NOVA SCOTIA

January 5, 2012

Honourable Gordie Gosse
Speaker
House of Assembly
Province of Nova Scotia

Dear Sir:

I have the honour to submit herewith my Report to the House of Assembly under Section 18(2) of the Auditor General Act, to be laid before the House in accordance with Section 18(4) of the Auditor General Act.

Respectfully submitted

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Auditor General

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Office of the Auditor General

Our Vision

A relevant, valued and independent audit office serving the public interest as the House of Assembly's primary source of assurance on government performance.

Our Mission

To make a significant contribution to enhanced accountability and performance in the provincial public sector.

Our Priorities

Conduct and report audits that provide information to the House of Assembly to assist it in holding government accountable.

Focus our audit efforts on areas of higher risk that impact on the lives of Nova Scotians.

Contribute to a better performing public service with practical recommendations for significant improvements.

Encourage continual improvement in financial reporting by government.

Promote excellence and a professional and supportive workplace at the Office of the Auditor General.

Who We Are and What We Do

The Auditor General is an independent nonpartisan officer of the Legislature, appointed by the House of Assembly for a ten-year term. He or she is responsible to the House for providing independent and objective assessments of the operations of government, the use of public funds, and the integrity of financial reports. The Auditor General helps the House to hold the government to account for its use and stewardship of public funds.

The Auditor General Act establishes the Auditor General's mandate, responsibilities and powers. The Act provides his or her Office with a modern performance audit mandate to examine entities, processes and programs for economy, efficiency and effectiveness and for appropriate use of public funds. It also clarifies which entities are subject to audit by the Office.

The Act stipulates that the Auditor General shall provide an opinion on government's annual consolidated financial statements; provide an opinion on the revenue estimates in the government's annual budget address; and report to the House at least annually on the results of the Office's work under the Act.

The Act provides the Office a mandate to audit all parts of the provincial public sector, including government departments and all agencies, boards, commissions or other bodies responsible to the crown, such as regional school boards and district health authorities, as well as funding recipients external to the provincial public sector. It provides the Auditor General with the authority to require the provision of any documents needed in the performance of his or her duties.

In its work, the Office of the Auditor General is guided by, and complies with, the professional standards established by the Canadian Institute of Chartered Accountants, otherwise known as generally accepted auditing standards. We also seek guidance from other professional bodies and audit-related best practices in other jurisdictions.

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1 Message from the Auditor General

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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.

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.

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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.

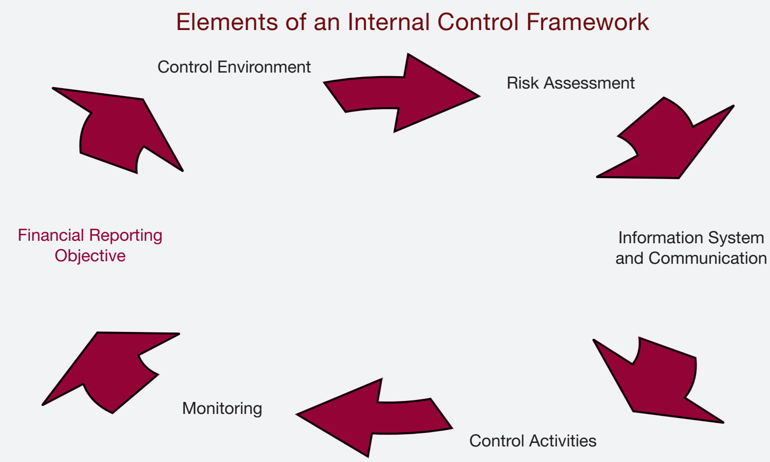
Recommendation 2.7
The Department of Finance's Government Accounting Division should ensure receipt of entity financial statements on time. Progress of the entity audits should be monitored to ensure audits and related auditor communications are completed and available to the Office of the Auditor General 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.



Source: 2011 Canadian Professional Engagement Manual (CICA Virtual Professional Library – 2011)

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.

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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.

NOVA SCOTIA

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.

3 Governance and Control Framework

Summary

Substantial investment activity is conducted through the Liability Management and Treasury Services Division of the Department of Finance, and monitored for compliance by the Department's Compliance and Reporting Division. The Liability Management and Treasury Services Division's transactions are accounted for by the Department's Capital Markets Administration Division.

We conducted an audit of the governance and control framework in these divisions in 2011. Our audit was a follow-up to a 2004 audit on this framework performed by a private-sector audit firm. That audit resulted in a denial of opinion. We repeatedly recommended that the province engage a private-sector firm to conduct a follow-up audit to determine if the deficiencies leading to the denial of opinion had been resolved.

We concluded the deficiencies had been substantively resolved. The governance and control framework in these divisions provides for the identification of major risks that impact investment activity. These risks are controlled through policies related to borrowing limits and credit ratings; compliance with these policies is monitored on a daily basis. In addition, the province's Debt Management Committee provides adequate oversight and challenge to the activities of these divisions, and reports its results to the Minister of Finance on an annual basis.

We further concluded that controls over transactions are adequate, but we made recommendations for improvement. A risk assessment should be prepared to determine if certain risks, such as lack of segregation of duties, have been adequately addressed through current processes. We have also recommended the need to independently calculate interest income related to sinking fund investments, and that there be evidence that reconciliations to custodian statements have been reviewed.

3 Governance and Control Framework

Background

3.1 In 2004, an external audit firm conducted an audit of the governance and control framework of the Investment Management, Liability Management and Treasury Services, and the Capital Markets Administration Divisions of the Department of Finance. The resulting report, issued in December 2004, identified several control weaknesses which resulted in a denial of opinion. The auditors categorized the significant deficiencies as follows:

- deficiencies related to the governance model including the need for an oversight body in both the Liability and Treasury Management and Investment Management divisions, and a more comprehensive risk management plan for the Liability Management and Treasury Services Division; and
- deficiencies related to internal controls including improved segregation of duties in each of the Liability and Treasury Management, Investment Management and Capital Markets Administration divisions.

3.2 Substantial investment activity is conducted through the Liability Management and Treasury Services Division. In addition, this Division and the Capital Markets Administration Division are responsible for $14.6 billion in debt in the province's general revenue fund, approximately $4.7 billion in derivative instruments, and $2.4 billion in sinking fund assets.

3.3 In 2007, the Internal Audit Centre conducted a follow-up to the 2004 audit of these Divisions. The objective of that engagement was to determine whether the 2004 audit recommendations had been implemented, or if not implemented, that strategies had been developed to mitigate related weaknesses or risks. The results of the follow-up noted the divisions were moving in the direction of addressing the recommendations. One significant issue from the 2004 audit was resolved through the establishment of the Compliance and Reporting Division. This Division functions to ensure that investment and debt management activities comply with legislation and Department of Finance policies. However, because the transactions processed by these divisions are significant and complex, we repeatedly recommended in past reports of the Auditor General that an audit by an external, experienced private sector firm be conducted to determine whether the deficiencies identified in 2004 have been corrected to the extent necessary for an unqualified audit opinion. In 2011, we undertook this audit ourselves in order to provide an independent opinion on the adequacy of the governance and control framework in these significant divisions.

Audit Objectives and Scope

3.4 In 2011, we conducted a follow-up audit to the 2004 audit of governance and control framework of certain divisions of the Department of Finance. We contracted with a private-sector firm to perform certain aspects of the fieldwork, and completed the remainder ourselves.

3.5 Our audit focused on two of the three divisions included in the 2004 audit scope: Liability Management and Treasury Services; and Capital Markets Administration. In addition, we included the Middle Office Compliance and Reporting Division which did not exist in 2004, but which was created in response to the 2004 audit. The Investment Division, which had been responsible for investments in the Province's funded pension plans, was transferred to the Nova Scotia Pension Agency in 2006, and was excluded from the scope of our follow-up audit. This audit was conducted in accordance with Sections 18 and 21 of the Auditor General Act as well as the Canadian Institute of Chartered Accountants' *Section 5025 – Standards for Assurance Engagements*.

3.6 The objectives of the audit were to determine whether the following elements of a governance and control framework exist.

- The divisions' objectives, policies and procedures contribute to the achievement of the goals in the Department of Finance's 2010-11 Business Plan.
- Major risks that may impact the divisions' ability to achieve their objectives or goals have been identified and controls are in place to ensure the risks are mitigated to an acceptable tolerance level.
- Divisional internal controls over transaction initiation, approval, recording, reporting, and custody of assets are designed in a manner to protect related financial assets and promote the accuracy and completeness of liabilities.
- The divisions are subject to monitoring from a centralized function.
- Roles and responsibilities of committees, management, and staff are well understood and capabilities exist to achieve objectives.
- There are appropriate reporting structures and performance measures to support achievement of the goals and objectives.

3.7 Generally accepted audit criteria consistent with the objectives of this audit existed for certain of the above objectives. For those objectives for which criteria did not exist, audit criteria were developed by this Office. These criteria were discussed with, and accepted as appropriate by, senior staff within the three divisions.

3.8 The audit approach included conducting interviews with staff from the three divisions and reviewing policies, procedures and other relevant documentation.

We determined whether the identified criteria were valid statements and supported related objectives. Walkthroughs were performed as at March 31, 2011 to determine if identified controls were operating as described. In addition, we tested a sample of transactions between January and November 2011 to determine if the described controls operated throughout that period.

Significant Audit Observations

Conclusions and summary of observations

We concluded that objectives related to the governance and control framework have been met, although we have identified deficiencies in certain reconciliation processes. Major risks that impact the ability of the province's investment and treasury functions have been identified and are controlled and monitored through policies related to borrowing limits and credit ratings. Compliance with these policies is monitored on a daily basis. In addition, the Debt Management Committee provides adequate oversight and challenge and reports the results of its activities to the Minister on an annual basis.

3.9 *Division objectives, policies and procedures* – The Liability Management and Treasury Services Division and the Capital Markets Administration Division have each adopted the mission of the Department of Finance as reflected in the Department's 2010-11 Business Plan. While the Liability and Treasury Division has a specified mandate, neither the Capital Markets Administration Division nor the Compliance and Reporting Division have established formal mandates. However, the role of each Division is noted on the Department of Finance's website.

