CROWN AGENCIES AND CORPORATIONS

11.

NOVA SCOTIA LIQUOR COMMISSION

BACKGROUND

11.1 The Nova Scotia Liquor Commission derives its mandate from the Liquor Control Act. It is responsible for the purchase, distribution and sale of liquor within the Province. In addition, the Commission may own or lease premises to sell liquor, grant licences and permits to purchase or use liquor for specialized purposes (eg., by hospitals or physicians) and determine, subject to the approval of Executive Council, the municipalities within which liquor may be sold. The Liquor Control Act mandates a separate agency - the Nova Scotia Alcohol and Gaming Authority - to grant licences to operate establishments for the sale and consumption of liquor.

11.2 The Act also gives the Commission a responsibility to regulate various practices of brewers, distillers and vintners such as marketing, advertising and packaging. In addition, the Commission regulates micro-breweries, farm wineries and manufacturers' retail stores, and the possession and use of liquor by groups and individuals.

11.3 The Commission was established in 1930 when the Liquor Control Act was passed into law. It is governed by a Board of up to three Commissioners who are appointed by Executive Council for ten-year terms. They are accountable to the Minister responsible for the Liquor Control Act who, at the time of the writing of this Report, was also the Minister of Tourism and Culture. On December 31, 1998 the term of one of the Commissioners expired, and the position was still vacant at the time of our audit.

11.4 The Commission operates 100 self-service stores throughout the Province. The head office and distribution centre used to supply the stores are located in the Bayers Lake Industrial Park in Halifax. The largest concentration of liquor outlets is in the Halifax Regional Municipality, where 34 of the stores are located. As of March 31, 2000 these stores accounted for approximately 43% of the Commission's sales revenue.

11.5 The Commission's net income from operations was $135.2 million for the year ended March 31, 2000. The Commission's net sales for this period were $371.4 million. Costs associated with store operations were $33.8 million and costs associated with administration and warehouse distribution totalled $12.4 million.

11.6 All profits of the Commission are transferred to the Department of Finance by way of regular payments throughout the year. Over and above net income, Harmonized Sales Tax collected on behalf of the Provincial and Federal governments was approximately $54.2 million for the year ended March 31, 2000, of which the Provincial share was $28.9 million.

11.7 Additional financial and statistical information relating to the Commission is provided in Exhibits 11.1 to 11.3, beginning on page 199.

RESULTS IN BRIEF

11.8 The following are the principal observations from this audit.

- The Board of the Commission performs its governance responsibility reasonably well.

- The number of Commissioners should be expanded beyond the maximum of three allowed by the Liquor Control Act in order to increase the effectiveness of the governance function.
- No formal performance evaluation is prepared for any member of senior management.
- The annual report lacks substantive information on the performance of the Commission, and thus does not fulfill its potential as an accountability document.
- The Liquor Control Act is out-dated in areas and is in need of significant review.
- The Commission is complying with key provisions of its enacting legislation and regulations, but should give more attention to its regulatory responsibilities in its key planning and accountability documents.
- The Commission is giving due regard to economy and efficiency in the planning, management and monitoring of its operations.
- The scope of internal audit activity should be broadened and changes should be made to enhance the independence of the internal audit function.

AUDIT SCOPE

11.9 In March 2000 we completed a broad scope audit of the Nova Scotia Liquor Commission under the mandate established by Sections 8 and 17 of the Auditor General Act. Our audit was performed in accordance with auditing standards established by the Canadian Institute of Chartered Accountants, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

11.10 The objectives of this assignment were to assess:

- the Nova Scotia Liquor Commission's governance structure and practices;
- the level of compliance of the Commission with key provisions of its enacting legislation and regulations; and
- whether the Commission gives appropriate attention to economy and efficiency in planning, operating and monitoring its business.

11.11 The audit criteria developed for our examination of the Commission's governance structure and practices were derived from CCAF-FCVI Inc.'s *Six Principles of Effective Governance*. Audit criteria for the other objectives of the audit were designed specifically for this assignment. The audit criteria were discussed with and accepted as appropriate by senior management of the Commission, and are outlined in Exhibit 11.6 on page 203.

11.12 The Commission's response to this audit is on page 205.

PRINCIPAL FINDINGS

Governance

11.13 *Audit conclusion* - We concluded that the Board of the Commission performs its governance responsibility reasonably well. There is a need to improve the accountability process as it relates to senior management, and to improve disclosure of governance and performance information in the Commission's reporting to the House of Assembly and public.

11.14 *Audit approach* - We conducted comprehensive surveys of the two Commissioners and two members of senior management who also regularly attend Board meetings to determine their views on certain issues impacting the role and effectiveness of the Board. In addition, each Board member was separately interviewed and various reports provided to and produced by the Board were examined.

11.15 *Board of Commissioners* - Commissioners of the Nova Scotia Liquor Commission are appointed by Executive Council and report to the Minister responsible for the Liquor Control Act. The Act provides for a maximum of three Commissioners to be appointed for ten-year terms. At the time of our audit there were only two Commissioners since one Commissioner's term expired on December 31, 1998 and the position was still vacant.

11.16 The Liquor Control Act defines various accountabilities and responsibilities of the Commissioners. However, some of these responsibilities are inconsistent with normal governance practices for government and profit-oriented organizations. The Act requires certain procedures and approvals of the Commissioners, the Minister and Executive Council which are not typical of other crown agencies in Nova Scotia. For example, the Liquor Control Act states:

- Executive Council may prescribe terms of employment and salaries, as well as duties and powers of Commission staff [Section 17].
- Every order for the purchase of liquor shall be authorized by the Chief Commissioner or by a person authorized by the Minister [Section 31(1)].
- The sale of liquor to the Commission by a brewer, distiller or vintner requires the approval of the Minister [Section 63(1)].
- Executive Council approval is required to purchase, lease, sublet or sell any land, building or other property [Sections 12(f) and 16].

11.17 An important part of corporate governance is having an appropriate allocation of responsibility between management and the governors. In our view, consideration should be given to assigning such responsibilities to a lower level.

11.18 We observed that attendance at Board meetings is very good and meetings are held on a regular basis. We found that Commissioners receive an orientation to the operations of the Commission upon joining the Board and are provided with sufficient other training and information to fulfill their responsibilities.

11.19 The responses to our survey indicate that the Board is satisfied with its effectiveness. However, respondents also feel that the number of Commissioners should be expanded beyond the maximum of three allowed by the Act in order to increase the effectiveness of the governance function. The current size hinders the Board from accessing a broader range of knowledge and experience which additional members would bring to the Board. For example, the current Board has no individuals with extensive experience in accounting, finance or retail merchandising. Additionally, the small Board size prevents a committee structure from being created and results in the full Board dealing with issues more effectively dealt with at a committee level (e.g., review of monthly financial statements, communication with auditors, human resource issues).

