

REPORT OF THE

**AUDITOR
GENERAL**

1998

Honourable Ronald S. Russell
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, 1998, to be laid before the House in accordance with Section 9A(2) of the Auditor General Act.

Respectfully submitted

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

Halifax, Nova Scotia
December 10, 1998

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INTRODUCTION

1.

OVERVIEW AND SIGNIFICANT ISSUES

INTRODUCTION

1.1 This Report contains the results of the work carried out by my Office during 1998. As in previous years, my objective is to assist members of the House of Assembly in exercising their responsibility to hold the government to account for the management of public funds.

1.2 We adhere to the standards promulgated by the Canadian Institute of Chartered Accountants (CICA) in the performance of our work. Chapter 21 provides a report on the Office of the Auditor General including a more detailed description of its mandate and strategic goals and objectives.

1.3 This chapter provides a summary of the most significant findings contained in the Report. However, readers are cautioned that a full understanding of these findings can only be obtained from the detailed results provided in the individual chapters. There are other issues reported in those chapters which warrant attention.

1.4 As well, three special reports were issued during 1998, all of which resulted from requests from either the government or a third party. The first of these was an examination of the first school lease signed as part of the public-private partnership initiative for school construction and it is summarized in Chapter 7. The second was an audit of the Workers' Compensation System and that special report is reproduced in Chapter 16. The third was an audit of the Teachers' Salary Continuation Plan which was requested by the Nova Scotia School Boards Association. That report is summarized in Chapter 8.

1.5 The government continued its efforts to improve management processes and accountability reporting. This is most evident through the communication of its strategic objectives and plans in *Government By Design* and its first attempt to report on achievements through *Nova Scotia Counts*. However balancing program and fiscal objectives has been challenging for government and this Report contains numerous issues that illustrate the complexities of these challenges.

AUDIT MANDATE

1.6 In each of my previous six Annual Reports, I took exception to the provisions of the Provincial Finance Act which provided for an audit of the Province's financial statements by a chartered accountant who reported to the Minister of Finance. During the 1998 Spring session of the Legislature, Bill 8, An Act to Amend the Auditor General Act and the Provincial Finance Act, was introduced and unanimously passed. The amendments result in three major changes to the mandate of this Office and the audit regime in Nova Scotia. These are as follows:

- (I) The provision in the Provincial Finance Act for the appointment of a chartered accountant was deleted. The Auditor General Act was amended to give the Auditor General the responsibility to audit the Province's financial statements and report to the House of Assembly.
- (II) The Auditor General Act was amended to establish a deadline of December 31 for tabling of the Annual Report. This will result in more timely reporting.

- (III) The Auditor General Act was amended to permit tabling of up to two reports in addition to the Annual Report during a year. This provides me with the opportunity to report matters on a more timely basis where this would be of assistance to members of the House of Assembly.

1.7 I very much support these amendments and believe that they create an opportunity for me and my staff to better serve the members of the House of Assembly and the people of Nova Scotia. The amendments also bring us much more in line with the audit regimes in other jurisdictions.

ACCOUNTABILITY INFORMATION AND REPORTING

1.8 The government continues to make progress in improving the quality of information provided to the House of Assembly to report on its accountability. However this reporting continues to be discretionary and I repeat my previous recommendation that these reporting requirements should be enshrined in legislation.

1.9 Progress has also been made towards achieving compliance with the recommendations of the Canadian Institute of Chartered Accountants' Public Sector Accounting and Auditing Board and the Province's financial statements are clearer and more understandable than previously. However, issues remain to be addressed. These are acknowledged by the government and on June 4, 1998 the Minister of Finance tabled a plan to address them. I strongly support this initiative and will be monitoring progress, particularly in relation to my new mandate to report to the House of Assembly on these financial statements.

YEAR 2000 READY OR NOT, HERE IT COMES!

1.10 Ready or not, here it comes! Nothing could be truer. As I write this there are fewer than 400 days till January 1, 2000. While I acknowledge that progress has been made over the past year much remains to be done and the risks increase as the window of opportunity diminishes.

1.11 Last year I strongly urged government to focus on plans and priorities for the remainder of its remediation efforts and to put in place a reporting framework so that members of the House of Assembly are fully informed of progress and remaining issues. Such a report was tabled in November 1998 along with a commitment to continue to report monthly.

PUBLIC-PRIVATE PARTNERSHIPS FOR SCHOOL CONSTRUCTION

1.12 The government has embarked on a major program of school construction with the stated objective of building schools without adding to the debt of the Province. Thus operating leases must be negotiated for the schools. As of November 1998 two leases had been signed, one of which I have audited. In addition, development agreements have been negotiated for four of the original eight schools and 26 of the 31 schools announced in December 1997. Four schools have been opened and two are under construction.

1.13 In December 1997 the government indicated that construction of a particular school would not commence until a lease was signed. It should be evident that the government assumes additional risks if this policy is not adhered to. In 1998 construction was started on two schools for which leases were not yet signed. However, development agreements had been approved by Executive Council and signed prior to construction with leases to follow at date of completion. I am unclear as to whether development agreements meet the requirements of government's policy.

1.14 Audit efforts to date indicate that the government should strive to achieve greater risk transfer to its private sector partners and it is clear that such arrangements must be negotiated in advance of commencement of construction. As the process has evolved government has made positive changes but additional improvements including monitoring and evaluating both the process and the results are needed.

CORPORATE FINANCIAL MANAGEMENT SYSTEM (CFMS)

1.15 In my 1997 report I raised concerns regarding the control environment of this newly installed system. The Department of Finance had similar concerns and therefore this Office and Finance jointly commissioned a review of the business control environment by a national public accounting and consulting firm. This review confirmed that concerns existed and the Department of Finance assigned staff to implement the recommendations resulting from it.

REGIONAL HEALTH BOARDS AND NON-DESIGNATED ORGANIZATIONS - COMMENTS ON FINANCIAL SITUATION

1.16 As at March 31, 1998 Regional Health Boards and Non-designated Organizations had accumulated deficits of \$121.8 million. These had been financed by borrowings from financial institutions and advances from the Department of Health. Auditors of these entities have expressed concern about the impact of these deficits on the ability of these entities to sustain health programs in the future.

1.17 As at March 31, 1998 the Department of Health had established a provision of approximately \$50 million for doubtful recoveries related to accounts receivable from Regional Health Boards and Non-designated Organizations, but the amounts were not formally communicated to these organizations. If the provision was formally allocated and the related receivables were written off, there would be no impact on the expenses of the Department of Health to the extent that a provision exists.

1.18 The government has taken some action to address the situation including establishing a Task Force on Regionalized Health Care and the Department of Health is engaged in a Business Plan Review process. These initiatives must be taken seriously and carried to a conclusion that identifies solutions to these serious financial problems.

QUEEN ELIZABETH II HEALTH SCIENCES CENTRE - COMMENTS ON FINANCIAL SITUATION

1.19 In my 1997 Report, I reported concerns with the QEII's financial situation and recommended that the Department of Health and the government carefully monitor the situation. The Centre now projects that it will have total debt of \$141.5 million at March 31, 1999. The Centre has a strategic plan, and a business plan dated November 6, 1998 which has been approved by the Board but it is unclear whether the Department of Health and the government have accepted this plan.

1.20 The Board of the Centre and its management have significant challenges ahead of them in dealing with this serious financial situation while continuing to maintain or improve the level of health care. I repeat my previous recommendation that the Department of Health and the government carefully monitor this situation.

WORKERS' COMPENSATION SYSTEM OF NOVA SCOTIA

1.21 At the request of the Executive Council of the Government of Nova Scotia, I undertook an audit of the Workers' Compensation System. Grant Thornton, under the direction of a Steering Committee which I established, performed this audit.

1.22 We are pleased to report that, in general, the Workers' Compensation System has made and continues to make significant improvements in its intake processing, case appeal and closure mechanisms. Our Report cited a number of specific systemic deficiencies which in many cases are currently being addressed by the respective components of the System. We note especially the need to continue to develop performance standards and to measure actual results against the standards. A further concern is that the current use of technology lags behind that found in other systems across the country.

1.23 Generally, with the exception of the appeals process, most critical elements of the system are functioning satisfactorily. However, improvement is required in certain key areas. Accountability and efficiency within the system can be significantly improved once the implementation of a system of performance measures and results comparison is in place. A concerted, special effort must be made to clear up the large appeals backlog at Workers Compensation Appeals Tribunal. Better use of technology, and most importantly a better working relationship among the components of the system will lead to further enhancements in service levels for the Workers' Compensation System in Nova Scotia.

CONCLUDING REMARKS

1.24 During 1998, the government continued its efforts to improve management processes. In particular, public reporting continued to develop through *Government By Design* and the first release of a performance report entitled *Nova Scotia Counts*. These initiatives are being recognized and acknowledged as ground-breaking efforts by other jurisdictions.

1.25 The government's efforts to address significant program priorities, particularly in health care and education, while maintaining a balanced budget have created strains on the system and continued to demonstrate the need for careful planning and risk assessment. The detailed comments contained in this Report illustrate these issues. We will continue to monitor these areas carefully.

1.26 With the amendments to the Auditor General Act which were promulgated in June 1998 as well as the requirement to respond to the requests for three special audits, the Office was strained to meet the new reporting deadline as well as gear up for new responsibilities. I want to thank all my staff for their efforts and commitment. New challenges will continue to face us but I am confident in our ability to respond.

GOVERNMENT-WIDE ISSUES

2.

ACCOUNTABILITY INFORMATION AND REPORTING

BACKGROUND

2.1 The need for quality accountability information and reporting, including the definition of basic accountability requirements in legislation, has been a topic of consideration in a number of jurisdictions. 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.

2.2 Exhibit 2.1 on page 26 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.

2.3 Exhibit 2.2 on page 26 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 that accountability to the public is relevant at all levels.

2.4 The purpose of this chapter is to provide updated summary comments on the quality of accountability information and reporting to the Members of the Legislative Assembly (MLAs), including the Province's financial statements. Adequate information and reporting on government's plans and performance (i.e., results or outcomes) are required, so that MLAs can hold government to account.

RESULTS IN BRIEF

2.5 The following are our principal observations this year.

- Progress towards improving the quality of accountability information and reporting by government continued, including the initial release of a summary performance report (i.e., *Nova Scotia Counts*) against *Government By Design*. The provision of such information and reporting to the House of Assembly on a timely basis is to a large part discretionary (i.e., not required by statute). We have suggested that government's plans and commitments for the continued evolution of the Planning and Accountability Framework be formalized and communicated to the House.

- The Auditor General's report on the 1998-99 revenue estimates, required under Section 65A of the Provincial Finance Act, was tabled in the House on June 4, 1998. In addition, summary comments and suggestions, as a result of our review procedures, were communicated to the Department of Finance May 30, 1998.
- The Auditors' Report, of the firm appointed under Section 65 of the Provincial Finance Act, on the Province's March 31, 1998 financial statements was released publicly July 31, 1998. In addition, the firm provided a letter to Finance as a result of the audit work summarizing certain observations and suggestions. That letter is reproduced in Appendix 2A to this chapter (page 33), and selected extracts are referred to in various chapters in this Report.
- Improvements made to the Province's financial statements in recent years have resulted in the Province's financial position and annual results being accounted for and reported more completely and understandably than in the past. Certain issues or concerns remain to be resolved, including the preparation of full consolidated financial statements. In June 1998, the government released a multi-year plan for further improvements to the accounting policies and presentation of the Province's financial statements.
- At the time this chapter was written, a resolution, under Section 13 of the Expenditure Control Act, for additional spending authority required for 1997-98 had been tabled in the House of Assembly, but was yet to be approved. In addition, the Executive Council approval, required under Section 23 of the Provincial Finance Act, of write-offs included in the financial statements as at March 31, 1998 was also outstanding. In our view, such approvals should be in place on a timely basis and preferably prior to the release of the financial statements.
- Accountability reporting on the procurement process within and across government should be improved. Efforts to provide for procurement-related reporting by government bodies using government's Corporate Financial Management System were near completion, but there were no corresponding efforts to ensure exception reporting by other Provincial public sector entities. The Procurement Branch of the Department of Finance is supposed to report policy exceptions to the Priorities and Planning Committee but there is no requirement for the Priorities and Planning Committee to report to the House of Assembly. Accountability would be enhanced if a report on procurement policy exceptions was provided to the House of Assembly, and if such reporting was available on a timely basis.

SCOPE OF REVIEW

2.6 This assignment represents a continuous ongoing identification, review and consideration of various matters or issues relating to the status of action taken or planned by government to improve the quality of accountability information and reporting to the House of Assembly.

2.7 In addition to considering the status of accountability-related initiatives undertaken by government, we have reviewed and provided commentary on selected matters, including the Province's non-consolidated financial statements published in the *Public Accounts* for the fiscal year ended March 31, 1998.

PRINCIPAL FINDINGS

2.8 Our principal findings and summary comments on general or specific matters relating to the quality of accountability information and reporting are presented under the following headings:

- Planning and Accountability Framework
- Review of Revenue Estimates
- Audit of Province’s Financial Statements
- Commentary on Province’s Financial Statements
- Spending Authorities and Reporting
- Procurement Policies and Reporting
- Supplement to the Public Accounts

Planning and Accountability Framework

2.9 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 been defined and is being implemented in Nova Scotia. The *Planning and Accountability Framework* is a government-wide initiative being coordinated through the Priorities and Planning Secretariat. During the past year, efforts continued to implement various aspects of the framework and to make necessary improvements. The information and reporting documents prepared as a result of the framework provide an increased focus on defined outcomes at both the overall government and departmental levels. The effective implementation and continued evolution of such information and reporting mechanisms represent a significant challenge, requiring a sustained commitment by government.

2.10 The *Planning and Accountability Framework* is intended to support the provision of improved information and reporting on the plans and performance of government, including at the department or agency level. In this regard, we note that there is currently no statutory provision requiring such information on and reporting by government overall or by departments to be made available to MLAs on a predetermined and timely basis, or at all. For example, the information in the primary summary publications, *Government By Design* (i.e., the plans) and *Nova Scotia Counts* (i.e., the results, first released in fall 1998), is not required by statute, and is therefore being provided to the members of the House of Assembly at the discretion of the government.

2.11 We understand that departments are expected to provide full versions of their business plans (including outcome measure tables) on their Internet web pages. Further, in addition to the *Government By Design* and *Nova Scotia Counts* publications, there are various other reports and publications currently available to the MLAs which can either directly or indirectly be utilized for accountability purposes. As noted in previous Reports, some of these are not required by legislation, and as such are also only available at the government’s discretion. We do acknowledge that the business plans of crown corporations are required to be tabled in the House under the provision of the Provincial Finance Act.

2.12 While as in previous years’ Reports, we acknowledge government’s initiatives under the *Planning and Accountability Framework*, we suggest that government’s plans and priorities for further implementation of this framework be formally documented and reported to the House.

Review of Revenue Estimates

2.13 Section 65A of the Provincial Finance Act provided the Auditor General with the following mandate ⁽¹⁾ with regard to the government's annual revenue estimates.

"The Auditor General shall annually review the estimate 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."

2.14 We first exercised this mandate, which is unique within the Canadian legislative audit community, in 1994. The unqualified report on the 1998-99 revenue estimates (see Exhibit 2.3 on page 27), was tabled along with the supporting information for the June 4, 1998 *Budget Address*. Our coverage and report on the 1998-99 revenue estimates did not extend to the government's revenue projections for subsequent fiscal periods, nor did it include consideration of the expenditure estimates.

2.15 At the conclusion of our review of the 1998-99 revenue estimates, in addition to providing a copy of the Auditor General's report on revenue estimates for budget printing purposes, we also forwarded a letter to the Minister of Finance. That letter dated May 30, 1998 provided the following summary comments on matters regarding the 1998-99 revenue estimates.

As per earlier correspondence to your predecessor, my report relates only to the 1998-99 revenue estimates, as prepared by the Department of Finance, of \$4,382,718,000 for total ordinary revenue. More specifically, my report does not relate to the expenditure estimates nor the 1997-98 forecast information to be included in your Budget Address. Further, as in prior years, recoveries, user fees or other income netted against expenditures for appropriation purposes, and sinking fund earnings which are reported separately on the Province's Statement of Revenue and Expenditures are not covered during our review or by my report.

I would like to draw your attention to the following considerations with respect to the 1998-99 revenue estimates:

- *In recent years the Province has received significant prior year adjustments through the various federal-provincial fiscal arrangements. It is our understanding that Finance management staff used the most recent formal information from the Federal government - adjusted in certain instances for more current local conditions or considerations - in order to arrive at the estimates for 1998-99. However, it must still be acknowledged that such adjustments will occur during 1998-99 for prior years and, with respect to the current year, in future years, and that they could be significant.*
- *The Gaming Corporation Profits for 1998-99 in your revenue estimates includes an amount (approximately \$4 million) which is conditional upon changes to Atlantic Lottery Corporation's profit distribution methodology being approved by all of its shareholders. We note that such changes are dependent on discussions with and decisions by parties external to the Nova Scotia Gaming Corporation, the Department of Finance, and the government of Nova Scotia.*
- *In light of the potential for significant differences between estimate and actual - both in total and for individual revenue line items - consideration could be given to incorporating some basic information with respect to the sensitivity of the key*

⁽¹⁾As a result of statutory amendments passed in June 1998, this mandate is now part of the Auditor General Act.

revenue items, especially those that have been and are subject to some variability from estimate due to external factors and changes to key indicators. Such information has been incorporated into the government's Debt Management Plan included in Government By Design.

Further, during the course of our review of the 1998-99 revenue estimates we noted that the 1997-98 revenue forecasts for personal and corporate income taxes reflect additional cash transfers received by the Province prior to March 31, 1998 as a result of changes to the instalment schedules implemented by the Federal government. Based upon the information available to us, due to the manner in which the Province accounts for income taxes, the 1997-98 revenue forecast is approximately \$40 million higher than it would have been if such a change had not been implemented. We suggest that the accounting for income tax revenues be reviewed.

Audit of Province's Financial Statements

2.16 Section 65 of the Provincial Finance Act created an audit reporting relationship which was unique in Canada.⁽²⁾ Nova Scotia was the only province in Canada where the legislative auditor did not audit and provide an opinion on the jurisdiction's financial statements. These financial statements were audited by a public accounting firm and the auditors' report (opinion) addressed to the Minister of Finance. The audit opinion in other jurisdictions is addressed to the House of Assembly or its equivalent.

2.17 Deloitte & Touche, the auditors appointed under Section 65 of the Provincial Finance Act, provided an unqualified Auditors' Report dated July 21, 1998 to the Minister of Finance. That report (see Exhibit 2.4 on page 28) was released publicly on July 31, 1998 along with the traditional non-consolidated financial statements in the *Financial Report 1997-98 - Hitting the Targets*, and will be published in the *Public Accounts*, Volume I due to be released prior to December 31, 1998.

2.18 In addition to the Auditors' Report, Deloitte & Touche issued a letter, dated August 28, 1998, in late October 1998 to the Deputy Minister of Finance. That letter (see Appendix 2A on page 33) provided summary comments on their observations under the following headings:

1. Department of Health
 - a) Receivables
 - b) Pharmacare
 - c) Ambulance Services
2. Department of Education
 - a) Loans
 - b) Public-Private Partnerships
3. Year 2000
4. Quality of Accounting Functions
 - a) General Bookkeeping
 - b) Interim Financial Statements
 - c) Cash Collection and Receivables
5. Internal Audit
6. Legislation Regarding Annual Surpluses
7. Derivative Financial Instruments
8. Public Sector Audit and Accounting Guidelines

2.19 Certain of the comments included in that letter have been considered and incorporated into this and other chapters of this Report.

⁽²⁾As a result of amendments to the Provincial Finance Act and the Auditor General Act passed in June 1998, beginning with the year ended March 31, 1999 the Auditor General will audit and report to the House of Assembly on the *Public Accounts*, including the Province's annual financial statements.

Commentary on Province's Annual Financial Statements

2.20 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. While we have previously identified concerns relating to the completeness and adequacy of the Province's financial statements, improvements made to the statements, in recent years, have resulted in the Province's financial position and results being accounted for and reported more completely and understandably.

2.21 The Members of the Legislative Assembly (and the public) require financial information 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 Public Accounts Committee (PAC) in its sub-committee report which was tabled in the House of Assembly in December 1996. Among other things, that report provided recommendations dealing with improvements to the Province's financial statements, including consolidation and timely release.

2.22 In our view, the release of the annual financial statements in late July or early August in recent years, along with the current statutory requirements for quarterly financial reporting and for the *Public Accounts* to be released by the end of December, address the issue of timeliness. However, certain issues and concerns, including the preparation of full consolidated statements, remain to provide for the completeness and adequacy of the government's financial reporting in relation to professional standards and practices being used by other provincial jurisdictions (i.e. see Exhibit 2.5 on page 29).

2.23 Finance has indicated its intention to make necessary changes and improvements to the Province's financial statements. This commitment to improve the Province's financial statements is evident, not only by recent initiatives and changes, but also in the Department's section of the 1998-99 *Government By Design* where under the heading "*Achieving Financial Accountability*" the following priorities were noted for 1998-99.

"Implement the first stages of a multi-year plan to improve the presentation of the province's financial statements and bring the province into a position of leadership in complying with generally accepted accounting principles.

Improve the understandability of financial reports, in particular the public accounts, by substantially changing the presentation, content, and organization."

2.24 On June 4, 1998, the Minister of Finance tabled the document *Financial Accountability: A Blueprint for Success* which outlined in some detail government's plans and a tentative timeframe for implementing improvements to the Province's financial statements and related reporting. We acknowledge and support these plans to move the Province's financial statement accounting policies and disclosure more in line with established professional standards and accepted practices.

2.25 In this regard, the following is extracted from Deloitte & Touche's management letter to Finance with respect to the audit of the Province's March 31, 1998 financial statements:

8. Public Sector Audit and Accounting Guidelines

We have encouraged the Province, in past reports, to adopt accounting policies consistent with PSAAB recommendations as it is fast becoming the generally accepted method of accounting for Provincial Governments. The Province continues to make progress in this area, particularly this year when the Department of Finance released a document called

the Financial Accountability - A Blueprint for Success. This document essentially creates a timeline for planned compliance with PSAAB recommendations and would put the Province at the forefront of government reporting in Canada.

We applaud this initiative and encourage the Department of Finance to closely monitor this project to ensure the timelines laid out in the document are met."

2.26 Finance indicates that it has started research on a number of the items noted in the *Blueprint*, but does not expect to implement significant changes to the reporting on the Province's financial position and results at March 31, 1999. The main topic area targeted for implementation on a reporting basis by March 31, 1999 was tangible capital assets. Although government may be in a position to report on the tangible capital assets held as at March 31, 1999, it was indicated this information would not likely be used to adjust the results and financial position reported for the Province, but it may be reported as supplementary information.

2.27 *Basis of accounting* - The Province's financial statements for the fiscal periods 1997-98 and 1996-97 are not presented on the same basis of accounting. The disclosed basis of accounting used for the March 31, 1997 financial statements was not fully appropriate in relation to generally accepted accounting principles, due to certain capital commitments being accrued as expenditures for the fiscal years ending March 31, 1996 and March 31, 1997. Finance changed this accounting practice for the fiscal year ended March 31, 1998. However, this change in policy should have been, but was not, made retroactively. If it had been accounted for properly, the comparative information for the 1996-97 period, as well as the results reported for 1997-98, would have been different.

2.28 Beginning with the fiscal year ended March 31, 1996 government implemented an inappropriate accounting policy which resulted in the recording of certain capital commitments as expenditures prior to being incurred. Capital commitments are not reported as expenditures as at March 31, 1998, but this change in accounting policy was not implemented retroactively as appropriate in the circumstances.

2.29 We are unaware of government's justification for not retroactively recording this change in the basis of accounting. However, we do note that for purposes of recording another unrelated change, as described in note 2 to the March 31, 1998 statements, Finance has, appropriately, made retroactive adjustments to the Net Direct Debt reported as at March 31, 1996. Why this change was made retroactively, while the change in the basis of accounting was not, could be interpreted as selective application of accounting principles.

2.30 *Reporting of annual results* - As suggested in previous reports, in the absence of retroactive changes to accounting policies, the only change to the Province's Net Direct Debt should be the annual surplus or deficit reported. However, we acknowledge that to fully implement this recommendation further adjustments to how the government accounts for its pension costs and for pension valuation adjustments may be necessary.

2.31 As has been the practice in the past, in the Province's March 31, 1998 financial statements, the government has accounted for the net change in deficiencies of certain crown agencies through charges recorded directly on the *Statement of Net Direct Debt*, as opposed to through the *Statement of Revenue and Expenditures*. Further, additional spending authority for these items is not obtained through the Provincial Finance Act or the Expenditure Control Act. In our view, to the extent such items represent provisions for guarantees likely to be honoured, they should be accounted for as expenditures in the calculation of the annual surplus or deficit report in the traditional non-consolidated financial statements.

2.32 *Funding for pension plans* - Under the heading “Pension and Retirement Obligations” in note 1 (i.e., Financial Reporting and Accounting Policies) to the Province’s March 31, 1998 financial statements, the following information is provided:

“Pension plans established under the Public Service Superannuation Act and the Teachers Pension Act are normally subject to formal triennial actuarial valuations. The last formal actuarial valuation for the Public Service Superannuation Pension Plan was March 31, 1995, and the Teachers’ Pension Plan was July 31, 1994. The pension liability for these plans is calculated on an actuarial basis using the Province’s best estimates to update the most recent formal valuations. The pension expense comprises the Province’s share of estimated current service contributions. Adjustments to net unfunded liabilities between reporting dates are charged or credited to Net Direct Debt.”

2.33 Note 4, titled “Pension and Other Obligations”, provides information on the accounting as at March 31, 1998 for the Public Service Superannuation Fund (PSSF) and the Nova Scotia Teachers’ Pension Fund (NSTPF). In this regard, we provide the following summary comments.

- The NSTPF was due for a formal triennial actuarial valuation as at July 31, 1997, and it was not completed prior to or available for purposes of the Province’s March 31, 1998 financial statements. The Province’s statements were prepared using *best estimates* to update the most recent formal valuation of the NSTPF which had been completed as at July 31, 1994. Further, the lack of a current formal valuation has significantly delayed the finalization of that Fund’s financial statements as at March 31, 1998.
- The PSSF was to be due for a formal triennial actuarial valuation as at March 31, 1998. The Province’s financial statements, finalized and released on July 31, 1998, appear to have been based upon updates to the March 31, 1995 valuation. The finalization of the PSSF’s March 31, 1998 financial statements was to be delayed pending the completion of the expected formal triennial actuarial valuation report. However, in October 1998, Finance pension management staff provided us a copy of a full actuarial valuation of the PSSF completed as at December 31, 1996, and reported upon July 31, 1997. Since this valuation was completed within the last three years, an extrapolation to March 31, 1998 would be acceptable for financial statement purposes. The earlier valuation report was not provided to us as auditors for the PSSF on a timely basis. It also appears that Deloitte & Touche and Finance’s accounting staff did not have access to it, since the Province’s March 31, 1998 statements refer to the March 31, 1995 valuation.
- Based upon the information in Note 4 to the Province’s statement, the PSSF valuation adjustment recognized in the *Statement of Net Direct Debt* was determined after taking into account the effect of certain changes and adjustments which required statutory amendments. While these adjustments were not fully consistent with the policy outlined in Note 1 to the Province’s statement, and government could have waited until the necessary statutory amendments were in place before accounting for such items, it is Finance’s opinion that the accounting approach taken was conservative and appropriate under the circumstances.

2.34 In November 1998, an actuarial report on the PSSF as at October 31, 1998 was completed. That report indicated that after taking into account the planned changes and adjustments, the PSSF had a surplus of \$38.6 million, with a funding ratio of 101.6%.

2.35 A copy of the *Actuarial Cost Certificate* from the report of the Fund’s actuaries (i.e., Morneau Sobeco) is included in Exhibit 2.6 on page 30 of this chapter. It indicates that total

current service cost exceeds contributions by \$3.73 million. In this regard, we acknowledge that the *Blueprint* tabled in the House in June 1998 identified the need to review how government's pension costs and obligations are accounted for and reported in the Province's statements.

2.36 *Contingencies and commitments* - Among other contingencies and commitments summarized in Note 8 to the Province's March 31, 1998 statements are the following specific items.

Environment Sites

Various province owned sites located throughout the province are considered environmental or contaminated sites. Studies are ongoing to assess the nature and extent of the damage and to develop a remediation plan. The Province's liability in remediating these sites is not determinable as at March 31, 1998 and no provision for these costs has been recorded in these financial statements.

Long-Term Disability Plan

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, 1998 of approximately \$44.8 million. [As per a December 1, 1992 actuarial valuation.]

As agreed to through a contractual arrangement between the Nova Scotia Government Employees Union and the Province, the Province is not required to fund this shortfall, therefore, no liability has been recorded in these financial statements.

2.37 When the costs of remediation for the various environmental sites are determinable, it will be necessary to account for the associated costs and liabilities in the Province's statements.

2.38 In the past, we have taken exception to the government's accounting position for the Long-Term Disability Plan. Further, we note that the March 31, 1997 annual report of the Plan indicates that actuarial liability has increased significantly since December 1, 1992.

2.39 *Emerging financial accounting and reporting issues* - Standards and practices for accounting and financial reporting are not static. They have and will continue to change, and this will impact upon what constitutes appropriate financial accounting and reporting for provincial governments.

2.40 There are usually various topics or issues being reviewed and studied by accounting standard setting bodies. At this time, there are issues being considered (or reconsidered) by the Public Sector Accounting and Auditing Board of the Canadian Institute of Chartered Accountants which may have an impact on financial accounting and reporting by the Province including government partnership arrangements; employee future benefits; consolidation; and leases.

2.41 In the *Blueprint*, Finance recognized the need to consider emerging issues, and it has a strategy in place to deal with such topics. Further, staff from Finance and this Office monitor, and in certain instances make individual contributions to, these standard setting activities.

Spending Authorities and Reporting

2.42 *Additional appropriations* - At the time this chapter was written, a resolution under Section 13 of the Expenditure Control Act, for additional spending authority required for 1997-98 had been tabled (i.e., on November 26, 1998) in the House of Assembly, but was yet to be approved. As a result, there continued to be expenditures reported in the Province's financial statements exceeding the authorized spending limits then in place for 1997-98.

2.43 The following is extracted from the notes to the Province's financial statements for the year ended March 31, 1998. Those statements were released publicly July 31, 1998.

10. Expenditures in Excess of Estimates

Pursuant to Section 13 of the Expenditure Control Act, a resolution to authorize program expenditures to the extent of \$184.0 million for the fiscal year 1997-98 is required and planned to be obtained in the fall (1998) sitting of the Legislative Assembly. The majority of this expenditure was by the Department of Health (\$140.6 million).

2.44 The Auditor General Act requires that the Auditor General identify any instances where appropriations are exceeded. Chapter 18 of this Report presents our reporting in this regard for the fiscal year ended March 31, 1998.

2.45 Our overall concern this year, as in past years, is that the timing of approval (by the Executive Council under Section 28 of the Provincial Finance Act or by the House of Assembly of a resolution under Section 13 of the Expenditure Control Act) is such that effective control of spending authorities is not being achieved to the extent appropriate or intended by the statutory provisions.

2.46 In November 1998, the resolution required under Section 13 of the Expenditure Control Act was submitted to the House of Assembly in order to obtain additional spending authority for expenditures incurred in 1997-98. As a result, the Members of the House of Assembly were asked to deal with spending authority well after the related expenditures were incurred. This appears to be contrary to Section 13 of the Expenditure Control Act which reads "*expenditures in excess of the amount authorized ...may only be made **after** [emphasis added] a resolution has been passed by the House of Assembly authorizing the expenditure.*" In our view, the timing of such approvals does not allow for effective control of spending authority by the House.

2.47 *Approval of write-offs* - At the time this chapter was written, the Executive Council approval required under Section 23 of the Provincial Finance Act had not been obtained for the write-offs accounted for in the March 31, 1998 financial statements of the Province and various funds. In our view, such approvals should be more timely.

Procurement Policies and Reporting

2.48 Prior years' reports included a separate chapter on procurement. Our procurement-related work for the current year was aimed at providing summary comments on the status of government issued policies and procedures. Specific comments on any procurement-related coverage are included in other chapters of this Report. For example, the results of procurement-related audit coverage at the Nova Scotia Alcohol and Gaming Authority are discussed in Chapter 14 on page 166.

2.49 It is our understanding that, while planned statutory provisions relating to authority of the government's procurement policy are not yet in place, all Provincial bodies are expected to adhere to the procurement policies established by the Province. Further, all exceptions from the procurement policy are to be reported to the Procurement Branch of the Department of Finance, which subsequently must report to the Priorities and Planning Committee.

2.50 To assist in the attainment of the policy objective on procurement (see Exhibit 2.7 on page 31), the Procurement Branch has undertaken several initiatives. During the year, two new policies and procedures were developed by the Procurement Branch to assist in the procurement process. There were also four policies finalized and made available during the year. Exhibit 2.8 on page 32 provides a summary listing of the current publications of the Procurement Branch as well as the status of the publications for the government and Provincially-funded entities such as academic

institutions, school boards, hospitals and crown corporations commonly referred to as the ASH sector.

2.51 *The Province of Nova Scotia, Policy on Government Procurement, Section 12, Information and Reporting*, issued January 1, 1996 states “where a procurement is to be undertaken that is an unsolicited proposal, is sole sourced, or is to be for a price other than the lowest tender, the Deputy Minister in the client department or equivalent officer must submit it to the Priorities and Planning Committee for approval.” Section 12 further requires if the Priorities and Planning Committee grants approval, the Minister and Deputy Minister of the Department of Finance must be formally notified.

2.52 To ensure Section 12 is complied with, Finance’s Procurement Branch undertakes bi-weekly audits of transactions processed through the government’s internal corporate financial management system (CFMS) which was implemented April 1, 1997 (see Chapter 9 in this Report). Irregularities noted are provided to departments for explanation and action. The Procurement Branch is not currently reporting exceptions to the Priorities and Planning Committee pending the CFMS programming required to extract the necessary information and to ensure the information is complete. Upon completion of the programming, the Procurement Branch is expecting to generate an initial procurement exception report covering the first two quarters of the current fiscal year (i.e. 1998-99) only. This report is expected to be available to the Priorities and Planning Committee by early 1999, with subsequent reporting on a quarterly basis. Currently, the Priorities and Planning Committee is dealing with procurement policy exceptions when the committee is notified by departments/agencies.

2.53 ASH sector entities which maintain financial systems separate from CFMS are not directly monitored by the Procurement Branch. The responsibility to enforce the government procurement policy lies with the Minister responsible for each such entity (oversight department), as outlined in the *Government Procurement Process, ASH Sector, Department of Finance, Procurement Branch, January 1997* publication. ASH sector entities are required to “provide Procurement with a quarterly report listing all contracts valued in excess of the Atlantic [Procurement] Agreement thresholds that were not conducted through the public tendering process.” The publication further requires the Procurement Branch to “provide Priorities and Planning Committee and the Atlantic Procurement Coordinating Committee with quarterly reports outlining all reportable exceptions to the Atlantic Agreement.” Although specific exception reporting is not required by the oversight department there is a requirement to report exceptions to the Procurement Branch. The Procurement Branch is not receiving these reports and there are no controls in place to ensure these reports are received. Currently, the Procurement Branch has no planned initiatives to directly monitor the ASH sector.

2.54 In this regard, Finance has indicated that when the Procurement Policy was created, reporting by the ASH sector was deemed to be a low priority item. Rather than rely on reports to assess ASH compliance, the view was that private sector complaints and reviews by oversight departments would be sufficient to ensure compliance. Therefore, the reporting provisions established were principally intended to satisfy expectations associated with the Atlantic Procurement Agreement. Further, it was indicated that since reporting by the ASH sector has not been emphasized by the Atlantic Procurement Coordinating Committee and will not be required under the terms of the Agreement on Internal Trade, it is Procurement’s intention to eliminate reporting requirements for ASH sector entities when the Procurement Policy is next revised.

2.55 At present, the Procurement Branch is expected to report policy exceptions to the Priorities and Planning Committee but there is no requirement for the Priorities and Planning Committee to report to the House of Assembly. Accountability would be enhanced if a report on procurement policy exceptions was provided to the Members of the House of Assembly, and if such reporting was available on a timely basis.

Supplement to the Public Accounts

2.56 *The Supplement to the Public Accounts* (Supplement) includes detailed information on staff salaries and other payments made for government departments and certain agencies which use the government's corporate financial management system (CFMS). We are not aware of any statutory provision or current policy directive requiring this level of detail to be published. Further, we note that the *Supplement* only covers departments of government (i.e., similar information is not published for all crown corporations, agencies or other Provincial public sector entities).

2.57 The reporting thresholds (i.e., the amounts above which detailed information is provided) for the *Supplement* were as follows:

Salaries	\$	25,000
Travel	\$	3,500
All other payments	\$	5,000

2.58 These reporting thresholds have not been updated or amended in a number of years, and as a result the *Supplement* continues to grow.

2.59 We suggest that after consideration of the information and accountability needs of MLAs and other interested parties, government establish compensation and other disclosure standards applicable to all departments, crown corporations, agencies and other Provincial public sector entities. For example, implementation of disclosure standards similar to those established by security or other financial regulatory bodies for executive and management compensation would provide meaningful information to MLAs and other interested parties.

2.60 It was indicated that in addition to continued availability on the government's Internet website (<http://www.gov.ns.ca>) Finance is considering improvements to the content and presentation of the *Public Accounts*, including the *Supplement*. Finance's goal is the provision of useful information, using what other jurisdictions provide as a reference point.

CONCLUDING REMARKS

2.61 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 or agencies, both from a financial and a program delivery or service perspective. The goal is better information and reports, not just more.

2.62 There have been a number of significant initiatives undertaken to improve the quality and timeliness of information and reports available on the 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.

Exhibit 2.1

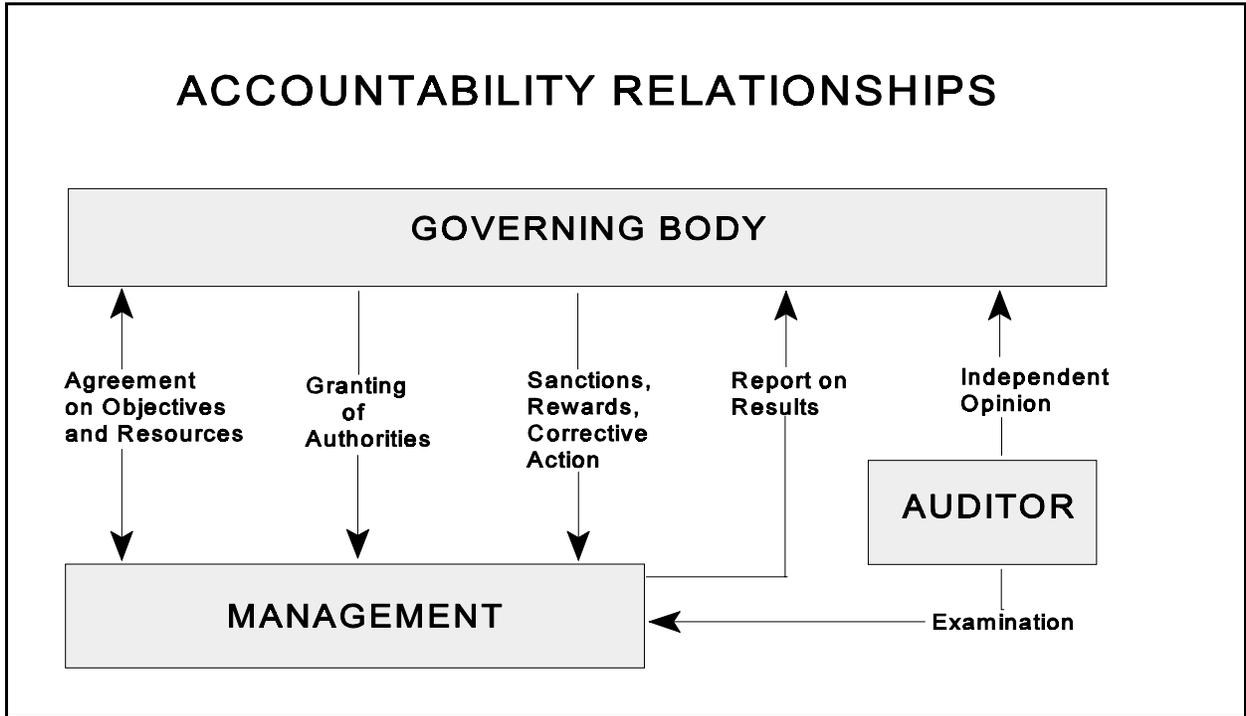
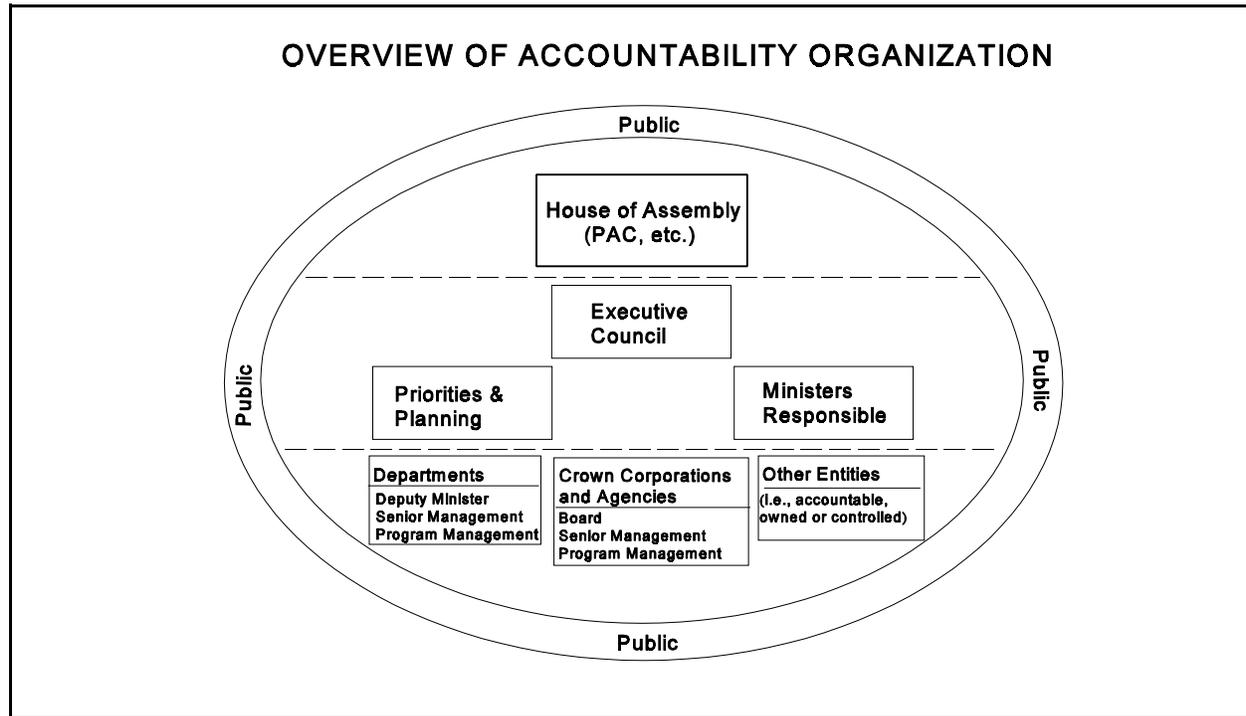


Exhibit 2.2



*Exhibit 2.3***REPORT OF THE AUDITOR GENERAL TO THE HOUSE OF ASSEMBLY ON THE ESTIMATES OF REVENUE FOR THE FISCAL YEAR 1998-99 USED IN THE PREPARATION OF THE BUDGET ADDRESS**

I am required by Section 65A of the Provincial Finance Act to provide an opinion on the reasonableness of the estimates of revenue used in the preparation of the annual Budget Address of the Minister of Finance to the House of Assembly.

The estimates of revenue for the fiscal year 1998-99 (the 1998-99 revenue estimates) are the responsibility of the Department of Finance and have been prepared by departmental management using assumptions with an effective date of May 30, 1998. I have examined the support provided by the department for the assumptions, and the preparation and presentation of the 1998-99 revenue estimates of \$4,382,718,000 for total ordinary revenue. My examination does not cover the 1998-99 expenditure estimates, the 1997-98 revenue forecast, sinking fund earnings, nor the recoveries, user fees or other income netted against expenditures for appropriation purposes. My examination was made in accordance with the applicable Auditing Guideline issued by the Canadian Institute of Chartered Accountants. I have no responsibility to update this report for events and circumstances occurring after the date of my report.

In my opinion:

- as at the date of this report, the assumptions used by the Department are suitably supported and consistent with the plans of the Government, as described to us by departmental management, and provide a reasonable basis for the 1998-99 revenue estimates; and
- the 1998-99 revenue estimates as presented reflect fairly such assumptions.

Since the 1998-99 revenue estimates are based on assumptions regarding future events, actual results will vary from the information presented and the variations may be material. Accordingly, although I consider the 1998-99 revenue estimates to be reasonable, I express no opinion as to whether they will be achieved.

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

Halifax, Nova Scotia
May 30, 1998

*Exhibit 2.4***REPORT OF THE AUDITORS
APPOINTED UNDER SECTION 65 OF THE PROVINCIAL FINANCE ACT****Auditors' Report**

The Honourable Donald R. Downe
Minister of Finance
Province of Nova Scotia
Halifax, Nova Scotia

Sir:

We have audited the statements of financial position of the Province of Nova Scotia as at March 31, 1998 and 1997 and the statements of revenue and expenditures, net direct debt and changes in financial position for the years then ended. These financial statements are the responsibility of the Province. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by senior officials, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Province of Nova Scotia as at March 31, 1998 and 1997 and the results of its operations and the changes in its financial position for the years then ended in accordance with the accounting policies stated in the notes to the financial statements.

Deloitte & Touche
Chartered Accountants

Toronto, Ontario
July 21, 1998

*Exhibit 2.5***PROVINCE'S FINANCIAL STATEMENTS
SUMMARY OF OPPORTUNITIES FOR IMPROVEMENT**

Consolidated financial statements - Full consolidated financial statements for the Province should be a primary financial accountability report for government. Consolidated financial information, and preferably full consolidated financial statements, should be available publicly on a timely basis. The need for consolidated budget information will require further consideration as part of the move to full consolidated financial statements.

Reporting entity - Finance continues to review the Province's reporting entity for financial statement purposes. Among other considerations, this involves assessing which Provincial public sector entities should be included for consolidated financial reporting, and which of those will be accounted for as government organizations or alternately as government business enterprises. The implementation of a financial reporting entity in accordance with current CICA recommendations will result in the Province's financial position and results being presented on a more complete and appropriate basis.

Reporting of annual results - Finance needs to clearly define its accounting policy on what will be recorded directly to the *Statement of Net Direct Debt*. In this regard, it is recommended 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. It is acknowledged that implementing such a policy would represent some further challenges to the annual budget preparation process. Finance has indicated that this is the reporting basis it intends to move towards over time.

Accounting for pension costs and obligations - Since 1993, Finance has implemented changes so that government's pension obligations (i.e., liabilities) are more fully accounted for in its financial statements. The accounting for annual pension costs is currently done based on contributions, which may or may not result in an accurate measure of the cost of services. Finance has previously indicated that since items such as annual or periodic 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 annual surplus or deficit. While such items may be challenging to determine, both from a budgeting and an accounting perspective, they still represent items that should be considered when assessing the government's fiscal performance.

Accounting for tangible capital assets - Alternatives and issues relating to the implementation of recent recommendations by the CICA on the accounting for and reporting of tangible capital assets by governments are being studied and worked on by Finance, with input from this Office and departments.

Exhibit 2.6

**ACTUARIAL COST CERTIFICATE
ON THE NOVA SCOTIA PUBLIC SERVICE SUPERANNUATION PLAN
AT OCTOBER 31, 1998**

Revenue Canada Registration Number 0284521

1. The Plan has a surplus of \$38.65 million, resulting in a funded ratio of 101.6%
2. The total current service cost for the 12 months starting November 1, 1998 is \$64.81 Million, which compares with the employees' and matching employer contributions of \$61.08 Million, resulting in a deficit of \$3.73 Million or 0.68% of covered pay. This deficit is expected to increase each subsequent year for a period of about 8 to 10 years due to an increase in the average age of the active members.

If the experience matches the actuarial assumptions in future years, i.e. if there is no gain or loss with regard to the assumptions, the present surplus of \$38.65 Million is expected to be sufficient to pay for the current service deficits that occur over at least the next 5 years (the estimated present value of the current service deficits over the next 5 years is \$34.3 Million).

In our opinion, the assumptions made in the valuation upon which this Certificate is based are adequate and appropriate and the methods employed are consistent with generally accepted actuarial principles. Also, based on various tests which we made regarding the accuracy of the membership data provided to us in connection with this valuation, we are of the opinion that such data fairly represents the Plan's membership.

MORNEAU SOBECO

Exhibit 2.7**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*

Exhibit 2.8

POLICIES AND GUIDELINES FOR PROCUREMENT		
<u>Document</u>	<u>Status</u>	<u>Date Released or Estimated Release</u>
Policy on Government Procurement Policy	Available	January 1996
Various Brochures Concerning doing Business with Government	Available	December 1996
Environmentally Responsible Procurement Policy	Available	December 1996
Government Procurement Process	Available	January 1997
Government Procurement Process - ASH Sector	Available	January 1997
Procurement and the Nova Scotia Economy	Available	January 1997
Departmental Guide to the Preparation of a RFP	Available	January 1997
Departmental Guide to the Evaluation of a RFP	Available	January 1997
How to Complete a RFP - The Proponent's Guide to RFP Preparation	Available	January 1997
Departmental Guide to Vehicle Rentals	Available	January 1997
Guide to the Submission & Evaluation of Unsolicited Proposals	Available	July 1997
A Process to Develop Cooperative Business Solutions	Available	October 1997
Procurement Manual Policies and Procedures	Available	October 1997
Engineering/Architect Procurement Process	Available	March 1998
Facilities Procurement Guide	Available	April 1998
Construction Contract Guidelines	Available	December 1998
Availability of Surplus Government Assets for Non-Profit Organizations	Available	December 1998
Supplier Complaint and Dispute Settlement Process	Draft	January 1999
A Procurement Process to Support the Development of Public Private Partnerships	Draft	January 1999

*Appendix 2A***MANAGEMENT LETTER OF AUDITORS APPOINTED UNDER SECTION 65 OF
THE PROVINCIAL FINANCE ACT****Deloitte &
Touche****Deloitte & Touche
Chartered Accountants**P.O. Box 2087
5161 George Street, Suite 800
Halifax, Nova Scotia B3J 3B7Telephone: (902) 422-8541
Telecopier: (902) 423-5820

August 28, 1998

Mr. Bernard Smith, CA
Deputy Minister of Finance
Province of Nova Scotia
1723 Hollis Street, 7th Floor
P. O. Box 187
Halifax, NS B3J 2N3

Dear Mr. Smith:

We have recently completed our audit of the accounts for the Province of Nova Scotia for the year ended March 31, 1998. Our examination was conducted primarily to enable us to formulate an opinion on the financial statements of the Province. Accordingly, it included such tests and other procedures, as we considered necessary in the circumstances.

During the course of our audit, certain observations were made which we wish to bring to your attention. All such matters have been discussed with appropriate senior personnel, and our major observations were discussed with you and the Minister of Finance during our meeting of July 21, 1998.

Our comments are provided in the following sections:

1. DEPARTMENT OF HEALTH
 - A) RECEIVABLES
 - B) PHARMACARE
 - C) AMBULANCE SERVICES
2. DEPARTMENT OF EDUCATION
 - A) LOANS
 - B) PUBLIC-PRIVATE PARTNERSHIPS
3. YEAR 2000

**Deloitte Touche
Tohmatsu
International**

Appendix 2A (Cont'd)

4. QUALITY OF ACCOUNTING FUNCTIONS
 - A) GENERAL BOOKKEEPING
 - B) INTERIM FINANCIAL STATEMENTS
 - C) CASH COLLECTION AND RECEIVABLES
5. INTERNAL AUDIT
6. LEGISLATION REGARDING ANNUAL SURPLUSES
7. DERIVATIVE FINANCIAL INSTRUMENTS
8. PUBLIC SECTOR AUDIT AND ACCOUNTING GUIDELINES

We understand that you plan to follow up on each of the recommendations in this report. Please do not hesitate to contact us if we may be of assistance in this regard.

We wish to express our appreciation for the excellent cooperation extended to us by members of all departments during the course of our audit. We shall be pleased to meet with you at any time, should you wish to discuss further any matters raised in this report.

Yours very truly,

Deloitte & Touche

Chartered Accountants

*Appendix 2A (Cont'd)***1. DEPARTMENT OF HEALTH****a) Receivables**

As of March 31, 1998, the Department had accumulated accounts receivable from a number of hospitals and, in particular, the Queen Elizabeth II Health Sciences Centre and the Cape Breton Regional Health Care Complex. Such advances totalled \$52 million, net of an allowance for doubtful accounts. Management is of the opinion that these amounts will be recovered in future periods through a combination of expense reductions and increases in non-traditional sources of revenues, rather than through increases in future appropriations from the Province. In order to protect its investment in these accounts receivable, the Province requested three-year business plans from all of the Health Boards that address the profitability of the related hospitals, as well as the financing of these receivables. We have had an opportunity to review some of the first drafts of these business plans and have determined that work needs to be done to ensure that the plans more specifically address the issues noted above, namely the systematic payment of these receivables to the Province. We have conveyed this concern to the Deputy Minister of Health and we understand that the Department has met with the respective hospitals and conveyed this concern to them.

We recommend that the Department of Health continue to work with all of the Health Boards in preparing the business plans to ensure that they address the relevant issues. The Department of Health has stated that these receivables will be paid by other than appropriations from the government. It is, therefore, important to ensure that the business plans provide for this in a reasonable time period, and that the Province receives ongoing financial information in order to monitor and assess the status of the accounts.

b) Pharmacare

Financing the costs of the Seniors Pharmacare program is currently structured to be on a 50/50 sharing basis between the Province and the senior citizens. The seniors pay their portion through a combination of annual premiums and co-pay formula when they purchase prescription drugs. History has shown that the combination of premiums collected plus co-pay from the seniors has not been sufficient to cover 50% of the cost. The most recent audited financial statements for the Insured Prescription Drug Trust Fund are for the year ended March 31, 1997. These statements show a deficit in excess of \$5 million. It is expected that the year ended March 31, 1998 will show a larger deficit. We understand that a committee is currently in place, with representation from the Department of Health as well as from the Board of Insured Prescription Drug Trust Fund to review and assess the various options available to resolve the financing problem.

We recommend that the Department continue to monitor the progress of the committee and encourage the committee to present their recommendations as quickly as possible. We remind the Department of Health that if loans are made by them to the Fund - they must be repaid from other than Provincial future appropriations.

c) Ambulance Services

EMC Limited is responsible for the operations and deployment of ambulances across the Province. The Province currently provides funding to the company for providing this service. During the course of our audit, we learned that there is no formal agreement between the Province and EMC to provide an official framework for this relationship. Our understanding is that there is a committee within the Department of Health which is charged

Appendix 2A (Cont'd)

with the responsibility of preparing an agreement. While we recognize the nature of this essential service, we also remind management that negotiating this agreement after the relationship has begun may impact the Department's negotiating position.

We recommend that the Department finalize the agreement as quickly as possible on the basis of normal market pricing and conditions.

2. DEPARTMENT OF EDUCATION

a) Loans

During the year, the Department advanced operating monies to various school boards and recorded them as accounts receivable. The amount of the original advances was in excess of \$6 million. Later in the year, upon reviewing the transaction, and carefully considering the ability of the boards to repay these amounts, the Province decided that because the amounts would, in all probability, be repaid from an increase in future Provincial funding, the amounts were recorded as ordinary expenses. This was not the original intent of the Department.

We recommend that the Province be cautious about loaning funds for the operations of the school boards, or any other government organizations who primarily depend on operational funding from the Province. The Province should not lend money to departments or other related entities unless it is clear at the outset that it will be repaid from other than Provincial future appropriations.

b) Public-Private Partnerships

The Public-Private partnership concept for school construction has grown extensively during the year, both in terms of projects and in terms of the development of architectural and operating standards.

As of March 31, 1998, only one signed lease is in place, that being the lease for O'Connell Drive School in Porter's Lake. Other schools that are substantially complete structurally are located in Sydney, Hants East Middle School, and Horton High School. At year-end, there were no leases in place for these schools and the Province has had to finance their construction and carry a net receivable of \$35 million in respect of these schools.

It is the Province's intent to complete the financing negotiations for these schools which will result in the collection of receivables and operating leases. It is based upon this intent, as well as the assumption that the Province find a willing third party to lease the schools, that the Province has recorded these net receivables. Should these circumstances change, the Province will have to reconsider its current accounting treatment. **We recommend that the Province finalize arrangements for these schools as quickly as possible.**

3. YEAR 2000

As you are aware, under the terms of our engagement, we will not provide any assurances, nor will we express any opinion, that the Province's systems or any other systems, such as those of the Province's agencies, service providers, subsidiaries, or other entities, are Year 2000 compliant. However, during our visits to your offices, we made inquiries about the Province's activities to address the Year 2000 issue. We have not performed any procedures to test the accuracy or completeness of the responses to our inquiries, but we have included our observations resulting from these inquiries, in the following paragraphs.

Appendix 2A (Cont'd)

We understand the Province has decided to take a two-tiered approach to address the Year 2000 compliance issue. The first line of responsibility for Year 2000 compliance has been charged to each of the Departments and/or government related agencies. Each must identify all potential exposures, create remediation plans, effect solutions where appropriate, and do it within their specific budgets. In addition to this, the Province has created a separate project office for the Year 2000 that reports to the Deputy Minister of the Technology and Science Secretariat. This office is to provide administrative and technical support and assess the Province's exposure as a whole. While this is a different approach than most Private entities where one Senior official has full authority for the project, we understand that the Province's approach is similar to that of the federal government.

We have been informed by various personnel that the departments are at varying levels of preparedness. We are advised that some have completed detailed inventory lists of potential exposures, others are in the process of doing this. Some have detailed plans, including timelines for completion as well as contingency plans in the event things do not happen as anticipated; others are not that far along. We remind management that the Year 2000 is not that far away. As the date approaches, access to remedial resources will clearly decrease so it is very important to maintain constant monitoring and produce frequent progress reports so that management can take appropriate action to meet the deadline.

Obviously, the Year 2000 issue is of critical importance to the Province. It is not just the individual Departments that must be assessed, but through association, the Province will be involved with problems that arise in agencies, crown corporations, hospitals, school boards, etc., any one of which may have a significant impact on the Province. **We strongly encourage the Province to stay closely informed on the status of the Year 2000 efforts in all of its departments, affiliates, and suppliers.**

4. QUALITY OF ACCOUNTING FUNCTIONS

a) General Bookkeeping

In our report of last year, we noted that while the basic bookkeeping by the various departments' staff is adequate, there were some shortcomings. Those shortcomings included inconsistent preparation of bank reconciliations, subledger reconciliations that were not performed on a timely basis, and several immaterial account balances that were not subject to any monitoring activity.

