

REPORT OF THE

**AUDITOR
GENERAL**

1996



Honourable Wayne Gaudet
Speaker
House of Assembly

Sir:

I have the honour to submit herewith my Report to the House of Assembly for the year ended March 31, 1996, to be laid before the House in accordance with Section 9(2) of the Auditor General Act.

Respectfully submitted

[original signed by E. R. Salmon]

E. Roy Salmon, F.C.A.
Auditor General

Halifax, Nova Scotia
March 21, 1997

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INTRODUCTION

1.

OVERVIEW AND SIGNIFICANT ISSUES

INTRODUCTION

1.1 This Report contains the results of the audit work carried out by my Office during 1996. My objective is to provide information to the House of Assembly to aid its members in carrying out their responsibility to hold the government to account for the management of public funds.

1.2 In conducting these audits we adhere to the standards promulgated by the Canadian Institute of Chartered Accountants. We are also guided by the recommendations of the Institute's Public Sector Accounting and Auditing Board.

1.3 This chapter provides a summary of the most significant findings outlined in the Report. The individual chapters provide the results of all our audit activity and identify other issues requiring attention. Those chapters also provide significantly more background and analysis of the findings discussed in this chapter and I caution readers that a fuller understanding would be obtained from reading them. In addition, two, more detailed, special reports were issued during the year, one on Atlantic Lottery Corporation to its shareholder, the Nova Scotia Gaming Corporation, and the second, on the Teachers' Group Insurance Plans, to the Minister of Education and Culture. The chapters in this Report dealing with those are summaries of the detailed reports.

1.4 The Report contains positive commentary on a number of government initiatives, many of which respond to recommendations and observations made in previous Reports. However this year's audit effort identified a number of significant matters warranting further action.

AUDIT MANDATE

1.5 The need to issue Special Reports, as discussed above, both as a result of the need to bring matters forward on a timely basis and in order to respond to specific requests, led me to seek clarification of my reporting mandate under the Auditor General Act. The legal opinion obtained indicates that I have greater flexibility than previously understood with regard to the tabling of both Special Reports and the Annual Report. I intend to use this flexibility in a cautious, responsible manner with the overriding objective of providing important information in a timely manner.

1.6 The legislated structure for the audit of the Province's financial statements, which calls for a chartered accountant appointed under the Provincial Finance Act to perform an audit and report to the Minister of Finance, is inconsistent with the traditional view that the Legislature should be the client for this audit. This matter was discussed extensively by the sub-committee of the Public Accounts Committee in preparing a report that recommends legislative improvements to the accountability structure, but no recommendation was made in this regard.

1.7 I will continue to review the financial statements and provide commentary. The comments on the financial statements for the year ended March 31, 1996 are contained in Chapter 2 and are summarized below.

ACCOUNTABILITY INFORMATION AND REPORTING

1.8 Significant progress is being made to improve the quality of accountability information and reporting by government. The improvements put in place - some supported by specific statutory provisions - coupled with those in progress or planned, put Nova Scotia in much more of a leadership role in relation to public sector accountability. In its 1995-96 report to the House of Assembly the Public Accounts Committee included a number of significant accountability-related recommendations which I encourage government to consider.

ANNUAL FINANCIAL STATEMENTS

1.9 Over the past 2-3 years, improvements made to the Province's financial statements have resulted in more complete and understandable reporting of the surplus/deficit and liabilities than in the past. There are certain issues that have been raised by my Office which have not yet been fully dealt with but are being considered. These include the need for full consolidated financial statements as the primary financial report.

1.10 The annual deficit reported in the Province's financial statements for the year ended March 31, 1996 was \$201,102,000. Net capital expenditures, which form part of this deficit, have been increased by \$50,913,759 of capital commitments. The notes to the financial statements and the supporting *Schedule of Net Capital Expenditures* provide disclosure of this matter. Further, we understand the adjustment was discussed during the public release of the 1996 *Financial Report* on August 8, 1996. We have held various discussions with Department of Finance officials and others with respect to the accounting treatment of these capital commitments. We have been provided with general background information on the discussions leading up to the decision to account for these items in 1995-96 (i.e., see Department of Finance's response to Chapter 2). However, we have not been provided, nor been able to determine, an appropriate basis upon which to justify accounting for the capital commitments as expenditures for 1995-96.

1.11 The \$50.9 million of capital commitments do not represent expenditures "incurred" during fiscal 1995-96, and reporting them as such is inconsistent with the Province's stated basis of accounting. Furthermore, comparisons between fiscal periods (1994-95 to 1995-96 to 1996-97) are affected significantly. Since these commitments would most likely result in expenditures in 1996-97 the effect is compounded.

DEBT MANAGEMENT

1.12 My last two annual reports have included chapters dealing with the results of our review of the government's debt management systems and practices. Due to other audit priorities and pending the availability of formal policies with respect to the use and control of derivatives by Finance, we have not completed a formal audit review in this area for 1996.

1.13 Government, through the Department of Finance, has taken and continues to take action to enhance its policies and practices for the ongoing management and control of the Province's debt and debt-related costs. In this regard, we note that statutory provisions passed in 1996 establish a specific target of 20% foreign debt. However, there were key areas where more detailed plans and specific policies and procedures needed to be established or finalized, including with respect to the use of alternative financial instruments (e.g., derivatives).

1.14 At a Public Accounts Committee meeting in early 1996, Finance undertook to have policies with respect to the use of derivatives drafted by the end of the year. These policies were in the

process of being finalized at the time that this Annual Report was completed. Once they are available to us, we will determine the nature and extent of our future audit work with respect to the management of the Province's debt and debt-related costs.

GOVERNANCE

1.15 The matter of "Governance" including the roles, responsibilities and relationships of governing bodies has been the subject of much discussion and research in recent years. Thus we decided to make it a theme for a number of the audits conducted this year, including a major survey of members of Boards of Governors in the Province's university system. The results are outlined in the various chapters but some common issues were identified.

1.16 Several of our audits resulted in findings from which we concluded that the relationship between the governing body (generally a Board) and the government was either unclear or not well understood. This was particularly true of the relationship between university boards and the Nova Scotia Council on Higher Education which is discussed in Chapter 6. As well these issues are the subject of ongoing efforts to define roles, responsibilities and accountability relationships as Regional and Community Health Boards are established. This is discussed in Chapter 8.

1.17 Strategic and program policy direction should be provided by government to organizations engaged in carrying out government programs. Government has established its priorities in terms of its four pillars, economic renewal, redesigned government, social responsibility, and fiscal recovery, and has communicated these through *Government By Design*. However, it would appear appropriate that organizations should receive more specific direction regarding these. As an illustration of this, the audit of Atlantic Lottery Corporation revealed that its Board and management could benefit from more specific government direction. It would seem appropriate for government to be more explicit regarding the balancing of fiscal versus social aspects of its priorities with respect to lottery activities in the Province from an operational perspective.

EDUCATION AND CULTURE - TEACHERS' GROUP INSURANCE PLANS

1.18 I had planned an audit of these plans in 1994 but was denied access by the Nova Scotia Teachers Union. As a result of amendments to the Education Act in 1995 my access was made more specific and I was granted access in 1996. The audit identified that, for a variety of reasons, primarily related to lack of clarity in the terms of negotiated agreements and absence of formal accountability reporting requirements, funds in excess of \$10 million plus earned interest over a number of years were accumulated by the NSTU Group Insurance Trustees. These funds were remitted by the Province, school boards and teachers and were not required to finance premiums. At the time of writing this Report negotiations were underway between the government and the NSTU related to the ownership of these surplus funds.

DEPARTMENT OF TRANSPORTATION AND PUBLIC WORKS - HIGHWAY 104 WESTERN ALIGNMENT PROJECT

1.19 This project was the government's largest venture into public/private partnering and represents our first attempt to audit the process. Although we were able to conclude that the initial stages of the process were competitive, in compliance with procurement policies and therefore open and fair, we could not conclude on the final result because of the negotiation process. Auditing these arrangements offers some unique challenges.

1.20 Based on our analysis, if the Province had borrowed the funds for the highway project directly, instead of Highway 104 Western Alignment Corporation, the debt service charge for the borrowing would have been significantly lower. However, if the Province borrowed the funds it would have assumed a greater amount of risk on the project, and we have been told by a representative of the company that designed and purchased HWAC's bonds that additional debt on the Province's books at this time could affect its credit rating and increase its average cost of borrowing. We cannot express an opinion on whether or not additional borrowing by the Province of this magnitude would change the Province's average borrowing rate. The financial markets determine interest rates, and it is very difficult to forecast the activity and demands of the market.

ATLANTIC LOTTERY CORPORATION (ALC)

1.21 This audit resulted from a request to me from the Nova Scotia shareholder, the Nova Scotia Gaming Corporation, to carry out an audit. The request was made pursuant to provisions of the bylaws of Atlantic Lottery Corporation. Previously plans had been made to conduct a regular audit under the Auditor General Act and to do it jointly with the Auditors General of the other Atlantic Provinces. Jurisdictional issues prevented that plan from going forward and I urge government to clarify the status of ALC so that such jurisdictional issues are avoided.

1.22 Staff from the Office of the Auditor General of New Brunswick participated in the 1996 shareholder's audit and the Auditors General of Prince Edward Island and Newfoundland and Labrador were consulted. An audit report was transmitted to the Nova Scotia Gaming Corporation on March 19, 1997 and provided to the Auditors General of the other Atlantic Provinces with permission to transmit it to the shareholders in their provinces. Chapter 12 in this Report is a summary of that more detailed report with some added focus on issues germane to Nova Scotia.

1.23 ALC is an established organization with procedures and systems in place to manage and control its activities. ALC has grown substantially since it was established in 1976, particularly with the growth of the video lottery program since 1991. Arrangements and agreements made in 1976 should be revisited and renegotiated by the shareholders and shareholder provinces. Issues such as public reporting, dispute resolution mechanisms and cost allocation methodologies need review.

1.24 We estimate that a more equitable basis of cost allocation would have benefited Nova Scotia by approximately \$5 million in 1995-96. Further, we estimate that under the current cost allocation methodologies and at the existing deployment levels, Nova Scotia would end up bearing approximately \$1 million more depreciation expenses over the next few years as a result of ALC's planned acquisition of new retail terminals for its regular lottery programs.

1.25 By majority vote of the Board in 1995, a long-term lease for a head office facility in Moncton was approved at the time that Nova Scotia was exploring alternative organizational arrangements. Given that Nova Scotia, under current cost allocation methodologies based on 1995-96 results, would bear approximately 40% of these accommodation costs, deferring such a decision until organizational issues were resolved would appear to have been more reasonable.

1.26 In my view, based on the results of our audit, Nova Scotia and Nova Scotia's ALC Board representatives need to ensure that interests and priorities of the Province are fully understood and adequately dealt with by ALC.

NOVA SCOTIA RESOURCES LIMITED

1.27 As a result of allegations made by members of the Legislature, media and public about the company's handling of certain negotiations and other business matters, I was requested to undertake an audit of the corporation.

1.28 All of the transactions, which were the subject of the allegations, were influenced by the government's decision, in early 1995, to dispose of the company and terminate its involvement in the oil and gas business. The audit determined that, once that decision was made, the government obtained expert assistance and commenced a process for the orderly disposal of the company's assets including its tax pools. Decisions had to be made that required balancing risks and rewards and the process is still not complete.

1.29 Given the uncertainty of future events and the potential risks that had to be considered, I concluded that decisions were made based on reasonable amounts of information and advice.

CONCLUDING REMARKS

1.30 During 1996 there was a continuation of previous initiatives designed to improve management processes, particularly in the area of planning and budgeting. However once again I raise the concern that such positive improvements may not be sustained in the absence of a legislated accountability framework.

1.31 The Public Accounts Committee made significant recommendations that if adopted would address much of this concern. I urge the government and the Legislature to give serious consideration to those recommendations.

1.32 This was an unusually difficult year for the Office, primarily due to the requests for special audits and the complexity of many of the matters addressed. I want to recognize the support of my staff and their willingness to accept new challenges and adapt to a rapidly changing environment.

1.33 The Office was also saddened when one of its longest serving employees, Tom Edwards, passed away suddenly on March 9, 1997. Tom was a dedicated professional who was also very active in community and charitable endeavours. He was looking forward to retirement in June and he will be sorely missed by his family, friends and associates.

GOVERNMENT-WIDE ISSUES

2.**ACCOUNTABILITY INFORMATION AND REPORTING****BACKGROUND**

2.1 In recent years, the Report of the Auditor General has included chapters dealing with accountability to the House of Assembly, including comments on the action taken or planned by government and suggestions for improving the quality of information and reporting provided to the House.

2.2 The purpose of this chapter is to provide updated and additional summary comments on the quality of accountability information and reporting to the House of Assembly, including the Province's financial statements.

2.3 Significant change continues or is planned in a number of programs and areas of the Provincial public sector. Adequate information and reporting on government's plans and performance (i.e., results or outcomes) are required, so the House can satisfy itself as to the effectiveness of these changes and the subsequent quality of performance or service levels in key areas.

2.4 Accountability, including the definition of basic accountability requirements in legislation, is a current topic of consideration in other jurisdictions. The need for quality accountability information and reporting is a significant issue in the public sector virtually everywhere.

2.5 In its simplest terms, accountability means the obligation to answer for an assigned responsibility. An accountability relationship involves at least two parties, one who allocates or assigns responsibility, and one who accepts it, with an understanding to report upon results or outcomes.

2.6 Exhibit 2.1 on page 24 provides a relatively simple two-dimensional overview of the key elements of an accountability relationship, including the role the audit function serves within it. This overview or model can be used when considering accountability at various levels within Provincial operations. For example:

- government's accountability to the House of Assembly;
- departments' and crown agencies' accountability to government;
- deputy head's or board's accountability to a Minister; and
- management's accountability to a deputy head.

2.7 Exhibit 2.2 on page 24 provides an overview of the accountability organization with respect to the Provincial public sector. It is not intended to present all parties or relationships involved, but rather to emphasize the various levels that exist and the fact accountability to the public is relevant at all levels.

RESULTS IN BRIEF

2.8 The following are the principal observations from this year's review.

- Significant progress is being made to improve the quality of accountability information and reporting by government. The improvements put in place - some supported by specific statutory provisions - coupled with those in progress or planned, put Nova Scotia in much more of a leadership role in relation to public sector accountability. In its 1995-96 report to the House of Assembly the Public Accounts Committee included a number of significant accountability-related recommendations which should be considered by government.
- Over the past 2-3 years, improvements made to the Province's financial statements have resulted in the Province's surplus/deficit and liabilities being accounted for and reported more completely and understandably than in the past. There are certain issues or concerns raised by this Office which have not yet been fully dealt with, including the need for full consolidated financial statements.
- The annual deficit of \$201,102,000 reported in the Province's March 31, 1996 financial statements includes \$50,913,759 of capital commitments as net capital expenditures. Although this one time adjustment is disclosed in the notes and supporting schedules to the financial statements, the capital commitments do not represent expenditures "incurred" during fiscal 1995-96, and reporting them as such is inappropriate. Further, reporting them as 1995-96 expenditures materially affects the reported results for that year, and in comparison to other years. As a result, the Province's results of operations for the year ended March 31, 1996 are not presented in accordance with the disclosed basis of accounting, nor are they reported consistently with the preceding year.

AUDIT SCOPE

2.9 The objective of this assignment was to review the status of action taken or planned to improve the quality of accountability information and reporting to the House of Assembly.

2.10 In addition to considering the planning and accountability initiatives undertaken by government, we have also reviewed and provide commentary on the Province's non-consolidated financial statements to be included in the *Public Accounts* for the fiscal year ended March 31, 1996.

PRINCIPAL FINDINGS

Significant Progress Being Made

2.11 For the House of Assembly to hold government to account, and for government to hold departments and agencies accountable, there must be an adequate standard framework in place requiring the provision of sufficient, appropriate, understandable and timely information or reports. Such a standard has now been defined. The *Planning and Accountability Framework*, which builds on certain initiatives that evolved from the integrated planning and budgeting process first used for the 1994-95 fiscal period, is a government-wide initiative being coordinated through the Priorities and Planning Secretariat. Government is continuing efforts to implement the various aspects of the framework and make necessary improvements, including an increased focus on defined outcomes at an overall government level as well as at the entity or program levels.

2.12 The improvements in place, coupled with those in progress or planned, put Nova Scotia in much more of a leadership role in relation to public sector accountability. It is acknowledged that the effective implementation of such improvements represents a significant challenge, requiring a sustained commitment. Based upon the information available to us, we believe the level of commitment in this regard is stronger than it has ever been in the past.

2.13 In 1995, the Public Accounts Committee (PAC) established a Sub-Committee to consider a number of topics relating to accountability. The Minister of Finance indicated support for the PAC's efforts in this regard. The Department of Finance, the Priorities and Planning Secretariat, and this Office provided staff support to the Sub-Committee. The PAC's report for 1995-96, which was tabled in the House in December 1996, included the Sub-Committee's report. While recognizing the improvements that had been made or were in progress, that report included a number of significant recommendations relating to the quality of accountability information and reporting to the House, including support for continued improvements to the Province's financial statements.

2.14 Appendix 2A on page 29 is a summary of the PAC's recommendations to the House of Assembly as a result of the deliberations of the PAC and its Sub-Committee. As part of its continuing efforts to implement improvements, we urge government to consider the various recommendations included in the PAC Sub-Committee report, including the further expansion and enhancement of statutory requirements associated with ensuring that the House of Assembly will receive quality accountability information and reports.

2.15 Certain significant accountability-related statutory amendments or provisions have been put in place in recent years which support the provision of improved and more timely information and reports to the House in selected areas. Further, the *Planning and Accountability Framework* initiatives will span a number of years and will support the provision of improved information and reporting on the plans and performance of government, including at the department or agency level.

2.16 There are various documents and reports currently available which can either directly or indirectly be utilized for accountability purposes. The timing of certain of these reduces their value to support an effective accountability review by the House of Assembly or its Public Accounts Committee. Further, some of these are not required by legislation, and as such are available at the government's discretion.

2.17 Annual reporting standards and practices of departments and agencies need to be updated, expanded and strengthened to support the provision of sufficient, understandable and timely information on the results or outcomes achieved in comparison to plans. Further, responsibility for monitoring compliance with annual reporting requirements needs to be clearly assigned. This is a point that has been made by our Office a number of times in the past, and we understand it is now being actively reviewed by government through the continued efforts of Priorities and Planning Secretariat staff as one of the *Planning and Accountability Framework* initiatives.

2.18 There are costs associated with such changes or improvements. However, the benefits of the effective implementation of improvements to the accountability process should outweigh the costs. In this regard one need only ask, *if previous governments had provided quality information on plans and performance, including complete and understandable consolidated financial statements, would we have started to face today's fiscal and related challenges earlier, or at least been better prepared to deal with them?*

2.19 Some may suggest this is hindsight. However, that notwithstanding, many of the fundamental challenges government now faces existed for some time and were created over many years, but the information and reports provided in the past did not effectively account for or disclose these matters.

Audit of the Province's Financial Statements

2.20 Section 65 of the Provincial Finance Act creates an audit reporting relationship which is unique in Canada. Nova Scotia is the only jurisdiction in Canada where the legislative auditor does not audit and provide an opinion on the financial statements. The Province's financial statements are audited by a public accounting firm and the auditors' report (opinion) is addressed to the Minister of Finance. The audit opinion in other jurisdictions is addressed to the House of Assembly (or its equivalent).

2.21 This Office has and will continue to place appropriate reliance on the audit of the financial statements as it relates to our mandate defined under the Auditor General Act. We will continue our efforts to monitor the results of this audit function and provide commentary on the overall completeness and adequacy of the Province's financial statements which are included in the *Public Accounts*.

2.22 In recent years we have made reference to the annual *Management Report* issued by the external firm appointed under Section 65 of the Provincial Finance Act. A draft of the *Management Report* resulting from the audit of the Province's March 31, 1996 financial statements was provided to us in March 1997, and will be considered during our audit planning for 1997. We are encouraged that Finance in collaboration with other departments has formally responded to the *Management Report*, which we understand will form the basis of an action plan.

Commentary on the Province's Annual Financial Statements

2.23 *Introduction and overview* - The Members of the House of Assembly (and the public) require financial information on and reporting of the Province's financial position and results - both plans and performance - on a complete, understandable and timely basis. This view is consistent with the recommendations made by the PAC's Sub-Committee in its report which was tabled in the House in December 1996. Among other things, that report provides recommendations dealing with improvements to the Province's financial statements, including consolidation and timely release.

2.24 Since 1993, the Report of the Auditor General has included commentary on the Province's annual financial statements, one of government's primary financial accountability documents. We have previously identified concerns relating to the completeness and adequacy of the Province's financial statements which are published in the *Public Accounts*. Over the past 2-3 years, improvements made to the financial statements have resulted in the Province's annual surplus or deficit and its liabilities being accounted for and reported more completely and understandably than in the past.

2.25 There are certain issues or concerns previously raised by this Office which have not yet been fully dealt with by Finance. Among these are the issues of full consolidated financial statements and certain costs and other adjustments being charged directly to the *Statement of Net Direct Debt* rather than being reported on the *Statement of Revenue and Expenditures* as part of the annual surplus or deficit. We acknowledge Finance has taken certain action with respect to these and, as we understand, intends to go further. Nothing short of full and complete accounting for and reporting of the Province's surplus or deficit and its liabilities should be considered acceptable.

2.26 Finance now includes a *Consolidated Financial Summary* in the *Public Accounts*. This represented an initial step toward full consolidated financial statements. However, until full consolidated financial statements are prepared, the Province's financial position and results of operations will not be reported completely. Finance has indicated that it wants to have consolidated budget information in place prior to moving to full consolidated financial statements. However,

we note that most other Canadian jurisdictions now issue consolidated financial statements without having implemented consolidated budgeting.

2.27 The timeliness of financial reporting by government has been less of an issue, to some extent, due to the Minister of Finance releasing the annual *Financial Report* (which has included the traditional non-consolidated statements for the Province) in August in recent years. In previous Annual Reports we have noted that the release of the *Financial Report* is discretionary (i.e., not required by statute), and that the *Public Accounts* cannot be released on a timely basis, due to the provisions of the Provincial Finance Act.

2.28 With respect to understandability of the Province's financial statements, by their very nature, the statements are a summary resulting from the selection of alternative accounting policies and disclosure practices. The impact or implication of these selections may not be fully understood or appreciated by other than a well-informed reader. This notwithstanding, one attribute of understandability that readers should be assured of is that of consistency. In situations where the government elects to change accounting policies, the onus is on it to ensure that such changes are appropriate, as well as fully and adequately disclosed in the notes to the financial statements themselves. In most instances, such changes should result in a retroactive restatement of the prior year's comparative data, so the financial statement readers are still presented with information on a consistent and comparable basis.

2.29 *Consolidated financial statements* - As previously recommended, full consolidated financial statements for the Province should be a primary financial accountability report for government. There is currently no legislative requirement for Finance to provide consolidated financial information. However, since 1993, the *Public Accounts* tabled in the House have included a separate *Consolidated Financial Summary*.

2.30 Note 1 to the March 31, 1996 financial statements indicates that the "*Province separately prepares consolidated financial information including the assets, liabilities, revenues and expenses of government entities; such consolidated information forms part of the Public Accounts as supplementary information.*"

2.31 We have previously acknowledged Finance's initiatives in this regard, and provide the following comments for consideration as efforts continue to improve the overall quality of the consolidated financial information available to the Members of the House of Assembly.

- Consolidated financial information, and preferably full consolidated financial statements, should be available publicly at the same time as the traditional non-consolidated statements. Reasonable effort should be taken to focus increased and appropriate attention on such consolidated financial information since it provides the "totals" as opposed to just part - albeit a significant part - of the Province's financial position and results of operations.
- In the *Consolidated Financial Summary*, the Workers' Compensation Board of Nova Scotia (WCB) and Halifax-Dartmouth Bridge Commission have not been accounted for as part of the Province's consolidated reporting entity. Both entities have significant liabilities which, in the case of the latter, are directly guaranteed by the Province.
- Significant adjustments recorded directly to net direct debt for purposes of the non-consolidated statements, have not been included in the consolidated (i.e., total) surplus or deficit of the Province reported in the *Consolidated Financial Summary*.

2.32 *Reporting of the annual deficit* - The Province's financial statements include a *Statement of Revenue and Expenditures* which now presents the annual surplus or deficit for a fiscal period in a more complete and understandable manner, more consistent and comparable to other jurisdictions. However, charges continue to be recorded directly to the *Statement of Net Direct Debt*, certain of which should more appropriately be included in the calculation of the annual surplus or deficit of the Province. Those charges for the 1995-96 fiscal period net out to only \$515,000, so the impact of reporting those items in the calculation of the annual deficit would not have been significant for that year. For the first time in many years the annual deficit reported essentially represents the changes to the Province's net direct debt.

2.33 Exhibit 2.3 on page 25 summarizes the changes to net direct debt as reported in the Province's financial statements in recent years. For purposes of the analysis we have used the same presentation of deficit used for the March 31, 1996 financial statements. However, we have not adjusted previous years' deficits for the improvements in accounting policies implemented since 1993.

2.34 Finance had previously indicated that since items such as pension valuation adjustments do not lend themselves to accurate and reliable budgeting, it is appropriate for them to be recorded to net direct debt rather than in the calculation of the surplus or deficit on the *Statement of Revenue and Expenditures*. We agree such items are more challenging to determine, both from a budgeting and an accounting perspective, than many other items. However, they still represent items that must be considered when assessing the financial position and fiscal performance of the government. Further, there are already a number of other revenue and expenditure items recorded to the *Statement of Revenue and Expenditures* for which estimation and accounting is relatively challenging or complex.

2.35 Finance needs to clearly define its accounting policy on what will be recorded directly to the *Statement of Net Direct Debt*. In this regard, we strongly recommend that, in the absence of extraordinary or retroactive adjustments due to changes in accounting policies, the annual surplus or deficit should be the only factor causing a change in the Province's net direct debt. All other items should flow through the *Statement of Revenue and Expenditures*, and be included in the determination of the reported surplus or deficit for a fiscal year. We acknowledge that implementing such a policy would represent some further challenges to the Province's annual budget preparation process. Finance has indicated that this is the reporting basis it intends to move towards over time.

2.36 *Completeness of reported liabilities* - There continue to be specific liabilities which have not been accounted for in the Province's financial statements or the *Consolidated Financial Summary*. For example, the following items have not been accounted for in the March 31, 1996 financial statements.

- *Workers' compensation liabilities* - The December 31, 1995 financial statements of the Workers' Compensation Board of Nova Scotia reported a significant unfunded actuarial liability. The WCB is a crown agency, but this liability is not reported in the Province's financial statements. The notes to the Province's *Consolidated Financial Summary* indicate the WCB is not considered part of the Province's reporting entity for financial statement purposes.

The financial statement accounting policies and disclosure practices for workers' compensation by governments vary significantly across the country. We will continue to monitor reporting practices in other jurisdictions in this regard.

In addition to the general unfunded liability, there are certain specific liabilities of the Province relating to workers' compensation which should be, but have not, been accounted for in the Province's financial statements. These included the Province's liability as a self-insurer, which has been estimated at \$25.5 million. This liability has not been accounted for in the March 31, 1996 financial statements of the Province, although it is disclosed in the notes to the financial statements.

- *Long-term disability* - We previously recommended Finance ensure its liability for long-term disability is appropriately accounted for or disclosed in the Province's financial statements. The notes to the March 31, 1996 financial statements disclose that *"the Long-Term Disability plan, which is funded on an equal basis by the Province and its employees, has an estimated unfunded liability as at March 31, 1996 of approximately \$45,000,000. The Province is not contractually committed to fund this shortfall; therefore, no liability is recorded in these financial statements."*

2.37 *Timeliness of financial reporting* - The Province's March 31, 1996 non-consolidated financial statements were released publicly August 8, 1996 as part of the Minister of Finance's *Financial Report 1995 - 1996, Hitting the Targets, Government by Design in Action*. This represents timely reporting, and would be even more noteworthy if there were consolidated financial statements provided at that time. Further, we acknowledge that under new provisions of the Provincial Finance Act the government is now required to provide quarterly financial reports to the House of Assembly on a timely basis. This is an important enhancement in the reporting process which will substantially improve the timeliness of financial information.

2.38 However, the Provincial Finance Act does not require (or allow for) the timely release of the *Public Accounts*. Section 10 of the Act requires that they be tabled or deemed tabled before March 31 but not before January 1 of the year following the fiscal year end to which they apply. The earliest they could be tabled is nine months after the year end to which they apply, which is not timely reporting. Ideally, the *Public Accounts* should be released at the same time as the annual *Financial Report*. Finance has indicated its support for changes such that the *Public Accounts* would be released prior to December 31.

2.39 On another matter regarding the timing of the release of the Province's March 31, 1996 financial statements, we note they were finalized and released despite the fact that spending authority for certain overexpenditures was still pending. The necessary spending authority for these expenditures was not received until November 1996 after a resolution under the Expenditure Control Act was approved by the House.

2.40 The notes to the Province's statements dealt with this matter as follows.

"An Additional Appropriation to authorize program expenditures to the extent of \$53.3 million for the fiscal year 1995-96 is required and planned to be obtained in the fall (1996) sitting of the Legislative Assembly. The majority of this expenditure was by the Department of Health (\$51.7 million). Authority for this spending is required from the House as per the Expenditure Control Act."

2.41 *March 31, 1996 adjustment for capital commitments (\$50.9 million)* - A significant issue was identified with respect to the Province's traditional non-consolidated financial statements which form part of the *Public Accounts* which will be tabled or deemed tabled prior to March 31, 1997. The matter relates to the decision to account for \$50,913,759 of capital commitments as liabilities as at March 31, 1996, and include them in the net capital expenditures reported for the year ended March 31, 1996. The reason for this treatment was identified in the notes to the

financial statements as being the result of a change in authority for capital spending from a two-year vote to a one-year vote.

2.42 As a result, net capital expenditures reported for 1995-96 were overstated in various departments as follows.

Department	Capital Commitments
Municipal Affairs	\$12,305,400
Supply and Services	14,474,800
Transportation	16,531,887
Health	<u>7,601,672</u>
	<u>\$50,913,759</u>

2.43 We understand that the decision to make this change in authority was based on the objective of achieving improved accountability and greater discipline in the management of capital projects. While we agree with this objective, we do not believe that deviating from the stated basis of accounting was appropriate.

2.44 Note 1 of the Province's financial statements titled *Financial Reporting and Accounting Policies*, includes a section titled *Basis of Accounting* which indicates "these accounts are maintained on an accrual basis, revenues recorded when earned and expenditures recorded when incurred."

2.45 The \$50.9 million adjustment is inconsistent with the Province's stated accounting policies, and is fundamentally wrong from an accounting principles perspective. The capital commitments do not represent expenditures "incurred" during fiscal 1995-96, and reporting them as such is inappropriate. Further, reporting them as 1995-96 expenditures materially affects the reported results for that year, as well as comparability to other years. As a result, the Province's results of operations for the year ended March 31, 1996 are not presented in accordance with the disclosed basis of accounting, nor are they reported consistently with the preceding year.

2.46 Exhibit 2.4 on page 26 summarizes the impact of the decision to account for the capital commitments in the manner chosen, including a focus on what the reported financial results would have been had the commitments been accounted for in a manner consistent with the "basis of accounting" and previous years. We have also included 1996-97 totals, based on the *Estimates* and assuming all the related capital projects will be completed in 1996-97 (i.e., the related expenditures will be incurred in 1996-97).

2.47 It is important to observe that if Finance had accounted for the \$50.9 million of capital commitments consistently and appropriately, the Province still would have reported progress towards government's stated goals of a balanced budget. Exhibit 2.5 on page 27 provides a graph showing the impact of the adjustment in this regard.

2.48 We have been provided with information and analysis of the capital projects making up the \$50.9 million. However, we have not been provided sufficient and appropriate support for recording the \$50.9 of capital commitments as liabilities as at March 31, 1996 or as capital expenditures for the 1995-96 fiscal period. The information received from Finance indicated that the recording of the capital commitments "does not materially misstate the province's financial position."

2.49 A decision as to what constitutes a material amount for the financial statements of the Province requires judgement and consideration of the interests and understanding of the users of the statements. For example, would a \$50.9 million change in the reported surplus or deficit significantly affect a financial statement reader's assessment of the Province's financial position or performance? In our view, the \$50.9 million of net capital expenditures being reported in 1995-96 as opposed to 1996-97 is material, and could affect a reader's assessment.

2.50 Further, it was indicated that the adjustment was disclosed in the supporting notes and schedules to the statements. Exhibit 2.6 contains extracts of the disclosure of the adjustment in the financial statements and the *Financial Report*. We also understand the adjustment was highlighted during the public release of the *Financial Report*. However, it is generally accepted that disclosure in the notes to financial statements is not a substitute for the use of appropriate accounting policies and practices.

2.51 Further, we understand that the impact of this adjustment on the forecast information for 1995-96 and the estimates for 1996-97 is reflected in the expenditure totals included in the 1996-97 *Estimates* tabled in the House, but there is insufficient explanation of the adjustment or its impact from a consistency or comparability perspective in the *Estimates*.

2.52 The implementation of a change in spending authority for capital from two years to one should more appropriately have been handled through the annual *Estimates* for 1996-97. Such would have preserved the consistency and comparability of the Province's financial reporting, while avoiding the use of an inappropriate accounting adjustment to the Province's liabilities and results for 1995-96.

CONCLUDING REMARKS

2.53 An effective accountability framework should provide or result in an appropriate balance of information and reports to the House of Assembly on the plans and performance of government overall and individual departments and agencies, both from a financial and a program delivery or service perspective. The goal is better information and reports, not just more.

2.54 There have been a number of significant initiatives undertaken to improve the quality and timeliness of information and reports available to the House and the public with respect to government's plans and priorities. The Department of Finance and the Priorities and Planning Secretariat have taken, and are still planning to take, steps to improve the nature and quality of the information and reports available, including an expanded focus on results and outcomes of departments and agencies in key areas.

2.55 An adjustment to record \$50.9 million of capital project commitments results in overstating the Province's liabilities as at March 31, 1996 and its expenditures for 1995-96. As a result, 1996-97 expenditures have been reflected in the annual deficit reported for 1995-96. This one time adjustment is inconsistent with the Province's stated accounting policies, affects comparability from year to year, and is fundamentally wrong from an accounting principles perspective.

2.56 As is my normal practice, Finance was offered the opportunity to respond to this chapter, as they have the responsibility for the financial statements. Their response, in the form of a letter from the auditors appointed under Section 65 of the Provincial Finance Act, is reproduced at page 31.

2.57 Contrary to the disclosure in the notes to the financial statements, the response states that the Province's basis of accounting has been changed and that capital commitments will be accrued

as expenditures in future years. This is contrary to generally accepted accounting principles and generally accepted accounting practices in the provincial and federal public sector.

Exhibit 2.1

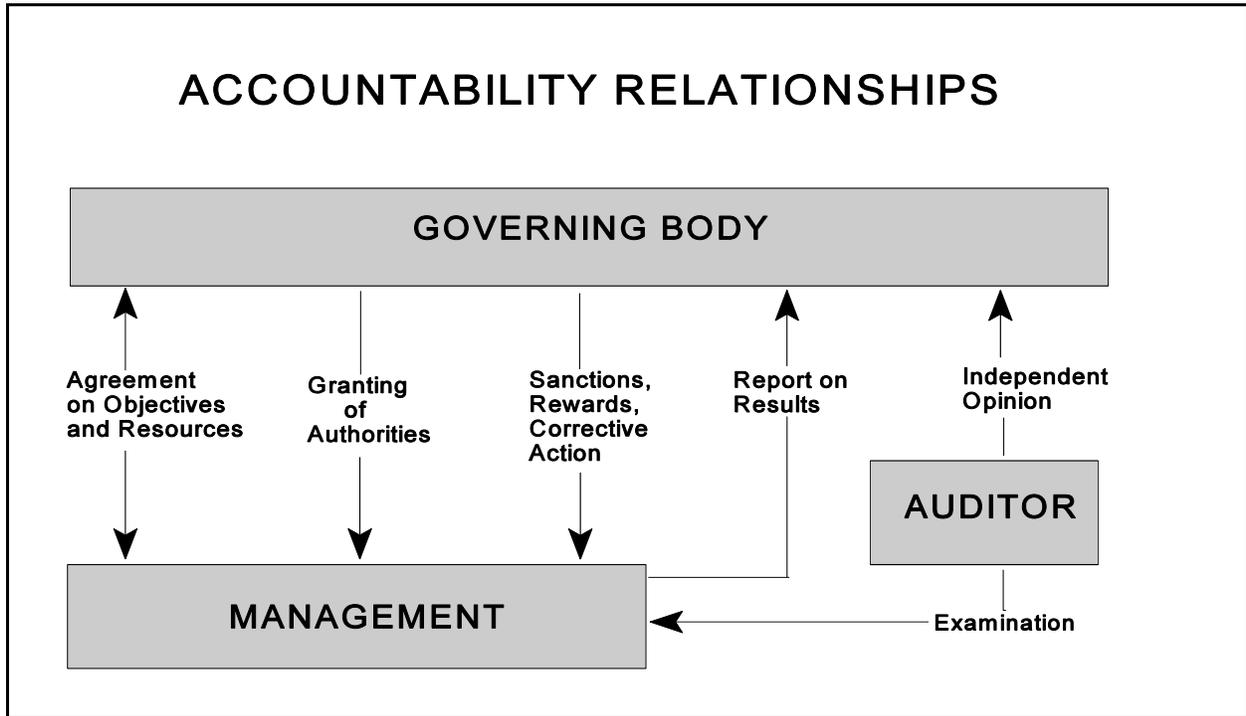


Exhibit 2.2

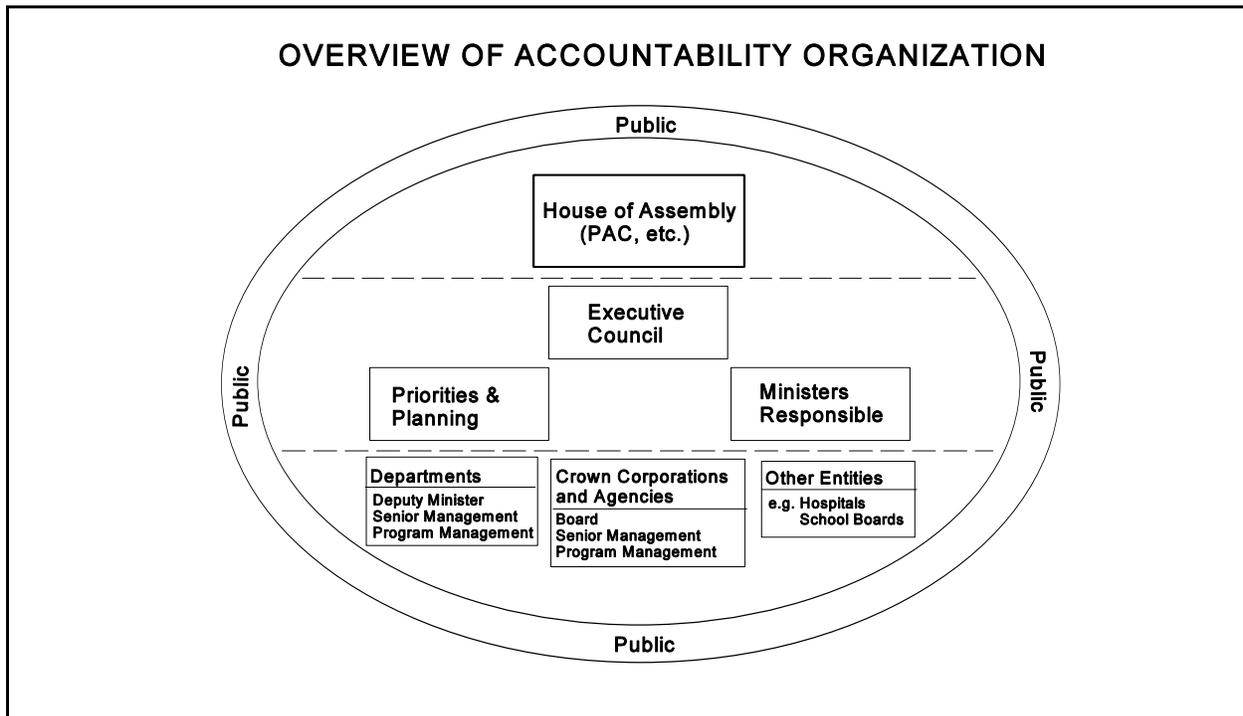


Exhibit 2.3

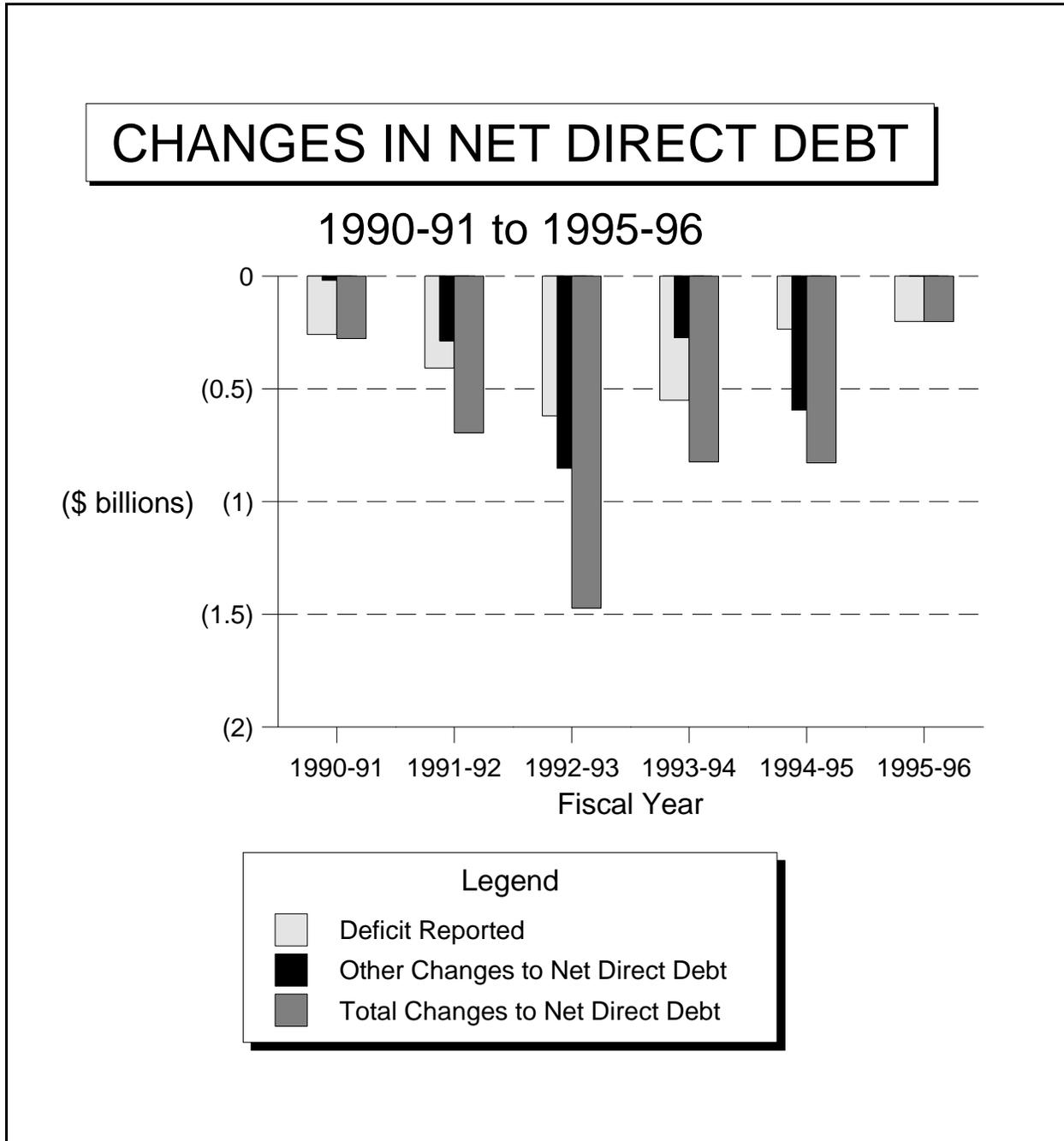


Exhibit 2.4

**March 31, 1996 Capital Commitment Adjustment
Analysis of Effect
(thousands of Canadian \$)**

Summary of the Province's Financial Results Reported*

	1994-95		1995-96		1996-97	
	Actual	Estimate	Actual	Estimate	Actual	Estimate
Current Account Surplus (Deficit)	\$ (84,745)	\$ (28,083)	\$ 101	\$ 40,076	\$ 101	\$ 40,076
Net Capital Expenditures	(260,196)	(284,980)	(317,603)	(159,175)	(317,603)	(159,175)
Sinking Fund Earnings	<u>109,870</u>	<u>129,800</u>	<u>116,400</u>	<u>121,900</u>	<u>116,400</u>	<u>121,900</u>
Budgetary Surplus (Deficit)	<u>\$(235,071)</u>	<u>\$(183,263)</u>	<u>\$(201,102)</u>	<u>\$ 2,801</u>	<u>\$(201,102)</u>	<u>\$ 2,801</u>

Restated

	1994-95		1995-96		1996-97	
	Actual	Estimate	Actual	Estimate	Actual	Estimate, plus commitments recorded as at March 31, 1996
Current Account Surplus (Deficit)	\$ (84,745)	\$ (28,083)	\$ 101	\$ 40,076	\$ 101	\$ 40,076
Net Capital Expenditures	(260,196)	(284,980)	(266,689)	(210,089)	(266,689)	(210,089)
Sinking Fund Earnings	<u>109,870</u>	<u>129,800</u>	<u>116,400</u>	<u>121,900</u>	<u>116,400</u>	<u>121,900</u>
Budgetary Surplus (Deficit)	<u>\$(235,071)</u>	<u>\$(183,263)</u>	<u>\$(150,188)</u>	<u>\$(48,113)</u>	<u>\$(150,188)</u>	<u>\$(48,113)</u>

* Based on non-consolidated financial statements and the support for the April 25, 1996 Budget Address.

Exhibit 2.5

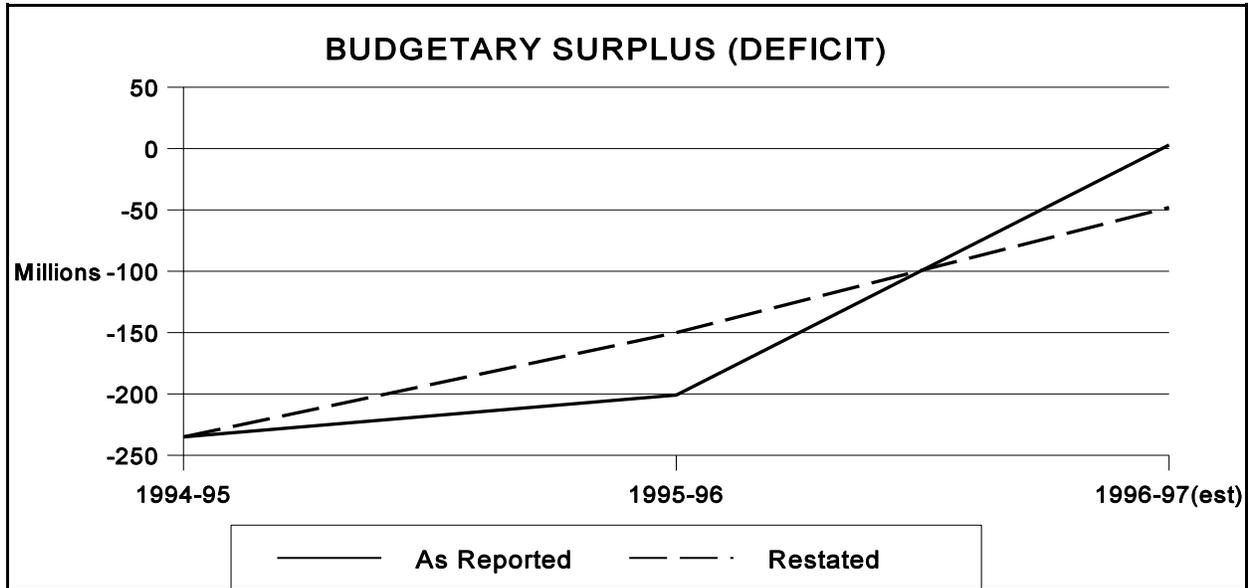


Exhibit 2.6**Extracts from 1995-1996 Financial Report
Re: Capital Project Commitments****Extract from page 10 of the Financial Report for 1995-96 - Capital Spending**

Net capital expenditures for 1995-96 of \$317.6 million exceed the budget level of \$285 million for an increase of \$32.6 million. This variance was caused by a change in budgeting authority, which requires capital items to be appropriated annually (versus a 2 year authority), commencing in 1996-97. This resulted in \$50.9 million of capital commitments being expensed in 1995-96, to facilitate the introduction of the new policy. Without this transitional adjustment, capital spending was underspent by \$18.3 million.

Extract from Note 5 to the March 31, 1996 financial statements re: Commitments

Due to the change in authority for capital spending commencing in the 1996-97 fiscal year, transitional funding has been provided whereby the province has incurred commitments to the extent of \$50,913,800, representing projects in progress as at March 31, 1996. This is in addition to the commitments referred to above.

Extract from footnote to Schedule 3 - Schedule of Net Capital Expenditures

Due to the change in authority for capital spending commencing in the 1996/97 fiscal year, the Province has expensed commitments to the extent of \$50,913,800, representing projects in progress as at March 31, 1996. These commitments have been recorded in the financial statements as capital expenditures for the year ended March 31, 1996 (see Note 5).

Appendix 2A**Sub-Committee on Public Accounts - Report - 1996
Summary of Recommendations****Overall Accountability Information and Reporting**

- I. The provision of sufficient, appropriate, understandable and timely (i.e. quality) accountability information and reports to the House of Assembly should be required by statute, but with the specific form and nature determined by government policy or other directives.*
- ii. Accountability information and reports should be available to the House of Assembly on the plans and performance of government overall as well as individual departments and agencies, both from a financial and a program delivery or service perspective.*
- iii. A comprehensive review and analysis of accountability related statutory provisions in place in other jurisdictions should be considered, and could support the development of draft statutory provisions/proposals for Nova Scotia.*
- iv. Departments and crown corporations or agencies (including inter-provincial crown entities with head-office operations outside of Nova Scotia) should be required to provide accountability information and reports to the House through a responsible Minister. For inter-provincial crown entities with head-office operations outside Nova Scotia the application of the provisions of the Auditor General Act and other provincial statutes need to be clarified.*
- v. If accountability information or reports will not be tabled when required, the House (i.e. to the Clerk of the Legislative Assembly) should be notified with a full and complete explanation, so Members will be made aware of the delay. This explanation should state an approximate date as to when the report requirement will be met.*
- vi. The statutory framework or standard shall also provide for timely interim reporting by government against its overall plans and budgets. The sub-committee recognizes the May 1996 amendments to the Provincial Finance Act require quarterly financial reporting on the state of public finances.*
- vii. Information in the Supplement to the Public Accounts, which traditionally has only included information about departments and agencies using Finance's central financial systems, should be required for crown corporations and agencies, and other Provincial public sector entities. Given the varied functions of such corporations, agencies and other entities, practical reporting requirement limits may vary from those required by government departments.*

Estimates and Budgeting

- viii. Additional appropriations and special warrants need to be reviewed by the House of Assembly on a more timely and effective basis. Where a department or agency has been allocated an additional appropriation the appropriation should be tabled in the House of Assembly or if the House is not sitting it shall be deemed tabled with the clerk of the House. The amount of the appropriation must also be included.*

Province's Financial Statements (i.e. the Public Accounts)

- ix. *Full consolidated financial statements for the Province should be a primary financial accountability report for government, and there should be consolidated estimate or budget information against which the actual financial position and results can be assessed by the House of Assembly.*
- x. *In determining the reporting entity for purposes of the Province's financial statements, as well as other accounting policy and disclosure decisions, the government should adopt the public sector accounting recommendations issued by the Canadian Institute of Chartered Accountants.*
- xi. *The annual surplus or deficit, in the absence of extraordinary or retroactive adjustments due to changes in accounting policies, should be the only factor causing a change in the Province's net direct debt.*
- xii. *The Provincial Finance Act should be amended so that the full Public Accounts (including full consolidated financial statements) are released at the same time as the annual Financial Report, or at least within nine months of year-end.*
- xiii. *The Auditor General should provide an opinion on the Provinces's financial statements to the House of Assembly on a timely basis. If the House is not sitting the report should be deemed tabled with the Clerk of the House.*

Annual Reporting

- xiv. *Annual reports (i.e. whether for government overall, its departments, crown or other agencies) should be tabled or deemed tabled in the House of Assembly within six months after the end of the fiscal year to which the reports apply.*
- xv. *If an annual report is not tabled by a defined deadline, a full and complete explanation should be tabled or deemed tabled in the House of Assembly. (See recommendation v. for further details.)*
- xvi. *There must be adequate policy direction and provision of government guidelines provided by the government to departments, crown or other agencies including direction on format and content of annual reports and other information to be provided to the House of Assembly.*

Auditor General's Mandate and Reporting

- xvii. *The release of the Report of the Auditor General should not be restricted or tied to specific actions or events the timing of which are controlled by government. In this regard, changes should be made to the Auditor General Act allowing the Auditor General to report to the House (table or deemed tabled) at least once, but no more than three times, each year, with the timing to be established at the discretion of the Auditor General.*
- xviii. *The results of any independent professional standards and/or peer review functions of the audit activities of the Auditor General should be made available to the PAC on a timely basis, along with the Auditor General's comments on action taken or planned to address improvements necessary.*

DEPARTMENT OF FINANCE'S RESPONSE

In reply to your offer to respond to your Annual Report, I request that the attached letter from Deloitte & Touche be printed in your Annual Report, as a direct response to your comments on "capital", contained in Chapter 2.

Thank you for your ongoing cooperation.

RESPONSE OF AUDITORS APPOINTED UNDER SECTION 65 OF THE PROVINCIAL FINANCE ACT

With reference to our meeting on March 17, 1997 in which you allowed us to read (but not retain) a copy of Chapter 2 of your Draft Annual Report relating to various accounting information matters of the Province of Nova Scotia ("Province"), we wish to express our significant concern with respect to statements made in your report dealing, in particular, with the transition in the Capital Vote carryover provisions that were initiated during the 1995/96 year.

Deloitte & Touche, in our capacity as auditors of the Province, issued an unqualified audit report on the Province's financial statements for the year ended March 31, 1996. In our opinion, these financial statements, in all material respects, present fairly the financial position and results of operations of the Province for that year. We stand by our opinion.

You have taken the position that the accrual for capital commitments of \$50.9 million as at March 31, 1996 materially affects the financial results of the Province for that year. We do not agree.

We wish to reiterate our comments to you at our March 17th meeting, in previous discussions and in our Management Report dated July 10, 1996 as follows:

- (a.) The accrual of \$50.9 million was a one-time transitional change, designed to facilitate improved accountability of the Province's financial affairs and reporting by moving from a two-vote system (operating and capital) to a single operating vote for all expenditures. This accrual reflects a more conservative accounting treatment by increasing the Province's deficit in 1995/96 by \$50.9 million. In future years, we have been advised by the Province, it is the Province's stated intentions to continue with this conservative accounting treatment and to accrue at year-end capital commitments which are verifiable and have received the requisite appropriations.*
- (b.) This change was clearly disclosed and noted in the financial statements along with the actual amount of the accrual so there was no question about the effect on the Province's financial position as at March 31, 1996; furthermore, this change was also specifically*

highlighted in the Government's public announcements when releasing the financial statements.

- (c.) The accrual of capital commitments was based on a detailed review of the projects at March 31, 1996 and included only those for which there were formal authorizations/signed contracts and/or purchase orders.*
- (d.) We performed a specific review of these projects, the resulting dollar amounts involved and the overall process as part of our examination of the Province's financial statements.*

We then addressed the impact of this one-time change in assessing materiality within the context of the Province's overall financial position. Our firm has adopted the following definition from the International Standards on Auditing (ISA) 25, "Audit Materiality", paragraph 3:

"Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size of the item or error judged in the particular circumstances of its omission or misstatement. Thus materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic which information must have if it is to be useful."

We interpret the term "economic decisions of users" included in the preceding paragraph as referring to the judgments and decisions made by a "reasonable" user. It is fair to assume that a "reasonable" user who may rely on financial statements is knowledgeable about them, at least to the extent of understanding their meaning and limitations.

Section 1000.17 of the CICA Handbook, in its definition of materiality, states that "materiality is a matter of professional judgment in the particular circumstances".

Total expenditures of the Province in 1996 (program, debt service and capital) amounted to \$4.169 billion. The accrual under discussion represents 1.2% of total expenditures. Based on our professional judgment, an accrual representing 1.2% of total expenditures is not material and would not be considered material by, or influence economic decisions of, an informed reader of the financial statements.

After examining all of these matters, and after taking all factors into consideration, it is our professional opinion that the results of this accounting treatment did not materially misstate the financial position or results of operations of the Province, as reflected in the financial statements taken as a whole for the year ended March 31, 1996.

3.

PROCUREMENT

BACKGROUND

3.1 The Government Purchases Act regulates the acquisition of goods in government. The Act assigns responsibility for acquisition of goods to the Government Purchasing Agency for the departments of government, and any board, commission or agency of government designated by Executive Council. The Public Tenders Office has responsibility for administering public tenders for goods and services over certain dollar limits. It also posts tenders and requests for proposals on the electronic bid notice system (EBNS) for departments which do not have direct access to this microcomputer-based tender information service. Both the Government Purchasing Agency and Public Tenders Office are part of the Procurement Branch of the Department of Finance.

3.2 The strategic plan of the Procurement Branch states:

“The Procurement Branch has responsibility for ensuring the acquisition of goods, services, construction and facilities by government departments, agencies, boards and commissions is conducted in a manner which is open, fair, consistent, efficient, and competitive. The role of the Procurement Branch is to provide operational assistance in procurement activity; to formulate and advise on policies and procedures governing the procurement process; to assist municipalities, academic institutions, school boards and hospitals (MASH Sector) in their procurement activities; to coordinate, with the Nova Scotia Economic Renewal Agency, the negotiation and administration of trade agreements as it relates to the public procurement function; to improve the procurement process by establishing quality assurance and standards for the acquisition of commodities and services; and to build public confidence in the integrity of public sector procurement processes.”

3.3 On January 1, 1996, the government released a *Policy on Government Procurement*. The Policy’s objective is “to establish and maintain a high level of confidence in the procurement process by ensuring that procurement is carried out in an open, fair, consistent, efficient and competitive manner.” The text of the objectives section of the Policy has been reproduced as Exhibit 3.1 on page 41. The Policy applies to all departments, agencies, boards and commissions effective January 1, 1996. Provincially funded public-sector entities such as academic institutions, school boards and hospitals (ASH Sector) must follow the policy effective June 1, 1996. The Policy does not, at present, apply to municipalities. For the purposes of the remainder of this chapter, the ASH Sector will include crown corporations.

3.4 The procurement of goods, services, construction, and facilities in government may be accomplished through the issue of an invitation to tender (ITT), a request for proposals (RFP) or through the use of a cooperative business solution (CBS) procurement process. An ITT is used when the requirement is adequately defined to permit the evaluation of tenders against clearly stated criteria and specifications. An RFP is used when a supplier is invited to propose a solution to a problem which has predefined criteria. The selection of the successful proposal is then based on the effectiveness, value and price of the proposed solution. The CBS process is used to address well-defined business problems for which the client has no preconceived solution. A supplier is selected, on the basis of qualifications and capability rather than price, to form a business alliance of shared risk, resources and benefit between the supplier and government. The goal is to develop an innovative and creative solution which provides fair value to both government and the supplier.

3.5 Limited resources have made it necessary for government to explore innovative ways to provide high quality services to the public and develop modern infrastructures. Public-private partnering (PPP) has been identified as one means of achieving this goal. Public-private partnering is characterized by the government and a partner establishing a formal relationship that shares the costs, risks and rewards on a project. These arrangements may involve varying degrees of private sector participation. Once it is decided to enter a PPP arrangement, the potential partners are identified through an RFP, CBS or a sole-source procurement process. However, whatever process is followed, it is important that the objectives of the *Policy on Government Procurement* are followed to ensure an open and fair process. We decided to include public-private partnering in the scope of this year's procurement audit.

3.6 The Procurement Branch is responsible for the procurement of goods in excess of \$1,000 and administering the public tenders for services and construction valued in excess of \$50,000 and \$100,000 respectively. During 1995-96 the Procurement Branch administered procurement of goods and public tenders for services and construction in excess of \$300 million.

RESULTS IN BRIEF

3.7 The following are the principal observations resulting from our examination.

- The Procurement Branch has taken significant steps to design and implement improved controls over the procurement process in the past few years. Through administrative refinements currently under development, staff expect that most outstanding control issues will be addressed within the next fiscal year.
- We reviewed a sample of CBS procurements. Our conclusions and recommendations were consistent with a majority of those identified in the Procurement Branch's 1996-97 internal review of the CBS process. The Branch's review was more detailed in certain areas which resulted in additional recommendations. Both reviews found instances where the CBS process was not properly utilized and all requirements in the process guidelines were not being followed. However, most of these deviations were not significant. As a result of these reviews, the Procurement Branch plans to release revised guidelines by April 1, 1997 which will provide improved guidance to departments with respect to the CBS process.
- At present there are no policies or guidelines established for government when considering and executing public-private partnerships. These are required to ensure efficient and effective arrangements. While steps have been taken towards addressing this concern, further efforts are required. In July 1996, the Executive Council approved the establishment of a Public-Private Partnering Task Force to champion and guide PPP in the Province and to assign responsibility for coordinating PPP to the Nova Scotia Economic Renewal Agency. As of January 1997, this task force had not been developed. Staff are in the process of searching for a chairperson to oversee the task force. The plan is to have the task force operational in 1997-98.

AUDIT SCOPE

3.8 The objectives of this assignment were to:

- review the internal controls established for the procurement function in government;

- ensure the CBS procurement process was properly utilized and that procurements using the CBS process complied with relevant guidelines; and
- review and assess the policies and guidelines established for PPP to determine if they ensure efficient and effective arrangements.

3.9 Our approach included interviews with senior management and staff of the Procurement Branch of the Department of Finance and the Nova Scotia Economic Renewal Agency. We examined relevant reports, proposals, procedure manuals, draft legislation and other documents.

3.10 We tested the operation of the controls over the procurement function which are administered by the Procurement Branch. We did not test the controls which are performed within each department, board, commission, or agency of government. The controls in place within ASH sector organizations and crown corporations were not reviewed during this audit. Audits of these entities, by this Office, may have included a review of procurement practices and controls. In such instances any procurement-related observations are reported in the Chapter dealing with the particular audit.

3.11 A new corporate financial management system (CFMS) for government is planned to be operational effective April 1, 1997. This system, combined with other process improvements the Procurement Branch has made, should enhance controls and accountability in government procurement. We could not audit the controls to be established with the CFMS since the processes to be followed have not been finalized and the system will not be operational until April 1997. Our conclusions about these controls are based upon discussions with staff and a review of draft documentation about how the system is to operate.

PRINCIPAL FINDINGS

Internal controls

3.12 *Overview* - We reviewed controls over the procurement function in government to ensure a fair, open and economical process is followed. This is the main objective of the Procurement Branch. We found the Procurement Branch has taken significant steps to improve control over the procurement function in the past few years and improvement continues to be an ongoing process.

3.13 *Controls* - Some of the controls we identified during our review include:

- *Policies and procedures* - The *Policy on Government Procurement* describes responsibilities with respect to the government procurement function and the processes which must be followed. It clearly demonstrates, to all involved, the integrity and ethical values expected. Draft amendments to the Government Purchases Act and Regulations and draft process and procedure manuals have been developed which will further strengthen procurement procedures.
- *Objectives* - The Procurement Branch has documented objectives and a strategic plan to guide efforts in achieving those objectives. Risks which could impact on the achievement of the Branch's objectives have been considered in the development of policies, processes and procedures to date and in the development of the strategic plan.
- *Feedback mechanisms* - There are adequate feedback mechanisms in place to support the flow of information between the Procurement Branch and others involved in the procurement process to ensure the Branch's objectives are met. This would include

providing suggestions for improvements and complaints as to non-compliance with policies and procedures.

