



1 Message from the Auditor General

Introduction

- 1.1 I am pleased to present my January 2012 Report to the House of Assembly. This new Report focuses on financial reporting issues and includes work completed by my Office during 2011.
- 1.2 I wish to acknowledge the valuable efforts of my staff who deserve the credit for the work reported here. As well, I wish to acknowledge the cooperation and courtesy we received from staff in departments and agencies during the course of our work.

Overview of Report

- 1.3 Our Office has a number of legislated responsibilities that are directly related to the financial management of government. Among these are the responsibility to audit and provide an opinion on the government's consolidated financial statements; to review and provide an opinion on government's revenue estimates in the annual budget; to audit the financial statements of a number of provincial agencies; and to review the audit opinions and management letters provided by external auditors on all the agencies that form a part of the government reporting entity. We may also conduct other financial audits as we consider appropriate. And we provide recommendations to improve financial management in government.
- 1.4 We have, in the past, included the results of this work in our semi-annual reports along with the results of our various performance audits. This year, we have decided to consolidate all our reporting on financial management issues in a single report and to provide that report to the House of Assembly separately. This will allow an appropriate focus to be placed on this important assurance service.
- 1.5 The report contains five chapters in addition to this introduction.
 - In our Chapter on the results of our financial audits and reviews, we note that we provided an unqualified opinion on the consolidated financial statements and we commend government for the timely release of the statements. As a result of the audit, we identified deficiencies and provided a number of recommendations to improve financial controls and financial management in government. The opinion on the revenue estimates was again qualified and we recommended measures to eliminate the qualification in future.
 - Our audit of governance and control over treasury management at the Department of Finance concluded that risks have been identified and



are being managed. Controls were relatively strong but we made some recommendations for improvements.

- The Chapter on financial indicators provides financial information and analysis related to the sustainability of government finances, with a focus on long-term debt.
- In our review of agency audit opinions and management letters, we found that independent auditors' recommendations for improvements in internal controls were often repeated from prior years. We also found that some school boards' auditors identified poor controls of school-based funds, and we recommended that the Department of Education take steps to strengthen controls in this area.
- Our follow-up of previous recommendations related to financial management found that while some progress is being made, the implementation rate, at 66%, is still too low; a number of recommendations date back several years.

1.6 Departmental responses to recommendations have been included in the appropriate Chapter. We will follow up on the implementation of our recommendations in two years, with the expectation that significant progress will have been made.

Auditor General's Commentary

The Problem with Long-term Debt

- 1.7 Our Chapter on financial indicators identifies an issue that affects the long-term sustainability of government operations.
- 1.8 The province's ongoing indebtedness is a drain on current and future resources and limits the ability of government to make choices in providing services to its citizens.
- 1.9 For the last few years much of the world has been immersed in an economic and financial crisis, the roots of which may be said to lie primarily in excessive household and public sector debt. Governments which appear otherwise stable and prosperous face impossible debt servicing costs, an inability to borrow at reasonable rates, and potential default on sovereign debt; they find themselves hindered in their ability to respond to the effects of the financial recession in their countries or states.
- 1.10 Nova Scotia, like most provinces and like the federal government, has accumulated long-term debt gradually over a period of decades, under several different governments.



- 1.11 Long-term debt is incurred whenever the government spends more than it receives in taxes and other revenues, and therefore borrows to finance its spending. A certain amount of this borrowing is incurred to finance large capital projects that otherwise might not be affordable in the short-term. For the most part, however, borrowing occurs to finance operating deficits. Government, in other words, in any given year, spends more than it earns. It does so in order to provide services to its citizens today, while deferring payment for those services until tomorrow. This decision has a number of effects.
- 1.12 Firstly, to the extent that current spending is financed by long-term debt, repayable at a future date, government decisions to spend are divorced from the need to raise funds to pay for that spending. Those making the spending decisions are not fully accountable to those who, in the future, will be required to pay for those decisions.
- 1.13 The recipients of government services – the current citizens of the province – receive services which they do not have to completely pay for. To the extent those services are not paid for out of current revenues, payment is deferred, through government debts, often for a very long period of time. In effect, people receive services today that their children will pay for tomorrow.
- 1.14 As this practice continues, and government debt accumulates, interest on that debt consumes an ever increasing proportion of government revenue. The full cost of the original services is hidden in the long-term cost of the interest on the loans required to pay for them. As this interest cost increases, government becomes constrained in its ability to provide future services.
- 1.15 At present, about 9% of revenue received by Nova Scotia (approximately \$860 million) is needed to pay interest on loans obtained to pay for services delivered in the past. This money is not available to finance other expenditures on basic needs such as health, education and infrastructure. In effect, we are all poorer today because of government spending in the past.
- 1.16 Finally, government becomes vulnerable to swings in national and global interest rates. Current rates are at historic lows as a result of the financial crises; however, they will increase at some point. As some governments are discovering, increasing costs of borrowing can have devastating impacts on a government's finances.
- 1.17 Government's practice of borrowing to pay for current expenditures raises ethical questions. Is it right for Nova Scotians to expect, and receive, government services that they as a group do not completely pay for, deferring part of the payment to future generations? Is it right to add significant interest costs that continue for an indefinite period of time to the cost of services, again paid for by future taxpayers? And is it right for governments to decide to spend more than they earn, for short-term benefits, deferring payment to dates far in the future, if at all?



- 1.18 I take the view that, while governments have the ability to spend in excess of their revenues, to do so is not financially responsible, except in exceptional circumstances. Governments may need to borrow in times of emergency, such as war or natural disaster; they may need to undertake very large scale capital projects, such as dams or major hospitals, that would be unaffordable without debt; and they may need to finance short-term downturns in the economy. In any such case, the borrowing government should consider what is an appropriate and reasonable pay-back time, to minimize the cost to the taxpayer.
- 1.19 In all other cases, I believe government has a responsibility to its citizens to live within its means. That involves paying for its spending from current revenue.
- 1.20 Further, government has a responsibility to pay back its borrowings. Long-term debt is damaging to the province. Government should have a goal to eventually eliminate long-term debt and should have a plan for doing so. That is only possible through operating surpluses, as painful as they may be.
- 1.21 This province has had periods during which surplus revenue has been used to pay down long-term debt. Those periods have been the exception to the norm. Nevertheless, it has been demonstrated to be possible.
- 1.22 I have no specific recommendations to government in this respect. I raise the issue out of concern for the wellbeing of this province, for the financial health of the government, and for the best interests of the people of Nova Scotia. I urge enhanced awareness of the risks associated with government debt; and I urge greater consideration of the ethical questions involved in excessive government borrowing and its costs to future generations.