In performing this year's audit, we noted good improvement. In particular, there was considerable improvement in the preparation of the bank and subledger reconciliations. There remain some unmonitored balances, but we understand that this issue will be addressed, as resources become available. We commend the Province for these improvements.

b) Interim Financial Statements

In addition to the above, we still encounter, in most departments, a pre-occupation with income statement accounts, but a lack of regular analysis of the balance sheet accounts until year end. This could have implications regarding the Province's quarterly reports.

Appendix 2A (Cont'd)

We recommend that, in addition to income statements, the Province issue full financial statements, including a balance sheet, in its quarterly reports. In addition, the Province should establish a plan to implement the preparation of full financial statements on a monthly basis for management purposes. We understand that both of these matters are currently being studied by the Department of Finance.

c) Cash Collection and Receivables

Also, in past reports, we commented that cash collection practices were inconsistent across government departments and generally below commercial norms. We were also critical of the lack of consistency in identifying and making provisions for doubtful accounts.

Again, we have noted improvements in these areas. The Department of Business and Consumer Services has assumed certain cash collection functions for programs in other departments, resulting in both efficiency and consistency of procedures. We also noted an improvement in the identification and provisions for doubtful accounts prior to the audit commencement. Management has taken a much more pro-active approach in this regard and we commend them for doing so.

In spite of these improvements, there is still work to do, as many receivable accounts are not subject to regular aging analysis, which is a useful management tool in collecting accounts receivable and assessing credit risk. **We recommend that as the Province moves forward, it make use of all the tools available in its new SAP system to assist in the management of cash collections.**

5. INTERNAL AUDIT

In past reports, we have made recommendations that the Province adopt a more corporate approach to the internal audit function rather than specific department allocation of personnel. It is our feeling that organizing internal audit in this fashion will allow the Province to obtain greater overall efficiency and benefits.

Our understanding is that a government-wide internal audit working group is now in place, which meets on an informal basis to share ideas and best practices. There is some concern that the focus of the group is more on departmental issues rather than addressing the larger overall picture of financial risks of the Province as a whole.

We recommend that the Deputy Minister of Finance act as Chair of this working group, assist in determining the priorities of the internal audit function, and ensure that they address the risk areas for the government, as a whole.

6. LEGISLATION REGARDING ANNUAL SURPLUSES

Legislation was introduced in the March 31, 1997 fiscal year that states that annual surpluses are to be applied to reduce taxes and/or reduce the Province's debt. In our 1997 report, we noted that the legislation lacked certainty on how, and when taxes are to be reduced (whether retroactively or subsequently), and to that end, we made a recommendation that policies and/or amendments to the legislation be developed to clarify these matters.

Appendix 2A (Cont'd)

In the current year, a surplus of \$38.5 million was realized, part of which was set-up as a provision to reduce Harmonized Sales Tax paid in the 1998 fiscal year, and the balance was reported on the Statement of Net Direct Debt. As new legislation or policy has not been introduced, it is still unclear whether the tax reduction is recorded in the proper period and specifically that the portion allocated to debt retirement has been reflected in the Public Debt Retirement Fund.

We, again, recommend that policies and/or legislative amendments be developed to clarify these matters. We further recommend that a continuity schedule of the Public Debt Retirement Fund be prepared and included in the financial statements of future periods.

7. DERIVATIVE FINANCIAL INSTRUMENTS

The Province continues to make increasing use of derivative transactions to manage its foreign exchange and interest risk profiles and to reduce overall debt servicing costs. As pointed out in previous reports, derivatives are not subject to traditional controls and it is, therefore, important to develop and employ sufficient and new controls to ensure risk is minimized within acceptable limits. To that end, during 1997, the Department of Finance prepared a draft policy and procedures document for derivative financial instruments. This document is still in draft form and, therefore, has not been formally authorized as policy.

We recommend that the draft policy and procedures document be appropriately reviewed, changes made and approval formalized as soon as possible to give formal effect to the controls contained therein.

8. PUBLIC SECTOR AUDIT AND ACCOUNTING GUIDELINES

We have encouraged the Province, in past reports, to adopt accounting policies consistent with PSAAB recommendations as it is fast becoming the generally accepted method of accounting for Provincial Governments. The Province continues to make progress in this area, particularly this year when the Department of Finance released a document called the Financial Accountability - A Blueprint for Success. This document essentially creates a timeline for planned compliance with PSAAB recommendations and would put the Province at the forefront of government reporting in Canada.

We applaud this initiative and encourage the Department of Finance to closely monitor this project to ensure the timelines laid out in the document are met.

3.

YEAR 2000 - READY OR NOT, HERE IT COMES !

BACKGROUND

What is the Year 2000 issue all about?

3.1 The approaching change of century brings with it a potential realization of significant risks for computers and equipment or devices containing microchips. Much has already been written about the Year 2000 and its possible worldwide impact. In summary, the risks are characterized by the manner in which dates had been captured allowing only 2 digits for the year (i.e., 1998 would typically have been recorded as 98). When the century changes to the year 2000, under the old format the year would be recorded as 00. Computers and/or microchips may then interpret this to be the year 1900 or some other system base year. As a result, computations or processes dependent on dates may be performed incorrectly or not at all. This has the potential to cause an innumerable variety of problems for computer systems, their users and clients, as well as a wide variety of electronic equipment containing microchips. Potential problems range from very minor to extremely dangerous or costly depending on the nature of the system, its functional purpose(s) and the extent of dependency by users and clients.

3.2 Year 2000 is not just an information technology (IT) problem. It is a business problem which may have an impact on many facets of an organization's operations and the dependencies among and between business partners. Even where an organization can achieve its own Year 2000 compliance, it still needs assurance that its business partners will do so as well. Therefore, there will be risks that are external to an organization and beyond its control.

How significant is the issue and what is the world doing about it?

3.3 In 1997, GartnerGroup, an independent research firm, estimated the costs to resolve the issue globally in the range of US \$300 billion to US \$600 billion. In June 1998 GartnerGroup reported *"The overall Year 2000 picture has not become rosier in the past year. As many as one-half of organizations will experience the pain of a mission-critical business process impairment. Total software remediation costs are still likely to fall somewhere in the \$300 billion to \$600 billion range."* The deadline for resolving this problem is a fixed target. It cannot be changed or deferred in any way.

3.4 In July 1998, GartnerGroup released the results of a world-wide survey it had recently concluded. Fifteen thousand organizations, including governments, in 87 countries were surveyed. The following is a summary of significant statistics that it had gathered:

- 23% of all organizations still had not started any year 2000 effort and more than 80% of these were small companies;
- 93% of IT budgets remained flat or were reduced from 1997 to 1998;
- 5% of IT budgets were spent on year 2000 efforts in 1997, but 30% was planned to be spent in large companies in 1998 and 44% in 1999;
- only 23% of companies already working on Year 2000 problems had begun researching supply chain risks and 11% had begun to research embedded system risks; and

- 50% of all companies were not planning to perform any year 2000 testing, as they intended to fix code and implement it.

3.5 These survey results indicated that on a global basis a great deal remained to be done.

RESULTS IN BRIEF

3.6 The following are our principal observations based upon information available to us up to mid November 1998.

- In the past year, the government has made progress in dealing with the Year 2000, but at varying degrees and not to the overall extent expected based on plans in place last year. Some departments appeared to have made significant progress in their efforts to resolve the Year 2000 problem and its potential impact on their business functions. Other departments, however, had been slower to react and were not sufficiently along in their efforts.

The challenges within the Provincial public sector and the commitment required to try to address them over the next year need to be well defined and understood by decision makers if the government is to achieve a planned state of readiness. In this regard, we again recommended that government provide sufficient appropriate information and reporting to the House of Assembly on its plans and performance relating to the Year 2000 issue. The first of these reports was released on November 30, 1998. It is available on the Province's Internet site, which we understand will be updated monthly.

- The Executive Council issued a formal Year 2000 policy statement in May 1998. However, in our on-going research of the Year 2000 issue and in particular our review of certain key government planning documents (*Government By Design 1998-99*, *Crown Corporation Business Plans 1998-99* and the *Estimates of the Government of Nova Scotia for 1998-99*) we noted that for most departments and crown corporations included in the documents, the Year 2000 issue was not specifically identified as a priority, even though these documents were tabled one month following the Executive Council policy statement.

While the Year 2000 is seen as a priority, it continues to compete for resources with a number of other government priorities and issues. This is particularly demonstrated by the fact that all costs associated with Year 2000 must come from within each department's existing budget.

- It is not a question of whether the government will be ready, but rather, to what degree will Year 2000 compliance be achieved? Further, what systems and/or processes will be most at risk and what contingency plans will be in place to minimize those risks? The answers to these questions were still being formulated when this chapter was written.

As of November 1998, there were still incomplete estimates of the resources required to address the issue government-wide. Further, all departments had not yet fully identified and prioritized their Year 2000 project components, nor had the government yet established its overall priorities for areas of highest risk.

SCOPE OF REVIEW

3.7 The objective of this assignment was to determine the status of actions taken or planned by the government to address the potential risks and impact that the change of century may have on the government's systems and processes that are date dependent.

3.8 In August 1998, we surveyed sixteen departments and one agency to obtain background information and representations on their Year 2000 plans and status. Responses were received from all and in addition one department (Health) provided two responses (one for the department and one for the Regional Health Boards and Non-Designated Hospitals). We received eighteen responses in total.

3.9 It is important to note that these survey results represented a self-assessment by the respondents near the end of August 1998. We have not performed specific procedures to verify the responses provided.

3.10 Further, in November 1998 we reviewed the October 30, 1998 monitoring reports that were prepared by the departments and submitted to the government's Year 2000 Project Office within Technology and Science Secretariat (TSS). We also held further discussions with representatives of the Year 2000 Project Office, and obtained and reviewed additional information on government's priorities and plans.

3.11 Due to the significance of the Year 2000 issue and implications for the business systems and processes within the Provincial public sector, we will continue to monitor and review government progress in this regard.

PRINCIPAL FINDINGS

Has the Nova Scotia government made sufficient progress in the past year?

3.12 Over the past year, since the writing of our last report, we acknowledge that there has been progress across government, but at varying degrees and not to the overall extent expected based on plans in place last year. Some departments appear to have made significant progress in their efforts to resolve the Year 2000 problem and its potential impact on their business functions. Other departments, however, have been slower to react and were not sufficiently along in their efforts.

3.13 It is not a question of whether the government will be ready. The pertinent question is which systems are likely to be completed and for those that are not, what are the risks of the failure to complete? Also, what strategies will be formulated to minimize business and service interruptions? As at November 1998, estimates of the resources required to address the issue still had not been fully assessed by the departments. Further, some departments still had not yet fully identified and prioritized their areas of risk. As well, the government had not yet established overall priorities for areas of highest risk, although criteria have been established to facilitate this process. We understand that these steps are to be completed by January 1999, which leaves very limited time to ensure they are properly dealt with.

3.14 The government still needs to establish the detailed budgetary and human resource requirements for the remainder of its Year 2000 efforts. These must be fully defined and provided so as to focus on the highest areas of risk. Further, these efforts and related resources will need to be planned for appropriate recognition and consideration of related requirements extending beyond the Year 2000.

What were the government's primary Year 2000 related accomplishments in the past year?

3.15 The following is a summary of the primary accomplishments by the government in the past year related to the Year 2000 issue, based on the information and representations provided to us by the Year 2000 Project Office.

- The Executive Council issued a Policy Statement dated May 8, 1998 (see Appendix 3A, page 50) which defined the primary roles and responsibilities for the government's Year 2000 project approach. In summary, it clearly established that *"Ministers are responsible for directing and evaluating the Year 2000 readiness of their departments, and any agencies, boards, and commissions for which they have ministerial responsibility."*
- The Premier wrote to all Cabinet Ministers on June 11, 1998 to emphasize a high priority for addressing the Year 2000 business problem.
- The Year 2000 issue was established as a regular agenda item for meetings of both the Executive Council and the Deputy Ministers.
- Establishment of the central Year 2000 Project Office was completed and funding for the administration of the Project Office was established in the budget of the Technology and Science Secretariat.
- The Project Office in consultation with the departmental Year 2000 Coordinators established weekly Year 2000 workshops and technical sessions, where information can be shared and issues raised and discussed. Several focused workgroups were established to research and provide guidance on issues of common interest.
- The Project Office established an information site on the government Intranet site as a means of supporting departments in their Year 2000 projects.
- The Project Office established a reporting mechanism for the departments to regularly report progress and status. The first set of monitoring reports were submitted by the departments for September 1998. October reports have also been received by the Project Office.
- The Project Office and the departmental Year 2000 Coordinators jointly developed a definition of Year 2000 Compliance, which was approved by the government's Business and Technology Advisory Committee (BTAC) for use throughout government. It was subsequently incorporated in all procurement activities by the Procurement Division of the Department of Finance.
- The Deputy Minister of the Technology and Science Secretariat has recently (October 1998) completed individual meetings with each of the Deputy Ministers and their Year 2000 Coordinators concerning each department's progress and status.
- The Minister responsible for the Technology and Science Secretariat (TSS) is to meet individually with each member of Cabinet to discuss the Year 2000 issue and each department's progress and status.
- The Department of Economic Development and Tourism has included on its Internet site Year 2000 awareness and other related information resources for private businesses.

- The Department of Housing and Municipal Affairs has provided links on its Internet site to assist Municipalities in their Year 2000 remediation efforts.
- The Department of Health established a central Year 2000 Project Office in support of the Province's health care organizations.
- A Local Area Network (LAN) based testing facility using Year 2000 compliant software and running in the year 2000, was established at TSS and made available to all departments for testing their LAN based applications.
- Testing tools for both mainframe and workstation based hardware and software were evaluated, acquired and widely deployed to assist departments.
- A strategy was developed for identifying and planning for assessment of embedded systems. This strategy had been implemented in nine departments.
- A Year 2000 legal strategy was formulated and communicated to all departmental legal counsel.
- A risk management strategy was researched and recently approved by the Priorities and Planning Committee. Training sessions will be provided to departmental project staff by early December 1998. A full risk management assessment is then to be completed in January 1999.
- A vendor management strategy was developed and a generic letter created which will be sent to all suppliers. To assist in this, detailed vendor lists were derived from the Department of Finance records and provided to the departments.
- It was indicated that certain significant contracts such as the SHL Systemhouse Agreement and the contract with MT&T are currently being renegotiated and that these new contracts will address Year 2000 issues.

Has the government effectively recognized Year 2000 as a high priority?

3.16 As previously indicated, the government has, in the past year, taken two very important steps in establishing Year 2000 as a high priority for government departments and agencies. These are the release of the Year 2000 policy statement in May 1998 and the letter from the Premier to all Cabinet Ministers in June 1998.

3.17 However, in our on-going research of the Year 2000 issue and in particular our review of certain key government planning documents (*Government By Design 1998-99*, *Crown Corporation Business Plans 1998-99* and the *Estimates of the Government of Nova Scotia for 1998-99*) we noted that for most departments and crown corporations included in the documents, the Year 2000 issue was not specifically identified as a priority, even though these documents were tabled one month following the Executive Council policy statement. One of the primary purposes of these planning documents is to communicate the budgets, priorities and plans (including goals) of the government departments and crown corporations for the upcoming year.

3.18 Our point in raising these matters is to demonstrate that the May 1998 release of the Executive Council policy statement was too late to affect the planning processes of the departments for 1998-99 as reflected in *Government By Design*, *Crown Corporation Business Plans* and the *Estimates* which were released in June 1998.

Has the Province provided disclosures regarding Year 2000?

3.19 On July 31, 1998 the Province released a publication entitled "*Financial Report 1997-98, Hitting the Targets.*" This publication included the Province's audited financial statements for the fiscal year ended March 31, 1998. The Notes to the financial statements included a note on Year 2000 as follows:

"The effects of the Year 2000 issue may be experienced before, on, or after January 1, 2000. If not addressed, the impact on operations and financial reporting may range from minor errors to significant systems failure which could affect the Province's ability to conduct normal business operations. It is not possible to be certain that all aspects of the Year 2000 issue affecting the entity, including those related to efforts of suppliers and other third parties, will be fully resolved.

The Province continues to prepare for and manage this risk. Each government department is responsible for identifying, creating, and executing remediation plans for date-sensitive systems that may impact their ability to continue normal operations. The costs associated with all Year 2000 efforts are to be financed from existing departmental operating budgets. A project team has been established to monitor and support the Province's year 2000 efforts as a whole. This team reports to a senior deputy minister of government."

What comments were provided by the auditors appointed under Section 65 of the Provincial Finance Act for the year ended March 31, 1998 to management?

3.20 The auditors appointed under section 65 of the Provincial Finance Act for the year ended March 31, 1998 were Deloitte & Touche. Their management letter dated August 28, 1998, which was subsequently received by this Office on November 6, 1998, provided the following commentary on the Province's approach and general status relating to Year 2000 remediation efforts:

"Year 2000

As you are aware, under the terms of our engagement, we will not provide any assurances, nor will we express any opinion, that the Province's systems or any other systems, such as those of the Province's agencies, service providers, subsidiaries, or other entities, are Year 2000 compliant. However, during our visits to your offices, we made inquiries about the Province's activities to address the Year 2000 issue. We have not performed any procedures to test the accuracy or completeness of the responses to our inquiries, but we have included our observations resulting from these inquiries, in the following paragraphs.

We understand the Province has decided to take a two-tiered approach to address the Year 2000 compliance issue. The first line of responsibility for Year 2000 compliance has been charged to each of the Departments and/or government related agencies. Each must identify all potential exposures, create remediation plans, effect solutions where appropriate, and do it within their specific budgets. In addition to this, the Province has created a separate project office for the Year 2000 that reports to the Deputy Minister of the Technology and Science Secretariat. This office is to provide administrative and technical support and assess the Province's exposure as a whole. While this is a different approach than most Private entities where one Senior official has full authority for the project, we understand that the Province's approach is similar to that of the federal government.

We have been informed by various personnel that the departments are at varying levels of preparedness. We are advised that some have completed detailed inventory lists of potential exposures, others are in the process of doing this. Some have detailed plans, including

timelines for completion as well as contingency plans in the event things do not happen as anticipated; others are not that far along. We remind management that the Year 2000 is not that far away. As the date approaches, access to remedial resources will clearly decrease so it is very important to maintain constant monitoring and produce frequent progress reports so that management can take appropriate action to meet the deadline.

Obviously, the Year 2000 issue is of critical importance to the Province. It is not just the individual Departments that must be assessed, but through association, the Province will be involved with problems that arise in agencies, crown corporations, hospitals, school boards, etc., any one of which may have significant impact on the Province. We strongly encourage the Province to stay closely informed on the status of the Year 2000 efforts in all of its departments, affiliates, and suppliers."

What were the results of our August 1998 survey?

3.21 In late July 1998, we prepared a survey and circulated it across 16 departments and one agency in order to gather basic background information and representations on the status of actions taken or planned since our 1997 report. The results of this survey represented a self-assessment by the departmental Year 2000 Coordinators at a point in time. We did not perform detailed verification procedures to substantiate the responses. Based on the responses provided, we were very concerned with the overall status indicated by these survey results as at the end of August 1998. Our concerns were not so much that there was a wide disparity across the departments in terms of status and progress, but that most of the significant actions taken, or still planned, had come too late or still had not yet been addressed.

What were the results of the October 30, 1998 monitoring reports submitted by the departments to the Year 2000 Project Office?

3.22 Subsequent to our August 1998 survey, the Year 2000 Project Office began receiving monthly status reports from the departments commencing at the end of September 1998. It also requested copies of the August survey the departments had submitted to us. Upon review of the information at these two dates, management of the Project Office became very concerned and arranged individual meetings with each Deputy Minister and their respective Year 2000 Coordinator to discuss the departmental plans and status. We were informed that based on the discussions at these meetings management of the Project Office concluded that neither our survey results nor its September monitoring reports accurately reflected the status and progress of the departments.

3.23 The departments were then requested by October 30, 1998 to provide an itemized listing of their Year 2000 sub-projects with an assessment of the priority for each item. We have now had the opportunity to review the October 30, 1998 reports and provide the following comments.

- The October reports indicated to us that significant effort and emphasis had been directed by several departments to their Year 2000 projects and that some appeared to be making progress in their remediation efforts. However, based upon the information provided, we still have significant concerns relating to the status and progress of certain departments. We do not imply that they have been doing nothing, in fact we know that all departments are now highly focused. Our concern, which is demonstrated by the following statistics, is that there is now only slightly more than one year remaining and both the departments' and the government's corporate efforts are still, to a large degree, focusing on identification and prioritization of projects for some of which estimates of costs and resource requirements still had not been fully defined. These estimates will not likely be finalized until January 1999.

- All of the departments provided a submission to the Project Office as requested. There were 227 projects identified in total of which 7 were assessed as critical and 127 assessed as high priority. There were 38 projects for which no prioritization had yet been defined.
- There were 83 identified projects where no cost estimates were provided and a further 91 where no resource-day estimates were provided. These particular projects will require a range of effort which has not yet been determined, but in total is likely significant.
- Based upon data at October 30, 1998, the total estimated costs identified to date by departments approximated \$22 million. Since the date of these reports, the government announced that Health organizations (external to the department) will require approximately \$65 million.
- The government did not have in place a "Skills Set Inventory" which would identify government employees who possess Year 2000 specialized skills. Such an inventory would enable a focused deployment of appropriate skills to each of the government's prioritized projects once they are established. It would also facilitate an identification of required skill sets not available internally.

What additional strategies and plans has the government identified?

3.24 The Priorities and Planning Committee, on the recommendation of the Year 2000 Project Office, has recently approved the acquisition and deployment of a risk management methodology for the Province. This methodology will be initially deployed to assist departments and the government in identifying the projects of highest risk. Training was scheduled to begin in late November 1998 and the departments are required to apply the methodology for a consistent assessment, or reaffirmation of their areas of highest risk. This process is to be completed by January 20, 1999.

3.25 Further, the government has recently communicated the following key milestones, including tentative completion dates, to the departments:

January 20, 1999	Risk Planning Complete
February 10, 1999	Essential Service Projects Confirmed for Government
March 3, 1999	1999/2000 Prioritized Budgets Finalized
June 15, 1999	Remediation of Essential Services Completed Business Continuity/Contingency Plans Completed
August 30, 1999	Implementations for Essential Services Business Continuity/Contingency Plans Tested
January 1, 2000	Contingencies Triggered
January/February 2000	Business Resumption

3.26 The government's Business Technology Advisory Committee (BTAC), which is comprised of selected Deputy Ministers, has recently been re-established and it will provide a Year 2000 steering committee function.

What are the Auditor General's plans and priorities for further coverage of Year 2000?

3.27 Our plans and priorities for monitoring the government's Year 2000 remediation efforts are as follows:

- consider the need for specific review of Year 2000 information provided to the House of Assembly;
- continue to review and monitor information available to us and raise issues and questions with the Year 2000 Project Office and others as required;
- continue to support internal audit initiatives focusing on the Year 2000; and
- consider the need for plans and procedures to address Year 2000 issues that extend beyond January 1, 2000.

What other audit-related initiatives are being considered?

3.28 Several government departments have internal auditors with a variety of audit responsibilities for departmental programs and operations. Internal auditors from across government have formed a committee called the Provincial Internal Audit Committee (PIAC). The general purpose of this committee is to provide a forum for sharing information and formulating plans on areas or issues of common interest. One such issue is the Year 2000. In June 1998, PIAC approved the establishment of a Year 2000 sub-committee to gather information and formulate a common audit strategy for reviewing and assessing departmental Year 2000 projects. The first meeting of this sub-committee was held in June 1998. The Auditor General agreed to have two staff members sit on this sub-committee in an advisory capacity, as a means of cooperation and coordination, and to minimize duplication of efforts.

3.29 The sub-committee has recently formulated a detailed Year 2000 audit strategy for internal auditors which was to be presented to the full PIAC committee for consideration in November 1998. However, the nature of the internal audit function across government is such that audit priorities must be approved by senior departmental management. As well, some departments with no internal auditors rely on the Department of Finance and some other departments have very small (one or two person) internal audit groups. Although there is now a detailed audit strategy, there is no guarantee that all internal audit groups or departments will have the necessary senior level support or the audit resources to focus on the Year 2000 issue in a timely and effective manner.

CONCLUDING REMARKS

3.30 While progress over the past year is acknowledged, it has occurred slower than intended by last year's plans. The risks from this issue should not be underestimated. Year 2000 still represents a very real threat to government and its ability to provide complete and uninterrupted service upon the turn of the century. During 1998-99, the issue started to receive increased levels of senior departmental support. The window of opportunity since last year has diminished by almost 50% and there is still a great deal of effort required.

3.31 The Year 2000 issue represents a fixed deadline that cannot be changed or deferred. There is not sufficient time or resources to ensure full compliance across the government. The government needs to complete its assessment and focus on this issue at a corporate level and establish priorities so that resources can be directed to the most significant areas of risk. In order to do this, the departments will first have to finalize the prioritization of their projects which will then have to be

assessed in the government's corporate context. Use of the new risk management methodology will be key to facilitating this process.

3.32 The unique nature of this problem and in particular the risks to the government, should be of significant and on-going interest to Members of the House of Assembly. Accordingly, we repeat our recommendation from last year that it would be appropriate for the Year 2000 Project Office to issue periodic status reports so government and the Members of the House of Assembly may be kept current on progress for this very important issue. These reports should provide sufficient and appropriate information for the Members of the House to assess the government's progress and plans. In this regard, the government released its first status report on November 30, 1998. This report is available through the Province's Internet site (www.gov.ns.ca) and it is our understanding that it will be updated on a monthly basis.

3.33 In our view, it is imperative that the accountability focus on Year 2000 be prospective rather than retrospective. At this point in time, from an accountability perspective, we suggest an appropriate focus needs to be placed on the government's plans, priorities and activities for the remainder of its Year 2000 remediation efforts, as opposed to having management resources focus extensively on what was or was not done in the past.

*Appendix 3A***POLICY STATEMENT OF THE
EXECUTIVE COUNCIL****Year 2000 Project
May 8, 1998**

Because of the serious concerns raised by the Year 2000 problem in relation to Government of Nova Scotia operations, the Executive Council has determined:

- Ministers are responsible for directing and evaluating the Year 2000 readiness of their departments, and any agencies, boards, and commissions for which they have ministerial responsibility.
- Departments, agencies, boards and commissions are each responsible for assessing the risks and impacts of their own Year 2000 problems and for mitigating them. These same entities are also responsible for identifying and discharging their duties and obligations to naturally affiliated external groups with which they have a community of interest.
- Departments will put together project plans, staffing, and reporting structures to address their Year 2000 problems.
- At a minimum, anticipated costs associated with carrying out risk assessments and with making known priority items either compliant or Year 2000 ready will be included in 1998-99 budgeting. Remaining Year 2000 expenses will be incorporated in departmental budgets for the fiscal year 1999-2000.
- Departmental Year 2000 coordinators will cooperate with the Year 2000 Project Office: keep it informed of the status and progress of their remedial efforts and provide it with regular updates on these activities.
- Approval is given to the Department of Finance decision to fund remedial Year 2000 work through the existing processes of departmental budgeting. This approval may be subject to change or revision, pending the outcome of completed risk assessments and financial impact statements.
- The Deputy Minister of the Technology and Science Secretariat will report and advise the government on the progress of its Year 2000 remedial efforts.
- The Year 2000 Project Office, established within the Technology and Science Secretariat, will support, coordinate and monitor departmental efforts to achieve Year 2000 readiness.

4.

ENVIRONMENTAL MANAGEMENT - A SURVEY OF GOVERNMENT PRACTICES

BACKGROUND

4.1 There are significant potential environmental impacts associated with many of the activities of government. Examples include Department of Agriculture and Marketing's advice relating to land use and pesticides, Department of Natural Resources' development of a sustainable forestry, and Department of Transportation and Public Works' building of highways and other construction projects.

4.2 A new Environment Act came into effect January 1, 1995; effectively updating the environmental laws of Nova Scotia and consolidating 16 pieces of existing environmental legislation. The Act is just as relevant to Provincial government operations as private-sector activities, as it specifically binds "*Her Majesty's corporations, agents, administrators, servants and employees and Government agencies.*" It addresses important environmental issues such as pollution, dangerous goods and pesticides, contaminated sites, water-resources, waste-resource and air quality. The Act is extensive and provides significant powers of enforcement. In addition, regulations were developed by government to help clarify the requirements of the Act. The only acceptable legal defence available under the Act is "*due diligence or reasonably and honestly (believing) in the existence of facts that, if true, would render the conduct of that person innocent.*"

4.3 One effective means of ensuring good environmental stewardship and displaying "due diligence" is to establish and maintain an environmental management system (EMS) wherever significant impacts on the environment are a possibility. The Canadian Standards Association defines an EMS as the organizational structure, responsibilities, practices, procedures, processes and resources for implementing environmental management. Such systems, if comprehensive and operating effectively, should ensure environmental risks and liabilities are properly identified, minimized and managed; as well as ensure entities comply with environmental laws.

4.4 An EMS will not necessarily exist as a discrete system, but may consist of policies, procedures and accountabilities integrated into an existing management framework. The complexity and size of the system should depend on the nature of the environmental responsibilities of the organization. Ideally, an EMS should contribute to the integration of environmental concerns into all levels of decision making.

4.5 In the fall of 1998, we surveyed various government departments to obtain an understanding of the systems and practices government uses to fulfil its responsibilities under the Environment Act.

SCOPE OF SURVEY

4.6 The objectives of this assignment were to:

- survey the government-wide policy framework for environmental management; and
- gain an understanding of the policies, systems and practices used at the departmental level to fulfil environmental responsibilities.

4.7 For purposes of our survey of departmental practices, we selected a sample of five departments with operations that have a significant potential of impacting the environment. The five departments included in our survey were:

Agriculture and Marketing

Environment

Fisheries and Aquaculture

Natural Resources

Transportation and Public Works

4.8 We interviewed senior managers who have responsibility for environmental issues in their department. Because this was not an audit, we relied on the representations made by each department in producing this Chapter. Our assignment did not include testing or other verification to ensure systems functioned as described, though we did review some supporting documentation to help us better understand the practices and issues involved.

4.9 Our interviews were guided by a questionnaire which we developed from our research. It focussed on five key areas of environmental management: definition of responsibilities, availability of resources, risk identification, management control and performance reporting. After a description of the government-wide policy framework for environmental management, the Chapter summarizes the results of our survey using the format of our questionnaire. Because of the nature of this assignment, our descriptions of environmental management are generalized and do not indicate the specific practices of individual departments surveyed.

PRINCIPAL FINDINGS

Government-wide Policy Framework

4.10 *Government By Design*, the government's annual planning document, indicates that the government's agenda is based on four pillars of public policy: social responsibility, economic growth, responsive government and fiscal stability. In the 1997-98 plan, under the pillar of social responsibility, protecting the environment and ensuring resources are managed for sustainability were stated as priorities. In the 1998-99 plan, under the pillar of economic growth, the government stated its commitment to securing a lasting future for the industries that capitalize on the Province's natural resources. Under the pillar of responsive government, the government expressed its commitment to protecting the environment. As such, the government's commitment to environmental stewardship has been integrated into its highest-level planning activities.

4.11 There is no government-wide policy framework for environmental management at this time. In 1997 a policy was implemented to outline environment-friendly purchasing practices for government, but there is no comprehensive guide to help departments manage all of their environmental responsibilities. In 1992 the Nova Scotia Round Table on Environment and Economy developed a policy paper on a strategy for sustainable development for Nova Scotia. The strategy addressed issues such as the state of the atmosphere, water management and biological diversity. It also proposed sustainable goals in a number of economic sectors, such as agriculture, forestry, fishing and aquaculture, and tourism and recreation. It was intended to apply to government operations, as well as to establish a framework for government's encouragement of the private sector

to adopt sustainable development practices. However, the strategy was never formally adopted by government and has not led to the development of central policy for environmental stewardship.

4.12 Later, in 1993, an Environmental Self-Assessment policy was approved by government and announced by the Department of the Environment. It required all departments, agencies, boards and commissions to conduct environmental self-assessments on significant new policy and economic development initiatives. The policy also highlighted five practices of good environmental management. In addition, there was now a requirement that a summary statement on environmental implications accompany all requests for approval from central government. However, no mechanisms were developed to encourage and monitor departments' self-assessment practices. Compliance by departments with the reporting requirement has not been regular, and there is little information with respect to the degree of compliance with the requirement for self-assessments.

4.13 Although the Nova Scotia Round Table on Environment and Economy was created by government in 1988, the 1995 Environment Act formally established it as an advisory body to government on sustainable development planning in Nova Scotia. Its mandate was formalized to include:

- researching and analyzing issues relating to sustainable development;
- advising government on the incorporating of environmental and economic considerations into its decision-making processes, and sustainable development principles and practices into its activities and undertakings;
- increasing public awareness of the cultural, social, economic and policy changes required to attain sustainable development; and
- assisting the government to overcome barriers to sustainable development.

4.14 The Round Table has since been active in advising on various environmental issues, including accountability and environmental self-assessment. However, in the past year, the Round Table's ability to function has been hampered by membership vacancies and legislative delays in filling those vacancies.

4.15 In lieu of government-wide policy, departments develop their own environmental policies, strategies and plans, and look to the Environment Act and its regulations for a comprehensive description of their environmental responsibilities. All of the departments we surveyed had an opportunity to advise on the writing of the legislation, and thus were well versed in it. The Department of the Environment has the lead role in overseeing and enforcing the Act, both with respect to private sector as well as government activities. We observed that, with respect to environmental issues, there is considerable communication and collaboration between the Department of the Environment and the other departments we surveyed.

Responsibility for Environmental Management

4.16 One characteristic of a well-functioning environmental management system is that environmental responsibilities are clearly defined. This can be achieved through an environmental policy that outlines the commitment to meeting environmental responsibilities and assigns roles and accountability for its achievement. Senior management commitment and leadership in implementing an organization's environmental management function are essential.

4.17 The five departments in our survey demonstrated an understanding of their responsibilities under the Environment Act. While only one department had a distinct environmental policy, all five departments included statements of their commitment to the environment in their annual business plans. The statements ranged from a broad, high-level commitment set out in the mission statement, to strategic goals of sustainability and environmentally responsible management, to specific operational priorities and objectives for the year ahead. Two departments have a division or branch with specific environmental management responsibilities, while the other three have a more decentralized form of environmental management. All five departments made environmental management a key responsibility of their senior management teams, but each also held the view that operating in a manner that is responsible to the environment is the duty of all departmental staff.

Availability of Resources

4.18 The availability of adequate resources in terms of knowledge, experience and funding is a requirement for effective management of environmental responsibilities.

4.19 In terms of knowledge and experience, management in all five departments indicated that they had adequate resources, either within their departments or available to them from other departments and outside sources. In three of the departments it was indicated that management of certain operational aspects of their environmental responsibilities was constrained by limitations in funding.

Risk Identification

4.20 The identification of environmental risks and liabilities inherent in an organization's operations is an important aspect of environmental management. It helps management understand the organization's potential for environmental impact, and to focus attention and resources on higher priority issues.

4.21 From our interviews we determined that none of the five departments have performed a formal, department-wide environmental risk analysis. Management of each department indicated that it has developed a good awareness of the environmental risks and liabilities inherent in its operations through its regular activities and through contacts with other departments and agencies. One department has completed a review of its legislation for potential conflicts with the Environment Act and two other departments have reviewed and prioritized certain risk sites. Management in all five departments noted that some of the work of the occupational health and safety committees helped identify environmental risks; for example, through the development of hazardous material identification and monitoring systems.

4.22 A comprehensive review of the Environment Act and its regulations, to be initiated within five years of its enactment, is a requirement under the Act. The Department of the Environment has begun planning for the review process and is developing approaches to provide opportunity for input from all stakeholders. Such a review process will likely help identify environmental risk factors relating to government's activities.

Environmental Management

4.23 Environmental management should include practices and controls such as planning, coordinating, monitoring, reporting and auditing to help ensure environmental responsibilities are met. Environmental management should be integrated with other areas of management and, as a result, environmental considerations should be included in all senior-level decision-making.

4.24 All five departments incorporated a variety of the above-noted elements in their management of environmental responsibilities. Although the elements were more apparent in the two departments with environmental service divisions, the three departments with more decentralized environmental management also demonstrated environmental practices and controls.

4.25 Each of the five departments had goals and outcome measures relating to the environmental impact of their operations, which were included in their annual business plans. The departments have also established a number of policies, guidelines and practices on conducting operations in a manner responsible to the environment. One department has developed a handbook for its private sector clients to guide them through the environmental regulations. Another department has implemented a pollution prevention program to promote improvement in operational practices. A third department is developing natural resource databases for better land-use planning and management. Three of the departments have undertaken initiatives to encourage good environmental practices in the workplace.

4.26 Annual performance appraisals are part of the management regime at all five departments, but are used to varying degrees as a means of establishing accountability for environmental responsibilities. At four of the departments, environmental responsibilities are included in annual performance goals to some degree, and achievement of these goals is subsequently evaluated. Of these four, annual performance appraisals are performed for all staff at two of the departments, and primarily with management personnel at the other two. In the one remaining department, environmental responsibilities are tied into performance goals to a much more limited extent.

4.27 Contractors and consultants hired by the departments are required to follow environmental regulations and guidelines. Environmental conditions are often specified in the contracts that govern their services. The departments monitor to ensure compliance with contract terms and conditions.

4.28 All five departments carry out inspections to ensure regulatory compliance by their clients, and inspectors generally prepare reports or letters to document their inspections. Internal reporting on environmental responsibilities is generally informal; usually through meetings, memos and briefings.

4.29 None of the departments have undergone an audit of their environmental management practices to provide assurance on proper implementation and effectiveness in achieving environmental objectives. There are also no established mechanisms for such audits.

Environmental Reporting

4.30 Under the Environment Act, the government is committed to reporting on the state of the environment in the Province. The first report was released in July 1998 and called *The State of the Nova Scotia Environment 1998*. This report gives an overview of environmental issues, concerns and actions related to air, water and waste management. Subsequent reports will cover land resources, biota, and coastal and marine ecosystems. The report focusses on the major responsibilities of the Department of the Environment, but also contains references to three of the other departments included in our survey. Even though the report claims that it is not comprehensive and that data gaps have been identified, we commend this effort to document the progress the Province has made in protecting the environment.

4.31 Each of the five departments reported performance results for 1997-98 in *Nova Scotia Counts*. This document reports on government's level of achievement of performance goals developed and reported in *Government By Design*. Thus, *Nova Scotia Counts* serves as a reporting mechanism on environmental responsibilities only to the extent that those responsibilities were

included in performance targets in the departments' business plans and in *Government By Design*. We noted that three of the departments had details on their environmental responsibilities included in *Government By Design*. We also noted that one department released a progress report in relation to an environmental strategy it developed, and another department plans to implement a regular reporting mechanism for one of its environmental responsibilities.

CONCLUDING REMARKS

4.32 The importance of environmental stewardship has been recognized in government's top-level planning, but there is no formal government-wide policy framework for managing the Province's environmental responsibilities. Departments are responsible for meeting the requirements of the Environment Act and regulations, and for developing the policies and systems that are most appropriate for their individual requirements.

4.33 There is no generally accepted model of an environmental management system and the focus of our survey was on the embodiment of sound environmental management principles, rather than on specific techniques and procedures. We also recognize that each department's environmental management needs are specific to that department. Practices must be allowed to vary to fit a department's business and management style, and evolve to reflect changes in a department's organization and business.

4.34 The departments in our survey were aware of their environmental responsibilities and had developed systems, policies and procedures to manage them. None of the departments have implemented a comprehensive environmental management system, but most have implemented a number of the component elements of a formal EMS and are actively developing others to meet environmental challenges. We support and encourage their continual improvement of environmental management and accountability.

DEPARTMENTAL AUDITS

5.

COMMUNITY SERVICES - HOMES FOR SPECIAL CARE - PHASE II

BACKGROUND

5.1 The Homes for Special Care Act provides a framework and conditions for the operation of long-term care facilities in Nova Scotia. Facilities covered by this legislation include nursing homes, homes for the aged, regional rehabilitation centres, residential care facilities, group homes, adult residential centres and developmental residences. The Province provides funding for residents in Homes for Special Care (HSCs) who qualify for assistance under various government programs. The Department of Health funds qualified residents of nursing homes and homes for the aged. The Department of Community Services funds qualified residents of each of the other types of facilities. In addition, Community Services funds residents in smaller facilities under a program called Community Based Options (CBO). CBO homes are facilities with three or fewer residents, and are not governed by the Homes for Special Care Act. However, under the authority of the Social Assistance Act, government has developed standards for their operation which are very similar to the conditions imposed on the operation of HSCs.

5.2 As of October 16, 1998 Community Services was responsible for 117 HSCs with 2,608 beds, and 440 CBO homes with 1,176 residents. As well, there are a number of supervised apartments, housing 621 residents, administered under the CBO program by 48 organizations. The facilities are owned and operated by either a municipality, a private non-profit agency or a private for-profit company. Community Services assesses and classifies residents which it has approved for care by a facility, and provides funding to facility operators on behalf of individual residents. Payments are made on the basis of per diem rates approved by the government for each individual resident. For the year ended March 31, 1998 Community Services paid \$57.2 million on behalf of residents of HSCs. As of March 31, 1998 CBO homes were under the jurisdiction of the municipalities, so payments on behalf of their residents were made by the municipalities and recovered from Community Services. In 1997-98 this amounted to \$32.8 million.

5.3 In Chapter 6 of our 1997 Annual Report, we discussed the results of an audit performed on the Departments of Community Services and Health focussing on Homes for Special Care. We also indicated that the audit was conducted in two phases. Phase I, reported last year, addressed the assessment and classification of HSC residents and applicants. It also reviewed issues pertaining to the roles and responsibilities of staff in the two departments, policies and procedures used by the departments to manage the system, the disposition of designated residences, and the role and regulation of Community Based Options homes under the responsibility of municipalities.

5.4 This chapter reports on Phase II of our audit. It addresses our review of the licensing and inspection of long-term care facilities, the process for ensuring the finances of facilities are adequately managed, and the procedures for setting per diem rates. It also discusses our review of the government's long-term planning with respect to the role, regulation and future need for long-term care facilities.

5.5 Last year, we combined the results of our audit of the two departments - Health and Community Services - into one chapter because there was a significant degree of integration and similarity within the two departments with respect to the systems examined in Phase I of our audit. This year, we are reporting Phase II of the audit in two chapters, each addressing a

different department. We found that the issues and systems addressed in Phase II were less common and integrated, and believed separate reporting would be more appropriate. This chapter addresses the findings of the audit that relate to the Department of Community Services. Chapter 11, on page 123, reports audit results relating to long-term care facilities under the jurisdiction of the Department of Health.

RESULTS IN BRIEF

5.6 The following are the principal observations from Phase II of the audit.

- Per diem rates were increased by 2% in November 1997. Previously, they had been frozen for four years for HSCs, and two years for CBO homes. During the rate freeze, increases had been granted in certain instances where costs were incurred to enhance the safety of residents. However, due to the freeze, the Department suspended its annual review of HSC budgets and financial plans.
- The staffing guidelines used in the per diem rate setting process have not been updated since the late 1980's.
- New licences for HSCs have been frozen for five years. We found that, before the freeze, an assessment of the need for additional HSC beds was not always applied in the decision to grant a new licence.
- Important certificates and other documentation required as part of the initial license application process were missing from Department files, but other evidence suggests copies of the documents filed elsewhere were reviewed by inspectors during the licensing process.
- Annual inspections of HSCs are performed before a licence is renewed, and deficiencies noted are addressed before the renewal is granted.
- Emergency plans are required as part of the licence renewal process. We found the Department ensures such plans are in place before granting a renewal.

AUDIT SCOPE

5.7 In early 1998 we completed Phase II of our audit of Homes for Special Care. Phase I of the audit was completed in September 1997, and reported in Chapter 6 of the 1997 Annual Report of the Auditor General.

5.8 The objectives of Phase II of our audit were to assess:

- the licensing and inspection functions for long-term care facilities, including follow-up on deficiencies and enforcement of penalties;
- the processes for reviewing HSC budgets and financial performance, and for setting per diems rates;
- the processes for monitoring facilities' compliance with legislation and government standards;

- the process for payment of claims received from facilities; and
- the government planning functions related to demand and capacity, and the process for approval of new facilities or facility expansion.

5.9 Criteria were developed to facilitate our audit. They were discussed with management at the beginning of the audit, and are outlined in Exhibit 5.1 to this chapter (page 65). Our approach to the audit consisted of interviews with management and staff of the Department, the review of various reports and system descriptions, and detailed testing of licensing and inspection practices.

PRINCIPAL FINDINGS

Licensing of Homes

5.10 *New licences* - There has been a moratorium on licences for new HSCs for the past five years. Before the moratorium, an application for a licence was evaluated against certain assessment criteria developed by the Department. A key requirement was the demonstration of the need for the home. The need for a HSC was verified by the Department through an analysis of the size and age of the population in the area to be served by the new facility. We tested the issuance of licences before the moratorium went into effect. We noted that in 20% of the files we examined, the need for the facility was questioned by Department assessors, but a licence was still issued. In 10% of the files examined, the HSC had started its operations without a licence and the Department felt it was in the best interest of the residents to grant a licence, rather than close the home. However, this was only done in cases where the homes were in complete compliance with all requirements of the Homes For Special Care Act and its regulations.

5.11 We believe that licences should not be granted unless there is clear justification of the need for a facility. Demonstration of need is important to ensure the number of HSCs within an area can be supported by the population, and thus not result in an oversupply of beds.

5.12 *Documentation* - Regulations to the Homes for Special Care Act describe certain certificates which must be obtained and submitted to the Department before a licence to operate a HSC is granted. These include certificates relating to fire safety, municipal zoning by-laws, public health inspections, and to the adequacy of electrical, plumbing and heating systems. Also, the applicant for a HSC licence must submit a financial plan for the home proposed outlining how the home intends to fund its operation and manage its expenditures.

5.13 In 95% of the files examined we noted that one or more of the required certificates were absent. Although we are concerned that the certificates are not evident in the files, there are indications that safety certification does occur, and perhaps the problem is more with file management practices rather than the licensing process. For example, the Regulations require that each HSC have an inspection by the Fire Marshal's Office each year before its licence is renewed. Our audit determined that these inspections do take place and deficiencies are corrected before a licence renewal is granted. Also, each HSC, as part of the application process, undergoes an inspection by Department staff to verify that application information is correct and that the homes have all of the required certifications.

5.14 In 80% of the files we examined financial plans were either absent or inadequate. According to Department management, the primary purpose of collecting financial plans was to provide information for the Department's annual review of per diem rates. When the rate freeze went into effect the Department no longer needed the information, and thus suspended its requirement for financial plans.

5.15 *Licences renewal* - The licence to operate a HSC is valid for a year. According to the Regulations to the Homes for Special Care Act, a home is required to have an annual inspection and any deficiencies noted must be corrected before its licence can be renewed. We observed that the inspection process is comprehensive and covers all aspects of a home's operation, including quality of resident care, record keeping, staffing schedules, dietary records and various safety-related issues. We found inspections to be appropriately documented. Inspection reports are reviewed by Department management, who make a final decision with respect to licensing.

5.16 In some instances, an inspection cannot be completed before a licence expires. In these situations, a temporary licence is issued until the inspection is finalized. A temporary licence may also be granted in cases where an inspection has uncovered problems that need to be addressed before a licence can be renewed. We tested the renewal process and noted that one licence out of our sample of twenty had expired and no inspection was done before it was renewed. In another instance, the licence expired and, although an inspection was done and the home continued to operate, a new licence had not been issued. We recommended that the Department establish procedures to ensure all homes are inspected and licensed each year.

5.17 *Sale of a facility* - When a HSC is sold, the new owners are required to apply for a licence to operate it. During our testing, we found one such instance where documentation in the file indicated there was an oversupply of beds in the area and the licence was not justified based on need. Management informed us that legal advice obtained at the time indicated it would be unable to refuse a licence to the new owners. It appears that there is a lack of legislation or regulation with respect to the government's authority to deny licence transfers in such instances, and this makes it difficult for government to consider the continuing need for the facility in its licensing decision.

5.18 *Unlicensed homes* - The Department uses a variety of means to ensure that no unlicensed homes are operating in the Province. The Department relies on information from other licensed facilities, perusal of obituaries and other articles in the newspapers, and the diligence of case workers in the field.

Financial Analysis

5.19 The Department of Community Services provides funding to HSCs and to municipalities for CBO homes based on the number of publicly funded residents under their care. Payments are determined in relation to the cost of caring for a resident for a day, and thus are called "per diems." The last change in per diems by the Department was a 2% increase in November 1997. Previously, as part of government's cost control measures, per diems had been frozen for four years for HSCs and two years for CBO homes. However, during the freeze, some per diem increases had been awarded in instances where the home was required to address fire and safety hazards. In such cases, HSCs were required to submit a budget to the Department to support the special need.

5.20 Since the freeze on per diems went into effect, the Department's analysis of the annual budgets of HSCs has been suspended. Management explained to us that the only reason they reviewed the budgets was to use the information in making decisions on changes to per diems. The Department does receive and review annual financial statements from private non-profit organizations operating homes. However, it does not receive statements from private for-profit organizations, unless these organizations are applying for a special rate review.

5.21 The Province funds 100% of the per diems for publicly supported residents in CBO homes. At the time of our audit, CBO per diems were based upon assessed level of care and the same rate schedule used for HSCs. Any review and analysis of the budgets of CBOs would be the responsibility of the municipality.

5.22 Before the rate freeze came into effect, the review of staffing requirements of a HSC was part of the Department's rate setting process. The Department used guidelines which were established for each type of HSC. We noted that these guidelines have not changed since the late 1980's. We recommended that the Department review the staffing guidelines to ensure they are still appropriate for the manner in which HSCs are operated today.

Compliance with Legislation and Standards

5.23 *Complaints* - The Department will receive complaints about the condition or operation of homes from residents or their family and friends. We examined the files for twenty homes to assess the adequacy of the system used for handling complaints. In our sample of twenty, there were nine homes where complaints had been documented. In six of the cases, the investigation and disposition of the complaint was adequate and timely. In the other three cases, the investigation was adequate and timely, but either documentation was not complete or the final disposition of the complaint was not documented.

5.24 *Emergency plans* - Emergency plans are an integral component of the safety of residents of HSCs. Regulations require that every HSC have one and that they be updated every three years and resubmitted to the Department. The plans should outline procedures for emergency evacuation, relocation and isolation, and should be prepared in cooperation with the Emergency Measures Organization and approved by the Fire Marshal's Office. We found that these plans are regularly reviewed by the inspectors as part of the licensing process, and that having an up-to-date plan is a condition of licence renewal. We tested a sample of HSC files to determine if emergency plans were present. Half of the files contained up-to-date plans and a quarter of the files did not contain a plan but the inspection report indicated one had been reviewed by the inspector. In the remaining quarter of the files, it was indicated that the plan was being updated or updating was a condition of issuing a future licence.

5.25 *Enforcement* - The Act contains a provision whereby contravention of the Act, its regulations or specific licensing provisions is punishable by a summary conviction and fine of not more than \$100 for each day the home is in a state of non-compliance. Department management told us that it rarely needs to resort to the courts to convince homes to comply.

Department's Planning for HSCs and CBOs

5.26 *Strategic planning* - The Department has begun a planning process to address the future requirements for HSC and CBO beds in Nova Scotia. The Department is a member of a steering committee also comprised of representatives from the Department of Health, Nova Scotia Association of Health Organizations, and Associated Homes for Special Care. The committee's mandate includes developing a common vision among all stakeholders with respect to the long-term care needs of residents in long-term care facilities. The committee will also address various operational issues relating to labour relations, staffing standards and human resources. Management has informed us that the results of the strategic planning process will form part of the revisions the Department will propose for the Social Assistance Act and the Homes for Special Care Act.

5.27 *Approval of additional capacity* - There has been a moratorium for five years on construction and renovation of HSCs with respect to publicly-funded beds. Before a HSC can be constructed or renovated, approval must be obtained from the Department. The approval process includes an assessment of the need for additional capacity in the area. As well, details of the construction or renovation must accompany the request. The Fire Marshal's Office reviews and approves plans for major renovations and construction. A follow-up review is conducted to ensure approved plans are followed. Minor renovations are approved by the Department after a

review to ensure they do not affect the safety and comfort of the residents. Our testing of renovations indicates that proper approvals were obtained.

CONCLUDING REMARKS

5.28 In our opinion, the licensing and inspection of homes for special care by the Department of Community Services is generally adequate and in compliance with the Act and regulations. However, file documentation was weak and it was difficult to determine the extent of some licensing procedures. We also noted that there are a number of factors that go into the determination of whether a new licence or a licence transfer should be granted, and the need for additional beds has not always been made the highest priority.

5.29 We also found that there is little review of the financial planning and performance of homes by the Department. Management does not see its role as one of ensuring the future viability of homes for special care. Accordingly, any review of financial planning by the Department is for the purpose of approving increases in per diems. With the imposition of the rate freeze in 1993, such reviews have been restricted to situations where a home has applied for a special rate review for purposes of rectifying safety concerns in the home.

*Exhibit 5.1***AUDIT CRITERIA**

Criteria are defined as reasonable and attainable standards of performance and control against which the adequacy of systems and practices can be assessed. They relate to the audit objectives developed for an assignment, and are used to design the detailed audit tests and procedures.

The following criteria were used in the performance of Phase II of our audit of Homes for Special Care.

- Licences should only be issued to homes which have met the requirements detailed in the Act and regulations.
- Licences should be renewed in accordance with the Act and regulations, and the renewal should result from an inspection process.
- The inspection process should consider the scope of the Act and regulations, and should result in a report noting the outcome of the inspection. The report should be distributed appropriately. The inspection process should include follow-up to ensure deficiencies have been addressed.
- There should be an annual review, following established guidelines, of the budgets and audited financial statements of homes as part of the process for setting per diem rates.
- There should be controls to ensure that funds are expended by homes in accordance with related guidelines and with due regard for economy and efficiency.
- There should be controls to ensure that per diem rates charged by homes do not exceed the rates determined by the Department, and claims from homes should be based on approved rates and only be paid if they relate to residents who have been approved for funding by the Department.

DEPARTMENT OF COMMUNITY SERVICES' RESPONSE

The scope of Phase Two of this audit incorporates two distinct components of service delivery - one component "Homes for Special Care" which are facilities licensed to operate under the auspices of the Homes for Special Care Act and the "Community Based Options" program - a large group of three and fewer care settings funded and overseen prior to April 1, 1998 by the respective municipalities throughout the Province.

There has been a moratorium in place within the licensed sector for a period of five years which has included any new development or expansion.

In addition, there was a rapid growth of the Community-Based Options program in the early 1990's. The need to provide appropriate administrative and standards infrastructure became critical, particularly in anticipation of the province assuming responsibility for this program. A moratorium was placed on new development within this system in June, 1995.

With the moratoria in place, the Department of Community Services with its partners has been concentrating efforts on a more strategic approach with regard to managing this large and diverse sector. The Department, along with representatives of the Department of Health and the long term care sector, have been meeting to collaborate on the planning required to address redesigning the system along with all the component parts associated with the redesign; namely, vision, documentation, staffing standards, assessment tools, budget management, licensing, etc. Further, the two Departments have been engaged in a process to research bed utilization requirements across the Province; thereby targeting any new bed development in areas of greatest identified need.

Further, in preparation for major redesign activities, the Department of Community Services has developed an inventory of all Community Based Options, developed and issued on November 26, 1996, "Interim Standards - Community Based Options", has moved to a regionalised delivery model to ensure services are located close to the operator, has provided financial officer positions to each region to assist with budget management of all programs and is working on a new rate setting process which consists of standards for documentation and decision making.

As can be seen, the Department of Community Services is acutely aware of the need to provide process improvements and standards which will be consistency applied throughout the Province. The work outlined above, along with helpful recommendations stemming from the Auditor General's Report, coupled with the sector-wide strategic planning underway will assist to achieve the joint outcomes of improved and fiscally accountable service delivery.

6.

ECONOMIC DEVELOPMENT AND TOURISM - ECONOMIC DIVERSIFICATION AGREEMENT

BACKGROUND

6.1 During 1998, we commenced a broad scope review of selected aspects of the management and control of the Province's participation in the Canada/Nova Scotia Cooperation Agreement on Economic Diversification (EDA). The purpose of this chapter is to report upon our results and observations to date.

6.2 The original EDA was signed effective March 30, 1994. The general objective of the Agreement was to undertake initiatives which would *"promote economic development, diversification and competitiveness within the Nova Scotia economy."* It was to cover a five-year period and provide \$52.6 million in assistance, with overall costs shared approximately 70:30 between the Federal and Provincial governments respectively. The final date of approval of projects under the Agreement was March 31, 1999 but claims for the projects could be paid until March 31, 2001. According to a September 1997 external consultant's report, which was commissioned by the Management Committee as an interim evaluation of the EDA, the Agreement *"had committed \$49.6 million or 94% of its available funds as of June 1996."*

6.3 The EDA was amended in July 1996. It was to become more strategically focussed, building on the existing economic strengths of the Province, as agreed upon by both levels of government. The funds available increased by \$187.9 million to \$240.5 million with overall costs shared on a Federal/Provincial basis of approximately 60:40. The project approval date was extended to March 31, 2001 with claims for projects being paid up to March 31, 2003.

6.4 In May 1998 the EDA was further amended to change the cost sharing ratio to 70:30 with the Federal government commitment remaining unchanged at \$144.3 million while the Provincial government commitment was reduced by \$34.3 million to \$61.9 million. The amendment to the cost sharing ratio was applied retroactively to projects approved under the Agreement and the Federal government issued a cheque to the Province for approximately \$4.3 million in July 1998. The amendment reduced the total funding available under the Agreement from \$240.5 million to \$206.2 million.

6.5 As defined in the EDA, the purpose of the Agreement is *"to provide a mechanism whereby Canada and Nova Scotia may jointly address a range of strategic priorities for economic development."* Those priorities as defined in the Agreement are to *"increase business investment activity; develop product and market opportunities; develop strategic sectors and industries; develop sustainable communities; and improve economic foundations."*

6.6 The detailed objectives of the Agreement are to:

- *"create quality sustainable jobs;*
- *develop profitable world-class companies that are export-oriented and market-driven;*
- *build on the potential of strategic sectors;*

- *use public-private collaboration to lever resources and ideas to achieve economic development objectives;*
- *combine and coordinate the efforts and resources of government in order to encourage focussed, effective approaches to economic development;*
- *enhance the sustainability of communities; and*
- *improve business climate and build an entrepreneurial culture through strengthened economic foundations.”*

6.7 The strategic sectors referred to in the objective are defined in the Agreement as, but not limited to, “ *information technologies, goods, facilities and services; environmental industries and solutions; marine industries and related services; aquaculture and sport fishery; health products and health related products and services; tourism; cultural industries; and education and educational related goods, services and facilities.*”

6.8 The EDA is divided into eight programs. These programs are Business Investment, Technology Infrastructure, Strategic Sector Development, Community Economic Development, Building Economic Foundations and Improving Business Climate, Strategic Initiatives, Administration and Evaluation, and Communications.