- *Procurement of goods* - The Procurement Branch is responsible for the procurement of goods in excess of \$1,000. Through the central procurement of goods and the use of purchase requisitions and purchase orders, there are adequate checks and balances in place to ensure an open, fair and economical procurement process.

3.14 Opportunities for improvement - During our review we identified some opportunities where further improvements could be achieved including:

- *Reporting* - The *Policy on Government Procurement* requires Priorities and Planning Committee approval of all procurements which are sole-sourced, unsolicited proposals, or are awarded to other than the lowest tender, and approvals given must be reported to the Procurement Branch. However, the total procurement transactions in government is not accumulated and reported by the Province's current accounting system and there is no reporting to the Legislature or the public of exemptions permitted. To address this, Procurement staff have defined reporting requirements in the draft regulations and process manuals which would improve the flow of information for monitoring and accountability purposes. As well, the CFMS will provide the accounting information which is currently unavailable.
- *Outcome measures* - In its 1997-98 operational plan, Procurement included a requirement to develop outcome measures and an associated tracking system. While we recognize this is not a simple task, it is an important one for achievement of the objectives of the Branch. We encourage the Procurement Branch to complete this undertaking during the 1997-98 fiscal year.
- *Vendor complaints* - During our review of a sample of complaints, we found no instances where follow-up action was not appropriate or timely. However, in our view, a formal tracking and reporting process would support improvements in the accountability and overall control framework of procurement activities. This would include establishing a regular and formal process where the number and nature of complaints received, the departments involved, the follow-up action taken and the time frame for resolution are reported to the Executive Director of Procurement.
- *Procurement of services* - Responsibility for the procurement of services has largely been delegated to departments. Improvements in the control over the procurement of services, to ensure the process is fair, open and economical, are required. This includes the establishment of appropriate procedures to ensure specifications do not limit competition or exceed the needs of the department and that vendors being selected will be able to supply quality services. The Procurement Branch has identified this area as a priority and has undertaken a number of projects designed to ensure suitable practices are followed and controls are in place. These include the implementation of a quality assurance group, the creation of a procedure manual and draft procurement process guidelines, the release of RFP guidelines, and the implementation of an RFP evaluation practice by the Procurement Branch. As well, the new CFMS will provide the systems support to ensure there are adequate controls in the procurement process.

Cooperative Business Solutions

3.15 *Overview* - In 1994-95, the government introduced a new procurement method designed to assist departments in finding solutions to business problems. Traditional tenders and requests for proposals require detailed specifications for the goods or services required. This is only possible if the departments are able to precisely define their needs. Sometimes departments require more assistance from a vendor to determine the nature of a product or a service required to meet the department's needs. The Cooperative Business Solutions procurement method was designed for these situations. The challenge is to ensure there is an appropriate policy and control framework to support a fair and open process and ensure fair value is obtained.

3.16 The former Department of Supply and Services was responsible for developing the CBS process and guidelines, and initiated all the projects which are now in progress. Responsibility for the management of the CBS process was transferred to the Procurement Branch of the Department of Finance late in the 1995-96 fiscal year. The Procurement Branch has not approved any projects for the CBS procurement process since it took over administration. The Procurement Branch has determined that all projects brought forward as potential CBS projects could be achieved through a traditional request for proposals and accordingly the RFP process has been applied in these circumstances.

3.17 *Review of projects* - At the time of our audit, there were eight CBS projects which had been initiated. We reviewed one of these projects, Department of Justice - Registry of Joint Stock Companies Redefinition, last year and found it was in compliance with the CBS guidelines to the stage reviewed during that audit. This year we reviewed the six other projects which had produced signed contracts for the initial phase of the project. One project had not reached that stage yet. We also reviewed the Department of Justice project to determine if a post-implementation review was completed. The results of this review are discussed in paragraph 3.21.

3.18 Four of the six new projects reviewed did not comply with some requirement of the CBS guidelines. However, most of these deviations were not significant and the actions taken did not interfere with ensuring a fair and open procurement process. The Department of Transportation and Public Works - Management Information System had what we believe to be a significant deviation. The Priorities and Planning Committee did not approve the contract reached for phase one of the project. When a contract was created at the end of phase two of the project, Priorities and Planning Committee approval was obtained for that phase.

3.19 *Guidelines* - When the Procurement Branch took over responsibility for the CBS procurement process, it undertook an internal review of the process to identify any weaknesses in the procedures followed and to make recommendations to improve its efficiency and effectiveness. A report was prepared which included recommended changes to the CBS guidelines. We agreed with a majority of the recommendations in the Branch's report. The Branch's review was more detailed than ours in some areas and resulted in more recommendations. We also identified additional concerns with respect to control of scope and contract changes in CBS projects. Our concerns about scope and contract changes were discussed with Procurement Branch staff and they indicated these will also be addressed in the revisions to the guidelines. The revised guidelines are planned to be released by April 1997. There were five principal aspects of the current guidelines which we identified as requiring improvements.

- *Shared risk, resources and benefits* - The CBS process is supposed to be used by government to select a supplier with whom to form a business alliance of shared risks, resources and benefits resulting in a cooperative or partnership approach to the initiative. The existing guidelines are unclear with respect to this requirement. Of the six projects we reviewed this year, we found two where these circumstances did not exist.

- *Commitment of funds* - When a preferred supplier is selected, it is not an award to supply goods or services but the award of an opportunity to negotiate with the department to find a solution to its problem. As a result, the department should not purchase anything from the supplier unless the Procurement Branch is notified. Procurement will determine appropriate action which complies with the *Policy on Government Procurement*. These points are unclear in the current guidelines. We found one project where a purchase of \$79,000 was made without notifying the Procurement Branch.
- *Reference checks* - The CBS guidelines require that the references provided in the responses to the RFPs be checked. They do not, however, require that documentation be maintained on the results of this process. Of the six projects we reviewed, we found three where there was no documentation to support the results of the reference checks.
- *Negotiation time frames* - There needs to be additional guidance provided with respect to the negotiation stage of the CBS process. We examined four projects where the length of negotiations ranged from eight and a half months to eleven and a half months. There were a number of reasons identified, by departmental staff, for these delays including a lack of understanding by the supplier and the department about the CBS process, departmental inexperience in negotiations and inconsistent staffing of the negotiation team by the supplier and the department. Unnecessarily long negotiation time frames could result in extra costs for a project.
- *Scope and contract changes* - CBS guidelines should clearly indicate the process to be followed when a significant change is made in the scope of or contract for a project once it has been approved by the Priorities and Planning Committee.

3.20 *Fair value* - The revised CBS guidelines will stress the need to clearly define goals and outcome measures for a CBS project in the initial steps of the process. From our review of the CBS projects initiated to date, it is apparent that staff within the departments recognize the need to measure the outcomes of a project but the inclination is to leave this until the projects have progressed past initial stages. There were some outcome measures identified for the projects initially but not for all goals identified. We acknowledge that the identification of outcome measures is a challenging activity, especially at the beginning of a CBS project, but one which is necessary to allow for adequate accountability and the measurement of fair value obtained. The outcome measures identified early in the process do not have to be final. They should be allowed to evolve as the parameters of the project are more clearly defined. Fair value obtained is a key concern for CBS procurements since the proposals received are evaluated on qualifications and capabilities rather than price.

3.21 The Department of Justice - Registry of Joint Stock Companies Redefinition project is the only project to date which has been completed. The project was completed in July 1996. A post-implementation review has not been completed yet and, therefore, it is not possible to conclude whether fair value was obtained.

Public-Private Partnering

3.22 *Overview* - In the 1996-97 Budget Address, the Department of Transportation and Public Works was identified as having lead responsibility for creating new public-private partnerships in the Province. In July 1996 the Nova Scotia Economic Renewal Agency was assigned responsibility for coordinating public-private partnering (PPP) for government. Government's goal in using PPP

is to provide government services and infrastructure more quickly, efficiently and/or more cost effectively while encouraging sustainable economic growth.

3.23 *Inventory of projects* - Government activity in this area has increased significantly over the past few years and it is the intent to expand partnering activities. However, there is no up-to-date inventory of PPP projects which have been initiated by government. The government is accountable for the results of those projects and as such should be able to provide a list of all projects initiated and the progress and results of the arrangements. This should be addressed with the establishment of the Public-Private Partnering Task Force which is discussed in paragraph 3.25. It is intended that this Task Force will be involved with all significant PPP projects and these projects will be inventoried by the Task Force.

3.24 *Policies and guidelines* - There are no formal policies or guidelines established with respect to these partnerships. In order for the government to avoid or minimize potential risks involved in PPP, the process followed must be formalized, with a comprehensive policy framework and guidelines established. These guidelines should include criteria for identifying suitable PPP opportunities, evaluating proposals received, training requirements, risk identification and management, content and monitoring of agreements, an accountability framework, and post-implementation reviews.

3.25 Staff have recognized this weakness and have taken steps to address it. In August 1995 a discussion paper on public-private partnering was released to obtain feedback. This paper suggests some key components of a comprehensive corporate strategy and guiding principles to consider. The responses received from this discussion paper were considered in the creation of a proposal for PPP which was approved by the Executive Council in July 1996. This proposal addresses the need for formal policies and guidelines. It calls for the establishment of a Public-Private Partnering Task Force to champion and guide PPP in the Province. This Task Force will be in existence for approximately two years and according to the proposal will be responsible to:

- *"coordinate, promote and set standards for partnering initiatives;*
- *provide a focal point for proposals by government departments, the private or not-for-profit sectors and evaluate proposals against conditions for success;*
- *develop strategies, principles and guidelines in areas such as human resources, taxation, communications, legislative and regulatory changes and best practices for partnering;*
- *develop and promote educational and professional development programs across government including identifying people within each department to act as a liaison;*
- *promote partnering within Nova Scotia and on behalf of the Province in the national and international marketplace;*
- *seek out partnering opportunities and identify ways to enhance partnership projects currently under way; and*
- *examine the feasibility and sustainability of financial vehicles..."*

3.26 As of January 1997 a Public-Private Partnering Task Force had not been established. Staff are in the process of finding a Chairperson to oversee the Task Force. It is hoped that the Task Force will be operational in 1997-98.

3.27 According to staff of the Nova Scotia Economic Renewal Agency, the public-private partnering activities undertaken by government to date have been uncoordinated and unfocused, with individual departments assuming responsibility for managing the process and working in isolation. The scope of our audit did not include reviewing the practices followed in each PPP project. We did review the Highway 104-Western Alignment project. See Chapter 11, page 123 for the results of that review.

Other

3.28 *Emergency Health Services Air Medical Transport Program Request for Proposals* - In January 1996 a request for proposals (RFP) was issued for program management services for a comprehensive, fully integrated air medical transport program. It is estimated that the cost of these services will be greater than \$8 million over five years. None of the four supplier proposals submitted were accepted because they did not meet the RFP requirements.

3.29 We found there are no documented guidelines to follow when there are no successful responses to a tender call. Staff of the Procurement Branch indicated that the process followed depends on the situation and could include the RFP being re-tendered, cancelling the requirement or assessing a sole-sourced solution.

3.30 In this instance, the situation was appropriately considered to be an emergency and the Department of Health began negotiations with the top ranked vendor resulting from the RFP. Subsequently the second ranked vendor became involved in the negotiations and a contract between the Province and these two vendors was approved by the Priorities and Planning Committee as a sole-sourced procurement.

3.31 We recommend that guidelines be developed to ensure a consistent, fair and open process is followed when there is no successful response to an RFP.

CONCLUDING REMARKS

3.32 Significant improvements in the controls over the government procurement function have been made in the past few years. While there are some weaknesses in the present controls, steps have been taken towards eliminating a majority of them.

3.33 At this point, it is still difficult to determine if fair value has been obtained with the use of the Cooperative Business Solution procurement method. However, the Procurement Branch has taken significant steps to ensure fair value is obtained in future CBS projects.

3.34 With government activity in public-private partnering increasing in the past few years and the government's intention to expand its activity in this area, it is important that formal policies and guidelines be established to take maximum advantage of the benefits and avoid or minimize the risks involved. The establishment of the Public-Private Partnering Task Force is critical to addressing these concerns. We urge the Nova Scotia Economic Renewal Agency to complete the establishment of this Task Force on a timely basis.

*Exhibit 3.1***EXTRACT FROM
POLICY ON GOVERNMENT PROCUREMENT****POLICY OBJECTIVE**

The objective of this policy statement is to establish and maintain a high level of confidence in the procurement process by ensuring that procurement is carried out in an open, fair, consistent, efficient, and competitive manner.

The Government of Nova Scotia is committed to

- *ensuring that the government's requirements for goods, services, construction, and facilities are met through an open and fair process that provides the highest degree of competition and value to the Province*
- *ensuring that all bidders have reasonable notice and opportunity to tender*
- *fostering economic development by giving every capable Nova Scotia supplier the opportunity to do business with the government*
- *encouraging Nova Scotia businesses to be competitive and to sustain quality product development*
- *adhering to the Agreement on Internal Trade and the Atlantic Procurement Agreement, which create economic opportunities for Nova Scotians*
- *being accountable to the public for procurement decisions*

DEPARTMENTAL AUDITS

4.**EDUCATION AND CULTURE - REGULATION OF
PRIVATE TRADE SCHOOLS****BACKGROUND**

4.1 The Minister of Education and Culture is responsible for the Trade Schools Regulation Act enacted in 1986. The Act requires the registration of any school or home study course teaching a trade as defined in the Regulations.

4.2 The requirement to register does not apply to universities or schools established under separate legislation such as community colleges. Registration is also not required for schools that do not teach a trade. Registration is optional for trade schools offering programs with hours of instruction under certain minimums or with tuition fees under a certain dollar value.

4.3 The Act establishes the position of Superintendent of Private Trade Schools for the day to day administration of the Act. This position, reporting to the Director of Adult Learning and Innovation of the Department of Education and Culture (DOE&C), was being filled on a part-time basis at the time of our audit.

4.4 The Act also establishes the Provincial Private Trade School Board. The role of the Board is to provide advice to the Minister and decide appeals of Department decisions and includes the following:

- reviewing registration applications and recommending to the Minister whether a certificate should be granted;
- recommending to the Minister criteria for industry operating and performance standards including curricula, instructor qualifications and certification and diplomas; and
- recommending to the Minister legislative and policy initiatives.

4.5 Staffing consists of a Superintendent and three other staff. Only one of the three staff positions were filled at the time of our audit. Registration revenues total approximately \$9,000 per year. Exhibit 4.1 on page 51 includes several key statistics for the program.

4.6 Thirty private trade schools were registered under the Act in 1987 and the number had increased to 98 by 1996. The increase in the number of private trade schools operating in the province attests to the growth of the private training industry in the Province. A 1993 Canadian Federation of Independent Business survey of small and medium sized business operator/owners ranked private trainers as the most effective post-secondary training path in preparing young people for their role in the workplace.

RESULTS IN BRIEF

4.7 The following are the principal observations from our examination.

- The Department of Education and Culture prepared a strategic plan entitled *Toward a Learning Culture...* in 1994-95. This plan does not specifically address the role of private trade schools in achieving the Department's strategic goals or the role of the Department in regulating the private training industry in the post secondary education system. There is no mission statement or other study which identifies stakeholder groups, establishes regulatory needs and defines roles, responsibilities and accountability relationships in light of the strategic direction of the Department.
- Standards, for several occupations we encountered, had not been developed for many important areas including whether course curriculum meets minimum occupational requirements, in-service training, examinations, certification and diplomas. As a result, there is a danger of inappropriate or subjective judgements about these matters when recommending a registration application for approval. We have recommended that the Board prepare an inventory of those areas and occupations where standards are not in place and develop a plan to develop required standards.
- The Board has not recommended performance standards for trade schools to the Minister. As a result, the Department does not obtain and monitor performance and outcome measures for trade schools such as graduation rates and employment rates after graduation.
- The practice of registering non-trade schools exceeds the regulatory jurisdiction defined in the Act. We have recommended that the Department study the implications of broadening the scope of those subject to regulation and to seek appropriate legislative amendments.
- Registration information was verified in the past by performing a pre-registration inspection. Pre-registration inspections are no longer carried out because of staff shortages. In addition, at the time of our audit, post-registration inspections were carried out infrequently, usually triggered by a student complaint. Without the ability to at least spot check registration information, we have concluded that controls over the registration process are not adequate.
- Department staff historically conducted inspections to ensure school operations comply with the Act. The frequency of inspections has declined over the last year due to staff shortages. At the time of our audit, inspections were only being carried out in reaction to a student complaint. There is no Department policy regarding the frequency of inspections or the circumstances that might warrant an audit. We have recommended that the Department conduct a risk analysis and establish policies concerning the frequency of inspections and audits.

AUDIT SCOPE

4.8 The objectives of this assignment were to:

- determine whether the DOE&C is complying with the provisions of the Trade Schools Regulation Act and Regulations;

- determine whether registration systems and procedures are sufficient to ensure that all trade schools are registered and all revenue to which the Province is entitled under the Act is collected and accounted for; and
- determine whether procedures for certifying private trade schools are sufficient to provide for due regard for economy and efficiency in the expenditure of public funds.

4.9 The following general criteria were used in our review.

- Roles and responsibilities should be adequately defined and communicated.
- The Trade Schools Regulations Act and Regulations should be complied with.
- There should be adequate systems for registering and monitoring private trade schools which should ensure that schools are fulfilling agreed upon roles and responsibilities.
- The registration process should provide for a review of proposed courses by the relevant professional association to ensure that courses include the basic requirements for the occupation. In cases where there is no established professional association, there should be an alternate method of reviewing course proposals and content.

4.10 This was our first audit of this function at the DOE&C.

PRINCIPAL FINDINGS

Scope of Regulatory Activity

4.11 *Background* - Activities contemplated under the Act can be summarized as follows:

- a registrar function requiring the registration of private trade schools, their agents, and home study courses; and maintaining information about trade schools operating in the Province;
- a protection function for students including the regulation of prices charged for text books, the content of contracts between the school and the student, tuition refund policies and security bonds from schools; and
- a standards setting function including standards for curricula, instructor qualifications, equipment and facilities, text books, examinations and certificates and diplomas.

4.12 Trade schools must register under the Act to qualify students for Canada and Nova Scotia student loans, for Provincial and Federal sales tax exemptions, to issue income tax receipts to students, and to qualify for Federally funded training programs.

4.13 *Registration of non-trade schools* - Section 12(4) of the Regulations under the Act permits voluntary registration of trade schools offering programs with less than 81 hours of instruction or tuition of less than \$351. There is no provision under the Act or Regulations for the registration of schools which do not teach a trade.

4.14 We found 25 of 97 schools registered as of November 1996 did not meet the definition of a trade school as outlined in the Act and Regulations. Non-trade schools offer General Equivalency Diploma (GED) programs, general upgrading courses, and instruction on general purpose computer software. Non-trade schools seek registration under the Act for the reasons outlined in paragraph 4.12.

4.15 We have concluded that the practice of registering non-trade schools exceeds the regulatory authority defined in the Act. We have recommended that the Department study the implications of broadening the scope of those subject to regulation and to seek appropriate legislative amendments.

4.16 *Standards of operation* - Section 22 of the Act requires the Board to recommend to the Minister criteria for developing standards for trade schools and home study courses. Criteria include student recruitment, instructor qualifications, in-service training, curricula, text books, equipment, examinations, certification and diplomas. Establishing standards is a necessary first step to objectively assess whether a certificate of registration should be recommended for approval.

4.17 As a practical measure, the Department and the Board rely on the training standards set forth by professional associations. In addition, the certification and regulatory policies of other Federal and Provincial government departments often become minimum standards for certain occupations. If a professional association does not exist for an occupation or if criteria, standards or certification requirements have not been established by the professional association or by legislation, then it is the responsibility of the Board to recommend appropriate criteria.

4.18 At the time of our audit there were 89 registered trade schools teaching 17 occupations. Of the 17 occupations, 12 did not have professional associations to establish standards. Existing regulations contain standards for certain matters such as advertising practices, tuition refund policies and surety bonds. Additional standards for instructor qualifications, certification and diplomas are contained in draft regulations but have not been approved. We also found evidence that the Department contacts other government departments to determine certification requirements although these were not always documented and formally approved.

4.19 However, standards have not been developed for many important areas including whether course curriculum meets minimum occupational requirements, in-service training and examinations. As a result, there is a danger of inappropriate or subjective judgements about these matters when recommending a registration application for approval.

4.20 We have recommended that the Board inventory those areas and occupations where standards are not in place and prepare a plan to develop the required standards.

4.21 *Performance standards for trade schools* - Section 22 (1)(d) of the Act requires the Board to recommend to the Minister performance standards for trade schools and home study courses. The Board has not recommended performance standards for trade schools to the Minister. As a result, the Department does not obtain and monitor performance and outcome measures for trade schools such as graduation rates and employment rates after graduation.

4.22 *Other matters of non-compliance* - We found several other examples of non-compliance with legislation which are of lesser significance but which require remedial action by management. These included the areas of student age restrictions, the timing of board meetings, the requirement for the Superintendent to approve or initiate certain actions and defining the publication used to define a trade. Amendments to regulations under the Act were drafted in 1993 but have not received the approval of Executive Council. In some cases, staff are operating in accordance with the draft regulations rather than Regulations approved by Executive Council. We have recommended that the Department seek approval of proposed amendments to the regulations and ensure that operating practices are consistent with approved legislation.

Roles and Responsibilities

4.23 *Linkage of regulatory activity to Department strategic plan* - The Department of Education and Culture prepared a strategic plan entitled *Toward a Learning Culture...* in 1994-95. This plan does not specifically address the role of private trade schools in achieving the Department's strategic goals or the role of the Department in regulating the private training industry in the post secondary education system.

4.24 There are several stakeholder groups with an interest in the regulatory environment affecting private trade schools. These include industry associations, the Student Assistance Section of the Department which is responsible for the issue of student loans, Provincial and Federal government agencies that fund student placements in training programs, the private trade schools, the Superintendent and the Board. It is important that the roles, responsibilities and accountability relationships between these various groups be clearly defined. There is no mission statement or other study which identifies stakeholder groups, establishes regulatory needs and defines roles, responsibilities and accountability relationships in light of the strategic plans of the Department.

4.25 *Policies and procedures* - There is a lack of approved policies and procedures to direct Department staff in their day to day activities. A draft policies and procedures manual has been prepared but not yet implemented because it is based on proposed regulations not yet approved.

4.26 The draft policy and procedures manual appears to be complete and well written with the exception that it lacks a policy concerning confidentiality of applicant information. A confidentiality policy is important because private trade schools compete with community colleges and other post-secondary institutions funded by the DOE&C. Material received by the Department from private trade schools may contain confidential information about course content. We have recommended that the policies and procedures manual be approved as soon as possible. We have also recommended the development of a policy concerning confidentiality of applicant information.

4.27 *Accountability reporting* - The Board does not prepare a document outlining its plans and objectives for the upcoming year. Consequently the Board does not prepare periodic reports on its activities and accomplishments. Adequate accountability reporting should include a requirement to periodically articulate objectives and plans and report on achievements.

4.28 *Position descriptions* - Position descriptions of Department staff carrying out regulatory duties under the Act were prepared many years ago and are significantly out of date. Inaccurate position descriptions fail to define position accountabilities of staff and are ineffective in evaluating performance. Updated job descriptions were drafted three to five years ago, but never received approval. We have recommended that position descriptions be updated.

Registration Process

4.29 *Background* - Section 5 of the Act requires the registration of all trade schools and home study courses operating in the Province. Applications for registration and supporting documentation are submitted to the Superintendent. Documentation is reviewed for adequacy together with health and fire inspection reports. In addition, the applicant is required to post a performance bond. When the Superintendent is satisfied with the application, it is submitted to the Board for review. The Board, if satisfied, recommends that the Minister issue a certificate of registration which is signed by the Minister and Superintendent and issued to the applicant.

4.30 *Verification of registration information* - Registration information was verified, in the past, by performing a pre-registration inspection. Pre-registration inspections are no longer carried out

because of staff shortages. In addition, at the time of our audit, post-registration inspections were carried out infrequently, usually triggered by a student complaint. Without the ability to at least spot check registration information, we have concluded that controls over the registration process are not adequate.

4.31 *File documentation* - Registration information is retained in files organized by school. We examined 15 school files and found two cases where an inventory of training equipment was absent and one case where a student list did not contain student addresses. In another case, we could not locate board minutes or a copy of the registration certificate proving that the school had been properly registered. In some cases we had difficulty locating fire inspection reports. We have recommended that file documentation standards be strengthened.

Inspections and Audits

4.32 *Background* - Department staff historically conducted inspections to verify the accuracy and completeness of registration information and to ensure school operations comply with the Act. Inspections were usually conducted on a surprise basis and were typically up to one day in duration and documented in a one or two page inspection report. Until approximately one year ago, schools were inspected 2-3 times each year. The frequency of inspections has declined over the last year due to staff shortages. At the time of our audit, inspections were only being carried out in reaction to a student complaint. In addition, Section 15 of the Act permits the Minister to conduct audits.

4.33 *Follow-up of inspection concerns* - We examined all inspections carried out in calendar years 1995 (39 inspections) and 1996 (1 inspection). Only 7 inspections contained findings that required follow-up by the inspector. In one case, in May 1995, the inspector had concerns about classroom occupancy capacity and the storage of paints and oils which the inspector considered a fire hazard. There was no documentation in the file that these matters were followed up although the school did pass a subsequent fire inspection. We have recommended that the Department strengthen controls to ensure that all inspection findings are subject to prompt follow-up and that follow-up actions are clearly documented in the files.

4.34 *Inspection checklists* - There are no written inspection checklists in Department files. It was therefore difficult to determine what exactly had been verified during an inspection. In addition, inspection reports contained ratings of “very good”, “good”, “OK”, or “unsatisfactory”. Without a checklist it was difficult to determine how a particular assessment had been determined. We have recommended that an inspection checklist be developed to ensure the completeness, consistency and objectivity of the inspection process.

4.35 *Frequency of inspections and audits* - As indicated above, inspections were very infrequent at the time of our audit. Inspections were only being carried out as staff were available or when a student complaint was received. Department staff informed us that audits under Section 15 of the Act had never been conducted. There is no Department policy regarding the frequency of inspections or the circumstances that might warrant an audit. Department staff informed us that schools should be inspected at least once annually. We have recommended that the Department conduct a risk analysis and establish a policy concerning the frequency of inspections and audits.

Surety Bonds

4.36 *Background* - Each private trade school must provide a surety bond or irrevocable letter of credit as a condition of registration. Surety bonds expire yearly. The required amount of the bond is defined in the Regulations under the Act. The maximum and minimum bond amounts are \$50,000

and \$2,000 respectively. There has been only one instance since 1986 where a surety bond was liquidated due to a business failure. The primary purpose of surety bonds is to enable the refund of student tuition fees should the school cease to operate.

4.37 *Amount of surety bonds* - Regulation 9 of the Act requires the bond amount to be calculated as the tuition amount multiplied by the number of students from the previous year or the number of student places. The Department follows the practice of not including in the bond calculation students placed by Federally funded training programs. This exclusion is not specified in the Regulations and the impact can be significant depending on the number of Federally funded students. For four schools examined, the required bond amount was reduced by \$30,000 to \$40,000 by excluding these students. We have recommended that the Department review the existing Regulations and seek appropriate changes where required.

4.38 *Documentation of bond calculation* - We could not determine whether the amount of surety bonds for three schools examined complied with the Regulations because of inadequate documentation in the files. We have recommended that all school files document how the amount of a surety bond is calculated.

CONCLUDING REMARKS

4.39 A quality post secondary education system is important to ensure that the Province has a well trained work force capable of attracting business investment. The Department's strategic plan should consider the role of the private training industry in the post secondary education system and ensure that the regulatory activities of the Department are consistent with these plans.

4.40 There may be an assumption on the part of many, because of the wording of Section 22 of the Act, that the registration of a school provides assurance about quality of course content and teaching facilities and instructor qualifications. However because of the lack of quality standards in many areas, no such assurances can be given. Quality standards contemplated in the Act should be developed as soon as possible.

4.41 The Act requires regulation only of private trade schools. The Department has extended regulatory activity to include non-trade schools. The scope of the Department's regulatory jurisdiction requires reexamination.

4.42 The ability to effectively regulate private trade schools is dependent on the ability to maintain a certain level of inspection and audit activity. The Department has not rationalized its requirements concerning frequency of inspections and audits. There is a danger that inspection and audit activity will only take place when resources are available which may not be sufficient.

*Exhibit 4.1***SUMMARY OF KEY STATISTICS**

	1994-95	1995-96	1996-97
Number of trade schools registered	84	90	98
Budgeted expenditures of DOE&C related to Private Trade School regulation	\$287,900	\$162,700	\$168,900
Number of inspections completed	172	104	9*
Number of Canada/NS Student Loans issued to Private Trade School students	1,730	2,145	1,611*
Value of Canada/NS Student Loans issued to Private Trade School students	\$13,629,157	\$16,699,910	\$11,562,477*
Number of students attending Private Trade Schools	Not available	6,586	Not available
Annual tuition fees at Private Trade Schools			
High	Not available	Not available	\$13,600
Low	Not available	Not available	\$150

*These figures are for the 9 months ended December 31, 1996.

DEPARTMENT OF EDUCATION AND CULTURE'S RESPONSE

The Department of Education and Culture is responsible for the Administration of the Trade Schools Regulation Act. An audit, conducted by the Office of the Auditor General, presented a series of observations to the Department in January, 1997.

The Adult Learning and Innovation Division within which the Private Trade School section is located has established an action plan to address concerns raised by the Audit.

Recent reorganization within the Department will result in a new branch being established focusing on adult learning and training. The Private Trade School section will be located in this branch. Future departmental strategic plans will, therefore, have a specific reference to adult education activities.

There are a number of issues which are in various stages of completion that were observed as requiring attention in the audit. The Department is working with a number of professional associations, groups, and agencies to establish standards for program curriculum. A number of the issues identified will be dealt with via new regulations which are presently in draft form. A Policy and Procedures manual has been drafted, and will be published with the changes in the regulatory regime. The role of the Private Trade School Board is currently in the beginning phase of being reviewed by the Board and as this evolves, changes may be required to legislation and/or policies of the section. Other areas highlighted are in various stages of analysis; for example, the file documents and contents review is in progress; job descriptions have been completed and forwarded for review and approval.

The Department of Education and Culture will be taking action to review and implement actions to address the concerns that were raised and identified as requiring direct and/or immediate attention. The monitoring of private trade schools will become a priority in the 1997/98 fiscal year with a full complement of staff in place. A review of third party registration will be conducted by fall. The private training industry is a growth industry in Nova Scotia, and with this growth an ongoing review of administration requirements and legislation has been established as a priority for the Department of Education and Culture.

5.

EDUCATION AND CULTURE - TEACHERS' GROUP INSURANCE PLANS

BACKGROUND

5.1 The Department of Education and Culture makes payments for medical, dental, life and accidental death and dismemberment (AD&D) group insurance for active and retired teachers in the Province according to provisions of the 1994 Collective Agreement between the Minister of Education and Culture and the Nova Scotia Teachers Union. Although retired teachers are not specifically covered by the Collective Agreement, an arbitration decision related to a grievance filed pursuant to the Teachers' Collective Bargaining Act in 1992 concluded that *"the Employer is under a contractual obligation to pay health care premiums for retired teachers in full and that such obligation forms part of the existing collective agreement."*

5.2 Premiums paid by the Department of Education and Culture, teachers and school boards are remitted to the Nova Scotia Teachers Union (NSTU) Group Insurance Fund Trustees who are appointed by the Executive of the NSTU under the provisions of a Trust Deed dated 1965. The Province started paying premiums for the life insurance and medical plans for active teachers in 1973, for the retired teachers' medical plan in 1978 and for the dental plan in 1987.

5.3 The NSTU Group Insurance Fund Trustees (the Trustees) receive premiums and make arrangements with plan administrators and insurance carriers for insurance coverage. For the year ended April 30, 1995 the Trustees received \$9.8 million from the Province and \$7.2 million from plan members and school boards as premiums for the plans described above. The insurance carrier for the medical/dental plans is Maritime Medical Care Inc. (MMC) and Maritime Life is the current carrier for the life insurance plan.

5.4 The Trustees are also responsible for various other insurance plans available to teachers. For those plans, premiums are generally paid by teachers and the Province makes no contribution. Among those is a salary continuation (long-term disability) plan. The premiums for the salary continuation plan are cost-shared with teachers by some school boards under the provisions of local collective agreements between the school boards and the NSTU. Currently, the school boards fund approximately 24% of the total annual premiums of \$2.5 million.

5.5 The 1994 Annual Report of the Auditor General (page 11) reported that we had attempted to audit the NSTU Group Insurance Fund as a transfer payment recipient under Section 15(b) of the Auditor General Act. At that time, the NSTU denied us access to the Fund. Section 143(1) of the Education Act, passed in 1995, includes the following:

"The payments made by the Minister or a school board for all or a portion of the cost of any policy of insurance or any other benefits plan provided to teachers including, without limiting the generality of the foregoing, life insurance, accidental death or dismemberment insurance or medical and dental plans, are financial assistance for the purpose of the Auditor General Act and subject to audit by the Auditor General."

5.6 We requested audit access to the Group Insurance Trust Fund from the NSTU in the spring of 1996 and our request was granted. The audit was conducted during the spring of 1996.

5.7 On November 8, 1996 we issued a report on this audit to the Minister of Education and Culture under Section 9(3) of the Auditor General Act. The text of the relevant section of the Auditor General Act is included in Appendix I to this Report (page 242). On November 12, 1996 the Deputy Minister of Education and Culture sent a letter to the Executive Director of the NSTU requesting certain actions to deal with the findings in the Report. This Chapter summarizes the major points in the November 8, 1996 Report to the Minister and includes references to subsequent events to the date of writing of this Chapter in early 1997.

RESULTS IN BRIEF

5.8 The following are the principal findings resulting from our examination.

- We are unable to determine whether all premiums paid by the Province to the Trustees for medical, dental, life and accidental death and dismemberment insurance have been expended for the purposes appropriated by the Legislature because there are no agreements between the Department of Education and Culture and the Nova Scotia Teachers Union regarding ownership of experience rating refunds, dividends and accumulated surpluses and deficits for the group insurance plans. Premiums received from the Province have been remitted by the Trustees to the plan administrators and insurance carriers as appropriate.
- Experience rating refunds on the life insurance plan from 1973-1995 totalled \$2.4 million. The disposition of these refunds is not covered by existing agreements and the funds were expended by the Trustees on other than life insurance. Since the Province pays 76% of the premiums for the life insurance plan, the disposition of refunds should be covered by an agreement negotiated between the Department of Education and Culture and the NSTU.
- As at January 31, 1996 the group medical plan had accumulated a surplus of \$2.6 million which was being held by MMC for the plan. Since the Province contributes 60-70% of gross premiums, a written agreement regarding disposition of this and any future surpluses and deficits should be negotiated by the Department of Education and Culture and the NSTU. On October 25, 1996, subsequent to the release of our draft report from this audit to the Department of Education and Culture and the Trustees, a cheque for \$2,991,707 was issued by MMC to the Trustees for the accumulated surplus in the medical plan to April 30, 1996.
- The salary continuation plan generated approximately \$5 million of dividends from 1978 to 1995. School boards fund approximately 24% of the premiums for the salary continuation plan. The school boards and Trustees should reach an agreement regarding disposition of these dividends.
- At the time of our audit, the situation with respect to the submission of audited financial information to the Department of Education and Culture did not provide for adequate accountability for the expenditure of public money. This has since been resolved. On October 21, 1996 the Trustees submitted a complete set of audited financial statements for the Provincially-funded plans for the year ended April 30, 1996 to the Department of Education and Culture for the first time.
- The Trustees are meeting regularly and appear to be fulfilling their responsibilities for plan governance. However, the interests of the Department of Education and Culture were not effectively represented on the Board of Trustees by the government

nominee in the past due to the provisions of the Trust Deed and the agreement on confidentiality which the government nominee was required by the Trustees to sign. The Department of Education and Culture and the NSTU should explore alternatives to the existing Trust as a decision-making structure for the plans. The Trustees should be given better access to audited financial information and should be given the opportunity to meet with the auditors annually.

- Article 34.05(i) of the Collective Agreement committed the NSTU to cutting \$3.0 million from the medical/dental or life insurance plans. The wording of the Article is not precise enough to enable us to determine compliance. The Department of Education and Culture, subsequent to the date of our audit report, initiated a grievance under the Collective Agreement related to this matter. As at the date of writing of this Report, the Department and NSTU have not resolved this issue.
- Since August 1994 school boards and members have been paying premiums based on medical and dental plan costs before 1994 benefit reductions. If premiums had been billed based on the actual premiums charged by MMC since August 1994, the school boards and members would have paid a total of \$1.4 million less.
- We commend the Department of Education and Culture for initiating timely action on the findings in our Report to the Minister of Education and Culture dated November 8, 1996. Negotiations between representatives of the Department of Education and Culture and the NSTU commenced in November 1996 and were still in progress at the time of writing this Report. Other issues, particularly those related to governance of these plans, will be raised by the Department of Education and Culture in the Collective Agreement negotiations which will be taking place later in 1997.

AUDIT SCOPE

5.9 The objectives of this assignment were to determine:

- whether funds have been expended for the purposes for which the funds were appropriated by the Legislature and in accordance with the Collective Agreement;
- whether funds authorized to be expended by the Legislature have been expended with due regard to economy and efficiency;
- whether related financial information received by the Department of Education and Culture is appropriate;
- whether reserve funds held by the Trustees are necessary and in accordance with minimum levels as determined by the insurance industry and specific agreements;
- the ownership of accumulated reserves, surpluses or deficits; and
- whether the Trustees are fulfilling their responsibilities for effective governance of the insurance plans.

5.10 During the early stages of this audit, the Trustees and our Office agreed to limit the audit to the insurance plans for which the Province or school boards cost share premiums with members rather than the entire operations of the Trustees. The agreed upon scope is consistent with Section 143(1) of the Education Act.

5.11 Our audit approach included interviews of management and staff of the Departments of Education and Culture and Finance, the NSTU, the private insurance firm which administers the plans on behalf of the Trustees, the Trustees' external auditors and Maritime Medical Care Inc. We reviewed minutes of the Trustees' meetings, audited financial statements of the Nova Scotia Teachers Union Group Insurance Trust Fund since Provincial funds were first contributed to the plans, various reports and other documents.

PRINCIPAL FINDINGS

Compliance with Purposes for which Funds were Appropriated

5.12 *Overall conclusion* - We are unable to determine whether all premiums paid by the Province to the Trustees for medical, dental, life and accidental death and dismemberment insurance have been expended for the purposes appropriated by the Legislature because there are no agreements between the Department of Education and Culture and the Nova Scotia Teachers Union regarding ownership of experience rating refunds, dividends and accumulated surpluses and deficits for the group insurance plans. Premiums received from the Province have been remitted by the Trustees to the plan administrators and insurance carriers as appropriate.

5.13 The Trustees have indicated that when the Province began making contributions to the group insurance plans in 1973, the Province did not want to be involved in the administration of the plans. The Province wanted to pay the premiums and let the Trustees administer the plans. Therefore, the only aspect of the plans included in the Collective Agreement was the payment of premiums.

5.14 The following practices have developed over the years and are not included in provisions of the Collective Agreement or other written agreements between the Trustees and the Minister of Education and Culture.

5.15 *Experience rating refunds* - The Province pays 100% of the premiums for the life insurance plan for members funded by the Province. Since there are also plan members not funded by the Province, the Province paid 76% of total life insurance premiums for the year ended April 30, 1995. The plan is experience-rated which means that the Trustees are responsible for funding any deficit or refunded any surplus by the carrier at the end of the policy year. During the period from 1973-74 to 1994-95, the carrier refunded a net total of \$2.4 million to the Trustees as experience rating refunds. These funds and accumulated interest over the years were used by the Trustees to fund discretionary medical payments to members of \$2.3 million (payments for medical costs in excess of amounts covered by the group medical plan including ancillary benefits available to all teachers), deficits on the group medical plan of \$.5 million and renovations to the NSTU building of \$.2 million.

5.16 An amendment to the Trust Deed dated February 1994 gives the Trustees the mandate to approve discretionary medical payments. The Trust Deed is an agreement between the NSTU and the Trustees so the Department did not approve this amendment.

5.17 The Province of New Brunswick and the New Brunswick Teachers Federation have a similar life insurance plan for teachers. The brochure describing the New Brunswick plan for members clearly states "*The Provincial Government contributes 50% of the premium for \$50,000 life insurance and in return, receives 50% of all dividends.*" Since the Province pays 76% of the premiums for the life insurance plan, the disposition of refunds should be covered by an agreement negotiated between the Department of Education and Culture and the NSTU.

5.18 *Medical/dental plan surplus* - As of January 31, 1996 the medical insurance plan had accumulated a surplus of \$2.6 million due to positive claims to premium experience over the period since September 30, 1993. Prior to 1993, no significant surpluses were generated. The surplus was being held by Maritime Medical Care Inc. but it belonged to the plan, not MMC. MMC credited the plan with interest on the surplus. For the year ended April 30, 1995 the Province contributed 60-70% of gross medical premiums. The remainder was contributed by members and school boards. On October 25, 1996, subsequent to the release of our draft report from this audit to the Department of Education and Culture and the Trustees, a cheque for \$2,991,707 was issued by MMC to the Trustees for the accumulated surplus in the medical plan to April 30, 1996.

5.19 In the past, medical plan deficits have been funded by increased premiums in following years and by experience rating refunds from the life insurance plan as described above.

5.20 The dental plan had a surplus of \$13,276 as at January 31, 1996. For the year ended April 30, 1995 the Province paid 46% of total dental premiums. Since the dental plan inception in 1987, deficits and surpluses have been prorated between the Department of Education and Culture and the Trustees based on the percentage of premiums paid by each.

5.21 *Salary continuation plan dividends* - The Province makes no payments for salary continuation plan premiums. The premiums are cost-shared with teachers by some school boards under the provisions of local collective agreements between the school boards and the NSTU. Currently, the school boards fund approximately 24% of the total annual premiums of \$2.5 million.

5.22 The salary continuation plan generated approximately \$5 million of dividends (net of payments to the insurance carrier) from 1978-79 to 1994-95. Again, there is no agreement between the Trustees and the school boards governing the disposition of these dividends.

Financial Statements

5.23 Articles 34.06 and 34.07 of the Collective Agreement relate to the provision of financial information by the Trustees to the Department of Education and Culture. The requirement for audited financial statements (Article 34.07) was added to the Collective Agreement in 1989. The first audited Statement of Receipts and Disbursements was prepared for the year ended April 30, 1994 and submitted to the Department of Education and Culture in September 1995 in response to several requests from the Department.

5.24 At the time of our audit the situation with respect to the submission of audited financial information to the Department of Education and Culture did not provide for adequate accountability for the expenditure of public money. This situation has since been resolved. On October 21, 1996 the Trustees submitted a complete set of audited financial statements for the Provincially-funded plans for the year ended April 30, 1996 to the Department of Education and Culture for the first time.

Plan Governance

5.25 *Background* - The Group Insurance Trust Fund is governed by a board of six trustees appointed by the Provincial Executive of the NSTU pursuant to the Trust Deed. Trustees are members of the NSTU and selected based upon their perceived ability to represent the membership. There is no attempt to seek trustees with a background or expertise in business, insurance, investments, etc. Consultants are engaged to provide specialized expertise as required. Trustees are appointed for three-year terms which are renewable for another three years. They receive no remuneration for their services. We reviewed minutes of Trustee meetings and determined that the Trustees are meeting regularly and appear to be fulfilling their responsibilities for plan governance.

5.26 *Suggested improvements in governance process* - Trustees of the NSTU group insurance plans receive appropriate information to aid them in decision making and appear to be fulfilling their governance role adequately.

5.27 The Trustees are given little exposure to audited financial information. Audited financial statements are presented briefly by the plan administrators at Trustees' meetings but Trustees are asked to return the statements at the conclusion of the meeting which means that they are not given the opportunity to review the statements thoroughly. The Trustees do not have an audit committee and the auditors do not meet with the Trustees. The Trustees should be given the opportunity to keep the audited financial statements for review and reference and should be given the opportunity to meet with the auditors annually.

5.28 The Trustees indicated to us that, although Trustees cannot keep the full set of audited financial statements due to the confidential nature of the information, each Trustee may review the file copy at any time.

5.29 *Representation of Department of Education and Culture in governance process* - There is no written provision for the Department of Education and Culture to have any representation on the Board of Trustees. However, both the NSTU and the Department of Education and Culture agree that during the 1986 negotiations regarding the establishment of the dental plan a commitment was made to have a trustee nominated by the Department and appointed by the NSTU. That position was filled by two successive officials from the Department of Education and Culture during the period from 1986 to 1994. In late 1994 the Department of Education and Culture's nominee was removed from the Board by the NSTU and a replacement appointment has not been made although the Department proposed nominees and requested that the appointment be made. In May 1996 the NSTU asked the Department of Education and Culture to nominate a Trustee but the Department declined because it would like to consider a new governance structure for the plans.

5.30 As a condition of their appointment the Department of Education and Culture's nominees were required to sign an agreement with the Trustees respecting confidentiality which included a clause specifying that the Trustee "*agrees that he shall not ... divulge to any person whomsoever and shall use his best endeavours to prevent the publication or disclosure of any information concerning the business or finances of the Trust or any of its dealings, transactions or affairs which may come to his knowledge ...*"

5.31 In our opinion the agreement signed makes it impossible for the trustee nominated by the Department of Education and Culture to effectively represent the interests of the Department.

5.32 The Department of Education and Culture and the NSTU should explore alternatives to the existing Trust as a way of making major decisions for the plans. As the major contributor to the financing of the plans, the Department should have input into plan decisions such as rate structures, benefits covered and disposition of surpluses and deficits and should receive sufficient information to allow it to monitor the expenditure of public funds. Although the NSTU states that the level of benefit for the plans is currently negotiated between the NSTU and the Department of Education and Culture, the Department does not have sufficient information or formal input into the governance process.

Economy and Efficiency Considerations

5.33 For the year ended April 30, 1995 the Trustees recorded administration fees paid to the plan administrator of \$.5 million. The plan administrator has performed services for the NSTU plan since its inception in 1965. The Trustees' requirement for administration services has never been tendered or subject to a request for proposals.

5.34 We believe that the Trustees should explore alternatives to the current administration arrangement for the medical/dental plans to determine whether it would be possible to maintain an adequate level of service and reduce costs.

5.35 The plan administrators periodically conduct a *market test* for insurance carriers for medical/dental and life/AD&D insurance. The *market test* involves soliciting quotations from a number of carriers and was last conducted in 1992. Another *market test* was initiated in late 1996. This practice is useful in that it gives the Trustees current information on the market place and may result in cost reductions.

\$3 Million Reduction in Costs per Article 34.05 of 1994 Collective Agreement

5.36 *Interpretation* - Article 34.05(i) of the Collective Agreement was introduced as a result of the 1994 negotiations and commits the NSTU to cutting \$3.0 million from the medical/dental or life insurance plans. This provision has become very difficult to administer and a source of many conflicting interpretations between the NSTU and the Department of Education and Culture. An objective of this audit was to determine whether that Article of the Collective Agreement has been complied with.

5.37 The impact of the conflicting interpretations is that we are not sure which savings are to be included in a calculation of compliance with the Article. Possible alternatives are:

- total savings to the Provincially-funded plans (including savings to the Department, boards and members);
- total savings to the Department of Education and Culture and the school boards (excluding savings to individual members);
- total savings to the Department of Education and Culture; or
- total savings to the Provincial Treasury.

5.38 Our review of correspondence indicates that at some point each of these alternatives has been used by either the Trustees or the Department of Education and Culture in discussing this Article of the Collective Agreement.

5.39 Our conclusion is that the wording of Article 34.05(i) is not precise enough to allow us to determine compliance. Another factor to be considered is that the Department of Education and Culture has been withholding \$3 million a year from premiums billed by the Trustees to the Department. Therefore, regardless of the amount of benefits actually cut from the plan, the Department has saved \$3 million annually from the amount that would otherwise have been payable since April 1, 1994.

5.40 *Billing to boards and members since 1994 benefit cuts* - When the benefits were changed in August 1994, the premiums submitted to MMC were reduced to a rate which reflected the reduced benefit level (net rates). However, the premiums charged to the Department of Education and Culture, the school boards and the members were not reduced (premiums were actually increased in October 1994 to more than pre-August 1994 levels). The amounts billed by the plan administrators were approved by the Trustees and included in the Insurance Profile binders given to plan members. These billings were based on the original rates (gross rates) and not the reduced rates payable to Maritime Medical Care Inc. (net rates). The Department of Education and Culture deducted \$3 million annually from the billings received from the Trustees so the Department was not negatively impacted by the billing practice.

5.41 The result of this billing practice is that boards and members paid a share of costs related to benefits which had been reduced. For example, members with family medical coverage were charged a premium of \$48.46 per month (50% of total premium per Profile Book) when the amount paid on their behalf for premiums to MMC plus administration costs was actually \$39.23 per month (decreased because certain benefits had been de-insured). Note that some school boards pay the members' share as defined in local Collective Agreements between the school boards and teachers.

5.42 We believe that the practice of billing at gross rates is very confusing and not clearly communicated to the school boards and plan members.

5.43 The total amount billed to boards and members during the period from August 1994 to March 1996 using gross rates is \$1.4 million higher than if the rates had been reduced and the net rates used. The \$1.4 million remained with the Trustees (was not remitted to Maritime Medical Care) and was used to offset the \$6 million reduction in the Department of Education and Culture's contributions over the period as described in paragraph 5.40 above.

5.44 The Trustees indicated, in a letter to our Office dated May 9, 1996, that:

"In the matter of whether or not they [gross rate billings] constitute an overpayment, it is our position that they do not, at least, insofar as the Boards are concerned. . . . Article 34.05(ii) specifically required the Government to 'pass on in grants' [to the school boards] the sum of \$3,000,000. This, we are informed, has been done by the Department."

Developments After Issue of our Report to the Minister on November 8, 1996

5.45 On November 12, 1996 the Deputy Minister of Education and Culture sent a letter to the Executive Director of the NSTU requesting certain actions to deal with the findings in the Report. Negotiations between representatives of the Department of Education and Culture and the NSTU commenced in November 1996 and were still in progress at the time of writing this Report. Other issues, particularly those related to governance of these plans, will be raised by the Department of Education and Culture in the Collective Agreement negotiations which will be taking place later in 1997.

CONCLUDING REMARKS

5.46 Our conclusion is that significant improvements are required in the decision-making processes and agreements related to the NSTU group insurance plans. The Province currently pays approximately \$10 million annually or 58% of the total premiums for the plans and should be able to ensure that this public money is spent in accordance with the purposes for which it was appropriated by the Legislature and with due regard for economy and efficiency. A new governance structure for the Provincial plans is required to give the Province adequate representation. The Department of Education and Culture has indicated that it will raise this issue in the Collective Agreement negotiations scheduled for later in 1997 and we will revisit this matter after the Agreement is finalized.

5.47 The process of billing the Province, school boards, and plan members for premiums on the basis of gross rates should be changed. The gross rates are not indicative of the current premiums remitted to the insurance carrier and do not provide appropriate information to those receiving the premium bills.

5.48 We commend the Department of Education and Culture for initiating timely action on the findings in our Report to the Minister of Education and Culture dated November 8, 1996. Negotiations with the NSTU have continued for several months. Senior Department management are giving the negotiations a high priority and remain involved on an almost daily basis.

DEPARTMENT OF EDUCATION AND CULTURE'S RESPONSE

Thank you for your letter of February 6, 1997, along with a draft chapter of the 1996 Report of the Auditor General concerning surpluses in the Teachers' Group Insurance Plans.

As you point out, the details of this matter were brought to the department's attention on November 8, 1996. The department agreed with the report's conclusions and was obviously very concerned.

As a result, the department immediately took steps to attempt to resolve this matter. This led to active discussions between the Department of Education and Culture and the Nova Scotia Teachers Union, which are continuing. I want to assure your office that the successful resolution of the issues identified in the report is a high priority for this department and we will keep your office informed of the status of this matter.

The department appreciates the efforts of the Office of the Auditor General in undertaking and completing the audit of the Teachers' Group Insurance Plans. As well, thank you for your ongoing interest and for your assistance.

6.

EDUCATION AND CULTURE - UNIVERSITY GOVERNANCE STUDY

BACKGROUND

6.1 The Province provides about \$187 million in operating grants to universities in Nova Scotia on an annual basis. This represented approximately 40% of revenue received from all sources by these institutions in 1995-96 (see Exhibit 6.3 for more details).

6.2 The quality of university governance is an important factor in maximizing the value from this significant Provincial expenditure. This point has been clearly stated by one person as follows:

“The provinces have the major responsibility for university support in Canada. The challenge for provincial governments is to find ways of ensuring that universities do contribute to public policy objectives, and do so efficiently, while at the same time enhancing their capacity to make choices. . . Provincial governments need to be more precise about what they want universities to do and not do, if they expect responsible compliance.

Government can certainly do its part to strengthen universities. But the main challenge faces the universities themselves. What should they be doing? My own conclusion is that the single most important step would be to strengthen governing boards. This is the body most likely to command public (including government) confidence, while at the same time being in a position to understand the true nature and mission of the university. In short, the board can justify state support while respecting academic self-government. It is the critical linchpin.” (David M. Cameron in *Institutional Management: How Should the Governance and Management of Universities in Canada Accommodate Changing Circumstances* as cited in *Public Purse, Public Purpose: Autonomy and Accountability in the Groves of Academe*, edited by James Cutt and Rodney Dobell, The Institute for Research on Public Policy and the Canadian Comprehensive Auditing Foundation, 1992, p. 179)

6.3 This Office undertook a study of board governance at Nova Scotia universities in the fall of 1996. The purpose of the study was to gain an understanding of the university governance arrangements in the Province and to solicit the views of board members on certain issues impacting the role and effectiveness of university boards. We distributed a survey to board members of Nova Scotia universities and interviewed each of the Board Chairs and Chairs of Audit Committees. Survey results were analysed, and each board has been provided with the results from their institution.

6.4 In the 1990 Report of the Auditor General (page 104), we reported the results of an audit of certain areas at seven universities in the Province. We followed up on the results of that audit in our 1992 Report (page 56). During the current study we followed up on the degree of progress made in addressing certain of our 1990 recommendations.

6.5 We wish to express our sincere thanks to each of the board members who completed our survey and to all those we interviewed. All of the board members are volunteers - for some even travel expenses are not paid. As one board member noted *“Pay is low (nil) and talent is high. A lot of busy people give a lot of time without hope of reward or enjoyment.”* Many of the people we interviewed commented on the extensive time commitment required to fulfill their responsibilities as university board members. Each of the people we approached for an interview consented to meet with us. Without exception, the board members were open and cooperative. They expressed

concern about important matters such as quality of education and university finances. Their insights were invaluable to us in completing this study.

RESULTS IN BRIEF

6.6 The following summarizes our principal findings.

- A number of respondents were unsure of their accountability relationships to the Province and to the Nova Scotia Council on Higher Education (NSCHE). Many board members expressed a lack of clarity with respect to the role of the NSCHE. We recommend that the NSCHE, in conjunction with the universities, develop an accountability framework for universities including descriptions of roles and responsibilities (including those of NSCHE, the Maritime Provinces Higher Education Commission, and the universities), objectives, outcome measures and standards, and a reporting framework.
- When asked whether they had seen the NSCHE's vision document *Shared Responsibilities in Higher Education*, 25% of those responding to our survey indicated they had not seen the document. In fact, 24% noted their board had not discussed this document. Many indicated that the interaction between the NSCHE and the university was with the university president, rather than the board. Documents of this nature should be clearly communicated by the NSCHE to all university boards so that they may be reflected in university strategic planning processes and accountability frameworks. Communication between the Council and university boards should be reviewed to ensure boards are aware of vision and policy with respect to post-secondary education in Nova Scotia.
- University board members are aware of their governance responsibilities and have identified priority areas for board involvement at their individual institutions that are consistent with accepted governance principles. They are conscious of the need to separate themselves from the day-to-day management of the university and deal with strategic issues.
- Our survey results indicate that most universities engage in strategic planning exercises. However, these plans may not be translated into clear operational plans and targets. In our opinion, the linkage of strategic plans to clear operational plans is an important element of good governance.
- The performance of university presidents is not reviewed on a regular basis at some universities and we recommend that this be done. Boards should also consider a regular self-evaluation exercise.
- The NSCHE and the Maritime Provinces Higher Education Commission (MPHEC) have a number of initiatives in progress to improve the performance of the university system. These include a study on performance indicators, a study on reporting comparable financial costing information, a discussion paper on options for quality assurance and proposed changes to the university funding formula. We believe there is a need for these projects to proceed on a timely basis.
- Some university board members are appointed by Order in Council. University board members expressed dissatisfaction with the length of time that it takes to fill a vacancy requiring an OIC appointment.

- Although most universities offer orientation and professional development sessions for board members which are viewed as useful by the board members, there are some areas where improvements could be made. We recommend more emphasis on key governance literature, issues associated with conduct of board members (such as conflict of interest and fiduciary duties), and the relationship between universities and government.
- Universities have been addressing the significant recommendations made by their external auditors over the past three years according to the management letters written by the auditors. Some progress has been made in implementing our 1990 recommendations relating to increased comparability among financial statements, but there is still room for improvement in certain areas. Again, we recommend compliance with Canadian Association of University Business Officers' guidelines to increase comparability of financial information among universities.

SCOPE OF STUDY

6.7 The objectives of this assignment were to:

- gain an understanding of university governance arrangements in the Province;
- solicit the views of university board members on certain issues impacting the role and effectiveness of university boards, including:
 - board composition and development;
 - responsibilities and accountabilities of boards and board members;
 - board structures and processes; and
 - adequacy and timeliness of information received by the board; and
- gain an understanding of the degree of progress made in addressing our 1990 recommendations with respect to university financial statement matters.

6.8 Criteria for this assignment were taken from recognized sources such as those described further in paragraph 6.11.

6.9 In addition to the surveys, we interviewed board chairs and the chair of the audit (or finance) committee of the board. Their responses to our questions provided further insight into the issues under study. We also had discussions with management of the Nova Scotia Council on Higher Education.

PRINCIPAL FINDINGS

Background - Key Thoughts on Governance

6.10 In the not-for-profit sector, *governance is the fulfilment of responsible ownership on behalf of the community. It is the exercise, by the board of directors, of authority, direction and control over the entity.* (CCAF-FCVI Inc.)

6.11 The importance of governance in both public and private sector institutions has been widely addressed in many important publications in recent years. These include:

- Canadian Institute of Chartered Accountants' (CICA) *Guidance for Directors - Governance Processes for Control*
- John Carver's governance model for public sector and not-for profit organizations as documented in *Boards That Make a Difference*
- CCAF-FCVI Inc.'s *Six Characteristics of Effective Governance*
- Toronto Stock Exchange's (TSE) *Guidelines for Improved Corporate Governance in Canada*

6.12 Many of these publications have a private sector (for-profit) focus and some people believe that public sector (not-for-profit) organizations (including universities) are different from the private sector; that the governance principles included in these works are not as relevant to the public sector. John Carver in *Boards That Make A Difference* clearly articulates the major differences between public and private sector governance:

“From a governance perspective, then, the relevant factor that sets most nonprofit and public organizations apart from profit organizations is not in the essence of managing, for the principles of management are the same in each setting. The difference is not in distribution of earnings, for this is a matter of accounting rather than substance. What is different - with profound effects - is the lack of a behavioural process [market for its products] to aggregate the many individual evaluations of product and cost. The organization is adrift from the foundation that would enable it to define success and failure, to know what is worth doing, and in the largest sense, even to recognize good performance.

So the typical public or nonprofit board is faced with a challenge business boards never have to face...” (p. 7)

Survey Instrument

6.13 The survey instrument used in our study was based on a questionnaire developed by the Office of the Auditor General of British Columbia for use in its *Crown Corporations Governance Study* which was tabled in the British Columbia Legislative Assembly in November 1996. The B.C. questionnaire was modified to reflect the context of Nova Scotia universities. The survey was distributed to each of the university presidents for their input prior to mailing and their comments were incorporated.

6.14 The survey included 43 questions organized under the following headings:

- background information;
- board composition and development;
- responsibilities and accountabilities;
- board structures and processes; and
- comments.

Response Rate

6.15 We mailed 310 surveys and received 197 responses, a return rate of 64%. Our surveys were mailed to all the board members of eleven universities in the Province excluding those board members who are administrative employees of the university. (Since this survey was focussed on governance, we excluded those with management responsibilities in the university.) Note that the Nova Scotia Agricultural College does not have a board, and was therefore excluded from our survey. After excluding non-voting members of the boards, and also those who had been with the board for less than a year, we analysed 143 responses, or 73% of those received.

6.16 Exhibit 6.1 shows the distribution of responses from the universities surveyed. About 41% of those who responded had served with their board for between four to ten years, and 32% had served three years or less. A minority (9%) had served for over ten years and 18% gave no indication of their term of service.

6.17 Many of the board members who responded to the questionnaire were experienced as board members in other sectors. The majority (89%) had served on the boards of other not-for-profit organizations, while 44% had served on the boards of private companies and 28% had served on the boards of public companies.

Board Composition and Development

6.18 *Orientation and development* - The TSE Report recognizes the importance of board orientation as a means of providing information on governance-related issues to new members. *Guideline (4)* notes the following:

“Every corporation, as an integral element of the process for appointing new directors, should provide an orientation and education program for new recruits to the board.”

6.19 Our survey results indicate that most universities in Nova Scotia consider orientation important as well. The responses indicated that 71% of the board members were provided with an initial orientation. Although we noted that issues associated with conduct as a board member (such as fiduciary duties and conflict of interest) were not dealt with by all universities, 91% of the respondents indicated they understood their duties and personal responsibilities as a board member.

6.20 Continuing education is also important in the development of board members. The majority of respondents (60%) were provided some form of information session during the past two years, and 87% of those who attended found the sessions to be useful.

6.21 Our analysis showed that those board members who had orientation and development sessions indicated a greater degree of understanding of the decision-making powers of the board, the president, and the senate or academic council than those who were not provided such sessions.

6.22 We asked board members to indicate their familiarity with governance publications such as the TSE and CICA reports. They indicated that they were generally unfamiliar with these documents (no more than 30% of respondents were familiar with any of the publications noted in paragraph 6.11). Those who attended orientation and continuing education sessions did not indicate a greater degree of familiarity.

6.23 These governance publications provide detail on the roles and responsibilities of board members. Accordingly, we believe that it would be beneficial to increase the exposure of board members to accepted governance principles during orientation and development sessions.

6.24 *Board composition* - Universities in Nova Scotia are governed by boards who are appointed through their respective enabling legislation. Appointees may be representatives of faculty, students, alumni, sponsoring or founding organizations such as churches, or they may be appointed by a board nomination process or the Executive Council. Exhibit 6.2 details the nature of appointment for those who responded to our survey. There are wide variations in the relative proportions of each type of appointment at individual universities.

6.25 As noted in Exhibit 6.2, 21% of the respondents indicated that they had been appointed by the government (Executive Council). When asked whether there should be government-appointed

members on university boards, it was evident that there are divergent points of view on this issue. Forty-one percent disagreed with the concept while 34% agreed. Many of those we interviewed did not think there was a difference in the roles of government appointees to the board and other board members as demonstrated in paragraph 6.65. One board member indicated that government appointees should be civil servants. Another survey respondent noted the following:

“I think it would be helpful to have a representative of the Government of Nova Scotia, specifically a person in authority and knowledgeable in government/policy on the Board. This would facilitate better communication between government or the council and the Board so as to improve decisions. There is a void now and much is left to the interpretation of the administration.”

6.26 Several interviewees noted that there is a problem with the process for appointments made by Executive Council. One board member made the following comment:

“The government has taken far too long in making OIC appointments and has left us with unnecessary vacancies. These positions would already have been filled by qualified persons if the Board itself made these appointments.”

6.27 Another board member noted that it may take six months to make an OIC appointment. We believe that Executive Council appointments to university boards should be made on a timely basis to ensure that boards are adequately staffed to perform the important tasks for which they are responsible.

6.28 *Members’ liability* - One of our survey respondents expressed the following serious concerns about the issue of directors’ liability.

“The impact of the societal trend to blaming others and litigation is to make the position of a director less tenable as time goes on...”

