
Financial Reporting



5 Government Financial Reporting

Summary

Financial reporting is a key component of government's accountability framework. Financial reports must be reliable and accurate, and must be provided on a timely basis so that they are relevant.

Our review opinion of the 2010-11 revenue estimates included in the April 6, 2010 Budget Address was again qualified. Third-party revenues were not estimated or included in the revenue estimates and therefore the budget was not prepared on the same basis as the consolidated financial statements. This is a requirement of generally accepted accounting principles (GAAP). We have again recommended these revenues be estimated to ensure compliance with GAAP. We have also recommended that Government implement the recommendations of a consultant's report, which it has accepted, to disclose these third-party revenues in the revenue estimates, for the preparation of the next estimates.

The Minister of Finance tabled the Province's Public Accounts for the year ended March 31, 2010 on July 29, 2010. The Auditor General's opinion on the consolidated financial statements included in the Public Accounts was unqualified. In October 2010, we provided a management letter to the Minister of Finance with detailed audit findings and recommendations. Our quantitative findings were neither individually nor cumulatively significant enough to affect the audit opinion; however, all findings impact the integrity of the financial statements. We noted Government has made progress in documenting its internal controls and is continuing this process.

The Province has a new Finance Act, effective August 1, 2010. Although the Province's consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles for the public sector, the new Finance Act does not prescribe the accounting principles to be adopted by the Province. We feel that sound financial reporting would be strengthened by inclusion of a requirement in the Finance Act to comply with generally accepted accounting principles.

The March 31, 2010 consolidated financial statements include a \$132.6 million provision for the cost of remediation of the Sydney Steel Corporation (SYSCO) and adjacent sites. Last year, we noted that a critical step in updating the estimate of the provision would be an independent analysis of the costs necessary to complete the remediation of the sites. At the time of our audit for the March 31, 2010 year end, the terms of reference for this analysis had been prepared and discussions with the consultant had commenced. We have again recommended this analysis be completed on a timely basis and that the balance of the provision be adjusted to reflect this estimate.

5 Government Financial Reporting

Background

- 5.1 Government financial reporting serves many purposes and is provided to stakeholders in various forms. Reports may be prepared to meet the needs of specific users, such as credit rating agencies and lenders. Individual entities may produce reports, such as annual reports, to demonstrate how they have complied with legislation throughout the year, and to measure and report on their financial condition and on the performance of funds, programs and activities. Financial reports prepared by government are intended to provide information on past or future activities to a variety of users for numerous reasons.
- 5.2 Financial reports are a means through which government fulfils its accountability responsibilities regarding the use of public funds and demonstrates its stewardship over those funds. Financial reports assist us in evaluating operating results and assessing the level of services the government provides. These financial reports must therefore be relevant, reliable, understandable and released on a timely basis if they are to be used to hold government fiscally accountable.
- 5.3 The Provincial Finance Act details the financial reporting cycle of the Province, from budget to actual results. The Act prescribes detailed financial reporting requirements as annual estimates (budget), regular forecast updates, and tabling of the Public Accounts (actual financial results). These annual reporting requirements are part of the government's accountability framework and contribute to oversight and the effective and efficient use of resources.

Budgets

- 5.4 Government uses the budget process to inform stakeholders of its fiscal plan and priorities for the upcoming year. The budget is a key policy document and, in Nova Scotia, forms the basis for the legal authority to spend throughout the year through the voting and approval of the Appropriations Act.
- 5.5 The budget is a critical component of government accountability against which forecast updates and actual performance are compared. Since the provincial government manages billions of dollars of public funds each year, the budget process is essential to effective fiscal management.

Forecasts

- 5.6 Forecasts provide a comparison of activity to date to the approved budget for the year, and update the estimate of the surplus or deficit for the year based on results to date.
- 5.7 Forecast updates are an important element of accountability. They enhance transparency by providing current information on the government's financial situation, and contribute to effective management of public funds. In order to be an effective accountability tool and to provide appropriate information for decision making purposes and resource allocation, forecast updates must be prepared with due diligence and adequate oversight.

Public Accounts

- 5.8 Financial statements are the final component in the financial reporting cycle. The Canadian Institute of Chartered Accountants' (CICA) Public Sector Accounting Board (PSAB) notes that *"They serve as a means by which a government provides an accounting of its administration of public financial affairs and resources. [They]... are a principal means of communicating financial information to those not involved in the government's financial administration."*
- 5.9 The Province's annual Public Accounts are prepared by the Controller on behalf of the Minister and Deputy Minister of Finance. The Provincial Finance Act required the Public Accounts to be tabled by September 30 each year.
- 5.10 The Public Accounts include Financial Statement Discussion and Analysis (FSD&A), which is a recommended practice by PSAB, and the audited consolidated financial statements (CFS) of the government. The FSD&A provides comparative financial highlights of the CFS and information on certain financial indicators. The CFS provide audited financial information for two years as well as comparison of budget to actual results. As the budget reflects the plan approved by the House, the comparison of budget to actual enhances transparency. The information provided in the Public Accounts can be used for a variety of purposes, including:
- to evaluate the government's performance for the year as compared to budget and prior year; and
 - to form the basis of analyzing government's financial performance and condition.
- 5.11 The release of the Public Accounts is a key component in the accountability framework of the government, comparing actual results for the year

against the approved budget, and providing important information to all stakeholders, including taxpayers and members of the House of Assembly.

Chapter Objective

5.12 The objective of this Chapter is to provide summary comments and recommendations on government financial reporting, specifically:

- the results of our review of the revenue estimates included in the April 6, 2010 budget address;
- information resulting from our audit of the Province's March 31, 2010 consolidated financial statements; and
- other financial reporting matters.

5.13 During the year, the Provincial Finance Act was repealed. The new Finance Act was proclaimed and was in effect on and after August 1, 2010. Throughout this Chapter, we will refer to legislation under the Provincial Finance Act as that was in effect during the period of our review and audit, except where the new Finance Act is specifically referenced.

