Chapter 2: Results of Public Accounts Audit and Review of Revenue Estimates

Why we did this work:

- The Auditor General is responsible for:
  - reporting on the reasonability of the province's revenue estimates
  - providing an audit opinion on the province's annual consolidated financial statements
- Nova Scotians count on our independent opinion
- To enhance accountability of financial reports
- Elected officials use financial information in allocating scarce resources

Overall comments:

- 2015-16 revenue estimates of $9.9 billion used to present the budget were reasonably calculated
- The 2015 consolidated financial statements fairly show Nova Scotia's financial situation including its $9.3 billion in accumulated deficits
- We made 12 recommendations

What we found:

- Not all assumptions used to estimate tax are reviewed
- Petroleum royalty estimate assumptions are not reviewed regularly
- Liability for environmental issues of SYSCO may be too high as it is based on old information
- Errors in support for obligations under contract caused audit inefficiencies
- Exceptions noted in SAP Service Management audit report to be addressed
- No written procedures to identify contaminated sites across the province
- Process to evaluate changes to the tax revenue estimation process is inadequate
- Government working on strengthening its internal control over financial reporting
- Government hospitality policy needs updating
- Government not publicly disclosing travel and hospitality expenses for senior bureaucrats

2 Results of Public Accounts Audit and Review of Revenue Estimates

Background and Chapter Objective

2.1 There are two components to government financial reporting – reporting on financial condition, and reporting on financial performance. Both components are included in Volume 1 of the Public Accounts, which includes the province's consolidated financial statements.

2.2 Financial condition provides information on government's financial health at a point in time. The government's statement of financial position is one of the most significant indicators of its financial condition at fiscal year end. The statement of financial position provides two key measures of government's health: net debt and accumulated surplus. Net debt is used to define the deficiency between financial assets and liabilities, and informs the extent to which government can honour its future obligations through realizing its financial assets. Accumulated surplus or deficit is the result of subtracting non-financial assets from net debt. In other words, accumulated surplus or deficit shows how much of net debt was used to purchase assets that will be used to provide government services.

2.3 The statement of operations provides summary level information on financial results. This statement includes the government's approved budget for the year along with actual results, enabling users to evaluate the extent to which the government has met its fiscal plan. The statements of changes in net debt and changes in cash flow provide additional information on how government has financed its operations and capital acquisitions.

2.4 The province's consolidated financial statements also serve the following purposes.

- Elected officials use financial information to make decisions regarding the allocation of scarce resources.
- Taxpayers use financial reports to assess government's stewardship over the resources entrusted to them.
- Other users, such as lenders and credit rating agencies, use financial reports to meet their specific needs.

2.5 The Nova Scotia Finance Act specifies financial reporting requirements for the province which includes tabling of the Public Accounts. Other requirements are the annual estimates (budget) and the periodic forecast updates comparing forecasted results at a point in time during the year with the budget. These reporting requirements are part of the government's accountability framework and contribute to oversight of the use of resources.

2.6 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 and Treasury Board'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.

2.7 In addition to the above, the Auditor General is the legislated auditor of four government entities and conducts two other annual audits; the results of these audits are discussed in chapter 3.

Significant Observations

Review of 2015-16 Revenue Estimates

Conclusions and summary of observations

We issued an unqualified review report on the 2015-16 revenue estimates of $9.9 billion included in the government's $10 billion budget. We repeated two prior year recommendations. The Taxation and Federal Fiscal Relations Division of the Department of Finance and Treasury Board should develop a process to review all tax model assumptions on a periodic basis, especially those that are not subject to annual review as part of the estimate process. The Department of Energy should develop a process to review inputs and calculations used in the models to estimate petroleum royalties. Both recommendations were repeated to ensure these revenues reflect management's best estimate.

Unqualified report on 2015-16 revenue estimates

2.8 *Unqualified opinion* – Under section 20 of the Auditor General Act, the Auditor General is required to provide an opinion on the reasonableness of the revenue estimates included in the annual budget tabled with the House of Assembly. We issued an unqualified opinion on the 2015-16 revenue estimates which was then included in the April 9, 2015 budget address provided by the Minister of Finance and Treasury Board.

