
5 Review of Audit Opinions and Management Letters



Summary

Under Section 23 of the Auditor General Act, we conduct a review of the audit opinions and related management letters of agencies which comprise the government reporting entity. The majority of these entities are audited by private sector auditors; four government agencies are audited by this Office.

During our review of management letters, we found auditors had identified numerous internal control and information technology deficiencies. The overall number of recommendations made by the auditors increased by 16% (23) over the previous year. 41% (69) of the recommendations made in 2011 were repeated from 2010. Control weaknesses such as lack of segregation of duties and deficiencies in access controls over financial reporting systems need to be remedied on a timely basis. Agency management should take steps now to address the deficiencies identified by their auditors, to ensure the integrity of their financial systems and financial reporting processes.

Although the majority of agency audits resulted in unqualified audit opinions, a number of entities received qualified opinions. Where possible, agencies should correct the deficiencies that lead to qualifications.

The audit opinions of several school boards were qualified due to the inability of the auditors to verify the completeness of school-based funds. In addition, several of the management letters resulting from these audits indicated weaknesses in the control systems over school-based funds, and in one instance, noted that there was a fraud involving these funds during the year. School-based funds totaled \$41.6 million in 2010-11. Due to their significance, and to the weaknesses identified, we have recommended that the Department of Education work with the school boards to implement the recommendations made by their auditors and improve controls over the receipt and safeguarding of these revenues.



5 Review of Audit Opinions and Management Letters

Background

- 5.1 The financial statement audits of crown corporations and agencies, funds of the Government of Nova Scotia, and trusts administered by the Government of Nova Scotia, are mostly conducted by private sector auditors licensed under the Public Accountants Act. The Office of the Auditor General is the legislated auditor for the remaining entities.
- 5.2 Section 23 of the Auditor General Act permits our 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.
- 5.3 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, 2011 statements are noted in Chapter 2 of this Report.

Chapter Objective

- 5.4 The objective of this 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

Qualified audit opinions were issued on the 2010-11 financial statements for thirteen agencies. The audits of several school boards were qualified due to the inability of the auditors to verify the completeness of school-based funds. We discuss additional issues related to school-based funds later in this Chapter. Where possible, agencies should correct deficiencies that lead to qualified opinions.



- 5.5 *Background* – The result of an audit is an opinion on whether financial statements present fairly in all material respects, the financial position of the entity at its fiscal year end, and the results of its operations for the year then ended, in accordance with Canadian generally accepted accounting principles (GAAP). Where there are qualifications of an audit opinion or situations in which it is not possible to render an opinion, we believe it is appropriate to report on such matters.
- 5.6 *Qualified audit opinions* – Several agencies included in the province’s consolidated financial statements derive revenue from donations or other contributions, including revenues related to school-based funds, 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. The following entities received this qualification.
- Art Gallery of Nova Scotia
 - Atlantic Provinces Special Education Authority
 - Cape Breton Victoria Regional School Board
 - Conseil scolaire acadien provincial
 - Nova Scotia Primary Forest Products Marketing Board
 - Public Trustee Trust Funds
 - South Shore Regional School Board
 - Strait Regional School Board
 - Tri-County Regional School Board
- 5.7 Qualified audit opinions can also result from insufficient evidence to support financial statement balances or disclosures, or if there are departures from GAAP. Qualified audit opinions were issued by the auditors of the following entities.
- Atlantic Provinces Special Education Authority – due to the application of public sector accounting standards in the determination of post-retirement benefits
 - Nova Scotia Fisheries and Aquaculture Loan Board – due to a departure from GAAP in understating the allowance for impaired loans
 - Nova Scotia Health Research Foundation – due to a departure from GAAP in accounting for grants payable at cost rather than the required method of amortized cost using the effective interest rate method
 - Nova Scotia E911 Cost Recovery Fund – due to insufficient evidence to indicate whether expenses of the fund were complete
 - Nova Scotia Power Finance Corporation – due to the inability to present investments using historical cost and the effective interest rate method