11.20 A Board comprised of individuals with diverse knowledge, skills and experience improves a Board's governance function. To achieve this, there should be specific criteria established to assist in the selection of new Board members. We found that the Commissioners have approved minimum background requirements for candidates for the current vacancy. We encouraged the Board to have a third Commissioner appointed as soon as possible and to pursue changes to the Act that would allow Board membership to be further expanded.

11.21 The current Commissioners were both appointed at the same time, and thus their terms will expire on the same date. In our view, this highlights the need for future Board members to have the expiration of their terms staggered so that continuity of Commission-related experience and knowledge is preserved as members retire and new members join the Board.

11.22 *Goals and strategies* - The Commission prepares an annual business plan, which is provided to the Provincial government. The 2000-01 business plan of the Commission was included in government's publication entitled *The Course Ahead*. The Commission's plans outline, among other things, its mission statement, strategic goals and plans for achieving them. We reviewed the process for preparing the annual business plan and found that Commissioners are appropriately involved. Commissioners and senior management meet in the fall each year to discuss current year's performance as it relates to last year's plans, and to develop and approve the strategic goals and plans for the ensuing year. The Commissioners use the business plan as the primary instrument for reviewing the progress of the Commission and the performance of management.

11.23 The mission statement (see Exhibit 11.5 on page 202) was prepared and approved during the term of previous Commissioners, but has been formally accepted by the current Commissioners. The statement is supported by guiding principles which direct how each segment of the Commission's mission is to be achieved. Ethical values have been integrated into the guiding principles, and have been adopted by the Board as guidelines for their own conduct, as well as for the conduct of management and staff of the Commission.

11.24 *Governance information* - An integral part of governance is obtaining appropriate, timely information about the operations of an organization. For the Board of the Commission, this is accomplished through regular meetings of the Board to receive reports from management and to monitor progress in meeting strategic goals. In addition, there is an annual audit of the Commission's financial statements and the Board will call special meetings and make requests of management for additional information.

11.25 As part of our audit, we examined minutes of Board meetings and reports presented to the Board. We found that the Commissioners regularly discuss and challenge the information being presented in reports from senior management. However, from our survey of and discussions with the Commissioners, we noted that at least one Commissioner was not fully satisfied with the nature and completeness of information provided to him. This leads us to believe that there may not be a full understanding and communication of the information needs of the Board of Commissioners. We recommended that the Commissioners formally define the nature and extent of information they require for effective governance and request management to present it to them on a regular and timely basis.

11.26 *Relationship between board and senior management* - The most senior managerial position at the Commission is referred to as the General Manager. The current General Manager was selected by the Commissioners in 1993 based on a nation-wide search. Upon recommendation of the Chief Commissioner at that time, he was subsequently appointed by Executive Council. The General Manager is formally accountable to the Chief Commissioner, and a written position description was prepared to define his role and responsibilities.

11.27 However, we observed that no formal performance evaluation is prepared for any member of senior management. We believe effective governance includes a formal, documented process of holding management accountable for their performance. In our view, Commissioners should perform a formal evaluation of the General Manager's performance each year. The Commissioners should require the General Manager to do likewise for other members of senior management, and the Commissioners should have input into and be apprised of the results of the evaluations.

11.28 *Accountability* - Under Section 22 of the Liquor Control Act, the Commission is required to present its annual audited financial statements to the House of Assembly within 15 days of the House's opening subsequent to the preparation of the statements. We observed that the Commission's Annual Report for the year ended March 31, 1999 was approved by the Board at its November 15, 1999 meeting. The report was subsequently sent to the Minister, who tabled it in the House of Assembly on January 18, 2000.

11.29 We believe seven and one-half months is too long a delay for reporting on the performance of an organization. We recommended that the annual report be prepared and approved on a more timely basis. Also, since the House opened for its 1999 fall session on October 7, and the Commission's external auditors completed their audit before that date, we believe the Commission did not fully comply with the statutory requirements for tabling its financial statements.

11.30 Also, we observed that the annual report lacks substantive information on the performance of the Commission, and thus does not fulfill its potential as an accountability document. The report does contain the mission statement and audited financial statements. However, it mainly discloses historical information concerning liquor volumes and sales and does not include important planning and performance information such as the Commission's annual goals, budget and measures of performance. Some performance information is included in the Commission's annual business plan, which has been available to the public during the last couple of years due to a government initiative to gather and report the business plans of certain crown corporations and agencies. However, we believe the public would have a greater expectation of finding performance information in an annual report, and likely would be more aware of the existence of such reports.

11.31 We reviewed annual reports prepared by liquor commissions and boards in other provinces and found that in one report a complete section was devoted to corporate governance. It provided the reader with a clear sense of the role and responsibilities of the organization's Board and we believe such information would be useful to readers of the Nova Scotia Liquor Commission's annual reports.

11.32 The Chief Commissioner is formally accountable to the Minister responsible for the Liquor Control Act. We noted that the Minister receives copies of the minutes from all Commission Board meetings, as well as key documents such as the Commission's annual report and business plan. In addition, the Chief Commissioner meets with the Minister periodically to discuss issues related to the Commission and the liquor industry.

Compliance with Legislation and Regulations

11.33 *Audit conclusion* - It appears to us that the Liquor Control Act is outdated in areas and is in need of significant review. We concluded that the Nova Scotia Liquor Commission is complying with key provisions of its enacting legislation and regulations, but should give more attention to its regulatory responsibilities in its key planning and accountability documents.

11.34 *Audit approach* - We examined the Liquor Control Act and all regulations pertaining to it. Commissioners and senior managers were interviewed to determine their knowledge and application of the Act and its regulations. We also reviewed the plans, policies and training programs of the Commission to assess consistency and attention to legislation and regulations. As well, we examined reports and other documents relevant to this audit area.

11.35 *The Liquor Control Act* - The Liquor Control Act was proclaimed in 1930. The Act is lengthy and dedicates much of its attention to controlling the distribution, sale and use of liquor with the objective of minimizing its negative affects on society. However, some of the protective procedures and restrictions built into the legislation may be inconsistent with the modern-day legal, business and social-responsibility practices of government.

