

17.**REVIEW OF FINANCIAL STATEMENTS AND
MANAGEMENT LETTERS****INTRODUCTION**

17.1 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.

17.2 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 chapter of our Report contains comments on audits conducted by the private sector and by this Office.

AUDITS BY THE PRIVATE SECTOR

17.3 We reviewed the financial statements audited and reports prepared by private sector auditors, being principally interested in whether:

- there was any indication of inadequate controls or accounting records in the auditor's letter to management or audit opinion;
- 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*.

17.4 The following are the observations resulting from our review.

Reservations of Opinion

17.5 A qualification of opinion was expressed in the audited financial statements of one corporation.

17.6 *Nova Scotia Resources Limited* - The auditors issued a qualification of 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 \$3.4 million, the opening deficit would have been reduced by \$6.8 million, and unamortized foreign exchange losses carried forward would be \$3.4 million.

Financial Controls and Records

17.7 As a result of the private sector audits, weaknesses in internal control were discovered in certain corporations and agencies, and were described 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 Nova Scotia Liquor Commission, Queen Elizabeth II Health Sciences Centre, Waterfront Development Corporation Limited, and the Workers' Compensation Board of Nova Scotia are appropriate to report.

- The auditors of the Nova Scotia Liquor Commission noted weaknesses in control over high turnover inventory items and weaknesses in accounts payable reconciliation procedures. Weaknesses were also noted in information system security and access, documentation and data integrity. In addition, the auditors identified the need for clarification of responsibilities in the Memorandum of Understanding between the Department of the Environment and the Commission pertaining to the Resource Recovery Fund.
- The auditors of the Queen Elizabeth II Health Sciences Centre reported weaknesses in controls over accounts receivable, research projects and leased equipment. In addition, the auditors noted weaknesses relating to computer password control, user access privileges and virus protection software. Other findings reported by the Centre's auditors are included in Chapter 15 of this Report, page 169.
- The auditors of the Waterfront Development Corporation Limited noted a lack of adequate general ledger reconciliation procedures and weaknesses in control over parking revenues.
- The auditors of the Workers' Compensation Board of Nova Scotia noted that the Province of Nova Scotia has agreed to guarantee the Board a real rate of return on the Board's invested assets. Although the guarantee is a key assumption used in the actuarial valuation of the Board's benefit liabilities, the understanding with the Province has not been formalized with a signed agreement. The auditors also reported weaknesses in control over accounts payable.

Timeliness of Financial Reporting and Release of Management Letters

17.8 Preparation, audit and release of financial statements and related management letters within six months of year-end are considered to be satisfactory. The financial statements for Nova Scotia Power Finance Corporation had not been audited and released by the time of our review assignment, approximately eight months after year-end.

17.9 As of December 1997, the audit of Sydney Steel Corporation had not been completed and financial statements had not been released for the year ended December 31, 1996. 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 the fulfilment of obligations by the Province, have not been resolved. Last year we reported that the audit of the 1995 financial statements was not completed for the same reason. As of the writing of our Annual Report, the 1995 audit has yet to be finalized.

17.10 As a consequence, the financial statements of Sydney Steel Corporation are not included in the March 31, 1997 *Public Accounts of the Province of Nova Scotia*. The 1997 *Public Accounts* includes draft unapproved financial statements for the Nova Scotia Power Finance Corporation.

Legislative Mandate

17.11 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 corporations and agencies include such a note in their financial statements.

17.12 All crown corporations and agencies included in our review complied with this recommendation.

Reporting

17.13 Previous Reports of the Auditor General have recommended that the *Public Accounts of the Province Nova Scotia* present the financial position and operating results of all entities which are owned or controlled by government.

