
2 Results of Financial Audits and Reviews



Summary

The results of our legislated review of the revenue estimates were consistent with prior years. The opinion, dated April 2, 2012, was again qualified because the estimates did not consider all revenues in the consolidated entity, and because we could not determine the scope of this omission. This qualification has occurred each year since 2001. We have recommended government prepare the revenue estimates for 2013-14 to include all revenues. Management at the Department of Finance told us that they plan to take action on this recommendation.

The revenue estimates presented to the public were overstated by \$27 million. This error could have been corrected but was not; it resulted in a 13% understatement of the deficit for the 2012-13 fiscal year. We recommended the Department of Finance determine a date during the preparation of the estimates before which all significant known errors will be corrected.

This chapter also focuses on the results of our legislated audit of the province's consolidated financial statements. Volume 1 of the Public Accounts, which includes these financial statements, was released on August 2, 2012. The audit opinion, dated July 30, 2012, was unqualified. The release of the Public Accounts on August 2, 2012 was well in advance of the September 30 legislated date under the Finance Act. We encountered difficulties completing the audit and have made recommendations to improve the audit process. We have also made recommendations to strengthen financial management processes.

We are concerned with the lack of communication on significant changes to the Public Service Superannuation Plan by the Minister of Finance as sole trustee of the Plan. Current and retired members may not be aware that all risks of the Plan will be shifted from the Province to the members once the new governance structure for the Plan is established. When these changes are implemented, the Province will no longer guarantee the Public Service Superannuation Plan. We have recommended the Minister of Finance prepare a direct communication to Plan members advising of these proposed changes.

Finally, we report the results of our agency audits. A significant matter arose from the audit we performed on Public Trustee Trust Funds; we recommended the need for a comprehensive financial accounting system, and changes to processes for accumulating amounts in the Special Reserve Fund. No significant matters arose from the legislated audit work we performed on three other government agencies. Additionally, the results of our audit of the House of Assembly, including our follow-up of recommendations made in our February 2010 Report of the Auditor General, are noted in Chapter 3 of this report.



2 Results of Financial Audits and Reviews

Introduction

- 2.1 Under Section 19 of the Auditor General Act, this Office is the legislated auditor of the Province's Public Accounts. Further, under Section 20 of the Act, the Auditor General conducts a review of the estimates of revenue used in the preparation of the Minister of Finance's budget address to the House of Assembly. The primary purpose of this chapter is to provide the results of our legislated requirements with respect to government financial reporting, and to make recommendations for improvements to government processes related to financial reporting.
- 2.2 In addition to the above, the Auditor General is the legislated auditor of four government entities.
 - Nova Scotia Gaming Corporation
 - Nova Scotia Crop and Livestock Insurance Commission
 - Trust funds administered by the Public Trustee
 - Nova Scotia Legal Aid Commission
- 2.3 Comments related to our audit of these agencies are included in Chapter 5 – Review of Audit Opinions and Management Letters.
- 2.4 On September 28, 2011 and March 28, 2012, the Auditor General was appointed auditor of the House of Assembly for the years ended March 31, 2011 and March 31, 2012 respectively. This was the first financial statement audit of the House of Assembly. We included the results of that audit, as well as of our follow-up of the recommendations from Chapter 4 of our February 2010 Report – Office of the Speaker: Members' Constituency and Other Expenses, in Chapter 3 of this report.

Background

- 2.5 Government financial reporting serves many purposes and is provided to stakeholders in various forms. Reports may be prepared which 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. Whatever the format or purpose, financial reports prepared by government are designed to



provide information, to a variety of users for numerous reasons, on past or future activities. In general, financial reports are a means through which government fulfills its accountability responsibilities on the use of public funds with which it has been entrusted.

- 2.6 The Provincial Finance Act provides certain financial reporting requirements for the province including annual estimates (budget), regular forecast updates, and tabling of the Public Accounts. These reporting requirements are part of the government's accountability framework and contribute to oversight of the efficient use of resources.
- 2.7 *Budgets* – Government uses the budget process to inform stakeholders of its fiscal plan and priorities for the upcoming year, including required borrowing and tangible capital asset requirements, and to ensure approval of the plan by Members of the House of Assembly (House) – the representatives of the people of Nova Scotia. The budget is a key policy document and forms the basis for the legal authority to spend throughout the year, which is established through the Appropriations Act. It is a critical component of government accountability against which forecast updates and actual performance are compared. In Nova Scotia, budgets show the planned revenues and expenditures, and must also show any other amounts to be paid out of the general revenue fund of the Province, even if these amounts do not require a vote of the Legislature to approve spending.
- 2.8 *Forecasts* – The Provincial Finance Act requires that financial forecasts be prepared and tabled in the Legislature by the Minister of Finance on at least four occasions during the year. Forecasts provide a comparison of activity to date to the approved budget for the year, and estimate the surplus or deficit for the year based on results to date. The province's forecast updates also include an analysis of significant variances and may provide current information on the province's economic performance and outlook. 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, forecasts must be timely, accurate and complete.
- 2.9 *Public Accounts* – The annual Public Accounts are prepared by the controller on behalf of the Minister and Deputy Minister of Finance. The Finance Act requires that the Public Accounts be tabled no later than September 30 after year end. Volume 1 of the Public Accounts includes a financial statement discussion and analysis, which is a recommended practice by the Public Sector Accounting Board, and the audited consolidated financial statements. The financial statement discussion and analysis provides comparative financial highlights of the statements and information on certain financial indicators. The consolidated financial statements provide audited financial information for two years as well as comparison of actual results to the budget. As the budget reflects the plan



approved by the House, the comparison of budget to actual enhances transparency and enables assessment of government's performance. 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
- form the basis of analyzing government's financial performance, condition and indicators of financial position.

