

BACKGROUND

- 2.1 Members of the Legislative Assembly need adequate information on the Province's financial plans, performance and condition to hold government accountable for its use and control of public funds and resources.
- 2.2 The Minister and Deputy Minister of Finance are assigned various authorities and responsibilities related to the role of a chief financial officer for the Province under the provisions of the Provincial Finance Act including a number of financial reporting requirements.
- 2.3 Further, Section 73 of the Provincial Finance Act requires that crown corporations' business plans, audited financial statements and proposed public financing be tabled in the House of Assembly each year.
- 2.4 As a foreign registrant of the Securities and Exchange Commission in the United States, or its equivalent in other countries, government must file required documents in order to be able to access financing or financial markets.
- 2.5 In addition to required financial reporting, government may and periodically does, at its discretion, publicly release other financial information or reports.
- 2.6 For the Province's financial reporting, oversight responsibility rests, to a significant extent, with the Executive Council. In addition, the House of Assembly, including its Public Accounts Committee, has an important role in the oversight and public accountability processes for the Province's financial reports issued by government.

CHAPTER OBJECTIVES

- 2.7 The Auditor General Act provides a broad mandate for the Office to examine and report on the use and control of public resources by government, its controlled entities, and recipients of financial assistance. Further, Sections 9 and 9B of that Act provide for specific annual reporting by the Auditor General on the Province's consolidated financial statements (an audit, with high assurance) and government's revenue estimates (a review, with moderate assurance).
- 2.8 The annual financial statements of various crown entities and trusts, depending on statutory or other arrangements, are audited and reported upon by either the Auditor General or a public accounting firm. We consider the results of those financial statement audits, as well as other government financial reporting, where appropriate, during the conduct of the Office's discretionary broad scope assignments in selected areas each year.

- 2.9** The Auditor General’s opinion on the 2006-07 revenue estimates, required under Section 9B of the Auditor General Act, was tabled in the House of Assembly on May 9, 2006 along with the government’s budget documents. The results of our examination of those revenue estimates were reported in Chapter 2 of the June 2006 Report of the Auditor General. A general election was called before the 2006-07 budget tabled on May 9, 2006 was approved by the House. As a result, another 2006-07 budget was tabled on July 4, 2006.
- 2.10** The purpose of this chapter is to provide summary comments and observations on the government’s financial reporting including:
- information on the results of our review of the government’s 2006-07 revenue estimates included in the July 4, 2006 budget documents; and
 - the results of our audit of the Province’s March 31, 2006 consolidated financial statements.

RESULTS IN BRIEF

- 2.11** The following summarizes our principal observations in this chapter.
- The Auditor General’s opinion on the 2006-07 revenue estimates, required under Section 9B of the Auditor General Act, was tabled in the House of Assembly on July 4, 2006 along with the government’s budget documents. Consistent with the opinion on the May 9, 2006 revenue estimates, it included reservations of opinion related to scope limitations and non-compliance with generally accepted accounting principles (GAAP).
 - The Auditor General’s audit report on the Province’s March 31, 2006 consolidated financial statements was unqualified. It was tabled September 29, 2006 as part of the March 31, 2006 Public Accounts. A management letter on this year’s audit will be issued to government in December 2006 which will include other findings and issues from the audit.
 - Significant steps have been taken to move government’s consolidated financial statements to full compliance with GAAP. We encourage government to continue its efforts to achieve full compliance with GAAP for both the financial statements and budget.
 - Additional appropriations of \$110,761,000 for 2005-06 expenses were approved on September 29, 2006 by Order in Council (OIC) 2006-413. A special warrant for \$325,537,000 was approved by OIC 2006-263 on June 22, 2006.
 - Current legislation impairs the effectiveness of control over changes to spending authority for public funds because it allows for after-the-fact approval of additional spending authority. As well, effective control and accountability to the House of Assembly for spending authority limits are impaired. For

example, there was no debate in the House of Assembly concerning the funding of March 2006 spending initiatives which resulted in approximately \$42 million in additional appropriations.

