disclosure of these amounts. Auditors are also concerned with the lack of segregation of duties in the accounts payable division and in the preparation of journal entries. These weaknesses were reported in 2008-09 and 2007-08.

7.21 *Strait Regional School Board* – The auditors noted 24 of 25 schools maintain their records using the same accounting system and they recommended the remaining school change its accounting system to promote consistency in reporting to the Board. The auditors also noted in their work on school-based funds that there was no indication certain source documents had been processed, or that bank reconciliations had been reviewed. However,

the auditors found that the individual schools within the Board have made significant improvements in procedures related to school-based funds.

- 7.22 *Nova Scotia Community College* – The auditors noted that there is no standardized approach to each campus reconciling its capital assets to the general ledger, which causes management to spend additional time reconciling the accounts for reporting purposes. The auditors recommended that a standardized template be developed to reconcile additions and disposals of capital assets for each campus in order to improve both consistency and quality of information used for management’s purposes. Consistent with the prior year, the auditors recommended that password policies be revised to be consistent with leading industry practice.

District Health Authorities and the IWK Health Centre

- 7.23 *Annapolis Valley District Health Authority, South Shore District Health Authority, and South West Nova District Health Authority* – The auditors recommended that management make it a priority to identify, document and test the internal controls within its various business and financial reporting cycles.
- 7.24 The business support office undertook a Section 9100 report on specified audit procedures which resulted in a number of recommendations for improvements in controls. The auditors recommended management continue to follow up with the business support office to ensure the recommendations are addressed in a timely manner.
- 7.25 *Cape Breton Health* – Numerous recommendations reported in prior year’s management letters were repeated again in the current year.
- Program maintenance processes are informal and lack consistency.
 - Management does not currently perform IT vulnerability assessments designed to identify IT security vulnerabilities.
 - New vendors are approved locally and forwarded to central operations in Halifax for initial set-up in the Board’s general ledger system (SAP); however, a one-time vendor set-up was created for vendors that are not expected to be recurring, causing a risk of employees creating fictitious vendors without proper approval.
 - There was a significant amount of overtime paid to employees. The auditors noted 26 employees receiving in excess of \$25,000, including two employees’ overtime of \$161,533 and \$90,217.
 - There was a segregation of duties issue with the Meditech software. Finance management employees have access to the same modules as the clerks processing transactions.

7.26 The 2009-10 management letter also included the following new recommendations related to information technology.

- The auditors noted that user access to financial applications was not reviewed on a regular basis; therefore, unauthorized access could extend for indefinite periods of time. They also noted instances where key information technology functions had not been appropriately segregated. Additionally, requests for access to systems are documented through email and could be easily lost or misplaced. The auditors recommended that approval of access to all financial applications be formally documented and retained in a central repository.
- The Authority has several versions of one computer program stored in the same file directory with different names. The auditors recommended that separate libraries be created for storage, development, testing and production versions of program code.

7.27 *Capital District Health Authority* – The auditors identified considerations for management related to IT controls for SAP. A finding from 2008 related to password settings remains unresolved.

7.28 *Colchester East Hants Health Authority* – Once again, access control issues were highlighted in the management letter. Recommendations made in 2007-08 and 2008-09 to strengthen password controls in two applications were not acted upon, and similar issues with another system were found in the current year.

7.29 In relation to findings in 2009-10, the auditors noted that senior management review and approval of posted journal entries was not taking place. The auditors also noted errors in the materials management system which, while individually not material to the financial statements of CEHHA, has the potential for a significant cumulative error. In addition, the auditors concluded that user access to the financial applications including the human resources application is not reviewed on a regular basis to ensure the level and type of access for each user is current and required by the user to perform their job responsibilities while maintaining an appropriate separation of incompatible duties.

7.30 We are aware that all health authorities converted to the SAP system during the year. In both Cape Breton Health and Colchester East Hants Health Authority, the auditors recommended additional training in SAP, including its reporting capabilities.