11.36 As illustrated in paragraph 11.16 above, the Act imposes a higher degree of oversight on the part of Executive Council, the Minister and the Commissioners, than is normal in other government businesses. In addition, it requires the Department of Finance to perform various procedures. Certain of these requirements are generally not complied with. These include:

- approval of all liquor purchases by the Chief Commissioner or a person authorized by the Minister [Section 31(1)];
- approval of Minister of the sale of liquor to the Commission by a brewer, distiller or vintner [Section 63(1)];
- checking and auditing of the Commission’s receipts at least every month by the Minister of Finance or a person designated by him [Section 26]; and
- approval by the Department of Finance of the bank accounts the Commission uses [Section 20(2)].

11.37 Further, the Act appears to have weaknesses relating to enforcement. For example, the Act specifies a number of legal and regulatory requirements, but is not always clear on who is responsible for enforcing them. In practice, enforcement of the Act generally rests with the Alcohol and Gaming Authority and various police agencies. One way of making responsibilities clearer may be to place liquor control requirements (e.g., monitoring and enforcement) into a separate piece of legislation since most of these responsibilities lie with groups other than the Liquor Commission.

11.38 The Act also provides certain powers to enforcement officers and courts of law that, on the surface, appear to be at risk of legal challenge (e.g., imposing a burden of proof on a defendant), and has certain prohibitions that are nearly impossible to enforce diligently (e.g., drunkenness in any house). The Act has a very wide definition of what constitutes liquor, which in the past has caused confusion on the part of the government and enforcement agencies with respect to high alcohol content products sold in grocery and convenience stores (e.g., cooking wines and bitters). As well, the Act restricts the giving of alcohol as a gift, except as permitted by regulations. However, regulations are silent on this matter.

11.39 The Liquor Control Act permits only stores operated by the Commission to sell liquor. This provides the Commission with the authority and power needed to control the sale and consumption of liquor in Nova Scotia. However, the conditions of the Act in this area are so stringent that it prevents the Commission from engaging in some alternative means of serving the public. Many other provinces in Canada have privately-owned ‘agency stores’ which purchase their liquor from a provincial liquor authority and are closely monitored and regulated by the authority. The Nova Scotia Liquor Commission would need legislative amendments to enter into similar arrangements.

11.40 It appears to us that the Act is in need of significant review. Based on discussions we had with Liquor Commission management and Commissioners, there have been a number of attempts by the Commission to have the legislation modernized. However, none of the attempts have been successful. In our view, it is not in the public interest to have legislation that is not conducive to good governance and business practices, and which does not apply reasonable and modern approaches to public protection. We recommended that government conduct a comprehensive review of the Liquor Control Act.

11.41 *Legislation awareness and communication* - The Commission has a broad mandate and a wide range of responsibilities under the Liquor Control Act. As discussed above, it has a mandate to operate a retail liquor operation for profit, as well as having a responsibility to act as a regulator of the distribution, sale and consumption of liquor. Our audit indicated that Commissioners and senior managers are appropriately aware of the requirements of the Liquor Control Act and its regulations. We determined, through discussions with senior management, that they are confident that the Commission is complying with all significant Provincial legislation and regulations.

11.42 We examined the policies of the Commission and found that they are either derived from or consistent with the Liquor Control Act and regulations. Policy manuals are reviewed and updated annually. Changes to the Act and regulations are discussed at senior management meetings and policy manuals are subsequently updated. Staff are informed of changes either through formal training or correspondence.

11.43 However, we noted an absence of attention to the Commission's regulatory responsibilities in some of its key planning and accountability documents. The Commission's business plan and mission statement are the key documents used to outline the reason for the Commission's existence, how it is to operate and the goals and strategies it has formulated for the current and future years. Our examinations indicated that the business plan was prepared taking the Act and regulations into account, but generally does not give much attention to the Commission's role as regulator of liquor distribution, sale and consumption. Almost all of the plan is focussed on the Commission's retail operations. We observed a similar lack of attention to the Commission's regulatory role in its Annual Report and the General Manager's position description. Considering the importance of these regulatory responsibilities, we believe they should be given more attention in such key documents.

11.44 *Social responsibility* - The Commission indicates in its mission statement that it *"shall strive to operate in a socially responsible manner"* (Exhibit 11.5 on page 202). Guiding principles were prepared to direct how management and staff will perform in the pursuit of the Commission's mission. One of these is *"We shall encourage consumers and society in general to develop a responsible attitude toward liquor and its consumption."* This goal is pursued in cooperation with liquor industry social responsibility programs and often includes providing financial support to assist various public interest groups with public service advertising and by supporting certain police forces in their public awareness campaigns.

11.45 Although not explicitly defined as part of its legislated mandate, the Commissioners believe that the Commission has a corporate obligation to promote social responsibility. They cite the many areas of the Act which address control of the movement, sale and consumption of alcohol, and make the case that promoting social responsibility is in some ways a more effective means of achieving the objectives of these sections of the Act.

11.46 We noted that the task of promoting social responsibility has been assigned to the merchandising division of the Commission. It is considered to be a promotions program not unlike those which market alcohol products. One reason social responsibility is assigned to the merchandising division is that many public awareness programs are conducted jointly with brewers and distillers, who also direct these programs through their marketing divisions. However, this assignment of responsibility for social responsibility programs appears to be in conflict with the merchandising division's larger responsibility of increasing sales for the Commission. Management has indicated to us that social responsibility is an organization-wide responsibility, and this is an issue more of appearance than substance. Considering the importance of perception in the success and acceptance of public programs, we have recommended that the responsibility for social responsibility programs be reviewed.

11.47 *Managing compliance* - Based on our review, compliance with legislation and regulations appears to be a priority of the Commission. Managers we interviewed have a reasonable knowledge of and respect for the Liquor Control Act and regulations. There are numerous policy and procedure manuals maintained at head office, and we determined that they appropriately incorporate and convey the legal requirements under which the Commission operates.

11.48 We found that store procedure manuals are based upon the policies of the Commission. Regional managers visit stores on a regular basis and, as part of their visits, ensure that the procedure manuals are being followed. Major changes to procedures are communicated through additional training for staff. To promote staff development and advancement, the Commission has developed training modules. These modules address changes to the Act and regulations. New employees are required to complete an orientation module which includes information about the Commission's mission statement and sections of the Act and regulations which all employees are required to know.

11.49 The Internal Audit and Security Division of the Commission conducts stores audits and, as part of these audits, ensures compliance with the policy and procedure manuals.

