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# 5 Review of Audit Opinions and Management Letters



## Summary

Management letters provided by auditors on completion of annual audits provide a wealth of information on accounting and management issues in entities included in the province's consolidated financial statements. Each year, we conduct a review of these letters under Section 23 of the Auditor General Act, and report matters of interest. Most of these entities are audited by private sector firms; four government agencies are audited by this Office. The Auditor General was also appointed auditor of the House of Assembly for the years ended March 31, 2011 and March 31, 2012.

Auditors have identified numerous internal control and information technology deficiencies. Many of these deficiencies also impact internal controls as they relate to inappropriate access by individuals to systems, applications or accounts that are not required to be accessed in fulfilling their duties. We found 12 instances of inappropriate access which accounted for 43% of all IT deficiencies.

Audit results also provide information on the oversight function within these entities. Correcting deficiencies is an indication of strong oversight. We found that 51% of deficiencies identified in the current year had been reported as a result of audits in 2010-11 and 31% of these recommendations had also been reported in 2009-10. Boards and management in some agencies are providing poor financial management by ignoring their auditors' recommendations.

Most entities in the Government Reporting Entity receive an unqualified audit opinion. The majority of the qualified opinions relate to the inability of the auditors to verify the completeness of revenues.

Revenue received by school boards through school-based funds totaled \$42 million in 2011-12 and the year-end balance held in trust in these boards was \$17 million. We have again recommended that the Department of Education work with boards to implement the recommendations made by their auditors related to these funds, and improve controls over their receipt and safeguarding.



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# 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 for which 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, 2012 statements are noted in Chapter 2 of this report. In addition, the Auditor General was appointed auditor of the newly-established House of Assembly Management Commission. The results of audits completed under that engagement are included in Chapter 3 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

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#### Conclusions and summary of observations

Qualified audit opinions were issued on the 2011-12 financial statements for 15 agencies. The audits of several entities were qualified due to the inability of their auditors to verify the completeness of certain revenues. This is a standard audit qualification. In other agencies, qualified opinions were due to insufficient audit evidence or departures from



generally accepted accounting principles. 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, which includes accounting principles issued for the public sector. 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 consolidated financial statements of the province derive revenue from donations or other contributions, including revenues related to school-based funds, the completeness of which may not be possible to 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
- 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 generally accepted accounting principles. Qualified audit opinions were issued by the auditors of the following entities.

- Gambling Awareness Foundation of Nova Scotia and Nova Scotia Health Research Foundation – due to a departure from generally accepted accounting principles in recording grants payable at cost rather than at amortized cost using the effective interest rate method
- Harbourside Commercial Park Inc. – due to the financial statements being prepared on a non-consolidated basis with the investment in the wholly owned subsidiary company, Sydney Utilities Limited, recorded at cost
- Nova Scotia E911 Cost Recovery Fund – due to insufficient evidence to indicate whether the expenses of the fund were complete



- Nova Scotia Fisheries and Aquaculture Loan Board – due to a departure from generally accepted accounting principles for the public sector in understating the allowance for impaired loans by \$1,479,000 for the year ended March 31, 2012
- Nova Scotia Power Finance Corporation – due to a departure from generally accepted accounting principles in not being able to provide the historical cost of investments or the effective interest rate as this information is not available

5.8 *Basis of accounting* – The financial statements of the Sherbrooke Restoration Commission are not prepared in accordance with generally accepted accounting principles. The Commission’s audited statements are prepared in accordance with the accounting principles adopted for museum boards in Nova Scotia. The basis of accounting used materially differs from Canadian generally accepted accounting principles.

