February
2013

Report of the Auditor General to the Nova Scotia House of Assembly

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January 11, 2013

Honourable Gordie Gosse
Speaker
House of Assembly
Province of Nova Scotia

Dear Sir:

I have the honour to submit herewith my Report to the House of Assembly under Section 18(2) of the Auditor General Act, to be laid before the House in accordance with Section 18(4) of the Auditor General Act.

Respectfully submitted

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Auditor General

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Office of the Auditor General

Our Vision

A relevant, valued and independent audit office serving the public interest as the House of Assembly's primary source of assurance on government performance.

Our Mission

To make a significant contribution to enhanced accountability and performance in the provincial public sector.

Our Priorities

Conduct and report audits that provide information to the House of Assembly to assist it in holding government accountable.

Focus our audit efforts on areas of higher risk that impact on the lives of Nova Scotians.

Contribute to a better performing public service with practical recommendations for significant improvements.

Encourage continual improvement in financial reporting by government.

Promote excellence and a professional and supportive workplace at the Office of the Auditor General.

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Who We Are and What We Do

The Auditor General is an independent nonpartisan officer of the Legislature, appointed by the House of Assembly for a ten-year term. He or she is responsible to the House for providing independent and objective assessments of the operations of government, the use of public funds, and the integrity of financial reports. The Auditor General helps the House to hold the government to account for its use and stewardship of public funds.

The Auditor General Act establishes the Auditor General's mandate, responsibilities and powers. The Act provides his or her Office with a modern performance audit mandate to examine entities, processes and programs for economy, efficiency and effectiveness and for appropriate use of public funds. It also clarifies which entities are subject to audit by the Office.

The Act stipulates that the Auditor General shall provide an opinion on government's annual consolidated financial statements; provide an opinion on the revenue estimates in the government's annual budget address; and report to the House at least annually on the results of the Office's work under the Act.

The Act provides the Office a mandate to audit all parts of the provincial public sector, including government departments and all agencies, boards, commissions or other bodies responsible to the crown, such as regional school boards and district health authorities, as well as funding recipients external to the provincial public sector. It provides the Auditor General with the authority to require the provision of any documents needed in the performance of his or her duties.

In its work, the Office of the Auditor General is guided by, and complies with, the professional standards established by the Canadian Institute of Chartered Accountants, otherwise known as generally accepted auditing standards. We also seek guidance from other professional bodies and audit-related best practices in other jurisdictions.

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1 Message from the Auditor General

Introduction

1.1 I am pleased to present my February 2013 Report to the House of Assembly. This Report focuses on financial reporting issues and includes work completed by my Office during 2012.

1.2 I wish to acknowledge the valuable efforts of my staff whose dedication and professionalism make this report possible. As well, I wish to acknowledge the cooperation and courtesy we received from staff in departments and agencies during the course of our work.

Overview of Report

1.3 Our Office has a number of legislated responsibilities that are directly related to the financial management of government. Among these are the responsibility to audit and provide an opinion on the government's consolidated financial statements; to review and provide an opinion on government's revenue estimates in the annual budget; to audit the financial statements of a number of provincial agencies; and to review the audit opinions and management letters provided by external auditors on all the agencies which are part of the government reporting entity.

1.4 As the appointed auditors of the House of Assembly, we audit the House's financial statements, internal controls, and compliance with policy. We may also conduct other financial audits in government as we consider appropriate. Finally, we provide recommendations as appropriate in all our audits and reviews, to improve financial management in government.

1.5 This report presents and discusses the results of this work. The report contains five chapters in addition to this introduction.

1.6 Chapter 2 deals with the results of our financial audits and reviews. We provided an unqualified opinion on the province's consolidated financial statements. We commented on difficulties we encountered in completing that audit this year, and made several recommendations to improve financial controls and financial management in government. The opinion on the revenue estimates was again qualified but we noted that government is taking steps to address the qualification.

1.7 Chapter 3 includes the results of our work as the newly-appointed auditors of the operations of the House of Assembly. We conducted a number of audits for the first time this year, as required by legislation. We issued unqualified opinions on the House of Assembly financial statements for the years ended March 31, 2011 and March 31, 2012, as well as opinions on compliance with policy, and the effectiveness of internal controls. We also audited progress by the House in implementing the recommendations resulting from our 2010 audit of Members' allowances and constituency expenses. We found that the House of Assembly Management Commission and its management have implemented 90% of our recommendations to date.

1.8 Our chapter on financial indicators provides financial information and analysis related to the sustainability, flexibility and vulnerability of government finances, with a focus on long-term debt.

1.9 In our review of agency audit opinions and management letters, we found that independent auditors' recommendations for improvements in internal controls and other financial management and reporting issues were often repeated from prior years. We also found that some school boards' auditors continued to identify poor controls over school-based funds; we recommended that the Department of Education work with those boards to strengthen controls in this area.

1.10 Our follow-up of previous recommendations related to financial management found that the implementation rate is virtually unchanged. A number of recommendations related to internal controls date back several years and have yet to be fully implemented.

1.11 Departmental responses to recommendations have been included in the appropriate chapter. We will follow up on the implementation of our recommendations in two years, with the expectation that significant progress will have been made.

Significant Issues

Internal Controls

1.12 Internal controls are those systems and processes that an organization puts in place to help it achieve its objectives, mitigate risks, maintain sound business practices and protect its resources. They start at the top of a department or agency, through policy and managerial or board direction, and form an intrinsic part of the organization's operations, including its communications, computer systems and transaction processing. Proper controls, such as approvals and reconciliations, help prevent or detect fraud and error. When costs are recorded accurately and on a timely basis, information can be used for decision-making purposes. When these systems and processes are working as they should, they are a vital factor in helping government programs and operations run smoothly and meet their objectives.

1.13 We frequently make recommendations for internal control improvements during our performance audits. Many have financial implications. In our November Report, we found significant deficiencies in Trade Centre Limited's internal control framework, including weaknesses in financial management processes over certain revenues and expenses. Chapter 3 of this report includes the follow-up of our 2010 recommendations on weaknesses in operations at the Office of the Speaker. These recommendations were made after we conducted an extensive audit of Members' expenses and identified significant deficiencies in the internal control processes to review and approve these expenses. These deficiencies allowed, and even enabled, inappropriate, excessive, even fraudulent activity to occur.

1.14 Internal control deficiencies are also regularly identified by external auditors in government agencies. Each year we review management letters resulting from government agency external audits and report the nature of these weaknesses. It is clear from the results reported in Chapter 5 that insufficient attention is being paid by many boards and management in these agencies to addressing these issues, as the same or similar recommendations are made every year. Continuing internal control deficiencies constitute poor business practice and expose agencies to unnecessary risk of fraud and error.

1.15 We have also made numerous recommendations for internal control improvements in government operations as a result of our annual audit of the province's financial statements. Some of these have, unfortunately, been repeated for a number of years. In Chapter 6, we point out that several internal control recommendations have been outstanding since at least 2007. Two of these deal with the need for greater control from central government – for government-wide documentation of internal controls, and for clear assignment of roles and responsibilities for these controls. Government needs to focus more attention on correcting these deficiencies and make the needed improvements to internal controls.

1.16 We direct many of our internal control recommendations to the Office of the Controller. We feel that government needs a stronger and more proactive controllership function; one that takes responsibility for the overall level of control in government and has the authority to manage controls. We recognize that the structure of government is decentralized, with much authority vested in departments and in agencies. However, some direction has always been exercised from the centre and an appropriate balance needs to be maintained between the autonomy of departments and agencies, and the governance of the organization as a whole. Our findings indicate a need for better central controllership. We suggest that Members of the House consider the need for stronger controllership when reviewing the financial operations of government.

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Changes to the Public Service Superannuation Plan

1.17 In Chapter 2 we discuss our concern that some major impacts of changes to the Public Service Superannuation Plan have not been communicated by the Minister of Finance, as sole trustee of the Plan, to current and retired Plan members. Communication to date on changes to the plan has focused on two aspects of the changes: the implementation of a new funding policy; and the anticipated move to joint trusteeship. Such communication has consisted primarily of news releases and passive updates of web sites. While such communication is valuable, it is not sufficient.

1.18 Joint trusteeship is expected to take place on April 1, 2013 when a new governance model comes into effect. When that happens, responsibility for the pension plan will be transferred to the new joint trustee and the Minister of Finance will no longer be trustee of the Plan. Further, and more significantly, as a result, the province will no longer financially guarantee the Plan. It will stand alone. It is primarily on this point that we feel communication has been missing. Members need to be aware that the elimination of this guarantee transfers all future risks of the Plan from the government to the Plan's members. The financial health of the Plan will depend solely on the success of investments held by the Plan and on the management of these resources to meet benefits.

1.19 As a matter of good governance, we believe this significant change should be communicated directly to members by the Minister of Finance, as the Plan's trustee.

1.20 The Department of Finance claim they and the Minister have communicated this information directly to Plan members. We do not agree. We are therefore bringing this information forward to provide at least some communication of these significant changes that affect over 29,000 working and retired Public Service Superannuation Plan members.

Auditor General's Commentary

The Issue of Long-term Debt

1.21 Last year I reported my concerns about the growth of government's long-term debt. I said that I believe government's use of long-term debt to pay for its expenditures is inappropriate in all but a few circumstances. I questioned the ethics of asking future generations to pay for current expenditures.

1.22 My concern regarding this issue has not abated.

1.23 Nova Scotia's long-term debt load has increased from $12.5 billion to $16.2 billion since 2008. $400 million was added to the debt in the last fiscal year. This total amounts to $13,900 of debt per person.

1.24 Government will incur debt when its revenues are not sufficient to cover the costs of both operations and capital spending. This has the effect of deferring payment for the year's revenue deficiency to a later date. If this practice is habitual, payment will be deferred, possibly indefinitely, and the debt balance will grow. Future taxpayers will bear the burden of the debt and pay interest every year to maintain it. This interest diverts funds from government programs, in effect to finance prior programs; it reduces government's ability to provide services to its citizens and limits its options in adjusting to changing circumstances and citizens' needs. $906 million was diverted in Nova Scotia last year to pay interest on debt. Debt also exposes government to the significant risk of large rises in interest rates and related constraints or even crises.

1.25 The potential impacts of excessive government debt today can be seen in the troubles faced by numerous governments globally.

1.26 Besides the damage to government's service delivery potential, and the risks facing governments with large debt loads, we must consider the ethics of government borrowing. I have put forward the proposition that it is fiscally irresponsible, in all but a few cases such as emergencies and mega-projects, for governments to consistently transfer payment for their expenditures to future generations. It is wrong to ask future generations to pay for our spending today, regardless of potential benefits they also might receive.

1.27 Ethical government requires, for the long term, at the least a goal and determination to live within one's means; to cease adding to long-term debt; and, eventually, to begin to pay down the debt, if not completely eliminate it.

1.28 This is the right approach. It is fiscally prudent. It is the ethical direction to take for future generations. I urge the Members of the House of Assembly to consider these issues when reviewing the financial management of government in future.

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.

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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.

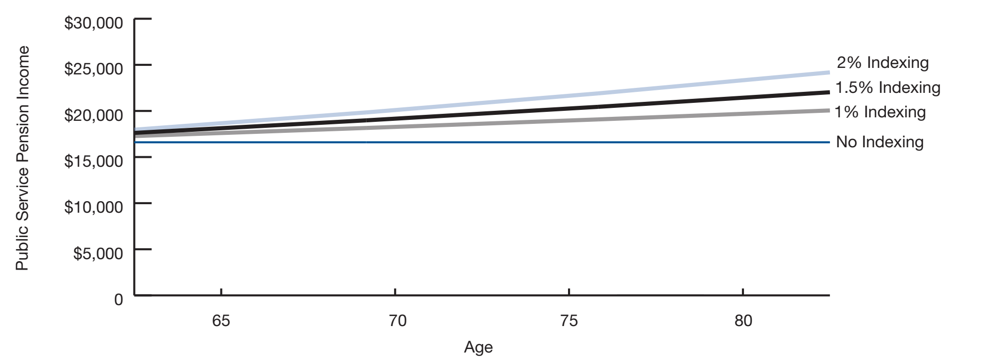
2.68 As noted, we are currently discussing the impact of these changes on the Province's financial position with the Department of Finance's Government Accounting division. Government Accounting prepares the analysis and accounting entries to determine the Province's liability for the Public Service 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.

Effects of Cost of Living Increases on Pension Amounts



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.

