
2 Results of Financial Audits and Reviews



Summary

The opinion on the review of the revenue estimates, dated April 4, 2011, was qualified because the Estimates did not consider all revenues in the consolidated entity. It was further qualified because no estimate was made of these revenues and we were therefore unable to determine whether the revenue estimates were materially misstated as a result of their exclusion. We have recommended repeatedly, and again this year, that these revenues be estimated. Department of Finance management informed us that they do not plan to implement this recommendation. We urge government to address this issue in time for the release of the 2012-13 Budget.

This Chapter also focuses on the results of our audit of the consolidated financial statements. Volume 1 of the Public Accounts, which includes these financial statements, was released on July 28, 2011. The audit opinion dated July 21, 2011 was unqualified. The release of the Public Accounts was well in advance of the September 30th legislated date under the Finance Act. We commend the province for providing timely and relevant financial reporting results to the public.

This Chapter includes several recommendations for improvements in financial management processes. In particular, we noted weaknesses in the province's internal control framework, including the need for departments to complete a risk assessment related to financial reporting. We recommended that departments identify how they monitor the internal controls used to ensure transactions are appropriately authorized; assets are safeguarded; and financial records are properly maintained.

Finally, we report the results of our agency audits. No significant matters arose from the legislated audit work we performed in four government agencies.

The response at the end of this Chapter was received from the Department of Finance and we have published it verbatim. We disagree with certain of the responses. For instance, we disagree with the response provided to Recommendation 2.1 in which it is stated that the inclusion of all revenues in the revenue estimates would require changes in the provincial budgeting process. Further, it is not clear from some of the responses whether the department agrees or disagrees with the recommendations, and whether, if agreed, they will be implemented.



2 Results of Financial Audits and Reviews

Introduction

- 2.1 Under Section 19 of the Auditor General Act, this Office is the legislated auditor of the province's Public Accounts. Further, under Section 20 of the Act, the Auditor General conducts a review of the estimates of revenue used in the preparation of the Minister of Finance's budget address to the House of Assembly. The primary purpose of this Chapter is to provide the results of our legislated requirements with respect to government financial reporting, and to make recommendations for improvements to government processes related to financial reporting.
- 2.2 In addition to the above, the Auditor General is the legislated financial statement auditor of four government agencies.
- Nova Scotia Gaming Corporation
 - Nova Scotia Crop and Livestock Insurance Commission
 - Trust Funds Administered by the Public Trustee
 - Nova Scotia Legal Aid Commission
- 2.3 Comments resulting from each of these audits are included in Chapter 5 of this Report – Review of Audit Opinions and Management Letters.
- 2.4 Finally, on September 28, 2011, the Auditor General was appointed auditor of the accounts of the House of Assembly. At the time of this report, our planning process for the audit of the financial statements of the accounts of the House for the year ended March 31, 2011 had just begun, as had the process to audit the operating effectiveness of the House's internal controls. We expect to include observations resulting from these audits in a later Report to the House. In subsequent years, the timing of this audit should be such that observations will be included in this annual report on financial matters.

Background

- 2.5 Government financial reporting serves many purposes and is provided to stakeholders in various forms. Reports may be prepared which meet the needs of specific users, such as credit rating agencies and lenders. Individual entities may produce reports, such as annual reports, to demonstrate how they have complied with legislation throughout the year, and to measure and report on their financial condition and on the performance of funds, programs and activities. Whatever



the format or purpose, financial reports prepared by government are designed to provide information, to a variety of users for numerous reasons, on past or future activities. In general, financial reports are a means through which government fulfills its accountability responsibilities for the use of public funds with which it has been entrusted.

- 2.6 The Finance Act provides certain financial reporting requirements for the province including annual estimates (budget), regular forecast updates, and tabling of the Public Accounts. These reporting requirements are part of the government's accountability framework and contribute to oversight of the efficient use of resources.

Budgets

- 2.7 Government uses the budget process to inform stakeholders of its fiscal plan and priorities for the upcoming year, including required borrowing and tangible capital asset requirements, and to ensure approval of the plan by Members of the House of Assembly – the representatives of the people of Nova Scotia. The budget is a key policy document and forms the basis for the legal authority to spend throughout the year, which is approved in the Appropriations Act. It is a critical component of government accountability against which forecast updates and actual performance are compared. In Nova Scotia, budgets show the prospective revenues and expenditures, and any other amounts to be paid out of the general revenue fund of the province.

Forecasts

- 2.8 The Finance Act requires that financial forecasts be prepared and tabled in the Legislature by the Minister of Finance on at least four occasions during the year. Forecasts provide a comparison of activity to date to the approved budget for the year, and estimate the surplus or deficit for the year based on results to date. The province's forecast updates also include an analysis of significant variances and may provide current information on the province's economic performance and outlook. Forecast updates are an important element of accountability. They enhance transparency by providing current information on the government's financial situation, and contribute to effective management of public funds. In order to be an effective accountability tool and to provide appropriate information for decision-making purposes, forecasts must be timely, accurate and complete.

Public Accounts

- 2.9 The annual Public Accounts are prepared by the controller on behalf of the Minister and Deputy Minister of Finance. The Finance Act requires the Public Accounts to be tabled not later than September 30th after the fiscal year end. Volume 1 of the Public Accounts includes a Financial Statement Discussion and Analysis, which is a recommended practice by the Public Sector Accounting



Board, and the audited consolidated financial statements of the government. The Financial Statement Discussion and Analysis provides comparative financial highlights of the consolidated financial statements and information on certain financial indicators. The statements provide audited financial information for two years as well as comparison of actual results to the budget. As the budget reflects the plan approved by the House, the comparison of budget to actual enhances transparency and enables assessment of government's performance. The information provided in the Public Accounts can be used for a variety of purposes, including to:

- evaluate the government's performance for the year as compared to budget and prior year; and
- form the basis of analyzing government's financial performance, condition and indicators of financial position.

2.10 The release of the Public Accounts is a key component in the accountability framework of the government and provides important information to all stakeholders, including taxpayers and members of the House.