2.10 The release of the Public Accounts is a key component in the accountability framework of the government, and provides important information to all stakeholders, including taxpayers and members of the House.

Chapter Objective

2.11 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 3, 2012 budget address;
- information resulting from our audit of the Province's March 31, 2012 consolidated financial statements; and
- comments on other matters.

Review of the 2012-13 Revenue Estimates

Conclusions and summary of observations

Under Section 20 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 opinion on the 2012-13 revenue estimates was again qualified because the revenue estimates did not include all revenues in the consolidated entity. We have had this qualification since 2001. Subsequent to our review, we have been informed that the Department of Finance is working to develop a model to include these revenues in future estimates. We recommended this be in place for the 2013-14 budget. The 2012-13 revenue estimates were overstated by \$27 million. We have further recommended that the annual revenue estimates process should include a date before which all known non-trivial errors are corrected.



- 2.12 *Reservation of opinion* – A reservation of opinion, dated April 2, 2012, was issued on the 2012-13 revenue estimates. The opinion was included in the April 3, 2012 budget address provided by the Minister of Finance. The qualifications noted in the report relate to two matters.
- The presentation of the revenue estimates was not in accordance with generally accepted accounting principles.
 - We were unable to determine the extent of the unestimated revenues as the information was not available.
- 2.13 Both the scope limitation and the qualified opinion are consistent with opinions issued on the revenue estimates for the past twelve years – since March 31, 2001. That was the first year after the Province’s financial statements were prepared on a consolidated basis, meaning that the financial statements included the results of government agencies such as school boards and health authorities. As a result of this change in presentation, the revenue estimates also needed to be prepared on a consolidated basis and include the revenues of these agencies, in order to comply with generally accepted accounting principles.
- 2.14 In addition to the revenue estimates not including these third party revenues, we were also unable to determine the extent of the unestimated revenues of these agencies. This lack of information represents a significant scope limitation in our report, and means we are unable to conclude on the quantification and presentation of the revenue estimates without qualification.
- 2.15 The management letter resulting from the review of the 2012-13 revenue estimates again included a recommendation that future revenue estimates include third-party agency revenues in an effort to comply with generally accepted accounting principles. Since the release of the letter in June 2012, we are pleased to report that progress is being made to address this qualification. The Department of Finance has populated a model designed to facilitate the process of estimating third-party revenues, including providing a trend analysis to support the estimate for the upcoming year. This is a significant improvement; however, we continue to note the following recommendation until the matter has been fully resolved.

Recommendation 2.1

The Department of Finance should include all revenues of the consolidated entity, including all agencies’ third party revenues, for the 2013-14 budget.

Department of Finance Response:

Agreed. The Department of Finance has previously indicated that it intends to review options to find an acceptable presentation format, and the appropriate level of review support required, to include the gross revenue for the Government Reporting Entity in Schedule 2A in the assumptions document.



- 2.16 Further, implementing this recommendation will ensure the resulting revenue estimates are consistent with the approach recommended by a government-hired consultant, Deloitte LLP, whose objective was to recommend an approach to resolving the qualification on future revenue estimates. The consultant's report, released in November 2009, recommended that a schedule of all revenues be prepared for inclusion in the budget documentation. Implementing this recommendation would result in the revenue estimates being prepared and presented in accordance with generally accepted accounting principles.
- 2.17 *Error in revenue estimates* – During the review, we were advised there would be an error resulting in a \$27 million overstatement of the revenue estimates. We suggested to management at the Department of Finance that Executive Council be informed of this known error prior to approving the estimates, and this was done. The error resulted from two main factors.
- A change in the calculation to adjust calendar year revenues determined by revenue models to fiscal year revenues.
 - Updated economic assumptions.
- 2.18 Although the error was less than the materiality level established for the engagement, we believe it was significant enough to be corrected. All information was available to support the change in sufficient time to revise the estimates. The error represented a 13% understatement of the estimated provincial deficit for the year ended March 31, 2013, changing the amount included in the 2012-13 budget from a deficit of \$211 million to a deficit of \$238 million. It was already known that the deficit included as part of the 2012-13 budget was unachievable when the Budget was presented to the public.
- 2.19 A process has been established for the Public Accounts audit to ensure known errors are corrected. Each year, a date is established as part of the audit process before which all known non-trivial errors are to be corrected. A similar process should be established for preparation of the revenue estimates.

Recommendation 2.2

The Department of Finance should establish a date during the revenue estimates process before which all known non-trivial errors are corrected.

Department of Finance Response:

Agreed. The Department of Finance will correct all significant known and accepted errors in the revenue estimates. Adjustments that in the professional judgment of the Department are not warranted will not be incorporated in the revenue estimates. A date for completion of errors will be completed for each revenue estimate process.

- 2.20 *Revenue models* – During the planning phase for the review of the 2012-13 revenue estimates, we were advised by staff in the Taxation and Fiscal Policy Division of



the Department of Finance that there was a change in the process used to forecast personal income tax revenue. These revenues are now estimated by using source data from the Canada Revenue Agency and adjusting this data for economic factors to determine provincial taxable income and tax yield. Calculations are performed using a software application, and both taxable income and the tax yield are entered into a second software application for further calculations and the resulting forecast.

- 2.21 This new process addresses a recommendation made previously by this Office. At that time, we recommended the estimation of personal income taxes reflect Nova Scotia economic factors.
- 2.22 The Government Accounting Division was not included as a stakeholder in this change process. This lack of involvement created a significant challenge when completing the audit of the March 31, 2012 consolidated financial statements. In this year's revenue estimates management letter, we recommended that best practices be followed in developing, designing and implementing new applications. We include further details of this matter later in this chapter as well as a recommendation related to changes in applications providing input to Public Accounts information.