7.31 *Cumberland Health Authority* – As reported in the prior year, there is still no reconciliation of employee benefits between the Authority's system and one of the employees' benefits providers. This has been outstanding since

2006. The auditors again recommended that procedures to standardize the process to terminate system access be developed.

7.32 The auditors also noted the following issues caused by the conversion to SAP during 2009-10.

- Various payroll duties are not completed on a timely basis, including reports not being prepared and presented to the Director of Finance regarding master file changes, and employee loans for benefits not being set up in the SAP payroll system.
- With respect to the purchasing process, older purchase orders are not followed up, receiving reports are not reviewed, and reconciliations of supplier statements are not completed on a timely basis.
- The accounts receivable subledgers have not been reconciled to the accounts receivable general ledger balance.

7.33 Other matters noted during the March 31, 2010 included segregation of duties issues in accounts payable and cash receipts, and with respect to system access. It was noted the employee master data had not been reviewed by management to ensure changes made were appropriate. Finally, the auditors recommended that computer policies be updated, and that the electronic funds transfer policy be written to formalize the policies and procedures to reduce the risk of unauthorized access changes.

7.34 *Guysborough Antigonish Strait Health Authority* – The auditors noted that a payroll journal or other report needs to be developed so management can ensure payroll for each individual has been recorded properly. They also noted that the SAP system improperly allocated some employees to cost centres, preventing managers from approving payroll for some of their employees. Additionally, expenses were improperly allocated which affected departmental budgets and expenses.

7.35 *Pictou County Health Authority* – Consistent with weaknesses found in the 2007-08 and 2008-09, the auditors noted password controls for certain applications could have been stronger.

7.36 *IWK Health Centre* – During the audit, the auditors noted that after the system conversion to SAP, the Health Centre's management had difficulties obtaining information for budget and audit purposes. The auditors indicated that findings observed during the interim audit in 2009-10 had been corrected by the year end audit.

Entities Providing Financial Assistance

7.37 *Industrial Expansion Fund* – Management prepares an annual review for each of the Fund's clients, but a more intensive review process was

recommended. The auditors also recommended that management ensure the balance of outstanding guarantees be properly set up in the accounting records. Consistent with the prior year, management has confirmed that there are no formal controls over journal entries.

7.38 *Nova Scotia Business Inc.* – As reported in prior years, management should consider an actuarial valuation for the public service awards liability. Furthermore, the auditor noted several account balances consolidated into one general ledger account code. Progress has been made in this area since the prior year, but there is still room for improvement.

7.39 In the current year, the auditors noted very little substance to support equity valuations and recommended reviewing the latest entity financial statements as part of the valuation process. Also, the review of payroll registers by management is inconsistent, and management has the ability to independently terminate an employee or make payroll changes without approval. Finally, the auditors noted that NSBI does not have a formal disaster recovery plan in place.

7.40 *Strategic Opportunities Fund Incorporated* – Consistent with prior years, the auditors recommended considering investments such as government treasury bills rather than bank deposits for cash on hand.

Government Business Enterprises

7.41 *Halifax Dartmouth Bridge Commission* – The auditors noted a significant number of inactive MacPass accounts with positive balances. Based on the customer agreement, a notice is to be mailed when a customer account is without activity for eighteen months, and the auditors recommended this process be followed. The auditors also recommended that the Commission set aside some investments to fund employee retiring allowances.

7.42 *Nova Scotia Gaming Corporation* – The auditors recommended that the Corporation perform a formal analysis of its accounting policy for prize expenses related to regional online games.

7.43 *Nova Scotia Liquor Corporation* – The auditors recommended that system access for terminated users be disabled or removed in a timely manner. Consistent with the prior year, the auditors continued to recommend the following improvements.

- Changes to user access rights in the Warehouse Management System (WMS) need to be made on a more timely basis.
- Access rights for those in the IT group need to be reviewed periodically.

- There are deficiencies in the password standards used in the WMS, and management should investigate options to implement and enforce separate password policies for each group within the system.
- There is a lack of segregation of duties in aspects of the WMS and other financial applications.
- Security-related logs should be independently reviewed.