Chapter Objective

2.11 The objective of this Chapter is to provide summary comments and recommendations on government financial reporting, specifically;

- the results of our review of the revenue estimates included in the April 6, 2011 budget address;
- information resulting from our audit of the province's March 31, 2011 consolidated financial statements;
- observations on preparation of periodic forecasts during the year; and
- summary comments on the results of our audits of government agencies.

Significant Observations

Review of 2011-12 Revenue Estimates

Conclusions and summary of observations

Under Section 20 of the Auditor General Act, we are required to provide an opinion on the reasonableness of the revenue estimates included in the Minister of Finance's annual budget address. The opinion on the 2011-12 revenue estimates was qualified because



the estimates did not consider all revenues in the consolidated entity. Additionally, no estimate was made of these revenues and we could not determine whether the revenue estimates were materially misstated as a result of excluding these revenues. The qualified opinion is consistent with prior years. We have repeatedly recommended that these revenues be estimated and we urge government to address this recommendation prior to the 2012-13 revenue estimates.

Results of Review

2.12 *Reservation of opinion* – A reservation of opinion was issued on the 2011-12 revenue estimates. The qualifications noted in the report relate to two matters.

- The presentation of the revenue estimates is not in accordance with generally accepted accounting principles.
- We were unable to determine the extent of the unestimated revenues as the information was not available.

2.13 These qualifications are a deficiency in this accountability document. The opinion has been qualified since the province's financial statements were first prepared on a consolidated basis in 2001, and first included the results of government agencies such as school boards and health authorities. As with the consolidated financial statements, Canadian generally accepted accounting principles require that the revenue estimates be prepared on a consolidated basis. The estimates should encompass all revenues of these agencies including grants provided by the province and third-party revenues from other levels of government. This would ensure that the House of Assembly and the public have complete information on all provincial revenue. The province's revenue estimates have never been prepared on a consolidated basis, despite repeated qualified opinions and recommendations in several reports of the Auditor General.

2.14 We were also unable to determine the extent of the unestimated revenues of these agencies. The Department of Finance was not provided with detailed support for these revenue items. This lack of information represents a significant scope limitation in the report leaving us unable to conclude on the amount and presentation of unestimated revenues without qualification.

2.15 The government needs to take action to deal with these matters in order to obtain an unqualified opinion. Chapter 6 of this Report – Follow-up on Financial Recommendations 2005 to 2009 – notes that government does not plan to implement this recommendation. We urge government to reconsider this decision and resolve the issues surrounding these revenues for the 2012-13 revenue estimates.

2.16 Our recommendation is supported by a similar recommendation from a government-hired consultant, Deloitte LLP, who were tasked with recommending an approach to resolving the qualification on future revenue estimates. The



consultant's report, released in November 2009, recommended that a schedule of all revenues be prepared for inclusion in the budget documentation. Implementing this recommendation would result in the revenue estimates being prepared and presented in accordance with Canadian generally accepted accounting principles. Government has taken no action to date to implement this recommendation.

Recommendation 2.1

The Department of Finance should ensure that the revenue estimates for 2012-13 include all revenues of the consolidated entity, including all agencies' third party revenues in a schedule as proposed by Deloitte LLP, to ensure the budget is prepared and presented fully in accordance with Canadian generally accepted accounting principles.

Recommendation 2.2

The Department of Finance should obtain support for estimates of third-party revenues of government units.

2.17 We understand the recommendation to include all revenues on a gross basis has been interpreted by some in government as a recommendation on how the province should prepare its budget for operating purposes. This is inaccurate. The recommendation is meant solely to improve presentation of the revenue estimates.

Model-based Revenues

2.18 *E-Views* – Provincial source revenues such as Personal Income Taxes, Corporate Income Taxes and Harmonized Sales Tax are forecasted using models in a software application (E-Views). We performed a detailed review of this application in early 2011 with the objective of obtaining an understanding of EViews' application and process controls. As a result of this review, we made the following recommendations for improvement in the revenue estimates management letter provided to the Minister of Finance on August 2, 2011.

- The logging function of EViews should be activated each time the program is run and these logs should be maintained.
- Program changes to EViews should be authorized before they are made; program change processes should include ensuring evidence of this approval.

2.19 We are pleased to note that, based on discussions with staff of the Department of Finance's Taxation and Fiscal Policy Division, both of our recommendations have been implemented.

2.20 *Petroleum royalties* – The management review and challenge of the assumptions used in the royalties models is informal, as is the approval of the resulting



estimated revenue. Formalizing these processes would improve internal controls. Controls would also be improved if there was an independent check on the model inputs used to estimate this revenue to ensure there are no errors. In our 2011-12 revenue estimates management letter we recommended these practices be put in place. The need for these changes to the internal control framework for forecasting petroleum royalties was supported by errors found during the year-end audit.

Recommendation 2.3

The Department of Finance should assign responsibility for an independent review of inputs to, and results of, the models to forecast petroleum royalties.

Audit of the March 31, 2011 Consolidated Financial Statements

Conclusions and summary of observations

We are required by Section 19 of the Auditor General Act to perform the annual audit of the province's consolidated financial statements. The audit opinion on the 2010-11 consolidated financial statements, dated July 21, 2011, was unqualified. The release of the Public Accounts on July 28, 2011 was well in advance of the September 30th legislated deadline under the Finance Act. We commend the province for providing timely and relevant financial reporting results to the public. Based on our financial audit work, we have made several recommendations to improve financial controls and financial management in government.

Introduction

2.21 Our Office is the legislated auditor of the province's consolidated financial statements. Our overall objectives as auditors of the statements are:

- to obtain reasonable, but not absolute, assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error; and
- to report on the consolidated financial statements, and communicate our audit findings, as required by Canadian Auditing Standards.

2.22 The unqualified audit opinion indicates that the consolidated financial statements are presented fairly, in all material respects in accordance with Canadian generally accepted accounting principles for the public sector. The accounting principles referred to are those issued by the Public Accounting Standards Board of the Canadian Institute of Chartered Accountants. The unqualified audit opinion also indicates that there were no quantitative findings, either individually or cumulatively, which were significant enough to impact the opinion.