2.9 The review opinion covers the 2015-16 revenue estimates, including all those components of the budget that meet the definition of revenue for purposes of financial reporting in accordance with Canadian generally accepted accounting principles (GAAP). Under this definition, the 2015-16 revenue estimates encompass the following components included in the government's budget:

a) ordinary revenues;
b) sinking fund earnings;
c) recoveries and fees;
d) revenue of government units included in the Consolidation and Accounting Adjustments for Government Units section of the budget summary; and
e) net income from government business enterprises.

Not all tax model assumptions thoroughly reviewed

2.10 *Assumptions* – Personal income tax, corporate income tax, harmonized sales tax, and petroleum royalties are estimated using statistical models. Economic assumptions are used as part of the process to estimate these revenues. These assumptions include, among others, gross domestic product, employment rate, the consumer price index, and interest and exchange rates. Other assumptions are based on past events such as results of prior year tax filings and the growth in tax rebates. Some of these are updated annually, while others are not.

2.11 We recommended last year that the Department of Finance and Treasury Board's Taxation and Fiscal Policy Division, now the Taxation and Federal Fiscal Relations Division, should develop procedures to review all tax model assumptions, particularly those not subject to annual consideration. The department agreed with our recommendation at that time. We are aware that some changes have been made to elasticity and calibration assumptions since then. However, a process has not been established to review all assumptions, and we continue to recommend this be done.

Recommendation 2.1
Taxation and Federal Fiscal Relations (a division of the Department of Finance and Treasury Board) should review all tax model assumptions on a periodic basis.

Department of Finance and Treasury Board Response: The Taxation and Federal Fiscal Relations Division is amending its methodology for reviewing Revenue Forecast Model Modules, which reflects management's decision to prepare a risk assessment analysis to identify aspects of the revenue forecast methodology, including, but not limited to assumptions, equations, and processes, that will be subjected to a more formal review. The risk assessment will help identify and prioritize particular areas of the methodology and models to be reviewed.

2.12 Management informed us that since May 2015 division staff have begun incorporating processes for periodic model review into their work plan, and will formalize the timing of this model review in an updated plan.

Petroleum royalty model inputs not regularly reviewed

2.13 *Petroleum royalties* – During last year's engagement, we noted several issues with the preparation of models used to estimate petroleum royalties. Assumptions used to prepare the models, such as inflation rate and natural gas prices, were inaccurate. During this year's engagement, there were fewer instances in which the model assumptions were in error. However, we noted the following deficiencies.

- The exchange rate did not agree with the rate approved by Treasury and Policy Board.
- The natural gas price assumption was not internally consistent between the models. The price calculated by the model used to determine current natural gas prices was not carried forward to the individual producers' royalty calculation files.

2.14 Although both of these deficiencies resulted in a trivial error and did not require correction, we have reported in the past the need to review inputs used in the models to determine petroleum royalties. This would ensure assumptions are current and reflect factors approved for use in the models. The review should also include a review of model calculations. This would confirm the accuracy of amounts included in the final revenue estimates presented in the budget. We repeat the recommendation made in prior years.

Recommendation 2.2
The Department of Energy should develop a process to review inputs and calculations used in the models to estimate petroleum royalties.

Department of Energy Response: The Department of Energy has put in place a process to review the inputs and calculations of the forecast models. The models will be peer reviewed and a formal checklist will be signed off.

2.15 *Tax model change management* – Changes made to tax models during the year were well-documented and supported. Changes included adjustments to the tax elasticity factor used to estimate personal income tax, and to the calibration factor used to refine the federal Department of Finance's harmonized sales tax revenue estimates. However, we recommended that changes impacting financial reporting should be reviewed by the Government Accounting Division to assess their potential impact on the Public Accounts. This matter is discussed further later in this chapter because it also impacted our audit of government's financial statements.

Audit of the March 31, 2015 Consolidated Financial Statements

Conclusions and summary of observations

We issued an unqualified audit opinion on the Province of Nova Scotia's 2014-15 consolidated financial statements. However, we identified issues and made recommendations on several matters. The liability to remediate the former SYSCO site is overstated and more current information is needed. We encountered issues related to completeness and accuracy of contractual obligations. Although all errors were corrected, there were audit inefficiencies in working with the incorrect information. We also found deficiencies in both the process to compile the listing of contaminated sites and the process to evaluate changes to the estimation process used to calculate tax revenues. We noted auditors of the province's general ledger system identified concerns with general computer controls which should be addressed.