11.50 One provision of the Act requires the Commission to control and supervise the advertising and marketing practices of manufacturers, distributors, agents and their representatives. This responsibility has been assigned to the merchandising division. The rules governing advertising are in the regulations to the Act. The Commission prepared advertising policies and procedures based on the legislation and provided them to all members of the liquor industry operating in Nova Scotia. The Commission has not dedicated staff to the pre-approval of advertising to ensure compliance with the regulations. Only in-store advertising plans by liquor industry members are vetted through the merchandising division. For external advertising, the industry is required to follow rules of the Canadian Radio-television and Telecommunication Commission (CRTC) for advertising. Changes to CRTC rules are communicated to the industry by the merchandising division. The division reviews major publications for print advertising. However, the industry is essentially self-regulating for compliance with the advertising regulations and is informed to contact the Commission if in doubt about compliance.

11.51 *External reporting* - Our review of external reports of the Commission revealed that they do not contain information on compliance with legislation. In discussions with senior management, it was indicated that reporting on compliance would be done on an exception basis (i.e., if a significant violation of legislation occurred). In our view, external reporting should be more pro-active with respect to compliance and state the key pieces of legislation and regulations pertaining to the Commission, the Commission's responsibility for ensuring compliance with them, generally how compliance is managed and ensured, and an assessment of its performance in this area.

Value-For-Money

11.52 *Audit conclusion* - We concluded that the Commission is giving due regard to economy and efficiency in the planning, management and monitoring of its operations. Reporting of the Commission in this area could benefit from more quantification of performance targets and results.

11.53 *Audit approach* - Our examination of due regard for economy and efficiency addressed all Commission expenses, with the exception of the purchase of merchandise for resale. Accordingly, we examined areas such as salaries and benefits, leasehold and other store costs, warehousing and distribution costs, and the procurement of goods and services. Our examination included review of operational planning, inspection of budgetary and other cost-control systems, and testing of a sample of expenditure transactions. An analysis of Commission expenses for the years 1998 to 2000 is presented in Exhibit 11.1 on page 199.

11.54 *Planning* - The business plan, as stated above, is the key document used by the Commission to communicate its goals and strategies for the current and future years. It contains information on performance in achieving the current year's strategic and financial goals and presents, at a summary level, the following year's budget. The various divisions within the Commission prepare operational plans to implement the strategies outlined in the business plan.

11.55 We observed that the Commission addresses many economy and efficiency issues in its business and operational plans. The primary focus of most plans is to improve the "bottom line" of the Commission through controlling costs and increasing sales. The Commission has reported considerable success in this area. Since 1991, net income has risen from $109 million to $135 million (for the year ended March 31, 2000), an increase of 23.9%. During the same period, store operating expenses, expressed as a percentage of sales, declined from 9.2% to 9.1%. Administration expenses declined from 5.1% of sales to 2.3%.

11.56 Information used by the Commission to measure performance is generally financial in nature and often expressed as a ratio (e.g., store operating expenses as a percentage of sales). Such information is regularly conveyed in various management reports, reports to the Commissioners and in the business plan. However, our review of the business plan and other reports of the Commission showed us that reporting on success in achieving goals is often qualitative rather than quantitative. Where possible, performance reporting should include quantitative measures that are compared with pre-determined targets, and supported by explanations for significant variances.

11.57 *Procurement* - The Provincial government's procurement policy applies to all its departments, agencies, boards and commissions. The Commission has developed a policy and procedure manual for procurement which incorporates all requirements of the government's policy. The Commission regularly uses the government's Public Tenders Office to conduct tenders, and uses government standing-offers in the procurement of items such as office equipment. Office and other supplies are purchased centrally to take advantage of lower prices available upon bulk purchases, as well as to provide a means of monitoring the use of supplies by the various divisions and stores. A business case must be prepared to support the request for new computer equipment, and it must illustrate that the equipment will recover its cost through efficiencies or higher profits.

11.58 We selected 26 purchases from the eight-month period ending November 30, 1999 to evaluate the Commission's compliance with its procurement policy. In general, we concluded that the Commission, in all material respects, follows its procurement policy and gives due regard for economy in its procurement function.

11.59 The Commission operates 100 liquor stores, 61 of which are in leased premises. The Commission procures its own leased space. Although government property management policies do not apply to the Commission, or any other crown agency which has its own property management function, we thought it would be useful to compare the Commission's facilities procurement practices to government's policies which we have previously assessed as including due regard for economy.

11.60 For the most part, the Commission's leasing policies were compatible with those of the government. One area where the Commission's policies may not be fully consistent relates to the leasing of retail space. The Commission will not always tender for retail space because the location of a liquor store is extremely important to its success. Sometimes, the Commission will determine the best site for a new or relocating store based on market and demographic studies, and negotiate directly with a landlord for space in the chosen area. Government leasing policies do not provide an exemption from tendering for retail space, perhaps because it is not common for government departments and agencies to provide retail service. The Commission sought an exemption from government for retail leasing practices, but have not yet been informed of the results. However, based on our audit, the Commission's practice for locating stores is reasonable in light of the fact that consideration must be given to a store's future revenues as well as costs.

11.61 We selected 13 lease transactions and examined them for compliance with the Commission's policy and determined whether they would be acceptable under the government's policy. We found that each of the leases was in compliance with the Commission's policies. The primary variations with government policy related to occasionally using invitational bids instead of tenders, having a lease remain on a month-to-month basis for over a year, and having original and option lease periods different from the government norms. In our view, none of these differences significantly affected the Commission's ability to achieve economy in these transactions.

11.62 However, there are three lease transactions which, in our view, warrant additional reporting.

- Lease payments totalling $14,659 were made for two months before the store opened due to delays in completing construction. For this lease the Commission requested proposals from three sources and the lowest proposal was not accepted. The Commission accepted a higher proposal as the location had better store visibility and offered better access for delivery of inventory.

- There were two leases where stores were being relocated and rent was paid for both the old and new locations, resulting in $20,571 in additional rental costs.

11.63 While the above-noted amounts are not material, we are concerned that the Commission's leasing practices permit rent to be paid before a store is opened and stores to be relocated before their leases expired.

11.64 *Space and location decisions* - The Commission has a property management division which is responsible for acquisition, layout design, and management of the space required by the Commission. The Commission's head office and warehouse facility were constructed in 1987 and were acquired under a capital lease. Of the Commission's 100 liquor stores, 39 are in Commission-owned buildings and the remaining 61 are in leased premises.

11.65 The Commission has a physical resource plan which determines the layout and size standards for stores. It is updated annually and approved by the Board. Market studies are sometimes conducted to assist in store location and renovation decisions. These studies show, for example, the demographics and shopping patterns of customers in the areas served by stores. In addition, liquor stores are stratified into three categories according to sales per square foot. These benchmarks, along with the market studies and certain other information, are used to monitor store performance. Based upon this information, changes necessary to achieve optimal store size are incorporated into the physical resource plan.