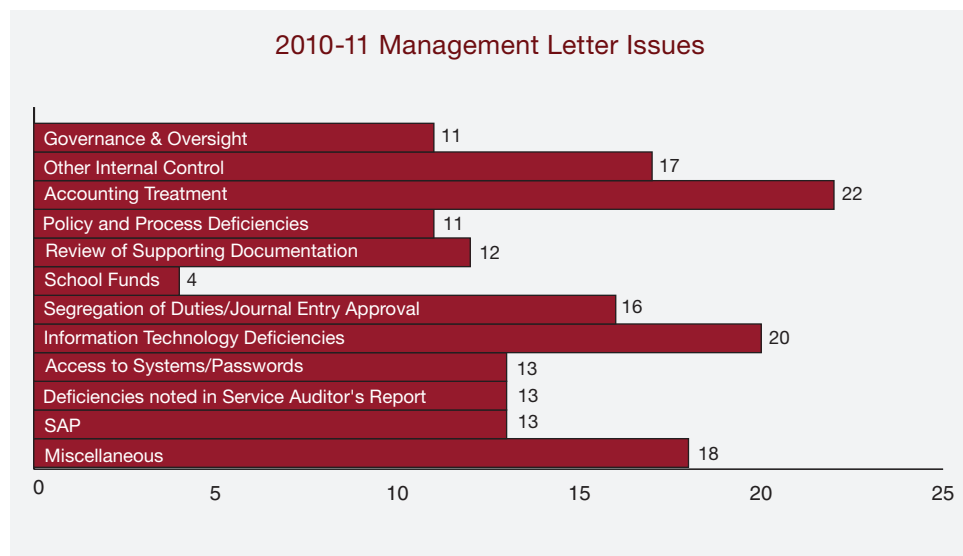
- 5.8 *Disclosed basis of accounting* – The audit opinion on the financial statements of the Sherbrooke Restoration Commission is not prepared in accordance with GAAP because amortization is not recorded on capital assets and capital expenditures are included in the statement of operations.

Review of Management Letters

Conclusions and summary of observations

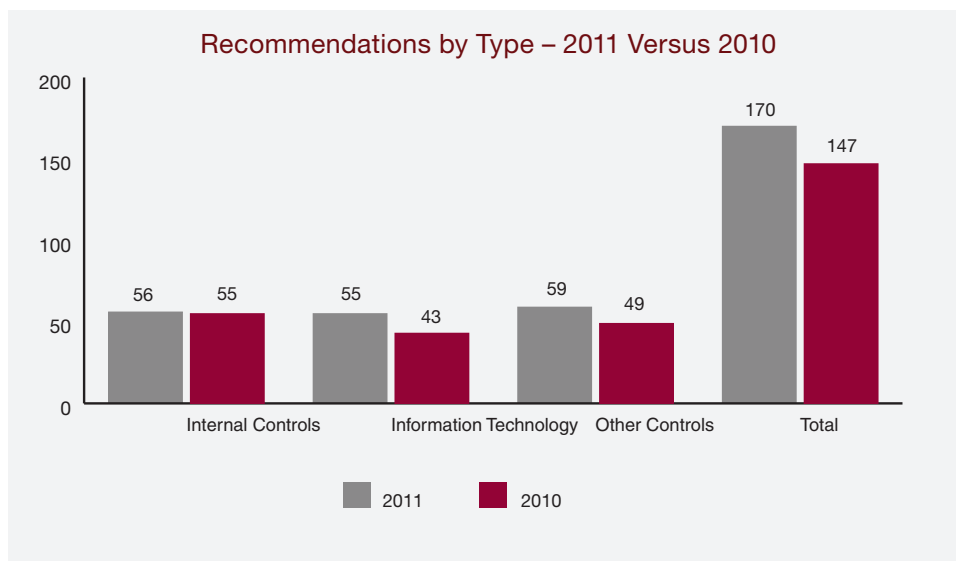
The number of findings and recommendations that remain outstanding from one year to the next in several agencies is concerning. The overall number of recommendations made increased by 16% (23) over the previous year. 41% (69) of the recommendations made in 2011 were repeated from 2010. A significant number of internal control deficiencies were reported in several agencies. Examples include improperly prepared and supported account reconciliations, poor segregation of duties and lack of sufficient controls. 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.

- 5.9 *Internal controls, information technology controls and other financial controls* – During financial statement audits, situations were noted in which 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 government entities. Other deficiencies reported include matters related to financial reporting and governance. The following exhibit shows 2010-11 issues by type.





- 5.10 Responding to audit recommendations is an indication of a strong overall control environment in an entity. The number of findings and recommendations that remain outstanding from one year to the next in several agencies is concerning. The overall number of recommendations made increased by 16% (23) over the previous year. 41% (69) of the recommendations made in 2011 were repeated from 2010. Management needs to address recommendations on a timelier basis to ensure the integrity of their accounting and controls systems and financial statements.



- 5.11 *School-based funds* – The March 31, 2011 financial statements of the province’s eight school boards show \$41.6 million in revenue from school-based funds. Five of the eight school boards had qualified audit opinions due to the completeness of school-based funds revenue. In addition, there were several findings reported in school boards’ management letters, including the identification of fraud at the Halifax Regional School Board and the subsequent resignation of the employee in question.

Recommendation 5.1

The Department of Education should work with the school boards to implement the recommendations made by their auditors and develop the appropriate controls to ensure the accuracy and completeness of this revenue in boards’ accounting records, and to ensure it is properly safeguarded.