Audit of the March 31, 2012 Consolidated Financial Statements

Conclusions and summary of observations

We are required by Section 19 of the Auditor General Act to perform the annual audit of the province's consolidated financial statements. The audit opinion on the 2011-12 consolidated financial statements, dated July 30, 2012, was unqualified. The Public Accounts were released on August 2, 2012. We experienced significant difficulties in completing the audit engagement due to delays in receiving requested information and a lack of cooperation in obtaining responses to audit questions. Our audit resulted in numerous recommendations to improve financial controls and financial management in government, and to improve the audit process.

- 2.23 *Introduction* – Our Office is the legislated auditor of the province's consolidated financial statements. Our overall objectives as auditors of the statements are to:
- obtain reasonable, but not absolute, assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error; and
 - report on the consolidated financial statements, and communicate our audit findings, as required by Canadian Auditing Standards.
- 2.24 The unqualified audit opinion indicates the consolidated financial statements are presented fairly, in all material respects, in accordance with Canadian generally



accepted accounting principles for the public sector, which are issued by the Public Sector Accounting Board of the Canadian Institute of Chartered Accountants. The unqualified audit opinion also indicates there were no quantitative findings, either individually or cumulatively, which were material enough to impact the opinion.

2.25 A management letter was provided to the Minister of Finance (Minister) in November 2012. It included detailed audit findings, recommendations and other comments related to the March 31, 2012 Public Accounts. Details of the information included in that management letter are noted below under the following headings.

- Audit completion
- Required communication of audit results
- Internal control
- Other Public Accounts matters

Audit Completion

2.26 *Timing of release* – The consolidated financial statements were released on August 2, 2012, well in advance of the legislated requirement of September 30. Our audit opinion was dated July 30, 2012.

2.27 *Difficulties encountered completing the audit* – Canadian Auditing Standards require that we communicate to those charged with governance significant difficulties encountered during the audit, including significant delays in management providing required information and extensive unexpected effort required to obtain sufficient appropriate audit evidence. Certain of the more significant difficulties reported are detailed in the following paragraphs.

2.28 *Tax revenue* – The Taxation and Fiscal Policy division of the Department of Finance made a significant change to the process by which personal income tax revenue is estimated. The impact of the change was considered for budget purposes but not for the consolidated financial statements. Updated tax revenue amounts were to be provided to our Office for audit by mid-June 2012. At that time, we were advised by the Taxation and Fiscal Policy division that the revenues estimated in February 2012 would be used for the consolidated financial statements. Government Accounting, the division within the Controller's Office responsible for the consolidated financial statements, had not been advised of the change in determining personal income taxes, and the impact on the consolidated financial statements had not been considered until we advised them of the situation.

2.29 Government Accounting determined that the personal income tax model required updating in order to ensure this significant estimate (\$2.1 billion at March 31, 2012) was based on the most recent available information. Corporate income



taxes and harmonized sales taxes were updated as well. However, the delay in receiving updated tax information, which then had to be audited, delayed the originally-planned date to approve the consolidated financial statements.

- 2.30 Since Government Accounting is responsible for preparing the Province's consolidated financial statements, its staff should be included in the change management process for the systems, including software applications, that are used to determine amounts and disclosures in the Public Accounts. This requires creating (or updating) and maintaining an inventory of systems that interface with the Province's general ledger system (SAP) and systems that produce journal entries entered into SAP. Guidelines should be established to determine the significance of those systems to be included in this inventory.

Recommendation 2.3

The Controller's Office should establish a process to ensure Government Accounting is included in change management processes to systems producing amounts and disclosures for the Public Accounts.

Controller's Office Response:

Agreed. A process will be in place to address this before the release of the March 31, 2013 Public Accounts.

- 2.31 *Consolidation of Nova Scotia Housing Development Corporation* – We encountered significant difficulties in obtaining information and explanations regarding the consolidated activities relating to the Corporation and the Department of Community Services. A considerable amount of time was required in the final days of the audit to determine the rationale for an increase of \$124 million over the prior year's results as noted in the Department's consolidated expenses included in Statement 2 of the consolidated financial statements. We determined a major source of the confusion was that the annual estimates for Community Services included estimates for the operations of the Corporation. The Department of Community Services should only include its portion of expenses related to the Corporation in its annual estimates. The Corporation's total expenses and recoveries should neither be estimated nor accounted for as part of the general revenue fund.

Recommendation 2.4

The Department of Community Services should only estimate and account for its share of expenses of the Nova Scotia Housing Development Corporation.

Controller's Office Response (on behalf of Department of Community Services):

Agreed. The Department of Community Services and the Office of the Treasury Board will explore options to address this recommendation.



Recommendation 2.5

The Department of Community Services should account for the Nova Scotia Housing Development Corporation as a separate agency of government.

Controller's Office Response (on behalf of Department of Community Services):
Agreed. The Department of Community Services and the Office of Treasury Board will explore options to address this recommendation.

2.32 Processes established by Government Accounting to identify and explain significant variances in the consolidated financial statements were not operating effectively during preparation of the March 31, 2012 consolidated financial statements. These processes should include identification of variances above a determined threshold, investigating and reporting results. A properly working variance analysis process would have identified the issues surrounding the difference in expenses between 2010-11 and 2011-12 in the Department of Community Services.

Recommendation 2.6

The Controller's Office should update the description of the variance analysis process conducted on major line items of the consolidated financial statements, including determining the thresholds to be used, and assigning roles and responsibilities for preparation and approval.

Controller's Office Response:
Agreed. A process will be in place to address this before the release of the March 31, 2013 Public Accounts.