11.66 The Commission's philosophy is that it is primarily a retail business. Management believes greater operational flexibility is achieved by leasing rather than owning retail space. Leasing enables the Commission to more easily adjust store sizes and to obtain more desirable locations as demographic, traffic and customer trends change. This flexibility can promote store economy and efficiency, as well as profitability. For example, the Commission had a net increase of eight stores since 1993 (all in leased premises), but the total amount of store space (owned and leased) was reduced in this period by 90,199 square feet. This was accomplished by down-sizing certain stores and relocating others to smaller locations upon the expiration of leases.

11.67 The Commission has standard specifications for the layout, furnishing and equipping of stores. The Provincial government also has space and furniture standards which are deemed to apply to all its departments, agencies, boards and commissions. However, the Commission's head office was constructed prior to the government's current standards coming into effect, and the government standards do not address warehouse and retail space.

11.68 *Human resource costs* - A staffing plan is maintained for each of the 100 stores operated by the Commission. The plan is based, in part, upon studies of the time required to complete certain store-related tasks. There are job descriptions to support each position. A corporate staffing plan is approved by the Board as part of the annual budget process.

11.69 The Commission has experienced significant personnel reductions during the last decade or so, despite rising sales. The total number of staff (on a full-time-equivalent basis) at March 31, 2000 was 746, which represents a reduction of 155 (17%) since March 31, 1990. During the period 1987 to 1999, the Commission reduced warehouse staff from 71 to 49, and Director and Executive Director positions from 14 to 8. In addition, more store employees now work on a casual and part-time basis so the stores have more flexibility to adjust staffing levels between periods of high and low sales. Requests for new positions must be supported with evidence of the need for the position and an explanation of why the current workforce cannot do the work the position will entail.

11.70 All store and certain head office employees are members of a union. The wages, benefits and other terms of employment are established through collective bargaining with the unions. Tentative settlements are approved by the Board and sent to the Executive Council of government for final approval. A tender was conducted recently for the administration of employee benefit programs.

11.71 Commission management has reviewed management salary levels in industry, government and other liquor commissions. The Commission also obtains the results of salary surveys conducted by national consulting firms to help it assess its compensation practices. Management salary increases are approved by the Board and submitted to Executive Council for approval.

11.72 All union staff and most managers receive annual performance evaluations, and advancement to a higher level within an employee's classification is based on satisfactory performance documented in the annual evaluation. However, as described above, the performance of members of senior management (seven positions) is not formally evaluated. In our opinion, senior management should be formally evaluated on an annual basis against criteria based upon their position responsibilities. Management of the economy and efficiency of Commission operations should be specifically addressed in the performance evaluations.

11.73 It is becoming a more regular practice for governments and crown agencies in Canada to report executive salaries and benefits in their annual reports or other accountability documents. For many years, the Province of Nova Scotia has reported salaries of department employees in its Supplement to the Public Accounts. It is also a practice of public companies listed on the Toronto Stock Exchange to report senior executive salaries. Such reporting serves to make organizations accountable for their remuneration packages as well as their performance. We believe that all Nova Scotia crown agencies should report, as a minimum, the highest five salary and benefit packages in their organization. We recommended this practice to the Nova Scotia Liquor Commission.

11.74 *Information technology* - There are several computer systems in place to record and report upon various activities of the Commission (e.g., finance and accounting, point-of-sale, human resources, facilities management). The systems are not fully integrated and this has caused inefficiencies in transferring data from one system to another. During our audit, an extensive revision of the information technology system was in progress. It will integrate the various systems, except facilities management which is to remain a stand-alone system. Based upon our discussions with senior management and review of the winning proposal for the project, we believe the Commission's decision to integrate these systems has the potential to create efficiencies in information processing.

11.75 *Monitoring of divisional performance* - We found monitoring of divisional performance by senior management to be comprehensive and timely. Reports on individual store operations are prepared on a weekly basis, while most other divisional reports are produced monthly. We reviewed many of these reports and discussed use and benefit with senior management. The reports provide extensive information on operations of the stores and divisions of the Commission, contain comparisons with prior year's results and show variances from budget. In addition, a separate monthly variance from budget report is produced for each division and variances exceeding certain limits are required to be analysed and explained by division managers and reported to the senior management committee. Based on our review of the reports and the way they are used, we believe that they provide the information management needs to conduct Commission business in an efficient and economic manner.

11.76 *Performance accountability* - Senior managers are held accountable for the efficiency and economy of their divisions by the Board of Commissioners. Senior management regularly report to the Commissioners on assigned areas of responsibility and are challenged to achieve all of the goals described in the Commission's business plan. However, as discussed above, there is a need to make the process more formal through annual documented performance evaluations for senior management.

11.77 We observed that staff and other managers are also held accountable for fulfilling their responsibilities, including the efficiency and economy of their functional areas. This is accomplished through annual performance evaluations, internal audits of stores, store reviews by Regional Managers and the Director of Store Operations, and budget variance reports. In addition, regular meetings are held by Regional Store Managers with the Store Managers they supervise. Store Managers meet on a regular basis with store employees to ensure the goals of the Commission are being met and, if necessary, to take corrective action.

11.78 Store audits are conducted on a regular basis by the internal auditors of the Commission. All stores are scheduled to be audited over a two-year period. The audit scope includes areas such as inventory management and merchandising and the audits help to ensure the stores are correctly implementing Commission policies. Audit reports are reviewed with the Store Managers. The reports are also provided to the responsible Regional Store Managers, as well as members of senior management. The Regional Managers in consultation with the Store Managers are required to prepare a written response outlining corrective action planned.

11.79 However, we observed that the manager of the Internal Audit and Security Division reports directly to the Director of Finance and Systems. This creates a situation where the auditor reports to the individual responsible for some of the systems being audited. In order for auditing to be perceived as unbiased, the auditor must be independent from the areas being audited. In addition, some staff of the Internal Audit and Security Division are assigned to non-audit tasks, such as counting the physical inventory in the warehouse and participating in the design and implementation of new computer systems. Auditors may be less independent, or perceived to be less independent, if they become involved in the accounting and control functions subject to audit.

11.80 Further, most of the attention of the Internal Audit and Security Division is on liquor stores. Due to resource constraints, the Division does not give much attention to the operations of Head Office.