6.9 Along with a focus on community economic development there are five economic strengths of the Province identified to guide activity under the Agreement. They are culture and heritage, trade, education and research, oceans and the environment, and gateway to North America.

6.10 The administration and management of the EDA is the responsibility of a joint Federal-Provincial Management Committee which consists of four voting members, two of whom are appointed Federally and two by the Province. The Committee is headed by a Federal Co-chair (Vice-President, Nova Scotia Region, Atlantic Canada Opportunities Agency) and a Provincial Co-chair (Deputy Minister of Economic Development and Tourism). In August 1997 four additional non-voting members were appointed to the Management Committee for their knowledge and experience in various sectors, two from the Federal government and two from the Provincial government. Projects must be approved by the Management Committee before they can proceed. For more background on the management and control of the EDA see Exhibits 6.1 and 6.2 on pages 76 to 78.

6.11 Exhibits 6.3 and 6.4 on pages 79 to 80 provide summary information on the budget, expenditures, recoveries and projects approved, by program and economic strength. As of November 15, 1998 there were 383 projects approved under the Agreement, committing \$183.1 million of the \$206.2 million of funds available and leaving \$23.1 million available to commit. Of the \$183.1 million committed, \$92.0 million had been disbursed and \$51.1 million recovered from the Federal government.

6.12 Some projects under the Agreement are referred to as blanket funding projects where a government department/agency is responsible for providing the funding approved for a project to various sub-projects. These sub-projects are treated in a similar manner to a typical project with regard to project assessment and monitoring processes.

6.13 Funds disbursed under the Agreement may go to government departments/agencies, non-government entities, and government departments/agencies for distribution to non-government entities on sub-projects. Information maintained on the disbursement of funds is not segregated by type of entity using the funds, but Exhibit 6.5 on page 81 provides information on projects or clients approved under the Agreement which committed \$2.5 million or more and who used the funds. These 48 projects represent \$103.3 million or 56% of the funds committed as of November 15, 1998.

RESULTS IN BRIEF

6.14 The following are the principal observations from our review.

- Management responsible for the EDA recognizes the importance of measuring the performance of the Economic Diversification Agreement in achieving its objectives. Outcome measures have been established against which to measure performance, an interim evaluation has been completed and a second evaluation is planned, in order to measure the performance of the Agreement. However, overall accountability of the Agreement would be improved with further development of the outcome measures that have been established. As well, targets should be established for the outcome measures with the timely monitoring of and reporting on the performance of the EDA against targeted outcome measures. The Department of Economic Development and Tourism has not prepared an annual report as required by its Act. Such a document could facilitate the provision of more detailed information on the Department's plans and performance, including those related to the EDA, to the members of the House of Assembly.
- In the past, management has recognized the need to improve the administrative processes and management of the EDA. As a result, initiatives were undertaken to address this issue and changes were made, beginning in August 1997. Efforts in improving processes are continuing through a planned second interim evaluation of the Agreement which is to include a review of administrative processes.
- Project proposals are evaluated by staff in order to determine eligibility under the EDA. We tested a sample of 25 projects and found the projects had defined objectives which were linked to the EDA's objectives. However, documentation supporting eligibility assessments of projects prior to August 1997 was not adequate. After August 1997, improvements to file documentation supporting eligibility assessments of projects were implemented.
- Controls have been established to ensure the terms and conditions for the assistance provided are being complied with and funds are used for their intended purposes. However, not all controls have been operating as intended or, due to a lack of documentation, we were unable to determine if the controls were operating appropriately.
- During the 1997-98 fiscal year, we found that there were controls in place to ensure funds due to the Province were claimed from the Federal government for its share of the Agreement costs. With the changes in accounting responsibilities for the Agreement in 1998-99, the planned processes to be followed for recoveries should provide improved controls to ensure all funds due to the Province are recovered.

SCOPE OF REVIEW

6.15 In the fall of 1998, we began a review of the Canada/Nova Scotia Cooperation Agreement on Economic Diversification. The objective was to review and assess the systems and practices of selected aspects of the management and control of the Canada/Nova Scotia Cooperation Agreement on Economic Diversification, including:

- the accountability framework;
- the project assessment and approval process;

- the system for monitoring compliance with the terms of the assistance provided, and performance of the Agreement; and
- the accounting systems for the receipt and disbursement of funds under the Agreement.

6.16 Our approach included interviews with Provincial and Federal staff involved with the Agreement, a survey of Federal and Provincial project officers, and a review of information made available to us. We tested a sample of 25 projects when assessing the adequacy of the project assessment, approval and monitoring processes. Since there were changes in the administrative processes in August 1997, we segregated our test sample to include 13 projects which were approved prior to August 1997 and 12 projects approved from August 1997 to September 1998.

6.17 As part of our sample selection process, we selected six blanket funding projects for testing. In these instances, we tested one sub-project within the project when assessing the adequacy of project assessment, approval and monitoring processes.

PRINCIPAL FINDINGS

Accountability

6.18 *Overview* - An adequate accountability framework includes clearly defined roles and responsibilities and Agreement objectives along with a process for measuring the achievement of results and timely reporting on performance.

6.19 *Roles and responsibilities* - The roles and responsibilities of the Management Committee and the Federal and Provincial Directorates, which are described in Exhibit 6.1, are clearly defined in the EDA and other planning documents related to the Agreement.

6.20 The responsibilities of the Provincial Coordinator along with the staff reporting to him are defined in job descriptions or, for one employee, an employment contract. However, the job description of the financial services officer and communications officer are not up-to-date. Staff indicated they are in the process of having them updated.

6.21 Currently project officer responsibilities are assigned to staff within the Federal and Provincial governments. The role and responsibilities of these project officers have not been formally communicated to them. While in our view such documentation would support improvements in the accountability and overall control framework for the Agreement, we found no instances during our review which would indicate that those assigned the EDA project officer role did not understand their role or related responsibilities.

6.22 Some guidelines are available to project officers in carrying out their responsibilities such as the required content of project briefs. However, additional guidelines are required. They should include such things as file documentation, and the monitoring of projects, including review and verification of information provided.

6.23 For each approved project, a letter of offer is signed which clearly defines the roles and responsibilities of the parties involved in the project. Of the 25 projects we reviewed, 22 required a letter of offer to be issued and had reached the stage where this would have been completed. In all instances a letter of offer was issued.

6.24 *Performance measurement* - There are clearly defined objectives for the EDA which are documented in the Agreement. As well, outcome measures against which to measure the

performance of the Agreement have been identified. The accountability framework would be improved with further development of those outcome measures identified, as noted in paragraph 6.25 to 6.27 below. As well, targets should be established for the outcome measures and the measures should be linked to each of the objectives of the Agreement to demonstrate how the performance of each of the objectives is to be measured.

6.25 Some of the outcome measures identified need to be more specific. For example, two measures identified are to improve the labour force and increase training but they do not identify how the labour force would be improved or what type of training would be increased.

6.26 A 1996 ACOA document called *Economic Development in Nova Scotia - Towards a Strategy and Framework* describes specific goals to be achieved related to each of the economic strengths of the Province, and outcome measures and targets for each. However, these outcome measures and targets are not being used to measure the performance of the Agreement. They would be a good basis for further development of applicable outcome measures which can be linked to the objectives of the EDA and used to demonstrate the performance in achieving each of the objectives.

6.27 As well, through *Government By Design*, government-wide outcome measures are identified for economic growth. The outcome measures of the EDA could be better linked to the government-wide outcome measures in order to demonstrate the EDA's impact towards achieving the targets set in *Government By Design*. For example, one of the outcome measures of the EDA is to increase employment while the outcome measures identified in *Government By Design* related to this would be the net number of new full and part-time jobs created.

6.28 Each project proposal recommended for approval has a completed project brief. The purpose of the project brief is to clearly define the goals and objectives of the project and link the project to the Agreement objectives. The project briefs are also required to describe, in measurable terms, the anticipated outcome of completing the project, including the impact on economic development.

6.29 We reviewed 25 projects and found project briefs which defined the goals and objectives of the project and linked them to the Agreement objectives.

6.30 Eleven of the 13 projects approved before August 1997 and all 12 projects approved after August 1997 described in measurable terms, the anticipated outcome of completing the project.

6.31 *Agreement evaluation* - Section 11 of the EDA requires an evaluation of the performance of the EDA. It requires the Management Committee to have an evaluation report issued on the EDA six months before the termination of the Agreement.

6.32 Management responsible for the EDA recognizes the importance of reporting on the performance of the Agreement as part of the accountability framework. Since the EDA was significantly amended in 1996, an interim evaluation on the original Agreement was requested. One objective of the evaluation was to measure the extent to which the Agreement objectives were achieved and the impact on the Province. This evaluation was performed by an external consultant with a final report released in September 1997. The evaluation covered the period between March 1994 and June 1996. It does not conclude specifically on the achievement of the Agreement objectives and outcomes because many of the projects were incomplete and for those completed, an insufficient amount of time had passed to generate substantial outcomes.

6.33 Rather than waiting until the end of the Agreement to evaluate its performance, as required in the EDA, a second interim evaluation was approved by the Management Committee in August 1998. This evaluation will revisit projects reviewed in the first evaluation and projects approved since then in order to assess the achievement of the objectives and impacts of the Agreement. The report on the results of this evaluation is expected to be released to the Management Committee by the spring of 1999.

6.34 *Evaluation of projects* - One of the terms which must be in all letters of offer for projects approved is the requirement of the recipient to submit an evaluation report on the project within four weeks of completion and as part of the final claim. The report is to include a review of the intended objectives and reporting on outcomes related to the objectives.

6.35 Of the 25 projects we reviewed, there were eight completed, four approved before and four approved after August 1997. Of the four approved prior to August 1997, three had not included a review of the intended objectives and reporting on the outcomes as part of a final evaluation report. Of the four approved after August 1997, one had not included a review of the intended objectives and reporting on the outcomes. One project did have a review of the intended objectives but did not report on the outcomes of the project.

6.36 Since August 1997, another evaluation report is required 12 to 18 months after completion of the project on the sustained results or impacts of the project. According to staff, no projects had reached this milestone by October 1998.

6.37 *Reporting* - There is no specific reporting to the House of Assembly on the results or outcomes from the EDA. Estimated expenditures and recoveries under the Agreement are included in the Department of Economic Development and Tourism's (EDT) annual budget submission. The EDA is part of the appropriation vote called *Funds for Federal/Provincial Economic Cooperation* which includes a number of cooperation agreements. Financial information on the EDA is not specifically disclosed in the *Estimates or Public Accounts*.

6.38 There have been some external communications to create awareness of the EDA. A range of general and project specific information is published through the EDA's internet web site. There have been press releases related to the Agreement and approved projects and two newsletters were published in the spring of 1996 and 1998 with a third in progress. Through these mechanisms no specific information has been reported on the actual outcomes of the Agreement and the achievement of its objectives. Some estimated outcomes on a project basis have been reported through the announcements of projects being funded under the Agreement.

6.39 It is expected that the second interim evaluation report of the Agreement will provide information on the performance of the Agreement to date but the accountability framework would be improved if there was a project tracking system in place to gather information and monitor, on a continuing basis, actual project outcomes against targets. This would aid in the timely reporting of the outcomes of the Agreement and the achievement of its objectives.

6.40 Performance information could be reported through the Annual Report of the department. However, it has not published an annual report, even though such reporting is required by Section 10 of its enabling Act which states "*the Minister shall annually submit to the Governor in Council and table in the House of Assembly a report respecting the work performed by the Agency (Department of Economic Development and Tourism) in the preceding fiscal year.*"

6.41 *Allocation of funds* - Schedule A of the EDA provides an allocation of the Agreement funds among the program areas of the EDA. The Agreement also gives the Management Committee the authority to reallocate these funds among programs without amending the Agreement. As can be seen in Exhibit 6.3, as of November 15, 1998 the funds committed in some program areas have already exceeded the original allocated amounts. However, the amounts reallocated were not subject to specific approval by the Management Committee. The Management Committee is not receiving information on the commitments to date compared to the allocated funds by program area so it is not aware of when projects it approves cause those planned allocations to be exceeded.

6.42 *Improvements in administrative processes* - Management of the EDA has identified areas of improvement in the administrative processes and management of the Agreement. As a result,

initiatives were undertaken to address this issue including having the first interim evaluation examine how to improve the efficiency and effectiveness of the delivery of the EDA. An external consultant was also hired to hold discussion group meetings in early 1997 to gather ideas and suggestions on potential projects for the EDA from key stakeholders.

6.43 Changes were implemented, beginning in August 1997, to improve the administrative processes and management of the EDA. Some of the improvements made are noted in this chapter including the establishment of Federal and Provincial Directorates dedicated to the administration of the Agreement, assigning the Provincial Directorate responsibility for receiving project proposals and tracking the status of those proposals, and developing a ranking process for proposals received. Exhibit 6.6 on page 84 provides a summary of observations for improvement from the first interim evaluation report along with departmental comments related to actions taken to address those observations.

6.44 Management responsible for the EDA has demonstrated the desire to continue to improve the administrative process. It has requested in the terms of reference of the second interim evaluation that the evaluation include consideration of questions such as “*are there more effective and/or efficient mechanisms to deliver and implement future programs and are there lessons learned which could be immediately applied to the Diversification Agreement?*”

Project Assessment and Approval

6.45 *Overview* - We reviewed a sample of 25 projects to evaluate the project assessment and approval process followed. We found that all projects had a project brief and project authorization form which noted a linkage to the EDA objectives. However, the file documentation supporting the analysis of how that linkage was determined was deficient before August 1997. Improvements were noted after August 1997. We also found project proposals were being approved as required under the EDA.

6.46 *Review of projects* - We reviewed 25 projects and found they were properly approved by the Management Committee.

6.47 Of the 25 projects reviewed, there were 13 project proposals approved prior to August 1997 which required analysis by the project officers for eligibility under the EDA. Five of these did not have documentation on file to support the analysis of how the linkage to the EDA was determined. Of the 12 projects approved after August 1997, one did not have adequate documentation on file to support the analysis.

6.48 According to prescribed policies, after August 1997, letters of offer had to be signed by the Deputy Minister of EDT if the commitment was in excess of \$250,000, otherwise the letters were signed by the Federal or Provincial coordinator. We reviewed four projects approved after August 1997 which had commitments in excess of \$250,000 and all were appropriately signed.

6.49 *Priorities* - The strategic priorities of the EDA are defined in the Agreement. According to policies established, the project brief and project authorization form must demonstrate how the project contributes to the objectives and priorities of the Agreement. Of the 25 projects reviewed, we found that the rationale for recommending projects was adequately documented and the rationale was consistent with the Agreement.

6.50 In August 1997 a new eligibility test was implemented which required project officers to answer a number of questions as to the eligibility of the proposal under the Agreement and each question had a weight in order to rank the project as low, medium or high. The purpose of the test was initially to improve the documentation supporting the eligibility of the project. If a project fell within the objectives of the Agreement, it was allowed to be recommended for approval. Since January 1998, due to the rapid reduction in funds available under the Agreement, the ranking

information produced was used to ensure remaining funds available would go to the highest ranking project proposals received. The Federal and Provincial Coordinators asked the project officers to provide them with priority project proposals and the Coordinators then ranked them based upon how they fit into the overall objectives of the EDA. The coordinators then confirmed the ranking with the project officers and the management committee.

Monitoring

6.51 Overview - Once an EDA project is approved and payments are made, it must be monitored to ensure the terms and conditions for the assistance provided are being complied with and the funds used for the purposes intended. The monitoring procedures required may vary according to the terms of assistance provided and may include such items as receipt of invoices supporting expenditures, progress reports or site visits. Controls have been established to ensure the terms and conditions for the assistance provided are being complied with and funds used for their intended purposes but not all controls have been operating as intended or, due to a lack of documentation, we were unable to determine if the controls were operating appropriately. The controls established include the following.

- *Internal audit* - It is the intention of staff involved in the Agreement to have a joint annual audit of expenditures under the Agreement by the internal auditor at EDT and ACOA. The objective of this audit, as described in the latest audit letter, is "to examine each selected transaction for evidence of being incurred and paid by the applicant and being claimed to ACOA. The audit also ensured the transactions or expenditures were consistent with the project agreements as approved by the Management Committee."

The last joint audit completed on the Agreement was related to expenditures of the 1994-95 and 1995-96 fiscal year and was completed in 1996-97. It was indicated that another audit is planned in 1998-99 to cover expenditures for 1996-97 and 1997-98. In order to identify issues on a timely basis and specifically before all or a significant portion of the funds have been advanced on a project, the internal audit coverage of the Agreement should be completed on a more timely basis.

- *Support for claims* - Claims received from clients for approved projects must include either actual invoices supporting the expenditures in those claims or a detailed accounting of how the funds were spent. The detailed accounting was allowed due to the volume of support which clients would have to send in with each claim. It is left to the discretion of the project officer as to what is required depending on their knowledge and experience with the client. The clients are informed that any claim submitted could be subject to audit at any time. According to the terms of assistance, clients are required to maintain the supporting documentation for a claim for a period of three years.

The appropriateness of providing a detailed accounting as support for a claim depends on audits of claims being conducted, on a timely basis, as allowed under the terms and conditions of the assistance provided. This would be accomplished by the joint annual internal audit which we have already indicated is not being done on a timely basis. Since an audit does not guarantee that all errors are identified and it may be a year or more before an audit is completed on expenditures claimed, a policy should be put in place which establishes an approved expenditure limit over which actual invoices must be submitted.

Of the 25 projects we reviewed, we found 22 which had payments made related to them, 13 approved prior to August 1997 and 9 approved after August 1997. Of the 13 pre-August projects, 6 did not have adequate support for the costs claimed. Three

others had support provided but the detail of information included was insufficient to determine if the costs were eligible. Of the 9 post-August projects, 2 did not have adequate support for the costs claimed. Three additional projects had a detailed accounting of the expenditures.

It should be noted that, on occasion, if staff are not comfortable about the accuracy or eligibility of costs being paid under a project, they have asked the internal auditor to do a review of the expenditures for that project.

Another method for ensuring claims are adequately supported is an option which is typically included in the letters of offer where the *“Minister may request the Recipient to provide an Audit Report/Certificate prepared and signed by the external auditor of the Recipient.”* It is at the discretion of the project officer, if he/she has a concern about the costs claimed under a project, whether this option is used and as noted in a letter of offer, the audit can deal with *“related party transactions, conformity with generally accepted accounting principles, any other government assistance received or to be received for costs that are being supported under the Project, and eligible project costs.”* Of the 25 projects we tested, we noted one instance where such an audit had been requested.

- *Project Officer responsibilities* - Project Officers have been assigned responsibility for monitoring projects to ensure compliance with the terms and conditions of assistance provided. Of the 21 approved projects we reviewed, which would require monitoring activity, there were 12 pre-August 1997 projects and nine post-August 1997 projects. Of the 12 pre-August projects, there were four which did not have sufficient documentation on file to support regular monitoring activity such as reports, correspondence, and results of site visits. Of the eight post-August projects, there was one which did not have sufficient documentation on file to support regular monitoring activity.
- *Cheque requisitions* - The project officers prepare cheque requisitions to initiate a payment for an approved project and can request that the cheque be returned directly to them for delivery to the client. There is a risk that an unsupportable cheque requisition is requested, the cheque is directed to the project officer, and is misplaced and goes undetected. The joint internal audit would be a control over this risk. However, controls would be improved if the cheques requested by the project officer were not returned to the officer before delivery to the client.

6.52 *Procurement* - If the Provincial government is the implementing party of the project, the Government Procurement Policy must be followed according to the terms of the EDA. The Policy addresses due regard for economy in government procurements. One of the objectives of the Policy is *“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.”* For projects that are not implemented by government, the letter of offer addresses due regard for economy including the requirement that *“an appropriate tendering process will be followed in all circumstances where more than one supplier of goods and services is believed to be available.”* It notes the procurement process followed should be acceptable to the project officer.

6.53 Of the 25 projects we reviewed, there were two projects which were implemented by a Provincial government department and had procurement transactions, one approved prior to August 1997 and one after this time. The project approved prior to August 1997 lacked documentation supporting compliance with the Government Procurement Policy. Of the remaining 23 projects, 15 were implemented outside of the Provincial government and had procurement transactions, (nine pre-August 1997 projects and six post-August 1997 projects). Of the nine pre-August projects, none had documentation on file to support whether due regard for economy was followed for

procurements under the projects. Of the six post August projects, three did not have documentation on file to support whether due regard for economy was followed for procurements.

6.54 *Repayable assistance* - Under the EDA, only the Federal portion of assistance under the Business Investment Program (BIP) has to be repaid. However, there have been some projects approved in other programs which require the Provincial portion to be repaid. There are no established criteria to define when the Provincial portion of a project should be repaid.

Accounting Controls

6.55 *Overview* - During the 1997-98 fiscal year the recovery of expenditures from the Federal government under the Agreement was the responsibility of the Department of Finance. This responsibility was transferred to the Provincial Directorate at EDT for 1998-99. EDT has been and remains responsible for accounting for the expenditures under the Agreement.

6.56 *Recoveries* - The Provincial government disburses all funds under the EDA and then recovers the Federal share of the costs. As noted in paragraph 6.59, claims are typically sent to the Federal government once a month. According to staff this would be the only type of payment due to the Province under the Agreement until 2000-01 when some of the Provincial costs of assistance become repayable from the clients.

6.57 During the 1997-98 fiscal year we found that there were controls in place to ensure funds due to the Province from the Federal government were recovered but improvements in the cash receipt function were required to ensure adequate controls. There was a segregation of duties weakness where one individual was responsible for setting up the receivable, receiving the cash, recording the receipt in the accounting records and following up on delinquent receivables. During our testing we did not note any instances where cash was not deposited intact.

6.58 At the time of our audit, no claims had been made to the Federal government for expenditures under the Agreement but the planned processes to be followed for recoveries should provide adequate controls to ensure all funds due to the Province are recovered.

6.59 Claims for expenditures under the Agreement, for 1998-99, are not being made on a timely basis. According to staff, claims typically are prepared on a monthly basis. However, as at November 15, 1998, there had not been a claim prepared for 1998-99 and there had been approximately \$13.5 million in funds disbursed under the Agreement of which \$9.45 million is recoverable by the Province from the Federal government.

CONCLUDING REMARKS

6.60 The Canada/Nova Scotia Cooperation Agreement on Economic Diversification provides a significant amount of government funding to promote economic development in the Province and identifies strategic priorities in order to focus efforts under the Agreement. It is important that those funds are properly managed and controlled to ensure the objectives of the Agreement are met and that an effective accountability framework is in place to provide information on the plans and performance of the Agreement in meeting those objectives.

6.61 Management responsible for the Agreement recognizes the importance of the proper management and control of the Agreement, initiatives have been undertaken to identify areas of improvement and changes have been implemented to improve management processes. Through our review, we have identified further improvements related to the management and control of the Agreement.

*Exhibit 6.1***BACKGROUND INFORMATION ON THE MANAGEMENT AND CONTROL OF THE EDA**

Federal responsibility for the Agreement belongs to the Atlantic Canada Opportunities Agency (ACOA), while Provincial responsibility lies with the Department of Economic Development and Tourism (EDT). The delivery structure of the EDA has changed in the last few years. In the past, there were various staff throughout the Federal and Provincial government who were assigned responsibility for various aspects of the Agreement either individually or as part of project committees. Most of these staff were not dedicated to the EDA. As of August 1997, a Provincial Directorate was established with nine positions dedicated 100% to the EDA. The Federal Government also has a directorate. These Directorates are responsible for areas including planning, policy development, financial reporting and budget control, administration and evaluation, and communication related to the EDA. Exhibit 6.2 provides a description of the governance, accountability and management organization of the Agreement for the Provincial government.

As of August 1997, the economic strengths of the Province are split between the two Directorates with each taking a lead role in their assigned strengths. There are some projects which do not fall into a specific strength. These are classified as multi-sectoral projects. The responsibilities of the lead role include evaluating proposals received, being the primary contact with the clients, and continued monitoring and follow up on projects. The Provincial Directorate has the lead role in culture and heritage, trade, and education and research; with the Federal Directorate responsible for oceans and the environment, gateway to North America and multi-sectoral projects. The Federal and Provincial Directorates share responsibility for community economic development but other staff within EDT and ACOA, rather than the directorates, are performing the lead role duties related to this area.

There are four project officer positions in the Provincial Directorate which have been vacant since the Directorate was established. In the meantime, various project officers have been selected throughout the provincial government as project proposals have come forward for review and subsequent monitoring, if approved. It was the intention that one project officer be responsible for all projects in an economic strength area. Since there are limited funds available for projects now, the plan is to fill only two of the project officer positions. At the time of our audit a competition was in progress to fill these positions. These project officers will be responsible for completing an analysis of project proposals received for the remaining uncommitted funds and monitoring projects approved to date and in the future.

The Provincial Directorate receives project proposals, distributes them to Provincial or Federal project officers accordingly, and tracks their status. All projects recommended for approval by project officers are reviewed by the Federal and Provincial Coordinators to ensure consistency of treatment for projects brought forward and a review based upon the knowledge of other priorities and pending initiatives of which the project officer may not be aware. According to the EDA, projects must be approved by the Management Committee before they can proceed.

The Provincial Directorate disburses all funds under the Agreement based upon costs claimed through projects. The Federal share of the costs are then recovered. The budget for EDT includes the expenditures of EDA net of recoveries from the Federal government. The 1998-99 EDA net expenditures budgeted for the Province were approximately \$11.1 million, while actual net expenditures for 1997-98 were reported as approximately \$7.9 million.

The EDA generally does not provide for direct assistance to a business or individual except under the Business Investment Program (BIP). Under the EDA, the Federal portion of assistance provided under the BIP is required to be repaid. As well, typically, in any program if the terms of assistance are not complied with, 100% repayment is required. There is no interest charged on repayable assistance except when there is a default on a project and then interest at the Bank of Canada prime rate on the day of default would be charged. According to staff of the Provincial Directorate, as of October 1998, there have been no defaults on agreements identified and there is approximately \$1.975 million in provincial expenditures from two projects which is recoverable from clients but no amount is payable until 2000-01 or later.

Exhibit 6.2

**PROVINCIAL
GOVERNANCE, ACCOUNTABILITY AND MANAGEMENT ORGANIZATION
AS OF NOVEMBER 1998**

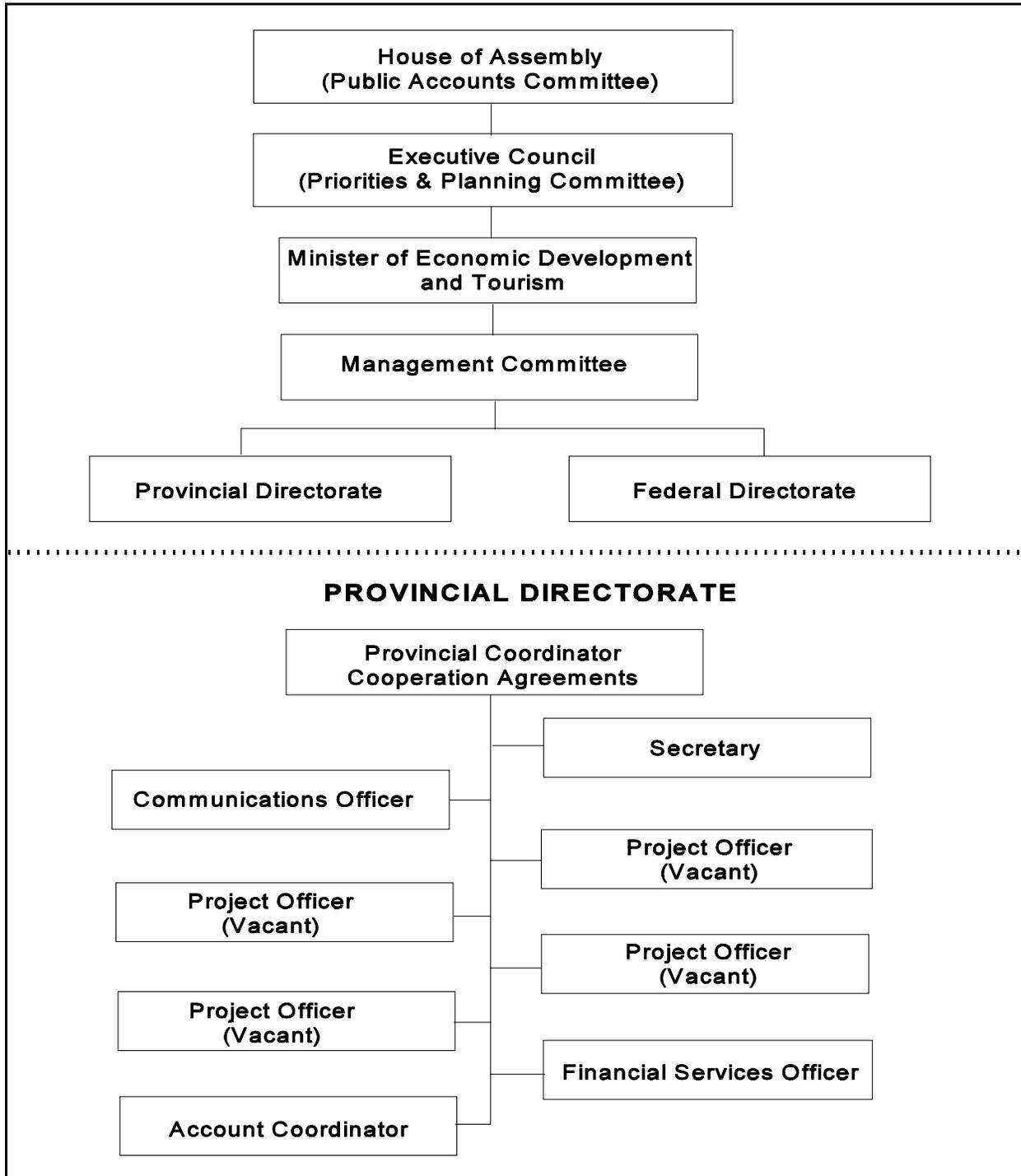


Exhibit 6.3

**SUMMARY INFORMATION ON THE EDA BY PROGRAM
AS AT NOVEMBER 15, 1998
(\$000)**

(Source: EDT and ACOA Staff)

Program	Total Budget for Agreement	# Projects Approved	% of Total Committed	Committed	Disbursed	Recovered From Federal Government
Business Investment	\$ 6,300	13	0.2	\$ 420	\$ 353	\$ 247
Technology Infrastructure	27,000	32	24.6	44,970	3,816	1,932
Strategic Sector Development	55,775	135	18.6	34,149	13,475	6,474
Community Economic Development	19,300	26	13.6	24,945	15,178	8,476
Building Economic Foundations and Improving Business Climate	30,000	97	6.6	12,129	6,344	3,507
Strategic Initiatives	63,520	63	34.2	62,584	50,061	30,358
Administration and Evaluation	2,860	13	1.9	3,431	2,532	59
Communications	1,430	4	0.3	462	217	79
TOTAL	\$ 206,185	383	100.0	\$ 183,090	\$ 91,976	\$ 51,132 (Note 1)

Note 1: The amount recovered plus the amount from paragraph 6.59, which is recoverable, does not equal 70% of the total disbursed to date. This is because the cost of each project approved may not be 70% recoverable from the Federal government. The cost sharing ratio can vary by project but at the end of the Agreement the total costs by program will be cost shared 70:30 between the Federal and Provincial government as noted in paragraph 6.4.

Exhibit 6.4

**SUMMARY INFORMATION ON THE EDA BY ECONOMIC STRENGTH
AS AT NOVEMBER 15, 1998
(\$000)
(Source: EDT Staff)**

Strength	# of Projects Approved	% of Total Committed	Committed	Disbursed
Culture and Heritage	54	25.3	\$ 46,306	\$ 30,845
Trade Centre	20	5.3	9,834	5,852
Education and Research	89	35.0	64,010	18,306
Gateway	14	3.4	6,163	1,456
Oceans and Environment	106	6.2	11,405	6,394
Multi-Sectoral	55	8.7	16,107	11,031
Community Economic Development	28	13.9	25,372	15,343
Administration and Evaluation	13	1.9	3,431	2,532
Communications	4	0.3	462	217
TOTAL	383	100.0	\$ 183,090	\$ 91,976

Note: The budget was established based upon programs and not strengths. The amount recovered by strength is not monitored and reported by the Directorate.

**PROJECTS APPROVED WHICH COMMITTED \$2.5 MILLION OR MORE IN FUNDS
AS OF NOVEMBER 15, 1998
(\$000)**

(Source: EDT Staff)

Project Name Program/Strength Date Approved	\$ Committed	\$ Spent	Type of Assistance (Note 1 & 2)	Project Objective
Information Economy Initiative Technology Infrastructure/Education and Research May 1998	\$ 35,000	\$ 0	Govt	The development of the human resource base and information technology infrastructure within universities, communities and schools to accelerate the development of the knowledge based economy of Nova Scotia.
Regional Development Authorities Community Economic Development (CED) /CED Various	13,426	9,314	GD (7 projects)	To provide core funding for the operation of 14 Regional Development Authorities (RDA) throughout Nova Scotia.
	5,051	1,799	GD (5 projects)	To assist the RDAs with the implementation of their strategic plans to enhance the sustainability of communities and create quality sustainable jobs.
	2,831	1,791	GD (19 projects)	To provide funding for various individual RDA projects not under the scope of core funding or strategic plans.
	<u>21,308</u>	<u>12,904</u>		
Halifax Summit Projects Strategic Initiatives/Multi Sectoral March 1995	2,578	2,578	Non-Govt	Infrastructure projects completed for: The Waterfront Development Corporation.
	1,577	1,577	Non-Govt	The former City of Halifax.
	800	800	Non-Govt	The former City of Dartmouth.
	720	720	Govt	The Province of Nova Scotia.
	<u>5,675</u>	<u>5,675</u>		

Project Name Program/Strength Date Approved	\$ Committed	\$ Spent	Type of Assistance (Note 1 & 2)	Project Objective
Black Business Initiative CED/CED June 1995	5,000	3,000	Non-Govt	This project is designed to create viable business opportunities by providing advice, counselling, training, and financial support to enable black communities throughout the Province to increase their economic activity.
Glace Bay Recreation Facility Strategic Initiatives/Culture and Heritage June 1994	4,850	4,850	Non-Govt	To construct a multi-purpose facility as part of the community's efforts to revitalize its infrastructure.
Middle Shoal Improvement Program Strategic Initiatives/Trade Centre August 1996	4,741	4,063	Non-Govt	To create a deeper channel that will improve the competitiveness of the mining and milling operations in the area of Little Narrows, Cape Breton.
Neptune Theatre Foundation Strategic Initiatives/Culture and Heritage August 1995	4,500	4,500	Non-Govt	To renovate and expand the Neptune Theatre located in Halifax, Nova Scotia
Pier 21 Society Strategic Initiatives/Culture and Heritage August 1997	3,850	2,836	Non-Govt	To assist Pier 21 Society establish the Pier 21 Centre, an historic attraction and multi-purpose facility to be located on the Halifax Waterfront.
International Year of Music Strategic Sectors/Culture and Heritage March 1997	3,484	1,884	GD	To substantially grow the cultural sector in the province through the development and implementation of a number of activities based upon the music and cultural traditions of the province.
Silicon Island Arts and Innovation Centre Strategic Initiatives/Education and Research June 1997	3,296	2,002	Non-Govt	To renovate the former Courthouse and adjacent facilities at MacDonald House in Sydney, Cape Breton to take advantage of the inherent strengths of the small but growing Cape Breton multimedia sector. The facilities will be used as a Digital Media Innovation Centre, Digital Art Gallery and Digital Business College.

Project Name Program/Strength Date Approved	\$ Committed	\$ Spent	Type of Assistance (Note 1)	Project Objective
BioScience Enterprise Centre Technology Infrastructure/Trade Centre January 1998	1,750	394	Govt	The Waterfront Development Corporation and EDT are to jointly establish an incubation facility in Halifax that will be a major catalyst in the creation of the bio-life science industry sector. The first project mentioned is for the capital improvements and maintenance of the facility and the second project is to cost share the renovations and laboratory installations with tenants.
	1,500	338	Govt	
	<u>3,250</u>	<u>732</u>		
Computers in Schools Strategic Initiatives/Education and Research April 1996	3,068	3,068	Govt	This project was to establish community education training centres in 135 junior and senior high schools.
Sobey Centre for Business Strategic Initiatives/Multi Sectoral July 1998	2,750	619	Non-Govt	This contribution to Saint Mary's University is to provide for costs earmarked for building space designated for non-academic and non-credit programs in the new building.
Harbour Edge Strategic Initiatives/Culture and Heritage April 1996	2,575	1,000	Non-Govt	To assist the former City of Dartmouth complete Phase II of a commercial and recreational infrastructure project on the Dartmouth Waterfront.
TOTAL	\$ 103,347	\$ 47,133		

Note 1: **Govt** - funds disbursed to government department/agency

Non-Govt - funds disbursed to non-government entity

GD - funds disbursed to government department/agency for sub-projects outside of government

Note 2: Each amount represents one project unless otherwise stated.

Exhibit 6.6

**FOLLOW-UP TO THE FIRST INTERIM AGREEMENT
EVALUATION RECOMMENDATIONS
STATUS AS OF NOVEMBER 1998
(Source: EDT Staff)**

Observations	Department Response
1. Establish a small secretariat with a full-time staff (including clerical) to serve as the central handling point for EDA projects.	Implemented August 1997.
2. Introduce a system of delegation for decision-making on project proposals to speed up project funding decisions and contribute to achieving the client friendly delivery the EDA is seeking.	Agreed to by the EDA Management Committee in November 1997; final component, the ability to make financial commitments below a certain value, subject to confirmation of authorities, is planned to occur in December 1998.
3. The EDA needs a clear strategic focus that both its staff and clients can easily understand.	A strategic plan and updating process for identifying priority projects was accepted in August 1997. The submission of consistent written statements of priority activities at regular Management Committee meetings commenced in February 1998.
4. Create a single entry point for EDA clients which facilitates tracking of proposal status from inception all the way through to completion.	A single entry point for projects was implemented in August 1997.
5. Create a project tracking system for Directorate staff to monitor the outcomes, results and progress of projects from inception to completion.	A unified tracking system for projects was implemented in August 1997. It provides information on the stage of project proposals from receipt to approval or rejection of the proposal. The tracking system is currently being enhanced to provide for effective monitoring and reporting of outcomes and results. Planned implementation is early 1999.

7.

EDUCATION AND CULTURE - PUBLIC-PRIVATE PARTNERSHIPS (P3s) FOR SCHOOL CONSTRUCTION - FOLLOW-UP REVIEW

BACKGROUND

7.1 The Minister of Finance announced in the April 1997 Budget Address to the House of Assembly that all future school construction projects in the Province would be built under public-private partnership (P3) arrangements. The government made a public policy decision with respect to school construction - schools will be built without adding to the debt of the Province - and the government has also stated that operating leases with the private sector will be used to accomplish its objective.

7.2 The mandate given to this Office under the Auditor General Act does not extend to assessment of public policy. We, therefore, do not express general comments on whether the debt for school construction should be kept off the Province's balance sheet or whether the Province should seek operating leases with the private sector. We will, however, as part of our mandate for audit of the March 31, 1999 and subsequent Public Accounts comment on the accounting treatment and disclosure issues related to signed leases and other agreements.

7.3 The government's school construction initiatives under P3 arrangements are extensive. Eight specific schools to be built under P3 arrangements were originally announced. One of those (Sherwood Park Junior High in Sydney) was opened in January 1997. Another (O'Connell Drive Elementary) was opened in September 1997. Two others (Horton High School and Hants East Middle School) were opened in September 1998 and two others (Hants East Elementary and Meadowfields Community School) are currently under construction. A development agreement has been signed for Amherst Regional High and the development agreement for Aspotogan Peninsula Elementary was recently approved by Executive Council, but construction has not started on either school.

7.4 In December 1997 Executive Council approved the *Report of the School Capital Construction Committee* dated September 1997. The government then announced that it would proceed with approximately \$360 million of school construction and renovations, including \$250 million relating to construction of 31 new schools under P3 arrangements. A two-stage Request For Proposals process was conducted during 1998 to select preferred private sector partners and in September 1998 government announced the selection of three preferred private sector partners to build the 31 schools.

7.5 We have issued two prior audit reports relating to certain aspects of the public-private partnership process for school construction. We strongly recommend that readers of this report also read our prior reports to gain a fuller understanding of the issues associated with P3 schools in the Province, and to establish an appropriate context for the current report.

- Our 1997 Annual Report (Chapter 8, page 78) included results of a detailed audit of the P3 process. At the date of writing of that report (December 1997) the Province had not signed leases for any of the eight P3 schools that had been announced, although two were occupied (Sherwood Park Junior High and O'Connell Drive Elementary) and construction had started on two others (Horton High School and Hants East Middle School).

- On July 23, 1998 we issued a Report which was tabled in the House of Assembly in response to a request from the Minister of Education and Culture for an audit of the lease on O'Connell Drive Elementary School. This was an audit of the first P3 school lease signed by the Province. The purpose of that Report was to convey our conclusions with respect to whether the Province's accounting for the 20-year lease, signed on March 12, 1998, complied with generally accepted accounting principles. The major findings from that report are included in paragraph 7.11 below.

7.6 The Canadian Institute of Chartered Accountants (CICA) makes recommendations relating to accounting principles. The CICA identifies two basic types of leases (operating leases and capital leases). An understanding of the distinction between the two is necessary to fully understand the issues related to accounting for P3 schools. The definitions below emphasize that the difference between an operating lease and a capital lease is based on the amount of risk transferred from the lessor (consortium) to the lessee (Province).

7.7 The main characteristics of operating and capital leases are as follows.

- An *operating lease* is a lease in which the lessor (private sector) does not transfer substantially all the benefits and risks incident to ownership of property. Lease rentals under an operating lease should be included in the determination of net income over the lease term on a straight-line basis. *The Province under an operating lease is, in effect, committing to fund expenditures from its annual revenues for each of the next 20 years. In the Province's financial statements, classification as an operating lease results in payments being recorded as expenditures when incurred, and no liability for future lease payments is recorded.*
- A *capital lease* is a lease that, from the point of view of the lessee (Province), transfers substantially all the benefits and risks incident to ownership of property to the lessee. A capital lease would be accounted for by the lessee as an acquisition of an asset and an assumption of an obligation to reflect the substance of the transaction in the year in which the lease was signed. *In the Province's financial statements, classification as a capital lease results in 100% of the cost of a leased asset being recorded as an expenditure and a liability when the lease is signed. Over the 20-year period, the only impact on annual results will be interest expense related to the outstanding liability.*

RESULTS IN BRIEF

7.8 The following are the principal observations resulting from this review.

- As of the date of writing of this Report (early December 1998), the Department of Education and Culture and private sector consortiums have signed final leases for two schools (O'Connell Drive Elementary and Hants East Middle). Our audit of the O'Connell Drive Elementary School lease was released in July 1998. We have not audited the accounting for the Hants East Middle School lease.
- Development agreements have been reached for four of the original eight P3 schools announced by government (three have been signed and an additional one was recently approved by Executive Council). Two of these schools are under construction and two are in the planning stage. The development agreements for two of the schools state that leases will be signed when construction is complete.

- A development agreement was signed in November 1998 for 13 schools for the Chignecto-Central Regional School Board, Conseil scolaire acadien provincial and the Halifax Regional School Board. It includes the approved construction costs for each school, the general form of the service agreement, and a schedule of service agreement fees (subject to adjustment for changes in interest rates to date of financial close). Construction has not started on these schools. A development agreement for 13 schools for the Cape Breton-Victoria Regional School Board and the Strait Regional School Board was approved by Executive Council in December 1998.
- As noted in our 1997 Annual Report (page 90), on December 11, 1997 the Priorities and Planning Secretariat released *Partnerships & School Construction: A Review* which made several recommendations to improve government control over P3 school construction initiatives including: “*No construction contracts for any new projects should be executed until financing is in place and leases are signed.*” We are not clear on whether the requirements of the Priorities and Planning Secretariat’s Review have been met for Hants East Elementary School and Meadowfields Community School. The approach that the Province has taken in signing development agreements before construction, and leases at the date of completion, is different from that contemplated by the Review. The development agreements were approved by Executive Council and the Priorities and Planning Committee, and the Department of Education and Culture has indicated that this occurred after a full briefing on the contents of the development agreements.
- As of March 31, 1998 the Department of Education and Culture had recorded construction advances of \$35.9 million to consortiums and a related provision for doubtful accounts of \$16.1 million. These amounts related to construction advances on Sherwood Park Junior High, Horton High School, and Hants East Middle School which are currently occupied. The advance for Hants East Middle School was repaid when the lease was signed and the advances for Horton and Sherwood Park are still outstanding. The construction costs of the two schools currently in progress (Hants East Elementary and Meadowfields) are being financed by the consortiums and/or their lenders.
- Development agreements and leases are being negotiated for the remaining schools.

SCOPE OF REVIEW

7.9 The objective of this follow-up review was to determine and report the status of certain aspects of the Department of Education and Culture’s P3 school construction initiative.

7.10 Our approach was based on discussions with management of the Department of Education and Culture and examination of documentation provided.

PRINCIPAL FINDINGS

July 1998 Report on O’Connell Drive Elementary School Lease

7.11 The major observations resulting from our July 23, 1998 report on the O’Connell Drive Elementary School lease follow. (The full report is available from the Nova Scotia Government

Bookstore or on the Internet at www.gov.ns.ca/legi/audg/pubs.htm#SPCREP). However, our July 23, 1998 report also noted that each school lease will be unique and that our comments related only to the lease for O'Connell Drive Elementary School.

Major Observations from July 23, 1998 Report of the Auditor General on O'Connell Drive Elementary School Lease

- The decision on whether the Province should proceed with lease arrangements for schools (and also in other sectors) is complex and should be based on a thorough analysis of costs and benefits including the economic impact on the Province now and in future years, and impact on the education of students in this Province. The accounting classification of specific leases is just one of many factors that should be considered when making decisions about whether needed public infrastructure will be made available to residents, and it should not be the determining factor.
- The most appropriate accounting for the O'Connell Drive Elementary School lease would be classification as a capital lease because most of the risks and benefits rest with the Province. The Province and consortium negotiated an amendment to the lease terms in July 1998 through which the consortium contributed additional services to the Province. The revised lease meets the quantitative tests included in the CICA Handbook for classification as an operating lease. Therefore, the Province's decision to account for the revised lease as an operating lease is acceptable.
- The private sector consortium obtained financing for the lease through a pension fund which operates in a tax-free environment. The end result for the Province is that the financing for the school is at the same rate as the Province would have incurred if it had borrowed.
- The Province has been successful in transferring some risk to the private sector, but the majority of the risk remains with the Province.
- This lease demonstrates the potential accounting issues associated with lease agreements where services, in addition to the basic net lease, are acquired. These issues relate to the difficulty in assigning gross lease payments to individual services and the appropriate valuation of those services.
- The Province has made significant, positive changes to the P3 process for future school construction projects. For example, the Stage II Request for Proposals issued in July 1998 for 31 new schools requires the proponents to specifically address risk transfer and financing arrangements in their proposals.

Eight Original P3 Schools

7.12 As of the date of writing of this Report (early December 1998), the Department of Education and Culture and private sector consortiums have signed final leases for two schools:

- O'Connell Drive Elementary (Porters Lake) - opened September 1997
- Hants East Middle - opened September 1998

7.13 Development agreements have been signed for three schools:

- Amherst Regional High - construction not yet started
- Hants East Elementary - construction in progress
- Meadowfields Community School (Yarmouth) - construction in progress

7.14 A development agreement was recently approved by Executive Council but has not yet been signed for one school:

- Aspotogan Peninsula Elementary School - construction not yet started

7.15 The status of the remaining two schools is as follows:

- Horton High - opened September 1998 - lease currently under negotiation
- Sherwood Park Junior High - opened January 1997 - lease currently under negotiation

7.16 As noted in our 1997 Annual Report (page 90), on December 11, 1997 the Priorities and Planning Secretariat released *Partnerships & School Construction: A Review* which made several recommendations to improve government control over P3 school construction initiatives including:

“No construction contracts for any new projects should be executed until financing is in place and leases are signed.”

7.17 *Hants East Elementary and Meadowfields Community School* - As noted in paragraph 7.13 above, construction is in progress for Hants East Elementary and Meadowfields Community School but leases have not yet been signed. These two schools are being constructed by the same private sector consortium and similar development agreements have been signed by the Province and the consortium for the two schools. The development agreements were approved by Order in Council (OIC 98-289 dated June 18, 1998 for Hants East Elementary and OIC 1998-411 dated August 13, 1998 for Meadowfields).

7.18 The development agreements for Hants East and Meadowfields include the following:

- approved construction costs;
- construction schedule;
- statement that consortium is responsible for interim financing of construction costs; and
- an agreement relating to the signing of a lease when construction is complete. (The following is in section 11.1c of both agreements: *“On the Completion Date or such other date as the Province, Lenderco [a company to be incorporated by the institutions providing permanent funding for the Facility] and Nova [the consortium] may agree:...(c.)the Province, Lenderco and Nova shall enter into the Lease in the form attached as Schedule H, with the appropriate adjustments in rent pursuant to Schedule A thereof...”*)

7.19 Schedule H of both development agreements includes an unsigned lease document but the dollar amounts have been left blank. In both leases, the lease payment is to be based on the "Initial Yield" which is defined as "*the yield to maturity, as at the Commencement Date [Hants East - August 1, 1999 and Meadowfields - September 1, 1999], based on the interpolated rate of the 10.25% Government of Canada bonds maturing on March 15, 2014 and the 9.75% Government of Canada bonds maturing on June 1, 2021, compounded and payable semi-annually, plus 91 basis points...*" (Section 2.1(n) of Meadowfields lease and 2.1(l) of Hants East lease).

7.20 In other words, the lease payments are to be based on market interest rates at a future point in time plus 91 basis points and will not be known with certainty until that time.

7.21 There is no indication in the development or lease agreements as to whether the consortium has arranged long-term financing for the two schools. However, we received written confirmation from the consortium that "*firm long term financing arrangements are in place for the Hants East Elementary School in Lantz and Meadowfields Community School in Yarmouth.*"

7.22 We are not clear on whether the requirements of the Priorities and Planning Secretariat's Review referred to in paragraph 7.16 above have been met for Hants East Elementary School and Meadowfields Community School. The approach that the Province has taken in signing development agreements before construction, and leases at the date of completion, is different from that contemplated by the Review. The development agreements were approved by Executive Council and the Priorities and Planning Committee, and the Department of Education and Culture has indicated that this occurred after a full briefing on the contents of the development agreements.

7.23 *Amherst High School and Aspotogan Peninsula Elementary School* - The development agreements for Amherst and Aspotogan incorporate an approach different from the other two signed agreements and include general parameters to govern development of a service agreement rather than a lease. The service agreements, including required payments by the Province, have not been signed yet but the Department of Education and Culture has indicated that they will be signed prior to the start of construction. Aspotogan Peninsula Elementary School is included in the development agreement described in paragraph 7.28 below.

7.24 *Hants East Middle School* - Hants East Middle School was opened in September 1998 and the lease was signed on September 1, 1998. A development agreement had previously been signed and was approved by Order in Council (OIC 1998-335 dated July 1998). The Department of Finance has reviewed the lease and determined that it meets the mathematical tests for classification as an operating lease as set forth in the guidance in the CICA Handbook. We have not audited the Department of Finance's calculations or accounting for this lease but we will need to audit this and any other leases or related agreement in order to express an audit opinion on the March 31, 1999 Public Accounts.

7.25 *Construction advances* - As of March 31, 1998 the Department of Education and Culture had recorded construction advances of \$35.9 million to consortiums (see page 89 of our 1997 Report) and a related provision for doubtful accounts of \$16.1 million. As of November 1998, the construction advance account balance was \$41.9 million and the related provision for doubtful accounts was \$14.4 million. These amounts relate to construction advances on Sherwood Park Junior High and Horton High School. Advances made for O'Connell Drive Elementary School and Hants East Middle School were recovered when leases were signed.

31 Schools Announced in December 1997

7.26 In September 1998, the Department of Education and Culture announced that it had selected preferred private sector partners for the 31 additional schools to be built. There are three private sector consortiums involved. Negotiations between the Province and the consortiums are proceeding, and one development agreement has been signed to date. Another has been approved by Executive Council. Construction has not started on any of the schools.

7.27 The development agreement signed in November 1998 relates to 13 schools for the Chignecto-Central Regional School Board, Conseil scolaire acadien provincial and the Halifax Regional School Board. It includes the approved construction costs for each school, the general form of the service agreement, and a schedule of service agreement fees (subject to adjustment for changes in interest rates to date of financial close).

7.28 The development agreement for 13 schools for the Cape Breton-Victoria Regional School Board and the Strait Regional School Board was approved by Executive Council in December 1998 but has not yet been signed. Management of the Department of Education and Culture anticipate that development agreements for the remaining five schools will be signed by the end of December 1998.

CONCLUDING REMARKS

7.29 The Department of Education and Culture is responsible for negotiating leases with private sector consortiums which comply with government policies including the requirement that the resulting leases be operating leases. The government's Co-operative Business Solutions procurement process has been used to select preferred private sector partners which means that a supplier is selected on the basis of qualifications and capability rather than price, to form a business alliance of shared risks, resources and benefits between the supplier and government. Cost is negotiated after a preferred supplier is selected. The Co-operative Business Solutions procurement process and the requirement for operating leases both restrict the government's negotiating options.

7.30 These are large projects which require significant financial investments and there are many risks to be considered by the Province and the consortiums. Negotiating these significant items takes time. Development agreements have been reached for 26 of the 31 schools where preferred private sector partners were announced in September 1998. This is a significant improvement over the length of negotiations for the original eight schools.

7.31 The only lease which we have audited to date is the one on O'Connell Drive Elementary School and the resulting report was tabled in the House of Assembly in July 1998. Accounting for P3 leases will be included in our audit of the March 31, 1999 Public Accounts. Our 1999 Annual Report and future reports will include any related comments.

7.32 As stated in our 1997 Report, monitoring and evaluating P3 arrangements both during and after implementation is important and we encourage government to establish an appropriate process to monitor and evaluate P3 schools which is independent of those with responsibility for the P3 initiative.

8.

EDUCATION AND CULTURE - TEACHERS' SALARY CONTINUATION PLAN

BACKGROUND

8.1 Section 143(1) of the Education Act 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.”

8.2 In our 1996 Annual Report (page 53), we included the results of an audit of the Teachers' Group Insurance Plans. That audit included a finding with respect to the Teachers' Salary Continuation (long-term disability) Plan which was summarized as follows:

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 the Nova Scotia Teachers Union Group Insurance Trustees should reach an agreement regarding disposition of these dividends.

8.3 In our 1997 Report (page 121), we reported that on October 20, 1997 the Nova Scotia School Boards Association requested our office to undertake an audit of the Salary Continuation Plan to determine changes in the Plan subsequent to our 1996 audit including the current existence of surplus funds identified in our 1996 Report.

8.4 The requested audit was conducted during 1998 and on August 28, 1998, we issued our audit report to the Executive Director of the Nova Scotia School Boards Association. This Chapter summarizes the major points of that report.

8.5 The Nova Scotia Teachers Union (NSTU) Group Insurance Fund Trustees offer insurance plans to teachers in the Province including a Salary Continuation (long-term disability) Plan. The Trustees are appointed by the Executive of the NSTU under the provisions of a Trust Deed dated 1965. The Trustees receive premiums and make arrangements with Plan administrators and insurance carriers for salary continuation insurance coverage.

8.6 The Salary Continuation Plan was established in 1965. Enrollment in the Plan is voluntary for eligible teachers. Approximately 6,000 teachers (60% of eligible teachers) are enrolled. At the time of our audit, the premiums were set at 1% of gross monthly income. In some cases, members' premiums are cost-shared by school boards under the provisions of local collective agreements. There are currently 12 (pre-amalgamation) boards making contributions ranging from 20% to 70% of premiums. Total premiums for 1997 were \$2.8 million. New local agreements between the NSTU and amalgamated boards are currently being negotiated.

8.7 Johnson Incorporated administers the Salary Continuation Plan and the current insurance carrier is Manulife Financial. Johnson Incorporated has been the administrator since the Plan was established. The carrier was Citadel General Assurance from establishment of the Plan until 1991.

In 1991, Confederation Life became the carrier and in 1994 Manulife Financial assumed that responsibility when Confederation Life went into liquidation.

RESULTS IN BRIEF

8.8 The following are the principal findings resulting from our review.

- As at December 31, 1997 the Salary Continuation Plan had an accumulated deficit of \$3.6 million which originated in the period from 1995 to 1997. Although the Plan is an experience-rated insurance plan and the insurer is responsible for any deficit upon plan termination, the NSTU Trustees have indicated it is not their present intention to force Manulife to absorb any existing deficit by terminating the Plan.
- The NSTU Trustees and Manulife negotiated a Guaranteed Deficit Reimbursement Agreement signed in May 1998 which includes provisions whereby the NSTU has absorbed some of the Plan risk upon termination which was previously the responsibility of Manulife. The Trustees will have to pay the insurer \$1.2 million at Plan termination if the Plan is still in a deficit position and they also agreed to raise premiums by 20% in September 1998. The Trustees have set aside \$1.2 million of the NSTU Group Insurance Trust Fund in a dedicated reserve to cover the costs of the Guaranteed Deficit Reimbursement Agreement.
- Insurance plans should be reviewed by actuaries every three years to establish the adequacy of reserves, however the Plan has not been reviewed by actuaries since 1991.
- The prior years' dividends of \$5 million plus accumulated interest, as reported in our 1996 Report, form part of the NSTU Group Insurance Fund and have not been specifically segregated from other funds of the Trustees. The school boards should seek legal advice with respect to entitlement to prior years' dividends. The Trustees and school boards should negotiate an agreement regarding ownership of any future Plan surpluses or dividends.
- The claims experience for this Plan is currently about 44 claims per 1,000 insured teachers which is very high. The Trustees and other stakeholders, including school boards, should analyze the root causes of the Plan's negative experience and take action to resolve whatever problems are indicated.
- A Joint Committee, comprised of representatives of the Trustees, insurer and plan administrator, is actively monitoring the Plan and making worthwhile recommendations. The school boards should have representation on the Joint Committee.
- The NSTU and school boards should work together to ensure that there is a regular exchange of information about teachers who are potential candidates for Salary Continuation Plan benefits to facilitate early intervention particularly in alleviating situational stress.
- The Trustees and school boards should meet to discuss appropriate governance for the Salary Continuation Plan which would ensure that the school boards' interests are adequately represented in the decision-making process, and that the boards have sufficient, appropriate information to enable them to contribute meaningfully to the decision-making process.

AUDIT SCOPE

8.9 The objectives of the audit were to review the existence, ownership and valuation of any accumulated reserves, surpluses or deficits related to the Salary Continuation Plan, and to determine whether school board contributions to the Plan have been expended in compliance with the agreements and with due regard for economy and efficiency.

8.10 Our audit approach included discussions with management of the NSTU Group Insurance Fund Trustees, the Plan administrator (Johnson Incorporated), and the insurance carrier (Manulife Financial.) We also reviewed related documentation including financial reports, audited financial statements, the insurance policy and underwriting agreement. Our audit did not include a review of files related to individual claims.