2.33 *Department of Education (Education) audit preparedness* – When we identify an audit issue, we contact the related department to obtain sufficient appropriate audit evidence to resolve the matter, or, if the matter is not resolved, to identify related amounts as errors. During the audit of the March 31, 2012 consolidated financial statements, we encountered significant delays in resolving matters related to tangible capital assets, deferred revenue and environmental liabilities from the Department of Education. We eventually asked Government Accounting to intervene so we could resolve these matters.

2.34 We are further recommending that the Controller instruct the Department of Education to fully cooperate with the audit to ensure we receive assistance and information on a timely basis.

Recommendation 2.7

The Controller's Office should direct the Department of Education to cooperate fully with the audit and provide requested information accurately and on a timely basis.

***Controller's Office Response:***

Agreed. This recommendation is fully implemented.

- 2.35 *Petroleum royalties* – The royalty agreement between the Province and the unit holders in the Sable Offshore Energy Project requires a refund to project operators of royalties received once approved capital site abandonment costs are incurred. The future refund was calculated as part of royalty revenue; however, no liability was reflected in the financial statements presented for audit. Considerable time was required by our Office to ensure the accounting treatment was in compliance with Public Sector Accounting Standards.
- 2.36 *Impact of difficulties* – It is presumed when financial statements are received for audit that significant account balances and disclosures are fully supported and in compliance with the appropriate standards. Many of the difficulties encountered during this year's audit resulted from management's inability to provide support for accounting and disclosure included in the financial statements. As noted above, the delay in updating tax revenues to reflect management's best estimates at year end resulted in a postponement of the approval date of the consolidated financial statements. The scheduled release date would have been in jeopardy had it been closer to the approval date.

Required Communication of Audit Results

- 2.37 The management letter issued to the Minister communicated certain matters as required under Canadian Auditing Standards. Those matters included identifying responsibilities of management and those charged with governance with respect to the preparation and oversight of the consolidated financial statements. The letter also communicated our responsibilities as auditors of the province's consolidated financial statements, and included audit findings and recommendations for improvement. It also included conclusions on accounting estimates and the fair presentation of the consolidated financial statements in accordance with Canadian generally accepted accounting principles for the public sector.

Internal Control

- 2.38 A strong internal control framework includes the following elements.
- Control environment, including oversight by those charged with governance
 - Risk assessment processes
 - Information system, including related business processes, and communication
 - Control activities, being the policies and procedures that help ensure that management directives are carried out
 - Monitoring of internal controls



- 2.39 *Responsibility for internal control* – The Finance Act includes general references to the roles and responsibilities of the Minister and Deputy Minister relating to internal control. The Controller prepares the consolidated financial statements of the Province of Nova Scotia on behalf of the Minister and Deputy Minister of Finance, as noted in the statement of responsibility for the consolidated financial statements for the Province of Nova Scotia. The statement of responsibility also notes “*The government is responsible for maintaining a system of internal accounting and administrative controls in order to provide reasonable assurance that transactions are appropriately authorized, assets are safeguarded, and financial records are properly maintained.*”
- 2.40 Our audit is planned and conducted to enable us to express an audit opinion on the annual consolidated financial statements, not to express an opinion on the internal controls of government or to determine whether internal controls are adequate for management’s purposes.
- 2.41 Certain matters which came to our attention during the conduct of the audit, related to internal controls and other financial reporting issues, were communicated to the Department of Finance in a management letter. Implementation of the recommendations in the management letter and this chapter will facilitate preparation of the consolidated financial statements.
- 2.42 *Risk assessments related to financial statements* – Risks to the amounts and disclosures in the consolidated financial statements would include the risk of fraud and error in the consolidated financial statements, including notes and other disclosure. The extent to which internal controls, including control activities, reduce the risk of fraud and error can only be evaluated as part of a comprehensive risk assessment. Risk assessment relevant to consolidated financial statements is management’s responsibility and is critical in ensuring financial reporting objectives are met.
- 2.43 A risk assessment process should include identification of business risks that are relevant to the consolidated financial statements and estimating the significance and likelihood of those risks. This would provide management with information required to manage risks either through implementing appropriate internal controls to mitigate the risk or by accepting the risk. In prior years, we requested that departmental management throughout government identify risks relevant to the financial statements; however, we determined several departments were not addressing risks related to the financial statements, including the risk of fraud or error. Without identifying risks relevant to financial reporting, management is unable to determine if current internal controls are designed to mitigate the appropriate risks.
- 2.44 Responsibility for risk assessments related to the consolidated financial statements should be clearly assigned and communicated to those responsible for



the assessment. The Controller's Office should provide oversight of this process to ensure it achieves the desired results and provides the necessary information to ensure this aspect of the Province's internal control framework is managed.

Recommendation 2.8

The Controller's Office should oversee the preparation of departmental risk assessments of material misstatement to the consolidated financial statements due to fraud and error.

Controller's Office Response:

The Controller's Office will assist in providing the tools necessary for Departments to appropriately identify and assess their Department's risk of material misstatement to the consolidated financial statements due to fraud and error.

2.45 *Monitoring of internal controls over financial reporting* – Monitoring of internal controls over financial reporting as defined by Canadian Auditing Standards is

“...a process to assess the effectiveness of internal control performance over time. It includes assessing the design and operation of controls on a timely basis and taking necessary corrective actions modified for changes in conditions. Monitoring of controls is a component of internal control.”

2.46 Monitoring of controls is an ongoing process that assesses the effectiveness of controls on a timely basis and should be a key component of the government's internal control framework. Government's Management Manuals should include a general description of how controls to be monitored should be identified and a process to monitor those controls. The Management Manuals should also assign responsibility for the process.