- Two concerns relating to compliance with the Provincial Finance Act were identified during our work on the consolidated financial statements. The first was a result of inconsistencies in the Act concerning overspending of appropriations. The second was government's undertaking to provide a level of financial commitment to the 2014 Commonwealth Games which was communicated to the Halifax 2014 Commonwealth Games Bid Committee prior to the required review and approval.
- During our audit of the consolidated financial statements and review of the revenue estimates, we were not provided access to certain information we requested. We have recommended that government work with our Office to clarify the boundaries of access to information under the Auditor General Act.

PRINCIPAL FINDINGS

Results of Review of Government's Estimates of Revenue

2.12 The Auditor General's Report on the 2006-07 Revenue Estimates, required under Section 9B of the Auditor General Act, was tabled in the House on July 4, 2006 along with supporting information for the 2006-07 Nova Scotia budget. Exhibit 2.1 on page 23 is a copy of the Report. The opinion was qualified for the following:

- First, we were not able to obtain sufficient appropriate information to complete a review of recoveries, user fees and revenues of certain governmental units. In addition, information related to HST reductions on home heating fuel and electricity was not made available for our review. As a result of these scope limitations, the Auditor General was unable to form an opinion as to the reasonableness of the estimates of these revenues or the support for their underlying assumptions.
- Further, sinking fund earnings and revenues of certain governmental units were excluded from the revenue estimates and included elsewhere in the estimates. As a result, the revenue estimates were not presented on a basis consistent with the Province's consolidated financial statements. In addition, certain recoveries and user fees as well as HST rebates on home heating fuel and electricity were excluded from the revenue estimates and netted against expenses elsewhere in the estimates. To the extent of these exclusions, the 2006-07 revenue estimates are not presented in accordance with generally accepted accounting principles (GAAP).

2.13 A more detailed reporting of the results and observations from our examination of government's 2006-07 revenue estimates included in the July 4, 2006 budget

documents was provided to the Department of Finance in a July 20, 2006 management letter.

- 2.14** The management letter discusses a number of other issues and findings from our review. For example, we did not agree with the decision to exclude any estimate for revenues from offshore licence forfeitures in 2006-07.
- 2.15** For purposes of the review, one new accounting standard needed to be considered: Public Sector Accounting Board Handbook (PSAB) Section 1150, *Generally Accepted Accounting Principles (GAAP)*. The section provides direction on the primary and secondary sources of reference in determining GAAP compliance (i.e., a GAAP hierarchy) for the public sector in Canada. This standard now restricts the options available for preparation of financial information on other than a GAAP-compliant basis.
- 2.16** To ensure compliance with current requirements of PSAB and with generally accepted auditing standards, our review was planned to include all revenue elements in the 2006-07 budget that meet the definition of revenues under GAAP. In comparison to our previous year's review, we estimated that additional elements included this year represented more than \$1 billion. Our additional information requirements were communicated to the Department of Finance in February 2006. Difficulties encountered in obtaining sufficient information to assess the reasonableness of some revenues and the support for their underlying assumptions led to a qualification in our Report on the Estimates of Revenue. The continued presentation of some revenues on a basis not compliant with current GAAP standards, such as netting against expenses, also led to a qualification in the Report.
- 2.17** In our June Report, as well as the previous report, we recommended that the revenue estimates included in the budget be prepared and presented in full accordance with generally accepted accounting principles. Management has indicated that they intend to work towards improving the budget presentation to make it more consistent with GAAP requirements and to improve the accessibility of materials required by this Office to perform the annual review of revenue estimates.

Results of the Audit of Province's Consolidated Financial Statements

- 2.18** Under Section 9 of the Auditor General Act, the Auditor General is mandated to examine and report on the Province's consolidated financial statements which are the responsibility of government, represented primarily by the Minister of Finance.
- 2.19** Government tabled and released the Province's March 31, 2006 consolidated financial statements on September 29, 2006 as part of Volume 1 of the Public Accounts. The Auditor General's opinion on those statements was unqualified.
- 2.20** Professional standards require that an auditor make arrangements for a pre-release general review of any information or other documents to be released concurrently, or in combination with, financial statements upon which the auditor has or will be

reporting. We read, but did not audit, the information in the Financial Statement Discussion and Analysis section of Volume 1 of the March 31, 2006 Public Accounts.