2.23 A management letter was provided to the Minister of Finance in October 2011. It included detailed audit findings, recommendations and other comments related to the March 31, 2011 Public Accounts. Our observations are detailed under the following headings.

- Required communication of audit results
- Accounting errors
- Audit completion
- Internal control

Required Communication of Audit Results

2.24 The management letter issued to the Minister communicated certain matters as required under Canadian Auditing Standards. These communications included identifying responsibilities of management and those charged with governance with respect to the preparation and oversight of the consolidated financial statements. The letter also communicated our responsibilities as auditors of the province's statements, and included audit findings and recommendations for improvement. It also included conclusions on accounting estimates and the fair presentation of the consolidated financial statements in accordance with Canadian generally accepted accounting principles for the public sector.

Accounting Errors

2.25 *Prior year adjustments* – Generally accepted accounting principles requires that errors discovered in subsequent periods be corrected by restating comparative balances. The most significant errors identified during this year's audit related to prior year's comparative figures. The March 31, 2010 consolidated financial statements were restated for the following.

- Subsequent to the release of the audited consolidated financial statements for the year ended March 31, 2010, Department of Finance senior management advised us of an error which resulted in an overstatement of personal income tax revenue of approximately \$88 million for the year then ended. The error resulted from misinterpretation of information provided by the federal government which collects these taxes on behalf of, and then remits them to, the province. Information related to this error, including the impact of the error on March 31, 2010 results, was provided on the Department's website in September 2010. For the year end March 31, 2011, management restated the comparative figures relating to March 31, 2010 year end to correct for this error.
- An error was identified during the audit which related to the fiscalization of corporate income tax (CIT). CIT is forecasted by calendar year and must be adjusted to reflect the fiscal year of the province. The formula



to fiscalize CIT changed during the year; however, the cumulative impact of the adjustment was not reflected in prior year's balances. The result was an understatement of CIT of approximately \$61 million which was corrected prior to the release of the consolidated financial statements. As a result of the change in the fiscalization formula for CIT, we recommend the fiscalization formulas for personal income tax and harmonized sales tax be reviewed to determine if the current fiscalization formulas require adjustment to better reflect how these revenues are earned during the year.

Recommendation 2.4

Department of Finance staff should review fiscalization formulas for personal income tax and harmonized sales tax revenues and ensure the formulas reflect how these revenues are earned during the year. Any adjustments resulting from the review should be recorded in the general ledger revenue accounts on a timely basis.

2.26 *Contractual obligations* – We continue to receive inaccurate information from departments regarding contractual obligations. Nontrivial errors of approximately \$354 million related to contractual obligations were identified and corrected during this year's audit.

2.27 Contractual obligations represent significant future expenditures of the province and provide useful information for assessing program costs. It is the Department of Finance's responsibility to ensure the completeness and accuracy of the contractual obligations for note disclosure. Guidance should be provided to departments regarding how to determine contractual obligations, including the review of Orders In Council. The information provided to the Department of Finance's Government Accounting Division and to this Office as part of our audit requirements should be accurate and complete.

Recommendation 2.5

The Department of Finance's Government Accounting Division should verify the accuracy and completeness of information to support the disclosure of contractual obligations in the consolidated financial statements prior to providing that information to this Office as audit evidence.

2.28 *Assistance to universities* – An audit adjustment of \$36.9 million was required to properly expense payments made to certain universities prior to year end. These amounts were originally recorded as advances, or prepayments, at March 31, 2011 and would have been recognized as expenses in the year ended March 31, 2012. However, because there were no eligibility requirements associated with the payments, they had to be expensed as grant payments in the current year to comply with the Public Sector Accounting Board's standard on government transfers.



Recommendation 2.6

The Department of Education should expense all grants made to universities unless there are eligibility requirements which the universities must meet in a subsequent period.

Audit Completion

- 2.29 *Timing of release* – The consolidated financial statements were issued on July 28, 2011, well in advance of the legislated requirement of September 30. Our audit opinion was dated July 21, 2011. We acknowledge government’s efforts in preparing timely and therefore relevant financial information.
- 2.30 *Difficulties encountered completing the audit* – The preparation of the consolidated financial statements takes considerable time as operations of over 100 entities must be consolidated with those of the general revenue fund. The Department of Finance’s Government Accounting Division provides us with a timetable each year which indicates when key deliverables, such as draft financial statements of the consolidated entities, will be received by Government Accounting and provided to us. Prior to the audit, Government Accounting provides all entities with a list of requirements and due dates to facilitate the consolidation process. We also communicate our requirements, including deadlines, with the auditors of the consolidated entities.
- 2.31 This year, the information we received related to several significant entities was received late by this Office, either because the statements were not provided to Government Accounting by the deadline, or because the auditors did not provide information to this Office by our deadline. This not only caused additional work but also seriously jeopardized the ability of our Office to complete the audit in order to meet the planned release date of the Public Accounts. The information we received from the following entities was late.
- Nova Scotia Housing Development Corporation
 - Nova Scotia Fisheries and Aquaculture Loan Board
 - Annapolis Valley District Health Authority
- 2.32 The target date for the release of the Public Accounts results in tight deadlines and the audit is scheduled based on predetermined due dates. Adherence to the schedule is essential to meet reporting deadlines. If information is not received by our Office in sufficient time, we may be forced to delay the timing of the opinion on the consolidated financial statements, or qualify the opinion if the missing information is significant.
- 2.33 In our view, Government Accounting has the ability to influence the timing of finalizing these entity audits in order to ensure the release of the Public Accounts



as planned. Government Accounting needs to closely monitor receipt of financial statements from these entities and assertively follow up those which have not provided required information.

Recommendation 2.7

The Department of Finance's Government Accounting Division should ensure receipt of entity financial statements on time. Progress of the entity audits should be monitored to ensure audits and related auditor communications are completed and available to the Office of the Auditor General based on the predetermined deadline.