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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.

3 Follow-up of Recommendations to the Office of the Speaker, and Audit of House of Assembly

Summary

The Auditor General was appointed auditor under the House of Assembly Management Commission Act. The audit engagements included audit opinions on: the Commission's financial statements for the years ended March 31, 2011 and March 31, 2012; the effectiveness of internal controls; and compliance with policies. During these audits, we conducted a further audit of the implementation status of the recommendations included in the February 2010 Report of the Auditor General – Chapter 4: Office of the Speaker: Members' Constituency and Other Expenses.

The House of Assembly Management Commission has made considerable progress in implementing the recommendations from our February 2010 Report, but improvements are still needed.

90% of the recommendations included in the 2010 Report are complete. The Commission told us it expects to fully implement all recommendations by March 31, 2013. It is evident the Commission and management took quick action on our recommendations and we commend them for their efforts.

We have recommended additional clarification in the House of Assembly Management Commission Regulations related to advertising expenses, and late fees. We also recommended improvements to the capital asset inventory system to improve controls designed to ensure completeness of assets.

We issued a qualified opinion on the financial statements for the year ended March 31, 2011 due to our inability to audit balances as at April 1, 2010; this is a standard audit qualification on a new engagement. The audit opinion as at March 31, 2012 was unqualified. We recommended several improvements to processes to ensure amounts included in the financial statements are accurate and complete.

Our audit opinions on compliance with policies of the Commission and, where applicable, the public service, were unqualified for the period from June 9, 2010 to March 31, 2011 and for the year ended March 31, 2012. We found no instances of noncompliance.

The Chief Clerk of the House of Assembly issued a certification as to the effectiveness of internal controls for the years ended March 31, 2011 and March 31, 2012. The Clerk has identified a deficiency with respect to capital assets in this certification. Our audit opinions on the appropriateness of the Chief Clerk's assessment were unqualified. As required, we also issued an opinion on the effectiveness of internal control for 2010-11 and 2011-12. Our opinions on the effectiveness of these controls were qualified with respect to the existence and accuracy of capital assets.

3 Follow-up of Recommendations to the Office of the Speaker, and Audit of House of Assembly

Introduction

3.1 In November 2009, the Office of the Auditor General completed a performance audit of constituency and other expenses of Members of the House of Assembly. To that point, we had not examined payments to Members in over fifteen years.

3.2 We focused on allowances and other payments to Members as representatives in the House of Assembly and administered through the Office of the Speaker. The objective for that engagement was to determine whether payments to Members of the House of Assembly for constituency and other expenses were reasonable, adequately supported, and in accordance with the acts, regulations and guidelines at the time. We conducted audit fieldwork at the Office of the Speaker from August to November 2009. The results of this audit were reported in our February 2010 Report – Chapter 4: Office of the Speaker: Members' Constituency and Other Expenses.

3.3 There were several significant findings resulting from the audit.

- Members received significant funding for expenditures which did not require receipts or other support. Written rules and guidelines did not clearly define how funds should be spent.
- Members claimed expenditures for personal items, expenses already covered by an allowance, items previously claimed, and items and services from ineligible relatives.
- Certain Members' purchases were unreasonable, and clearer, more comprehensive regulations and guidelines were required.
- Inadequate documentation, such as photocopies of invoices, no evidence of payment and no supporting documentation, hindered House of Assembly staff's ability to monitor and ensure the appropriateness of expenditures. Only complete and proper documentation should be accepted and processed.
- Several Members made additional payments for employees and were reimbursed through expense claims; therefore, payroll remittances were not made.
- There were weaknesses in legislation which allowed Members to claim per diems as well as the cost of meals for the same day, and also to claim late fees for untimely payments.

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3.4 The audit resulted in nine recommendations for improvements to systems and processes. The recommendations were supported by consider points to further illustrate good business practices, and to enhance stewardship of public funds.

3.5 On May 11, 2010, the House of Assembly Management Commission Act was passed. The Legislature Internal Economy Board established under the Public Service Act was replaced by the House of Assembly Management Commission. Under Section 22 of the Act, an annual audit of the accounts of the House of Assembly must be performed, which includes the following elements:

- a financial statement audit expressing an opinion on whether the accounts of the House of Assembly are fairly presented in accordance with general accepted accounting principles;
- an opinion on whether the expenses incurred by the Assembly are in accordance with the policies of the Commission and, where applicable, the policies of the public service of the Province; and
- an opinion on whether the Chief Clerk's assessment of the effectiveness of internal controls of the House of Assembly is fairly stated and whether the internal controls are operating effectively.

3.6 On September 28, 2011 and March 28, 2012, the House of Assembly Management Commission appointed the Auditor General to conduct these audits for the years ended March 31, 2011 and March 31, 2012 respectively. The Auditor General accepted the appointment.

3.7 The Act further requires that a compliance audit be conducted by the Auditor General of the accounts of the House of Assembly at least once every General Assembly, to express an opinion on, among other requirements, whether public money has been collected and disbursed in accordance with regulations. This audit will be conducted at a later date.

Audit Objectives and Scope

3.8 From February 2012 to October 2012, we conducted an audit for each of the years ended March 31, 2011 and March 31, 2012, in accordance with section 22(5) of the House of Assembly Management Commission Act.

3.9 In addition, in fall 2012, we assessed the implementation status of the performance audit recommendations included in the February 2010 Report of the Auditor General – Chapter 4 – Office of the Speaker: Members' Constituency and Other Expenses. The objective of this assignment was to determine the extent of implementation of the recommendations from that report. It is our practice to follow-up on the implementation status of our recommendations two years after

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they have been made. We believe two years is sufficient time for auditees to substantively address our recommendations.

Follow-Up of 2010 Recommendations

Conclusion and summary of observations

Considerable progress has been made in implementing the recommendations from our 2009 audit of Member expenses and allowances. 90% of the recommendations have been implemented to date and progress is being made toward full implementation by March 31, 2013. We have made additional recommendations related to advertising and late fees which will further strengthen the House of Assembly Management Commission Regulations. We also recommended improvements to the capital asset inventory system to improve controls designed to ensure completeness of assets.

3.10 *Background* – We requested that the House of Assembly Management Commission complete a self-assessment of its progress in implementing each 2010 recommendation. We also asked the Commission to provide supporting information and documentation. Our audit focused on whether self-assessments and information provided by the Commission were accurate, reliable and complete. We substantiated information provided by management through interviews and examination of documentation, much of which was conducted during the audits we performed under Section 22 of the Act.

3.11 Our Office policy is to follow up on the implementation status of our recommendations after two years. We typically provide review level assurance as to the reasonableness of the statuses reported to us. However, because we were conducting audits of the financial statements, internal controls and compliance, we were able to perform additional procedures which allowed us to conclude with more certainty that the implementation status of these recommendations is accurate.

3.12 *Allowances and expenses* – The following chart provides information on allowances and other payments to Members at the time of our audit, and as of June 2011.

Allowances and Other Payments	2009	2011
Standard allowance (no receipts required)	$1,050/month	Eliminated
Constituency expenditures allotment	maximum $4,198/month (with receipts)	Same, maximum $4,198/month; requires original invoice and proof of payment
Franking and travel (within constituency based on size)	$13,783/year to $18,194/year (no receipts required)	Same values of $13,783/year to $18,194/year; requires a claim to be completed identifying dates, purpose of travel, kms and franking (postage) receipts required
Living allowance (outside members only)	$1,470/month (no receipts required)	Same value of $1,470/month; requires a current lease on file and original invoice and proof of payment for eligible living expenses
Living allowance (outside Executive Council members and party leaders)	$1,700/month (no receipts required)	Same value of $1,700/month; requires a current lease on file and original invoice and proof of payment for eligible living expenses
Electronic technology fund	maximum $2,500/year (with receipts)	Eliminated
Non-government party leaders expenses	maximum $41,200/year (with receipts)	Same; maximum $41,200/year; requires original invoice and proof of payment
Speaker's travel expenses (with receipts)	amount not specified	Same; amount not specified
Transition allowance (former members, maximum 3 months)	$15,000/month – maximum 3 months (no receipts required)	Eliminated
New member's allowance		$2,500 is permitted as a start up allowance to set up constituency offices and $2,500 for living accommodations (outside members only); requires original invoice and proof of payment (total of $5,000)
Per diems (within province, no receipts required)	$84/day	$38/day (Halifax) $38/day or reasonable (outside Halifax)
Mileage	$0.4092/km	$0.3813/km

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3.13 *Implementation status of recommendations* – The following paragraphs note each recommendation, and our evaluation of progress made in implementing the recommendation. In total, 90% of our recommendations have been implemented, and progress is being made toward full implementation by March 31, 2013.

2010 – Recommendation 4.1 – A comprehensive examination of the funding system for Members' constituency and other expenses should be carried out. The examination should address which expenditures should be funded, why, and to what extent, and should take into account consider points provided in this Chapter. Clear and appropriate guidance on expenditures should be developed and communicated to Members. Implementation of any changes should be effectively monitored.

Implementation Status – Complete

3.14 Our office examined the new House of Assembly Management Commission Regulations. A significant difference between these Regulations and those in place at the time of our audit is that the new Regulations, in discussion of expense claims, include overarching concepts such as principles (e.g., that claims and invoices must be made in accordance with the intent and purpose of the Act and Regulations), Member responsibility for claims, and proper record-keeping. There is also considerably more information and description of allowable constituency expenses, and leased premises for outside members.

3.15 The regulations also require that the Chief Clerk of the House of Assembly prepare a semi-annual statement for each member including details of individual expenditures. These statements are available to the public.

3.16 In addition, the Members' Manual is a more comprehensive document than the manual which was in place during our 2009 audit. It communicates and expands on information included in the regulations by providing illustrations of payroll forms and travel logs.

2010 – Recommendation 4.2 – Payments to Members for personal items, expenses already covered by an allowance, items or services from relatives defined in the regulations, and items previously claimed should be recovered by the Office of the Speaker.

Implementation Status – Complete

3.17 We verified the recovery of payments from Members. Recoveries were made of duplicate payments. Other amounts were agreed to by the Commission as valid expenses, and recovery was not required. We also audited a sample of Members' expenses for the years ended March 31, 2011 and March 31, 2012. There were no instances of claims not being accompanied by an original invoice and proof of payment. In addition, there were no instances of invoices claimed and payments made for items of a questionable nature in these sample items.

2010 – Recommendation 4.3 – Rules and guidance on advertising should clearly define acceptable nonpartisan practices. Partisan advertising should not be claimable by Members through their constituency expense claims.

Implementation Status – Complete

3.18 Section 22 (3) of the previous regulations included advertising as an expense which could be claimed in the constituency allowance. No details were provided on the nature or content of advertisements. We noted in our 2010 Report that partisan advertising increases the risk of creating barriers between some constituents and their representatives.

3.19 We note that the new Regulations define advertising expenses as *"...including constituency office hours, contact telephone numbers for the member, email addresses, notices of constituency meetings and advertising messages of welcome and congratulations."* Further, Section 21(3) of the Regulations notes that *"...advertising may not include solicitations of membership in or monetary contributions to any political party or notices of political-party meetings and other political-party events."*

3.20 Section 43 (4) of the Regulations specifies the annual limit on advertising. We tested the budget monitoring process during our audit of internal controls and noted that no Member's allowance was exceeded. The advertising limit can be readily monitored because the annual allowance is entered into the general ledger. Once the annual limit is reached, a Member cannot claim further advertising expenses.

3.21 We did not see evidence of inappropriate advertisements during our audit. The Director of Administration noted that most ads are sent to the Office of the Speaker for review. It should be a requirement that advertisements be reviewed when the cost of the advertisement is being claimed.

Recommendation 3.1
The House of Assembly Management Commission should revise the House of Assembly Management Commission Regulations to require advertisements be reviewed.

House of Assembly Management Commission Response:
The HofA management agrees with this recommendation. The Audit Committee will recommend to the House of Assembly Management Commission at its next meeting that advertising claims be supported with copies of the advertisement.

2010 – Recommendation 4.4 (a) – Ownership by the Province of assets purchased with public funds should be clearly established.

Implementation Status 4.4 (a) – Complete

3.22 Section 43(8) of the Regulations states: *"Furniture and equipment acquired pursuant to this Section on or after October 28, 2009, is the property of Her Majesty in right of the Province."* This clearly establishes ownership of such assets.