Other Agencies

- 7.44 *Canada-Nova Scotia Offshore Development Board* – The Board should continue to assess the online payment system to ensure that all safeguards are being followed and that system passwords are routinely changed. This was consistent with the prior year.
- 7.45 As a result of the 2009-10 audit, the auditors recommended that the key code for the safe be changed after personnel changes to ensure there is no unauthorized access. Additionally, policies related to the use of Board credit cards should be revisited and credit card bills should be monitored. With respect to payroll, it was noted that vacation pay was not accrued at year end and should be recognized in the accounting records, and that some taxable benefits paid to employees were not included on their T4 slips.
- 7.46 *Canadian Blood Services* – The auditors recommended reviewing card access to the computer rooms and that a review of SAP user access be performed at least annually and include all key users and roles.
- 7.47 *Canadian Sport Centre Atlantic* – The auditors noted that Harmonized Sales Tax (HST) returns had not been completed and submitted on a timely basis since March 31, 2008, and that failure to submit could result in penalties. Consistent with the prior year, the auditors noted that when accounts receivable balances were paid in cash by vendors, revenue was credited a second time instead of reducing accounts receivable. The auditors recommended a monthly reconciliation be done to ensure all balances that have been paid are no longer included in the accounts receivable listing.
- 7.48 *Harbourside Commercial Park Incorporated (HCPI), and Nova Scotia Lands Incorporated* – The auditors recommended transferring excess cash into an income-generating financial instrument as it is currently in a non-interest bearing bank account. Furthermore, they noted land sales in HCPI in the current year equated to the value of the land at the date of purchase, and recommended that the company review the fair market value estimates for future land sales to ensure it is maximizing return.

- 7.49 *Medavie (for certain programs administered on behalf of the Department of Health)* – The auditors noted instances where user access had not been removed from applications and operating systems for terminated users, and user access was granted to operating systems without proper approval. The auditors further recommended that management review user access rights on a timely basis. This recommendation is consistent with 2008-09.
- 7.50 The auditors made the recommendation that physician licence numbers in the Medavie systems should be made a mandatory six-digit field and include a review process to ensure it is a valid license number. Furthermore, the auditors noted that detection edits to prevent duplicate claims were removed during the H1N1 pandemic, and recommended that changes to edits be tested, or that new controls be reviewed by a third party for design effectiveness, before implementation.
- 7.51 *Nova Scotia Crop and Livestock Insurance Commission* – Consistent with the prior year, the Commission should continue to work towards the development of a new computer system, and also develop a quality control process to ensure the premium rates on the insurance certificates are accurate. In the current year, the auditors noted the Commission does not have a formal investment policy, and recommended they develop a process to periodically monitor investment results to ensure investments made are in compliance with the policy.
- 7.52 *Nova Scotia Gaming Foundation* – Consistent with 2008-09, the Foundation’s Board should develop a process for monitoring compliance with the investment policy and for measuring performance of the investment manager. In 2009-10, the auditors encountered numerous errors in accounting for the Foundation’s new investment portfolio and recommended that the financial records should accurately and completely recognize the results of investment activities.
- 7.53 *Nova Scotia Health Research Foundation* – The auditors noted that grant processing is dependent on the accuracy of data entry and recommended that financial reports be verified against external source data.
- 7.54 *Nova Scotia Innovation Corporation (InNOVAcorp)* – The auditors recommended management remain closely involved through review of accounting activities and financial reports as a means to maintain effective internal controls until a more structured control environment becomes cost effective.
- 7.55 *Nova Scotia Legal Aid Commission* – The auditors noted that management should review the system to estimate certificate liabilities and should ensure older certificates are finalized on a timely basis. The auditors also noted

that the Commission should obtain an actuarial valuation for long service awards payable to retiring employees.