We also performed specific testing of executive compensation, vacation, travel and hospitality expenses and recommended a modern, government-wide hospitality policy be implemented and monitored. To enhance openness and transparency, we have also recommended the Department of Finance and Treasury Board require senior management of government departments, and agencies, boards and commissions to publicly disclose their travel and hospitality claims.

2.16 *Background* – Our Office is the legislated auditor of the province's consolidated financial statements. We are required by section 19 of the Auditor General Act to perform the annual audit of the province's consolidated financial statements. Our overall objectives as auditors of the statements are to:

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

The province's March 31, 2015 consolidated financial statements were fairly stated

2.17 *Unqualified audit opinion* – We issued an unqualified opinion on the province's March 31, 2015 consolidated financial statements. The unqualified audit opinion indicates the consolidated financial statements are presented fairly, in all material respects, in accordance with Canadian generally accepted accounting principles for the public sector, which are issued by the Public Sector Accounting Board of the Chartered Professional Accountants of Canada (CPA Canada). The unqualified audit opinion also indicates there were no quantitative findings, either individually or cumulatively, which were material enough to impact the opinion.

2.18 Our Office provided a letter to the Minister of Finance and Treasury Board on July 30, 2015. It included required communications to those charged with governance under Canadian Auditing Standards, and other matters that came to our attention during the course of the audit, of which we believe the Minister should be aware. We also provided a management letter to the Deputy Minister of Finance and Treasury Board in October 2015. This communication included detailed audit findings, recommendations and other comments related to the March 31, 2015 public accounts. The more significant information included in the management letter is noted below under the following headings.

- Audit Completion
- Internal Control
- Other Matters

Audit Completion

2.19 *Results and significant findings* – The consolidated financial statements were released on July 30, 2015. We issued an unqualified audit opinion dated July 23, 2015.

2.20 Canadian Auditing Standards require that we communicate to those charged with governance the following information:

- significant matters, if any, arising from the audit that were discussed or subject to correspondence with management; and,
- other matters, if any, arising from the audit that, in the auditor's professional judgment, are significant to the oversight of the financial reporting process.

2.21 We communicated these matters to the Minister of Finance and Treasury Board.

2.22 As part of the audit we also provide specific information about the findings of our audit in a management letter to the Deputy Minister of Finance and Treasury Board. The management letter communicates detailed audit findings, difficulties encountered during the audit, and any other matters arising from the audit that we feel should be communicated to management. Issues that directly impacted audit completion and that, in our judgment, are important to oversight of the financial reporting process are noted below.

Liability for former SYSCO site may be too high as it is based on old information

2.23 *Department of Transportation and Infrastructure Renewal* – SYSCO – The liability to complete the remediation and monitoring of the former Sydney Steel Corporation and adjacent sites, including the Sydney Tar Ponds, is a provision based on management's best estimate. The estimated costs are reviewed each year and the provision is assessed to ensure it is sufficient. The provision at March 31, 2015 totaled $73 million. Management's best estimate is supported by two documents – a contract with the federal government for monitoring the Sydney Tar Ponds site, and a consultant's report related to future monitoring and further remediation of SYSCO.

2.24 As part of the audit, the Department of Finance and Treasury Board's Government Accounting Division staff prepared an analysis of outstanding contracts and of expected monitoring costs for the next several years and determined that the provision was overstated by $6.4 million. In addition, we identified two misstatements, including the need to factor inflation costs into the remediation cost estimates as required by accounting standards. The net result is that the provision is overstated by $5.1 million and should be adjusted to reflect this revised amount.

2.25 As noted above, a consultant's report supports a portion of the total provision. The report is dated 2011 and addresses future remediation and monitoring costs. We are not aware of industry standards for updating such reports or conducting new studies. However, given the significance of the provision, we believe the Department of Transportation and Infrastructure Renewal should assess the need for a new or updated report. This would help ensure the estimated costs for the site are current, and better support the recorded amount.