Significant Observations

Review of 2010-11 Revenue Estimates

5.14 *Background* – Under Section 9B of the Auditor General Act, the Auditor General is required to provide an opinion on the reasonableness of the revenue estimates included in the budget tabled with the House of Assembly. The Auditor General's opinion on the 2010-11 revenue estimates was tabled in the House of Assembly on April 6, 2010 along with the Government's budget documents.

5.15 *Results of review* – The opinion on the revenue estimates indicates whether:

- at the date of the opinion (April 3, 2010), the assumptions used by departmental management are suitably supported and consistent with the plans of the government, as described by management, and provide a reasonable basis for the 2010-11 revenue estimates;
- the 2010-11 revenue estimates fairly reflect these assumptions; and
- the 2010-11 revenue estimates comply with the presentation and disclosure standards of the CICA.

- 5.16 Consistent with prior years, the opinion on the 2010-11 revenue estimates was qualified with respect to the CICA's presentation and disclosure standards. Specifically, the opinion was qualified for two reasons as discussed in the following paragraphs.
- 5.17 *Presentation of revenue estimates* – There was a reservation of opinion because revenues of certain government units were excluded from the revenue estimates. These revenues relate primarily to the Departments of Health (district health authorities) and Education (school boards). Canadian generally accepted accounting principles require the budget to be prepared using the same accounting principles as the historical financial statements against which they will be compared – in this case, the Province's consolidated financial statements. Therefore, revenues of these government units are to be reported as separate line items in the Province's revenue estimates because they are reported, on a consolidated basis, as separate line items in the consolidated financial statements.
- 5.18 In addition, the estimates for these revenues, which include third-party revenues such as ancillary operations in health authorities or municipal funding in school boards, are included elsewhere in the budget as an offset to related expenses for these government units and are therefore presented on a net basis. This presentation is not consistent with CICA standards which require that the revenue estimates be presented on the same gross basis as the consolidated financial statements. Since these revenues are excluded, the related departmental budgets are not complete. This means all revenues and expenditures of the departments are not subject to review and challenge in the budget process.
- 5.19 *Supporting information* – Management does not have support for these third-party revenues and consequently, there is a scope limitation on our review of the revenue estimates. We were unable to perform a review of these third-party revenues, which would include determining their nature and amount.
- 5.20 In each of the past several years we have recommended that the revenue estimates include all revenues of the consolidated entity so that the revenue estimates comply with Canadian generally accepted accounting principles. This was never intended as a recommendation to revise the way in which the government prepares its budget for operating purposes. Rather, it is a recommendation made for the sole purpose of advising that the presentation of the revenue estimates included in the annual budget should be on a gross basis to ensure consistency with the consolidated financial statements of the Province.

Recommendation 5.1

The Department of Finance should include estimates of all revenues of the consolidated entity in the Provincial budget, including all agencies' third-party revenues, to ensure the budget is prepared and presented fully in accordance with Canadian generally accepted accounting principles.

5.21 The above recommendation is consistent with that provided by a Government-hired consultant whose objectives included recommending an approach to resolving the qualification on future revenue estimates. The consultant, Deloitte LLP, released its report in November 2009 and recommended that a schedule of all revenues be prepared for inclusion in the budget documentation. The Government accepted all the recommendations of the consultant's report but has taken no steps to implement this recommendation.

Recommendation 5.2

The Department of Finance should implement the recommendations of the Deloitte LLP report, previously accepted by the Government, to disclose agencies' third-party gross revenues in the revenue estimates, for the preparation of the next estimates.

5.22 The qualified opinion on the 2010-11 revenue estimates is indicative of deficiencies in the budget process as it relates both to completeness of revenues at specific departments (Health and Education as discussed above) and also accountability to the Department of Finance, which has overall responsibility through the Minister and Deputy Minister, as per the Provincial Finance Act, to examine and compile the annual estimates, including the budgeted revenue figures.

5.23 There are challenges to estimating third-party revenues of these entities. However, we emphasize the need to recognize these revenues in the budget and therefore, we have recommended that future revenue estimates include these amounts. The assumptions and calculations used to determine these revenues should be provided to the Department of Finance.

5.24 To effectively carry out its budget mandate, the Department of Finance must be able to hold all department management accountable for the timely preparation and presentation of budget information. No changes to this aspect of the budget development protocols were undertaken in the current year despite this Office's previous recommendations and, as a result, we encountered many of the same issues found in 2009-10 when reporting on the 2010-11 estimates.

5.25 The duties of the Deputy Minister of Finance, as described in Section 11 (3) of the Provincial Finance Act (effective to July 31, 2010; Section 12(3) of

the new Finance Act (effective August 1, 2010)), provide the authority for the Deputy Minister to compel departments to provide necessary support, on a timely basis, for completion of the revenue estimates. This authority should be exercised in the preparation of future revenue estimates.

Recommendation 5.3

The Department of Finance should obtain all necessary information from departments to prepare the revenue estimates, including estimates of third-party revenues of government units, in accordance with generally accepted accounting principles.

5.26 *Economic forecasting model* – In the preparation of the 2010-11 revenue estimates, material adjustments were made to the Provincial forecasting model for the impact of the Government of Nova Scotia Economic Stimulus Package. It was difficult to review changes made to economic assumptions due to incomplete management and audit trails supporting such adjustments. Adequate documentation would ensure there is support to facilitate independent review and approval of changes to the model.

Recommendation 5.4

The Economic and Statistics Division of the Department of Finance should ensure key economic assumptions are supported appropriately and that clearly documented management and audit trails of adjustments are maintained.

5.27 *Petroleum royalties* – The management review and challenge of the assumptions used in the royalties models is informal, as is the approval of the resulting estimated revenue. Controls would be improved if there was an independent check on the inputs to the models used to estimate this revenue to ensure no errors were made. Controls would be further improved if there were support for management's assessment that changes in certain market data have a negligible impact on the forecast.

Recommendation 5.5

The Department of Finance should implement a process for a formal and documented review and challenge of the assumptions used in the preparation of the petroleum royalties estimate.

Audit of the March 31, 2010 Consolidated Financial Statements

Introduction

5.28 The Province's consolidated financial statements (CFS) are included in Volume 1 of the Public Accounts. The Auditor General is required to report

annually to the House on these financial statements, under Section 9(1) of the Auditor General Act.