2010 – Recommendation 4.4 (b) – Assets purchased by Members beginning in 2006 and onward should be inventoried and properly accounted for.

Implementation Status 4.4 (b) – Work in Progress

3.23 During our audit of the financial statements of the House of Assembly, and our related control work, we noted the inventory system in use allows for recording assets, but it was difficult to determine the existence of those assets as no physical verification was completed by the Office of the Speaker. We verified the existence of assets we selected for testing during our financial statement audit.

3.24 This weakness was initially identified by a private sector consultant hired by the Commission to evaluate certain internal controls. The consultant recommended that annual asset counts be conducted in order to determine those assets existed. This would also assess the condition of the assets to determine if any write-down of their book value was needed to recognize their value in use. The management letter resulting from our audit engagements included the following recommendation on this matter.

Recommendation 3.2
Management of the House of Assembly should perform periodic reconciliations of inventory listings to the system used to record capital assets, and should also conduct periodic physical inspections.

House of Assembly Management Commission Response:
House of Assembly management agrees with this recommendation. Management will develop a process for verification of sample inventory items for divisions and MLAs by March 31, 2013.

2010 – Recommendation 4.5 – Complete and proper documentation, including original invoices, evidence of payment, and purpose of the expenditure, should be included to support claims for reimbursement. Claims which are not properly supported should not be paid by the Office of the Speaker.

Implementation Status – Complete

3.25 We audited a sample of Members' claims for the years ended March 31, 2011 and March 31, 2012. There were no instances of claims not being accompanied by an original invoice and proof of payment. Further, we did not identify payments for any claims that were unreasonable in nature, except for overdraft interest and late fees which are discussed later in this chapter.

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3.26 We identified several internal controls related to expense claims, including the following:

- claims are not processed without approval from the Member;
- the Director of Administration reviews and approves claims for processing; and
- claims are checked for supporting documentation, proof of payment, and accuracy.

3.27 These controls provide for the accuracy of claims processes, and also ensure claims made are in compliance with the Act and Regulations.

2010 – Recommendation 4.6 – The Legislature Internal Economy Board should examine and reform the system and practices for compensating Members' staff and ensure responsibilities are clearly and properly established. These responsibilities should address proper administration, including necessary payroll remittances for all payments in accordance with federal regulations. Requirements for proper documentation to support additional salaries paid should also be addressed.

Implementation Status – Complete

3.28 Regulations now include a comprehensive section on support staff which specifies that each Member can have one full-time equivalent constituency assistant, and that the salary, benefits and contract must be as approved by the Commission. All payroll services, including processing deductions, are to be provided by the Office of the Speaker.

3.29 The Members' Manual includes a section titled *Member's Responsibilities as an Employer*. The Manual distinguishes between the two types of support staff available to Members: constituency assistants who are under contract and whose salary and benefits are not charged to Members' expenses; and casual support staff who are paid an hourly rate and submit timesheets. Sample contracts, job descriptions and deduction forms are included.

3.30 We tested Members' expense claims and found no instances of employees being paid and reimbursement issued to the Member by the Office of the Speaker. We also tested payroll expenses for the years ended March 31, 2011 and March 31, 2012, including amounts paid to casual staff and contract employees. We found proper approvals were in place. For those employees who were under contract, we noted that the contract was signed by both parties and the agreed upon salary adhered to the pay scale set forth in the Members' Manual.

2010 – Recommendation 4.7 – All additional salary payments to staff in 2009 should be properly reported and necessary submissions made prior to the February 2010 reporting deadline.

Implementation Status – Complete

3.31 Further, we tested to determine that appropriate submissions were made for salary payments to staff in 2009. We concluded these amounts were properly supported and submitted as necessary.

2010 – Recommendation 4.8 – The purpose of per diems should be clearly established and communicated. Reimbursement for an expense should not be permitted more than once, whether the expense is governed by one or more Acts or regulations.

Implementation Status – Complete

3.32 The Regulations specify that per diems can be paid in the following circumstances:

- to all Members when the House is sitting;
- to certain outside members when commuting to Halifax for caucus, committee and other meetings;
- for out-of-town caucus meetings (all Members); and
- to committee Members when the House is not sitting.

3.33 The Regulations allow Members to submit actual receipts rather than claim a per diem in certain circumstances. All per diems are the same as those specified in the Civil Service Management Manuals, including, where necessary, the rate per individual meal. The Regulations clearly state that a claim cannot be made for an amount already claimed under another regulation; this was also noted in the prior regulations.

3.34 We tested per diem claims during our testing of Members' expenses and found no exceptions to policies. Further, we did not find instances of misuse of per diems or expense reimbursements made more than once. Each claim is approved by the administration of the Office of the Speaker, and disclosure of expenses can be scrutinized on the Legislature's website.

2010 – Recommendation 4.9 – Late fees and other avoidable expenses should not be eligible for reimbursement to the Members.

Implementation Status – Complete

3.35 Regulations do no specify the nonpayment of late fees or other avoidable expenses. During our testing, we noted two instances in which amounts of this nature were reimbursed. The first related to overdraft interest, and the second to late fees on a phone bill. Neither amount was significant. However, guidance to Members should clearly state that items of this nature are not claimable.

Recommendation 3.3
House of Assembly management should update the House of Assembly Management Commission Regulations to specify that late fees and other expenses of this nature are not claimable.

House of Assembly Management Commission Response:
House of Assembly management agrees with this recommendation. The Audit Committee will recommend to the House of Assembly Management Commission at its next meeting that late fees and overdraft interest and similar penalties be ineligible for reimbursement.

Audits of the House of Assembly

Conclusion and summary of observations

The Auditor General issued an unqualified audit opinion on the financial statements of the House of Assembly for the year ended March 31, 2012. The audit opinion for the year ended March 31, 2011 was qualified with respect to opening balances; this is a standard audit qualification for the initial audit of an entity. Our opinion on compliance of expenses with policies of the Commission and of the public service was unqualified for the period from June 9, 2010 to March 31, 2011, and for the year ended March 31, 2012. The Chief Clerk of the House of Assembly issued a certification as to the effectiveness of internal controls for the years ended March 31, 2011 and March 31, 2012. The Clerk identified a deficiency with respect to capital assets in this certification. Our audit opinions on the appropriateness of the Chief Clerk's assessment were unqualified. As required, we also issued an opinion on the effectiveness of internal control for the years then ended. Our audit opinions were qualified with respect to the existence and accuracy of capital assets. We recommended improvements in several processes, and identified the need for the Commission to prepare a risk assessment.

3.36 *Background* – The Auditor General was appointed auditor of the House of Assembly for the years ended March 31, 2011 and March 31, 2012, pursuant to Section 22 of the House of Assembly Management Commission Act. In addition to the audits of the financial statements of the House for the years then ended, we were appointed to provide audit opinions on:

- whether expenses incurred by the Assembly are in accordance with the policies of the Commission and, where applicable, the policies of the public service of the Province; and
- whether the Chief Clerk's assessment of the effectiveness of internal controls of the House of Assembly is fairly stated and whether the internal controls are operating effectively.

3.37 *Financial statement audit* – We conducted our audit in accordance with Canadian Auditing Standards as determined by the Canadian Institute of Chartered Accountants. The objective of our audits was to obtain reasonable assurance that the accounts of the House of Assembly were fairly presented in accordance with generally accepted accounting principles for the public sector.

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3.38 We issued a qualified opinion for the year ended March 31, 2011. This is a standard qualification for a first-time audit due to the inability to audit opening balances. Our audit opinion for the year ended March 31, 2012 was unqualified.

3.39 We issued a management letter detailing the results of all of our audits in which we recommended certain improvements to processes, including the following.

- A significant challenge in completing the audit was determining proper accounts payables and accruals. We spent considerable time determining the composition of the payroll accrual at March 31, 2011 and March 31, 2012. The payroll accrual for the pay period which spanned year end in each year was accurate. However, the accounts payable for the last pay period in the fiscal year which was to be paid in April was inaccurate (2011) or not posted (2012).
- There were cut-off issues in determining accounts payable related to Members' expense claims.
- We encountered difficulties related to recoveries. For the House of Assembly, recoveries relate to amounts received from other areas of government to offset expenses incurred by the House. These recoveries were not included in the draft financial statements provided at the start of the audit for either year.
- We also needed to analyze certain expenses which related to amounts paid in the current year for goods to be received in the next year. These prepaid expenses required adjustment in the draft financial statements.

3.40 All the above matters were resolved. We discussed our findings with management and the financial statements for each year were adjusted.

Recommendation 3.4
Management of the House of Assembly should analyze expense accounts to ensure expenses included in the financial statements of the House of Assembly are accurate and complete.

House of Assembly Response:
House of Assembly management agrees with this recommendation and have implemented it immediately. Details of the transactions in the balance sheet and expense accounts will be reviewed quarterly to ensure the accounts are accurate and complete. An additional variance analysis of "actual this year to actual prior year" has been added to our routine financial review.

3.41 Members' claims must be accompanied by actual invoices and receipts in order to be processed, and per Regulation, all claims must be submitted by April 30 (for a March 31 year end) in order to be paid. Members cannot control when vendors provide invoices for goods and services purchased late in the fiscal year. The Regulations should be revised to allow for receipt of such items in the normal course of business. A change in the Regulations to allow for this will necessarily result in the need to ensure accruals have been established at year end for estimated expenses.

Recommendation 3.5
The House of Assembly Management Commission should revise House of Assembly Management Commission Regulations to allow Members to submit claims for year end expenses in a reasonable period subsequent to March 31. Management will need to adjust procedures for determining year end accruals to ensure expenses are reasonably stated.

Commission Response:
House of Assembly management agrees with this recommendation. At its December 19, 2012 meeting, the House of Assembly Management Commission approved a change to the regulations to allow Members 90 days after year end to submit expenses relating to the prior fiscal year. An expense accrual will be estimated based on prior history to determine the % dollar value per expense account in the general ledger. Both recommendations will be effective this upcoming year-end.

3.42 *Compliance with policies* – We conducted an audit on whether the expenses incurred by the Members of the House of Assembly complied with the policies of the Commission and the applicable polices of the public service. This audit was conducted in accordance with Section PS 5300 of the CICA Handbook – Auditing for Compliance with Legislative and Related Authorities in the Public Sector. We expressed an unqualified opinion with regards to the Member's compliance with policies for the period from June 9 to March 31, 2011 and for the year ended March 31, 2012.

3.43 In our February 2010 Report, we recommended that a comprehensive examination for the funding of Members' constituency expenses should be carried out. Since that time, the House of Assembly Management Commission enacted Regulations entitled the *House of Assembly Management Commission Regulations* which were last revised in May 2011. These Regulations describe clear and appropriate guidance on claims by Members including timing, supporting documentation, proper forms, and purpose of expenditures. Under Section 22 of the House of Assembly Management Commission Act, we audited the compliance of those expenditures with the policies and Regulations.

3.44 We assessed compliance with numerous regulations, including the following.

- Eligibility for constituency office accommodation
- Renting from associated person
- Office operations, supplies and communications

- Donations
- Standard office allocation
- Support staff
- Leased premises
- Committee expenses
- Caucus offices
- Expenses for Leader of Opposition and Leader of Recognized Party
- Franking and travel

3.45 For fiscal year ended March 31, 2011, and March 31, 2012 our Office tested Member expenses. All items tested were in compliance with the Regulations and applicable policies.

3.46 *Effectiveness of internal controls* – Section 22 (5)(c) of the House of Assembly Management Commission Act requires the appointed auditor to express an opinion on whether the Chief Clerk's assessment of the effectiveness of internal controls is fairly stated. Our opinions on the Chief Clerk's assessment for the years ended March 31, 2011 and March 31, 2012 were unqualified. We are also required to issue an opinion on the effectiveness of internal controls. Our opinions were qualified with respect to the existence and accuracy of capital assets for each year. This is consistent with the certifications issued by the Chief Clerk, each dated December 19, 2012.

3.47 The first draft of the Chief Clerk's assessment, which the Chief Clerk has included in a certification of internal controls, limited the assessment to internal controls over financial reporting. We advised that, in our view, this assessment should be expanded to include the objective as noted above. We suggested revised wording for the Chief Clerk's certification which focused on the elements of internal controls and this revision was accepted. The Chief Clerk's certification now refers to the broader internal control objectives of:

- accuracy and completeness of accounting records;
- safeguarding of assets;
- prevention and detection of fraud and error;
- provision of timely and reliable financial and management information; and
- adherence to the House of Assembly's policies and plans.

