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# 1 Message from the Auditor General



## Introduction

- 1.1 I am pleased to present my February 2013 Report to the House of Assembly. This Report focuses on financial reporting issues and includes work completed by my Office during 2012.
- 1.2 I wish to acknowledge the valuable efforts of my staff whose dedication and professionalism make this report possible. 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 which are part of the government reporting entity.
- 1.4 As the appointed auditors of the House of Assembly, we audit the House's financial statements, internal controls, and compliance with policy. We may also conduct other financial audits in government as we consider appropriate. Finally, we provide recommendations as appropriate in all our audits and reviews, to improve financial management in government.
- 1.5 This report presents and discusses the results of this work. The report contains five chapters in addition to this introduction.
- 1.6 Chapter 2 deals with the results of our financial audits and reviews. We provided an unqualified opinion on the province's consolidated financial statements. We commented on difficulties we encountered in completing that audit this year, and made several recommendations to improve financial controls and financial management in government. The opinion on the revenue estimates was again qualified but we noted that government is taking steps to address the qualification.
- 1.7 Chapter 3 includes the results of our work as the newly-appointed auditors of the operations of the House of Assembly. We conducted a number of audits for the



first time this year, as required by legislation. We issued unqualified opinions on the House of Assembly financial statements for the years ended March 31, 2011 and March 31, 2012, as well as opinions on compliance with policy, and the effectiveness of internal controls. We also audited progress by the House in implementing the recommendations resulting from our 2010 audit of Members' allowances and constituency expenses. We found that the House of Assembly Management Commission and its management have implemented 90% of our recommendations to date.

- 1.8 Our chapter on financial indicators provides financial information and analysis related to the sustainability, flexibility and vulnerability of government finances, with a focus on long-term debt.
- 1.9 In our review of agency audit opinions and management letters, we found that independent auditors' recommendations for improvements in internal controls and other financial management and reporting issues were often repeated from prior years. We also found that some school boards' auditors continued to identify poor controls over school-based funds; we recommended that the Department of Education work with those boards to strengthen controls in this area.
- 1.10 Our follow-up of previous recommendations related to financial management found that the implementation rate is virtually unchanged. A number of recommendations related to internal controls date back several years and have yet to be fully implemented.
- 1.11 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.

## Significant Issues

### Internal Controls

- 1.12 Internal controls are those systems and processes that an organization puts in place to help it achieve its objectives, mitigate risks, maintain sound business practices and protect its resources. They start at the top of a department or agency, through policy and managerial or board direction, and form an intrinsic part of the organization's operations, including its communications, computer systems and transaction processing. Proper controls, such as approvals and reconciliations, help prevent or detect fraud and error. When costs are recorded accurately and on a timely basis, information can be used for decision-making purposes. When these systems and processes are working as they should, they are a vital factor in helping government programs and operations run smoothly and meet their objectives.



- 1.13 We frequently make recommendations for internal control improvements during our performance audits. Many have financial implications. In our November Report, we found significant deficiencies in Trade Centre Limited's internal control framework, including weaknesses in financial management processes over certain revenues and expenses. Chapter 3 of this report includes the follow-up of our 2010 recommendations on weaknesses in operations at the Office of the Speaker. These recommendations were made after we conducted an extensive audit of Members' expenses and identified significant deficiencies in the internal control processes to review and approve these expenses. These deficiencies allowed, and even enabled, inappropriate, excessive, even fraudulent activity to occur.
- 1.14 Internal control deficiencies are also regularly identified by external auditors in government agencies. Each year we review management letters resulting from government agency external audits and report the nature of these weaknesses. It is clear from the results reported in Chapter 5 that insufficient attention is being paid by many boards and management in these agencies to addressing these issues, as the same or similar recommendations are made every year. Continuing internal control deficiencies constitute poor business practice and expose agencies to unnecessary risk of fraud and error.
- 1.15 We have also made numerous recommendations for internal control improvements in government operations as a result of our annual audit of the province's financial statements. Some of these have, unfortunately, been repeated for a number of years. In Chapter 6, we point out that several internal control recommendations have been outstanding since at least 2007. Two of these deal with the need for greater control from central government – for government-wide documentation of internal controls, and for clear assignment of roles and responsibilities for these controls. Government needs to focus more attention on correcting these deficiencies and make the needed improvements to internal controls.
- 1.16 We direct many of our internal control recommendations to the Office of the Controller. We feel that government needs a stronger and more proactive controllership function; one that takes responsibility for the overall level of control in government and has the authority to manage controls. We recognize that the structure of government is decentralized, with much authority vested in departments and in agencies. However, some direction has always been exercised from the centre and an appropriate balance needs to be maintained between the autonomy of departments and agencies, and the governance of the organization as a whole. Our findings indicate a need for better central controllership. We suggest that Members of the House consider the need for stronger controllership when reviewing the financial operations of government.