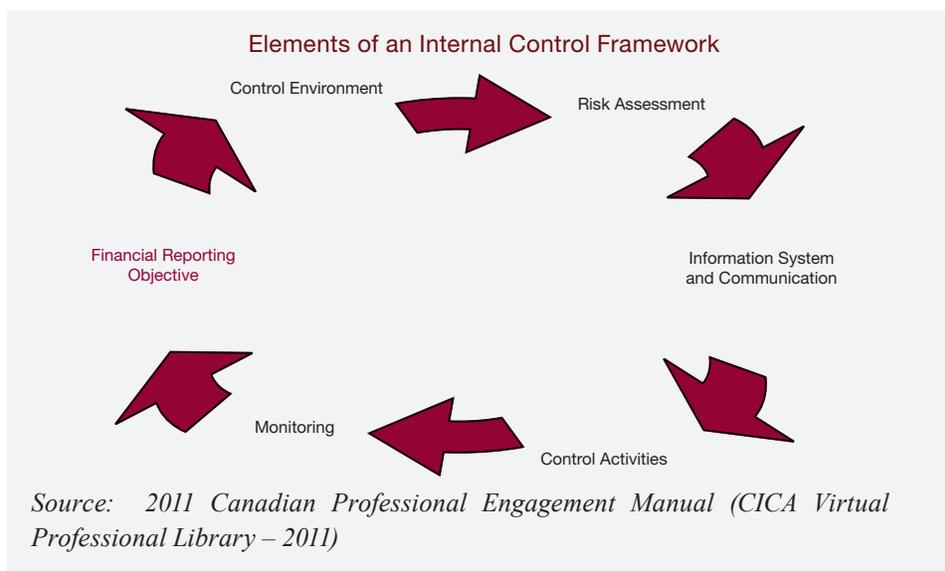
Internal Control

2.34 *Internal control framework* – An internal control framework is a set of interrelated processes that support entity objectives, including an objective of accurate and complete financial reporting. An accepted framework used in the private sector is the framework developed in 1985 in the US by the Committee of Sponsoring Organizations (COSO). The five components of the COSO Framework, and the extent of their presence in an organization, are noted in the following table.

COSO Framework			
Extent	Component	Definition	Factors to Consider
Pervasive controls	Control environment	Sets the tone of an organization	Ethical values Assignment of authority and responsibility
	Risk assessment	Identification and analysis of risks including how to manage these risks	Controls necessary to mitigate risks Materiality of risks
	Monitoring	Process that assesses the quality of an entity's internal control system over time	Frequency of monitoring activities
Specific controls	Information system	Preparation and communication of financial information	Procedures to process transactions to the general ledger
	Control activities	Policies and procedures that help ensure entity objectives	Approvals, authorizations, reconciliations Review of operating performance



- 2.35 The following exhibit shows the interaction between these various components, all of which have a role in meeting the financial reporting objectives of an entity.



- 2.36 We have reported in the past that government has an ongoing project – internal controls over financial reporting (the project) – to identify controls related to financial reporting. The project was developed to provide support for the Statement of Responsibility included in the province’s consolidated financial statements. The COSO Framework has been adopted by the province in setting out the objectives for this project. The project includes the five components of internal control shown above.
- 2.37 The first phase of this project was completed in 2009-10 and focused on the control environment. Department of Finance management have indicated that the project will become more robust over time. The focus during 2010-11 related to certain revenue reporting processes in the general revenue fund (the fund) and the interactions between the fund and consolidated entities. Management has indicated that roles and responsibilities for the design, implementation, operation and maintenance of internal controls have been proposed as a result of the 2010-11 review and will be presented to senior management throughout government. Department of Finance management also informed us that draft policies exist and will be added to the government’s Management Manuals after appropriate review and approval.
- 2.38 We acknowledge management’s efforts related to this project. However, a timeframe should be established for completion of the project. In addition, progress towards completing the project should be monitored on a regular basis.

Recommendation 2.8

The Department of Finance’s Controller’s Office should establish a timeframe for completion of the internal controls and financial reporting project and monitor progress to completion.



- 2.39 During the audit, we identified several matters related to internal control components. We discuss certain entity-level control findings related to departments and agencies under the following headings.
- Financial risk assessment
 - Control activities
 - Monitoring
- 2.40 In addition, our findings related to specific control activities are also discussed below.
- 2.41 *Financial risk assessment* – Risk assessment relevant to financial reporting is management’s responsibility. It is an important tool in ensuring financial reporting objectives are met. The risk assessment process includes identification of business risks that are relevant to financial reporting and estimating the significance and likelihood of those risks. This process would provide management with the information required to manage risks either through implementing appropriate internal controls to mitigate the risk or by accepting the identified risk.
- 2.42 During the audit of the consolidated financial statements, we asked management of the departments to provide us with their department’s risk assessment if one had been prepared. The responses received indicated the current risk assessment practices in several departments are not addressing the risks related to financial reporting, including the risk of fraud or error. Without identifying risks relevant to financial reporting, management is unable to determine if current internal controls are designed to mitigate the appropriate risks.

Recommendation 2.9

The Department of Finance should require departments to identify the risks related to financial reporting, especially risks related to fraud and error, and to complete a related risk assessment. This assessment should be updated on a periodic basis.

- 2.43 *Control activities* – Certain of the province’s controls activities are documented in Management Manual 200 – Budgeting and Financial Management. As we noted above, management has advised us that roles and responsibilities for the design, implementation, operation and maintenance of internal controls over the revenue reporting and financial close processes have been proposed. In addition, we note that the Finance Act provides limited guidance on internal controls over financial reporting although it does include the requirement to monitor appropriations against actual expenses.
- 2.44 Department of Finance management informed us that the Statement of Responsibility in the consolidated financial statements will become more robust over time. The Statement notes that government “...is responsible for maintaining a system of internal accounting and administrative controls in order to provide



reasonable assurance that transactions are appropriately authorized, assets are safeguarded, and financial records are properly maintained.”