## Review of Management Letters

### Conclusions and summary of observations

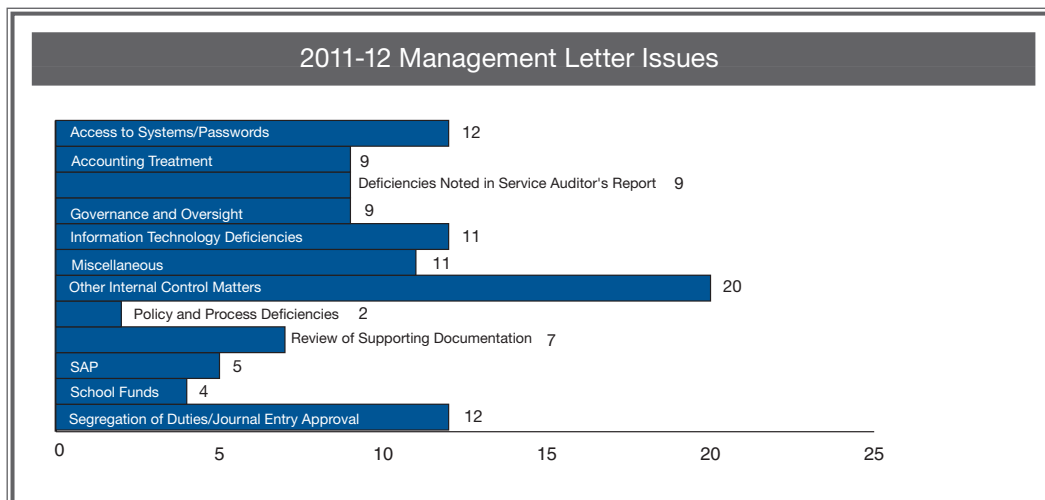
The overall number of recommendations made decreased by 53 (32%) over the previous year, however, 57 (51%) of the recommendations made in 2012 had also been reported in 2010-11, and 34 (31%) of these had also been made in 2009-10. Boards and management in some agencies are providing poor financial management by ignoring their auditors’ recommendations. A significant number of internal control deficiencies were reported in several agencies. Examples include improperly prepared and supported account reconciliations, and poor segregation of duties. There are also numerous findings and recommendations related to information technology. Many of the IT deficiencies also impact internal controls as they relate to inappropriate access by individuals to systems, applications or accounts that are not required to be accessed in fulfilling their duties. We found 12 instances of inappropriate access which accounted for 43% of all IT deficiencies.

5.9 *Overall results* – The 50 management letters issued to agencies of government identified 111 deficiencies. 25 agencies received no final communication from their auditors, and there were no deficiencies to report in 16 entities. The following table illustrates the number of deficiencies found in total, in the various entities.

Number of Government Entities with:	2011-12
Five or more management letter issues	8
One to four management letter issues	26
No management letter issues	16
No management letter	25

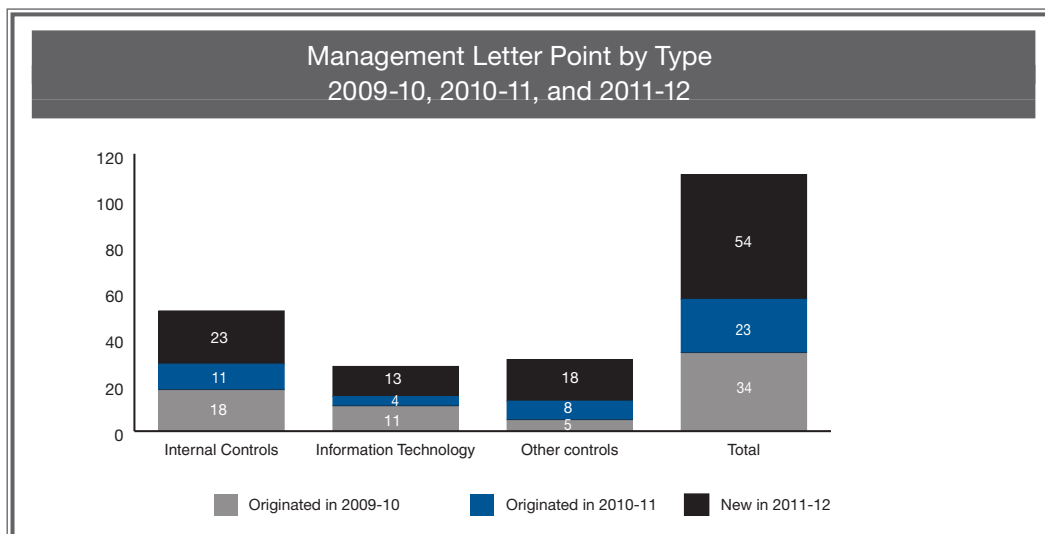


5.10 *Internal controls, information technology controls and other financial controls* – During financial statement audits, situations were noted in which accounting and control systems or procedures, including those related to information technology systems, were deficient. These weaknesses were reported by the auditors in management letters to government entities. Other deficiencies reported include financial reporting matters and governance. The following exhibit shows the nature of issues identified in 2011-12 audits.