3.10 Outcomes in the Business Plan have been used by Liability and Treasury Division management in establishing policies related to credit limits and risk tolerances. These divisional policies are included in the Treasury Management Policy.

3.11 The Division also has a compliance manual which establishes the policies and procedures to be used by the Compliance and Reporting Division to ensure Liability and Treasury Division activity is in compliance with legislation and policies. The Capital Markets Administration Division has a manual which includes the procedures for settling and accounting for transactions. Neither the capital markets manual nor the compliance manual includes specific divisional goals; however, a review of the policies indicates they support the described role of each division.

3.12 Policies and procedures are subject to internal review to ensure their legitimacy, and alignment with the Department of Finance mandate. Each division submits its policies to the Debt Management Committee for review and to the Minister for approval. Once approved, policies and procedures are communicated to division personnel and to internal and external stakeholders if appropriate.

3.13 *Risk management* – One of the key findings from the 2004 audit related to risk management:

> *"There are currently insufficient risk management policies and procedures within the Division [LMTS] for the debt management function of the Province. As such, risk tolerances, targets or performance benchmarks for assessing the effectiveness of the portfolio management activities, and liquidity guidelines against which the portfolio can be assessed have not been formalized or approved."*

3.14 In the 2004 audit, risk management was assessed only in relation to the Liability Management and Treasury Services Division. We agree with that decision as this Division has the most significant risk exposures and these exposure relate to factors external to the Division. The Division's mandate notes that it is responsible for *"ensuring effective money management, maximizing return on investments and minimizing debt servicing costs within risk tolerances acceptable to government."* It is evident that risk management is critical to the success of the Division.

3.15 The significant risks the Division manages are as follows.

- interest rate risk – risk due to variability in interest rates
- credit risk – risk due to a counterparty's ability to meet its obligations
- liquidity risk – risk that there is inadequate cash (including cash equivalents) on hand to meet liquidity needs
- foreign currency risk – risk that an exchange rate will change unfavourably over time

3.16 We concluded that the Liability Management and Treasury Services Division has adequate risk management policies that provide a framework for identifying, prioritizing, managing, and reporting and monitoring major risks to the Division. This framework includes the establishment of risk tolerances. The Division's Treasury Management Policy addresses numerous risk elements including target exposures for currency, interest and liquidity risks, and credit limits with specified issuers.

3.17 The Treasury Management Policy is approved by the Minister and is subject to annual review. Revisions to policies are brought forward to the Debt Management Committee (this Committee's role and responsibilities are discussed later in this Chapter) by Division management after an environmental scan and review has taken place. Changes are recommended by the Deputy Minister of Finance (who chairs the Debt Management Committee) for approval by the Minister of Finance. During the year, the Debt Managment Committee receives regular reports on the Liability Management and Treasury Services Division's activities. These results assess the effectiveness of risk management processes by demonstrating how the Division has met established targets and benchmarks.

3.18 Another key risk for the Liability Management and Treasury Services Division is compliance risk – the risk that the Division is not complying with established legislation and policies. The Compliance and Reporting Division (the Middle Office) was created in response to a finding from the 2004 audit which noted that compliance risk had not been considered. The role and responsibilities of this Division are discussed in greater detail later in this Chapter.

3.19 *Internal controls* – In the 2004 audit, the following findings were noted related to internal controls.

- There was need to develop a monitoring and compliance function for both the Liability Management and Treasury Services Division and Investment Divisions to ensure compliance with policies and procedures, including risk limits.
- There was a lack of segregation of duties for certain incompatible functions.
- Certain key controls were not documented in operational policies and procedures.

3.20 The first deficiency was addressed by the creation of the Compliance and Reporting Division. We examined this Division and concluded there is still a need for improved internal controls. More detailed observations on the Compliance and Reporting Division are provided later in this Chapter.

3.21 We discussed internal controls over transaction initiation, approval, recording, reporting, reconciling, and custody of assets with management and staff within the three Divisions. We conducted walkthroughs and detailed tests of these controls. We determined that the controls as described are designed effectively.

3.22 We tested 30 trade tickets issued between January and November 2011 to ensure controls related to their processing were operating effectively during that time. There were no errors in any of the processes related to short-term investing and borrowing for transactions in the general revenue fund. Controls exist to ensure assets are completely and accurately recorded in the Province's general ledger (SAP) and that they are appropriately safeguarded.

3.23 We found deficiencies in the reconciliation processes related to sinking fund assets. Interest income is entered into SAP from the custodian's statements. This differs from the processes for recording interest income and expense for short-term investments and borrowing in the general revenue fund as these are calculated by the Millennium Treasury Management System and reconciled to the custodian statements each month. This provides an independent calculation of the interest amounts. There is no independent calculation of interest in the sinking funds portfolio. In addition, the Capital Markets Administration Manual describes the current process of transposing interest from the custodian statements as a reconciliation. This is inaccurate and should be corrected.

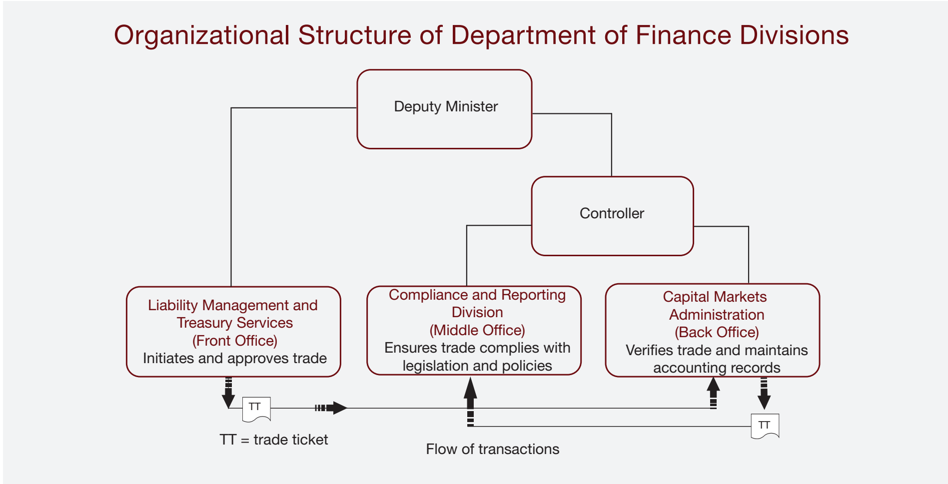
Recommendation 3.1
The Department of Finance's Capital Markets Administration Division should perform an independent calculation of interest activity in the province's sinking fund accounts and reconcile these calculations to the custodian statements. The Capital Markets Administration Manual should be updated to include accurate reconciliation processes.

3.24 During this audit, we tested certain controls as required to conclude whether they were designed effectively, and operating during our testing period. We also tested controls during our audit of the March 31, 2011 Public Accounts. At that time, we noted that reconciliations of sinking fund accounts to custodian statements were not being completed on a timely basis. This finding is discussed in greater detail in Chapter 2 – Results of Financial Audits and Reviews – of this Report. We have recommended that these reconciliations be performed.

3.25 In addition, we noted there was no evidence that reconciliations prepared by the Capital Markets Administration Division were being reviewed. This monitoring control ensures that reconciliations are performed accurately and on a timely basis. Without documentation such as reviewer's initials, there is no evidence to ensure the review is being completed. This increases the risk of inaccurate balances in the general ledger.

Recommendation 3.2
Management of the Department of Finance's Capital Markets Administration Division should ensure the review of reconciliations is documented.

3.26 Daily trades such as short-term investments and borrowings originate in the Liability Management and Treasury Services Division and are approved by authorized staff. The information is entered into the Treasury Management System (Millennium). The trade ticket that Millennium produces becomes the source document used by staff in the Compliance and Reporting Division to ensure the trade complied with approved policies. The trade ticket is also used by the Capital Markets Administration Division to settle and account for the transaction. The following exhibit provides overall details of the functions of each Division.



3.27 There are approximately 125 functions available to users in the Millennium system. Access to each function is controlled by the system administrator. Both the system administrator and the individual who provides backup to the administrator have full access to all functions within Millennium. This super-user access increases the risk of unauthorized transactions. In addition, the system administrator role is performed by staff in the Compliance and Reporting Division who monitor compliance with the parameters established in the Treasury Management Policies. This is an inappropriate segregation of duties.

3.28 Risks related to inappropriate segregation of duties are to be mitigated by access and other controls in the Millennium system. These controls are also important because the Director of the Capital Markets Administration Division and the Compliance and Reporting Division is the same individual, which is a further example of inappropriate segregation of duties. However, the access controls prevent users in the Capital Markets Administration Division and the Compliance and Reporting Division from having access to functions for which the Director is ultimately responsible.

3.29 The Millenium system produces a daily report which details activity by user for transactions as well as for changes to access privileges. This daily report is reviewed by the system administrator. The Millennium system also produces a weekly report by user which is reviewed by the Director.

3.30 It is not uncommon for there to be a super-user with conflicting responsibilities in an operation with few staff, as is the case with these three divisions. However, the responsibilities of these divisions are significant. We believe a risk assessment of the roles and responsibilities of positions within the divisions should be prepared to ensure identified risks are sufficiently mitigated.

Recommendation 3.3
Management of the Department of Finance's Liability Management and Treasury Services, Capital Markets Administration, and Compliance and Reporting Divisions should complete a risk assessment of roles and responsibilities and ensure controls exist to mitigate identified risks.

3.31 In addition, staff in the Compliance and Reporting Division make changes to the limits they monitor. During our testing we did not detect any errors in the initiation, approval and monitoring of transactions. However, the ability of the Compliance and Reporting Division to enter and change the limits and other parameters it monitors in Millennium increases the risk that trades which do not comply with approved policies could occur. We understand these changes to limits and parameters would be reported in the daily and weekly activity reports. Although these changes are reviewed by the Director of the Compliance and Monitoring Division, they should be verified to the Millennium system. This would maintain the integrity of the compliance function.

Recommendation 3.4
The Department of Finance's Liability Management and Treasury Services Division should verify that changes made to limits and other parameters in the Millennium system are accurate.