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3.48 It is our understanding that the Chief Clerk's certification will be supported each year by work performed by private sector consultants. The work performed by these consultants for each of the years March 31, 2011 and March 31, 2012 focused on internal controls over financial reporting. The scope of their work should be revised to ensure the result will provide support for the Chief Clerk's assessment in accordance with legislation. This assessment should focus on whether controls to ensure expenditures are reasonable and made for the purposes intended are effective for the related year, including expenses for capital assets.

Recommendation 3.6
The Chief Clerk's assessment of internal controls should refer to the effectiveness of internal controls.

Chief Clerk's Response:
House of Assembly management agrees with this recommendation. The Chief Clerk's assessment has already been written to broaden the certification over internal controls, not just internal controls over financial reporting.

3.49 In addition, the reports issued by the consultants for the years ended March 31, 2011 and March 31, 2012 had several recommendations to improve internal controls, including recommendations related to capital assets similar to Recommendation 3.2 above. Management noted they have addressed several of these to date.

Recommendation 3.7
Management of the House of Assembly operations should ensure consultant's recommendations for improvements to internal controls are implemented by March 31, 2013.

House of Assembly Management Commission Response:
House of Assembly management agrees with this recommendation. The recommendations from the consultants will be implemented by March 31, 2013.

3.50 Finally, we recommended in our management letter that the internal control framework of the House of Assembly Management Commission would be strengthened through the preparation of a risk assessment, including the risk of fraud and error in financial reporting. This risk assessment should identify risks to the Commission and the controls in place, or to be designed, which mitigate such risks.

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Recommendation 3.8
The House of Assembly Management Commission should prepare a comprehensive risk assessment.

House of Assembly Management Commission Response:
House of Assembly management agrees with this recommendation. Management will investigate the process for a comprehensive risk assessment to present to the House of Assembly Management Commission for approval with the intent of completion by March 31, 2014.

4 Indicators of Financial Condition

Summary

Last year, we commented on the province's long-term debt position as part of our annual chapter on financial indicators. We continue to provide certain indicators illustrating the province's debt and other results which demonstrate the province's financial sustainability, flexibility and vulnerability. We also include summary information on the financial performance of government for the year ended March 31, 2012.

The planned deficit for the year ended March 31, 2012 was $389.6 million; the actual deficit was $248.5 million. 87% of this positive variance is due to increased federal-source revenue, a revenue over which the government has no control.

Actual results for the year ended March 31, 2012 varied significantly from those of the prior year. The surplus position of $585.4 million at March 31, 2011 reversed to a deficit position of $248.5 million, a change in operating results of $833.9 million. Increased expenses of $588.1 million ($293 million to universities), coupled with an overall reduction in revenues of $245.8 million, accounted for the change.

The province's debt continued to grow in 2011-12. The province's debt position at March 31, 2012 was $13.2 billion, an increase of 3.8% or $485 million from March 31, 2011 ($12.8 billion). Net debt per capita is now $13,960, the second highest among the jurisdictions we compared. Long-term debt has increased over $3 billion since 2008.

The province's reliance on federal transfers remains evident. 33% of all revenues came from the federal government. This % may increase in the future as provincial-source revenues such as petroleum royalties decline.

4 Indicators of Financial Condition

Introduction

4.1 The consolidated financial statements provide a snapshot of the province's financial position at its fiscal year end (March 31) and the results of its operations, and changes in both cash flow and net debt for the preceding fiscal year. However, the financial position of the province as reflected in the consolidated financial statements is only one factor in determining government's financial condition. The consolidated statements do not provide a full picture of the province's financial health nor indicate how well it is performing in relation to its economic and fiscal environment.

4.2 For the past three years, this Office has provided information on certain indicators of financial condition. Several of these are recommended for reporting in the Public Sector Accounting Board's Statement of Recommended Practice 4: Indicators of Financial Condition. The Statement is not part of generally accepted accounting principles, but is meant to provide guidance on appropriate methods for reporting supplementary information on financial condition.

4.3 The province currently provides information on the economy, including several indicators, in the Financial Statement Discussion and Analysis (Volume 1 of the Public Accounts). However, the Discussion and Analysis does not include comparative indicators for other provinces and territories in Canada. This chapter is meant to provide further information beyond what is already reported. Our report includes a comparison, where appropriate, to five other provinces: New Brunswick, Prince Edward Island, and Newfoundland and Labrador because they operate in the same regional economic environment; and Manitoba and Saskatchewan because they are comparable in population. The information for the exhibits in this chapter has been taken from these jurisdictions' public accounts from 2008 to 2012 for all provinces except Newfoundland and Labrador, and Prince Edward Island which have not yet released public accounts for the year ended March 31, 2012.

4.4 There are numerous indicators which can be used to assess a government's financial condition. The Statement of Recommended Practices recommends that, at a minimum, indicators related to sustainability, flexibility and vulnerability are considered. We have included several of these indicators as well as other information we feel is useful in demonstrating the province's financial condition. Definitions of these assessors follow, as well as a selection of indicators related to each. In addition, we provide an overview of the province's financial performance for the year ended March 31, 2012.

Financial Performance 2011-12

4.5 *Budget to actual variance* – A measure of financial performance is the extent to which government adhered to the fiscal plan detailed in its budget. For the year ended March 31, 2012, the Province of Nova Scotia estimated a deficit of $389.6 million. The actual deficit was $248.5 million, a variance from the budget estimate of $141.1 million. The following table provides an overview of the variance by significant financial element that contributed to this positive result.

Budget to Actual Variance ($ millions)			
Element	2011-12 Estimate	2011-12 Actual	Variance
Provincial-source Revenue	$6,124.9	$6,123.8	$(1.1)
Federal-source Revenue	3,056.1	3,179.3	123.2
Expenses	(9,925.2)	(9,921.9)	3.3
Government Business Enterprises (net income)	354.6	370.3	15.7
Deficit	($389.6)	($248.5)	$141.1

4.6 As can be seen, $123.2 million of the $141.1 million (87%) reduced deficit is attributable to a positive variance in federal-source revenues, a revenue source which cannot be directly controlled by the Province. The province's vulnerability to this source of revenues is discussed later.

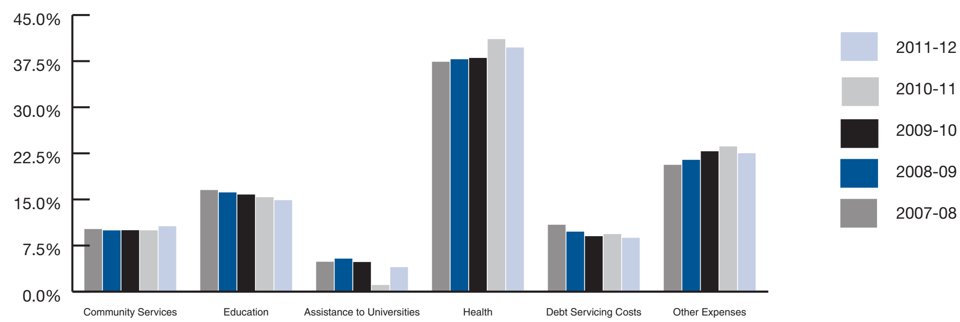
4.7 *Actual to actual variance* – The province's March 31, 2011 financial statements showed a surplus of $585.4 million. During the year, this surplus position changed to a deficit position of $248.5 million. The following table details variances in revenues and departmental expenses to explain this $833.9 million change in operating results.

Actual to Actual Variance ($ millions)			
Revenues and Departmental Expenses	Revenue	Expenses	Surplus (Deficit)
2010-11 Surplus	$9,919.2	$9,333.8	$585.4
Decreased Provincial Tax Revenue	(91.0)		
Decreased Federal Revenue	(32.5)		
Increased Net Income from Government Business Enterprises	12.4		
Decreased Other Provincial Revenue	(134.7)		
Increased Community Services Expenses		124.1	
Increased Education Expenses		42.3	
Increased Health and Wellness Expenses		106.1	
Increased Pension Valuation Adjustment		62.8	
Increased Assistance to Universities		293.7	
Reduced Debt Servicing Costs		(6.1)	
Decrease – Other		(34.8)	
2011-12 Deficit	$9,673.4	$9,921.9	($248.5)

4.8 The most significant variance between results at March 31, 2011 and at March 31, 2012 is an increase in payments to universities. Due to prepayments to universities made under the former Memorandum of Understanding with these institutions, no amounts were owed in 2010-11. Payments under the new agreement began in 2011-12 as scheduled.

4.9 *Expenses by department as a percentage of total expenses* – The following table shows the proportion of total expenses allocated to the various areas of government spending. An increase in the ratio in one or more areas indicates the rate of growth for these areas is increasing at a rate faster than the increase of total expenses. This trend may reduce funding available for other areas of government spending.

Expenses by Department as a Percentage of Total Expenses for Nova Scotia



Source: 1 (see end of chapter)

Expenses by Department as a Percentage of Total Expenses for Nova Scotia	2007-08	2008-09	2009-10	2010-11	20011-12
Community Services	10.1%	9.9%	9.9%	9.9%	10.6%
Education	16.5%	16.1%	15.7%	15.3%	14.8%
Assistance to Universities	4.8%	5.3%	4.8%	1.0%	3.9%
Health	37.3%	37.7%	37.9%	41.0%	39.6%
Debt Servicing Costs	10.8%	9.7%	8.9%	9.3%	8.7%
Other Expenses	20.5%	21.3%	22.8%	23.5%	22.4%
Total Expenses	100.0%	100.0%	100.0%	100.0%	100.0%

4.10 Several changes occurred in the 2011-2012 year which affect the structure of government departments. As a result of this government restructuring in 2011-12, the Department of Health Promotion and Protection and the Department of Heath were combined into the Department of Health and Wellness, and responsibility for Higher Education moved from the Department of Education to the Department of Labour and Advanced Education. The 2011-12 Public Accounts take into account these changes. Therefore, in order to maintain consistency, results for 2008 to 2010 have been adjusted to reflect these changes.

4.11 The exhibit shows the five largest areas of government spending. Debt servicing costs declined as a percentage of total expenses over this five-year period. The percentage of expenses allocated to health increased significantly in 2011 to 41.0%; however, this percentage decreased in 2012 to 39.6%. This is an overall increase in health of 2.3% over five years. In 2012, the percentage of expenses for health, education and community services continued to be the three highest and comprised 65% of total expenses.

Indicators

Sustainability

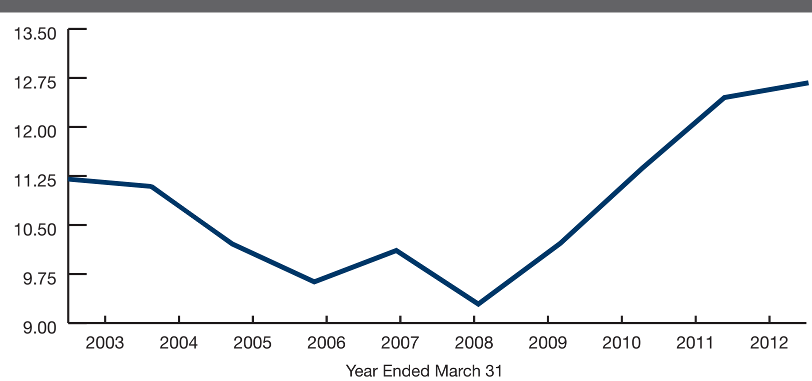
4.12 Sustainability measures the extent to which a government's financial capacity is sufficient to fund its existing programs and services, and its obligations to creditors, without having to introduce disruptive revenue and expenditure adjustments such as increased debt or increased tax rates. These indicators provide insight into how a government balances its commitments and debts. The following indicators have been selected to assess sustainability.

Indicators of Debt Position

4.13 *Long-term debt* – Details of the province's long-term debt are noted in Schedule 4 of the March 31, 2012 Public Accounts. Gross long-term debt totalled $16.2 billion, an increase of $400 million or 2.5% during the fiscal year. This includes the debt of all entities in the government reporting entity. However, 92% of gross long-term debt ($14.9 billion) is debt issued by central government.

4.14 Gross long-term debt is offset by sinking fund assets of $3.5 billion. The net long-term debt of $12.7 billion is a significant indicator of fiscal sustainability in Nova Scotia. The following exhibit shows the actual growth of net long-term debt in the past ten years, with an increase of $3 billion since 2008.

