
7 Review of Agency Financial Statements and Management Letters

Summary

Under Section 17 of the Auditor General Act, we conduct a review of the audit opinions and related management letters of those agencies audited by private sector auditors. We consider those results, as well as results from our audits of agencies within the GRE, when auditing the consolidated financial statements of the Province. The purpose of this Chapter is to highlight matters of interest as a result of this review.

Although the majority of audits conducted on agencies within the GRE resulted in unqualified audit opinions, there were also a number of qualified opinions. The audit opinions for several of the school boards were qualified due to the inability of the auditors to verify the completeness of school-based funds. In our view, these qualified opinions do not diminish the usefulness of the related financial statements. However, the continuing qualification of the audit opinion of one of the Province's loan funds due to insufficient support for management's estimate of provisions on asset impairment, means those financial statements cannot be used to evaluate the performance of the fund.

During our review of management letters we found auditors had identified numerous internal control and information technology deficiencies. Many deficiencies identified by auditors in the prior year still existed in 2008-09. We noted that about 40% of the recommendations made in 2008-09 were repeated from 2007-08 and of these, over half had been reported in the prior year as well. Deficiencies were also identified in two provincial loan boards regarding documentation to support financial statement balances.

Control weaknesses will continue to be identified as auditors increase their awareness of the control environment in these agencies. Management should address the deficiencies identified by their auditors to ensure the integrity of their financial systems and financial reporting processes.

7 Review of Agency Financial Statements and Management Letters

Background

- 7.1 The financial statements of crown corporations and agencies, funds of the government of Nova Scotia and trusts administered by the government of Nova Scotia, are in some cases audited by the Office of the Auditor General, and in other cases by private sector auditors licensed under the Public Accountants Act.
- 7.2 Section 17 of the Auditor General Act permits this Office to conduct additional reviews of those agencies where financial statements are reported on by private sector auditors. This Chapter includes comments on our review of the results of financial statement audits by private sector auditors, as well as comments on audits performed by this Office.
- 7.3 In prior years, we have included the results of the annual audit of regional development authorities in this Chapter. It has been determined these entities should be excluded from the scope of our review as they are not part of the government reporting entity.
- 7.4 As noted in Chapter 5 of this Report, the Auditor General is responsible for the annual audit of the consolidated financial statements of the Province of Nova Scotia. Comments and observations on our audit of the Province's March 31, 2009 statements are noted in that Chapter.

Chapter Objective

- 7.5 The objective of the review of financial statements and management letters is to identify matters of interest to the users of public sector financial statements.

Significant Observations

Review of Audit Opinions

Conclusions and summary of observations

We noted qualified audit opinions were issued in several agencies due to the inability of their auditors to audit completeness of certain revenues. We also

noted during our review that a qualified opinion was issued in one instance where there was insufficient support for the provision for impairment in one of the loan funds. This was consistent with the prior year and reduces the usefulness of these financial statements in assessing the recovery of financial assistance.

7.6 *Background* – The result of an audit is an opinion on whether financial statements present fairly the financial position of the entity at its fiscal year end, and the results of its operations for the year then ended. Where there are qualifications of an audit opinion, or situations in which it is not possible to render an opinion, we believe it appropriate to report on such matters.

7.7 *Qualified audit opinions* – Several agencies included in the consolidated financial statements of the Province derive revenue from donations or other contributions, the completeness of which is difficult to verify during an audit. The audit opinions for these agencies are therefore qualified. This is a standard qualification for entities with these types of revenues.

7.8 Qualified audit opinions can also result from insufficient evidence to support financial statement balances or disclosures. The audit opinion of the Nova Scotia Farm Loan Board was qualified because of insufficient satisfactory evidence relating to management’s estimate of provisions for loan impairment. The audit opinion of the Nova Scotia Power Finance Corporation was qualified because the Corporation was unable to provide historical cost and effective interest rate of investments. Both audit opinions are consistent with those issued at March 31, 2008.

7.9 Qualified audit opinions were issued by the auditors of the following agencies. The opinions are identical to those issued in 2007-08.