PRINCIPAL FINDINGS

Responsibility for Deficits and Surpluses

8.11 The Salary Continuation Plan is fully experience-rated. Any deficit in the Plan upon termination of the policy is the responsibility of the insurer. This has been confirmed in our discussions with the NSTU Trustees, Johnson Incorporated and Manulife. Any surplus in the Plan would be returned to the Trustees.

8.12 If the Plan is not terminated, Manulife wishes to break even over a reasonable period of time. This can be accomplished through changes to the Plan (e.g., increasing premiums or reducing benefits).

8.13 As of December 31, 1997, the Salary Continuation Plan had an accumulated deficit of \$3.6 million which originated in the period from 1995 to 1997. Although the NSTU Trustees are not legally obligated to fund deficits, they have indicated it is not their present intention to force Manulife to absorb any existing deficit by terminating the Plan. The NSTU, in a letter to our Office, indicated the following.

"The NSTU maintains that the deficit/surplus relationship must be viewed in its entirety. That is, under a Surplus Refund Contract such as that which exists between the parties, the insured cannot act on a day-to-day basis in a manner that holds the insurer is totally responsible for deficits. To do so would mean chaos, with widely fluctuating premiums that would drive away voluntary participation."

Guaranteed Deficit Reimbursement Agreement

8.14 During the fall of 1997 and the early part of 1998, the NSTU Trustees and Manulife attempted to negotiate a solution to the deficit problem which would keep premium increases to a minimum. Various alternatives were examined and the two parties reached a Guaranteed Deficit Reimbursement Agreement which was signed by the Trustees in May 1998. The Agreement is significant because the NSTU will absorb some of the risk of the Plan which was previously the responsibility of Manulife. This risk transfer is in the form of a Special Payment of \$950,000 at Plan termination which the Trustees will make if the Plan still has a deficit.

8.15 Although Manulife was seeking a larger increase, the Agreement included a premium increase of 17% effective January 1, 1998 but the Trustees subsidized the full amount of the increase until August 31, 1998 at a cost of \$250,000 which will be payable at Plan termination. In addition, the Trustees agreed to adjust rates and/or benefits effective September 1, 1998 to offset a 20% increase in premiums.

8.16 The Trustees set aside \$1.2 million of the Group Insurance Trust Fund in a dedicated reserve to cover the costs of the Guaranteed Deficit Reimbursement Agreement.

8.17 We have recommended that agreements which transfer significant risk from the insurer to Plan members and/or school boards should not be signed by the NSTU without consultation with the stakeholders in the Plan.

8.18 In a letter to our Office, the Trustees indicated that they disagree with this recommendation and made the following comments.

"The governance of the Plan is the jurisdiction of the Trustees. The Boards do not carry any fiduciary burden to protect the Plan members. During each round of regional bargaining the Boards are at liberty to cease their contributions - which they do on a regular basis whether the premiums go up or down.

No other actions, taken in recent years more properly reflect the fiduciary role of the Trustees than their move to secure the Plan. This Plan was developed by teachers for the protection of teachers without any help, cooperation or encouragement from School Boards. This was, and continues to be, viewed as a necessary interim measure until the Plan stabilizes."

Disabled Life Reserves

8.19 Disability insurance companies are required by regulation to hold disabled life reserves. These reserves represent the actuarial cost of providing benefits to approved claimants until age 65. At the time a claimant is approved for benefits, the insurance company creates a disabled life reserve sufficient to pay benefits until age 65 and the amount (calculated by actuaries) is charged as an expense against annual premiums received during the year. The insurer currently holds disabled life reserves which are expected to be sufficient to fund the cost of future disability payments for approved claimants.

8.20 The amount of required disabled life reserve is calculated by actuaries employed by the insurance company. The Trustees have not had an actuarial review of the Plan performed by independent actuaries since 1991. Such a review would give the Trustees assurance with respect to the financial position of the Plan and the adequacy of the disabled life reserve. We have recommended that the Trustees engage an independent actuary with disability plan experience to perform an actuarial review of the Salary Continuation Plan every three years.

Prior Years' Dividends

8.21 As noted in our 1996 Annual Report (see paragraph 8.2 above) dividends of \$5 million relating to the Salary Continuation Plan were received by the Trustees from a previous insurer (Citadel General) in the 1978-79 to 1994-95 time period. These funds are still being held by the Trustees and form part of the NSTU Group Insurance Fund. The funds have not been specifically segregated from other funds of the Trustees.

8.22 There are no formal agreements between the Trustees and the school boards relating to the Salary Continuation Plan and therefore, there is no agreed-upon methodology to disperse these dividends even though school boards contributed to the plans. Since the question of ownership of prior dividends raises legal questions which are outside the scope of this audit, we have recommended that the school boards seek legal advice on this matter. As well, the Trustees and school boards should negotiate an agreement regarding ownership of any future Plan surpluses.

Increase in Number of Claims

8.23 The claims experience for this Plan is about 44 claims per 1,000 insured teachers which is high. The number of approved claimants has almost doubled between 1994 and 1997. Various reasons for the high claims experience were put forward by those we interviewed during the course of the audit.

8.24 We believe the Trustees should have a detailed analysis performed by the insurer, Plan administrator and/or insurance consultants to identify the root causes of the Plan's negative experience. In conjunction with other stakeholders, including school boards, an action plan should be developed to resolve any problems identified.

Rehabilitation of Claimants

8.25 Economical operation of the Plan depends on getting claimants back to work as soon as possible. Early intervention is critical in reaching this goal. We were told that the probability of returning to work decreases as the length of the claim increases.

8.26 The Salary Continuation Plan is experiencing difficulty in getting claimants back to work. There are several reasons for this difficulty:

- *Length of time before intervention takes place* - Salary Continuation does not commence until after sick leave expires which may be a year after the disability was incurred. The Salary Continuation Plan receives no information from/about future claimants until sick leave is about to expire which means that the Plan suffers from a lack of information in the early stages of the disability.
- *Teachers' Pension Disability* - There is a separate process for approving eligibility for Teachers' Pension Disability which has been described to us as less rigorous than the Salary Continuation approval process. The existence of a separate decision-making authority with little, or any, interaction with the Plan leads to inconsistent decision-making and pressure for Salary Continuation to accept claimants who have been approved by Teachers' Pension.
- *Lack of employer participation in the process* - Many claimants are deemed to be suffering from *situational stress* which may be able to be remedied through cooperation of the school board in changing factors such as the school or grade level of the disabled teacher. Currently, school boards are not formally involved in the rehabilitation process and there is little communication between the Trustees and the boards.

8.27 An Employee Benefits Facilitator was hired in early 1998 with the hope that such a position will result in net cost savings for the Plan. The role of the Employee Benefits Facilitator is to be a liaison between the claimant and the Plan and to make recommendations which result in putting claimants back to work.

8.28 We have recommended that the NSTU and school boards work together to ensure that there is a regular exchange of information about teachers who are potential candidates for Salary Continuation Plan benefits to facilitate early intervention. Also, the NSTU and school boards should work together to ensure that situational stress is relieved to the maximum possible extent by employer participation in efforts to reduce such stress.

Monitoring of Plan

8.29 There is a Joint Claims Review Committee which monitors the Plan and is responsible for bringing forth recommendations for problem remediation to the Trustees. It is comprised of representation from the NSTU Trustees, the Plan administrator (i.e., Johnson Incorporated) and the insurance company, but it does not include a representative from the school boards. The Trustees' representative on the Committee prepares an annual review and report for the Trustees. Our review of the Report indicates the Joint Committee is actively monitoring the Plan and making worthwhile recommendations. In our opinion, a school board representative would help the Committee to fulfill its mandate especially in relation to problem remediation.

Plan Governance

8.30 The Trustees are responsible for governance of the Salary Continuation Plan which includes responsibility for setting premiums. School boards do not receive information relating to the financial position and performance of the Plan nor are they involved in any of the decision making processes. The Trustees noted the school boards have never requested involvement in Plan governance or additional information about the Plan.

8.31 We believe the Trustees and school boards should meet to discuss appropriate governance for the Salary Continuation Plan. The boards' interests should be adequately represented in the decision-making process and the boards should have sufficient, appropriate information to enable them to contribute meaningfully to the decision-making process since the boards bear a significant portion of the costs associated with the Plan.

Other Recommendations

8.32 We made several recommendations related to other aspects of the Plan. The more significant of these are summarized below:

- The Trustees and school boards should consider whether the Salary Continuation Plan should be a mandatory Plan for all teachers. This would help to diversify risk and improve Plan experience.
- Open enrollment periods (times when teachers can join without medical evidence of insurability) should not be held without specific direction from Plan members and school boards as they have a negative impact on Plan experience and increase the costs to those who pay the Plan premiums.
- The premiums for the Salary Continuation Plan should be set at the level recommended by insurance carriers/actuaries to cover the projected costs of the Plan. In the past, premiums have been kept below the level recommended by the insurer to maintain or increase enrollment levels.
- The Trustees should review the benefits provided under the Plan to determine if changes should be made to increase the economy and equity of the Plan. Examples of changes which should be considered are decreasing the 70% benefit when it is non-taxable in the hands of the recipient, and mandatory retirement at some age prior to 65.
- A disabled teacher with more than two years of service also collects disability benefits under Sections 24 and 25 of the Teachers Pension Act. The benefit is 2% per year of service. The 70% benefit payable under Salary Continuation Plan is

reduced by benefits under Teachers Pension, Canada Pension and Disability benefits. The disabled person does not accumulate pensionable service under the Teachers Pension Act while collecting Salary Continuation Plan benefits. Disability benefits under the Teachers Pension Act and their relationship to the Salary Continuation Plan should also be reviewed by the NSTU and school boards, and recommendations should be made to the appropriate authority for modification of those benefits if required.

CONCLUDING REMARKS

8.33 There are no agreements between school boards and the Trustees covering the disposition and ownership of Plan dividends received by the NSTU Trustees in prior years and related interest which would have accumulated over the years. The question of ownership of prior dividends raises legal questions which are outside the scope of this audit.

8.34 The NSTU Salary Continuation Plan provides a valuable benefit to Plan members and school boards by ensuring that disabled teachers do not suffer financially because of their disabilities. It is important that the Plan be financially sustainable over the long-term.

8.35 There are a number of fundamental issues affecting the Salary Continuation Plan such as benefit levels; premiums; sharing of costs, dividends and risks; and governance. These issues can only be resolved by open dialogue between the stakeholders. In order to ensure that teachers return to productive employment as soon as they are able, employer flexibility and intervention may be required. For this reason, it is especially important that employers be involved in plan governance and the monitoring work of the Joint Committee.

9.**FINANCE -
CORPORATE FINANCIAL MANAGEMENT SYSTEM (CFMS)****BACKGROUND**

9.1 In 1995, Department of Finance staff developed a departmental business analysis to provide a framework for identifying departmental and government-wide opportunities to redesign business processes and to utilize supporting technology. One opportunity identified as a priority was the acquisition and implementation of a new, fully-integrated financial management system to gather, accumulate and summarize the financial transactions of the Province. This system became known as the Corporate Financial Management System (CFMS).

9.2 In October 1995, the Department issued a request for proposals to *"...supply the application and operating software/hardware and provide professional staff to implement a corporate financial management system for the Province of Nova Scotia."* This tender was awarded in March 1996. The application software selected was *Systems Applications and Products in Data Processing (SAP)* and the proponent selected was Deloitte & Touche Consulting Group / ICS.

9.3 An October 10, 1996 CFMS project bulletin stated *"...Nova Scotia is the first province or state in North America to implement SAP."* The vision for the project as defined in the bulletin was *"...A fully integrated Corporate Financial Management System, will effectively transform the manner in which we conduct the financial business of government in the future, provide for enhanced decision making, provide for improved cost control, and establish the foundation for streamlining processes and procedures..."*

9.4 The SAP application, which runs at the Department of Finance, consists of a number of integrated modules for general ledger, budgeting, funds management, cash management, accounts payable, project accounting, procurement, goods receipt, inventory, and accounts receivable. Software licenses for the payroll and related administration systems modules were not acquired. These functions continue to be processed through the Province's existing human resource management system (HRMS), which runs at the Systemhouse Data Centre. It was indicated to us that SAP is considered compliant with regards to the Year 2000 issue (a topic which is discussed in Chapter 3 of this Report).

9.5 The 1997 Report of the Auditor General included observations and comments from a preliminary review of CFMS and the CFMS project. The objective of that review was to gather project-related documentation and information, and to identify and develop lines of inquiry to support planning for more detailed audit coverage. Our primary concern expressed in that report related to several significant control issues that had not been dealt with prior to implementation of the CFMS on April 1, 1997 and still had not been addressed at the time of writing that report. We commented that those control issues *"...may represent significant risk to the system of internal control as it relates to the accounting for public funds."*

9.6 During 1998, this Office and the Department of Finance jointly commissioned a national public accounting and consulting firm to conduct a review of the business control environment surrounding CFMS and the CFMS implementation project.

RESULTS IN BRIEF

9.7 The following is a summary of our principal observations.

- The CFMS was implemented on April 1, 1997 as planned. A detailed review performed in March 1998 by an external firm, at the joint request of the Department of Finance and this Office, identified a number of areas or opportunities, some significant, for improving the level of control over the CFMS and related processes and functions. The external firm stated *“while we did not detect any monetary errors during our limited testing of controls, the focus of our testing was on control compliance rather than detection of monetary errors.”*
- The Department of Finance has recently assigned a full-time person to manage the process of developing a strategy and timetable, and the implementation of the specific recommendations. This process is currently underway and has been identified by management as a priority for the Department. Progress and issues should be regularly tracked and reported to senior management.
- Further, specific strategies and plans need to be formulated, approved and acted upon, if government is to make appropriate progress towards realizing the potential business process improvements and other benefits from a system like CFMS.

SCOPE OF 1998 REVIEW

9.8 As previously indicated, we conducted a preliminary review of the CFMS and the CFMS project and provided observations and comments in our 1997 Report. Since that time this Office and the Department of Finance jointly commissioned a review of the business control environment surrounding CFMS and the CFMS implementation project. This was part of our overall strategy to gain an understanding of the CFMS and its supporting infrastructure as well as to specifically focus on the control structures. The results of this review, including our participation in the review project, will serve to support and enhance our future audit efforts as we undertake new audit responsibilities for the *Public Accounts* of Nova Scotia.

9.9 In February 1998, Ernst & Young, a national public accounting and consulting firm, was selected as the successful proponent to conduct an assignment entitled “Review of CFMS System Controls and Implementation.” The following is an excerpt from the Objectives and Scope section of the Ernst & Young report dated March 1998:

“...The primary objectives of this review are to:

- review the new procedures implemented as a result of the CFMS project and evaluate whether there are adequate controls in place for processing transactions;*
- determine if the physical and online access security is limited to only appropriately authorized users and system support staff and managers;*
- review and assess the general IT environment controls including program change controls, back up and recovery procedures and disaster recovery plans to address the risk of system failure due to hardware and communications malfunctions;*
- assess the project implementation management to determine if the project management risks were properly managed and to ensure there are no other risks which have not been addressed. (This does not include an audit of the conversion.)*

- *determine if the new system is meeting the user needs;*
- *assess the adequacy of the training developed by the project team;*
- *review the reporting functions in use and, through input from the users, determine if additional reporting is required;*
- *compare the original Request for Proposal (RFP) for the SAP implementation to the actual features of the system implemented."*

PRINCIPAL FINDINGS

Auditor General's Observations and Comments

9.10 As noted in Chapter 12 of the 1997 Report of the Auditor General, Department of Finance management and the Office of the Auditor General agreed to jointly contract for a review of the business and control environment surrounding CFMS and the CFMS implementation project. This project was tendered and the successful proponent was Ernst & Young, a national public accounting and consulting firm. One of the clauses of this contract was that staff of the Department of Finance Internal Audit Division as well as staff of the Office of the Auditor General would actively participate on the team led by Ernst & Young.

9.11 The fieldwork was performed primarily in March 1998. A report was drafted, reviewed and cleared over the summer and a final report was issued to the Deputy Minister of Finance and the Auditor General in September 1998.

9.12 Information we gathered last year, in conjunction with observations from the Department of Finance Internal Audit Division, and our participation in the Ernst & Young review, raises a number of concerns, with respect to the adequacy of the system and controls in place, which need to be addressed by Finance and government generally. Further, specific strategies and plans need to be formulated, approved and acted upon, if government is to make progress towards realizing the potential business process improvements and other benefits from the CFMS system.

9.13 Since the release of the final report, we have contacted Finance management in an effort to determine whether specific strategies and detailed plans have been identified to manage and monitor the process for addressing the recommendations contained in the report. We were provided a preliminary listing of the key recommendations with general status information. Considering that not all of the recommended actions are the responsibility of Finance, it is important that there be a formal and appropriately detailed action plan and management trail in place to ensure that all recommended actions are fully considered as well as to manage and monitor the ongoing progress. Finance has recently assigned a full-time person to manage the process of developing a strategy and timetable, and the implementation of the specific recommendations. This process is currently underway and has been identified by management as a priority for the Department. Progress and issues should be regularly tracked and reported to senior management.

9.14 As previously mentioned, the Province of Nova Scotia was the first province or state in North America to implement SAP. The CFMS Project Manager has further stated that "*...the Nova Scotia government played a large role in clearing the way for SAP implementations in the Public Sector in North America. This project is known throughout North America as a SAP Success Story. We have hosted several site visits from organizations such as government of Puerto Rico, Quebec (Provincial), Manitoba, and Orlando airport. I have presented the Nova Scotia experience at several conferences in North America.*"

Ernst & Young Review - Background

9.15 In order to put this project in perspective the following background information was provided in the Ernst & Young report.

“The mission statement for the CFMS implementation project was:

To successfully implement standard business practices, enabled by an integrated technology: to support Financial Services for the government

The government’s CFMS implementation project was organized into several sub-teams all working together as one integrated project group. The project team was broken into individual teams consisting of management, quality assurance or internal audit, communication, training, technical and various functional teams (accounts payable, budgeting, general ledger, procurement, accounts receivable/cash management and inventory). The planning and scoping of the project began in April, 1996, with the system going live on April 1, 1997.

The government’s implementation of SAP R/3 involved many inter connecting modules and required a high degree of interaction and teamwork. Management of the implementation project was two-tiered.

- Strategic direction was provided by the Steering Committee and the Project Manager.*
- Tactical day-to-day operational direction was provided by the Project Manager, two Integration Managers and the team leaders of the individual sub-teams.*

The project was resourced utilizing approximately forty full-time government staff seconded to the project from various government departments. The implementation partners were Deloitte & Touche/ICS Consulting Group. On average, there were seven full-time consultants working with the project team with another six consultants working part-time throughout the project when appropriate and as required. There was also an extended team in place which consisted of personnel from across government. This team was used as a mechanism to provide feedback, confirm modifications to processes, hierarchy design, information flow and verify procedures. The extended team was assembled on an as needed basis to review and critique the work in progress.

At the time of the CFMS implementation project, other major initiatives affecting the same client base were underway within the Nova Scotia government. Two of these initiatives included:

- A project to blend the Nova Scotia provincial sales tax and the federal government’s GST. Deadline for this initiative was also April 1, 1997.*
- Massive restructuring to the finance, information technology and human resource divisions across all government departments and agencies. This restructuring resulted in the establishment of Corporate Service Units (CSUs) which were created at the same time as the implementation phase of the CFMS project.*

The creation of the CSUs affected all of the financial, information technology and human resource management staff across government. New organization structures were put in place to support the extended client base. Directors and managers in the areas of finance,

human resources and information technology had to re-apply for expanded positions. This made it extremely challenging for the staff involved to create positions, recruit staff, rationalize services and define new procedures; while at the same time contribute to the CFMS project. Coincidentally, the CFMS project itself was developing and enabling process and procedural change.

The CFMS Project Manager was also required to serve as the Information Technology Director for the Finance CSU, technically fulfilling two full time positions. The two SAP R/3 integration managers were also required to assume additional duties and roles. The finance directors, who sat on the CFMS Project steering committee and were responsible for the strategic direction of the CFMS project, were also responsible for creating and implementing new financial CSU structures within their respective departments.

It was a time of major change within the Nova Scotia government. It is our understanding that a decision was made to phase in the implementation of standard business practices, and the first two steps to achieving this goal were completed in parallel which were: i)the SAP R/3 implementation across government and, ii)the completion of the Corporate Service Unit restructuring. These two steps alone amounted to significant organizational and procedural change. Incorporated into the CFMS project were various changes to procedures allowing the government to implement SAP R/3 without customization.

The third critical step towards the implementation of standard business practices was a plan to follow the CFMS implementation project with a project that would ensure that best business practices are adhered to across government. This would be achieved by completing and refining the redesign processes, formalizing new procedures into policy and teaching clients to apply SAP to their business in order to work "smarter". It is our understanding that these tasks have already been worked on in pockets throughout government over the past year, but still require a formal, government-wide approved initiative with high level commitment of resources. This will complete the work necessary to achieve maximum benefit of SAP R/3 within the Nova Scotia government. It is our understanding that with approval from the senior financial executives of the various departments, it is the intention of Finance's Corporate Information Systems Divisions to initiate and plan this project."

Overview of Results of Ernst & Young Review

9.16 As previously indicated, Ernst & Young completed fieldwork in March 1998 and reported findings and recommendations to the Department of Finance and the Auditor General in September 1998. Certain of the issues identified by Ernst & Young had previously been raised by the Quality Assurance Team on the SAP implementation project and reported to the CFMS project steering committee prior to or around the time the system was implemented on April 1, 1997.

9.17 Ernst & Young's work confirmed the concerns previously identified by the Department of Finance Internal Audit Division and this Office, and also identified a variety of other matters that need to be considered by Department of Finance and government.

9.18 The following is a summary of the principal observations reported by Ernst & Young.

- *"Government requires significant improvement to the level of automated and manual controls to achieve control objectives. Improvements to the controls are required to ensure the integrity of information and allow for proper management trails to support recorded transactions."*

- *“Government has implemented appropriate controls in several key areas, such as system startup parameters. However, we also noted several opportunities for improving the SAP control environment.”*
- *“We identified several areas where improvements to the IT environment could be considered.”*
- *“Most users have not achieved an acceptable level of understanding of the system required for their position, and still have a number of misunderstandings and questions about the system.”*
- *“It is not possible, as at the time of this review, to judge whether CFMS has resulted in benefits for the government.”*

9.19 Ernst & Young’s report identified a variety of recommendations for consideration by Finance and government generally (see Exhibit 9.1 on page 105 for a list of recommendations).

CONCLUDING REMARKS

9.20 The review of CFMS conducted by Ernst & Young has served to confirm the preliminary issues discussed in our 1997 Annual Report and has gone further to identify additional areas of risk and concern that need to be appropriately addressed by government.

9.21 If government and its departments are to realize the full benefits of the CFMS, a significant commitment is needed to plan for and implement the recommendations on an appropriately structured and prioritized basis. Finance has recently assigned a full-time resource to manage the implementation of the recommendations provided by Ernst & Young. It has been indicated that an assignment of priorities and accountabilities has been started and that certain recommendations have already been completed.

*Exhibit 9.1***LISTING OF ERNST & YOUNG'S KEY RECOMMENDATIONS**

Listing of Key Recommendations from Review of CFMS System Controls and Implementation

This appendix includes an extract of the key recommendations from the Report on the Review of CFMS System Controls and Implementation.

The recommendations from the review cover system configuration, access controls and transaction processing controls. For security reasons, specific recommendations related to certain sensitive security control issues have been excluded from this appendix.

Process Integrity

- To address the control weaknesses identified in this report, the government should focus on redesigning the processes to take advantage of the automation and controls that are possible in an SAP environment. This will assist with the development and implementation of appropriate controls to ensure the accuracy of the government's financial reporting. As well, this will help the government to maximize the net benefits from the implementation of SAP. The challenge will be to undertake a process redesign given the other government initiatives that are competing for resources.

Such a project would obviously be a major undertaking. The project would cross all departments and require the participation and commitment of all departments. Therefore sponsorship for the project will have to be at the senior levels of the government for it to be successful.

Since the redesign of the processes may eliminate many of the control concerns identified in this report, it would not necessarily be worthwhile to invest the time and effort to address all the control concerns identified in this report. However, there are some issues which pose a greater risk to the government which should not be delayed until the redesign of the processes is undertaken. A summary of these issues is as follows:

- There is a lack of segregation of duties. Some users have the ability to create purchase orders and goods receipts and authorize invoices for payment.
- It is possible that unauthorized purchases and payments can be made and not be detected. Specifically, some concerns are:
 - Departments do not have an up-to-date list of signatures of people with the authority to purchase goods and services.
 - A single 'tolerance group' has been set up within SAP (tolerance groups are used to limit dollar amount postings by employee per account item and per document). The government should consider setting up tolerance groups for each 'class' of employee, limiting the amount they are allowed to post per document and per account item.

Exhibit 9.1 (Cont'd)

- Users share their passwords thereby enabling them to access incompatible functions. Password standards need to be developed and communicated to all users regarding the appropriate use of passwords.
- The primary control over the accuracy of an inventory system is the performance of physical inventory counts. A physical inventory count had not been performed for at least a year, as of the time of our review.

Specific recommendations are presented by business process:

Accounts Payable

- Individuals should not be allowed to have functions which are incompatible, such as procurement and invoice authorization. A more rigorous application of SAP Authorizations could also reduce this risk. Additional user training would also be helpful in emphasizing the importance of SAP's matching concept.
- Procedures are required to ensure that invoices are appropriately matched with the related PO. As well, consideration should be given to rejecting vendor invoices which do not include a PO number, a requirement that is clearly stated on the PO. Reconciliations of the Goods Receipt/Invoice Receipt (GR/IR) accounts will also assist with this.
- All departments should have an up-to-date list of authorized signatures available to the individuals responsible for processing documents.
- A review should be undertaken to delete duplicate and inactive vendors from the vendor master file. Further, periodic reviews of the master file would facilitate the detection of duplicate/inactive vendors. Also, the policies and procedures outlining the responsibilities for the addition/modification of vendor records should be clarified across departments, given the importance of this control.
- The GR/IR accounts must be reconciled regularly for this control to be effective.
- The electronic authorization feature of SAP should be implemented for purchase orders and invoices (in those instances where there are no purchase orders).
- Authorization limits should be configured in SAP for cheque requisitions.

Accounts Receivable

- The accounts receivable processes should be reviewed to develop more efficient processes and eliminate duplication of effort. The government should re-address the use of SAP to generate invoices and/or consider electronic interfaces with legacy applications.
- At the Registry of Motor Vehicles (RMV) the processing of invoices and payments should be assigned to different individuals to provide adequate segregation of duties. Alternatively, someone other than the A/R clerk at the RMV should be reconciling the NSF bank clearing account and the A/R clearing account in the general ledger.

Exhibit 9.1 (Cont'd)**Procurement**

- Employees should be given unique user IDs with access only to those features required by their job function. This is essential to ensure proper segregation of duties and accountability. Appropriate policies for password security should be developed which include a requirement that users should not share their user IDs and passwords. All employees should be required to review the policies and sign a statement that they have read the policies and agree to comply with them.
- Appropriate policies and procedures should be developed to ensure that all transactions are properly approved prior to input into SAP. This could be achieved through the implementation of the electronic authorization feature of SAP.
- There should be adequate segregation of duties to ensure that individuals are not responsible for incompatible functions.
- A vendor number can be changed when entering the invoice. This could potentially allow the payment to be directed to a vendor other than the supplier of goods. The appropriate implementation of '3 way matching' using SAP and controls surrounding the GR/IR accounts could mitigate this risk.
- Appropriate policies and procedures should be developed to ensure that all purchases are appropriately approved in advance.
- All departments should have an approved list of signing authorities. This list should be readily available to those who are responsible for ensuring that purchases are approved prior to entering in SAP. Procedures are also required to ensure that the list is kept current.

General Ledger

- A formal policy be developed which will provide a process for requesting and authorizing new general ledger (G/L) accounts. Approved lists of individuals within each department authorized to request new G/L accounts should be maintained.
- Overall guidelines are required to allow for a level of consistency of the account structure between departments while allowing for flexibility to allow departments to structure their accounts to meet their needs.

Inventory Management

- Independent physical counts of inventories should be performed on a regular basis and reconciled to the system's perpetual records.

*Exhibit 9.1 (Cont'd)***Budgeting**

- Appropriate evidence of the final authorized budget should be retained.
- Policies and procedures should be developed to document the review and approval process for preparing the budget. The overall budget should be supported by detailed information. Documentation of reviews and approvals should be retained.

Project Accounting

- Users be provided with additional training so that they utilize project accounting module more effectively.
- Consideration should be given to strengthening the controls over the use of orders by implementing the following options, if appropriate.
 - modified authorizations for objects required to execute the transactions can restrict the number of users who have access to the function.
 - logs can be activated to record changes to master data in orders (i.e. date, items, user, fields changed). However, this log would only be effective if there was an independent review.
 - key fields can be set as mandatory. In particular, a posting cost centre should be required.
 - management reports detailing the status of orders and periodic review of major projects.
- To help ensure that orders are appropriately settled, policies and procedures should be developed.
- Consideration should be given to using Statistical Orders to track project transactions rather than Internal Orders.

Security and Authorization**Security Design Review**

- **Corporate Hierarchy Restrictions**
The government would benefit from having a formal security philosophy that was incorporated into an overall government-wide security policy.

Exhibit 9.1 (Cont'd)**Environment Review*****Security Administration and System access*****General**

- Formal policies and procedures should be developed and implemented for security and administration of the SAP servers.
- SAP is a complex application and requires an appropriate level of support.

Disaster recovery/Business Continuity Planning

- The risk of a prolonged systems outage has been reduced by measures such as regular backups and the use of third party systems that can be quickly replaced. However, to minimize the disruption that might be caused by a computer-related disaster, the government should develop a recovery strategy and a detailed recovery plan for its critical information technology.

Facilities management

- Physical security over the computer facility should be improved.

Communication/System Interfaces

- Formal policies and procedures should be developed to ensure that there are appropriate controls over the development, testing and implementation of the interface programs.
- Proper documentation of the interface programs should be developed.

Problem management

- A formal problem tracking system should be implemented which includes escalation procedures.

Change Management and Program Change Controls

- Formal procedures should be developed for changes to software on the servers.

System Software Maintenance

- Adequate human resources are required to properly maintain system software on the servers. Consideration should be given to assigning additional resources to achieve this.

Exhibit 9.1 (Cont'd)**Operations**

- Adequate human resources are required to properly operate the servers. Consideration should be given to assigning additional resources to operate the servers.

CFMS Training Program Review

The following actions should be taken and have an appropriately high level of sponsorship:

- A formal review of training needs should be undertaken. Training requirements should be detailed based on the needs of particular positions and departments.
- Based on known training requirements, target SAP skill levels and learning objectives should be established for each area, with training and support activity designed to help users attain the required proficiency.
- Post training evaluation should be conducted based on documented learning objectives.
- Training curriculum should be designed sensitive to the business process requirements of particular departments where appropriate. This activity should be undertaken based on the departmental business process innovation efforts recommended elsewhere in this report.
- SAP trainers should be recruited, trained, and evaluated based on competencies in both SAP content and in training techniques.

CFMS Implementation Review

- More flexible and market-driven compensation strategies are required for SAP specialists.
- Future corporate wide systems should be managed, or at least sponsored by, a high level committee that has representation from all departments.
- Business cases for enterprise wide systems require a more comprehensive level of review before they are approved. More attention needs to be paid to the true, across the board costs of corporate systems initiatives, with appropriate budgeting and funding mechanisms put in place to ensure completion and benefits realization.
- Effective two way communication and change management has to be considered an integral part of any future corporate wide systems initiative.

*Exhibit 9.1 (Cont'd)****User Feedback***

The following actions should be undertaken and have an appropriately high level of sponsorship:

- The positions outlined for the Corporate Information Systems (CIS) group should be filled as soon as possible. Once in place, staff should be directed to place a priority on functional improvements that would benefit the greatest number of users.
- Corporate Information Systems should develop a pro-active communications plan with the following objectives:
 - receive feedback from users;
 - encourage sharing of “how to” information among users;
 - manage user expectations regarding SAP functionality;
 - keep users and management up to date on what support and functionality is available.
- A program should be established to help individual departments reengineer and streamline their organizations based on SAP capabilities. This will be beyond the resources of the currently planned CIS support. A project team should be established to help coordinate this throughout government. Special attention should be given to effective executive sponsorship of this initiative vis a vis the user departments.
- The cost allocation approach used to fund CFMS should be reviewed to determine if alternative mechanisms would accelerate the acceptance and effective use of CFMS within the user departments. Particular attention should be paid to individual licensing costs.

10.

HEALTH - COMPUTER ENVIRONMENT CONTROL REVIEW - MARITIME MEDICAL CARE INC.

BACKGROUND

10.1 The Health Services and Insurance Act provides insured medical, physician, dentist, optometrist and pharmacist services to eligible Nova Scotians. These services are commonly known as the Medical Services Insurance (MSI) Program. The Minister of Health, through the Insured Programs Branch of the Department of Health, is responsible for the delivery of this program.

10.2 Day-to-day program administration has been carried out under contract, since 1967, by Maritime Medical Care Inc. (MMC). The latest MSI administration contract between the Province and MMC was signed on May 22, 1992. In addition to MSI administration, MMC processes medical and pharmacy claims for the Department of Community Services Pharmacare Plan and for the Workers' Compensation Board.

10.3 For the 1997-98 fiscal year, MMC processed 9.8 million MSI claims with a value of \$386.5 million. MMC billed the Province \$7.4 million for the administration of the MSI program or 1.9% of claims paid. Exhibit 10.1 provides a historical summary of MSI claims paid by MMC and the administration charges billed to the Department.

10.4 Computer systems for the processing of claims from providers (physicians, pharmacists and others) were originally developed approximately 30 years ago. Until 1996, these systems physically resided off-site at the Provincial Data Centre in Halifax which is a mainframe processing environment. The Provincial Data Centre was acquired by SHL Systemhouse in 1992.

10.5 By 1992, the Department of Health (DOH) was finding it increasingly difficult to manage the MSI Program using the systems operating at the Data Centre. The software was written in old computer languages that were difficult to support and data was stored using out of date technology that was difficult to manipulate and analyse. Systems changes necessitated by changing policies and procedures were difficult and costly to implement.

10.6 An information and systems management consulting firm was retained to develop options for modifying or replacing the MSI system. The firm submitted a re-engineering report in 1993 which recommended replacing the existing mainframe system with a client server system to be located at the head office of Maritime Medical Care Inc. in Dartmouth. In June 1994, Cabinet approved a contract with the firm to develop the new system.

10.7 In the fall of 1993, this Office conducted a summary review of the old mainframe system at the Data Centre. We also reviewed procurement practices for the development of the new MSI system. These matters were reported in Chapter 13 of our 1994 Annual Report.

10.8 Given the large dollar value of medical claims processed by MMC and the significant investment by the Province in developing the new MSI system, this year we reviewed computer environment controls in place at the new installation located at MMC. We also reviewed project management practices associated with the development of the new MSI system.

10.9 This audit was conducted in accordance with Section 8 of the Auditor General Act and Section 39 of the May 22, 1992 Agreement between the Province and MMC.

RESULTS IN BRIEF

10.10 The following are the principal observations from the review.

- Data processing for the new MSI system is carried out by the Information Services Section of Maritime Medical Care Inc. The control environment at MMC should be subject to periodic independent assessments.
- We reviewed controls over various aspects of the MSI computer installation and found them to be satisfactory. We have made recommendations for improvement in a few areas.
- The lack of a disaster recovery and contingency plan was reported during our 1994 audit. Some progress in developing a plan has been made. However, this facility is still without a complete and tested disaster recovery and contingency plan. We have recommended that the plan be completed and tested as soon as possible.
- Planned systems development costs for the new MSI system, including hardware, software and project management were \$3.4 million. Actual systems development costs, to September 1998, were \$5.7 million. The additional cost of \$2.3 million was due primarily to additional hardware, software and financing costs.
- Significant tangible and intangible benefits were expected to accrue from the new MSI system as documented in the project planning documents. The Department has not conducted a formal post-implementation review to determine the extent to which benefits have been realized and how these results compare to original plans. We have recommended that the Department complete a post-implementation review as soon as feasible.
- MMC provided bridge financing for the MSI systems development project by paying development costs approved by the Department and periodically billing the outstanding balance, plus interest, to the Department. The Department failed to record the liability owing to MMC in its accounting records at year end resulting in misstatements of Provincial liabilities and Department expenditures in the Public Accounts of the Province.
- A Year 2000 assessment of the MSI system was completed in July 1998. The report indicates that corrective action may cost between \$2.5 and \$3.1 million. A detailed project plan was being developed at the time of our audit but was not complete.

SCOPE OF REVIEW

10.11 The objectives of this assignment were to:

- evaluate the adequacy of environmental controls for the computer installation at MMC including organizational controls; development and program change controls; operations controls; documentation controls; logical access controls; and disaster recovery and contingency planning.

- review project management practices for the development of the new MSI system; and
- determine the steps taken by MMC and DOH to ensure Year 2000 readiness of MSI-related hardware and software.

10.12 The following general criteria were used in our review.

- There should be adequate computer environmental controls in place at the Maritime Medical Care Inc. data processing facility.
- Sound project management practices should have been utilized in the development of the new MSI system.
- The Department and MMC should have a plan to ensure Year 2000 readiness of the hardware and software supporting the MSI system.

10.13 Our approach consisted of interviews with staff of the Department of Health and MMC. We examined documentation associated with the new MSI system. We did not examine, in detail, systems documentation for the new system or test the appropriateness of the access privileges granted to users of the system.

10.14 We also reviewed a report prepared by the Audit and Consulting Section of the Department of Health and presented to senior Department officials in February 1998. This report focussed primarily on the costs associated with the new system. The report also raised many of the same issues reported in paragraphs 10.44, 10.45 and 10.46 below concerning project financing and approval of additional project costs.

PRINCIPAL FINDINGS

Organizational Controls

10.15 *Background* - A review of organizational controls includes assessing the electronic data processing section's position within the organization, the existence of effective senior management control of the information technology environment and the existence of effective controls over the concentration of functions in the EDP (Electronic Data Processing) department.

10.16 MSI transactions are processed by the Information Services Section of Maritime Medical Care. Programmers are permitted to copy production programs and make programming changes to the copy in a test environment. After testing and user acceptance, programmers are permitted to copy revised programs back into production. We have recommended that programming staff not be permitted to copy revised programs into production. This function should be performed by an independent person without programming responsibilities.

10.17 Under the old MSI system, the SHL Systemhouse Data Centre was subject to a yearly systems audit. An audit firm was retained to express an independent opinion on the suitability of the controls at the Data Centre. The audit opinion provided assurance that MSI transactions were being processed in a controlled environment.

10.18 Under the new MSI system, data processing functions are carried out at MMC's facilities in Dartmouth. We note that the Department has made no provision for periodic independent

assessments of the control environment at MMC. We have recommended that the Department conduct periodic, independent audits of the EDP control environment at MMC.

Development and Program Change Controls

10.19 *Background* - Development controls are procedures that ensure proposed applications are implemented only if they will produce greater benefits than alternative proposals. Program change controls are procedures that ensure systems changes are properly authorized and tested and that adequate segregation of functions is maintained for program changes.

10.20 *Systems development methodology* - The Province requires departments and agencies to follow a standard systems development methodology called Productivity Plus. The major systems development at MMC was the development of the new MSI system. Generally, we found that the requirements of Productivity Plus were adhered to for this project.

10.21 A notable exception was the absence of a formal cost benefit analysis for the Seniors' Pharmacare Premium Billing System component of the MSI system. This system was developed because of changes in the Seniors' Pharmacare Program announced in 1995. These changes introduced a requirement to charge premiums to seniors to help offset program costs thus necessitating a revenue collection system. We were informed that a formal cost benefit analysis of processing alternatives was not prepared due to time constraints in the introduction of the Seniors' Pharmacare Program in 1995.

10.22 The Premium Billing System was developed at a cost of approximately \$600,000. The system processes approximately \$22.0 million of premium revenues annually. In our view, a formal cost benefit analysis of processing alternatives should have been completed for this system addition.

10.23 *Control over system changes* - It is important to ensure that systems additions and changes take place in a controlled environment including proper authorization and testing prior to implementation.

10.24 In April 1998, the Department of Health developed the MSI - IS Management Plan. This plan created the MSI Change Management Committee and defined roles and responsibilities of those involved in the operation and management of the MSI system.

10.25 The MSI Change Management Committee is responsible for assessing proposed systems enhancements, deciding on change request priorities, ensuring the efficient and effective use of IT resources and ensuring proposed changes are consistent with the strategic direction of the MSI Program. In general, we found the system for the authorization and control of systems changes to be strong.

Operations Controls

10.26 Operations controls are those procedures designed to prevent or detect accidental or deliberate errors during processing, misuse of classified information and accidental destruction of records. We found operations controls to be satisfactory.

Documentation Controls

10.27 Documentation controls are designed to ensure that adequate, up-to-date standards and documentation exist for systems, programming and operations. We found documentation controls to be satisfactory.

Disaster Recovery and Contingency Planning

10.28 *Background* - Disaster recovery and contingency plans are important to ensure the timely and cost effective resumption of processing in the event of a service interruption.

10.29 The lack of a disaster recovery and contingency plan was reported in our 1994 Annual Report. An impact analysis, prepared by a consultant, was completed in the summer of 1998. A business resumption study was near completion at the time of our audit. We have recommended that the disaster recovery and contingency planning process be completed and tested as soon as possible.

Logical Access Controls

10.30 *Background* - Logical access controls include procedures that ensure only authorized individuals gain access to the system and that access privileges are commensurate with an individual's duties. The password system is the primary means by which logical access control is established.

10.31 *UNIX root authority access* - The MSI system resides on hardware which uses a Unix operating system. Unix requires the granting of supervisory (root authority) access to operators. Root authority access is very powerful which provides unlimited capability to add, delete and modify data files and directories. Therefore root authority access should only be granted to a limited number of persons and an independent review of the activities of those with root authority access should be undertaken on a regular basis.

10.32 MMC has granted root authority access to a limited number of persons (six). However there is no regular internal review of the activities of those with this access. We have recommended that an independent review process be established.

Project Management - MSI Systems Development

10.33 *Background* - In 1994, Priorities and Planning Committee approved the development of a new MSI system. The systems development was carried out under contract by a systems development firm. The firm was the lowest qualified bidder for development of the new system. In addition to systems development work, the contract included systems maintenance and operations support to March 31, 1999. The contract amount was \$4.5 million. In addition, the plan provided an additional \$1.6 million for systems conversion support for providers and for provincial sales taxes on equipment purchases.

10.34 The project was to be financed from the planned operating budgets of the Department and from savings to be generated by the new system. No new funding was authorized by the Priorities and Planning Committee.

10.35 The plan approved by the Priorities and Planning Committee projected that the new system would generate net savings of \$947,000 annually. In January 1995, the systems development firm released a Systems Architecture Report which provided a detailed implementation plan for the new MSI system. This report contained a revised cost benefit analysis. Revised projections indicated net cost savings of approximately \$1.7 million annually commencing in the 1996-97 fiscal year. This report targeted the delivery of full systems capabilities by April 1, 1996.

10.36 The new system involved significant differences in the way claims are processed. Claims are now submitted online, provider staff are now responsible for data entry rather than MMC staff and payments to providers are now made by electronic funds transfer. The MSI system requires

providers to classify the type of service provided to patients. The number of service categories increased significantly under the new system in an effort to generate improved health management information.

10.37 *Project management practices* - We found project management practices to be satisfactory. A Steering Committee was established at the outset of the project which included senior officials from DOH, MMC and the systems development firm. The Committee met on a regular basis, kept minutes and discussed a comprehensive range of issues related to the project. Progress reports which included finances and deadlines were prepared for most meetings.

10.38 Two project managers were assigned to oversee the day-to-day operation of the project. One project manager was an employee of DOH and the other was employed by the systems development firm. All invoices from the systems development firm were approved by the DOH project manager prior to payment.

10.39 *Deadlines* - The Pharmacare component of the system was implemented on schedule on January 1, 1996. The planned implementation date of the Medicare component was April 1, 1996. Implementation was tested at eleven selected sites in July 1996. The remaining providers were implemented by January 1997. Providers initially experienced significant delays in gaining electronic access to the new system. Electronic access difficulties were not resolved until more powerful equipment was acquired in the summer of 1997.

10.40 *Systems development costs* - Planned systems development costs including hardware, software and project management were \$3.4 million. The contract also included a provision for systems maintenance and operations support to March 31, 1999, and provincial sales taxes on equipment purchases, for a total contract amount of \$4.5 million. Actual systems development costs, to September 1998, were \$5.7 million. The additional cost of \$2.3 million was due primarily to the development of the Seniors' Pharmacare Premium Billing System, additional hardware acquired to achieve more timely electronic access for providers, financing interest and greater than expected development costs for the Medicare application software. The additional costs were authorized by change orders to the original development contract and by obtaining additional funding from the Managed Care Initiatives Fund administered by the Department of Finance.

10.41 *Post-implementation review* - Net tangible benefits expected from the new system consisted of reduced computer processing and data entry costs minus additional operating costs associated with administering the new system. Department and MMC staff provided us with an analysis demonstrating that the new system achieved substantial cost reductions in the areas expected. However, Exhibit 10.1 on page 120 demonstrates that the cost of administering the MSI program has increased significantly since 1994-95. We were unable to determine how much of this increase is due to unexpected additional costs associated with administering the new system. We were therefore unable to conclude whether the net tangible benefits expected from the new system have been realized.

10.42 Intangible benefits were identified in the project planning documents. Benchmarks were quantified at the outset of the project based on old system performance. Intangible benefits include faster turnaround time for claims and registering residents and providers, decreased claim rejection rates and errors, improved response time for queries and requests for information, and decreases in the average cost of processing a claim. These intangible benefits were intended to provide improved service levels for providers and residents.

10.43 The Department has not conducted a formal post-implementation review to determine whether the tangible and intangible benefits of the new system were realized and how these results

compare to original plans. We have recommended that the Department undertake a post-implementation review as soon as feasible.

10.44 Project financing - The 1994 memorandum to the Priorities and Planning Committee did not disclose the expected interest costs for financing the project. MMC provided bridge financing for the project by paying development costs approved by the Department and billing the outstanding balance to the Department periodically. MMC charged the Department interest on the monthly outstanding balance at the chartered bank's prime lending rate plus 1%. Total interest charged to DOH from September 1994 to September 1998 was \$388,000. In our opinion, Priorities and Planning should have been more fully informed of the financing arrangements and the interest costs to be incurred.

10.45 In addition, the Department failed to record the liability owing to MMC in its accounting records at year end. As a result, the Province's liabilities were understated and Department expenditures as reported in the Public Accounts of the Province were misstated as follows:

Fiscal Year	Liability Understatement	Expense Understatement (Overstatement)
Year ended March 31, 1995	\$ 1,116,398	\$ 1,116,398
Year ended March 31, 1996	\$ 1,592,928	\$ 476,530
Year ended March 31, 1997	\$ 2,644,234	\$ 1,051,306
Year ended March 31, 1998	\$ 1,107,871	\$ (1,536,363)

10.46 Approval of other significant changes to project plans - There were other significant changes to the project, approved by the Steering Committee and DOH that, in our opinion, the Priorities and Planning Committee should have been informed of. These include:

- The development of the Pharmacare Premium Billing system at a cost of \$600,000.
- Systems maintenance and operations support were supposed to be included in the original contract with the developer to March 31, 1999. However this funding was expended by 1997. The Department entered into separate contracts with the developer for system maintenance for the 1997-98 and 1998-99 years at a cost of approximately \$300,000 per year.
- Additional funding from the Managed Care Initiatives Fund of \$1.2 million was secured for the purchase of additional hardware and for provider support.

10.47 Ownership of software - The MSI program is administered under a May 1992 agreement between the Province and MMC. Section 16.2 of the Agreement states that "*computer programs totally or partially designed and or developed by the Corp for the Plan are owned jointly and severally by the Province and the Corp.*" Thus the new MSI system software appears to be jointly owned by the Department and MMC even though MMC's contribution to the project has been limited to providing personal computers for systems access. Department of Health staff informed us that they believe the Province has sole ownership and use of the MSI program software. We have recommended that ownership of the system be clarified by legal counsel.

Year 2000 Readiness

10.48 *Background* - Concern about the Year 2000 Issue arises because older computerized systems use two digits rather than four to identify a year. These systems may recognize the year 2000 as some other date, resulting in errors when information using year 2000 dates is processed. The effects of the Year 2000 issue may range from minor errors to significant systems failures. It is important that steps be taken to identify and correct significant Year 2000 problems on a timely basis.

10.49 Certain actions have been taken regarding the Year 2000 issue for government applications at MMC. A Public Year 2000 Steering Committee was established in May 1998. Committee members include senior officials from MMC and the Department. The Executive Director of the Insured Programs Branch of the Department chairs the Committee.

10.50 A consulting firm was retained to conduct a Year 2000 assessment and the report was released in July 1998. From the assessment report, the Committee has an understanding of the Year 2000 corrective action required. The report indicates that corrective action may cost between \$2.5 and \$3.1 million. A detailed project plan was being developed at the time of our audit but was not complete.

10.51 Prompt decisions regarding funding and courses of action will be required, primarily by the Department, in order to ensure Year 2000 activities will be completed, tested and implemented prior to January 1, 2000. We urge that the necessary decisions and actions be made on a timely basis.

CONCLUDING REMARKS

10.52 This was our first examination of computer environment controls for the new MSI system. Although we found weaknesses and recommended corrective action in the areas of disaster recovery and contingency planning, logical access controls and programmer access to production programs, in general, we found control over the EDP environment to be satisfactory. It is important that the Department of Health establish periodic, independent audits of the EDP control environment at MMC to ensure that the integrity of environmental controls is maintained.

10.53 The development of a Province-wide MSI claims processing and information system was a significant, complex undertaking. The system has been operating successfully for over a year and has many advantages over the old system it replaced. The decision to develop this system was based upon estimated costs and benefits, both tangible and intangible, asserted in the original planning documents. It is important that the Department conduct a post-implementation review to ensure that taxpayers have received all of the tangible and intangible benefits expected from the new system and to ensure that costs in addition to those planned are justified.

10.54 The MSI system is an integral part of the Province's health system. It is important that this system handle Year 2000 dates properly. We urge that the Department take the necessary steps to ensure Year 2000 activities are completed, tested and implemented on a timely basis.

*Exhibit 10.1***MSI CLAIMS PROCESSED BY MMC FOR THE DEPARTMENT OF HEALTH**

Fiscal Year	Total Claims Paid By MMC (\$ Millions)	Administration Fees Charged By MMC (\$ Millions)	Percentage of Administration Fees To Claims Paid %
1994-95	\$341.6	\$6.0	1.8%
1995-96	\$355.8	\$7.0 ¹	2.0%
1996-97	\$356.3	\$7.2	2.0%
1997-98	\$386.5	\$7.4	1.9%
1998-99 (Estimate)	\$401.3	\$7.8	2.0%

¹The new Seniors' Pharmacare Program was introduced on April 1, 1995 resulting in increased administrative fees.

11.

HEALTH - HOMES FOR SPECIAL CARE - PHASE II

BACKGROUND

11.1 The Homes for Special Care Act governs many long-term care facilities throughout the Province including nursing homes, homes for the aged, homes for the disabled and residential care facilities. Individuals in these homes may have assistance from the Departments of Health and Community Services for the payment of per diems as provided for under the Social Assistance Act. The Department of Health provides financial assistance to residents in nursing homes and homes for the aged and is responsible for licensing these facilities under the Homes for Special Care Act. The Department of Community Services, as noted in Chapter 5, is responsible for all other homes for special care governed by the Homes for Special Care Act, including regional rehabilitation centres, residential care facilities, group homes, adult residential centres and developmental residences.

11.2 The 1997 Report of the Auditor General (Chapter 6) included the results of Phase I of our audit of homes for special care. Phase I focussed on the classification and assessment process for admitting individuals to these homes which is a joint effort between the Departments of Health and Community Services.

11.3 The results of Phase II of the audit are reported separately for each of the Departments of Health and Community Services as the functions and related audit procedures performed were specific to the type of home for special care funded by each department. See Chapter 5 for results of the Department of Community Services audit.

11.4 Residents requiring financial assistance in nursing homes and homes for the aged are funded through the Long-Term Care budget at the Department of Health. The total amount approved by the Department of Health to operate these facilities for 1997-98 was \$198.5 million. Of this amount, approximately \$88.7 million was contributed by residents of these homes towards the cost of their care. The net amount of \$109.8 million is included in the 1997-98 Estimates for the Department. The 1998-99 Estimates for the Department indicate an expenditure of \$133.2 million is budgeted which represents an increase of 21.3% over the 1997-98 fiscal year budget.

11.5 As of April 1997, there were 70 of these facilities throughout the Province. These facilities may be municipally-owned, private non-profit or private for-profit entities and include the six long-term care facilities associated with hospitals in the Province. The 1998-99 Budget Address indicates an additional 170 beds are expected to be in place during fiscal 1999-2000. This represents an increase of 3% over the current 5,856 beds.

11.6 Approximately 24 of the 70 facilities have received accreditation through the Canadian Council on Health Services Accreditation (CCHSA). This is a non-profit, non-government organization that helps health service organizations examine and improve the quality of the care and services they provide to their clients. Performance is assessed against national standards set by CCHSA in collaboration with the health care community and related stakeholders.

RESULTS IN BRIEF

11.7 The following are the principal observations from this audit.

- Nursing homes and homes for the aged are inspected by the Department of Health at least annually, but legislation requires semi-annual inspections for nursing homes. We attended an inspection of a nursing home in late 1997 and found the inspection to be thorough, including a detailed discussion with administrative staff on the findings resulting from the inspection.
- During our review of the licensing and inspection processes and related documentation, we noted several instances where current practices did not reflect legislation. Management of the Long-Term Care Division has indicated that legislation surrounding nursing homes and homes for the aged should be reviewed, but a timetable for this review has yet to be established. Certain medical aspects of the regulations are being reviewed. We urge the Department to continue with the review and make changes to ensure legislation better reflects current practices.
- The Department should establish an accountability framework for its relationship with the homes. Documented goals for performance and the monitoring and reporting on those goals should be an integral part of the framework. Appropriate monitoring and reporting are essential components of any accountability relationship and are currently lacking in the relationship between the Department of Health and the homes. The Department recognizes the importance of appropriate monitoring which is dependent upon good information systems. Because the Department is focussing its efforts in information technology at the current time on year 2000 compliance, required changes to the information systems will not be immediate.
- Budget requests are to be submitted each year, but there are no guidelines for funding and funding for the homes has been based on the historical amounts. We also noted that the financial statements are not used extensively to verify the reasonableness of the requested budget. As a result, it is possible that any inefficiencies built into past budgets continue to be included in current funding.
- Effective per diem rates are not established prior to the start of the fiscal year. Consequently, administrators of homes are required to plan for current year's activities without knowing the anticipated revenue. Per diem rates should be set prior to the beginning of the year and communicated to homes.
- The Department is beginning to monitor occupancy rates and waiting lists on a regular basis. Waiting lists are maintained by regional Community Services offices responsible for assessing individuals for placement in a home for publicly funded residents. However, private paying patients may not appear on those lists. This system does not enable the Department to ensure that individuals with the greatest need are placed in a home first.
- There is a need for the Department to perform a comprehensive review and analysis of all available data to forecast future long-term care bed needs. Proper planning is necessary to ensure that resources are used economically and efficiently, and that appropriate services are available for residents when they are required.

AUDIT SCOPE

11.8 The objectives for Phase II of the audit were to:

- assess the licensing function for nursing homes and homes for the aged and the extent to which compliance with standards is monitored during this process;
- review and assess the process for setting per diem rates for these long-term care facilities, and determine the extent to which their financial performance is monitored; and
- review the Department’s planning processes with respect to long-term care, and the extent to which outcome measures have been identified and reported.

11.9 The following general criteria were used in our audit.

- Licences should only be issued to those nursing homes and homes for the aged which have met the requirements detailed in the Act and regulations.
- Licences should be renewed in accordance with the Act and regulations and the renewal should result from an inspection process.
- The inspection process should consider the scope of the Act and regulations and should result in a report noting the outcome of the inspection. The report should be distributed appropriately. The inspection process should include follow-up to ensure deficiencies have been addressed.
- There should be an annual review, following established guidelines, of the budgets and audited financial statements of nursing homes and homes for the aged as part of the process for setting the per diem.
- There should be controls to ensure that funds are expended by homes in accordance with related guidelines and with due regard for economy and efficiency.
- There should be controls to ensure that the per diems charged by homes for publicly funded residents do not exceed the per diems determined by the Minister of Health and that claims from homes should be based on approved per diem rates and only be paid if they relate to residents who have been approved for funding by the Department of Health.

11.10 Our audit approach consisted of interviews with staff and management of the Long-Term Care Division of the Department of Health. We also reviewed documentation related to the inspection and licensing process, and financial statements and budget data used to establish per diem rates for the homes.

PRINCIPAL FINDINGS

Licensing and Inspection

11.11 *Roles and responsibilities* - The job description for the Long-Term Care Advisors at the Department of Health notes that they are to inspect the homes to ensure compliance with the Act and regulations, and to prepare and submit reports and recommendations for licensing of homes. The

process also includes follow-up on problems identified in the home. The inspections do not include review of financial management, internal controls, or due regard for economy and efficiency at homes.

11.12 Reports, including recommendations for licensing, are reviewed within the Long-Term Care Division at the Department of Health, and then provided to the respective regional director. This individual then makes the appropriate licensing recommendation to the Minister. Signed licences are sent from the regional director's office to the home, along with a letter detailing the recommended actions to be taken on problems identified during the inspection.

11.13 *Inspection process* - The regulations to the Homes for Special Care Act require that homes for the aged be inspected at least once a year, and that nursing homes be inspected at least twice a year. Our review of the current inspection practices indicates that inspections are conducted in each facility at least annually, and therefore there are nursing homes which are inspected only once a year.

11.14 Inspections are conducted based on a schedule maintained by each Long-Term Care Advisor for their respective region (the regions correspond to the four health regions in the Province.) Visits to the homes are unannounced. The results of the inspection are recorded on a completed licensing tool (see paragraph 11.16).

11.15 We attended the inspection of a nursing home in the Northern Region in late fall 1997. We noted that the inspection was detailed and that an exit interview was used to communicate the findings of the inspection to the administration of the home. The Division should consider providing a completed copy of the licensing tool to the home to reflect the comments made during the inspection and the exit interview.

11.16 *Monitoring of compliance with standards* - A licensing tool has been developed for use during the inspection. The tool is provided to and completed by administration of the home in advance of the inspection visit.

11.17 We reviewed the licensing tool to determine if it appropriately considered the Act and regulations and noted that there are many aspects of the regulations which are not detailed on the licensing tool. Examples of these omissions and some related explanations include the following.