Net Long-term Debt ($ billions)

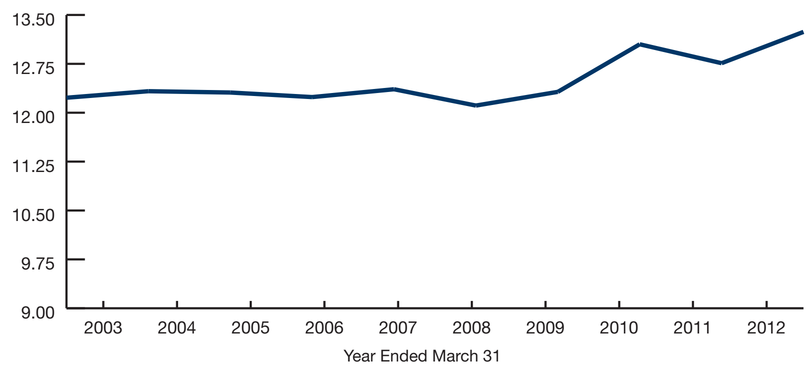


Source: 1 (see end of chapter)

4.15 *Net debt* – Page 29 of the March 31, 2012 Public Accounts describes net debt accurately.

> *"Net debt is the amount that current and past generations have accumulated through annual deficits and net investments in tangible capital assets. It represents the amount of liabilities to be funded from future revenues, including taxation. These amounts remain an obligation for future generations to fund through annual surpluses or to continue to carry as debt. Net debt results when a government's total liabilities exceed its total financial assets."*

Net Debt ($ billions)

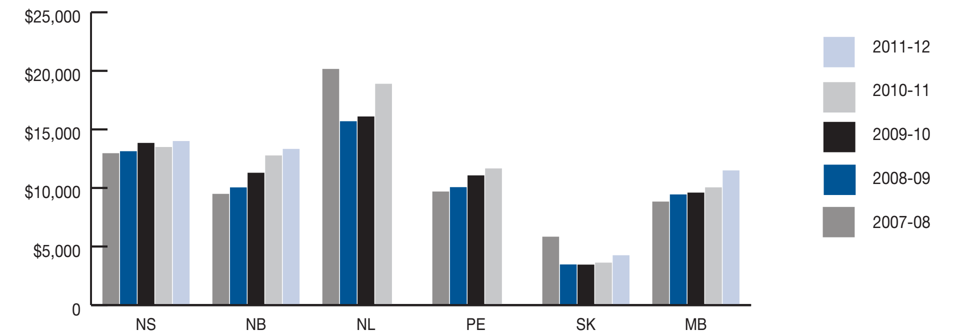


Source: 1 (see end of chapter)

4.16 Net debt has increased by over 9% or $1.115 billion over the past ten years, including an increase of $485 million or 3.8% in the current year. Net debt has grown each year since 2008, except for the year ended March 31, 2011. The surplus of $585 million reduced net debt in that year.

4.17 Net debt per capita shows the amount of net debt attributable to each person living in a province or territory. Nova Scotia has the second highest net debt per capita of the provinces we compared (see below). Net debt per capita is increasing in Nova Scotia because our population is not growing as much as net debt is increasing. Our aging population has the potential to exacerbate this problem due to the cumulative impact of increased health costs and reduced employment income. Net debt per capita has increased every year over the past five years except 2011. The amount of net debt per capita ranges from a low of $12,922 in 2008 to a high of $13,960 in 2012.

Net Debt Per Capita



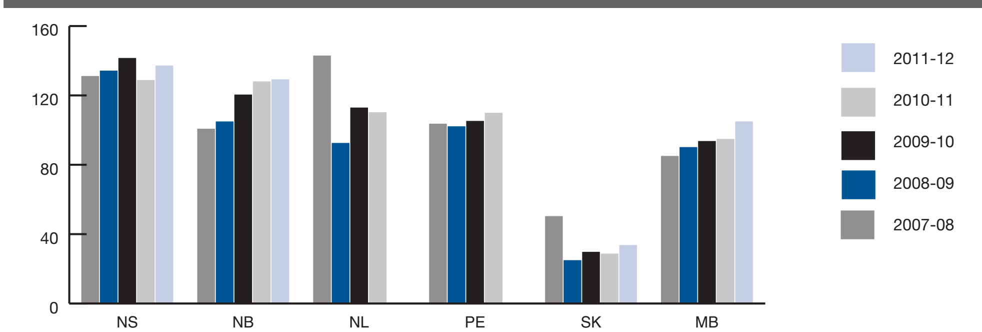
Source: 1, 2, 3 and 5 (see end of chapter)

Net Debt Per Capita (Nova Scotia)	2008	2009	2010	2011	2012
Net Debt ($ thousands)	$12,114,763	$12,318,239	$13,045,146	$12,758,315	$13,243,494
Population (thousands)	937.5	940.6	945.2	948.5	948.7
Net Debt per Capita	$12,922	$13,096	$13,801	$13,451	$13,960

4.18 *Net debt as a percentage of total provincial revenues* – Net debt provides a measure of future revenues which will be required to pay for past transactions and events. An increasing trend means it will take longer to repay this debt, and such a trend may not be sustainable.

4.19 Over the past five years, net debt as a percentage of total provincial revenues has fluctuated in Nova Scotia from a high of 141.3% in 2010 to 128.6% in 2011. Over the same time period, two jurisdictions had significant decreases in this ratio and two jurisdictions experienced a significant increase in this ratio. The ratio for Nova Scotia has been consistently higher than the other jurisdictions over this time period.

Net Debt as a Percentage of Total Provincial Revenues



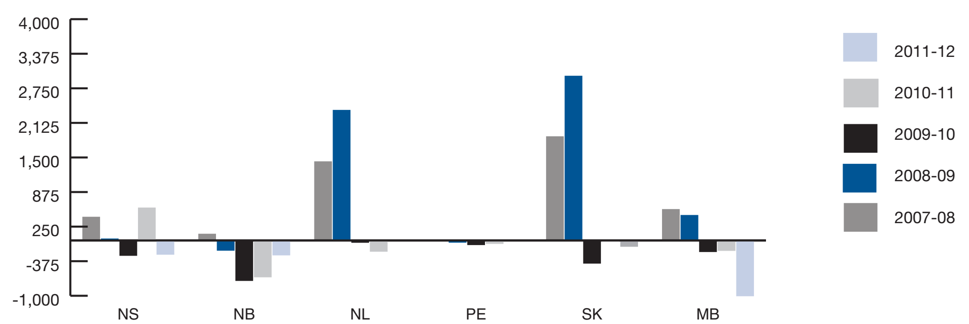
Source: 1, 2 and 3 (see end of chapter)

Net Debt as a Percentage of Total Provincial Revenues (Nova Scotia)					
Year Ending March 31	2008	2009	2010	2011	2012
Net Debt ($ millions)	$12,115	$12,318	$13,045	$12,758	$13,243
Provincial Revenue ($ millions)	$9,253	$9,196	$9,231	$9,919	$9,673
Revenue/GDP	130.9%	134.0%	141.3%	128.6%	136.9%

4.20 *Annual surplus or deficit* – The annual surplus or deficit indicates the extent to which government's revenues are more or less than its expenses during the year. A surplus means revenues exceed expenses while a deficit indicates that government has not lived within its means. Recurring deficits on a long-term basis are not sustainable.

4.21 A structural deficit occurs when the economy is operating at its potential but the government is still incurring a deficit. The following exhibit shows the fluctuation in Nova Scotia's results over the past five years and does not indicate the existence of a structural deficit. As can be seen, there have been no consistent trends in the operating results of the provinces although all incurred deficits during the 2009-10 and 2011-2012 fiscal years.

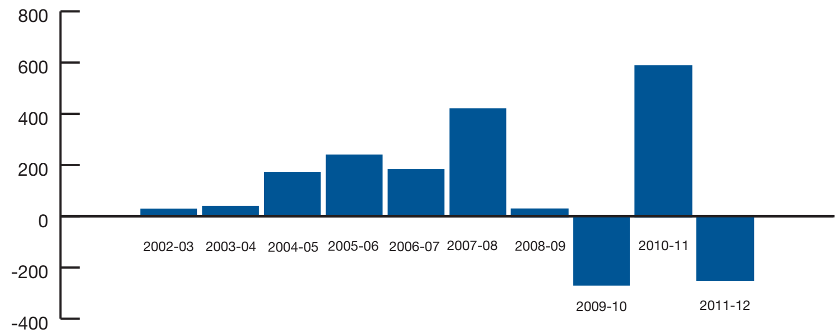
Annual Surplus or Deficit ($ millions)



Source: 1, 2 and 3 (see end of chapter)

4.22 The Province of Nova Scotia has incurred a surplus in eight of the past ten years. There are significant fluctuations in the Province's annual results from 2003 to 2012, ranging from a surplus of $585.4 million in 2011 to a deficit of $268.5 million in 2010.

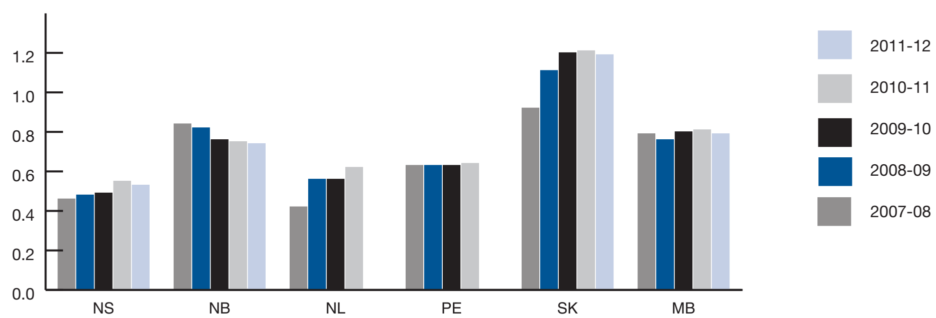
Nova Scotia Annual Surplus or Deficit (in millions)



Source: 1 (see end of chapter)

4.23 *Assets-to-liabilities ratio* – The assets-to-liabilities ratio measures the ratio of government's total assets, including capital assets, to its liabilities. A ratio greater than one shows assets are greater than liabilities and government has an accumulated surplus. A ratio less than one indicates liabilities are greater than assets and the government has been financing its operations by issuing debt. A decreasing trend in this ratio means a government is increasingly relying on debt to cover its cost of operations. Three of the six provinces we compared had increases in this ratio since 2008. Nova Scotia's ratio has improved from 0.46 in 2008 to 0.53 in 2012, but continues to be the lowest of all comparable jurisdictions.

Assets-to-liabilities Ratio

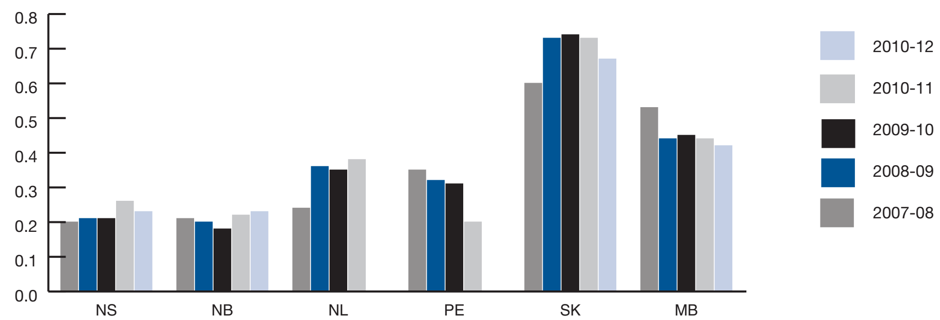


Source: 1, 2 and 3 (see end of chapter)

Assets-to-liabilities Ratio (Nova Scotia)					
Year Ending March 31	2008	2009	2010	2011	2012
Assets ($ millions)	$6,890	$7,393	$8,070	$9,349	$9,130
Liabilities ($ millions)	$15,077	$15,554	$16,500	$17,140	$17,169
Financial Assets/ Liabilities	0.46	0.48	0.49	0.55	0.53

4.24 *Financial assets-to-liabilities ratio* – The financial assets-to-liabilities ratio shows the extent to which government's future revenues will be required to pay for past transactions or events. A ratio greater than one indicates financial assets are sufficient to meet current obligations and to finance future operations. A ratio less than one means a reliance on future revenues or increasing debt to pay for past decisions. A decreasing trend in this ratio may not be sustainable as it means that government may have difficulties meeting its obligations and covering its costs of operations. The following exhibit shows the ratio for Nova Scotia has ranged from a low of 0.20 in 2008 to a high of 0.26 in 2011. Three of the other provinces also have experienced an overall increasing trend with some fluctuations, while the remaining jurisdictions show an overall decrease in this ratio.