- Cape Breton Victoria Regional School Board, South Shore Regional School Board, Strait Regional School Board, Conseil scolaire acadien provincial, and Tri-County Regional School Board – due to the inability to verify the completeness of school-based funds
- Public Trustee – due to insufficient evidence to indicate whether trust income and assets are complete
- Art Gallery of Nova Scotia – due to insufficient evidence to indicate whether revenue is complete
- Nova Scotia Agricultural College Foundation – because pledges were not recognized as revenue

7.10 A qualified audit opinion was issued for the E911 Cost Recovery Fund due to insufficient evidence to indicate whether expenses of the fund were complete. A qualified audit opinion was also issued for the Nova Scotia Health Research Foundation due to the inappropriate application of an accounting policy related to grants payable.

7.11 *Disclosed basis of accounting* – Auditors can no longer provide an unqualified opinion on general purpose financial statements prepared on a basis of accounting other than generally accepted accounting principles (GAAP).

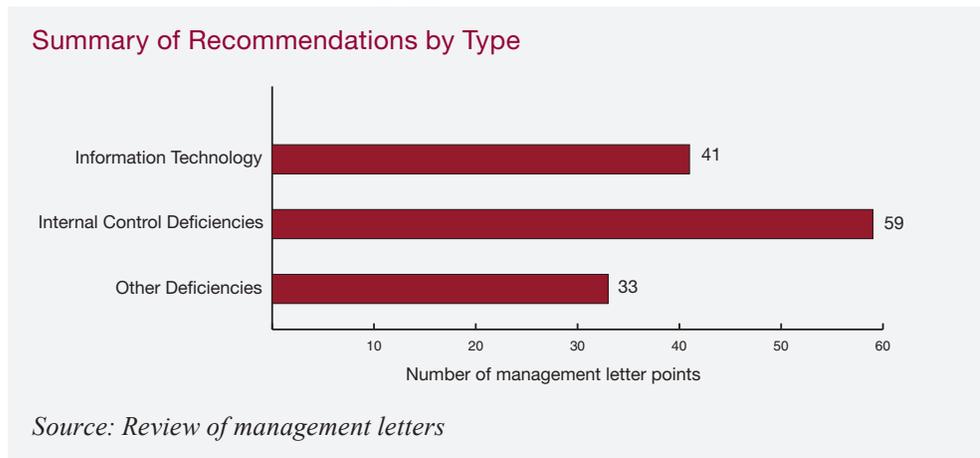
7.12 A qualified audit opinion was issued for the Sherbrooke Restoration Commission. The Commission’s financial statements were prepared using accounting principles for museum boards in Nova Scotia as prescribed by the Department of Tourism, Culture and Heritage. This preparation is consistent with prior years.

Review of Management Letters

Conclusions and summary of observations

Many of the findings noted in the management letters we reviewed were reported in prior years and management have failed to respond to auditors’ recommendations for improvement. A significant number of internal control deficiencies were reported in several agencies. Examples include improperly prepared and supported account reconciliations, and poor segregation of duties. In addition, there are numerous findings and recommendations related to information technology, including system access issues such as continuing access rights for terminated employees and access rights that are in excess of those needed to perform duties.

7.13 *Information technology controls, and financial controls and records* – During financial statement audits, situations were noted where accounting and control systems or procedures, including those related to information technology systems, were deficient. These weaknesses were reported by the auditors in management letters to the crown corporations or agencies. Other deficiencies reported include matters related to governance and other financial reporting matters. The exhibit below provides the number of weaknesses identified by type.



- 7.14 We noted that audit findings reported in 2007-08 in each of the public sector pension plans had been addressed during the current year, and there were no findings to report in 2008-09. We acknowledge the efforts of management of these plans in implementing audit recommendations.
- 7.15 Responding to audit recommendations is indication of a strong overall control environment in an entity. The number of control recommendations that remain outstanding from one year to the next in several agencies is concerning, as is the number of new findings and recommendations. In fact, about 40% of the recommendations made in 2008-09 were repeated from 2007-08, and of these, over half had been reported in 2006-07. Management needs to address recommendations on a timely basis to ensure the integrity of their financial statements.
- 7.16 Although they were not of a magnitude to require reservation of an audit opinion, the auditors of several agencies recommended improvements regarding the deficiencies noted to ensure financial records provide complete and accurate information on a timely basis. These recommendations are detailed below.