## Changes to the Public Service Superannuation Plan

- 1.17 In Chapter 2 we discuss our concern that some major impacts of changes to the Public Service Superannuation Plan have not been communicated by the Minister of Finance, as sole trustee of the Plan, to current and retired Plan members. Communication to date on changes to the plan has focused on two aspects of the changes: the implementation of a new funding policy; and the anticipated move to joint trusteeship. Such communication has consisted primarily of news releases and passive updates of web sites. While such communication is valuable, it is not sufficient.
- 1.18 Joint trusteeship is expected to take place on April 1, 2013 when a new governance model comes into effect. When that happens, responsibility for the pension plan will be transferred to the new joint trustee and the Minister of Finance will no longer be trustee of the Plan. Further, and more significantly, as a result, the province will no longer financially guarantee the Plan. It will stand alone. It is primarily on this point that we feel communication has been missing. Members need to be aware that the elimination of this guarantee transfers all future risks of the Plan from the government to the Plan's members. The financial health of the Plan will depend solely on the success of investments held by the Plan and on the management of these resources to meet benefits.
- 1.19 As a matter of good governance, we believe this significant change should be communicated directly to members by the Minister of Finance, as the Plan's trustee.
- 1.20 The Department of Finance claim they and the Minister have communicated this information directly to Plan members. We do not agree. We are therefore bringing this information forward to provide at least some communication of these significant changes that affect over 29,000 working and retired Public Service Superannuation Plan members.

### Auditor General's Commentary

#### The Issue of Long-term Debt

- 1.21 Last year I reported my concerns about the growth of government's long-term debt. I said that I believe government's use of long-term debt to pay for its expenditures is inappropriate in all but a few circumstances. I questioned the ethics of asking future generations to pay for current expenditures.
- 1.22 My concern regarding this issue has not abated.



- 1.23 Nova Scotia's long-term debt load has increased from \$12.5 billion to \$16.2 billion since 2008. \$400 million was added to the debt in the last fiscal year. This total amounts to \$13,900 of debt per person.
- 1.24 Government will incur debt when its revenues are not sufficient to cover the costs of both operations and capital spending. This has the effect of deferring payment for the year's revenue deficiency to a later date. If this practice is habitual, payment will be deferred, possibly indefinitely, and the debt balance will grow. Future taxpayers will bear the burden of the debt and pay interest every year to maintain it. This interest diverts funds from government programs, in effect to finance prior programs; it reduces government's ability to provide services to its citizens and limits its options in adjusting to changing circumstances and citizens' needs. \$906 million was diverted in Nova Scotia last year to pay interest on debt. Debt also exposes government to the significant risk of large rises in interest rates and related constraints or even crises.
- 1.25 The potential impacts of excessive government debt today can be seen in the troubles faced by numerous governments globally.
- 1.26 Besides the damage to government's service delivery potential, and the risks facing governments with large debt loads, we must consider the ethics of government borrowing. I have put forward the proposition that it is fiscally irresponsible, in all but a few cases such as emergencies and mega-projects, for governments to consistently transfer payment for their expenditures to future generations. It is wrong to ask future generations to pay for our spending today, regardless of potential benefits they also might receive.
- 1.27 Ethical government requires, for the long term, at the least a goal and determination to live within one's means; to cease adding to long-term debt; and, eventually, to begin to pay down the debt, if not completely eliminate it.
- 1.28 This is the right approach. It is fiscally prudent. It is the ethical direction to take for future generations. I urge the Members of the House of Assembly to consider these issues when reviewing the financial management of government in future.