GAAP compliance

2.21 The June 2006 Report of the Auditor General identified certain areas in which the Province's consolidated financial statements were not yet fully in compliance with GAAP, and recommended that steps be taken to ensure fuller compliance. We are pleased to acknowledge that significant steps have been taken to address many of these areas as described below. We encourage government to continue in their efforts to more fully comply with GAAP.

- Previously, the consolidated financial statements did not include budget amounts for the line items on the Statement of Operations and Accumulated Deficits or the Statement of Change in Net Direct Debt as required by GAAP. For the 2005-06 statements, budget amounts were included on the Statement of Operations and Accumulated Deficits. There is still a need to include budget information on the Statement of Change in Net Direct Debt.
- PSAB requires that expenses be disclosed at gross value. In past years, various user fees, chargeables and recoveries were netted against expenses on the Consolidated Statement of Operations and Accumulated Deficits. This also included federal transfer payment revenues which were recorded as recoveries. For the 2005-06 consolidated financial statements, user fees, chargeables and recovery account balances were more properly recorded as revenue rather than being netted against expenses. We understand from discussions with management that there are further revenue amounts which are netted directly against expense accounts. It was indicated to us that an analysis will be completed during 2006-07 to ensure these amounts are properly reflected in the March 31, 2007 statements.
- Previously, a number of smaller crown entities and government partnership arrangements were not consolidated as required by GAAP. For 2005-06, all crown entities were consolidated, and where there was agreement as to the existence of a Government Partnership Arrangement, they were also consolidated. For one entity, there is disagreement between the Department of Finance and the Office of the Auditor General as to whether it is a Government Partnership Arrangement. This matter will be subject to further consideration during next year's audit.
- GAAP requires that, as part of the consolidation process, the accounting for government organizations (other than government business enterprises) be adjusted to be consistent with the government's accounting policies. In previous years and again this year, when consolidating the tangible capital assets (TCA) balances of entities included in the consolidated financial statements, those balances were not adjusted to comply with the government's TCA accounting policy requirements for such factors as thresholds and

amortization rates. This issue would not be as significant if the TCA thresholds of the Province were lower.

- We have had a concern with the high level of the TCA thresholds for some time. Our concern is that there could be a material balance of transactions related to the acquisition of TCA, as defined by GAAP, which are expensed rather than capitalized since the balances fall below the government's threshold for capitalization. GAAP requires that accounting policies of consolidated entities be consistent with those of government. Adjusting the TCA thresholds of all entities consolidated to the Province's thresholds would reduce the amount of TCA balances which would be capitalized. Because of the high TCA threshold limits of the Province, compliance with this GAAP requirement could actually impair the fair presentation of the TCA balances on the consolidated financial statements. There is a need to further research and review the Province's TCA threshold limits to ensure they allow for the fair and consistent presentation of the TCA balance on the consolidated financial statements.

- 2.22 A new issue concerning GAAP compliance which arose during this year's audit was the proper accounting treatment of the Workers' Compensation Board (WCB) in the consolidated financial statements. Historically, this entity has been included as a trust in the financial statements. During the 2004-05 audit, we raised the question of whether it really is a trust and communicated the need to obtain a legal opinion on this issue. In 2006, government obtained a draft legal opinion which indicated that WCB is not a trust. Our Office's view has always been that if WCB is not a trust, it should be considered as part of the reporting entity which would require consolidation of its operations. There is information available which suggests that WCB is controlled by government and thus should be consolidated. The Department of Finance has indicated that it will be researching this issue and that WCB will be appropriately reflected in the 2006-07 consolidated financial statements based upon the results of that research. For the 2005-06 consolidated financial statements, WCB has been noted as a *Trust-Like Fund under Administration* because it is clear that it is not a trust as previously reported. The government needs to analyze this issue in detail to determine appropriate disclosure and ensure the WCB is properly accounted for in accordance with GAAP.