Regional School Boards, Nova Scotia Community College and Atlantic Provinces Special Education Authority

- 7.17 *Cape Breton Victoria Regional School Board* – Numerous recommendations reported in prior year’s management letters were noted again in the current year.
- Management should determine if there is any obligation to provide future health retirement benefits to confidential employees.
 - Management needs to review the payroll register for accuracy of payroll expenses.
 - The payroll journal should be reconciled to SAP.
 - Improvements in cash flow are still needed by collecting on the March 31, 2009 accounts receivable balance.
 - Management should assess the impact of exceptions noted to control objectives in the service provider’s audit report for physical access controls, logical access controls, and application software development and implementation.
- 7.18 The auditors also noted that management of the Board develop a plan to ensure school-based funds are properly accounted for and included in the financial statements. A new recommendation is that management should perform a review of all bank accounts to ensure disclosure of all funds belonging to the Board in the financial statements.

- 7.19 *Conseil scolaire acadien provincial* – The Conseil’s auditors noted that improvements had been made over the year and that time will be needed to implement all recommendations. As in 2007-08, auditors continued to recommend a formal procedure be adopted for evaluating internal controls. Resource constraints prevented the creation of a manual. However the Conseil now has access to a template developed by another entity that it is able to adapt in the formation of its own manual.
- 7.20 With respect to school-based funds, the auditors continued to recommend that all accounts, and only those accounts and transactions, related to school-based funds be included in the system to record these funds. The establishment of an internal audit review of these funds is also still recommended from the prior year.
- 7.21 *South Shore Regional School Board and Tri-County Regional School Board* – Though the Board has made significant effort to develop an internal audit function for school-based funds in the past few years, there is still a need to establish procedures for documenting, testing and evaluating internal controls at the individual school level to ensure complete and accurate disclosure of these amounts. Auditors are also concerned with the lack of segregation of duties in the accounts payable division and in the preparation of journal entries. These weaknesses were reported in 2007-08.
- 7.22 *Strait Regional School Board* – Individual schools within the Board have made significant improvements in procedures related to school-based funds. The auditors continue to note two other findings with respect to school-based funds: the existence of pre-signed cheques and unclaimed HST rebates. At the Board level, the auditors have further recommended that management should assess the impact of exceptions noted in the service provider’s audit report related to the Board’s general ledger system.
- 7.23 *Nova Scotia Community College* – The auditors noted an instance where a test plan had not been documented for a system change. They also recommended that password policies be revised to be consistent with leading industry practice. With respect to bookstore operations, a consistent policy was needed on the timing of returns to suppliers. Auditors also advised management to review file accumulation procedures to ensure information included in personnel files is appropriate.
- 7.24 *Atlantic Provinces Special Education Authority (APSEA)* – The auditors recommended that credit card transactions be recorded in the general ledger as they are incurred, in order to facilitate the process of reconciling the monthly credit card statement. The auditors further recommended the financial statements be released on a timely basis. (These recommendations

relate to the March 31, 2008 financial statements. The March 31, 2009 financial statements have not been issued to date.)

District Health Authorities and the IWK Health Centre

- 7.25 *Annapolis Valley Health, South Shore Health, and South West Health* – Auditors noted control deficiencies in the use of procurement cards and recommended policies related to these cards be communicated to cardholders again. Additionally, cardholders need to approve credit card statements prior to these statements being approved by supervisors. Computer security issues were of concern this year. Password parameters were not consistent with leading practice and user accounts were not always deactivated for all systems upon termination of an employee. Physical access to the system needs to be better controlled. Management should approve all operating system changes, and changes should be tested prior to implementation. Auditors made note of the continuous improvements made by management in addressing recommendations from the 2008 audit. In addition, with respect to Annapolis Valley Health only, the auditors have recommended the entity obtain formal authorization from the Department of Health for the deferral of funds related to a redevelopment project.
- 7.26 *Cape Breton Health* – Numerous significant deficiencies were identified in the current year. No report was generated from the accounts payable system indicating new vendor set-up that would help detect the creation of a fictitious vendor, and inventory was not valued correctly in the system. HST claims were not supported by a detailed listing of the related purchases. Segregation of duties issues were noted in the revenue processing area and in the access to software applications, and passwords were not meeting standards. Access rights were also not updated immediately upon termination or transfer of an employee. Finally, with respect to system deficiencies, it was noted that program change controls are weak including the ability of programmers to access the live production environment. Several of these items were reported in the prior year.
- 7.27 Other audit observations were numerous and most related to payroll issues. Assets provided to employees such as cell phones needed to be tracked, and there was a need to reconcile data on payroll reports to the general ledger when preparing T4s. Variances between T4 amounts and payroll amounts need to be formally approved and maintained with the T4 file. The management letter highlighted that overtime paid to one employee totaled almost \$140,000 and that overtime paid to two other individuals totaled nearly \$110,000. Finally, management review and documentation of IT vulnerability assessments and authorized access were lacking.
- 7.28 *Colchester East Hants Health Authority* – Access control issues were highlighted in the management letter. Recommendations made in 2007-08