17.14 In addition to Sydney Steel Corporation, referred to above, the March 31, 1997 *Public Accounts* do not contain the annual financial statements prepared for the following government-controlled entities:

Halifax-Dartmouth Bridge Commission
Nova Scotia Credit Union Deposit Insurance Corporation
Sydney Tar Ponds Clean-Up Inc.
Workers' Compensation Board of Nova Scotia

17.15 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

17.16 The following observations resulted from audit assignments conducted by the Office of the Auditor General of Nova Scotia.

Reservations of Opinion

17.17 This Office has responsibility for the annual financial statement audit of 26 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.

17.18 This year there was only one case where it was necessary for our Office to express a qualification of opinion.

17.19 *Nova Scotia Gaming Corporation* - As a result of our audit we qualified our opinion on the March 31, 1997 financial statements as follows:

“The Nova Scotia Gaming Corporation has prepared the financial statements as they relate 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 expense allocation approach which recognizes the payment of the shortfalls that arose in the previous year referred to in Note 3(h) to the Corporation's financial statements as an expense for the current year. In my opinion, the amounts that represent these shortfalls are expenses which should be recognized in the year incurred. If these shortfalls had been recognized as expenses in the previous year, net income of the Corporation reported for that year would have been reduced by \$2,143,409 and net income of the Corporation being reported for the current year would have been increased by \$2,143,409."

17.20 Note 3(h) to the financial statements states:

"During the previous year, the income was insufficient to allocate to the Operator the maximum allocation to which the Operator was entitled with reference to their capital investment (Note 3e). The Operator's accumulated shortfall as at March 31, 1996, which has been eliminated, totalled \$459,799 in Halifax and \$1,683,610 in Sydney. These amounts were allocated to the Operator from income during the year ended March 31, 1997 and accordingly were recorded as expenses of the Corporation in the current year."

System Weaknesses

17.21 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.

17.22 *Insured Prescription Drug Plan Trust Fund* - Maritime Medical Care Inc. administers the Pharmacare Program on behalf of the Department of Health and the Seniors' Pharmacare Board. Our financial statement audit resulted in several recommendations for improvements in the Program administrative controls at Maritime Medical Care Inc. which were reported in the management letter issued to the Seniors' Pharmacare Board at the conclusion of the audit. These recommendations included:

- more frequent reconciliations of general ledger control accounts and sub-ledgers;
- improvements in the process for monitoring overdue accounts;
- improvements in the process for verification of seniors' income when determining eligibility for the low income credit;
- improvements to controls over the cash receipts function including more timely depositing of cheques received from seniors; and
- the need for better control of password access to computerized accounting systems.

17.23 Subsequent to the audit, we were advised by Maritime Medical Care Inc. that all of the above recommendations had been implemented.

17.24 In addition, we noted that the Seniors' Pharmacare Board and the Department of Health prepared projections for the Seniors' Pharmacare Program for the 1996-97 fiscal year but did not approve a budget. We have recommended that a budget for revenues and expenditures be approved by the Board and the Department of Health prior to the start of each fiscal year. Budgeted revenues and expenditures should be disclosed in the annual audited financial statements to facilitate comparison of actual performance in relation to budget and analysis of associated variances.

17.25 *Nova Scotia Business Development Corporation* - We noted that staff of the Department of Economic Development and Tourism posted entries to revise the reserve balances of the Nova Scotia Business Development Corporation Fund and the Industrial Expansion Fund. The amount of the entries was not supported by any analysis and did not agree with the Corporation's assessments. Adjustments to the reserve balances should only be initiated by staff of the Corporation, and only after an analysis of the account portfolio has been completed and the Board of Directors is satisfied with the amount of reserve to record. We were also told that formal recommendations concerning the Industrial Expansion Fund are being made to Executive Council by Department officials without staff of the Corporation being informed on a timely basis.

17.26 *Nova Scotia Film Development Corporation* - We noted that the Corporation's listings of equity investments and development loans were incomplete and inaccurate. We recommended that procedures be established to ensure the completeness and accuracy of these records. We also recommended that long-term strategies and plans be developed for the Corporation's audit of recipients of assistance. Such strategies should include a regular review of the spending of Film Development Corporation assistance to ensure it was used for the purposes intended.