11.81 In our opinion, the scope of internal audit activity should be broadened to include regular evaluation of the Commission's efficiency and economy, as well as its Head Office operations. As well, certain reporting relationships and job assignments should be reconsidered in order to enhance the independence of the internal audit function. For example, in other government departments and organizations, internal auditors generally report to the deputy minister or chief executive officer, and where a Board structure is in place sometimes communicate directly with the audit committee of the Board. As a minimum, we believe the Internal Audit and Security Division should not report to the senior financial officer of the Commission.

CONCLUDING REMARKS

11.82 Based upon our audit, we believe the Nova Scotia Liquor Commission is governed in an appropriate manner, gives suitable attention to its guiding legislation and regulations, and gives due regard to economy and efficiency in its operations. We believe there is a need to expand upon internal and external accountability processes through more progressive performance evaluation and reporting. We also see a need for a major review of the Liquor Control Act with the objective of making it more consistent with modern legal, business and social responsibility practices.

Exhibit 11.1

NOVA SCOTIA LIQUOR COMMISSION
REVENUES AND EXPENSES
($ thousands)

Actual 1997-98	% of Sales	Actual 1998-99	% of Sales	Actual 1999-2000	% of Sales		Budget 2000-01	% of Sales
331,868	100.0	351,662	100.0	371,365	100.0	Sales	380,623	100.0
167,563	50.5	176,451	50.2	187,609	50.5	Cost of sales	190,499	50.0
164,305	**49.5**	**175,211**	**49.8**	**183,756**	**49.5**	**Gross Profit**	**190,124**	**50.0**
						Expenditures		
30,218	9.3	31,359	9.1	33,787	9.1	Store Operating Expense	33,767	8.9
3,563	1.1	3,774	1.1	3,850	1.0	Warehousing-Distribution	3,799	1.0
5,121	1.5	3,898	1.1	3,465	0.9	Depreciation Expense	3,468	0.9
7,762	3.0	8,306	3.0	8,522	2.3	Administrative Expense	8,591	2.3
1,157	0.3	514	0.1	1,067	0.3	Other Expense	1,085	0.3
(2,950)	(1.8)	(2,657)	(1.6)	(2,856)	(0.7)	Other Revenue	(2,232)	(0.6)
1,005	0.3	794	0.2	751	0.2	Early Retirement Program	598	0.2
45,876	**13.8**	**45,988**	**13.1**	**48,586**	**13.1**	**Total Expenditures**	**49,076**	**12.9**
118,429	**35.7**	**129,223**	**36.7**	**135,170**	**36.4**	**Net Operating Income**	**141,048**	**37.1**

Exhibit 11.2

NOVA SCOTIA LIQUOR COMMISSION
SALES AND INCOME FROM OPERATIONS
($ millions)