3.32 The Director of the Capital Markets Administration Division and the Compliance and Reporting Division is the same individual. During our review of Millennium access, we determined that the Director has super-user access to all functions within Millennium. This reduces the impact of the controls provided in the Millennium system. The Director is responsible for the review and approval of activities in the Divisions and there is no requirement for the Director to have this level of access to the Millennium system.

Recommendation 3.5
The Director of the Department of Finance's Capital Markets Administration Division and the Compliance and Reporting Division should have read-only access to the Millennium system.

3.33 The Millennium system is a stand-alone system used to enter daily trade information. Millennium does not interface with any other systems. The system is being upgraded to a new version called WallStreet. We discussed, but did not audit, the processes being used to convert to the new system and note that they appear adequate to ensure a seamless transition to the upgrade.

3.34 *Centralized monitoring* – Industry practice requires three functions related to debt and investment activities: front office, which initiates transactions; middle office, which focuses on compliance with debt and investment policies, including risk limits; and back office which settles and records transactions.

3.35 A finding from the 2004 audit was that there was no middle office and therefore compliance with policies was not being monitored. Soon after that audit was completed, a middle office function was established – the Compliance and Reporting Division. The Division's primary focus is to ensure Liability Management and Treasury Services is in compliance with Department, Division, and legal requirements. As noted above, we tested 30 transactions from January to November 2011 to ensure certain controls were operating, including controls in the Compliance and Reporting Division. We found no errors in the controls related to this Division.

3.36 The Division prepares a monthly report on the results of monitoring activities. This report is provided to the Debt Management Committee each month.

3.37 The Division's policies and procedures are detailed in the Compliance Manual. However, the Compliance Manual is not fully aligned with the policies and procedures of the Liability Management and Treasury Services, which are detailed in the Treasury Management Policy Manual. This increases the risk that policies will not be fully monitored and that reporting of monitoring activities will not be complete.

Recommendation 3.6
Management of the Department of Finance's Compliance and Reporting Division should update the Compliance Manual to ensure it reflects the complete range of debt and investment policies to be monitored.

3.38 *Roles and responsibilities* – A significant finding from the 2004 audit related to the role of the Debt Management Committee. At that time, the Committee was assigned management responsibilities and therefore its ability to provide oversight to the debt management function was compromised.

3.39 The role of the Committee is defined in its current Governance Guidelines as

> *"... to provide independent advice necessary to foster the long-term success of efforts by the Minister, Deputy Minister and Management to prudently manage the financial assets and liabilities of the General Revenue Fund. The Committee has no executive authority, and is therefore only advisory...It is the responsibility of Management to ensure that the Committee are kept well informed of changing risks."*

3.40 The Committee currently consists of full committee members and ex-officio committee members; the Guidelines note that full committee members cannot be management. The Guidelines specify that at least one member of the Committee has, among other competencies, an understanding of fiduciary duty; financial literacy or accreditation; and knowledge or understanding of the role played by each of the three divisions. We reviewed the current membership of the Committee and note that there are three full members external to the Department of Finance with one of these members being independent of government. The other full members are with the Department, but not management in the Divisions.

3.41 We conducted a brief survey of a sample of current Debt Committee Members to determine whether the members felt that the Committee as a whole has sufficient expertise or knowledge to challenge information presented to it by management. We also asked whether the Committee felt it was provided with sufficient information in order to fulfill its advisory role to the Minister.

3.42 The responses from the members were generally positive with respect to both questions asked. In particular, the expertise of the external, independent member of the Committee was noted.

3.43 Although Committee members are required to sign off on a code of conduct, they are not required to acknowledge their understanding of their roles and responsibilities, and we suggested this be done. We are pleased to note that, in accordance with good governance practices, the Committee completes an annual self-assessment. In addition, the Committee prepares an annual report of its activities and provides this to the Minister of Finance.

3.44 The Governance Guidelines do not include the Committee's responsibilities for receiving and reviewing the results of compliance work performed by the Compliance and Reporting Division. Without proper documentation of its responsibilities there is a risk that the Committee compliance review activities may not happen or that new members may be unaware of their responsibilities. If a thorough review is not conducted by the Debt Management Committee there is a risk that noncompliance activities are not being properly addressed and corrected.

Recommendation 3.7
The Department of Finance's Liability Management and Treasury Services Division should update the Governance Guidelines to indicate the review processes to be conducted by the Debt Management Committee with respect to the reports received from the Compliance and Monitoring Division.

Response: Department of Finance

The recommendations highlighted below are from the Auditor General's final draft report on the Governance and Control Framework follow up audit completed in 2011.

Recommendation 3.1
The Department of Finance's Capital Markets Administration Division should perform an independent calculation of interest activity in the province's sinking fund accounts and reconcile these calculations to the custodian statements. The Capital Markets Administration Manual should be updated to include accurate reconciliation processes.

CMA agrees with this recommendation and it has been implemented.

Recommendation 3.2
Management of the Department of Finance's Capital Markets Administration Division should ensure the review of reconciliations is documented.

CMA agrees with this recommendation and it has been implemented.

Recommendation 3.3
Management of the Department of Finance's Liability Management and Treasury Services, Capital Markets Administration, and Compliance and Reporting Divisions should complete a risk assessment of roles and responsibilities and ensure controls exist to mitigate identified risks.

Management agrees with this recommendation and an implementation plan will be developed.

Recommendation 3.4
The Department of Finance's Liability Management and Treasury Services Division should verify that changes made to limits and other parameters in the Millennium system are accurate.

Management agrees with this recommendation and it has been implemented.

Recommendation 3.5
The Director of the Department of Finance's Capital Markets Administration Division and the Compliance and Reporting Division should have read-only access to the Millennium system.

Administrator access will be removed from the Director, however, the Director requires limited access for operational purposes, ie. trade verification.

Recommendation 3.6
Management of the Department of Finance's Compliance and Reporting Division should update the Compliance Manual to ensure it reflects the complete range of debt and investment policies to be monitored.

The Compliance Manual has always provided complete compliance coverage of the debt and investment policies monitored. Management will add a table to the front of the Compliance Manual mapping the debt and investment policies to the compliance program.

Recommendation 3.7
The Department of Finance's Liability Management and Treasury Services Division should update the Governance Guidelines to indicate the review processes to be conducted by the Debt Management Committee with respect to the reports received from the Compliance and Monitoring Division.

Management agrees with this recommendation and will recommend the appropriate change to the Governance Guidelines.

4 Indicators of Financial Condition

Summary

In recent reports, we have included information on certain indicators of sustainability, flexibility and vulnerability. This year we have focused our Report on sustainability indicators. Additional indicators can be found under the Publications tab on our website at oag-ns.ca.

We believe sustainability indicators are the most relevant in the current global climate in which high levels of sovereign debt have greatly reduced the ability of certain countries to raise and finance their debt. Sustainability indicators are a measure of government's ability to maintain existing programs and services, including maintaining obligations to creditors, without increasing debt or raising taxes.

Detailed reporting on sustainability is a recent development in government reporting. The International Public Sector Accounting Standards Board recently published an exposure draft for a recommended practice on government reporting: *Reporting on the Long-Term Sustainability of a Public Sector Entity's Finances*. It recommends that government provide projections of the sources and uses of resources over a longer term, and provide commentary on the main risks impacting these projections. The reporting is meant to supplement information found in public sector financial statements and further enhance financial reporting objectives – accountability and decision-making. Several governments, including Canada, are publishing fiscal sustainability reports as part of their annual reporting package.

Volume 1 of the Public Accounts includes several indicators of government's financial position. These include five-year trends of revenues, expenses, and net debt and accumulated deficits per capita. The current Budget Assumptions and Schedules document includes a medium-term outlook (four years) for certain assumptions, and also identifies the key variables impacting revenue estimate assumptions. We encourage government to review its present reporting and consider enhanced reporting on the long-term sustainability of its programs.

4 Indicators of Financial Condition

Introduction

4.1 The province's consolidated financial statements provide a snapshot of its financial position at fiscal year end (March 31) and the results of its operations, and changes in both cash flow and net debt for the preceding fiscal year. However, the province's financial position as reflected in the consolidated financial statements is only one factor in determining the financial condition of the government. The consolidated statements do not provide a complete indication of the financial health of the province nor indicate how well it is performing in relation to its economic and fiscal environment.

4.2 In recent reports, this Office has provided information on certain indicators of financial condition. Several of these are included in those recommended for reporting by the Public Sector Accounting Board's *Statement of Recommended Practice 4: Indicators of Financial Condition*. The Statement is not part of generally accepted accounting principles, but is meant to provide guidance on appropriate methods for reporting supplementary information on financial condition.

4.3 The province currently provides information on the economy in the Financial Statement Discussion and Analysis, included in Volume 1 of the Public Accounts, including several indicators. However, the Financial Statement Discussion and Analysis does not include comparative indicators for other provinces and territories in Canada; this Chapter is meant to provide further information beyond what is already reported. Our report includes a comparison, where appropriate, to five other provinces; New Brunswick, Prince Edward Island and Newfoundland and Labrador because they operate in the same regional economic environment; and Manitoba and Saskatchewan because they are comparable in population. The information in this Chapter's exhibits has been taken from these jurisdictions' public accounts from 2007 to 2011 for all provinces except Newfoundland and Labrador, which has not yet released public accounts for the year ended March 31, 2011.

4.4 There may be numerous indicators to assess a government's financial condition. The Statement of Recommended Practice recommends that, at a minimum, indicators related to sustainability, flexibility and vulnerability be considered. This Chapter focuses on certain sustainability indicators. Additional indicators on sustainability, flexibility and vulnerability can be found under the Publications tab on our website at oag-ns.ca.