Recommendation 2.3
The Department of Transportation and Infrastructure Renewal should remeasure the liability for the estimated future costs for remediation of the tar ponds and obtain an update to the consultant's report used to measure the liability.

Department of Transportation and Infrastructure Renewal Response: This liability will continue to be utilized for future long-term maintenance and monitoring activities essential to the remediation of the SYSCO and Tar Ponds sites. Based on currently available information, the provision, in aggregate, is sufficient to cover the estimated costs to remediate and monitor these sites. Transportation and Infrastructure Renewal (TIR), along with Government Accounting, will continue to assess the liability for remediation at each year-end to ensure it is fairly stated in the Province's Public Accounts. Government Accounting obtains from TIR senior management periodic status updates and cost updates on the SYSCO Remediation Project.

The Tar Ponds sites have entered a maintenance and monitoring phase, but the SYSCO site still has a number of outstanding uncertainties that have yet to be confirmed. Until the project is fully complete and signed off, the full costs of remediation will not be truly known. Therefore, our position remains to make no adjustments to the provision until all known projects are complete due to the uncertain nature and complexities of the remaining work and their costs.

Although TIR does not foresee any of the major assumptions changing in the report dated 2011, the department has agreed to arrange for an update of the consultant's report relating to remediation and monitoring of SYSCO in fiscal 2016.

Internal Control

2.26 *Responsibility for internal control* – The Nova Scotia Finance Act includes general references to the roles and responsibilities of the Minister and Deputy Minister of the Department of Finance and Treasury Board relating to internal control. The Controller prepares the consolidated financial statements of the Province of Nova Scotia on behalf of the Minister and Deputy Minister as noted in the statement of responsibility for the consolidated financial statements for the Province of Nova Scotia. The statement of responsibility also notes *"The 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."*

2.27 Our audit is planned and conducted to enable us to express an audit opinion on the annual consolidated financial statements, not to express an opinion on the internal controls of government or to determine whether internal controls are adequate for management's purposes.

2.28 Certain matters which came to our attention during the conduct of the audit, related to internal controls and other financial reporting issues, were communicated to the Department of Finance and Treasury Board in a management letter. Implementation of the recommendations in the management letter and this chapter will facilitate preparation of the consolidated financial statements and strengthen financial reporting. There were no significant deficiencies noted during the audit that required communication with those charged with governance, as would be required by Canadian Auditing Standards.

Errors in support for obligations under contract caused audit inefficiencies

2.29 *Various departments – contingencies and contractual obligations* – During our testing of contractual obligations, we encountered many issues related to the completeness and accuracy of amounts disclosed in the draft consolidated financial statements provided to us for audit purposes. Departmental listings of contractual obligations were not complete and did not include obligations from the prior year that remained obligations in the current year.

2.30 All errors in the contingencies and contractual obligations schedules were eventually corrected and we concluded disclosure of these amounts was fairly stated. The following are the more significant deficiencies, eventually corrected, which we identified during the audit.

- The Department of Transportation and Infrastructure Renewal provided details of the obligation related to the new convention centre. However, the obligation did not include the net present value of the lease payments the province will be required to make for the facility. This resulted in a $43.7 million understatement of contractual obligations included in the draft consolidated financial statements.

- Executive Council had contracts due to expire in future years but the Department of Internal Services did not include these on their contractual obligations listing. Responsibility for these contracts had changed to the Department of Internal Services but we were informed the department was unaware of this. The department revised its listing to reflect this transfer of responsibility.

2.31 Departments are responsible for the accuracy and completeness of information provided to Government Accounting for preparation of the consolidated financial statements. We were informed that Government Accounting has provided guidance to departmental financial staff on identifying and measuring contingencies and contractual obligations. It is evident from our findings that more attention is needed.

Recommendation 2.4
Government Accounting (a division of the Department of Finance and Treasury Board) should provide additional training to departmental financial staff on accounting for and disclosing contingencies and contractual obligations. In addition, Government Accounting should review schedules submitted for significant and unexpected variances and investigate any unexpected variances.