The public - if it wants good boards for public institutions, should indemnify board members except in cases of blatant disregard of public safety.”

6.29 The Toronto Stock Exchange has addressed the issue of directors’ liability. As the TSE *Guidelines for Improved Corporate Governance in Canada* notes, “The concern for corporate governance is that increasing personal liability of directors compounds the difficulty of recruiting qualified individuals to serve as directors.” A recent revision to the *Government of Nova Scotia Management Manuals* (Manual 500) indicates that:

“Where specifically stated in the appointment, the Province will defend, negotiate, or settle claims or charges made against a person appointed by the Province to any board, including board of directors of a corporation, commission or agency, and indemnify them from personal liability, provided the Province is satisfied the claim arises out of the person’s activities in relation to the appointment, and is not based on fraud or criminal activity.”

6.30 Currently, the decision to provide directors’ liability insurance rests with the individual university.

Responsibilities and Accountabilities

6.31 *Whose interests do board members represent?* - During our interviews, many alluded to the makeup of university boards as an inherent difficulty in achieving good governance. One person drew the analogy between university boards and a manufacturing company where the board would

be made up of consumers (students in a university setting), representatives from the employees' trade unions (faculty and other employees), government and others. The typical corporate board is comprised of owners and others selected by the owners to represent their interests. Obviously, governance would be more difficult in the hypothetical manufacturing company because of the multitude of stakeholders and interests. In the corporate world, profit for the owners is usually the dominant interest, but once the board membership is broadened the ultimate goal becomes less clear.

6.32 One survey respondent made the following comment with respect to the composition of the board:

“I find that the fact that individuals are appointed to the Board on behalf of particular interest groups results in individuals sometimes acting in those interests rather than the broader public interest.

A Board which is diverse in nature by selection rather than divided by accountability of its members would be more effective.”

6.33 Our survey asked university board members whose interests they thought they must primarily represent. The top three responses were:

- the university as a whole;
- students; and
- the public at large.

6.34 However, when responses to this question were analysed by source of appointment (Exhibit 6.2), it became obvious that faculty and alumni answered this question differently from other board members. Eighty-eight percent of faculty listed faculty as one of the top three interests they must represent, and 64% of alumni listed alumni as one of the top three interests.

6.35 The TSE Report provides clarification regarding whose interests directors on private sector boards should represent. It notes *“The business corporations statutes require directors to act ‘with a view to the best interests of the corporation.’”* We were encouraged to see that this attitude exists among those who govern Nova Scotia universities, although there may be specific instances where certain board members put the interests of the group they represent first.

6.36 *What areas do board members identify as important for overseeing the direction of the university?* - When asked this question, more than 90% of board members responded that the following areas were very important or somewhat important:

- selecting the President;
- setting strategic directions and goals;
- ensuring the university has adequate resources;
- evaluating the performance of the President;
- participating actively on committees;
- monitoring the achievement of goals and objectives;
- ensuring accountability obligations are discharged;
- lobbying for change in government policy; and
- acting as “watchdog” on behalf of the public interest.

6.37 We concluded that board members who responded to our survey were largely consistent with governance literature in terms of what they considered to be important in their role as governors.

6.38 Overall, it appears that board members view themselves as strategists. They recognize that their role is to provide direction to the university president. They consider it important to monitor

the achievement of goals and objectives and to leave the administration of the university to management, which is appropriate.

6.39 We determined through our interviews with board and audit committee chairs that most universities engage in strategic planning exercises and that these plans are revisited and updated on a regular basis. One respondent noted that “... *planning strategies...will enable the university to continue to provide and improve the best post-secondary education to its students.*”

6.40 The survey results provide some indication that strategic plans may not be translated into clear operational plans. Specifically, about 35% of the respondents disagreed with the statement or were not sure when asked to reflect upon whether performance targets had been identified for the university or whether operational plans were closely linked to the university’s strategic plan. In our opinion, the linkage of strategic plans to clear operational plans is an important element of good governance.

6.41 Finally, the importance of the relationship between the president and the board is evidenced by the fact that 99% of those who responded thought it was very important or somewhat important that the board be involved in selecting the president. Although most also thought the board should evaluate the performance of the president, only 54% of the respondents noted that the performance of the president *is* reviewed on a periodic basis, and through interviews we determined that this review usually takes place when the term of the president is up for renewal. In our view, there should be a formal evaluation of the president on a regular basis with mutually agreed-upon objectives, action plans and target dates resulting from that process. Boards should also consider undertaking periodic self-evaluations as most respondents indicated this should be done but presently was not.

6.42 *To whom are university boards accountable?* - The accountability relationship is clearly defined in a private sector corporation; the board is accountable to the shareholders. In a university setting, the relationship is not as clearly defined and in fact there are many groups to whom individual board members may feel they are accountable.

6.43 When asked about their present accountability to various stakeholders, board members ranked the possibilities as follows (in order of most to least support by board members):

- the university;
- the students;
- the public;
- the government;
- faculty;
- the Nova Scotia Council on Higher Education; and
- management and staff.

6.44 Only about 64% of the respondents believed they were clear as to their accountability responsibilities. We noted that there were some significant differences between board members’ views on accountability which appeared to relate to the source of the appointment to the board. For example, fewer faculty members indicated that boards are accountable to students, faculty, the university, and the public than other respondents. Alumni were more likely to indicate accountability to students, and less likely to indicate accountability to government than other sectors of the population. Eighty-three percent of those appointed by the Governor in Council thought they were accountable to the government whereas only 64% of the total responses recognized that accountability.

6.45 *How do university boards discharge their accountability obligations?* - CCAF-FCVI Inc. in its *Six Principles for Effective Governance* notes the following “*Governing bodies fulfill their accountability obligations to those whose interests they represent by reporting on their organization’s performance.*”

6.46 Responses to the survey indicate that many board members are unclear as to how their board’s accountability obligations are discharged. Most (a total of 64%) disagreed with or were unsure whether their board had developed guidelines for information to be provided to key stakeholders, and only 38% thought the information provided was sufficient to provide an evaluation of how well the university had performed. Those we interviewed thought their university’s annual report (if prepared) was the key accountability document provided to stakeholders. However, we have seen little evidence of comprehensive performance reporting. For example, as universities do not generally track outputs such as graduate satisfaction, post-graduate study and employment results, we question the ability of any reports currently produced to provide substantive support for an institution’s effectiveness. We recommend that guidelines be developed by individual boards to facilitate the provision of adequate information to stakeholders including the NSCHE. This is discussed further in paragraph 6.61.

6.47 In 1995 the Maritime Provinces Higher Education Commission (MPHEC) funded a study to determine the information requirements for Maritime universities in light of growing demands for enhanced accountability of public institutions. The report resulting from that study recommends a significant number of performance indicators, some of which will measure outcomes. A consultant has been hired by the MPHEC to further discuss information requirements, including performance indicators, with governments and universities in the Maritimes. MPHEC recently released a discussion paper on “*Options for Quality Assurance in Higher Education in the Maritimes*”.

6.48 In addition, a survey of 1995 graduates of 17 universities in the Maritimes one year after graduation was conducted on behalf of the MPHEC in 1996. Its objectives included providing additional information on outcomes including labour markets, student debt loads and graduate satisfaction. The survey results were released in late 1996. Although this study included graduates of all Nova Scotia universities, the results were not reported by university.

Board Structures and Processes

6.49 *Board committees* - Establishing the proper committees is critical to effective board operations. Our interviews revealed that a significant amount of board work is delegated to committees and our survey results indicate that the vast majority feel the authority of the board and that of committees is clearly defined.

6.50 Board members in our survey said it was a board member’s responsibility to participate actively on committees and 75% of the respondents indicate that they also sit on one or more board committees. We observed that those who did sit on committees were more inclined to think that the board had established proper committees and that those committees were doing a good job of carrying out their responsibilities.

6.51 *Board information* - Our survey results indicate that there is a high level of satisfaction with the information being provided to boards for use in decision-making. Information is considered to be sufficient and relevant by 81% of respondents, and received in a timely manner. They generally feel they can request, and do receive, information they require from management.

6.52 *Financial information* - Board members are generally satisfied with the detail they are provided with on the costs of programs and faculties, and administrative and academic costs, but are

less satisfied with the information provided on the costs of courses. One board member noted he would like a better breakdown of course and program costs to benchmark against other similar institutions.

6.53 We are aware from our interviews and survey results that universities are not providing information on the costs of individual courses, and therefore these inputs are not being monitored by boards. Only 20% of board members responded that monitoring other inputs such as enrolment levels and class sizes is very important to overseeing the direction of the university. Information on these inputs would seem relevant to decision-making at these institutions, especially in view of the fact that outputs are not being tracked as noted in paragraph 6.46 above.

6.54 Despite the fact that there is general satisfaction with the financial information produced, some board members indicated a need for major changes. For example, one board member responded as follows:

“The rationalization efforts of government have lacked any clear definition, have not been based on empirical analysis. With no clear objective and no meaningful cost analysis of how various universities use the funding provided the rationalization process can only result in uninformed change...”

In the rationalization process and consideration of funding formula changes government must ensure that the process rewards efficiency and effectiveness. I have no confidence that this will happen. It can't happen until there is accurate comparative costing information available.”

6.55 Universities maintain that the provision of cost information for individual courses is a complex issue. Although direct costs may not be difficult to produce, allocation of overhead and capital costs on a comparable basis is a major problem for the universities. MPHEC commissioned a study, reported upon in January 1996, which recommends that comparable financial information be reported by the universities. For example, direct costs of courses along with descriptors such as class sizes and teaching load would be reported. Phase II of this project will be initiated in the spring of 1997 and will include the further development of standards, and the implementation of the report's recommendations at selected Maritime universities in order to test the validity of recommendations. We support this initiative and hope that it is completed on a timely basis.

Role of Government in Universities

6.56 The Province of Nova Scotia, through the NSCHE, contributed \$203 million to universities in 1995-96, \$187 million of which was in the form of operating grants. As can be seen from Exhibit 6.3, the Province provided the most significant portion of revenue when compared with all other sources of revenue for universities in 1995-96.

6.57 Several questions in our survey were designed to provide insight into board members' perceptions of their relationship with the government, and with the Nova Scotia Council on Higher Education in particular.

6.58 Accountability for the use of public funds is not well understood by some board members. Only 64% of those who responded to our survey thought their board was accountable to the government, and even less (34% on one question and 50% on another) thought they were accountable to the NSCHE. Perhaps this is because, as one board member noted, the link between the Council and the boards has yet to be formally established.

6.59 Although the function and duties of the Council are described in its legislation, many of the board and audit chairs we interviewed were unsure of the role of the Council. There are no terms of reference for the Council. In virtually every interview we conducted, board members commented on a lack of clarity with respect to the role of the NSCHE, and the accountability relationship between the universities and NSCHE. Most indicated that the existing relationship is informal and that it is between the university presidents and NSCHE, rather than between the boards and the NSCHE. The boards appear, therefore, to feel somewhat removed from the accountability loop. Many also commented that the lack of clarity may be due to the constantly evolving role of the NSCHE. The CICA's *Guidance for Directors - Governance Processes for Control* indicates that overseeing external communications is one of the major roles of governing bodies. Accordingly, the lack of interaction between the boards and a major external stakeholder is a problem which should be rectified.

6.60 Those we interviewed indicated their institutions provide NSCHE with information it requests, but generally, with respect to accountability for public funds, the situation appears to be as described by one individual:

"It is not clear to me to whom the Board reports on any regular basis, although legislatively we are a creature of the province and therefore the public. What does this mean on a month-to-month basis?"

6.61 We recommend that the NSCHE develop an accountability framework in conjunction with the universities which includes descriptions of roles and responsibilities, objectives, outcome measures and standards, and a reporting framework.

6.62 In December 1995 the NSCHE released a Report to the Minister of Education and Culture titled *Shared Responsibilities in Higher Education*. That document sets out the vision and goals for the university system in the Province and recommends rationalization of academic programming among certain institutions. The Report calls on government to confirm policy in certain areas and *"underscores the importance of using public funding to achieve public policy goals"* (p. vi). One survey respondent commented on the government's responsibility to articulate policy for the university sector in the Province as follows:

"There is a lack of clear government strategic plans and actions concerning post-secondary education. The N.S. Council on Higher Education should be given the Executive authority to clearly implement government policy once it has been determined."

6.63 One university president indicated to us that *Shared Responsibilities in Higher Education* has been *"superseded by other documents and activities that now more closely reflect the government's policy direction."* Therefore, it appears that there is some uncertainty regarding the status of *Shared Responsibilities in Higher Education* as the government's vision for the university system. There appears to be a need to confirm the vision.

6.64 When asked whether they had seen *Shared Responsibilities in Higher Education*, 25% of those responding to our survey indicated they had not seen the document. In fact, 24% note their board has not discussed this document. Documents of this nature should be clearly communicated by the NSCHE to all university boards so that they may be reflected in university strategic planning processes, accountability frameworks and rationalization efforts. Many of the board chairs referred to the important role played by the board chairs themselves in the process of establishing the Business Plan for the Metro Halifax Universities which indicates a cost-saving of \$5 to \$7 million annually. To participate effectively in rationalization efforts, board members need to be familiar with government's vision for the university system.

6.65 Over 80% of respondents said that university board members have a role to play in the university rationalization process and many noted that this role included maintaining the characteristics of their respective institutions. We compared the responses to this question according to the source of the appointment to the board (as described in paragraph 6.24) and we determined that the source of appointment had no significant impact on the response to the question. For example, government-appointed board members' responses are not significantly different from those of other groups.

6.66 The NSCHE has been having discussions with the universities regarding significant changes to the funding formula which has been relatively unchanged since 1990-91 (aside from funding decreases). Large changes in enrollments since that time have not been recognized by the funding formula, giving rise to perceived inequities in funding by various universities. Many board members were anxious to learn of changes to the funding formula - one board member noted "*Uncertainty as to funding causes uncertainty in planning and implementation.*"

Review of Financial Statements and Management Letters

6.67 We requested and received the March 31, 1996 audited financial statements for the 11 institutions involved in our survey. All universities received an unqualified audit opinion.

6.68 The operating fund balance for five of the eleven universities has been in a deficit position for the past two fiscal periods.

6.69 We also wished to determine the extent to which each university had implemented any recommendations made by its external auditors in the last three fiscal years. We requested copies of the management letters provided by the external auditors for all universities for the fiscal years ended March 31, 1994-1996. One institution did not provide us with this information for the year ended March 31, 1996.

6.70 In all cases where information was provided, we concluded that there were no recommendations or that university management has addressed or is continuing to address the significant recommendations made by their external auditors.

Follow-up on 1990 Audit

6.71 In 1990 we reviewed aspects of the operations of the seven largest universities in the Province and made specific recommendations relating to the financial statements of each university in an effort to increase comparability. During the current assignment, we followed up on the status of the more significant of these recommendations. Our conclusions are based on a review of the financial statements for each of these universities for the year ended March 31, 1996.

6.72 The Canadian Association of University Business Officers (CAUBO) has issued a set of guidelines relating to the financial statement accounting and disclosure practices of Canadian universities. While the March 31, 1996 financial statements of all seven of the largest universities indicate that they have been prepared in accordance with generally accepted accounting principles, only three of the seven statements make specific reference to CAUBO guidelines.

6.73 During our 1990 review we noted that most of the universities had attempted to comply with CAUBO guidelines. We made certain recommendations based on these guidelines to increase comparability among financial statements. Our review of the March 31, 1996 financial statements indicated the following with respect to the status of our 1990 recommendations.

- We noted in 1990 that certain universities recorded encumbrances (outstanding purchase orders and commitments for goods and services yet to be received) and unspent budget allocations as expenditures and liabilities. This resulted in expenditures being recorded in a fiscal period to which they did not apply. At March 31, 1996, we noted improvement in this area. However, two universities continue to allow unspent budget allocations to be expensed and carried forward.
- CAUBO supports the use of appropriations and reserves to provide for specific future plans or commitments and recommends adequate note disclosure of the purposes of these amounts. As at March 31, 1996 two universities continue to use appropriations for unspecified purposes.
- In 1990 we noted that fixed asset policies and disclosure practices varied among universities. Not all of the universities were capitalizing and disclosing major renovations as part of their plant asset fund. At least one university has improved its practices in this area, but we could not determine the implementation status for other universities from the information provided to us.
- CAUBO recommends that ancillary operations be separated from operating fund results. Three of the seven universities we reviewed in 1990 were not following this recommendation. This recommendation has been implemented in all but one university which has indicated disagreement with the basic recommendation.
- We had reported in 1990 that, although not significantly affecting the reporting results, most universities were not reporting tuition and/or residence fee revenues in the fiscal year in which they were earned. All universities have now adopted the recommended practice.

6.74 Our general conclusion with respect to implementation of our 1990 recommendations relating to increased comparability among financial statements is that some progress has been made, but that there is still room for improvement in certain areas. Again, we recommend compliance with CAUBO guidelines to increase comparability of financial information among universities.

CONCLUDING REMARKS

6.75 In the 1990 Report of the Auditor General we commented that the accountability of universities to the Province, particularly with respect to outcomes and results, had not been adequately defined. Now, six years later, we are repeating the same point. As noted in paragraph 6.2 above “*Provincial governments need to be more precise about what they want universities to do and not do, if they expect responsible compliance*” (i.e., government needs to clearly articulate its policy for the university sector).

6.76 The Nova Scotia Council on Higher Education’s *Shared Responsibilities in Higher Education* document was released in December 1995. That document sets forth NSCHE’s vision for the university system in this Province, and is a first step towards completion of the required accountability framework. However, there is still a need for government to confirm this vision and supplement it with more detailed objectives, standards and targets; to communicate it appropriately to governing bodies and other university stakeholders; and to incorporate it into a comprehensive accountability framework for the university sector.

6.77 We support the current NSCHE and MPHEC initiatives to improve reporting of university outcomes and provide more comparable financial information. Outcome measures and financial information are two of the necessary components of an accountability framework. The successful

completion of these initiatives should contribute to provision of better information for use in decision-making by those responsible for university governance, as well as government and other university stakeholders.

6.78 The establishment of an appropriate accountability framework, in conjunction with the enhancements to university governance suggested above, should help to ensure that maximum value is obtained from the Provincial expenditure on universities.

Exhibit 6.1

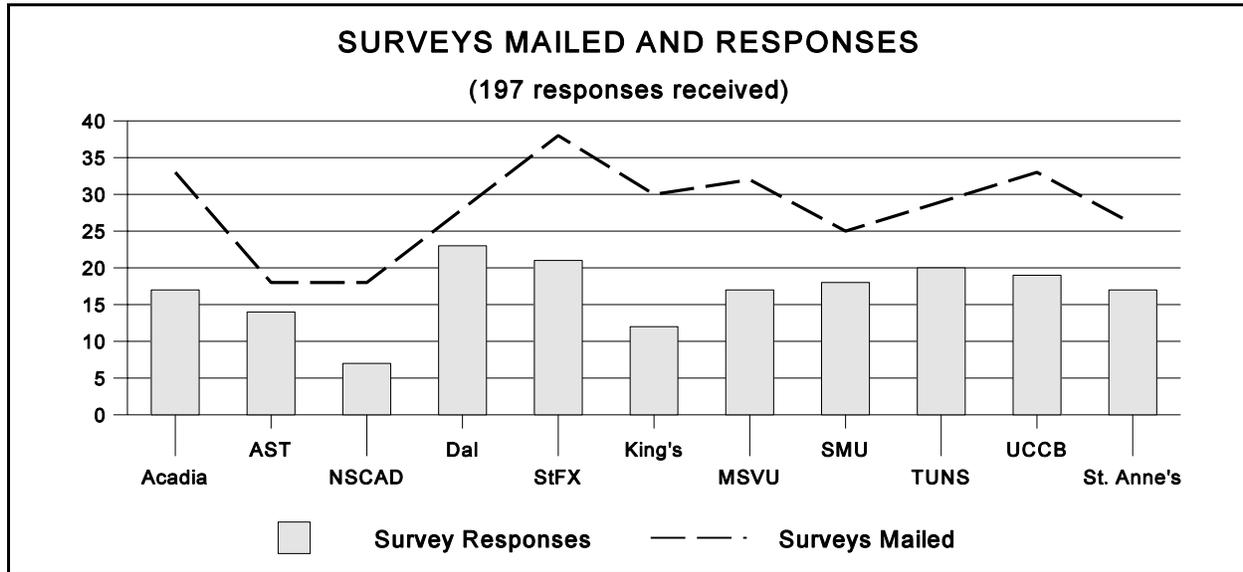


Exhibit 6.2

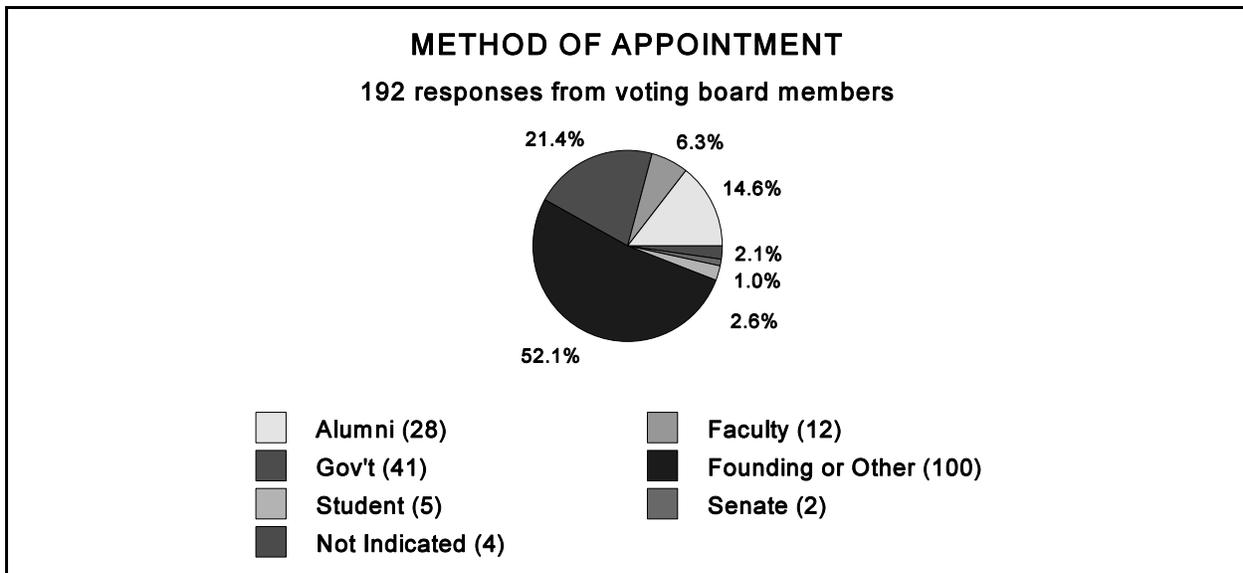
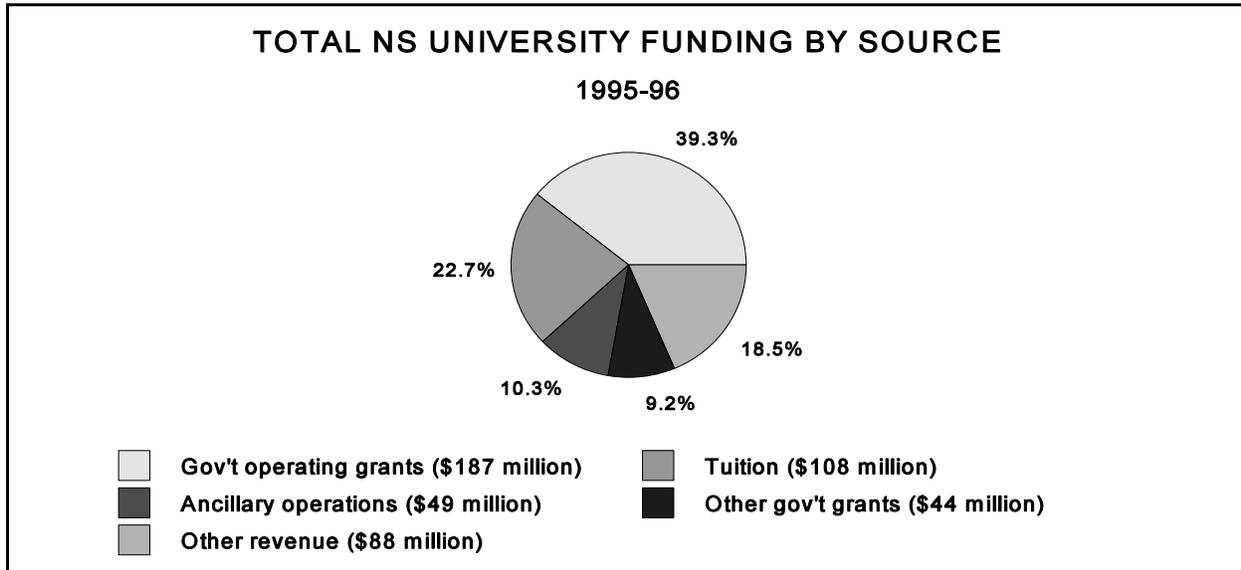


Exhibit 6.3

NOVA SCOTIA COUNCIL ON HIGHER EDUCATION'S RESPONSE

The chapter provides some very useful insights into the state of university governance in Nova Scotia based on a mailed out survey of all university Board members in the Province, supplemented by interviews of each Board Chair and Audit Committee Chair to solicit their views on certain aspects of university governance including the relationship of university Boards and Government.

I have noted the comments which relate directly to the Nova Scotia Council on Higher Education and will be discussing with staff and Council members how the issues raised can be addressed.

I congratulate the Office of the Auditor General on this initiative which follows the 1990 recommendations with respect to university Financial Statement matters.

7.

HEALTH - HOME CARE NOVA SCOTIA**BACKGROUND**

7.1 Home Care Nova Scotia was developed to replace the Coordinated Home Care Program (CHCP) which had provided services to seniors and the disabled. CHCP had been established in 1988 and was administered by the Departments of Health and Community Services. In April 1993, the Department of Community Services was given responsibility for the program and in November 1993 it was transferred to Health.

7.2 In April 1994, *Nova Scotia's Blueprint for Health System Reform* included the following comments about the program.

“Nova Scotia's existing Home Care Program provides a necessary and valuable service, but is too narrow in scope, too hard to access and is unevenly available.... As a result, too many Nova Scotians are either falling through the cracks, or using expensive hospital services when they could just as effectively, if not more effectively, be cared for in their homes or communities.”

7.3 It is generally acknowledged that action on home care was one of the most important aspects of the *Blueprint Report*.

7.4 In October 1994 *Home Care Nova Scotia - A Plan for Implementation* was released and Home Care Nova Scotia began operating on June 1, 1995. It is part of the Operations and Regional Support Division of the Department of Health.

7.5 The mission of Home Care Nova Scotia is *“to deliver an array of services to assist Nova Scotians of all ages who have assessed unmet needs in order that they can achieve and maintain their maximum independence while living in their own homes and communities.”*

7.6 Home Care Nova Scotia currently consists of a category for individuals with assessed unmet needs who are convalescing, chronically ill, disabled, or experiencing debilities of old age (Chronic Home Care) and a second category available to individuals with acute episodic illnesses who may be treated safely and effectively within the home (Home Hospital Care). Home Hospital Care may be used to divert individuals from hospitals, or in connection with early discharge from hospital.

7.7 Home Care Nova Scotia provides single entry access to home support, personal care and nursing services through a toll-free number accessible throughout the Province. There are plans to expand Home Care Nova Scotia to include other categories - rehabilitative, extraordinary assistance, palliative care, pediatric, self-managed home care - and other services such as occupational therapy, physiotherapy, nutritional counselling, and social work. Even with the development and expansion into these other areas, it is anticipated that 80% of Home Care Nova Scotia clients will be Chronic Home Care users at any time.

7.8 The program has gone through a high-growth period and the number of clients served continues to grow. When we last audited CHCP in 1992, approximately 7,000 clients per year were being served by the program. There were approximately 15,500 clients served in 1995-96 and it is estimated that 18,000 to 18,500 clients will be served during the current year. It is estimated that 28,000 people annually will use Home Care Nova Scotia services by the year 2000.

7.9 The budget for Home Care Nova Scotia in 1995-96 was \$44 million and actual expenditures totalled \$49 million. The 1996-97 budget for Home Care Nova Scotia is \$60 million. The budget includes approximately \$11 million related to In-Home Support, a program that had been jointly funded by the municipalities and the Province until 1995 when it became part of the Department of Health through Provincial-Municipal Service Exchange. In-Home Support is currently administered by the municipalities on behalf of the Department of Health. In 1992, when we last audited home care, the total budgets of the Departments of Health and Community Services related to the program plus the municipal In-Home Support component totalled approximately \$27 million. The annual budget for home care in the Province has, therefore, increased by about \$30 million since 1991-92. It is interesting to note that the budget for hospital services in the Province has declined by approximately \$140 million during the same time period.

7.10 Home Care Nova Scotia provincial office staff consists of three permanent and three term positions plus administrative support staff. The program is now administered on a regional basis and the regions correspond geographically to the regions served by the four Regional Health Boards.

7.11 The program is structured to separate accountability for assessment and service delivery. Assessments of unmet needs are performed by Care Coordinators who are employees of the Department of Health (DOH). The Department of Health contracts with service providers for most nursing and all home support services. Nursing services are provided by the Victorian Order of Nurses (VON) and Martha's Home Health Care (MHHC). DOH staff provide nursing services in those areas not serviced by VON (about 25% of total nursing services). Home support services are provided by 27 home support agencies. Some of the agencies are municipally-owned; others are either non-profit or private for-profit agencies. Home support agencies are funded by DOH on the basis of a line-by-line budget. User fees collected by agencies for home support services provided under Home Care Nova Scotia are netted against agency budgets. User fees are for Chronic Home Care clients only. Clients are not charged for nursing services.

RESULTS IN BRIEF

7.12 The following are the major findings resulting from our review of Home Care Nova Scotia.

- Strategic and operational plans have been developed for Home Care Nova Scotia. The plans are consistent with the strategic goals of the Department of Health as reported in *Government By Design*. Home Care Nova Scotia has addressed or has plans to address many of the recommendations in *Nova Scotia's Blueprint for Health System Reform* related to the provision of health services in the home. Additional services are expected to be implemented in 1997-98 prior to the devolution of the program to the Regional Health Boards which is anticipated to occur in 1998 or 1999.
- The Department of Health forecasts that Home Care Nova Scotia expenditures for the 1996-97 fiscal year will not exceed the current budget of \$60 million.
- Waitlisting procedures have been in effect in Home Care Nova Scotia since August 26, 1996 in order to allow caseload review and reassessment in connection with policy changes. One result of the waitlisting procedures has been to manage program growth. Our conclusion is that measures have been taken to mitigate the risks associated with these procedures although risks would be further reduced if clients were assessed before they were waitlisted. Management has noted that there is ongoing management of the waitlist by regional Waitlist Coordinators, and monthly contact with individuals on the waitlist and/or their families. If there is concern over the person's condition or situation, he/she is to be contacted more frequently.

- Risk management and liability have not been completely addressed in Home Care Nova Scotia's planning processes to date. The Department should perform a comprehensive analysis of risks and potential liabilities including strategies for minimizing the risks, and consideration of the costs and benefits of insurance and self-insurance.
- There is a need to expand outcome measures and performance standards. Information systems and reporting are currently inadequate but this should be rectified later in 1997 when a new information system is implemented.
- The cost of nursing and home support services is determined for each Home Care Nova Scotia client by applying specified rates for each of these services to the frequency of their occurrence. The total is then compared to the maximum cost per client specified in the program policies. For nursing services, the cost represents the actual fee paid by DOH to the service provider but DOH does not have current information showing how this figure relates to the actual costs incurred by the service provider. For home support services, the rate is based on a 1995 analysis of the average cost of providing these services in 1993-94. We recommend rates for nursing and home support services be reviewed. We also recommend that DOH explore other options for the delivery and funding of Home Care Nova Scotia services to determine whether costs can be reduced.
- The Department has developed reasonable policies for key areas of the program. We have made recommendations for improvements in certain policy areas including recommendations that income levels for those receiving homemaker services be verified to external sources; and that agency audits include verification that services provided are consistent with assessed service requirements.
- Home Care Nova Scotia has instituted controls to ensure compliance with its policies and standards including agency audits and program evaluation. We have made recommendations for improvement in certain audit procedures in order to increase their effectiveness. We have also recommended that future evaluations more closely incorporate the objectives of the program.

AUDIT SCOPE

7.13 The objectives of this assignment were to review:

- the planning and budgeting process for Home Care Nova Scotia;
- policies and contracts in certain key areas;
- the control framework for the program to determine whether it provides for monitoring of compliance with policies, and achievement of due regard for economy and efficiency; and
- the performance measurement and reporting process.

7.14 The following general criteria were used in our review.

- There should be appropriate long-term planning and annual budgeting with a link between planning for this program and other planning initiatives at the Department of Health.

- There should be appropriate policies, procedures and controls to ensure that resources are used efficiently and economically and that policies are complied with.
- There should be an established process for measuring performance and reporting results of key programs and initiatives in relation to the established objectives.
- The information system should provide appropriate, timely information for decision-making.

7.15 We also followed up on the findings from our 1992 audit of the Coordinated Home Care Program to determine the status of recommendations made which are relevant to Home Care Nova Scotia. We noted that the majority of recommendations have been addressed. One significant recommendation has not been adequately addressed to date (see paragraph 7.52).

7.16 Our approach consisted of interviews with provincial office staff and a review of Home Care Nova Scotia manuals, reports and other documents. We also interviewed Care Coordinators from two of the four regions in the Province and one Regional Director.

PRINCIPAL FINDINGS

Planning and Budgeting

7.17 *Planning* - The mission statement for Home Care Nova Scotia (see paragraph 7.5) was developed based on a review of mission statements from other home care programs and input from service delivery agencies. The document was approved by the Priorities and Planning Committee.

7.18 Strategic and operational plans have been developed for Home Care Nova Scotia and have been revised on three occasions to date. The plans are consistent with the strategic goals of the Department of Health as reported in *Government By Design*. The operational plans have been migrated to the regions and have been fine-tuned by each of them to meet their own needs. This is an initial stage in preparing regional offices for devolution of the program to the Regional Health Boards which is scheduled for 1998 or 1999.

7.19 Home Care Nova Scotia has addressed many of the recommendations in *Nova Scotia's Blueprint For Health System Reform* related to the provision of health services in the home. Recommendations not yet implemented include:

- single entry “*access to a system of continuing care which includes all aspects of home care/home based care and long-term care, including nursing, medical, social, housing and in-home support services*” (currently being addressed by the Department);
- devolution of responsibility for home care to Regional Health Boards (RHBs) and Community Health Boards which is scheduled for 1998 or 1999;
- implementation of Palliative Home Care, Self-Managed Home Care, Pediatric Home Care, Rehabilitation Home Care, and Extraordinary Assistance Home Care (currently included in plans as discussed in paragraph 7.20 below); and
- lessening the burden on individuals receiving care and their families through respite care, and recognition of the financial burden associated with the informal care giver network and the special needs of persons with disabilities. (Staff noted that Home Care Nova Scotia allows for twice as much respite as was provided under CHCP.)

7.20 Chronic Home Care and Home Hospital Care were implemented on a Province-wide basis on June 1, 1995. Other categories will be implemented through pilot projects in selected areas and the results of each project will be evaluated. Depending on the results of the evaluation and the availability of funding, the pilot project will be expanded to full scale implementation. To date there has been a Self-Managed Implementation Project in Metro and a Palliative Care Pilot Project in Western King's. There are tentative plans for implementation of further program categories in 1997-98 and an amount has been included for Palliative Home Care and Pediatric Home Care in the 1997-98 budget request.

7.21 Risk management and liability have not been completely addressed in Home Care Nova Scotia's planning processes to date. Some analysis of risks has been done as part of the Home Care Nova Scotia Continuing Quality Management initiative (see paragraph 7.45). To date, DOH legal counsel and Home Care Nova Scotia staff have identified certain risk factors associated with the program. However, DOH has not performed a comprehensive analysis of the potential liability associated with these risks for the Department and service providers, developed strategies for minimizing the risks, or analysed costs and benefits of insurance coverage and self-insurance.

7.22 *Budgets and forecasts* - We reviewed the budget process at Home Care Nova Scotia for 1996-97 and financial results to the date of the audit. The budget process for Home Care Nova Scotia has varied in each of the years the program has been operating and is expected to change again for 1997-98.

7.23 The 1996-97 budget was prepared based on input from the Regional Directors. This input related not only to each regional office but also to the home support agencies which submitted detailed budgets to their respective Regional Director. Regional Directors also used the rates specified in the contracts with the nursing agencies to determine the budget for nursing services. The number of visits would be based on the number of visits in the prior year adjusted for planned program growth. DOH does not receive budgets from each nursing agency.

7.24 The resulting regional budgets were combined into a global program budget. This was then compared to a total budget prepared at Home Care Nova Scotia's provincial office which determined the cost of the program for the year based on expected utilization rates.

7.25 Program utilization rates are estimated based on a review of the factors which determine utilization. These include age, mortality, morbidity and disability rates, and the use of long term and acute care facilities. Some statistical information is obtained from Statistics Canada although this is not as current as staff would like. Other information comes from the database used by Home Care Nova Scotia to record program statistics such as admissions, discharges, etc. This database is supplemented by a manual system maintained by each of the regions. Program statistics are provided by the regions to the provincial office on a monthly basis.

7.26 There was a round table discussion of DOH senior management, Home Care Nova Scotia provincial office staff and regional staff to arrive at the 1996-97 budget request of \$60 million. However, the budget approved in the 1996-97 Estimates for Home Care Nova Scotia was \$49 million. We were unable to determine the rationale for the decrease in the budget from the \$60 million requested to \$49 million. In late summer 1996, the Department of Health received an additional allocation of Provincial funds (\$64.1 million) to cover shortfalls in the 1996-97 budget identified to that point in time. A portion of this amount - \$11 million - was allocated to Home Care Nova Scotia which increased the approved budget to \$60 million.

7.27 Home Care Nova Scotia provincial office staff indicated that they were unaffected by this additional funding as they had always considered \$60 million to be the 1996-97 budget and had operated the program accordingly. There was a mid-year review of the Home Care Nova Scotia

budget by DOH (Corporate Services and Operations and Regional Support Divisions) which analysed monthly program utilization statistics and financial results to date. This resulted in a reallocation of resources between and within the regions to reflect program operations to that point in time and to allow for anticipated future growth in each region. Program expenditures for 1996-97 are forecasted to total \$60 million. Home Care Nova Scotia has acknowledged that the waitlisting procedures introduced in August 1996 have assisted Home Care Nova Scotia in meeting the 1996-97 budget.

7.28 Because the Directors of Home Care Nova Scotia were involved in the reallocation of the 1996-97 budget, the 1997-98 budget process will be more centralized. Regional budgets will be based on 1996-97 budgets and Regional Directors will be given a bottom line to manage. The provincial office will determine and control the budget associated with any new program areas and assign it to the regions as necessary.

Contracts with Service Providers

7.29 *VON/MHHC contracts* - The current contract with each of these entities expired on April 1, 1996 and has been running on a month-to-month basis since then. The contract allows for \$41.47 per visit for a Registered Nurse (RN) and \$30.66 per visit for a Licensed Practical Nurse (LPN). The contract is between VON Nova Scotia (or MHHC) and DOH. VON Nova Scotia receives semi-monthly payments from DOH and allocates these funds to each of its branches throughout the Province. DOH is not involved in this allocation process.

7.30 In 1993-94 the Internal Audit Division of DOH reviewed the revenues allocated to three VON branches by VON Nova Scotia and the actual costs incurred by these branches in delivering CHCP. It was determined that the actual costs for program delivery were in excess of the allocated funds. The procedures performed by Internal Audit were not intended to verify the appropriateness of the contract rate in place at that time. DOH was not able to provide us with an analysis supporting the current contract rates. As well there has been no comparison of the cost of nursing services provided by DOH staff with that provided by VON/MHHC.

7.31 DOH has started working in partnership with the RHBs to define service delivery options. DOH is undertaking some changes and RHBs will continue to pursue any number of options to secure nursing services necessary for delivering the program. Although we understand that DOH does not want to lock itself into a contract situation which may not meet the needs of the regional health boards, we believe the current contract rate should be reviewed to ensure it provides the most economical means of obtaining nursing services. To control costs between now and April 1999, DOH should explore other options for delivery and funding of nursing services to determine if costs can be reduced.

7.32 *Home support services* - Home support agencies are funded by DOH based on an annual budget submission which includes estimated costs and service hours. Payments are made on a semi-monthly basis and adjustments are made if the actual service hours provided differ from the estimate. Agencies are responsible for collecting user fees from Home Care Nova Scotia clients.

7.33 When Care Coordinators prepare the Resource Allocation Plans for a client as part of the assessment process, they determine the number of hours of home support services required by an individual. These hours are then multiplied by \$15.18 to determine the cost for home support services for that client. The total cost of the Resource Allocation Plan for the client (home support and nursing services) is compared with the program maximums to ensure they are not exceeded. The \$15.18 does not represent the rate actually paid to the agency as the agency is funded on the basis of its approved budget.

7.34 Home Care Nova Scotia staff provided us with an analysis supporting the hourly rate for the home support component of the Resource Allocation Plans. This analysis was conducted in 1995 and determined the average cost of providing home support services based on the 1993-94 financial results of home support agencies. Home Care Nova Scotia staff have indicated there are plans to review the rate again but such a review has not been scheduled yet. As this amount is a key component in determining total cost of service, and ultimately the level of service, for all Home Care Nova Scotia clients, we recommend it be reviewed in detail to ensure it properly reflects the cost of providing home support services.

7.35 We noted that the letter provided to home support agencies indicating their budget allocation for the year does not specifically require adherence to Home Care Nova Scotia policies and procedures, and it does not contain an audit provision. We recommend these features be incorporated into any agreements with service providers. We also recommend that DOH explore other options for delivery and funding of home support services to determine if costs can be reduced.

Policy Development and Implementation

7.36 The Department has developed reasonable policies for key areas of Home Care Nova Scotia which are documented in the Policy Manual. The Policy Manual is provided to a wide range of individuals and organizations including Home Care Nova Scotia staff, hospitals, service provider agencies and some physicians. Standard forms reflecting Home Care Nova Scotia policies have been developed for use by staff in performing their duties. We reviewed policies in certain areas including performance of assessments and waitlist management.

7.37 *Assessment* - Home Care Nova Scotia uses a generalist assessment model which means that one individual (the Care Coordinator who is usually a nurse or a social worker) assesses the unmet functional needs of an individual and determines the required nursing, personal care and homemaker services. The Care Coordinator is the basic gatekeeper for access to Home Care Nova Scotia. For the Home Hospital Care program, the Care Coordinator ensures Home Care Nova Scotia services are in place before a client is discharged to the program.

7.38 The assessment process provides for due regard for economy and efficiency in service delivery through the following practices.

- *The most cost efficient level of care provider who is qualified and appropriate to deliver the service is assigned to an identified task.* Tasks are assigned by the Care Coordinator according to Home Care Nova Scotia charts which indicate the appropriate level of staff to safely deliver a service at the lowest cost. In addition, the Care Coordinator is to ensure family, community and volunteer services are maximized before Home Care Nova Scotia services are recommended.

There is an informal Peer Review system at Home Care Nova Scotia which allows Care Coordinators to receive feedback as to the appropriateness of their assessments. We believe this system should be formalized and include a periodic review of selected Care Plans to ensure the appropriate service provider has been authorized, and to ensure volunteer services have been appropriately considered.

- *There are documented time frames for completion of assessments for clients entering Home Care Nova Scotia through discharge from hospital or upon referral to Home Care Nova Scotia by a physician.* These individuals are contacted by a Care Coordinator within 3-5 days of admission into Home Care Nova Scotia.

We noted that there are standard response times for contacting clients who access Home Care Nova Scotia through the 1-800 number. We believe standards should also be established for the initial assessment of clients entering Home Care Nova Scotia, and for the reassessment of existing clients.

- *There are service maximum guidelines limiting clients in Chronic Home Care to \$2,200 per month in services.* This amount approximates the average monthly cost to the Province of long-term care facilities in Nova Scotia.

Service maximum guidelines for those in Home Hospital Care are \$2,000 for the first 15 days to a maximum \$4,000 per month. We were told these rates approximate those used in home hospital programs in other provinces but we did not verify these amounts.

Care Coordinators have the authority to approve resource allocation plans costing less than \$1,000 per month. Cases in excess of \$1,000 per month must be approved by the Supervisor of Assessment. Any cases which will exceed the \$2,200 guideline must be approved by the Regional Director of Home Care.

- *Some Chronic Home Care clients are charged for home support services.* The maximum charges for home support services are \$6 per hour to a maximum of \$360 per month. There is no charge for nursing services for Chronic Home Care or Home Hospital Care clients. Home Hospital Care clients are also not charged for medication and supplies related to their acute condition. Chronic Home Care clients are not charged for supplies used during nursing visits. Individuals who require nursing services through Home Care Nova Scotia are automatically eligible for home support services which may be billed. Home support services only are available to others who meet certain financial criteria. Policies state that “*low risk individuals who require only cleaning and laundry, who are financially able to make provision for such service, are ineligible for admission to the program.*” We believe that this policy is not specific enough and that the term “financially able” should be more clearly defined.

Home support charges to clients are based on Canada Assistance Plan income guidelines. However, clients are not required to provide any proof of income. The policy manual notes that income inquiries need not be made of individuals who are willing to pay the maximum home support fee per month (\$360).

A system should be implemented by Home Care Nova Scotia to verify clients' income to external sources. Income levels for those registered under the Seniors' Pharmacare Program are verified against electronic files obtained from Revenue Canada and we recommend that a similar procedure be developed for Home Care Nova Scotia clients, or that Home Care Nova Scotia access the database for the Seniors' Pharmacare Program when a client is a senior.

7.39 *Waitlist management* - Intake management and interim waitlist procedures were initiated on August 26, 1996 to allow for a caseload review and reassessment in connection with the policy revisions which had recently been announced. A result of these procedures was slower program growth. Waitlisting applies only to those requiring Chronic Home Care services who are considered low risk in accordance with Home Care Nova Scotia intake policies. Individuals eligible for services under Home Hospital Care or referred to Home Care Nova Scotia through Adult Protection Services are considered high risk and are not waitlisted for assessment for home care services.

7.40 Individuals seeking Chronic Home Care services are now assigned a priority rating by the intake worker who completes a Priority Intake Tool (PIT) which is a risk assessment instrument. The information to complete the PIT is obtained over the phone. Individuals who score 11 or above per the PIT are considered high risk and are assessed according to the standard response times within each region. Individuals who score below 11 are placed on a waitlist and instructed to contact the intake worker if there is a change in their condition. These individuals are to be seen as time and resources permit with the most urgent cases assessed first. Management noted that there is a Waitlist Coordinator in each region who contacts individuals on that region's waitlist, and/or their families, by telephone, at least on a monthly basis. Individuals whose situation or condition changes may be assessed immediately.

7.41 No individuals who have scored below 11 have been admitted to the program since waitlisting procedures were implemented. Waitlist information to the end of December 1996 indicates that there have been 1,527 admissions to Home Care since September 1, 1996 while 467 individuals had been screened for intake and were awaiting assessment during that four-month period. Once an individual has been assessed, there is no further waitlist for assessed services to commence.

7.42 Our conclusion with respect to waitlisting is that there are procedures in place to manage the risk associated with this policy. The PIT assigns higher factors to individuals who, for example, are at risk for admission to a facility if Home Care Nova Scotia services are not provided and those whose situation is at risk due to care giver support breakdown. However, there is some risk that completion of the PIT based on information obtained over the phone may result in errors in assigning priorities to potential clients. Waitlisting clients after assessment by a Care Coordinator, rather than before, would help to minimize this risk. We understand that the decision to defer assessments for certain individuals was primarily due to the staffing demands of the caseload review.

7.43 *Policy changes* - Home Care Nova Scotia has an informal process that is followed for program changes. The extent of involvement of staff at the regional offices depends on the extent of the change and the time frame for its implementation. Focus groups consisting of provincial office and regional office staff may be used to discuss the impact of changes.

7.44 Home support agencies are informed of the effective date of changes in services to be provided by means of the Home Support Authorization form given to them by the Care Coordinator. This is a revision to the form completed at the time of assessment. Clients are informed of the changes through a letter and through contact by the Care Coordinator. There is usually a grace period to allow the client time to make alternate arrangements before services are reduced or discontinued.

Compliance with Policies

7.45 Home Care Nova Scotia has instituted controls to ensure compliance with its policies and standards. The controls include the following:

- a Continuing Quality Management (CQM) program including agency audits;
- caseload review;
- program evaluation;
- implementation of a new management information system (SACPAT II);
- review of reports and invoices from service providers; and
- standards for training and qualification of service providers.

7.46 These are discussed in the following paragraphs.

7.47 *Agency audits* - The CQM program includes measuring the quality of services delivered by evaluating the activities of service providers against standards; taking appropriate actions once the evaluation is completed; and then reevaluating the service.

7.48 The standards of service delivery were developed by Home Care Nova Scotia staff and address areas such as the qualifications of service providers (e.g., training for Home Support Workers). These standards will be reviewed and revised on a regular basis. Compliance with these standards is determined through agency audits which are to be conducted every six months or annually, depending on the standard. All agencies (including home support and nursing services) are to be audited on a regular basis according to a predetermined schedule, in response to complaints, or if a standard has not been met. Agency audits were performed for the first time in mid-1996. We were informed that the purpose of this first attempt at agency audits was to familiarize both the auditors and the agencies with the concept of testing compliance to standards. Contracts with these agencies do not presently include a provision for these audits to take place and we recommend that Home Care Nova Scotia obtain the proper authority.

7.49 Audits are conducted by Home Care Nova Scotia regional staff such as Supervisors of Assessment and Program Planners. These individuals are trained by the Coordinator of Continuing Quality Management who has been extensively involved in hospital accreditation processes.

7.50 Agency audits determine compliance with Home Care Nova Scotia standards and policies including funding guidelines. However, the audits do not include all aspects of agency operations. Specifically, the audits do not examine whether:

- services provided were appropriate;
- services were provided by the most cost-effective service provider;
- volunteer and family resources were used to their full extent; and
- agencies utilized funds with due regard to economy and efficiency.

7.51 Home Care Nova Scotia staff indicated that some of these areas are included in the multi-year CQM plan.

7.52 An Agency Auditing Tool has been developed for use during these audits and it notes each standard to be audited and the documentation to be obtained during the audit to determine if there has been compliance with the standard. We reviewed the Agency Auditing Tool and noted the following areas for improvement.

- The Tool should provide guidelines for the number of client and personnel files to be examined during the audit.
- The Tool should require that the documentation be examined for completeness and accuracy. For example, the required documentation for one standard is a supervision schedule. Checking for existence of the schedule is not sufficient. The Tool should require the auditor to review the schedule to determine whether all service providers have been observed, or will be observed, by the agency supervisor while performing their duties in a client's home. The standard should also be expanded to indicate whether the Supervisor has observed that the care giver is providing only those services authorized by the Care Coordinator. A finding resulting from our 1992 audit of the Coordinated Home Care Program was that controls were not adequate to ensure only authorized services were provided.
- One of the finance standards requires the auditor to ensure all services billed to Home Care Nova Scotia have been provided by employees of the agency; all services

invoiced have been provided; and that the agency complies with Home Care Nova Scotia program guidelines and its contractual obligations or funding agreements in connection with the submission of invoices. This standard presently applies only to nursing agencies. The standard should be reworded so that it is applicable to home support agencies as well.

7.53 We reviewed audit files and/or reports resulting from the 31 agency audits conducted to date. The results of agency audits are reported to the Director of Home Care Nova Scotia and to DOH senior management. There is a requirement to follow-up on the recommendations made to the agency as a result of the audit within three months of the audit. Follow-up procedures have not taken place to date and we recommend that these be performed during the next round of agency audits.

7.54 *Caseload review* - A Program Review was started in July 1996 resulting in revisions to program policies and the case management process as well as strategies to effectively manage program growth. The impact of policy changes on existing Home Care Nova Scotia clients was determined through a caseload review undertaken in fall 1996. Care Coordinators conducting the caseload review were asked to confirm that their clients were receiving the appropriate Home Care Nova Scotia services in light of new and/or revised policies.

7.55 Home Care Nova Scotia staff have indicated that they do not intend to undertake caseload reviews on a regular basis because there will be regular client reassessments in the future.

7.56 *Program evaluation* - The Research, Statistics and Evaluation (RSE) section of DOH conducts program evaluations in accordance with Departmental priorities and in 1996 conducted an evaluation of Home Care Nova Scotia. The evaluation was conducted through four separate surveys of Home Care Nova Scotia clients and others. We have the following comments regarding these surveys.

- *The scope of the evaluations was limited.* Three of the four surveys were sent to clients who were serviced through Home Care Nova Scotia implementation projects (two for home hospital care and one for palliative care) in the Western region of the Province. A total of 77 clients, care givers, family members/support persons and physicians responded to the surveys. The fourth survey was sent to 800 of approximately 12,000 Home Care Nova Scotia clients participating in either Home Hospital Care or Chronic Home Care. The response rate was 50% as 399 clients completed the survey.
- *The linkage between the survey questions and the objectives of the program was not strong.* Program objectives include preventing or delaying admission to a hospital and improving the client's level of independence. The survey questions dealt mainly with client satisfaction which was very high (e.g., 96% for the random sample of Home Hospital Care and Chronic care clients). We understand that the evaluation process is evolutionary and to date client satisfaction only has been addressed. Staff has indicated that future evaluations will address other program objectives. We recommend that survey questions and other evaluation methods be designed to relate to specific program objectives.
- *The survey results related to the home hospital care implementation project include useful information regarding costs for services delivered.* The cost per day for Home Care Nova Scotia clients in the program from 1-15 days was \$132.93 in one region and \$195.48 in another. The cost per day declined significantly for clients in the program in excess of 15 days (to \$59.37 in one region and \$43.23 in another). These costs include only direct costs and there is no allocation of program overhead. The

evaluators acknowledge that these costs were determined based on a small number of Home Care Nova Scotia clients and therefore may not be indicative of program costs in all regions of the Province.

7.57 The findings from the program evaluations have not yet been followed up. Home Care Nova Scotia indicated follow-up was delayed because of the caseload review in the fall of 1996.

7.58 The RSE section plans to look at Home Care Nova Scotia processes during 1997-98 and develop outcome measures. For example, the efficiency and effectiveness of the general assessment model (a single assessment for both nursing and personal needs), and the home care policies on eligibility, entitlement and payment will be examined.

7.59 There is a Home Care Nova Scotia Evaluation Development Team which consists of Home Care Nova Scotia Head Office staff and other DOH staff. The purpose of the team is to act as an advisory group to the RSE division during the program evaluation. An evaluation framework noting the goals, objectives, actions and evaluation methods was prepared for the team and will be revised by Home Care Nova Scotia staff when they conduct their own program evaluations. The evaluation process will include client surveys which are scheduled to take place on an ongoing basis.

7.60 *SACPAT II management information system* - Home Care Nova Scotia has entered into an agreement with Manitoba Health to further develop Manitoba's Screening, Assessment and Care Planning Automated Tool (SACPAT). The tool will automate the current intake, assessment and care planning functions. The ability of the system to handle the volume of clients served by Home Care Nova Scotia will be tested during March and April 1997 with full Province-wide implementation to take place during April-June 1997.

7.61 SACPAT II features specific edit checks which will assist in ensuring compliance with Home Care Nova Scotia policies and procedures. For example, the system will prevent a task which can only be assigned to a Registered Nurse, according to Home Care Nova Scotia policies, from being assigned to a home support worker. The system also flags care plans in excess of \$1,000 for approval by a case supervisor.

7.62 *Review of reports and invoices from service providers* - Home Care Nova Scotia regional offices receive reports or invoices from all service providers monthly. The invoices and reports are reviewed for compliance with policies.

7.63 Home Care Nova Scotia pays the VON a semi-monthly advance based on an estimated number of visits. The VON sends detailed monthly bills to each regional office noting the actual number of visits for each client in that region. The Regional Director reviews the bills to ensure client eligibility and the Care Coordinator reviews a sample, and periodically all, of the invoices to ensure the number of visits charged is consistent with authorized visits per the care plan. Adjustments are made throughout the year to reflect the actual amount owed to the VON based on the authorized visits.

7.64 Home support agencies provide monthly reports to Home Care Nova Scotia regional offices. The reports indicate the total number of service hours for Home Care Nova Scotia clients although they are not broken down by service hours per client. The service hours are not verified to service hours per the care plan and we recommend this be done as part of the agency audits as noted in paragraph 7.52.

7.65 *Standards for training and qualification of service providers* - There are standards for qualification and training of service providers which help to ensure compliance with policies. Nursing staff are either Registered Nurses or Licensed Practical Nurses who belong to professional

associations. As such, they are required to maintain high standards of care and conduct. Training of home support workers is monitored during the agency audits described in paragraph 7.48.

Performance measurement

7.66 *Outcome measures* - Although there are outcome measures for the Department of Health reported in *Government By Design*, there are none specifically related to Home Care Nova Scotia. There are plans to develop these in 1997-98. The province of Saskatchewan is currently undertaking a study of outcome measures in relation to its home care program and Home Care Nova Scotia staff hope to incorporate any relevant results of that study into the development of outcome measures for Home Care Nova Scotia.

7.67 Although there are no outcome measures for the program, there are a number of program statistics and indicators (input and output measures) which are being monitored monthly by Home Care Nova Scotia management both regionally and on a Province-wide basis. These include the number of intakes and assessments for the current month, the monthly caseload, and the assessment waitlist. Financial results for Home Care Nova Scotia are monitored through monthly forecasting procedures.

7.68 The introduction of SACPAT II will enable better monitoring of outcomes and indicators. Planned improvements include better reporting of:

- assessment and service waitlists;
- long-term care waitlists (Home Care Nova Scotia clients awaiting placements in long-term care facilities);
- projected costs on an individual case or total basis; and
- actual outcomes in comparison to those outlined in the care plan.

7.69 *Performance standards* - Appropriate monitoring of performance requires setting of standards or targets for results to be achieved. Home Care Nova Scotia has set certain performance standards including the following.

- Care Coordinators are assigned cases based on a caseload ratio. The average ratio for a community-based Care Coordinator is 130 cases.
- There are standard notification times for Home Care Nova Scotia patients being discharged from the hospital into the program.
- There are regional response time standards for Care Coordinator contact of an individual who has been determined to be low risk during the intake process. These response time standards can be extended whenever waitlist management is in place. Response time standards are in draft form for inclusion in the SACPAT II Procedure Guide.
- The Home Support Authorization Form includes a task list. Housekeeping duties have an assigned standard time for completion. Standard times have not been assigned to all personal care items.

7.70 As noted in paragraph 7.48, agency audits determine compliance with standards of service delivery.

CONCLUDING REMARKS

7.71 Home Care Nova Scotia faces a number of significant challenges. It is a key component of health reform in the Province and is in the midst of a high growth period. Along with other health programs, it also faces severe fiscal pressures. There are plans to devolve the service delivery aspects of the program from the Department of Health to the Regional Health Boards in 1998 or 1999. Management of a program undergoing such rapid growth and change is not an easy task.

7.72 The Department of Health has developed strategic and operational plans for the program. The plans are consistent with the strategic goals of the Department of Health as reported in *Government By Design*. Many of the recommendations in *Nova Scotia's Blueprint for Health System Reform* related to home care have been implemented. Implementation of additional services recommended in the *Blueprint* will depend on future availability of funding. Waitlist management also is related to available funding.

7.73 Although many current policies for the program incorporate due regard for economy and efficiency, the largest determinants of costs for the program are the contracts with service providers and the provision of services in accordance with assessments of unmet needs. We recommend that the Department of Health explore other options for the delivery and funding of Home Care Nova Scotia services to determine whether costs can be reduced, and increase monitoring to ensure services are delivered in accordance with assessments.

8.

HEALTH - PLANNING FOR HEALTH RENEWAL - FOLLOW-UP

BACKGROUND

8.1 The Department of Health's mission is "to promote, maintain and improve the health status of Nova Scotians at a cost that is sustainable for Nova Scotia." To meet this mission, the Department had a budget of \$1.1 billion for 1996-97 net current account expenditures which is 35.7% of the total net current account expenditures (excluding net debt servicing charges) for the Province of Nova Scotia.

8.2 The 1996-97 Estimates for the Department of Health describe the responsibilities of the Department as follows:

"The Department is responsible for the provision of hospital, medical, community based health and drug dependency programs to the residents of Nova Scotia. The major programs are: maintenance of a modern system of hospitals and hospital standards; administration of the medical insurance system; provision of community based health programs through regional health units; provision of treatment services in the area of drug dependency; provision of operating and capital funds to hospitals and other health care institutions; and, ensuring that facilities for the training of doctors, nurses and other health care workers are available."

8.3 In August 1996, the Department of Health reorganized to more closely integrate planning and operations. The Department now has five divisions - Strategic Planning and Policy Development, Administrative Services, Operations and Regional Support, Emergency Health Services, and Insured Programs Management and Clinical Rationalization.

8.4 In 1995 we conducted an audit to review selected planning initiatives within the Department of Health and examined the Department's progress in addressing the recommendations of certain major reports prepared over the past few years. This year, we reviewed the status of the planning initiatives examined last year and major initiatives undertaken during 1996-97. We also reviewed the Department's interim financial results for the 1996-97 fiscal year.

8.5 This audit was performed under Section 8(c) of the Auditor General Act which gives the Auditor General the mandate to ascertain whether funds have been expended with due regard for economy and efficiency. Health care is the biggest single expenditure of the Province and health care renewal is intended to lead to improvements in provision of health care services while increasing the economy and efficiency of health expenditures. Appropriate planning is a key component of proper management of change such as health care renewal.

RESULTS IN BRIEF

8.6 The following are the principal observations resulting from our audit.

- The Department of Health has made significant progress on several major initiatives related to planning for health renewal during 1996-97. These include development of an accountability framework to define the relationship between the Regional Health Boards, Community Health Boards, the Department and others; establishment

of a devolution team for Drug Dependency and Public Health; development of 18-month operational plans for the health system in the Province; an ongoing initiative to develop standards for services which RHBs must provide; formation of 18 Community Health Boards and tools designed to assist Community Health Boards in their work; and designation of all but four hospitals to RHBs.

- There are still a number of issues regarding roles and responsibilities of the Department of Health, Regional Health Boards and Community Health Boards which must be clarified. For example,
 - *Funding of Regional Health Boards* - The Department has established a Regional Funding Working Group with representation from Regional Health Boards and non-designated hospitals which will examine options for future funding.
 - *Regional Health Boards' role in reallocation of services* - For the 1997-98 fiscal year, funding will be non-portable, that is, the RHBs will not have the authority to move the funds from one program to another. Starting with the 1998-99 fiscal year, the Regional Health Boards will have the authority to reallocate funding. It should be noted that the RHBs must still meet the standards for health services established by the Department.
 - *The role of Community Health Boards in selecting RHB members* - The Department intends to evaluate this as part of the 18-month operational plan.
- The Provincial Advisory Council and the Provincial Leadership Committee have been formed to serve as a policy development and issues forum for the renewed health system through joint management by the Department, the Regional Health Boards and the non-designated hospitals.
- Early in fiscal 1996-97, the Department prepared a new strategic directions document from its previous draft strategic plan. The strategic directions document was used to guide the Department during the transition period while the Department focussed on moving forward with the health renewal agenda. Detailed operational plans for the next 18 months were developed and the Department is committed to a planning cycle which includes strategic, business and operational planning. The Department hopes to have a strategic plan for the Department in place by June 1997. We believe that it is critical for the strategic planning initiative to proceed as planned. The Department also intends to produce a strategic plan for the renewed health system at a later date.
- We reported in 1995 that there is a need to publicly report on the progress of health renewal on a timely basis. Although there have been some communication initiatives in the last year including public and stakeholder consultations in various areas, we believe that there is need for more comprehensive communication. Given that a number of changes have been made to the plans outlined in *From Blueprint to Building* and the renovation schedule outlined in the document has not been completely achieved (e.g., the Emergency Health Services Act has not been proclaimed), a comprehensive report on *From Blueprint to Building* including the status to date and the plans for future implementation should be issued.
- At the time of our audit, the Department was forecasting a \$68.1 million (5.9%) net over expenditure of its approved budget for the 1996-97 fiscal year. In August 1996, the Minister announced that an additional \$64.1 million would be allocated to the

Department thus reducing the anticipated over expenditure to \$4 million (less than 1%). To date, an Order in Council approving this additional appropriation has not been issued. The Department plans to seek an OIC in the spring of 1997.