5.29 The Minister of Finance tabled Volume 1 of the Public Accounts on July 29, 2010. An unqualified audit opinion dated June 30, 2010 was issued on the March 31, 2010 consolidated financial statements.

5.30 A management letter including detailed audit findings, recommendations and other comments was provided to the Minister in October 2010. The unqualified audit opinion on the CFS indicates that there were no quantitative findings, either individually or cumulatively, which were significant enough to impact our opinion. However, the management letter included several recommendations for improvements to be implemented by the Department of Finance. We discuss the key findings and recommendations in the following paragraphs, under these headings:

- required communication of audit results;
- systems and controls;
- audit misstatements and accounting policies;
- general ledger maintenance and other reportable matters;
- audit completion; and
- accounting and auditing standards.

Required communication of audit results

5.31 *Responsibility for the consolidated financial statements* – The preparation of the consolidated financial statements in accordance with Canadian generally accepted accounting principles for the public sector is the responsibility of the Department of Finance’s Government Accounting Division. Government management is also responsible for the maintenance of adequate accounting records and internal controls; prevention and detection of fraud and errors; safeguarding of assets; selection and application of suitable accounting policies; and appropriate disclosure of financial information in the financial statements.

5.32 Our Office is the legislated auditor of these financial statements. Audit standards require that we report the following information.

- We plan and perform our audit procedures to provide reasonable, but not absolute, assurance of detecting fraud and errors that have a material effect on the financial statements.
- Based on our audit, we concluded the consolidated financial statements presented fairly, in all material respects, the financial

position of the Province as at March 31, 2010, and the results of its operations, changes in net direct debt and cash flows for the year then ended in accordance with Canadian generally accepted accounting principles for the public sector.

- We reviewed, but did not audit, the information in the Financial Statement Discussion and Analysis (FSD&A) section of Volume 1 of the March 31, 2010 Public Accounts. We did not find any inconsistencies between the information in the FSD&A and the information in the consolidated financial statements.
- At the conclusion of this year's audit, there were no significant outstanding concerns with the estimated accounting balances used in preparing the March 31, 2010 consolidated financial statements, including those estimates that are particularly sensitive to differing future actual results.

5.33 In September 2010, subsequent to the release of the CFS, senior Department of Finance staff brought to our attention an error in the audited consolidated financial statements. The error resulted in personal income tax (PIT) revenue being overstated by \$87.7 million (including related prior year adjustments) for the year ended March 31, 2010. The error was discovered by Department of Finance staff during the September 2010 forecast update on the 2010-11 budget. We were provided details on the error and the full impact on financial reporting. Management further advised that comparative figures which will be included in the 2010-11 Public Accounts will be adjusted to reflect adjusted PIT revenue for 2009-10. We commend management for promptly addressing this issue in an open and transparent manner.

Systems and controls

- 5.34 *Responsibility of the auditor* – As part of our audit, internal controls were studied and evaluated to the extent considered necessary under Canadian generally accepted auditing standards. We did not determine whether internal controls are adequate for management's purposes. Our audit will not necessarily disclose all deficiencies requiring attention by management. In addition, we have placed reliance on the audit work of public accounting firms appointed to report on the financial statements of agencies included in the consolidated entity. Chapter 7 in this Report includes information and commentary on selected weaknesses in internal controls, and other deficiencies, which were reported to those entities by their auditors.
- 5.35 *Responsibility for internal control* – Roles and responsibilities concerning internal controls are delegated throughout government. While the Provincial Finance Act included general references to the roles and responsibilities of

the Minister and Deputy Minister in this regard, additional guidance needs to be developed, and effectively communicated on a more comprehensive basis. This would include the roles and responsibilities of departmental and crown entity governing bodies and senior management in the design, implementation, operation and maintenance of internal controls. We had commented on the need for action in this area in our Reports as early as 2003 continuing through to Chapter 5 (Government Financial Reporting) of the February 2010 Report of the Auditor General.

- 5.36 Government has begun the process of identifying internal controls related to financial reporting. The first phase of this project has been completed and a report has been issued by the Department of Finance. This phase of the project focused on entity-level controls. The assessment of these was completed by management with the assistance of contracted expertise. The report identifies internal control objectives, key controls, control tests and results of these tests. These results indicate whether the key control is effective or ineffective. The report notes that the controls assessed as being ineffective were not materially significant and that remediation actions have been identified. We noted that documentation supporting the assessment of deficiencies was inadequate and suggest such documentation be stronger in future reports on controls.
- 5.37 We acknowledge management's efforts in this project. The report completes the first phase of the Government's project to support the annual certification requirement by management on the consolidated financial statements, and to address recommendations related to the documentation and communication of internal controls made by this Office in prior years. However, because the annual certification by management relates to a system of internal controls for the consolidated financial statements, and not just the Consolidated Fund (i.e., the Fund that includes the results of departmental activities), our prior recommendations on internal controls over financial reporting on a government-wide basis still need to be implemented.

Recommendation 5.6

Management should complete the review and documentation of internal controls for the consolidated financial statements and include the documentation in the Corporate Policy Manuals.

Recommendation 5.7

Management should assign roles and responsibilities for the design, implementation, operation and maintenance of internal controls as part of the documentation of internal controls.

- 5.38 Management's response to similar recommendations resulting from our March 31, 2009 audit noted that the internal control project will become more robust over time.
- 5.39 As noted in paragraph 5.33, a significant error was included in the CFS for year-end March 31, 2010. In addressing the error during the September 2010 forecast update for the 2010-11 fiscal year, management discussed the ongoing project with respect to internal controls over financial reporting and advised that evaluating the existing controls over revenue would be given priority. We are pleased with management's commitment to identifying and evaluating weaknesses in its controls over revenue in order to mitigate the risk of significant revenue errors in future financial reports. As part of the audit of the CFS, we will continue to monitor management's progress in implementing the above recommendations.
- 5.40 *Seniors' Pharmacare Program* – The Seniors' Pharmacare Program is administered on behalf of the Province by a third-party service provider. Seniors pay a premium during the year and also make a copayment on each prescription filled. The net cost to the Province for the Program is \$137.9 million.
- 5.41 The Province relies on the service provider's computer system to adjudicate pharmacy claims and determine the amount of copayment to collect on each prescription and the amount to be paid by the Program. Copayment revenue is recorded by the Department of Health based on a report the Department generates from this system. The amount is assessed for reasonableness but is otherwise not verified by the Department.
- 5.42 Copayment revenue is a key component in determining the total cost of the Program and therefore in determining premiums to charge seniors. The Department of Health should assess the processes in place to ensure the accuracy and completeness of the copayment revenue. We understand other insured services are subject to internal audit activities at the service provider and suggest the Department should consider requesting copayment information produced by the computer system be subject to internal audit as well.