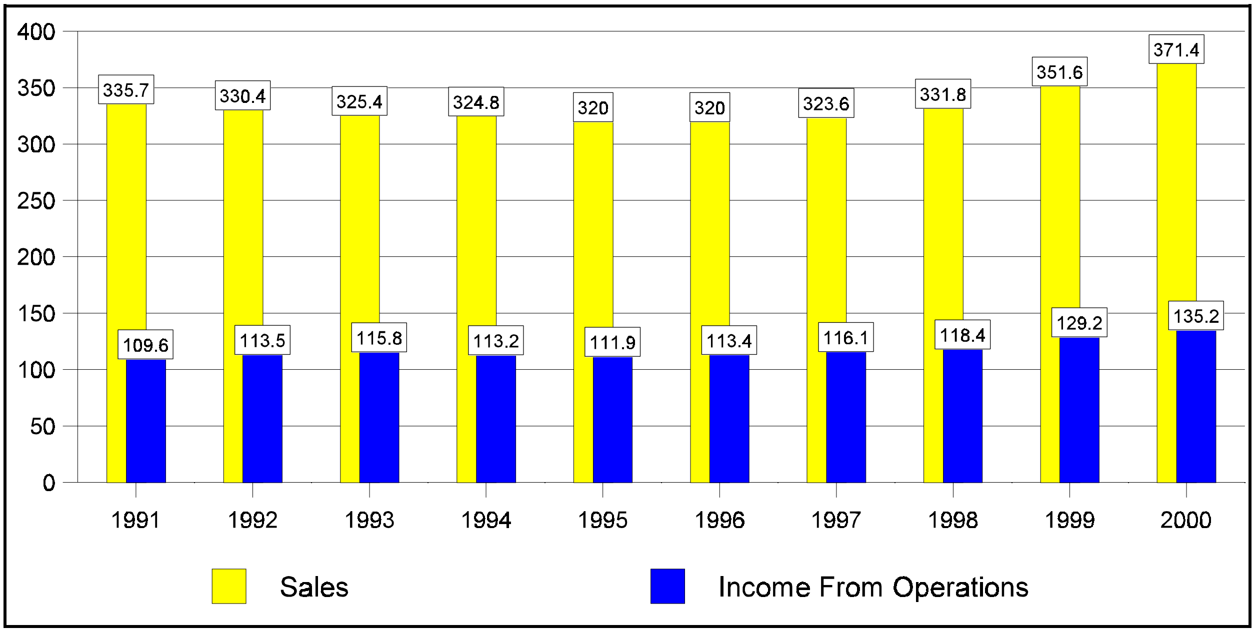

Exhibit 11.3

NOVA SCOTIA LIQUOR COMMISSION
SALES INFORMATION
YEAR ENDED MARCH 31, 2000

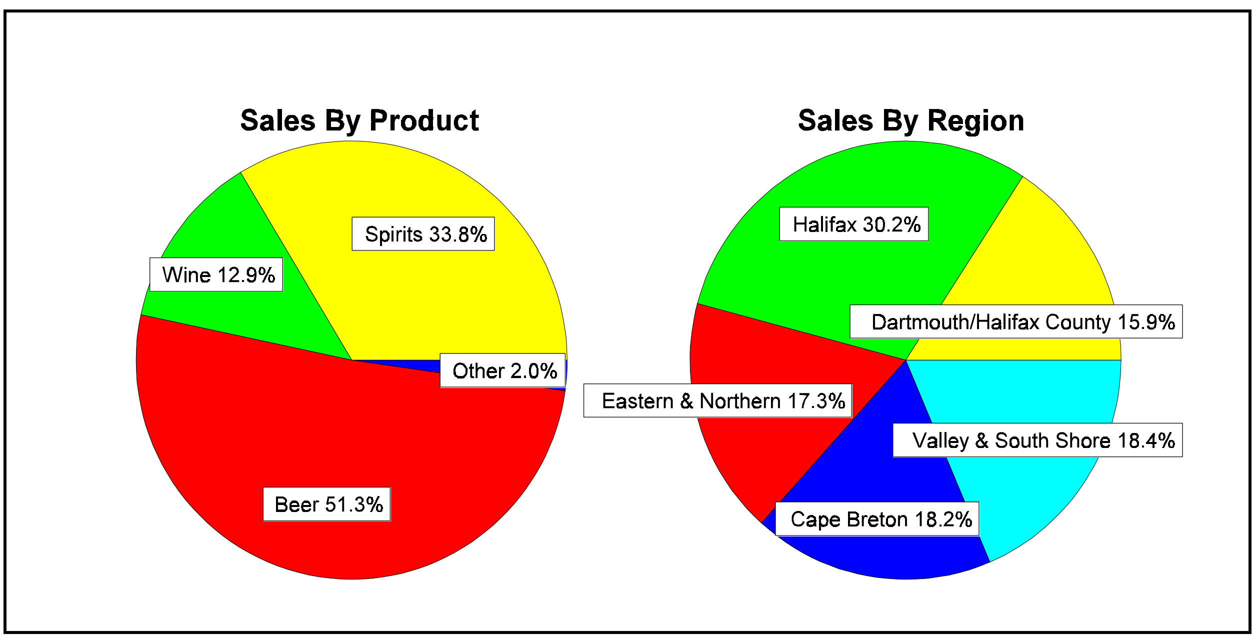

Exhibit 11.4

NOVA SCOTIA LIQUOR COMMISSION
ORGANIZATION CHART

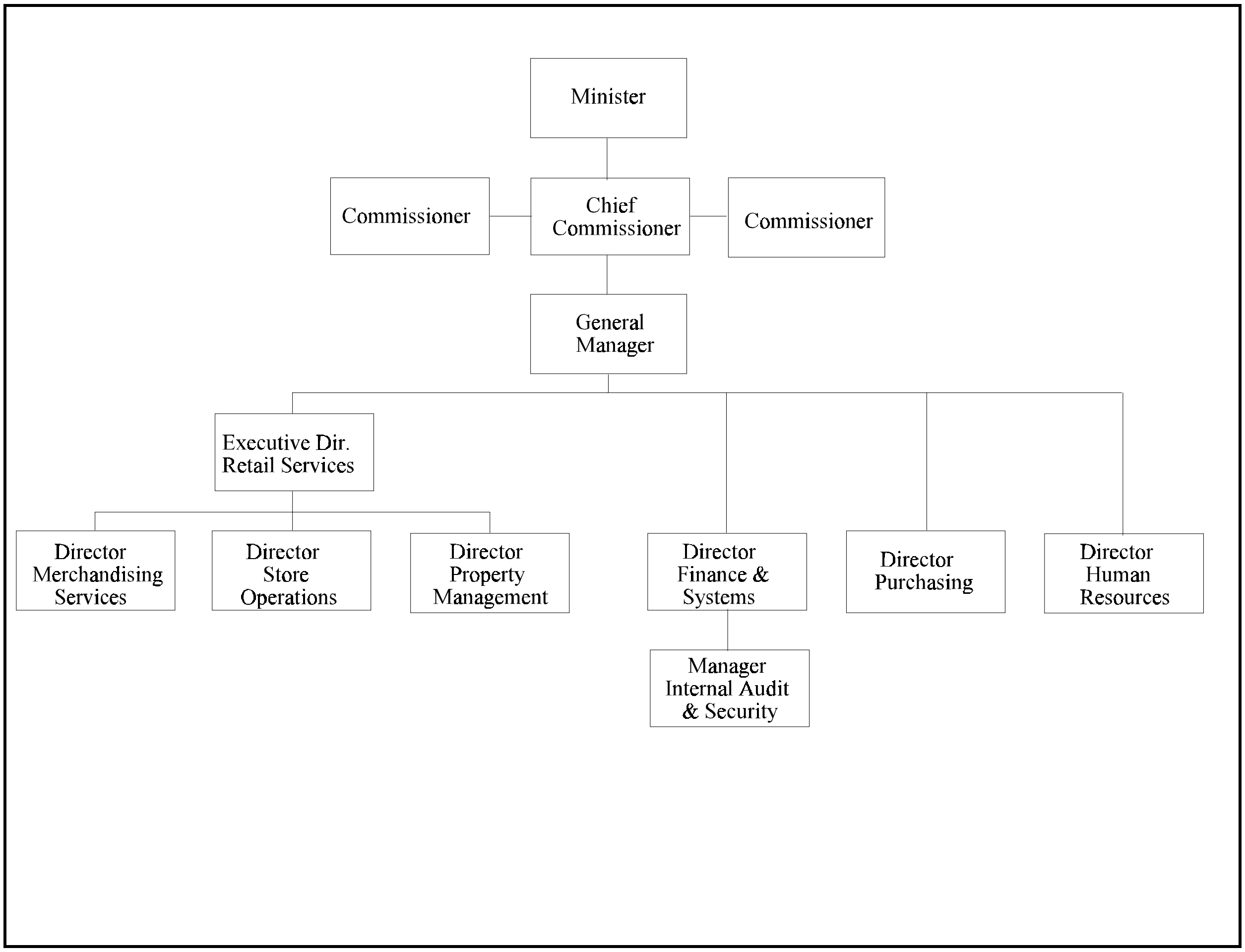

Exhibit 11.5

NOVA SCOTIA LIQUOR COMMISSION
MISSION STATEMENT

The Nova Scotia Liquor Commission regulates the sale of liquor products under the authority of the Liquor Control Act.

The Nova Scotia Liquor Commission shall strive to:

- *operate in a socially responsible manner*
- *provide responsible and progressive customer service with a variety of quality controlled products in modern facilities*
- *generate revenue as a retailer through efficient financial and operating practices*
- *provide its employees with progressive management, equality of opportunity and career development*

The management and staff of the Nova Scotia Liquor Commission are dedicated to the principles of the Mission Statement

Exhibit 11.6

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 Liquor Commission.

Governance

- The Commissioners should have the necessary knowledge, ability and commitment to fulfill their responsibilities.
- The Commissioners should understand the objectives and strategies of the Nova Scotia Liquor Commission.
- The Commissioners should understand their purpose and whose interests they represent.
- The Commissioners should understand what constitutes reasonable information for good governance and obtain it.
- Commissioners should be prepared to act to ensure that the organization's objectives are met and that performance is satisfactory.
- Commissioners should fulfill their accountability obligations to those whose interests they represent by reporting on the performance of the Nova Scotia Liquor Commission.