AUDIT SCOPE

8.7 The objectives of this assignment were to:

- determine the status of the planning initiatives of the Department including strategic planning; program evaluation/outcome measurement; and the establishment of an accountability framework for the Regional Health Boards;
- determine the progress made in implementing key aspects of health renewal including formation of community health boards, and takeover of hospitals and other services by Regional Health Boards; and
- review the latest projections for the Department's actual financial performance in comparison to the budget for the 1996-97 fiscal year.

8.8 The following general criteria were used in our review.

- The Department should have appropriate strategic, operational and capital plans.
- There should be an accountability framework which clearly defines the roles and responsibilities of the various players in the renewed health care system.
- Performance of major programs should be measured and reported on a regular basis.
- Implementation of key aspects of health renewal should proceed according to established plans.
- Reports on the progress of health renewal should be issued on a regular basis to the House of Assembly, and other stakeholders.
- The Department should have a realistic financial plan which is linked to the Province's expenditure control plan and the Department of Health's strategic and operational plans for health renewal.

PRINCIPAL FINDINGS

Key Initiatives undertaken during 1996-97

8.9 The Department of Health has made significant progress on several major initiatives related to planning for health renewal during 1996-97. These initiatives are described in the following paragraphs.

8.10 *Accountability framework* - In last year's Report, we indicated that the Department recognized the need to develop an accountability framework for RHBs. The Department has developed a document entitled *Accountability in Nova Scotia's Health System* which was well received by the members of the Regional Health Boards when it was discussed at the December 1996 Partners in Health Conference. This document outlines the key elements of the accountability process, including the setting of expectations, reporting and evaluation, and how these will be

achieved in the relationship between the Department of Health, the Regional Health Boards and the non-designated facilities. As well, the document describes the accountability relationship between the RHBs and the Community Health Boards.

8.11 The Regional Health Boards Act outlines the duties that RHBs shall perform, where authorized by Regulations. Some of these duties are to develop regional health-service plans, develop regional health human-resources plans, fund regional health programs and participate in the development of a provincial health plan. The accountability document discusses these requirements in more detail and includes the requirement to submit plans to the Department for review and endorsement. However, we noted that Regulations under the RHB Act passed during the year include only very generic accountability provisions:

- “11 (1) *The Board shall submit to the Minister such reports as the Minister may from time to time require.*
- 11 (2) *Without limiting the generality of the foregoing, the Board shall provide the Minister with an annual report containing such information as the Minister requires.”*

8.12 We believe that it would be preferable to have the accountability framework included in the Regulations to provide assurance that the important requirements included therein will continue to be met. The requirement for the submission of audited financial statements to the Minister should be specifically stated in Regulations or legislation.

8.13 The accountability framework requires RHBs to submit a Health Services Business Plan to the Department which includes information on health services and programs, human resources, and business. To assist Regional Health Boards in the development of Business Plans, the Department has provided the Regional Health Boards with a draft business plan template document. Business plans are scheduled to be received from the Regional Health Boards in early March 1997 and will be reviewed by senior management of the Department of Health.

8.14 *Accountability in Nova Scotia's Health System* is a major step forward in planning for health renewal. However, there are still a number of issues regarding roles and responsibilities of the Department of Health, Regional Health Boards and Community Health Boards which must be clarified. For example,

- *Funding of Regional Health Boards* - The Department has established a Regional Funding Working Group with representation from Regional Health Boards and non-designated hospitals which will examine options for future funding.
- *Regional Health Boards' role in reallocation of services* - For the 1997-98 fiscal year, funding will be non-portable, that is, the RHBs will not have the authority to move the funds from one program to another. Starting with the 1998-99 fiscal year, the Regional Health Boards will have the authority to reallocate funding. It should be noted that the RHBs must still meet the standards for health services established by the Department.
- *The role of Community Health Boards in selecting RHB members* - The Department intends to evaluate this as part of the 18-month operational plan.

8.15 The Department has established joint management and policy forums for the reformed health system. A Provincial Advisory Council was established in 1996 to develop and maintain a common mission and overall plan for the renewed health system through a forum for Province-wide planning, consultation and policy development. This Advisory Council is comprised of the Minister of Health

(Chair), the Deputy Minister and the Chief Executive Officers and Chairs of the Regional Health Boards (RHBs) and non-designated hospitals. As well, a Provincial Leadership Committee comprised of the Deputy Minister (Chair) and the Chief Executive Officers is responsible to develop coordinated service plans and policies on a Province-wide basis including business planning, clinical resource management, program planning, administration, procurement, information technology and human resource planning.

8.16 Reporting to the Provincial Leadership Committee, eight task-oriented working groups and sub-committees will examine underlying issues in more detail and provide recommendations to the Provincial Leadership Committee. These working groups are: Performance Indicators, Clinical Resource Management, Information Technology, Human Resource Planning, Labour Relations, Regional Funding, Provincial Purchasing and Management Support, and Mental Health.

8.17 *Standards for services provided by RHBs* - The Department is developing a Health Standards Manual to articulate the standards for services which the RHBs must provide. These standards should help to reassure the public that certain services will be available in each Health region. Currently this manual relates to services for Drug Dependency and Public Health. Mental Health is being dealt with separately. As well, the development of standards for Acute Care is now underway. For Drug Dependency and Public Health, the manual identifies the core services (e.g., Drug Dependency - Health Promotion), the focus population, the outcome (e.g., programs contribute to reduced incidence and prevalence of harm arising from alcohol/other drug/gambling use and abuse), the target, the accessibility, staff and measurement approaches.

8.18 This draft manual has been presented to the RHBs for discussion and comment. It is anticipated that the standards for Drug Dependency and Public Health will be agreed to by April 1997. While there is still much to do before the manual is complete, the manual represents an important first step in communicating the standards of service to be provided by the Regional Health Boards.

8.19 *Community Health Boards* - Health renewal includes the formation of Community Health Boards. The role of the Boards is clearly specified in the Accountability Framework with one major exception. The *Blueprint Report* recommended that one of the responsibilities of the Community Health Boards would be to appoint 2/3 of the members of the Regional Health Boards. However the *Accountability in Nova Scotia's Health System* document did not note this as a responsibility of Community Health Boards. The decision as to whether this will be a responsibility of the Community Health Boards has been placed on hold and will be evaluated according to the 18-month operational plan. In the meantime, interim RHBs have been established through appointment by the Minister.

8.20 As of February 1997, 18 Community Health Boards had been established by the Regional Health Boards. Interested people were solicited through a variety of mechanisms and applications were evaluated by a Community Steering Committee using predefined selection criteria. A number of materials have been developed by the Department to assist Community Health Boards in their new role. These materials provide information on relevant areas such as how boards make decisions, developing teams, consensus, how to develop a primary health care plan, sources of information, research strategies, and data analysis supports. As well, information about the various programs offered by Health, the *1995 Health Survey Highlights*, and a resource guide entitled *Getting Started, A Resource for Community Health Planning* were included with the materials.

8.21 The Department has indicated the next step in the process will be to conduct an evaluation of the functioning of the Community Health Boards. The development of Regulations for Community Health Boards has been placed on hold until this evaluation process has occurred. The Department expects to prepare a formal report on the evaluation.

8.22 *Designation of hospitals and devolution of services to Regional Health Boards* - As of January 1, 1997, all hospitals with the exception of four merged sites or tertiary facilities - Nova Scotia Hospital, QE II Health Sciences Complex, the Cape Breton Healthcare Complex and the Izaak Walton Killam-Grace Health Centre for Children, Women and Families - had been designated to the Regional Health Boards. In all cases, Regulations including the basic accountability provisions noted in paragraph 8.11 above were in place prior to designation.

8.23 On April 1, 1997, responsibility for Drug Dependency and Public Health will be devolved to the Regional Health Boards. Other programs will be devolved according to the Department's operational plan. For the first year of operation, it is anticipated that few changes will be made to the devolved programs and the budgets assigned to those services will be non-portable at this time. Starting with the 1998-99 fiscal year, the RHBs will have the authority to reallocate funding.

8.24 *Quality, Collaboration, Integration, and Support: A Health Research Strategy* - In April 1996, the Task Force issued a report containing 20 recommendations on health research in Nova Scotia. A draft response to this report has been prepared by Department staff but to date it has not been finalized by senior management. The report recommended the establishment of a Nova Scotia Health Research Foundation however the identification of the source and amount of funding for the Foundation is a major stumbling block to the acceptance of the report.

8.25 *Health Survey* - In 1996-97, the Department released *1995 The Nova Scotia Health Survey* which presents information on 3,227 adults from across the Province. This survey was designed as a 10-year follow-up to the 1986 Nova Scotia Heart Health Survey and was expanded to combine information on risk factors for heart disease with other important measures of health such as symptoms of depression, screening practices, and care giving activities. This information can be used by communities, organizations, and governments to develop policies and plan programs to improve the health of Nova Scotians.

8.26 *Other initiatives* - The Department has also made progress on other initiatives including the implementation of Emergency Health Services, tobacco control implementation, Home Care Nova Scotia (see Chapter 7) and the establishment of a devolution team for Drug Dependency and Public Health.

Follow-up on Planning Initiatives included in 1995 Audit

8.27 *Strategic plan* - In our 1995 Annual Report, it was noted that the Department of Health had developed a draft strategic plan which was targeted for finalization in March 1996. This draft plan included the overall purpose and direction for the Department but did not include specific objectives and actions required to achieve the strategic goals.

8.28 Early in fiscal 1996-97, the Department prepared a new strategic directions document from its previous draft strategic plan. The strategic directions document was used to plan and guide the Department during the transition period while the Department focussed on moving forward with the health renewal agenda.

8.29 The Department established an operational plan which identified a number of strategic areas or priorities including regionalisation, home care development and communications. Detailed operational plans for these priorities over the next 18 months were developed which include time frames for completion of the tasks outlined in the plans.

8.30 Our discussions with staff at the Department indicate that it is committed to a planning cycle which includes strategic, business and operational planning. A proposal will be submitted to senior

management in the near future which will outline how the strategic planning process will work. A Steering Committee chaired by the Deputy Minister will be established to oversee the work of the strategic planning team. All areas of the draft strategic directions document will be reviewed. The Department hopes to have a departmental strategic plan in place by June 1997. The Department, in conjunction with the Provincial Advisory Committee, also intends to produce a strategic plan for the renewed health system at a later date.

8.31 *Management information systems* - Last year, we reported that the Department had drafted a memorandum to the Priorities and Planning Committee recommending a Province-wide health information systems strategy. Approval was received to proceed with a Call for Proposals, however due to severe financial challenges, the decision was made not to embark on a public-private partnership as planned.

8.32 The Department has prepared a proposal for funding of seven major projects relating to management information systems under the Canada/Nova Scotia Cooperation Agreement on Economic Diversification. This Agreement was designed to expand and diversify the economic base of Nova Scotia. The projects submitted by Health focus on updating old hardware and software to current specifications which would enable the Department to proceed with the development of a Health Intranet - linking health-related entities electronically.

8.33 In addition, the Department has initiated the development of an integrated Management Information System (central health information database) which will provide statistical information and other data to RHBs and other health entities for sound decision making.

8.34 *Program evaluation/outcome measurement* - Indicators included in *Government By Design* are very broad and are directed towards achieving a healthier Nova Scotia. Indicators for the 1997-98 *Government By Design* document are currently under review as the Department would like to include additional broad-based indicators of the health of Nova Scotians.

8.35 Senior management and branch directors receive quarterly and annual indicator reports. These reports include comparisons from year to year and between regions. The Department has established targets for some of the indicators, but not all. While we recognize the difficulty in developing meaningful targets, we urge the Department to develop targets for all indicators. Targets enable senior management to monitor the performance of the Department and take action on problem areas.

8.36 The Department is working on new indicators which provide more comprehensive information than the indicators currently in use. Many of the new indicators will not be available until new information systems are developed.

Monitoring and Reporting the Progress of Health Care Renewal

8.37 In our 1995 Annual Report, we noted there was a need to publicly report on the progress of health care renewal on a timely basis. As well, the Department informed us that it had planned to launch a major communication initiative in the spring of 1996 which would provide the public with a progress report on health care renewal, the rationale for actions taken and assurance of continued quality health care. In September 1996, a direct mail pamphlet was delivered to all homes in Nova Scotia which provided a basic overview of some of the changes in the health care system. We are concerned that this pamphlet does not provide the necessary level of detail concerning the progress of health renewal.

8.38 We recognize the nature of communicating with the public on the “health agenda” is that multiple audiences have very different and specific needs, both in terms of the type of information they seek and the forum in which the information is communicated so as to be meaningful. Meeting the expectations of all in terms of adequate communication is extremely difficult. The Department issues press releases and conducts information seminars at public forums such as the Seniors’ Expo which we feel are important to provide information to the public. As well, several presentations on health renewal were made at the December 1996 Partners in Health conference, a speaking tour of 19 hospitals was conducted in the spring of 1996, and numerous public consultations were held during the development of key policies for Home Care Nova Scotia, Long Term Care Advisory Committee and Community Health Boards. However, these communication vehicles provide only fragmented information on health renewal to certain target groups and do not provide a complete picture of the direction and status of health renewal for the general public.

8.39 As noted in our 1995 Report, the communication of future plans to key stakeholders including consumers and employees of the health care system is critical to the success of health care renewal. Such communication is also necessary to achieve appropriate accountability.

8.40 The Department continues to work toward meeting the objectives of *Nova Scotia’s Blueprint for Health System Reform*. As noted in our 1995 Report, the *Blueprint* was accepted by the Department as the framework for health care renewal. *From Blueprint to Building* was issued in April 1995 as a response to the *Blueprint* and it noted that future highlights would be issued to keep the public informed of changes. To date, there has not been a comprehensive update on the status of the implementation plans noted in *From Blueprint to Building*. Management has indicated that progress is monitored by the Department on a monthly basis.

8.41 Given that a number of changes have been made to the plans outlined in *From Blueprint to Building* and the renovation schedule outlined in the document has not been completely achieved (e.g. the Emergency Health Services Act has not been proclaimed), a comprehensive report on *From Blueprint to Building* including the status to date and the plans for future implementation should be issued.

Review of 1996-97 Financial Performance

8.42 The Department required additional appropriations of \$79 million for the 1995-96 fiscal year. In June 1996, the Department of Health (with the support of the Priorities and Planning Secretariat and the Department of Finance) initiated a study to determine the reasons for the over expenditure. The study was undertaken by staff of the Department of Finance’s Internal Audit Division under direction from a Steering Committee comprised of Deputy Ministers. This was followed by a Department reorganization in August 1996.

8.43 At the time of our audit, the Department was forecasting a \$68.1 million (5.9%) net over expenditure of its approved budget for the 1996-97 fiscal year. We noted the following categories contributed \$67.7 million (99.4%) to this shortfall:

- Insured Program Management by \$22.4 million (Payments to Physicians \$15.8 million, Pharmacare \$3.9 million, Other \$2.7 million);
- Home Care by \$8.9 million;
- Hospital Insurance by \$45.5 million (Expenditures \$20.6 million over, Out of Province Recoveries \$20.6 million under budget, Other Recoveries \$4.3 million under budget); and
- Capital Construction was under the budgeted amount by \$9.1 million.

8.44 In August 1996, the Minister announced that an additional \$64.1 million would be allocated to the Department thus reducing the anticipated over expenditure to \$4 million. To date, an Order in Council approving this additional appropriation has not been issued. The Department plans to seek an OIC in the spring of 1997.

8.45 We are concerned that the budgeting process did not yield a budget that could be reasonably achieved. For example, officials from the Department did not have input into the budget for the Out of Province Recoveries which will be short by \$20.6 million. In addition, our audit of Home Care Nova Scotia (see Chapter 7) indicated an approved budget of \$49 million but that Home Care Nova Scotia viewed its budget to be \$60 million even though the additional funding was not announced until the fall of 1996.

8.46 Department officials also commented that service levels for physicians have not increased dramatically over the years, but that the government's expenditure plan placed a cap on physician payments of \$246 million which could not reasonably be met without significant changes to the unit value or physician payment schemes. The most recent agreement with the Medical Society of Nova Scotia (March 1995 - 1997) indicates that any shortfall will be recovered through changes to the unit value during the 1997-98 fiscal year unless the parties agree to another solution. The unit value, which is the basis for fee-for-service payments for physicians, was last adjusted on April 1, 1995. The Department recently issued a discussion paper *Good Medicine: Securing Doctors' Services for Nova Scotians* which outlines alternate methods of payment for physician services.

8.47 During our interviews, it was noted that significant funds (\$29 million) have been spent under the Compensation Assistance Program/Labour Adjustment Strategy. This program was designed to provide assistance with the additional expenditures to be incurred as a result of hospital closures and other layoffs. Early retirement incentives were part of this program and related payments were made to the Nova Scotia Association of Hospital Organizations (NSAHO) pension plan. The Department is now considering a partnership with the Department of Finance to have an actuarial study conducted to determine if the amount paid to the pension plan in relation to this program was appropriate.

8.48 The Department is continuing to review its financial position and make adjustments to ensure fiscal targets are met. The Department has informed us that finance is the first item on the weekly Senior Management Committee agenda. As well, Health has conducted meetings with the Department of Finance to ensure mutual understanding of Health's financial position and budget for the 1997-98 fiscal year and strategies for managing the target approved by government.

Status of Major Reports

8.49 *Report of the Pharmacare Working Group* - As of February 1996, the Department had addressed all accepted recommendations except for 10 which were to be completed by January 1997. As of February 1997, the Department had completed one and six more were in various stages of completion. Many of these six recommendations are the subject of ongoing discussions and definite completion dates could not be determined. One other recommendation was contingent on successful negotiation with generic drug manufacturers which did not materialize. The remaining two recommendations are under consideration and the Department has not determined if these will be implemented.

8.50 *Report on Emergency Health Services* - As of February 1996, there were a number of recommendations of the report which had not been implemented. Many recommendations were dependent on the proclamation of Bill 96 - Emergency Health Services Act. To date, Bill 96 has not been proclaimed and Department officials have informed us the Bill has undergone major revisions

to address deficiencies in the area of accountability. The revised Act has been submitted to the Minister for review but at this point in time it is unknown when the revised Bill will be taken to the House of Assembly.

8.51 Our discussions with Department officials indicate the Emergency Health Services Division has continued to work towards the goals of the Report. The Department has worked with the various entities involved in Emergency Health to formulate solutions to the problems facing this area. While this consultative approach has worked to date, staff acknowledge the Act is necessary to provide authority to implement solutions that may not be agreeable to all. In some cases, the Act is necessary before some recommendations can be implemented. Many of these recommendations refer to the creation of an independent Emergency Health Services Agency, the bylaws of the Agency, the staffing and Advisory Board. Without an Act establishing the Agency, several of these recommendations will remain outstanding.

8.52 *January 1994 Joint Management Audit of the Departments of Health and Community Services* - Last year, we reported that the Department had implemented all but 16 of the accepted recommendations related to the Department of Health. As of February 1997, the Department had begun to address 10 of the remaining recommendations. Another five are scheduled for completion the first half of fiscal 1997-98 and the last recommendation will be implemented in the 1998-99 year. The explanations provided by the Department relating to the six recommendations not yet implemented were reasonable.

CONCLUDING REMARKS

8.53 The Department of Health has made significant progress during the last year in addressing some of the key elements of health renewal such as definition of an accountability framework for the major players in the renewed health system. Progress continues in addressing the recommendations of key reports prepared for the Department in the past. Another key initiative has been the formation of the Provincial Advisory Council and the Provincial Leadership Committee which will serve as a policy development and issues forum for the renewed health system through joint management by the Department, the Regional Health Boards and the non-designated hospitals.

8.54 We believe that there should be a well defined strategic plan which outlines the direction of the Department in achieving health renewal. Without such direction, it is possible that renewal initiatives will be fragmented, and not as well integrated as they should be. We acknowledge the existence of 18-month operational plans and planning initiatives in the past such as the *Blueprint Report* and *From Blueprint to Building*, and joint planning with the Regional Health Boards and non-designated hospitals through the Provincial Advisory Council and Provincial Leadership Committee. However, there are certain sections of the *Blueprint* which have not yet been implemented and it is unclear as to whether they will be addressed. A strategic plan would help to ensure that all stakeholders have a common understanding of the future direction of the Department. We are cognizant of the urgent time frames and tasks necessary for health renewal. However, given the significant dollars under the control of the Department, it is critical that the strategic planning initiative (both for the Department and for the renewed system) proceed as planned by the Department.

8.55 Communications play an important role in the health renewal process. A formal, comprehensive update on the status of the recommendations outlined in *From Blueprint to Building* is necessary to provide interested parties with appropriate information on health renewal and to provide the appropriate accountability to the public on the rationale for decisions made and changes to the recommended plan of action.

9.**HOUSING AND MUNICIPAL AFFAIRS -
INFRASTRUCTURE WORKS PROGRAM****BACKGROUND**

9.1 In early 1994 the Federal government entered into an agreement with each province and territory to implement the Canada Infrastructure Works Program. The Canada/Nova Scotia Infrastructure Works Agreement was signed on January 14, 1994 and its purpose is to:

- *“renew and enhance the quality of Canada’s and Nova Scotia’s infrastructure which is instrumental in the provision of public services, notably in local communities; and*
- *provide for timely and effective employment creation.”*

9.2 The financial and operating responsibilities of the parties involved are outlined in the Agreement and are illustrated in Exhibit 9.2. The responsibilities of Nova Scotia and the Federal government are exercised through a Management Committee which consists of four members, two of whom are appointed Federally and two by the Province. The Committee is headed by a Provincial Co-chair and a Federal Co-chair, each of whom are deputy ministers, and both co-chairs must agree on a decision before the Committee may act upon it.

9.3 The Federal implementing agency for the Program is the Atlantic Canada Opportunities Agency (ACOA). Federal contributions to the Program will total \$68.8 million and have been budgeted for receipt until March 31, 1998. The remaining 2/3 funding will come from Provincial and other sources. The Province plans to contribute \$68.6 million over the same period through the budget of the Department of Housing and Municipal Affairs (formerly the Department of Municipal Affairs). Another \$68.6 million will be spent by project proponents which are municipal units and non-municipal organizations.

9.4 Funds were to be disbursed in each of the three years of the Program although only 15% of the total was to remain for distribution in 1996-97, the third year of the Program. This restricted schedule influenced the projects selected for funding under the Agreement as Federal funds had to be expended by March 31, 1997. This date was revised through subsequent amendments to the Agreement to March 31, 1999.

9.5 Over 700 applications from municipal units and other applicants in Nova Scotia have been received to date and 316 projects have been approved for funding. The funding for most projects is shared equally among the Federal, Provincial and duly-elected municipal governments. The majority of projects will be owned by municipal units upon completion, however, the Province has contributed approximately \$8.8 million to 47 projects which will be owned by non-municipal organizations including \$3.7 million in university projects.

9.6 The Program has been subjected to an extensive audit by the Auditor General of Canada and many observations from that review, dated November 1996, have been included in this chapter. The Program has also been audited by the Audit & Evaluation branch of ACOA and the report resulting from that assignment was released in June 1996.

9.7 In February 1997 the Province announced that an amendment was to be made to the Agreement to provide for additional funding. The Federal government will contribute \$14.3 million to the Program during the period April 1, 1997 to March 31, 1998. The Province, and municipal and non-municipal entities, will provide the remaining 2/3 funding, for a total investment of at least \$42.8 million.

RESULTS IN BRIEF

9.8 The following are the principal observations from our review.

- The results of Program funding to date indicate that about 72% of the projects address core infrastructure needs (sewer, water and transportation). The majority of the remaining projects are described as meeting community needs such as fire stations, church improvements, and recreational facilities. The Agreement defined infrastructure as “*physical capital assets in Canada instrumental in the provision of public services.*” The Auditor General of Canada has noted that this definition allows for a broad interpretation of infrastructure. The definition in the Agreement is not precise enough for us to conclude on whether it extends to all community needs projects.
- The Department of Municipal Affairs consulted with the Departments of Health and Environment to determine water and sewer needs for the Province. The most significant sewage problems identified through this process were dealt with through the Program.
- The Management Committee should establish an audit process to ensure that proponents comply with the terms and conditions of the Agreement, particularly with respect to awarding and monitoring contracts for goods and services.
- An evaluation of the Program has been completed by an external consultant and it notes that the actual jobs created for projects examined are significantly lower than the estimates provided at the time of project application. For example, the eight approved projects in Halifax were estimated to yield 325 short-term jobs; the contractors interviewed as part of the evaluation estimated that 203 jobs, or 60% were actually created. In one instance, a project was estimated to yield 140 short-term jobs but it was estimated that 35 jobs, or 25% were actually created.
- Documents made available to the public which attribute job creation to the Program should indicate that these statistics are based on estimates. The January 1997 Program Newsletter notes for the first time that job statistics are based on the Statistics Canada input/output model.
- Applications were evaluated by Departmental staff in order to determine which projects should be nominated. Although specific criteria were addressed in this evaluation, we were unable to conclude on the appropriateness of the evaluation process as there was insufficient documentation in project files. There was also insufficient evidence to support the Department’s assessment of the reasonableness of project costs although in some cases there were consultants’ reports to support these costs.
- Policies and procedures were developed by Departmental staff for the review and processing of project claims for Federal/Provincial funds. While we noted instances

where there were departures from these policies and procedures, in general the claim process was adequate.

AUDIT SCOPE

9.9 The objectives of this assignment were to:

- review and assess the management of the Program, including planning, monitoring and reporting;
- review the project approval process and assess the adequacy of the documentation;
- select a sample of projects and test them for compliance with established guidelines; and
- test the process for submitting cost recovery claims to ACOA to ensure the Province recovered these funds on a timely basis.

9.10 Our approach included interviews with staff at the Department of Housing and Municipal Affairs, and a review of information made available to us. We tested 70 of the 314 projects approved to August 1996 for compliance with specific provisions of the Agreement and with established policies and procedures.

PRINCIPAL FINDINGS

Roles and Responsibilities

9.11 Exhibit 9.2 outlines the roles and responsibilities of the Federal and Provincial governments, and project proponents. The responsibilities of the Management Committee are noted in the Agreement. A review of the minutes of the Management Committee meetings indicates that a process was defined for the approval of nominated projects. Guidelines for the eligibility and assessment of projects were reflected in the Program information packages.

9.12 Roles and responsibilities for Departmental staff included application review and selection, and recommendation to the Provincial Co-chair for nomination to the Management Committee. Staff also administered the Program and performed functions such as project tracking, cash-flow management, claiming Provincial funds owed by the Federal government, communication and other functions.

9.13 We were told that the time frame of the Program influenced the development of policies and procedures. For example, projects requiring extensive pre-design engineering and environmental work were not considered since these processes would have exceeded the original Program completion date of March 31, 1997.

Project Selection

9.14 *Project eligibility* - The Agreement defines infrastructure as “*physical capital assets in Canada instrumental in the provision of public services.*” The November 1996 Report of the Auditor General of Canada noted the following.

“This definition allows for a very broad interpretation. It was used, for example, to justify assisting investment by firms involved in private sector or quasi-private sector activities such as recreational services...and extending natural gas distribution networks to private consumers... Traditionally, infrastructure assistance programs have focussed on the public sector. The scope of government assistance for infrastructure development merits clarification in any future federal-provincial agreements for programs of this type.”
(Paragraph 26.41)

9.15 The definition of infrastructure was not articulated in detail by the Management Committee but there was some clarification provided and communicated in the General Program Information sheet included in the information package distributed to Provincial municipal units. Infrastructure for purposes of the Canada-Nova Scotia Agreement is defined in terms of Provincial priorities and is described as follows.

“The Nova Scotia provincial priorities for the Infrastructure Works Program are the core infrastructure areas of municipal solid waste disposal and water supply and municipal transportation infrastructure. Other priority projects for consideration are high technology for municipal services and community needs projects.”

9.16 These priorities were established within the Department through consultation with other Provincial departments. File documentation at the Department indicates verbal approval by ACOA of the information packages before they were distributed. This distribution was noted at the Management Committee meetings.

9.17 *Allocation to geographic areas* - Funds were allocated to the 18 counties within the Province based on a formula which considered population and unemployment factors within each county. Staff noted that the result of this allocation method was that 18 infrastructure programs were run simultaneously. Universities within Nova Scotia were also asked to submit applications for projects eligible under the Program. Funds for university projects were taken from the allocation of the county in which the university is located.

9.18 Municipal units within each county submitted applications to the Department for projects they wished to have funded through the Agreement. In addition to municipal units, other entities applied to receive funding for projects which were of a community nature. In order to be considered, there had to be support from the respective municipality for these projects as the funds came out of that county's allocation.

9.19 Several municipal units indicated priorities for the projects for which they applied. Although Departmental staff indicated that they challenged priorities of certain municipal units, no projects were nominated which had not been applied for or supported by a municipal unit, and projects were considered by the Department based on the priorities noted by the municipal units and the ability of the applicant to fund its share of the project.

9.20 *Application priorities* - Staff indicated it was not possible to analyze and prioritize core infrastructure needs on a Province-wide basis. There was insufficient information to develop a Province-wide priority list for transportation needs. Staff worked closely with the Departments of Health and Environment (DOH and DOE) to develop lists of water and sewer projects which reflected those Departments' priorities at that time.

9.21 The core infrastructure needs of municipal units were considered by Departmental staff when applications were reviewed in the first few months of the Program. Staff from DOE and DOH were also involved in the discussion of projects to be nominated to the Management Committee. Although there was a list reflecting Provincial priorities for water projects, we were informed that

water projects were not given the same priority as sewer projects as there is a mechanism, through water rates, to finance these projects.

9.22 Applications were reviewed numerous times and, in continuous consultation with DOE and DOH, Departmental staff recommended core infrastructure projects from the remaining applications. The priority of a project to a municipality, the availability of Program funds and the timing of the project were also considered. A review of the projects funded under the Program indicates that many of the top sewage priorities identified by DOE were met to a great extent. We observed that of the 178 projects nominated between February and May 1994, 150 or 84% were projects addressing core infrastructure needs.

9.23 The Province has approved 316 projects and contributed \$67.9 million to the Program as of February 28, 1997 and the amount is distributed as illustrated in Exhibit 9.1.

9.24 *Project evaluation and approval* - The Agreement notes that the Management Committee is to assess all nominated projects. The Committee meeting minutes indicate discussion on some specific nominated projects. Background information would have been provided verbally on each nominated project as well as a completed Project Evaluation Summary, and we have been informed that each project was discussed to some extent. All projects were nominated to the Committee by the Provincial Co-chair as is required by the Agreement. These nominations resulted from recommendations of Departmental staff who performed the detailed project evaluations.

9.25 Applications were assessed according to the criteria noted in the Agreement and the result of the assessment process was a Project Evaluation Summary. These criteria included, among others, the incrementality or acceleration of a project because of the Program, the number of short and long-term jobs created by that project, and enhancing environmental quality and sustainability. Staff indicated that they also assessed each project against the first priority which was whether the project provided for renewed infrastructure.

9.26 Although each of these criteria was evaluated by the Department for projects to be nominated, there is no documentation in project files to support this evaluation. Applicants were not asked to address each criteria in their applications. For example, we were unable to determine the incrementality or acceleration of individual projects because the municipal units were not required to submit capital budgets with their applications. With respect to this particular criteria, staff noted that the incrementality and acceleration of many projects were questioned by ACOA, and staff followed up the issue with the project proponent. However, there is no file documentation to support this process.

9.27 In our view, there should be adequate documentation in project files to support the conclusions of the Department in recommending projects for nomination. A lack of documentation was also noted by the Auditor General of Canada as a result of that Office's Canada-wide examination of files maintained by the Federal departments involved:

“While some proposals for large and complex projects contained more detailed analysis...Most of the 200 project proposals we examined [nationally] lacked persuasive analysis of the projects against selection criteria.” (Paragraph 26.70)

“For example, in determining whether projects would represent additional [incremental or accelerated] investment by a municipality over and above what would otherwise have occurred, federal representatives often accepted provincial assessments [that were] made simply on the basis of a declaration by the applicant, without any supporting information or analyses.” (Paragraph 26.73)

Implementation and Monitoring

9.28 As noted in paragraph 3.3 of this Report, the *Policy on Government Procurement* does not apply to municipalities. Section 5 of the Agreement details procedures to be followed when contracts for goods and services are entered into for projects approved for Program funding. These procedures, along with others including the right of the members of the Management Committee or their representatives to inspect the terms of the contract, are described in Schedule C to the Agreement. Project proponents must sign this and Schedule A and return them to the Department before receiving any Program funds. The definition of costs eligible for funding under the Agreement is also noted in Schedule C.

9.29 In our view, Management Committee should have established an audit process to ensure that contracts for procurement of goods and services were awarded in accordance with the Agreement and that funds were spent for the intended purposes. This process should be independent of the administrative procedures undertaken by staff to ensure compliance. Our concerns regarding deficiencies in monitoring contracts are supported by comments from the Auditor General of Canada:

“...the Canada Infrastructure Works Program is a contributions program...Contribution agreements are subject to audit to satisfy the implementing federal departments that all conditions, financial and non-financial, have been met.” (Paragraph 26.46)

“We found, however, that the [federal-provincial] agreements do not clearly identify roles and responsibilities for providing ongoing monitoring and performance information and carrying out audits.” (Paragraph 26.47)

9.30 We are aware that certain projects have been monitored but that this was not done as part of an audit process to ensure compliance with the Agreement. We also understand that there are established industry practices regarding the receipt of permits and licences, particularly with respect to construction projects. However, given the accountability requirements inherent in an agreement of this nature, we recommend that a monitoring system be established, and that the Department's internal audit group implement this system. We noted that the draft amendment to the Agreement covering additional Program funds to March 31, 1998 requires the Management Committee to approve an audit plan for the Program.

9.31 We were pleased to note that the Department requires the costs of completed projects to be audited by a registered municipal auditor and reported on a Final Claim form. In future, the audit should determine whether the costs comply with the terms of the Agreement and there should be a requirement for on-site inspection as part of the municipal audit process.

Outcome Measurement

9.32 *Program evaluation* - An evaluation of the Program is required under Section 9.0 of the Agreement. An evaluation was performed by an independent consultant selected by the Management Committee and the resulting report was released in June 1996.

9.33 The purpose of the evaluation was to assess the impact of the Program against its primary objectives of job creation and improvements to infrastructure in Nova Scotia. Three municipal units were selected for the evaluation - the Town of Digby; the City of Halifax; and the Municipality of the County of Victoria. Each unit was evaluated against similar criteria - how the unit selected the projects for which it applied; the extent of incrementality of the projects undertaken; and the impact of the Program on areas such as the local economy and employment in the municipal unit.

9.34 The evaluation report notes that all three units submitted applications for projects they considered to be priorities. Approved projects in Halifax and Victoria initiated by non-municipal organizations represented 9% or less of total Program funds for these units. In terms of assessing whether approved projects were incremental, the report concludes that projects ranged from partially to fully incremental, the latter being those projects which would not have taken place without funds provided by the Program.

9.35 In evaluating the impact of the Program on employment in each of the municipal units, the report notes that, for two of the three units, the number of actual jobs created from the projects undertaken was significantly lower than the estimates provided at the time of application. For example, the eight approved projects in Halifax were estimated to yield 325 short-term jobs; the contractors interviewed as part of the evaluation estimated that 203 jobs, or 60% were actually created. One specific project was estimated to create 140 short-term jobs but it was estimated that 35 jobs, or 25% were actually created.

9.36 It should be noted that in addition to the primary objectives of the Program as indicated in paragraph 9.1, there were secondary objectives such as upgrading and maintaining worker skills and developing new technologies. The evaluation did not address these secondary objectives and therefore we cannot comment on the extent to which they were met.

9.37 *Program reporting* - Regular reports are prepared by staff at the Department for the Deputy Minister and a report is also prepared on a quarterly basis for the Minister's briefing book. Details of the Program are noted in the Department's Annual Report and *Government By Design* and in a joint newsletter of the Department and ACOA titled *Nova Scotia at Work* which is published on the anniversary date of the signing of the Agreement.

9.38 With the exception of the report prepared for the Deputy Minister, all other documents provide statistics on job creation. The job creation figure is obtained from the estimates for short and long-term jobs noted on the application forms submitted for each project. These estimates may be reviewed by senior staff at the Department for reasonableness, but they are not updated to reflect the current employment situation as the project progresses.

9.39 Our concern regarding the accuracy of the job creation statistic used in reporting on Program results is supported by the findings of the Program evaluation as noted in paragraph 9.35. The accuracy of job creation statistics reported to the public is also an issue discussed in the Report of the Auditor General of Canada. That Report notes that the program's employment effects are calculated using a Statistics Canada model which considers both on-site and off-site employment benefits. The Report notes:

"In the context of this audit, the issue is not the reliability of Statistics Canada data. Rather, the issue is the appropriateness of relying exclusively on this approach to determine the amount of employment created directly by the program. We believe there are sound reasons for supplementing the on-site employment estimates derived from using the Statistics Canada approach with other sources of information, including operational data from ongoing monitoring of individual projects." (Paragraph 26.106)

"In addition, we believe the limitations of the estimates ought to be pointed out in reporting them to the public ..." (Paragraph 26.106)

9.40 We noted that the newsletter published in January 1997 indicates that job creation statistics are based on the Statistics Canada model.

Compliance with Agreement

9.41 We reviewed 70 approved projects for compliance with the Agreement and with established policies and procedures. In addition, we assessed the adequacy of documentation in the approval process, and determined whether the selected projects were undertaken with due regard for economy and efficiency.

9.42 *Application/approval process* - Section 3.5(b) of the Agreement notes that projects will be nominated by the Provincial Co-chair and that they will be evaluated by technical experts. The timing and nature of this evaluation is unclear from the Agreement.

9.43 Department staff completed a Project Evaluation Summary for each nominated project as noted in paragraph 9.24. Staff providing input to the Summary included professional engineers and others knowledgeable of municipal infrastructure requirements. In 50 of the 70 projects we tested, the Summary was supported by design studies or other external consultants' reports. Studies were not present for all projects of a similar nature. It is not clear whether the completion of the Project Evaluation Summary for projects for which there was no additional external support satisfies the requirement of a technical evaluation per the Agreement.

9.44 A formal cost analysis for each project was not prepared. This would include a review of cost components including labour and materials. We were informed that staff assessed the reasonableness of some project costs by comparing them with similar projects although there is no documentation of this process. Project costs were supported by external consultants' reports in 37 of the projects we tested.

9.45 We noted that in the two instances where the Department had required certain conditions to be met prior to funds being advanced, there was no documentation in the project files to indicate that the project proponent had met these conditions.

9.46 As noted in paragraph 9.28, Schedule A must be signed by the project proponent and returned to the Department before any funds are advanced for an approved project. We noted one instance where a revised Schedule A - Project Authorization Summary was not signed by a municipal representative before project funds were advanced. We also noted that Schedule C was not present in six of the 70 project files we reviewed.

9.47 Finally, 14 projects we reviewed were funded completely or in part by non-municipal organizations. For nine of these projects, there was nothing in the project file to indicate that the ability of these organizations to finance their share of the project costs had been verified.

9.48 *Procurement process* - We requested project proponents provide us with documentation to enable us to determine, for our sample items, whether a competitive process was in place for the significant contracts awarded and whether the lowest qualified bid was accepted. We limited our procedures to the largest contract associated with the project.

9.49 We received 49 responses to the 58 requests we made (there were 9 projects for which interim claims had not yet been submitted and 3 projects for which only a project manager had been selected to date) and noted that for 44 of these responses, or 90%, there was a competitive process and the lowest bid was accepted. In 5 instances, the contract was sole sourced.

9.50 *Claim process* - Although the Agreement defined eligible costs, it did not provide much guidance with respect to the claim process. We noted that the Department established clear policies and procedures with respect to submitting and reviewing claims, including further clarification of eligible costs.

9.51 A detailed review process which identified ineligible costs claimed and any errors in the claims submitted was developed by Departmental staff. The claim forms and supporting documentation were reviewed in detail for the eligibility of costs claimed, mathematical accuracy, etc. Evidence of these reviews was provided on the claim forms. In addition, staff relied on the review provided by professional engineers on construction progress claims and the fact that each claim form was approved by a municipal signing authority as evidence of a further check on cost eligibility.

9.52 In order to facilitate the completion of the project audit by a municipal auditor, the Program Administrator established a practice of holding back funds on the last claim submitted before the Provincial and Federal shares reached their maximum, regardless of whether there was also a construction holdback. Unfortunately, this practice could not be applied when projects were completed under budget. The Final Claim form described in paragraph 9.31 must still be signed and submitted for each project.

9.53 We noted that there is inadequate segregation of duties for the processing of payments to municipalities and other project proponents. A person independent of the claim review process should be responsible for receiving the cheques from the Provincial Department of Finance, and distributing these cheques to project proponents for the recovery of the Federal and Provincial portion of project costs.

9.54 Our review of 482 claims for the 70 projects sampled revealed several deficiencies of an administrative nature and we have discussed these with Department staff. We also detected monetary errors in 28 claims or supporting invoices but noted that the total error was insignificant in light of total Program expenditures.

Reimbursement Process

9.55 The Province submits claims to recover the Federal portion of project costs on a monthly basis. We tested 19 of the 46 claims submitted to date and our tests indicated that the claims were properly approved, supported, accurate and remitted on a timely basis. Funds were received from ACOA within one to three months of the submission of the claim. We noted that the individual responsible for preparing the claims also receives the resulting cheques from the Federal government. We recommended that the cheques be received by an individual independent of claim preparation and this change has been implemented.

Osprey Ridge Golf Course

9.56 The Province has contributed toward the first phase of a project for an 18-hole golf course in Lunenburg County. This phase involved clearing and grading land in preparation for further course development. Construction costs for the balance of the project are being financed by the Municipality. This project has received a significant amount of media and political attention and therefore we reviewed the Province's involvement in the project through the Program.

9.57 The golf course will be operated by a private club although one condition of funding approval under the Agreement is that it be accessible to the public. The golf club is not required to contribute any funds until the course starts operating.

9.58 The land being used for the golf course is owned by the Municipality and will be purchased by the golf club at its fair market value of \$500,000. Payments will be made annually from 2002 to 2011 although these payments will not include interest.

9.59 In addition, the Municipality has borrowed \$2.5 million from Municipal Finance Corporation. This amount, plus interest, will be repaid to the Municipality over 20 years by the golf club. Title to the golf course transfers to the golf club when the loan is repaid.

9.60 The Province's involvement in the golf course project was similar to its involvement with other projects funded under the Program:

- the project was proposed by and was a priority of the Municipality as a community needs project (see paragraphs 9.14 and 9.18);
- the Department reviewed the Municipality's ability to pay its share of project costs;
- the project was approved by the Management Committee with certain terms and conditions noted in Schedule C - Terms and Conditions, and Schedule D - Federal Environmental Screening Report; and
- the Municipality agreed to abide by the terms and conditions of the Agreement.

9.61 Environmental issues and the process used by the Municipality to approve and secure financing for the project are drawing attention to this project. As noted previously, our audit objectives did not include a review of municipal practices and therefore we cannot comment on the appropriateness of the Municipal approval process or the ability of the Municipality to finance this project. As noted in paragraph 9.49, we requested support for procurement of the largest contract (golf course construction) and determined that there was a competitive process and the lowest qualified bid was selected.

9.62 In terms of environmental issues, our procedures were limited to ensuring that the Federal Environmental Screening Report had been completed for the items in our sample, which included this project. The final approval letter provided to the proponent indicated that the final approval package would be forthcoming. The package was provided about six months later and included the Screening Report. A review of the invoices submitted for reimbursement indicates no significant work with respect to this phase of the project had taken place prior to the provision of that Report.

9.63 A representative from the Department of Environment made site visits to determine whether general Provincial environmental regulations were being followed (note that there are no Provincial environmental regulations concerning golf courses). The DOE Regional Manager then gave clearance to project invoices based on these reviews.

9.64 In addition, Federal funds were withheld until environmental issues were resolved. A portion of these funds (\$300,000 of the \$450,000 Federal contribution) was released in mid-December; the remaining \$150,000 will be released once outstanding Federal environmental requirements have been met.

9.65 This project was applied for by the Municipality after funds became available due to the withdrawal by the Municipality of a sewer project which had been previously approved by the Management Committee. Our concern regarding the approval of the golf course project is that there was an outstanding application predating that of the golf course for which there appeared to be adequate remaining funding in the County's allocation. This application was for a \$2.1 million water supply project in Lunenburg County. The Department did not challenge the Municipality's decision to advance the golf course over the water supply project.

CONCLUDING REMARKS

9.66 The Program has addressed a number of core infrastructure needs identified by municipal units throughout the Province. The Departments of Environment and Health were consulted as project applications were reviewed and we noted that the top sewer projects were dealt with to a large extent through the Program.

9.67 The Agreement defined infrastructure as “*physical capital assets in Canada instrumental in the provision of public service.*” The Federal Auditor General has noted that this definition allows for a broad interpretation of infrastructure. The definition in the Agreement is not precise enough for us to conclude on whether it extends to all community needs projects.

9.68 An audit process needs to be established by the Management Committee to ensure there is compliance with terms and conditions of the Federal-Provincial Agreement and also agreements with municipalities related to individual projects. This monitoring would help fulfill the accountability requirements to the Federal government for expenditures under this Program, and provide economy and efficiency in the expenditure of Provincial funds.

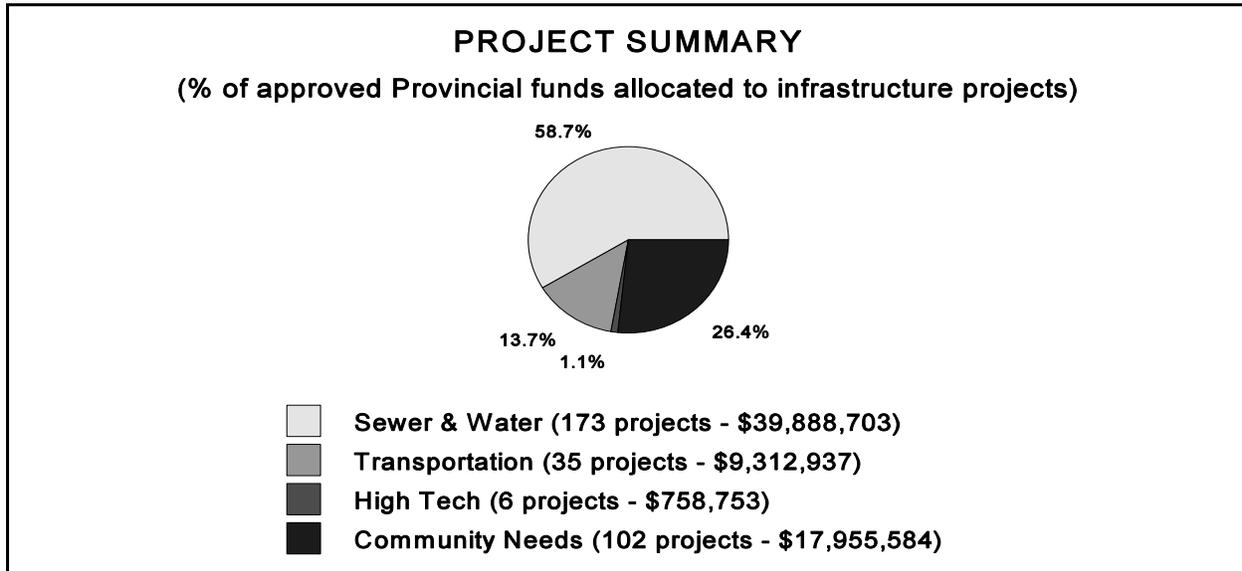
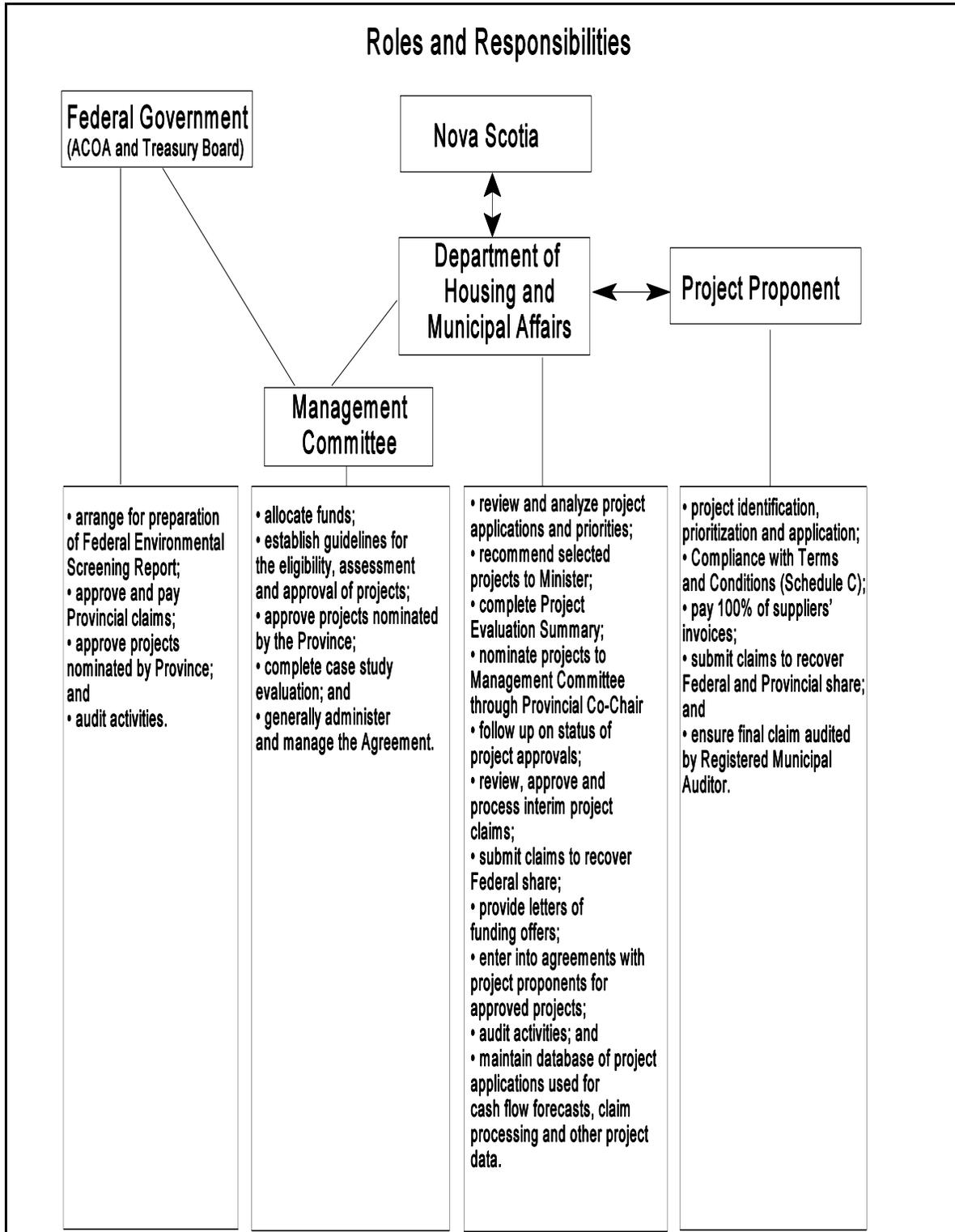
Exhibit 9.1

Exhibit 9.2



10.

NOVA SCOTIA ECONOMIC RENEWAL AGENCY - SPECIAL ASSISTANCE PROGRAM

BACKGROUND

10.1 The Special Assistance Program, as described in the *1996-97 Estimates*, “provides funding for projects which have potential for being the basis of new economic activity or for enhancing existing economic activity.” With 1996-97 budgeted net expenditures of \$5,596,000, the Special Assistance Program is a significant discretionary fund in government.

10.2 The Special Assistance Program is administered by the Nova Scotia Economic Renewal Agency (NSERA), although requests for funding may originate from any department within government. No matter where they originate, all requests for funding are referred to a staff member of the NSERA who becomes the project officer for that project. This could be an individual in any division of the NSERA. There is integration of assessment and monitoring activities of the Program with other NSERA programs. Assistance provided to a company, through any program of the NSERA, would have the same project officer. The project officer is responsible for evaluating the request for assistance to determine if assistance should be provided through the Program, the ongoing monitoring of the project if it is approved, and ensuring all funds due to the Province are recovered.

10.3 There are no funding limits set for individual projects. Assistance agreements typically incorporate a shared risk arrangement whereby the client receiving the assistance provides a portion of the financing. Projects may extend over several years and assistance may be fully repayable, partially repayable or non-repayable depending on the terms and conditions of the agreement. All applications for assistance must have final approval by the Minister of the NSERA and those of significant value may receive approval from the Priorities and Planning Committee.

10.4 Exhibit 10.1 on page 121 provides a financial summary of the Program over the past three years. Projects approved in prior years have a significant impact on current expenditures. Expenditures for projects approved prior to April 1, 1995 accounted for approximately \$6,458,596 million or 65% of total expenditures for 1995-96.

10.5 Exhibit 10.2 on page 122 provides information on assistance authorized through the program in excess of \$1 million which has incurred expenditures since April 1, 1995.

RESULTS IN BRIEF

10.6 The following are the principal observations resulting from our review.

- Improvements are required in overall accountability for the Special Assistance Program. Outcome measures and targets need to be established for the Program with timely monitoring of and reporting on performance. NSERA has not prepared an annual report as required by its Act, but such a document could facilitate the provision of more detailed information on the plans and performance of the Department’s programs like the Special Assistance Program.

- Guidelines should be established for the authority limits for the Program. These guidelines should consider all assistance provided to an entity and not just the amount which is being considered under the Special Assistance Program.
- Adequate documentation is required to facilitate accountability and performance monitoring of the Special Assistance Program. Documentation supporting assistance approved has improved in the past few years. However, prior to April 1, 1995, there were some projects funded where there was insufficient documentation to support the use of the Special Assistance Program.
- We found projects funded were being monitored to ensure the terms and conditions of the assistance provided were complied with before payments were made, the funds were used for the purposes intended, and all funds due to the Province were collected.

AUDIT SCOPE

10.7 The objective of this audit was to review and assess the systems and procedures used to control and account for the Special Assistance Program, including:

- the internal and external accountability frameworks;
- the project assessment and approval process; and
- the system for monitoring compliance with terms of assistance and performance of the program.

10.8 We reviewed selected projects which incurred expenditures since April 1, 1995. These projects were approved both before and after April 1, 1995, including projects approved up to October 31, 1996.

PRINCIPAL FINDINGS

Accountability

10.9 *Overview* - In order to have an adequate accountability framework, roles and responsibilities and program objectives must be clearly defined along with a process for measuring the achievement of results. Responsibilities can be communicated through formal policies and procedures, and should include timely reporting on performance.

10.10 *Policies and procedures* - There are no documented policies and procedures for the Program. These should include items such as the roles and responsibilities with respect to establishing the budget for the Program, review and approval of applications for assistance, disbursement of funds, monitoring of projects approved, required file documentation and reporting on performance. While in our view such documentation would support improvements in the accountability and overall control framework for the Program, we found no instances during our review which would indicate that staff involved in the Program did not understand their role or responsibilities.

10.11 *Performance measurement* - There is a documented objective for the Program. However, no outcome measures or targets have been established to monitor the achievement of that objective. Projects are monitored on an individual basis but there is no tracking mechanism in place to measure and evaluate the results of the Program.

10.12 The Agency is aware of this deficiency and, as part its 1997-98 budget exercise, it is in the process of developing an improved program tracking system which will monitor large scale projects. Project officers will be required to report quarterly on results achieved relative to projected economic impact. Economic impact will be assessed in terms of investment, jobs, leverage, industry infrastructure support, size of industry and industry goals.

10.13 *Reporting* - Reporting to senior management on the Special Assistance Program consists of a schedule of budgeted and actual expenditures reconciled to the Department of Finance general ledger account. The information reported to the Legislature consists of the estimate of program expenditures contained within the NSERA annual budget submission, and the total actual expenditure compared to budget which is reported in the *Public Accounts*. There is no information reported on the outcomes of the Program and the achievement of its objectives. Program specific performance information could be provided through the annual report of the NSERA. However, the NSERA does not publish an annual report, even though such reporting is called for under its enabling Act.

Project Assessment and Approval

10.14 *Overview* - We reviewed a sample of projects to evaluate the project assessment and approval process followed. We found that in the past there has been insufficient documentation in the project files to support the use of the Special Assistance Program. Adequate documentation is required to facilitate accountability and performance monitoring for the Program. We did note improvements in file documentation in the past few years.

10.15 *Review of projects approved before April 1, 1995* - We tested six projects approved before April 1, 1995. There was insufficient documentation in the project files to support the use of the Program in three of the six projects reviewed. These three projects had a total approved budget of \$5,196,000. In one case, there was also no economic analysis completed on the project to demonstrate the economic impact of providing funding of \$1,396,000.

10.16 In two instances, it appears the funding could have been achieved through other government assistance programs such as the Business Development Corporation Fund (BDCF) or the Industrial Expansion Fund (IEF). In one of these cases, a loan had been approved through the BDCF and the Program was used to pay principal of \$1,500,000 on the loan for the company.

10.17 *Review of projects approved since April 1, 1995* - We reviewed a sample of nine new projects approved after April 1, 1995. We found one project with a value of \$500,000 where there was inadequate documentation to support the use of the Special Assistance Program. There was also no economic analysis completed on the project to demonstrate the economic impact of providing the funding.

10.18 *Approval guidelines* - The Program is a discretionary fund of the Minister of the NSERA. However, as can be seen from Exhibit 10.2 on page 122, approval is obtained from the Priorities and Planning Committee and Executive Council for some assistance projects. There should be guidelines established as to the authority limits for the Program, especially in light of the fact that in certain instances the assistance is to be paid out over a number of years while the Minister's discretion relates to the current year's budget. Thresholds should be established, based upon the nature and size of the assistance, which identify projects which warrant Priorities and Planning Committee or Executive Council approval. These thresholds should consider all assistance provided to an entity, not just the amount which is to be charged to the Special Assistance Program for one particular project.

10.19 There are certain loan funds administered by the Nova Scotia Business Development Corporation (NSBDC) which require Executive Council approval for repayable loans where the Province has security against those loans. In the case of the BDCF, this includes all loans or other assistance in excess of \$1 million. With the Program, much of the assistance provided is grants or is only repayable if the terms of the assistance are not met. It would be appropriate for the Program to consider using authority limits similar to those established for the NSBDC.

10.20 Staff have indicated that an approval threshold of \$1 million will be established for the Program. Assistance in excess of this amount will require Priorities and Planning Committee approval. This threshold is to be based upon each particular funding request rather than considering all assistance provided to an entity.

Monitoring

10.21 *Overview* - Once assistance is approved, projects must be monitored to ensure the terms and conditions of assistance provided are being complied with before payments are made, the funds were used for the purposes intended, and all funds due to the Province are collected in accordance with the terms of the assistance. The monitoring procedures required vary according to the terms of assistance provided and can include such items as receipt of invoices, audited financial statements or an audit certificate on employment levels maintained. There may also be a need to perform one or more field visits to a company.

10.22 *Review of projects* - We examined eight projects to determine if they were being properly monitored and found seven of the projects were properly monitored. In the eighth case, based upon discussions with the project officer, the project was properly monitored but there was insufficient documentation in the project file to support the monitoring activities.

CONCLUDING REMARKS

10.23 While we have identified some areas for improvement in the systems and procedures used to control and account for the Special Assistance Program, we found that the projects approved under this Program have been properly monitored. There have been improvements in the project assessment process to support the appropriate use of the funds.

10.24 Overall accountability for the Program needs to be improved in order to determine and report on whether funds issued under the Program have been well spent.

*Exhibit 10.1***THREE YEAR ANALYSIS OF BUDGETED AND ACTUAL NET EXPENSES**

Period	Budget	Expenditures	Recoveries	Net Expenditures
1993-94	\$ 7,610,300	\$ 7,515,008	\$141,348	\$7,373,660
1994-95	7,592,000	9,368,053	672,218	8,695,835
1995-96	10,120,000	10,070,732	102,593	9,968,139

Note 1 - The budget figure includes the impact of projects approved in prior years as well as an allowance for new projects. New assistance approved during 1995-96 totalled \$4,341,830. Some of this assistance will be disbursed in subsequent years.

*Exhibit 10.2***AUTHORIZED ASSISTANCE IN EXCESS OF \$1 MILLION WHICH HAS INCURRED EXPENDITURES SINCE APRIL 1995**

Project Name	Budget \$ (Note 3)	Date Approved	Approved by Priorities and Planning Committee	Associated Industry
OSP Consultants	950,000	June /96	N	Technology and Telecommunications
	950,000	Apr. /95	N	
Atlantic Theatre Festival	665,000	May /96	Y	Culture and Tourism
	350,000	Oct. /95	Note 1	
	245,000	May /95	Y	
CIBC Call Centre	3,400,000	Feb. /95	N	Technology and Telecommunications
Newbridge Networks	2,000,000	Mar. /96	Y	Technology and Telecommunications
SHL Systemhouse	2,300,000	Jan. /95	Note 2	Technology and Telecommunications
Dynatek Automation Systems	1,500,000	Jan. /95	N	Technology and Telecommunications
Amherst Aerospace Cleanup	1,369,000	Nov. /93	Y	Aerospace
Comeau's Sea Foods	1,405,000	Feb. /90	Y	Manufacturing and Processing
Larsen Packers	1,750,000	Nov. /89	Y	Manufacturing and Processing
Air Nova	1,200,000	May /89	Y	Aerospace
Louisiana Pacific	6,000,000	Nov. /88	Y	Manufacturing and Processing

Note 1 - Staff have indicated that the project was approved by the Priorities and Planning Committee but there is no documentation on file to support this.

Note 2 - This non-repayable assistance was approved by the Executive Council. However, at the time of authorization, the program funding source was not specified.

Note 3 - Some of this assistance has been disbursed over a number of years.

11.

DEPARTMENT OF TRANSPORTATION AND PUBLIC WORKS - HIGHWAY 104 WESTERN ALIGNMENT PROJECT

BACKGROUND

11.1 A number of years ago, the government identified the construction of a four-lane divided highway between Amherst and New Glasgow as a high priority. A portion of this stretch, from Amherst to Truro, represents Nova Scotia's highway link to the rest of Canada and the United States, and as such is heavily travelled by cars and trucks.

11.2 The distance between Amherst and New Glasgow is approximately 170 kilometres. The stretch was serviced by the Trans Canada Highway, which for most of the distance was only two lanes wide. Most of the Department's plans could be accomplished by twinning the existing highway. However, a section of this highway included a stretch through the Wentworth Valley, which has been the site of an above average number of automobile accidents. Several alternate routes were analysed and the Western Alignment was selected as the best option to bypass the Wentworth Valley.

11.3 After study and public consultation, the Department chose a 45 kilometre route linking Thomson Station to Masstown. The stretch was referred to as the Highway 104 Western Alignment. Although the completion of the bypass was a high priority, the Department had to work with decreasing financial resources as a result of government's fiscal reform program. Department officials realized that they required an innovative solution to complete the bypass project in a timely manner. It was decided to involve the private sector in the project, and to make the bypass partly self-funding. Part of the financial requirements would be met through borrowing by a non-government entity, which would be repaid by the collection of tolls on the public's use of the highway.

11.4 In the fall of 1994, the Province selected a consultant to study the feasibility of the Western Alignment project, and subsequently to help select a private sector partner to finance, design, build and operate the highway. In July 1995, by an Act of the Legislature, the Province incorporated the Highway 104 Western Alignment Corporation (HWAC) to provide for the financing, design, construction, operation and maintenance of the Western Alignment through a partnership of the public and private sectors. The Act declares the Corporation to be a non-government entity for all but certain specific purposes.

11.5 In June 1994 the Department issued a Request for Expression of Interest (REI) to design, finance, construct, operate and maintain the bypass, and seven responses were received. In January 1995 the Department issued a request for qualifications to the seven REI respondents and received four submissions. In July 1995 the Department issued a request for proposals to three qualified groups. Each group submitted a proposal and an in-depth process was used to evaluate them. In May 1996 the government, HWAC and the successful contractor concluded negotiations and entered into the contracts needed to establish a public-private partnership.