Recommendation 5.8

The Department of Health should develop and implement controls that would ensure the accuracy and completeness of revenues and expenses of the Seniors' Pharmacare Program.

- 5.43 *Reconciliations* – Reconciliations are an important control process that ensure the government's general ledger agrees with reports provided by third parties. Regular reconciliations also ensure the general ledger

reflects current results. Without regular reconciliations, there is a risk that management is making decisions based on incorrect information.

- 5.44 Certain of the government's revenues are determined annually through the use of revenue models. Reconciliations of those model-determined revenues to the related accounts receivable or accounts payable should be performed at least on an annual basis. Outstanding amounts related to taxation years that have been finalized by the Canada Revenue Agency will be neither collected nor received, and should be adjusted to income. During the March 31, 2010 audit, we analyzed the accounts receivable and accounts payable of certain model-determined revenues and concluded there were amounts that should have been adjusted. Regular reconciliations would have more promptly identified these adjustments.

Recommendation 5.9

The Department of Finance's Taxation and Fiscal Policy Division should perform regular reconciliations of model-determined revenues and related accounts receivable or payable. Outstanding amounts related to closed years should be adjusted to income.

- 5.45 *Payroll termination processes* – We updated our system description for payroll and noted that the termination process does not include formal documentation to remove access for terminated individuals from certain government systems, including the Province's general ledger system (SAP), and that each department has its own process for eventually addressing access removal.
- 5.46 One of the risks of unauthorized access to SAP is that it increases the possibility of inaccurate financial reporting. There should be a process to ensure access to SAP of individuals no longer employed by the Province is removed immediately as part of the termination process. This process should be formalized to be consistently applied throughout government. Department of Finance staff have indicated procedures to address this deficiency have been established since it was identified during the audit.

Recommendation 5.10

The Department of Finance's Payroll Division should ensure the process to terminate employees includes removal of access to SAP.

Audit misstatements and accounting policies

- 5.47 *Accounting errors* – As noted above, we issued an unqualified opinion on the March 31, 2010 consolidated financial statements. In forming this opinion, we considered any unresolved, unadjusted errors or differences in determining whether the statements were presented fairly in accordance

with GAAP. Management has represented, and we have concluded, there were no errors or differences that would, individually or collectively, materially affect the Province's reported financial position, results of operations, changes in net direct debt or cash flows.

- 5.48 Generally accepted auditing standards require that all non-trivial, known errors identified in the Province's consolidated financial statements during the year-end accounting or audit processes be corrected, and this is not being done. These errors should be corrected to enhance the accuracy of the financial statements. We have commented on this in past years and again recommend that action be taken to correct identified errors.

Recommendation 5.11

The Department of Finance's Government Accounting Division should ensure all non-trivial, known errors identified during the audit are corrected.

- 5.49 *Other matters* – Additionally, there were a number of other accounting, disclosure and audit issues which arose and were communicated to government staff at various points in the audit process. Some of these issues were resolved either by review of additional information provided to us or by adjustments to the financial statements.
- 5.50 *Significant accounting policies* – Our management letter resulting from the March 31, 2010 audit identified certain areas in which improvements to the consolidated financial statements were needed to ensure full compliance with GAAP. We expect these matters to be resolved during next year's audit. We made a recommendation, as noted below, with respect to one matter related to Tangible Capital Assets.
- 5.51 In each of the past several years, we have noted our concern over the high level of thresholds used by government for capitalizing certain classes of Tangible Capital Assets. We are especially concerned with the threshold related to roads, bridges and highways. We contacted staff in several other legislative audit offices to determine the threshold for these asset classes in their respective jurisdictions. The highest threshold in any jurisdiction we contacted was \$100,000, considerably lower than the \$500,000 threshold used in Nova Scotia.

Recommendation 5.12

The Department of Finance's Government Accounting Division should lower the threshold for capitalizing roads, bridges and highways from \$500,000 to a level more consistent with common practice.

General ledger maintenance and other reportable matters

- 5.52 *Business areas in the general ledger* – The Province’s general ledger is divided into business areas, each of which is used to record transactions related to a department or other entity such as special operating agencies of government (Sydney Tar Ponds Agency, for example). The general ledger also includes business areas used to record transactions for operations that are not part of the government reporting entity, and for recording transactions of other entities which use the Province’s bank accounts rather than establishing their own bank account.
- 5.53 During the audit, we prepare an analysis of these business areas to ensure balances are appropriately reflected in the CFS. In each of the last three years, errors were noted in the consolidation process of these business areas. This further supports the recommendation we have made in the past that the Government Accounting Division should determine if it is appropriate for the Province’s general ledger to include business areas of stand-alone entities or to include business areas to record transactions for operations which are not part of the government reporting entity. Any business areas considered inappropriate should be removed from the general ledger.

Recommendation 5.13

The Department of Finance’s Government Accounting Division should remove all inappropriate business areas and any entities which are not part of the consolidated entity from the general ledger.

- 5.54 *Contractual obligations* – We continue to receive inaccurate information from departments on contractual obligations. This year the information provided to us to support the balance of contractual obligations disclosed in the CFS had errors totalling \$30.6 million. These errors were corrected.
- 5.55 We acknowledge the amounts included in Note 12 to the CFS do not impact the operating results or accumulated deficits of the Province. However, these contractual obligations represent significant future expenditures of the Province and provide useful information for assessing program costs. The information provided to Government Accounting and to this Office as part of our audit requirements should be accurate.