Indicators

Sustainability

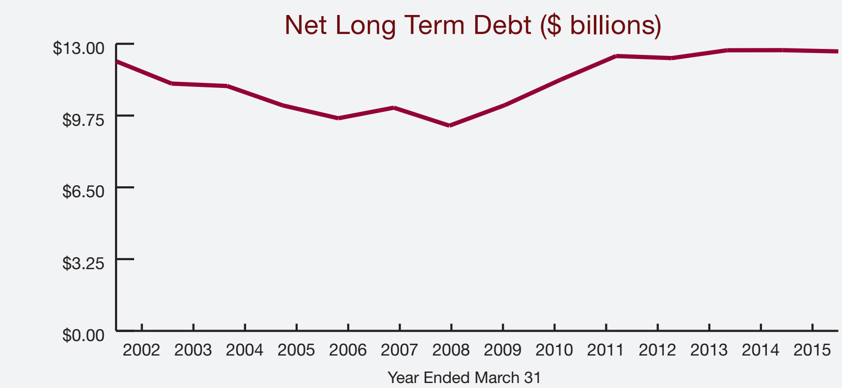
4.5 Sustainability measures the ability of a government to maintain its existing programs and services, including maintaining its obligations to creditors, without increasing its debt or raising taxes. These indicators provide insight into how a government balances its commitments and debts.

4.6 The International Public Sector Accounting Standards Board (Board) has recently published an exposure draft for a recommended practice on government reporting: *Reporting on the Long-Term Sustainability of a Public Sector Entity's Finances*. The exposure draft recommends that government and public sector entities provide projections of inflows and outflows of resources over a longer term, and also provides commentary on the main risks facing these projections. The Board notes in an overview of the exposure draft that *"This information allows the users of general purpose financial reports to assess the extent to which current policies are sustainable, and complements the financial statements, which remain at the core of public sector financial reporting."*

4.7 Nova Scotia's annual budget assumptions and schedules has reflected government's four-year fiscal plan, and includes a medium-term economic outlook and projected borrowing requirements to 2014-15. Most other assumptions are forecast for one year, to March 31, 2012. In addition, key variables impacting the revenue estimates assumptions are noted, but additional information on the sensitivity of these variables would assist users in understanding the impact of economic changes on revenues. We believe government should consider additional information in its annual budget documents including longer-term projections and sensitivity of significant revenues. This would provide the House of Assembly and the public with an indication of the sustainability of government programs and services.

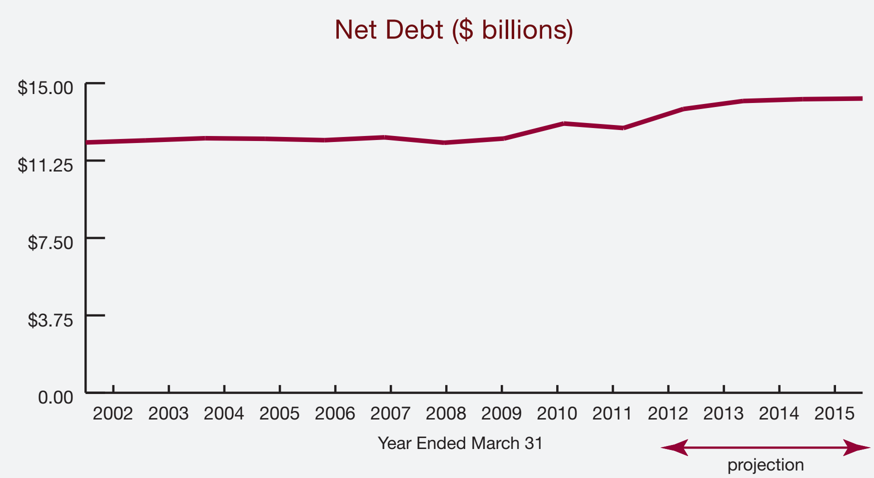
Indicators of Debt Position

4.8 *Long-term debt* – Details of the province's long-term debt is included in Schedule 4 of the March 31, 2011 Public Accounts. Gross long-term debt totalling $15.8 billion is offset by sinking fund assets of $3.4 billion resulting in a net long-term debt of $12.4 billion. The majority of this amount consists of bonds (net of sinking funds) issued by the province totalling $12.2 billion. Long-term debt is a significant indicator of fiscal sustainability in Nova Scotia.



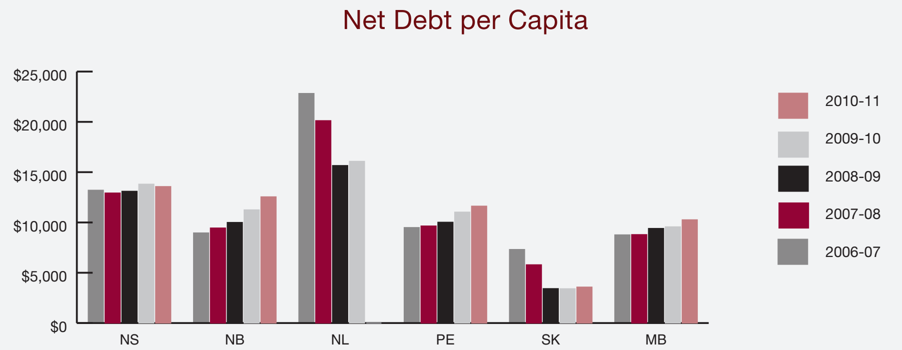
Source: 1 and 6 (see end of chapter)

4.9 *Net debt* – Net debt is the difference between the province's financial assets and financial liabilities. It is an indication of the government's current obligations that must be funded through future revenues, including taxation. Net debt has increased by 5% or $700 million over the past ten years, although as can be seen, the increase was on an already significant net debt position of $12.1 billion at March 31, 2002. Net debt declined in 2011 because payments to universities totalling $375 million had been made in 2009-10; this reduced 2010-11 expenses. These payments will resume in 2011-12.



Source: 1 and 6 (see end of chapter)

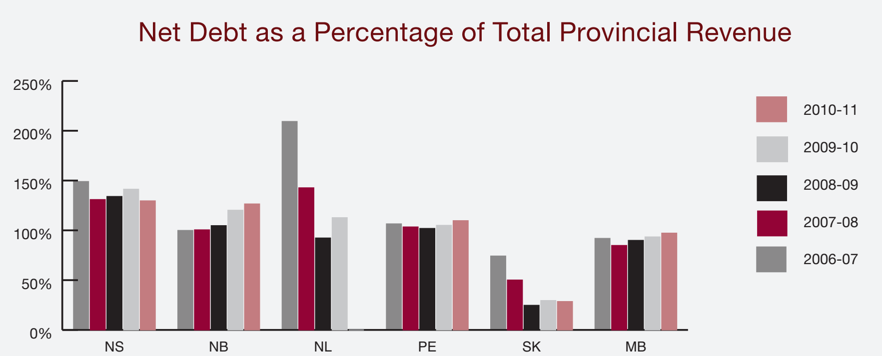
4.10 *Net debt per capita* – Another indicator of sustainability is net debt per capita. This shows the amount of net debt attributable to each person living in a province or territory. An increasing net debt per capita shows net debt is increasing at a rate exceeding population growth, and may not be sustainable. A decreasing ratio shows that net debt is growing at a slower rate than the growth in population. The ratio in Nova Scotia has been relatively stable over the past five years ranging from a low of $12,927 in 2008 to a high of $13,841 in 2010. This is due to a population growth which approximates the growth in net debt.



Source: 1, 2, 3 and 5 (see end of chapter)

Net Direct Debt per Capita – Nova Scotia					
Year ended March 31	2007	2008	2009	2010	2011
Net Debt ($ thousands)	$12,357,205	$12,114,763	$12,318,239	$13,045,146	$12,827,331
Population (thousands)	935.8	937.2	940.3	944.8	945.4
Net Debt per Capita	$13,205	$12,927	$13,100	$13,807	$13,568

4.11 *Net debt as a percentage of total provincial revenues* – This indicator measures a government's net debt as a percentage of its total revenues or the amount of future revenues required to pay for past transactions. An increasing trend indicates additional time will be needed to eliminate net debt, and may not be sustainable. Over the past five years this ratio has fluctuated in Nova Scotia from a high of 149.0% in 2007 to 129.6% in 2011. Over the same time period two of our five comparative jurisdictions had significant decreases in this ratio and one jurisdiction experienced a significant increase in this ratio. The ratio for Nova Scotia has been higher than the other jurisdictions over much of this time period.

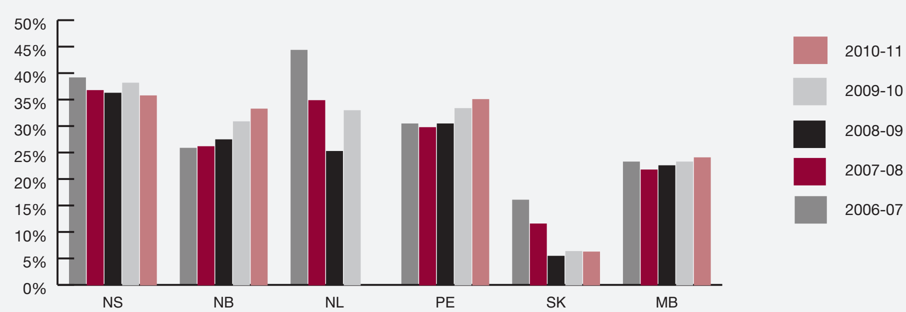


Source: 1, 2 and 3 (see end of chapter)

Net Debt as a Percentage of Total Revenue – Nova Scotia					
Year ended March 31	2007	2008	2009	2010	2011
Net Debt ($ millions)	$12,357	$12,115	$12,318	$13,045	$12,827
Provincial Revenue ($ millions)	$8,293	$9,253	$9,196	$9,231	$9,897
Revenue/GDP	149.0%	130.9%	133.9%	141.3%	129.6%

4.12 *Net debt as a percentage of provincial GDP* – This indicator provides insight into the impact of a government's debt on its economy. A higher percentage indicates that a government's debt is becoming an increasing burden on the economy, and may not be sustainable. A stable or decreasing percentage shows the growth of net debt is equal to, or less than the growth of the economy and is likely sustainable. The following exhibit shows this ratio has fluctuated in Nova Scotia; however, the overall trend has been a declining ratio from 39.1% in 2007 to 35.7% in 2011. In the past five years two jurisdictions had significant decreases in this ratio and one jurisdiction experienced an increase in this ratio. The ratio for Nova Scotia has been higher than the other jurisdictions over much of this time period.