11.6 The Western Alignment toll road is expected to be completed by December 1997, which represents a 20-month construction period. The contracted cost of completing the road construction is \$112.9 million. The government estimated that it would have taken between three and eight years

using traditional Department construction and capital financing methods, and that it would likely have cost government more to complete the project.

11.7 The construction of the bypass is being funded by a \$27.5 million Federal government contribution, a \$27.5 million Provincial government contribution and \$66.4 million of long-term debt issued by HWAC. The debt financing for the project was arranged by a bond underwriter using a financial instrument called “accreting debt.” The accreting debt schedules the payment of principal and interest at a time and rate that corresponds to the collection of toll revenues. Accordingly, total debt will increase in the early years. There will be no toll revenues during the construction period and unpaid interest charges will compound and be added to the total debt. Furthermore, in the early years of the toll road’s operation, toll revenues will not be enough to cover the cost of servicing the debt, and a portion of interest will similarly compound. It is projected that toll revenues will increase over the years due to scheduled toll increases and forecasted higher traffic volumes, and at a future time the revenue will be sufficient to begin to pay both principal and interest, thus reducing the compounded debt. It is forecast that the total original debt of \$66.4 million will increase to approximately \$96.5 million in year 2006 before starting to decline.

RESULTS IN BRIEF

11.8 The following are the principal observations from this audit.

- The process used by the Department to select consultants and contractors for the project complied with government procurement objectives and followed principles of openness and fairness.
- We believe due regard was given to obtaining the lowest cost to construct the bypass. However, due to the nature of the public-private partnering process used, we could not assess whether negotiations subsequent to the selection of the private sector partner to establish the terms of the partnership resulted in the lowest possible cost and risk for the government.
- Accountability for the Western Alignment project could be improved. The accountability responsibilities of Highway 104 Western Alignment Corporation should be included in its incorporating Legislation.
- A summary of all costs of the project was not available from the Department as it has not been its nor government’s practice to accumulate all costs of a capital project in one place in the Province’s books of account.
- Based on our analysis, if the Province had borrowed the funds for the highway project directly, instead of Highway 104 Western Alignment Corporation, the debt service charges for the borrowing would have been significantly lower. However, if the Province borrowed the funds it would have assumed a greater amount of risk on the project, and we have been told by a representative of the company that designed and purchased HWAC’s bonds that additional debt on the Province’s books at this time could affect its credit rating and increase its average cost of borrowing. We cannot express an opinion on whether or not additional borrowing by the Province of this magnitude would change the Province’s average borrowing rate. The financial markets determine interest rates, and it is very difficult to forecast the activity and demands of the market.

- Financial projections for the project indicate that, over the 30-year term of the project, approximately \$151 million will be returned to the Province from the operation of the toll-road. However, we acknowledge that projections made for such a long period of time involve significant uncertainty and actual experience may differ. Also, there are provisions in the contracts to forego future toll increases, if agreeable to all parties to the contracts.

AUDIT SCOPE

11.9 In October 1996 we commenced a broad scope audit of the Highway 104 Western Alignment project in accordance with the provisions of the Auditor General Act. Our objectives were to:

- determine if the process used to select the project consultants and contractors gave due regard to economy and efficiency, and complied with government procurement objectives and policies; and
- assess the accountability structure and reporting established for the project.

11.10 The following general criteria were used in our audit.

- The process used to select the contractors and consultants, and the subsequent negotiations, should give due regard to economy and efficiency, and the process should comply with relevant government procurement objectives and policies.
- The principal accountabilities should be defined in Legislation and Regulations, and accountability reporting should be timely and address predefined project goals and performance measures.
- The Department should account to Executive Council and the Legislature for the planning and conduct of the project, as well as its experiences with the public-private partnering process.

PRINCIPAL FINDINGS

Selection of Contractors and Consultants

11.11 The final result of the Department's selection process was a partnership with a consortium of companies that will finance, design, build and operate the bypass. Various financial consultants, lawyers, engineers and other professionals were also required to facilitate the selection process and to help implement the project. As part of our audit, we examined the selection and hiring of all contractors and consultants for which significant sums were paid.

11.12 There are a number of policies and guidelines which were used by the Department to select contractors and consultants, including:

- the June 1992 Government Procurement Policy;
- the September 1992 Atlantic Procurement Agreement;
- the December 1993 Fairness in Government policy;

- the August 1994 Cooperative Business Solutions policy; and
- the July 1994 National Procurement Agreement.

11.13 The Western Alignment project was termed a public-private partnership, for which there are currently no specific policies, guidelines and procedures. (We comment further on the public-private partnership process in Chapter 3 of this Report.) Furthermore, HWAC is not considered by the government to be a crown corporation or an agent of the crown and, as such, was not required to follow government policies and guidelines. Yet, for the hiring of contractors and consultants we examined, there was compliance with most of the requirements embodied in the above-noted procurement policies and agreements. There were provisions in the request for qualifications and in subsequent proposals and discussions favouring Nova Scotia labour and subcontractors, which are not permitted by the Atlantic Procurement Agreement. However, the Atlantic Procurement Agreement does not identify HWAC as one of the entities to which the Agreement applies.

11.14 In public-private partnering, the private sector partner may be selected before a project is fully planned and all costs are determined. In such situations, the partner will assist in the planning and costing of the project. Government may select a partner using criteria such as a company's qualifications, experience, financial stability, willingness to assume a share of the project risk, and commitment to invest in the project. In the early stages of the project, as the planning and design component progresses, the costs and fees to be paid by and to each partner may be negotiated. Accordingly, when there is a lack of detailed consideration of costs and fees during the competitive stage of the selection process, it is difficult to review a public-private partnership project and assess whether fair value was achieved.

11.15 The Western Alignment project involved such a selection and negotiation process. However, we noted that the road construction cost was an outcome of competitive proposals, and we believe that due regard for economy was demonstrated for this, the major cost component of the project (\$112.9 million).

11.16 We cannot express an opinion upon whether the December 1995 to May 1996 negotiations with the chosen contractor resulted in the lowest possible cost and risk to the government. For example, there were several project requirements in the Department's request for proposals (and also reflected in the proposal submitted by the contractor), which were not met upon the completion of the negotiations.

11.17 Our original intent was to highlight in this section of the Report some of the outcomes of the negotiation process. However, most of these relate to information that the contractor considers confidential. The contractor is currently before the courts to argue that a document requested by other individuals under the Freedom of Information and Protection of Privacy Act should not be released. The items we wish to report are addressed by this document. However, there were two negotiated items in another document which is considered public, and we note them below.

- The request for proposals noted the Province would not guarantee the debt, but the final contracts included at least 13 specific covenants that, if breached, would require the Province to guarantee the debt (or alternately, the Province would have the option of repaying all outstanding debt plus a premium). Two examples include: “[if] the construction of the Project is terminated or abandoned by the Province or the Borrower prior to the completion of the Project” and “[if] the Design Build Contract is terminated for any reason and the Borrower does not within 90 days make arrangements to complete the construction of the Facility.”

- The request for proposals noted the Province would not guarantee the traffic volumes, but the final agreement required the Province to compel large trucks to use the road, to maintain a 30 kilometre per hour speed differential between the old and new road, and to agree to several obligations regarding traffic enforcement.

11.18 We do not suggest that these negotiated changes were inappropriate or represent inadequate regard for the costs and risks which the Province will bear. In fact, some negotiated changes favouring the contractor were counter-balanced with concessions by the contractor that improved the highway and/or lowered the Province's cost and risk. We are likewise restricted in discussing these items.

11.19 The purpose of this discussion is to illustrate how the negotiation process used to establish a public-private partnership can significantly affect project costs and outcomes, and how it can be very difficult for an auditor to assess whether the negotiation process resulted in the lowest possible cost and risk for government.

Accountability

11.20 There are three principle partners in the Western Alignment project: the government, HWAC and the contractor. We reviewed the accountability structure and reporting in place for the government (through the Department of Transportation and Public Works) and HWAC. In the section immediately below, we discuss the corporate structure of HWAC and its ramifications on accountability. The following three sections discuss accountability requirements and reporting relating to both the Department and HWAC.

11.21 *Corporate status* - In July 1995, HWAC was incorporated by an Act of the Legislature. The Act notes the purpose of the Corporation is “to provide for the financing, design, construction, operation, and maintenance of the Western Alignment of Highway 104 (Trans Canada Highway) in the counties of Colchester and Cumberland by a partnership of the public and private sectors.” The Act specifically notes that HWAC is not a crown corporation or an agent of the Province.

11.22 In several documents related to the project it was noted that a primary purpose of the Corporation was to insure the financing for the project is *non-recourse* to the Province (i.e., the government would not be responsible for any default on the debt). Accordingly, the Act declares that the Province is not liable for any debt of the Corporation. The Act also exempts the Corporation from various pieces of Provincial Legislation, including those relating to Provincial taxes and freedom of information and protection of privacy. However, the Act states “*the Corporation is an agency of government within the meaning of the Auditor General Act and that Act applies to the Corporation.*”

11.23 The Provincial Finance Act defines a crown corporation as one where the majority of board appointments are made by Governor in Council, as well as one where government owns at least 90% of the outstanding voting shares. In the case of HWAC, the government owns all of the outstanding shares and appoints each member of the Board of Directors. However, based on legal advice obtained by the Department, the definitive wording of the Act that created HWAC, and the fact that this Act was proclaimed subsequent to the Provincial Finance Act, gives it preeminence.

11.24 HWAC was set up to separate the project from the control and ownership of the government, and to separate government from certain financial and legal obligations. However, the Legislature created the Corporation, the Province owns and controls it, the purpose of the Corporation is to help build Provincial infrastructure that is funded by public money and owned by the Province, and there

are contract covenants that may, if breached, require the Province to guarantee the outstanding debt of the Corporation. It is our opinion that, *for accounting purposes*, HWAC is a government-owned corporation. Generally accepted principles for government accounting, adopted by the Federal and most provincial governments in Canada, require the inclusion of any government owned and/or controlled operation in the government's "reporting entity." Accordingly, the assets, liabilities and operations of HWAC should be included in the Government of Nova Scotia's reporting entity, and thus the Corporation should be fully accountable to the government and the Legislature.

11.25 Management disagrees with our view that the liabilities of HWAC should be included in the Government of Nova Scotia's reporting entity. Management does not see any reason for the government to account for liabilities that are non-recourse to the Province. In our view, the liabilities are non-recourse to the Province's consolidated fund. However, since the bond holders do have recourse to HWAC, and HWAC is owned and controlled by the Province, from the perspective of the Province's reporting entity (in accordance with generally accepted government accounting principles), the liabilities are those of the Province.

11.26 *Accountability requirements* - Whereas accountability requirements of government entities should be well defined and communicated, we recognize that there are alternative means of accomplishing this. Accountability requirements can be defined in legislation, Regulations, corporate charters and bylaws, and even in formal agreements. It is our Office's opinion, however, that the basic responsibility for a government entity's accountability to the House of Assembly should be included in legislation. In the case of HWAC, this would mean its July 1995 Act of incorporation. In the case of government departments, there are no significant legislated accountability requirements. Our Office, on several other occasions, has recommended the drafting and inclusion of such requirements in the *Provincial Finance Act*.

11.27 We noted the Act that created HWAC does not adequately define its accountability responsibilities. As a minimum, it would be appropriate for the legislation to have required:

- corporate accounts and records to be maintained;
- an annual financial statement;
- an annual audit;
- meetings of directors to be held;
- an annual meeting; and
- an annual report suitable for tabling in the House of Assembly.

11.28 We do not imply that such basic requirements do not exist. For example, we did note that a Corporation bylaw was created in May 1996 which indicated that meetings of directors *may* be called, shareholder meetings *may* be held, and directors *may* appoint auditors. (However, in most organizations there is a requirement to hold meetings and appoint auditors.) We also noted that the April 1996 Senior Bond Indenture requires the Corporation to maintain books and records in accordance with good accounting practices. Some of the Corporation's accountability and reporting requirements are also addressed in various other contracts and agreements to which the Corporation is a party. We suggest that such requirements be embodied in legislation so they can only be changed by a decision of the Legislature - the body to which the Corporation is ultimately accountable.

11.29 *Accountability reporting* - The Department provided us with reports it prepared on the planning and conduct of the Western Alignment project. For the most part, the documents were memorandums to the Executive Council and/or its Priorities and Planning Committee. They provided information on the project's background, financing, agreements, contingencies, as well as an evaluation of project objectives. However, we understand that, since May 9, 1996, no formal reporting has been made on the Western Alignment project, except for press releases.

11.30 We examined the documents provided and believe that some significant information was absent from the Department's reports, such as:

- a clear, concise financial summary or an indication of the expected total project cost, including all costs to be borne by the Department and Province;
- the costs of financing the debt, including the incremental interest rate and costs of private sector financing versus Provincial financing; and
- savings, if any, over the Department's cost to build the road with its usual methods.

11.31 We have been informed by management that much of this, as well as other information was conveyed to the Executive Council and its Priorities and Planning Committee verbally. Also, within the Department, there is a steering committee which is monitoring the project and the Department's Deputy Minister is a member. There is not yet any defined accountability reporting structure for the committee, but management informed us that it keeps the Minister well apprised. We cannot express an opinion on whether or not government decision-makers received all relevant information on the project because of the lack of formal documentation. We recommended that reporting in the future be more formal.

11.32 We believe that reporting to the Legislature, to date, has not been adequate as only limited information has been provided. Although questions have been asked in the House of Assembly about the project, and answers have been provided, there has been no formal reporting to the Legislature. Construction began in 1996, and at the time of our audit, a full year had not yet passed. We asked if the Department has included any of the planning details for the project in its annual report to the Legislature, but found that the last annual report tabled covers the year 1992-93, and its March 31, 1996 annual report has not yet been prepared. We asked whether the Department and HWAC will table reports in the future that discuss the project, and we were told that there is no definite date for reporting from either entity.

11.33 *Performance reporting* - We recommend that future reporting by the Department and HWAC be performance-based. That is, reports should define the objectives, requirements and assumptions established for the project, and indicate whether they are being achieved.

11.34 In the Department's July 1995 request for proposals to select a private sector partner, five objectives were outlined.

- To arrange for the private sector to carry out the project.
- To achieve the development of the facility at a reduced cost and in a shorter period than would be possible by traditional means.
- To minimize the Province's financial commitment to the project.
- To identify innovative financing and construction methods which may be applicable to other highway projects.
- To ensure that the highway, when its operation reverts to the Province after 30 years, is in a good state of repair and preservation, and is free and clear of encumbrances.

11.35 In addition, the project was undertaken after several studies and reports documented basic assumptions about toll road usage including traffic volumes and flows, potential transit time savings, fuel/energy savings, and accident statistics.

11.36 In the fall of 1996, the Department commenced a case study of the Western Alignment project. The study intends to assess the partnership selection and negotiation process, as well as the use of private sector advisers. The study will address and report upon areas of perceived success, problem areas that could be improved, and steps that could be eliminated.

11.37 We believe the case study is a valuable initiative and the insights gained should be shared with other government departments and agencies. At this time, the study will cover events only up to and including the conclusion of the negotiations in May 1996. We recommended that the Department consider also reviewing, at a later time, the period of construction in 1996 and 1997, and the project after a year or two of highway operation. Such assignments should examine the accuracy of the assumptions made to establish the project's viability, and should focus on the results of the project in comparison with the objectives noted above. Management indicated that it plans to conduct such reviews.

Other Observations

11.38 The objectives of our audit were to review the selection of the contractor and consultants used in the Western Alignment project, as well as to review the accountability structures and reporting employed for the project. The assignment required us to review an extensive number of documents and interview many individuals in order to understand the issues being examined. As a result, we made observations that are not related to our original audit objectives, and upon which we wish to report.

11.39 *Project costs* - The documents we reviewed noted the construction cost of the toll road as \$112.9 million. We did not see any document which provided an estimate of the total cost of the project, including all costs to the Province. We attempted to tabulate the full estimated cost of the project, as follows.

	(\$ millions)
Construction cost	\$ 112.9
Estimated sales and gas tax rebates	5.9
Upfront closing costs	2.4
Upfront post-closing costs	2.6
Land purchase and expropriation	2.9
Consultants and advisors	<u>2.8</u>
	<u>\$ 129.5</u>

11.40 The tabulation does not reflect salaries and benefits paid to staff of the Departments of Transportation and Public Works, Finance, Justice and others who dedicated considerable time and effort to the project. Discussions held with management indicated that, for the Department of Transportation and Public Works alone, up to 4.5 person-years of staff time were absorbed by the project. Also, because there may be costs relating to the project recorded in the accounts of other departments, we cannot be sure our tabulation is complete.

11.41 Based on discussions with Department officials, we understand that it is not their practice to accumulate and account for all highway construction costs in one report or place in the accounts of the Department. Based on our experience in other audits, it is also not normal accounting practice in other departments to account for all capital project costs together in this manner. In the past we have recommended, and we do so again, that the government develop a practice of accumulating and reporting all significant project costs so that government and the Legislature are aware of the total amount of public money spent on a project.

11.42 *Project financing* - The funding of the Western Alignment project is to be provided from the following sources.

	(\$ millions)
HWAC Debt Issues:	
Senior Bond Indenture - 30 years at 10.520%	\$ 51.0
Junior Bond Indenture - 15 years at 11.203%	9.9
Subordinated Note - 30 years at 16.864% (estimated)	5.5
Strategic Highway Improvement Program funding:	
Federal government's portion	27.5
Provincial government's portion	<u>27.5</u>
	<u>\$ 121.4</u>

11.43 One of the directions of government for the Western Alignment toll road project was to borrow a significant portion of the required funds without increasing the Province's total debt or other obligations (e.g., guarantees). To achieve this, the government created HWAC (and declared it not an agent of the crown), and had all debt financing for the project held by it.

11.44 As part of our audit, we examined the financing of the project to determine if due regard was given to economy. We compared the costs and benefits of financing the project in the manner selected, to the costs and benefits of financing the project in a more traditional method by way of public borrowing by the Province. Our analysis contrasts the two methods in terms of net effects over the 30-year term of the senior bonds

11.45 An October 1995 consultant's report prepared for the Department noted that, after reviewing various financing proposals, unrated or low-rate investment-grade senior debt placed privately (i.e., outside of government) may have an interest rate premium of 1.75% to 2.0% over long-term Canada (i.e., government) bonds. Subordinated debt may have a 4.75% interest rate premium. We understand that the Province of Ontario opted to fund a toll road project through the government as the interest rate premium for private financing was estimated to be about 1.5%.

11.46 The preceding funding summary indicates the effective annual yield of the various project debt issues. We have prepared the following estimate of interest rate differentials for the Western Alignment project.

	Senior Bonds \$51.0 million BBB(high)	Junior Bonds \$9.9 million (unrated)	Subordinate Notes \$5.5 million (unrated)
Government of Canada Bonds - June 1, 2025 - as of April 3, 1996	8.101%		8.101%
Government of Canada Bonds- June 1, 2010 - as of April 3, 1996		7.904%	
Add premium for Province of Nova Scotia's lower credit rating	<u>.400%</u>	<u>.400%</u>	<u>.400%</u>
Estimated rate if Province had issued the debt	8.501%	8.304%	8.501%
Effective annual yield of debt issues by HWAC	<u>10.520%</u>	<u>11.203%</u>	<u>16.864%</u>
Excess of HWAC rates over estimated rates available to the Government of Nova Scotia	<u>2.019%</u>	<u>2.899%</u>	<u>8.363%</u>

11.47 We applied the excess rates to the scheduled repayment of debt and calculated that the extra interest paid over the term of the project, estimated on a net present value basis, may be in the range of \$20 million to \$25 million.

11.48 A representative of the company that designed and purchased the bonds of HWAC indicated to us that financing the project through an issue of public debt by the Province would have affected the Province's credit rating and could have increased the cost of the Province's borrowing on all of its debt. It was suggested that the lower credit rating could add .05% to the Province's average borrowing rate. However, the financial effect of such an increase in the average rate of borrowing is very difficult to quantify. The incremental increase in interest rates would only apply to new issues of debt by the Province, and to refinancing of debt as it matures. Depending on the extent of new issues and the timing of maturities, the additional cost to the Province could be significant.

11.49 We cannot express an opinion on whether or not additional Provincial borrowing of \$96.5 million would have triggered an increase in the Province's average borrowing rate. The highest level to which the project debt would accrete (\$96.5 million) is very small in terms of total Provincial unmatured debt of \$8.2 billion. Also, in the case of the toll road project in Ontario, it was believed there would be no impact on the Provincial credit rating and debt service costs because the rating agencies would make allowances for the self-financing aspects of a toll road project. However, management reminded us that the bond rating agencies are very sensitive about the Province's debt levels, and any incremental increase in the Province's debt could be the transaction that triggers a change in its credit rating.

11.50 Other benefits were attributed to the financing arrangements made for the Western Alignment project. The accreting nature of the debt made it possible to match debt servicing costs to revenues from the toll road. If the Province had borrowed the debt through a traditional public offering, the consolidated fund of the Province would have had to subsidize toll rates in the earlier years of the operation of the road in order to meet the objective of having tolls begin at \$3 per car and \$2 per axle of larger trucks, and to have the tolls increase no faster than the rate of inflation in the Province.

11.51 Also, the financing arrangement selected transferred certain risks from the Province to the bond holders. If the Province had issued debt, it would have borne more risk with regard to the revenue performance of the toll road.

11.52 *Toll revenues* - The Department's financial consultants prepared a Project Transaction Summary for the project in June 1996. The summary includes a projection of sources and uses of cash over the 30-year term of the project. The projection anticipates that approximately 52% of toll revenue will be derived from larger trucks which are compelled to use the road and 48% of tolls will come from cars and small trucks. The projection also estimates that, of the \$576 million of revenues received over the 30 years, potentially \$151 million could be returned to the Province.

11.53 Based on discussions with Department officials, the \$151 million would be available to the Province only if actual toll road operations occur exactly as forecasted, and then the cash would be available only in the latter half of the term. The projection estimates revenues and costs over a 30-year period, and such future-oriented analysis is subject to considerable uncertainty. Further, if excess cash becomes available there are provisions in the contracts to forego future toll increases, if agreeable to all parties to the contracts.

11.54 *Provincial commitments and obligations* - On May 22, 1996, HWAC entered into at least 22 agreements, indentures and contracts to implement the Western Alignment project. The closing agenda on that day listed 82 items or documents related to the closing. Subsequent to the closing, the Corporation's lawyers prepared a substantial list of the Corporation's obligations resulting from the agreements and contracts.

11.55 The closing also gave rise to a number of commitments and obligations for the Province. We understand there is no similar comprehensive list of Provincial obligations, but noted that several documents contain significant matters which should be monitored. We recommended that all Provincial commitments and obligations be summarized so responsibility to monitor and control the obligations can be delegated.

11.56 *Highway 104 Western Alignment Corporation* - The Corporation was created in July 1995 by an Act of the Legislature. The Act requires that all members of the Board of Directors be appointed by the Governor in Council. To date, only one person has been appointed to the Board. The Corporation has no employees, but does use the services of contract staff and staff of the Department of Transportation and Public Works.

11.57 As of January 1997, there were no accounting-related books or other records available for HWAC. Highway construction costs are paid and reported to HWAC by the construction trustee contracted by the Corporation. However, there are no books of account at HWAC that record these costs, other corporate costs, or its assets and liabilities. We understand that a consultant will be hired to record the accounting transactions in time for the audit of HWAC's March 31, 1997 financial statements.

11.58 We recommended that the accounts of HWAC be recorded and financial statements be prepared on a regular, timely basis. Such records and reports are important to management's control and decision making with respect to the Western Alignment project.

CONCLUDING REMARKS

11.59 The Highway 104 Western Alignment project represents one of the government's first major experiences with public-private partnering. We have observed that there are advantages in the use of this approach, including the sharing of project risk, the leveraging of private-sector expertise, and the mobilization of greater amounts of physical and financial resources towards a project.

11.60 Based on our audit, we have three observations we wish to highlight for consideration with respect to future use of public-private partnering. First, it is very difficult to determine whether, once a private partner is selected, negotiation of contract terms and conditions has minimized the government's cost and risk on a project. The Western Alignment project established the construction cost of the highway as part of the selection of the partner, and accordingly later negotiations involved costs and risks that were of lesser significance. We wish to warn that other public-private partnerships may leave the determination of a more substantial portion of project costs and risks to the negotiation stages, thus making it even more difficult for management and auditors to determine if the lowest cost and risk was obtained for the Province.

11.61 Our second observation relates to project financing. It appears to be generally accepted that financing a project through an entity other than the government increases the cost of borrowing for the project. However, there may be other costs involved if the Province were to borrow to fund a project, including the financial effect of a change in its average borrowing rate. It is important that the costs and benefits of alternative borrowing arrangements be explicitly factored into all future government decisions about the costs and benefits of public-private partnerships.

11.62 Our third observation relates to accountability. It is our view that partnerships between the government and private sector that involve significant amounts of public funds be accountable to the House of Assembly. This is fundamental to stewardship over public funds, and represents a significant responsibility of elected members of the House to the public they represent. Accordingly, we believe future public-private partnerships should be structured to preserve such accountability.

DEPARTMENT'S RESPONSE

Attached please find the response of the Department of Transportation and Public Works to the Report of the Auditor General on the Highway 104 Western Alignment project.

Thank you for the time and consideration of you and your staff in assessing this unique public-private partnership. Your perspective in auditing all facets of government business is a valuable part of our democratic process.

Be assured my Department will always facilitate your efforts to ensure all the facts are available for your consideration.

The Department of Transportation and Public Works acknowledges that the Office of the Auditor General has produced a fair analysis of the Highway 104 Western Alignment public-private partnership.

We are pleased the Auditor General recognizes that the process used by the Department to select consultants and contractors for the project complied with government procurement objectives and followed principles of openness and fairness. The Auditor General also agrees that due regard was given to obtaining the lowest cost to construct the highway.

With this prototype public-private partnership, Nova Scotia holds a leading position on the North American stage in leveraging the combined resources of the public and private sectors to develop essential infrastructure in times of fiscal restraint.

The Highway 104 Western Alignment is built on the foundation of sound fiscal policy that draws the line on government borrowing. Adding to the provincial debt was not an option for this project.

Thanks to the creative leadership of the public sector, and the innovation and efficiency of private sector partners, Nova Scotians are getting a safer, faster highway to move people and goods through the heartland of Atlantic Canada.

In a public-private partnership, sophisticated negotiations determine how the costs, risks, and rewards of a project are shared. In the Highway 104 negotiation, the private partner has assumed significant risk, including cost overruns on construction as a result of factors such as design flaws or interruptions due to weather.

The private investors in this project have taken the full risk for traffic volume and thus for revenue flow from the tolls. If there is a shortfall in revenue, the government is not liable for the difference. This was key to making the deal viable for the Province of Nova Scotia. As the Auditor General acknowledges, the liabilities of the Highway 104 Western Alignment Corporation are, in fact, non-recourse to the Province's consolidated fund.

Understandably, through the negotiating process, the private sector partners have asked for and received certain undertakings by the Province to ensure a viable toll operation. These covenants do not provide direct financial guarantees on the debt, and all are within the Province's control.

The result for Nova Scotians is a safer highway, built faster with minimal government financial contribution or risk, while honouring the Government's responsibility to ease the burden of Nova Scotia's staggering debt.

This project has been lauded nationally and internationally for its innovative financing and risk-sharing design. The House of Commons Standing Committee on Transport says Highway 104 is the best example of how a public-private partnership should work. This project has been praised in three international trade magazines: Privatization International Infrastructure Yearbook; Infrastructure Finance; and Project and Trade Finance.

The Government of Nova Scotia stands behind public-private partnerships as a way of providing costly infrastructure for its citizens. The Auditor General reiterates the advantages of this approach, including "the sharing of project risk, the leveraging of private-sector expertise, and mobilization of greater amounts of physical and financial resources towards a project."

The Government is confident that all facets of this public-private partnership are sound, supportable and conceived in the best interests of Nova Scotia.

CROWN AGENCIES AND CORPORATIONS

12.

ATLANTIC LOTTERY CORPORATION INC. - 1996 SHAREHOLDER'S AUDIT

BACKGROUND

12.1 This chapter highlights the results of the first direct audit coverage by a legislative audit function of the Atlantic Lottery Corporation Inc. (ALC). The audit was requested under the Shareholder's Audit provision of ALC's corporate bylaws by the Nova Scotia Gaming Corporation (NSGC), in its capacity as the Nova Scotia shareholder.

12.2 ALC was incorporated in 1976 under the Canada Business Corporations Act, and is jointly and equally owned by the Atlantic provinces. Since being established, ALC has reported sales in excess of \$4.7 billion up to and including the fiscal year ended March 31, 1996. After prizes, commissions and other costs of approximately \$3.1 billion, ALC has distributed profits of \$1.56 billion to its shareholders, including \$623.6 million to Nova Scotia. On behalf of its four shareholders ALC is now directly involved in the annual management and control of more than \$1 billion of public funds through its various gaming products and related activities. At the time of our audit the corporation had approximately 400 permanent and casual staff.

12.3 The original enabling inter-provincial agreements signed in 1976 provided the following with respect to the mandate or purpose for the corporation.

"The Atlantic Lottery Corporation, a body corporate incorporated under the Canada Business Corporations Act, is designated as and hereby becomes an agency of Her Majesty in the right of [each of the shareholder provinces] for the purpose of conducting and managing lottery schemes in each of those Provinces or other Provinces."

12.4 ALC's mission as per its corporate strategic plan, approved by the Board of Directors in 1993, is as follows:

"The Atlantic Lottery Corporation will profitably create, develop, market and manage lottery and gaming activities with integrity in partnership with the Shareholder Provinces."

12.5 Each jurisdiction has lottery and gaming related statutes in place, with supporting Regulations, that must be appropriately considered and complied with by ALC. While similar, there are some regulatory or policy directive differences (e.g., re: video lottery terminals). Historically, ALC has played a role in the monitoring of regulatory compliance for each jurisdiction. Various inter-provincial agreements have been signed with respect to ALC. Further, ALC has corporate bylaws, last updated and approved by the corporation's Board of Directors and the shareholder provinces in 1994. These lay out the basic framework under which ALC's Board and management must function.

12.6 Each shareholder province can appoint two representatives to an eight member Board of Directors, and each shareholder has one of its Board representatives on the corporation's audit committee. Decisions are usually determined based upon a majority vote, with one exception being changes to the methodology for allocation of profits to the shareholders, which requires unanimous approval.

12.7 Each shareholder province also holds a share in and has one representative on the Board of Directors of the Inter-Provincial Lottery Corporation (ILC). The ILC coordinates and manages the national lottery programs through “regional marketing organizations.” ALC is the regional marketing organization for Atlantic Canada, and must adhere to defined policies and standards for national lottery games (e.g., 6/49, super 7).

12.8 Additional background information and analysis on ALC is provided in the exhibits at the end of this chapter, including the following:

Exhibit 12.1 - Overall Governance, Accountability and Management Organization in 1996

Exhibit 12.2 - Summary of Results

Exhibit 12.3 - Summary of Operating Expenses

Exhibit 12.4 - Summary of Staffing Levels and Costs

Exhibit 12.5 - Corporate Strategic Objectives

Exhibit 12.6 - Summary of Terminals and Sites

Exhibit 12.7 - Allocation of Gross Profit by Game Type

Exhibit 12.8 - Income from Video Lottery

Exhibit 12.9 - Video Lottery Receipts

Exhibit 12.10 - Profits Distributed

Exhibit 12.11 - Summary of Economic Benefits

RESULTS IN BRIEF

12.9 The following highlights our principal observations from this audit.

- ALC is an established organization, with various systems, processes and procedures in place to manage and control its ongoing operational responsibilities. Considerable time and resources have been and continue to be invested in implementing systems and practices to support the corporation's operations and activities. We have identified some opportunities to improve the level of control and reporting in selected areas. However, nothing was observed that would indicate the integrity of ALC's lottery and other gaming products has been adversely affected.
- The inter-provincial agreements and the corporate bylaws should be revisited by the shareholders and the shareholder provinces to ensure they provide the necessary guidance with respect to the operations and overall accountability and control of an inter-provincial organization of the size and complexity of ALC.
- ALC's status as a crown agency should be formally clarified, and the applicability to its operations of the various and differing statutory and other administrative policy directives (e.g., wage restraint, expenditure control) in the shareholder provinces needs to be determined.

- As part of the updating of ALC's strategic plans, its mission statement should be interpreted, including appropriate clarification or segregation of the fiscal, societal and other aspects of the corporation's mandate and mission. Further, the corporation's mission statement should be formally approved by the shareholder provinces.
- The information and reporting to the Legislature on ALC's activities and results need to be significantly improved in order to support an effective and timely accountability review. Sufficient and appropriate information and reporting on the corporation's plans and performance (i.e., financial and non-financial) should be available to the Board, the shareholders and the Legislature in each shareholder province on a timely basis. Improvements should be made to both the internal and external reporting of ALC's results and performance. The content and distribution of ALC's annual report needs to be improved, including an expanded and appropriate focus on the corporation's strategic objectives. Further, the following key improvements to the corporation's financial reporting (i.e., either through its financial statements and/or other annual report sections) should be made:
 - disclosure of gross profit by game type;
 - reconciliations demonstrating compliance with the video lottery payout regulations for each of the shareholder provinces;
 - inclusion of depreciation expense in the divisional expenses; and
 - comparison of budget figures to actual with appropriate variance analysis.
- The manner in which ALC's costs and profit are being allocated results in certain shareholder provinces, in essence, subsidizing other jurisdictions. More specifically, using information for the 1995-96 fiscal year, we estimate that Nova Scotia's share of ALC's profit distribution could have been approximately \$5 million higher.
- The Board's decision (i.e., by majority vote) in October 1995 to enter into a long-term lease for the new head office space was made at a time when the Nova Scotia shareholder was reviewing the structure and arrangements for the corporation, which should have warranted deferral of the decision until such matters could be fully resolved by the shareholders. The Board's deliberations and decisions relating to the acquisition of ALC's new head office were not adequately documented. Further, the net benefits to accrue to shareholders through future profit distributions as a result of the additional costs to be incurred were not formally quantified. In this regard, it should be noted that under the current profit distribution methodology, Nova Scotia will bear the related costs based on its share of net sales of regular lottery products (i.e., approximately 39% based on 1995-96 results).
- In fall 1996, the Board decided to proceed with the \$31 million New Retail Terminal Project, an initiative that had been subject to considerable study and discussion by the Board. In our view, it would have been appropriate if the net benefits to accrue to the shareholders through future profit distributions had also been specifically and formally updated from those that had been identified in 1992.
- The current commission rates for video lottery terminal (VLT) site-holders are set by the shareholder governments through regulation, and are among the highest in Canada. We are not aware of ALC or others having formally assessed the costs and risks associated with the VLT site-holders' involvement or responsibilities with respect to the video lottery program (VLP) to justify the level of commission paid.

In Nova Scotia, based on the results for 1995-96, a 1% change in commission rates for VLT site-holders would equate to a \$1 million change in the Province's profit distribution from ALC.

AUDIT SCOPE

12.10 By letter dated December 15, 1995, the Nova Scotia Gaming Corporation (NSGC), in its capacity as the Nova Scotia shareholder for ALC, requested the Auditor General of Nova Scotia to “perform an audit of the operations of the Atlantic Lottery Corporation including issues of economy and efficiency that could impact the Province of Nova Scotia.” This request was made under the Shareholder's Audit provision, Section 20, of ALC's corporate bylaws.

12.11 There were no restrictions or limits placed on the scope of the assignment, which was planned and conducted essentially as if it were a legislative audit conducted under the mandate of Nova Scotia's Auditor General Act. Further, as had been planned since the first attempts to exercise mandates under the respective Auditor General Acts, the assignment was performed jointly by audit staff from Nova Scotia and New Brunswick.

12.12 The assignment's overall audit objective was to review the systems and practices for the management and control of selected areas or aspects of ALC's operations, in order to assess and/or report upon whether there was adequate:

- compliance with statutory and other policy requirements;
- control systems or procedures in place and functioning; and
- due regard for economy and efficiency.

12.13 In auditing towards this overall objective, we selected five audit projects or lines of inquiry for coverage during 1996, including:

- overall governance, accountability and management control framework;
- video lottery program;
- information technology;
- procurement; and
- allocations to shareholders.

12.14 As part of our detailed planning for the assignment, specific audit objectives and criteria were defined for each of the lines of inquiry, and used to determine the nature and extent of our coverage in the various areas. In order to avoid any unnecessary duplication of audit effort, our plans included reviewing and relying, to the extent appropriate, on the coverage and results of the corporation's external and internal audit functions.

PRINCIPAL FINDINGS

Introduction and Overview Comments

12.15 At the outset, we feel it appropriate to observe that while we are reporting on a number of matters with respect to the management and control of ALC's operations, nothing was observed that would indicate the integrity of ALC's lottery and other gaming products has been adversely affected.

12.16 During the course of this 1996 audit, we identified opportunities to improve the level of control and reporting in selected areas. Our report to the Nova Scotia Gaming Corporation as a

result of the 1996 Shareholder's Audit includes various recommendations for consideration by the appropriate combination of ALC's management, Board, shareholders and/or shareholder provinces. Appendix 12A to this chapter on page 167 lists our recommendations organized under the major headings of that report. Based upon information and comments received from ALC, action has been taken or is planned for many of the improvements suggested (see ALC's response on page 170 the end of this chapter).

Compliance with Statutory and Policy Requirements

12.17 ALC is required to comply with various acts, regulations and other policy directives including the requirements of the inter-provincial agreements and its corporate bylaws. In 1995, the new Gaming Control Act and related Regulations were approved in Nova Scotia. The new Act provides for a more appropriate segregation between the operations and regulatory functions associated with gaming and lottery activities within the Province than had previously existed. The Nova Scotia Gaming Corporation (NSGC) is responsible for gaming operations within Nova Scotia, including being the Province's ALC shareholder. The Nova Scotia Gaming Control Commission is now responsible for regulatory-related matters (e.g., licensing, monitoring, inspections) with respect to gaming and lottery activities in Nova Scotia. It is our understanding that the Commission has identified certain issues relating to how ALC's operations will need to be modified in order to more fully meet the regulatory requirements in Nova Scotia.

12.18 Further, each shareholder jurisdiction has implemented budget/expenditure restraint (including wage freezes and/or rollbacks) to some degree and in differing ways. For example, ALC management and staff did not experience the same rollbacks and wage freezes applied to public sector employees in the shareholder provinces, and have received both economic and merit increases in recent years. However, in this regard it is unclear as to which jurisdiction's requirements (statutory or policy directives) should be applied to ALC's operations and activities. The inter-provincial agreements are silent in such regard. As a result, it is not possible for us to definitively conclude on ALC's level of compliance with such requirements, due to the fact that no decision or directive has been made with respect to which jurisdiction's requirements apply to the corporation.

Adequacy of Systems and Controls

12.19 ALC is an established organization, with various systems, processes and procedures in place to manage and control its ongoing operational responsibilities and activities. There has been and continues to be considerable time and resources invested to implement improved, updated systems and practices (including selected management policies, information technology systems, organizational structure) to support the ongoing management and control of the corporation. Such changes or initiatives have had, and should continue to have, a constructive impact on the overall adequacy of ALC's management systems and practices.

12.20 With respect to more traditional internal accounting or procedural controls, we did not identify any significant control weakness that would impact upon the overall integrity of ALC's financial records. However, information technology systems and resources, which are seen as mission critical, should be subject to expanded audit coverage to ensure the Board has the appropriate assurance on the level of controls in place. Further, suggestions for enhancing the internal audit function, an important and integral element in the corporation's overall control framework, have been identified.

Due Regard for Economy and Efficiency

12.21 The area of due regard for economy and efficiency as it relates to ALC offers some unique considerations, both from a management and operational perspective. Due regard must be considered at a number of levels, certain of which may at times be somewhat incongruent. For example, due regard for the corporation overall could be achieved, but at the expense of one or more of the shareholders. Likewise, what is good for one shareholder may result in increased costs or less benefit for others.

Governance, Accountability and Management Control

12.22 *Inter-Provincial Agreements* - The inter-provincial agreements, corporate bylaws and other key policies (e.g., profit distribution) for ALC need to be fully reviewed and updated/modernized to ensure that the current interests and concerns of the individual shareholders are clearly defined and can be met. For example, during our audit we noticed a number of issues which indicate the inter-provincial agreements and corporate bylaws should be revisited to determine if they provide the appropriate level of guidance to ALC and its shareholders. These key issues include:

- the requirement to more precisely define ALC's status as a crown agency;
- concerns over the content and method of accountability reporting to the Legislature in each shareholder province;
- a responsibility to more explicitly define the division of business and social responsibility for gaming between ALC and the shareholder governments;
- a need for periodic re-examination of the profit allocation methodology;
- concerns over the fairness and equity of the distribution of corporate activity among shareholder jurisdictions;
- the applicability of legislation from various shareholder provinces (e.g., wage restraint, financial budgeting and reporting); and
- moves toward increased Atlantic co-operation in various fields.

12.23 Under the inter-provincial agreements and the corporate bylaws decisions are usually determined by majority vote. Changes to the agreements themselves and to the profit distribution methodology require unanimous vote at the Board and/or shareholder levels.

12.24 We have suggested the inter-provincial agreements and the corporate bylaws be revisited by the shareholders and the shareholder provinces to ensure they provide the necessary guidance with respect to the operations and overall accountability and control of an inter-provincial organization of the size and complexity of ALC.

12.25 Further, ALC's status as a crown agency and the jurisdictional boundary limits of provincial statutes are significant matters yet to be fully resolved. The inter-provincial agreements make it quite clear that ALC is "*an agency of Her Majesty* [i.e., the crown] *in the right of*" each of the shareholder provinces. In 1994, we obtained a legal opinion that concluded that ALC was an "agency of government" as defined in the Auditor General Act in Nova Scotia, and that ALC was collecting and expending public money. However, during the audit there continued to be views expressed by others that ALC is not a crown agency. The fact that ALC was not listed as a regional organization for purposes of the Atlantic Procurement Agreement further complicates or clouds the questions - is ALC a crown agency, and if not what is it?

12.26 *Organization Overview* - ALC, through its Board of Directors, has operational and regulatory accountability relationships to each of the Atlantic provinces. Exhibit 12.1 on page 156 provides summary information on the governance, accountability and management organization for ALC's operations at the time of our fieldwork in 1996. Subsequent to our fieldwork, organizational changes

were approved at ALC, including the creation of a sixth division and the realignment of some management responsibilities.

12.27 ALC's internal management systems and practices have been going through a significant amount of change in recent years, including a number since we first attempted to initiate a legislative audit review in 1994. Certain of the changes that have been made relate to, or otherwise can be linked back to, a report resulting from an external consulting study by Smith Green & Associates Inc. completed in 1991-92. That report included a number of significant comments and recommendations on the organization and management processes of the corporation, as well as the overall governance process, many of which were consistent with matters raised during our audit.

12.28 *Corporate Mission* - Over the years, as the corporation's activities have continued to evolve and mature, management with the approval of the Board of Directors has defined the mission of the corporation using different words. The corporation's mission as defined in the 1993 Corporate Strategic Plan is to "*profitably create, develop, market and manage lottery and gaming activities with integrity in partnership with the Shareholder Provinces.*"

12.29 While it may appear on the surface to be relatively straight-forward, the corporation's mission statement does in fact have some complexities - e.g., "profitably" and "integrity"-, each of which can mean different things to different people. It also, as far as we can determine, has not been formally approved by the shareholder provinces.

12.30 During our discussions with management staff, we observed a fairly consistent emphasis on the maximization of profits to the shareholders as being the priority. However, in this regard, certain views focused on the maximization of sales (e.g., through new products, expanding the market share or penetration), while others tended to focus on maximizing the return from existing levels and activities.

12.31 We did observe that management was control conscious, especially in terms of revenues and compliance considerations. While consideration of the social or societal consequences and implications of the corporation's products was not absent, clearly performance in terms of sales and profits is the predominant focus for management and the Board. In light of the nature and extent of the changes in the lottery and gaming industry generally and specifically in Atlantic Canada, it would be appropriate for a clearer definition of the desired balance to be incorporated into ALC's mandate and its mission statement.

12.32 *Accountability to the Legislature* - Information and reports available to interested external parties (including the Legislature in each of the shareholder provinces) on ALC's plans and performance need to be expanded and improved to support an accountability review of the nature and extent warranted for an organization involved in the management and control of such significant public program activities.

12.33 In order to support them in their role in the accountability process as it relates to public gaming, the Legislators in the shareholder provinces require and have a right to receive sufficient, appropriate and timely information on ALC's plans and performance (i.e., from both financial and non-financial perspectives).

12.34 In this regard, we acknowledge that the Nova Scotia Gaming Corporation's annual and interim financial statements are tabled or deemed tabled and released publicly on a timely basis. They include summary information on ALC's financial results, the nature of which had not previously been readily available to the Legislators or the public. Further, we understand that as part of the business planning information that it now needs to submit to the Legislature under the provisions of Section 73 of the Provincial Finance Act, the NSGC will be providing summary planning information with respect to ALC operations in Nova Scotia.

12.35 Corporation's Annual Report - ALC's corporate bylaws state that "*the Board will annually make public the results of its operations.*" ALC management does prepare a formal annual report, however we do not believe the spirit of this bylaw requirement has been adequately met. In our view, if one of its primary purposes is to provide information that supports a meaningful accountability review by interested external parties, then the content and distribution of ALC's annual report need to be improved.

12.36 This requirement should be met by a more formal public and directed release of ALC's annual report. This should include the provision, through the shareholder provinces' ALC Board representatives, of sufficient copies of the corporation's annual report to the responsible Minister in each jurisdiction for tabling or deemed tabling in the respective Legislature.

12.37 We are not aware of ALC's 1996 or past annual reports having been tabled or deemed tabled in the respective Legislature of each shareholder province. Information provided indicates that ALC's annual report is distributed to selected parties, including the media and certain Ministers of the Crown in each shareholder province. However, the corporation indicated that copies of its annual report would be provided to anyone who made a request.

12.38 ALC's 1996 annual report includes ten pages, five of which are the corporation's audited financial statements for the fiscal year ended March 31, 1996. Beyond the financial statements, the report does not include adequate information in order to support a modern and appropriate accountability review by interested parties external to ALC. It does not provide substantive summary information on the corporation's plans and performance, clearly linked to its mission statement and strategic objectives. However, we note that ALC's shareholders had not directed the corporation to provide such information in its annual report.

12.39 During the course of our work, we did review the annual reports of other Canadian lottery organizations, and found ALC's annual report lacking in comparison. ALC's Board needs to determine the nature and extent of the information that should be included in the corporation's annual report, and provide clear direction to management. ALC has indicated that it "*will be improving disclosure*" in its annual report for the 1996-97 fiscal year.

12.40 Board of Directors - Each shareholder province can appoint two representatives to an eight member Board of Directors, and each shareholder has one of its Board representatives on the corporation's audit committee. Historically, the Board had been made up of senior public servants from the shareholder provinces. Decisions are usually determined based upon a majority vote, with one exception being changes to the methodology for allocation of profits to the shareholders, which requires unanimous approval.

12.41 One of the roles of the shareholder's representatives on ALC's Board is to ensure their jurisdiction's investment or interests are appropriately protected and utilized to the benefit of their government and taxpayers. However, this role must be appropriately balanced with the individual Board member's responsibility to all shareholders (i.e., the corporation collectively).

12.42 It should be noted that ALC's size and the complexities of public gaming have increased substantially since ALC was established (and certainly in the past 5-6 years). In light of this, and considering the trends (or emphasis) on governance and accountability for public sector entities and/or public programs, changes to the Board structure for ALC could be constructive and add value to the quality of the overall governance and accountability processes. We believe such changes warrant consideration due to the magnitude of the public funds (i.e., in terms of sales, expenses, profit distributions) involved, as well as the significance of the public program activities from social or societal perspectives.

12.43 We found that the Board minutes did not always provide sufficient information on the nature or substance of the discussions regarding certain key issues or decisions (e.g., re: new head office facilities). For an organization responsible for such amounts of public funds, we would have expected to see the Board minutes provide a more comprehensive trail of the Board's deliberations.

12.44 *Overall Management Control Framework* - There are various systems, processes and procedures in place at ALC which are used to manage and control the corporation's operations and related activities. Among these are the following:

- The Board and its audit committee provide oversight review and approval both from a financial as well as an operational/program perspective.
- The regulatory agencies in each jurisdiction add further oversight.
- A formal organization structure exists, with assigned responsibilities and reporting relationships.
- Policy statements exist for key areas or activities. Certain of them are in draft or in the process of being updated.
- The external and internal audit functions provide some assurance key policies and procedures are in place.
- Annual planning and budgeting processes are in place for the corporation overall, with some divisions having a detailed annual planning process for their activities.
- There is regular financial reporting to and review by the Board.
- Various gaming and business systems are in place, certain of which have been or are being upgraded.
- Certain divisions have identified and are monitoring selected performance indicators.
- Internal management communications and exchanges occur through various mechanisms, including regular senior management and divisional management meetings.
- An annual management and staff performance appraisal process is in place and monitored by the human resources section.

12.45 *Corporate planning and budgeting processes* - ALC has implemented or undertaken a variety of processes to support corporate and divisional planning and budgeting. Corporate and divisional planning activities have increased and been enhanced in recent years. Indications were that the corporate and divisional planning focuses have tended to be shorter or medium term due to uncertainties associated with policy direction of the shareholders.

12.46 ALC's 1993 corporate strategic plan, which was approved by the Board of the day, identified 11 objectives for the corporation (see Exhibit 12.5 on page 160). These objectives are referred to in ALC's annual planning and budgeting process, and summary information is included in the annual budget manual provided to the Board.

12.47 Initiatives have been started or planned by management to update the corporation's strategic plans - overall and for information technology. Further, strategic planning was in process for the

video lottery program, which was implemented in 1991 and now represents approximately 58% of ALC's results.

12.48 The Board needs to be more directly and collectively involved in the strategic planning for the corporation, overall and in key regards (e.g., information technology and the video lottery program) than had been the practice. The Board, with appropriate input from the shareholders and/or the responsible Ministers, needs to clearly define and incorporate into ALC's strategic plans the goals and objectives - along with desired outcomes (i.e., financial and non-financial) - that it expects management to work towards. These need to be measurable and such that specific targets can be established as part of the corporation's annual and other planning. The results against these targets should then be formally reported to and monitored by the Board as part of its accountability review of management's performance.

12.49 ALC has an annual planning and budgeting process at the corporate level, which does include review and approval by the Board of Directors. Certain, but not all, divisions have established detailed annual planning processes for their activities, which result in formal planning documents being prepared and available for review by senior management and the Board as and if necessary.

12.50 Management's annual budget proposal, that is presented to the Board for review and approval purposes, is supported by a fairly detailed manual providing summary information (both quantitative and qualitative) on the corporation's overall as well as product plans and priorities.

12.51 The formal budget manual prepared and presented to the Board provides information on planned sales and revenue levels as well as direct and other costs to be incurred, including detailed analysis (e.g., staffing by division). It also provides summary information on significant strategic and other initiatives planned in key areas. However, ALC's annual planning and budget process focuses only on the next fiscal year. ALC is not yet preparing formal three or four year budget projections as is now being required by certain shareholder governments.

12.52 *Financial control and reporting* - ALC's audited financial statements are presented to the Board and published in the corporation's annual report. The operating expense totals reported for each division on the statements are incomplete since they are exclusive of depreciation expense which is disclosed as a separate line item. For example, the 1996 financial statements report operating expenses for the information technology division as \$16,493,000 when, including its share of depreciation, the division's total operating expenses were \$25,412,000 (see Exhibit 12.3 on page 158).

12.53 There are standard or regular reports at the corporate and divisional levels. The Board receives quarterly reports on results against the approved budget, including management's revised forecasts for the balance of the fiscal year. Once the revised forecasts are accepted by the Board, the subsequent reporting and analysis by management focuses on variances from the current/revised forecast as opposed to the original approved annual budget.

12.54 As discussed elsewhere in this chapter, we have identified concerns relating to the adequacy of the financial reporting on the results of the video lottery and other lottery programs managed by ALC on behalf of the shareholder provinces.

12.55 *Audit Functions* - ALC is subject to a range of financial and other audit coverage, including work by a public accounting firm (appointed by the shareholders) and the corporation's internal audit group. In addition, another public accounting firm has been hired to audit the printing process for the passive (e.g., scratch'n wins, breakopens) ticket games to ensure game parameters as well as security and other requirements are met by the printing company.

12.56 However, while the corporation is subject to external and internal audit coverage in selected areas, its information technology systems and resources, which are seen as mission critical, should be subject to expanded audit coverage to ensure the Board has the appropriate assurance as to the adequacy and operational performance of controls in this area.

12.57 There is a Board approved internal audit policy statement, which has been in place for a number of years. The manager of internal audit reports to the president, but also has a reporting relationship to the Board's audit committee. The manager provides quarterly and certain other reports (e.g., results of selected audits or specific requests) to and meets with the audit committee.

12.58 ALC's internal audit resources are involved in a variety of regular and special audit and other assignments, including providing support to ALC's external auditors during their annual audit of the corporation's financial statements. Internal audit has also been involved in certain regulatory compliance related work.

12.59 Internal audit indicated that the nature of its efforts continue to change to meet opportunities and priorities identified by the manager, the president and/or the audit committee. It was indicated that internal audit continues to receive a number of special requests from senior management within the corporation, not all of which can be considered or met with the available resources.

12.60 We have suggested that the internal audit function, an important and integral element in the corporation's overall control framework, should more formally document its planning for the use of available resources on an annual and assignment basis, including an expanded focus on value for money issues.

Video Lottery Program (VLP)

12.61 *General Comments* - Since the implementation of VLP started in 1990-91, the video lottery program has been and is the fastest growing of ALC's gaming programs. There are differences in how the program is regulated and resourced by the individual shareholder provinces. The VLP has been the subject of significant public interest, and concerns have been raised in the past about the adequacy of the information and reporting on the program's activities and results. Exhibit 12.6 on page 161 titled "*Summary of Terminals and Sites*" includes information on the results, sites and commissions related to the VLP in comparison to the regular lottery activities for the year ended March 31, 1996.

12.62 *Information on and Analysis of Program Results* - The following comments and information on the VLP, much of which has already been reported publicly by the New Brunswick Auditor General, provide an indication of both the significance of the program and the need for improved information and reporting of ALC's plans and results with respect to it.

12.63 *Summary of ALC's results* - Exhibit 12.2 on page 157 provides information from ALC's *Statement of Operations and Allocation of Profit* over the last five years and in total for the life of the corporation. It shows ALC has two main sources of revenue, the "Net video lottery receipts" from the VLP and the "Gross ticket sales" from all other lottery programs. It would be useful to distinguish direct expenses for each of these two main sources of revenue to show the contribution that each makes to gross profit.

12.64 Using information received from ALC and its external auditor, the analysis in Exhibit 12.7 on page 162 was prepared. It categorizes the direct expenses from the financial statements under the headings "Video Lottery" and "Ticket Games", to determine a gross profit by game type. The exhibit illustrates the significant growth of the VLP with respect to its contribution to the gross profit

of ALC. The VLP contribution to gross profit in 1994 was approximately 77% of the amount generated from Ticket Games. Two years later in 1996 the VLP gross profit is 111% of the amount generated from ticket games. Since 1994, the VLP's contribution to gross profit had increased 66% from \$109 million to \$181 million. Ticket Games grew from \$142 million to \$163 million, an increase of about 15% during the same period.

12.65 Reporting VLP and other lottery/gaming program results on a full-cost segregated basis would allow a level of review with respect to due regard for economy beyond that possible with the existing financial statements and other reporting.

12.66 The VLP has become the largest contributor to ALC's bottom line. We believe it would be better disclosure if, as a minimum, such gross profit information was included in ALC's financial statements and/or other external reports. Our research indicates that other lotteries in Canada present more details in their annual report and financial statements on their various lottery programs than ALC. We believe similar schedules by program would provide important information to ALC's shareholders and the Legislators in the respective jurisdictions. In this regard, we acknowledge that the Nova Scotia Gaming Corporation does provide additional information in its financial statements on ALC's results, including a segregation of the VLP and regular lottery programs.

12.67 *Income from video lottery* - New Brunswick and Prince Edward Island have involved third-party private sector coin-operators in carrying out the video lottery program. ALC has operated this program for Nova Scotia and Newfoundland without private sector coin-operators. Exhibit 12.8 on page 163 provides the net video lottery receipts and the related expenses for each shareholder province for the year ended March 31, 1996.

12.68 *Compliance with VLT prize payout regulations* - Financial information was obtained from ALC to enable the preparation of a schedule showing gross video lottery receipts, prize expense and the resulting net video lottery receipts, which agreed with the financial statements of ALC. Results for the last four years are shown in Exhibit 12.9 on page 164.

12.69 The description of the amounts has changed recently, with "Gross Video Lottery Receipts" now described as "Cash In" and "Prize Expense" now described as "Cash Out." "Cash In" (\$839 million in 1995-96) is the total cash which all players collectively have put into the machines and "Cash Out" (\$558 million in 1995-96) is the total cash all the players have collectively taken out.

12.70 ALC advised that in order to verify compliance with the various regulations it is necessary to factor in all the winnings of the machines being played. Winnings are awarded in various increments of credits during the course of play. The credits are often wagered and played as the machine user continues a session with the VLT. Only those credits remaining at the time the player ends the session or when a player requests cash payout of a prize would be represented in the "Cash Out". Similarly "Cash In" would not include those credits won, wagered, and lost. ALC has indicated it has the information and the technology to provide this type of improved disclosure to regulatory bodies and other interested parties in each shareholder province.

12.71 As noted, there are two main components to ALC's operations, namely ticket games and the video lottery program, and a separate statement or schedule should be prepared for each. In our opinion, this would be better disclosure, and would demonstrate the program's compliance with the payout regulation.

12.72 Further, segmented information by shareholder jurisdiction would be useful to the Legislators in each province. Using information available to us during the audit we have prepared Exhibit 12.10 on page 165, which provides a segmented analysis of the results for 1995-96 for ALC in total and Nova Scotia's share. During the year ended March 31, 1996, Nova Scotia's share of net

sales amounted to \$178,505,985. Residents of Nova Scotia risked a total of \$510,590,602 (video lottery, cash in, \$345,992,102 and regular lottery \$164,598,500) on the lottery products offered by ALC. Of the total risked, \$332,084,617 (video lottery, cash out, \$246,809,361 and regular lottery \$85,275,256) was returned to players.

12.73 VLP Strategic Planning - At the time of our audit, ALC management was developing formal VLP strategic plans. Clearly, in light of the growth of this program since its implementation in 1991 and its current contribution of approximately 58% of the corporation's net sales, such a planning process is required. Further, the fact the VLP has been and continues to be a subject of significant social and societal concern would support such a plan dealing appropriately with more than just the financial or business aspects of the program.

12.74 The VLP strategic planning exercise is due to be completed around March 31, 1997, six years after the program started, and well after it was seen as a significant element and growth component of the corporation's sales/revenue. Based upon our inquiry and review of information available, the VLP strategic planning process is a good initiative, well planned, and with some sensitive or significant program issues/opportunities to address. The Board has been given periodic updates on the status and direction of the VLP strategic planning process, and individual Board members have been interviewed by ALC staff responsible for developing the plan.

12.75 Allocation of Costs and Profits - The established profit distribution methodology or policies (circa 1991) are being adhered to. However, these policies were established when the VLP was just getting started. Since 1991, the VLP has grown significantly in terms of revenue and operational/management considerations as well as in regard to public interest and sensitivity. Under the existing methodology the VLP results are not being allocated any of the corporation's general overhead costs. Our review and analysis indicates that there are reasonable alternatives to the existing methodology that could be used for allocating costs and profits, not only to the VLP and other gaming programs, but also amongst the shareholder provinces.

12.76 VLT Commissions Rates - The current commission rates for VLT site-holders, which are set by the shareholder governments through regulation and in certain instances are subject to additional contractual or other arrangements, are among the highest in Canada. We are not aware of ALC or others having formally assessed the costs and risks associated with the VLT site-holders' involvement or responsibilities with respect to the VLP. This suggests that the issue of commissions should be examined in some detail. In Nova Scotia, based upon 1995-96 results, a one percent change in the commission rates equates to approximately \$1 million.

12.77 Further, ALC does not bill or otherwise allocate information technology costs to its business partners (i.e., coin-operators, VLP site-holders, on-line retailers) who benefit from the use and existence of the corporation's systems and resources. In this regard, it could be argued that the commission rates established for these parties could indirectly address this matter. However, we are not aware of any such specific consideration by the shareholder jurisdictions who have established the commission rates. Further, due to differences in the gaming programs between jurisdictions (i.e., especially VLP), without specific identification and allocation of such costs, they are allocated amongst all the shareholders through the profit distribution policies, which may not be fair and equitable.

Information Technology (IT)

12.78 Information technology (IT) systems and other resources are considered mission critical by ALC. Management indicated that 80% of ALC's revenues are dependent on the availability of quality information technology resources and/or systems. ALC's information technology division

is by far the largest of the corporation's divisions with approximately 35% of ALC's permanent staff and accounting for approximately 49% of the annual operating expenses. Further, during 1996, major systems projects were in process (close to conclusion) involving significant software development and hardware costs.

12.79 Considerable public money has been and is invested annually on the development and maintenance of ALC's IT related resources. Relative to its significance, both in terms of the 80% of revenue and to the overall control framework, information technology security and controls should be subject to additional and more detailed audit coverage by the internal or other audit resources.

12.80 There is an approved information technology strategic plan (circa 1992), which needs to be updated. It was indicated the update will be initiated after the updating of ALC's corporate strategic plans is completed.

12.81 In 1992, the Board of Directors approved the information technology strategic plan and requested a business plan be provided to identify the benefits of the initiatives identified in that strategic plan. A business plan was prepared and submitted to the Board in December 1992. In summary, it indicated that the impact on profit from these initiatives, through a combination of reduced costs and increased revenues, would accumulate to \$50 million by the end of 1997-98.

12.82 Although the then existing hardware and software were considered to have "*reached their limits in terms of capacity, reliability and functionality*", substantial increases in the volume of sales have been experienced since 1992. This is demonstrated by the increase in gross ticket sales of 41% between 1992 and 1996 as well as the increase of 233% in net video lottery receipts over the same period. This has been achieved without all the planned new hardware and software.

12.83 It was indicated to us that these increases were primarily due to the result of increases in volume of play and not the result of increased functionality, reduced costs or improved customer service which are to be realized by the initiatives soon to be implemented. However, management has not formally updated the benefits stated in the 1992 business plan to determine if they are still valid, and in our view it would have been appropriate if such had been done.

12.84 This is particularly important since the most significant initiative planned in 1992 from a cost perspective is now actively underway. The New Retail Terminal Project, which will replace all existing on-line retail terminals at an estimated total cost of \$31.2 million over the next three years, is a substantially changed project from the one approved in 1992. With an investment of this magnitude, it is vital that the benefits identified in 1992 be reviewed and revised to reflect not only the current initiative but also the significant changes which have been experienced in the gaming industry since 1992.

12.85 This initiative - the New Retail Terminal Project - represents the single largest procurement transaction in the history of ALC, and was subject to extensive management and Board review. We note that economic analysis studies were commissioned by ALC to assess the economic benefits that might accrue from the corporation's expenditures associated with this initiative. A presentation made to the Board in 1996 indicated that the alternative being selected would cost at least \$3 million more than going with another manufacturer's product. However, it was indicated to us the other manufacturer's product was not considered to have the functionality that the new retail terminals will provide, and would have meant a significant procurement from a company outside of Atlantic Canada.

12.86 Based on the information provided to us, this project had been subject to considerable review by the Board prior to approving the signing of the related contracts in the fall of 1996. In our

view, it would have been appropriate for the net benefits in terms of future profit distributions to the shareholders to have also been estimated and formally presented to the Board.

12.87 Further, under the existing methodology, depreciation on the new terminals will be allocated to the shareholder provinces through the general allocation of operating expenses based on net sales from regular lottery products, as opposed to allocation based on actual deployment of the terminals. This allocation process may or may not equate to the actual depreciation that should be recorded against the specific units deployed in each jurisdiction. Unless there is a direct correlation between the net sales and units deployed in the individual shareholder provinces, some jurisdictions will be subsidizing others.