Recommendation 2.1

We recommend that government complete a detailed analysis of the appropriate accounting treatment for the WCB, and ensure full compliance with GAAP in the 2006-07 and future financial statements.

- 2.23 Accounting standards and pronouncements that comprise GAAP continue to evolve. There are new accounting pronouncements and some in process that will have an impact on the government's future financial reporting. For example, the following are significant matters on which PSAB has recently released final or revised pronouncements or is developing new or revised pronouncements:

- tangible capital assets;
- tax revenues;
- government transfers; and
- financial instruments.

2.24 New formal recommendations or guidance in such areas could require changes to government's financial reporting in the future. Further, government should disclose the nature and impact of required or planned accounting changes as soon as practical, ideally no later than during the presentation of the budget for the fiscal year in which the changes will take effect.

Systems and controls

2.25 We obtained a sufficient understanding of the systems and controls to plan the audit. Where we relied upon controls, sufficient audit evidence was obtained to support that assessment. However, the scope of our review of government's systems and controls during the audit of the March 31, 2006 consolidated financial statements was not planned or conducted in order to conclude on the adequacy of the overall level or quality of controls.

2.26 While conducting the financial statement audit, areas were identified where internal controls could be strengthened or operating improvements achieved. Certain matters identified during the current year have implications which warrant government's consideration. These have been communicated to Finance as part of a management letter. As part of the audit of the Province's March 31, 2007 consolidated financial statements, we will follow up on these matters to determine the status of actions taken or planned.

2.27 In relation to the internal controls of the crown corporations and agencies consolidated in the Province's financial statement reporting entity, we have relied on the audit work of public accounting firms appointed to report on the financial statements of those entities. Chapter 8 of this Report includes information on selected weaknesses in internal controls which were reported to those entities by their auditors.

Management letter

2.28 In December 2006, a management letter will be issued to government providing various observations from our audit of the Province's March 31, 2006 consolidated financial statements. The following are the more significant observations which have not already been included in other parts of this chapter.

- Government's preparation of the Province's consolidated financial statements requires the use of significant accounting estimates, certain of which are particularly sensitive to differences between future actual results and government's assumptions upon which the accounting estimates were based. At the conclusion of this year's audit, there were no significant outstanding concerns with the estimates used in preparing the March 31, 2006 consolidated financial statements.

- During the audit of the March 31, 2006 consolidated financial statements, a number of accounting, disclosure and audit issues arose, and were communicated to government staff at various points in the audit process. Some, but not all, of these were resolved either by review of additional information provided or by adjustments to the financial statements.
- With regard to the Province's consolidated financial statements and other government financial reporting, it is appropriate for all known errors or identified misstatements to be corrected, other than trivial ones. However, each year a number of residual issues remain at the conclusion of the audit. These were considered when preparing the Auditor's Report on whether the statements are presented fairly in accordance with GAAP.
- A key control for ensuring reliable financial reporting and safeguarding of resources is the existence of documented policies and the effective communication of those policies. In February 2003, updated government Management Manuals were released on the Treasury and Policy Board website. These manuals include some, but not all, relevant policies. Government Accounting staff have acknowledged the need and intention to further develop and enhance government's financial management and accounting policies. However, only one new policy has been added to the manuals since they were released. We understand that there are some draft policies, as well as amendments to existing policies to bring them up to date, which are awaiting approval. We reiterate the need to develop a defined plan and schedule to ensure the government management manuals are updated, to include all relevant financial and accounting policies, in a timely manner.