Recommendation 2.9

The Controller's Office should prepare a description of the process for monitoring of internal controls and include this in the Management Manuals. The description should assign responsibility for the process, provide an overview of how to determine which controls are to be monitored, and guidelines as to the frequency of the process.

Controller's Office Response:

Agreed. The scope of the Internal Controls over Financial Reporting program continues to expand each year. Draft policies exist and will be added to the management manuals after appropriate review and approval.

2.47 *Control activities* – Control activities are those policies and procedures that help management achieve the organization's objectives. Control activities should be designed and implemented to address risks, as identified in management's risk assessment, which should be mitigated through internal controls.



- 2.48 A recurring observation in this year's audit was the need for additional guidance on roles and responsibilities for internal controls related to the consolidated financial statements. The guidance should be developed and communicated on a comprehensive basis throughout the Government Reporting Entity and should include roles and responsibilities of departmental and crown entity governing bodies and senior management in the design, implementation, operation, and monitoring of internal controls. This would also include updating the province's management manuals to include roles and responsibilities for internal controls, including monitoring of internal controls.
- 2.49 We identified several instances in which additional guidance on assigning roles and responsibilities is required.
- 2.50 Government Accounting identified departmental audit readiness as a control over the financial statement preparation process. Financial representatives in departments are to review and approve year end audit support and sign off to indicate that support is complete. The documented control also states that information provided by departments should demonstrate that items have been properly accounted for. However, the sign-off by certain departments does not assert the support is in compliance with public sector accounting standards. If those departments were required to confirm that information was in compliance with standards, the issues we encountered might have been identified before the audit started. Responsibility for compliance with public sector accounting standards must be assigned. If it is determined that departments are responsible for ensuring this compliance, a statement of responsibility should be included with the departments' audit support and signed by staff responsible for ensuring amounts required for the consolidated financial statements are complete and accurate.

Recommendation 2.10

The Controller's Office should assign and communicate responsibility for ensuring account balances and disclosures are in compliance with public sector accounting standards. If this responsibility is assigned to departments, as a requirement for audit support, each should be required to acknowledge that the information provided to support balances and disclosures complies with standards. Control descriptions should be updated to reflect this process.

Controller's Office Response:

Agreed. This is part of an ongoing improvement process.

- 2.51 After we reported this control deficiency in the management letter, Government Accounting told us it is reviewing roles and responsibilities of departmental financial executives and will draft a compliance statement for the 2012-13 audit.
- 2.52 *Service organizations* – Government uses external service organizations to provide systems to record transactions in certain programs. Information



from these systems is used to provide amounts for the consolidated financial statements, as well as for forecast updates during the fiscal year. When using service organizations, it is imperative that the province assess its internal controls (referred to as complementary user entity controls) to ensure they provide for the completeness and accuracy of transactions entered into the service organization's system. For example, there should be a reconciliation of the volume of transactions entered into the external system. These controls, as well as the controls in place at the service organization to process transactions, support that general ledger transactions are complete and accurate for financial reporting purposes.

Recommendation 2.11

The Controller's Office should develop a process to identify, evaluate and monitor complementary user entity controls in government departments using external service organizations.

Controller's Office Response:

Agreed. The Controller's Office will undertake a process to identify the service organizations used by government. The identification and assessment of compensating entity controls more appropriately resides at the department level.

Other Public Accounts Matters

- 2.53 *Revenue recognition and related cut-off* – Certain sources of revenues, including provincial and corporate income taxes along with harmonized sales tax, are measured, “...using management's best estimates based on assumptions that reflect the most probable set of economic conditions and planned courses of action.” (Note 1, March 31, 2012 Public Accounts)
- 2.54 Earlier in this chapter, we discussed the impact when those responsible for the preparation of the government's financial statements are not involved in setting revenue recognition policies. There is further need for documented policies in the Management Manuals to describe the method to determine tax revenues for the consolidated financial statements. The policy should establish the cut-off timeframe for updating assumptions and models to ensure the estimates reflect the stated accounting policies of the province. The policy should consider the new accounting standard related to tax revenue which comes into effect for the year ended March 31, 2013.

Recommendation 2.12

The Controller's Office should prepare policies and procedures for determining tax revenues, including establishing the cut-off timeframe for updating assumptions and models. This policy should be included in the province's Management Manuals.



Controller's Office Response:

Agreed. Policies and procedures for determining tax revenues will be provided in the Province's Management Manuals at an appropriate level of detail. It should be noted that this topic is currently under review as a result of a new PSAB section, PS 3510 - Tax Revenue.

2.55 *Accumulated sick leave benefits* – Certain governmental units provide sick leave provisions which, if not used, may accumulate as a government liability. The value of sick leave benefits liabilities for certain organizations in the Government Reporting Entity, including district health authorities, has not yet been determined and therefore not recorded in the consolidated financial statements. Our opinion included an emphasis of matter paragraph related to the measurement uncertainty for accumulated sick leave benefits at March 31, 2012. Although the liability is expected to be significant, my opinion was unqualified as, in accordance with Public Sector Accounting Standards, liabilities that cannot be reasonably estimated should not be recognized in the financial statements and disclosure is encouraged. Management has advised that once these liabilities have been determined, they will be recorded in that year with a retroactive restatement of comparative years. This matter is expected to be resolved for the March 31, 2013 consolidated financial statements.

Recommendation 2.13

Government Accounting should record all accumulated sick leave benefits liabilities for the March 31, 2013 consolidated financial statements.

Government Accounting Response:

Agreed. A process will be in place to address this before the release of the March 31, 2013 Public Accounts.

2.56 *Contractual obligations* – Contractual obligations represent significant future expenditures of the province and provide useful information for assessing program costs. As noted in tables below, contractual obligations disclosed in the March 31, 2012 consolidated financial statements were \$9.5 billion – an increase of \$3.3 billion from the prior year. The most significant increases were related to the RCMP contract and assistance to universities.