5.11 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.

5.12 The overall number of recommendations made decreased by 32% over the previous year. However, 57 (51%) of the total recommendations reported as a result of audits conducted for 2011-12 had also been reported in 2010-11. Of these, 34 (31%) had previously been reported in 2009-10. Management needs to address recommendations on a more timely basis to ensure the integrity of their accounting and control systems, and their financial statements.





- 5.13 *School-based funds* – Last year we recommended that the Department of Education work with school boards to implement the recommendations made by their auditors related to school-based funds. The Department accepted the recommendation and indicated it would work with the boards on implementation. However there are still numerous findings related to internal controls surrounding these funds. We were informed by the Department that there have been discussions with the boards regarding these funds, but to date, no changes have occurred.
- 5.14 Revenue from school-based funds in all school boards totaled \$41.9 million during the fiscal year, and the balance held in trust at March 31, 2012 totaled \$17.1 million. This is a significant amount. There should be appropriate internal controls in each board to reduce the risk that amounts received are inaccurately recorded in the school's records; that disbursements made are not authorized and controlled; and that the year-end balance in a student's or the school's account does not reconcile to records and the bank. Where auditors have identified weaknesses in controls related to these funds, management should ensure any related recommendations are implemented on a timely basis.

#### Recommendation 5.1

The Department of Education should work with school boards to implement recommendations made by their auditors and develop appropriate controls to ensure the accuracy and completeness of school-based funds in board's accounting records, and to ensure these funds are properly safeguarded.

#### ***Department of Education Response:***

*The department agrees with the recommendation. The department will renew consultations with school boards to develop a strategy to achieve PSAB compliance. Recognizing the complexity of the issues that may arise the department will ask for school board compliance on or before March 31, 2014.*

- 5.15 The following paragraphs summarize external auditors' findings and recommendations related to broad sectors within the Government Reporting Entity.

#### ***Government Business Enterprises***

- 5.16 *Halifax-Dartmouth Bridge Commission* – Since at least 2010, the auditors have noted that accounting staff have the ability to set up new suppliers in the accounting system, record purchase invoices, and set up and remit electronic funds transfers without the approval of a second person. Although auditors noted improvements in these controls related to the accounts payable system, they recommended the entity evaluate whether the current level of risk in the system is acceptable or if it should be further mitigated. The auditors also noted that the overall administrative password to the accounting system has not been changed in some time and is known by many of the employees.



- 5.17 *Nova Scotia Liquor Corporation* – The auditors noted that the segregation of duties and password weaknesses and deficiencies related to the Warehousing Management System have both been remedied. We note this is a significant improvement as there were numerous deficiencies identified in the management letter last year.

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

- 5.18 *School boards* – Management letters for six of the eight school boards discussed issues related to school-based funds noting improvements in internal controls or the need for an internal control function. The auditors for the Halifax Regional School Board provided an update on their involvement in the fraud investigation related to inappropriate expenditure of school-based funds found in 2010-11, noting that the final report has not yet been issued. We reported last year that the management letter resulting from the March 31, 2011 audit stated there was a fraud related to school-based funds that resulted in a loss of approximately \$20,000.
- 5.19 Exceptions in the operating effectiveness of various control activities at the service organization used by boards to process transactions were reported in six of the seven management letters issued; those letters also noted that the report was not available before year end to assist in audit planning.
- 5.20 Previous issues with inadequate segregation of duties related to the accounts payable function reported in two boards continued in 2011-12. Additional matters related to inadequate segregation of duties were reported by the auditors of two boards in relation to information technology. The auditors again recommended that the Conseil scolaire acadien provincial continue work in the area of establishing procedures to document, test and evaluate internal controls since they do not have an internal audit group.
- 5.21 The management letter for the 2011-12 audit of Cape Breton-Victoria Regional School Board identified instances in which the Board's expense report policies were not followed; approval of timesheets for non-teaching staff was not provided on a timely basis; and the amount of the original, approved standing purchase order was exceeded. The auditors also reported that the Board cannot obtain insurance coverage for sexual misconduct situations because it does not have a policy for acceptable/unacceptable behavior for employees. Four of the identified deficiencies were also reported in each of the past two years.
- 5.22 *Nova Scotia Community College* – The management letter for the Nova Scotia Community College noted that the College completed its review of certain liabilities and a previously reported finding was addressed.
- 5.23 *Atlantic Provinces Special Education Authority* – Neither the financial statements nor the management letter for the March 31, 2012 audit have been issued yet.