Planned accounting considerations

2.29 The June 2006 Auditor General's Report identified some specific accounting considerations to address during the completion of the March 31, 2006 audit of the consolidated financial statements (see Chapter 2 paragraph 2.31 of that Report). The following provides information on the results of our consideration of these items:

- We reviewed supporting information on the accounting for various spending initiatives approved by Treasury and Policy Board in March 2006. See paragraph 2.35 for further discussions concerning these spending initiatives.
- There were no accounting or disclosure issues identified for the various federal transfers, initially recorded as deferred revenue, or for related expenses incurred. See paragraph 2.40 for information on some of the funds involved.
- Our Office and Finance management disagree on the accounting treatment of the removal of the Provincial guarantee related to the Nova Scotia Teachers' Pension Plan as a result of the June 22, 2005 agreement between the Nova Scotia Teachers' Union and government. We believe the change is a plan amendment. Management disagrees with our position. The required accounting treatment depends on the classification of the change. The impact

of this matter has been considered in reaching our opinion of the financial statements.

Other Matters

Additional appropriations and special warrants

- 2.30** Section 9A of the Auditor General Act requires, among other things, that we call attention to every case observed in which any appropriation is exceeded or a special warrant is authorized. Our last reporting under that section was in the June 2006 Report of the Auditor General, Chapter 2.
- 2.31** Under the provision of Section 28 of the Provincial Finance Act, on September 29, 2006 Executive Council approved OIC 2006-413 approving additional appropriations for 2005-06 of \$94,777,179 for net program expenses, \$5,614,938 for the pension valuation adjustment and \$10,369,085 for capital purchase requirements. The original approved appropriations for 16 votes had been exceeded.
- 2.32** While it may be too early to determine the additional spending authority ultimately required for the 2006-07 votes, information included in the government's Forecast Update dated September 8, 2006 indicated that the voted appropriation in one department was forecasted to be exceeded.
- 2.33** An issue we have raised on numerous occasions in previous reports which continues to be a concern is that current legislation impairs the effectiveness of control over changes to spending authority for public funds because it allows for after-the-fact approval of additional spending authority. As well, effective control and accountability to the House of Assembly for expenses in excess of original spending authority limits are impaired as no debate is required in the House of Assembly for additional appropriations approved by the government. This would include approximately \$42 million in year end spending initiatives discussed further in paragraph 2.35.
- 2.34** We note that one special warrant was approved by Executive Council (OIC 2006-263) under Section 29 of the Provincial Finance Act for \$325,537,000 on June 22, 2006. The warrant was required to defray charges and expenses for the fiscal year ending March 31, 2007 prior to the approval of the appropriations for that fiscal year by the House of Assembly.

Compliance with the Provincial Finance Act

- 2.35** The following two instances of non-compliance with the Provincial Finance Act were identified during the audit of the March 31, 2006 consolidated financial statements.
- As part of our audit of the consolidated financial statements, we requested information about any contractual obligations of the Province. This year, we

specifically inquired as to the existence of a financial obligation related to the 2014 Commonwealth Games bid. It was indicated to us, by various staff throughout government, that there was no financial obligation related to the Games. Late in the audit process, a letter dated November 28, 2005 and signed by a member of Executive Council was discovered and brought to our attention by staff. This letter, to the Chair of the Halifax 2014 Commonwealth Games Bid Committee, communicated the Province's intention to provide a level of financial commitment to the Games.

According to Section 59C of the Provincial Finance Act, all intended financial obligations of the Province must be communicated to the Minister of Finance along with specific information, including a request for authorization of the financial obligation. The Minister of Finance must then forward the request, along with specified information, to the Governor in Council for authorization. The external communication of the intention of the Province to provide a level of financial commitment for the 2014 Commonwealth Games did not comply with Section 59C of the Provincial Finance Act. It is our understanding that the undertaking communicated in the November 28, 2005 letter was not communicated to the Minister of Finance and was not authorized by OIC.

- In March 2006, Treasury and Policy Board approved approximately \$45 million of grants to various entities. Most of these grants were paid out in the last few days of March 2006 and were recorded as 2005-06 expenses. The recording of these expenses resulted in appropriations of government being exceeded by approximately \$42 million. According to Section 13 of the Provincial Finance Act, before a cheque can be issued, a sufficient balance must be available in the appropriation for the specified purpose and, where an appropriation is exhausted, no further contractual obligations or commitments may be charged to the exhausted appropriation. As a result, neither the payment of these amounts, nor the recording of the liabilities in 2005-06, is in compliance with Section 13 of the Provincial Finance Act.