12.88 In this regard, Nova Scotia's share of deployed retail terminals (i.e., 34.5% as at March 31, 1996) is lower than its share of net sales of regular lottery products (i.e., 38.9% for 1995-96) which is the basis upon which such costs have been allocated to the shareholders. Without a change in the allocation methodology - which requires a change to the inter-provincial agreement - and assuming Nova Scotia's deployment and net sales relative to the other shareholder provinces does not shift significantly, the Province could end up bearing \$1.1 million more costs than if it were charged directly for the depreciation expenses for the units deployed in the Province.

Procurement

12.89 *General Comments* - In general, our review of procurement activities indicated ALC's procurement policies were being complied with. We did identify some opportunities for improvement in policies, including improved reporting which would support an enhanced level of review with respect to compliance and due regard for economy. For example, reporting on procurement activities and/or exceptions consistent with the requirements of the Atlantic Procurement Agreement should be implemented.

12.90 *Distribution of Procurement by Shareholder Provinces* - It is important to note that the inter-provincial agreements, corporate bylaws, and Board resolutions do not provide any specific parameters with respect to achieving fair and equitable distribution of the economic impact or benefits to the shareholder jurisdictions. They are silent in this respect.

12.91 Despite the absence of direction on the delivery of economic benefits, Board members have maintained a steady interest in the distribution of ALC's procurement activity. Since 1990, ALC has prepared at least four reports titled *Economic Benefits Analysis*. They appear to have originated at the request of the Board, and assign payments made to vendors and employees across the four Atlantic jurisdictions and resulting percentages of activity by province. Generally the studies assign activity to where the payments were directed, not necessarily where the goods or services are provided or consumed. The reports have made some attempt to adjust for this anomaly, particularly in the case of data line services, vehicle charges, and advertising payments. Exhibit 12.11 on page 166 shows the results from the report for the fiscal year ending March 31, 1995.

12.92 *Policies and Procedures in Place* - ALC has a policy and procedures manual in place. The policies seem clearly defined and understandable. General approval was granted by the Board of Directors in 1987 and several policies have received specific Board approval since then. These include the contract authorization policy; incorporation of the Atlantic Procurement Agreement principles; and an allowance for sole-sourcing exceptions based on a strong business case. Purchasing has prepared a revised policy manual which is expected to receive management committee and Board approval in 1997.

12.93 Our transaction testing results indicate that ALC's procurement policies are being adequately adhered to. In the transactions sampled, though, we noted that two major suppliers had received significant contract extensions in cases where ALC had unspecified renewal periods in the original RFP. In both cases, the original 1992 contracts were for two years plus an unspecified renewal period, and resulted in contract terms of at least five and a half years. ALC has informed us that the practice of unspecified terms for contract extensions was discontinued in 1993, and that contract extensions are now subject to a formal review and evaluation process.

12.94 *Atlantic Procurement Agreement* - ALC informed us that it complies with the intent of the Atlantic Procurement Agreement. Although ALC is not mentioned in the regional organizations listed in an appendix of that Agreement, a 1993 Board of Directors minute suggested "*that ALC should incorporate the Atlantic Procurement Agreement into its purchasing policies.*" We were unable to find conclusive documentation stating why ALC has been excluded from the regional organizations listed in the Agreement. However, we note that the dollar thresholds for public tendering in ALC's policy conform to the specifications of the Agreement.

12.95 One of the major areas where ALC does not comply with the Atlantic Procurement Agreement is in the area of reporting (i.e., re: Section 9 of the Agreement, titled *Information and Reporting*). Since ALC management has been directed by the Board to comply with the general intent of the Atlantic Procurement Agreement, we believe it should endeavor to develop reporting consistent with Section 9. Given the Board members' interest in the distribution of economic activity, such reporting would be beneficial to the shareholders. As well, standard reporting of exception transactions above the thresholds would serve as an additional control protecting ALC staff and management from undue criticism in cases of bid protest and dispute settlement.

12.96 *Head Office Facilities Project* - ALC's head office staff and related activities have been located in a combination of owned and rented office space for a number of years. In 1997, ALC's head office will be consolidated in premises in a newly renovated building in downtown Moncton under the terms of a ten-year lease.

12.97 In the early 1990s, the launch of the video lottery program, the roll-out of the IT strategic plan, and continued growth in traditional games increased ALC's space requirements, including for its head office. In 1992, ALC management staff began a detailed planning process that resulted in a June 1994 presentation of a facilities strategic plan to the Board of Directors. After a number of key changes, a formal procurement process, as well as various presentations to and discussions at Board meetings, this eventually led to the Board's decision in October 1995 to lease new head office space.

12.98 The Board's decision, by majority vote, was made at a time when Nova Scotia was in the process of reviewing the structure and arrangements for the corporation. In our view, this should have warranted deferral of a decision until such matters could be fully resolved by the shareholders.

12.99 Our review and analysis raised concerns about the adequacy of the audit/management trail supporting the Board's deliberations and decisions relating to the acquisition of ALC's new head office facilities, which will consolidate head office staff and related activities in one location. The issue of ALC's head office space was dealt with at numerous Board meetings. However, the extent of the Board's review, challenge or approval of key assumptions made and analysis provided by management (e.g., average space standard per position and projections for staff growth) could not be determined from the Board minutes or supporting information available. Further, although various qualitative benefits were identified by management, the net benefits to accrue to shareholders through future profit distributions as a result of the additional costs to be incurred were not formally quantified and provided to the Board as part of its decision-making process.

12.100 It is our understanding that at the time the October 1995 decision to go forward with a ten-year lease arrangement represented one of the largest procurement transactions that had been entered into by the corporation. The move will result in significantly more available space (i.e., approximately 25,000 sq. ft. more; a 50% increase) for ALC's head office activities than was being used at the time of our audit. There are significant additional costs associated with the new head office facilities, when compared to the arrangements at the time of our audit. In this regard, management indicated that *"at the time of the audit, space standards, special area requirements and consolidation were not in place. The new facility cannot be properly compared to existing conditions."*

12.101 Further, it was indicated that as a result of logistical and space considerations, ALC was incurring additional operating costs of approximately \$220,000 per year. In addition, it was indicated to us that there were certain soft costs that could not be readily quantified, including impaired corporate communication and loss of synergy from multiple locations, which *"are without a doubt more significant than the quantifiable costs."*

12.102 Until ALC has actually moved into the new space, the actual additional costs cannot be fully determined. However, based on the information available to us more than \$4 million is being spent by ALC prior to occupancy (i.e., fit up, moving and other costs), and there could be additional net costs of approximately \$600,000 each year. Other costs estimated at \$580,000 will be incurred converting the existing owned head office space for warehouse and other purposes. At a time of restraint in the public sector, an increase in costs of this magnitude is not insignificant. Further, it should be noted that under the current profit distribution methodology, Nova Scotia will contribute funding necessary to pay for the head office space based upon its share of ALC's net sales of regular lottery products (i.e., approximately 39% based on 1995-96 results).

12.103 For planning purposes the amount of space required for ALC's head office was determined using an average standard per position (i.e., 242 sq. ft.) developed in 1992 and a projection of ALC's staffing level growth based on the trend over the past ten years. The original request for expression of interest indicated that ALC was looking for provision of 81,000 sq. ft. of usable office space, and this was the quantity used for purposes of evaluating the responses to the RFP that was sent to the selected proponents. However, ALC management has indicated that they will be moving into approximately 73,200 sq. ft. of usable space (i.e., 82,200 of rentable space).

12.104 In light of the fact that the successful proponent did not receive the highest score in the RFP evaluation process, but did have the lowest (albeit marginally so) cost per sq. ft., if ALC subsequently reduced its space requirements, the procurement process should have been revisited.

12.105 This becomes more of a due regard for economy consideration when one takes into account that there now is a 12.3% (i.e., $82,200 \div 73,200$) spread between the rentable and usable space totals, as opposed to the 5.15% spread estimate used to evaluate the successful proponent's response to the RFP. ALC will be paying rent based on the rentable space total, which we understand is standard practice. However, the response to the RFP for the highest evaluated proponent, who we understand was proposing to build the head office facility on vacant land outside of the downtown core of Moncton, was evaluated using a 4.26% spread. Based on the total usable space ALC will be leasing, this 8% (i.e., 12.3% less 4.26%) gap equates to more than \$100,000 per year in added lease costs.

Allocations to Shareholders

12.106 ALC's profit allocation methodology was established in 1991 when the video lottery program (VLP) was just being implemented. This key program, which now represents 58% of ALC's net sales, is not charged with any of ALC's general overheads. Further, certain costs related

to the VLP are being allocated instead to ALC's other games. This inconsistency has highlighted the need to re-examine the whole profit allocation methodology. In our view, ALC management should have identified such matters to the Board so the shareholders could have determined if an earlier review of allocation methodologies was in order.

12.107 Using alternative methodologies for allocating costs and profit distribution will require a change in the inter-provincial agreements and the corporate bylaws, both of which will require unanimous approval of ALC's Board and the shareholder provinces. In this regard, it must be acknowledged that if a change is made that benefits one or more shareholders, one or more of the remaining shareholders' profit allocations will be reduced.

12.108 Our analysis indicates that the manner in which costs and profit are currently being allocated results in certain shareholder provinces, in essence, subsidizing the results in other jurisdictions by having more than their share of direct costs charged against their net sales. This latter point is especially relevant to retail commissions and depreciation, which more reasonably should be charged directly to each province as opposed to being allocated based on net sales. Using information for the 1995-96 fiscal year, Nova Scotia's profit distribution from ALC could have been \$5 million higher if alternative allocation methods were used.

CONCLUDING REMARKS

12.109 ALC is an interesting and unique experiment in inter-provincial cooperation. The shareholders have invested and continue to invest significant amounts of public funds for the development, maintenance and management of ALC's operations. ALC's revenue and expenses, and its profit distributions are significant to each of the shareholder provinces.

12.110 The corporation has existed for 20 years, and no doubt there are numerous lessons that can be learned which could be used, not only to make any necessary adjustments to the arrangements for ALC, but also for consideration during the planning/establishment of any such joint ventures in the future. Clearly, each shareholder jurisdiction would be interested in, among other things (e.g., regulatory compliance, social responsibility), optimizing the return (directly and indirectly) on its investment in ALC.

12.111 There has been, and continues to be, considerable time and resources invested by ALC to implement improved updated systems and practices to support the ongoing management and control of the corporation. Such changes or initiatives have had, and should continue to have, a constructive impact on the overall adequacy of ALC's management systems and practices.

12.112 During the course of this 1996 audit, a number of opportunities for further improvement were identified, the more significant of which have been provided for consideration and, where appropriate, action by the appropriate combination of ALC's management, Board of Directors, shareholders and/or shareholder provinces.

Exhibit 12.1

Overall Governance, Accountability and Management Organization in 1996

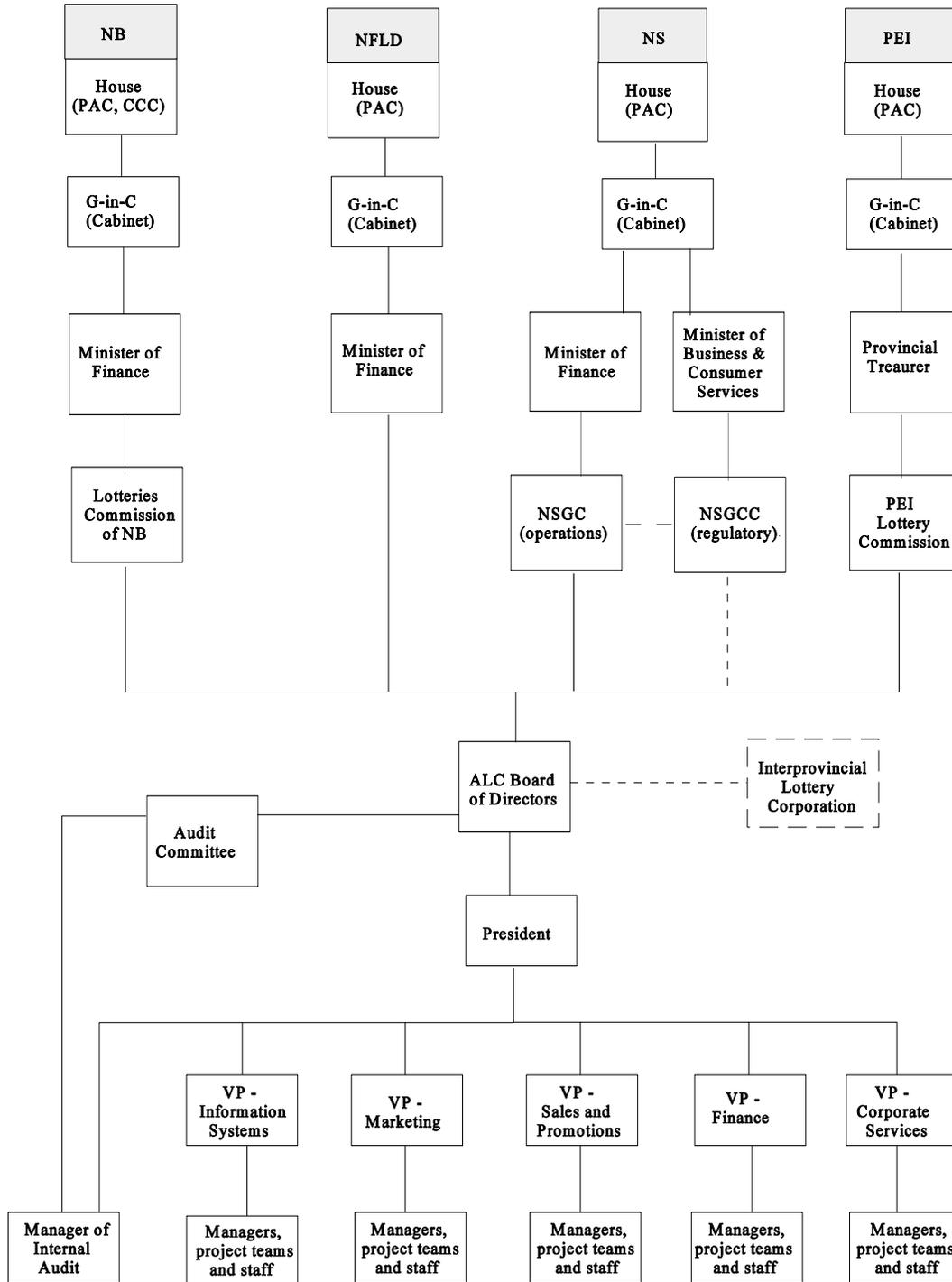


Exhibit 12.2

Summary of Results as at March 31 (\$000)
(Source: ALC's audited and internal financial statements)

	Total	1996	1995	1994	1993	1992	Sub-total 1976 to 1991
Sales:							
Gross ticket sales	\$ 3,730,643	\$ 436,781	\$ 409,406	\$ 370,037	\$ 346,995	\$ 309,312	\$ 1,858,112
Net video lottery receipts	<u>1,001,560</u>	<u>281,047</u>	<u>246,507</u>	<u>195,493</u>	<u>183,897</u>	<u>84,480</u>	<u>10,136</u>
	4,732,203	717,828	655,913	565,530	530,892	393,792	1,868,248
Direct expenses:							
Prizes on ticket sales	1,864,072	233,035	216,014	193,295	180,665	158,808	882,255
Commissions	662,158	131,708	122,805	112,357	111,724	67,315	116,250
- Regular lottery	243,985	31,916	29,335	26,380	24,686	21,917	109,751
- VLT site-holders	286,124	70,919	64,303	59,773	60,153	27,633	3,343
- VLT owners (coin operators)	132,049	28,873	29,166	26,204	26,885	17,765	3,156
Ticket printing	<u>108,444</u>	<u>9,461</u>	<u>9,272</u>	<u>8,318</u>	<u>9,092</u>	<u>8,729</u>	<u>63,572</u>
	<u>2,634,674</u>	<u>374,204</u>	<u>348,091</u>	<u>313,970</u>	<u>301,481</u>	<u>234,852</u>	<u>1,062,077</u>
Gross profit	2,097,529	343,624	307,822	251,561	229,411	158,940	806,171
Operating expenses:							
Operating profit	<u>1,654,830</u>	<u>292,299</u>	<u>256,743</u>	<u>209,548</u>	<u>188,735</u>	<u>123,147</u>	<u>584,357</u>
Interest and other income	<u>23,266</u>	<u>2,852</u>	<u>886</u>	<u>645</u>	<u>989</u>	<u>1,080</u>	<u>16,814</u>
	1,678,096	295,151	257,629	210,194	189,724	124,227	601,171
Less:							
- Government of Canada	52,799	3,565	3,525	3,584	3,444	3,354	35,327
- Goods and Services Tax	52,252	11,970	11,250	9,549	11,319	7,215	949
- Special commissions to non-profit organizations	3,572	220	260	254	302	444	2,092
	<u>6,547</u>	<u>3,733</u>	<u>2,814</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
- NS retailers bonus	<u>115,170</u>	<u>19,488</u>	<u>17,849</u>	<u>13,387</u>	<u>15,065</u>	<u>11,013</u>	<u>38,368</u>
Profit available for distribution	<u>\$1,562,926</u>	<u>\$ 275,663</u>	<u>\$ 239,781</u>	<u>\$ 196,806</u>	<u>\$174,659</u>	<u>\$ 113,214</u>	<u>\$ 562,803</u>
Profit allocation:							
New Brunswick	\$ 472,576	\$ 82,031	\$ 63,902	\$ 57,412	\$ 47,236	\$ 37,021	\$ 184,974
Newfoundland	383,621	74,117	69,173	54,627	43,664	30,840	111,200
Nova Scotia	623,609	104,916	94,055	73,320	75,266	39,818	236,233
Prince Edward Island	<u>83,120</u>	<u>14,599</u>	<u>12,650</u>	<u>11,447</u>	<u>8,493</u>	<u>5,535</u>	<u>30,396</u>
	<u>\$1,562,926</u>	<u>\$ 275,663</u>	<u>\$ 239,781</u>	<u>\$ 196,806</u>	<u>\$174,659</u>	<u>\$ 113,214</u>	<u>\$ 562,803</u>

Exhibit 12.3

Summary of Operating Expenses (\$000)
(Source: ALC's audited and internal financial statements)

	1996		1995		1994		1993		1992	
Expense by Division										
Marketing	\$ 8,694	16.9%	\$ 8,757	17.1%	\$ 5,230	12.4%	\$ 6,389	15.7%	\$ 6,302	17.6%
Sales and Promotion	7,108	13.8%	7,519	14.7%	6,543	15.6%	6,221	15.3%	5,312	14.8%
Finance	2,105	4.1%	2,053	4.0%	2,042	4.9%	1,760	4.3%	1,745	4.9%
Corporate Services	7,276	14.2%	7,011	13.7%	6,171	14.7%	6,530	16.1%	5,929	16.6%
Information Systems	16,493	32.1%	15,849	31.0%	12,604	30.0%	11,734	28.8%	10,686	29.9%
Depreciation	<u>9,649</u>	18.8%	<u>9,890</u>	19.4%	<u>9,422</u>	22.4%	<u>8,042</u>	19.8%	<u>5,819</u>	16.3%
Total	<u>\$ 51,325</u>	100.0%	<u>\$ 51,079</u>	100.0%	<u>\$ 42,012</u>	100.0%	<u>\$ 40,676</u>	100.0%	<u>\$ 35,793</u>	100.0%
Expense by Division including Depreciation										
Marketing	\$ 8,694	16.9%	\$ 8,757	17.1%	\$ 5,230	12.4%	\$ 6,394	15.7%	\$ 6,315	17.6%
Sales and Promotion	7,601	14.8%	7,984	15.6%	7,028	16.7%	6,658	16.4%	5,715	16.0%
Finance	2,108	4.1%	2,058	4.0%	2,048	4.9%	1,760	4.3%	1,745	4.9%
Corporate Services	7,511	14.7%	7,218	14.1%	6,334	15.1%	6,667	16.4%	6,011	16.8%
Information Systems	<u>25,412</u>	49.5%	<u>25,062</u>	49.1%	<u>21,372</u>	50.9%	<u>19,197</u>	47.2%	<u>16,007</u>	44.7%
Total	<u>\$ 51,325</u>	100.0%	<u>\$ 51,079</u>	100.0%	<u>\$ 42,012</u>	100.0%	<u>\$ 40,676</u>	100.0%	<u>\$ 35,793</u>	100.0%
Expense by Object										
Salaries & benefits	\$ 15,391	30.0%	\$ 14,175	27.8%	\$ 12,242	29.1%	\$ 11,226	27.6%	\$ 9,639	26.9%
Depreciation	9,649	18.8%	9,890	19.4%	9,422	22.4%	8,042	19.8%	5,819	16.3%
Advertising	5,962	11.6%	6,277	12.3%	3,673	8.7%	5,275	13.0%	5,057	14.1%
Market development	998	1.9%	991	1.9%	824	2.0%	461	1.1%	452	1.3%
Communication										
material	656	1.3%	543	1.1%	509	1.2%	665	1.6%	556	1.6%
General services	2,214	4.3%	2,356	4.6%	1,581	3.8%	0	0.0%	0	0.0%
Professional services	180	0.4%	173	0.3%	279	0.7%	2,345	5.8%	1,817	5.1%
Occupancy cost	1,438	2.8%	1,618	3.2%	1,334	3.2%	1,220	3.0%	1,075	3.0%
Office supplies	510	1.0%	678	1.3%	879	2.1%	788	1.9%	751	2.1%
Vehicle leasing	56	0.1%	0	0.0%	0	0.0%	0	0.0%	0	0.0%
Rent of equipment	74	0.1%	133	0.3%	139	0.3%	218	0.5%	0	0.0%
Equipment &										
maintenance	3,598	7.0%	3,528	6.9%	2,315	5.5%	2,839	7.0%	3,099	8.7%
Telecommunications	5,545	10.8%	4,943	9.7%	4,358	10.4%	3,830	9.4%	3,814	10.7%
Travel & vehicle	1,867	3.6%	1,775	3.5%	1,655	3.9%	1,750	4.3%	1,512	4.2%
Retail sales support	1,808	3.5%	2,184	4.3%	1,267	3.0%	879	2.2%	0	0.0%
Human resources	185	0.4%	346	0.7%	316	0.8%	124	0.3%	0	0.0%
Training	327	0.6%	330	0.6%	428	1.0%	218	0.5%	0	0.0%
Bad debt	100	0.2%	234	0.5%	102	0.2%	170	0.4%	0	0.0%
Other	<u>767</u>	1.5%	<u>905</u>	1.8%	<u>689</u>	1.6%	<u>626</u>	1.5%	<u>2,202</u>	6.2%
Total	<u>\$ 51,325</u>	100.0%	<u>\$ 51,079</u>	100.0%	<u>\$ 42,012</u>	100.0%	<u>\$ 40,676</u>	100.0%	<u>\$ 35,793</u>	100.0%

Exhibit 12.4

**Summary of Staffing Levels and Costs
Permanent Positions - Budget 1995/96**
(Source: ALC budget manual)

	Total	Marketing	Sales & Promotion	Finance	Corporate Services	Information Systems	President & Internal Audit
Division Total	363	27	83	61	45	134	13
Head Office	234	27	8	61	45	80	13
Regional Offices							
- NB/PEI	36		21			15	
- NS	50		29			21	
- Nfld	43		25			18	

Payroll Costs - March 31, 1996 (\$000)
(Source: ALC's internal financial statements)

	Total	Marketing	Sales & Promotion	Finance	Corporate Services	Information Systems	President & Internal Audit
Division Total	\$15,391	\$1,105	\$3,822	\$1,763	\$1,988	\$6,098	\$615
Head Office	\$9,712	\$1,105	\$358	\$1,763	\$1,988	\$3,883	\$615
Regional Offices							
- NB/PEI	1,555		991			564	
- NS	2,108		1,254			854	
- Nfld	2,016		1,219			797	

Actual Staff Complement, January 1997

	Total	Permanent	Casual (FTEs)
Total Complement	396	336	60
Head Office	267	224	43
Regional Offices			
- NB/PEI	23	21	2
- NS	53	48	5
- Nfld	53	43	10

Exhibit 12.5**Corporate Strategic Objectives**

(Source: ALC's 1993 corporate strategic plan)

- *To ensure that honesty, integrity and credibility are integrated in all business activities and work relationships throughout the Corporation.*
- *To maintain its industry leadership position by offering innovative products and services to its customers.*
- *To initiate and maintain programs and values that assure satisfied, productive, contributing employees.*
- *To ensure accurate portrayal of the Atlantic Lottery Corporation to its shareholders and publics.*
- *To continually improve our systems and processes to enhance retailer and consumer satisfaction.*
- *To empower employees by providing them with the training, work tools and work environment they need to make confident decisions.*
- *To promote the benefits which can be realized when cross-functional/divisional teams act on corporate issues.*
- *To be recognized as consulting experts in new gaming activities.*
- *To constantly monitor and adjust all facets of the Atlantic Lottery Corporation in order to return to its shareholders maximal profits.*
- *To cultivate, encourage and support business and industry throughout Atlantic Canada.*
- *To introduce and support programs that guarantee siteholder and coin machine operator satisfaction.*

Exhibit 12.6

**Summary of Terminals and Sites
For the Year Ended March 31, 1996**
(Source: ALC & ALC's internal financial statements)

	Total	NB	Nfld	NS	PEI
Regular Lottery					
Gross Sales	\$ 436,780,722	\$ 102,869,681	\$ 145,417,812	\$ 164,598,500	\$ 23,894,729
Retailer Commissions	\$ 35,648,834	\$ 6,374,822	\$ 13,351,360	\$ 14,339,259	\$ 1,583,393
Average Number of On-Line Terminals	3,227	841	1,120	1,114	152
Average per On-line Terminal					
- Gross Sales	\$ 135,352	\$ 122,318	\$ 129,837	\$ 147,754	\$ 157,202
- Retailer Commissions	\$ 11,047	\$ 7,580	\$ 11,921	\$ 12,872	\$ 10,417
Video Lottery					
Total Cash In	\$ 838,692,150	\$ 254,204,556	\$ 202,494,905	\$ 345,992,103	\$ 36,000,586
Net VLT Receipts (Net Sales)	\$ 281,046,963	\$ 107,300,983	\$ 58,387,607	\$ 99,182,741	\$ 16,175,632
Siteholder Commission	\$ 70,918,699	\$ 25,059,594	\$ 14,540,309	\$ 27,505,343	\$ 3,813,453
Average Number of VLTs	9,047	3,589	2,084	2,753	621
Average Number of Siteholders	2,861	1,602	469	544	246
Average Cash In					
- Per VLT	\$ 92,704	\$ 70,829	\$ 97,166	\$ 125,678	\$ 57,972
- Per Site	\$ 293,147	\$ 158,679	\$ 431,759	\$ 636,015	\$ 146,344
Average Net VL Receipts (Net Sales)					
- Per VLT	\$ 31,065	\$ 29,897	\$ 28,017	\$ 36,027	\$ 26,048
- Per Site	\$ 98,234	\$ 66,979	\$ 124,494	\$ 182,321	\$ 65,755
Average Siteholder Commission					
- Per VLT	\$ 7,839	\$ 6,982	\$ 6,977	\$ 9,991	\$ 6,141
- Per Site	\$ 24,788	\$ 15,643	\$ 31,003	\$ 50,561	\$ 15,502

Exhibit 12.7

Allocation of Gross Profit by Game Type (\$000) (Source: ALC & ALC's external auditor)									
	1996			1995			1994		
	Video Lottery	Ticket Games	Total	Video Lottery	Ticket Games	Total	Video Lottery	Ticket Games	Total
Gross ticket sales	\$ -	\$436,780	\$ 436,780	\$ -	\$ 409,406	\$ 409,406	\$ -	\$ 370,037	\$ 370,037
Net video lottery receipts	<u>281,047</u>	<u>-</u>	<u>281,047</u>	<u>246,507</u>	<u>-</u>	<u>246,507</u>	<u>195,493</u>	<u>-</u>	<u>195,493</u>
	<u>281,047</u>	<u>436,780</u>	<u>717,827</u>	<u>246,507</u>	<u>409,406</u>	<u>655,913</u>	<u>195,493</u>	<u>370,037</u>	<u>565,530</u>
Direct expenses									
Prizes on ticket sales	-	233,035	233,035	-	216,014	216,014	-	193,295	193,295
Commissions	99,792	31,915	131,707	93,469	29,336	122,805	85,976	26,380	112,356
Ticket printing	<u>231</u>	<u>9,230</u>	<u>9,461</u>	<u>137</u>	<u>9,135</u>	<u>9,272</u>	<u>158</u>	<u>8,160</u>	<u>8,318</u>
	<u>100,023</u>	<u>274,180</u>	<u>374,203</u>	<u>93,606</u>	<u>254,485</u>	<u>348,091</u>	<u>86,134</u>	<u>227,835</u>	<u>313,969</u>
Gross profit	<u>\$ 181,024</u>	<u>\$ 162,600</u>	<u>\$ 343,624</u>	<u>\$ 152,901</u>	<u>\$ 154,921</u>	<u>\$ 307,822</u>	<u>\$ 109,359</u>	<u>\$ 142,202</u>	<u>\$ 251,561</u>
	53%	47%	100%	50%	50%	100%	43%	57%	100%

Exhibit 12.8

Income from Video Lottery									
For the Year Ended March 31, 1996 (\$000)									
(Source: ALC & ALC's external auditor)									
	Total	N.B.		P.E.I.		N.S.		Nfld.	
			%		%		%		%
Net video lottery receipts	\$ 281,047	\$ 107,301	100	\$ 16,175	100	\$ 99,183	100	\$ 58,388	100
Direct costs									
Retailer commission	70,919	25,060	23.35	3,813	23.57	27,506	27.73	14,540	24.90
Coin-operator commission	28,873	25,060	23.35	3,813	23.57				
Ticket costs	231					145		86	
Gross profit	181,024	57,181	53.29	8,549	52.85	71,532	72.12	43,762	74.95
Operating expenses									
Salaries and benefits	1,348					699	0.70	649	1.11
Depreciation - vehicles	159					80	0.08	79	0.14
Depreciation - terminals	5,979					3,665	3.70	2,314	3.96
Terminal movement	13					13	0.01	-	0.00
Occupancy costs	157					100	0.10	57	0.10
Vehicle leasing	3					3	0.00	-	0.00
Equipment & maintenance	520					299	0.30	221	0.38
Video lottery software	615					384	0.39	231	0.40
Vehicles and travel	290					106	0.11	184	0.32
Bad debts	61					27	0.03	34	0.06
Meetings	4					3	0.00	1	0.00
Video lottery license fees	1					-	0.00	1	0.00
Financing	770					436	0.44	334	0.57
GST	7,260	3,531	3.29	461	2.85	2,110	2.13	1,158	1.98
Terminal write offs	23					23	0.02	-	0.00
Total operating expenses	17,203	3,531	3.29	461	2.85	7,948	8.01	5,263	9.01
Income from video lottery	\$ 163,821	\$ 53,650	50.00	\$ 8,088	50.00	\$ 63,584	64.11	\$ 38,499	65.94

Note: Shaded areas represent jurisdictions using coin operators.

Exhibit 12.9

Video Lottery Receipts (\$000)
(Source: ALC & ALC's external auditor)

	New Brunswick		Prince Edward Island		Nova Scotia		Newfoundland		Total	
	\$	%	\$	%	\$	%	\$	%	\$	%
1995-1996										
Cash In	254,204	100.0	36,001	100.0	345,992	100.0	202,495	100.0	838,692	100.0
Cash Out	146,904	57.8	19,825	55.1	246,809	71.3	144,107	71.2	557,645	66.5
Net Sales	107,300	42.2	16,176	44.9	99,183	28.7	58,388	28.8	281,047	33.5
1994 - 1995										
Gross Video Lottery receipts	211,718	100.0	32,659	100.0	311,006	100.0	160,918	100.0	716,301	100.0
Prize Expense	120,020	56.7	17,936	54.9	220,646	70.9	111,192	69.1	469,794	65.6
Net Video Lottery Receipts	91,698	43.3	14,723	45.1	90,360	29.1	49,726	30.9	246,507	34.4
1993 - 1994										
Gross Video Lottery Receipts	180,093	100.0	31,152	100.0	225,350	100.0	117,272	100.0	553,867	100.0
Prize Expense	100,286	55.7	17,755	57.0	160,585	71.3	79,748	68.0	358,374	64.7
Net Video Lottery Receipts	79,807	44.3	13,397	43.0	64,765	28.7	37,524	32.0	195,493	35.3
1992 - 1993										
Gross Video Lottery Receipts	176,464	100.0	32,502	100.0	258,271	100.0	70,937	100.0	538,174	100.0
Prize Expense	105,367	59.7	19,560	60.2	183,029	70.9	46,321	65.3	354,277	65.8
Net Video Lottery Receipts	71,097	40.3	12,942	39.8	75,242	29.1	24,616	34.7	183,897	34.2
Totals - four years										
	822,479	100.0	132,314	100.0	1,140,619	100.0	551,622	100.0	2,647,034	100.0
	472,577	57.5	75,076	56.7	811,069	71.1	381,368	69.1	1,740,090	65.7
Net Video Lottery Receipts	349,902	42.5	57,238	43.3	329,550	28.9	170,254	30.9	906,944	34.3

Exhibit 12.10

Profits Distributed
Year Ended March 31, 1996 (\$000)
 (Source: ALC's audited and internal financial statements)

Atlantic Lottery Corporation	Regular Lottery	%	Video Lottery	Total
Sales				
Gross ticket sales	\$ 436,780		\$ -	\$ 436,780
Net video lottery receipts	<u>-</u>		<u>281,047</u>	<u>281,047</u>
	436,780		281,047	717,827
Prizes on ticket sales	<u>233,035</u>		<u>-</u>	<u>233,035</u>
Net Sales	<u>203,745</u>	100	<u>281,047</u>	<u>484,792</u>
Allocated expenses				
Commissions	31,915		99,792	131,707
Ticket printing	9,230		231	9,461
Operating expenses	41,382		9,943	51,325
Interest and other income	(2,713)		(139)	(2,852)
Payments to Government of Canada	3,565		-	3,565
Goods and Services Tax	<u>4,709</u>		<u>7,261</u>	<u>11,970</u>
	88,089	100	117,087	205,176
Special commissions to non-profit organizations	220		-	220
Nova Scotia retailer bonus	<u>3,733</u>		<u>-</u>	<u>3,733</u>
Total allocated expenses	<u>92,042</u>		<u>117,087</u>	<u>209,129</u>
Profit distributed to shareholders	<u>\$ 111,703</u>	100	<u>\$ 163,960</u>	<u>\$ 275,663</u>

Nova Scotia Share	Regular Lottery	%	Video Lottery	Total
Sales				
Gross ticket sales	\$ 164,598		\$ -	\$ 164,598
Net video lottery receipts	<u>-</u>		<u>99,183</u>	<u>99,183</u>
	164,598		99,183	263,781
Prizes on ticket sales	<u>85,275</u>		<u>-</u>	<u>85,275</u>
Net Sales	<u>79,323</u>	38.9	<u>99,183</u>	<u>178,506</u>
Allocated expenses				
Commissions	10,606		27,506	38,111
Ticket printing	3,490		145	3,635
Operating expenses and disturbances (net)	<u>20,196</u>		<u>7,809</u>	<u>28,005</u>
	34,292	38.9	35,460	69,752
Special commissions to non-profit organizations	105		-	105
Nova Scotia retailer bonus	<u>3,733</u>		<u>-</u>	<u>3,733</u>
Total allocated expenses	<u>38,130</u>		<u>35,460</u>	<u>73,5903</u>
Profit distributed to Nova Scotia	<u>\$ 41,193</u>	39.6	<u>\$ 63,723</u>	<u>\$ 104,916</u>

Exhibit 12.11

Summary of Economic Benefits (Source: Summary of Economic Benefits Study 1994-95 Fiscal Year)			
Jurisdiction	Total \$ Value of Purchases & Salaries	% of ALC Total Purchases & Salaries	Jurisdiction's % of ALC's Net Revenue
Newfoundland	\$ 6,861,342	11.88%	28.90%
Prince Edward Island	618,066	1.07%	5.30%
New Brunswick	15,446,876	26.75%	26.60%
Nova Scotia	11,089,013	19.20%	39.20%
Other	<u>23,731,278</u>	<u>41.10%</u>	-
Totals	<u>\$ 57,746,575</u>	<u>100.00%</u>	<u>100.00%</u>

*Appendix 12A***1996 Shareholder's Audit of Atlantic Lottery Corporation
Summary of Recommendations for Consideration****Compliance with Statutory and Policy Requirements**

1. The applicability to ALC operations of the various and differing statutory and other administrative policy directives in the shareholder provinces needs to be determined.

Inter-Provincial Agreements

2. The provisions of the inter-provincial agreements should be subject to review and updating to ensure an appropriate and modern governance and accountability framework and process are in place for ALC. Among other matters, this should include consideration of the following:
 - establishing a set of guiding principles or values to support the interpretation and implementation of the agreements;
 - establishing the obligation to provide sufficient and appropriate accountability information and reporting to the Legislature in each shareholder province on the corporation's financial and program plans and performance;
 - changes necessary to the profit distribution methodology in order to ensure the allocation of costs and results are fair and equitable; and
 - sunset clauses on selected aspects of the arrangements, so that they will be subject to periodic review and updating.
3. ALC's status as a crown agency should be formally determined and clarified, both for accountability purposes, and also as to its responsibility to comply with the various statutory and other administrative policy directives in the shareholder provinces.

Corporate Mission

4. As part of the review and updating of ALC's strategic plans, its mission statement should be interpreted, including appropriate clarification or segregation of the fiscal, societal and other aspects inherent/implicit in the mandate and mission of the corporation.
5. The corporation's mission statement should be formally approved by the shareholder provinces.

Accountability to the Legislature

6. Sufficient, appropriate and timely accountability information and reporting on ALC's plans and performance should be provided to the responsible Minister in each shareholder province, so such is available for tabling or deemed tabling in the respective Legislature.

Corporation's Annual Report

7. ALC's annual report distribution should be expanded, including tabling or deemed tabling in the Legislature on a timely basis.
8. ALC's annual report should include sufficient and appropriate information on the performance of the corporation, especially in relation to its defined plans, budget and goals.

For example:

- financial and other information on the corporations's plans and performance against its strategic goals/objectives and its approved annual budget, with an appropriate emphasis on results compared to planned outcomes;
- segregated and full-cost reporting of the results for the video lottery program, including information re: cash-in, credits won, credits played and cash-out.
- increased information on the costs or expenditures of the corporation (e.g., management compensation, travel expenses, major supply and service arrangements, external/consulting services, and/or other significant costs); and
- appropriate per capita (i.e., per adult population) information and trends re: sales results and targets.

Board of Directors

9. In order to support an improved and modernized Board governance function, as part of a review of the inter-provincial agreements (which would encompass the corporation's bylaws), the Board structure and complement should also be considered.
10. The Board should ensure that appropriate comprehensive standards governing Board, management, and staff behaviour are adopted for ALC.
11. The minutes of the Board meetings should provide an appropriate audit/management trail (i.e., re: the background and rationale for significant deliberations and decisions) and also provide an indication of the voting results for Board decisions (e.g., unanimous, approved - number of votes for, against and abstentions).
12. The process for controlling and following up on the status of action taken or planned as a result of Board decisions or requests should be more formalized.

Overall Management Control Framework

13. The preparation of current corporate and other key divisional or program specific strategic plans, with appropriate input, involvement and approval by the Board and shareholder provinces, should be completed as soon as possible.
14. ALC's internal and external reporting should include appropriate information on its plans and performance against the corporation's approved strategic goals/objectives, using defined outcome measures or indicators.
15. ALC should continue efforts to increase and enhance its use of performance indicators/targets at both the corporate and the divisional levels, and to the extent possible, measurable indicators should be defined focusing on planned outcomes.
16. ALC should move to a multi-year budget process, and continue efforts to enhance the contents and presentation of the supporting information in the Board's budget manual.
17. ALC's financial statement disclosure of total divisional operating expenses should include depreciation expense.
18. ALC's internal/interim financial reporting and variance analysis should also provide a continuing link back to the original approved budget for a fiscal period.

19. ALC's annual reporting (e.g., through its financial statements or otherwise) should provide a comparison to the original approved budget for the fiscal period.
20. As part of its review and approval of internal audit's annual plans, the Board - through the audit committee - needs to consider whether and ensure there are sufficient and appropriate resources available, and that they are deployed in the areas that can be of greatest benefit to the overall level of control for the corporation.

Video Lottery Program

21. ALC should provide schedules segmenting the gross profit portion of the statement of operations by program type in its annual financial statements.
22. ALC should be required to provide a detailed statement on the video lottery program reconciling the results of operations to the required payout specified in each shareholder province's regulations.
23. The methodology for allocating costs and profits to the gaming programs and to the shareholder provinces should be subject to a comprehensive review to ensure ALC's costs and profits are shared and reported on an appropriate and reasonable basis.
24. The commission rates paid should be assessed to determine if the current commissions deliver an appropriate return in line with the costs and risks associated with those components of ALC's operations.

Information Technology (IT)

25. The management and control of ALC's information technology systems and resources should be subjected to additional and comprehensive audit coverage.

Procurement

26. ALC should prepare standard reports of its procurement activity in a manner consistent with the Atlantic Procurement Agreement, Section 9.
27. ALC should continue to periodically evaluate its list of exceptions to standard procurement practices to ensure economic acquisition of goods and services. For example, given the current competition in the telecommunications market, ALC should consider tendering for those services.
28. ALC should formally document as part of its purchasing policy its practice of specifying initial contract terms and the renewal period. Further, formal documentation should be required of the contract review and evaluation process prior to the award of a contract extension.

Allocations to Shareholders

29. ALC's reporting to its Board and external interested parties of the results of the VLP and its other gaming programs should be clearly segregated and on a more full-cost basis to the extent practical and appropriate. As a minimum, the results down to gross profit by program by shareholder province should be reported.
30. Where staff are directly involved in significant and continuing efforts related to regulatory or other activities associated with one or more but not all shareholder provinces, consideration should be given to allocating reasonable and appropriate costs to the specific shareholders concerned.

ATLANTIC LOTTERY CORPORATION INC.'S RESPONSE

Thank you for the invitation to provide a formal response to the audit that was requested by our Nova Scotia shareholder. We appreciate the time and effort that your office has put into this report. It contains a number of helpful suggestions.

We thank you for your acknowledgment that the cooperation of the Atlantic Lottery Corporation's (ALC) Board and Management was significant in the conduct and completion of the audit work. We expected, and the report states, that "nothing was observed that would indicate the integrity of ALC's lottery and other gaming products has been adversely affected."

We intend to act upon the positive suggestions contained in your report. Our shareholders, the four Atlantic Provinces, should be proud of the successes of the Atlantic Lottery Corporation. ALC games have a 20-year history of integrity. Lottery and gaming revenues continue to grow and are an important source of revenue for our shareholder governments.

The enclosed document is ALC's response regarding the 30 recommendations. It is our understanding that the ALC's responses will be included in the 1996 Report of the Auditor General.

RESPONSE TO SUMMARY OF RECOMMENDATIONS FOR CONSIDERATION (SEE APPENDIX 12A PAGE 167)

- R1 ALC believes it is in compliance with shareholder provincial requirements. ALC responds in a timely fashion to any information requests or directives from shareholders.
- R2 We accept your observations. The ALC shareholders and Board are constantly aware of changing situations. ALC's shareholders have reviewed and revised the profit sharing formula from time to time and recognize that it is timely to do so once again. ALC intends to issue an RFP for the conduct of an economic benefit study in the near future.
- R3 ALC is federally incorporated and each of the four Atlantic provinces own one share. ALC believes this method was followed to demonstrate Atlantic provincial cooperation.
- R4 The ALC strategic plan is being updated. ALC is certainly conscious of societal issues; however, these issues remain in the domain of the shareholder provinces. Agree this should be evaluated.
- R5 ALC's mission statement has been approved by its Board of Directors and will be reaffirmed at the next annual shareholders' meeting.
- R6-
R8 ALC is considering enhancements to its annual report.
ALC's annual report is widely distributed and is available to all on request. ALC will consider an even wider distribution.
Tabling of reports in Legislatures is a shareholder decision.
- R9 The Board believes the Board structure and complement are appropriately constituted.

- R10 ALC has these in place and continues to enhance such standards in keeping with appropriate national corporate standards of ethics.
- R11 In order to ensure more comprehensive recording of minutes, a recording secretary now attends Board meetings. Board decisions are recorded by majority and only in instances where a Board member so requests is an individual vote identified.
- R12 Board members are briefed on previous and outstanding business during two recurring agenda items: the President's report and matters arising from previous minutes.
We will give consideration to a more formalized process.
- R13 - R15 Corporate strategic planning is in process. Key divisional and program specific strategic plans have been conducted, others are currently in progress, and yet others will be revised/redone at the appropriate time.
- R16 ALC has a multi-year strategic planning process in place; however, the Board prefers to approve budgets on an annual basis.
- R17 This recommendation will be considered.
- R18 This has been implemented.
- R19 This recommendation will be considered.
- R20 ALC has always placed emphasis on the internal audit function and will continue to do so.
- R21 ALC will implement this recommendation in this year's annual report.
- R22 ALC will consider whether to implement this in the future; however, we are aware that most lottery jurisdictions in North America do not provide this level of detail in their annual reports.
- R23 Shareholders have looked at this from time to time and will continue to do so. This will be again reviewed as part of the conduct of the economic benefit study.
- R24 Commission rates are established nationally by ILC or, in Atlantic Canada, by the shareholders.
- R25 When the ALC Board approved the IT strategic plan, they also directed that an independent audit be conducted by an outside firm on IT subsequent to the implementation of the strategic plan. This will be done. Other audit coverages have either been done or are being considered.
- R26 While ALC is not subject to the requirements of the Atlantic Procurement Agreement, the Board instructed ALC on March 7, 1994, to incorporate, wherever possible, the general intent of the Agreement into its procurement policies.
- R27 ALC is currently doing this.
- R28 The procedures were changed in 1993 and are documented in the new purchasing policies. Contract review and evaluations have been and continue to be documented.
- R29 See R21, R23
- R30 This will be considered.
-

13.

NOVA SCOTIA RESOURCES LIMITED - SPECIAL AUDIT

INTRODUCTION

13.1 Section 15 of the Auditor General Act empowers the Auditor General to conduct and report on special audits throughout the year. In October and November 1996, in response to requests by government, the Public Accounts Committee of the House of Assembly and individual members of the Legislature, we conducted a special audit of Nova Scotia Resources Limited (NSRL).

13.2 Members of the Legislature, media and public have made allegations about the Company's mishandling of certain negotiations and other business matters during the past few years. The allegations related to:

- circumstances surrounding the Company's termination of three senior officers;
- a lack of follow through on certain business transactions commenced before the terminations occurred; and
- the mishandling of the disposal of certain NSRL assets.

13.3 Each allegation purported that the Company either made expenditures it could have avoided, or missed opportunities to lower costs and increase revenues.

13.4 We have examined those issues involving financial transactions. The circumstances relating to the employee terminations were excluded from the scope of our audit because the issues relating to the terminations are primarily legal in nature.

13.5 We had previously conducted an audit of NSRL in 1991, which was followed up in 1992. During the 1991 assignment we examined issues relating to accountability, financial management, planning and compliance with policies. The results of those assignments were discussed in the 1991 and 1992 Reports of the Auditor General.

RESULTS IN BRIEF

13.6 This section of the chapter summarizes the major observations and conclusions of the audit. It does not provide sufficient information for a complete understanding of the issues examined by the audit, or the support for our conclusion. It should be read in conjunction with the other sections of the chapter to obtain an appropriate understanding of the issues.

- An agreement between Nova Scotia Resources Limited (NSRL) and LASMO Nova Scotia Limited to have NSRL assume complete ownership of all partnership assets upon completion of the Cohasset project may have been of marginal value to NSRL. However, execution of the agreement would have exposed the Company to greater risk and NSRL was having difficulty negotiating how much legal liability LASMO would continue to have under the new arrangement.

- NSRL's decision to conduct a joint development of the Balmoral oil field with LASMO as an alternative to a redistribution of partnership assets was beneficial to NSRL.
- NSRL's plan to negotiate a transaction with PanCanadian Petroleum Limited to monetize some of NSRL's tax pools was terminated due to government's decision to divest itself of the Company. We concluded that if the government had executed the agreement with PanCanadian, it could have benefited by approximately \$5 million between the fall of 1994 and the end of 1996. However, when government made the decision to dispose of NSRL in early 1995, it would not have been able to predict how long it would take to sell the Company and/or its assets. Also, management believed the transaction may have negatively impacted the divesture process, and that monetization of these tax pools could be achieved at a later date.
- The rules under the *Canadian Income Tax Act* regulating the type of transaction that was being negotiated between NSRL and PanCanadian were terminated in early 1996. However, NSRL taxation advisors suggest there are other possible means of monetizing tax pools, and we have observed negotiations by NSRL with other companies to achieve this result as part of the divesture of NSRL. Until a specific transaction is agreed to between NSRL and other parties and presented to Revenue Canada for approval, it will not be certain whether additional benefits will be available to NSRL from its tax pools.
- A competitive process was used to dispose of the western Canada oil and gas properties. Yet, some of the properties were sold for less than valuations would suggest as their worth. Based on this conflicting information, we cannot express an opinion on whether or not NSRL received what the properties were worth. However, the sale was conducted with the objective of maximizing the sales price while minimizing risk, and holding on to the properties with the hope that better offers could be found was believed to have an unacceptable element of risk.
- The government had a reasonable amount of information and advice upon which to base its decision to dispose of NSRL.

AUDIT SCOPE

13.7 Our audit addressed NSRL's handling of three specific business matters, based on allegations that:

- The Company did not execute an agreement with LASMO Nova Scotia Limited that would have provided the Company greater benefit upon completion of the Cohasset project.
- The Company did not execute an agreement with PanCanadian Petroleum Limited that would have enabled NSRL to receive a benefit on account of tax deductible exploration and development expenditures. It was further claimed that recent changes to the *Canadian Income Tax Act* make a similar business arrangement of limited value to the Company if it were to be completed now.
- The Company disposed of western Canada oil and gas properties that were very profitable, and did not receive the best price possible from the sale.

13.8 The scope of our audit did not include any areas other than those we considered to be directly related to these three issues. It does not address the sale of any assets or ownership interest other than the western properties (which includes an ownership in Direct Energy Marketing Limited) because, to date, no other sales have been finalized. It would be inappropriate for our Office to comment on any divestiture activities that are currently in progress, as our comments could impact the outcome of any negotiations underway.

13.9 Each of the issues are described in greater detail in later sections of this chapter. However, we first provide a brief history of the Provincial government's involvement in oil and gas exploration and development which should assist readers in understanding these issues, as well as our audit conclusions.

13.10 We examined reports, correspondence, agreements, minutes and other documents relating to the above noted issues. We interviewed officers of government and NSRL, as well as others in the oil and gas industry. Background research, review of taxation law and various analyses were conducted to facilitate our planning of the audit and our understanding of the issues examined.

13.11 At all times during this audit, Company and government officials have been very cooperative and helpful. This chapter has been reviewed and discussed with Company and government officials. Responses to the audit have been prepared by NSRL management and the government, which are included in our Report, immediately following this chapter.

PRINCIPAL FINDINGS

Background

13.12 This section of the chapter summarizes background information relevant to an understanding of the issues addressed by our audit. It does not represent a complete history of Nova Scotia's oil and gas activities.

13.13 *Offshore oil and gas* - The exploration for petroleum in the waters off Nova Scotia began in 1959 with the issuing of an exploration license to Mobil Oil Canada Ltd. Mobil and its partners drilled Nova Scotia's first offshore well in 1967. This initiated an exploration cycle that lasted until 1978. Although commercial quantities of oil and natural gas were not discovered, some significant discoveries were made. As a result, a second exploration cycle began in 1979 and over ten years resulted in the discovery of 12 significant natural gas finds, and a few such oil finds. As of November 1996, more than 135 wells have been drilled offshore and approximately 6.4 trillion cubic feet of natural gas and 217 million barrels of oil and natural gas condensates have been discovered. The Scotian Shelf is still relatively unexplored, and it has been estimated that findings to date represent only 35% of total natural gas potential and 20% of total oil potential.

13.14 Oil and gas operations offshore of Nova Scotia are jointly managed by the governments of Nova Scotia and Canada, in accordance with the Canada-Nova Scotia Offshore Petroleum Resources Accord Implementation Act and the Canada-Nova Scotia Offshore Petroleum Resources Accord Implementation (Nova Scotia) Act; both proclaimed in January 1990. The Accords give Nova Scotia the right to negotiate royalty payments for its sole benefit. The legislation created the Canada-Nova Scotia Offshore Petroleum Board, which oversees the day-to-day management of offshore petroleum operations on behalf of both governments.

13.15 To encourage offshore exploration and development, the Federal and Provincial governments later repealed provisions of the legislation which required that production licenses have at least 50% Canadian ownership. This increased the potential for foreign investment as a means of funding offshore ventures.

13.16 Canada's first offshore development project, at the Cohasset and Panuke oil fields, commenced production on June 3, 1992. The fields are located in 36 metres of water, 250 kilometres southeast of Halifax and 41 kilometres southwest of Sable Island. The project was the result of a joint venture between NSRL and LASMO Nova Scotia Limited, an affiliate of LASMO PLC of England. LASMO assumed the role of project operator. At the start of the project, it was estimated that the fields would yield approximately 50 million barrels of oil, at rates up to 40,000 barrels per day. Whereas such reserves are small by world standards, it was predicted that the fields' high productivity, shallow water depth and moderate climate would make development viable.

13.17 *Nova Scotia Resources Limited* - Nova Scotia Resources Limited is a wholly owned corporation of the government of Nova Scotia. It was incorporated under the Nova Scotia Companies Act in 1979, and conferred Crown corporation status in 1981. Its mandate is to invest in and manage the Province's participation in petroleum, energy and mineral development. The Company has been involved with onshore energy projects, but the majority of its activity has related to offshore exploration and development.

13.18 As of December 31, 1995, NSRL and its subsidiaries held the following assets.

- An interest in 19 significant hydrocarbon discovery areas offshore Nova Scotia.
- A 50% interest in the Cohasset and Panuke oil fields.
- Ownership of 7.2% of all discovered natural gas reserves offshore Nova Scotia, including 10% of the Venture Gas Project fields.
- Interests in producing oil and gas properties in western Canada. (The Company sold all of its remaining western Canada properties in 1996.)

13.19 NSRL managed its investment in onshore and offshore projects through a series of subsidiary companies. (NSRL's corporate organization is depicted in Exhibit 13.1 on page 187.) Most offshore activity has been conducted by Nova Scotia Resources (Ventures) Limited [NSR(V)L]. NSR(V)L is 99.9% owned by Nova Scotia Resources Exploration Limited, which is a wholly owned subsidiary of NSRL. The corporate structure was designed to enable NSR(V)L to declare itself a taxable corporation in accordance with the *Canadian Income Tax Act*. This declaration made NSR(V)L eligible for Federal government assistance through the Petroleum Incentive Program which ran until March 1986.

13.20 Aside from a \$525,000 grant made in NSRL's first year of operation (1981), the Provincial government has not injected any operating funds into the Company. However, the Federal government provided \$109 million of incentives to the Company during the period 1987 to 1992. The remainder of NSRL's financial requirements have been met through borrowing. The Company's debt peaked in March 1994 at \$501 million. As of December 31, 1995 NSRL had total debt of \$439 million; all of which is guaranteed by the Province. (NSRL's unaudited consolidated financial statements dated September 30, 1996 indicate total debt had further dropped to \$430 million.) Between 1981 and 1995, NSRL paid \$232 million to service its debt.

13.21 As of December 31, 1995 NSRL assets had a book value of \$27 million. Throughout its existence NSRL has made considerable investment in offshore ventures. However, in accordance with generally accepted accounting principles, these investments have been written-down to reflect the prospects for recovery of invested capital through future revenues. Write-offs to December 31, 1995 have totalled \$357 million.

13.22 NSRL had an accumulated deficit of \$412 million at December 31, 1995. This represents the total of all annual net incomes and net losses by the Company since its incorporation.

13.23 *The Cohasset Project* - In September 1990, the Canada-Nova Scotia Offshore Petroleum Board approved a development plan for the Cohasset and Panuke oil fields. By that time NSR(V)L and LASMO Nova Scotia Limited each owned 50% of the oil fields. A joint operating agreement between NSR(V)L and LASMO was executed on July 12, 1990, with LASMO declared the operator of the development project. After approximately two years to arrange for the equipment, work force and necessary authorizations and agreements, the project commenced production on June 3, 1992. This event represented the first commercial offshore oil production in Canada.

13.24 At the time of the start of production, the two offshore fields had estimated recoverable reserves of approximately 50 million barrels. It was expected that daily flow at full production would approximate 40,000 barrels and the project would produce for six years. The oil was very light and sulphur free, which was expected to attract a premium price in the world markets.

13.25 In September 1990, when the project received the approval of both the Provincial government and the Canada-Nova Scotia Offshore Petroleum Board, the total cost of the project was estimated to be \$705 million. Of this, \$225 million was forecasted for capital expenditures on items such as well head platforms, flow lines, a CALM buoy and production facilities (to be built upon the leased jack-up drilling platform Rowan Gorilla III). Operating costs of \$480 million were projected for salaries; supplies; and the lease of the Rowan Gorilla III, helicopters and two tanker ships. Revenues of \$970 million were forecasted, yielding a projected net positive cash flow of \$265 million. One-half of this would accrue to NSR(V)L.

13.26 The Cohasset project has been controversial, primarily due to significant and regular changes in the project's revenue and cost projections. The most current estimate of the project's total capital and operating expenditures is \$1.04 billion. This represents a 48% increase from the estimates made at the time of the project's approval. As this estimate rose gradually over the years, and the estimated profit turned into a net loss (at one point estimated to be as high as \$100 million, with NSRL responsible for one-half), the relations between NSRL and LASMO became strained. In a meeting of the Public Accounts Committee on October 6, 1993, the new President and CEO of NSRL criticized LASMO for the cost overruns. He also indicated that estimated reserves had been down-sized from 50 million to 34 million barrels.

13.27 Reserve estimates subsequently rose again and are now estimated to be 44 million barrels. Also, in August 1995 NSRL entered into an agreement with LASMO to produce from the adjacent Balmoral field under the terms of the original joint operating agreement. Accordingly, NSRL management now estimate that, excluding debt service costs, the Company will break even on the project. Each of the partners in the venture were to finance their contribution in any manner considered appropriate. NSRL borrowed its requirements on the open market. The most current estimates by NSRL management indicate that interest paid on money borrowed for the Cohasset Project by NSRL will total \$65 million.

13.28 Upon completion of the Cohasset project, the Provincial government will have received \$23 million of royalties from the venture partners. Other benefits of the project to the Province include increased employment, economic spin-offs to local industry and a greater tax base for the government.

13.29 *Divesture of Nova Scotia Resources Limited* - A business plan proposal was completed by NSRL in the summer of 1993 and presented to the Minister of Natural Resources. Company management were confident that they could develop offshore oil projects under a cost structure significantly lower than currently in existence for the NSRL/LASMO joint venture. Accordingly, a course of action was recommended that would have NSRL become an operator of small oil fields after the Cohasset project was completed.

13.30 On July 22, 1993, Cabinet approved the course of action proposed, subject to receiving a favourable second professional opinion. The government contracted with Indeva Energy Consultants to review the business plan and comment on the viability of the recommendations included therein. The consultant reported to government in September 1993, concluding that the future operations of NSRL were viable under all but worst-case scenarios. A new Board of Directors, with most members having significant experience in the oil and gas industry, was selected to govern the operation of NSRL.

13.31 Upon the installation of the new Board of Directors on March 28, 1994, the government asked the Company to prepare a comprehensive business plan with more detail and alternative courses of action over a longer time frame (five years). The plan was prepared during the next few months and was approved by NSRL's Board in September of 1994. It provided scenarios for various courses of action, ranging from continued operation as an oil and gas developer to a wind-up of the Company. Each scenario included revenue and cost estimates. The plan forecasted that, in terms of future cash flow, the best scenario still involved becoming an operator of small oil fields. Accordingly, the plan recommended such a future for NSRL.

13.32 Before government received the plan, it started a process to select a firm to value the Company in order to provide information upon which to base a decision on whether or not to sell the Company. The government hired Rothschild Canada Limited to conduct a valuation of NSRL (which was reported in March 1995). On February 27, 1995 most of the Board of Directors and three senior officials of NSRL were dismissed. Upon review of the preliminary results of the valuation, and NSRL's plan, and after discussion by Executive Council, the government chose to divest itself of the Company as quickly as possible. A new Board of Directors comprised entirely of senior members of the government's public service was installed. On June 7, 1995, Rothschild was hired by NSRL to help with the divestiture of the Company.

Negotiations with LASMO

13.33 *Description of the issues* - Soon after the start of the Cohasset project, serious concerns were expressed about cost overruns. NSRL and the government attributed a significant responsibility for the over expenditures to LASMO, the operator of the project. In August 1993, in response to these concerns, NSRL and LASMO agreed in principle to a new distribution of the remaining partnership assets upon the conclusion of the Cohasset project. There were a number of conditions to the understanding, but the four major requirements were as follows.

- NSRL would assume operation of the Cohasset and Panuke oil fields after LASMO deemed that production of the fields by the partnership was no longer economically viable. All risk of continued operation would be borne by NSRL.
- NSRL would assume 100% ownership of the Balmoral oilfield. The field was owned equally by the two partners, but was not slated for development because of its low estimated reserves.
- All equipment owned by the partnership would be sold to NSRL for one dollar at the conclusion of the partnership.
- Project abandonment costs (e.g., equipment retrieval, well sealing), effective at the time of LASMO's withdrawal, would be estimated and agreed upon, and LASMO would provide for its share of that cost.

13.34 This arrangement was very attractive to NSRL management because of its vision of the Company's future at the time. Management was of the opinion that the Company could profitably

operate oil fields that were too small to be developed by larger oil and gas companies. They believed that NSRL could operate the Cohasset and Panuke oil fields at a lower cost than under the joint operating agreement, primarily through renegotiation of equipment leases and/or acquisition of lower cost equipment and supplies. At the time, LASMO estimated that the Cohasset project would no longer be economically viable to the partners once daily production dropped below 10,000 to 15,000 barrels per day. NSRL management believed the Company could become an operator of the fields after LASMO deemed them no longer feasible, and make profits as long as rates of flow remained above 6,000 barrels per day. Management also believed that NSRL could profitably develop the Balmoral field.

13.35 Based on the above assumptions, management believed it was beneficial for NSRL to assume ownership of the oil fields and partnership assets upon LASMO's quitting of the project. NSRL planned to continue production until its minimum daily production (i.e., 6,000 barrels per day) was met. Thereafter, the Company would have equipment it could deploy to other small fields it owned or acquired.

13.36 Over the following year or so, both companies negotiated the details of this agreement. However, early in 1995 the government decided to get out of the oil and gas business. Thus, the agreement in principle with LASMO was no longer as beneficial to NSRL. NSRL would not be developing oil fields, and without this activity government believed the remaining partnership assets lost much of their value to the Company.

13.37 The primary assets owned by the venture partners are the production facilities on the Rowan Gorilla III, a CALM buoy, two well head platforms and various flow lines. The drilling rig and tanker ships were leased and will return to their owners at the end of the project. Current management of NSRL estimate that the partnership assets could be disposed of for about \$10 million (one-half accruing to NSRL). The production equipment installed on the Rowan Gorilla III cost the partnership approximately \$115 million, but it would cost \$10 million to remove it from the leased rig and there would be a very small market for its resale.

13.38 Also, NSRL and LASMO could not agree on how this agreement in principle would affect LASMO's legal liability after the joint operating agreement expired. Faced with this difficulty, and an agreement that would provide NSRL with properties it would have no capacity to develop and equipment of marginal salvage value, it negotiated a different agreement with LASMO. This agreement involved the joint development of the Balmoral oil field.

13.39 The Balmoral oil field is located three to four kilometres from the current location of the Rowan Gorilla III jack-up rig on the Cohasset field. The field was considered by the venture partners to be too small to produce feasibly at the time that the reserve was discovered in 1991. However, at that time, it was assumed that production would involve the relocating of the drilling rig upon the completion of production at the Cohasset and Panuke fields.