### ***District Health Authorities and the IWK Health Centre***

- 5.24 Segregation of duties issues in certain authorities, and the need for journal entries to be reviewed at an appropriate level, were again noted this year. The auditors of one authority noted inappropriate accounting treatment of cost recoveries, while the auditor of another noted that the authority now has a policy for conversion of foreign currency to Canadian dollars. For one authority, the auditor recommended the authority grant security administrative access privileges and responsibilities only to information technology staff who do not perform incompatible duties and controls over passwords must be strengthened for its healthcare management software.
- 5.25 The amount of overtime at Cape Breton District Health Authority remained significant enough for the auditors to bring it to the attention of the Board. In two instances, employees were paid overtime which exceeded their regular salaries; these two staff members were among the 29 who were paid overtime in excess of \$25,000. In its response to the audit finding, the Authority noted several planned initiatives to ensure relief capacity is maintained. Nine of the deficiencies reported to the Board in 2011-12 were also reported in 2010-11; eight of these were identified in 2009-10 as well.
- 5.26 Certain health authorities' auditors noted some improvements but continue to note control deficiencies with the SAP accounting system. Certain auditors also noted the audit report for the service organization used to process their transactions was not available prior to year end.
- 5.27 We noted that no deficiencies were identified in the following four authorities.
- Annapolis Valley Health
  - Capital Health
  - South Shore Health
  - South West Health

### ***Entities Providing Financial Assistance***

- 5.28 *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
  - Nova Scotia Business Inc.
  - Nova Scotia Farm Loan Board
  - Nova Scotia Fisheries and Aquaculture Loan Board





- 5.29 With the departure of the CEO and Director of Finance at Film Nova Scotia the auditors recommended utilizing current staff as much as possible to segregate some of the acting CEO's duties and make a concentrated effort to fill vacant positions.
- 5.30 The auditors of Nova Scotia Business Inc. noted the need for additional improvements in the annual valuation processes, as well as recommending the entity follow established policies and procedures. They also recommended that Nova Scotia Business Inc. implement enhanced review procedures for journal entries; prepare, print and sign bank reconciliations for all bank accounts; and determine an approach to clear outstanding cheques that have accumulated on the outstanding cheque listing.
- 5.31 There were errors in the Nova Scotia Farm Loan Board's and Nova Scotia Fisheries and Aquaculture Loan Board's manual calculation of interest expense and the auditors recommended increased diligence, investigation, and correction of differences.

***Other Entities***

- 5.32 *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
  - Harbourside Commercial Park Inc.
  - Nova Scotia E911 Cost Recovery Fund
  - Nova Scotia Public Service Long Term Disability Plan Trust Fund
  - Nova Scotia School Boards Association
  - Nova Scotia Teachers' Pension Plan
  - Nova Scotia Utility and Review Board
  - Resource Recovery Fund Board Inc.
  - Sherbrooke Restoration Commission
  - Sydney Tar Ponds Agency
  - Trade Centre Limited
- 5.33 Management letters were not prepared as a result of the audits of some entities such as the Nova Scotia Public Service Superannuation Plan, Accounts Established under the Members' Retiring Allowances Act, Waterfront Development Corporation Limited and the Nova Scotia Housing Development Corporation.