Recommendation 5.14

The Department of Finance’s Government Accounting Division should instruct departments on the identification and disclosure requirements related to determining the amount of contractual obligations at year end.

- 5.56 *Up-to-date revenue models* – Tax revenues included in the consolidated financial statements are point-in-time estimates calculated through revenue

models. A model is also used to determine royalty revenue. These models, which consider provincial and global economic circumstances as appropriate, and actual payments received during the year for each revenue stream, are also used to forecast revenues during the year.

- 5.57 The March 31, 2009 Public Accounts were released on September 10, 2009. The royalty revenue included in the CFS was based on a model prepared in June 2009. Significant tax revenues, including corporate and personal income tax, and harmonized sales tax, were based on models dated prior to June 2009. No further update was provided to us as part of the audit.
- 5.58 Subsequent to our audit and the release of the Public Accounts, the 2009-10 Budget was released in late September 2009. An updated royalty model was prepared for the Budget and a \$14.5 million decrease to prior year revenues (i.e., 2008-09) was recognized at that time. Updated tax revenue models were also prepared for the Budget. Our preliminary assessment of the update for the personal income tax (PIT) model indicates forecasted PIT revenues for 2008-09 declined by approximately \$27 million. All adjustments to prior year revenues are recorded in the current year and therefore these decreases impacted 2009-10 results.
- 5.59 The Province's CFS should reflect the most current information. Government Accounting should ensure updates to models used to forecast revenues are provided for the audit within a reasonable timeframe prior to the release of the statements. This reduces the risk of necessary adjustments being deferred to a subsequent year.

Recommendation 5.15

The Department of Finance's Government Accounting Division should ensure updated revenue models are prepared for the audit of the consolidated financial statements.

- 5.60 *Presentation of gross unmatured debt and sinking fund assets* – Schedule 4 of the consolidated financial statements includes details of gross debt and sinking fund assets. The net amount of unmatured debt on this Schedule agrees to the Consolidated Statement of Financial Position.
- 5.61 The narrative accompanying the Schedule notes that of the \$2.2 billion in sinking fund assets held at March 31, 2010, \$1.0 billion of this amount is an investment in the Province's own debentures. Consequently, the amount of both gross debt and sinking fund assets shown in Schedule 4 is overstated by \$1.0 billion since this debt is not owed to any third-party entity. This presentation does not accurately disclose the gross amount of outstanding debt and related sinking fund assets and should be corrected.

- 5.62 We understand there is rationale for not formally cancelling this debt, including legal and other fees. We suggest the Department of Finance explore the process to cancel this debt.

Recommendation 5.16

The Department of Finance should revise Schedule 4 of the consolidated financial statements to disclose the gross debt and sinking fund assets of the consolidated entity.

Audit completion

- 5.63 *Timing of release* – The consolidated financial statements were issued on July 29, 2010, well in advance of the legislated requirement of September 30. Our audit opinion was dated June 30, 2010. The audit deadline was met through cooperation from departments and other entities included in the consolidated financial results of the Province.
- 5.64 *Difficulties encountered performing audit* – Each year, a schedule of audit deliverables, including the due date, is provided to departments. For the most part, the audit working papers and other documentation we requested from departments were received as requested and in a timely manner. However, we encountered significant delays in receiving requested support from Treasury Board for certain expenses as well as from the Department of Finance’s Taxation and Fiscal Policy Division for model-determined revenue.
- 5.65 The target for the release of the Public Accounts results in tight deadlines and our resources are scheduled based on the due dates included in the schedule of audit deliverables. This Office requires receipt of accurate information by the due date. It is evident, based on delays encountered this year and last year, that processes must be developed to ensure the accuracy and timeliness of audit support being provided to this Office.

Recommendation 5.17

The Department of Finance’s Government Accounting Division should monitor the progress of departments, including significant divisions within departments, in providing information to the Office of the Auditor General, as detailed in the schedule of audit deliverables for the consolidated financial statement audit.

Accounting and auditing standards

- 5.66 *New accounting standards* – There are new accounting pronouncements and some in process that will have an impact on the government’s future financial reporting. Some of the more significant issues on which the Public Sector Accounting Board (PSAB) has recently released final or revised

pronouncements or is developing new or revised pronouncements, or issuing statements of principle, include tax revenue, government transfers and financial instruments.

- 5.67 New formal recommendations or guidance in such areas could require changes to government's financial reporting in the future. The nature and impact of required or planned accounting changes should be disclosed 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.
- 5.68 In addition, there are accounting topics which will impact those crown corporations and agencies that determine adoption of PSAB is appropriate for their organizations, including first-time adoption of this accounting framework.
- 5.69 As well, the move to international accounting standards is fast approaching. Publicly accountable enterprises in Canada, which include government business enterprises, are to adopt International Financial Reporting Standards starting for fiscal years beginning on or after January 1, 2011. Other government organizations will need to determine which GAAP is appropriate based on the guidance provided by PSAB.
- 5.70 Numerous entities within the government reporting entity have independent boards of directors or other oversight bodies to assist in the decision as to the appropriate accounting framework. However, each entity in which there is discretion over the selection of an accounting framework should ultimately reflect the financial reporting objectives of government. Government Accounting and/or the Deputy Minister of Finance should provide guidance to entities to determine appropriate accounting standards.

Recommendation 5.18

The Government Accounting Division should initiate appropriate measures to ensure that all organizations forming part of the government reporting entity adopt the appropriate GAAP based on the amendment to the Public Sector Accounting Handbook.

- 5.71 *New auditing standards* – The Canadian Auditing and Assurance Standards Board is adopting International Standards on Auditing as Canadian Auditing Standards (CAS) for the audits of financial statements for periods ending on or after December 14, 2010. As a result, the audit of the CFS for the year ended March 31, 2011 will be conducted under CAS rather than the existing standards. We anticipate changes in our audit approach including increased involvement in the independent audits of significant agencies included in the consolidated financial statements.

Other Financial Reporting Matters

Introduction

5.72 During the audit of the consolidated financial statements and throughout the rest of the year, we became aware of other financial reporting matters for inclusion in this Chapter. We provide details of each of these under the following headings.