Net Debt as a Percentage of Provincial GDP

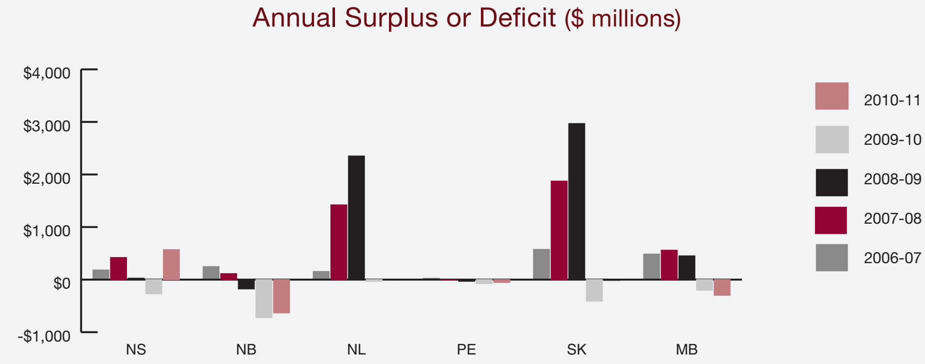


Source: 1, 2, 3 and 4 (see end of chapter)

Net Direct Debt as a Percentage of Provincial GDP – Nova Scotia					
Year ended March 31	2007	2008	2009	2010	2011
Net Debt ($ millions)	$12,357	$12,115	$12,318	$13,045	$12,827
Provincial GDP ($ millions)	$31,644	$33,031	$34,041	$34,283	$35,952
Net Debt/GDP	39.1%	36.7%	36.2%	38.1%	35.7%

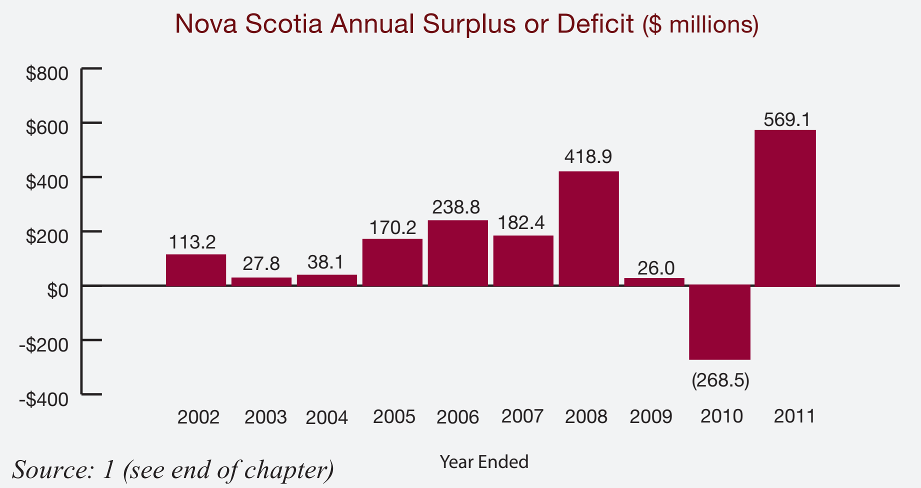
Results of Operations as Indicators of Sustainability

4.13 *Annual surplus or deficit* – This annual result indicates the extent to which the government's revenues are more or less than its expenses during the year. A surplus means revenues exceed expenses while a deficit indicates that government has not lived within its means. Recurring deficits on a long-term basis are not sustainable. As noted in the exhibit below, there have been no consistent trends in the operating results of the provinces; however, all provinces incurred deficits during the 2009-10 fiscal year.



Source: 1, 2, 3 (see end of chapter)

4.14 The Province of Nova Scotia has incurred a surplus in nine of the past ten years. There are significant fluctuations in the province's annual results from 2002 to 2011, ranging from a surplus of $569.1 million in 2011 to a deficit of $268.5 million in 2010.



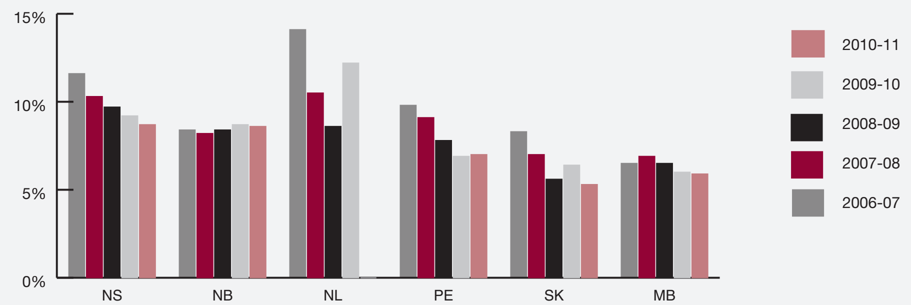
Source: 1 (see end of chapter)

Other Indicators of Sustainability

4.15 In addition to the indicators focusing on debt, information on the following indicators is also recommended for reporting under the Public Sector Accounting Board's *Statement of Recommended Practice 4: Indicators of Financial Condition*. There have been improvements in each of these indicators over the past five years. Irrespective of this, our concerns remain with the government's debt position.

4.16 *Debt servicing costs as a percentage of total revenue* – The proportion of debt servicing costs to revenue indicates the amount of current revenues that is required to service past borrowing decisions and, as a result, is not available for current and future programs and services. An increase in this ratio could reduce future flexibility, as lenders might be less likely to lend to jurisdictions with significant debt loads. In Nova Scotia this ratio has decreased from a high of 11.6% in 2007 to a low of 8.7% in 2011. The decreasing trend is consistent with three of our comparative jurisdictions. The ratio for Nova Scotia has been higher than the four other jurisdictions for most of this time period.

Debt Servicing Costs as a Percentage of Total Revenue

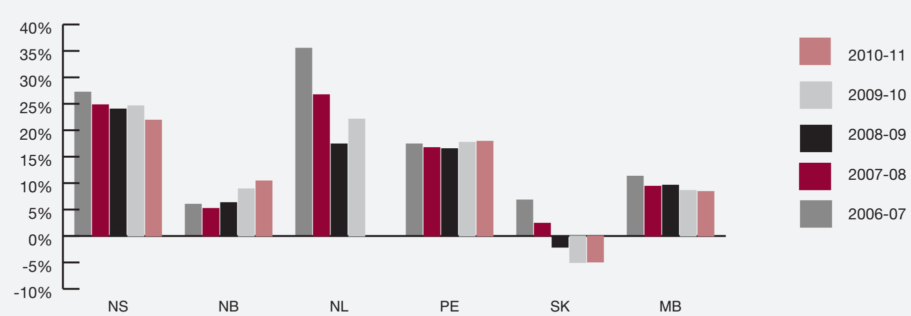


Source: 1, 2 and 3 (see end of chapter)

Debt Servicing Costs as a Percentage of Total Revenue – Nova Scotia					
Year ended March 31	2007	2008	2009	2010	2011
Debt Servicing Costs ($ millions)	$959	$954	$887	$850	$861
Total Revenue ($ millions)	$8,293	$9,253	$9,196	$9,231	$9.897
Debt Servicing Costs as a percentage of Revenue	11.6%	10.3%	9.7%	9.2%	8.7%

4.17 *Accumulated surpluses/deficits as a percentage of provincial gross domestic product* – This indicator measures a government's accumulated surpluses/deficits as a proportion of gross domestic product (GDP). Accumulated surpluses/deficits are the sum of all surpluses and deficits incurred to date, and measure the extent to which past revenues were sufficient or insufficient to cover the cost of past transactions. An increasing ratio indicates the growth of accumulated deficit is greater than the growth of the economy, and is not likely to be sustainable. The ratio for Nova Scotia declined from 27.2% in 2007 to 21.9% in 2011 meaning that the economy grew at a faster rate than the accumulated results.

Accumulated Surpluses or Deficits as a Percentage of Provincial GDP



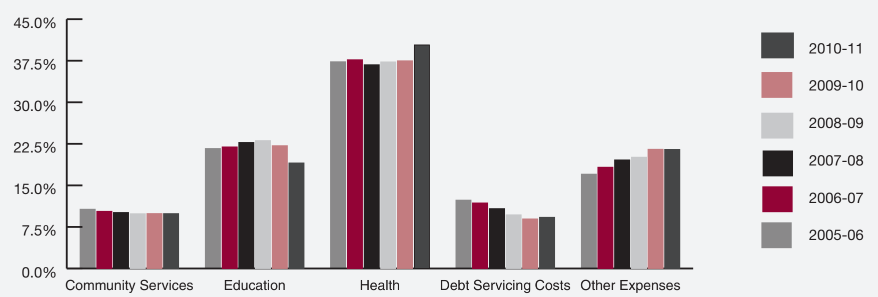
Source: 1, 2, 3 and 4 (see end of chapter)

Accumulated Deficit as a Percentage of Provincial GDP – Nova Scotia					
Year ended March 31	2007	2008	2009	2010	2011
Accumulated Deficit ($ millions)	$8,606	$8,187	$8,161	$8,429	$7,860
Provincial GDP($ millions)	$31,644	$33,031	$34,041	$34,283	$35,952
Accumulated Deficit/GDP	27.2%	24.8%	24.0%	24.6%	21.9%

4.18 *Expenses by department as a percentage of total expenses for Nova Scotia* – This indicator shows the proportion of total expenses allocated to the various areas of government spending. An increase in the ratio in one or more areas indicates the rate of growth for these areas is increasing faster than the increase of total expenses. This trend may reduce funding available for other areas of government spending and provides indication of sustainability of all government programs. Information for this indicator is presented for Nova Scotia only as other jurisdictions allocate their expenses differently than Nova Scotia.

4.19 The following exhibit shows the six largest areas of government spending. Debt servicing costs declined as a percentage of total expenses over this five year period. The percentage of expenses allocated to health was approximately 37.3% of total expenses from 2007 to 2010; however, this percentage increased to 40.3% in 2011. In 2011, the percentage of expenses for health, education (including universities) and community services comprised 69.3% of total expenses.