Financial Assets-to-liabilities Ratio



Source: 1, 2 and 3 (see end of chapter)

Financial Assets-to-liabilities Ratio (Nova Scotia)					
Year Ending March 31	2008	2009	2010	2011	2012
Financial Assets ($ millions)	$2,962	$3,236	$3,455	$4,382	$3,926
Liabilities ($ millions)	$15,077	$15,554	$16,500	$17,140	$17,169
Financial Assets/ Liabilities	0.20	0.21	0.21	0.26	0.23

Sustainability Indicators Related to GDP

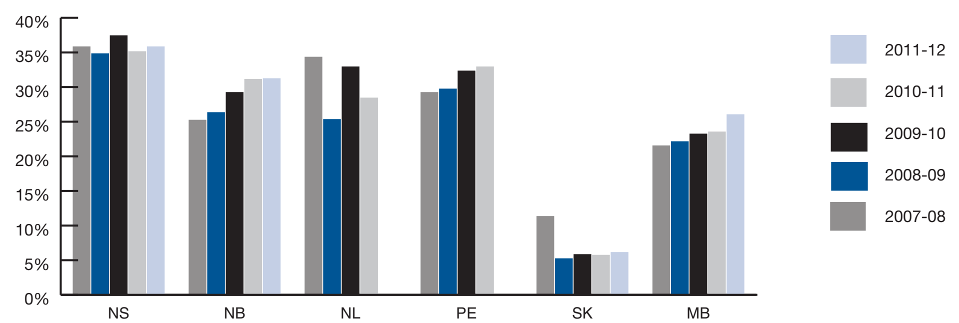
4.25 Gross domestic product (GDP) is one of the primary indicators used to measure a province's or country's economy. GDP can be measured by either summing the value of income generated in an economy (income approach) or by the total dollar value of all goods and services purchased by households and the government (expenditure measure). GDP is usually stated as a rate of change in a three-month period over the prior three-month period. An economy with two consecutive periods of reduced growth is said to be in recession.

4.26 *Net debt as a percentage of provincial GDP* – Net debt as a percentage of provincial GDP provides insight into the ability of an economy to support government's debt.

A higher percentage indicates that a government's debt is becoming an increasing burden on the economy, and may not be sustainable. A stable or decreasing percentage shows the growth of net debt is equal to, or less than, the growth of the economy and is likely sustainable. In theory, a larger economy should be able to absorb a higher amount of government debt.

4.27 The following exhibit shows this ratio has fluctuated in Nova Scotia; however, the overall trend has remained relatively stable with a high of 37.4% in 2010 to a low of 34.8% in 2009. In the past five years, two jurisdictions had overall decreases in this ratio and three jurisdictions experienced an increase in this ratio. The ratio for Nova Scotia has been higher than the other jurisdictions over this time period.

Net Debt as a Percentage of Provincial GDP

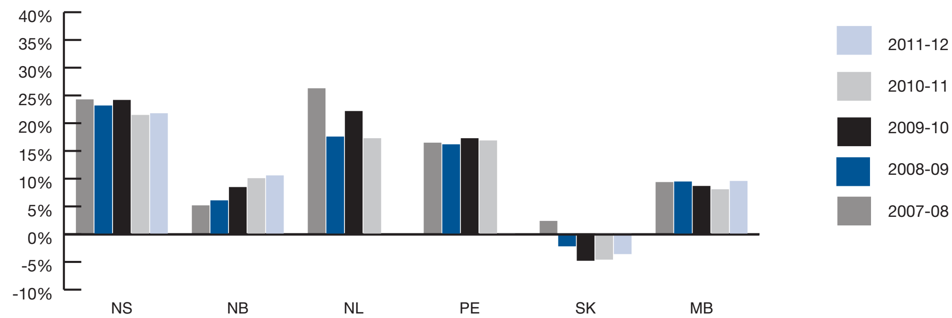


Source: 1, 2, 3 and 4 (see end of chapter)

Net Debt as a Percentage of Provincial GDP (Nova Scotia)					
Year Ending March 31	2008	2009	2010	2011	2012
Net Debt ($ millions)	$12,115	$12,318	$13,045	$12,758	$13,243
Provincial GDP ($ millions)	$33,852	$35,394	$34,921	$36,350	$37,015
Net Debt/GDP	35.8%	34.8%	37.4%	35.1%	35.8%

4.28 *Accumulated surpluses or deficits as a percentage of provincial gross domestic product (GDP)* – Accumulated surpluses or deficits are the sum of all surpluses and deficits incurred to date, and measure the extent past revenues were sufficient or insufficient to cover the cost of past transactions. When accumulated deficits as a percentage of provincial GDP increases, this indicates the growth of accumulated deficit is greater than the growth of the economy, and is not likely to be sustainable. The ratio for Nova Scotia declined from 24.2% in 2008 to 21.7% in 2012 meaning that the economy grew at a faster rate than the accumulated deficit.

Accumulated Surpluses or Deficits as a Percentage of Provincial GDP

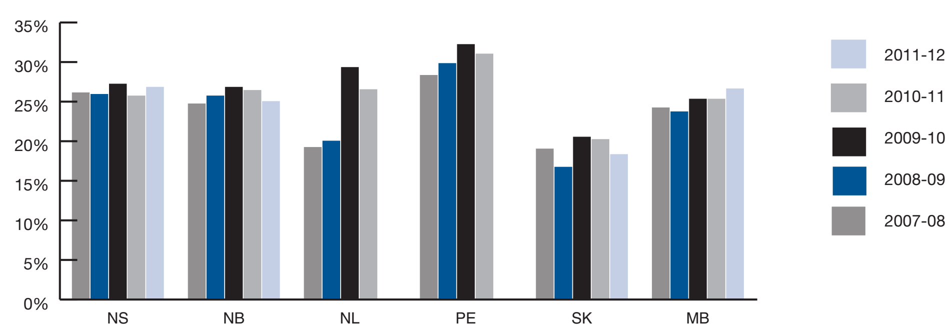


Source: 1, 2, 3 and 4 (see end of chapter)

Accumulated Deficits as a Percentage of Provincial GDP (Nova Scotia)					
Year Ending March 31	2008	2009	2010	2011	2012
Accumulated Deficits ($ millions)	$8,187	$8,161	$8,429	$7,791	$8,040
Provincial GDP ($ millions)	$33,852	$35,394	$34,921	$36,350	$37,015
Accumulated Deficits/ GDP	24.2%	23.1%	24.1%	21.4%	21.7%

4.29 *Total expenses as a percentage of provincial GDP* – Total expenses as a percentage of provincial GDP compares the rate of growth of government's spending with the economy in which it operates. If the ratio is increasing, government spending is increasing at a faster rate than the growth of the economy, and may not be sustainable. The following exhibit shows the ratio for Nova Scotia has fluctuated over the past five years from a low of 25.7% in 2011 to a high of 27.2% in 2010. All other provinces experienced fluctuations in this indicator over the same period.

Total Expenses as a Percentage of Provincial GDP



Source: 1, 2, 3 and 4 (see end of chapter)

Total Expenses as a Percentage of Provincial GDP (Nova Scotia)					
Year Ending March 31	2008	2009	2010	2011	2012
Total Expenses ($ millions)	$8,834	$9,170	$9,499	$9,334	$9,922
Provincial GDP ($ millions)	$33,852	$35,394	$34,921	$36,350	$37,015
Expenses/GDP	26.1%	25.9%	27.2%	25.7%	26.8%

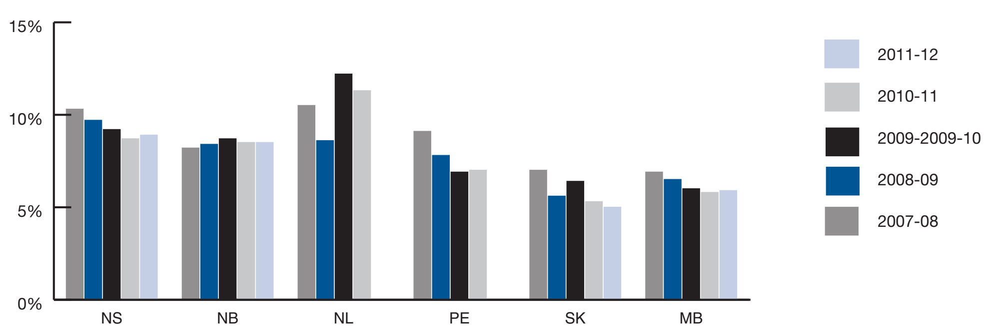
Flexibility

4.30 Flexibility describes the extent to which government can change its debt burden or raise taxes within an economy. Increasing debt and taxation reduces flexibility and the government's ability to respond to changing circumstances. Assessing flexibility provides insight as to how government manages its finances. The following indicators have been selected to assess flexibility.

4.31 *Debt servicing costs as a percentage of total revenues* – Debt servicing costs are variable only to the extent they fluctuate with the amount of debt issued. However, once debt is issued, interest payments on that debt are a fixed cost of government, and are its first commitment. Failure to pay interest impacts the ability to raise future debt, and can also increase government's borrowing rate. As debt increases, government is less able to respond to economic changes.

4.32 The proportion of debt servicing costs to revenues indicates the amount of current revenues that are required to service past borrowing decisions and, as a result, are not available for current and future programs and services. In Nova Scotia, this ratio has decreased from a high of 10.3% in 2008 to a low of 8.7% in 2011, and then experienced a slight increase to 8.9% in 2012. The overall decreasing trend is consistent with three other jurisdictions. The ratio for Nova Scotia has been higher than four other jurisdictions during this period.

Debt Servicing Costs as a Percentage of Total Revenues



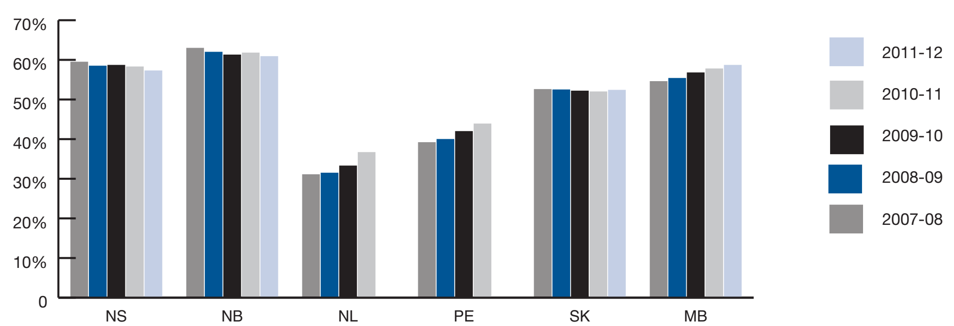
Source: 1, 2 and 3 (see end of chapter)

Debt Servicing Costs as a Percentage of Total Revenues (Nova Scotia)					
Year Ending March 31	2008	2009	2010	2011	2012
Debt Servicing Costs ($ millions)	$954	$887	$850	$866	$860
Total Revenue ($ millions)	$9,253	$9,196	$9,231	$9,919	$9,673
Debt Servicing Costs as a Percentage of Revenue	10.3%	9.6%	9.2%	8.7%	8.9%

4.33 *Net book value of tangible capital assets as a percentage of cost of tangible capital assets* – Capital repair and replacement is a significant issue for governments. Net book value of tangible capital assets as a percentage of the cost of tangible capital assets measures the estimated useful life of government's tangible capital assets. A decrease in this ratio indicates that assets are not being replaced at the end of their estimated useful lives. The flexibility of a government to make changes in programs and services could be negatively impacted if the cost of repairing or replacing aging assets becomes too burdensome.

4.34 The following exhibit shows there has been a slight decrease in this ratio from 59.4% in 2008 to 57.2% in 2012. Three of the other jurisdictions had an increase in percentage for this ratio; the ratio for the remaining jurisdictions was stable for one province and decreasing for the other.