- 2.45 Since the consolidated financial statements include all boards and agencies of government, and not just central government activity, we believe that in order to support the assertions in the Statement of Responsibility, the Controller’s office should provide guidance for the review and documentation of internal controls over financial reporting on a government-wide basis. This would help ensure that each entity included in the consolidated financial statements has a system of internal controls that contributes to the integrity of the consolidated results.

Recommendation 2.10

The Department of Finance’s Controller’s Office should provide guidance to departmental, board and agency management to complete the review and documentation of internal controls.

Recommendation 2.11

The Department of Finance’s Controller’s Office should provide guidance to departmental, board and agency management to assist in assigning roles and responsibilities to individuals throughout government for the design, implementation, operation and maintenance of internal controls as part of the documentation of internal controls.

- 2.46 *Monitoring* – A key aspect of internal controls over financial reporting is management’s monitoring of controls to determine if they are operating effectively over time. This monitoring can be done by management (for example, regular review to see that reconciliations are being performed) or separate evaluations may be performed (for example, by an entity’s internal audit group) depending on the risks related to the system and the results of management’s ongoing monitoring procedures.
- 2.47 As part of the audit, we are required to ask for management’s assessment of the internal control framework, including how controls are monitored. Responses from departmental management to this question indicated a consistent lack of understanding of monitoring. When asked how internal controls over financial reporting were monitored, management often described control activities, rather than indicating how management monitors the internal control system. For example, management noted segregation of duties as an example of a monitoring activity; this is an example of a standard control activity.
- 2.48 Monitoring of internal controls over financial reporting is scheduled as the last phase of the internal controls over financial reporting project. However, given the importance of monitoring the effectiveness of internal controls and the uncertainty of management throughout government departments on the nature of



monitoring of internal controls, this phase of the project should be conducted on a timely basis (see Recommendation 2.8 above). Regardless of that project, the processes by which government management monitor internal control systems need to be identified. Improvements to these processes should be implemented on a timely basis.

Recommendation 2.12

The Department of Finance's Controller's Office should identify how management monitors internal controls over financial reporting and take steps to ensure these processes are operating effectively.

2.49 Findings related to specific control activities are reported below under the following headings.

- Model-based revenue
- Debt amortization and deferred foreign exchange
- System access
- Reconciliations

2.50 *Model-based revenue* – As discussed earlier in this Chapter, certain revenues are recognized based on models and require significant estimation and judgments. Management of the Taxation and Fiscal Policy Division has a control process to review the reasonability of the forecasts of provincial own-source revenues determined by models. Management approval of the forecasts and journal entries is required prior to recording these revenues.

2.51 Although the above controls were found to be operating, several errors were detected during the audit. In some cases, the related journal entry posted amounts to the wrong account or the wrong inputs were used in the models. In one instance, the review process did not identify that a \$61.1 million adjustment was required to restate prior year amounts due to a change in the method used to fiscalize calendar-year-determined revenue. (This is discussed further under *Accounting errors* earlier in this Chapter.)

2.52 Management needs to evaluate their processes and determine whether control activities such as review of support need to be strengthened. In addition, these control activities should be monitored on an ongoing basis to ensure they are operating as designed.

Recommendation 2.13

The Department of Finance's Taxation and Fiscal Policy Division should assess the design and effectiveness of the controls over model-based revenue processes, including the preparation of journal entries. Improvements should be made as needed and these internal control activities should be monitored on an ongoing basis.



2.53 *Debt amortization and deferred foreign exchange* – The calculation of these amounts is based on data entered into a spreadsheet. Consistent with prior years' results, our audit of general ledger accounts under the responsibility of the Capital Markets Administration Division resulted in numerous audit adjustments due to errors in these calculations. It is evident from the volume of errors that improvements in control activities are required.

Recommendation 2.14

The Department of Finance's Capital Markets Administration Division should review the support and calculations of transactions posted to SAP to ensure the accuracy of the account balances it manages. In addition, the Division should regularly assess the control activities over calculations and ensure they are appropriate and are operating effectively.

2.54 *System access* – During the province's review of revenue controls in the Taxation and Fiscal Policy Division, it was observed that certain employees had inappropriate access to information, and a past employee continued to have access. Inappropriate access increases the possibility of fraud and inaccurate financial reporting. System access should be reviewed on a regular basis to ensure access is restricted to authorized individuals and that the level of access authorized is appropriate for each individual's job responsibilities.

Recommendation 2.15

The Department of Finance's Taxation and Fiscal Policy Division should review access to systems on a regular basis and adjust access as required. The access rights of individuals no longer employed by the Taxation and Fiscal Policy Division should be removed immediately.

2.55 *Reconciliations* – Reconciliations are important control activities that ensure the government's general ledger agrees with reports provided by third parties. The most basic example is the reconciliation of the province's bank accounts to the general ledger. Regular reconciliations also ensure the general ledger reflects current results. Without regular reconciliations, management may make decisions based on incorrect or outdated information. The following are deficiencies identified with respect to certain balances.

- *Model-based revenue* – In Chapter 5 of our November 2010 Report, we recommended that regular reconciliations of model-determined revenues and related accounts receivable or payable should be performed by the Department of Finance's Corporate Services Unit. We also recommended that amounts related to taxation years that have been finalized by the Canada Revenue Agency should be adjusted to income as they will be neither collected nor refunded by the province. Management agreed with our recommendations. During the 2010-11 audit, we found that reconciliations for open years (years for which revenues have not yet been



finalized) are not being performed. The absence of regular reconciliations may result in amounts being included in accounts receivable or payable which do not meet the definition of financial asset or liability in accordance with public sector accounting standards.

Recommendation 2.16

The Department of Finance's Corporate Services Unit should perform reconciliations of model-determined revenues and related accounts receivable or payable for all open years. This should be done on at least an annual basis.

- *Investments* – The reconciliation to custodian statements for investments is also an important internal control activity ensuring results of changes in investments, including sinking fund assets, are accurately recorded in the general ledger at any time during the year. In 2009, we recommended that the Capital Markets Administration Division should prepare monthly reconciliations to custodian statements and the general ledger should be updated each month to reflect the results of transactions. Management indicated the Division had implemented this recommendation and no further action was required.