Expenses by Department as a Percentage of Total Expenses for Nova Scotia



Source: 1 (see end of chapter)

Expense by Function as a Percentage of Total Expense						
	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11
Community Services	10.69%	10.31%	10.10%	9.88%	9.91%	9.90%
Education	21.65%	21.93%	22.74%	23.08%	22.16%	19.04%
Health	37.31%	37.67%	36.77%	37.28%	37.48%	40.34%
Debt Servicing Costs	13.33%	11.82%	10.80%	9.68%	8.94%	9.23%
Other Expenses	17.02%	18.27%	19.59%	20.08%	21.51%	21.49%

Sources:

1. *Nova Scotia – Public Accounts for March 31, 2007 – March 31, 2011*
2. *New Brunswick, Prince Edward Island, Saskatchewan, Manitoba – Public Accounts March 31, 2007 – March 31, 2011*
3. *Newfoundland and Labrador – Public Accounts March 31, 2007 to March 31, 2010*
4. *Statistics Canada – Gross domestic product, expenditure-based, by province and territory (2006-2009)*
5. *Statistics Canada – Population by year, by province and territory (July 2007 – 2011)*
6. *Budget Assumptions and Schedules for the fiscal year 2011-12*

Income from Government Business Enterprises (GBE) has been included in the calculation of own source revenue, and total revenue for all provinces. These amounts were not consistently reported in our previous year's chapter due to the different methods of presentation in the financial statements of the other provinces. This change ensures that information presented is comparable among provinces and is consistent with the way in which most provinces report financial indicators. As a result, certain numbers have changed from those reported in our prior year's Chapter.

5 Review of Audit Opinions and Management Letters

Summary

Under Section 23 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. The majority of these entities are audited by private sector auditors; four government agencies are audited by this Office.

During our review of management letters, we found auditors had identified numerous internal control and information technology deficiencies. The overall number of recommendations made by the auditors increased by 16% (23) over the previous year. 41% (69) of the recommendations made in 2011 were repeated from 2010. Control weaknesses such as lack of segregation of duties and deficiencies in access controls over financial reporting systems need to be remedied on a timely basis. Agency management should take steps now to address the deficiencies identified by their auditors, to ensure the integrity of their financial systems and financial reporting processes.

Although the majority of agency audits resulted in unqualified audit opinions, a number of entities received qualified opinions. Where possible, agencies should correct the deficiencies that lead to qualifications.

The audit opinions of several school boards were qualified due to the inability of the auditors to verify the completeness of school-based funds. In addition, several of the management letters resulting from these audits indicated weaknesses in the control systems over school-based funds, and in one instance, noted that there was a fraud involving these funds during the year. School-based funds totaled $41.6 million in 2010-11. Due to their significance, and to the weaknesses identified, we have recommended that the Department of Education work with the school boards to implement the recommendations made by their auditors and improve controls over the receipt and safeguarding of these revenues.

5 Review of Audit Opinions and Management Letters

Background

5.1 The financial statement audits 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.

5.2 Section 23 of the Auditor General Act permits our 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.

5.3 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, 2011 statements are noted in Chapter 2 of this Report.

Chapter Objective

5.4 The objective of this 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

Qualified audit opinions were issued on the 2010-11 financial statements for thirteen agencies. The audits of several school boards were qualified due to the inability of the auditors to verify the completeness of school-based funds. We discuss additional issues related to school-based funds later in this Chapter. Where possible, agencies should correct deficiencies that lead to qualified opinions.

5.5 *Background* – The result of an audit is an opinion on whether financial statements present fairly in all material respects, 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 (GAAP). Where there are qualifications of an audit opinion or situations in which it is not possible to render an opinion, we believe it is appropriate to report on such matters.

5.6 *Qualified audit opinions* – Several agencies included in the province's consolidated financial statements derive revenue from donations or other contributions, including revenues related to school-based funds, 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. The following entities received this qualification.

- Art Gallery of Nova Scotia
- Atlantic Provinces Special Education Authority
- Cape Breton Victoria Regional School Board
- Conseil scolaire acadien provincial
- Nova Scotia Primary Forest Products Marketing Board
- Public Trustee Trust Funds
- South Shore Regional School Board
- Strait Regional School Board
- Tri-County Regional School Board

5.7 Qualified audit opinions can also result from insufficient evidence to support financial statement balances or disclosures, or if there are departures from GAAP. Qualified audit opinions were issued by the auditors of the following entities.

- Atlantic Provinces Special Education Authority – due to the application of public sector accounting standards in the determination of post-retirement benefits
- Nova Scotia Fisheries and Aquaculture Loan Board – due to a departure from GAAP in understating the allowance for impaired loans
- Nova Scotia Health Research Foundation – due to a departure from GAAP in accounting for grants payable at cost rather than the required method of amortized cost using the effective interest rate method
- Nova Scotia E911 Cost Recovery Fund – due to insufficient evidence to indicate whether expenses of the fund were complete
- Nova Scotia Power Finance Corporation – due to the inability to present investments using historical cost and the effective interest rate method

5.8 *Disclosed basis of accounting* – The audit opinion on the financial statements of the Sherbrooke Restoration Commission is not prepared in accordance with GAAP because amortization is not recorded on capital assets and capital expenditures are included in the statement of operations.

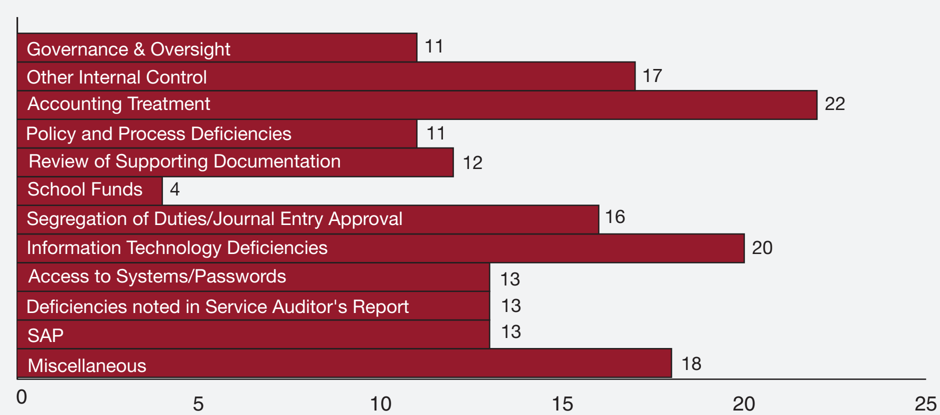
Review of Management Letters

Conclusions and summary of observations

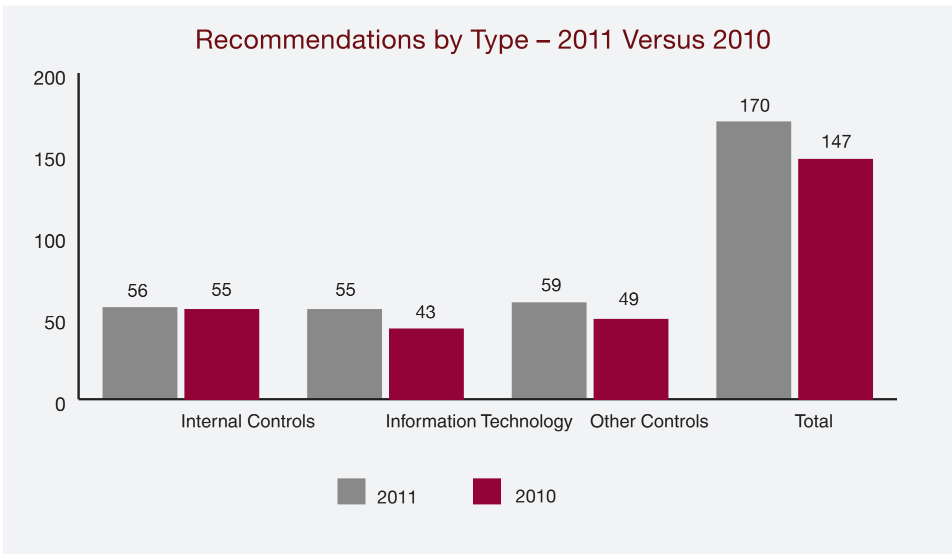
The number of findings and recommendations that remain outstanding from one year to the next in several agencies is concerning. The overall number of recommendations made increased by 16% (23) over the previous year. 41% (69) of the recommendations made in 2011 were repeated from 2010. A significant number of internal control deficiencies were reported in several agencies. Examples include improperly prepared and supported account reconciliations, poor segregation of duties and lack of sufficient controls. 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.

5.9 *Internal controls, information technology controls and other financial controls* – During financial statement audits, situations were noted in which 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 government entities. Other deficiencies reported include matters related to financial reporting and governance. The following exhibit shows 2010-11 issues by type.

2010-11 Management Letter Issues



5.10 Responding to audit recommendations is an indication of a strong overall control environment in an entity. The number of findings and recommendations that remain outstanding from one year to the next in several agencies is concerning. The overall number of recommendations made increased by 16% (23) over the previous year. 41% (69) of the recommendations made in 2011 were repeated from 2010. Management needs to address recommendations on a timelier basis to ensure the integrity of their accounting and controls systems and financial statements.



5.11 *School-based funds* – The March 31, 2011 financial statements of the province's eight school boards show $41.6 million in revenue from school-based funds. Five of the eight school boards had qualified audit opinions due to the completeness of school-based funds revenue. In addition, there were several findings reported in school boards' management letters, including the identification of fraud at the Halifax Regional School Board and the subsequent resignation of the employee in question.

Recommendation 5.1
The Department of Education should work with the school boards to implement the recommendations made by their auditors and develop the appropriate controls to ensure the accuracy and completeness of this revenue in boards' accounting records, and to ensure it is properly safeguarded.

5.12 The following paragraphs summarize external auditors' findings and recommendations related to broad sectors within the government reporting entity.