to strengthen password controls in two applications were not acted upon, and similar issues with another system were found in the current year.

- 7.29 *Cumberland Health Authority* – As reported in the prior year, reconciliations of supplier statements to accounts payable were not completed on a regular basis. Current year findings were related to the following: late HST reports as a result of not having filed on a monthly basis, miscellaneous MSI billings were not accrued, and an erroneous entry related to employee benefits was recorded because a reconciliation of these benefits had not been performed. Monitoring cash collection processes needs to be performed regularly, and there should be evidence of the reconciliation of accounts receivable sub ledgers to the general ledger. Development of procedures to standardize the termination system access process was recommended.
- 7.30 *Guysborough Antigonish Strait Health Authority* – Cheque numbers recorded in the general ledger for one bank account did not match the cheque numbers clearing the bank; certain accounts payable accounts remained unchanged from prior years, and system users were not required to change passwords on a regular basis. These findings were consistent with those noted in 2007-08. Current year recommendations include strengthening exception reports related to cheque disbursements in excess of \$25,000 and payroll cheques greater than \$25,000. It was also noted that the procurement binder, including approval limits, should be kept up-to-date to prevent unauthorized purchases.
- 7.31 *Pictou County Health Authority* – Consistent with weaknesses found in the 2007-08 year, password controls for certain applications could have been stronger and administrative access for a specific application needed to be reviewed for two business users to ensure there was appropriate segregation of duties. In addition, journal entries prepared by senior management were only reviewed for part of the year. Auditors recommended the Authority's use of the Province's general ledger system be included within the scope of the Province's annual system audit report.
- 7.32 *IWK Health Centre* – Issues related to prior year findings on the inventory system had been addressed by management, except that controls over entries to override the inventory system need to be improved. There were still instances where users were emulating other users in one system and also copying the access rights of another user. These were reported in the prior year. In the current year, auditors noted time processed by payroll that was not reviewed or signed off by department managers.

Entities Providing Financial Assistance

- 7.33 *Film Nova Scotia* – As reported in the prior year, the Corporation should develop a detailed tangible capital asset policy.

- 7.34 *Nova Scotia Business Inc.* – The auditors noted very little substance to support equity valuations and recommended reviewing the latest financial statements as part of the process. The auditors also recommended improvements to the valuation process including use of a checklist with probing questions, and obtaining entity interim financial statements to provide more timely information. As reported in prior years, management should consider an actuarial valuation for the public service awards liability.
- 7.35 *Nova Scotia Farm Loan Board* – The Board has made some progress in loan monitoring and documentation to support loan valuations, but the auditors were still unable to conclude on the accuracy of provisions for loan impairment, and the Board should ensure there is independent and objective support for the valuation of loans.
- 7.36 *Nova Scotia Fisheries and Aquaculture Loan Board* – The Board’s books of accounts did not report all transactions and accounts. Year end accounting processes should include preparation of a trial balance showing all accounts and adjustments to support the financial statements. There was inadequate documentation supporting the allowance amount for impaired loans and the auditors recommended formalizing and approving a process for determining the annual allowance for doubtful accounts. The Board should assess the need for an audit committee.
- 7.37 *Strategic Opportunities Fund Incorporated* – The auditors recommended considering investment opportunities for the \$9 million balance of the Fund.