The general ledger for the year end March 31, 2011 indicates no sinking fund earnings were recorded in the general ledger until December, 2010 and ten months of earnings for one sinking fund were posted to the general ledger on January 31, 2011. As a result, for the first several months of the year, the general ledger did not reflect the actual results of changes in sinking fund assets, nor related earnings.

Reconciliation processes were identified as a finding in the audit of the governance and control framework of this Division, the results of which are discussed in Chapter 3 of this Report. Recommendation 3.1 includes further improvements to the reconciliation processes.

Recommendation 2.17

The Department of Finance's Capital Markets Administration Division should prepare monthly reconciliations to trustee statements and the general ledger should be updated each month to reflect the results of transactions.



Other Matters

Preparation of Budget Forecast Updates

2.56 *Observations* – Financial forecasts are to be prepared and tabled in the House of Assembly during the year, as required by the Finance Act. Under Section 57(1),

“The Minister [of Finance] shall submit to the House of Assembly financial reports on the state of the public finances for a fiscal year in accordance with the following schedule:

- (a) on or before September 30th of the fiscal year to which the report relates;*
- (b) on or before December 31st of the fiscal year to which the report relates;*
- (c) as part of the estimates tabled in the House of Assembly for the following fiscal year; and*
- (d) as part of the Public Accounts prepared respecting the fiscal year.”*

2.57 Through our testing of controls and of transactions for the audit of the Public Accounts, we know that departmental expenses are recorded in the province’s general ledger (SAP) as they occur. A key control for department staff is that they compare recorded expenses to that department’s appropriation on a monthly basis and therefore it is important that expenses recorded in SAP be complete and accurate. Results of this comparison are reported to Treasury Board each month. This process is detailed in Management Manual 200.

2.58 Management Manual 200 requires that a similar process as that described for expense monitoring be in place to compare ordinary revenues, which includes tax revenues, to estimates, except that the results are to be provided to the Department of Finance Taxation and Fiscal Policy Division.

2.59 There are several significant accounts for which there was little or no recorded activity in SAP during the year. Examples of these accounts are noted in the following table, as well as the first date transactions were recorded in SAP. While these revenues were forecasted in December 2010, the table shows this forecast was not based on amounts recorded in the general ledger.

\$ Millions				
Account	2010-11 Estimate	December 2010 Forecast Update	March 31, 2011 Actual	Posted to SAP
Provincial Income Tax	\$1,896.9	\$1,968.4	\$2,046.1	February 2011
Corporate Income Tax	\$343.6	\$337.3	\$473.1	February 2011
Petroleum Royalties	\$173.6	\$170.1	\$197.0	August 2010
Pension Valuation Adjustment	\$8.4	(\$23.7)	(\$25.7)	March 2011



- 2.60 A review of the internal controls related to certain revenues took place during 2010-11. (This is discussed in greater detail earlier in this Chapter.) One of the deficiencies noted in that review was that an identified control – variance analysis – could not be performed because there was no balance in the general ledger. We understand the general ledger is not updated until the December forecast for the significant revenue items because a more accurate forecast of the fiscal year is available in December than at the start of that year in April. Since the general ledger contains the accounting records of the province and forms the basis for the preparation of the financial statements of the general revenue fund, it should be updated on a regular basis. Current financial information in the general ledger is an essential component of good financial management and should support the forecast updates during the year.

Recommendation 2.18

The Department of Finance's Controller's Office should ensure the province's general ledger is updated on a regular basis throughout the year and that the general ledger supports the forecast updates.

Accounting Standards

- 2.61 *New accounting standards* – There are new accounting pronouncements either made or in process that will have an impact on the government's future financial reporting. Some of the more significant issues on which the Public Sector Accounting Board (PSAB) has recently released new or revised pronouncements include tax revenue, foreign currency translation and government transfers.
- 2.62 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.
- 2.63 In addition, PSAB updated the introduction to public sector accounting standards which outlines the appropriate generally accepted accounting principles (GAAP) for use by public sector organizations. Government business enterprises are required to adopt International Financial Reporting Standards starting for fiscal years beginning on or after January 1, 2011. Other government organizations, including government not-for-profit entities, were required to determine which GAAP is appropriate based on the guidance included in the standards. We understand that this decision process has been undertaken by the Controller's office and that these entities will be required to adopt public sector accounting principles. When new standards are adopted, some entities may need to restate prior year comparative amounts. Accordingly, Government Accounting Division will need to determine the impact on consolidation of first time adoption of new standards by other government organizations, including government not-for-profit organizations.

**Recommendation 2.19**

The Department of Finance's Controller's Office should provide guidance to those entities forming part of the government reporting entity which will be adopting, for the first time, generally accepted accounting principles for the public sector for the year ended March 31, 2012. The Government Accounting Division should initiate appropriate measures to ensure all these entities will meet the reporting deadlines for next year's audit.

Other Legislative Audits

2.64 The Office of the Auditor General is the legislated auditor for four government agencies.

- Nova Scotia Gaming Corporation
- Nova Scotia Crop and Livestock Insurance Commission
- Trust Funds Administered by the Public Trustee
- Nova Scotia Legal Aid Commission

2.65 The findings and recommendations related to those audits are reported in Chapter 5 of this Report – Review of Agency Audit Opinions and Management Letters. Unqualified audit opinions were issued as a result of the audit in each of these entities with the exception of the audit of the Trust Funds Administered by the Public Trustee. The audit opinion is qualified each year because it is not possible to ensure the financial statements reflect all assets assigned by the courts to be administered by the Office of the Public Trustee. This is a common qualification for entities such as this and is not as a result of deficiencies in the Office of the Public Trustee's systems and controls.



The following response was received from the Department of Finance and we have published it verbatim. We disagree with certain of the responses. For instance, we disagree with the response provided to Recommendation 2.1 in which it is stated that the inclusion of all revenues in the revenue estimates would require changes in the provincial budgeting process. Further, it is not clear from some of the responses whether the department agrees or disagrees with the recommendations, and whether, if agreed, they will be implemented.