- The regulations require specific information be maintained for each resident including a treatment plan and a record of changes in condition. While the licensing tool provides an area for general comments concerning the process used by the home to maintain resident records, it does not address the details required to be maintained in each resident's file. We observed that resident records were examined on a sample basis during the inspection we attended. However, there is no documentation of this sample review and we recommended that this be performed for all inspections. As noted in paragraphs 6.26 through 6.28 of our 1997 Report, caseworkers are supposed to review residents' care needs semi-annually but this is not being done.
- The regulations require that each home for special care shall carry adequate liability insurance and that proof of this insurance is required for license renewal. The inspection tool addresses the existence but not the adequacy of liability insurance.
- Quarterly reports detailing resident statistics such as deaths and admissions are to be prepared by the homes and submitted to the inspectors. These reports are not being prepared. We noted that the licensing tool requires that these statistics be reported, but the frequency of this reporting is not as required by the regulations.

11.18 Those involved with the medical care of residents feel there is a need to review the legislation associated with this area. The Long-Term Care Division is in agreement, but a time frame for this review has yet to be established.

11.19 The Long-Term Care Advisors have developed an extensive draft document outlining standards of care in nursing homes and homes for the aged. This document covers more than just the care of the resident. Areas such as governance and administration and physical environment are addressed. We urge the Department of Health to finalize this draft as it is necessary to set standards to measure outcomes of homes.

11.20 *Review of documentation* - We reviewed documentation for a sample of homes to assess its completeness and to determine the extent of follow-up performed on recommendations made during previous inspections. We felt that for most items, documentation was complete and appropriate. There was adequate follow-up on the recommendations made during prior inspections. Two areas where we felt documentation could be improved are as follows.

- Each facility is to submit an emergency plan to the Minister and these plans are to be exercised and revised at least once every three years. We noted that the Long-Term Care Advisors have a record noting the status of these plans and the exercise for each of their regions, and that any deficiencies in these plans were noted on the respective licensing tool as areas for improvement. A review of the Long-Term Care Advisors' status reports indicates that most of the homes in our sample had current plans.

However, we were unable to locate a plan in the file for the majority of homes we selected. We were informed that the plan for each home is kept at the home after it has been reviewed for completeness by the home using a checklist developed by the Provincial Emergency Measures Organization.

- The regulations also require that there be an annual health inspection. This inspection is being performed by the Department of Agriculture and Marketing. The inspection has concentrated on food preparation and eating areas of each home, although we understand that the inspection will eventually cover the entire facility.

Only 45% of the files we reviewed contained evidence that the health inspection had been performed. We have been informed that a process is being developed to ensure the Long-Term Care Division receives copies of all reports related to health inspection.

11.21 In addition, we also reviewed documentation to determine if there was consistency in the licensing recommendations made for each home based on the deficiencies found during the inspection. We were informed that there have been no license suspensions. Interim licences are issued for a period of less than a year if the Long-Term Care Advisor feels the deficiencies noted during the inspection require follow-up sooner than that which would be indicated by issuing an annual license. These interim licences can be for any number of months.

11.22 Our conclusion is that the absence of guidelines may lead to a lack of consistency in the recommendations made. We discussed the inconsistency with one of the Long-Term Care Advisors who provided explanations for the license terms recommended. While the explanations were reasonable, we feel that guidelines should be developed which recommend licensing terms relating to certain deficiencies. While the need for professional judgement is acknowledged, guidelines would promote consistency and objectivity in licensing recommendations and provide support in the case of a dispute.

11.23 *Unlicensed facilities* - Facilities which meet the definition of nursing homes and homes for the aged in the Act require a license to operate regardless of whether or not residents in the home are in receipt of public funds. For smaller facilities in violation of the Act, the Department of Health liaised with the Department of Community Services during its review of facilities under its Small Options Program. This review was completed and a report released on August 5, 1998. The review process identified facilities which should have been licensed and were not. The Department of Community Services is currently taking action to remedy the identified situations with support from DOH as appropriate. The report recommended that the Departments of Community Services and Health determine which department should assume responsibility for the Community Based Options Program which serves the elderly population. In addition, the report recommended that the government seek input on the question of government's role in small options settings in which individuals receive no financial assistance. The Department of Health is developing a formal protocol for identifying and dealing with homes in violation of the Act.

Facility Finances

11.24 *Funding for facilities* - Nursing homes and homes for the aged are not directly funded by the Department of Health. Rather, Health makes payments to the homes on behalf of the homes' approved residents based on a daily per diem rate, that is, Health will assist residents with the cost up to the maximum per diem based on financial need. Approval of residents for funding from the Department of Health was discussed in our 1997 Annual Report. The homes obtain the remaining necessary funding from the private-paying residents and other sources.

11.25 Nursing homes and homes for the aged participate in this funding process by submitting a summary level budget proposal to the Department of Health each year. Information received is not detailed (eg. total salaries, employee benefits, and operation and maintenance.) The Department will also ask for information on the critical areas - areas where the homes feel extra funding is needed. For many of the budget submissions we reviewed, the focus of the extra funding requests dealt with salaries and benefit costs which comprise the bulk of the budget. Administrators alluded to the fact that salaries have not increased for a number of years in accordance with wage restraint legislation and also commented on the increase in related costs such as Workers Compensation. It should be noted that for the 1998-99 fiscal year, the Department has increased funding to cover the actual costs of Workers Compensation premiums and assist with Harmonized Services Tax.

11.26 Budget requests are reviewed and discussed by a number of people in the Department. We noted that there are no established documented guidelines for the performance of these reviews, but we believe that there is a need for such guidelines to ensure consistency. As well, audited financial statements are not used extensively during the process. We were provided with a listing of all the homes and the date of the financial statements provided. In some cases, the most recent set of financial statements was March 1993 and in three instances, no statements were received as the home operated as part of a hospital. We reviewed some of the financial statements and noted that there was a lack of consistency among homes in the information presented. Legislation does not require audited financial statements to be submitted although the Department has been attempting to introduce this requirement. We urge the Department to continue with this initiative and to use the financial statements as a starting point for establishing a reporting framework for financial results. This framework would enable the Department to make meaningful comparisons between budget and actual results and comparisons among homes.

11.27 Based on the discussions and analysis, an annual budget is approved for each home. The approved budget is converted into a daily per diem rate by dividing the expected number of resident days for the year into the approved budget for each home. These budgets are usually based on the historical funding of the home. Since the determination of the per diem rate is based on the historical budgets and not on established guidelines, it is possible that there are inefficiencies built

into the budget. The Department of Health indicated it will provide more staff resources to the Long-Term Care Division to strengthen the budget process for the next fiscal year.

11.28 In some cases, additional funding is provided to meet priorities of the Department such as increasing direct care staffing which was part of the focus for the 1997-98 year. Direct care staffing exceeds the standards noted in the Regulations. Other staffing guidelines are outdated (dated December 1980) and need to be updated. We recommended the Department continue to review the existing staffing guidelines as a starting point for more detailed guidelines which would outline what will be funded and how it will be calculated.

11.29 Once the budget (per diem rate) has been approved, a letter is forwarded to the home outlining the amount. Although funding is portable, that is, non-restricted, the homes are informed of the approved staffing complement as Health wishes to advise the homes of where it would like to see the funds directed particularly in the case of funding increases for additional staff. The April 1, 1997 approved per diem rates for long-term care beds ranged from \$68.77 to \$135.42. Per diem rates may and do change during the year as additional funding for staffing may not be effective until later in the year.

11.30 *Claims* - Each month, homes are required to prepare a claim(s) to obtain funding for approved residents from the Department of Health. If a home has residents associated with different municipalities, then a claim for each Department of Community Services region must be prepared. These claims show the residents for which a claim is being made, the per diem rate, the number of days for each resident, any other funding the resident may have (e.g., pensions a resident may receive, as this is deducted from the claim amount) and special expenditures for the resident (special expenditures are discussed further in paragraph 11.37). Any residents being funded solely by private funds are not shown on any claim.

11.31 At the time of our audit, claims followed one of two processing routes - either through the Department of Community Services or the municipalities. Claims for residents associated with Queens, Cape Breton and Halifax municipalities were reviewed and processed by the Community Services caseworkers. A cheque was issued to the home by the Department of Community Services which in turn recovered the expenditure from the Department of Health.

11.32 For claims for residents associated with the other municipalities, the municipality was responsible for all the verification work associated with the claim. After the municipality had reviewed the claim, it was forwarded to the Department of Health for payment. The Department reviewed the claim for mathematical accuracy and proper per diem.

11.33 In conjunction with the April 1, 1998 transfer of all social assistance programs to the Province, and subsequent to our audit, a change was made to the above process. All claims are now reviewed by Community Services caseworkers. Approved claims are forwarded to the Department of Health and a cheque is issued to the home.

11.34 We noted that the homes were not informed of the per diem rate in effect for April 1, 1997 until several months later. This has many consequences as it makes it difficult for staff at the homes to manage resources efficiently. In a few cases, the per diem rate was reduced. In one case, this resulted in a reduction of over \$100,000 in anticipated revenue. Since the homes were not informed of the decrease until several months into the current year, any decisions to deal with the reduction in revenue were compounded by the fact that some of the expenditure had already occurred.

11.35 We reviewed a number of claims and noted that in some cases, the incorrect per diem rate was used as the current rate was not available on a timely basis. As a result, an adjusting claim for the difference had to be prepared by the home. We noted there was no follow-up process to ensure

that an adjusting claim was filed. Expediting the per diem setting process would assist in ensuring claims are paid using the correct rate as well as providing homes with better financial data to plan for current year's activities. We also noted that in some cases, claims were not signed by the appropriate official. Claims should not be processed for payment unless they are signed by the appropriate authorized official.

11.36 As indicated in paragraph 6.22 of our 1997 Report, there are currently no requirements for periodic reassessment of a resident's financial situation so income figures on the claims cannot be properly verified. We recommended that policies be changed to require regular review of residents' financial data.

11.37 *Special needs* - Special needs include items such as eyeglasses, hearing aids, dentures and other items necessary to the well-being of the resident. Each municipality has its own rules for the approval of special needs. As a general rule, if the item is greater than \$1,500 or is very unique, it would come to the department for approval before purchase. Thus at the time of our review of the claims, the approval of special needs was based on the guidelines of the entity reviewing and approving the claim. We did not note any special needs claims that seemed excessive or unusual.

11.38 Subsequent to our audit, the Department established a Policy Manual - Community Supports for Adults - which was effective April 1, 1998 and is to be used for all residents. This should assist in ensuring that approvals of special expenditures are consistent from resident to resident. In addition to special needs, this manual also provides guidance on a number of other areas including determination of program eligibility and determination of financial eligibility. The Department has initiated a review of this manual to determine the relevance and usefulness of the manual from both the homes' and caseworkers' perspectives.

11.39 *Monitoring of performance* - Audits of the homes' financial management functions were originally conducted by the Department of Community Services until April 1993 when the program was transferred to the Department of Health. At that time, the Department of Health became responsible for the audit activity in Nursing Homes and Homes for the Aged. As well, in the past, funding of long-term care facilities was cost-shared with the municipalities. Various municipal units may have also conducted some reviews of the expenditures being incurred by the homes.

11.40 Audit activity in homes has been limited to the residents' trust funds and personal use allowance since the program was transferred to the Department of Health. There was one audit conducted in 1994 but no other detailed audits have been conducted since that time to review the financial management functions of the homes, compliance with guidelines, or due regard for economy and efficiency with the exception of some audits on resident trust funds. Appropriate monitoring and reporting are essential components of any accountability relationship and are currently lacking in the relationship between the Department of Health and the homes. The Department of Health's Audit and Consulting Section has indicated that it would like to expand the scope of its audits of homes within the next fiscal year and has just recently initiated one audit. In addition, the Department of Health indicated it will increase the audit staff resources devoted to audits of homes in the next year.

11.41 The Long-Term Care Advisors make note of the staffing complement when conducting a licensing visit, however, this comprises only a small component of the inspection and would not necessarily identify irregularities or areas for improvement. We believe it is important for the Department to review staffing issues in more detail to ensure homes are using the funds in accordance with the approved staffing complement outlined in the budget letter.

Outcome Measures

11.42 Outcome measures are an important feature of any program. Well defined outcome measures assist in determining if a program is achieving its intended goals.

11.43 Currently the Department of Health has responsibility for establishing outcome measures for the Long-Term Care program. The Department should implement a process to develop outcome measures and appropriate targets. A Long-Term Care Working Group sub-committee on Outcome Measures was created to deal with this issue. However, the working group disbanded after only a few meetings.

11.44 The Division has begun to track and gather certain types of information from the Licensing Report which may assist in the creation of standards and outcome measures. In addition, the Division plans to introduce a system which will monitor and measure the length of time it takes to obtain access to a long-term care bed. These initiatives may lead to improvements in this area. However, further refinement of this system will be delayed as the Department's priority in the information technology area is year 2000 compliance.

Waiting Lists and Planning for Beds

11.45 *Occupancy and waiting lists* - The Department is beginning to monitor occupancy rates or waiting lists. Forecasts of demand and wait times are not done. Occupancy rates are estimated based on the budgets provided to the Department by the homes but these rates are not monitored throughout the year.

11.46 Waiting lists are maintained on a regional basis by Community Services offices. These lists may not include private-paying patients. As well, many individual homes maintain their own wait lists which are not coordinated with the wait lists of the Community Services offices. Therefore it is possible that some individuals that have been on a wait list may get into a facility before another individual who has been waiting longer.

11.47 The Department is reviewing the concept of a single entry access system. Access to a wide variety of services available from a number of departments would be through one application. Each person would be assessed by a caseworker to determine which program would best suit his/her needs. The Department of Health has made a commitment to address the issue of single entry access during the next year.

11.48 A single entry access system would facilitate better monitoring of occupancy rates and the waiting times on a province-wide basis. This would assist in determining if individuals needed to be placed in a Nursing Home/Home for the Aged or whether other programs would better meet the needs of that person. As well, those with the greatest needs would be admitted first.

11.49 Monitoring of wait lists will also assist in future capital budgeting. The lists could be analyzed for trends and used to determine if future additional beds will be required and the type of facility needed. At the current time, the Department is just starting to look at bed planning issues, however, management noted that this is very difficult as there is inadequate information on waiting lists and other aspects of long-term care on which to base plans.

11.50 *Bed planning* - At the current time, the future demand for long-term care beds is not being analyzed and forecasted by the Department of Health. The Nova Scotia Continuing Care Bed Planning Guidelines January 1997 were developed in draft format by the Long-Term Care Working Group but never finalized. These draft guidelines outline a number of factors that should be considered when trying to project future demand for long-term care beds.

11.51 Without adequate forecasting for future demand, including projection of the type of care that may be required, it is possible that appropriate facilities may not be constructed on a timely basis, forcing long-term care residents into other more costly facilities. Alternatively, facilities may be constructed unnecessarily or in an inappropriate location.

11.52 *Construction, renovation and sale of facilities* - Construction, acquisition and sale of facilities, and replacement and renovation of facilities must have the approval of the Department of Health as these items could have significant impacts on the number of beds and the funding requirements. Licenses do not automatically transfer to a new owner if a facility is sold.

11.53 We reviewed some of the major renovations that have been approved for homes in the past year. Most of the renovations were a result of deficiencies identified by the Fire Marshall. We did not encounter any irregularities in the application process and these renovations were properly considered.

Other Issues

11.54 *Follow-up from 1992 Report of the Auditor General* - In our 1992 Annual Report, we made several recommendations concerning the sharing of services between hospitals and nursing homes. At the time of that report, Nursing Homes and Homes for the Aged were the responsibility of Community Services so there were difficulties in implementing sharing arrangements because two departments were involved. However the findings are still relevant in that sharing arrangements between hospitals and nursing homes could be more easily accomplished now that both types of facilities receive funding from the Department of Health.

11.55 To date, little progress has been made in addressing the recommendations. While the Department is flexible in the funding arrangements to encourage sharing, this is at the initiative of the homes. Some of the homes linked to hospitals make arrangements for purchasing services from the hospital instead of trying to provide the service themselves. The Department and Regional Health Boards should consider encouraging more shared arrangements as this may result in cost savings and increased efficiencies.

11.56 *Complaint investigation* - The job description for the Long-Term Care Advisors includes the responsibility to investigate complaints received regarding homes and submit detailed reports of the investigation. Discussions with the Advisors indicate that complaints are infrequent. The extent of their investigation and the distribution of any resulting reports depends on the nature of the complaint. It was also indicated that many homes have internal policies regarding complaint investigation and resolution.

11.57 Staff have indicated that the process they encourage is for persons with concerns to first discuss the issue with appropriate personnel at the home. The Department of Health, or other external parties such as professional licensing groups, can be contacted if the complaint has not been addressed by the home to the individual's satisfaction. However, there is a need for a formal, written policy outlining the procedures to follow when investigating complaints. There is also a need for guidelines detailing the appropriate action to take given the nature of the complaint and the frequency of complaints at a particular home. We have been informed that these issues are being considered in a review of policies for these facilities.

CONCLUDING REMARKS

11.58 The Long-Term Care program is evolving as the responsibility for this program is transferred from a shared arrangement between the Province and municipalities to one that is the total

responsibility of the Province. Coordination between the Departments of Health and Community Services is essential to ensure individuals are placed in the most appropriate cost-effective care facility. Single entry access is viewed by Departments as a way to accomplish better co-ordination. The Department of Health has made a commitment to address the issue of single entry access during the next year.

11.59 There are a number of issues that must be resolved to ensure the Long-Term Care program operates in an efficient and effective manner and complies with legislation. Funding of facilities continues to be a critical area. We believe that scarce funds should be allocated to the homes in a systematic and rational manner based on established guidelines and standards, and that an appropriate accountability framework should set out key terms of the relationship between Departments and homes.

11.60 The Department of Health should make it a priority to establish outcome measures for the program and individual homes, and to monitor performance. Outcome measures provide key information to assess a program's performance. Without such measures, it is not possible to determine if a program is meeting its intended goals and objectives.

12.

HEALTH - REGIONAL HEALTH BOARDS AND NON-DESIGNATED ORGANIZATIONS - COMMENTS ON FINANCIAL SITUATION

BACKGROUND

12.1 In June 1994 *An Act to Establish Regional Health Boards* was passed. In the subsequent months, four Regional Health Boards (RHBs) were formed as specified in the legislation:

- Central Regional Health Board
- Eastern Regional Health Board
- Northern Regional Health Board
- Western Regional Health Board

12.2 During 1996-97, the RHBs assumed responsibility for governance of all but four of the hospitals in the Province. The four remaining hospitals are known as Non-designated Organizations (NDOs) and are governed by their own Boards of Directors. The four NDOs are:

- Cape Breton Healthcare Complex
- Izaak Walton Killam Grace Health Centre for Children, Women & Families
- Nova Scotia Hospital
- Queen Elizabeth II Health Sciences Centre

12.3 In April 1997, the RHBs assumed responsibility for Drug Dependency and Public Health Services which had previously been delivered by the Province.

12.4 The following previous Reports of the Auditor General dealt with issues related to accountability and planning for RHBs:

- 1995 Report - Chapter 11 - Planning for Health Reform and Follow-up to Management Audit (page 119)
- 1996 Report - Chapter 8 - Planning for Health Renewal - Follow-up (page 94)

12.5 The Auditor General Act gives the Auditor General the mandate to audit agencies of government and recipients of financial assistance from the government. An agency of government is defined as an entity where all of the members of the board of directors are appointed by an Act of the Legislature or the Executive Council. All members of Regional Health Boards are currently appointed by the Minister of Health under the provisions of Section 5(3) of the Regional Health Boards Act until such time as Regulations permitting another mode of appointment are enacted. Regulations under the RHB Act also specify that the Governor in Council appoints a member to be the Chair of each of the RHBs. Therefore, all of the RHBs currently fit the definition of an agency

of government under the Auditor General Act. Not all of the members of the Board of Directors of the NDOs are appointed by the Province therefore they may/may not be agencies of government depending on the specific governing legislation.

12.6 In those cases where the financial statements are audited by a private sector public accountant, the Auditor General Act gives the Auditor General the mandate to review findings and recommendations reported to management by their auditors as well as the audited financial statements. The financial statements of all of the RHBs and NDOs, except for the Nova Scotia Hospital, are audited by private sector firms. The Office of the Auditor General performs the audit of the financial statements of the Nova Scotia Hospital.

12.7 The 1998-99 Estimates of the Department of Health reflect a net expenditure of \$785 million for operating grants and contributions to RHBs and NDOs and a further \$24 million for capital grants. This represents 55.6% of the total Estimates for the Department of Health. The first quarterly financial report for the 1998-99 fiscal year, prepared by the Department of Finance and released in September 1998, forecasts that the Department of Health will exceed its total Estimate of \$1.455 billion by \$28.9 million but the overexpenditure is entirely in other areas of the Department and not related to RHBs/NDOs.

12.8 Chapter 15 of this Report is devoted to comments on the financial situation of the Queen Elizabeth II Health Sciences Centre and should be read in conjunction with this chapter.

RESULTS IN BRIEF

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

- The Regional Health Boards and Non-designated Organizations reported total operating deficits of \$38 million on shareable operations (i.e., operations for which the Department of Health provides funding) for the year ended March 31, 1998 and one RHB also reported a non-shareable deficit of \$33 million. The organizations reported accumulated deficits of \$121.8 million as at March 31, 1998. These deficits were financed primarily by borrowing from financial institutions (\$30 million) and advances from the Department of Health (\$85 million).
- The auditors of the financial statements of these entities expressed concerns about the size of the deficits in relation to annual budgets and their impact on the entities' abilities to sustain health programs in the future. We concur with the observations of these auditors.
- Auditors of two RHBs identified total transfers of \$10 million of hospital funds (donations and operating surpluses) to hospital Foundations by predecessor hospital Boards at the time of formation of the RHBs. The auditors expressed concerns about the legal authority of the boards to make these transfers and the need for legal opinions to clarify the authority. The auditors also expressed concern that appropriate agreements between the RHBs and the Foundation boards to define accountability for the control and disposition of the transferred funds had not been prepared. We believe that the source of the funds should be an important consideration for the RHBs and the Department of Health when deciding on appropriate action. The Department of Health is currently reviewing the transfers.

- The Department of Health has initiated a business planning process for RHBs/NDOs and is currently conducting a review of those plans. We urge the Department to continue its Business Plan Review process and meet its target dates for making recommendations to government. There is an urgent need for government and the RHBs/NDOs to deal with the financial problems of these organizations.
- The Department of Health has not recognized any liability for the deficits of RHBs/NDOs in its accounting records. The Department of Finance has identified the issues with respect to whether quasi-government organizations like RHBs/NDOs should be included in the government financial reporting entity in its 1998 publication *Financial Accountability - A Blueprint for Success* and has established a work schedule with target dates for major decisions in the 1998-99 fiscal year. We urge the government to deal with this major issue according to the timetable it has described and we will follow-up progress and provide comments in future Annual Reports.
- As at March 31, 1998 the Department of Health had recorded accounts receivable of approximately \$100 million from RHBs/NDOs. A provision of approximately \$50 million for doubtful recoveries was recorded as an expense by the Department of Health and deducted from receivables in the Public Accounts so that receivables were valued at the estimated collectible amount (i.e., the net accounts receivable related to RHBs/NDOs totalled approximately \$50 million). The provision for doubtful recoveries has not been formally communicated to the RHBs/NDOs so their financial statements still show the entire related amounts recorded as accounts payable to the Department of Health and the impact is included in the RHB/NDO deficits. If the \$50 million previously provided for doubtful accounts of RHBs/NDOs was formally allocated to the individual RHBs/NDOs and the related receivables were written off by the Department of Health, liabilities and recorded deficits of the RHBs/NDOs would be reduced accordingly and there would be no impact on the expenses of the Department of Health to the extent that a provision exists. The Department of Health has indicated that the provision was established for general contingencies that may occur at the Department of Health and that it will be used to provide for problem accounts receivable which may/may not be related to RHBs/NDOs.

SCOPE OF REVIEW

12.10 The objectives of this assignment were to:

- review the audited financial statements and auditors' management letters for the RHBs for the year ended March 31, 1998 to determine their financial position and operating results and any significant, identified weaknesses in financial management and internal controls;
- gain an understanding of any plans of the Department of Health and the RHBs and NDOs for addressing reported deficits and deficiencies in financial management; and
- consider and describe the issues with respect to whether the deficits of the RHBs and NDOs should be reported in the Public Accounts of the Province.

12.11 We reviewed the audited financial statements and management letters issued by the external auditors for the year ended March 31, 1998 for all of the RHBs and NDOs. The financial statements

and management letter of the Cape Breton Healthcare Complex had not been finalized at the date of our review because of unresolved issues between the Complex and the Department of Health but we did review the documents in draft form. We did not perform any additional verification of any of the financial statements and management letters. We had discussions with management of the Department of Health and reviewed documents relating to the Department's business planning process for the RHBs and NDOs.

PRINCIPAL FINDINGS

Financial Position of RHBs and NDOs

12.12 We reviewed the audited financial statements of the RHBs and NDOs for the year ended March 31, 1998. Exhibit 12.1 on page 142 summarizes the financial position and operating results for the year.

12.13 The accumulated deficits in Exhibit 12.1 do not include balances in capital funds, although the operating deficits include amortization of capital revenue and capital assets for some facilities. Both the Queen Elizabeth II Health Sciences Centre and the Cape Breton Healthcare Complex have large differences between the unamortized book value of capital assets acquired to date and the amount received in capital asset funding (Cape Breton - capital asset book value exceeds funding by \$23.5 million, and QEII - capital asset book value exceeds funding by \$45.8 million). These amounts will represent net expenditures in future years when deferred funding and book values are amortized to the Statements of Revenues and Expenditures and the related expense will exceed the funding.

Comments included in Auditors' Management Letters

12.14 We reviewed the management letters prepared by the auditors of the financial statements of each of the RHBs and NDOs. The purpose of the review was to determine whether the auditors reported any significant weaknesses in financial management and internal controls. As noted previously, the management letter for the Cape Breton Healthcare Complex has not been finalized so we reviewed a draft. The following items which were noted in the management letters are significant enough to report.

12.15 *Budgeting and expenditure control* - Budgetary controls are very important when fiscal resources are limited. Three of the management letters noted that improvements are required in the areas of budgeting and/or monitoring of expenditures. A comprehensive budget for the year was not prepared in one organization because each department was given the same budget as the prior year. The auditors noted that this resulted in ineffective management controls as inefficient departments were allocated an amount equal to the prior year's expenditures. Two organizations were cited as not having timely reporting of performance in relation to the budget and formal explanation of any variances.

12.16 *Deficits* - Three of the management letters included comments on organization deficits. The following are extracts from two of those letters:

"The accumulating deficit has reached a point where bank borrowings will be required to fund future deficits. The chartered banks will lend to the Regional Health Board believing the loans are effectively to the Province of Nova Scotia. The Department of Health must address this issue immediately as the accumulating deficit of the Regional Health Board is seen as a deficit of the Province of Nova Scotia. If the Board of Directors are to be held

accountable for financial deficits, they must be provided with sufficient funds to break even or given instructions to cut back on programs...

The Board should take steps to eliminate any further operating deficits. We recommend the Board continue to discuss its concerns with the Department of Health and request increased funding for past deficits and future operations to the level required to operate current programs. Should this additional funding not be available, the Board will be forced to cut programs in order to operate within its allocated resources.” (letter from external auditor to a Regional Health Board dated July 9, 1998)

“The Board must support management in its initiatives to either:

- 1.) Negotiate new funding arrangements with the Department of Health.*
- 2.) Eliminate certain programs or other cost reduction measures.”* (letter from external auditor to the Board of an NDO dated June 26, 1998)

12.17 *Transfers to Foundations by predecessor hospital boards* - Two of the management letters identified findings with respect to transfers of significant amounts of funds to hospital charitable Foundations by predecessor hospital boards. These transfers were made prior to the dismantling of the hospital boards when the Regional Health Boards were formed.

12.18 With respect to one RHB, \$3.7 million was transferred by hospital boards to four hospital Foundations. The financial statements indicate:

“These assets have not been recorded in the accounts of the [Regional Health Board] as the Board of Directors of the [Regional Health Board] do not have custody or control over the funds.”

12.19 The management letter from the RHB’s external auditors to the Board Chair dated June 9, 1998 notes:

“[The funds] primarily arose from donations and operating surpluses...it was unclear whether the predecessor Boards had the authority to transfer the funds. [The auditors] understand that the issue of authority has not been pursued. As well, it is [the auditor’s] understanding that no official policy has been established with the foundations for the return and use of these funds for future projects of the hospital sites...[The auditors] recommend that management of the [Regional Health] Board approach the Foundations to determine the use of the transferred funds...and to set out future capital requirements for each of the facilities.”

12.20 A similar situation exists in the second board. In that case, ten hospital boards transferred \$6.1 million to Foundations.

12.21 As noted above, these amounts are not disclosed in the audited financial statements of the RHBs because the RHBs do not have control of the funds. The amounts are disclosed, however, in notes to the financial statements and are reduced each year by the amount of contributions received by the RHB from the Foundation as funding for designated projects. Similar transfers are not disclosed in the notes to the financial statements of the other two RHBs but it is possible that similar transfers were made but not disclosed. We recommended that the Department of Health undertake the following actions:

- investigate all of the transfers that hospital boards made to Foundations when the RHBs were formed;
- take action to ensure that the RHBs obtain legal authority or recover the funds in any cases where the hospital board did not have the legal authority to make the transfer; and
- ensure that there are appropriate agreements between the Foundations and the RHBs and/or hospitals to define accountability for the control and disposition of the transferred funds which are in the custody of the Foundations.

12.22 Because some of the amounts resulted from donations and other fund-raising in the communities, we believe that the source of the funds should be an important consideration for the RHBs and the Department of Health when deciding on appropriate action.

12.23 The Department of Health has indicated that it is currently conducting a review of the transfers.

12.24 *Disputed amounts* - The management letter of one non-designated organization noted the Department of Health had confirmed outstanding accounts receivable from the organization related to project cost overruns and hospital requested change orders during construction totalling \$3.2 million. The items are being disputed by the non-designated organization, which is taking legal action to recover related amounts from the contractor, and they have not been recorded in the NDO's financial statements. A second non-designated organization has recorded accounts receivable of \$6.75 million from the Department of Health which the Department has not confirmed as owing to the organization. According to the Department of Health, the amount in dispute is about \$5.5 million.

Department of Health's Business Planning Process

12.25 In December 1996, the Department of Health published *Accountability in Nova Scotia's Health System* to outline the accountabilities of each of the partners in the Province's health system (i.e., Minister of Health, Department of Health, RHBs, NDOs, and Community Health Boards). This document identified the Health Services Business Plan as the key planning document to be provided annually by RHBs and NDOs to the Department of Health. The purpose of this Plan was to serve as the basis for the Department of Health and the RHB/NDO to set out and agree upon performance expectations for the RHB/NDO for the year. A list of specific items to be addressed in the Health Services Business Plan was included in the December 1996 publication.

12.26 For the 1997-98 fiscal year, RHBs and NDOs were asked to prepare Health Services Business Plans prior to the commencement of the fiscal year in accordance with *Accountability in Nova Scotia's Health System*. However, for the 1998-99 fiscal year the Department of Health indicated that the Plans need not be submitted prior to the beginning of the fiscal year. Since the Plans are an integral part of the accountability framework for the health system, the Department of Health should request the Plans annually prior to making funding decisions for RHBs/NDOs.

12.27 In his 1998-99 Budget Address to the House of Assembly presented in June 1998, the Minister of Finance announced a business planning process for RHBs:

"...we're asking health boards across the province to present three-year business plans to ensure that the same fiscal responsibility we've shown with the Province's books will be reflected by those institutions that care for Nova Scotians. These business plans will ensure

that any deficits incurred during that time will be recovered by the end of the three-year period.” (page 10)

12.28 Accordingly, a process for RHB/NDO Business Plan Review was implemented in 1998-99. The objectives of the Review were to:

- confirm the expected budget performance of the RHB/NDO for the 1988-99 fiscal year;
- identify any changes in program scope and service utilization projected during the current fiscal year;
- define any unique issues associated with the RHB/NDO; and
- identify potential opportunities for improved efficiency of the RHB/NDO in future years.

12.29 In conjunction with the Review, the RHBs and NDOs were required to submit current business plans to the Department. The Department established a template for review and analysis of the plans and assigned responsibility to certain staff for completion of the analysis. Another component of the process consisted of site visits by a team of Departmental staff (including the Deputy Minister for most of the visits) to each of the RHBs/NDOs in early fall 1998. Following the visits, the Department developed options for meeting health system objectives and these were discussed with members of the Provincial Leadership Committee, which consists of the Deputy Minister of Health and the Chief Executive Officers of each of the RHBs/NDOs. Options are to be brought to the Priorities and Planning Committee of government and Executive Council for approval in December 1998. The Department of Health requested that the RHBs/NDOs not implement significant changes identified in their business plans until after the options are discussed with the Priorities and Planning Committee and Executive Council.

12.30 The Department is in the process of developing performance indicators and benchmarks for RHBs/NDOs and setting guidelines for a business planning process for the 1999-2000 fiscal year. The target dates for preparation and approval of 1999-2000 business plans for RHBs/NDOs are prior to the start of the fiscal year and it is essential for these targets to be met if the process is to be a success.

Role of the Department of Health in Nova Scotia’s Health System

12.31 In December 1996, the Department of Health published *Accountability in Nova Scotia’s Health System* to outline the accountabilities of each of the partners in the Province’s health system. The role of the Department of Health was defined as follows:

“While the Department of Health will retain final accountability for health care, its role will change to one of setting strategic direction and provincial policy, developing standards, and monitoring and evaluating the provincial system. Regional Health Boards and Non-Designated Organizations will have input into these activities.” (Accountability in Nova Scotia’s Health System, page 7)

12.32 In contrast, the role of the Regional Health Boards is defined as:

“Regional Health Boards have been given the legislated responsibility and authority to plan, manage, deliver, monitor and evaluate health services within their regions.” (Accountability in Nova Scotia’s Health System, page 6)

12.33 These definitions confirm that the RHBs/NDOs have responsibility for governance and financial management while the Department of Health's role is focussed on strategic direction, standard-setting and monitoring. The Department of Health is currently reviewing its role and that of the RHBs/NDOs to determine whether changes are required. In October 1998, the government announced the formation of the Task Force on Regionalized Health Care with the following terms of reference.

"The Task Force will put forward recommendations, strategies and options for a regionalized health care delivery system that:

- *values local involvement in decision-making and is responsive and accountable to local communities, including in the governance and management of hospitals;*
- *ensures consistency and coordination between and across communities;*
- *has appropriate, clearly-defined, distinct and mutually supportive roles and responsibilities for CHBs [Community Health Boards], RHBs, NDOs and the DOH;*
- *maximizes the public's access to health care services;*
- *optimizes the use of public dollars spent on health care; and*
- *is built on appropriate health care region boundaries."* (from terms of reference for the Regionalization Review Task Force)

12.34 The Task Force is expected to report in the spring of 1999.

Reporting of RHB/NDO Deficits in the Public Accounts

12.35 There has been a significant amount of recent discussion in the House of Assembly and the media relating to the operating results and financial position of the RHBs and NDOs and the fact that any deficits are not reflected in the Public Accounts of the Province.

12.36 As at March 31, 1998 the Department of Health had recorded accounts receivable of approximately \$100 million from RHBs/NDOs. This amount is mainly related to advances made to RHBs/NDOs and results of final settlement reviews related to prior years. A provision of approximately \$50 million for doubtful recoveries was recorded as an expense by the Department of Health and deducted from receivables in the Public Accounts so that receivables were valued at the estimated collectible amount (i.e. the net accounts receivable related to RHBs/NDOs totalled approximately \$50 million). In his 1998-99 Budget Address to the House of Assembly presented in June 1998, the Minister of Finance stated the following with respect to the financial results for the 1997-98 fiscal year:

"...we made an allowance in the amount of \$49.8 million for potential uncollectible receivables within the health care system. The amounts have come up in a number of program areas, including regional health boards and non-designated organizations such as the QEII hospital. This provision reflects the very real pressures in the health care system."
(page 5)

12.37 The provision for doubtful recoveries has not been formally communicated to the RHBs/NDOs so their financial statements still have the entire related amounts recorded as accounts payable to the Department of Health and the impact is included in the RHB/NDO deficits. If the

provision for doubtful accounts related to RHBs/NDOs was formally allocated to the individual RHBs/NDOs and the related receivables were written off by the Department of Health, liabilities and recorded deficits of the RHBs/NDOs would be reduced accordingly and there would be no impact on the expenses of the Department of Health to the extent that a provision exists. The Department of Health has indicated that the provision was established for general contingencies that may occur at the Department of Health and that it will be used to provide for problem accounts receivable which may/may not be related to RHBs/NDOs (i.e., the provision was calculated on the basis of amounts owing from the RHBs/NDOs but may not be applied on that basis).

12.38 The Department of Health has not recorded any liability with respect to the accumulated deficits of RHBs/NDOs. As noted in the Public Accounts, the financial statements of the Province include the accounts of the Consolidated Fund of the Province and commercially-oriented government enterprises. The Province also prepares a Consolidated Financial Summary which is included in the Public Accounts as supplementary information. It includes, in addition to the Consolidated Fund and commercially-oriented government enterprises, the assets, liabilities, revenues and expenditures of *government organizations*. Note 1 to the Consolidated Financial Summary indicates that

“Government organizations exist primarily to provide services to government and are accountable for the administration of their financial affairs and resources either to a minister of the government or directly to the Legislative Assembly.”

12.39 The Consolidated Financial Summary does not include RHBs/NDOs as *government organizations*.

12.40 The Canadian Institute of Chartered Accountants’ Public Sector Accounting and Auditing Board (PSAAB) issues guidance with respect to accounting and auditing in the public sector. Section PS 1300 of the PSAAB Handbook makes the following recommendation related to the scope of the reporting entity in terms of the organizations whose financial affairs and resources should be accounted for in a government’s financial statements:

“The government reporting entity should comprise the organizations that are accountable for the administration of their financial affairs and resources either to a minister of the government or directly to the legislature...and are owned or controlled by the government.”
(PS 1300.07)

12.41 That recommendation is followed by a discussion of a number of factors which should be considered when making determinations related to accountability, ownership and control. Reaching a conclusion on whether the RHBs/NDOs and similar entities such as school boards should be included as part of the government reporting entity is complex as there are many related factors to consider.

12.42 In conjunction with his 1998 Budget Address to the House of Assembly, the Minister of Finance tabled a document titled *Financial Accountability - A Blueprint for Success*. That document is the Department of Finance’s plan to improve the financial accountability of the government through preparation of financial statements that fully comply with generally accepted accounting principles. One of the issues addressed by *A Blueprint for Success* is the issue of preparation of consolidated financial statements and the scope of the government reporting entity. The Department of Finance describes the scope issue as follows:

“For all of Nova Scotia’s public sector organizations, we must determine if they are owned or controlled by the Province of Nova Scotia. For many, this is an easy determination. For

others, such as organizations that report to an independent (and sometimes elected) board, the determination is more difficult.” (Financial Accountability - A Blueprint for Success, page 21)

“The implications of these decisions have significant impacts in public understanding of the budgetary process. They also have implications for the province’s Balanced Budgets Law. If the government is required to account for agencies at an arm’s length relationship, if the government is required to plan and budget on the basis of their performance, it is imperative that they be required to live up to the same standards and requirements as the government imposes on itself...If we are to achieve our goal of comparability with other jurisdictions, we must consider their presentations so that our financial statements are comparative and thus easier for users to understand...” (Financial Accountability - A Blueprint for Success, page 33)

12.43 The Department of Finance has defined a work schedule for dealing with this issue with target dates for major decisions in the 1998-99 fiscal year. We urge the government to deal with this major issue according to the timetable it has described and we will follow-up progress in future Annual Reports.

CONCLUDING REMARKS

12.44 The financial problems of the Regional Health Boards and Non-designated Organizations have been discussed in the House of Assembly and reported in the media. Our review confirms that the financial difficulties experienced by these entities are serious.

12.45 The government has initiated processes to address the situation. The Department of Health has an RHB/NDO Business Plan Review process in progress. In October 1998, the government announced the formation of the Task Force on Regionalized Health Care which will examine the current approach to delivering health care in Nova Scotia, recognizing that regionalization is relatively new. The group will put forward recommendations, strategies and options for improving the health care delivery system. These processes must be taken seriously and carried to a conclusion in order to find a solution to the financial problems in the health sector.

12.46 We will revisit this topic in future Annual Reports to determine progress in addressing the significant financial issues facing the government and other organizations in the health sector.

Exhibit 12.1

**RHB AND NDO FINANCIAL RESULTS
FOR THE YEAR ENDED MARCH 31, 1998
\$ MILLIONS**

	1997-98 Operating (Deficit) Surplus	As at March 31, 1998		
		Accumulated (Deficit) Surplus (Notes 3 and 5)	Bank Indebtedness (Note 4)	Due to (from) Department of Health
RHBs				
Central	(\$1.1)	(\$4.2)	\$1.1	(\$0.6)
Eastern (Note 2)	(\$1.0)	(\$8.8)	\$1.3	(\$0.6)
Northern	(\$1.1)	(\$8.1)	\$0.0	\$1.5
Western	(\$1.2)	(\$8.1)	\$0.5	(\$2.9)
RHBs sub-total	(\$4.4)	(\$29.2)	\$2.9	(\$2.6)
NDOs				
Cape Breton (Notes 1, 2)	(\$5.8)	(\$48.8)	\$0.0	\$55.2
IWK-Grace	(\$2.1)	(\$3.1)	\$1.5	(\$2.6)
Nova Scotia Hospital	\$0.1	\$0.6	\$0.0	(\$0.1)
QEII	(\$26.2)	(\$41.3)	\$26.1	\$35.6
NDOs sub-total	(\$34.0)	(\$92.6)	\$27.6	\$88.1
Total	(\$38.4)	(\$121.8)	\$30.5	\$85.5

Note 1 - The March 31, 1998 financial statements and management letter of the Cape Breton Healthcare Complex have not been finalized yet due to unresolved issues between the Complex and the Department of Health. These figures are from draft financial statements which do not include an auditor's report.

Note 2 - These organizations also reported non-shareable operating deficits for the year as follows: Eastern Regional Health Board - \$.9 million and Cape Breton Healthcare Complex - \$33.9 million. For the Cape Breton Healthcare Complex, the majority of this amount related to settlements of prior years' grants from the Department of Health.

Note 3 - These amounts include only operating fund deficits and surpluses and do not include any balances in capital funds. Any non-shareable equity balances are also excluded from these figures. Non-shareable equity balances reported in the financial statements are as follows: IWK-Grace - \$4.8 million, Northern Regional Health Board - \$.5 million, Nova Scotia Hospital - \$.2 million.

Note 4 - Regulations under the RHB Act give RHBs the power to borrow funds.

Note 5 - The accumulated deficits for RHBs include the following deficits accumulated by predecessor hospital boards which were transferred to the RHBs when the hospitals were designated:
 Central - approximately \$2 million - \$3 million
 Eastern - approximately \$2 million - \$3 million
 Northern - approximately \$6 million - \$7 million
 Western - approximately \$7 million - \$8 million

13.

JUSTICE - ALTERNATIVE DISPUTE RESOLUTION PROGRAM FOR COMPENSATION OF VICTIMS OF ABUSE AT PROVINCIAL YOUTH INSTITUTIONS

BACKGROUND

13.1 On November 2, 1994 government announced three goals to deal with allegations of sexual abuse at Provincial youth institutions, which it wanted to accomplish in a reasonable amount of time at reasonable public expense. Government's three goals were to:

- ensure abuse could not recur;
- determine what happened and who was responsible; and
- provide fair compensation to victims.

13.2 The first goal was addressed by an institutional audit that looked at the safety of children within Provincial institutions. The audit was conducted in early 1995 and the report *In Our Care* (Samuels-Stewart) was produced in March 1995. The second goal was addressed in June 1995 when an investigation and report by retired Judge Stuart G. Stratton, Q.C. documented a number of conclusions related to allegations of abuse at five Provincial institutions. The investigation identified 89 victims of abuse at three of the institutions. In July 1995 the Department of Justice announced an Alternative Dispute Resolution (ADR) process which would focus on goal three: the compensation of victims.

13.3 In February 1996 government began negotiations with the lawyers representing claimants. A Memorandum of Understanding (MOU) outlining a process for resolution of claims was finalized on May 3, 1996 and became effective on June 17, 1996. At the time the MOU was finalized, the estimated number of claimants had increased to 500. In 1996 government allocated \$33.3 million for claims. In 1997, an additional \$15.4 million was approved to provide funding for an increased number of claims.

13.4 The ADR Program was developed and approved by government. It does not derive any of its mandate from legislation passed by the House of Assembly. Most of the costs of the program were not included in the Annual Estimates of the government, but rather were established by way of Additional Appropriations approved by the Executive Council.

13.5 On November 1, 1996 the ADR process was put on hold by government and the MOU was revised. The number of claimants had increased significantly, program staff could not achieve the 45 day turnaround required by the MOU, documents thought to have been destroyed were discovered, there was increasing evidence that a number of claimants' statements were unreliable, and fraudulent claims had been detected. When the process restarted on December 19, 1996 there were 1,457 claimants. Later, in November 1997, the Department released a new set of guidelines to govern the assessment of claims, the administration of the ADR Program, and the process used for appeals of Program decisions.

13.6 Upon release of the new guidelines, the claims process became the operation that was in place at the time of our audit. Claims received by the ADR Program are forwarded to the Department's Internal Investigations Unit for analysis. Claimants are interviewed for purposes of providing additional support for the claim, as well as evidence that may later be used in the Department's determination of disciplinary action against any perpetrators of abuse still employed by government. Based on evidence gathered and conclusions drawn by investigators, claims assessors classify the alleged abuse in accordance with a scale contained in the MOU and guidelines, and present a compensation offer to the claimant. Upon being made an offer, claimants have a right to have their case evaluated by a file reviewer; an independent lawyer who will examine the facts of the case and make a binding decision with regard to the amount of compensation to be paid. Upon finalization of the claim, the greater of 20% of the claim or \$10,000 will be paid to the claimant immediately, and any amount in excess will be paid, with interest, over a four-year period. Based on referrals from the Internal Investigations Unit, claimants may also be required to be interviewed by members of a police agency. Operation Hope - an undertaking of the Royal Canadian Mounted Police - is one such group that interviews claimants as part of its investigation of alleged criminal abuse.

13.7 As of September 1998, 1,248 demands, totalling \$71.4 million had been received by the Program, and 812 had been settled with offers totalling \$25.0 million. Some claimants have foregone the ADR Program in favour of litigation, while others pursue civil litigation in addition to participating in the ADR Program. However, if claimants settle a claim with the Program, they waive their right to proceed with a civil action. The Department has referred 29 suspected fraudulent claims valued at \$1 million to the RCMP, but other suspected frauds have not been sent as there is insufficient evidence for a criminal proceeding. It is anticipated that the Program's claims assessment process will be completed by July 1999, but payment of claims may continue for another four years.

13.8 By the fall of 1998, allegations had been made by claimants against 363 employees and former employees, and 328 of them had been investigated by the Department.

RESULTS IN BRIEF

13.9 The following are the principal observations from this audit.

- Internal performance reporting is sufficient, but external accountability is deficient and could be improved if regular comprehensive reports were published and provided to the House of Assembly on a timely basis.
- Extensive planning was conducted between late 1994 and early 1996, but many of the planned procedures and guidelines for the Program were later changed, partly as a result of negotiations with the claimants' legal representatives. As the ADR process progressed, the government unilaterally changed Program guidelines to implement some of the features originally planned.
- Guidelines, standards and procedures have been established for all of the Program's key processes, roles and responsibilities. Our tests indicated that there was appropriate compliance with these by Program staff.
- The ADR process was developed in 1994 and 1995, and started operating in 1996. The process was amended in December 1996, and again in November 1997. We believe that process management and controls improved over time. However,

because of the nature of the Program and the importance of negotiation in its development we were unable to form an opinion on whether value-for-money increased as a result of these improvements.

AUDIT SCOPE

13.10 The audit was conducted in accordance with Section 8 of the Auditor General Act. Our audit objectives were to examine and assess:

- the accountability structure and reporting practices of the ADR Program;
- strategic, operational and financial planning;
- compliance with legislation, government policy and program guidelines; and
- issues relating to economy and efficiency.

13.11 Audit criteria developed for this assignment were discussed with program management at the beginning of this audit, and are described in Exhibit 13.2 on page 154. Our audit procedures consisted of interviews with Program management and staff; examination of processes, controls and related documents; and detailed testing of systems. Testing included an examination of a sample of claim files to assess how well the Program complied with the standards and guidelines that were developed for the compensation of victims of abuse.

13.12 Accordingly, the focus of the audit was on Departmental operations with respect to the ADR Program. It did not address expressed complaints and concerns of Program stakeholders such as past and present employees of the youth institutions, and the victims of abuse. We did not meet with representatives of these groups because their concerns, as expressed in letters to our Office, are related closely to matters of government policy and the achievement of Program goals. Our assignment was not a Program evaluation, and thus did not evaluate whether goals were met or whether the Program adhered to principles of natural justice and fairness. In our opinion, it would have been beyond our legislated mandate to address such issues in the performance of the audit.

PRINCIPAL FINDINGS

Accountability

13.13 The ADR Program is administered by the Department of Justice. The program was announced by government in July 1995 and a Memorandum Of Understanding (MOU) was reached with claimants' lawyers in May 1996. The MOU set out the Program principles, the compensation parameters and outlined a claims resolution process. In November 1997 the Department issued new guidelines for the administration of the Program and other matters. However, the accountability and reporting requirements of the Program were never specified.

13.14 We observed that claim assessors report on a regular basis to the Program Director, and claims investigators used by the Program report regularly to the Executive Director of Police and Public Safety. Semi-monthly statistical and financial reports, and a monthly financial report are prepared for the Deputy Minister. We concluded that internal reporting is timely and addresses appropriate topics.

13.15 However, we noted a separation in Program reporting responsibilities which had reportedly caused work flow problems. The ADR Program Director is responsible for all activity related to compensation claims, including timely processing of claims. Internal Investigation Unit staff investigate claims before awards are finalized, but this group did not report directly to the Program Director. They received their work assignments and priorities from the Department's Executive Director of Policing Services. Effective August 1998, all activities relating to the compensation of victims of abuse were made the responsibility of the ADR Program Director.

13.16 We concluded that external reporting has been deficient. The Department briefly mentioned the Program in its 1996 and 1997 Annual Reports, but these reports were not issued on a timely basis and the information presented in them is not comprehensive. For example, the March 1997 Annual Report was tabled in September 1998 and contains no operational, financial, statistical or other performance information for the Program. The information provided to date, primarily through Department media announcements, has generally been issue specific and has not provided a broad overview of all aspects of the Program.

13.17 The cumulative cost of the ADR Program has not been reported and compared with the funds appropriated by government for the Program. We have tabulated costs relating to the compensation of victims of institutional abuse (see Exhibit 13.1 on page 153), but cannot be certain that we have detected all costs relating to this issue. For example, related costs of other departments and those of Justice staff other than members of the ADR Program and Internal Investigation Unit have not been tabulated and included in the accounting for the Program. Other costs, such as those of the RCMP's Operation Hope, are also not included. Furthermore, Exhibit 13.1 does not include the forecasted cost to settle claims which were still in process at the time of our audit. Thus, the total public cost of the Program is not known.

Program Planning

13.18 In early 1994 several civil actions were initiated against the Province by individuals who had been in custody at the Shelburne Youth Centre in the mid to late 1960's. In all cases, the accused staff person had pled guilty or been convicted of an offense. As part of the settlement procedure, the Department of Community Services (which had responsibility for the Centre at the time) and the Department of Justice began planning a process to redress the harm suffered by the individuals. The objective was to determine a cost effective, timely process for responding to incidents of sexual abuse at the Shelburne Youth Centre which would be acceptable to the claimants and the public. The planning process involved an assessment of alternatives, including traditional litigation, public inquiry and an alternative dispute resolution process.

13.19 In August 1994 responsibility for the Shelburne Youth Centre was transferred from the Department of Community Services to the Department of Justice.

13.20 In the Fall of 1994 memoranda were submitted to government outlining proposals for a response to the sexual abuse at the Shelburne Youth Centre. The proposals included initiating an independent investigation into the incidents and initiating an independent audit of present practices at the Centre. At the time, seven legal actions had been initiated against the Province and dozens more were expected.

13.21 In November 1994 government announced its response to the incidents of sexual abuse at the Shelburne Youth Centre. The government announced three goals which were to be accomplished in a reasonable amount of time and at reasonable public expense. The goals were to ensure the incidents could not recur, to determine what happened and who was responsible, and to provide fair compensation.

13.22 In March 1995 an independent auditor reported on the current practices at the Shelburne and Waterville Youth Centres. The report concluded that young offenders were not adequately protected against abuse and recommendations were provided to make the institutions safer. In June 1995 an independent investigator presented a report to government which indicated abuse had occurred at three of the five Provincial facilities. At that time, 89 individuals were identified as having suffered abuse.

13.23 In June 1995 the Department of Justice reviewed compensation programs in other jurisdictions, conducted planning sessions and presented a proposed plan of action to government. In July 1995 government approved the Alternative Dispute Resolution (ADR) process which was based on the Ontario government's experience with its Grandview facility. Planning for the ADR process anticipated that claimants would be organized into an advocacy group. The group would be coordinated by an independent national non-profit counselling association which had a long history of dealing with sexual abuse. It was acknowledged that it was essential to the ADR process that the government negotiate with no more than one or two groups to arrange the terms and conditions of a compensation agreement.

13.24 The number of claimants was expected to double once the government began to compensate. The ADR process was expected to take two years and eight months and cost \$13.2 million dollars. This contrasted with the alternative of defending lawsuits, which would take five years at an expected cost of \$11.4 million. The maximum award in the Ontario program was \$60,000 plus special damages for counselling and education. The maximum award planned by the Nova Scotia government was approximately \$50,000 for each of the expected 170 claimants, plus any additional amounts for special damages. The claims were to be adjudicated, which would take two to three hours for each hearing and be completed in 12 months, following a year and eight months of planning and preparation for the adjudication process. The process would include investigators who would scrutinize and validate claims before awards were paid. In other jurisdictions, claims were verified before compensation was paid. The experience of these other jurisdictions was that investigations found claims to be valid in approximately 95% of the cases.

13.25 In February 1996 the Department entered negotiations with claimants' lawyers to determine a process for compensation of their clients. In May 1996 government agreed to a Memorandum of Understanding (MOU) with the lawyers, which included a schedule of compensation with a range of awards up to \$120,000. It provided for compensation for physical abuse, in addition to sexual abuse. Some of the factors relating to physical abuse, while considered abusive by today's standards, would not have been recognized as a criminal offense when the alleged offense took place. Also, a significant portion of the MOU was devoted to the remuneration of the numerous legal representatives for the claimants. At the time of our audit, there were 62 lawyers acting on behalf of claimants. Based on experience in other jurisdictions and the Department's planning process, it was anticipated there should not be a need for a large number of lawyers representing individual and small groups of claimants.

13.26 The ADR Program began operating on June 17, 1996 and the estimated number of claimants had increased from 89 to 500. The revised Program announced in the House of Assembly in December 1996 noted the objectives were to compensate the abused and bring the perpetrators to justice. The process was designed to spare claimants the hardship of going through the rigours of common law courts. However, claimants still had the option of pursuing civil litigation if they wished to do so. As a result, 19 individuals opted for civil action against the Province. Also, claimants may be required to testify in the criminal court trials of alleged abusers.

13.27 In our view, planning for the ADR Program was thorough. Different alternatives were examined and the experiences of other jurisdictions were considered. However, when the Program

began to operate, it was significantly different from that originally proposed to government. The negotiations with claimant lawyers resulted in substantial changes. We cannot express an opinion on the appropriateness of the changes resulting from the negotiations with claimant lawyers. In our opinion, it is not possible for auditors to retroactively assess the compromises made in such negotiations.

Compliance with Program Guidelines and Standards

13.28 Compensation criteria were established in May 1996 when the Memorandum of Understanding (MOU) between the Department and the claimants' lawyers was signed. The MOU documented the compensation process and defined categories of compensation, lawyers' fees, the file review (appeals) process, and other related matters.

13.29 In 1996, contrary to the original plan, compensation claims were generally accepted as stated and the level of proof required to approve a claim was not rigorous. At the outset, investigations focussed primarily on the accused abusers and the need for disciplinary action. Investigators often could not obtain corroborating evidence to support a claim because there were very few medical or other records available to use as evidence. Also, prior to 1997, statements were taken from some, but not all of the employees of youth institutions to assess the compensation claims and/or the allegations against them. In later years there was more documentary evidence available and the Program was able to interview the majority of the accused employees.

13.30 The Program was suspended on November 1, 1996 as the number of potential claims had risen to 1,457, documentation thought destroyed was discovered, there was increasing evidence that a number of claimants' statements were unreliable, and fraudulent claims were under investigation. In December 1996 the Program was revised to extend the time to respond to a claim to 120 days because the original 45 day target was not realistic. Also, portions of larger awards were now to be paid by installments over four years. One significant change required the Internal Investigation Unit to expand its investigation to include the validation of compensation claims. The evaluation of claims was improved when more interviews and evidence from accused employees were included in the claim investigation process, and when investigators were able to access medical records, previously assumed to be destroyed, to help validate claimants' demands.

13.31 New Program guidelines were issued in November 1997 to replace the MOU to help ensure only legitimate claims would be awarded compensation. The new guidelines allowed the admission of polygraph evidence on a voluntary basis. The time to process claims and give a response was extended to seven months. In addition, the independent file review process was given a standard of proof to use in the evaluation of cases and offers of compensation. Previously, no standards of proof had been set for the conduct of file reviews. The file review process permitted personal testimony of claimants and new evidence not seen by the ADR assessors to be presented during the appeal process. The new guidelines required file reviewers to base their decisions only on documentary evidence considered in the original claim assessment.

13.32 Based on our tests and examinations, the ADR Program is complying with the current Program guidelines.

Economy and Efficiency

13.33 Our audit examined issues related to the economy, efficiency and management of resources of the ADR program.

13.34 *Lawyer and file reviewer fees* - As of September 30, 1998, 62 private lawyers representing claimants billed the Program approximately \$2.4 million and 20 file reviewers billed fees of approximately \$0.4 million. The total of \$2.8 million is approximately 11% of compensation awards made to that date.

13.35 The ADR process planned in July 1995 anticipated that all claimants would be organized into an advocacy group which would be coordinated by an independent, national non-profit counselling association. The ADR plans recognized that there would be significant delays in settling compensation claims and substantial legal bills if each claimant engaged a private lawyer.

13.36 A November 1995 review of the ADR process indicated there was no interest in forming a claimants' advocacy group and, at the time, there were 21 private lawyers representing 109 claimants. By February 1996 there were 38 lawyers representing 309 claimants. Department of Justice staff recommended that lawyers' contingency fees for current claimants should be no more than 20% of claims awarded and the percentage should be even lower for new claimants. They further recommended that claimants pay legal fees from their awards because there was no need for individual legal representation in the ADR process.

13.37 In documentation and correspondence we reviewed, it was suggested that it was necessary for the program to pay the legal fees in order to close the deal and have people involved "feel good about it." Department officials were concerned there would be significant negative press fuelled by the large number of lawyers and victims. Other government correspondence noted a quick settlement might avoid the time and cost of a public inquiry and/or protracted litigation.