- 5.34 Lack of segregation of duties continues in several agencies and auditors recommended improved processes and procedures over expenses, inventory, payables, and financial reporting to strengthen controls and ensure compliance with policies and procedures in certain agencies.
- 5.35 The auditors of one entity noted it was prudently holding investments equivalent to its post-retirement liability, while auditors of another entity recommended the entity consider increasing investment to match the accrued pension and other liabilities. The management letter of Harbourside Commercial Park Inc. commented that the entity has not made any repayments on its outstanding loan with the province for purchase of additional land from Sydney Steel Corporation.
- 5.36 *Accounting and financial reporting software* – The management letter for the Nova Scotia School Boards Association notes the accounting software is deficient in providing information that is readily available in most accounting systems today. The auditor for Sherbrooke Restoration Commission noted that the year end information and reports were manually prepared and many accounting adjustments could have been made by accounting staff before year end. Auditors of the Nova Scotia Public Service Long Term Disability Plan Trust Fund recommended it review its internal control structure on a regular basis because the contracted external accountant has access to all aspects of the general ledger, banking, accounts receivable and accounts payable. The auditors of the Sydney Tar Ponds Agency noted that provincial staff have access to the Agency’s general ledger and have the ability to post entries without the knowledge or consent of the Agency.
- 5.37 The auditors of the Nova Scotia Teachers’ Pension Plan noted that management of the Nova Scotia Pension Agency (which administers the Plan) places reliance on the financial reporting capabilities of the Plan’s custodian. They also noted that certain accounting information is held by government. The lack of a comprehensive in-house general ledger system means that management cannot readily access all of its accounting information on a timely basis and does not fully facilitate the Plan’s financial reporting requirements. The lack of such a system does not facilitate financial reporting requirements under generally accepted accounting principles. The auditors have recommended that management maintain its own accounting records and reconcile these to the custodian’s statements each month.
- 5.38 *Resource Recovery Fund Board Inc.* – The auditors noted the entity has addressed the deficiency related to user access to accounting software but has not changed the way in which HST is reported between the Board and the Fund.
- 5.39 *Trade Centre Limited* – The absence of formal process and policy documentation surrounding IT general controls was noted by the auditors, as well as two instances in which purchase orders were approved after the invoice was received



and three instances in which disbursements were made to hourly employees without evidence of approval.

### ***Audits Conducted by the Office of the Auditor General***

- 5.40 *Nova Scotia Gaming Corporation* – There were no matters to bring to the attention of management or the Corporation’s Board as a result of the audit.
- 5.41 *Nova Scotia Crop and Livestock Insurance Commission* – The Commission continues to use spreadsheets to calculate premium revenues and implemented a tracking system to track changes to the spreadsheet. We recommended the Commission review the changes to ensure the spreadsheet modifications are valid. We also recommended the Commission assess its information technology needs. The Commission has not conducted an overall formal risk assessment and a key control to ensure cash is deposited in full and on a timely basis was not performed for the majority of the year. We also recommended the Commission enforce a due date for receipt of premium revenue and cancel coverage if premiums are not paid within this timeframe.
- 5.42 *Nova Scotia Legal Aid Commission* – Again we recommended that management review the system to estimate certificate liabilities to ensure the resulting liability provides a reasonable estimate of the cost to complete future cases. The Commission should have standard processes for approving journal entries, reviewing security logs and monitoring internal controls which include documenting evidence of the approval or review. The Commission should also adjust unsupported balances in the accounts payable subledger to operating results.
- 5.43 *Public Trustee Trust Funds* – We continued to recommend that the Office of Public Trustee obtain a recognized and comprehensive financial accounting and reporting system. We have also recommended changes to the accumulation of amounts in the Special Reserve Fund.
- 5.44 *House of Assembly* – Observations and recommendations resulting from the March 31, 2011 and March 31, 2012 financial statement audits of the House of Assembly, as well as compliance and internal control audits, are included in Chapter 3 of this report.

## **Late Entities**

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### **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. The number of entities submitting late financial statements decreased in 2011-12, and has decreased significantly over the last six years. APSEA has met the June 30 submission deadline only once in the past six years.

5.45 *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).

5.46 Although the number of entities submitting financial statements after the deadline continues to decline, some entities still submit statements late. In 2011-12, four entities were not successful in providing audited financial statements and requested information by the June 30 deadline. Of these entities, the Atlantic Provinces Special Education Authority was also late in providing the requested information in 2010-11 and had not yet provided the 2011-12 information when this chapter was written. The Atlantic Provinces Special Education Authority 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 the use of inaccurate information for decision-making purposes. The following agencies were late providing information for 2011-12.

- AgraPoint International Inc.
- Atlantic Provinces Special Education Authority
- Nova Scotia E911 Cost Recovery Fund
- Nova Scotia Power Finance Corporation

5.47 The Province's March 31, 2012 consolidated financial statements were released on August 2, 2012, meeting the reporting requirement set out in the Provincial Finance Act.