- Variance explanations
- Additional appropriations
- Accounting principles
- Provision for remediation
- Audit of governance and control framework
- Special warrants
- Cash and other losses

Variance explanations

5.73 Government has provided explanations for certain variances that resulted in a reduced deficit by comparing the budget estimate and actual results for the Consolidated Fund in the Financial Statement Discussion and Analysis included in the Public Accounts.

5.74 On consolidation, departmental results vary significantly from pre-consolidation results in several departments. The budget, which is prepared on a non-consolidated basis as noted previously in this Chapter, is adjusted during the preparation of the consolidated financial statements for revenues and expenses of government agencies, in order to provide comparative amounts. However, there are insufficient variance explanations relating to consolidated results.

5.75 The following table provides a comparison of results of certain departmental expenses before and after consolidation.

Department	Budget per 2009-10 Estimates (000's)	Consolidated Budget (000's)	Actual Expenses (000's)	Variance per Consolidated Financial Statements (Under) Over Budget (000's)
Community Services	\$ 945,813	\$1,020,009	\$ 941,186	(\$78,823)
Education	\$1,285,147	\$1,614,084	\$1,654,183	\$40,099
Health	\$3,422,276	\$3,530,898	\$3,557,162	\$26,264
Total of above departments	\$5,653,236	\$6,164,991	\$6,152,531	(\$12,460)
Total expenses	\$8,115,994	\$9,663,362	\$9,511,589	\$151,773
% of Total expenses	69.7%	63.8%	64.7%	

5.76 Users of the consolidated financial statements cannot determine from the Public Accounts why actual expenses in the above departments vary from the consolidated budget. It is not possible to identify whether budget variances are due to changes in programs delivered through government agencies such as school boards and health authorities. It is also not possible to evaluate whether variances resulting in the current year will impact program delivery in subsequent years.

5.77 Variance explanations assist users in evaluating results. These explanations also support government's stewardship over resources, and enhance transparency. Expanding the variance explanations in the Financial Statement Discussion and Analysis to discuss significant variances in consolidated results would increase the usefulness of the Public Accounts in evaluating performance.

Recommendation 5.19

The Department of Finance should consider expanding the Financial Statement Discussion and Analysis to include variance analysis of actual consolidated results to the consolidated budget.

Additional appropriations

5.78 *Required reporting* – We are required under Section 9 of the Auditor General Act to report on any appropriations that were exceeded during the year. Subsequent to year end, Executive Council approved additional appropriations of \$23.8 million via Order-in-Council 2010-292.

5.79 *Significance of additional appropriations* – In total, additional appropriations of \$23.8 million were approved for the year ended March 31, 2010. This is significantly less than any amount approved since 2005-06. The following exhibit notes total additional appropriations in each of the last five years.

Additional Appropriations

(in millions of dollars)

Year	Surplus/(Deficit)	Additional Appropriations
2009-10	(\$242)	\$24
2008-09	\$26	\$408
2007-08	\$419	\$385
2006-07	\$182	\$222
2005-06	\$239	\$111

Source: *Public Accounts, Volume 1*

5.80 The most significant source of additional appropriations in 2007-08 and 2008-09 related to Assistance to Universities - \$165.8 million and \$256 million respectively. These additional appropriations resulted from the decision to advance funding to the universities a year earlier than scheduled per the Memorandum of Understanding between the Province and these institutions. This practice was ended in 2009-10.

Accounting principles

5.81 As Government policy, the Province's consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles for the public sector. Those standards provide guidance for accounting in the public sector and define generally accepted accounting principles for public sector organizations. Adherence to generally accepted accounting principles ensures both comparability with other jurisdictions and consistent treatment of similar transactions. It also promotes transparency and confidence in financial reporting results.

5.82 The Provincial Finance Act did not prescribe the accounting principles to be adopted by the Province. The new Finance Act is also silent on this issue. We feel that sound financial reporting would be strengthened by the inclusion of a requirement in the Finance Act to comply with generally accepted accounting principles.

Provision for remediation

5.83 The consolidated statement of financial position includes a \$132.6 million provision for the remediation cost of the Sydney Steel Corporation (SYSCO) and adjacent sites, including the Sydney Tar Ponds Agency (STPA). At the start of last year's audit, we were provided with an internal report prepared by senior management of the Sydney Tar Ponds Agency to support the reduced general ledger balance recorded at that time. The report explained the need to reduce the provision at December 2008 to reflect only those future costs required to complete the project. During the audit, the

reduction in the provision was reversed and the previous balance of the provision reinstated.

- 5.84 Last year, we noted that a critical step in updating the estimate of the provision would be an independent analysis of the costs necessary to complete the remediation of Sydney Steel Corporation and related sites. Management advised the analysis should commence in 2009-10 and the provision would be adjusted accordingly upon completion and acceptance of the costing.
- 5.85 During the 2009-10 audit, we were advised by management that a Terms of Reference has been prepared for this analysis, and that a proposal has been received and negotiations with the consultant were underway. Given the significance of the amounts related to this provision, we have repeated our recommendation that this analysis be completed on a timely basis.

Recommendation 5.20

The Department of Transportation and Infrastructure Renewal should ensure an independent analysis of the costs necessary to complete the remediation project of Sydney Steel Corporation and adjacent sites is conducted. The balance of the provision should be adjusted to reflect this estimate.

Audit of governance and control framework

- 5.86 An audit of the governance and control framework of the Investment Management, Liability Management and Treasury Services, and the Capital Markets Administration Divisions of the Department of Finance was conducted by an external audit firm and completed in 2004. The resulting report, issued in December 2004, identified several control weaknesses which resulted in a denial of opinion.
- 5.87 Substantial short-term investment activity is conducted through the Liability Management and Treasury Services Division. In addition, this Division and the Capital Markets Administration Division are responsible for the Province's \$13.3 billion in unmatured debt, approximately \$5 billion in derivative instruments, and \$2 billion in sinking fund assets. The transactions processed by these divisions are significant and complex.
- 5.88 In 2007, the Internal Audit Centre conducted a follow-up to the 2004 audit of these Divisions. The objective of that engagement was to determine whether the recommendations of the 2004 audit had been implemented, or, if not implemented, that strategies had been developed to mitigate related risks. The results of the follow-up note that one significant issue from the 2004 audit was resolved through the establishment of a separate function (a middle office) to ensure that investment and debt management activities

comply with legislation and Department of Finance policies. In addition, an Executive Director of Liability Management and Treasury Services was appointed subsequent to the 2004 audit. The oversight provided by this new position is a positive addition to the governance structure.