However, Section 28 of the Provincial Finance Act allows up to ninety days after the tabling of the Public Accounts for the approval of additional appropriations related to the appropriations in the Public Accounts. This is not consistent with Section 13 of the Act.

Recommendation 2.2

We recommend that the Provincial Finance Act be amended to eliminate the existing inconsistency related to additional appropriations and steps be taken to ensure all actions taken by government are in compliance with the requirements of the Act.

Access to Information

- 2.36** While completing our work on the 2006-07 revenue estimates and the 2005-06 consolidated financial statements, we were not provided access to certain information requested.
- 2.37** With the review of the revenue estimates, this resulted in a qualification of the opinion. With the financial statement audit, as a result of alternative audit procedures completed, the restrictions to information were not significant enough to warrant a reservation due to scope limitation.
- 2.38** There were instances where we were allowed to see information requested but were not allowed to make a photocopy as audit support for our files. In these instances, we had to manually reproduce the information in order to have support for our work in the audit file.

Recommendation 2.3

We recommend that Treasury and Policy Board and the Department of Finance work with the Office of the Auditor General to clarify the boundaries, both in substance and form, of the access to information allowed under the Auditor General Act.

Review of financial reports

- 2.39** The Department of Finance has previously indicated its intention to complete a review of its primary financial reporting vehicles to determine potential improvements. Little progress had been made as of the June 2006 Report of the Auditor General. We are pleased to note that the terms of reference for this initiative have since been approved and progress is being made on this project. We continue to support the government's plans to review the content of its financial reports for improvements. We noted that one requirement of the project is that the resulting content of the Public Accounts be in compliance with GAAP. Such a requirement should apply to the government's budget documents as well.

Deferred revenue

- 2.40** In the past few years, the Province has received significant federal government transfer payments to be used for specific purposes. The federal government placed no time constraints on when some of the funds must be used. The funds are initially recorded as deferred revenue and recognized as revenue when eligible expenses are incurred. The following table provides information concerning the funds received to date where the Province has control over the timing of expenditures, and the unspent balances remaining as of March 31, 2006. The unspent amounts have not yet been recognized as revenue because the eligible expenses have not yet been incurred.

Fund	Amount Received as Deferred Revenue	Date	Revenue Recognized 2003-04	Revenue Recognized 2004-05	Revenue Recognized 2005-06	Balance Remaining at March 31/06
Diagnostic and Medical Equipment	\$44,808,135 <u>14,678,232</u> 59,486,367	2003-04 2004-05	\$4,381,705	\$12,013,798	\$13,287,524	\$29,803,340
Public Health and Immunization	11,680,106	2004-05	-	2,333,131	3,402,947	5,944,028
Wait Time Reduction	122,660,075	2004-05	-	18,347,788	18,201,160	86,111,127
Additional Early Learning and Childcare	20,432,221	2005-06	-	-	-	20,432,221

Note: The table only includes funds in deferred revenue at March 31, 2006 where there are significant balances remaining of the initial funds received.

- 2.41** In order to ensure adequate accountability to the House of Assembly for these funds, consideration should be given to determining the information requirements, if any, of the House of Assembly concerning the plans for and use of these funds.

Cash and Other Losses

- 2.42** Section 9A (1) (e) of the Auditor General Act requires that we report every case in which we have observed that "... there has been a deficiency or loss through fraud, default, or mistake of any person".
- 2.43** The Nova Scotia Management Manuals no longer contain a requirement for departments and crown entities to report losses to this Office. However, some departments have reported the following losses to us for 2005-06. The list below may not include all losses; just the ones reported to our Office.

Departments	Cash	Property	Total
Justice (1)	\$1,799	-	\$1,799
Service Nova Scotia and Municipal Relations	199	-	199
Office of Aboriginal Affairs	50	-	50
Environment and Labour	-	719	719
Office of the Auditor General	-	80	80
Total	\$2,048	\$799	\$2,847

(1) Includes \$591 cash loss incurred in a prior period.