13.40 Between May and August 1995, the venture partners designed an alternative means of producing the Balmoral field that would be profitable. They agreed to drill into the field from the rig's current location by way of a technology referred to as directional drilling. This technology enables a well to be drilled into a field located a distance away from the drill rig by directing the drill bits to produce a well that runs for a distance under the surface of the ground. The benefits of this approach are that the rig would not have to be relocated, with the associated costs, and the flow from the Cohasset and Panuke wells would not be interrupted. Thus, the only significant incremental cost of producing Balmoral would be the cost of drilling the directional well.

13.41 NSRL negotiated participation in this project costing a maximum of \$1.1 million if a dry hole resulted, or \$1.6 million if the well produced. The two partners would equally share in the revenues.

Upon completion of the drilling, NSRL's share of the drilling costs were estimated to be 40%, which was funded by assistance from the Federal government's Offshore Development Fund.

13.42 The drilling was successful. The estimated reserves for Balmoral were increased from 1.1 million to 3.5 million barrels. Also, adding the extra flow from Balmoral to the declining flow from existing wells made it feasible to extract greater amounts from the Cohasset and Panuke wells than originally estimated. Management of NSRL estimate that at an average oil price of approximately \$28 (Canadian) per barrel, the Balmoral field and the extra flow from Cohasset and Panuke wells will provide revenue to NSRL of \$56 million.

13.43 The agreement to produce the Balmoral field was executed on August 28, 1995. This event put an end to the negotiation over the sharing of partnership assets and costs at the completion of the Cohasset project.

13.44 *Conclusions* - Based on our review, the Balmoral project has been beneficial to NSRL. However, we asked management why the Company would proceed with a new development project when it was in the process of divesture. Management explained that there was a time-specific window of opportunity for optimizing the return from the Balmoral project. It had to start after the flow from the Cohasset wells subsided enough to allow for additional flow from Balmoral, and before the depletion of the Cohasset wells, after which the rig would move to the Panuke field. Further, the Balmoral property would not have been attractive to a purchaser of NSRL because this window of opportunity would likely have been missed.

13.45 In addition, we asked NSRL management if the Balmoral project could have been more profitable to the Company if it had acquired 100% of the oil field as part of the negotiation to redistribute partnership assets at the end of the Cohasset project. Management indicated that under that scenario and based on the information available at the time, it could not have made more profit. NSRL would have had to wait until the Cohasset project was over and the partnership with LASMO dissolved. Then, assuming an average price of oil at \$28 (Canadian), estimated recoverable reserves of 1.1 million barrels, completion costs of \$4 million, operating costs of \$150,000 per day and a project length of 180 days, the project would have lost approximately \$200,000. Using the same assumptions as noted above, but having the development of Balmoral in partnership with LASMO, would net NSRL \$13.8 million. The reason for this difference is that the partnership does not experience any increase in operating costs under this arrangement.

13.46 After the project commenced, reserve estimates were increased based on experience in the production of the well. Even if the higher recoverable reserves were forecasted at the time negotiations with LASMO were occurring, it is unlikely a different decision would have been made. Assuming recoverable reserves of 3.5 million barrels and using the assumptions noted above, NSRL would have made a profit of \$21 million if it conducted the project on its own, but is projected to make a profit of \$47 million developing it along with its current partner.

13.47 However, we have not seen evidence that the agreement to develop Balmoral and the agreement to redistribute partnership assets were mutually exclusive (i.e., both agreements could have been executed). The Balmoral project was profitable to both partners, and was included in the Joint Operating Agreement as a project for future consideration. LASMO took some extra risk in drilling Balmoral and incurred a little more than fifty percent of drilling costs but, this concession does not appear to exceed the value of a redistribution of the partnership assets. If sold outright, the partnership equipment may have netted an additional \$5 million to NSRL (LASMO's share of the salvage value of the equipment). However, we agree with management's assertion that completing the redistribution of assets agreement with LASMO would have created additional risk for NSRL, especially in the area of project abandonment and liability for future claims. The potential marginal gain from the agreement does not appear to outweigh the additional risks involved.

13.48 We also enquired whether the Company may have been more attractive in the divesture process if NSRL obtained full ownership of the equipment and oil fields, or whether the remains of the Cohasset and Balmoral fields may have had value to another company if sold separately. We observed expressions of interest in the purchase of the Cohasset and Balmoral fields and other partnership assets upon completion of the joint venture. However, the companies showing interest were excluded from bidding on them. According to our enquiries, there are legal requirements that offshore oilfields be operated only by companies that demonstrate experience, expertise and adequate financial backing. We were informed that the companies that bid on the offshore properties did not meet these requirements. This issue is discussed further in the section of the chapter entitled *Western Canada Oil and Gas Properties* on page 183.

Monetization of Tax Pools

13.49 *Description of the issues* - The *Canadian Income Tax Act* recognizes that the nature of oil and gas exploration is one of significant investment and costs that do not result in income until years later when projects begin to produce and the petroleum products are sold. The Act permits eligible property acquisition, exploration, development and overhead expenses to be placed into “tax pools”, effectively capitalizing them in anticipation of future earnings. In accordance with detailed provisions of the Act, the pools can be amortized over a period of future years, thus applying the past expenses over a term that corresponds to the period that revenue is produced from an oil or gas property.

13.50 As of December 31, 1995 NSR(V)L had \$457 million of deductions available to reduce future taxable income. Although it is difficult to attribute the total in the tax pools to individual activities of the Company, roughly one-half represents natural gas exploration between 1981 and 1988, and the other half represents investment in the Cohasset Project. However, assuming a break-even outcome of the Cohasset project, some of the tax pools may be required by NSR(V)L to reduce future taxable income from the project.

13.51 Management of NSR(V)L, over the years, regularly forecasted how much of the tax pools were needed by the Company to offset its future taxable income. Such forecasts have always indicated that significant portions of the tax pools would not be required by the Company (notably, those relating to NSR(V)L’s exploration for natural gas). Accordingly, management has often explored alternative means of using the tax pools to increase the cash flow of NSR(V)L. This is sometimes referred to as *monetization* of tax pools.

13.52 One means of monetization that has been employed by NSR(V)L for a number of years involved the purchase of Canadian oil and gas properties that were already producing. By investing in properties that were proven to be profitable (see the following section on page 183 which discusses these investments), NSR(V)L could earn a good rate of return which was completely sheltered from income tax. This was effected by applying expenses accumulated in the tax pools against the taxable incomes of the properties.

13.53 However, the transaction that is the subject of this section of the chapter is somewhat more involved.

13.54 NSR(V)L negotiated to enter into a tax pool monetization transaction with PanCanadian Petroleum Limited, a Canadian-controlled oil and gas company with headquarters in Calgary. By using the Joint Exploration Corporation provisions of the *Canadian Income Tax Act*, NSR(V)L and PanCanadian could form a joint undertaking in which certain of NSR(V)L’s accumulated tax deductions (i.e., tax pools) could be transferred to PanCanadian to reduce its taxable income. The transfer is referred to as a *renouncing* of expenses.

13.55 To facilitate this transaction, NSR(V)L planned to declare itself a Joint Exploration Corporation and issue shares to PanCanadian to effect joint ownership. Under the Joint Exploration Corporation rules, only expenses incurred while an entity is a shareholder can be renounced to the shareholder; and then only to the extent of the shareholder's investment in the Joint Exploration Corporation's equity and debt. The planned transaction involved the renouncing of a portion of NSR(V)L's annual interest on its debt (which is eligible for capitalization into tax pools). The principal details of the transaction were to be as follows.

- NSR(V)L would issue 4,000 Class B Non-voting Common Shares to PanCanadian and one of its affiliates for \$100,000, and then declare itself a Joint Exploration Corporation.
- NSR(V)L would issue debentures to PanCanadian equal to the amount of current eligible exploration and development expenses (i.e., interest) incurred by NSR(V)L subsequent to when PanCanadian became a shareholder. The debentures would be purchased by PanCanadian at a value in excess of their face value. In effect, this would have NSR(V)L returning less money to PanCanadian than it had borrowed, thus establishing the price PanCanadian was to pay for the renouncing of the eligible expenses. The portion of the money received by NSR(V)L that would have to be repaid would be placed in a sinking fund earning approximately the same as the debenture rate.
- Each year, NSR(V)L would renounce all exploration and development expenses (i.e., interest) incurred during the year to its new shareholder.
- After five years the agreement would terminate, the debentures held by PanCanadian would be bought back by NSR(V)L, and NSR(V)L would buy back its shares.

13.56 It was understood that the success of the transaction would be subject to the approval of Revenue Canada.

13.57 NSR(V)L estimated it would have at least \$12 million of renounceable expenses each year; totalling \$60 million over the five-year term of the agreement. At an average premium of approximately 20% on its debentures, NSR(V)L would earn \$2.4 million each year, or \$12 million over the five years. There was also a provision for increasing the annual renouncing of expenses if NSR(V)L took on a new development project and incurred additional renounceable expenses.

13.58 It is not clear how much benefit PanCanadian would earn from the agreement. However, according to NSR(V)L's tax advisors, the transaction was structured so that PanCanadian was the only entity that risked loss if the transaction was not deemed appropriate by Revenue Canada. Also, NSR(V)L could terminate the agreement with little cost if a decision was made to sell the Company or its assets.

13.59 Planning for this transaction began in the spring of 1994. A member of NSRL's Board of Directors was selected to help management identify and negotiate monetization opportunities. PanCanadian expressed interest and a framework for a monetization transaction was drafted. At this point, the Minister of Natural Resources was informed of the Company's intentions regarding PanCanadian. However, in a letter dated July 13, 1994, the Minister required that all discussion of the tax deal be halted. The Minister indicated that he and Executive Council would require the business plan of NSRL to be completed before they would grant approval for such a transaction. It was indicated that government wanted to be sure the substance of the transaction was consistent with plans for future operations of the Company.

13.60 Because of a pending deadline for the renouncing of 1994 expenses, management and Board members requested (and the Minister approved) an arrangement that would sell the 4,000 Class B Non-voting Common Shares to PanCanadian before approval to enter into the remaining terms of the transaction was granted. A put/call agreement would be executed whereby either party to the share purchase/sale agreement could require the other party to sell/buy back the shares at any time for any reason. The share purchase/sale and the put/call agreements were executed in November 1994.

13.61 As described earlier in this chapter, the government decided in early 1995 that it did not want to remain in the oil and gas business. It decided to sell NSRL and/or all of its assets. The negotiations with PanCanadian were terminated as they were perceived to be of value only upon the continuance of NSR(V)L. On June 6, 1995 NSRL exercised its right to “call”, and subsequently repurchased NSR(V)L’s shares from PanCanadian for \$100,000, the amount originally paid by PanCanadian.

13.62 In January 1996, PanCanadian purchased LASMO Nova Scotia Limited. PanCanadian became NSRL’s new partner in the Cohasset Project, but the change in ownership did not affect the terms of the agreement that governs the project.

13.63 *Conclusions* - In our opinion, participating in the PanCanadian transaction for the period up to the sale of NSRL would have profited NSRL (as well as PanCanadian). If the PanCanadian transaction had been executed in late 1994, NSR(V)L could have participated, to date, in the renouncing of a little more than two years’ expenses, which would have earned it approximately \$5 million.

13.64 Yet, we did not see any evidence that it was possible to accurately predict how long it would take to sell NSRL, and that the monetization transaction could have lasted so long. The valuation of NSRL by Rothschild was reported on March 3, 1995. The Confidential Information Memorandum used to generate interest in purchasing the Company is dated August 1995. As of January 1997, the sale of NSRL or its assets, except for the western properties, has not been finalized.

13.65 In our opinion, the PanCanadian transaction was structured so that participation would not hinder efforts to sell NSRL and/or its assets. An argument could be made that executing the transaction may have made NSRL more attractive to a prospective buyer. It is likely that PanCanadian would have continued the agreement with the new owners of NSRL, if they so wished. However, in its 1996 budget address, the Federal government indicated that the Joint Exploration Corporation rules of the *Canadian Income Tax Act* were terminated effective March 6, 1996, subject to certain transitional rules. The rule changes could also act to prohibit a renewal of the agreement, thus limiting its benefit to a purchaser of NSRL. Also, the purchaser of NSRL would have had to assume NSRL’s debt in order for the monetization transaction to be applicable, and management indicates that this would be an unlikely scenario.

13.66 Management also expressed concern that having PanCanadian as a minority shareholder may have hindered the process of divesting of NSRL.

13.67 We saw correspondence from NSRL’s taxation advisors indicating other means of monetizing tax pools may be possible. We also have seen evidence of expressions of interest and preliminary negotiations concerning the “purchase” of portions of NSR(V)L’s historic tax pools. NSRL’s historic tax pools are much larger than the annual additions to the pool which were the focus of the PanCanadian transaction. Of course, for NSRL to benefit from any such transaction, it would need to receive the approval of Revenue Canada. Such approval will not be forthcoming until the exact details of a transaction are agreed upon and provided to Revenue Canada for its review. Also,

we are unable to conclude whether such a transaction would adequately monetize the interest costs that were the subject of the PanCanadian transaction.

Western Canada Oil and Gas Properties

13.68 *Description of the issues* - In 1985-86, NSRL began to invest in working interests in oil and gas properties in western Canada. The Company purchased and sold, individually and in lots, numerous properties in Saskatchewan, Alberta and British Columbia. Most of the properties were producing oil and gas at the time of purchase. The primary objectives of NSRL were to acquire investments that would generate cash flow that could be sheltered from income tax by amortization of NSR(V)L's tax pools, and to provide a source of positive cash flow to contribute towards the overhead costs of the Company.

13.69 As a result of the purchase of one particular group of western properties, NSRL also acquired 9.9% interest in the shares of a company called Direct Energy Marketing Limited (DEML). DEML is a privately owned gas marketing company based in Calgary. It enters into long and short term contracts for the purchase and sale of gas.

13.70 A company named Venwest Resources Limited was incorporated to hold the western properties and the shares in DEML. All of Venwest's shares are held by NSR(V)L (refer to Exhibit 13.1 on page 187). Venwest contracted with a Calgary oilfield management company to manage its properties. Over the years, the management company bought and sold oil and gas properties for Venwest and managed its portfolio of properties with the goal of generating the highest return possible. Venwest held as many as 89 properties in 1988.

13.71 Rothschild Canada Limited was hired on June 7, 1995 to help with the divestiture of NSRL. The consultant sought purchasers interested in the Company as a whole, or in individual or specific groups of assets. The nature of the expressions of interest led to DEML and the western properties being marketed and sold separately from NSRL's other assets.

13.72 DEML was sold on June 30, 1995 for \$2.5 million. The oil and gas properties were sold on January 1, 1996 for \$4.7 million.

13.73 *Conclusions* - DEML was sold for an amount in excess of the \$1.5 million value estimated by Rothschild during its earlier assignment to value the assets of NSRL. The western properties were sold for less than the amount at which the consultant previously valued them, and were sold to a company that was not completely independent of NSRL. We examined these two situations, and discuss them below.

13.74 NSRL's western oil and gas properties were valued by Rothschild at between \$7.2 and \$7.9 million, as of January 1, 1995. The valuations were based on reserve estimates dated April 1, 1994, a 15% discount rate applied to post-tax cash flows from the properties, as well as other valuation parameters such as comparative acquisition prices. This discount rate was selected as it represented what Rothschild believed would be a required rate of return for a future owner of the properties. The high value of the range was derived by applying the discount rate to 100% of the properties' proved and probable reserves, whereas the low value was derived by applying the rate to 100% of proved reserves and 50% of probable reserves.

13.75 A later evaluation of the properties conducted by Paddock Lindstrom & Associates for Venwest indicated a present value of future forecasted revenue of \$8.5 million, assuming a 15% discount rate. The estimate was dated December 31, 1994 and indicated an increase in oil and natural gas liquid reserves, and a decrease in gas reserves, resulting in a net increase in the properties' total value.

13.76 One year of production occurred between December 31, 1994 and the time the properties were sold. Management of NSRL estimate that the year of production would have reduced the present value of the properties by \$1.5 million. Subtracting this amount from the \$8.5 million estimated by Paddock Lindstrom & Associates yields an adjusted present value of \$7.0 million. The properties were sold for \$4.7 million.

13.77 It is generally accepted that if a competitive and fair process is used to sell an asset, the result will be receipt of the fair value. Accordingly, we reviewed the process used to sell the properties.

13.78 The properties were offered for sale in two rounds of bidding. The first round established interest and non-binding offers, and the second round narrowed the list of bidders and required more detailed bids. Rothschild indicated to us that ten companies were invited to participate in the second round, and six responded. Geo-Energy Corporation, the company that previously managed the properties for Venwest, submitted the bid with the greatest cash benefit to NSRL. Management indicated to us that there was an advantage in selling to Geo-Energy in addition to receiving the highest proceeds. Because of Geo-Energy's previous involvement with the properties, there was a significant reduction in the legal requirements and transaction costs to effect the sale.

13.79 Management of NSRL informed us that Geo-Energy had no involvement in preparing the information provided to potential bidders, and that it had no additional access to Rothschild Canada Limited, the administrator of the bid process. We were reminded that Rothschild was being remunerated on a commission basis, so it was in its best interest to get the highest price possible. We recognized that the reserve estimates were a major decision factor for prospective buyers, so we reviewed controls over accuracy of the estimates. We found that the Rothschild valuation relied on the estimates of reserves, production, costs and other cash flows assessed by Gilbert Lautsen Jung Associates Ltd. as of January 1, 1995, as well as an independent evaluation by Paddock Lindstrom & Associates dated April 1, 1994.

13.80 However, we came across one situation in the sales process which we believed required further review. K2 Energy Corporation (K2) is a Calgary based junior oil and gas exploration and production company. Its current President and Chief Executive Officer is James Livingstone, who was the past President and Chief Executive Officer of NSRL. K2 expressed an interest in bidding on the assets of NSRL. K2 signed the appropriate confidentiality agreements, but were invited to bid only for the western properties. However, K2 had an interest in purchasing all of the oil properties of NSRL, including those offshore of Nova Scotia. Accordingly, the Chairman of K2 wrote a letter to ask why it was being excluded from bidding on all of the assets. The government rejected K2's bid for the offshore properties based on a concern about the adequacy of K2's experience, expertise and financial backing, and about its lack of decision as to whether or not it would have a partner. (K2 contested this action in a legal action before the Supreme Court of Nova Scotia, but was not successful.)

13.81 However, after receiving the letter from the Chairman of K2, his company was cut out of the bidding for the western properties as well. A letter from Rothschild to the Chairman of K2 dated September 14, 1995 indicated that "*it has been determined not to entertain offers from K2 Energy Corporation for the purchase of any or all of the assets of NSRL*" (emphasis added). Two weeks later K2 was again invited to bid on the western properties.

13.82 In our opinion, in the interest of minimizing future risk and exposure to the government and public of Nova Scotia, it was reasonable for the government to set conditions for eligibility in the bidding for the offshore properties. Excluding K2 from bidding on the western properties was not in the best interest of making the sale as competitive as possible, but this situation was later corrected.

13.83 With the exception of the minor delay relating to K2 Energy Corporation's eligibility to bid on the western properties, as discussed above, we concluded that the process to sell the western properties was fair. Yet, the properties were sold for less than the evaluation of the present value of forecasted cash flows would suggest as their worth. Based on this information, we cannot express an opinion on whether or not NSRL received what the properties were worth.

13.84 However, we were informed that Rothschild and the Board of NSRL conducted the sale with the objective of maximizing the sales price while minimizing risk. Holding on to the properties with hopes that a better offer could be found was believed to have an element of risk, and was not considered to be a reasonable option.

Divestiture of Nova Scotia Resources Limited

13.85 Each of the issues we examined in our audit were heavily impacted by the government's decision to dispose of NSRL. Due to this fact, we reviewed the government's reasons for leaving the oil and gas business in the manner that it did. The September 1994 business plan of NSRL provided alternative means of exiting the business, as well as alternatives for remaining in it. The exit strategies ranged from a gradual wind-down by completing the Cohasset project to one of immediate wind-up and sale. The business plan indicated that immediate wind-up had the least favourable future cash flow for the Company (\$82 million), and continued operation had the highest (\$336 million).

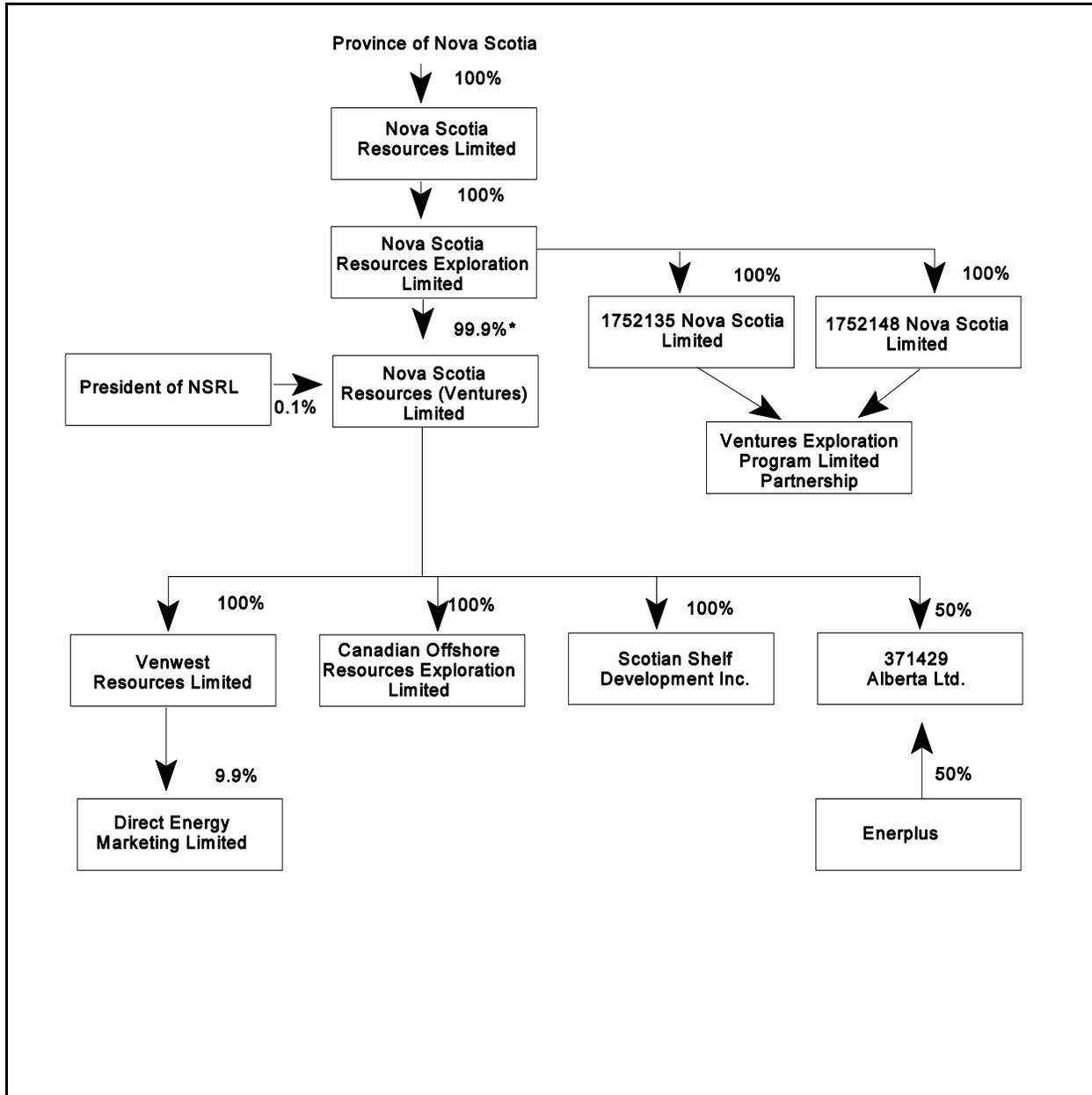
13.86 The government chose to divest itself of NSRL as quickly as possible. Government officials indicated that the following considerations were a factor in the decision.

- There was concern about the reasonableness of the assumptions described in the business plan, and concern about the recommendation that government pay or assume \$300 million of NSRL's debt in return for a greater equity position in the Company.
- There was concern that if NSRL became an operator in the offshore, it would be exposed to significant risks in the areas of health, safety and environmental liability.
- The operations of NSRL had never been profitable. Significant losses had been incurred, and the Company had debt of over \$470 million
- At the time the decision was made, the Cohasset project was projecting a net loss. Concern was expressed about the ability of the venture partners to control project costs. Government officials were not confident that NSRL could be more effective operating similar or smaller projects on its own or with different partners.
- Government re-evaluated its reasons for being in the oil and gas business. It concluded that government's goals with respect to economic development could be furthered by means other than direct participation in energy projects. Thus, there was little reason to incur the costs, debt and risk involved in the oil and gas business.

13.87 We reviewed government's concern about the reasonableness of the September 1994 business plan of NSRL. Government officials believed the assumptions in the plan were overly optimistic. Based on Rothschild's valuation and their own deliberations, they were very concerned about the risk of future events and business operations not coinciding with the plan. Also, the Rothschild valuation indicated that a divestiture of NSRL could possibly produce a higher cash flow than indicated by the business plan.

13.88 Based on our review, we do not believe that government officials acted without regard for the government's financial interests. Each day, government must make decisions based on uncertain assumptions, estimates of future benefits and costs, and upon the level of risk it is willing to bear. As auditors, it would be very difficult to second guess decisions based on such factors; and the disposal of NSRL is one such decision. However, we believe the most important factor in such circumstances is that government avail itself of the best possible information, expert advice and analysis (including risk analysis); and that it give adequate attention to each of these in its decision making processes. In this situation, we did observe that information and advice were sought in making the decision about NSRL's future.

13.89 We wish to stress that our Office has not assessed the reasonableness of the business plans, financial projections or consultants' valuations. Additionally, some of our other audit conclusions are based on estimates made by NSRL management over the years, such as the various revenue/expense projections for the Cohasset and Balmoral projects, and estimates made about salvage values for partnership assets. Likewise, the reasonableness of these projections have not been assessed by our audit.

*Exhibit 13.1***CORPORATE ORGANIZATION CHART**

GOVERNMENT'S RESPONSE

The government welcomes the Auditor General's report on recent business transactions of Nova Scotia Resources Limited. The province has full confidence that those transactions were conducted in a manner that was prudent, responsible and in the best interests of Nova Scotians.

The business dealings of Nova Scotia Resources Limited must be viewed in context. During its 15 year history to 1995, NSRL had amassed losses totalling \$501 million. The business plan developed by NSRL management in 1994, called for an additional public investment of \$300 million. That same plan also proposed that NSRL become a developer and operator of offshore oil and gas fields. The government was unwilling to increase the taxpayers' exposure in this company, nor was it willing to take Nova Scotians into the high-risk business of developing and operating oil and gas fields. The policy decision, therefore, was made in 1995 to divest the province of NSRL and/or its assets.

With respect to the specific transactions examined by the Auditor General, the government is confident that, since 1995 management and the board of NSRL have provided sound stewardship of the Crown Corporation.

For example, the proposed agreement between LASMO and NSRL, whereby the Crown Corporation would assume sole ownership of the two companies' partnership assets, would have exposed Nova Scotians to unacceptable risk. The decision to forego that deal, as results now show, was not only prudent but astute. The course of action taken will result in a return of some \$47 million. Had NSRL assumed the partnership assets and become the operator at Cohasset and Balmoral, the company's maximum return would have been \$21 million.

The government is satisfied the report of the Auditor General is conclusive in its findings that each of the transactions under examination has been conducted in a responsible manner. Management of NSRL will respond with respect to specific transactions.

NOVA SCOTIA RESOURCES LIMITED'S RESPONSE

I am grateful for the opportunity to respond to the results of the Special Audit.

Background

As at March 31, 1994, Nova Scotia Resources Limited (NSRL) had accumulated a deficit position of \$501 million by investing in the oil and gas business. In 1994, NSRL management proposed that NSRL become an operator and developer of oil and gas fields in the offshore; thereby, requiring an additional investment of \$300 million.

I was appointed President of NSRL on February 27, 1995. In March, 1995, Government decided "to get out of the oil and gas business and divest of NSRL and/or its assets". My instructions were simple - "run NSRL like a business, but minimize risk and maximize return".

LASMO Negotiations

In my opinion, it was neither practical nor prudent for NSRL to finalize with Lasmo an agreement which would require NSRL to assume responsibility and risk for operation of the oil fields (Cohasset/Panuke):

- *NSRL lacked management depth and experience necessary to operate and develop oil fields.*
- *Risks (e.g. environmental) associated with development and operation of offshore oil fields are significant.*
- *NSRL was to become the operator only when Lasmo deemed that oil production was no longer economically viable. The Board of NSRL believed it would not be in NSRL's best interest to takeover a project deemed uneconomic by an experienced operator.*

Tax Pool Monetization

In my opinion, it was appropriate for NSRL to cancel plans with Pan Canadian to monetize tax pools of NSRL because:

- *In order to implement the planned tax monetization transaction with Pan Canadian, it was necessary for Pan Canadian to become a minority shareholder of NSRL. However, Pan Canadian was regarded as a potential purchaser of NSRL. The Board of Directors of NSRL viewed the addition of this minority shareholder as an unnecessary complication to the planned divestiture process.*
- *By foregoing the Pan Canadian opportunity, monetization of NSRL's tax losses was not lost - only deferred.*

Monetization of future NSRL tax losses by a purchaser of NSRL was dependent on NSRL's debt (\$501 million) being assumed by the purchaser. Management of NSRL considered this possibility as unlikely and remote.

Sale of Western Canada Assets

NSRL sold its western oil and gas properties at their fair market value after Rothschild Canada Limited completed an extensive tendering/bidding process. The highest offer was accepted.

For purposes of clarification, the schedule below provides details of NSRL's debt and deficit position. Readers will note the following:

- *NSRL's overall debt has been reduced from \$501 million as at March 31, 1994 to \$436 million as at December 31, 1996.*
- *For the past three periods, NSRL generated net income which reduced the deficit by \$37 million.*

Nova Scotia Resources Limited Schedule of Debt & Deficit

<i>Period Ended December 31st</i>	<i>Debt \$ (millions)</i>	<i>Deficit \$ (millions)</i>
<i>96</i>	<i>436</i>	<i>405</i>
<i>95</i>	<i>439</i>	<i>412</i>
<i>94</i>	<i>470</i>	<i>431</i>
<i>March 31st</i>		
<i>94</i>	<i>501</i>	<i>442</i>

During the past two years, NSRL management attempted to make the best possible business decisions based on the best available information.

14.**PUBLIC PROSECUTION SERVICE -
REVIEW OF OPERATIONS****BACKGROUND**

14.1 In response to the December 1989 report of the Marshall Inquiry, the Province of Nova Scotia became the first jurisdiction in Canada to create an independent prosecution service. Previously, public prosecutions were the responsibility of the Department of Justice (then Department of Attorney General).

14.2 The Public Prosecution Service (PPS) derives its mandate from the Public Prosecutions Act, which was proclaimed in 1990. The Service is responsible for all prosecutions within the jurisdiction of the Attorney General of the Province, and has developed as its mission, fair and equal treatment in the prosecution of offences. Its head office is located in Halifax. The Service is structured regionally, with Crown Attorneys' offices located in 18 centres throughout four regions of the Province.

14.3 The Service reports that in the six and one-half months ended October 18, 1996 it prosecuted 12,324 criminal code cases, 10,547 summary conviction cases and 50 appeals. Expenditures of \$8.5 million were forecast for the year ended March 31, 1997, with the major category of expenses being salaries and benefits (\$6.8 million). The Service has 67 permanent Crown Attorneys, one manager of administration and 46 support staff.

14.4 The Service is one part of a complex justice system which includes many stakeholders, including the public, Parliament, Provincial Legislature, judges, court administration, lawyers, police, correctional facilities, as well as various other social institutions.

RESULTS IN BRIEF

14.5 The following are the principal observations from this audit.

- The PPS has not reported to the House of Assembly since August 31, 1993. Except for this legislative requirement, the PPS has complied with key requirements of the Public Prosecutions Act.
- The PPS has prepared business plans for 1996-97 and 1997-98, but has not yet developed long-range strategic plans or multi-year performance targets.
- The PPS has a system to monitor and control finances, but has not yet developed a comprehensive electronic system for assisting case management.
- The PPS has implemented measures to provide additional tools and access to information for its staff, as well as to improve its work environment. There are plans to make further improvements as resources become available.

AUDIT SCOPE

14.6 In November 1996 we commenced a broad scope audit of the Public Prosecution Service in accordance with the provisions of the Auditor General Act. Our audit objectives were to review and assess:

- the accountability structure and reporting practices of the Service;
- the Service's compliance with key provisions of the Public Prosecutions Act;
- strategic and operational planning at the PPS; and
- issues relating to efficiency in the operations of the Service.

14.7 The following general criteria were used in our audit.

- The responsibilities and accountability of the Service should be formally defined and accountability reporting should be accurate and timely. Reporting should address performance relative to the PPS's goals and priorities, and should be supported by a system of performance measurement.
- The Service should comply with all requirements of relevant legislation and regulations. Summary information related to compliance should be reported annually to the House of Assembly.
- Strategic and operational planning should be performed on a regular basis and should be consistent with the Service's legislated mandate. The Service's goals should be outcome oriented and measurable, and the goals and other plans should be communicated to all staff.
- Staff should have the information and resources necessary to do their work efficiently, and should receive training on a regular basis. The Service should have adequate management systems for the monitoring and control of its court cases, personnel and finances.

14.8 Our audit involved the review of various documents and systems, as well as interviews with various staff at the Public Prosecution Service. As part of our assignment, we examined the August 31, 1994 report on the independence, accountability and management of the PPS prepared by Bruce P. Archibald and the late Joseph A. Ghiz. The report was the result of a government sponsored study of the PPS, and made 35 recommendations for improving the Service. Where the scope of this review aligned with our audit, we enquired whether the PPS had addressed the recommendations of the Ghiz/Archibald report.

PRINCIPAL FINDINGS

Accountability and Compliance

14.9 The Attorney General is the Minister responsible for all matters related to the administration of justice in Nova Scotia and, accordingly, is responsible for public prosecutions. Thus, the Attorney General is accountable to the House of Assembly for this responsibility.

14.10 The position of Director of Public Prosecutions was created by statute in 1990. The Public Prosecutions Act states that the Director is responsible for all prosecutions within the jurisdiction of the Attorney General, conducted on behalf of the Crown, and the Director is the Attorney General's lawful deputy in respect of prosecutions. Prosecutions may be conducted independent of the Attorney General, except the Service must comply with all written instructions or guidelines issued by the Attorney General if they have been published in the Royal Gazette. The Attorney General has the right to be informed about the conduct of specific prosecutions, but no other member of the government or Legislature has a similar right.

14.11 Further, the Act puts the onus on the Director of Public Prosecutions, instead of the Attorney General, to report annually to the House of Assembly. This is unusual, as normal expectations for accountability to the House of Assembly put the onus on the Member of the House who is responsible for an operation of government. The purpose of this arrangement, as explained to us, is to further enhance the independence of the Public Prosecution Service from other operations of government. The accountability of the Attorney General for prosecutions is upheld through his responsibility to make public any direction provided to the Director of Public Prosecutions, and through the addressing of questions raised in the Legislature.

14.12 *Accountability issues* - We found the Service has fulfilled its accountability responsibilities, with the major exception that the Director has not reported annually to the House of Assembly. No reports have been made since the period ended August 31, 1993. The current Director was appointed in the fall of 1995, and he plans to prepare a report for the period September 1, 1993 to March 31, 1997.

14.13 The PPS's financial plans are reported to the Legislature in the Provincial Estimates. In recognition of its independence from the Department of Justice, its budget is reported under the Public Service classification. The Service's actual financial results are reported in the Public Accounts of the Province, with a similar separation from the Department of Justice's financial results.

14.14 The Act notes that either the Attorney General or the Director of Public Prosecutions may issue instructions respecting prosecutions, but such directives must be published. The Act requires directives from the Attorney General to be published in the Royal Gazette, but is not specific on the publishing of directives from the Director. The Director indicated that he applies his discretion in deciding where to publish his directives, but as a minimum ensures that all staff of the Service receive a written copy. The last directive issued by the Director was dated June 1992 and concerned the exercise of prosecutorial discretion. The last directive of the Attorney General pertained to spousal/partner violence and was issued in April 1996. Both were published in the Royal Gazette. Based on our review, it appears that all directives of the Attorney General and the Director are appropriately published.

14.15 The Ghiz/Archibald report made a number of recommendations concerning the accountability of the Public Prosecution Service. The PPS has implemented several recommendations, and is making progress toward the remainder.

14.16 *Other compliance issues* - The Public Prosecutions Act sets requirements for the PPS beyond the issue of accountability. These requirements address matters such as the appointment and remuneration of the Director of Public Prosecutions, the qualifications of Crown Attorneys, and services to police officers. We reviewed key legislative requirements and found that the Service is in compliance with the Act.

Planning

14.17 Strategic planning serves to provide overall direction and coordination, and should include both high-level and specific planning which incorporate objective setting, establishment of priorities, creation of performance measurement techniques and the design of a process to ensure scarce resources are applied toward the more important objectives.

14.18 *Strategic and operational plans* - The PPS prepared business plans for 1996-97 and 1997-98. All government departments which report annually in the government's accountability document *Government By Design* are required to submit business plans prepared in accordance with guidelines developed by government. The PPS does not participate in this process, and is not included in *Government By Design*. However, it used the guidelines developed by the government to prepare its business plans.

14.19 The business plans describe the mission and goals of the PPS, as well as performance achievements, priorities, financial forecasts and performance measures. Several improvements were made for the 1997-98 edition of the business plan. It better correlated performance measures and annual priorities to PPS goals, and it was expanded to include more information. Also, an annual operating budget is prepared each year which outlines the current financial plans of the PPS. The annual business plans and budgets are reviewed and compared to actual results at monthly meetings of the PPS's Management Committee.

14.20 However, longer-term strategic plans have not yet been prepared by the Service, although the development of a five-year business plan has been identified as a priority. The annual business plans do not contain any multi-year strategies or performance targets. However, four-year financial projections are prepared.

14.21 *Consistency and integration* - Government has identified priorities to guide all of its operations, which are summarized under four categories: economic renewal, redesigned government, social responsibility, and fiscal stability. Although the PPS is not fully included in the government's Integrated Planning and Budgeting Process, we observed that the goals and priorities of the PPS appear consistent with the government's overall priorities and strategies.

14.22 We found the goals and priorities outlined in the Service's annual business plans are consistent with its legislated mandate. We noted consistency in the allocation of budgetary resources towards the more significant priorities and plans, to the extent permitted by the total resources provided for the operation of the Service.

14.23 The Public Prosecution Service is one part of a justice system which includes many groups, and although each group is independent, they are also interdependent. Thus, the effectiveness of the justice system is the result of the quality of performance of each of its members. To operate effectively, the Service must coordinate its planning with that of the other groups. As discussed in a following section of this chapter, we found that the PPS is involved in initiatives with a number of other justice system stakeholders, such as to improve coordination and communication, to establish disclosure guidelines and to improve the flow of cases through the courts.

14.24 *Performance measurement* - Ideally, the goals of an organization should be outcome-oriented and the achievement of goals should be measurable. By outcome, we refer to the intended effects that an operation will have relative to its clients or operational environment.

14.25 In our view, the goals outlined in the Service's business plans could be more outcome-oriented. However, the goals are associated with a number of performance measures. The Service has not yet developed performance targets for future years, but we understand it has only recently

begun to accumulate performance data and has plans to revise and enhance its information gathering and reporting systems. One such initiative is a plan to survey various groups in the justice system on their opinion of the PPS's performance.

14.26 *Communication* - The goals and priorities outlined in the Service's current business plan were communicated throughout the PPS by means of the Management Committee, annual staff conference, newsletters and other communications. As well, management indicated that every office of the PPS has an employee orientation manual which includes a copy of the business plan.

Efficiency

14.27 *Government initiatives* - In August 1994 a report on the independence, accountability and management of the Service was submitted to the Minister of Justice (the Ghiz/Archibald Report). The report included 15 recommendations related to efficiency. We reviewed the recommendations and found that progress is being made by the PPS in their implementation.

14.28 The PPS is a partner in a government-wide *Access to Justice* initiative commenced by the Department of Justice in September 1996. The initiative is intended to improve the management of the justice process and to improve the delivery of justice-oriented programs. As described in planning documents for the project, it was undertaken because each group in the justice system has developed a different way of managing cases, which has led to inefficiency, wasted resources and lack of co-ordination of effort. Part of the initiative will be to improve the technology used to store and share justice-related information.

14.29 The PPS is also participating in several other initiatives to improve the justice system, and has initiated multi-stakeholder working groups to address such concerns as adequacy of disclosure and delays in the Provincial courts.

14.30 *Human resources* - The PPS has implemented several initiatives related to its human resources, including:

- the creation and filling of a new position which will be responsible for handling the administration of the Service (leaving more time for staff professionals to be involved with the PPS's core services);
- a review of its staffing levels and ratio of Crown Attorneys to support staff;
- development of training priorities for positions within the Service and increasing funding for staff training and development;
- implementation of an internal transfer policy; and
- reinstatement of performance appraisals for permanent Crown Attorneys.

14.31 The Service has made progress related to human resource management. However, the PPS does not have a sophisticated system to monitor and manage the work and case loads of Crown Attorneys. Currently, information in this area is primarily paper-based or based on observations, and staffing and case management decisions are made by the Management Committee based on these limitations. An electronic management information system is needed to provide more information on work and case loads, patterns and trends.

14.32 The Service has relied on per diem attorneys (i.e., the short-term hiring of private sector lawyers) to provide additional personnel to handle its volume of cases. The 1996-97 operating budget of \$8.5 million included approximately \$381,000 (5%) for per diem attorneys. The PPS reviewed the use of per diem attorneys in certain offices and found that hiring full-time attorneys may be more efficient in certain circumstances. A committee was established to review issues relating to the use of per diem attorneys, which will report by March 1997. We recommended that policies developed also include a method to review and evaluate the work of per diem attorneys, and a procedure for reviewing and revising the roster from which per diem attorneys are selected.

14.33 *Information resources* - To perform their jobs efficiently, Crown Attorneys need timely access to relevant information, as well as up-to-date equipment. We found that, since March 1996, all staff of the PPS have been assigned their own computer. Crown Attorneys have access to various case law reports and decisions, and we noted that the Service has increased its expenditures in this area during the last couple of years. However, for offices outside of the Halifax metro area, most of this information is in non-electronic (i.e., paper) format and access is slow. Crown Attorneys in the Halifax area currently have on-line computer access to Federal and Provincial statutes and also have the ability to use e-mail, but other regions do not because there is not yet a Province-wide computer network for the government.

14.34 To remedy this, the PPS plans to improve access to such information by participating in a number of initiatives, including an on-line case law service, once all offices have been provided Internet access. Current plans are for Internet service to be provided to all offices by 1998.

14.35 PPS management wishes to establish an internal management information system, in conjunction with the government's *Access to Justice* initiative, which will provide an opportunity for better case management by the Service. The Service may also gain greater access to library resources if the recommendations of a January 1996 joint committee report are implemented. The report recommended greater sharing of information resources among the PPS, Department of Justice, judge's offices and the Barristers' Society.

14.36 *Office resources* - Working environments can effect efficiency and productivity. In 1996 the PPS developed office space standards and determined that some of its offices do not meet basic requirements. Plans have been made to renovate or relocate offices to provide appropriate work environments, as funds become available and as leases expire. In particular, all staff currently located in three separate offices in Halifax will be moved to one centrally located office.

14.37 PPS offices now employ centralized file storage systems using government filing and retention standards. Planned improvements to office resources include increasing office security and further improving file storage.

CONCLUDING REMARKS

14.38 Management of the Public Prosecution Service has made significant improvements to the operation of the Service during the last couple of years. It has commenced a strategic approach to management involving goal development, priority setting and performance measurement. Strategic planning has been short-term to date, but management intends to take a longer-term approach to planning in the near future. There are plans to make reporting to the House of Assembly more regular and timely. We encouraged the PPS to do so, and also to have such reporting focus on goals and related performance.

15.

REVIEW OF FINANCIAL STATEMENTS AND MANAGEMENT LETTERS

INTRODUCTION

15.1 The financial statements of crown corporations and agencies of the government of Nova Scotia are in some cases audited by the Office of the Auditor General and in other cases by private sector auditors. A complete listing of crown corporations and agencies that have been audited is included in Appendix II.

15.2 Section 17 of the Auditor General Act permits this Office to conduct additional reviews of those crown corporations and agencies audited by the private sector. This section of our Report contains comments on audits conducted by the private sector and by this Office.

AUDITS BY THE PRIVATE SECTOR

15.3 We reviewed the financial statements and reports received from private sector auditors, being principally interested in whether:

- there was any indication of inadequate financial controls and records mentioned in letters to management or indicated by reservations of audit opinion on the financial statements;
- there was timely preparation and audit of annual financial statements;
- there were notes to the financial statements outlining the legislative mandate of the entity; and
- there was adequate disclosure of the entity's audited financial statements, preferably in the *Public Accounts*.

15.4 The following are the observations resulting from our review.

Reservations of Opinion

15.5 A qualification of opinion was expressed in the audited financial statements of two corporations.

15.6 *Nova Scotia Resource Recovery Fund* - The auditors issued a qualification of opinion as they were unable to verify the completeness of Fund revenue. Agreements between the Minister of the Environment and external parties require payment to the Fund of a fixed fee or a fee based on production volumes or sales amounts. Fund management does not verify production volumes or sales amounts, and the auditors were not able to verify these by other means.

15.7 *Nova Scotia Resources Limited* - The auditors qualified their audit opinion due to the failure of the Corporation to defer and amortize foreign exchange gains and losses on long-term monetary

items over the term of the related debt. If they had been deferred and amortized, net earnings would have decreased by \$7.5 million, the opening deficit would have been reduced by \$14.3 million, and unamortized foreign exchange losses carried forward would be \$6.8 million.

Financial Controls and Records

15.8 As a result of the private sector audits, weaknesses in internal control were discovered in certain corporations and agencies. These were noted in letters from the auditors to management. Although most were not serious enough to include in this Report, observations in letters to management at the Queen Elizabeth II Health Sciences Centre, the Waterfront Development Corporation Limited, and the Workers' Compensation Board of Nova Scotia are appropriate to report.

- The auditors of the Queen Elizabeth II Health Sciences Centre noted weaknesses in control over payables which were caused by inadequate segregation of duties and reconciliation procedures. Weaknesses were found in the recording and reporting of sponsored research programs. In addition, the auditors noted computer password control weaknesses and a lack of formal change management procedures to monitor and control changes to the Centre's application software. They also identified the need for a formal disaster recovery plan and business continuation plan.
- The auditors of the Waterfront Development Corporation Limited noted that bank and general ledger reconciliation procedures were not being completed.
- The auditors of the Workers' Compensation Board of Nova Scotia reported weaknesses in control over accounts payable and computer security. They also noted weaknesses in the method for determining the allowance for doubtful accounts and in the monitoring of investment schedules. Management has indicated to us that it has addressed each of these weaknesses.

Timeliness of Financial Reporting and Release of Management Letters

15.9 Preparation, audit and release of financial statements and related management letters within six months of year-end are considered to be satisfactory. This was achieved by all crown corporations and agencies with the exception of Sydney Steel Corporation.

15.10 As of February 1997, the audit of Sydney Steel Corporation had not been completed and the financial statements had not been released for the year ended December 31, 1995. The status of certain matters pertinent to the *Joint Operation, Sale and Long-Term Agreement* between the Province and China National Metals & Minerals Import and Export Corporation, particularly those related to concurrence on the Corporation's financial position at the commencement of the Agreement, have not been resolved.

15.11 As a consequence, the financial statements of Sydney Steel Corporation will not be included in the March 31, 1996 *Public Accounts of the Province of Nova Scotia*.

Legislative Mandate

15.12 It is important for the reader of financial statements to be aware of the legislative mandate under which the entity operates. This is most conveniently communicated as a note to the financial

statements, but can also be shown in an entity's annual report. It is recommended that all crown corporation and agencies include such a note in their financial statements.

15.13 We noted only two agencies that did not include this information in a note to their most recent financial statements, and they did discuss their legislative mandate in their annual report.

Reporting

15.14 Previous Reports of the Auditor General have noted that the *Public Accounts of the Province of Nova Scotia* should strive to present full disclosure of the financial position and operating results of all entities which are owned or controlled by government.

15.15 We have been informed that the March 31, 1996 *Public Accounts* will not contain the financial statements prepared for the following entities:

Art Gallery of Nova Scotia
Halifax-Dartmouth Bridge Commission
Law Reform Commission of Nova Scotia
Nova Scotia Credit Union Deposit Insurance Corporation
The Public Archives of Nova Scotia
Sydney Tar Ponds Clean-Up Inc.
Workers' Compensation Board of Nova Scotia

15.16 In addition, the financial statements of joint operations with other governments are not included in the *Public Accounts*. These include the Atlantic Lottery Corporation Inc., Canada-Nova Scotia Offshore Petroleum Board and the Council of Maritime Premiers.

AUDITS BY THIS OFFICE

15.17 The following observations resulted from our audit assignments.

Reservations of Opinion

15.18 This Office has responsibility for the annual financial statement audit of 27 crown corporations and agencies (Appendix II). An audit opinion is expressed on whether these statements present fairly the financial position of the entity at its fiscal year-end and the results of its operations for the year then ended. Where there are qualifications of audit opinion, or situations in which it was not possible to render an opinion, we believe it appropriate to report such to the House of Assembly.

15.19 This year there was only one case where it was necessary for our Office to express a qualification of opinion.

15.20 *Nova Scotia Gaming Corporation* - The Auditor General is appointed auditor of the Nova Scotia Gaming Corporation under Section 31(1) of the Gaming Control Act, which received Royal Assent on February 6, 1995. The first year of operations ended on March 31, 1996.

15.21 As a result of our review we qualified our opinion on the financial statements as follows:

“The Nova Scotia Gaming Corporation has prepared the financial statements related to casino gaming based upon their interpretation of the Operating Contract between

the Corporation and Metropolitan Entertainment Group. This interpretation results in the adoption of an income allocation approach which does not reflect the shortfalls referred to in Note 3(h) as an expense for the period. In my opinion, generally accepted accounting principles require that these shortfalls be recognised as an expense for the period. If these expenses had been recognised, income of the Corporation would have been reduced by \$2,143,409.”

15.22 Note 3(h) to the financial statements states:

“During the year, the income was insufficient to allocate to the operator the maximum allocation to which the operator is entitled with reference to their capital investment. In the three month period ended March 31, 1996 the Operator shortfall amounted to \$459,799 in Halifax, and in the eight month period ended March 31, 1996 the Operator’s shortfall amounted to \$1,683,610 in Sydney. These amounts are not expenses of the Corporation and accordingly, have not been recorded in the financial statements. These amounts will be eligible for allocation to the Operator from income in subsequent years as the income is earned and will be accounted for at that time.”

System Weaknesses

15.23 We noted situations during our audits where accounting and financial systems and procedures were deficient. Although they were not of a magnitude to require reservations of audit opinion, a number of these situations are significant enough to report to the House of Assembly.

15.24 *Atlantic Provinces Special Education Authority* - We found several control weaknesses in the administration of trust funds for the visually impaired. Accounting records for these funds were not updated in a timely manner and inter-fund balances were not reconciled and cleared on a timely basis. We also noted deficiencies in maintaining current documentation in the personnel files which support payroll expenditures.

15.25 *Department of Finance Pension Fund Administration* - Last year we commented on the need for formalized policies and procedures with respect to the use and control of alternative financial instruments (i.e., derivatives). This year we noted an increase in activity in this area, but there is still a need for formalized policies and procedures, and a system for recording complete information on derivative transactions. The Department of Finance has informed us that a draft policy on derivatives has been prepared, and is in the process of being finalized, once consultations are complete.

15.26 *Housing Development Fund* - In 1995 we reported accounting and control weaknesses associated with the system used to capitalize interest costs to land development projects. We observed several of the same weaknesses again this year. We also noted the need to implement a process of scheduled, periodic assessments to ensure the accurate valuation of land development projects.

15.27 *Insured Prescription Drug Plan Trust Fund (PTF)* - This fund is used to accumulate contributions from seniors and the Province, and to pay for the costs of the Seniors’ Pharmacare Program. This was the first year of operation for the PTF and the first audit of the financial statements by our Office. We support management’s efforts to improve verification of seniors’ income for those who receive a low income credit.

15.28 *Nova Scotia Farm Loan Board* - The allowance for doubtful accounts was calculated using information relating to the collectibility of receivables and in a manner consistent with the previous year. However, we noted it was subsequently adjusted downward by Corporate Services Unit staff, apparently to meet Departmental budgetary objectives, without prior consultation with Farm Loan Board management. Allowance for doubtful accounts should be based solely on the collectibility of accounts receivable, and on no other considerations.

15.29 *Nova Scotia Film Development Corporation* - We noted the Corporation was responsible for approximately \$6.8 million of equity investments, but had not conducted any audits to verify whether repayments were due to the Corporation. We also suggested the requirement for audited cost reports from funded projects should be reduced to an amount below the current \$500,000 threshold. We further recommended better monitoring and collection of approximately \$134,000 of demand promissory notes issued in 1992.

15.30 *Nova Scotia Grain and Forage Commission* - The government entered into an agreement with the Nova Scotia Grain Marketing Board to privatize the operations of the Commission. Last year we reported that the joint management agreement did not assign responsibility for the accounting function of the new entity formed, nor did it address grant repayment requirements in the event of termination of the agreement. This year we found that there was still no resolution of these issues. We also noted terms of the agreement were not fully met with respect to the refunding of unspent portions of government payments for capital improvements and personnel costs.

15.31 *Nova Scotia Hospital* - We observed that approximately 50% of the Hospital's receivables were in the non-current category at year end and that second notices are not issued until an account is outstanding for 90 days. We recommended that all accounts outstanding for more than 30 days be followed up. We also noted a control weakness in the cash receipts system for patient trust funds and recommended better segregation of duties to improve the situation.

15.32 *Nova Scotia Innovation Corporation* - The Corporation made significant fixed asset purchases during the year, and on April 1, 1996 it took title to the fixed assets of the Nova Scotia Research Foundation Corporation. We noted the need to establish a fixed asset subledger to facilitate control over the Corporation's fixed assets.

15.33 *Nova Scotia Legal Aid Commission* - The 1995-96 budget of the Commission was never formally approved by the Commission. It was reviewed by its Executive Committee, but was not approved by the Committee until approximately nine months into the fiscal year.

15.34 *Nova Scotia Research Foundation Corporation* - We noted that the Corporation provided interim financing to a third party. The amount was provided interest free with no specified terms of repayment and was not secured. This arrangement was not approved by the Corporation's Board, although the Board was aware of its terms. In our view, the financing arrangement resulted in an unacceptable level of risk for the Corporation, and subsequently for the Nova Scotia Innovation Corporation when the Nova Scotia Research Foundation Corporation was dissolved and all rights, title, interest and obligations were transferred to the Nova Scotia Innovation Corporation.

Legislative and Policy Compliance Weaknesses

15.35 We noted situations where there was lack of compliance with legislation or policy. Although they were not of a nature to require a reservation of audit opinion, five of these situations should be brought to the attention of the House of Assembly.

15.36 *Nova Scotia Business Development Corporation* - Under the regulations of the Business Development Corporation Act, and subject to the approval of the Minister, the Nova Scotia Business Development Corporation Board can change the existing terms and conditions of loans authorized by the Executive Council without further Executive Council approval. In 1994 and 1995 we recommended that, where Executive Council approved assistance and subsequent events required a significant change to the terms of the assistance, Executive Council be requested to approve the changes. We observed two cases this year where approval of significant changes had not been requested of Executive Council.

15.37 *Nova Scotia Film Development Corporation* - We noted several cases where total funding on a project exceeded the level approved by the Program Committee or the Board of Directors. In addition, the full Board was not always advised when a project's funding was increased. We also noted cases where a loan was not collected when due and a loan was advanced before the contract was signed.

15.38 *Nova Scotia Hospital* - An amendment to Section 23 of the Hospitals Act stipulates that, 30 days after receiving a written notice of discharge, a patient is solely liable for his or her cost of maintenance as long as the individual continues to stay in a hospital. Nova Scotia Hospital staff were directed by the Hospital Board of Management in July 1995 not to issue invoices for these costs and, subsequently, 30 day notices were no longer issued to patients. We were informed that the vast majority of the individuals are financially incapable of paying these costs. The Department of Health gave approval for the Hospital's non-compliance with the amendment to the Hospitals Act. This practice also contravenes Section 23(1) of the Provincial Finance Act which requires the Executive Council to approve write-offs or settlements of Provincial claims against a person.

15.39 *Nova Scotia Legal Aid Commission* - The Legal Aid Act establishes the Commission and defines the number of directors and their terms of office. We noted that several directors agreed, upon request, to continue to participate in the deliberations of the Commission although their terms had expired. Their participation included voting on Commission decisions. We were informed that this practice was the result of delays in having new director nominations approved by the government.

15.40 *Upper Clements Family Theme Park Limited* - Upper Clements Family Theme Park Limited entered into an agreement with another private sector business for the provision of certain attractions at the park. We noted that the crown corporation may not have fully complied with certain terms of the agreement with respect to advertising.

Financial Statement Audit Delays

15.41 We consider the readiness of the auditee to be a critical factor in the timely completion of financial statement audits. We encountered difficulty in completing the audit of one entity on a timely basis.

15.42 *Nova Scotia Grain and Forage Commission* - The audit for 1995-96 was significantly delayed due to inadequate accounting records and a lack of audit preparedness. The delay was mainly attributable to the absence of assigned responsibility for maintaining the books and records of the Commission.

Other Matters

15.43 In the fall of 1996 we performed a follow-up review from our 1995 financial statement audit of the Schooner Bluenose Foundation. As part of this review we also assessed the controls in place to ensure the Schooner Bluenose is appropriately used and protected and that the annual funds provided to the Bluenose II Preservation Society are spent for the purposes intended.

15.44 *Schooner Bluenose Foundation* - Traditionally, we have audited the annual financial statements of the Foundation. The last audit completed was for the fiscal year ended March 31, 1995. As of March 31, 1995, the Foundation was inactive and we understand that it continues to be inactive. We had an outstanding concern resulting from our last audit and we performed a follow-up review during the fall of 1996.

15.45 Our concern was with the public trust funds which had been administered by the Foundation. In 1994 a separate entity, also named the Schooner Bluenose Foundation (the Society), was established as a charitable organization under the Societies Act. During the 1995 fiscal year, payments totalling \$294,454 were made to the Society by the Foundation. These payments were based on invoices submitted by the Society and a final payment of approximately \$135,000 to transfer the remaining funds of the Foundation when it became inactive. These payments were approved by the then Minister of the Nova Scotia Economic Renewal Agency (NSERA) in his role as Chairman and President of the Foundation.

15.46 We understand that the operations of the Society were (and still are) placed on hold after the Bluenose II Preservation Trust Society assumed control of the refurbishment and operation of the schooner in the fall of 1994.

15.47 We recognize the funds involved may be seen as immaterial in relation to other Provincial activities or expenditures, but we see the use of these public trust funds as a matter of some significance. In our view, the Foundation has a responsibility to ensure the transferred funds have been and are used appropriately, with due regard for economy and efficiency and in accordance with the Schooner Bluenose Foundation Act.

15.48 Staff of the Nova Scotia Economic Renewal Agency receive the annual audited financial statements of the Society which do provide summary information on the status and use of these funds. Information available to us indicates that the public trust funds disbursed by the Foundation were the Society's major source of funds.

15.49 The Society's December 31, 1995 statements indicate that approximately \$44,000 of the transferred funds was unspent. They also indicate there is property and equipment, with a net book value of approximately \$22,800, which belong to the Society. Staff of the NSERA have indicated that because the Society is an independent non-profit organization, they are unable to determine where those assets are located now and whether they are being used for purposes consistent with the mandate of the Foundation. They are also unable to determine if the transferred funds were used with due regard for economy and efficiency.

15.50 *Schooner Bluenose* - Part of the mandate of the Nova Scotia Economic Renewal Agency is to maintain the Schooner Bluenose II, which is a crown asset. There is an agreement between the Province and the Bluenose II Preservation Trust Society (BPTS) for the operation and maintenance of the vessel. The Province provides funding to the BPTS based on a mutually agreeable percentage of operating costs as contained in the annual budget of the BPTS. In 1995-96 the Province provided \$521,800 towards the operating costs of the BPTS. This represented 84% of the BPTS budget for that year. Part of the operating expenditures of the BPTS include the salary of a NSERA employee who was seconded to the BPTS as the operations manager. As well, the Province paid \$90,000 to

the BPTS during 1995-96, through the Canada/Nova Scotia Cooperation Agreement on Economic Diversification, to repair the Schooner Bluenose II for use in the G7 Summit.

15.51 We found there are controls in place to ensure this crown asset is appropriately used and protected, and that the annual funds provided to the Bluenose II Preservation Trust Society are spent for the purposes intended.

16.

WORKERS' COMPENSATION BOARD - REVIEW OF OPERATIONS

BACKGROUND

16.1 The Workers' Compensation Board (WCB) derives its mandate from new legislation (the Workers' Compensation Act) which came into effect February 1, 1996. The new Act has significantly changed the methodology used to determine the level of benefits awarded to injured workers. Long-term benefits are now primarily determined by the wages that a worker will forego due to his inability to work (whether at all, or at the same level as before the accident). The new Act also creates more incentive for the employer to practice better work-place safety by varying employer premiums based on its accident and claim experience. Employers can reduce their premiums by having a safety record that is better than the average for their industry class. These and other changes to the mandate of the WCB have necessitated significant changes to the Board's policies, procedures and organizational structure.

16.2 The WCB is accountable to the Minister of Labour. Its head office is located in Halifax, and a branch office is located in Sydney. The Board has recently undergone an organizational restructuring to prepare for its new mandate. As part of the restructuring, staff levels have increased and the number of divisions increased from four to seven. Under the Client Services Division, five Integrated Service Units (ISU) were established, each serving a specific geographical region. They combine a number of previously separated functions in order to provide quicker, more effective service by moving to a collaborative, client-centred approach. According to WCB statistical reports, over the last four years claims processing time has been improved by 22% and duration on short-term disability has been reduced by 32%.

16.3 The WCB had expenditures of \$162 million for the year ended December 31, 1995 (1994 - \$151 million). Included in this is a \$38 million (1994 - \$27 million) increase in the present value of the WCB's benefits liability. Benefit payments represent approximately 64% of total expenditures, while salaries represent another 6.8%. Revenues for 1995 and 1994, comprised primarily of employer premiums, were \$173 million and \$159 million respectively.

16.4 As of December 31, 1995, the WCB had an unfunded benefit liability of \$368 million (1994 - \$379 million). The Board has a long-term plan to address the liability. Through the new assessment premium structure, it is projected that current and future benefit costs will be fully covered, and \$.45 of the average premium (currently at \$2.54) will be available to apply against the unfunded liability. This strategy is designed to eliminate the unfunded liability over a 45 year period. As part of the new legislation, the Province is contributing approximately \$23 million over five years to assist in stabilizing assessment rates. Also, the Province has guaranteed a real rate of return of 4.75% on the Board's funded liability for existing claims and those arising during the next five years. After five years, at the turn of the century, assessment rates may increase \$.28.

RESULTS IN BRIEF

16.5 The following are the principal observations from this audit.

- We have recommended means by which the Board can reduce its risk of making overpayments with respect to compensation benefits and reimbursable medical expenses.
- The Board has a number of performance measures which have been developed to help monitor and control compliance of WCB operations with the Workers' Compensation Act. We recommended additional measures be used.
- Between January 1, 1991 and December 31, 1995 total salaries at the WCB rose 92%, while the complement of staff rose 62%. The Board has complied with the terms and provisions of wage restraint legislation. However, we cannot express an opinion on whether the Board followed the spirit of wage restraint due to a lack of documentation pertaining to position reclassifications made in the years 1991 to 1993.
- The Board is not following all of the requirements of the Provincial government's procurement policy. Government approval is not always sought for sole-sourcing and selection of other than the lowest cost bids.
- Contracts are not always used to control the hiring and performance of private-sector consultants.
- Extensive training was provided to staff on the provisions of the new Act. The Board has made considerable efforts to provide information about the Board, its policies and the new Act to employers, workers and the public. However, training for new staff needs improvement and the Board is preparing plans for a formalized training program.
- The WCB Board of Directors is in the initial stages of developing a process to self-evaluate its governance structures and practices. We have provided the Board with literature and sources of research to assist it in conducting its review.