Contractual Obligations (\$ millions)	2012	2011	2010
General Revenue Fund	\$9,307.9	\$5,907.2	\$6,147.9
Governmental Units	188.8	251.7	238.3
Government Business Enterprises	38.7	38.7	12.1
Total Contractual Obligations	\$9,535.4	\$6,197.7	\$6,398.3

Source: 2010, 2011 and 2012 Public Accounts Volume 1



Significant Contractual Obligations – General Revenue Fund (\$ millions)	2012	2011	2010
Health – Long-term Care Facilities	\$4,210.7	\$4,296.9	\$4,449.6
Justice – RCMP	\$2,821.4	\$98.0	*
Health – Ground Ambulance Fleet	\$757.4	\$823.8	\$950.6
Assistance to Universities	\$865.3	*	*
Education – P3 School Maintenance Agreements	\$244.1	\$260.2	\$282.3
* disclosure began in subsequent years			
Source: 2010, 2011 and 2012 Public Accounts Volume 1			

2.57 Contractual obligations are included in note disclosure in the consolidated financial statements and do not impact operating results or accumulated deficits of the Province; however, they represent significant future expenditures of the Province and provide useful information for assessing program costs.

2.58 We continue to receive inaccurate information regarding contractual obligations and each year there are significant audit adjustments. Two of the more significant audit adjustments in 2012 included a \$577 million increase to contractual obligations to properly disclose assistance to universities and a \$153 million decrease relating to Transportation and Infrastructure Renewal. It is management's responsibility to ensure note disclosure is complete and accurate. As discussed earlier, Government Accounting is drafting a compliance statement for next year's audit which is to be included with departmental audit support. Departmental acknowledgement of responsibility for determining the amount of contractual obligations in compliance with accounting standards may resolve this matter.

Other Matters

Conclusions and summary of observations

The Minister of Finance has not directly and adequately communicated significant changes to the Public Service Superannuation Plan to its members. While impending changes to the governance structure of the Plan have been highlighted, the fact that the Superannuation Plan will no longer be guaranteed by the Province of Nova Scotia once these governance changes are effected, and the resulting transfer of risk to Plan members, has not been communicated in sufficient detail. In addition, we reviewed information related to presentation of recent forestry transactions in the September 25, 2012 forecast update and have concluded these were properly accounted for in the update.



Changes to the Public Service Superannuation Plan

- 2.59 *Introduction* – The Department of Finance contacted our Office in October 2012 to discuss the accounting implications of recent changes to legislation surrounding the Public Service Superannuation Plan, and of impending changes in the Plan’s governance structure. As a result of this request, we reviewed these changes and make the following comments.
- 2.60 *Communication of Public Service Superannuation Plan changes* – In the April 3, 2012 Budget Address for the 2012-13 Budget, the Finance Minister noted the following information regarding changes to the Public Service Superannuation Plan.
- “We also reformed the Public Service Superannuation Plan, and we did so in a way that was fair to all past and current members and also to taxpayers. As promised in the 2010 Budget, we have been positioning the plan for a transfer to joint trusteeship, and we are now ready to do so. The new governance model will form an important part of this year’s Financial Measures Act. Again, this will make the plan more secure over the long term.”*
- 2.61 Indeed, the Financial Measures Act describes the new governance model for the Superannuation Plan. Bill No.17 (Financial Measures (2012) Act (An Act Respecting Certain Financial Measures)) received Royal Assent on May 17, 2012. The Act establishes the Public Service Superannuation Plan Trustee Incorporated and notes that the objects and purpose of this Corporation are:
- to act as Trustee; and
 - to carry out such other activities or duties as may be authorized or required by the Act.
- 2.62 The Act further describes significant changes to the Plan, as follows.
- 2.63 The legislation includes a detailed funding policy which defines actions required when the Plan’s funded status is below 100%, including increased contribution rates and the possibility of reduced benefits. The Act also establishes the requirement for a funding reserve should the funded status exceed 100%.
- 2.64 Upon appointment of the Public Service Superannuation Plan Trustee, the obligation of the Minister of Finance through the Province of Nova Scotia to fund future Plan deficits is terminated.
- 2.65 It is our view that the Minister of Finance, as sole trustee of the Public Service Superannuation Plan, has provided insufficient communication of these significant changes to members. As at December 31, 2011 (the last date member

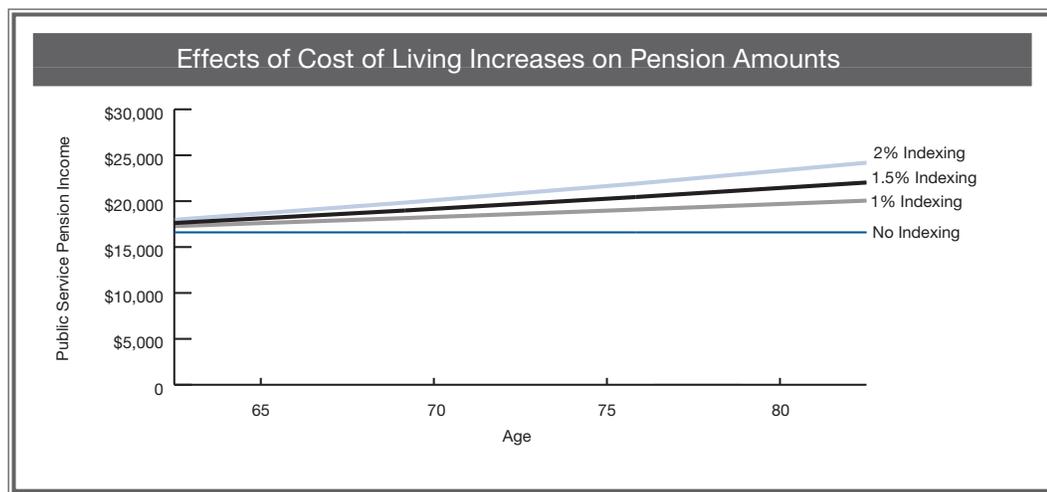


data was accumulated for purposes of the actuarial valuation), the Plan provided benefits to 12,926 pensioners and survivors, and received contributions from 16,521 members. Communication by the Minister has focused on the revised governance structure and not on the impact these changes will have on members. We are concerned that the vast majority of members will be unaware that the benefits described to them when they were hired are not necessarily what they will receive when they retire.