Government Business Enterprises

5.13 *Halifax Dartmouth Bridge Commission* – The auditors noted accounting staff have the ability to set up new suppliers in the accounting system, record purchase invoices, and set up and remit electronic fund transfers without the approval of a second person. It was recommended no staff have responsibility for all of these functions. The auditors also recommended that management review the current $1,000 threshold for the capitalization of fixed assets given the overall size and nature of operations of the Commission.

5.14 *Highway 104 Western Alignment Corporation* – The auditors noted improved processes and controls concerning the purchasing of goods and the preparation of accruals. They recommended the controller monitor accruals at month-end and perform an analysis of the reasonableness of amounts accrued.

5.15 *Nova Scotia Liquor Corporation* – The auditors noted control deficiencies from the prior year related to the Warehouse Management System have not been fully addressed. These deficiencies dealt with system access and segregation of duties. Similar deficiencies were identified in SAP, the Corporation's accounting system. Access termination deficiencies noted last year have been addressed.

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

5.16 *School boards* – Management letters related to five school boards had a recurring theme – the need for improvements to the systems to record and safeguard school-based funds. The management letter resulting from the audit of the Halifax Regional School Board noted there was a fraud related to school-based funds during the year that resulted in a loss of approximately $20,000 and that the employee in question had resigned.

5.17 Inadequate segregation of duties was reported in two boards and, in several boards, there was no evidence that bank reconciliations and journal entries were being reviewed. These recommendations had all been reported in the prior year. The management letter for the 2010-11 audit of the Cape Breton Victoria Regional School Board identified that unusual expense claims had been filed by a Board employee and reimbursed. The auditors noted that school board management is addressing the issue.

5.18 *Nova Scotia Community College* – In prior years, the auditors recommended that password policies be revised to be consistent with industry leading practice. NSCC now has separate password polices for different user groups and have indicated the costs and benefits associated with stricter password polices will continue to be evaluated.

5.19 *Atlantic Provinces Special Education Authority* – Banking records for one account are not up to date and the cash clearing accounts are not being used appropriately. Investments should be adjusted to fair value to accurately capture valuation gains and losses in accordance with Canadian GAAP.

District Health Authorities and the IWK Health Centre

5.20 *District health authorities* – In addition to specific findings related to SAP (see below), health authorities' auditors identified additional IT deficiencies including the need to review access rights to online banking and financial applications on a periodic basis, and to review changes made to the payroll master file. At one authority, the need to monitor system changes that have been made to the live production environment was noted. Segregation of duties issues were reported in certain authorities as well, including the need to review journal entries. Finally, the auditors of the Cape Breton District Health Authority felt it was important to bring to the attention of the Board that there was a significant amount of overtime being paid to individuals. In two instances, employees were paid overtime equal to their regular salaries; these two were among 35 who were paid overtime in excess of $25,000.

5.21 *SAP* – All health authorities converted to the SAP accounting system during the previous fiscal year. Auditors of various authorities noted the following control deficiencies to be corrected.

- There is need for additional training to SAP users, including the reporting capabilities in SAP.
- Termination requests to remove SAP system user accounts were not processed in a timely manner.
- SAP application user access reports provided to the health authorities were not designed to include a complete list of users with access to production data. This report is used to confirm that access is appropriately restricted. The IWK Health Centre auditors also noted some SAP support users had access to the IWK Health Centre production data.
- Certain payroll deficiencies were identified.
- Exceptions were noted when testing for authorized changes to the vendor master file in a related support system.

Entities Providing Financial Assistance

5.22 *Management letter summary* – Auditors provided findings and recommendations as a result of their audits of the following provincial agencies providing financial assistance.

- Film Nova Scotia
- Industrial Expansion Fund
- Nova Scotia Business Inc.
- Nova Scotia Farm Loan Board

- Nova Scotia Housing Development Corporation
- Nova Scotia Strategic Opportunities Fund

5.23 Approval processes related to journal entries, rescinded loans and payroll changes were identified as needing strengthening at two agencies. In another, it was recommended that interest calculations supporting journal entries for interest expense be independently reviewed. The Industrial Expansion Fund's auditors again noted there is need for additional improvements in the annual valuation process. Finally, auditors at the Nova Scotia Housing Development Corporation noted instances in which the mortgage repayment did not agree with the mortgage schedule, and also recommended that documents supporting amendments to mortgage agreements be maintained. These recommendations resulted from the March 31, 2010 audit. The management letter for the March 31, 2011 audit has not been issued yet.

Other Entities

5.24 *Management letter summary* – Auditors provided findings and recommendations as a result of their audits of the following provincial agencies:

- Canada-Nova Scotia Offshore Petroleum Board
- Canadian Sport Centre Atlantic
- Harbourside Commercial Park Inc
- Nova Scotia E911 Cost Recovery Fund
- Nova Scotia Lands Incorporated
- Nova Scotia Public Service Long-Term Disability Plan
- Nova Scotia School Boards Association
- Resource Recovery Fund Board Incorporated
- Nova Scotia Utility and Review Board
- Sherbrooke Restoration Commission
- Sydney Tar Ponds Agency
- Trade Centre Limited
- Medavie (for certain programs administered on behalf of the Department of Health and Wellness)

5.25 The lack of reconciliations of significant general ledger accounts such as cash was identified in two agencies and in several agencies, there was a lack of segregation of duties. In one entity, the auditors noted that capital assets were purchased using the credit card of a senior manager.

5.26 *Trade Centre Limited (TCL)* – The liability related to advance ticket sales for Ticket Atlantic was recorded by Halifax Metro Centre Ltd. (HMC). The cash account for Ticket Atlantic was held under the HMC banking facility even though it is a liability of TCL. The financial statements of TCL and HMC have been restated to reflect this correction. The auditor was waiting for management's position paper on the valuation of a receivable related to an advance paid to a promoter of a summer concert to determine if the amount recorded will be recovered.

5.27 *Medavie* – Medavie's auditors recommended that access controls be strengthened, including review of user activity to certain applications. The auditors also again recommended that management implement a process to verify and document that all new physicians being set up as providers are valid physicians with a valid license number from the College of Physicians and Surgeons of Nova Scotia.

Audits Conducted by the Office of the Auditor General

5.28 *Nova Scotia Crop and Livestock Insurance Commission* – The Commission uses spreadsheets to calculate premium revenue; we recommended the Commission assess its IT needs and develop or purchase a computer system to meet those needs. We further recommended the Commission perform an analysis of access rights to limit the number of individuals who have the authority to make changes to these spreadsheets. We also noted errors in premium calculations and recommended improvements.

5.29 *Nova Scotia Legal Aid Commission* – We again noted that management should review the system to estimate certificate liabilities to determine if the average number of days to complete a case requires updating. The Commission does not currently have an audit or finance committee and the need to establish such a committee should be evaluated.

5.30 *Public Trustee Trust Funds* – Findings which we reported in the previous year related to the need for bonded individuals to remove assets from client's homes, and to establish an oversight function for the operations of the Public Trustee have not been addressed. We noted financial statements are now prepared on an accrual basis in accordance with generally accepted accounting principles. Gains and losses on the sale of other assets are now recognized in the financial statements.

5.31 *Nova Scotia Gaming Corporation* – There were no findings to bring to the attention of management or the Corporation's Board as a result of the audit.

NOVA SCOTIA

Timeliness of Financial Reporting

Conclusions and summary of observations

Management of all agencies within the government reporting entity need to ensure their financial statements are available by June 30 each year for inclusion in the consolidated financial statements of the province. Although the number of entities submitting late financial statements has decreased significantly over the last five years, a number of agencies continue to be late. APSEA has only met the June 30 submission deadline once in the past five years.

5.32 *Compliance with deadlines* – The Finance Act requires financial statements and other information for government business enterprises and government units to be submitted to the Minister of Finance by June 30 following their fiscal year end (usually March 31).

5.33 Although the number of entities submitting financial statements past the deadline has declined, there continues to be a problem with receiving submissions by the deadline. In 2010-11, six entities were not successful in providing audited financial statements and requested information by the June 30 deadline. Of these entities, the Nova Scotia Housing Development Corporation and the Atlantic Provinces Special Education Authority (APSEA) were late in providing the requested information in 2009-2010. APSEA has not provided timely financial statements since 2006-07. When financial statements are not provided by the deadline, unaudited information must be used in preparing the province's consolidated financial statements. This results in inaccurate information for decision-making purposes. The following exhibit provides a list of agencies providing late information for 2010-11.

Late Agencies – 2010-11
Agritech Park Inc.
Atlantic Provinces Special Education Authority
Conserve Nova Scotia
Nova Scotia Housing Development Corporation
Trade Centre Limited
Nova Scotia Fisheries and Aquaculture and Loan Board

5.34 The Province's March 31, 2011 consolidated financial statements were released on July 28, 2011 meeting the reporting requirement set out in the Finance Act.

NOVA SCOTIA

Response: Department of Education

Recommendation 5.1
The Department of Education should work with the school boards to implement the recommendations made by their auditors and develop the appropriate controls to ensure the accuracy and completeness of this revenue in the boards' accounting records, and to ensure it is properly safeguarded.

The Department of Education accepts the recommendation and will work with school boards to implement it.

6 Follow-up of 2005 to 2009 Financial Recommendations

Summary

The overall implementation rate of our recommendations related to financial reporting from our 2005 to 2009 audits is 66%. This 14% increase over the prior year's rate of 52% is partly due to a change in our calculations.

We performed a review of departments' self-assessments of their progress in addressing our recommendations. We evaluated these self-assessments and discussed the support for the implementation status. Some adjustments were made to the assessments. As a result of this review, we provide moderate assurance to readers of this Chapter. Nothing came to our attention to cause us to believe that the representations made by government, as adjusted, are not complete, accurate and reliable.

Since 2006, we have recommended that the revenue estimates included in the annual budget be prepared on a consolidated basis. The revenue estimates are prepared on a gross basis for the general revenue fund only, and not for the consolidated entity; as a result our opinion is qualified every year. This recommendation has been outstanding for a number of years; government needs to take steps to address this issue for the 2012-13 revenue estimates.