- 5.89 We have repeatedly recommended an audit by an external, experienced private sector firm be conducted to obtain an unqualified audit opinion on the governance and control framework of these divisions. This has not occurred. Consequently, it is our intention to conduct this audit ourselves within the next two years.

Special warrants

- 5.90 *Required reporting* – Section 9A of the Auditor General Act requires that we report whether any special warrants have been issued. A special warrant is required under Section 29 of the Provincial Finance Act for expenses that have not been provided for by the Legislature and are immediately and urgently required for the public good. No special warrants were issued since our last Report.

Cash and other losses

- 5.91 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.*”
- 5.92 There is no longer a requirement in the Corporate Policy Manuals for departments and crown entities to report losses to this Office. However, during the year, the Department of Justice reported cash losses totalling \$2,481 and the theft of an LCD Projector. We appreciate receipt of this information.

Response: Department of Finance

Thank you for the opportunity to review and respond to the draft of Chapter 5 “Government Financial Reporting” in your November 2010 report. We offer the following comments, which may be included in your report as the response of the Department of Finance.

Review of 2010-11 Estimates

Recommendation 5.1

The Department of Finance should include estimates of all revenues of the consolidated entity in the Provincial budget, including all agencies’ third-party revenues, to ensure the budget is prepared and presented fully in accordance with Canadian generally accepted accounting principles.

Management recognizes that the annual Estimate includes revenue for only the Consolidated Fund and not all revenues of the Government Reporting Entity. The inclusion of all revenues, and the associated offsetting expenses in the annual budget, would require changes in the provincial budgeting process and additional resources to coordinate this additional information. Management does not feel the benefits provided by this recommendation warrant the resources required to implement this change at this time.

It is important for readers to understand that the Public Sector Accounting Handbook does not include presentation or disclosure standards for budgeting. The underlying accounting policies in the annual budget are consistent and in accordance with GAAP. An Estimate reconciliation to the presentation format of the actual results is included in the Public Accounts.

Recommendation 5.2

The Department of Finance should implement the recommendations of the Deloitte LLP report, previously accepted by the Government, to disclose agencies’ third-party gross revenues in the revenue estimates, for the preparation of the next estimates.

Phase two of the Deloitte Report was provided to the Government in November 2009. Upon receipt of that report, the Minister of Finance stated that “... government will consider the options presented as it moves forward with the next budget.” The recommendations are still under consideration.

Recommendation 5.3

The Department of Finance should obtain all necessary information from departments to prepare the revenue estimates, including estimates of third-party revenues of government units, in accordance with generally accepted accounting principles.

RESPONSE:
DEPARTMENT OF
FINANCE

The inclusion of third party revenues is not so much a matter of having, or using, authority provided to the Department of Finance under the Finance Act. As stated in our response to recommendation 5.1, management does not feel the benefits provided by this recommendation warrant the resources required to implement this change at this time.

Recommendation 5.4

The Economic and Statistics Division of the Department of Finance should ensure key economic assumptions are supported appropriately and that clearly documented management and audit trails of adjustments are maintained.

The Economics & Statistics Division prepared process documentation on material changes made to the forecast to accommodate planned increases in government infrastructure spending. The process documentation included a detailed description of how the forecast was adjusted to reflect infrastructure spending. The impacts of these adjustments were documented at each step in the process. In the Department's view, documentation was adequate to review the accuracy of key economic assumptions and the reasonableness of the forecast.

Recommendation 5.5

The Department of Finance should implement a process for a formal and documented review and challenge of the assumptions used in the preparation of the petroleum royalties estimate.

Management agrees with this recommendation. The Department conducts review and challenge sessions as part of the revenue estimates including revenue associated with petroleum royalties.

Audit of the March 31, 2010 Consolidated Financial Statements

Recommendations 5.6

Management should complete the review and documentation of internal controls for the consolidated financial statements and include the documentation in the Corporate Policy Manuals.

Recommendation 5.7

Management should assign roles and responsibilities for the design, implementation, operation and maintenance of internal controls as part of the documentation of internal controls.

Management agrees with both of these recommendations. Management is committed to completing its multi-year project to review and document internal controls for financial reporting. It should be noted that the Internal Controls over Financial Reporting project, and the annual certification requirements will become

more robust over time. The focus however will remain with the Consolidated Fund and the interactions between the Consolidated Fund and consolidated entities. Management will advise consolidated entities on the need to assign and document internal controls within their organizations.

Recommendation 5.8

The Department of Health should develop and implement controls that would ensure the accuracy and completeness of revenues and expenses of the Seniors' Pharmacare Program.

Management agrees with this recommendation. Prior to April 1, 2008 the Senior's Pharmacare Program was operated as a trust and was therefore subject to an external audit. In August 2010, external auditors were engaged to review and assess the service provider's compliance with the criteria established by the contractual arrangement. This will include processes and controls in place relating to Senior's registrations, premium calculations, premium collections, premium adjustments and refunds through to the inclusion in reports. The scope of the audit will cover both the 2008-09 and 2009-10 fiscal years.

Recommendation 5.9

The Department of Finance's Taxation and Fiscal Policy Division should perform regular reconciliations of model-determined revenues and related accounts receivable or payable. Outstanding amounts related to closed years should be adjusted to income.

Management agrees with this recommendation. The Department reconciles model determined revenues on an accrual basis and accounts receivable and payable at the end of each year. Generally, reporting determined by revenue models are not finalized for as many as six years after the publication of the public accounts. Similarly the amount receivable, amount payable, or income associated with the revenue is not finalized until such time. The Department accommodates for this annually through a process of reconciliation between prior year adjustments, and amounts receivable or payable.