Response: Department of Finance

Recommendation 2.1

The Department of Finance should ensure that the revenue estimates for 2012-13 include all revenues of the consolidated entity, including all agencies' third-party revenues in a schedule as proposed by Deloitte LLP, to ensure the budget is prepared and presented fully in accordance with Canadian generally accepted accounting principles.

The Office of the Auditor General has a statutory requirement to annually review estimates of revenue used in the preparation of Estimate. This is a unique requirement, as no other province is subject to this level of review.

The Department of Finance recognizes that the annual budget includes revenue for only the General Revenue Fund (GRF) and not all revenues of the Government Reporting Entity (GRE). The inclusion of all revenues, and the associated offsetting expenses in the annual budget, would require changes in the provincial budgeting process and additional resources to coordinate this additional information. The benefit of this change, given the resources required, is questionable.

Revenue information from the GRE would likely not be available in time and have the required detail to meet the Province's schedule of releasing its annual budget. Including revenues from the GRE would add confusion to the budgeting process and may reduce the transparency of transactions dealing solely with the General Revenue Fund.

A point of clarity that is important for readers to understand is that the Public Sector Accounting Handbook does not include presentation or disclosure standards for budgeting. The underlying accounting policies in the annual budget are consistent with the Public Accounts and in accordance with GAAP. Furthermore, a reconciliation of the Estimates, from the original annual budget to the presentation format of the actual results on a consolidated basis, is included in the Public Accounts.

**Recommendation 2.2**

The Department of Finance should obtain support for estimates of third-party revenues of government units.

Third party revenues are not included in the Estimates of the Province however these revenues projections are incorporated in the government funding decisions for these third party organizations. Management believes it has sufficient information on these revenues for this purpose.

Recommendation 2.3

The Department of Finance should assign responsibility for an independent review of inputs to, and results of, the models to forecast petroleum royalties.

The Department conducts review and challenge sessions as part of the revenue estimates including revenue associated with petroleum royalties. However, certain inputs to the petroleum royalty model include proprietary information and an independent review is not permissible.

Recommendation 2.4

Department of Finance staff should review fiscalization formulas for personal income tax and harmonized sales tax revenues and ensure the formulas reflect how those revenues are earned during the year. Any adjustments resulting from the review should be recorded in the general ledger revenue accounts on a timely basis.

The Controller's Office agrees with this point and will work with the Taxation and Fiscal Policy Division and the Finance CSU to strengthen the process of preparing and reviewing model-based revenues, including the review and analysis of the fiscalization formulas for PIT and HST.

Recommendation 2.5

The Department of Finance's Government Accounting Division should verify the accuracy and completeness of information to support the disclosure of contractual obligations in the consolidated financial statements prior to providing that information to this Office as audit evidence.

Government Accounting has implemented numerous controls to ensure the accuracy and completeness of reported contractual obligations. Each year, we provide departments with templates which include detailed instructions on how to report their commitments and contingencies. We track media releases and orders in council to identify potential contracts and we cross reference these items to the contractual obligations reported by the departments. We also ensure any prior year contracts are carried forwarded or eliminated, as appropriate in current year disclosure. In addition to this, we provide periodic training to departments regarding contractual obligations and have drafted a management manual section on this topic. Once approved, this policy



will be incorporated into the existing management manuals to allow all accounting personnel access to this guidance. Despite the numerous processes already in place, we acknowledge that audit results suggest further improvements could be made. For the 2011-12 year-end, we intend to continue training and supporting the Financial Manager's Forum in the disclosure of contractual obligations. Further, we plan to implement a checklist that departments will complete and sign before submitting their contractual obligations schedules. The checklist will ensure that departments have considered all relevant factors in compiling their contractual obligations listings.

Recommendation 2.6

The Department of Education should expense all grants made to universities unless there are eligibility requirements which the universities must meet in a subsequent period.

Findings related to Assistance to University funding and student assistance should be reported under the Department of Labour and Advanced Education (LAE). Decisions made around advancing university funding were made by LAE and not the Department of Education.

The Department of Labor and Advanced Education reviews and authorizes transactions not only based on merit but in accordance with Canadian Generally Accepted Accounting Principles (GAAP) for the public sector while adhering to Provincial policies and procedures.

LAE considered the available options and determined that under current PSAB (Section 3410) and Provincial Policy (Management Manual 200, Chapter 12), the payments to the two universities met the criteria of an advance and recorded them as a financial asset of the Province at year-end. The Department acknowledges the OAG's interpretation of Section 3410, thus the amounts in question were expensed as recommended.

Recommendation 2.7

The Department of Finance's Government Accounting Division should ensure receipt of entity financial statements on time. Progress of the entity audits should be monitored to ensure audits and related auditor communications are completed and available to the Office of the Auditor General based on the predetermined deadline.

The Department of Finance agrees with this point. Government Accounting monitors the progress of entities in meeting established deadlines by reviewing and updating our entity tracking spreadsheet and following up with the entities on a regular basis. The Division plans to meet with the entities that have been late in meeting financial reporting deadlines in the past to discuss improvements. Government Accounting will plan to request more regular updates from the entities as well as progress updates on their audit work. The Division will discuss with the Office of the Auditor General



the related auditor communications that are required and coordinate a plan to monitor their completion.

Recommendation 2.8

The Department of Finance's Controller's Office should establish a timeframe for completion of the internal controls and financial reporting project and monitor progress to completion.

The ICFR project is an ongoing program to address targeted areas of internal control over financial reporting each year. This program provides management's assessment of the design and operating effectiveness of the internal controls over financial reporting. In fiscal 2011-12, all documentation related to ICFR from 2010-11 will be reviewed and updated, and additional business processes will be included in the scope of this year's program. Completion of this year's program is anticipated to be prior to the issuance of the 2011-12 Public Accounts.

Recommendation 2.9

The Department of Finance should require departments to identify the risks related to financial reporting, especially risks related to fraud and error, and to complete a related risk assessment. This assessment should be updated on a periodic basis.