- 7.56 *Nova Scotia Public Service Long-Term Disability Trust Fund* – The auditors noted that the bank statement should be reviewed for unusual items, and that the bank reconciliation should be approved by the Board chair. They also noted that all journal entries should be printed and reviewed by a member of the finance committee. Finally, the auditors recommended that investment funds only be withdrawn upon receipt of a properly validated Board resolution.
- 7.57 *Nova Scotia School Boards Association (NSSBA)* – The auditors recommended that the Board establish an internal audit committee that reports directly to the Board. They also recommended NSSBA examine software alternatives that may provide a more efficient system.
- 7.58 *Provincial Drug Distribution Program (PDDP)* – It was recommended that a process be put in place to ensure interentity accounts receivable and accounts payable balances are reconciled on a monthly or quarterly basis. The auditors also recommended PDDP follow up with the various district health authorities to confirm drop shipments received prior to year-end as it would help ensure completeness of revenues and expenditures.
- 7.59 *Public Trustee Trust Funds* – The Public Trustee should develop a system to ensure revenue and expense transactions are properly classified as they are recorded and prepare the financial statements on an accrual basis to be in compliance with generally accepted accounting principles. The Public Trustee should establish a policy for valuing real estate, and should also recognize gains and losses on the sale of other assets. These findings and recommendations were all reported in the prior year. In the current year, the auditors noted that the individuals hired to remove assets from client’s homes are not bonded, which transfers risk of theft to the Public Trustee. Furthermore, the auditors noted that the Department of Justice should establish an oversight role for the Office of the Public Trustee.
- 7.60 *Resource Recovery Fund Board* – The auditors continued to recommend that management determine the appropriate amount of administration fees to charge between the Resource Recovery Fund and the Resource Recovery Fund Board Inc. and that appropriate steps be taken to ensure HST is reported correctly in both funds. In the current year, the auditors recommended that the Board finalize, approve, and implement policies and procedures related to change management. The auditors also noted that the Board had implemented controls in the current year to address system deficiencies identified in prior years.

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- 7.61 *Sherbrooke Restoration Commission* – The auditors again recommended that the Commission hire at least one member with financial reporting expertise.
- 7.62 *Sydney Tar Ponds Agency (STPA)* – Consistent with the 2008-09 year, the auditors noted that the Province has the ability to post transactions to the STPA general ledger. They have recommended these entries should only be made to reflect payments made by the Province on behalf of the Agency. The auditors have further recommended the Agency establish an audit committee. In the current year, the auditors recommended that all contracts clearly state reporting requirements and punitive provisions for the contracted company should they not meet the requirements. They also recommended that the Province reconcile payments to vendor statements periodically and follow up on variances on a timely basis to avoid potential disputes or double payments.
- 7.63 *Waterfront Development Corporation* – The auditors found that the segregation of duty issue identified in the prior year had been eliminated.

Timeliness of Financial Reporting

Conclusions and summary of observations

The usefulness of financial information is impacted by its timeliness. Management of all agencies 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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- 7.64 *Compliance with deadlines* – The Provincial Finance Act required that financial statements for government business enterprises and government units be submitted to the Minister of Finance by June 30 following their fiscal year end (usually March 31). The new Finance Act imposes the same deadline.
- 7.65 There continue to be problems with receiving submissions by the deadline although the number of agencies in violation of this deadline has decreased for the year ended March 31, 2010. In 2009-10, eight agencies were not successful in providing audited financial statements and requested information by June 30. Three of these agencies were also late in providing the requested information in 2008-09. This delay results in using unaudited information for planning and monitoring purposes in the current year. The following exhibit provides a complete list of late agencies for 2009-10.

Late Agencies

IWK Health Centre
Nova Scotia Health Research Foundation
Nova Scotia Strategic Opportunities Fund Inc.
Provincial Drug Distribution Program
Industrial Expansion Fund
Nova Scotia Fisheries and Aquaculture Loan Board
Nova Scotia Housing Development Corporation
Sherbrooke Restoration Commission

7.66 The Province's March 31, 2010 consolidated financial statements were released on July 29, 2010 meeting the reporting requirement set out in the Provincial Finance Act.

REVIEW OF AGENCY
FINANCIAL STATEMENTS
AND MANAGEMENT
LETTERS