13.38 In February 1996 government began negotiations with lawyers representing claimants and a Memorandum of Understanding (MOU) was completed in May 1996. The MOU included a schedule of tariffs which ranged from \$75 per hour for an articling clerk to a maximum rate of \$175 per hour for lawyers with ten years experience. The guidelines set a maximum of 15 hours for each individual case. Legal costs could also include travel time, travel expenses and disbursements for office costs.

13.39 As part of our audit, we compared the fee schedule to rates paid by the government in the past to private lawyers working as Workers' Advisers in the Workers' Compensation System, and to private lawyers engaged by the Nova Scotia Legal Aid Commission. The Workers' Advisers Program, before it was recently changed, paid private lawyers \$40 per hour. Legal Aid pays private lawyers \$55 per hour for cases which cannot be staffed by Legal Aid personnel. We understand that the higher rates for the ADR Program may be due to several factors. There is a different reporting relationship for the lawyers as they were selected by and report to the claimants, not the government. The lawyers were engaged by the claimants prior to the start of the Program. Also, in some people's view, the maximum of 15 hours billable for each case may be insufficient. However, we have seen no detailed analysis explaining why the differences are so large. Without such analysis and explanation, we cannot assess the reasonableness of the rates.

13.40 *File review* - The Memorandum of Understanding documented a process whereby an independent file review would be performed if a claimant and the Program assessor could not negotiate acceptable compensation. The decision of the file reviewer would be final and not subject to further appeal. The guidelines, standards and processes for file review were initially inadequate, but were improved over the term of the Program. We noted one instance in a test of 40 claims where a claimant's demand was \$50,000 and the Program assessor evaluated the claim as invalid because medical evidence did not support the claim, but the file reviewer awarded \$30,000 on appeal. We understand this was not an isolated incident and noted 37 claims where awards totalling \$1,162,500 were made on appeal after the Program assessor determined there was insufficient evidence to support the claimant's demand. It appears from our review that a lack of standards for the file

review process enabled file reviewers to give substantial weight to factors other than documentary evidence. We cannot estimate how many of the discrepancies described above were the result of an absence of file review standards.

13.41 File review guidelines were improved by defining a standard of proof for file reviewers to use when evaluating claims. The November 1997 amendment to the guidelines also required that file reviews be based only on documented evidence, and allowed the results of voluntary polygraph tests on accused youth institution employees to be used as evidence.

13.42 We noted that in 1996, file reviewers awarded 32 claimants \$1.6 million which was 79% of the original demands. After the program was revised in 1996, file reviewers awarded 84 claimants \$3.1 million; about 60% of the original demands. After the new guidelines were issued in 1997, file reviewers awarded 55 claimants \$1.1 million; about 37% of the original demands. It appears to us that the revised file review standards reduced the number and dollar amount of appeals awarded to claimants. We cannot estimate the possible monetary effect if the more stringent guidelines had been in place at the beginning because there may be other factors that partly account for the decline in the dollar amount of appeals awarded.

13.43 *Insurance* - In July 1995 the Department located insurance policies which might have provided coverage for the compensation awarded for abuse and injuries inflicted on former youth centre residents. The Department retained an independent lawyer to determine whether the policies covered risks relating to sexual assaults, and whether the coverage might be voided by entering into agreements with claimants before the matter was resolved with the insurance providers. Planning documents indicated the ADR process would take two years and eight months, but the process was expected to be delayed by up to two years if the Province's insurance coverage for each individual case had to be assessed. A February 1996 review of options for the compensation process acknowledged that the ADR process might void insurance policies. The decision was made to proceed with the ADR Program without first ascertaining the validity of any insurance claims so as not to delay the process. We understand that the Province is considering legal action against its insurers to recover some compensation costs.

13.44 *Process amendments* - To September 30, 1998, the ADR compensation program has awarded \$25.0 million to 812 claimants, and has accumulated related counselling costs of \$7.3 million; legal fees of \$2.8 million and other costs of \$7.8 million (see Exhibit 13.1).

13.45 When the compensation process began in June 1996, the Department expected up to 500 claims and anticipated that the incidence of claim exaggeration and fraud would be small. Claimants submitted demands that were based, in part, on statements made to investigators employed by the Program. The statements were not subject to the same level of scrutiny as later became the norm. In addition, accused employees of the youth institutions were not always interviewed as part of the compensation validation process. In other jurisdictions, compensation claims were investigated, corroborated and verified before compensation was awarded.

13.46 By the fall of 1996, investigators had noted conflicting information in several cases and there was evidence that some compensation awards were excessive because claims were exaggerated or false. In addition, the number of claims had increased from an estimated 500 to approximately 1,457. The process was stopped in November 1996 and changes were made to the Program which included expanding investigations so they always included the validation of compensation claims. When the compensation process restarted in December 1996, 278 claims awarding \$11.1 million had been settled. The process was amended again in November 1997 as a result of new guidelines that would help ensure only legitimate claims were paid.

13.47 The Internal Investigations Unit has reviewed 234 compensation files and has sent 29 files to the RCMP for investigation of false or exaggerated claims. There are 508 more files pending review. However, the investigators have not sent numerous files that are of a doubtful nature because there is insufficient evidence for criminal prosecution.

13.48 After December 1996, portions of larger awards were paid over a four-year period. The Department's current policy is to suspend compensation payments if there is evidence that a claim is exaggerated or false and a criminal charge has been laid. If the claimant is subsequently found guilty by a court of law, the program will permanently cease payments and seek restitution for amounts previously paid.

13.49 As described throughout this Chapter, the ADR Program was made more rigorous as it proceeded. Over time, the Nova Scotia compensation process has been amended to resemble that of other jurisdictions where claims are fully investigated before compensation is awarded. We cannot estimate whether or not the Program would have paid fewer or lower compensation claims if the requirement for thorough claims investigation, as well as the more rigorous standards, guidelines and processes in other Program areas, had been in place from the beginning of the Program. We noted that the average award, including counselling costs, declined from about \$47,000 in 1996 to about \$36,000 in 1997, after the first revision to the Program. The average settlement in 1998 declined to about \$20,000 after the second revision to the Program. We also noted that the amount of the final settlements compared to the original claimants' demands declined from 64% in 1996 to 54% in 1997, and then to 32% in 1998. Management believes these declines were primarily the result of a more strict and evidence-based process, more evidence becoming available for validation of claims, as well as Program staff and file reviewers becoming more experienced as the ADR Program proceeded.

13.50 *Management of resources* - We observed that the Program was given high priority by government and resources were provided when required. In 1996, funds totalling \$33.3 million were provided for compensation awards, and in 1997 an additional appropriation of \$15.4 million was approved for compensation because the estimated number of claimants had increased. In addition to the amounts appropriated for payment of compensation, the Department's budget included estimated costs for the operations of the ADR Compensation Program group and the Internal Investigation Unit. The Department provided the resources needed for the Program and three new information systems were developed. The systems developed for the Compensation group produce regular financial and statistical reports to help management monitor the Program's costs and progress. We found financial management to be appropriate for the nature of the Program's operations.

13.51 *Staff development* - The program hired experienced staff, generally on a contract basis, and secondments were arranged with other agencies and organizations. New staff joining the Program received background orientation, training in the Program's computer systems, and were teamed with personnel experienced in the Program for on-the-job instruction.

CONCLUDING REMARKS

13.52 The ADR Program had been in process for about two years at the time of our audit. During that period there were two major revisions to the Program and, as a result, its processes became better defined and more rigorous. Standards, procedures and controls which had been originally planned at the beginning of the Program were implemented as the Program evolved. At the time of our audit, the Program was complying with the stricter guidelines and processes, and generally functioning well.

13.53 Because of the nature of the Program and the importance of negotiation in its development, we found it impossible to evaluate from an efficiency and economy perspective. For example, it is not possible to determine whether the total cost of the ADR Program will be greater due to the delayed implementation of the guidelines and standards now in place. We could not ascertain whether declining trends in Program costs were primarily the result of more rigorous processes, or whether other factors had an influence.

13.54 We also acknowledge that the Department had to consider fairness to the victims of abuse in the development of the Program's processes and controls. One objective of the Program was to avoid unnecessary additional hardship for individuals who have already suffered as a result of their experience with a government-operated institution. We cannot assess the value of achieving this objective and compare it with the additional cost, if any, of having claimant-sensitive processes and controls. In addition, our audit did not assess whether the Program achieved its goal with respect to fairness to victims, or any other involved individuals. That issue remains beyond the scope of our examinations.

Exhibit 13.1

**COSTS OF THE ALTERNATIVE DISPUTE RESOLUTION PROGRAM
 TO SEPTEMBER 30, 1998
 (\$ MILLIONS)**

Compensation Awards	\$ 25.0
Counselling Awards	7.3
Compensation Program Group	2.6
Internal Investigation Unit	3.3
Claimants' Lawyers	2.4
File Review Lawyers	.4
Litigation Costs	.3
Other Costs	<u>1.6</u>
Total	<u>\$ 42.9</u>

Exhibit 13.2

AUDIT CRITERIA

Audit criteria are reasonable and attainable standards of performance and control, against which the adequacy of systems and practices can be assessed. They relate to the audit objectives developed for the assignment, and are used to design the tests and procedures used during the audit.

The following criteria were used in our audit of the Alternative Dispute Resolution Program implemented by the Department of Justice for the compensation of victims of abuse at Provincial youth institutions.

- Responsibilities and accountability for the Program should be clearly defined and accountability reporting should be timely and accurate. Reporting should address performance relative to Program goals and priorities, and should be supported by a system of performance measurement.
- Strategic, operational and financial planning should be conducted on a regular basis and be consistent with the Program's mandate. Goals should be outcome oriented and measurable. Goals and other plans should be approved by senior management and communicated to all Program staff.
- Guidelines should be established for all key processes and there should be criteria to evaluate/assess compensation claims. Roles and responsibilities of staff involved in the Program should be clearly defined and there should be an overview function to ensure guidelines are being followed.
- Staff should have the information and resources to do their work efficiently and staff should be adequately trained. The Program should have adequate management systems for monitoring and controlling claims and Program finances.

CROWN AGENCIES AND CORPORATIONS

14.

NOVA SCOTIA ALCOHOL AND GAMING AUTHORITY - REVIEW OF OPERATIONS RELATING TO PART II OF THE GAMING CONTROL ACT

BACKGROUND

14.1 *The Gaming Industry* - Gaming in Nova Scotia is comprised of games of chance in two licensed casinos, interprovincial lotteries, video lottery terminals (VLTs), charitable and commercial bingos, charitable lotteries and raffles, and parimutuel betting on harness racing.

14.2 Wagers reported for the year ended March 31, 1997 were \$844 million. This represents the total amount of cash deposited in VLTs and slot machines, and the total amount paid for lottery tickets, bingo cards and casino chips. It does not include betting on harness racing or gaming on native reserve lands. (Complete information on these categories of gaming revenues was not available.) In terms of the amount of money wagered, gaming is a significant part of the economy of Nova Scotia. As a comparison, for the calendar year 1997 gross revenues in the Nova Scotia fishery were \$479 million, total farm receipts were \$374 million, and tourism revenues were \$1 billion.

14.3 The largest component of wagers in 1997-98 related to VLTs, which amounted to \$404 million, or 43% of total wagers. Casinos were the second highest source of wagers, totalling \$254 million (27%) in 1997-98. Interprovincial lotteries grossed \$179 million (19%), bingos \$94 million (10%), and charitable lotteries and raffles \$9 million (1%).

14.4 For VLTs and slot machines, wagers can be measured in two ways. In the above figures, VLT and slot machine wagers only include actual cash put into the machines. It does not include non-cash winnings (i.e., credits) subsequently replayed without being first redeemed for cash. Alternatively, wagers could include the replaying of credits. It could be argued that this measurement is more representative of the total amount of money put at risk by the player. However, due to the difficulty of accurately determining total money put at risk, wagers are reported on a cash basis.

14.5 The government of Nova Scotia controls casino operations through a Crown agency called the Nova Scotia Gaming Corporation. The Corporation also owns the Province's one-quarter share of Atlantic Lottery Corporation. As such, the Atlantic Lottery Corporation acts as the Gaming Corporation's agent in operating VLTs and interprovincial lotteries within the Province. At March 31, 1998 there were 3,130 VLTs in Nova Scotia. On June 29, 1998 the Video Lottery Terminals Moratorium Act was passed, which froze the number of VLTs in the province at 3,224. (The Act does not apply to VLTs on native reserve lands. The maximum number of these machines is determined by agreements between native bands and the Province.)

14.6 For the year ended March 31, 1998, the Province earned gaming revenue of \$142 million, representing the Province's net receipts from the casinos and Atlantic Lottery Corporation minus the operating expenses of the Nova Scotia Gaming Corporation. This figure amounts to 5.4% of the Province's 1997-98 revenue from Provincial sources.

14.7 Nova Scotia is one of the few provinces which has established an entity independent of its gaming operations to license and regulate gaming. It is the only province which has legislation requiring continuous study of the impacts of gaming on the Province and its people and businesses. These functions were assumed by the Nova Scotia Gaming Control Commission on April 4, 1995. A reorganization in 1997 placed the responsibility with a new entity called the Nova Scotia Alcohol and Gaming Authority.

14.8 *The Authority* - The Nova Scotia Gaming Control Commission was established in 1995 upon the merger of the Nova Scotia Liquor License Board, Nova Scotia Lottery Commission and Nova Scotia Amusements Regulation Board. Its current name was assumed on July 15, 1997, along with a few additional changes to its mandate. The Authority derives its mandate from Part II of the Gaming Control Act, from the Liquor Control Act and from the Theatres and Amusement Act. Accordingly, the Authority is mandated to regulate most forms of gaming, all establishments and events which serve alcohol, and places of amusement such as theatres, fairs and video rental outlets. It is also required to study and report on certain aspects of gaming in Nova Scotia.

14.9 The Alcohol and Gaming Authority has no authority to study, monitor or regulate gaming on native reserve lands. This is now the responsibility of the Provincial government's Office of Aboriginal Affairs. The Authority also has no jurisdiction with respect to betting on horse racing.

14.10 The Authority is governed by a Board of Commissioners who are appointed by the Executive Council and accountable to the Minister responsible for Part II of the Gaming Control Act. The Act requires that this Minister not be the same as the one responsible for Part I of the Act and the operation of the Nova Scotia Gaming Corporation. At the time of the writing of this report, the Minister of Natural Resources was responsible for the Alcohol and Gaming Authority, whereas the Minister of Finance was responsible for Part I of the Act.

14.11 The Authority's head office is located in Dartmouth and a branch office is situated in Sydney. The Authority had revenue of \$10.3 million and expenditures of \$6.5 million for the year ended March 31, 1998. Revenue is comprised primarily of fees for licences, the majority of which are fees charged to liquor licensees collected and remitted to the Authority by the Nova Scotia Liquor Commission. Salaries and benefits of \$3.4 million for its full and part-time staff of approximately 100 represented about 52% of the Authority's total expenditures in the 1997-98 fiscal year.

RESULTS IN BRIEF

14.12 The following are the principal observations from this audit.

- The Authority has adequate internal reporting and accountability structures, and fulfils its legislated responsibility for reporting on its studies of gaming in Nova Scotia. However, reporting on the Authority's finances and activities could be more comprehensive.
- The Authority prepares an annual business plan, but it is not the result of a longer-term strategic planning process and does not present measures and targets for future evaluation of performance.
- Although the Authority was established to provide for regulation of gaming which is independent of the government's own involvement in gaming, it has not been given an explicit mandate for the monitoring and regulating of interprovincial lotteries and certain aspects of video lottery terminals.

- We observed that the Authority is generally fulfilling its responsibilities for the registration, licensing, and inspection of casinos and other forms of gaming in Nova Scotia. We made recommendations to improve the policies, guidelines and information systems used by the Authority, and to improve the documentation gathered to support inspections. Also, we made suggestions to make some inspection procedures more comprehensive and regular.
- The Authority has never formally approved the internal control systems at the casinos, as required by the Gaming Control Act and regulations.
- The Authority is fulfilling its mandate to conduct impact studies and public interest polling on gaming in Nova Scotia, to review gaming experiences in other jurisdictions, and to make recommendations for changes in gaming legislation and regulations.
- The Authority complied with the government's 1994 wage restraint legislation. We made recommendations for better control of the procurement of goods and services.

14.13 Gaming on native reserve lands is outside of the responsibility of the Alcohol and Gaming Authority. However, we made some observations with respect to this aspect of gaming in Nova Scotia which we believe should be reported. In summary, we found that most on-reserve gaming is controlled by way of formal agreements between the Province and Native Band Councils. However, the government does not have complete information on the volume of native gaming, has never received the audit reports specified in the agreements, and has not conducted any inspections or other compliance work to ensure there is full compliance with the agreements.

AUDIT SCOPE

14.14 In October 1998 we completed a broad scope audit of the Alcohol and Gaming Authority in accordance with Section 8 of the Auditor General Act. The objectives of this assignment were to review and assess the Authority's:

- accountability framework and planning practices;
- licensing, inspection and enforcement operations related to its responsibility under the Gaming Control Act;
- compliance with key provisions of the Gaming Control Act and its various regulations;
- compliance with government wage restraint and procurement policies; and
- due regard for economy and efficiency in the acquisition of goods and services.

14.15 The audit did not address operations of the Authority unrelated to gaming, such as those pertaining to the regulation of establishments and events which serve alcohol and the regulation of places of amusement. However, the audit briefly addressed some issues relating to gaming on native reserve lands. Such gaming activity is outside of the responsibility of the Authority and was not a part of our original audit objectives. However, since the subject is closely related to the scope of this audit, we report some observations concerning native gaming at the end of this chapter (see paragraphs 14.74 to 14.81).

14.16 Audit criteria were developed to assist in our assessment of the policies and practices of the Authority. They were discussed with Authority management at the beginning of the assignment. The criteria are described in Exhibit 14.1 on page 169. Our audit procedures included extensive interviews with management and staff, detailed testing of the Authority's regulatory practices, as well as examination of significant reports, files and other documents.

PRINCIPAL FINDINGS

Accountability and Planning

14.17 *Board of Commissioners* - The Authority is governed by seven Commissioners, all of whom are appointed by Executive Council. The Commissioners approve all policy pertaining to the Authority, and are extensively involved in the review and approval of key business documents such as the budget, business plan and annual reports. The Commissioners hold senior managers accountable for the activity within their respective divisions. Each month, senior managers present a report to the Board. We found the reports to be comprehensive and thoroughly challenged by the Commissioners.

14.18 *Annual reporting* - Under Section 56 of the Gaming Control Act, the Authority is required to prepare an annual report on gaming in the province. Under Section 66, it is also responsible for an annual report on the finances and activities of the Authority for its fiscal year ending March 31. June 30 was established as the deadline for Section 66 reports, but no deadline exists for Section 56 reports.

14.19 The Authority has published two Section 56 reports; one for 1995-96 when it was the Nova Scotia Gaming Control Commission, and one for 1996-97 under its current organizational form. We found the reports to be detailed in their analysis of gaming. They contain statistical data and analysis of the various forms of gaming, details of gaming activities in other provinces, public opinion surveys on gaming, and studies of the effects of gaming on businesses and the public. Senior management and Commissioners were extensively involved in preparation of the reports. In our opinion, the reports provide an important review of gaming activities and impacts, and meet the requirements of the Act.

14.20 The Gaming Control Act requires the Authority to study and report upon the economic impacts of gaming in Nova Scotia. Management told us that the depth of analysis provided by the economic impact study included in the 1996-97 report was restricted due to time constraints for publishing. They indicated that future studies will be more in depth in order to more fully meet the intent of legislation. In addition, the Authority has contracted for a comprehensive study of the social impacts of gaming within the Province. An interim report on the study will be released upon the tabling of the Authority's 1997-98 Section 56 report.

14.21 Management has also informed us that Nova Scotia is the only province which studies and reports upon the economic and social impacts of gaming. Our review of the annual reports of other provincial regulatory bodies supports this statement.

14.22 As mentioned above, there is no statutory reporting deadline for the Authority with respect to Section 56 reports. However, the Act requires the Minister responsible for the Authority to table the report in the House of Assembly within 60 days of receiving it. The 1996-97 report was sent to the Minister responsible for Part II of the Gaming Control Act, and it was tabled in the House of Assembly within the time limit set out in the Act.

14.23 In our opinion, the Authority has not fully complied with the statutory requirements for Section 66 reports on its finances and activities. At the time of our audit, the only Section 66 report issued since the inception of the Gaming Control Commission was for the year ended March 31, 1996, published in January 1998. The Act requires reporting of the fiscal year's activity by June 30; three months after the end of the fiscal year.

14.24 In addition, we believe the report is incomplete and does not fulfil its potential as an accountability document. While the report includes a description of operations and an accounting of financial performance for the year, it does not include important planning and performance information such as the Authority's strategic plans, annual goals, budget and measurements of performance.

14.25 *Financial statements* - An audit of the Authority's financial statements for the year ended March 31, 1997 was completed in May 1998, and was conducted at the same time as the audit of the March 31, 1998 statements, which was completed in June 1998. Management informed us that the delay in the 1997 audit was due to the heavy workload involved in starting up a new organization, and the time involved in conducting a tender for the audits. At the time of our audit, neither set of audited financial statements had been tabled in the House of Assembly or made available to the public. The 1998 statements will be placed in Volume Two of the *Public Accounts* of the Province, which is scheduled for release in December 1998. We believe financial statements should be audited and released within six months of year end. Anything later detracts from their usefulness.

14.26 *Planning* - In government, a business plan should be prepared annually and describe a department's or Crown agency's goals for the upcoming year and the activities required to achieve them. The plan should indicate how the entity links its goals and activities to the government's priorities and fiscal plan. The plan should be an outcome of a strategic planning process, and as such, should guide the entity towards its long-term strategic goals.

14.27 The Authority has prepared a business plan for the 1998-99 fiscal year. However, it was not based on long-range strategic planning, and thus its focus is on short-term goals. The Authority has undertaken certain elements of strategic planning, such as the development of a mission statement, and we encouraged it to complete its first strategic planning exercise in time for its next annual business plan.

14.28 Our review of the 1998-99 business plan indicated that it conforms to the basic structure set by government for its boards and agencies. However, it does not contain outcome measures and it does not adequately relate the Authority's goals to overall government priorities. Based on our enquiries, the Authority has not yet developed outcome indicators for purposes of measuring and reporting on its performance.

Licensing, Inspection and Enforcement

14.29 *Introduction* - There are seven categories of legalized gaming in Nova Scotia: casinos, VLTs, interprovincial lotteries, charitable lotteries and raffles, bingos, harness racing, and gaming on native reserve lands. The Authority does not have a mandate to regulate the latter two forms of gaming.

14.30 For the year ended March 31, 1998 the Authority's Licensing and Registration Division issued licences for 3,130 VLTs; 6,041 charitable lotteries and raffles; and 625 bingos. In addition, it registered 2 casinos and 634 companies and individuals involved in gaming, including all of the employees and major suppliers of the casinos.

14.31 The Authority's Investigation and Enforcement Division is responsible for inspecting the casinos and all other licensees. Management estimates that the Division conducted over 20,000 individual inspection procedures at the casinos during the year ended March 31, 1998. Statistics also indicate that the Division conducted 656 inspections on bingos and 33 inspections on charitable lotteries during the same year. Inspections were also performed for approximately 100 one-time special events not included in the above noted statistics. In addition, the division received 244 complaints and conducted 52 investigations.

14.32 The Authority supplements its own staff with Royal Canadian Mounted Police (RCMP) officers to maintain a surveillance of the two casinos. The Authority has its own surveillance office in each casino. The RCMP also provide security clearances for companies and individuals who must be registered with the Authority, as required by the Gaming Control Act.

14.33 *Mandate of the authority* - One of the House of Assembly's objectives in creating the Alcohol and Gaming Authority was to provide for casino and VLT regulation that is independent of the part of government which receives gaming revenues and deals with the operators of the casinos and VLTs. The Authority reports to a Minister different from the one who oversees the Nova Scotia Gaming Corporation. The purpose of this arrangement was to help government manage its sometimes conflicting goals of increasing gaming revenues while ensuring gaming activities in Nova Scotia are socially responsible.

14.34 We reviewed the sections of the Gaming Control Act and its regulations which pertain to the activities of the Authority. The Act and regulations provide the Authority with sufficient power to perform its regulatory function with respect to the casinos and placement of VLTs, as well as with respect to bingos and charitable lotteries. However, the regulatory powers of the Authority with respect to interprovincial lotteries managed by Atlantic Lottery Corporation, and the Corporation's design and operation of the VLTs, are very general in nature. The Authority is of the view that it requires additional regulatory powers to regulate these aspects of gaming to the same extent as casinos, bingos and charitable lotteries are regulated.

14.35 Interprovincial lotteries and VLTs represent 62% of gaming wagers in the province for 1997-98 and are, in effect, only partially regulated in Nova Scotia. Whereas the Authority monitors some aspects of these games, such as age restrictions and payout percentages, most controls currently in place to ensure the integrity of these forms of gaming are under the direction of the organization that operates the games - Atlantic Lottery Corporation. In our opinion, this is inconsistent with the government's objective of separating gaming regulation from gaming management. If the monitoring and control of gaming in Nova Scotia is to be kept separate from its management, the Authority should have powers with respect to the licensing and inspection of interprovincial lotteries that are similar to those pertaining to charitable lotteries and raffles. Also, the Authority should be able to approve the design and test the operation of VLTs, as it currently does for slot machines operated by the two casinos.

14.36 During inspections of licensed premises, Authority staff ensure that only VLTs installed by Atlantic Lottery Corporation are present, and that all licensing conditions have been met. A person has been hired by the Authority to assume a number of duties relating to VLT gaming, including the inspection and testing of the operation of VLTs. However, testing of VLTs has not yet been done because the Authority does not have the regulatory power to perform the tests. Likewise, due to limitations in its mandate, the Authority has not examined Atlantic Lottery Corporation's computer systems which operate the VLTs. Also, the Authority must rely on the reports issued by Atlantic Lottery Corporation to ensure the payouts of VLTs meet or exceed the standard set for VLTs in Nova Scotia.

14.37 *Licensing and registration* - Under the Gaming Control Act, the Authority is responsible for licensing charitable lotteries and raffles, bingos and VLTs, as well as for registering the Halifax and Sydney casinos, their employees and their suppliers. We reviewed the systems used by the Authority to ensure it receives complete and accurate information for the processing of applications and registrations. Our findings are noted below.

14.38 We believe management control would be improved if formal policies and procedures were developed to provide guidance in critical areas such as eligibility for licences. For example, all organizations receiving a licence must have charitable, religious or community objectives or purposes. There is no formal guidance on how a person or group would qualify for eligibility.

14.39 The Authority has prepared guidelines for charitable, religious and community groups who wish to conduct a lottery or raffle. The guidelines help the groups to understand the conditions for receiving a licence, as well as the procedures to be followed upon receiving one. Though the guidelines are a bit out-of-date, we believe they are very helpful in ensuring gaming laws and regulations are understood and followed. However, there are no similar written guidelines provided to the operators of commercial and charitable bingos. The Authority has observed shortcomings in the operation and reporting of some bingos, and we suggested that written guidelines may be helpful in correcting misunderstandings between bingo operators and the Authority.

14.40 The Bingo Regulations require the net operating receipts (i.e., profit) of a charitable bingo be a minimum of 15% of the gross receipts, and that these receipts be used for charitable, religious or community purposes. We observed that the Authority is permitted, under the Bingo Regulations, to issue a licence to a bingo operator with a rate of return under 15% if it is a smaller operation and is of benefit to the community. Many bingo operators were not meeting the 15% requirement and, rather than deny licences, the Authority chose to work with the operators to help them meet this requirement.

14.41 We reviewed the process used to renew the certificates of registration for the two casinos. The Authority appears to have received the appropriate documents and to have performed sufficient security reviews before renewing the licences.

14.42 VLTs are only permitted in establishments that have a valid liquor licence. At present, applications for VLT licences are required to include information on projected revenues from VLTs, beverage sales and food sales. The information is reviewed for reasonableness, but there is no formal analysis or verification of the information because the Authority cannot restrict licensing of VLTs based on the volume of wagers relative to other revenues.

14.43 Although the Authority cannot be certain that all gaming activities are licensed, it may be made aware of unlicensed establishments or events through observations by compliance staff, complaints from the public or advertising in newspapers or the broadcast media. If the Authority becomes aware of an unlicensed gaming activity, and the game operator is a charitable organization, it will ask the operator to obtain a licence. If the organization refuses, or the operator is not a charitable entity, the Authority will refer the matter to the local law enforcement agency for investigation.

14.44 *Inspection of casinos* - The Gaming Control Act and the Casino Regulations have detailed requirements concerning the management, operation and inspection of the casinos. During our audit we reviewed the following inspection functions performed by the Authority:

- review and approval of the casinos' systems of internal control;

- approval and testing of slot machines and related computer systems;
- surveillance of casinos' gaming floor;
- review of reports by the casinos to the Nova Scotia Gaming Corporation; and
- review of incident reports by the RCMP, the casinos, the Nova Scotia Gaming Corporation and the Atlantic Lottery Corporation.

14.45 Our findings are described in the following paragraphs.

14.46 The Casino Regulations require the casinos to have an independent audit performed on their systems of internal control, at the direction of the Authority. We noted that the casinos have had audits conducted by their external auditor each year, but they were only for the purpose of providing an opinion on the casinos' financial statements. Although the audits resulted in some internal control recommendations, they were not internal control audits. Authority management was not satisfied that the casinos' audits were comprehensive enough for regulatory purposes. Consequently, the Authority placed no reliance on them and hired its own auditor to review the casinos' systems of internal control. However, we also noted that the Authority provided no direction to the casinos with respect to the scope and objectives of their audits. In our view, it is not efficient to have two auditors doing similar work at the casinos, and it does not seem appropriate for the Authority to pay for audits which are the responsibility of the casinos. We recommended that, in place of having two audits, the Authority provide explicit directions for the scope and objectives of the casinos' audits so that they fully meet the Authority's needs.

14.47 The casinos are required to implement internal control systems which comply with the requirements of the Casino Regulations, and the Authority must approve the systems. The internal control audit conducted on behalf of the Authority, described above, was completed in November 1995, and subsequently updated in November 1997. However, at the completion of our audit in October 1998, the audit reports had not yet been formally accepted by the Board of Commissioners. Accordingly, the Authority has never formally approved the internal control systems of the casinos. Nonetheless, the systems and controls developed by the casinos have been fully implemented, recommendations from the audits have been addressed, and the systems are being monitored by the Authority.

14.48 All slot machines used in the casinos must comply with the requirements of the Casino Regulations and must be approved by the Authority. We observed that the Authority has appropriate procedures to ensure new slot machines are adequately tested before they are authorized for use. Once the slot machines are installed, there is adequate monitoring and testing by the Authority of all slot machines and other permitted games of chance.

14.49 RCMP officers work with the Authority's own staff to provide for casino surveillance, including watching for "cheat of play" offenses. The RCMP regularly report activities and observations to the Authority. However, our tests indicated that not all surveillance reports had been submitted to the Authority. Also, we observed that there are times when no staff from either the RCMP or the Authority are on duty at the casinos. We noted that the Authority coordinates the scheduling of its staff with the RCMP, but gaps in the surveillance of the casinos do occur. Authority management indicated that it does not have the resources to conduct around-the-clock surveillance at the casinos.

14.50 As noted above, RCMP officers have been engaged to perform casino surveillance and security clearances. The services are provided in accordance with the Provincial Policing Agreement administered by the Department of Justice. A separate contract was prepared to outline the terms and conditions under which the RCMP would provide services to the Authority, but this contract was never signed. The Authority is charged by the Department of Justice for the services (approximately \$825,000 in 1997-98). In our view, since the Authority's arrangement is with the Department of Justice, there should be a formal agreement between the Authority and the Department.

14.51 Authority staff perform a variety of inspection procedures at the casinos to ensure they are operating in accordance with the established internal control framework and the requirements of the Casino Regulations. We determined there is a need for increased supervision of inspections performed because not all inspection procedures are being done on a regular basis. Management has indicated to us that, based on our reporting of this observation during the audit, the Authority has strengthened its casino inspection routines.

14.52 The Authority conducts routine reviews of the Nova Scotia Gaming Corporation to ensure the revenue and expenditures reported by the casinos are complete and accurate. We observed that the reviews are performed at irregular intervals and we recommended that they be more frequent. Also, we advised that documentation prepared to support the reviews be more complete.

14.53 The Nova Scotia Gaming Corporation is required by the Gaming Control Act to report any illegal or criminal activity which occurs at the casinos. We reviewed the reporting of such incidents by the Corporation, as well as incident reports of the casinos and the Atlantic Lottery Corporation. Based upon our review, incidents are being properly reported and the Authority is taking appropriate follow-up measures.

14.54 *Other inspections and enforcement* - In addition to inspections of the Nova Scotia Gaming Corporation and the Halifax and Sydney casinos, the Authority inspects other gaming activities licensed under the Gaming Control Act. For purposes of discharging this responsibility, and responsibilities under the Liquor Control Act and Theatres and Amusements Act, the Province is divided into 23 territories. Inspectors assigned to each territory are responsible for inspecting all regulated activities occurring within their territories.

14.55 We examined the system used by the Authority to manage inspections and investigations. Our findings are reported in the following paragraphs.

14.56 As mentioned above, the Authority has no responsibility for the licensing and inspection of interprovincial lotteries. Currently, the Authority is relying on staff of Atlantic Lottery Corporation to report and resolve any irregularities related to these lotteries. After the Authority receives formal notification of such irregularities, staff will determine what follow-up activity, if any, is required to be taken by the Authority.

14.57 Due to the volume of gaming licenses issued, the Authority cannot inspect all licensees on a regular basis. The Authority has prepared a risk assessment to determine which gaming activities and licensees should receive the most attention and how frequent inspections should be. These policies have been communicated to all compliance staff. The results of the risk assessment appear reasonable to us.

14.58 Compliance staff perform a series of rotating inspections, other non-routine inspections and special investigations assigned by supervisory staff. Time sheets and other documentation are submitted to supervisory staff to support the work conducted by the inspectors. Written reports are

prepared when violations of the regulations or the conditions attached to the licences have been observed. We found that the Authority has appropriate policies and procedures to ensure that violations are documented and appropriate corrective action is taken.

14.59 The only type of gaming which is inspected with the aid of inspection forms is bingo. We believe inspection forms or checklists should be used to document the inspections of VLTs and charitable lotteries as well. We also recommended that the bingo inspection forms be expanded to address all of the requirements of the Bingo Regulations. The use of forms or checklists, if they are comprehensive, should ensure compliance staff consider all regulatory and licensing requirements when they perform an inspection. As well, such forms will provide evidence that an inspection was done.

14.60 Many licensees, such as bingo operators, are required to submit monthly remittances to the Authority, along with a report outlining information required by the Authority to process the monthly return. We found many of the returns submitted were inaccurate, incomplete and/or submitted after the due date. The Authority is working with licensees to correct returns deemed inaccurate or incomplete, and to ensure that licensees are knowledgeable in how to complete the return. We observed a significant improvement in the quality of reporting by licensees during the last year.

14.61 However, we also found that the Authority needs to identify and follow-up on overdue remittances on a more timely basis. We recommended that compliance staff be made aware of overdue remittances so they can enquire about them when inspections are performed. We also recommended that compliance staff perform procedures during their inspections to verify that information provided in monthly returns is correct.

14.62 *Computer systems* - Most transactions related to the Authority's licensing, registration and inspections functions are recorded by one of three computerized systems. We found the systems to be lacking in certain capabilities. There is a lack of integration among the systems, and they are limited in their ability to record and report upon performance-based information. For example, the systems do not have the capacity to generate customized work schedules and record the results of inspections. The systems cannot readily report licences issued and which licensees are overdue for an inspection, and cannot generate statistics on the types and prevalence of violations discovered during inspections.

14.63 The Authority has entered into a contract with a software vendor to determine the information system requirements of the Authority and to develop and implement a system which better meets its needs. As part of this project, the Authority should determine the feasibility of providing for remote computer access so that compliance staff working outside the office can access the information they require and update the systems for the results of their inspections.

14.64 *Staff development* - All staff have formal job descriptions. Staff evaluations are conducted annually. All compliance staff are given extensive training before they are assigned to work in their territories. Additional training is provided to compliance staff assigned to the casinos.

Compliance with Legislation and Regulations

14.65 *Mandate* - the Alcohol and Gaming Authority has a broad mandate under the Gaming Control Act, which includes:

- ensuring casinos and other lottery schemes managed by the Nova Scotia Gaming Corporation are in accordance with the Act and the Criminal Code of Canada;
- carrying on a continuous study of the operations and administration of the casinos and other lottery schemes, including the experiences of other jurisdictions;
- carrying on a continuous study of public interest and reaction to casinos and other lottery schemes and games of chance;
- carrying on a continuous study of the social, health, justice, economic and environmental impacts of casinos and other lottery schemes;
- making recommendations to the Minister for changes to the Act and its regulations; and
- submitting a report dealing with the above to the Minister on an annual basis.

14.66 Various areas of gaming for which the Authority has a regulatory responsibility are governed by regulations (e.g., casinos, bingo, bingo suppliers, VLTs, Atlantic Lottery Corporation). These regulations provide for how, and under which conditions, gaming activity can be conducted.

14.67 Our review indicated regulations are consistent with the Authority's mandate under the Gaming Control Act, and the Authority is addressing each of its regulatory and research responsibilities. Within the limitations of its regulatory authority, described above, the Investigations and Enforcement Division of the Authority is ensuring casinos and VLTs are managed by the Nova Scotia Gaming Corporation and Atlantic Lottery Corporation in accordance with the Act. Authority compliance staff and members of the RCMP assist in ensuring Criminal Code compliance at the casinos. Authority staff inspect licensees to ensure bingos and charitable lotteries comply with the applicable regulations. When the Authority determines that a violation of the regulations has occurred, it often holds a formal hearing which may result in a fine or the revoking or suspending of the vendor's gaming licence.

14.68 We also observed that the Authority is active in studying the various impacts of gaming in Nova Scotia. This includes the polling of Nova Scotians and out-of-Province gamblers with respect to their opinions and gaming habits. An extensive report is published on the results of all research and polling done by the Authority. The reports include recommendations for changes to the Gaming Control Act and its regulations.

Wage Restraint and Procurement

14.69 *Wage restraint* - Based on our examination, the Authority (and its predecessor: the Nova Scotia Gaming Control Commission) have complied with the requirements of the Public Sector Compensation (1994-97) Act, which came into effect on April 29, 1994. As with all other public sector agencies, the Authority maintained a wage freeze until the Act expired in November 1997. The Gaming Control Commission was established after 1994, so the 3% salary roll-backs that went into force upon proclamation of the Act were not relevant.

14.70 *Procurement policies* - The Provincial government's procurement policy applies to all of its departments, agencies, boards and commissions. 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 performed tests to evaluate the Authority's compliance with the policy.

14.71 We selected 40 purchases since the Gaming Control Commission came into existence. We found three instances where there was no evidence that comparable prices were obtained when selecting companies to provide gaming research and public relations services. We could not determine whether this is indicative of non-compliance with the policy, or merely an inability to locate documents which would demonstrate that such procedures did occur.

14.72 *Contracts* - We observed instances where goods and services were purchased without a formal contract to support the transactions. Authority management indicated that it agrees that procurements of a higher cost should be accompanied by a contract. However, it believes that it is not always cost-effective to have a contract for transactions that are less material.

14.73 We advised the Authority that contracting for such transactions need not be an onerous exercise, and that management control would be improved by executing formal contracts for all but trivial amounts. Such a practice would ensure complete understanding between the Authority and the contractor as to all of the terms and conditions of the agreement, and the quality of the product or service to be provided.

OTHER GAMING ISSUES

Gaming on Native Reserve Lands

14.74 *Background* - As described earlier, the Authority has no responsibility for gaming on native reserve lands. Nonetheless, gaming on native lands is significant and there is a need for monitoring and regulation. As of March 31, 1998, there were about 400 VLTs on native reserve lands. For the year ended March 31, 1998, net wagers on the VLTs totalled \$11.7 million. We were not able to obtain information on the volume of wagers for other types of gaming on native lands.

14.75 The Province has entered into agreements with ten of the thirteen native bands in Nova Scotia to place limits on native gaming. In return, the Band Councils receive a share of the Sydney casino's profits for funding of economic development projects on the Reserves. These agreements prohibit the licensing of casinos on native reserve lands, determine how gaming revenues can be used, and set conditions on the type and operation of gaming, including the maximum number of VLTs permitted on a Reserve. The agreements are formalized by contracts between the Chief of a band and the Minister responsible for Aboriginal Affairs. Contract terms range from two months to five years; with a clause allowing automatic renewal if neither party wishes to renegotiate the agreement.

14.76 Gaming on native reserve lands is not regulated in the same manner as off-reserve gaming because the Parliament of Canada exercises exclusive legislative authority over matters respecting First Nation members and lands. However, Federal law gives the provinces authority to license native gaming. The government of Nova Scotia chose to exercise this delegated authority by way of agreements with individual Band Councils. The agreements negotiated by the government require each Band Council to establish and maintain its own gaming commission for purposes of licensing and regulating on-reserve gaming. The agreements also require an annual audit of the native gaming commissions and give the government the right to conduct inspections.

14.77 The responsibility for managing the contracts with Band Councils was originally assigned to the Nova Scotia Gaming Corporation. In January 1998, responsibility was assigned to the Provincial government's Office of Aboriginal Affairs. We discussed native gaming contracts with individuals from both organizations and made the following observations.

14.78 *Statistical information* - The only information collected by the government on native gaming pertain to VLTs on native reserve lands. There is no collection and analysis of information pertaining to other types of gaming, such as bingos and lotteries. Such information would be useful for determining if there is a risk that not all conditions of gaming agreements are being met, and whether a closer examination is warranted.

14.79 *Audits of Native Gaming Commissions* - The first native gaming agreements were executed in 1995. Each agreement has a clause which requires the Band Council to have an independent audit conducted on its gaming commission, and to submit the report on the audit to the government. Staff of the Nova Scotia Gaming Corporation and the Office of Aboriginal Affairs were not aware of any such audits having been performed.

14.80 Further, the nature of the required audits is unclear from the wording of the agreements. The agreements state: "*Annual independent audits of gaming activities on the Reserve Lands will be provided by the Gaming Commission to Nova Scotia.*" This wording provides no indication whether the audit should primarily be financial in nature, or should also address the native gaming commissions' compliance with the terms of the native gaming agreements. We recommended that the requirement for gaming commission audits be made more clear, and that the government ensure annual audits are performed for each native gaming commission.

14.81 *Compliance with Native Gaming Agreements* - None of the individuals with whom we discussed the subject of native gaming agreements were aware of any inspections or other compliance work done by the government. Although the agreements give the government certain powers in this regard, it appears that little has been done to ascertain whether there is full compliance with the terms and conditions of the agreements.

CONCLUDING REMARKS

14.82 The Nova Scotia Gaming Control Commission, the predecessor of the Alcohol and Gaming Authority, was created in 1995 and given a broad mandate, including the monitoring and regulation of two new casinos. As part of the development of this new organization, management had to integrate the mandates, systems and staff of three existing government agencies. As described by management, and observed in this audit, this complex challenge resulted in some delays in establishing sophisticated planning, reporting and information systems. However, management appears to be aware of the areas that require improvement and is developing plans for strengthening management systems and controls.

14.83 However, in our view, the most significant weakness in the regulatory regime for gaming in Nova Scotia is that regulations do not provide for the monitoring and control of all types of gaming in the Province. It appears that there is little support in legislation and regulations for full regulation of VLTs and interprovincial lotteries. We believe gaming regulation should cover all significant forms of gaming in the Province, and it would likely be more efficient if the Alcohol and Gaming Authority were the organization to assume responsibility for additions to the regulatory regime.

Exhibit 14.1

AUDIT CRITERIA

Audit criteria are reasonable and attainable standards of performance and control, against which the adequacy of systems and practices can be assessed. They relate to the audit objectives developed for an assignment, and are used to design the detailed audit tests and procedures.

The following criteria were used in our audit of the Nova Scotia Alcohol and Gaming Authority.

- *Accountability and Planning* - The responsibilities and accountability of the Authority should be formally defined and communicated with appropriate input, review and challenge from the Commissioners. The annual reports required under sections 56 and 66 of the Gaming Control Act should be complete, accurate and published on a timely basis. The objectives, goals and priorities of the Authority should be consistent with its mandate and provide clear direction for the activities of the Authority. Goals should be outcome-oriented and designed in a manner to make success in achieving them measurable. There should be adequate systems and controls to ensure completeness and accuracy of the information reported. There should be regular strategic, operational and financial planning performed by the Authority. There should be a business plan which complies with government's planning and budgeting framework.
- *Licensing, Inspection and Enforcement* - Systems and procedures should be present to ensure licences are only issued upon compliance with terms of the Gaming Control Act. Systems and procedures should be present to detect unlicensed facilities and activities. There should be adequate documentation, supervision and control of the investigation and enforcement function. Compliance staff should have adequate training and qualifications, and receive regular evaluation of their performance.
- *Compliance with Legislation and Regulations* - The policies of the Authority should be consistent with its mandate and the Gaming Control Act. The Authority should comply with the applicable provisions of the Gaming Control Act and its regulations. There should be systems and procedures to help management ensure all key provisions are complied with.
- *Procurement and Wage Restraint* - The Authority should adhere to the government of Nova Scotia procurement and wage restraint guidelines. Procurement practices should ensure capital assets, goods and services are acquired at competitive prices. Only goods and services relevant to the mandated operation of the Alcohol and Gaming Authority should be acquired.

15.

QUEEN ELIZABETH II HEALTH SCIENCES CENTRE - COMMENTS ON FINANCIAL SITUATION

BACKGROUND

15.1 In Chapter 15 of my 1997 Annual Report, I included extracts from a July 29, 1997 management letter from the Queen Elizabeth II Health Sciences Centre's (QEII) financial statement auditors to its Chief Executive Officer which raised serious concerns about operating losses and the accumulated deficit of the Centre. At that time, the Centre was undergoing a reengineering initiative and had prepared a business plan which anticipated that savings would be generated in future years to offset the accumulated deficits. The auditors stated that *"should savings levels not be obtained and deficits continue to escalate, then the provincial government will have to underwrite those deficits in order for the hospital to continue to meet its financial obligations and continue as a going concern."* In my 1997 Report, I stated that the situation at the Centre was serious enough to warrant careful monitoring by the Department of Health and the government.

15.2 During the current year, my Office planned to undertake an audit of the Centre to follow up on these concerns. An audit plan was prepared and discussed with the Centre's Finance and Audit Committee in March 1998. The Committee, the Board Chair and the Chief Executive Officer of the Centre all indicated their support for the proposed audit. Staff from my Office visited the Centre in early April 1998 to obtain preliminary information and finalize plans for more detailed audit work to be conducted in late summer or early fall of 1998.

15.3 The audit plan discussed with the Centre's Audit and Finance Committee in March 1998 specified the following scope for the proposed audit:

- Governance and accountability including strategic and operational planning and performance reporting
- Financial management
- Capital expenditure planning and control
- Procurement
- Use and control of information technology including Year 2000 readiness of financial and non-financial systems including medical equipment
- Use and control of the work of consultants

15.4 In early June 1998, my staff were informed that the Centre's Board of Directors had engaged a firm of management consultants to consult and report on a number of issues relating to the QEII's financial situation and business plan initiatives. We learned that the scope and objectives of the proposed consulting assignment included those that we had presented to the Board in March. We discussed the apparent duplication of audit effort with members of the Centre's Board and management and the appointed firm. We agreed to discontinue our planned audit on the condition that we would receive copies of any reports produced by the firm, and be invited to attend Board and Committee meetings where findings were presented by the firm. We indicated to the Board Chair our intention to rely upon the firm's work in preparation of our Annual Report to the House of Assembly. We have received copies of reports issued to date and have attended meetings of the Finance and Audit Committee where these were presented.

15.5 Accordingly, this report is primarily based upon information included in reports prepared by a firm of management consultants and released to the Board of the Centre in the fall of 1998.

RESULTS IN BRIEF

15.6 The following are the principal observations from our review:

- The audited financial statements for the year ended March 31, 1998 reported an operating deficit of \$26.2 million for the year (including depreciation and amortization of capital funding) and an accumulated deficit of \$41.3 million. This deficit is consistent with the projected deficit of \$48.9 million included in the Centre's March 1996 Business Plan (projected deficit for 1996-97 was \$30.9 million and for 1997-98 was \$18.0 million).
- The Canadian Council on Health Services Accreditation performed a review of the Centre in June 1998. The review resulted in award of a three-year accreditation and the reviewers indicated that "*excellent care processes are evident throughout the organization.*" The review report included several recommendations for improvement, and also noted that "*the organization verges on financial non-viability as a result of the significant \$42,000,000 debt it carries.*"
- The Centre is projecting an operating deficit of \$33 million for 1998-99 (including depreciation, but excluding \$20 million estimated for Year 2000 costs for which the Centre has requested funding from the Department of Health and the write-off of deferred reengineering costs). An operating deficit of \$18.6 million (including depreciation, but excluding Year 2000 costs) is projected for 1999-2000. The Centre's total debt as at March 31, 1999 is projected to be \$141.511 million (if there is no funding from the Department of Health for Year 2000 costs). The Centre has a strategic plan, and a Business Plan dated November 6, 1998 which has been approved by the Board.
- The Department of Health approved the Centre's 1996 and 1997 Business Plans. Senior management of the QEII told us that the Centre had been asked by the government to delay certain initiatives in the Business Plan until the 1998-99 fiscal year and that the Centre received a payment of \$12.330 million from the Department of Health which was compensation to the Hospital for the financial impact of delayed initiatives.
- Consultants reviewing aspects of the Centre's finances and financial management processes have identified significant deficiencies in financial management of both operations and capital projects. There is an urgent need for the Centre's Board and management to improve the fundamental financial management processes of the Centre and establish a plan to deal with the existing deficits so that the Centre may continue to meet its mission in the future and deliver essential health care services to the public. The Centre has prepared a response to the consultants' report which includes a plan for dealing with identified deficiencies.
- A review of the Centre's Year 2000 readiness by external consultants noted that although significant progress has been made in the last year, some deficiencies remain which must be dealt with by the Centre to ensure that potential problems are avoided. The Centre indicated that it has a plan in place to deal with any deficiencies noted.

- The Centre's Board had concerns about a large reengineering project known as Project QUEST and hired consultants to review it and report to the Board. The consultants intended to finalize their report and issue it to the Board in late October 1998. However, the Board's consultants and the private sector partner for Project QUEST (also a consulting firm) disagreed with respect to certain aspects of the draft report. The private sector partner has provided additional information and comments during a number of meetings with the Board's consultants. The information is being considered for inclusion in an adjusted draft report. At the time of writing of this Report (early December 1998), a final report had not yet been issued. We will continue to monitor the status of the consultants' report related to Project QUEST and will comment on it in our 1999 Annual Report.
- The Centre released its audited financial statements for the year ended March 31, 1998 in June which showed \$8.5 million in deferred reengineering costs related to Project QUEST as an asset. In October 1998, the Canadian Institute of Chartered Accountants issued guidance which suggests that reengineering costs incurred after October 1998 be expensed. The Centre has indicated that the \$8.5 million will be expensed during the 1998-99 fiscal year. This amount is not included in the Centre's projected operating deficit of \$33 million for 1998-99.

SCOPE OF REVIEW

15.7 Our review included the following documents:

- audited financial statements of the Queen Elizabeth II Health Sciences Centre for the year ended March 31, 1998
- management letter from the Centre's external financial statement auditors to the Chair of the Board of Directors of the Queen Elizabeth II Health Sciences Centre dated June 26, 1998
- *Queen Elizabeth II Health Sciences Centre Year 2000 Health Check* prepared by external consultants and issued to the Board of the Centre in September 1998
- *Preliminary Report Queen Elizabeth II Health Sciences Centre - Financial Areas* prepared by external consultants and issued to the Board of the Centre in October 1998
- *Canadian Council on Health Services Accreditation Survey Report* dated June 21-26, 1998
- QEII Health Sciences Centre Health Services Business Plan approved by the Centre's Board on November 6, 1998
- management letter from the Centre's external financial statement auditors to the Centre's Vice-President Finance and Corporate Services dated July 29, 1997 relating to capital projects for the New Halifax Infirmary and Victoria General sites (this letter was received by the Centre in 1997 but was not reviewed by our Office until after the 1997 Annual Report of the Auditor General had been released).

15.8 We discussed certain aspects of these documents with members of the Centre's Board and management, staff of the management consulting firm who prepared the reports, and management of the Department of Health.

PRINCIPAL FINDINGS

Finances

15.9 *Financial results for the year ended March 31, 1998* - The audited financial statements for the year ended March 31, 1998 reported an operating deficit of \$26.2 million for the year (including depreciation and amortization of capital funding) and an accumulated deficit of \$41.3 million. This deficit is consistent with the projected deficit of \$48.9 million included in the Centre's March 1996 Business Plan (projected deficit for 1996-97 was \$30.9 million and for 1997-98 was \$18.0 million).

15.10 The deficit has been financed by borrowing. The Centre shows bank indebtedness of \$26 million (1997 - \$14 million) and amounts owing to the Department of Health of \$35.6 million as at March 31, 1998 (1997 - \$4 million owing from Department of Health).

15.11 In addition, the Centre reports an unfunded balance of \$45.8 million in its capital fund. This represents capital acquisitions to date in excess of funding received, and will affect operations in future years as depreciation expense in excess of the funded amounts. This amount has been financed through borrowings of the capital fund from the operating fund.

15.12 *Consultants' preliminary report to Board of Directors on financial areas* - As part of the consulting engagement referred to in paragraph 15.4 above, external consultants issued a report to the Centre's Board of Directors dated October 9, 1998 on the Centre's finance area and financial reporting. The following are extracts from that report:

Extract from Preliminary Report Queen Elizabeth II Health Sciences Centre - Financial Areas dated October 9, 1998

- "Based upon the QEII's current financial situation, and as recognized and projected by management, it will begin to experience cash flow problems again at the latest in early January 1999. In this fiscal year...cash requirements have already exceeded the \$30M Line of Credit arrangement established with the Bank...This occurred in July, and an advance of some \$22M on this year's revenue was received from the Department of Health to cover the shortfall. It is estimated that the cash shortfall will increase throughout the balance of the fiscal year to a point where it reaches approximately \$75-\$85M as of the end of March 1999. (This excludes the August 31, 1998 amount owing to the Department of Health of \$41M.) It must be noted that the March 31 shortfall is premised upon a number of significant assumptions. For example, Y2K expenditures are included as cash outflows of \$20M. According to the Y2K plan, a comprehensive evaluation and costing of remediation of the Y2K issue will not be completed until late October 1998. It will not be known until that point in time, as to the amount of money required to fulfill this particular initiative. As requested by the Department of Health, no funding revenue has been included with respect to these expenditures.

As well, budgetary overruns have already occurred in year-to-date actual to budget financial performance. Should this continue it will increase the ending indebtedness.

Further, in the latest budget there are proposed savings initiatives of approximately \$5M, the achievement of which may or may not occur. Should these not be achieved, and budget overruns continue, it is entirely possible that the unfunded amount will be greater.” (pages 21-22)

- “The QEII now clearly faces a very serious issue as to how the current cash flow deficit, currently estimated at some \$75-\$85M as at the end of this fiscal year, is going to be financed. This needs to be addressed immediately or the QEII will have inadequate cash resources to meet its current liabilities in early 1999...It is not likely that a financial institution will lend further funds if a repayment mechanism is not in place. Financial institutions are not so much interested in collateral security as they are in attachable future cash flow. It is our view that the Department of Health may be the only financing alternative available; however complete business plans including cash projections and repayment initiatives will undoubtedly be required to support any additional short term financing.” (pages 8-9)
- “Our view at the present time, is that there is no formal recovery planning in place at the hospital...” (page 18)
- “On June 3, 1998 the Minister of Health requested that all health care entities in the Province prepare and submit a Business Plan in a prescribed format...To date [October 9, 1998] the Plan has not been submitted although the majority of detailed financial information requested by the Department of Health and due on August 31 was submitted...We recommend that substantially greater emphasis and commitment to producing quality, accurate and timely information begin to take place, and communication be improved between the QEII and the Department of Health so that each are working with a common agenda.” (pages 19-20)
- “The draft budget for the fiscal 1998-1999 year was first submitted to the Finance and Audit Committee on March 30, 1998. It has been changing over the past several months, and as recently as October 6, 1998. This has made analysis by us and the Committee very difficult as it has been a moving target. Further, at this date, almost halfway through the fiscal year, it still remains unapproved. This is unacceptable for an organization of this size. We recommend that the budget process begin earlier and be fixed and approved at a much earlier date.” (page 10)
- “It is our observation that the quality, timeliness and accuracy of cash flow monitoring and projecting is less than satisfactory. Given the serious financial situation faced by the Hospital we believe that much greater emphasis should be placed on this process to ensure that accurate and complete cash flow projections are available to senior management and the Board.” (page 7)
- “We suggest that the skills and depth of resources of the finance department may be inadequate to meet current project and business needs. Additional skilled staff may be required to support the function.” (page 8)

15.13 The consultants’ report includes a 60 Day Action Plan with seven recommendations. It also identifies three areas of immediate action which, they believe, can positively impact the financial situation at the hospital in the near term.

15.14 *Management's response to consultants' report* - In late November 1998, the Centre's management indicated that the recommendations in the consultants' report had been accepted and were being addressed. Specifically, management indicated the following:

- The Department of Health made a commitment to provide cash financing and \$10.8 million was to be received in late November.
- The timing of Year 2000 spending continues to be difficult to predict.
- Based on the October 31, 1998 financial statements, there is no significant variance between actual and budgeted results.
- The Centre feels strongly that the Department of Health must be a significant part of the recovery plan. The Centre indicated the Department of Health continues to move forward with its planning and that the Department has indicated that the Centre will receive further instructions in the new year in order to begin preparation of a multi-year plan. The Centre has hired an interim Chief Financial Officer with no responsibilities other than finance, and management believes that it has expertise to develop and implement recovery planning.
- The QEII is making efforts to improve communication with the Department of Health.
- The Centre's budget process has been changed for 1999-2000 to allow earlier tabling of the budget.
- Cash flow reporting requires constant monitoring and is an area where management believes it is improving. Improvements will continue to be made.
- Financial Services now reports to an interim Chief Financial Officer whose sole focus is financial issues.