- 2.66 *Loss of guarantee* – The existing requirement for the Province to fund Public Service Superannuation Plan deficits is not unusual in public sector pension plans, although we acknowledge that it is becoming less common with increasing pension obligations in this sector. It should be noted that pension plans in the private sector in Nova Scotia are protected by regulations under the Pension Benefits Act which prescribes a timeframe over which plan owners must fund plan deficits.
- 2.67 The removal of the Province’s guarantee significantly shifts the risks of the Public Service Superannuation Plan from the Province, as employer, to the members of the Plan. This should have been communicated. In addition, while there is considerable information on the Nova Scotia Pension Agency’s website regarding the planned governance changes and the funding policy described in the Act, there is little mention that the Province’s future financial obligation under the new structure is limited to its contributions. While we acknowledge the Agency’s role in administering the Public Service Superannuation Plan, we believe communication of these changes should be actively made to members by the Minister as the sole trustee of the Plan, not passively through the Agency.
- 2.68 As noted, we are currently discussing the impact of these changes on the Province’s financial position with the Department of Finance’s Government Accounting division. Government Accounting prepares the analysis and accounting entries to determine the Province’s liability for the Public Service Superannuation Plan under generally accepted accounting principles for the public sector. At March 31, 2012, the Plan’s deferred actuarial losses totaled \$382.5 million. (This amount will change for the year ended March 31, 2013 as a result of actuarial calculations which are currently being performed.) If it is determined that the Province is no longer liable for benefits under the Public Service Superannuation Plan, there will be an immediate recognition of these deferred amounts as an increase to the Province’s deficit (reduction of surplus). This matter must be resolved prior to preparation of the province’s March 31, 2013 consolidated financial statements, but more urgently, in preparation for the 2013-14 budget.
- 2.69 We note earlier in this chapter the need for Government Accounting to be consulted when changes are made to systems providing information included in the Province’s Public Accounts. In our view, the accounting implications of these changes should have been discussed with Government Accounting.



- 2.70 *Changes in Public Service Superannuation Plan benefits* – In his April 6, 2010 Budget Address for the 2010-11 budget, the then Minister of Finance announced a significant change to Plan benefits – the loss of indexing on pension benefits. This retroactive change in previously earned benefits immediately impacted some 11,000 retirees.
- 2.71 Government has indicated that the new funding policy will not impact benefits earned to date, only future benefits. We believe this statement is inaccurate and misleading. Indexing is a considerable benefit and maintains the purchasing power of benefits when there are increases in the cost of living. The following exhibit illustrates the impact of cost of living increases on pension income of \$16,600 per annum.



- 2.72 The exhibit demonstrates the impact of indexing on an annual pension income of \$16,600 at age 60. As can be seen, indexing has a significant impact on the cumulative effect of cost of living increases. For example, in a ten-year period, if indexing matches a cost of living increase of 1%, pension earnings increase to \$19,081 per annum. At 2%, earnings increase to \$21,903.
- 2.73 Indexing is currently set at 1.25% until January 2016. The new funding policy will maintain this rate in future five-year cycles as long as funding ratios meet specified targets. The first of these cycles will begin on January 1, 2016. The Act notes that if the funded ratio of the Plan is below 100% at that time, there will be no indexing for the five-year period ending December 31, 2020.
- 2.74 *Contribution rates* – We are also concerned that the structure of the new Public Service Superannuation Plan Trustee creates a potential conflict of interest. The Trustee will establish contribution rates if funding targets are not met. However, given that the new governance model includes only one director representing retirees (of a total of ten to twelve directors), there may be less interest for current employees to increase rates sufficiently to ensure contribution targets are met. Decreased benefits can also achieve these targets.



- 2.75 *Nova Scotia Pension Agency* – The Nova Scotia Pension Agency is the administrator of the Public Service Superannuation Plan under existing legislation and will continue in this role until the new trustee is appointed. Coincidental with that, it is anticipated that there will be a change in the Agency’s status. A successor non-profit corporation will be created and the Nova Scotia Pension Agency will no longer be an agency of government.
- 2.76 The significance of the Nova Scotia Pension Agency to the Public Service Superannuation Plan’s financial health is worth noting. We are planning an audit at the Agency to begin in early 2013. The preliminary objectives of the audit are:
- to determine that pension benefits are calculated accurately;
 - to assess the process to determine the appropriate asset mix of the Public Service Superannuation Plan, and to monitor investment performance; and
 - to assess the process used to determine proposed changes to the Public Service Superannuation Plan, including evaluation of alternatives and consultation with stakeholders.
- 2.77 This audit will complement an audit of investment management we conducted in 2004. We made several recommendations as a result of that audit to improve financial controls and processes; however, we did not find any significant deficiencies. Nevertheless, without the Province’s guarantee, current and future pensioners are reliant on the Nova Scotia Pension Agency’s ability to manage investments to meet the Public Service Superannuation Plan’s obligations. The new trustee must ensure that its policies and procedures provide adequate monitoring of investment results.