2.44 In addition, government's Internal Audit and Risk Management Centre conducted an investigation at the Department of Justice which identified \$6,493 in cash losses. There are other possible losses being investigated by government's Internal Audit and Risk Management Centre but the reports on the assignments were outstanding at the time this Report was written.

CONCLUDING REMARKS

2.45 We noted in the June 2006 Report of the Auditor General that improvements were required in government's financial reporting to bring the government's budget and the Province's consolidated financial statements fully into compliance with GAAP. Significant steps have been taken, since that Report, to address areas in which the Province's consolidated financial statements were not fully in compliance with GAAP. We encourage government to continue efforts to make the financial statements more fully GAAP-compliant and reemphasize the need to bring government's budget fully into compliance with GAAP as well.

Report of the Auditor General to the House of Assembly on the Estimates of Revenue for the fiscal year ending March 31, 2007 used in the preparation of the July 4, 2006 Budget Address

Exhibit 2.1

I am required by Section 9B of the Auditor General 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. I had previously reported on the 2006-07 estimates of revenue used in the preparation of the May 9, 2006 Budget Address. That reporting, dated May 5, 2006, included a reservation of opinion.

The estimates of revenue for the fiscal year ending March 31, 2007 (the 2006-07 revenue estimates) are the responsibility of the Department of Finance and have been prepared by departmental management using assumptions with an effective date of June 8, 2006. I have examined the support provided by departmental management for the assumptions and the preparation and presentation of the 2006-07 revenue estimates. My examination did not include, and my opinion does not cover, the budget speech, the 2005-06 forecast or the 2006-07 expense estimates. Except as explained in the following paragraph, my examination was made in accordance with the applicable Assurance and Related Services 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.

I was not able to obtain sufficient appropriate information to complete my review of recoveries, user fees and revenues of certain governmental units. In addition, information related to HST reductions on home heating fuel and electricity was not made available for my review. As a result, I have been unable to form an opinion as to the reasonableness of the estimates of these revenues or the support for their underlying assumptions.

Further, sinking fund earnings and revenues of certain governmental units are excluded from the revenue estimates and are included elsewhere in the estimates. As a result, the revenue estimates are not presented on a basis consistent with the consolidated financial statements. In addition, certain recoveries and user fees as well as HST rebates on home heating fuel and electricity are excluded from the revenue estimates and netted against expenses elsewhere in the estimates. To the extent of these exclusions, the 2006-07 revenue estimates are not presented in accordance with generally accepted accounting principles.

In my opinion, except that certain revenues have been excluded from the revenue estimates as noted in the preceding paragraph, and except for the effect of adjustments, if any, which I might have determined to be necessary had I been able to obtain sufficient information with respect to certain revenues, as discussed above,

- As at the date of this report, the assumptions used by departmental management 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 2006-07 revenue estimates; and
- The 2006-07 revenue estimates as presented reflect fairly such assumptions; and
- The 2006-07 revenue estimates comply with presentation and disclosure standards established by the Canadian Institute of Chartered Accountants.

Since the 2006-07 revenue estimates are based on assumptions regarding future events, actual results will vary from the information presented and the variations may be material. Accordingly I express no opinion as to whether the revenue estimates will be achieved.

Jacques R. Lapointe, CA•CIA
Auditor General

Halifax, Nova Scotia
June 30, 2006

DEPARTMENT OF FINANCE'S RESPONSE

Thank you for the opportunity to provide a management response to Chapter 2 of the December 2006 Report of the Auditor General. This chapter primarily deals with the revenue review of the 2006/07 Estimates and the audit of the 2005/06 Public Accounts. It should be noted that in preparing the response to this Chapter, Management has only recently received a draft management letter to the audit of 2005/06 Public Accounts and has not yet had the opportunity to meet with the staff of the Office of the Auditor General to discuss the content of the draft management letter. We request that in future years the management letter be provided shortly after the conclusion of the audit of the Public Accounts and well in advance of the December Report.