15.15 *Comments on finances included in CCHSA Accreditation Survey Report* - The Canadian Council on Health Services Accreditation (CCHSA) is a non-profit, non-government organization that helps health service organizations across Canada examine and improve the quality of the care and services they provide to their clients. Approximately 1,500 health service organizations voluntarily participate in the CCHSA's accreditation program. According to the CCHSA, "accreditation is one of the few and most effective measures that health service organizations can use to accurately assess their level of performance. It is a peer review and a self-assessment process that focuses on ways to continuously improve the health care system. Each health service organization's performance is assessed against national standards set by the CCHSA in collaboration with the health care community and related stakeholders. The assessment is designed to address processes, outcomes, and structures with the focus on continuous improvement within the health service delivery system." (taken from CCHSA website)

15.16 The CCHSA conducted an accreditation review of the Centre in June 1998. The process resulted in the award of a three-year accreditation to the Centre. The CCHSA Accreditation Survey Report includes many positive comments with respect to the Centre's operations such as "excellent care processes are evident throughout the organization." (page 1). It also states that "there is no question that the board members are committed to maintaining and improving the standards of care throughout the organization. The board has a remarkably good understanding of the requirements of the health care system in the region, and its role and relationship to it. Its members are also

committed to creating, with government and the province as a whole, a better health care system for the people of Nova Scotia.” (page 22)

15.17 However, the Accreditation Survey Report includes a strong recommendation with respect to the finances of the Centre. That recommendation is as follows:

Extract from CCHSA Accreditation Survey Report dated June 21-26, 1998

Recommendation

It is important that the board understand its requirements to maintain and ensure the financial viability of the organization, confirming the resources available can support the overall programs and services of health care delivery for which it is responsible. The staff perceive that they are under-staffed even though there are several reports and strong evidence to the contrary. Clearly from the staff’s viewpoint, a major chasm between reality, practice and perceptions has been created partly because the government appears unable to meet the financial requirements to assure the board of its fiscal viability. The board must either receive additional funding or reduce the cost to match the available resources.

In essence, it is apparent that the organization verges on financial non-viability as a result of the significant \$42,000,000 debt it carries. The estimated \$26,000,000 deficit this fiscal year, and the apparent resistance and unwillingness of government to permit the appropriate actions be taken exacerbates this fundamental problem. It is therefore recommended that the board work with management and the staff to ensure that they understand the importance of achieving a balanced budget and that actions are taken to achieve this through a business, operational budgeting and planning process as soon as possible. Further, it is imperative that the board work directly with government to resolve the issues associated with such a plan and act directly on the plan in order to re-establish the financial integrity of the principal hospital in Nova Scotia. (pages 22-23)

15.18 *Conclusions* - The Centre’s financial position and operating results have deteriorated in the last year. Consultants reviewing aspects of the Centre’s finances and financial management processes have identified significant deficiencies in financial management of both operations and capital projects. There is an urgent need for the Centre’s Board and management to improve the fundamental financial management processes of the Centre and establish a plan to deal with the existing deficits so that the Centre may continue to meet its mission in the future and deliver essential health care services to the public.

15.19 Management of the QEII has indicated that the cash management and budgeting issues have been addressed. The QEII acknowledges the seriousness of its cash flow situation, appears to be working diligently to address the issues identified by the consultants and would welcome any assistance in this area.

Business Plan

15.20 The Centre prepared a Business Plan dated March 1996 which was described by Centre management as the official business plan in April 1998. The Centre also has a strategic plan dated February 1998 which includes a goal relating to demonstration of fiscal accountability (page 9) and an initiative to “*establish a plan with government to remove accumulated debt by March 1999.*”

15.21 As noted in Chapter 12 of this Report (paragraph 12.25), the Department of Health introduced an accountability framework for the health sector in December 1996 which required the

annual submission of a Health Services Business Plan to the Department of Health. It was to be the key planning document to set out and agree upon performance expectations for the year. The Centre prepared a Business Plan in January 1997 according to the Department of Health's accountability framework but the Centre did not yet have a budget for 1997-98 when that Plan was prepared so it did not include 1997-98 projections.

15.22 The Department of Health approved the Centre's 1996 and 1997 Business Plans. In October 1997, the Department of Health sent the Centre a cheque for \$16.83 million representing an increase from Department of Health funding allocated to the QEII during the Estimates process. Included in that cheque was an amount of \$12.330 million which was identified as "*loss of projected savings associated with delays in Business Plan initiatives...It is expected that this funding will enable the QEII to operate within their planned operating deficit of \$19.25M as outlined in the business plan presented by the QEII to the Department of Health...*" (letter from Deputy Minister of Health to CEO of QEII, dated October 1, 1997). Senior management of the QEII told us that the Centre had been asked by the government to delay certain initiatives in the Business Plan until the 1998-99 fiscal year and that this payment represented compensation to the Hospital for the financial impact of delayed initiatives.

15.23 The Minister of Finance announced in his June 1998 Budget Address to the House of Assembly that business plans would be required from Regional Health Boards and Non-designated Organizations. On June 3, 1998 the government officially requested that business plans be prepared for the 1998-99 fiscal year by July 10, 1998. We have concerns about the Department's decision to not require Business Plans for 1998-99 prior to the beginning of the fiscal year (see Chapter 12, paragraph 12.26). The Department of Health indicated that it would respond to the submissions by August 31, 1998. The Office of the CEO of the QEII believed that insufficient time had been provided for preparation of the Plan and the QEII was the only organization which did not submit the business plan by August 31, 1998. The Centre did provide some of the more detailed information that had been requested by August 31, 1998. The QEII filed a Health Services Business Plan, which had been approved by its Board of Directors, with the Department of Health on November 6, 1998.

15.24 We reviewed a copy of the Health Services Business Plan dated November 6, 1998. It includes the following projections (made September 6, 1998) for the 1998-99 fiscal year:

Projected Operating Deficit	\$25.847 million
Projected Capital Amortization	<u>7.929</u>
Net Expenditures over Revenue	<u>33.776</u>
Projected Year 2000 Cost	<u>20.000</u>
Total Deficit for 1998-99	<u>\$53.776</u> million

15.25 In addition to this amount, the Centre has an opening accumulated deficit of \$41.3 million, and the Centre projects that its accumulated capital expenditures (difference between the unamortized balance of capital assets acquired to date and capital funding received) will be \$46.433 million. If the QEII does not receive funding of anticipated Year 2000 costs, the projected total debt as at March 31, 1999 will be \$141.511 million which is comprised of:

1998-99 Deficit	\$ 53.776 million
Deficit at beginning of 1998-99 fiscal year	41.302
Unamortized net capital expenditure	<u>46.433</u>
Total Projected Debt as at March 31, 1999	<u>\$141.511</u> million

15.26 The Centre's Business Plan identifies several fiscal initiatives to generate savings/reduce costs but the 1998-99 impact of \$5 million has been incorporated in the \$25.847 operating deficit projection for the year. These initiatives are projected to generate savings/cost reductions of \$12 million in 1999-2000 and another \$9 million savings/cost reduction is expected from other identified initiatives. The Centre projects that expenditures (including \$10 million of capital amortization) will exceed revenues in 1999-2000 by \$18.6 million even when the savings/cost reductions are included. The annual target for savings/cost reductions from these fiscal initiatives when fully implemented is \$49 million. The Business Plan does not include financial projections beyond the 1999-2000 fiscal year.

15.27 As noted in Chapter 12 of this Report (paragraph 12.29), the Department of Health is currently analysing Business Plans received from the Regional Health Boards and Non-designated Organizations and developing options for meeting health system objectives which are to be reviewed with the Priorities and Planning Committee and Executive Council. The QEII does not yet know whether its Business Plan has been approved.

Year 2000 Readiness

15.28 The firm of management consultants hired by the Centre's Board issued a report to the Board in September 1998 titled *Queen Elizabeth II Health Sciences Centre Year 2000 Health Check*. The objectives of the review were to:

- review and comment on the status of the key Year 2000 activities for the hospital using the Year 2000 Health Check methodology to ensure that the project is moving forward in a way that meets its objectives and deadlines; and
- provide recommendations in respect of any deficiencies which came to their attention during the review.

15.29 The following comments are extracted from *Queen Elizabeth II Health Sciences Centre Year 2000 Health Check*.

Extract from *Queen Elizabeth II Health Sciences Centre Year 2000 Health Check*

Conclusions - A summary of findings

- Business ownership of the Year 2000 problem is evident with some exceptions.
- Project plans and control mechanisms are not yet sufficient to adequately manage the initiative.
- The target date of September 1999 places the hospital at considerable risk.
- It is not clear that the organization has recognized the urgency of Year 2000 work.
- Policies exist to ensure that new purchases/development are Year 2000 compliant but they are not always followed.
- A formal communication plan exists but has not always been followed.
- The QEII does not have contingency plans dealing with the Year 2000.
- The inventory of "products" is largely complete.
- It is not clear that sufficient human resources have been secured for the successful completion of the project.
- There are a number of areas of concern with respect to remediation activities.
- Communication with "service" suppliers has not yet started.

- QEII has established clear contractual guidelines.

In conclusion while the QEII has made significant progress in the past year, there are a number of areas to address in order to ensure that the Year 2000 project is successful. To summarize:

- There is uneven participation across the portfolios that should be addressed by the Office of the CEO - the primary areas of concern are Information Technology Services and physicians.
- Priorities have to be established with respect to system implementation work - all but Year 2000 work and mission critical or life threatening system delivery activities should be put on hold until after Year 2000 compliance. Shifting of resources will follow this re-prioritization.
- Detailed remediation and testing plans that roll up to a master timeline are critical and must be monitored closely to ensure that the project is progressing on time.
- Risk assessment and contingency planning should begin in earnest for the QEII.

We would suggest that the recommendations made during the review be adopted and that the Board and Office of the CEO adopt an “emergency room” view of the Year 2000 project over the next several months to ensure that efforts are focused exclusively on Year 2000 activities and that realistic plans are in place and being followed. (pages 36-38)

15.30 Management has indicated that the QEII accepts all but one of the consultants’ recommendations in this area. The consultants recommended that all communications in response to inquiries from external parties relating to the Centre’s Year 2000 readiness be cleared with the QEII’s legal counsel and it is this recommendation which has been rejected.

15.31 The Centre estimates costs of \$30 million related to dealing with the Year 2000 problem (of which \$20 million is estimated for 1998-99). At the date of writing of this report (late November 1998), there was no approved source of funding for this expenditure.

Reengineering

15.32 *Project QUEST* - On July 19, 1996 the Centre issued a call for expressions of interest related to the selection of a private sector partner to assist the Centre in meeting its operational and fiscal challenges. The following objectives for the strategic partnership were included in the *Partnership Expression of Interest Specifications* dated July 19, 1996:

- “Specifically, the partnership will work together to:*
- *provide strategic project management in organizing and preparing the institution for coming changes;*
 - *provide a proven methodology/process(es) in achieving redesign success;*
 - *jointly identify and prioritize potential process redesign projects that yield the greatest potential for quality, service, and cost improvement targets;*
 - *provide project resources (project leaders, project staff, change management professionals, etc.) to compliment our process teams;*
 - *to assist in implementing process redesign projects and to measure results against identified targets;*
 - *to design and implement a “transfer of knowledge” program in which process redesign/change management skills are transferred to QEII management and staff;*
 - *to jointly identify and prioritize functions within Information Technology Services which could be provided more effectively and more efficiently using alternate delivery vehicles (eg. network management, desktop support);*

- to provide resources (people, technology, financial) to ensure the successful implementation of current enabling technology solutions;
- to assess the potential of expanding QEII information solutions regionally and provincially to satisfy and support health reform initiatives;
- to provide resources (people, technology, financial) to develop marketing strategies, proposals and services where appropriate to support the regional and provincial provision of information technology solutions and services;
- to maintain the QEII "technology current" in support of hospital and regional and provincial information technology requirements;
- to provide innovative funding/financing arrangements where risks are shared, benefits and milestones are achieved and future potentials are explored and realized." (pages 8 and 9)

15.33 In early 1997, a contract was signed with a management consulting firm which became the private sector partner for the Start-Up Phase of the project which became known as Project QUEST. This first contract had a maximum cost of \$1.1 million. A second contract for the Diagnostic, Visioning and Redesign Phase was signed in March 1997 for a maximum cost of \$2.8 million. Additional letters of agreement were signed by the Centre and the firm during the following months. As at March 31, 1998, the Centre had incurred costs of \$8.5 million related to the project (excluding related hardware and software acquisitions).

15.34 There was a clause in most of the agreements between the Centre and the firm which indicated that a portion of fees (20-25%) would be held back until net savings in operations of the Centre had been realized.

15.35 In July 1997, the private sector partner wrote to the Centre regarding the "less stable" environment in which the project was then operating and the firm's concern that events outside of the control of the firm and the Centre would prevent the generation of some of the anticipated net savings. The letter proposed the following:

"In the event that occurrences completely outside the control of [name of firm] prevent the generation of "Net Cost Savings", [name of firm] will be reimbursed in full for all fees incurred up to that point in time. We would work with you to develop a mutually acceptable payment schedule."

15.36 Management of the Centre agreed to the proposal and, therefore, assumed additional risk related to the Project QUEST partnership from the private sector partner. The amount of the holdback referred to in this agreement is in the range of \$1 million to \$2 million. The Centre has not paid the amount to the private sector partner and is currently considering whether the amount is owed.

15.37 The Centre's Board had concerns about Project QUEST. The consultants hired by the Board in April 1998 and referred to in paragraph 15.4 were asked to review various aspects of Project QUEST and report to the Board. On October 27, 1998 the consultants made a presentation of the tentative findings in their draft report to the Finance and Audit Committee of the Board of the Centre to confirm the accuracy and seek additional information. We attended that presentation. The consultants intended to finalize their report and issue it to the Board shortly after the October 27 meeting. We intended to review that report and use it as the basis for our comments on Project QUEST in our current Report to the House of Assembly.

15.38 Following the October 27, 1998 meeting, the consultants hired by the Centre to review Project QUEST provided information from their draft report to the private sector partner for Project

QUEST (a firm of management consultants as described in paragraph 15.33 above) to confirm the accuracy and obtain any additional information. The two firms of consultants disagreed on certain aspects of the draft report. The private sector partner has provided additional information and comments during a number of meetings with the Centre's consultants. The information is being considered for inclusion in an adjusted draft report. At the time of writing of this Report (early December 1998), a final report had not yet been issued.

15.39 We will continue to monitor the status of the consultant's report related to Project QUEST and will comment on it in our 1999 Annual Report.

15.40 *Deferred reengineering costs* - The March 31, 1998 audited financial statements of the Centre report \$8.479 million (1997 - \$2.144 million) in deferred charges related to Project QUEST as an asset on the Statement of Financial Position. Note that this amount is reported as an asset and was not included in the calculation of the operating deficit for the year. Note 7 to the financial statements indicates "*During the year, \$6,355,000 (1997 - \$2,144,000) in re-engineering costs were deferred. These costs, which total \$8,479,000 as at March 31, 1998, consist of external consulting fees and internal expenditures incurred on the re-engineering project. The deferred costs will be amortized in future periods as savings are realized.*"

15.41 In their management letter to the Centre's Board Chair dated June 2, 1998, the Centre's external auditors noted the following under the caption *Management Judgments and Accounting Estimates Relating to Sensitive Accounting Estimates and Disclosures*:

"Management believes that this deferred charge does have future economic benefit and that future cost savings will result, against which the deferred amount will be amortized. For this reason, the deferred amount has not been written-off as a charge against income."

15.42 The Canadian Institute of Chartered Accountants (CICA) issues guidance with respect to generally accepted accounting principles in Canada in the form of a Handbook. At the time of the March 31, 1998 financial statement audit, the CICA Handbook did not deal specifically with the issue of accounting treatment for reengineering costs but included general guidance on concepts related to the nature of an asset and recognition of expenses and losses: "*Expenses and losses are generally recognized when an expenditure or previously recognized asset does not have future economic benefit.*" (Section 1000.50) Whether a future economic benefit will result from the incurrence of the \$8.5 million expended on Project QUEST is largely a matter of professional judgement with respect to the likelihood of achieving projected savings. Management and the external auditors believed that it was likely that a related future benefit would materialize.

15.43 Subsequent to the issue of the audited financial statements, the CICA Emerging Issues Committee issued an Abstract related to Accounting for the Costs of a Business Process Reengineering Project which requires that reengineering costs incurred after October 28, 1998 be expensed as incurred. This guidance does not directly apply to the QEII's situation because the reengineering costs were incurred prior to October 1998.

15.44 The Centre's management has indicated that the \$8.5 million will be expensed during the 1998-99 fiscal year. This amount is not included in the Centre's projected operating deficit of \$33 million for 1998-99.

Audit/Consulting Assignment in Progress

15.45 As noted in paragraph 15.4 above, the Centre's Board of Directors engaged a firm of management consultants in the spring of 1998 to consult and report on a number of issues relating

to the QEII's financial situation and business plan initiatives. As noted previously, most of the work has been completed but the firm is to perform additional work in the areas of governance and the Centre's contract with Health Staff Inc. relating to casual staffing in the nursing area (contract was signed on October 31, 1996 and later discontinued).

CONCLUDING REMARKS

15.46 We reported concerns about the QEII's financial situation in our 1997 Annual Report. During the past year, the situation has deteriorated even further and others (auditors, consultants, accreditation reviewers) have also expressed concerns. In 1997 we indicated that the situation was serious enough to warrant careful monitoring by the Department of Health and the government and we repeat that recommendation. Although the Department of Health has initiated a business planning process for Regional Health Boards and Non-designated Organizations (see Chapter 12, page 137), an approved plan to deal with the financial situation of the Centre and the other Regional Health Boards and Non-designated Organizations has not yet been developed and we urge the government to give this critical matter priority.

15.47 The Centre has undergone several recent staffing changes in key positions which may have contributed to the deficiency in financial management and financial planning. At the time of writing of this Report a new CEO had recently been hired and the key position of Vice President of Finance and Corporate Services, which had been vacant, had been recently filled on an interim basis. Those in key Board and management positions have significant challenges ahead of them in dealing with the critical financial situation of the Centre while continuing to maintain or improve the level of care.

16.

WORKERS' COMPENSATION SYSTEM OF NOVA SCOTIA

BACKGROUND

16.1 In 1996 a new Workers' Compensation Act came into effect. The new Act represented the first major revision of workers' compensation legislation in Nova Scotia since it was originally conceived in 1915. The new legislation brought about very significant changes, including how claims are assessed, compensation is calculated, assessment rates are levied, and compensation decisions are appealed.

16.2 However, at the time of the introduction of the new Act, there was a sizable back-log of claimants waiting to appeal compensation awards. Also, changes to the appeal process brought about by the new Act served to compound the back-log while the new Appeals Tribunal established itself. This and other aspects of the workers' compensation system caused considerable frustration among some individuals and injured worker groups throughout the Province. As a consequence, the government received numerous requests for a review of the system.

16.3 A Select Committee on the Workers' Compensation Act was struck in the 1998 spring sitting of the House of Assembly to examine the issues and report back to the House. The nine-member, all-party Committee was established by Resolution 844 on June 22, 1998, and given the mandate of reviewing "*changes to the Workers' Compensation Act and, in particular, to review recommendations of the Auditor General with respect to his audit of the Workers' Compensation Board, Workers' Advisors Program and Workers' Compensation Appeals Tribunal.*" The Committee was empowered to hire staff, expend funds, and to table an interim or final report with the Clerk of the House if the Legislature was not sitting when the report was completed.

16.4 On June 30, 1998, Pursuant to Section 15 of the Auditor General Act, our Office was directed by the Executive Council to make a "*program-oriented broad scope examination and audit*" of the three organizations noted above. The order was in response to a recommendation by the Minister of Labour to Executive Council dated June 23, 1998.

THE AUDIT

16.5 Because of the technical nature of the subject matter, and due to most of our staff being committed to other audit assignments, we chose to hire a private sector auditor to conduct the assignment under our direction. Two senior auditors of our Office were provided to assist the private sector auditors, and to bring to the assignment our experience with previous audits of the workers' compensation system. In accordance with Section 15 of the Auditor General Act, the government provided for the Office to receive the additional funds necessary to cover the cost of the assignment.

16.6 Terms of reference were developed by our Office based on meetings and correspondence with the Select Committee, the three organizations subject to audit and management of the Department of Labour. We also considered the nature and types of concerns being expressed publicly by injured workers. Before being approved for use in the audit, the terms of reference were reviewed with the three organizations to be audited.

16.7 Our Office then conducted an open competition for the purpose of selecting the private sector auditor. Grant Thornton, Chartered Accountants and Management Consultants, was successful in the competition. The firm was contracted to perform the audit and asked to develop an audit plan based on the terms of reference.

16.8 The Auditor General formed a steering committee which included himself, members of his staff, as well as the Ombudsman of Nova Scotia. The steering committee actively monitored and directed the private sector auditor in all phases of the audit.

16.9 The final report on the audit was presented by the Auditor General to the Minister of Labour on November 19, 1998. The Minister tabled the report in the House of Assembly the following day. On November 26, 1998 the Select Committee tabled its report in the House of Assembly. A number of recommendations were made for changes to the Workers' Compensation Act.

16.10 The remainder of this Chapter is the report on the audit, minus two appendices of a technical nature. Included in the original report, and reproduced in this Chapter, are the official responses to the audit by management of the Workers' Compensation Board and Workers' Advisers Program. The Workers' Compensation Appeals Tribunal did not wish to provide a formal response to the audit.

Grant Thornton

Audit of the Nova Scotia Workers'
Compensation System

November 1998

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EXECUTIVE SUMMARY

At the request of the Executive Council of the Government of Nova Scotia, the Auditor General of Nova Scotia has undertaken to audit the Workers' Compensation System. Grant Thornton, under the direction of a Steering Committee established by the Auditor General, has performed this audit. A summary of our findings follows.

AUDIT OBJECTIVES

The objectives of the audit were established by the Auditor General in consultation with the Executive Council and each of the three components of the Workers' Compensation System of Nova Scotia, namely the Workers' Compensation Board (WCB), the Workers' Compensation Appeals Tribunal (WCAT), and the Workers' Advisors Program (WAP). These objectives are:

- I. Assess the efficiency, effectiveness, and accountability of the Workers' Compensation System with respect to benefit claims intake, processing, appeal and closure. Make recommendations for improvement.
- II. Determine the causes for and recommend solutions to the backlog in benefit decision appeals. Recommend efficient and economic means of preventing future backlogs in the appeals process.
- III. Assess the degree to which policy, procedures and practices relating to benefit claims intake, processing, assessment and appeal comply with the Workers' Compensation Act of Nova Scotia.
- IV. Assess the roles and responsibilities of medical professionals in the Workers' Compensation System, and make recommendations to address any observed uncertainty, inappropriateness or non-compliance with legislation.
- V. Assess the quality of the relationship of the various components of the system with its clients, and suggest means of improvement.
- VI. Assess the quality of the relationship and cooperation among various components of the system with each other, and between the system and external sources of disability insurance (notably, Canada Pension Plan and private insurance providers). Recommend ways various stakeholders could work together more efficiently and cooperatively.

MAJOR FINDINGS

We are pleased to report that, in general, the Workers' Compensation System has made and continues to make significant improvements in its intake processing, case appeal and closure mechanisms. Our report cited a number of specific systemic deficiencies which in many cases are currently being addressed by the respective components of the System.

We note especially the need to continue to develop performance standards and to measure actual results against the standards. A further concern is that the current use of technology lags behind that found in other systems across the country.

The appeals backlog at the Workers' Compensation Appeals Tribunal, currently numbering approximately 2500 cases, has arisen primarily from the time required to move the system from the Appeal Board under the "Old Act" to the Workers' Compensation Appeals Tribunal established under the "New Act". The old board effectively ceased accepting appeals on June 1, 1995. WCAT did not commence operation until January of 1996. Its first leave decision was not rendered until May of 1996. Proceeding cautiously, it rendered 411 final decisions by the end of 1997. During that time 1833 new and 1264 transitional appeals (relating to "Old Board" appeals) were filed, leaving a total backlog of 2686 at the end of 1997. During the first seven months of 1998, 508 cases were decided, while 356 additional appeals were filed. It appears that the system can handle the current appeal volume, but special initiatives are required to eliminate the backlog.

Each component of the Workers' Compensation System appears to generally be in compliance with the Workers' Compensation Act of Nova Scotia. Monitoring of this compliance forms part of the quality assurance process at the Workers' Compensation Board. The Workers' Adviser Program has a less formal monitoring process, while the Workers' Compensation Appeals Tribunal relies primarily on the courts to monitor its compliance.

Medical professionals within the Workers' Compensation Board itself appear to be aware of and in compliance with the Act and related policies and procedures. Medical professionals outside the direct control of the Workers' Compensation Board also play a vital role in the Workers' Compensation System. Although medical professionals inside the system are often seen to be the "bad guy", substantial improvements in services to the injured worker often result when external medical professionals work in cooperation with Workers' Compensation Board Case Managers. There is clearly a need to continue to educate both external medical professionals and other stakeholders on the vital role that these external medical practitioners can play in assuring that injured workers receive fair treatment from the system. We recommend that an independent medical review panel be created to help resolve cases where conflicting medical opinions have been rendered.

As evidenced by our review of submissions to the Select Committee on the Workers' Compensation System, the sit-in by a group of injured workers at the Premiers' office, media reports and informal discussions with other stakeholders, it is apparent that there exists a broad level of dissatisfaction by various stakeholders with "The Compensation System".

Based on this limited analysis, it appears that generally most discontentment arises from either getting an adverse case ruling or getting no ruling at all. Adverse rulings are obviously a necessary product of this type of system. The ability to get a timely reconsideration of such decisions and the support and introduction of an internal

conciliation process offered by the Workers' Advisers Program, as recommended in this report, should help to alleviate some dissatisfaction. It will never be completely eliminated.

The current large backlog of appeals at Workers' Compensation Appeals Tribunal appears to be a major source of the apparent dissatisfaction with the system. WCAT has developed a plan aimed at eliminating this backlog by July 2000. Success of this plan is predicated on the prompt resolution of several substantive issues. This important initiative, combined with access and reporting improvements recommended in our report, should assist in enhancing the relationship of the system with its stakeholders.

The Workers' Compensation System does not appear to function as a cohesive system. Each component seems to view the others as an adversary. There is no common strategic planning, no common data bases, and appears to be limited direct contact except on some specific matters. There does exist a tri-partite committee with representation from the senior management group of each agency. However, this committee meets only as issues arise among the three groups. We recognize and support the need for each agency to maintain an arms length relationship at an operational level. Not all client data can or should be shared. This is true of other types of data as well. However, presumably the ultimate objective of each agency is the same – provision of all benefits to which an injured worker is entitled at the earliest possible date. Respect for the important role that each agency plays in delivering this vital service, and co-operation in establishing broad strategy objectives that would be common to each group, together with sharing of appropriate information in areas of common interest, should significantly improve the working relationships among the groups, and the delivery of improved service levels to users of the system.

CONCLUSIONS

Generally, with the exception of the appeals process, most critical elements of the system are functioning satisfactorily. However, improvement is required in certain key areas. Accountability and efficiency within the system can be significantly improved once the implementation of a system of performance measures and results comparison is in place. A concerted, special effort must be made to clear up the large appeals backlog at Workers Compensation Appeals Tribunal. Better use of technology, and most importantly a better working relationship among the components of the system will lead to further enhancements in service levels for the Workers' Compensation System in Nova Scotia.

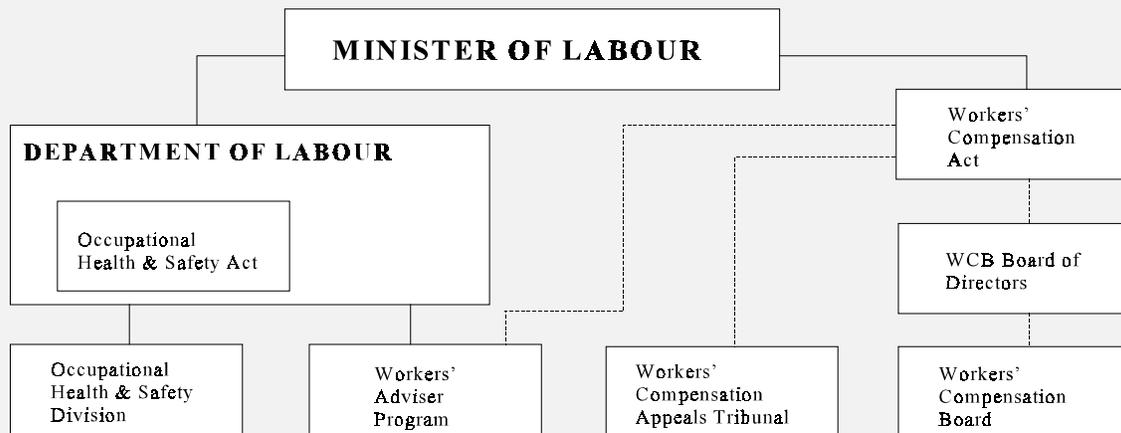
BACKGROUND

The Workers' Compensation System in Nova Scotia is currently undergoing a significant amount of scrutiny from injured workers, labour groups, employers, government and the general public. The system has a backlog of appeals of approximately 2,500 cases. A recent sit-in by injured workers at the Premier's office drew public awareness to the backlog. The government has formed an all-party committee to hear from Nova Scotians and to draft legislation aimed at improving the Act.

In addition, at the request of the Executive Council of the Government of Nova Scotia, the Auditor General of Nova Scotia has undertaken to audit the Workers' Compensation System. Grant Thornton was selected to perform the audit, under the direction of a Steering Committee established by the Auditor General.

WORKERS COMPENSATION SYSTEM

The Nova Scotia Workers Compensation System includes the Workers' Compensation Board, Workers' Compensation Appeals Tribunal, workers and their representatives (Workers' Advisers Program), employers, the medical community, service providers, government and others involved in injury and disease prevention.



The **Workers' Compensation Board** (WCB) was established by the Nova Scotia Legislature in 1917, under the Workers' Compensation Act (the Act). A new Workers' Compensation Act received Royal Assent on February 6, 1995. The WCB is responsible, in accordance with the provisions of the Act, for administering the payment of benefits to injured workers; levying and collecting assessment revenues from established classes of employers in amounts sufficient to cover the costs of claims and administration; and investing funds held for future payments which relate to claims arising from events which have already occurred.

The **Workers' Compensation Appeals Tribunal** (WCAT) was established as a legal entity in June 1995. Its authority, mandate and terms of reference are legislated under the Workers' Compensation Act of 1995, PART II. WCAT describes itself as an independent tribunal operating separately from the Workers' Compensation Board, but within the Workers' Compensation system itself. It is funded by the accident fund of the WCB, and must operate within the policies established by the WCB Board of Directors.

The **Workers' Advisers Program** (WAP) was established by the Workers' Compensation Act of 1995, PART III. It was set up to be an independent agency representing the interests of injured workers. The program's role is to advise, assist and represent injured workers who have been denied benefits by the WCB. This representation occurs both at the WCB, WCAT and at the Nova Scotia Court of Appeal.

NEW WORKERS' COMPENSATION ACT

On February 1, 1996, a new Workers' Compensation Act came into full effect. It represented the first fundamental overhaul of workers' compensation legislation in Nova Scotia since the inception of workers' compensation in 1917.

The major changes that took effect February 1, 1996 included:

- The transition from a clinical rating scale to a wage loss methodology for computing compensation benefits for workers with permanent physical impairments who have an earnings loss resulting from their injury.
- A transition from calculating compensation benefits based on a percentage of pre-accident gross earnings to a net loss of earnings (pre-accident earnings minus post-accident earnings).
- Introduction of the 2/5ths waiting period.
- Introduction of re-employment provisions.
- Establishment of the Workers' Compensation Appeals Tribunal and the Workers' Advisers Program.
- Introduction of firm-level experience rating for calculating assessment rates.

AUDIT SCOPE

The audit addressed the Workers' Compensation System, which for the purposes of the audit comprised the current administration and operations of the Workers' Compensation Board of Nova Scotia, the Workers' Compensation Appeals Tribunal, the Workers' Advisers Program, and any administrative support provided by the Nova Scotia Department of Labour.

AUDIT OBJECTIVES

The objectives established for the audit of the Nova Scotia Workers' Compensation System are as follows:

- I.** Assess the efficiency, effectiveness, and accountability of the Workers' Compensation System with respect to benefit claims intake, processing, appeal and closure. Make recommendations for improvement.
- II.** Determine the causes for and recommend solutions to the backlog in benefit decision appeals. Recommend efficient and economic means of preventing future backlogs in the appeals process.
- III.** Assess the degree to which policy, procedures and practices relating to benefit claims intake, processing, assessment and appeal comply with the Workers' Compensation Act of Nova Scotia.
- IV.** Assess the roles and responsibilities of medical professionals in the Workers' Compensation System, and make recommendations to address any observed uncertainty, inappropriateness or non-compliance with legislation.
- V.** Assess the quality of the relationship of the various components of the system with its clients, and suggest means of improvement.
- VI.** Assess the quality of the relationship and cooperation among various components of the system with each other, and between the system and external sources of disability insurance (notably, Canada Pension Plan and private insurance providers). Recommend ways various stakeholders could work together more efficiently and cooperatively.

AUDIT METHODOLOGY

The audit was performed under the guidance of a Steering Committee of the Nova Scotia Auditor General. The audit consisted of a three-phase process:

1. The design and preparation of an audit plan.
2. Execution of comprehensive audit procedures.
3. Preparation and delivery of a detailed report outlining audit findings and recommendations.

The audit plan established the audit scope, materiality level, budget resources and timelines, audit criteria, detailed audit procedures and audit techniques and evidence. Input from the Steering Committee was incorporated into the final plan.

Comprehensive audit procedures were designed for each criteria developed in the audit plan. The nature and extent of audit procedures was based on the potential impact to financial information from improvement to the process under assessment and other considerations. This judgement was developed based upon our experience with WCBs across the country. We obtained audit evidence through staff interviews, inspection and review of policy and procedure documentation and a sample of claims and appeals files. In addition, we reviewed transcripts of meetings of the Select Committee on the Workers' Compensation System.

Our audit findings and recommendations are presented in the following section.

AUDIT FINDINGS AND RECOMMENDATIONS

Individual findings and recommendations may apply to more than one objective. Recommendations are presented in **bold** and *italic* font.

OBJECTIVE I

Assess the efficiency, effectiveness, and accountability of the Workers' Compensation System with respect to benefit claims intake, processing, appeal and closure. Make recommendations for improvement.

PROCESS

1. At the first level of appeal, the Reconsideration stage, the original claim decision-maker reviews their own decision. The original decision-maker may be perceived as not being objective when reconsidering their own opinion. As a result, the Reconsideration stage may not be effective in reducing further appeals.
The WCB should reevaluate the benefits of the Reconsideration stage to ensure this is an effective tool in the internal appeal process. It may be better performed outside the formal appeal process.
2. At the WCB internal appeals level (Reconsideration and Hearing Officer), an injured worker who has requested representation by WAP often has to wait up to eight weeks until a Workers' Adviser can review the case. During this eight week period, Reconsideration and Hearing Officer appeals must be filed in order to meet pre-established deadlines. Consequently, Workers' Advisers may be forced to file these appeals without all the pertinent information, resulting in appeals that have no reasonable expectation of success.
This area could be addressed by the WCB and WAP working together to come to a mutually agreeable timeframe to register appeals. Alternatively, WAP may serve as a conciliator between the injured worker and the WCB prior to the commencement of deadlines for filing appeals. If the conciliation failed, the legal services branch of WAP would take over the client support during the formal appeal process, much as it does now. The informal conciliation phase should serve to reduce the number of formal appeals, saving time, money and frustration to all parties involved. In this model WAP would have two distinct branches and services – a conciliation group and a legal services group. Each would require different employee skill sets and training.
3. The hours for workers to contact the WCB, or consult with a representative regarding claims, is limited. According to letters being written to workers, the hours available for consultation are very limited; 8:30 am to 3:30 pm. Workers, who work 12-hour shifts and/or do not have access to a telephone,

may have trouble contacting the WCB. This was acknowledged in a November 1997 external consultant's report. Management has informed us the current process is under review in the Registration to First Payment Project.

The WCB should continue their examination of extending hours of operation.

4. WCAT has two levels of appeal, the Leave and Merit stages. Once an appeal is granted leave, considerable time can elapse before the merit stage. Consequently, all parties involved in the appeal must again review the details of the file, causing unnecessary inefficiencies.

WCAT should consider implementing a procedure that ensures the leave and the merit stages occur as close together as possible to make the most efficient use of the time of all parties involved.

5. WAP has documented criteria to determine which clients to represent, and the criteria are generally being followed. However, implementation of the conciliation model may impact the appropriateness of the criteria.

6. WCAT appeal cases are assigned in a random manner with an attempt to ensure a balanced number of cases per Appeal Commissioner. Assigning cases based on an Appeal Commissioner's experience with similar cases and/or issues should further assist in the efficiency and effectiveness of rendering decisions.

WCAT should consider the benefits of implementing a structured intake system whereby Appeal Commissioners are matched up with clients that have cases with similar traits. This would assist in establishing consistency and develop some level of "specialty" to ensure files are handled in an efficient manner. Specialties should be broad enough to ensure a reasonable caseload distribution.

7. WAP generally does not assign client files strategically. Files are assigned based on intake day assigned, and not necessarily assigned to the most appropriate staff. The Chief Workers Adviser attempts to assign files regionally, so as to minimize travel by Workers' Advisers.

WAP should consider the benefits of implementing a structured intake system whereby advisors are matched up with clients that have cases with similar traits. This would assist in establishing consistency and develop some level of "specialty" to ensure files are handled in an efficient manner. Specialties should be broad enough to ensure a reasonable caseload distribution.

PERFORMANCE EXPECTATIONS AND ACTUAL PERFORMANCE MEASUREMENT

8. The WCB has recently developed a number of performance expectations related to claims and appeals processing; as this process is in the early stages, most actual performance is below established benchmarks. Management has informed us that they intend to periodically review the appropriateness of these performance expectations.

The WCB should continue reviewing target performance expectations to ensure they are appropriate and attainable. Thereafter, the WCB should continue to strive to meet all performance expectations and should explore methods to encourage this.

9. The WCB does not have any specific caseload expectations by individual employee. As a result, the WCB does not know if the workload of staff is reasonable or distributed fairly. Management informs us that an internal workload measurement committee is currently examining this issue and during recent years, staff levels have been determined with respect to the organization as a whole compared to other Canadian WCBs.

The WCB should continue with the development and implementation of caseload expectations and the monitoring of actual performance against these expectations regularly.

10. The WCB has indicated that one of its major goals is to return injured workers to the workplace. The WCB, in cooperation with Revenue Canada, has generated historical return to work data that could serve as the basis for the establishment of performance expectations in this area. However, management has informed us that it will be some time before the WCB will be able to collect and report data that will allow for measurement of its success in returning injured workers to the workplace.

The WCB should continue, in conjunction with other appropriate bodies, to establish a data collection system that will allow reliable return to work data to be utilized for results measurement.

11. The WCB annual report is the primary vehicle used to communicate performance to stakeholders. A number of performance statistics are reported, including such critical statistics as average claims processing time, internal processing time, and duration of short-term disability claims. While these statistics are presented on a year by year basis, they are not compared to either industry standards or performance expectations. This would provide readers a contextual basis for performance assessment.

The WCB should establish and report performance expectations for each reported performance statistic.

12. WCAT generates and monitors monthly statistics with regard to appeal decisions rendered in various categories, as well as the number of appeal decisions per Appeal Commissioner. However, WCAT appears unable to generate statistics on appeals assigned to individual Appeal Commissioners. This limits WCAT's ability to monitor workload and the status of appeals in their system.
WCAT should determine if it has the ability to generate statistics on appeals assigned and monitor caseloads and the status of appeals on a regular monthly basis.
13. There is no maximum time limit specified for WCAT decision making on appeals that have not yet been assigned to an Appeal Commissioner. This limits the ability to hold WCAT accountable for delays in issuing decisions on cases. The principle of natural justice alone appears to indicate an appellant's right to a timely resolution. Management has informed us that this issue is currently being considered.
WCAT should develop and implement decision time limit expectations as appropriate, recognizing that flexibility should be a necessary component of such expectations.
14. The system of tracking time spent on each file by a Worker Adviser is not monitored on a regular basis. As a result, there is little control over the time spent on a file, and this may lead to excessive, or not enough time being spent on each file.
WAP should consider reviewing time spent per file in a more structured manner so that monitoring and management intervention can occur on a timely basis.

DOCUMENTATION AND INFORMATION

15. The WCB has not been consistently preparing case plans, due to time commitments and other administrative duties. This has resulted in some case plans not being prepared in accordance with WCB procedures, and case management decisions not supported by adequate documentation.
All case management decisions should be supported by adequate documentation, consistent with stated case management procedures.
16. The WCB Form 67 (report of accident) is sometimes not being filled out completely by employers. Incomplete Form 67s must be followed up by the WCB staff, impacting the WCB's ability to efficiently process claims.
The WCB should consider returning incomplete form 67s to employers and imposing a penalty. The WCB should also consider communicating with

employers to illustrate added costs and processing delays resulting from incomplete information.

17. The decisions rendered from the NS Court of Appeal can have a significant impact on the operations of the WCS. The WCB Legal Department thoroughly reviews, analyzes and assesses the implications of Court of Appeal decisions. It appears this information is not shared with WAP or WCAT, and as a result, duplication of effort may be occurring, or all components of the WCS may be not benefiting from all available information. It should be recognized that, in some cases, the three organizations will have very different perspectives on what the implications of that information are and what the appropriate course of action might be.

There needs to be more sharing of information on NS Court of Appeal decisions within the WCS.

18. Our review of WCB claim files indicates that overall, claims are being processed efficiently and in accordance with the Act. However, for the population sampled, file documentation to support how the claim calculation was arrived at appears inadequate. Management has recognized the need for improvement in this area.

The WCB claim files should have adequate documentation to support the claim calculation.

19. Key data and internal controls required to process a claim appear to be adequate. However, a recent WCB internal Data Quality Audit indicated that some of the statistical data elements in the computer system are not as accurate as desired, and system documentation is inadequate. Internal controls over operational statistics and special reports are weak.

The WCB should have adequate systems documentation. Internal controls over operational statistics should be established, documented, implemented and tested.

20. In a 1997 survey of workers injured since 1996, workers gave a rating of 8.1 out of 10 on the clarity of letters received from the WCB. However, our review indicates certain letters communicating claim decisions appear confusing and difficult to understand. Clear, concise letters are essential to good communication, and will assist the WCB in explaining its position.

All letters communicating claim decisions should be clear, concise and understandable.

21. Only recently the WCB began planning to report employer satisfaction performance measures. These employer satisfaction performance measures

will be reported externally for the first time in October 1998, subject to approval by the Board. Presently, there is no written commentary provided to explain significant variances noted.

The WCB should continue with its plans to obtain and externally report employer satisfaction performance measures, including written commentary to explain any variances.

22. The communication of eligibility and right to appeal appears to be effective. The WCB uses various methods of communicating eligibility to employers and workers. These include brochures, quarterly newsletters, Form 67 - report of accident, public libraries and the WCB internet site. Initial decision letters provide information on the right to Reconsideration of a decision and how to contact WAP. Additionally, the right to appeal and the right to contact WCAT are also communicated. Applicable toll free phone numbers for WCB, WCAT, WAP are provided.
23. Our review of WCAT appeal files indicates that WCAT has adequate documentation in their files to process client appeals effectively.
24. WCAT Appeal Commissioners are required to prepare short, concise case summaries (Head Notes) for all decisions rendered. Head Notes assist in ensuring WCAT decision consistency. We understand some Commissioners did not prepare Head Notes for all decisions rendered.
Appeal Commissioners should prepare Head Notes for all decisions rendered.
25. WCAT has limited management information system internal controls. This could lead to incomplete or inaccurate information. WCAT may not be able to effectively monitor the status of appeals, limiting their ability to efficiently process appeals.
Controls should be put in place to ensure that reliable statistics are compiled by WCAT and are used as input for management decision making.
26. Our review of WCAT external communication indicates that WCAT adequately communicates with external people/bodies. However, the volume and level of detail of information provided to injured workers may be confusing.
WCAT should consider reducing the volume of materials sent to injured workers and concentrate on providing clear, concise communication.

27. Our review of WAP external communication indicates that WAP adequately communicates with external people/bodies. WAP issues clear, concise and understandable communication.

OTHER

28. The WCS does not have a strategic plan. Although the individual components may have different strategic goals and performance measures, the WCS should have a common objective and mission. The elements must function together as one system to ensure that the expectations of all stakeholders are achieved to the maximum extent possible. Currently, the WCB and WAP have prepared individual strategic plans; WCAT has not. Without coordination, objectives and goals for each component may be inconsistent.

The WCS should work together in developing and implementing a single, coordinated strategic plan that establishes broad objectives for the entire system. This plan should be approved by each component and ultimately the Minister responsible for the WCS.

29. The WCB does not have a formal job specific orientation program for newly hired staff. New staff are assigned to work with Adjudication Advisers or senior case managers. Consequently, staff may not receive adequate initial training in case management techniques and practices, the Act and Regulations. Management has informed us that a proposal has been developed to create this program.

The WCB should continue, on a timely basis, to develop a job specific orientation program for new staff.

30. WCAT has a formal orientation and training program for new staff.

31. WAP does not provide any formal training program for its Workers' Advisers regarding the Act and policies of the WCB. It does however, have an informal mentoring system. Training is essential to the efficient and effective operation of WAP.

WAP should implement a formal training program for Workers' Advisers.

32. The WCB uses informal communication methods with other WCBs in Canada to share efficiencies. Major projects such as Registration to First Payment and Disability Case Management, involve communication with other WCBs on their procedures and practices. The WCB is knowledgeable of other practices in Canada and considers these practices in major projects underway at the WCB.

33. The Clients Service Division of the WCB is critical to the efficient and effective processing of claims. Some of the division's staff do not have access to computers and the related software. Major documents, such as case plans, must be hand written or dictated. Case plans cannot be updated on a timely basis.

Clients Service Division staff should have access to the appropriate technology, and acquire adequate training to prepare case plans electronically. Current WCB initiatives in this area should continue on a priority basis.

34. Use of technology in the WCS may not be adequate to achieve an optimal level of efficiency in its operations. Our experience with other WCSs in Canada indicates that Nova Scotia trails in the use of technology.

The WCS should evaluate the benefits of utilizing a higher degree of technology in its operations.

OBJECTIVE II

Determine the causes for and recommend solutions to the backlog in benefit decision appeals. Recommend efficient and economic means of preventing future backlogs in the appeals process.

35. The following table summarizes appeals filed and final decisions of WCAT. Final decisions do not include leave granted, as these appeals would still remain in the backlog until the merit decision is rendered.

Year	Transitional appeals filed	New appeals filed	Final Decisions	Backlog contribution
1995 (from June)	208	188 (incl. 80 from Appeal Board)		396
1996	862	672	(38)	1496
1997	194	973	(373)	794
1998 (to July)	4	352	(508)	(152)
	1268	2185	(919)	2534

36. Backlog history:

- In June 1/95, WCAT was established as a legal entity and all WCB appeals filed after that date were to be filed with WCAT. Prior to this, the old Appeal Board was the legal entity, under the old Act, where WCB appeals were filed. Appeals could be filed at the Appeal Board before being heard by a WCB Hearing Officer.

- At June 1/95 there was a backlog of appeals at the old Appeal Board. We have been unable to determine the exact number of appeals in backlog at that time. However, these appeals in backlog can be broadly classified as:
 - Appeals of final decisions of a Hearing Officer
 - Appeals not yet heard by a Hearing Officer
- The new Act states that all appeals filed at WCAT must be final decisions of the WCB, which means the Hearing Officer must have reviewed and decided on the appeal.
- At June 1/95, there were 2,153 appeals at the appeal board that did not have a Hearing Officer's decision. These were immediately (on June 1/95) sent back to the WCB Hearing Officers for a decision.
- Of the 2,153 appeals that were sent back to the Hearing Officers at June 1/95, the Hearing Officers had rendered decisions on essentially all by February 1997. WCAT refers to these as "transitional appeals".
- Of these 2,153 transitional appeals, 1,268 (59%) were eventually filed with WCAT.
- All appeals that were at the appeal board at June 1/95 that had a Hearing Officer's decision, stayed at the old Appeal Board. The old Appeal Board continued to hear cases until January 31/96. At January 31/96, approximately 80 appeals were not heard by the old Appeal Board and were transferred to WCAT.
- Between June 1/95 and December 31/95, 396 additional appeals were filed with WCAT (208 transitional, 188 new appeals).
- In January 1996, WCAT commenced operations by formally opening offices and hiring 3 full time Appeal Commissioners. In April 1996, 2 more full time Appeal Commissioners were hired.
- In May 1996, WCAT made its first leave decision. Initially WCAT was purposely taking its time in writing decisions to ensure quality, making 881 decisions from January 1997 to July 1998. However, during this same period 1,523 additional appeals were filed.

37. The WCS does not have a system in place to identify and determine why there is a backlog, and no component of the WCS has taken ownership of the backlog. Consequently, it is unlikely backlogs can be avoided in the future.

The WCS should establish parameters to identify what constitutes a backlog of appeals. Once a certain number of appeals are reached, the Tri-partite Committee of the WCS should meet to establish a formal plan to resolve the backlog.

38. As of December 31/96, WCAT had made 81 decisions, including 43 Leave decisions granting entitlement to the appeal process (i.e. remained in the backlog). Therefore, during the period June 1/95 to December 31/96, a period of 19 months, while 1,930 appeals were filed at WCAT, only 81 decisions were made, which only eliminated 38 cases from the backlog. When WCAT was established, there appears to have been no plan in place to deal with:
- (1) the backlog of appeals existing at the old Appeal Board; and,
 - (2) additional appeals filed during WCAT start up phase.

WCAT appears to be very legalistic in nature and design. Decisions are highly detailed and appear to focus primarily on issues of law. This type of approach may not be appropriate for a mass appeals system, where disputes frequently arise over questions of judgement rather than over specific legal points.

Consideration should be given to streamlining appeals into two categories; appeals that relate to a complex issue of law and interpretation, and those that are of a more routine nature. More resources should be directed to those appeals that relate to a complex issue of law and interpretation.

39. In their submission to the Select Committee, WCAT presented their plan of action to deal with the appeal backlog by July 2000. It is difficult to determine whether this deadline is reasonable because it depends upon the hiring of ten additional Appeal Commissioners, approval of amendments to the WCB Act and the use of the Alternative Dispute Resolution (ADR) process. Based on the results illustrated in the above table, no documented analysis appears to have been undertaken to determine the cost of this plan, nor is it clear how the plan will achieve a July 2000 elimination date.
- WCAT should complete a documented assessment of the cost of the backlog reduction plan, and clearly state how the July 2000 elimination date will be met. Performance expectations should form an integral part of this assessment.***

40. The ADR process was an effective means to hear a large volume of appeals in a short period of time. This process helped to reduce the volume of the backlog.
- WCAT should continue to use ADR as a means to clear the backlog. In doing so, the WCS must be cognisant of which types of appeals work best***

with ADR. Strict guidelines should be implemented and agreed upon to ensure only the most appropriate appeals are processed using ADR.

OBJECTIVE III

Assess the degree to which policy, procedures and practices relating to benefit claims intake, processing, assessment and appeal comply with the Workers' Compensation Act of Nova Scotia.

41. Our review of the WCB, WCAT and WAP documented policies and procedures indicates that they are in compliance with the Act.
42. Our tests of benefit claims and appeals indicate that practices of the WCS are in accordance with the Act.
43. The WCB monitors its compliance with the Act through documented quality assurance procedures, its internal auditor function and Board of Director reporting.
44. Although they are in compliance with the Act, WCAT does not have any specific procedures to ensure compliance. Compliance with the Act is essential to effective operation of the WCS.
WCAT should develop and establish procedures to monitor its compliance with the Act.
45. WAP has policies in place to ensure compliance with the Act. This compliance is monitored; however this monitoring is informal and unstructured.
WAP's current practice of spot checking files at WAP by the Chief Worker Advisor should be expanded so that files are selected randomly, on a periodic basis, and reviewed.
46. The WCB, WCAT and WAP reporting of compliance with the Act is limited. Current reporting does not allow stakeholders to determine if the WCB, WCAT and WAP are complying with the Act.
The WCB, WCAT and WAP should report to appropriate stakeholders the results of their monitoring of their compliance with the Act.

OBJECTIVE IV

Assess the roles and responsibilities of medical professionals in the Workers' Compensation System, and make recommendations to address any observed uncertainty, inappropriateness or non-compliance with legislation.

47. The WCB Medical Advisors have clearly defined roles; however there appears to be a significant discrepancy in the interpretation of their roles by stakeholders. The WCB medical advisors do not make benefit claim decisions. They provide assistance and commentary on external doctor reports and assessments. Depending on the nature of the benefit claim, Case Managers or Adjudication Advisors review and weigh the evidence available, and render a decision.

The roles and responsibilities of WCB Medical Advisors should be clearly communicated to all stakeholders.

48. The roles and responsibilities of medical professionals outside the WCS are not clearly defined, and their significance in the WCS is not effectively communicated. *A plan should be established to meet with and inform the medical community regarding their significance to the WCS.*

49. There is no consistent application of the Permanent Medical Impairment (PMI) guidelines between external medical professionals and WCB internal medical professionals. This causes differences of opinion between medical professionals, ultimately leading to appeals. Management informs us that a plan is currently in place to review the current PMI guidelines.

A comprehensive communication program should be carried out to ensure all external medical professionals are aware of the PMI guidelines and any changes to these guidelines that may occur as a result of the current management review.

49. As previously stated, differing medical opinions are resolved by the weighing of evidence. This involves significant judgement on part of the decision-maker. We were unable to determine the level of training and medical knowledge of decision-makers.

All decisions based on medical evidence should be made by individuals possessing some level of training in medical terminology and practices.

50. The Act contains provisions for operation of a Medical Review Commission. In the Manitoba WCS, a Medical Review Panel (MRP) mechanism, comprised of three medical practitioners, has been established to assist with

resolving differing medical opinions. The MRP is involved primarily at the appeal stage, but is available to provide guidance to the WCB Board upon request, and acts as an independent, objective body that reviews opposing medical opinions, and provides recommendations to the Manitoba WCS. The Chairman of the MRP is a permanent employee of the senior appellate body and is a medical practitioner. The MRP is established, and its authority is derived, directly from legislation. For each case, the injured worker and the employer are each required to appoint the remaining two MRP members from a medical practitioner list provided by the medical society. The MRP has access to all medical history and can test and examine the injured worker as is necessary. Recommendations of the MRP are non-binding but carry considerable influence with the decision-making body requesting its assistance.

The WCS should further investigate the Manitoba MRP, and adopt those components that are appropriate to the Nova Scotia system.

OBJECTIVE V

Assess the quality of the relationship of the various components of the system with its clients, and suggest means of improvement.

52. The WCB has no central complaints register. Integrated Service Unit (ISU) managers investigate complaints and write letters to complainants.

The WCB should establish a more formal system to record, monitor and resolve complaints.

53. Our review of submissions to the Select Committee on the Workers' Compensation System indicates there is a perception the appeal system is bureaucratic and legalistic. Consequently, injured workers experience frustrations with the current system and many injured workers feel confused about the operation and the people and groups involved in the current appeals system.

As previously recommended the implementation of a conciliation phase system and redefining the WAP role will address these concerns.

54. Through surveys of its clients, the WCB has been able to determine client needs. Other less formal methods include case manager interaction with clients and ISU manager speaking engagements. Performance expectations have been developed to measure the extent to which the WCB is meeting the needs of clients.

The WCB should continue to gather data to enable them to measure the extent to which these expectations are being met.

OBJECTIVE VI

Assess the quality of the relationship and cooperation among various components of the system with each other, and between the system and external sources of disability insurance (notably, Canada Pension Plan and private insurance providers). Recommend ways various stakeholders could work together more efficiently and cooperatively.

55. A tri-partite committee, consisting of senior management of the WCB, WCAT and WAP is in place to coordinate issue identification and resolution between WCB, WCAT and WAP. However, the committee does not meet on a regular basis and this informality may impede its effectiveness.

The tri-partite committee should establish a formal meeting schedule to proactively raise and resolve issues facing the WCS.

56. There is regular administrative correspondence among the various components of the system. Administrative correspondence dealing with complaints appears to be dealt with on a timely basis with an aim to resolving the conflict by providing further explanation or by offering a meeting to deal with the conflict. Dispute resolution between the various components appears to be functioning adequately.

57. There appears to be differences in interpretation of the roles and responsibilities of each component of the WCS, both externally and within the WCS. For example, WAP has informed us that injured workers sometimes question their objectivity. As a further example, none of the components have a consistent interpretation of how and where new medical evidence should be handled. These differences in interpretation, especially at the appeal level, limit the ability of the WCS to meet the needs of its stakeholders.

The roles and responsibilities of each component of the WCS need to be clearly defined and communicated, both within the WCS and externally. The treatment of new medical evidence in the process should be specifically addressed.

58. Communication between external sources of disability insurance is regular but informal. The WCB has recently signed an information sharing agreement with the Canada Pension Plan, and an internal focus group has been established to implement the agreement. Management information systems are not yet in place to share information electronically.

The WCB should continue to investigate the advantages of sharing information with external sources of disability insurance and should improve this area on a timely basis.

RESPONSE FROM WORKERS' COMPENSATION BOARD OF NOVA SCOTIA

The need for fundamental changes and improvements to the WCB was recognized by the new stakeholder based WCB Board of Directors. Through management, they initiated activities which resulted in the development of WCB's new earnings loss service delivery, quality assurance, internal audit and planning processes. Those activities have fundamentally changed the WCB, and are the basis for 18 of the 20 recommendations contained in the Auditor General's report that deal solely with the WCB.

The WCB agrees with most of the findings and recommendations contained in the report as they pertain to the Workers' Compensation Board. There are four recommendations relating to the WCB and the broader system which we believe warrant comment and further consideration, as we as a society attempt to further improve the system.

It is important to note that the auditors "...review of WCB claim files indicates that overall, claims are being processed efficiently, and in accordance with the Act." (page 14) It is important in light of the past concerns that stakeholders know that these independent auditors made this determination as well as finding that "The WCB monitors its compliance with the Act through documented quality assurance procedures, its internal auditor function and Board of Director reporting." (page 20)

This by no means suggests that there is not room for further improvement. In fact, all but two of the recommendations which deal solely with the WCB processes have been identified as a result of our internal quality assurance and internal audit program. There are, as noted in the report, projects underway to address these items.

The Board is of the view that the new Act is generally working with the exception of the appeals process. This seems to be supported by the fact that during the Select Committee hearings held across the province, of the 170 presenters, only eight people had been injured since the new Act came into effect in 1996.

Additionally, of the approximately 80,000 individuals who had a workplace accident since February 1, 1996, about 300 workers - less than half of one percent - have filed an appeal at the external appeal body, the Workers' Compensation Appeals Tribunal. Overall, 98% of all the cases handled by the WCB are resolved, and less than 2% require the involvement of the Workers' Advisers or WCAT. This is another clear indication the new Act is working.

There are several recommendations in the report on which we would like to provide specific comment:

2. ...the WCB and WAP (should) work together to come to a mutually agreeable time frame to register appeals. Alternatively, WAP may serve as a conciliator between the injured worker and the WCB prior to the commencement of deadlines for filing appeals. If the conciliation failed, the legal services branch of WAP would take over the client support during the formal appeal process...

Response:

The WCB Board of Directors has set very clear performance expectations for the hearing of internal appeals. Ninety five percent of all hearing officer decisions are to be issued within 90 days or less of the filing of an appeal. In addition, decisions are to be issued within 30 days of a hearing.