Government Business Enterprises

- 7.38 *Halifax Dartmouth Bridge Commission* – The auditors recommended an allowance be established for MacPass accounts in arrears, to recognize possible collectability issues with these amounts. They have also advised that the liability recorded for customer deposits on lost or stolen transponders should be taken into income. Both recommendations were reported last year. In the current year, the auditors have recommended adjusting the liability for retiring allowances each year, and that the Commission should consider having an actuary determine this liability. The Commission should also consider restricting some of its assets to fund this liability
- 7.39 *Highway 104 Western Alignment Corporation* – No new findings were identified in the current year’s audit, but each of the 2007-08 findings remained outstanding. These related to the tolling system that had been in place during the March 31, 2009 fiscal year but which was replaced subsequent to year end. A weakness in the previous tolling system was that several users had the same passwords, and it was recommended this be taken into account in the new system.

7.40 *Nova Scotia Liquor Corporation (NSLC)* – Several observations resulting from the Province’s service auditor’s report were applicable to NSLC. The auditors specifically noted the following significant deficiencies.

- Security access should be reviewed to ensure the ability by one individual to make system changes is appropriate.
- Controls over application software development, implementation and testing should be reviewed to ensure they are operating effectively. The auditors recommended this review be conducted by internal or external auditors.

7.41 In addition, the auditors had numerous findings on other system-related matters.

- Changes to user access rights in the Warehouse Management System (WMS) need to be made on a more timely basis.
- Access rights of personnel within the IT group need to be reviewed on a periodic basis, as do access rights to certain privileged-level accounts.
- There are deficiencies in the password standards used in the WMS. The scope of the existing documented password policy at NSLC is limited to the network and should be expanded to include all significant financial applications.
- There is a lack of segregation of duties in aspects of the WMS and other financial applications.
- Requests for application access should be approved by the owner of the business application.
- Security-related logs should be independently reviewed.

7.42 Additional findings related to each of the above matters were identified in the auditor’s management letter resulting from the March 31, 2008 audit. NSLC had addressed several findings but the above remained outstanding at March 31, 2009.

Pension Funds

7.43 *Members’ Retiring Allowances Act accounts* – Consistent with 2007-08 recommendations, management should ensure the pension confirmation process is applied to all pensioners. In the 2008-09 year, the process was not applied to retired MLAs. Also consistent with prior year recommendations, the Plan needs a formal amendment to reflect previously approved changes so a formal waiver can be obtained from the Canada Revenue Agency. Auditors also recommended management amend the legislated interest

rate. In the current year, it was noted that journal entries were approved by an individual without proper authorization per the signing authority book.

Other Agencies

- 7.44 *Canada-Nova Scotia Offshore Development Board* – The Board should continue to assess the on-line payment system to ensure that all safeguards are being followed and that passwords to this system are routinely changed. Also, the Board should consider restricting a further amount to make up the funding shortfall of pension and other retirement obligations.
- 7.45 *Canadian Blood Services* – Procedures to remove user access for former employees need to be complied with. Also, the auditors recommended that a complete audit trail is implemented to ensure all system jobs have been run to normal completion, and access to the general ledger batch job administrative functions should be reviewed and restricted to a small group of IT staff.
- 7.46 *Canadian Sport Centre Atlantic* – The auditors noted all the observations and recommendations resulting from the March 31, 2008 audit were still relevant. In the current year, they recommended an accounts receivable subledger be created and reconciled to the general ledger each month, and that the payroll register and prepaid payroll account be reviewed on a monthly basis.
- 7.47 *Nova Scotia Crop and Livestock Insurance Commission* – The Commission should continue to move forward with the development of a new information system. Incorrect rates were used in the calculation of insurance premiums due to errors in manual spreadsheets. The Commission should check all calculations for accuracy before insurance coverage is written. Monthly reconciliations should be completed for government accounts receivable, premium revenue, and claims to ensure submissions are accurate and complete.
- 7.48 *Nova Scotia Gaming Foundation* – Auditors identified the Foundation’s non-compliance with the Memorandum of Agreement with the Department of Health Promotion and Protection in 2007-08, and repeated this finding in 2008-09. Management should document review of bank reconciliations. Finally, the Board of the Foundation should develop a process for monitoring compliance with the investment policy, and for measuring performance of the investment manager.
- 7.49 *Nova Scotia Health Research Foundation* – Auditors recommended management review the payroll summary for each payroll cycle to ensure all changes were appropriate.