The Department of Finance agrees with this point. The Internal Audit Centre is currently working on a fraud risk project that will be disseminated to the various departments and CSUs in the near future. As the Internal Controls over Financial Reporting (ICFR) project and the annual certification requirements become more robust, departmental ICFR process and testing documentation will enhance the risk assessments. Government Accounting will continue to discuss this topic at FMF meetings and provide guidance where needed.

Recommendation 2.10

The Department of Finance's Controller's Office should provide guidance to departmental, board and agency management to complete the review and documentation of internal controls.

The ICFR program is a top-down risk based approach. The Controller's Office plans to provide guidance to departmental management to complete the review and documentation of internal controls over financial reporting. Following the initial year of documentation and testing, departmental management will be responsible for updating the control documentation on an annual basis. At this time, boards and agencies with independent auditors are required to provide internal control documentation in accordance with their independent auditor's audit requirements.

**Recommendation 2.11**

The Department of Finance's Controller's Office should provide guidance to departmental, board and agency management to assist in assigning roles and responsibilities to individuals throughout government for the design, implementation, operation and maintenance of internal controls as part of the documentation of internal controls.

The Controller's Office continues to agree with this recommendation. The ICFR program is a top-down risk based approach. The Controller's Office plans to provide guidance to departmental management to assist in assigning roles and responsibilities to individuals throughout government for the design, implementation, operation and maintenance of internal controls over financial reporting. Following the initial year of documentation and testing, departmental management will be responsible for updating the control documentation on an annual basis.

Roles and responsibilities for the design, implementation, operation and maintenance of internal controls were proposed as part of the 2010-11 management assessment that was presented to the Deputy Ministers Committee. Draft policies exist and will be added to the management manuals after appropriate review and approval.

Recommendation 2.12

The Department of Finance's Controller's Office should identify how management monitors internal controls over financial reporting and take steps to ensure these processes are operating effectively.

The ICFR program is a top-down risk based approach that continues to address targeted areas of internal control over financial reporting each year. As the design and operating effectiveness of the internal controls over financial reporting for each business process is conducted, the Controller's Office plans to provide guidance to departmental management relating to the monitoring of those internal controls. Any design or operating deficiencies identified at any time during the year are addressed immediately by management.

Recommendation 2.13

The Department of Finance's Taxation and Fiscal Policy Division should assess the design and effectiveness of the controls over model-based revenues processes, including the preparation of journal entries. Improvements should be made as needed and these internal control activities should be monitored on an ongoing basis.

The Controller's Office will plan to assist the Taxation and Fiscal Policy Division in assessing the design and monitoring of the financial controls over model-based revenues and to help facilitate the flow of financial information to the Finance CSU in order to prepare the appropriate journal entries on a timely basis.

**Recommendation 2.14**

The Department of Finance's Capital Markets Administration Division should review the support and calculations of transactions posted to SAP to ensure the accuracy of the account balances it manages. In addition, the Division should regularly assess the control activities over calculations and ensure they are appropriate and are operating effectively.

As part of its system of internal controls over financial reporting, the Capital Markets Administration (CMA) Division has a process in place to review the support and calculations of transactions posted to SAP for the account balances it manages. CMA has assessed the control activities over calculations to ensure that they are designed appropriately and operating effectively.

Recommendation 2.15

The Department of Finance's Taxation and Fiscal Policy Division should review access to systems on a regular basis and adjust access as required. The access rights of individuals no longer employed by the Taxation and Fiscal Policy Division should be removed immediately.

The Controller's Office agrees with this point and will continue to work with the Taxation and Fiscal Policy Division to strengthen controls in this area.

Recommendation 2.16

The Department of Finance's Corporate Services Unit should perform reconciliations of model-determined revenues and related accounts receivable or payable for all open years. This should be done on at least an annual basis.

The Controller's Office agrees with this point and will continue to work with the Taxation and Fiscal Policy Division and the Finance CSU to reconcile model-based revenues and related accounts receivable or payable to the general ledger.

Recommendation 2.17

The Department of Finance's Capital Markets Administration Division should prepare monthly reconciliations to trustee statements and the general ledger should be updated each month to reflect the results of transactions.

Reconciliations to all custodian statements are performed monthly and evidence of all the reconciliations for 2010-11 was provided to the auditors. Any adjustments required are posted once the reconciliations are reviewed. At year-end, the custodian statements are received after Government Accounting's month-end cut-off dates for the closing of the general ledger so any adjustments required will always be posted at least one month after the statement date, assuming there are no major reconciliation items that need to be cleared with the front office.



The Department of Finance has also transitioned to a new custodian that is able to calculate amortization. This provides for clean reconciliation between the custodian statements and SAP without the requirement for manual monthly calculation of amortization, gains, and losses. Automating this control will greatly enhance the monthly sinking fund reconciliation process.

Recommendation 2.18

The Department of Finance's Controller's Office should ensure the province's general ledger is updated on a regular basis throughout the year and that the general ledger supports the forecast updates.

The Controller's Office agrees with this point and will work with the Taxation and Fiscal Policy Division and the Finance CSU to strengthen the process of updating the general ledger to support the Budget Forecast Updates.

Recommendation 2.19

The Department of Finance's Controller's Office should provide guidance to those entities forming part of the government reporting entity which will be adopting, for the first time, generally accepted accounting principles for the public sector for the year ended March 31, 2012. The Government Accounting Division should initiate appropriate measures to ensure all these entities will meet the reporting deadlines for next year's audit.

Government Accounting has initiated appropriate measures to ensure that all organizations forming part of the government reporting entity adopt the appropriate GAAP based on the amendment to the Public Sector Accounting Handbook. All controlled government entities are aware of the accounting framework they need to adopt upon transition from Part V of the CICA Accounting Handbook.

Government Accounting has taken numerous steps to ensure the entities' successful and timely transition to their new appropriate basis of GAAP. Over the past two years, the division has monitored the entities' implementation of their new accounting frameworks. Government Accounting has provided individual training and guidance as needed and distributed relevant professional development material to the affected entities. In addition to general PSAB guidance, the division has developed in-house training specifically focussed on the needs of the Province's entities.