Compliance with Authorities

- The Nova Scotia Liquor Commission should comply with applicable provisions of enacting legislation and regulations.
- The policies of the Nova Scotia Liquor Commission should be consistent with its mandate under Provincial legislation and regulations.
- There should be systems and procedures in place to enable management and Commissioners to ensure all key provisions of Provincial legislation and regulations are complied with.
- There should be adequate reporting to inform the Commissioners, Minister and House of Assembly of the Commission's compliance with relevant legislation and regulations.

Exhibit 11.6 cont'd

Value-for-Money

- Business planning should explore means by which operations can be made as efficient and economic as possible.
- Planning should include the establishment of management expectations (i.e., goals/objectives) that relate to the efficiency and economy of operations.
- Procurement/construction projects should be conducted in an open, fair, efficient and competitive manner; in accordance with government procurement policies.
- Salaries should be the result of a competitive process (e.g., collective bargaining) or an understanding/study of the remuneration appropriate and competitive for the responsibilities entailed.
- Space and staffing decisions should be made with due regard to economy and efficiency.
- Appropriate use of Information Technology should be made to make Commission operations as efficient as possible.
- Managers should get the information they need to do their work efficiently, and the information should be used in the conduct of their operations.
- Division costs, activities and outputs/outcomes should be measured and reported to senior management on a regular and timely basis.
- Costs, activities and outputs/outcomes should be compared to each other and to management expectations (and possibly to results of other jurisdictions) on a regular basis.
- Failure to meet expectations should be analyzed and explained, and corrective action should be planned (if needed).
- Managers should be held accountable for the economy and efficiency of the areas under their responsibility.

NOVA SCOTIA LIQUOR COMMISSION'S RESPONSE

Annual Report*:* *The NSLC does not agree that the Annual Report lacks information on the performance of the Commission. The report includes an executive review of the past year's operations as well as future objectives. The objective of each report is to illustrate to various stakeholders a representation of programs and activities during the past year that played a part in the overall results. The Annual Report includes audited financial statements and a number of exhibits outlining statistics as well as commentary on performance. Based upon the standard requirements of Annual Reports, the NSLC does meet them. We would suggest that our annual Business Plan and Budget contains the necessary accountability that the Auditor General refers to in their principal findings.*

Internal Audit Activity: *The Internal Audit Department of the NSLC prepares an annual plan for approval of senior management. Because of the nature of the business, retailing, the on-going work effort is the review and formal audit of our retail stores. Loss Prevention personnel also conduct risk assessment of these outlets. Both the internal audit and loss prevention area assess and conduct information systems reviews/audits, operational reviews/audits and manufacturer reviews/audits. Since there are no specific areas indicated by Auditor General in which independence has been compromised, we will continue to review mission critical areas where the NSLC receives the most value. The NSLC position is that the independence of the internal audit group has not been compromised in any way and the internal audit group as well as our external auditors reinforce this position.*

Governance: *Senior Management of the NSLC agrees with the office of the Auditor General that it is difficult at times, under the current Liquor Control Act, to carry out governance practices for government and profit-oriented organizations. We also agree that requirements of the LCA that are purely on-going business decisions are best handled efficiently when they are appropriately assigned to Senior Management at the NSLC. This has been achieved and has allowed the NSLC to be successful in meeting overall objectives of the organization.*

The Commissioners are well informed of the business operations including performance reviews on programs, projects and strategic plans. Senior Management does formally meet with the Commission and are readily available to answer inquiries or meet intermittently if business issues arise outside regularly scheduled meetings. Any requests for further information, clarification or additional reporting have been handled professionally and effectively.

The NSLC agrees that the Board needs to be diversified and have senior level expertise in areas such as retail merchandising, management experience in a large organization or finance.

Accountability: *The NSLC agrees that our Annual Report should be produced earlier. Efforts have been made over the years to improve this and action will be taken to further improve the timing.*

Compliance with Legislation and Regulations: *The NSLC is a successful, efficient and effective business operation. This has been achieved, not withstanding that the LCA is in need of review and is somewhat restrictive for a retail organization. The NSLC has achieved compliance with legislation and regulations through its formal business policies and procedures for all operations of the retail business. The organization does not believe that there is an absence of attention to regulatory responsibilities as the organization has an aggressive social responsibility program and* *other policies and procedures that ensure regulatory responsibilities are appropriately addressed. Work with key interest groups ensures that customers as well as the public are well educated and informed about the products sold. This commitment is reinforced through the Mission Statement and Guiding Principles, which encompass plans, objectives and strategies. As stated in section 11.42, we believe the Auditor General says it best: "We examined the policies of the Commission and found that they are either derived from or fully consistent with the Liquor Control Act and regulations. Policy manuals are reviewed and updated annually. Changes to the Act and regulations are discussed at senior management meetings and policy manuals are subsequently updated. Staff are informed of changes either through formal training or correspondence."*

Social Responsibility: *It is everyone's responsibility in the organization with senior management involved in the strategies, objectives and programs with respect to social responsibility. Participation and joint efforts with other interest groups has been very successful over the years in increasing public awareness of responsible use of beverage alcohol. Therefore we do not agree that the responsibility for social responsibility programs needs to be moved to another functional area of the NSLC.*

External Reporting: *As indicated by the Auditor General in section 11.41, 11.42, 11.47 and 11.48 the priority of the Commission is compliance with legislation and regulations. Everyone interviewed has a knowledge of the Liquor Control Act and Regulations. All policy and procedure manuals appropriately incorporate and convey the requirements under which the Commission operates. Internal reporting includes performance monitoring of programs and operations resulting in polices and procedures that are consistent with the Liquor Control Act and Regulations.*

Value-For-Money: *Where possible and material to NSLC operations, quantifiable performance measures have and will be incorporated into our annual Business Plan and Budget.*

There will be occasions when rent will be paid before a retail outlet is open because there may be a number of leasehold improvements to be made as well as prestaging the customer retail service area before opening for business. There are also other occasions when the new location is only available before the lease expiry date from the transfer location. The organization always negotiates the best possible value for the NSLC considering all factors.

The Auditor General states it best in 11.63 where they indicate that the noted "amounts are not material."

Performance Evaluations: *The NSLC utilizes a performance evaluation process for its employees. The performance of senior management is evaluated on an ongoing basis and measured against their achievement of key objectives in the functional areas they are responsible for and their contribution to the overall objectives of the organization. Management and members of the Commission believe the processes in place are adequate and appropriate.*

The NSLC would like to thank the Auditor General's staff for their comments and observations. This input will be of assistance to the ongoing NSLC process of reviewing its operations to identify potential areas for change that would materially improve the organization.