- 7.50 *Nova Scotia Housing Development Corporation* – The auditors recommended an annual review of access privileges for all user accounts be performed, and that the change management process be expanded to include documentation of these changes, and approvals. Internal control weaknesses in three housing authority offices were identified, including lack of segregation of duties.
- 7.51 *Nova Scotia Innovation Corporation (InNOVAcorp)* – Management should consider modifying the security access rights of senior financial reporting personnel to remove their ability to post journal entries.
- 7.52 *Nova Scotia Primary Forest Products Marketing Board* – Working papers prepared for the audit should reconcile to the general ledger.
- 7.53 *Nova Scotia Public Service Long-Term Disability Trust Fund* – As in the prior year, the auditors encouraged the formation and greater use of committees such as investment, benefit, and human resource committees. Authority to withdraw investment funds has not yet been established.
- 7.54 *Nova Scotia School Boards Association* – The audit committee should conduct periodic testing to monitor compliance with Board policies and procedures. A written policy should be established for investing surplus funds. There should be an approval process for expenses exceeding a predetermined amount. Finally, the Association should investigate its eligibility to apply for the GST rebate available to non-profit organizations.
- 7.55 *Nova Scotia Utility and Review Board* – The Board should continue to evaluate its IT processes and policies and implement changes similar to those made by government in response to the April 2009 Report of the Auditor General, and should also consider these recommendations during the selection and implementation of its new IT system for the Motor Carrier Division. It was also noted that stale-dated cheques should be investigated and removed from the bank reconciliations.
- 7.56 *Public Trustee Trust Funds* – The Public Trustee should develop a system to ensure revenue and expense transactions are properly classified as they are recorded. The financial statements should be prepared on an accrual basis to be in compliance with GAAP. The Public Trustee should establish a policy for valuing real estate and should also investigate and remove stale-dated cheques.
- 7.57 *Resource Recovery Fund Board* – The auditors continue to recommend that password setting and user access for certain applications be reviewed. They also recommended that change management policies and procedures be developed and documented. In addition, the auditors recommended

that formal approval be obtained from the Board of Directors for the postponement of payments on a note receivable, and additional documentation on the continuation of a customer's personal guarantee.

- 7.58 Sydney Tar Ponds Agency (STPA) – The auditors noted that the Province has the ability to post transactions to the STPA general ledger. They have recommended these entries should only be made to reflect payments made by the Province on behalf of the Agency. The auditors have further recommended the Agency establish an audit committee.
- 7.59 *Waterfront Development Corporation* – The Board should approve all dividends paid and the Controller should not prepare journal entries. Both findings were noted in the prior year.

Timeliness of Financial Reporting

Conclusions and summary of observations

The usefulness of financial information is impacted by its timeliness. Management of all agencies within the government reporting entity need to ensure their financial statements are released as required by legislation. Timely financial results are important for decision-making purposes.

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- 7.60 *Compliance with deadlines* – The Provincial Finance Act requires that financial statements for government business enterprises and government units be submitted to the Minister of Finance by June 30 following their fiscal year end (usually March 31).
- 7.61 There continue to be problems with receiving submissions by the deadline although the number of agencies in violation of this deadline has decreased by over 50% for the year ended March 31, 2009. This year, 11 agencies (2008 – 32) were not successful in providing audited financial statements and requested information by June 30. Four of these agencies were also late in providing the requested information on time in 2008. This delay results in using unaudited information for planning and monitoring purposes in the current year. The exhibit below provides a complete list of late agencies for 2008-09.



Late Agencies

Atlantic Provinces Special Education Authority	Nova Scotia Municipal Finance Corporation
Conserve Nova Scotia	Nova Scotia Strategic Opportunities Fund Inc.
Industrial Expansion Fund	Provincial Drug Distribution Program
Nova Scotia E911 Cost Recovery Fund	Public Trustee Trust Funds
Nova Scotia Farm Loan Board	Trade Centre Limited
Nova Scotia Housing Development Corporation	

REVIEW OF AGENCY FINANCIAL STATEMENTS AND MANAGEMENT LETTERS

- 7.62 The Province's March 31, 2009 consolidated financial statements were released on September 10, 2009 meeting the reporting requirement set out in the Provincial Finance Act.