Department of Finance and Treasury Board Response: Numerous controls have been implemented over the past few fiscal years to help with the accuracy and completeness of reported contingencies and contractual obligations. With the recent change to shared services within the Department of Internal Services, Government Accounting will continue to work with departments and offer training to ensure that they understand their review and reporting responsibilities, as well as formally document a post-submission review process, which will include relevant procedures in an effort to mitigate any errors in the completeness, existence, and accuracy of the contingencies and contractual obligations schedules. In addition, Government Accounting will continue to review schedules submitted for significant and unexpected variances, and any significant variances will be investigated further.

Exceptions noted in SAP Service Management audit report

2.32 *SAP Service Management (SAPSM) – CSAE 3416* – The SAP Service Management Division manages the SAP system. Auditors of the SAP Service Management's description of its infrastructure and application support services for the period April 1, 2014 to March 31, 2015 issued a qualified opinion. The qualification was based on the results of testing whether or not logical access to SAP systems is appropriately restricted to authorized users.

2.33 We also obtained the CSAE 3416 report for IBM Canada because SAP application management services are outsourced to IBM. Both reports are needed to obtain a full understanding of the SAP general control environment. The independent auditors' report for IBM Canada was unqualified. However, in both reports – SAPSM's CSAE 3416 and IBM's CSAE 3416 – the respective auditors noted that complementary controls needed to be operating effectively. In other words, notwithstanding the unqualified opinion on the IBM CSAE 3416 report, both auditors are indicating that in order for the general control environment to be operating effectively, controls at both IBM and the province need to be operating as they should be.

2.34 A qualified opinion is a serious deficiency. Although the qualified opinion had no impact on our procedures or our overall audit conclusion, such a qualification reflects poorly on the overall control environment. Unauthorized access can result in inappropriate transactions and/or access to confidential information. Although the qualification does not indicate there was any such breach, and the controls in place collectively provide an appropriate foundation for the control environment, the controls to monitor access were unavailable for two periods during the year. This means that management was unable to monitor access as part of an overall control environment and respond to issues as needed.

Recommendation 2.5
SAP Service Management (a division of the Department of Internal Services) should address the exceptions identified in the CSAE 3416 report.

Department of Internal Services Response: The SAP Service Management Division of the Department of Internal Services has addressed these exceptions, and all items have been completed as recommended.

2.35 As noted, SAP Service Management staff state these deficiencies have been addressed. We have not audited the actions taken but are encouraged that the issues raised appear to have been addressed on a timely basis.

Other Matters

No written procedures to identify contaminated sites across the province

2.36 *Contaminated sites* – Public Sector Accounting Standard (PSAS) 3260 came into effect April 1, 2014. This standard establishes the recognition and measurement of liabilities associated with remediation of contaminated sites.

2.37 As part of our audit, we met with staff of the Departments of Transportation and Infrastructure Renewal and Natural Resources in order to obtain an understanding of the process each department used to compile its listing of contaminated sites. The process used by both departments included reviewing contamination reports from field staff, analyzing related site expenses, and considering Occupational Health and Safety reports which reflect contamination. In our view, these processes were sufficient to mitigate the risk of materially misstating the consolidated financial statements through nondisclosure of contaminated sites.

2.38 However, the process discussed at each department was not documented, was fragmented, and roles and responsibilities had not been established. A documented process would help ensure completeness and accuracy of the contaminated sites listing reported to Government Accounting for the purposes of preparing the consolidated financial statements.

2.39 We selected these two departments as together they are responsible for provincial assets which pose the most significant contamination risk. We did not review or discuss the process for identifying contaminated sites in other departments. In order to ensure liabilities for contaminated sites are complete and accurate, there should be an appropriate management trail to support recorded amounts or to confirm that a liability does not exist. Government Accounting should work with departments to ensure processes exist and are documented fully, and that the result of such processes ensures compliance with the accounting standard.

Recommendation 2.6
Government Accounting (a division of the Department of Finance and Treasury Board) should assist departments in determining how to identify and assess contaminated site liabilities, including establishing roles and responsibilities.

Department of Finance and Treasury Board Response: Departments have established risk-based processes to identify and assess contaminated sites. On a collective basis, these processes provide for a complete and accurate consolidated listing that meets the accounting requirements set out in PS 3260. Government Accounting will work with the departments to ensure their processes are appropriately documented in sufficient detail, including the assignment of individual roles and responsibilities.