17.27 *Nova Scotia Grain and Forage Commission* - Effective August 6, 1997, the government entered into an agreement to facilitate the transfer of the Commission's operations to a private trust. We noted that the agreement did not specifically address the transfer of the cash, accounts receivable and liabilities of the Commission. We also observed that Goods and Services Tax owing from July 31, 1995 had not yet been remitted to the Federal government.

17.28 *Nova Scotia Hospital* - We noted that programming changes to the computerized inventory system were tested against a transaction file containing "live" (i.e., actual) Hospital data. We found no material errors in the financial statements due to this weakness, but it could potentially lead to material errors. We recommended that programming changes be made in a test environment, using a file set up in the system containing data for testing purposes only.

17.29 *Housing Development Fund* - Last year we reported accounting and control weaknesses within the system used to capitalize interest costs to land development projects. We also noted the need to implement a process of scheduled, periodic assessments of land holdings to ensure the accurate valuation of land development projects in the financial statements of the Fund. During our 1997 audit we noted similar weaknesses in the systems of control and repeated our recommendations to the Department of Housing and Municipal Affairs.

17.30 *Nova Scotia Innovation Corporation* - We noted that the Board of Directors approved, in general terms, the investment by the Corporation in another enterprise. However, details such as the percentage ownership, funds involved and the method of investment were not reviewed and approved by the Board. In our view, the Board should give final approval to the details of investments made by the Corporation.

Legislative and Policy Compliance Weaknesses

17.31 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, four of these situations should be brought to the attention of the House of Assembly.

17.32 *Fisheries and Aquaculture Development Fund* - The Fisheries and Coastal Resources Act (Part IV, Section 37) states "All repayments and all recoveries made in respect of any transaction out of the Fund shall be credited to the Fund." It has been the Nova Scotia Fisheries and Aquaculture Loan Board's practice to reduce the balance of the Fund when loans are written off.

However, we understand that subsequent recoveries are credited to the Province's consolidated fund, and not to the Fisheries and Aquaculture Development Fund.

17.33 *Nova Scotia Business Development Corporation* - We noted that the Property Management Committee, a committee of the Board of Directors, had approved a property transaction for which it did not have approval authority. The Board of Directors should approve transactions outside the Committee's jurisdiction or the delegated authority levels should be revised.

17.34 *Nova Scotia Hospital* - As we reported last year, Section 30 of the Hospitals Act stipulates that, 30 days after receiving a written notice of discharge, a patient is solely liable for his or her costs of maintenance as long as the individual continues to stay in a hospital. The Hospital Board of Management decided not to issue invoices or 30 day notices to these patients because the vast majority were deemed to be financially incapable of paying these costs. The practice was continued this year with the approval of the Department of Health. 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.

17.35 *Housing Development Corporation* - The Corporation guarantees loans under Section 9(d) of the Housing Development Corporation Act. However, the Corporation has not made the required reports to the Minister of Finance and received appropriate Governor in Council approval for guarantees made, as required under Section 59(4) of the Provincial Finance Act. This section of the Provincial Finance Act was enacted in 1994. Department staff were not aware of the amendment to the Act until recently. Department staff informed us that guarantees are now being submitted to the Governor in Council for approval.

Financial Statement Audit Delays

17.36 We consider readiness of the auditee to be a critical factor in the timely completion of financial statement audits. There was one delay this year resulting from a lack of readiness by the auditee.

17.37 *Housing Development Fund and Corporation* - The financial statements and related management letters of the Housing Development Fund and Housing Development Corporation for the year ended March 31, 1997 were not released until late in the fall of 1997. Delays were due primarily to problems in the implementation of changes to accounting policies for profit recognition on land sales. We recommended that sufficient, appropriate resources be devoted to the accounting function so that financial statements can be issued on a timely basis in future years.