These standards are based on the expectations of injured workers, and the philosophy that it is critical that the worker gets the service he or she needs at an early stage in the process. This is crucial in light of the concept of early intervention, particularly for those workers who may develop chronic pain.

With a current wait of up to eight weeks to see a Worker Adviser, there is a serious concern that any lengthening in the appeal process would simply add further delays between the time of the original injury and delivery of services. For a recovering injured worker, time delays are a significant barrier that should be shortened, not lengthened.

Recommendations in the report regarding the establishment of an intake system at the Workers' Advisers Program may help to alleviate their current backlog of cases and ensure in the future that files are handled and prioritized within resources.

16. *The WCB should consider returning incomplete form 67's to employers and imposing a penalty...*

Response:

The WCB recognizes that this process is not working as well as it should, but instead of imposing further penalties, and potentially introducing further delays in getting payments to workers, the Board is developing a more efficient process of reporting.

This will be achieved through a shift from the current system of paper dependent reporting (Form 67) to telephone reporting and on-screen authorization of payments. By the end of 1999, the WCB will have a telephone reporting service, which should address this concern, rather than just using punitive measures. By the year 2002, this new process is intended to result in 90% of claims being paid within 15 days.

The WCB now fines those who do not file the report on time. This helps to get the key information in so the claim can be opened. Once the claim is open, the WCB works with the employer and the employee to get any data that is missing in the original report. It should be noted that since January 1, 1997, employers have paid \$465,649 for 1,546 late reports.

28. *...The WCS should work together in developing a single, co-ordinated strategic plan that establishes broad objectives for the entire system. This plan should be approved by each component and ultimately the Minister responsible for the WCS.*

Response:

Conceptually, the WCB agrees that it would be useful for all agencies in the system to share a strategic plan, but there needs to be recognition that there are three distinct roles necessary to protect the rights of individuals in conflict in a quasi-judicial system. These roles present difficulties in attempting to coordinate a strategic plan.

The report does not recognize the administrative law principles underlying the arms length nature of the three agencies in a system such as this. The Workers' Advisor Program is somewhat independent, but clearly reports to the Deputy Minister of Labour. WAP must, however, provide true legal counsel, which implies resolute advocacy of its clients' interests in accordance with the ethical obligations of all lawyers. There are often inherent conflicts between what is good for the system and what is good for an individual client. These are the conflicts that the Department of Labour deals with through the Workers' Advisers program.

WCAT is a self-administering body subject only to financial and hiring oversight by the Government. It must not only be truly impartial and separate from WCB and WAP, it must be seen to be impartial. The WCB, WCAT and WAP must independently play their proper roles in applying the legislation.

In fact, we believe that, in a sense, strategic planning was the intent of Section 183 of the new Act. This section explicitly gives the WCB Board of Directors power to make policies governing the exercise of discretion where it is left open under the legislation. Section 183 makes those policies binding on the WCAT and therefore by process on the WAP.

Evidently, the WCB Board was assigned this broad policy oversight role because it is the only agency in the system structured and mandated to work with the system as a whole, rather than on a case by case basis. It is the only agency in the system governed by those the system is designed to serve - employers and workers.

As a result, responsibility for handling *all* claims lies with the WCB Board of Directors who, as representatives of the employers and workers the system is designed to serve, have developed a strategic plan and set performance expectations for service delivery. Since February 1, 1996, less than half of one percent of these cases have proceeded to the external level of appeal.

37. *The WCS should establish parameters to identify what constitutes a backlog of appeals...*

Response:

We understand this recommendation is focussed on the WCAT component of the appeal system, as there are systems in place to address the identification and management of any backlogs at the WCB. Ninety-eight percent of all the cases handled by the WCB are resolved internally. Only about 2% require the involvement of the Workers' Advisers or WCAT. There are backlog and case management information systems for 100% of the cases handled by the WCB, and performance is reported to the stakeholder Board of Directors on a monthly basis. There is no backlog of appeals at the WCB. All cases are monitored and decisions must be issued within 30 days of a hearing in 95% of cases. As noted earlier, the WCB operates its appeal process with a series of time limits. We agree that performance measures should be established and monitored.

There is a 2500 appeal case backlog at the WCAT and an eight-week wait at the Workers' Advisor Program prior to a file being reviewed to determine if they will represent the client. As the senior appellate body in a quasi-judicial system, WCAT must be largely independent from the executive branch of government, but it reports to the Legislature through the Minister of Labour, who is responsible for the Act. The Workers' Advisor Program formally reports through the Deputy Minister of Labour.

The WCB can provide data from its backlog and case management information systems to the WAP and the WCAT to assist them in dealing with the claims they come in contact with. The WCB has a common data base with the WCAT and currently shares certain data with them. We are willing to provide similar services to the WAP, enabling WAP to input data into the comprehensive file. This would assist with the development of a comprehensive picture of the file flows.

The WCB has worked with both parties to identify and implement Alternative Dispute Resolution (ADR), as one example of a process solution identified to resolve the appeals backlog. We are willing to do so while respecting the rights of those in the appeal system.

The WCB actively monitors and reports on policy and legislation related issues arising from the WCAT. Because it is the senior appellate body, the WCAT's decisions are used as precedent. If a WCAT decision is thought to be contrary to the law, it is challenged in the Court of Appeal, and of course, what the Court of Appeal says is given effect. It must be understood that the WCB, WAP and WCAT each assess and deal with the rulings of the Court of Appeal and the WCAT according to their respective roles in the system.

There is a backlog of a large number of cases that arose before the new Act was in place. The backlogging of these cases creates hardship for those affected, as they need to know the final outcome of their cases. The WCB Board of Directors has recognized that legislative clarity is a key factor in the resolution of this backlog. To that end, the Board has made recommendations for legislative change.

From a system point of view, the backlog has meant that the WCAT has not heard new cases expeditiously. The WCB Board of Directors has called for a double streaming of the Workers' Advisor and WCAT process for new claims. This is intended to allow cases that have arisen since the introduction of the new Act to be dealt with on a timely basis.

The WCB has not addressed the issue of how the WAP and WCAT allocate their resources, which primarily is how they prioritize cases. This is not something the WCB can do while maintaining the arms length relationship contemplated in the Act, and as required by the general principles of administrative law. This was discussed in connection with the recommendation about strategic planning for the system.

It is worthwhile noting, however, that from the resource allocation perspective, there is already a significant amount of resources allocated at the appeals level compared to the claims processing level. In 1998, of the total system costs budgeted for claims processing (including appeals), 74.4% (\$10,643,119) are allocated directly to claims processing at the WCB, 4.4% (\$625,917) are allocated to the WCB's Internal Appeals, 8.7% (\$1,249,298) are allocated to the WCAT and 12.5% (\$1,793,000) are allocated to the Workers' Advisers Program.

The WCB Board of Directors, as the representatives of the stakeholders who have the responsibility for policy and administrative practices for all workers' compensation cases, has established time frames for the rendering of decisions by the WCB. This cannot govern the WCAT, nor can it take account of the fact that an appeal decision may be based on information additional to that in the file upon which the decision under appeal was based.

If new information can be introduced at the final level appeal, as is currently the case, there will continue to be delays built into the system. Each case is decided anew at each level, with no useful precedents established to guide the WCB front line decision makers, the WCB hearing officers or WAP.

The focus should be on getting the decision right the first time. To achieve this, the model of the courts should be adhered to, even though in the short run it may appear inefficient to send a matter back to the front line decision maker to consider new evidence. If the evidence is truly new, it may well lead to a new decision that can quickly be made by someone already familiar with the case. This is the way to efficiently address the appellant's problem. If this process does not solve the concern, the appellant could keep his or her place in the appeal queue, to avoid being lost in the process.

General Comments

As noted above, the WCB Board of Directors has directed a significant reform and restructuring of the organization since the introduction of the new governance model.

The new system appears to be working. Of the more than 80,000 individuals injured since the new Act was passed, less than 300 have filed an appeal at the external Appeal body, WCAT.

The overall responsibility for handling *all* claims lies with the WCB Board of Directors as representatives of the stakeholders the system is intended to serve. Claims processing standards are being enforced and reported on for all cases handled by the WCB. Since February 1, 1996, less than 0.5% of these cases have proceeded to the external level of appeal. This is another clear indication the new Act is working.

The new *Act*, through sections 183, 245 and 246, intended to establish the stakeholder appointed Board of Directors as the overseer of all policy matters under the Act. Unfortunately, this aspect of the *Act* has not been given an opportunity to mature and is now being challenged. Recently there has been a series of WAP challenges, and now a WCAT decision that appear to be directed at the efforts of the Legislature to bring some focus to the system which previously did not even have a common set of policies.

It is important to take into consideration the context of how the Workers' Compensation Board has evolved, and to place the findings of this report into that context. The situation at the WCB today is very different from the one that existed in the past. This is due we suggest, to having those ultimately receiving the services of the system, governing it.

A system in transition

Some of the initiatives and accomplishments since the new stakeholder governance system was introduced include:

- ▶ Shifting the payment of benefits from the old Clinical Rating Scale to a system of compensation for earnings loss. This has resulted in the average allowance for time loss benefits increasing from \$6,802 in 1993 to \$10,136 in 1997.
- ▶ Setting a new focus of providing early assistance with the objective of a timely return to work as part of the medical and vocational rehabilitation process. Between 1993 and 1997, reduced the length of time to process a claim by 18%, and the duration of short term claims by 27%, while reducing the number of cases going to appeal and virtually eliminating any delay in the internal appeals process.

- ▶ Introducing Integrated Service Units (ISUs) to provide more successful management of workplace injury claims including: utilizing a case management team, including case manager, a vocational rehabilitation counsellor and a physician. The focus is timely and appropriate assistance while recognizing that returning to work is part of the recovery process.
- ▶ Investing in staff training to better meet client's needs. Since 1992, staff have invested extensively in training - 36,000 hours in the last three years - including training on the new *Act*. In 1997 a comprehensive training program on customer service and effective case management was established. Less than 300 claims filed in 1996 and 1997 have proceeded to the external appeal body.
- ▶ Introducing quality assurance measures, including the Case Review Committee, which provides a peer review mechanism for complex decisions. Less than 2.50% of claims filed in 1996 and 1997 have proceeded to the first level of appeal (Reconsideration) and 0.50% of claims filed in 1996 and 1997 have proceeded to the Hearing Officer level of appeal. Less than 0.50% of claims filed in 1996 and 1997 have proceeded to WCAT.
- ▶ Introducing a funding strategy that would allow for the provision of earnings loss benefits while at the same time providing financial stability by gradually and systematically eliminating the unfunded liability by the end of the year 2039. From 1995 to 1998 the WCB's financial position improved beyond that expected in the original Funding Strategy, due in large part to the improving provincial economy. At the end of 1997, the WCB was 50% funded. Although this is an improvement over what was anticipated, Nova Scotia remains the worst funded Board in Canada and has the third highest average assessment rate in the country.
- ▶ Restructuring the rate setting model to ensure the WCB collects sufficient revenues to meet its obligations to injured workers, while maintaining equity among employers. Under the new model those rate groups (groupings of industries) that are responsible for a given percentage of claims costs are responsible as a group for paying that percentage of assessments. The average assessment rate has been stable at \$2.54 since 1994.
- ▶ Further improving the assessment model by the introduction of an experience rating system ensuring a firm's individual premium will be affected by its accident record. Sixty-eight percent of all participating firms received a rate reduction in 1997 because of the experience rating system.
- ▶ Entering into a partnership with the Department of Business and Consumer Services and Revenue Canada in planning the delivery of the Nova Scotia Business Registry (NSBR). Services such as registration, licensing, and other approvals, as well as making payments for those transactions, would all be made available to businesses through multiple access channels, including telephone, fax, Internet, and Access Nova Scotia offices.
- ▶ Introducing the Functional Restoration Program (FRP) for chronic pain cases, based on the principle that early intervention and pain management are critical in assisting workers with chronic pain.

Continuous Improvement

In 1997, the WCB prepared a strategic process to design and implement a client-centred service delivery model. The model, known as the Long-term Business Plan (1998-2002), reflects a three-pronged strategy that includes: (1) the implementation of process/structural improvements, (2) the application of technology to address service and administration issues, and (3) a focus on the establishment of partnerships to make sure the disability benefits and taxation systems are providing optimal service.

To improve the quality and cost of WCB service and administration a series of process and structural improvements are planned:

- redesigning the WCB's front-end registration and initial entitlement processes to pay and assess claims for disability benefits and provide appropriate case management services more quickly. This will be achieved through a shift from the current system of paper dependent reporting (Form 67) to telephone reporting and on-screen authorization of payments. By the year 2002, this new process is intended to result in 90% of claims being paid within 15 days;
- introducing a 'risk management' service to assist employers with high volume/severity-of-accident experience in understanding the nature of business or management issues that may be driving their workers' compensation costs.
- implementing a periodic payment system to provide employers with additional payment options. The periodic payment initiative should improve cash flow for employers and deal with the major issues associated with payment in advance and estimating payroll. Implementation is scheduled for 1999.
- in October 1998, the WCB, Revenue Canada and the Province of Nova Scotia signed a partnership agreement that will enable the WCB to utilize Revenue Canada's Business Number as a single identifier for a registered business. This will set the stage for future opportunities for information and resource sharing, reducing duplication of effort for Nova Scotia businesses.

These initiatives will contribute to the improvement of the WCB's internal service levels and the effectiveness and efficiency of the administrative process.

Corporate Performance Measures

As part of the Board of Directors determination to have an efficient, open and accountable system, a number of corporate performance measures have been created to track the WCB's progress on service improvements and establish clear and attainable goals. The initial rating for these performance measures was based on actual performance, established through current statistical data or customer satisfaction surveys.

The corporate performance measures have only recently been established, and a review of the performance expectations is planned to ensure they are appropriate and attainable as actual performance is compared to the target. It was determined that setting targets at current actual performance levels would not be motivating for the organization.

These targets clearly set goals for the staff and management to strive to attain. Staff development programs and system improvements have been put in place to help achieve the targets.

The corporate performance measures provide a balanced measure of the WCB's performance, including:

- ▶ Service measures, which provide objective measures of the timeliness of the WCB's initial payments to workers and its internal appeal process.
 - Timeliness of Accident Reporting
 - Internal Processing Time
 - Timeliness of First Payment
 - Timeliness of WCB Internal Appeals Decisions
- ▶ Stakeholder Satisfaction measures, which are based on annual surveys of injured workers and registered employers who are asked to rate the WCB's service.
 - Promptness of Benefits Delivery (injured workers)
 - Frequency of Contact (injured workers)
 - Ability of WCB Staff to Answer Questions (injured workers and employers)
 - Clarity of Letters Sent by the WCB (injured workers)
 - Politeness of WCB Staff (injured workers and employers)
 - Clarity of Forms (employers)
 - Promptness of Service (employers)
 - Accessibility of WCB Staff (employers)
- ▶ Financial Measures which are objective measures of the WCB's financial performance and situation.
 - Percentage Funded (assets to liabilities ratio)
 - Real Rate of Return on investment portfolio
 - Average Actual Assessment Rate
 - Administration Costs per \$100 of assessable payroll

Corporate performance measures are tracked and updated regularly as new data become available and are provided quarterly and annually to the Board of Directors, WCB staff, and external stakeholders (via the WCB web site - www.wcb.ns.ca, the annual report and the newsletter, Inside Workers' Compensation.) The WCB's web site includes information on these corporate performance measures, the annual report and the WCB's submission to the Select Committee.

These measures cover key areas of responsibility for the Board of Directors of the Workers' Compensation Board within the workers' compensation system and were established, as highlighted in the Audit report, on the belief that *"Accountability and efficiency within the system can be significantly improved once the implementation of a system of performance measures and results comparison is in place."*

Conclusion

Overall, we agree with many of the report's findings and recommendations and believe it addresses the key issues raised by the stakeholders of the workers' compensation system, highlights the significant improvements the system has undertaken to improve service, and identifies projects currently underway to improve service in the future.

RESPONSE FROM THE WORKERS' ADVISERS PROGRAM

The Workers' Advisers Program was given an opportunity to participate and be informed of all phases of the audit being conducted by the Auditor General. We believe that agencies being audited in such a manner should be given an opportunity to participate fully in the audit process. Throughout this process, we have been given every opportunity to provide meaningful input and to participate fully in the audit process.

We found that the objectives of the audit may have been restrictive for a variety of reasons and therefore, issues important to the Workers' Advisers Program, such as the Program's perceived independence and potential conflicts arising due to the reporting structure under the *Workers' Compensation Act*, were not able to be addressed.

We also feel that there was insufficient time for field work to be conducted to address operation details of the Workers' Advisers Program, such as the appropriateness of performance standards and the appropriateness and adequacy of the intake process and its impact on injured workers. While we certainly understand that audits must be structured, objective and clearly defined to secure the credibility and effectiveness of an audit, it is our belief that restricted time and narrow objectives left certain questions unanswered and resulted in some vague and incomplete recommendations.

We believe that a system such as the Workers' Compensation System in Nova Scotia is designed to protect and preserve the rights of workers and employers and cannot be judged or assessed only by quantitative values. To determine whether or not a system such as this one is effective and adequately serving the people it was designed to serve, an audit must include a very broad look at the impact such a system has on the lives and well-being of its clients. When an audit is severely restricted in time and in objectives, it could lead to decisions being made on the basis of purely quantitative measures, and those of us who are advocates for injured workers would caution the decision makers to not only look to quantitative measures, but also look to the protection of the individual.

Once again, I would like to thank the members of Grant Thornton for their professional work. We appreciate the fact that you kept us involved and would like to thank you for this most enlightening process.

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 list 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 crown corporations and agencies audited by the private sector. This section of our Report contains comments on financial statement audits conducted by the private sector and by this Office.

AUDITS BY THE PRIVATE SECTOR

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

- there was any indication of inadequate controls or accounting records;
- 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 public 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 two corporations.

17.6 *Highway 104 Western Alignment Corporation* - The auditors issued a qualification of opinion due to deficiencies in the Corporation's tolling system. For the four-month period ended March 31, 1998, the auditors were unable to obtain sufficient evidence with respect to the completeness of operating revenue and the accuracy of customer account balances.

17.7 *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, the net loss would have increased by \$3.4 million, the opening deficit would have been reduced by \$3.4 million, and unamortized foreign exchange losses carried forward would be nil.

Financial Controls and Records

17.8 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. Many of these are not serious enough to include in this Report. However, some observations were more significant, and are summarized below.

- The auditors of Highway 104 Western Alignment Corporation noted they encountered numerous deficiencies in the highway operator's tolling system and control procedures. They recommended that the Corporation undertake a regular review of the operator's systems and controls to ensure they are adequate and adhered to on a regular basis. The auditors also recommended the establishment of a process for monitoring the funding and distributions for each of the Corporation's reserve accounts.
- The auditors of the Nova Scotia Alcohol & Gaming Authority reported weaknesses in control over cash receipts and the processing of journal vouchers. The auditors also recommended the Authority take steps to ensure computers and systems are Year 2000 compliant.
- The auditors of the Nova Scotia Arts Council noted that accounting policies and procedures require substantial improvement. Weaknesses were identified in control over cash receipts and official donation slips, payroll records and procedures, bank and general ledger reconciliation procedures, and the process of paying supplier invoices.
- The auditors of the Nova Scotia Liquor Commission noted that accounts receivable and payable subledger reconciliation procedures were not being completed. Last year the auditors reported the need for clarification of responsibilities in the Memorandum of Understanding between the Department of the Environment and the Commission, concerning which organization is to absorb the net gain or loss of the Commission's bottle return program. The auditors noted there was no resolution of this issue during the year.
- The auditors of the Resource Recovery Fund Board Inc. noted a need for regular monitoring of perpetual inventory records and the performance of periodic inventory counts.
- The auditors of the Sherbrooke Restoration Commission reported weaknesses in control over inventory and in bank reconciliation procedures. In addition, the auditors recommended that the Commission investigate the source of computer system problems identified by management and staff, and take steps to ensure computers and systems are Year 2000 compliant.
- The auditors of the Waterfront Development Corporation Limited noted a lack of adequate reconciliation of Harmonized Sales Tax (HST) remittances with the general ledger's HST accounts.

Timeliness of Financial Reporting and Release of Management Letters

17.9 We believe the preparation, audit and release of financial statements and related management letters within six months of year-end is satisfactory.

17.10 The audited financial statements for Sydney Steel Corporation had not been approved and released by the time of the writing of this Report, approximately ten months after year-end. Draft unapproved financial statements for the year ended December 31, 1997 are to be included in the March 31, 1998 *Public Accounts*. Last year we reported that the audits for the 1995 and 1996 fiscal years for Sydney Steel Corporation were not completed. Neither of these two audits were finalized during the current year.

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 described 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* present audited information on the financial position and operating results of all entities which are owned or controlled by government.

17.14 The March 31, 1998 *Public Accounts* do not contain the annual financial statements of the following government-controlled entities.

- Halifax-Dartmouth Bridge Commission
- Nova Scotia Credit Union Deposit Insurance Corporation
- 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 OFFICE OF THE AUDITOR GENERAL

17.16 The following observations resulted from financial statement audits 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 25 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 The Auditor's Reports on the March 31, 1998 financial statements of the Nova Scotia Business Development Corporation Fund and the Industrial Expansion Fund were qualified due to the fact that Executive Council approval of write-offs being reported, required under Section 23 of the Provincial Finance Act, was still outstanding when the statements were released.

System Weaknesses

17.19 We noted situations during our audits where accounting and control 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 include in this Report.

17.20 *Insured Prescription Drug Plan Trust Fund (Seniors' Pharmacare)* - The Seniors' Pharmacare program has incurred deficits totalling \$23.0 million for the three years ended March 31, 1998; due primarily to revenues being insufficient to meet program costs. The Department of Health has funded the deficits to date. Various options for eliminating continuing revenue shortfalls have been examined by the Seniors' Pharmacare Board and the Department of Health. However, no decision has been made concerning program changes to prevent future revenue shortfalls and ensure the program is sustainable over the longer term.

17.21 *Nova Scotia Business Development Corporation* - We noted a lack of segregation of duties relating to the receiving and recording of funds. Compensating controls have been put in place to address this control weakness, but further improvements are required. Staff have indicated that they have addressed this situation in the current year.

17.22 *Nova Scotia Farm Loan Board* - We noted that total loan advances and repayments, as well as other account balances recorded in the Board's financial records, did not agree to the amounts recorded in the Province's accounting records maintained by the Department of Finance. A reconciliation of the Board's records with those at the Department of Finance was not performed until year-end; and upon completion no explanation could be provided for the differences. We recommended that monthly reconciliations be performed on a timely basis.

17.23 *Nova Scotia Fisheries and Aquaculture Development Fund* - The Board of the Fisheries and Aquaculture Development Fund is comprised of ten members from various areas of the Province, all of whom are appointed by Executive Council. At the time of our audit, one Board member was also a senior employee of a company which was the single largest borrower from the Fund. We noted from a review of Board minutes that the member abstained from votes concerning his company's loan applications, but did participate in related discussions. We understand that no other loan applicant has a similar opportunity to appear before the Board to present a case for financial support. We also noted that the Board member participated in discussions concerning loans and guarantee applications of competitors to his company. Upon follow-up, a few months after our audit, we were informed that this person is no longer a member of the Board of Directors.

17.24 *Nova Scotia Housing Development Corporation* - In 1997, the Corporation entered into an agreement to transfer the administration of certain social housing programs from Canada Mortgage and Housing Corporation (CMHC) to the Corporation. In our testing of transactions we noted that legal documents to support the existence, ownership and cost-sharing arrangements for various social housing assets were missing from program files.

17.25 *Provincial Drug Distribution Program* - The Provincial Drug Distribution Program supplies drugs to health care facilities in the Province and is administered by the Nova Scotia Hospital. The Program contracts with vendors in the private sector to supply drugs. The Program may purchase pharmaceuticals from an alternate source if the contract vendor is unable to deliver the items as specified in the contract. Under terms of the contract, the difference between the contract price and the alternate supply price may be recovered from the contract vendor. Currently, the amounts are not recovered and are borne by the Program. We recommended that staff recover from contract vendors all amounts to which the program is entitled. Program management has indicated that the recommendation will be implemented.

17.26 Public Trustee Trust Funds - We noted control weaknesses in the cash receipt and disbursement systems. We recommended that the mail book be reconciled to bank deposits on a regular and timely basis and forms for recording receipts and disbursements be prenumbered.

Legislative and Policy Compliance Weaknesses

17.27 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 are significant enough to describe in this Report.

17.28 Nova Scotia Business Development Corporation - We observed that the Finance Committee, a committee of the Board of Directors, had not reviewed the reserves, arrears and write-offs of the Corporation prior to the preparation of the draft financial statements. In order to comply with the terms of reference approved for the Committee and to improve controls over the management of the funds, the write-offs, reserves and arrears should be reviewed by the Finance Committee prior to finalization of the draft financial statements.

17.29 Nova Scotia Hospital - The Corporate Services Committee of the Hospital approved the writing off of bad debts of \$278,000. Executive Council approval for the write-offs was not sought, as had been done in previous years. Hospital staff obtained an opinion from Department of Finance staff which led them to believe this approval was not required. We recommended that the Hospital seek a legal opinion with respect to whether the requirement for Executive Council approval for write-offs, as described in Section 23(1) of the Provincial Finance Act, applies to the Hospital.

17.30 As we reported in previous years, 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.

17.31 Pension Funds - The Teachers' Pension Act requires that a formal actuarial valuation be conducted for the Teachers' Pension Fund every three years. The Fund was due for its triennial valuation effective July 31, 1997. However, the valuation was not started until the latter part of 1998 and had just been finalized at the time this Report went to print in December 1998. At the request of management, we deferred the completion of our audit of the Fund's March 31, 1998 financial statements until this valuation was completed.

17.32 Originally, it was thought that the Public Service Superannuation Fund (PSSF) was due for its triennial actuarial valuation as at March 31, 1998 since the Fund's March 31, 1997 statements indicated the last such review was completed as at March 31, 1995. However, it was subsequently brought to our attention that a full valuation had been completed as at December 31, 1996. We were not provided timely notice of this review and, as a consequence, there was a significant delay in the completion of our audit of the PSSF's March 31, 1998 financial statements.

17.33 The Teachers' Pension Act provides for the appointment of a Teachers' Pension Board. However, after passing of the new Act in 1989 the terms of Board members were allowed to expire, with no effort made to appoint new members. As a result, the Board ceased to function for a period. Board appointments were made effective May 1998. However, management indicated that, pending planned changes to the Act, the current appointments were made to deal with appeals only, and not all of the other Board responsibilities under the Act.

17.34 Changes to the Members' Retiring Allowance Act on November 25, 1993 established the Members' Supplementary Retiring Allowances Plan. As in prior years, we recommended that there be an appropriate segregation of the accounting for and reporting on the supplementary plan's contributions, interest, refunds and allowances from that of the original plan.

17.35 *Upper Clements Family Theme Park Limited* - Upper Clements Family Theme Park Limited entered into an agreement with a private sector agency for the operation of the Park. We noted that the crown corporation may not have fully complied with the agreement with respect to the timing of the payment of annual operating grants.

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.

17.37 The Auditor's Report for the Nova Scotia Teachers' Pension Fund's March 31, 1998 financial statements had not been issued at the time of writing this Report because management had been waiting for completion of the actuarial valuation necessary for the completion of the financial statements.

OTHER AUDIT OBSERVATIONS

18.**ADDITIONAL APPROPRIATIONS****BACKGROUND**

18.1 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.

18.2 The Provincial Finance Act provides the Executive Council the authority to approve 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.

18.3 The Expenditure Control Act Section 12(2) provides “*Notwithstanding subsection (1), an amount may be expended in a fiscal year for net program expenditures and net debt servicing costs that is no more than one percent more than the amount appropriated by the Legislature for those net program expenditures and forecast to be spent on net debt servicing costs.*” Section 13 of the Expenditure Control Act requires that expenditures in excess of the one percent threshold “*may only be made after a resolution has been passed by the House of Assembly authorizing the expenditure.*” A resolution of the House of Assembly provides the authority for an additional appropriation. For purposes of this chapter, any additional spending authority related to a resolution of the House of Assembly under Section 13 of the Expenditure Control Act is included as an additional appropriation.

18.4 Exhibit 18.1 on page 231 includes extracts from the Provincial Finance Act relating to additional appropriations and special warrants. Exhibit 18.2 on page 232 includes extracts from the Expenditure Control Act.

18.5 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 over-expenditure situation. Depending on the circumstances, an additional appropriation may be necessary. Further, it was indicated by Finance that it waits to obtain an additional appropriation until it knows with a high degree of certainty the exact amount of the additional appropriation. Finance also stated, the exact amount is not known until year end adjustments are made. Per Finance, the current practice avoids seeking additional appropriations for minor amounts.

18.6 Finance also indicated that it is reluctant to seek approval of additional spending authority when there is a good probability that departmental spending pressures can be managed down to the original budgetary limit.

18.7 Section 9(2)(e) of the Provincial Finance Act requires that the *Public Accounts* include a summary listing of any additional appropriations or special warrants authorized for the fiscal year. Under Section 9A(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

18.8 The following are the principal results from our 1998 review of additional appropriations and special warrants:

- The timing of approvals of additional appropriations continues to be a concern. Two additional appropriations for the 1997-98 fiscal year were approved by the Executive Council. A resolution seeking additional spending authority was submitted to the House of Assembly for approval. Once approved, a third additional appropriation will be sought. However, all of the related expenditures had been incurred before the approvals were received or requested.
- There were additional appropriations totalling \$222,977,000 approved or requested for the fiscal year ended March 31, 1998. None of the additional appropriations had received approval prior to March 31, 1998 (i.e., before the over-expenditures had been incurred). Further, at the time this chapter was written, approval of additional appropriations totalling \$184.3 million required for the 1997-98 fiscal year was outstanding.
- There were no special warrants approved for the 1997-98 fiscal year.

SCOPE OF REVIEW

18.9 The objective of our annual review of additional appropriations and special warrants is to determine if they were properly authorized in accordance with the provisions of the Provincial Finance Act and where appropriate, the Expenditure Control Act.

PRINCIPAL FINDINGS

Additional Appropriations

18.10 The Appropriations Act, 1997 contained 38 votes for expenditures totalling \$4,605 million (including sinking fund instalments and serial retirements of \$192.5 million). There were additional appropriations totalling \$222,977,000 approved or requested for the fiscal year ended March 31, 1998.

18.11 Additional appropriations were approved by the Executive Council under Section 28 of the Provincial Finance Act on May 5, 1998 and June 30, 1998. Further, a resolution, under Section 13 of the Expenditure Control Act, was submitted to the House of Assembly on November 26, 1998, but was yet to be approved as of early December 1998 when this Report went to print.

18.12 In our view, incurring expenditures before the necessary additional spending authority is in place, may be contrary to the Provincial Finance Act and the Expenditure Control Act. Further, the timing of these approvals impairs the effective control of and accountability for expenditures in excess of original spending authority limits.

18.13 Our review noted that votes for five departments, one public service and Restructuring Costs listed below accounted for approximately 96% of the total additional appropriations for 1997-98.

	(\$ millions)
Health	\$140.9
Restructuring Costs	22.8
Economic Development and Tourism	14.1
Labour	13.3
Community Services	9.1
Transportation and Public Works	7.3
Public Service - Legislative Services	<u>6.7</u>
	<u>\$214.2</u>

18.14 Based on information provided to us, the more specific details on the additional appropriations for three of the departments is as follows:

- **Health** - The Department of Health required additional funding for costs associated with Regional Services, Emergency Health Services, Pharmacare, Long-term Care, the Physician's Agreement and capital. A resolution for the additional appropriation was submitted to the House of Assembly on November 26, 1998. The resolution had not been approved at the time this Report went to print.
- **Economic Development and Tourism** - Additional funding was required in order to recognize the present value of the concessionary assistance provided to Michelin. The additional appropriation was approved by Order in Council (OIC) on June 30, 1998.
- **Labour** - The Department of Labour required additional funding to meet a previous obligation to the Workers' Compensation Board to stabilize employer's contribution rates. A resolution for the additional appropriation was submitted to the House of Assembly on November 26, 1998. The resolution had not been approved at the time this Report went to print.

18.15 It was indicated that the Restructuring Costs were related to all departments. The additional authority was required for salary negotiations, labour restructuring costs in the health acute care sector and costs associated with physician managed care initiatives. A resolution for the additional appropriation was submitted to the House of Assembly on November 26, 1998. The resolution had not been approved at the time this Report went to print.

18.16 The following is a list of additional appropriations totalling \$222,977,000 for the year ended March 31, 1998.

Additional Appropriations

Department	Date Approved	Authorized
Approved by OIC		
Agriculture and Marketing	June 30, 1998	\$ 1,421,000
Business and Consumer Services	June 30, 1998	678,000
Community Services	May 5, 1998	9,050,000
Economic Development and Tourism	June 30, 1998	14,095,000
Fisheries and Aquaculture	June 30, 1998	219,000
Natural Resources	June 30, 1998	2,844,000
Public Service		
Government Contributions to Benefits Plans	May 5, 1998	168,000
Government Contributions to Benefits Plans	June 30, 1998	5,000
Human Rights Commission	May 5, 1998	125,000
Legislative Services	May 5, 1998	6,698,000
Office of the Ombudsman	May 5, 1998	65,000
Public Inquiry, Westray Mine	May 5, 1998	275,000
Public Prosecution Service	May 5, 1998	836,000
Technology and Science Secretariat	June 30, 1998	2,163,000
Pending Approval By Resolution in the House of Assembly		
Health		140,916,000
Labour		13,307,000
Public Service		
Technology and Science Secretariat		15,000
Restructuring Costs		22,757,000
Transportation and Public Works		<u>7,340,000</u>
		<u>\$ 222,977,000</u>

Special Warrants

18.17 We are required under Section 9A(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 Executive 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."

18.18 There were no special warrants approved for the 1997-98 fiscal year.

CONCLUDING REMARKS

18.19 Expenditure of funds beyond the votes or appropriations approved by the House of Assembly continues to occur prior to Executive Council approval required under the Provincial Finance Act or the passing of a resolution by the House of Assembly under the Expenditure Control Act. Finance has indicated that the determination of exact numbers is necessary to avoid seeking additional appropriations for minor amounts. If the objective is to ensure adequate controls over the spending authority are in place, forecasting should be used to determine the additional appropriation. By using forecasting methods, the authority could be put in place prior to the incurrence of the expenditures thereby improving the control over the expenditure process.

18.20 Current legislation and administrative practices raise questions as to the effectiveness of the House of Assembly's control over the expenditure of public funds. The practice of obtaining after-the-fact approval for additional appropriations does not necessarily constitute *effective control* and, we believe, may contravene the intent of the requirements of the Provincial Finance Act and the Expenditure Control Act.

Exhibit 18.1**EXTRACTS FROM THE PROVINCIAL FINANCE ACT*****Prerequisite to issue of 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.*

Consequences 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.*

Suspension of right to commit

27(A) *The Governor in Council, upon the recommendation of the Minister, may order the suspension for such a period as the Minister deems fit of the right to commit any appropriation or part thereof except the salaries, wages and expenses of members of the public service, including the civil service, or the indemnities and expenses of the members of the House of Assembly.*

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 therefore, 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.*

EXTRACTS FROM EXPENDITURE CONTROL ACT - PART II**Application of Part II**

11 For greater certainty, this Part applies to the 1996-97 and subsequent fiscal years of the Province.

Limits on appropriations

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 program expenditures and the net debt servicing costs as defined in the budgetary summary of the annual Estimates of the Province shall not exceed the amount of revenue estimated by the Minister for that fiscal year.

(2) Notwithstanding subsection (1), an amount may be expended in a fiscal year for net program expenditures and net debt servicing costs that is no more than one per cent more than the amount appropriated by the Legislature for net program expenditures and forecast to be spent on net debt servicing costs.

(3) Where net program expenditures and net debt servicing costs for a fiscal year exceed revenue 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.

(4) Where the amount of revenue received or to be received by the Minister in a fiscal year exceeds the amount appropriated by the Legislature for net program expenditures and the net debt servicing costs for that year, the resulting surplus shall, after accounting for any recoveries required pursuant to subsection (3) and any additional expenditures referred to in subsection (2) or Section 13, be used to reduce the public debt of the Province or reduce taxes, or both.

Requirement for resolution of House

13 Where net program expenditures and net debt servicing costs for a fiscal year exceed the amount authorized to be spent pursuant to Section 12, the expenditures in excess of the amount authorized by subsections 12(1) and (2) may only be made after a resolution has been passed by the House of Assembly authorizing the expenditure.

19.**CASH AND OTHER LOSSES****BACKGROUND**

19.1 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.

19.2 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 losses identified by or reported to us.

RESULTS IN BRIEF

19.3 The following summarizes our principal findings from our 1998 review.

- The losses reported to us for the year ended March 31, 1998 totaled \$335,537; consisting of cash losses of \$10,787, property losses estimated at \$349,750 and recoveries of \$25,000.
- Overall the departments and crown agencies are not complying on a timely basis with the loss reporting requirements of the Management Manual.
- Entities that report throughout the year have been reporting to both the Office of the Auditor General and the Department of Finance.

SCOPE OF REVIEW

19.4 Our objective was to review the information provided by departments and agencies, and compile a summary listing of the cash and property losses reported to us for the year ended March 31, 1998.

19.5 We sent letters to departments and crown agencies to confirm the completeness of the losses reported to us. Further, we have performed no additional or specific audit procedures on the losses reported.

19.6 This review did not consider the losses which resulted from write-offs of uncollectible receivables or advances approved annually by Executive Council.

PRINCIPAL FINDINGS***Losses Reported***

19.7 The following is a summary of the cash and property losses for the year ended March 31, 1998 identified either as a result of our confirmation request or reported to us during the year.

Losses reported by the entities for property lost or damaged are determined on a historical cost, estimated market value or estimated replacement cost basis.

Departments Reporting Losses	Cash	Property	Recoveries	Total
Business and Consumer Services	\$ 414	\$ 8,797	\$ -	\$ 9,211
Communications Nova Scotia	-	800	-	800
Community Services	-	8,319	-	8,319
Economic Development and Tourism	520	2,832	-	3,352
Health	-	9,845	-	9,845
Housing and Municipal Affairs	-	3,600	-	3,600
Human Resources	-	3,223	-	3,223
Justice	1,065	300	-	1,365
Labour	200	8,047	-	8,247
Natural Resources	470	66,690	-	67,160
Transportation and Public Works	-	118,508	(25,000)	93,508
	<u>2,669</u>	<u>230,961</u>	<u>(25,000)</u>	<u>208,630</u>
Crown Agencies Reporting Losses				
InNOVAcorp	-	6,621	-	6,621
Nova Scotia Hospital	404	-	-	404
Nova Scotia Liquor Commission	7,647	104,745	-	112,392
Nova Scotia Review & Utility Board	-	7,223	-	7,223
Nova Scotia Sport & Recreation Commission	-	200	-	200
Office of the Speaker	67	-	-	67
	<u>8,118</u>	<u>118,789</u>	<u>-</u>	<u>126,907</u>
Total Reported	<u>\$ 10,787</u>	<u>\$ 349,750</u>	<u>\$ (25,000)</u>	<u>\$ 335,537</u>

19.8 The above table is not complete as not all departments and crown agencies have included values for property items which have been lost, damaged or destroyed. For example, the Department of Justice reported that, based on information in its fixed asset inventory system, 66 items have been misplaced and 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. Further, the Department of Labour gave loss values to two items it reported to Finance but did not include those values when it reported to our Office. As well, four other departments reported losses of specific items but did not provide information on the cost or estimated value of the lost items.

19.9 With 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.

Compliance with Reporting Requirements

19.10 Not all entities are complying with the requirement to report losses on a timely basis to Finance and this Office. Failure by some 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.

19.11 There were two losses with a total value of \$6,134 that were reported during this fiscal period that relate to the 1996-97 fiscal period. These items were not received on a timely basis and therefore were not included in that year's Cash and Other Losses report. They are not included in the above listing.

CONCLUDING REMARKS

19.12 None of the specific losses reported to us with respect to the 1997-98 fiscal year appear to be of such significance (i.e., due to the nature, circumstances or size of the losses) that they warrant further or special attention by this Office at this time. We will consider the results of the Department of Finance internal audit group's work on these reported losses as part of our 1999 review.

20.**CLAIMS UNDER FEDERAL-PROVINCIAL AGREEMENTS****INTRODUCTION**

20.1 The Province has entered into a number of agreements with the Government of Canada for various cost-shared programs. Our Office audits programs and sub-programs under certain of these agreements. For the year ended March 31, 1998, we commenced audits of claims under six separate agreements (although not all of these audits were completed at the time of the writing this Report). The agreements were administered by three government departments and two Provincial agencies. Total estimated expenditures under these agreements amounted to \$23 million of which \$15 million is estimated to be recoverable from the Government of Canada. Since our last Report, we also finalized the audits of claims under five separate agreements for the year ended March 31, 1997.

20.2 Our responsibility is to determine whether the departments and agencies concerned have complied with the terms of the agreements and whether the amounts incurred and claimed are in accordance with the agreements. Also, as part of our audits, we review and evaluate the systems used to control the processing of expenditures under the agreements.

PRINCIPAL FINDINGS***Reservation of Opinion***

20.3 This year there were two cases where it was necessary to express reservations of opinion.

20.4 *Canada/Nova Scotia Development Fund Agreement* - Consulting and Audit Canada is contracted by Natural Resources Canada to conduct an annual audit of expenditures incurred under this agreement. We qualified our audit opinion on the 1996-97 claim because the Management Committee responsible for the agreement had not determined whether it would accept the adjustments recommended in the audit report prepared by Consulting and Audit Canada for the year ended March 31, 1997.

20.5 *Agreement on Sustainable Economic Development* - We qualified our audit opinion on the 1996-97 claim under this Agreement. We were unable to determine whether the correct amounts were paid to applicants for projects administered by the former Nova Scotia Centre for Environmentally Sustainable Economic Development, based upon the information contained in the project files. We were also unable to determine which projects had been approved by the Federal/Provincial Management Committee and claimed under the Nova Scotia Environment Industries and Technologies program.

Client Readiness

20.6 We consider client readiness to be a critical factor in the timely completion of claims audits.

20.7 *Agreements on Canada Assistance Plan and Vocational Rehabilitation of Disabled Persons* - We have not finalized the audits of the claims under these two agreements for the fiscal year ended March 31, 1996 because we are awaiting information from the Department of Community Services. We have not started our audit of the claim under the Vocational Rehabilitation of Disabled Persons Agreement for the fiscal year ended March 31, 1997 because we have not yet received the claim.

The Canada Assistance Plan agreement expired on March 31, 1996, thus there is no 1996-97 claim to be audited for this agreement.

Other Findings

20.8 As a result of our claims audits, we have other findings and observations concerning the management and control of Federal/Provincial Agreements. Although they were not of a sufficient magnitude to require a reservation of opinion, some are significant enough to include in this Report.

20.9 *Canada/Nova Scotia Development Fund Agreement* - Under the Industrial Assistance - Shipyard Assistance Program, applicants are required to fund 25% of the total project cost by means of internal funding or a repayable loan from the Province. The Province is required to spend a sum equivalent to the repaid portion of the loans on additional infrastructure projects. The Management Committee responsible for the agreement has not resolved a number of issues related to the Program. These issues relate to the write-off of amounts owed to the Province, whether interest received on these loans should be returned to the Fund to reduce the total cost of the program, and how the proceeds of the potential sale of two shipyards will be allocated between the Province and the Fund.

20.10 *Agreement on Legal Aid* - 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 there was insufficient information on file for us to determine whether they met the Commission's financial eligibility requirements.

OFFICE OF THE AUDITOR GENERAL

21.

REPORT ON THE OFFICE OF THE AUDITOR GENERAL

MANDATE

21.1 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 on page 252 of this Report includes extracts of the audit mandate and reporting sections of the Auditor General Act.

21.2 Some other Provincial statutes and regulations, as well as other enabling arrangements for certain entities, provide additional or more specific 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. The Office's mandate with respect to the review of the annual revenue estimates is quite unique. During 1998, amendments to the Auditor General Act were passed expanding the Auditor General's Mandate, most notably with regard to the audit of the *Public Accounts* commencing with the fiscal year ended March 31, 1999.

21.3 In addition to the Office's statutory mandate(s) there have been instances where audit coverage by this Office has been incorporated into policy guidelines and control standards approved by government. For example, see the extracts from internal policy and standard guidelines in Appendix 21A on page 250. Further, the Department of Finance's draft policy for debt management also includes reference to specific involvement by this Office.

21.4 While we do not take exception to general reference to the Office's work in such policy statements, we are concerned that there may be some misunderstanding about the nature, extent or timing of our coverage in such regards. As presented, it could be interpreted that this Office actively audits each of the respective areas or matters on a detailed and almost continuing basis. This may not be the case, since each year we make decisions as to which aspects of government operations and control will get specific and more detailed coverage.

MISSION, VISION AND VALUES

21.5 Exhibit 21.1 on page 247 is an extract from the Office's *Business Plan* which had been prepared after consideration of the guidelines issued within government for use by departments and agencies.

STRATEGIC GOALS AND OBJECTIVES

21.6 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.

21.7 These goals are reviewed each year and will continue to evolve. Further, we monitor our overall performance against these goals.

CORE BUSINESS FUNCTIONS

21.8 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 each of these our function is to provide information to the House of Assembly, and where appropriate, 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 and by responding to queries.

OUTCOME MEASURES

21.9 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.

21.10 We have begun to gather and consider general information against these outcome measures, and are committed to making this a more formal and integral element of our ongoing planning and performance management processes. Further, initiatives within the legislative audit community, particularly under the auspices of the Canadian Council of Legislative Auditors (CCOLA), have provided more structured and detailed mechanisms that will support our efforts in this regard.

ORGANIZATION

21.11 As at December 1998, we had 24 staff. Subject to the availability of funds, we outsource for specialist expertise and other audit resources on selected assignments.

21.12 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 three teams each headed by a senior manager. Staff members are periodically rotated among the teams to provide career development opportunities, technical training, and to meet operational priorities. Each of the senior managers reports to the Auditor General, participates in the overall management of Office activities, has overall responsibility for a group of departments and agencies, and is the prime focus for communications with those organizations.

21.13 In order to ensure continuity within the Office, a recommendation was made to the Governor in Council for the appointment of a senior manager from within the Office to the position of Deputy Auditor General. This appointment was made, and in addition the titles of the other two senior managers were changed to Assistant Auditor General to more accurately reflect their responsibilities.

21.14 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.

21.15 Exhibit 21.3 on page 249 provides summary financial information on the Office's operations. Staff costs consistently account for 80% or more of the Office's expenditures on an annual basis.

21.16 The Office's restructuring and downsizing initiatives in recent years were supported in part by increased use of information technology resources, including a system obtained from the Federal Department of Public Works and Government Services Canada.

COMMITTEE OF INDEPENDENT ADVISORS

21.17 In 1994 an Independent Advisory Committee of senior members of the business and academic community was established. The terms of reference for the committee are provided in Exhibit 21.2 on page 248. Certain other legislative auditors in Canada successfully use similar advisory committee arrangements.

21.18 The creation of this group and its participation have been positive initiatives, and we appreciate the open and insightful contributions it continues to make to our efforts to plan and manage the Office's activities and outputs.

PROFESSIONAL AFFILIATIONS AND ACTIVITIES

21.19 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 Council of Legislative Auditors (CCOLA)

The Canadian Institute of Chartered Accountants (CICA)

CCAF-FCVI Inc.

The Certified General Accountants Association

The Financial Management Institute

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

21.20 Professional staff at all levels participate as members of committees, by providing input and commentary on research publications, and by attending various professional conferences, seminars and meetings.

PERFORMANCE

21.21 In addition to our required and planned assignments, the Office continued to receive various general and specific matters referred to it from sources external to the Office, including government, opposition parties and the general public. Our ability to react or respond to such matters, if appropriate, is contingent on our available resources and other priorities.

21.22 Overall, we are pleased with our achievements in the past year, but much remains to be done. The following are summary comments on the Office's activities and accomplishments over the past year.

- We continue to be the only legislative audit office in Canada that provides an opinion on a 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.
- We again made successful use of external contract audit resources to meet our financial statement audit deadlines. With the increasing workload relating to annual financial statement attestation, the Office will continue to expand its use of contracted resources.

- Staff development continues to be a priority, particularly in the area of information technology.
- The use, control and audit of information technology resources is of strategic importance to the performance of the Office. We have made significant investments in recent years aimed at providing our staff with the resources, training and support processes needed. This will represent an ongoing and continuing commitment by the Office, and we monitor the results and payback of the related investments.
- We have inventoried and assessed our risks and exposures to the Year 2000 problem and its potential impact on our business functions and activities. Our overall risks have been assessed as low since most of our hardware and software are already compliant.
- The Office continues to receive requests for information on or demonstration of the Lotus Notes based audit suite which we implemented in order to automate more of our audit process and file working papers.
- An internal review of our audit methodology and practices, including consideration of the implication of the CICA's new standards for assurance engagements, was conducted and a number of matters requiring senior management consideration have been identified.
- At the request of government, an assignment was conducted and special report issued on the O'Connell Drive Elementary School lease.
- At the request of the Nova Scotia School Boards Association, we audited the Teachers' Salary Continuation Plan and issued a report.
- With Finance, we jointly sponsored an external assessment of the controls relating to the new corporate financial management system. Audit staff from Finance, and this Office worked with the successful proponent on this assignment.
- At the request of Executive Council an audit of the Workers' Compensation System was completed and a special report issued in November 1998. The audit work was tendered and contracted to an external firm, although two staff from our Office participated in the performance of the assignment.
- We commenced a joint audit of the Federal/Provincial Infrastructure Works Program with the Federal Office of the Auditor General, and are participating in a study group of the Canadian Council of Legislative Auditors on joint audits.
- We initiated discussions with government's internal audit community to improve liaison and coordination of our respective audit mandates and resources.
- Due to statutory changes passed in June 1998 requiring release of the Auditor General Report by December 31, we adjusted our audit timetable and schedule in order to have this year's Report ready for release approximately a month earlier than last year.
- We continued our participation in a Canadian Council of Legislative Auditors study group on performance management and reporting by the legislative audit function, and remain committed to expanding our use of various performance indicators which have been identified through the study group.

- The Office has established an occupational health and safety (OH&S) committee as required by statute and government policy. The results of an initial assessment of the Office as it relates to OH&S identified opportunities for improvement, which are to be considered by the committee and senior management.

PRIORITIES

21.23 Strategic and long-range planning for the Office is based on an analysis of the Office's audit universe. This gives due consideration to the needs of the Legislature, areas of risk, major themes and, of course, availability of resources.

21.24 On the administrative side, our priorities are to continue to operate within our expenditure control plan. This will entail filling certain vacancies that arise as a result of retirements or resignations with more junior professional staff.

21.25 Within these overall strategic priorities, our specific goals are the following:

- To improve the quality of our audits, including the work related to the Office's new public accounts audit mandate, 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.
- To complete our remediation, testing and implementation of the changes to address our Year 2000 issues and risks.
- To build on and expand the use of information technology as a means of optimizing the cost effectiveness of Office resources.

21.26 In addition to the above and the specific audit projects planned in 1999, we plan to:

- Successfully plan and perform the audit of *Public Accounts* as at March 31, 1999.
- Make further scheduling adjustments such that the *1999 Report of the Auditor General* can be ready for release by early December 1999.
- As necessary or requested, provide constructive and timely 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 the extent appropriate this will include timely audit input and advice during the development of proposed improvements.
- Be prepared 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 audit functions in other jurisdictions.

- Continue our involvement and support for the CCOLA and its various study groups and other efforts.
 - Pursue opportunities to conduct joint or concurrent audits in selected areas with the legislative audit functions in other jurisdictions.
 - Make decisions and implement any necessary changes to our audit methodology and practices, including adhering to the CICA's new standards for assurance engagements.
 - Continue efforts to enhance liaison and coordination with the internal audit community within government, especially in relation to achieving cost-effective audit coverage of significant areas of common concern across government. For example: the adequacy of financial systems and controls, the year 2000 issue, as well as compliance with government's procurement policies and information technology standards.
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*Exhibit 21.1***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.

*Exhibit 21.2***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.

Exhibit 21.3

OFFICE OF THE AUDITOR GENERAL SUMMARY FINANCIAL INFORMATION			
	1997-98 Estimate	1997-98 Actual	1998-99 Estimate
Salaries & Benefits	<u>\$ 1,486,400</u>	<u>\$ 1,303,674</u>	<u>\$ 1,505,600</u>
Operating Costs			
- Travel	69,500	40,434	57,000
- Professional & special services	23,000	68,823	40,000
- Supplies & services	81,000	74,380	85,200
- Other (including IT related costs)	<u>75,900</u>	<u>132,334</u>	<u>130,000</u>
	<u>249,400</u>	<u>315,971</u>	<u>312,200</u>
Gross Expenditure	1,735,800	1,619,645	1,817,800
<i>Less:</i> Fees & other charges	<u>(112,800)</u>	<u>(143,300)</u>	<u>(112,800)</u>
Net Expenditures	<u>\$ 1,623,000</u>	<u>\$ 1,476,345</u>	<u>\$ 1,705,000</u>
<p>(1) During 1997-98, the Office reallocated certain staff costs to fund technology investments. Also during 1997-98, the Technology & Science Secretariat acquired information technology resources for the Office at a cost of \$25,000, which are not included above.</p> <p>(2) The costs associated with the Office's leased premises are not included above. Those costs - approximately \$108,669 for 1997-98 - are reported by the Department of Transportation and Public Works.</p>			

*Appendix 21A***Extracted from Procurement Guidelines***Audit*

All procurement activities will be subject to such audit processes as may be determined appropriate by the Auditor General or the Auditor General in consultation with the Procurement Branch. Two forms of audit may occur. A compliance audit may be conducted to determine the level of adherence with established procurement rules and policies. A quality audit may also be undertaken in conjunction with or separately from compliance audits. The quality audit will examine the process undertaken and decisions reached from a defensibility and accountability point of view. Departments experiencing unacceptable compliance or quality audits and, in the opinion of the Minister of Finance, fail to undertake suitable measures for their resolution, may have all delegated procurement authority revoked until such time as satisfactory steps have been taken.

All procurement activities will be subject to audit by departmental internal auditors and specific audits as instructed by the Procurement Branch.

Extracted from Information Technology (IT) Standards*Review for Compliance:*

Perform formal review of various departments' use of IT standards. Done by the Office of the Auditor General.

Audit Process and Report:

Produce formal audit report on departments' use of IT Standards. Done by the Office of the Auditor General.

Audit for Benefit and Value:

Perform audit of IT standards use in departments regarding the benefit and financial value. Done by the Office of the Auditor General.

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 on the financial statements of the Government that are included in the public accounts required under Sections 9 and 10 of the Provincial Finance Act, respecting the fiscal year then ended.
- (2) The report forms part of the public accounts and shall state
 - (a) whether the Auditor General has received all of the information and explanations required by the Auditor General; and
 - (b) whether in the opinion of the Auditor General, the financial statements present fairly the financial position, results of operations and changes in financial position of the Government in accordance with the stated accounting policies of the Government and as to whether they are on a basis consistent with that of the preceding year.
- (3) Where the opinion of the Auditor General required by this Section is qualified, the Auditor General shall state the reasons for the qualified opinion.

SECTION 9A

- (1) The Auditor General shall report annually to the House of Assembly and may make, in addition to any special report made pursuant to this Act, not more than two additional reports in any year to the House of Assembly on the work of the Auditor General's office and shall call attention to every case in which the Auditor General 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 provision of the *Provincial Finance Act*, authorized the payment of money; or
 - (g) money that is authorized to be expended by the Legislature has not been expended with due regard to economy and efficiency,
- (2) The annual report of the Auditor General shall be laid before the House of Assembly on or before December 31st of the calendar year in which the fiscal year to which the report relates ends or, if the House is not sitting, it shall be filed with the clerk of the House.
- (3) Where the Auditor General proposes to make an additional report, the Auditor General shall send written notice to the Speaker of the House of Assembly thirty days in advance of its tabling or filing pursuant to subsection (2).
- (4) Whenever a case of the type described in clause (1)(a), (b), or (e) comes to the attention of the Auditor General, the Auditor General shall forthwith report the circumstances of the case to the Minister.
- (5) 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.
- (6) 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 9B

- (1) 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.
- (2) The opinion of the Auditor General shall be tabled with the budget address.

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.

Section 9 of the *Auditor General Act* was repealed and replaced with Sections 9, 9A and 9B by Chapter 5 of the Acts of 1998, the *Auditor General Act and Provincial Finance Act (amended)*, which received Royal Assent on June 29, 1998. Section 3 of that Act states “This Act applies to the 1998-99 and subsequent fiscal years.”

*Appendix II***CROWN CORPORATIONS, BOARDS, COMMISSIONS AND FUNDS****Financial Statement Audits Performed by Auditor General*****Agricultural Organizations***

Nova Scotia Crop and Livestock Insurance Commission
Provincial Community Pasture Board

Educational Institutions

Atlantic Provinces Special Education Authority

Health Organizations

Insured Prescription Drug Plan Trust Fund
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 and Aquaculture Development Fund
Nova Scotia Housing Development Corporation

Pension Funds

Members' Retiring Allowances Act Accounts
Nova Scotia Teachers' Pension Fund
Public Service Superannuation Fund

Other

Environmental Trust Fund
Nova Scotia Film Development Corporation
Nova Scotia Gaming Corporation
Nova Scotia Gaming Foundation
Nova Scotia Innovation Corporation
Nova Scotia Legal Aid Commission
Nova Scotia Primary Forest Products Marketing Board
Nova Scotia Talent Trust
Public Accountants Board of Nova Scotia
Public Trustee Trust Funds
Upper Clements Family Theme Park Limited

Financial Statement Audits Performed by Private Sector Auditors

Art Gallery of Nova Scotia
Atlantic Lottery Corporation Inc.
Canada-Nova Scotia Offshore Petroleum Board
Council of Maritime Premiers
Halifax-Dartmouth Bridge Commission
Highway 104 Western Alignment Corporation
Nova Scotia Alcohol & Gaming Authority
Nova Scotia Arts Council
Nova Scotia Credit Union Deposit Insurance Corporation
Nova Scotia Liquor Commission
Nova Scotia Municipal Finance Corporation
Nova Scotia Police Commission
Nova Scotia Power Finance Corporation
Nova Scotia Resources Limited
Nova Scotia Utility and Review Board
Public Archives of Nova Scotia
Queen Elizabeth II Health Sciences Centre
Resource Recovery Fund Board Inc.
Sherbrooke Restoration Commission
Sydney Environmental Resources Limited
Sydney Steel Corporation
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**Review by Auditor General of revenue estimates**

The Auditor General shall annually review the estimates of revenue used in the preparation of the annual Budget Address of the Minister to the House of Assembly and provide the House of Assembly with an opinion on the reasonableness of the revenue estimates.

These sections of the *Provincial Finance Act* were repealed by Chapter 5 of the Acts of 1998, the *Auditor General Act and Provincial Finance Act (amended)*, which received Royal Assent on June 29, 1998. Section 3 of that Act states, "This Act applies to the 1998-99 and subsequent fiscal years."