2.40 In addition, during the audit, in response to our questions on the completeness of contaminated site listings, Government Accounting asked the Department of Environment for their internal list of contaminated sites. In comparing this list to the original listing provided by the department to Government Accounting we identified an additional four sites. This comparison should have been undertaken by Government Accounting prior to the audit.

2.41 We also noted that ten sites maintained by the Department of Transportation and Infrastructure Renewal were identified as contaminated, but no liability had been recorded. These sites were the same as 19 other sites used for similar purposes, and for which liabilities were recorded; we therefore suggested that contamination was likely. We further suggested that a reasonable estimate of the liability could be made based on the liability recorded for the 19 other sites. Government Accounting agreed with our analysis and a liability was recorded for these ten additional sites.

Inadequate evaluation of changes to revenue estimation

2.42 *Corporate income taxes* – The revenue model used to estimate and forecast Corporate Income Taxes includes an adjustment for Nova Scotia's economic circumstances (the Nova Scotia Economic Adjustment factor). This factor is based on a formula, and is an assumption in the process to determine tax revenues. We have recommended in the past that this factor be subject to periodic review.

2.43 In the process of updating the Corporate Income Tax model for the March 31, 2015 Public Accounts, Taxation and Federal Fiscal Relations Division staff noted that maintaining the adjustment factor at its current level had a minor impact on March 31, 2015 results, but had a significant impact on the March 31, 2016 forecast update which was issued in September 2015. Division staff felt the latest information from the federal Department of Finance on 2014 and 2015 Canadian corporate results, used as an input to the estimation process, was optimistic. As a result, the division reduced the Nova Scotia Economic Adjustment factor to zero in an effort to normalize the 2015-16 forecast.

2.44 For accounting purposes, changes to the estimation process used to calculate tax revenues need to be evaluated to determine if the changes result in better financial reporting and whether disclosure of the change is required. In response to our request to support the decision made, division staff explained the large forecasted variability, but did not provide adequate detail as to why this change resulted in better financial reporting. Such an explanation is needed when there is a change in an estimate; that is, the new method results in a better estimate on a go-forward basis. Methods used to estimate financial statement items should be applied consistently. Therefore, if this new factor (now at nil) is the best estimate, it should not be adjusted in future without adequate support.

2.45 In the management letter resulting from our review of 2015-16 revenue estimates, we recommended that changes to estimates used in calculating tax revenues be approved by senior management within the Department of Finance and Treasury Board to support that such changes result in improved financial reporting. We further recommended that these changes be communicated to the Government Accounting Division to determine whether disclosure is required in the public accounts.

2.46 In response to that recommendation, we were informed the revised practice would be that such changes would be approved. We were provided evidence that both the Director of Taxation and Federal Fiscal Relations and the Executive Director of Fiscal Policy, Economics and Budgetary Planning retroactively reviewed and approved recommended changes to the models used to prepare the revenue estimates, in support of this revised practice. The procedure to approve changes made during our audit of the province's public accounts was through discussions that included Government Accounting along with senior management of the Taxation and Federal Fiscal Relations Division. The Executive Director of Fiscal Policy, Economics and Budgetary Planning provided implicit approval of the changes made as one of the recipients of the support provided to us which explained the large forecasted variability. If the Department of Finance and Treasury Board's Taxation and Federal Fiscal Relations Division is comfortable with this procedure, it should be included in their process documentation.

Recommendation 2.7
Taxation and Federal Fiscal Relations (a division of the Department of Finance and Treasury Board) should update process documentation to include the procedure followed to approve changes made to tax revenue models.

Department of Finance and Treasury Board Response: The Department of Finance and Treasury Board agrees that process documentation should be updated to include the procedures for approving tax revenue model changes.

2.47 There was no evidence that changes made to the estimation process resulted in better estimates either currently or in the future. We also found that changes made to the estimation process used in calculating tax revenues were not evaluated by Government Accounting in order to determine whether disclosure is required in public accounts. Government Accounting should analyze such decisions as they have the expertise to determine whether these decisions have an impact on the public accounts. Therefore, we have included a similar recommendation, to that made during the revenue estimates review, as a result of our audit of the March 31, 2015 consolidated financial statements.