Recommendation 5.10

The Department of Finance's Payroll Division should ensure the process to terminate employees includes removal of access to SAP.

Management agrees with this recommendation, however it should be noted that responsibility of this recommendation does not rest with the payroll division. Processes are being put in place to ensure appropriate controls are in place for terminated employees.

RESPONSE:
DEPARTMENT OF
FINANCE

Recommendation 5.11

The Department of Finance's Government Accounting Division should ensure all non-trivial, known errors identified during the audit are corrected.

Management feels that the financial statements present fairly, in all material respects, the financial position of the Province as at March 31, 2010. Management is committed to correcting all known non-trivial errors identified during the course of the audit.

Management feels that any known errors not corrected are immaterial or insignificant items or matters and in accordance with paragraphs .13 and .14 of the introduction to public sector accounting standards.

Recommendation 5.12

The Department of Finance's Government Accounting Division should lower the threshold for capitalizing roads, bridges and highways from \$500,000 to a level more consistent with common practice.

Thresholds for the Consolidated Fund are set high because the value of the operations is very large. The tangible capital asset (TCA) capitalization threshold is set to allow for the capitalization of the significant assets that have future benefit to operations. In a large organization, such as the Consolidated Fund, large dollar assets are capitalized as they are more material to decision making.

The Department of Transportation and Infrastructure Renewal (TIR) reported that in 2009/10 it cost approximately \$3 million to twin 1 kilometre of highway. Building a new 2-lane 100-Series highway cost approximately \$3.5 million, plus bridges and approximately \$6 million for a new 4-lane highway. Based on these figures, management does not feel that the benefits of lowering its capitalization thresholds for roads, bridges, and highways would outweigh the administrative costs.

Recommendation 5.13

The Department of Finance's Government Accounting Division should remove all inappropriate business areas and any entities which are not part of the consolidated entity from the general ledger.

Management agrees with this recommendation. Government Accounting established a review process and will continue to monitor the 9900 Business Areas to ensure they are properly reflected in the consolidated financial statements.

Recommendation 5.14

The Department of Finance's Government Accounting Division should instruct departments on the identification and disclosure requirements related to determining the amount of contractual obligations at year end.

Management will continue to make efforts to address the deficiencies noted. In the 2009-10 fiscal year, refresher training was provided to departmental financial managers and further guidance is planned for 2010-11. In collaboration with the departments, Government Accounting will develop detailed procedures for the identification, quantification, and reporting of contractual obligations.

Recommendation 5.15

The Department of Finance's Government Accounting Division should ensure updated revenue models are prepared for the audit of the consolidated financial statements.

Management agrees that up-to-date revenue models should be used for the audit of the consolidated financial statements .

Recommendation 5.16

The Department of Finance should revise Schedule 4 of the consolidated financial statements to disclose the gross debt and sinking fund assets of the consolidated entity.

Management has interpreted the public sector accounting standard on Long-Term Debt (PS 3230) as providing the option to disclose repurchased financial liabilities or to derecognize them. We continue to support paragraph PS 3230.22 and are of the opinion that financial liabilities should not be derecognized unless they are cancelled or legally defeased. Governments that buy back some of their debt may do so as part of their sinking fund arrangements as the sinking fund investments represent separate instruments that can still be traded on the open market.

Recommendation 5.17

The Department of Finance's Government Accounting Division should monitor the progress of departments, including significant divisions within departments, in providing information to the Office of the Auditor General, as detailed in the schedule of audit deliverables for the consolidated financial statement audit.

Management agrees with this recommendation.

Recommendation 5.18

The Government Accounting Division should initiate appropriate measures to ensure that all organizations forming part of the government reporting entity adopt the appropriate GAAP based on the amendment to the Public Sector Accounting Handbook.

Management continues to be committed to GAAP compliance and therefore places a high priority on monitoring the developments in this area. The Controller

and members of Government Accounting participate in teleconferences with the other Canadian governments to discuss new proposed standards (PSAB, CICA, and IFRS) and their possible impacts on government financial reporting.

Management has communicated with the Province's government business enterprises (GBEs) and other government organizations (OGOs) to notify them of the amendment to the Public Sector Accounting (PSA) Handbook as well as to request information to help us determine the impacts of their GAAP transition. Management has also conducted communication to its government not-for-profit organizations (GNFPOs). Government Accounting will be available to assist and support entities during this transition, while ensuring that these entities adopt the most appropriate GAAP for their financial statement users.

Recommendation 5.19

The Department of Finance should consider expanding the Financial Statement Discussion and Analysis to include variance analysis of actual consolidated results to the consolidated budget.

Management recognizes that expanding the variance explanations in the Financial Statement Discussion and Analysis to discuss significant variances in consolidated results would increase the usefulness of the Public Accounts in evaluating performance. This initiative would require changes in the consolidation process and additional resources to coordinate this additional information. Management will review to determine the extent of additional resources needed to implement this change.

Recommendation 5.20

The Department of Transportation and Infrastructure Renewal should ensure an independent analysis of the costs necessary to complete the remediation project of Sydney Steel Corporation and adjacent sites is conducted. The balance of the provision should be adjusted to reflect this estimate.

Management agrees that an independent costing analysis should be conducted on a timely basis to adequately assess the provision. The work to hire an independent consultant commenced in 2009-10 and will continue in 2010-11 with the goal of updating the cost estimates necessary to complete the remediation project of Sydney Steel Corporation and adjacent sites.

Indicators of Government Financial Condition

While the Department of Finance recognizes that the report in Chapter 6, "Indicators of Financial Condition" that was produced by the Office of the Auditor General does not offer specific recommendations, management felt it necessary to still provide comment.

It is management's responsibility to determine the format and type of reporting within Generally Accepted Accounting Principles (GAAP). "Indicators of Financial Condition" is a Statement of Recommended Practice, which is not required for GAAP compliance. We believe that most of the content is already available in other reports.

By producing this report, the Office of the Auditor General blurs the line between the preparer of financial reports and the reviewer of such information.

RESPONSE:
DEPARTMENT OF
FINANCE