- 5.12 The following paragraphs summarize external auditors’ findings and recommendations related to broad sectors within the government reporting entity.

Government Business Enterprises

- 5.13 *Halifax Dartmouth Bridge Commission* – The auditors noted accounting staff have the ability to set up new suppliers in the accounting system, record purchase



invoices, and set up and remit electronic fund transfers without the approval of a second person. It was recommended no staff have responsibility for all of these functions. The auditors also recommended that management review the current \$1,000 threshold for the capitalization of fixed assets given the overall size and nature of operations of the Commission.

- 5.14 *Highway 104 Western Alignment Corporation* – The auditors noted improved processes and controls concerning the purchasing of goods and the preparation of accruals. They recommended the controller monitor accruals at month-end and perform an analysis of the reasonableness of amounts accrued.
- 5.15 *Nova Scotia Liquor Corporation* – The auditors noted control deficiencies from the prior year related to the Warehouse Management System have not been fully addressed. These deficiencies dealt with system access and segregation of duties. Similar deficiencies were identified in SAP, the Corporation’s accounting system. Access termination deficiencies noted last year have been addressed.

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

- 5.16 *School boards* – Management letters related to five school boards had a recurring theme – the need for improvements to the systems to record and safeguard school-based funds. The management letter resulting from the audit of the Halifax Regional School Board noted there was a fraud related to school-based funds during the year that resulted in a loss of approximately \$20,000 and that the employee in question had resigned.
- 5.17 Inadequate segregation of duties was reported in two boards and, in several boards, there was no evidence that bank reconciliations and journal entries were being reviewed. These recommendations had all been reported in the prior year. The management letter for the 2010-11 audit of the Cape Breton Victoria Regional School Board identified that unusual expense claims had been filed by a Board employee and reimbursed. The auditors noted that school board management is addressing the issue.
- 5.18 *Nova Scotia Community College* – In prior years, the auditors recommended that password policies be revised to be consistent with industry leading practice. NSCC now has separate password policies for different user groups and have indicated the costs and benefits associated with stricter password policies will continue to be evaluated.
- 5.19 *Atlantic Provinces Special Education Authority* – Banking records for one account are not up to date and the cash clearing accounts are not being used appropriately. Investments should be adjusted to fair value to accurately capture valuation gains and losses in accordance with Canadian GAAP.



District Health Authorities and the IWK Health Centre

- 5.20 *District health authorities* – In addition to specific findings related to SAP (see below), health authorities’ auditors identified additional IT deficiencies including the need to review access rights to online banking and financial applications on a periodic basis, and to review changes made to the payroll master file. At one authority, the need to monitor system changes that have been made to the live production environment was noted. Segregation of duties issues were reported in certain authorities as well, including the need to review journal entries. Finally, the auditors of the Cape Breton District Health Authority felt it was important to bring to the attention of the Board that there was a significant amount of overtime being paid to individuals. In two instances, employees were paid overtime equal to their regular salaries; these two were among 35 who were paid overtime in excess of \$25,000.
- 5.21 *SAP* – All health authorities converted to the SAP accounting system during the previous fiscal year. Auditors of various authorities noted the following control deficiencies to be corrected.
- There is need for additional training to SAP users, including the reporting capabilities in SAP.
 - Termination requests to remove SAP system user accounts were not processed in a timely manner.
 - SAP application user access reports provided to the health authorities were not designed to include a complete list of users with access to production data. This report is used to confirm that access is appropriately restricted. The IWK Health Centre auditors also noted some SAP support users had access to the IWK Health Centre production data.
 - Certain payroll deficiencies were identified.
 - Exceptions were noted when testing for authorized changes to the vendor master file in a related support system.

Entities Providing Financial Assistance

- 5.22 *Management letter summary* – Auditors provided findings and recommendations as a result of their audits of the following provincial agencies providing financial assistance.
- Film Nova Scotia
 - Industrial Expansion Fund
 - Nova Scotia Business Inc.
 - Nova Scotia Farm Loan Board



- Nova Scotia Housing Development Corporation
- Nova Scotia Strategic Opportunities Fund

5.23 Approval processes related to journal entries, rescinded loans and payroll changes were identified as needing strengthening at two agencies. In another, it was recommended that interest calculations supporting journal entries for interest expense be independently reviewed. The Industrial Expansion Fund's auditors again noted there is need for additional improvements in the annual valuation process. Finally, auditors at the Nova Scotia Housing Development Corporation noted instances in which the mortgage repayment did not agree with the mortgage schedule, and also recommended that documents supporting amendments to mortgage agreements be maintained. These recommendations resulted from the March 31, 2010 audit. The management letter for the March 31, 2011 audit has not been issued yet.