Recommendation 2.8
Taxation and Federal Fiscal Relations (a division of the Department of Finance and Treasury Board) should demonstrate that changes made in determining taxation revenue improve financial reporting. Also, Government Accounting Division staff should determine whether changes in estimating tax revenues will impact the government's consolidated financial statements.

Department of Finance and Treasury Board Response: The Department of Finance and Treasury Board believes sufficient support was provided to show that the tax model change would result in better revenue estimates. As stated in the memo provided to the Office of the Auditor General in July 2015, assumptions about corporate net operating surplus (CNOS) are not well-suited to estimating taxable income. CNOS was used as a variable to estimate corporate taxes when Statistics Canada eliminated the collection of the 'corporate profits' variable. Unlike Finance Canada for national corporate taxes, Nova Scotia is unable to estimate corporate profits for the Province due to a lack of historical data.

The limitations in CNOS became especially apparent when its use lead to the result that the value of oil and natural gas exports was generating significantly greater growth in net operating surplus in Nova Scotia than was expected for Canada. The Province's share of national corporate taxable income is highly sensitive to the adjustment factor and it is well known that oil and natural gas exports do not generate significant taxable income for the Province. It was unreasonable to estimate corporate income tax revenues using the adjustment factor and staff exercised their professional judgment to reduce an over-optimistic result by employing a 3-year average share approach to the adjustment factor. The tax model change and the rationale were discussed by the Taxation and Federal Fiscal Relations Division with Government Accounting, the Controller, and the Associate Deputy Minister.

The Department of Finance and Treasury Board agrees that there is always room for increased and enhanced communication with Government Accounting concerning tax revenue model changes and will ensure that Government Accounting is kept apprised of tax model changes so they may determine the impact on the Public Accounts. Tax model process documentation will be updated to reflect the inclusion of Government Accounting in the notification of tax model changes.

Internal control over financial reporting project adds value but needs attention

2.48 *Internal control over financial reporting* – The Department of Finance and Treasury Board implemented a project, Internal Control over Financial Reporting (ICFR), approximately six years ago. The project is part of an overall governance objective that includes other projects such as Enterprise Risk Management and the implementation of the SAP Governance, Risk and Compliance module. The objective of the ICFR project is for management to assess their internal controls on a periodic basis and report the results to the Controller, in order to support the statement of responsibility for internal controls included in Volume 1 of the Public Accounts.

2.49 We met with management of the Department of Finance and Treasury Board in August 2015 to determine the current status of the project. At that time, management had completed the documentation and testing of entity level controls. Certain key corporate process controls, such as those relating to estimating provincial revenue, have been identified, documented and are being updated and tested on an annual basis.

2.50 An overall risk assessment of departments and entities included in the government reporting entity is complete. From this risk assessment, a multi-year plan has been developed to determine the cycle for reviewing controls at certain departments and entities. The extent of review at each entity is determined based on its assessed risk. It is anticipated that this project will take a number of years to complete.

2.51 Business processes have not been documented at departments and entities. Generic risk control checklists for entity level controls have been provided to departments to complete. These checklists are to be completed for the following areas: control environment; risk assessment; information and communication; and monitoring. They are not specific to each department and the controls noted are not necessarily relevant to the public sector (for example, controls include those related to collecting cash, a process which is not relevant to all departments). The intent of the checklists is to familiarize departmental financial staff with controls so that department-specific controls can be identified in due course.

2.52 The Department of Internal Services was established during the past year and is (or will be) responsible for providing the following services to all departments:

- Vendor master file maintenance
- Accounts payable data entry
- Vendor payments from SAP
- Enquiries and exception handling
- Accounts receivable (centralized with SAP as possible)
- Procurement
- General accounting (general ledger and subsystem reconciliations, month-end close, master file maintenance)

2.53 As a result, it is anticipated that business processes related to these services will be developed and formalized by that department.

2.54 We have recommended in past reports that internal controls be identified and documented, and that roles and responsibilities for these controls be formally assigned. Once achieved, the outcome of the Internal Controls over Financial Reporting project will likely address this recommendation. Whether controls are identified by the Department of Internal Services or individual departments, we believe this project adds value and that resources should be allocated to its completion.