AUDIT SCOPE

16.6 In October 1996 we commenced a broad scope audit of the Workers' Compensation Board in accordance with our mandate under the Auditor General Act. The objectives of this assignment were to:

- review and assess claims processing for accuracy, completeness and compliance with the Workers' Compensation Act;
- review and assess compliance with wage restraint legislation and current government procurement policies, and assess the acquisition of services for economy and efficiency;
- review and assess case management practices used to ensure injured workers receive only the benefits to which they are entitled; and

- examine the process being used by the WCB Board of Directors to review its governance activities.

16.7 The following general criteria were used in our audit of the Workers' Compensation Board.

- *Claims processing* - The WCB should have adequate systems to ensure claims are processed in accordance with the new Workers' Compensation Act. Internal policies and guidelines for the processing of claims should be consistent with the requirements of the Act. There should be adequate training of staff. There should be adequate performance measures in place to inform the Board of its compliance with the Act.
- *Wage restraint and procurement* - The WCB should be in compliance with the Public Sector Compensation Restraint Act and the Public Sector Compensation (1994-1997) Act. The WCB should comply with the Provincial procurement policy which became effective for crown corporations on June 1, 1996. Services should be purchased with due regard for economy and efficiency.
- *Case management* - Eligibility criteria for claims should be clearly defined and well communicated to WCB staff, employers and applicants. The WCB should be aware of all significant means by which errors in processing claims can occur and fraudulent application for benefits can be perpetrated. Adequate controls should exist to prevent processing errors and approval of fraudulent claims, and should include timely reassessment of recipient eligibility (where appropriate). Where appropriate, controls should exist to ensure that investigations of claims do not contravene the Freedom of Information and Protection of Privacy Act.
- *Corporate governance* - There should be a formal review process established and approved by the Board. There should be specific criteria to follow in reviewing the governance process. The Board should have knowledge of and access to current research and literature on governance. The Board should have a strategy for the evaluation and implementation of the results of the review.

16.8 Our audit objectives and criteria were reviewed with Board management at the beginning of the assignment. Our audit procedures included extensive interviews with management and staff, as well as examination of significant reports, files and other documents.

PRINCIPAL FINDINGS

Claims Processing

16.9 *Initial processing* - When an injured worker's claim is initiated, the WCB must be informed of how much the employee earned during the four weeks immediately prior to the accident. (Procedures are in place for workers who have worked less than four weeks.) Based upon this information, the benefit the worker is entitled to for the first 12 weeks of a claim period is calculated. After 12 weeks, a claim is considered long-term and a new benefit amount is calculated.

16.10 On occasion, an employer will report earnings for a period other than four weeks, and will also report an inaccurate amount of earnings for the period. This may result in an understatement or overstatement of initial benefits paid. The inaccurate benefit could continue up to a maximum of 12 weeks when a long-term rate is set using more accurate wage information. Overpayment of

initial benefits resulting from the reporting of inaccurate initial information is not recovered from the worker, unless the inaccuracy was the result of an intentional effort to mislead. WCB's internal auditor has recommended automated processes that could help prevent such errors, and we support the recommendation.

16.11 In another type of accident situation, a worker may become injured but continue to work for a number of days or weeks. Later, the injury becomes serious enough for the worker to stop working indefinitely and to file a claim for benefits. If during the four weeks prior to the filing of the claim the injured worker lost wages due to the injury, a wage adjustment is manually calculated to account for the lost wages. Not adjusting for days lost in such cases will result in lower benefits to the injured worker. Prior to the implementation of the new Act, this calculation was automated to reduce errors. However, the new computer processes implemented by the Board do not include this process. The nature of the changes made to the computer system made it inappropriate to have this automated process remain. Changes planned for the future will reestablish an automated process.

16.12 Payments made to or on behalf of a worker by the WCB are reported to the employer following the registration of a claim, as they can impact future premiums. The Board also sends, to those employers who elect to receive them, monthly advice notices summarizing program costs. The WCB places reliance on the employers' review of such reports as a means of identifying errors such as inaccurate salary information and duplicate claims. In our opinion, control could be strengthened if the monthly advice were sent to all employers of employees who have an active claim. Also, we found the format of the monthly advice to be a bit confusing, and suggested that there be efforts to ensure employers understand the reports and their relevance to future premiums, and how the employer can assist the WCB in controlling errors and fraud.

16.13 *Medical aid payments* - When an injury occurs, a worker may incur expenses which are eligible for reimbursement by the WCB (e.g., health care equipment, hospital fees, medical specialists). Invoices for such expenses are forwarded to the WCB, but are not being properly cancelled when processed by the registration section. This increases the risk of duplicate payments, and we have recommended that these invoices be properly cancelled upon payment.

16.14 *Internal audit* - The WCB has an internal auditor who has conducted audits of the various systems and controls designed to implement the new Act. We reviewed some of these audits and followed-up on recommendations made by the internal auditor. The Board has addressed most recommendations, but we observed that several have not been addressed, which, in our opinion, should be implemented. Of particular note, the internal auditor was concerned about the quality of internal reporting to WCB managers. Whereas the internal auditor noted the existence of regular reporting and matching to authorization of payments over \$5,000, the auditor suggested that improvements to internal reporting would help management ensure:

- longer-term payments are accurate and caseloads are properly balanced amongst staff; and
- employers are not misreporting the date of an accident so that they can register a previously unregistered company prior to the alleged date of the accident.

16.15 Following the introduction of the new claims payment system, it was made the subject of an internal audit. There were errors found by the internal auditor in the processing of claims. These were primarily attributed to the fact that staff were still being trained in the new processes and procedures. As a result, additional training was provided to staff. A follow-up internal audit noted that errors were still occurring, but at a lesser rate than before. We selected a sample of 40 claims to assess the accuracy of claim processing and our audit results were consistent with the results of

the follow-up internal audit. Another internal audit of claims processing is scheduled to follow-up on this issue.

16.16 Performance measurement - Performance measurement is an important part of the management and accountability process, and is needed to help both management and a Board of Directors ensure operations are efficient, effective and in compliance with all legal requirements. Performance measurement is a priority of the WCB and the Client Services Division has as part of its 1997 annual goals “to develop internal service delivery standards, measurement tools and evaluation methodology.” Based on our review, the WCB has a number of performance indicators and other statistics that aid in assessing Board compliance with the Workers’ Compensation Act. We found information on claims processing time, volume and cost, as well as the duration a claim remains open. As well, the Board has a number of financial indicators. Most performance indicators and statistics are summarized and reported to the WCB’s Board of Directors on a monthly basis.

16.17 However, management notes that performance measurement can be strengthened, and is committed to making improvements. In the following paragraphs we note a few additional areas where performance measurement would be of value.

16.18 Case files are subject to review at different intervals in the claims process by different levels of staff or management. To provide for the efficient processing of claims, we believe it would be helpful to have measures in place to inform management of the occurrence and timing of case reviews to ensure they are being conducted properly and on a timely basis.

16.19 Similarly, once a claim has been processed and regular payments commence, the Board establishes review dates, at which time case workers ensure that the status of a claim (e.g., claimant is still unemployed and unable to work) is still accurate. In our view, management should be aware of when key dates have passed and reviews have not been performed. This will not only assist it in ensuring compliance with the Act, but also will identify areas where problems (e.g., excessive caseloads) may exist.

16.20 Compensation appeal decisions are one indicator of how well staff are processing and making decisions on benefit applications. Presently, statistics generated on decisions made by the Internal Appeals Division combine decisions related to claims under the old and new Acts. Additionally, there are no statistics indicating the number of appeal decisions based upon new information becoming available. Decisions overturned due to new information are less likely to be due to errors on the part of claims processors. As well, the statistics which are generated are not formally communicated to senior management or broken down by areas under its authority. This hinders senior management in assessing compliance with the new Act and in obtaining information about potential problem areas. Verbal reporting on appeal decisions is provided during monthly meetings of senior management of the ISUs. We have been informed that this will be formalized in the future.

Wage Restraint and Procurement

16.21 Wage restraint - The Board’s budgeted number of full-time equivalent (FTE) staff has risen by 93 (62%) in the period January 1, 1991 to December 31, 1995 (actual FTEs were not tracked by the Board). Also, during this period salaries and staff benefits rose by approximately \$5.3 million (92%). Board management has indicated that these significant increases occurred because:

- the Board required additional staff to implement the new Act (which came into effect on February 1, 1996);

- there were significant payments for overtime and vacation leave not taken due to the work loads created by the implementation of the new Act; and
- reclassifications were made to higher-paying positions for 25 union positions (74% of total union positions) and for 11 management positions (34% of total management positions) to reflect increased levels of responsibility. (The Board was not able to locate any documented information about management position reclassifications in the calendar years 1991 and 1992, but based on memory, it does not believe there were any.)

16.22 Based on our review, the WCB has complied with the terms and provisions of the Public Sector Compensation Restraint Act, effective on May 14, 1991, and the Public Sector Compensation (1994-97) Act, effective on April 29, 1994. For example, the wage rollbacks, wage freezes and unpaid leave instituted in government departments were implemented at the WCB. However, the magnitude of the position reclassifications and total salary increase over the five years, and the fact that the salary increase was 30 percentage points larger than the increase in the number of staff during that period, led us to review the changes to see if they followed the spirit of wage restraint.

16.23 However, we could not form an opinion on the issue due to a lack of documentation at the WCB to fully describe the changes. The Board does not have a complete record of positions which were reclassified in the calendar years 1991, 1992 and 1993. Also, during that period there was inadequate record keeping to support management's evaluation of each candidate's suitability for the new position and higher responsibilities. As part of our audit, we asked for a list of all job positions at the WCB and the number of staff filling each of these. This information was unavailable for years before 1996. We are concerned that adequate records were not maintained to control and account for the reorganization.

16.24 *Procurement* - On June 1, 1996, the scope of the Provincial government's procurement policy was extended to apply to all crown agencies and corporations. One of the criteria listed in the Provincial Finance Act which defines a crown corporation states "*the Governor in Council is entitled to appoint and remove at least a majority of its directors.*" Under the Workers' Compensation Act, the Governor in Council is required to appoint all members of the Board of Directors. Accordingly, in our opinion, WCB purchases are now governed by this policy. The government has developed numerous procedures to support its policy objective of "*... ensuring that procurement is carried out in an open, fair, consistent, efficient, and competitive market.*" We conducted various tests to evaluate the Board's compliance in this area.

16.25 We selected a sample of 40 purchases made during 1996 to assess compliance with the procurement policy. We found nine instances where there was non-compliance. Management has informed us, as our audit testing revealed, that the Board did not regularly tender long-term services (e.g., legal, accounting, audit, actuarial) in the past. It is our opinion that such services should be tendered every three or four years. (The government policy is not specific on the frequency of tendering of long-term services.) Management indicated that it now has an internal policy that requires tendering at least every five years.

16.26 With regard to all of its procurement, the WCB does not obtain government approval for sole-sourcing and situations where the selected offer is not the lowest cost tendered. This is required by the current government procurement policy. Management indicated to us that it does not believe the WCB is legally subject to the government's procurement policy, but that it does support its objectives. However, it does not believe it is appropriate to report such procurement exceptions to government.

16.27 *Control over consulting assignments* - Over the five years ended December 31, 1995 professional fees have risen by approximately \$664,000 (281%). We reviewed payments to a sample of 19 consultants for the purpose of assessing the Board's control over professional assignments. We found:

- seven instances where there was no signed contract for legal, actuarial and computer-related services;
- one instance where the engagement letter describing audit services to be provided was signed by WCB in November 1996, but the audit was completed in March 1996; and
- one instance where an extension of a contract for project management services commenced in January 1996, but the amendment was not signed by both parties until April 1996.

16.28 We are concerned that some services were and are being purchased without formal signed contracts to control them. Contracts are necessary to provide for management control over areas such as project deliverables, fees, milestones and termination.

Case Management

16.29 *Training and communication* - The new Workers' Compensation Act came into effect on February 1, 1996. This represented a major change to the way in which benefits were to be calculated. It is crucial that staff be well trained to implement the provisions of the Act to prevent delays in benefits being paid to eligible recipients. It is also important that workers and employers fully understand the changes necessitated by the new Act.

16.30 Extensive training for employees was provided on the new Act and the operational changes that were to result because of it. Policy and procedure manuals were developed to assist staff in interpreting the new legislation. Staff are also provided with ongoing training to maintain and update their knowledge of the Act.

16.31 In addition, employers, workers and the general public are being informed of the new requirements, processes and benefit structures. This is being accomplished through various means, including:

- newsletters;
- meetings with worker and employer groups;
- placement of policy and procedure manuals in public libraries;
- a Home Page available through the Internet; and
- a toll free number to access staff trained to handle enquiries.

16.32 In our view, the Board has done a thorough job of training its staff, and in communicating its policies and the changes brought about by the new Act.

16.33 However, training for new staff needs improving. New staff are not provided comprehensive training, but are assigned to work with a more experienced staff member. The Board has recognized this as a problem and is preparing plans for a formalized training program.

16.34 *Quality control* - Due to demands connected with implementing the new legislation, case files are not being reviewed as frequently as they should be, and quality assurance standards and measures are yet to be developed. Case file reviews serve to ensure that Board policies are being followed and errors are identified and corrected in a timely manner. As well, they can help identify areas where additional training in the processing of claims may be required and assist in evaluation of staff performance. We are concerned that these key control functions have not been fully carried out. It is even more important to have such control at this time as the changes made to the systems and processes of the WCB increase the risk of errors occurring.

16.35 We also reviewed risk management at the WCB. We were provided a copy of a detailed report resulting from a study conducted by the Board's external auditors. It described a number of risk factors and control weaknesses that should be addressed, and management has indicated it is committed to monitoring the situation. Also, the Board has formalized an agreement with Human Resource Development Canada to share information maintained for the Employment Insurance program. This will help the Board investigate and reduce fraudulent application for and receipt of compensation benefits. The Board is pursuing the sharing of Canada Pension Plan information maintained by Human Resource Development Canada, as well as some information maintained by Revenue Canada and the Nova Scotia Registry of Motor Vehicles.

16.36 *Eligibility review* - The Board has an Investigations Unit which conducts investigations into compensation claims and employer assessments where allegations of misconduct have been made. Investigations may be started as a result of referrals from the ISUs or phone calls from members of the public. According to WCB financial reports, for the two year period ended December 31, 1996, the Investigations Unit's budgeted costs are \$25,000 (8%) in excess of savings or recoveries to the Board. However, management has informed us that one of the main roles of the Unit is to act as a deterrent to misconduct and that savings related to this have not been factored into the recoveries stated in the financial reports.

16.37 The Freedom of Information and Protection of Privacy Act is an important control over the scope of investigations of employers and workers carried out by WCB. It is critical that the terms and provisions of the Act be adhered to and Board employees be knowledgeable about them. WCB has provided training to all staff on the Act and adheres to its terms and conditions. Outside firms hired by WCB to conduct investigations are required to comply with all Provincial and Federal laws.

16.38 *Overpayments* - Overpayments arise when workers, employers (who pay the worker and are reimbursed by the WCB) or medical service providers have been paid benefits to which they are not entitled. Under most circumstances, if an overpayment of benefits is made, and it was not due to an intentional effort to mislead or a worker could not have reasonably known of the overpayment, the overpayment is not required to be repaid to the Board. However, future benefits will be adjusted upon the discovery of an overpayment situation. If similar circumstances lead to an underpayment of benefits, the Board will make a payment to correct any past shortfalls.

16.39 As at November 30, 1996 recorded outstanding overpayments totalled approximately \$680,000. However, no record is maintained for (and thus this figure does not include) overpayments which, according to policy, are not recovered (as described above). We believe it would be useful to management to know the total of all overpayments made during a year, regardless of their nature. Such information may be a good measure of improvement or deterioration in the quality of control over claims processing.

16.40 An internal review of the overpayments system was conducted in the fall of 1995. It concluded that “*the overpayment system as it exists contains no accountability and there are no controls in place to ensure all overpayments are recorded and all recoveries are deposited and recorded on the system.*” A report was presented in December 1995, but its recommendations have not yet been implemented due to heavy work loads associated with implementing the new legislation. We have been informed by senior management that the necessary changes will be implemented by May 1997. We recommended that the Board proceed as quickly as possible with its plans to implement the necessary corrections to the overpayment system.

16.41 Under the Workers' Compensation Act, recipients or their survivors can receive pensions for life. Often payments are made by direct deposit to banks or to trustees (e.g., nursing homes). In these situations it is difficult to confirm that the pensioner or survivors are still living. A recent internal audit identified this as an area where overpayments can occur and recommended that more procedures be used to confirm on a regular basis that such individuals are still alive. We concur with this and support the recommendation.

16.42 *Information technology* - The WCB is in the preliminary stages of developing a Business Information Technology Strategy (BITS). This project will significantly change the way cases are managed. The objectives of the project are to examine:

- current manual processes to determine if there are ways to streamline them; and
- opportunities to automate other aspects of the WCB's business.

16.43 The Board has identified 25 significant issues related to case management which need to be improved. Some examples of improvements the BITS project is expected to deliver include:

- the development of caseload standards in areas where they do not presently exist;
- the implementation of automatic prompts as to when specific action on a case is required; and
- the establishment of electronic case files to provide more timely access to file information and a more efficient process for putting information into a file.

16.44 In our view, case management is crucial to assisting injured workers in returning to work earlier, and accordingly, controlling benefit costs. We concluded that the BITS project should improve case management at the WCB.

Corporate Governance

16.45 Governance is the authoritative direction or control over an entity, and is the principal function of an entity's board of directors. It is an increasingly important function in the operation of public and non-profit entities, due in part to the continual pressure for reducing costs of providing services while trying to meet the increasing expectations of the public.

16.46 It was our intention to review the process the WCB Board of Directors planned to use to examine its own governance structure and practices. However, at the time of our audit the Board of Directors was only in the very initial stages of developing a process to conduct the review. Thus, it was too soon for us to meaningfully assess it.

16.47 However, we commend the Board for initiating this process and encourage it to complete its review in a timely manner. We have provided WCB management with literature and sources of information to assist in this endeavour, and will follow up on the Board's progress at a later time.

WORKERS' COMPENSATION BOARD'S RESPONSE

The Workers' Compensation Board of Nova Scotia would like to thank the Auditor General's office for their contribution to the process of checking the introduction of the new Workers' Compensation Act which was passed February of 1995. Throughout 1995 and 1996 staff at the Workers' Compensation Board worked to develop the new policies, procedures and computer systems that were required to implement the Act.

The WCB's internal auditor and external auditor (Deloitte & Touche) engaged in a series of reviews to ensure that the new Act, policies, procedures and systems were in fact being employed in an appropriate and timely fashion. The audit that was conducted in the fall of 1996 by the provincial auditor was another and very thorough check on the system.

We recognize that there are areas where improvements are still needed and the Board and staff are committed to making the necessary changes.

OTHER AUDIT OBSERVATIONS

17.

ADDITIONAL APPROPRIATIONS

BACKGROUND

17.1 Every year the *Estimates*, representing the Government's spending plans, are presented to the House of Assembly for review and approval. The *Estimates* are summarized in the Appropriations Act, which authorizes spending amounts (or votes) for the coming year.

17.2 The Provincial Finance Act allows adjustments to these spending plans in the form of additional appropriations. The Provincial Finance Act also permits the Executive Council to approve special warrants when an expenditure, which was not provided for in the original Estimates, is urgently and immediately required.

17.3 Exhibit 17.1 on page 224 includes sections of the Provincial Finance Act relating to additional appropriations and special warrants. In addition, for the 1995-96 fiscal period Section 9 of the Expenditure Control Act required “*a program operating expenditure or capital expenditure that exceeds the amounts authorized to be spent pursuant to this part may only be made after a resolution has been passed by the House of Assembly authorizing the expenditure.*”

17.4 Finance's current practice is that when forecasting indicates an expenditure vote may be exceeded it works with the affected department to identify alternatives and opportunities to avoid the overexpenditure situation. If necessary, the Minister of Finance, the Minister responsible for the affected department, and senior staff meet with the Chairman of the Executive Council (i.e., the Premier) to discuss and decide upon the appropriate course of action. Depending on the circumstances, an additional appropriation may be necessary.

17.5 Section 9(2)(e) of the Provincial Finance Act requires that the *Public Accounts* include a summary listing of additional appropriations and special warrants for the fiscal year authorized under Sections 28 and 29 of that Act. Under Section 9(1) of the Auditor General Act, we are required to call attention to every case in which an appropriation was exceeded, and every case in which a special warrant was made pursuant to the provisions of the Provincial Finance Act.

RESULTS IN BRIEF

17.6 The following are the principal results from our 1996 review of additional appropriations and special warrants.

- The timing of approvals of additional appropriations continues to be a concern. All additional appropriations and special warrants for the 1995-96 fiscal year were approved by either the Executive Council or the House of Assembly. However, contrary to the Provincial Finance Act and the Expenditure Control Act, some expenditures had been incurred before the approvals were received.
- There is a need to clarify the provisions of the Expenditure Control Act, including how they relate to the approval of additional appropriations under that Act as opposed to the provisions of the Provincial Finance Act.
- There were 16 additional appropriations totalling \$142,090,252 for the fiscal year ended March 31, 1996, of which \$120,115,274 was spent. Six of the additional

appropriations totalling \$53,285,192 were approved subsequent to March 31, 1996, after the overexpenditures had been incurred. These additional appropriations did not receive Executive Council approval under the provision of the Provincial Finance Act, but were approved under the provisions of the Expenditure Control Act by a resolution in the House of Assembly in November 1996.

- There was one special warrant for \$3,000,000 for the 1995-96 fiscal year. It was approved by the Executive Council on March 26, 1996. It was for additional funding for the Innovation Fund which was initially funded by a special warrant issued in March 1995. In our view, this additional funding could have more appropriately been dealt with in the *Estimates* for 1996-97.

AUDIT SCOPE

17.7 The objective of our annual review of additional appropriations and special warrants was to determine if they were properly authorized in accordance with the provisions of the Provincial Finance Act. Our review also included consideration of the requirements of the Expenditure Control Act.

17.8 In addition to reviewing the supporting information obtained from Finance, we also performed a search of Orders in Council to verify completeness of the listing of additional appropriations and special warrants to be published in the *Public Accounts*.

PRINCIPAL FINDINGS

Additional Appropriations

17.9 The Appropriations Act, 1995 contained 68 votes for current expenditures totalling \$4,122 million (including sinking fund instalments and serial retirements of \$206.4 million) and 12 votes for capital expenditures totalling \$285 million.

17.10 All additional appropriations and special warrants for the 1995-96 fiscal year were approved by either the Executive Council or the House of Assembly. However, contrary to the Provincial Finance Act and the Expenditure Control Act, some expenditures had been incurred before the approvals were received.

17.11 There were 16 additional appropriations totalling \$142,090,252 approved for the fiscal year ended March 31, 1996, of which \$120,115,274 was spent. Six of these additional appropriations totalling \$53,285,192 were not approved by the Executive Council under the provision of Section 28 of the Provincial Finance Act, but were approved subsequent to the year-end by a resolution in the House of Assembly under the provisions of Section 9 of the Expenditure Control Act. The resolution in the House of Assembly, approving the six additional appropriations, was approved in November 1996 (i.e., seven months after the year end).

17.12 Eleven current expenditure votes required additional appropriations totalling \$140.6 million, or approximately 3.4% of the current expenditures in the *Estimates* approved by the House of Assembly. An additional appropriation for \$1.5 million was approved for one capital expenditure vote.

17.13 Four votes required two additional appropriations. Three pertained to the Department of Health and one to the Public Service (i.e., Public Inquiry, Westray Mine).

17.14 Our review noted that the four departments listed below accounted for approximately 98% of the total additional appropriations for 1995-96.

	(\$ millions)
Health	\$ 79.4
Justice	32.0
Finance	23.4
Community Services	4.8
	<u>\$139.6</u>

Health - The Department of Health required additional appropriations, totalling \$79.4 million, in the following areas: Departmental Support \$4.6 million, Insured Programs Management \$16.8 million, and Regional Programs \$58 million.

Justice - Additional funding was required for the Compensation of Victims of Institutional Abuse Program in the amount of \$33,295,500, which was partially offset by a reduction in policing costs of \$1,257,600.

Finance - The Department of Finance requested an additional appropriation totalling \$23.4 million for restructuring costs. The main reasons for the overexpenditure were to be in the area of health care restructuring costs, as well as a greater acceptance of the early retirement incentive program by eligible employees. A journal entry was processed on March 29, 1996 to set up \$20,500,000 for health care restructuring costs, but this entry was subsequently reversed. As a result, only \$2,653,291 of the additional appropriation was necessary to cover actual expenditures reported.

Community Services - The Department of Community Services required additional funding for Community Based Options (\$2,186,900) to reduce pressures to the In Home Support Program (Department of Health); to compensate for reduced savings resulting from the reform initiatives to the Pharmacare Program (\$1,813,100), and a decline in CPP payments under the Family Benefits Program (\$800,000).

17.15 The following is a summary of additional appropriations for the last ten years.

**Additional Appropriations
(\$ millions)**

Year	Current	% of Estimate	Capital	% of Estimate	Total
1995-96	\$140.6	3.4%	\$ 1.5	0.5%	\$142.1
1994-95	51.2	1.2%	1.6	0.5%	52.8
1993-94	33.5	0.7%	8.0	2.4%	41.4
1992-93	118.5	2.7%	26.0	8.8%	144.5
1991-92	86.3	2.0%	3.2	1.2%	89.5
1990-91	77.0	1.9%	3.3	1.1%	80.3
1989-90	126.3	3.3%	32.6	9.3%	158.9
1988-89	87.6	2.5%	16.8	12.2%	104.4
1987-88	50.4	1.5%	8.4	5.4%	58.8
1986-87	38.2	1.2%	4.9	6.6%	43.1

17.16 The following departments requested additional appropriations for current expenditure votes in each of the last five years.

**Additional Appropriations
(\$ millions)**

Department	Five-Year Total
Health	\$ 132.6
Community Services	42.1
Public Service	10.8

17.17 The following is a list of additional appropriations of \$50,000 or greater, totalling \$142 million or 99.9% of the \$142.1 million approved for the year ended March 31, 1996. A complete listing is included in Volume I of the Province's *Public Accounts*.

**Additional Appropriations
\$50,000 or Greater**

Department	Date Approved	Authorized	Expended
Health			
Department Support	Mar. 26/96	\$ 961,400	\$ 961,400
Department Support	Nov. 22/96	3,670,686	3,670,685
Insured Programs Management	Mar. 26/96	10,500,000	10,500,000
Insured Programs Management	Nov. 22/96	6,261,400	6,261,400
Regional Programs	Mar. 26/96	16,163,600	16,163,600
Regional Programs	Nov. 22/96	41,803,649	41,803,649
Justice			
Compensation for Victims of Institutional Abuse	Mar. 26/96	32,037,900	32,037,141
Finance			
Restructuring Costs	Mar. 26/96	23,411,160	2,653,291
Community Services			
Income Assistance	Mar. 26/96	4,800,000	3,644,665
Supply and Services (capital)			
Public Works and Special Projects	Nov. 22/96	1,461,612	1,461,612
Public Service			
Public Inquiry, Westray Mine	Mar. 26/96	750,000	750,000
Public Inquiry, Westray Mine	Nov. 22/96	78,295	78,294
Election Expenses	Oct. 10/95	<u>140,000</u>	<u>94,703</u>
		142,039,702	120,080,440
Additional appropriations less than \$50,000		<u>50,550</u>	<u>34,834</u>
		<u>\$142,090,202</u>	<u>\$120,115,274</u>

Expenditures Charged to Incorrect Appropriation

17.18 Also, under Section 9(1) of the Auditor General Act, we are required to call attention to every case in which we observe that any appropriation was applied to a purpose or in a manner not authorized by the Legislature. In this regard, during a general review of the Province's March 31, 1996 year-end adjusting entries, we noted that \$5 million of expenditures relating to the N.S. Seniors' Pharmacare Program were recorded to a debt charges account by the Department of Finance.

Special Warrants

17.19 We are required under Section 9(1)(f) of the Auditor General Act to call attention to every case in which "*a special warrant, made pursuant to the provisions of the Provincial Finance Act, authorized the payment of money.*" The Provincial Finance Act allows the Governor in Council to approve a special warrant, when the Legislature is not in session, which authorizes "*an expenditure which was not provided for by the Legislature*" and "*is urgently and immediately required for the public good.*"

17.20 On March 26, 1996, a special warrant was approved authorizing an expenditure of \$3,000,000 for the Public Service to add to the Innovation Fund, which was initially funded by a special warrant in March 1995. The Innovation Fund is internal to government and is to be used to fund innovative projects related to key areas of government policy and reform.

17.21 The continuity of the Innovation Fund is summarized in the following table which reflects the original special warrant obtained in 1995, the 1996 special warrant referred to above and the balance in the fund's account at Finance as at December 31, 1996.

Transaction Date	Installment	Withdrawal	Balance
March 1995	\$ 3,000,000		
December 1995		\$ 235,000	\$ 2,765,000
March 1996	\$ 3,000,000		\$ 5,765,000
May 1996		\$ 3,417,000	
December 31, 1996			\$ 2,348,000

17.22 In our view, authority for the additional funds for the Innovation Fund could have more appropriately been dealt with in the *Estimates* for 1996-97. Further, the additional funds were reflected as expenditures for the 1995-96 fiscal period, when it appears they should have more appropriately been charged to the 1996-97 period. Based on the timing of the expenditures reflected against the Innovation Fund account, it does not appear that the authority for the funding should have been via special warrants.

Expenditure Control Act

17.23 Amendments to the Expenditure Control Act passed in 1996 will affect when an over expenditure situation in 1996-97 and beyond will require a resolution passed by the House. See Exhibit 17.2 on page 225 which includes Part II of the Act passed in 1996.

17.24 A review of the revised provisions considering the definition for "net program operating expenditures" raises some concerns as to whether they will achieve the level of control intended. Finance has indicated that amendments necessary to clarify that Act will be brought forward in 1997.

17.25 For example, the fact that "gross debt charges" and certain other costs are excluded from the definition of "net program operating expenditures" for purposes of the Act has a significant impact on the interpretation of Section 12(1) and 12(3) as providing for balanced budgeting. Further, Section 12(4) now establishes a definition of "surplus" that is inconsistent and incomplete from both budgeting and accounting perspectives.

17.26 When an overexpenditure situation exists requiring a resolution to be "*passed by the House of Assembly authorizing the expenditure*" under the provisions of the Expenditure Control Act, Section 28 of the Provincial Finance Act is not being used to obtain spending authority. In those circumstances where the House passes a resolution under the Expenditure Control Act, the Executive Council's approval under Section 28 of the Provincial Finance Act would presumably become subordinate. In this regard, it would be helpful if there was some clarification provided through statutory amendments and supported by appropriate administrative interpretations (i.e., policy directives).

CONCLUDING REMARKS

17.27 Expenditure of funds beyond the votes approved by the House of Assembly continues to occur prior to authorization of additional appropriations as required under the Provincial Finance Act and the Expenditure Control Act.

17.28 Current legislation and administrative practices raise questions as to the effectiveness of the House of Assembly's control over expenditure of public funds. The practice of obtaining after-the-fact approval for additional appropriations does not constitute *effective control* and, we believe, contravenes the intent of the requirements of the Provincial Finance Act and the Expenditure Control Act.

17.29 Finance has indicated that they do not fully agree with our interpretation of the provisions of the Provincial Finance Act or the Expenditure Control Act. In this regard, we have tentatively agreed to participate with Finance staff in a review of the policies and practices in other jurisdictions for the use and control of additional appropriations.

Exhibit 17.1**EXTRACTS FROM THE PROVINCIAL FINANCE ACT*****Prerequisite to issue money***

13(2) *The Deputy Minister [of Finance], or an officer designated by him, before the issue of public money out of the Consolidated Fund, shall ensure that there is sufficient balance available in the appropriation for the specified purpose.*

Consequence of exhausted appropriation

13(3) *When an appropriation is exhausted, the Deputy Minister shall forthwith notify the department to which the appropriation was granted and the Minister, and shall not sanction any further contractual obligations or commitments to be charged to the exhausted appropriation.*

Report of insufficient appropriation

28(1) *When it appears to the Minister or principal officer having charge of a service that the sum appropriated by the Legislature for an ordinary or usual service is insufficient to meet the requirements of that service during the year for which the appropriation has been made or that the sum appropriated by the Legislature to be expended on capital account is insufficient for the service for which it was appropriated, the Minister or principal officer shall make a report of that fact to the Minister of Finance and shall in such report estimate the additional sum required to carry out the service.*

Supplementary appropriation

28(2) *Upon the receipt of such report, the Minister of Finance may make a report to the Governor in Council showing the need of additional appropriation and thereupon the Governor in Council may order that such additional sums as are deemed necessary for the said service be appropriated accordingly, provided that the additional sums appropriated to be expended on capital account shall not exceed twenty-five per cent of the amount appropriated by the Legislature for the service.*

Report of urgently required expenditure

29(1) *When it appears that an expenditure which was not provided for by the Legislature is urgently and immediately required for the public good, the head of the department concerned shall make a report of that fact to the Minister of Finance and shall in such report estimate the amount of the proposed expenditure.*

Special warrant

29(2) *Upon receipt of such report, the Minister may make a report to the Governor in Council that the said expenditure is urgently and immediately required for the public good, and that there is no legislative provision therefor, and the Governor in Council may thereupon order a special warrant to be prepared to be signed by the Lieutenant Governor for the issue of the amount estimated to be required and may order the amount to be charged to Capital Account or to Current Account, or partly in one way and partly in the other.*

Conditions for special warrant while house in session

29(3) *A special warrant pursuant to the provisions of this Section shall not be made when the Legislature is in session unless the House of Assembly has not sat for any of the five days immediately preceding the issue of the special warrant.*

Exhibit 17.2**EXTRACTS FROM EXPENDITURE CONTROL ACT****Application of Part II**

11 For greater certainty, this Part applies to the 1996-97 and subsequent fiscal years of the Province.

Expenditure reductions for 1996-97

12(1) In each and every fiscal year of the Province commencing with the 1996-97 fiscal year, the amount appropriated by the Legislature for net capital expenditures and net program operating expenditures shall not exceed the amount of revenue forecast to be received by the Minister for that fiscal year.

Expenditure exception

12(2) Notwithstanding subsection (1), an amount may be expended in a fiscal year for net capital expenditures and net program operating expenditures that is no more than one percent more than the amount appropriated by the Legislature for those expenditures.

Time limit for recovery of deficit

12(3) Where net capital expenditures and net program operating expenditures for a fiscal year exceed the total revenues for that year, the resulting deficit shall be recovered no later than the end of the second fiscal year following the fiscal year in which the deficit occurred by a reduction in expenditures or an increase in revenue, or both, over that period.

Use of surplus

12(4) Where the amount of revenue to be received by the Minister in a fiscal year exceeds the amount appropriated by the Legislature for net capital expenditures and net program operating expenditures for that year, the resulting surplus shall, after accounting for any recoveries required pursuant to subsection (3), be used to reduce the public debt of the Province or reduce taxes, or both.

Resolution of House

13 Where net capital expenditures and net program operating expenditures for a fiscal year exceed the amount authorized to be spent pursuant to Section 12, the expenditures in excess of the amount authorized by subsection 12(1) and (2) may only be made after a resolution has been passed by the House of Assembly authorizing the expenditure.

18.**CASH AND OTHER LOSSES****BACKGROUND**

18.1 The Government of Nova Scotia Management Manual 200, Chapter 8 requires that departments, boards, or commissions immediately report any instances of loss of public money or public property to the Department of Finance, and to the Office of the Auditor General. Finance is responsible for establishing procedures to be followed for the reporting of any irregularities or losses.

18.2 Section 9(1)(e) of the Auditor General Act requires that we report annually every case observed where there has been a deficiency or loss through fraud, default or mistake of any person. This chapter summarizes the results of our annual review of those losses identified and reported to us.

18.3 During our audit of the Nova Scotia Hospital conducted during the year we encountered a situation where amounts owing to the Province were not recorded as accounts receivable and, accordingly, write-offs of the amounts owing were not approved by Executive Council as required by Section 23(1) of the Provincial Finance Act. Details of this situation are reported in Chapter 15, Review of Financial Statements and Management Letters, page 202.

RESULTS IN BRIEF

18.4 The following summarizes our principal findings.

- The losses reported to us for the year ended March 31, 1996 totaled \$300,164 consisting of cash losses of \$7,504, property losses estimated at \$320,194 and recoveries of \$27,534.
- Some, but not all, departments and crown agencies are complying with the loss reporting requirements of the Management Manual. Not all entities are reporting, and not all reporting is on a timely basis.
- As suggested in previous Reports, Finance has reviewed and clarified the policies and practices for the reporting of losses by departments. However, Finance has not provided similar guidance to government agencies or commissions. Also, the Management Manual does not define the value to be reported for a loss.

AUDIT SCOPE

18.5 Our objectives were to review the information provided by departments and agencies, and to compile a listing of the cash and property losses reported to us for the year ended March 31, 1996. We sent letters to departments and crown agencies to confirm the completeness of the losses reported to us. This review did not consider the losses which resulted from write-offs approved annually by Executive Council. In recognition of the fact departments and agencies may be able to recover some of their losses, as part of this year's confirmation process we asked that specific recoveries be reported as well.

18.6 We have performed no additional or specific audit procedures on the specific losses reported.

PRINCIPAL FINDINGS

Losses Reported

18.7 The following is a summary of the cash and property losses for the year ended March 31, 1996 identified either as a result of our confirmation request or reported to us during the year. Certain of the losses reported represent the entity's estimated value of property lost or damaged.

Departments Reporting Losses	Cash	Property	Recoveries	Total
Agriculture and Marketing	\$ 160	\$ -	\$ -	\$ 160
Education	80	6,903	-	6,983
Environment	-	3,632	-	3,632
Fisheries	-	3,765	-	3,765
Health	6,017	3,850	-	9,867
Human Resources	30	340	-	370
Justice	1,187	300	-	1,487
Labour	-	4,850	-	4,850
Municipal Affairs	-	3,000	-	3,000
Natural Resources	-	21,163	-	21,163
N.S. Economic Renewal Agency	-	5,719	(4,194)	1,525
	<u>7,474</u>	<u>53,522</u>	<u>(4,194)</u>	<u>56,802</u>
Crown Agencies Reporting Losses				
Nova Scotia Gaming Control				
Commission	-	1,395	-	1,395
Nova Scotia Hospital	30	-	-	30
Nova Scotia Liquor Commission	-	193,330	(17,824)	175,506
Nova Scotia Workers'				
Compensation Board	-	200	-	200
Queen Elizabeth II Health Sciences				
Centre	-	64,056	(550)	63,506
Office of the Auditor General	-	7,691	(4,966)	2,725
	<u>30</u>	<u>266,672</u>	<u>(23,340)</u>	<u>243,362</u>
Total Reported	<u>\$ 7,504</u>	<u>\$ 320,194</u>	<u>\$ (27,534)</u>	<u>\$ 300,164</u>

18.8 The Department of Justice reported that, based on information in its fixed asset inventory system, 75 items have been misplaced. There was no dollar value reported for those items. Justice is the only government entity reporting these types of losses, and we believe other entities should be required to do so.

18.9 In regards to the Nova Scotia Liquor Commission, it should be acknowledged that it is a retail organization and not a government department. As such, it is subject to different risks of losses. As a self-service retail organization, it is inevitable that some inventory shrinkage will occur. The property losses reported for the Nova Scotia Liquor Commission represent the cost of inventory stock losses from its retail and warehouse operations.

18.10 The loss reported by the Office of the Auditor General includes the theft of two notebook computers.

18.11 The Nova Scotia Hospital provided a listing of the loss and damage which occurred to Hospital property during 1995-96. Items lost included a video cassette recorder, two portable radio/cassette players, a set of stereo speakers, and a dumb bell. The listing did not provide dollar values for items lost or damaged.

Compliance with Reporting Requirements

18.12 All entities are not complying with the requirement to report losses to Finance and this Office. There is inconsistency in the application of loss reporting requirements among entities.

18.13 Failure by all entities to report consistently and on a timely basis restricts Finance's ability to ensure that necessary follow-up procedures are performed to determine the reason for a loss and whether appropriate corrective action has been taken.

18.14 The Management Manual does not specify the value to be reported for a loss. This allows entities the flexibility to report property losses at cost, estimated current value, or estimated replacement value. Some property losses were reported without a monetary value.

18.15 For the fiscal year 1996-97, Finance has taken steps to ensure adequate and consistent compliance by departments, but not agencies or commissions, with the defined policy and procedures. The Internal Audit Division at Finance now investigates losses reported to determine what steps have been taken to prevent such losses from occurring in the future.

CONCLUDING REMARKS

18.16 The Department of Finance has made efforts to upgrade the reporting requirements and processes in this area by distributing a memorandum to departments which clarifies loss reporting requirements and stresses the importance of timely reporting of losses. However, the policies and practices for the reporting of losses need to be clarified and expanded to include appropriate and timely reporting of losses of public money or public property by crown entities. As well, steps must be taken to define the value of losses (see paragraph 18.14 above) to be reported.

19.**CLAIMS UNDER FEDERAL-PROVINCIAL AGREEMENTS****INTRODUCTION**

19.1 The Province has entered into a number of agreements with the Government of Canada for various cost-shared programs. Our Office has the responsibility to audit programs and sub-programs under certain agreements. For the fiscal year ended March 31, 1996, we commenced audits of claims under thirteen separate agreements (although not all of these audits were completed at the time of the writing of this Report). The agreements were administered by eight government departments and two Provincial agencies. Total expenditures under these agreements amounted to \$630 million, of which \$315 million was recoverable from the Government of Canada.

19.2 Our responsibility is to determine whether the departments and agencies concerned have complied with the terms of the agreements and whether amounts incurred and claimed are in accordance with the agreements. We also review and evaluate the system of internal control to process expenditures under the agreements.

PRINCIPAL FINDINGS***Reservation of Opinion***

19.3 This year there were two cases where it was necessary to express a reservation of opinion.

19.4 *Agreement on Social Housing* - We qualified our opinion on the Private Non-Profit Housing Subsidies claim because internal audits conducted by staff of the Department of Housing and Municipal Affairs and auditors of the housing sponsors, upon which we rely to support our audit opinion, did not conclude that the rent-to-income (RGI) scale was applied correctly by project sponsors.

19.5 *Agreement on Sustainable Economic Development* - Staff assigned to this agreement have assumed responsibility for projects administered by the former Nova Scotia Centre for Environmentally Sustainable Economic Development. We qualified our audit opinion because we were unable to determine whether amounts requested by and paid to project applicants were eligible according to the Letters of Offers and supported by actual project expenditures.

Other Findings

19.6 We found certain situations during our claims audits where accounting and financial systems and procedures were deficient. Although they are not of a magnitude to require a reservation of opinion, three such situations are significant enough to report to the House of Assembly.

19.7 *Agreement on Legal Aid* - All applicants who request legal aid services from the Nova Scotia Legal Aid Commission are required to complete application forms. We noted instances where applications were not fully completed, and for some applicants we were unable to determine whether they met the Commission's financial eligibility requirements.

19.8 *Agreement on Social Housing* - Claims under this agreement include costs incurred by Non-Profit Housing sponsors. All sponsors are required to submit financial statements to the Department of Housing and Municipal Affairs. Adjustments to the amount claimed from Canada Mortgage and Housing Corporation were not being processed on a timely basis after the Department had calculated adjustments due to/from project sponsors. The subsidy payments to Special Purpose sponsors were not recalculated by Department staff taking into account the change in interest rates when the mortgages were renewed resulting in overpayments to certain sponsors. As we reported in our 1995 Annual Report, formal standards have not been established for the audit, contents and presentation of the financial statements of sponsors.

19.9 *Agreement on Vocational Rehabilitation of Disabled Persons* - The Department of Health provides funding to a number of agencies in the form of grants which are cost shareable with Human Resources Development Canada under the agreement. The Department did not require the agencies to submit detailed budget information, sign a Letter of Understanding with the agencies, have a system in place to ensure financial statements were received on a timely basis, and conduct evaluations of programs delivered by the agencies.

OFFICE OF THE AUDITOR GENERAL

20.

REPORT ON THE OFFICE OF THE AUDITOR GENERAL

MANDATE

20.1 The responsibilities and authorities of the Auditor General are derived from the Auditor General Act (Chapter 28, 1989). The Act specifies the responsibility to examine the accounts of the Province and its various agencies and the requirement to report to the House of Assembly on the government's stewardship of public funds. Appendix I of this Report includes extracts of the audit mandate and reporting sections of the Auditor General Act.

20.2 In addition, certain other Acts provide more specific audit mandates to this Office. For the most part these relate to the performance of the annual financial statement audit function for certain crown agencies or funds.

MISSION, VISION, VALUES

20.3 Exhibit 20.1 is an extract from the Office's *Business Plan 1997-98 to 2000-2001* which was prepared consistent with the guidelines issued for the *Integrated Planning and Budget Process* now used by government.

STRATEGIC GOALS AND OBJECTIVES

20.4 As a result of internal planning activities, the Office has identified the following key goals that are being used to guide our audit and related activities.

- To achieve positive change in the accountability for and management of public funds.
- To provide assurance on the credibility of financial statements and other representations in order to assist the House of Assembly to hold the government to account.
- To strive for excellence through the pursuit of state-of-the-art knowledge, skills and abilities, and to work to the highest standards of our profession.
- To provide cost effective use of resources in support of the role and responsibilities of our Office.

20.5 These goals are reviewed each year and will evolve as required or appropriate. Further, we monitor our overall performance against these goals.

*Exhibit 20.1***Office of the Auditor General
Mission, Vision and Values**

Our Mission - The Office derives its mandate from the Auditor General Act (Chapter 28, 1989). The people of Nova Scotia, through their elected representatives, need assurance that their tax dollars are expended for the purposes intended. As the legislative auditor of the Province, the Office helps the House of Assembly to hold the government to account by providing opinions:

- on the credibility of financial statements and other government representations;
- concerning compliance with legislation, regulations, agreements, and policies;
- on the adequacy of control; and
- on the extent of due regard for economy and efficiency in the management of public funds.

In addition, the Office provides advice to assist in improving the accountability for, and the management of, public funds.

Our Vision - The Office strives for excellence in public sector management and value for money in the use of public funds.

Our Values - In pursuing our mission, we value our clients, our people, and our professionalism.

- We strive to provide quality service to the House of Assembly, its members, and other clients. We do this with initiative and commitment, employing state of the art knowledge, skills, and abilities. We seek to be progressive, encouraging leadership, intelligent risk-taking, and high standards of reliability.
- We treat each other with fairness and equality, communicating openly, honestly, and respectfully. We place great importance in career development, training, professional fulfilment, and quality of work life. We work together as a partnership, support staff and professionals, recognizing each person's unique contribution.
- We work to the highest standards of our profession, maintaining a relationship with the House of Assembly and the government that is confidential, independent, objective, and professional. We endeavor to be creative while remaining practical, economical, and efficient. We share our knowledge, values, ideas, and experiences within the Office, the government, and our profession.

CORE BUSINESS FUNCTIONS

20.6 The Office conducts audits under the Auditor General Act and reports the results to the House of Assembly. The types of audits and reports provided are described in the Mission. However, for purposes of a more complete description, our business function is comprised of the following elements:

- In addition to the Auditor General Act, other legislation, including the Provincial Finance Act, specifies audit responsibilities. Under all of these our function is to provide information to the House of Assembly, and advice to both the government and managers of government entities.
- We perform assessments from which flow the provision of assurance, advice, recommendations and analyses.
- We identify and monitor emerging issues, and research developments and initiatives in other jurisdictions related to the management and control of public funds in order to provide advice regarding opportunities for improvement.
- We support the Public Accounts Committee by providing information through briefings, research and by responding to queries.

OUTCOME MEASURES

20.7 While outcomes can only be measured through compilation and interpretation of data from various sources, for purposes of performance monitoring, we have identified the following outcome measures relating to the achievement of the Office's strategic goals and objectives.

- The degree to which positive change has occurred in the management of public funds. This can only be measured over time and requires benchmarking and subsequent comparison.
- The extent to which financial statements and other management representations are presented fairly, on a timely basis, and are considered useful as accountability reports. This also can only be measured over time and requires benchmarking and subsequent analysis.
- The extent of external recognition of the Office as an effective professional legislative audit function. This can be measured in a variety of ways including peer review, report user feedback, media analysis and professional recognition.
- The comparison of the costs of the Office to the costs of similar legislative and other audit organizations. Various cost comparisons can be developed and analyzed to measure Office performance.

20.8 We have begun to gather and consider general information against these outcome measures. However, we are committed to this being a more formal element of our ongoing planning and performance management processes. Further, initiatives within the legislative audit community, particularly under the auspices of the Conference of Legislative Auditors (COLA), appear to have the potential for refinement of outcome measures for audit offices. We will continue to participate in these efforts while striving to utilize those outcome measures we have identified.

ORGANIZATION

20.9 As at December 31, 1996 we had 28 staff, two of whom were seconded to the Department of Education and Culture. Subject to the availability of funds, we outsource for specialist expertise and other audit resources on selected assignments.

20.10 Public funds of the Province of Nova Scotia are collected and expended through various departments and agencies. In order to effectively plan and manage the activities of the Office, we are organized into teams each headed by a senior manager. Each senior manager has overall responsibility for a group of departments and agencies, and is the prime focus for communications with those organizations.

20.11 Staff members are rotated among the teams to provide career development, technical training, and to meet operational priorities. Each of the senior managers reports to the Auditor General and participates in the overall management of Office activities.

20.12 It is a responsibility of each senior manager to periodically review past and intended audit coverage of assigned portfolio departments and agencies. These reviews are to be consolidated into multi-year strategic and longer-range plans giving due consideration to the needs of the House of Assembly, intended themes for reporting, evaluation of risk factors, and availability of resources.

20.13 The government's expenditure control plan and the early retirement program significantly impact on the Office's resources. Staff costs consistently account for 90% or more of the Office's total expenditures on an annual basis. Any material change in budgetary requirements must therefore result from savings in the human resources area.

20.14 As eligible staff members retire in the next few years, they will either not be replaced or be replaced by entry level staff. As part of the plans to meet our expenditure control targets, we restructured the Office to three from four teams, and reduced our administrative support staff from three to two. These restructuring and downsizing initiatives are supported by increased use of information technology resources. Of particular note was the installation of a Local Area Network in late 1995. This has improved communication internally and with officials in other departments.

20.15 Replacements during the balance of the expenditure control period will be primarily at the entry-level thus opening up opportunities for people entering the work force. The mix and number of staff will change and will place greater responsibility on all levels of staff and management.

20.16 The Office was also saddened when one of its longest serving employees, Tom Edwards, passed away suddenly on March 9, 1997. Tom was a dedicated professional who was also very active in community and charitable endeavours. He was looking forward to retirement in June and he will be sorely missed by his family, friends and associates.

COMMITTEE OF INDEPENDENT ADVISORS

20.17 In 1994 an Independent Advisory Committee of eight senior members of the business and academic community was established. The terms of reference for the committee are provided in Exhibit 20.2 on page 239. Several other legislative auditors in Canada successfully use such an advisory committee.

20.18 We believe the creation of this group is a positive initiative and appreciate the open and insightful contributions it makes to our efforts to plan and manage the Office's activities and outputs. To date, the committee has met on five occasions.

PROFESSIONAL AFFILIATIONS AND ACTIVITIES

20.19 The Office strives to remain at the leading edge of legislative and other professional audit practices, and to share knowledge and experiences within those communities. We do this through participation in a variety of professional organizations including the following.

The Canadian Conference of Legislative Auditors

The Canadian Institute of Chartered Accountants (CICA)

CCAF-FCVI Inc.

The Certified General Accountants Association

The Information Systems Audit and Control Association

The Institute of Chartered Accountants of Nova Scotia (ICANS)

The Institute of Internal Auditors (IIA)

The Society of Management Accountants

20.20 Professional staff at all levels participate. The Auditor General is a Governor of CCAF-FCVI Inc. and is a member of a committee of ICANS. Other staff participate as members of committees, by providing input to and commentary on research publications, and by attending various professional conferences, seminars and meetings.

PERFORMANCE 1996-97

20.21 While this Office is not specifically mentioned in *Government By Design*, the Auditor General fully supports the emphasis by government on establishing corporate objectives and budgetary targets covering several years. One of the government-wide reporting issues in recent Annual Reports pertained to planning and budgeting. We are encouraged by developments, whether or not they may be attributed to this Office.

20.22 Overall, we are pleased with our achievements to date in 1996-97 and recent years. Much remains to be done, but the following are just a few examples of our achievements.

- A complete review of our audit universe was completed. This involved assessing each auditable entity against a set of criteria in order to establish priorities and ensure our resources are being employed most effectively. Plans for the remainder of 1996-97 and beyond were adjusted based on this analysis.
- Plans were adjusted to respond to concerns regarding a crown agency, Nova Scotia Resources Limited.
- We undertook the first broad scope audit of Atlantic Lottery Corporation. The assignment was staffed jointly by this Office and the Office of the Auditor General of New Brunswick. This is a complex assignment both in terms of the nature of the business, the inter-provincial issues and the inter-office coordination required to manage the project.

- In response to a decision to establish an earlier deadline for completion of the Province's financial statements, we completed all audits of entities for which we are responsible in much tighter time frames.
- A regularly scheduled audit of expenditures of the Department of Education and Culture raised particular concerns over the management of funds intended for teachers' medical and other insurance benefits. As a result, a special report under Section 9 of the Auditor General Act was issued to the Minister of Education and Culture.
- Extensive support was provided to the Public Accounts Committee in its development of a report recommending legislative changes to establish a formalized accountability framework. That report was completed and tabled in the Legislature in December 1996.
- The Public Accounts Committee continues to meet regularly and appears to appreciate the briefings and other assistance provided by our Office.
- We continue to be the only legislative audit office that provides an opinion on the government's annual revenue estimates and such a review was once again performed. Interest in the provision of this service has been expressed by other jurisdictions.
- Communications with central agencies, departments, other government agencies, professional organizations and the public have been maintained and enhanced. Outside counsel through the Independent Advisory Committee has been of great benefit.
- Staff development continues to be a priority, particularly in the area of information technology. The Office's decision, two years ago, to return to the CA training program was rewarded as one of our students qualified this year.

PRIORITIES FOR 1997-98

20.23 Based on an analysis of the Office's audit universe which was completed in 1996-97, multi-year strategic and long-range plans are being updated. These will give due consideration to the needs of the Legislature, areas of risk, major themes and, of course, availability of resources.

20.24 With the continuing development of the government's public agenda as described in *Government By Design*, the Office will focus its activities on relating its audit objectives to the government's priorities of economic renewal, social responsibility, cost-effective and client-focussed service, and fiscal stability.

20.25 We will monitor the government's development of a new Corporate Financial Management System, providing advice as appropriate and considering the implications of this new system on our audit activities.

20.26 On the administrative side, our priorities are to continue to operate within our expenditure control plan. This entails a general down-sizing/right-sizing as retirements and other staff turnovers take place.

20.27 Within these overall strategic priorities, our specific goals are the following:

- To improve the quality of our audits by utilizing contracted specialists when it is cost effective to do so and where funds are available.
- To improve the quality of external communication.
- To continue to provide appropriate support to the Public Accounts Committee and to seek ways in which we can provide the Committee with more timely information on issues and developments.
- To complete the development of an Office effectiveness improvement plan and work towards its implementation.
- To continue to provide constructive advice and assistance to the Public Accounts Committee, the central agencies of government and various departments and agencies to strengthen and formalize accountability arrangements.
- To build on and expand the use of information technology as a means of optimizing the cost effectiveness of Office resources.

20.28 In addition to the above and the specific audit projects planned, we plan to:

- arrange to have our financial statement audit practices assessed by the Institute of Chartered Accountants of Nova Scotia's Professional Standards Review program;
 - pursue opportunities to have our broader-scoped audit practices subject to a peer review by qualified and experienced representatives from legislative functions in other jurisdictions;
 - pursue opportunities to conduct joint or concurrent audits in selected areas with the legislative audit functions in other jurisdictions; and
 - participate in a Conference of Legislative Auditors' study group on performance management and reporting by the legislative audit function.
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Exhibit 20.2**AUDITOR GENERAL OF NOVA SCOTIA
COMMITTEE OF INDEPENDENT ADVISORS****TERMS OF REFERENCE****OBJECTIVE**

The role of the committee is to advise the Auditor General on issues facing the Office and to assist in promoting effective management of public funds and improved accountability.

More specifically the Committee will consider and advise on:

- 1. Initiatives designed to strengthen the professional competence, adherence to professional standards and overall effectiveness of the Office.*
- 2. Technical and managerial issues arising from government-wide and departmental audits.*
- 3. Accountability issues with particular regard to information published by the Government on financial and program performance.*
- 4. Strategic and long-term operational objectives of the Office.*

MEMBERSHIP

- 1. The Committee consists of no fewer than six and no more than eight senior members of the business and academic community selected for their knowledge and experience in the fields of management, finance, accounting and auditing in both the public and private sectors.*
- 2. Members serve on a voluntary basis at the invitation of the Auditor General for a term of one year and are eligible for reappointment.*
- 3. The Committee is chaired by the Auditor General with secretarial support provided by his Office.*

MEETINGS

- 1. Meetings are held at least semi-annually at the call of the chair.*
- 2. An agenda and briefing material are prepared by the Auditor General and circulated in advance of the meeting. Additional briefings are provided by staff of the Office.*

APPENDICES

*Appendix I***AUDITOR GENERAL ACT****SECTION 8**

The Auditor General shall examine in such manner and to the extent he considers necessary such of the accounts of public money received or expended by or on behalf of the Province, and such of the accounts of money received or expended by the Province in trust for or on account of any government or person or for any special purposes or otherwise, including, unless the Governor in Council otherwise directs, any accounts of public or other money received or expended by any agency of government appointed to manage any department, service, property or business of the Province, and shall ascertain whether in his opinion

- (a) accounts have been faithfully and properly kept;
- (b) all public money has been fully accounted for, and the rules and procedures applied are sufficient to secure an effective check on the assessment, collection, and proper allocation of the capital and revenue receipts;
- (c) money which is authorized to be expended by the Legislature has been expended without due regard to economy or efficiency;
- (d) money has been expended for the purposes for which it was appropriated by the Legislature and the expenditures have been made as authorized; and
- (e) essential records are maintained and the rules and procedures applied are sufficient to safeguard and control public property.

SECTION 9

- (1) The Auditor General shall report annually to the House of Assembly the results of his examination and call attention to every case in which he has observed that
 - (a) any officer or employee has wilfully or negligently omitted to collect or receive any public money belonging to the Province;
 - (b) any public money was not duly accounted for and paid into the Consolidated Fund of the Province;
 - (c) any appropriation was exceeded or was applied to a purpose or in a manner not authorized by the Legislature;
 - (d) an expenditure was not authorized or was not properly vouched or certified;
 - (e) there has been a deficiency or loss through fraud, default or mistake of any person;
 - (f) a special warrant, made pursuant to the provisions of the *Provincial Finance Act*, authorized the payment of money; or

(g) money which is authorized to be expended by the Legislature has not been expended with due regard to economy and efficiency,

and to any other case that the Auditor General considers should be brought to the notice of the House of Assembly.

- (2) The report of the Auditor General shall be laid before the House of Assembly on a day following the day upon which the Public Accounts have been laid before the House of Assembly.
- (3) Whenever a case of the type described in clause (a), (b), or (e) of subsection (1) comes to the attention of the Auditor General, he shall forthwith report the circumstances of the case to the Minister.
- (4) The Auditor General shall, as soon as practical, advise the appropriate officers or employees of an agency of government of any significant matter discovered in an audit.
- (5) Notwithstanding subsection (1), the Auditor General is not required to report to the House of Assembly on any matter that the Auditor General considers immaterial or insignificant.

SECTION 15

Notwithstanding any provision of this Act, the Auditor General may, and where directed by the Governor in Council or the Management Board shall, make an examination and audit of

- (a) the accounts of an agency of government; or
- (b) the accounts in respect of financial assistance from the government or an agency of the government of a person or institution in any way receiving financial assistance from the government or an agency of government,

where

- (c) the Auditor General has been provided with the funding the Auditor General considers necessary to undertake the examination and audit; and
- (d) in the opinion of the Auditor General, the examination and audit will not unduly interfere with the other duties of the Office of the Auditor General pursuant to this Act,

and the Auditor General shall perform the examination and audit and report thereon.

SECTION 17

- (1) Where the Governor in Council pursuant to this Act or any other Act has directed that the accounts of public money received or expended by any agency of government shall be examined by a chartered accountant or accountants other than the Auditor General, the chartered accountant or accountants shall

- (a) deliver to the Auditor General immediately after the completion of the audit a copy of the report of findings and recommendations to management and a copy of the audited financial statements relating to the agency of government; and
 - (b) make available to the Auditor General, upon request, and upon reasonable notice, all working papers, schedules and other documentation relating to the audit or audits of the agency accounts.
- (2) Notwithstanding that a chartered accountant or accountants other than the Auditor General have been directed to examine the accounts of an agency of government, the Auditor General may conduct such additional examination and investigation of the records and operations of the agency of government as he deems necessary.
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*Appendix II***CROWN CORPORATIONS, BOARDS, COMMISSIONS AND FUNDS****Financial Statement Audits Performed by Auditor General*****Agricultural Organizations***

Gross Revenue Insurance Plan
Nova Scotia Crop and Livestock Insurance Commission
Nova Scotia Grain and Forage Commission
Provincial Community Pasture Board

Educational Institutions

Atlantic Provinces Special Education Authority

Hospitals

Nova Scotia Hospital

Lending Organizations and Funds

Housing Development Fund
Industrial Expansion Fund
Nova Scotia Business Development Corporation
Nova Scotia Farm Loan Board
Nova Scotia Fisheries Development Fund
Nova Scotia Housing Development Corporation

Pension Funds

Members' Retiring Allowances Act Accounts
Nova Scotia Teachers' Pension Fund
Public Service Superannuation Fund

Regulatory Bodies

Public Accountants Board of Nova Scotia

Other

Environmental Trust Fund
Insured Prescription Drug Plan Trust Fund
Nova Scotia Film Development Corporation
Nova Scotia Gaming Corporation
Nova Scotia Innovation Corporation
Nova Scotia Legal Aid Commission
Nova Scotia Primary Forest Products Marketing Board
Nova Scotia Research Foundation Corporation
Nova Scotia Talent Trust
Public Trustee
Upper Clements Family Theme Park Limited

Financial Statement Audits Performed by Private Sector Auditors

Art Gallery of Nova Scotia
Atlantic Lottery Corporation
Canada-Nova Scotia Offshore Petroleum Board
Check Inns Limited
Council of Maritime Premiers
Halifax-Dartmouth Bridge Commission
Law Reform Commission of Nova Scotia
Nova Scotia Credit Union Deposit Insurance Corporation
Nova Scotia Liquor Commission
Nova Scotia Liquor License Board
Nova Scotia Municipal Finance Corporation
Nova Scotia Police Commission
Nova Scotia Power Finance Corporation
Nova Scotia Resource Recovery Fund
Nova Scotia Resources Limited
Nova Scotia Utility and Review Board
Public Archives of Nova Scotia
Queen Elizabeth II Health Sciences Centre
Sherbrooke Restoration Commission
Sydney Steel Corporation
Sydney Tar Ponds Cleanup Incorporated
Trade Centre Limited
Waterfront Development Corporation Limited
Workers' Compensation Board of Nova Scotia

*Appendix III***PROVINCIAL FINANCE ACT****SECTION 65****Audit and accountants**

(1) The Governor in Council shall annually cause the accounts of the Province to be examined and audited by a chartered accountant or accountants, appointed annually for that purpose by the Governor in Council, and may pay the accountant or accountants such salary or remuneration as the Governor in Council determines.

Access to information

(2) Such accountant or accountants shall have access at all times to all sources of information under the control of any department, officer or person expending or collecting public money.

Report of auditors and tabling of report

(3) The accountant or accountants so appointed shall report in writing to the Minister respecting such examination and audit and the Minister shall cause such report to be presented to the House of Assembly during the session next after such examination and audit.

SECTION 65A

The Auditor General shall annually review the estimates of revenue used in the preparation of the annual Budget Address of the Minister of Finance to the House of Assembly and provide the House of Assembly with an opinion on the reasonableness of the revenue estimates.