Two other recommendations have been made in successive reports. The first relates to the need for an independent follow-up audit to be conducted on divisions within the Department of Finance after a 2004 audit resulted in a denial of opinion. This audit was performed by our Office in 2011 and the results are reported in Chapter 3 – Governance and Control Framework. In addition, we have recommended that internal controls in government be identified and related roles and responsibilities for these controls be assigned. Some progress is being made toward implementation of these recommendations.

While government has taken some action to address our recommendations, implementation rates are still too low, and a number of outstanding recommendations date back several years.

Details of all financial recommendations from 2005 to 2009, along with their current status, can be found on our website at oag-ns.ca.

6 Follow-up of 2005 to 2009 Financial Recommendations

Background

6.1 Financial reporting is a key component of government's accountability framework; it is a means through which government fulfils its accountability responsibilities regarding the use of public funds and demonstrates its stewardship over those funds. We include a chapter on government financial reporting each year in our reports to the House of Assembly. We have also included chapters concerning other financial matters such as Chapter 2 – Payments to Vendors – included in our November 2008 Report. Each chapter contains recommendations which we believe provide practical, constructive advice to address issues raised by these audits.

6.2 Our reports have included formal recommendations since 2002. We follow up the implementation status of these recommendations after two years. We believe two years is sufficient time for auditees to address our recommendations.

6.3 This year we will be preparing two follow-up chapters. This Chapter will report the status of recommendations concerning financial reporting and other financial management issues and how responsive departments and agencies have been in implementing the recommendations from our 2005 to 2008 audits. (There were no financial reporting chapters in our 2009 Reports). We will report the results of our follow-up on the implementation status of the remaining recommendations from our 2005 to 2009 performance audits in our spring 2012 report.

6.4 We requested that government management complete a self-assessment of their progress in implementing the outstanding 2005 to 2008 recommendations in Treasury Board's Tracking Auditor General Recommendations (TAGR) system. We also asked management to provide supporting information. Our review process focused on whether self-assessments and information provided by management were accurate, reliable and complete. This Chapter includes summary level information on implementation status; more detailed information, including specific recommendations can be found on our website at oag-ns.ca.

6.5 In May 2011, government committed to updating Nova Scotians on the progress of implementing our recommendations every six months. On November 9, 2011 the first *Provincial Update on the Auditor General Recommendations as at October 31, 2011* was released. We will be providing additional comments on this document in our spring 2012 report.

Review Objective and Scope

6.6 The objective of this assignment was to provide moderate assurance on the implementation status of recommendations concerning financial reporting and other financial management issues included in reports of the Auditor General from 2005 to 2009. This level of assurance is less than for an audit because of the type of work performed. An audit would have enabled us to provide high assurance, but would have required a significant increase in the resources devoted by the Office of the Auditor General to this follow-up assignment.

6.7 We have included 2009 in this timeframe as it is consistent with our Office policy of following up recommendations two years after they have been made; however, no recommendations related to financial matters were made in 2009.

6.8 Each entity is expected to document its self-assessment of progress on the implementation of our Office's recommendations in the TAGR system. Our review was based on information included in the TAGR system as of September 30, 2011. We provide each entity with attributes to consider when determining implementation status. We understand these attributes are consistent with those used by departments and agencies when assessing status for purposes of the TAGR system.

6.9 We performed additional procedures on those recommendations which government has assessed as *do not intend to implement.* We focused on the reasons why government has chosen not to implement these recommendations. If the rationale provided appears reasonable, we have removed the recommendation from our statistics and will not conduct further follow up on it.

6.10 Our review was based on representations by government management which we substantiated through interviews and examination of documentation. Moderate assurance, in the context of this assignment, means performing sufficient work to satisfy us that the implementation status as described by government is plausible in the circumstances. Further information on the difference between high and moderate assurance is available in the *Canadian Institute of Chartered Accountants (CICA) Handbook, Section 5025 – Standards for Assurance Engagements other than Audits of Financial Statements.*

6.11 Our criteria were based on qualitative characteristics of information as described in the CICA Handbook. Management representations on implementation status were assessed against three criteria.

- Accurate and neither overstate nor understate progress
- Reliable and verifiable
- Complete and adequately disclose progress to date

Significant Observations

6.12 *Review results* – We performed a review of departments' self-assessments, including an evaluation of supporting documentation. We provide moderate assurance to readers of this Chapter. Nothing came to our attention to cause us to believe that the representations made by government are not complete, accurate and reliable. We wish to emphasize that the work performed during this follow-up assignment is not an audit; therefore we provide only moderate assurance that these recommendations have been implemented. Only during a subsequent audit can we say, with high assurance, that the reported implementation status is accurate.

6.13 *Scope of review* – During this assignment we followed up the status of 57 recommendations, most of which were addressed to the Department of Finance. The remaining recommendations are the responsibility of the Departments of Economic and Rural Development and Tourism, Service Nova Scotia and Municipal Relations, and Treasury Board. Since responsibility for certain recommendations has been reassigned this year by the TAGR Steering Committee, the information reported in this Chapter has changed from that reported in Chapter 2 of our May 2011 Report. These changes were made by the Committee to ensure responsibility to implement the recommendations was assigned to the appropriate department or agency.

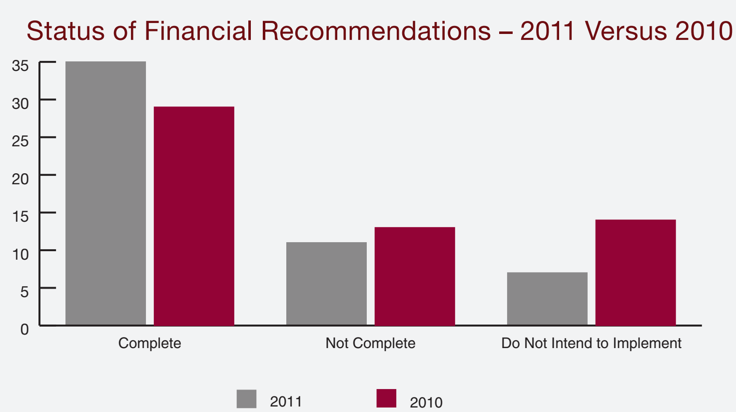
6.14 *Do not intend to implement* – Eleven recommendations were reported to us as *do not intend to implement*. We reviewed the information provided by government with respect to these recommendations and determined that the rationale provided for four of the recommendations is reasonable. These recommendations have been removed from further analysis and statistics. We disagree with government's rationale for not implementing the other seven recommendations. We will continue to follow up the status of these recommendations.

6.15 The following exhibits summarize the implementation status of the remaining 53 financial recommendations made from 2005 to 2008. There are no recommendations for 2009.

Report and Chapter	Entity	Complete	Not Complete	Do Not Intend to Implement	Total
June 2005					
Chapter 2: Government Financial Reporting	DOF	6		1	7
Chapter 3: Government Systems and Controls	DOF	1			1
	DERDT	1			1

Report and Chapter	Entity	Complete	Not Complete	Do Not Intend to Implement	Total
December 2005					
Chapter 2: Government Financial Reporting	DOF	3	3	2	8
	TB	1			1
	SNSMR		1		1
June 2006					
Chapter 2: Government Financial Reporting	DOF	1		1	2
Chapter 3: Government Systems and Controls	DOF	2	1		3
December 2006					
Chapter 2: Government Financial Reporting	DOF	3			3
June 2007					
Chapter 7: Government Financial Reporting	DOF			1	1
February 2008					
Chapter 6: Government Financial Reporting	DOF	4			4
November 2008					
Chapter 2: Government-Wide: Payments to Vendors	DOF	8	3		11
Chapter 7: Government Financial Reporting	DOF	5	3	2	10
Total Recommendations		35 66%	11 21%	7 13%	53 100%

DERDT	Department of Economic and Rural Development and Tourism
DOF	Department of Finance
SNSMR	Service Nova Scotia and Municipal Relations
TB	Treasury Board



Source: TAGR and OAG

Status of Financial Recommendations After Removing Four in 2011		
	2011	2010
Complete	35 (66%)	29 (52%)
Not complete	11 (21%)	13 (23%)
Do not intend to implement	7 (13%)	14 (25%)
Total	*53 (100%)	56 (100%)

* *Recommendation 2.1, December 2005 was split into two recommendations this year.*

6.16 The overall implementation rate this year is 66%, a 14% increase over the implementation rate of 52% determined in May 2011, partly due to a change in our calculations. The number of recommendations assessed as *do not intend to implement* has decreased from the prior year because we reevaluated governments' rationale for not implementing several recommendations and determined it was reasonable. Accordingly, these recommendations have been excluded from our statistics. This has resulted in an improved implementation rate this year.

6.17 *Other comments* – A recommendation that has been made in several of these reports relates to the review opinion on revenue estimates. This opinion has been qualified for several years with respect to two CICA presentation and disclosure standards. First, third-party revenues of certain government units, such as ancillary operations in district health authorities and municipal funding in school boards, are excluded from the revenue estimates. Second, no estimate of these third-party revenues is made and therefore we are unable to determine their significance to the estimates. This presentation is not consistent with CICA standards. We have recommended that the revenue estimates include all revenues of the consolidated entity. Government has again indicated they do not intend to implement. This recommendation has been outstanding for a number of years and we urge government to reconsider their decision not to implement this recommendation, and to address this deficiency for the 2012-13 revenue estimates.

6.18 In addition, two recommendations resulting from our 2008 audit of payments to vendors related to internal controls concerning the government's SAP corporate accounting system are still outstanding. Both recommendations relate to ensuring access privileges are consistent with staff roles and responsibilities, and are reviewed on a periodic basis. Access privileges enhance segregation of duties which is a critical element in an effective control environment. Government should implement these recommendations as soon as possible.

6.19 Finally, one recommendation related to an audit of the governance and control framework of the Investment Management, Liability Management and Treasury Services, and the Capital Market Administration Divisions of the Department of Finance. We reported the results of this audit in our December 2005 Report and a recommendation related to the need for an independent external audit opinion remained outstanding. In 2011, we undertook an audit to address this recommendation. The results of our follow-up audit on the Governance and Control Framework of the Liability Management and Treasury Services, Capital Markets Administration, and Compliance and Reporting Divisions are reported in Chapter 3 – Governance and Control Framework – of this Report.