Review of Revenue Estimate

As indicated in our response to the management letter regarding the review of revenue, the Department feels the broader scope of this year's review is not in keeping with the intent of Section 9B of the Auditor General Act. The inclusion of revenue of certain consolidated government units (such as School Boards and District Health Authorities) in this review creates practical challenges given the time lines of the review and budgeting methodology of the Province. As well, the inclusion of recoveries and user fees in the review of revenue would require the Office of the Auditor General to make a reasonable determination of certain program expense estimates. Not only does this go beyond the intent of Section 9B of the Auditor General Act, it is inappropriate for the Office of the Auditor General to form an opinion on program expense estimates. Management accepts that certain revenue items such as recoveries and user fees, sinking fund earnings and HST home heating rebates have been netted against expenses which is inconsistent with GAAP. This presentation format, however, has no impact on the reported surplus of the Province. Management changed this practice for the 2005/06 Public Accounts and will introduce changes in the 2007/08 Estimate.

Management will also work with the Office of the Auditor General on the protocols for the revenue review but an examination of expense estimates will not be a part of the review. As in previous years, the revenue of consolidated government units will not be included in the information provided for the revenue review.

Under the Province's revenue recognition policy, offshore licenses forfeitures revenue will be recognized when Notice of Forfeiture is provided. This same policy is used for budget development. Given the fluctuating nature of this revenue, any inclusion of forfeiture revenues in the budget based on historical trends or any other estimating tool, would not be prudent and could lead to inappropriate budget decisions.

Audit of the Consolidated Financial Statements

We are pleased that the Office of the Auditor General acknowledged our progress to ensure further compliance with GAAP. We anticipate additional improvement for the 2006/07 Public Accounts.

The Office of the Auditor General concludes there is one government partnership that was not consolidated. This is in reference to Canadian Blood Service (CBS), for which management has assessed that no partnership arrangement exists with this organization. This position is consistent with most other provinces that have their blood services managed by CBS. It should be noted that the exclusion of CBS in the consolidated process has no material impact to the financial statements of the Province nor has it created a qualification to the audit opinion provided by the Office of the Auditor General.

GAAP require that TCA policies, including thresholds, be appropriate for the entity in question. Given the diverse nature and size of all entities within the Government Reporting Entity (GRE), it would not be appropriate to have a uniform TCA policy for all, or to adjust the balances of consolidated entities to the Province's policy upon consolidation. Management has decided to review certain thresholds to ensure they remain appropriate.

Management agrees that the proper accounting treatment for WCB needs to be resolved. While the WCB may not presently be a legal trust, Management's control assessment concluded that the WCB should not be included in the GRE. The Office of the Auditor General does not agree with this assessment but agreed that further research on this issue is warranted. Management commits to work with the Office of the Auditor General on this research and conclude the analysis by March 31, 2007.

Provincial Finance Act

The Province's support letter to the Halifax 2014 Commonwealth Games Bid Committee was necessary to complete the bid proposal to be selected as Canada's proposed site for the 2014 Commonwealth Games. The financial obligation implications of the letter were not appreciated by the authors at the time, so the omission of seeking Section 59C approval was an innocent oversight. It should be noted that the disclosure requirement of this letter, as a contingent liability, was properly included in the 2005/06 Public Accounts.

Management believes that the only proper accounting treatment for the March, 2006 grants was to record the grants as 2005/06 expenses. In fact, since the decision was made by Treasury & Policy

Board, authorized under Section 28 of the Provincial Finance Act and the recipients were informed of the decision, the Province had no discretion but to treat the grants as liabilities for 2005/06. Management does agree that there are inconsistencies between Section 13 and Section 28 of the Provincial Finance Act. The Office of the Auditor General's Report acknowledges that under Section 28 of the Provincial Finance Act approval for additional appropriations can be obtained up to ninety days after the tabling of the Public Accounts. In the case of these grants, additional appropriations were obtained on September 29, 2006 which provided the authorization under the Provincial Finance Act to make these payments and record the liability in 2005/06.

Thank you again for the opportunity to provide these comments. I look forward to continuing to work with the Office of the Auditor General to improve the Province's financial reporting.