Net Book Value of Tangible Capital Assets as Percentage of Cost of Capital Assets



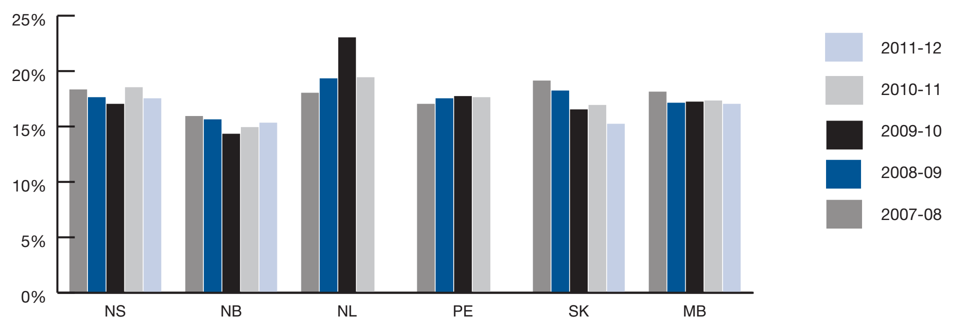
Source: 1, 2 and 3 (see end of chapter)

Net Book Value of Tangible Capital Assets as a Percentage of Cost of Capital Assets (Nova Scotia)					
Year Ending March 31	2008	2009	2010	2011	2012
Net Book Value ($ millions)	$3,850	$4,070	$4,523	$4,877	$5,122
Total Cost ($ millions)	$6,487	$6,974	$7,719	$8,383	$8,955
Net Book Value as a Percentage of Cost	59.4%	58.4%	58.6%	58.2%	57.2%

4.35 *Own-source revenue as a percentage of provincial GDP* – Own-source revenue as a percentage of provincial GDP is an indicator of government revenue derived from the provincial economy, through taxation or other sources, compared to the provincial GDP. Higher percentages may indicate a reduction in flexibility as taxpayers may not be willing to shoulder increased tax rates by government.

4.36 There were small fluctuations in this ratio for Nova Scotia with an overall decreasing trend from 18.3% in 2008 to 17.5% in 2012. The following exhibit indicates that three jurisdictions also had small fluctuations with an overall decrease in this ratio and two jurisdictions experienced an increasing trend.

Own-source Revenue as a Percentage of Provincial GDP



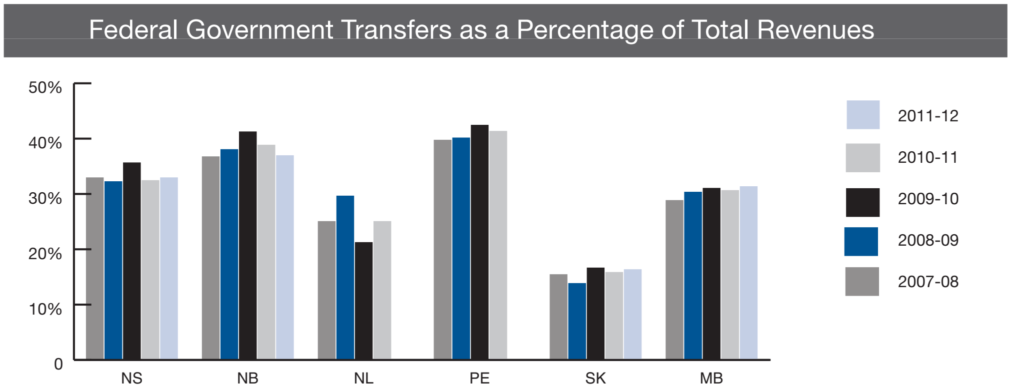
Source: 1, 2, 3 and 4 (see end of chapter)

Own-source Revenue as a Percentage of Provincial GDP (Nova Scotia)					
Year Ending March 31	2008	2009	2010	2011	2012
Own-source Revenue ($ millions)	$6,205	$6,232	$5,943	$6,707	$6,494
Provincial GDP ($ millions)	$33,852	$35,394	$34,921	$36,350	$37,015
Own-source Revenue as a Percentage of Provincial GDP	18.3%	17.6%	17.0%	18.5%	17.5%

Vulnerability

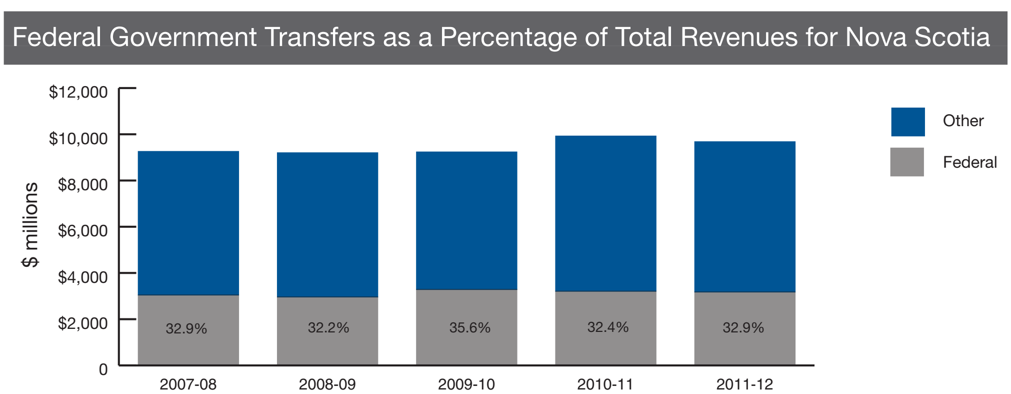
4.37 Vulnerability indicators can measure the amount government is dependent on sources of revenue outside its control as well as exposure to risks which might affect government's ability to meet its commitments. The lower government's own-source revenue, the more it relies on fiscal decisions of others. The following indicator has been selected to assess vulnerability.

4.38 *Federal government transfers as a percentage of total revenues* – Federal government transfers as a percentage of total revenues demonstrates the extent to which a province relies on federal government transfers compared to total government revenues. The higher the percentage, the more reliance the provincial government has on receipt of funds from the federal government, These transfers are dependent on policy decisions at the federal level and outside the control of the provincial government. This ratio remained mostly stable for Nova Scotia with a slight spike in the percentage of federal government transfers in 2010. Overall, federal transfers as a percentage of total revenues have fluctuated slightly in all jurisdictions.



Source: 1, 2 and 3 (see end of chapter)

Federal Government Transfers as a Percentage of Total Revenues (Nova Scotia)					
Year Ending March 31	2008	2009	2010	2011	2012
Federal Transfers ($ millions)	$3,048	$2,964	$3,287	$3,212	$3,179
Total Revenue ($ millions)	$9,253	$9,196	$9,231	$9,919	$9,673
Federal Transfers as a % of Total Revenue	32.9%	32.2%	35.6%	32.4%	32.9%



Source: 1 (see end of chapter)

Sources:

1) Nova Scotia – Public Accounts for March 31, 2003 – March 31, 2012

2) New Brunswick, Saskatchewan, and Manitoba – Public Accounts March 31, 2008 – March 31, 2012

3) Newfoundland and Labrador, and Prince Edward Island – Public Accounts March 31, 2008 to March 31, 2011 (2011-12 Public Accounts not released at the time this chapter was written.)

4) Statistics Canada – Gross domestic product, expenditure-based, by province and territory (2007-2011)

5) Statistics Canada – Population by year, by province and territory (July 2008 – July 2012)

Note: Income from government business enterprises has been included in the calculation of own source revenue, and total revenue for all provinces. This change ensures that information presented is comparable among provinces and is consistent with the way in which most provinces report financial indicators.

5 Review of Audit Opinions and Management Letters

NOVA SCOTIA

Summary

Management letters provided by auditors on completion of annual audits provide a wealth of information on accounting and management issues in entities included in the province's consolidated financial statements. Each year, we conduct a review of these letters under Section 23 of the Auditor General Act, and report matters of interest. Most of these entities are audited by private sector firms; four government agencies are audited by this Office. The Auditor General was also appointed auditor of the House of Assembly for the years ended March 31, 2011 and March 31, 2012.

Auditors have identified numerous internal control and information technology deficiencies. Many of these deficiencies also impact internal controls as they relate to inappropriate access by individuals to systems, applications or accounts that are not required to be accessed in fulfilling their duties. We found 12 instances of inappropriate access which accounted for 43% of all IT deficiencies.

Audit results also provide information on the oversight function within these entities. Correcting deficiencies is an indication of strong oversight. We found that 51% of deficiencies identified in the current year had been reported as a result of audits in 2010-11 and 31% of these recommendations had also been reported in 2009-10. Boards and management in some agencies are providing poor financial management by ignoring their auditors' recommendations.

Most entities in the Government Reporting Entity receive an unqualified audit opinion. The majority of the qualified opinions relate to the inability of the auditors to verify the completeness of revenues.

Revenue received by school boards through school-based funds totaled $42 million in 2011-12 and the year-end balance held in trust in these boards was $17 million. We have again recommended that the Department of Education work with boards to implement the recommendations made by their auditors related to these funds, and improve controls over their receipt and safeguarding.

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 for which 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, 2012 statements are noted in Chapter 2 of this report. In addition, the Auditor General was appointed auditor of the newly-established House of Assembly Management Commission. The results of audits completed under that engagement are included in Chapter 3 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 2011-12 financial statements for 15 agencies. The audits of several entities were qualified due to the inability of their auditors to verify the completeness of certain revenues. This is a standard audit qualification. In other agencies, qualified opinions were due to insufficient audit evidence or departures from generally accepted accounting principles. 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, which includes accounting principles issued for the public sector. 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 consolidated financial statements of the province derive revenue from donations or other contributions, including revenues related to school-based funds, the completeness of which may not be possible to 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
- 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 generally accepted accounting principles. Qualified audit opinions were issued by the auditors of the following entities.

- Gambling Awareness Foundation of Nova Scotia and Nova Scotia Health Research Foundation – due to a departure from generally accepted accounting principles in recording grants payable at cost rather than at amortized cost using the effective interest rate method
- Harbourside Commercial Park Inc. – due to the financial statements being prepared on a non-consolidated basis with the investment in the wholly owned subsidiary company, Sydney Utilities Limited, recorded at cost
- Nova Scotia E911 Cost Recovery Fund – due to insufficient evidence to indicate whether the expenses of the fund were complete

- Nova Scotia Fisheries and Aquaculture Loan Board – due to a departure from generally accepted accounting principles for the public sector in understating the allowance for impaired loans by $1,479,000 for the year ended March 31, 2012

- Nova Scotia Power Finance Corporation – due to a departure from generally accepted accounting principles in not being able to provide the historical cost of investments or the effective interest rate as this information is not available

5.8 *Basis of accounting* – The financial statements of the Sherbrooke Restoration Commission are not prepared in accordance with generally accepted accounting principles. The Commission's audited statements are prepared in accordance with the accounting principles adopted for museum boards in Nova Scotia. The basis of accounting used materially differs from Canadian generally accepted accounting principles.

Review of Management Letters

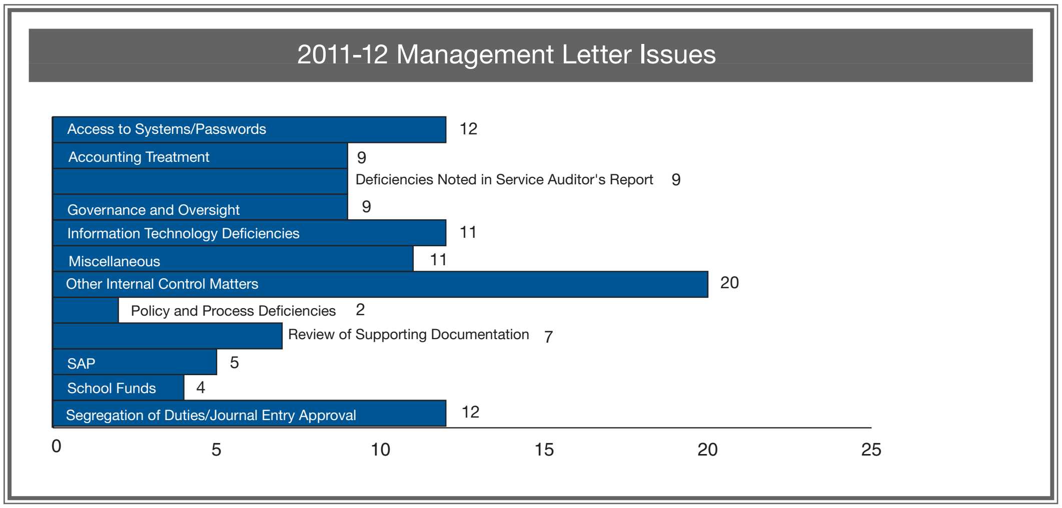
Conclusions and summary of observations

The overall number of recommendations made decreased by 53 (32%) over the previous year, however, 57 (51%) of the recommendations made in 2012 had also been reported in 2010-11, and 34 (31%) of these had also been made in 2009-10. Boards and management in some agencies are providing poor financial management by ignoring their auditors' recommendations. A significant number of internal control deficiencies were reported in several agencies. Examples include improperly prepared and supported account reconciliations, and poor segregation of duties. There are also numerous findings and recommendations related to information technology. Many of the IT deficiencies also impact internal controls as they relate to inappropriate access by individuals to systems, applications or accounts that are not required to be accessed in fulfilling their duties. We found 12 instances of inappropriate access which accounted for 43% of all IT deficiencies.