Recommendation 2.14

The Minister of Finance should directly communicate all significant proposed changes to the Public Service Superannuation Plan to its members.

Department of Finance Response:

We agree communication with plan members is essential and believe that it has been completed. In 2010, the Minister of Finance (as Trustee of the PSSP) directly communicated with plan members to explain the changes to the PSSP resulting from the Financial Measures Act 2010.

The following major changes were communicated.

- *Enabling of a replacement trustee and simultaneous removal of the provincial backstop.*
- *The modification of future benefits and creation of a new funding policy.*



The Financial Measures Act 2012 further refined these changes following intensive stakeholder consultation with unions, retirees and employers, as well as expert advice. Both pieces of legislation were debated in the House, subject to the Law Amendments process and received media coverage. Additionally, the results of the FMA were shared with members through a broadcast email and PSSP newsletters, website and annual reports.

Overview of Forestry Transactions

2.78 *Port Hawkesbury Mill* – On September 22, 2012, the Province announced it had reached a deal involving the sale of the Port Hawkesbury Mill operations to another party. The deal provided several financial incentives to this party. The following are the significant aspects of the transactions.

- \$40 million repayable loan with interest and principle payments commencing in 12 years
- \$24 million forgivable loan
- \$1.5 million grant related to forestry programs through the Department of Natural Resources
- \$1 million grant to implement a market plan
- \$3.8 million annual grant for 10 years

2.79 In addition, the Province has invested \$36.8 million through the Forestry Infrastructure Fund to keep the mill ready for resale.

2.80 Due to the significance of this transaction, we asked management at the Department of Economic and Rural Development and Tourism, and at the Nova Scotia Jobs Fund, how the various types of financial assistance was accounted for. We also asked whether forecasted expenses disclosed in the September 25, 2012 forecast update included provisions for this assistance. The preparation of updated forecasts throughout the year is a requirement under the Finance Act and is also a significant component of government's financial reporting and accountability processes.

2.81 Through these enquiries, we are satisfied that the Department's revised forecast for 2012-13, provided on September 25, 2012, includes the following, and that, without having performed an audit, the transactions appear to have been accounted for in accordance with generally accepted accounting principles for the public sector.

- Recognition of the \$24 million assistance as a grant due to the concessionary terms associated with this assistance
- Recognition of \$14 million as a grant related to the deferred repayment terms associated with the \$40 million credit facility



- Recognition of \$10 million grant issued by the Nova Scotia Jobs Fund through the Forestry Infrastructure Fund
- 2.82 We obtained information from management at the Department which confirmed that the financial assistance related to the sale of the mill had been considered when the 2012-13 budget was prepared. Therefore, the forecast did not vary significantly from budget upon completion of this sale.

Accounting Standards

- 2.83 *New accounting standards* – There are new accounting pronouncements either made or in process which will have an impact on government’s future financial reporting. Some of the more significant issues on which the Public Sector Accounting Board has recently released new or revised pronouncements include tax revenue, foreign currency translation, financial instruments and government transfers.
- 2.84 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.
- 2.85 *Government transfers* – This revised section of the Public Sector Accounting Board standards (Section 3410) is one of the most controversial and has been released after many years of deliberations. This section establishes recognition, presentation and disclosure criteria for both transferring and recipient governments. The significant criteria are those related to authorization, eligibility and stipulations for the recipient government. This section is effective for fiscal years beginning on or after April 1, 2012.
- 2.86 There are many types of government transfers, including those where the Province is the transferor. Further analysis is needed by Government Accounting to address the various types of transfers from the perspective of the Province both as transferor and as recipient. The results of this analysis need to be provided as guidance to departments, and entities within the Government Reporting Entity using Public Sector Accounting Board standards. This will further ensure that all governmental units are consistently adopting the standard on government transfers and will facilitate their consolidation. Government Accounting, under the direction of the Minister of Finance, should ensure all governmental units are aware of the new standard and the interpretation of the standard as it applies to the consolidated financial statements. That knowledge will be required to either conform to the above interpretation or to identify government transfer issues to be considered during consolidation.

**Recommendation 2.15**

The Controller's Office should provide guidance to governmental units reflecting the government's position on the application of PS 3410 – Government Transfers for the year ended March 31, 2013.

Controller's Office Response:

Agreed. Government Accounting is in the process of drafting a Management Manual policy on the application of PS 3410 – Government Transfers. Once approved, we will undertake to share this with governmental units.

Other Legislative Audits

2.87 The Office of the Auditor General is the legislated auditor for four government agencies.

- Nova Scotia Gaming Corporation
- Nova Scotia Crop and Livestock Insurance Commission
- Trust Funds Administered by the Public Trustee
- Nova Scotia Legal Aid Commission

2.88 The findings and recommendations related to those audits are reported in Chapter 5 of this report – Review of Audit Opinions and Management Letters. Unqualified audit opinions were issued as a result of the audit in each of these entities with the exception of the audit of the Trust Funds Administered by the Public Trustee. The audit opinion is qualified each year because it is not possible to ensure the financial statements reflect all assets assigned by the courts to be administered by the Office of the Public Trustee. This is a common qualification for entities such as this and is not as a result of deficiencies in the Office of the Public Trustee's systems and controls. Further, we recommended that the Public Trustee obtain a comprehensive financial accounting system, and changes to processes for accumulating amounts in the Special Reserve Fund.

2.89 The Auditor General was appointed auditor of the House of Assembly Management Commission for the years ended March 31, 2011 and March 31, 2012. The results of those audits, and our audit of the implementation status of recommendations made in our February 2010 Report (Chapter 4 – Office of the Speaker: Members' Constituency and Other Expenses), are included in Chapter 3 of this Report.