Other Entities

5.24 *Management letter summary* – Auditors provided findings and recommendations as a result of their audits of the following provincial agencies:

- Canada-Nova Scotia Offshore Petroleum Board
- Canadian Sport Centre Atlantic
- Harbourside Commercial Park Inc
- Nova Scotia E911 Cost Recovery Fund
- Nova Scotia Lands Incorporated
- Nova Scotia Public Service Long-Term Disability Plan
- Nova Scotia School Boards Association
- Resource Recovery Fund Board Incorporated
- Nova Scotia Utility and Review Board
- Sherbrooke Restoration Commission
- Sydney Tar Ponds Agency
- Trade Centre Limited
- Medavie (for certain programs administered on behalf of the Department of Health and Wellness)

5.25 The lack of reconciliations of significant general ledger accounts such as cash was identified in two agencies and in several agencies, there was a lack of segregation



of duties. In one entity, the auditors noted that capital assets were purchased using the credit card of a senior manager.

- 5.26 *Trade Centre Limited (TCL)* – The liability related to advance ticket sales for Ticket Atlantic was recorded by Halifax Metro Centre Ltd. (HMC). The cash account for Ticket Atlantic was held under the HMC banking facility even though it is a liability of TCL. The financial statements of TCL and HMC have been restated to reflect this correction. The auditor was waiting for management’s position paper on the valuation of a receivable related to an advance paid to a promoter of a summer concert to determine if the amount recorded will be recovered.
- 5.27 *Medavie* – Medavie’s auditors recommended that access controls be strengthened, including review of user activity to certain applications. The auditors also again recommended that management implement a process to verify and document that all new physicians being set up as providers are valid physicians with a valid license number from the College of Physicians and Surgeons of Nova Scotia.

Audits Conducted by the Office of the Auditor General

- 5.28 *Nova Scotia Crop and Livestock Insurance Commission* – The Commission uses spreadsheets to calculate premium revenue; we recommended the Commission assess its IT needs and develop or purchase a computer system to meet those needs. We further recommended the Commission perform an analysis of access rights to limit the number of individuals who have the authority to make changes to these spreadsheets. We also noted errors in premium calculations and recommended improvements.
- 5.29 *Nova Scotia Legal Aid Commission* – We again noted that management should review the system to estimate certificate liabilities to determine if the average number of days to complete a case requires updating. The Commission does not currently have an audit or finance committee and the need to establish such a committee should be evaluated.
- 5.30 *Public Trustee Trust Funds* – Findings which we reported in the previous year related to the need for bonded individuals to remove assets from client’s homes, and to establish an oversight function for the operations of the Public Trustee have not been addressed. We noted financial statements are now prepared on an accrual basis in accordance with generally accepted accounting principles. Gains and losses on the sale of other assets are now recognized in the financial statements.
- 5.31 *Nova Scotia Gaming Corporation* – There were no findings to bring to the attention of management or the Corporation’s Board as a result of the audit.



Timeliness of Financial Reporting

Conclusions and summary of observations

Management of all agencies within the government reporting entity need to ensure their financial statements are available by June 30 each year for inclusion in the consolidated financial statements of the province. Although the number of entities submitting late financial statements has decreased significantly over the last five years, a number of agencies continue to be late. APSEA has only met the June 30 submission deadline once in the past five years.

5.32 *Compliance with deadlines* – The Finance Act requires financial statements and other information for government business enterprises and government units to be submitted to the Minister of Finance by June 30 following their fiscal year end (usually March 31).

5.33 Although the number of entities submitting financial statements past the deadline has declined, there continues to be a problem with receiving submissions by the deadline. In 2010-11, six entities were not successful in providing audited financial statements and requested information by the June 30 deadline. Of these entities, the Nova Scotia Housing Development Corporation and the Atlantic Provinces Special Education Authority (APSEA) were late in providing the requested information in 2009-2010. APSEA has not provided timely financial statements since 2006-07. When financial statements are not provided by the deadline, unaudited information must be used in preparing the province's consolidated financial statements. This results in inaccurate information for decision-making purposes. The following exhibit provides a list of agencies providing late information for 2010-11.

Late Agencies – 2010-11

Agritech Park Inc.
 Atlantic Provinces Special Education Authority
 Conserve Nova Scotia
 Nova Scotia Housing Development Corporation
 Trade Centre Limited
 Nova Scotia Fisheries and Aquaculture and Loan Board

5.34 The Province's March 31, 2011 consolidated financial statements were released on July 28, 2011 meeting the reporting requirement set out in the Finance Act.



Response: Department of Education

Recommendation 5.1

The Department of Education should work with the school boards to implement the recommendations made by their auditors and develop the appropriate controls to ensure the accuracy and completeness of this revenue in the boards' accounting records, and to ensure it is properly safeguarded.

The Department of Education accepts the recommendation and will work with school boards to implement it.