Recommendation 2.9
The Department of Finance and Treasury Board should have timeframes for departments to complete their documentation of controls and ongoing monitoring.

Department of Finance and Treasury Board Response: The departments are required to submit their Statement of Management Responsibility to Government Accounting by May 5th for the immediately preceding fiscal year. This Statement is senior management's acknowledgement of the accuracy and reliability of their financial records and the effectiveness of their system of internal controls over financial reporting. Departments are also requested to submit to Government Accounting their Risk Control Checklists, which identify specific control activities that address certain control objectives related to accounts receivable, accounts payable, inventory, and tangible capital asset processes. These checklists also include Entity Level Controls (ELC) at the department level, which include monitoring controls.

2.55 In addition, based on discussions with management, the project does not currently include monitoring of controls. Monitoring of internal controls is an integral part of a strong control framework. The objective of monitoring these controls is to ensure they are effective and operating as intended and responding to identified deficiencies. Monitoring is to be performed by individuals independent of the control; for example, an individual who has oversight for a monthly approval process. The Department of Finance and Treasury Board should provide information to departments on establishing a process to monitor controls, including a system to provide results of monitoring to departmental senior management.

Recommendation 2.10
The Department of Finance and Treasury Board should include monitoring of internal controls in the Internal Controls over Financial Reporting project.

Department of Finance and Treasury Board Response: The Department of Finance and Treasury Board is following the COSO Framework to effectively and efficiently develop a system of internal controls over financial reporting (ICFR) for the Province. One of the components of this framework is monitoring activities. Ongoing evaluations, separate evaluations, or some combination of the two will be used to ascertain whether internal controls exist and are operating effectively. Departments will be provided additional guidance on the key monitoring activities that should be included in their ICFR system. The results of testing will be reported to senior management and provide supporting documentation for the Statements of Management Responsibility.

Government hospitality policy needs updating

2.56 *Specific testing* – As part of our audit of the province's March 31, 2015 consolidated financial statements, we performed limited work on executive compensation, vacation, travel and hospitality expenses. We made the following two recommendations as a result of this work.

Recommendation 2.11
The Department of Internal Services should put in place a government hospitality policy that captures modern public sector expectations, and monitor that this policy is being met.

Department of Internal Services Response: The Department agrees that more clarity is required around expenditures related to public sector meetings, conferences, and other events. The Province will conduct a policy review to determine if more clarity can be provided within an existing policy, or whether a new policy is required.

No reporting of senior bureaucracy travel and hospitality expenses

Recommendation 2.12
To enhance openness and transparency, the Department of Finance and Treasury Board should require senior management of government departments, agencies, boards and commissions, to publicly disclose travel and hospitality claims.

Department of Finance and Treasury Board Response: The Department of Finance and Treasury Board agrees with this recommendation and will work on this initiative with the Department of Internal Services as part of their policy review as mentioned in 2.11 above.

2.57 *New accounting standards* – Some of the more significant issues on which the Public Sector Accounting Board has recently released new pronouncements include liability for contaminated sites (in effect for the current year), foreign currency translation and financial instruments. New standards 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.

2.58 *Foreign Currency Translation and Financial Instruments* – The most significant impacts of these sections are the requirement for a new financial statement (Statement of Remeasurement Gains and Losses) and the removal of hedge accounting provisions. The Statement will include unrealized foreign exchange gains or losses and unrealized changes in the fair value of certain financial instruments. Unrealized amounts will be reversed when balances have been settled in a future period and realized gains or losses are recognized. These sections were to be effective for fiscal periods beginning on or after April 1, 2016. However, the Public Sector Accounting Board recently extended the effective date to April 1, 2019. Corresponding amendments have been made to PS 3040 Portfolio investments (now PS 3041).

2.59 In addition, the following sections are effective April 1, 2017.

2.60 *Related Party Disclosures and Inter-Entity Transactions* – These sections define related parties and establish related disclosure requirements and standards on accounting for inter-entity transactions. No significant impact is expected when these new standards are implemented as most related party and inter-entity transactions are eliminated upon consolidation.

2.61 *Assets, Contingent Assets and Contractual Rights* – These three sections define assets and contractual rights and establish related disclosure requirements. The impact of implementing these standards has not yet been assessed.