5.9 *Overall results* – The 50 management letters issued to agencies of government identified 111 deficiencies. 25 agencies received no final communication from their auditors, and there were no deficiencies to report in 16 entities. The following table illustrates the number of deficiencies found in total, in the various entities.

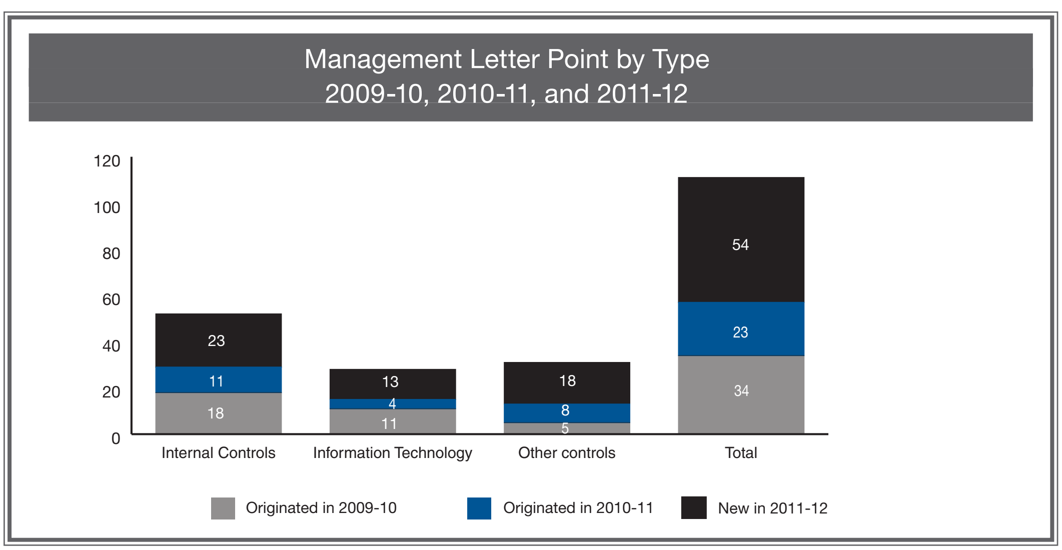
Number of Government Entities with:	2011-12
Five or more management letter issues	8
One to four management letter issues	26
No management letter issues	16
No management letter	25

5.10 *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 financial reporting matters and governance. The following exhibit shows the nature of issues identified in 2011-12 audits.



5.11 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.

5.12 The overall number of recommendations made decreased by 32% over the previous year. However, 57 (51%) of the total recommendations reported as a result of audits conducted for 2011-12 had also been reported in 2010-11. Of these, 34 (31%) had previously been reported in 2009-10. Management needs to address recommendations on a more timely basis to ensure the integrity of their accounting and control systems, and their financial statements.



NOVA SCOTIA

5.13 *School-based funds* – Last year we recommended that the Department of Education work with school boards to implement the recommendations made by their auditors related to school-based funds. The Department accepted the recommendation and indicated it would work with the boards on implementation. However there are still numerous findings related to internal controls surrounding these funds. We were informed by the Department that there have been discussions with the boards regarding these funds, but to date, no changes have occurred.

5.14 Revenue from school-based funds in all school boards totaled $41.9 million during the fiscal year, and the balance held in trust at March 31, 2012 totaled $17.1 million. This is a significant amount. There should be appropriate internal controls in each board to reduce the risk that amounts received are inaccurately recorded in the school's records; that disbursements made are not authorized and controlled; and that the year-end balance in a student's or the school's account does not reconcile to records and the bank. Where auditors have identified weaknesses in controls related to these funds, management should ensure any related recommendations are implemented on a timely basis.

Recommendation 5.1
The Department of Education should work with school boards to implement recommendations made by their auditors and develop appropriate controls to ensure the accuracy and completeness of school-based funds in board's accounting records, and to ensure these funds are properly safeguarded.

Department of Education Response:
The department agrees with the recommendation. The department will renew consultations with school boards to develop a strategy to achieve PSAB compliance. Recognizing the complexity of the issues that may arise the department will ask for school board compliance on or before March 31, 2014.

5.15 The following paragraphs summarize external auditors' findings and recommendations related to broad sectors within the Government Reporting Entity.

Government Business Enterprises

5.16 *Halifax-Dartmouth Bridge Commission* – Since at least 2010, the auditors have noted that accounting staff have the ability to set up new suppliers in the accounting system, record purchase invoices, and set up and remit electronic funds transfers without the approval of a second person. Although auditors noted improvements in these controls related to the accounts payable system, they recommended the entity evaluate whether the current level of risk in the system is acceptable or if it should be further mitigated. The auditors also noted that the overall administrative password to the accounting system has not been changed in some time and is known by many of the employees.

5.17 *Nova Scotia Liquor Corporation* – The auditors noted that the segregation of duties and password weaknesses and deficiencies related to the Warehousing Management System have both been remedied. We note this is a significant improvement as there were numerous deficiencies identified in the management letter last year.

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

5.18 *School boards* – Management letters for six of the eight school boards discussed issues related to school-based funds noting improvements in internal controls or the need for an internal control function. The auditors for the Halifax Regional School Board provided an update on their involvement in the fraud investigation related to inappropriate expenditure of school-based funds found in 2010-11, noting that the final report has not yet been issued. We reported last year that the management letter resulting from the March 31, 2011 audit stated there was a fraud related to school-based funds that resulted in a loss of approximately $20,000.

5.19 Exceptions in the operating effectiveness of various control activities at the service organization used by boards to process transactions were reported in six of the seven management letters issued; those letters also noted that the report was not available before year end to assist in audit planning.

5.20 Previous issues with inadequate segregation of duties related to the accounts payable function reported in two boards continued in 2011-12. Additional matters related to inadequate segregation of duties were reported by the auditors of two boards in relation to information technology. The auditors again recommended that the Conseil scolaire acadien provincial continue work in the area of establishing procedures to document, test and evaluate internal controls since they do not have an internal audit group.

5.21 The management letter for the 2011-12 audit of Cape Breton-Victoria Regional School Board identified instances in which the Board's expense report policies were not followed; approval of timesheets for non-teaching staff was not provided on a timely basis; and the amount of the original, approved standing purchase order was exceeded. The auditors also reported that the Board cannot obtain insurance coverage for sexual misconduct situations because it does not have a policy for acceptable/ unacceptable behavior for employees. Four of the identified deficiencies were also reported in each of the past two years.

5.22 *Nova Scotia Community College* – The management letter for the Nova Scotia Community College noted that the College completed its review of certain liabilities and a previously reported finding was addressed.

5.23 *Atlantic Provinces Special Education Authority* – Neither the financial statements nor the management letter for the March 31, 2012 audit have been issued yet.

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District Health Authorities and the IWK Health Centre

5.24 Segregation of duties issues in certain authorities, and the need for journal entries to be reviewed at an appropriate level, were again noted this year. The auditors of one authority noted inappropriate accounting treatment of cost recoveries, while the auditor of another noted that the authority now has a policy for conversion of foreign currency to Canadian dollars. For one authority, the auditor recommended the authority grant security administrative access privileges and responsibilities only to information technology staff who do not perform incompatible duties and controls over passwords must be strengthened for its healthcare management software.

5.25 The amount of overtime at Cape Breton District Health Authority remained significant enough for the auditors to bring it to the attention of the Board. In two instances, employees were paid overtime which exceeded their regular salaries; these two staff members were among the 29 who were paid overtime in excess of $25,000. In its response to the audit finding, the Authority noted several planned initiatives to ensure relief capacity is maintained. Nine of the deficiencies reported to the Board in 2011-12 were also reported in 2010-11; eight of these were identified in 2009-10 as well.

5.26 Certain health authorities' auditors noted some improvements but continue to note control deficiencies with the SAP accounting system. Certain auditors also noted the audit report for the service organization used to process their transactions was not available prior to year end.

5.27 We noted that no deficiencies were identified in the following four authorities.

- Annapolis Valley Health
- Capital Health
- South Shore Health
- South West Health

Entities Providing Financial Assistance

5.28 *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
- Nova Scotia Business Inc.
- Nova Scotia Farm Loan Board
- Nova Scotia Fisheries and Aquaculture Loan Board

5.29 With the departure of the CEO and Director of Finance at Film Nova Scotia the auditors recommended utilizing current staff as much as possible to segregate some of the acting CEO's duties and make a concentrated effort to fill vacant positions.

5.30 The auditors of Nova Scotia Business Inc. noted the need for additional improvements in the annual valuation processes, as well as recommending the entity follow established policies and procedures. They also recommended that Nova Scotia Business Inc. implement enhanced review procedures for journal entries; prepare, print and sign bank reconciliations for all bank accounts; and determine an approach to clear outstanding cheques that have accumulated on the outstanding cheque listing.

5.31 There were errors in the Nova Scotia Farm Loan Board's and Nova Scotia Fisheries and Aquaculture Loan Board's manual calculation of interest expense and the auditors recommended increased diligence, investigation, and correction of differences.

Other Entities

5.32 *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
- Harbourside Commercial Park Inc.
- Nova Scotia E911 Cost Recovery Fund
- Nova Scotia Public Service Long Term Disability Plan Trust Fund
- Nova Scotia School Boards Association
- Nova Scotia Teachers' Pension Plan
- Nova Scotia Utility and Review Board
- Resource Recovery Fund Board Inc.
- Sherbrooke Restoration Commission
- Sydney Tar Ponds Agency
- Trade Centre Limited

5.33 Management letters were not prepared as a result of the audits of some entities such as the Nova Scotia Public Service Superannuation Plan, Accounts Established under the Members' Retiring Allowances Act, Waterfront Development Corporation Limited and the Nova Scotia Housing Development Corporation.

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5.34 Lack of segregation of duties continues in several agencies and auditors recommended improved processes and procedures over expenses, inventory, payables, and financial reporting to strengthen controls and ensure compliance with policies and procedures in certain agencies.

5.35 The auditors of one entity noted it was prudently holding investments equivalent to its post-retirement liability, while auditors of another entity recommended the entity consider increasing investment to match the accrued pension and other liabilities. The management letter of Harbourside Commercial Park Inc. commented that the entity has not made any repayments on its outstanding loan with the province for purchase of additional land from Sydney Steel Corporation.

5.36 *Accounting and financial reporting software* – The management letter for the Nova Scotia School Boards Association notes the accounting software is deficient in providing information that is readily available in most accounting systems today. The auditor for Sherbrooke Restoration Commission noted that the year end information and reports were manually prepared and many accounting adjustments could have been made by accounting staff before year end. Auditors of the Nova Scotia Public Service Long Term Disability Plan Trust Fund recommended it review its internal control structure on a regular basis because the contracted external accountant has access to all aspects of the general ledger, banking, accounts receivable and accounts payable. The auditors of the Sydney Tar Ponds Agency noted that provincial staff have access to the Agency's general ledger and have the ability to post entries without the knowledge or consent of the Agency.

5.37 The auditors of the Nova Scotia Teachers' Pension Plan noted that management of the Nova Scotia Pension Agency (which administers the Plan) places reliance on the financial reporting capabilities of the Plan's custodian. They also noted that certain accounting information is held by government. The lack of a comprehensive in-house general ledger system means that management cannot readily access all of its accounting information on a timely basis and does not fully facilitate the Plan's financial reporting requirements. The lack of such a system does not facilitate financial reporting requirements under generally accepted accounting principles. The auditors have recommended that management maintain its own accounting records and reconcile these to the custodian's statements each month.

5.38 *Resource Recovery Fund Board Inc.* – The auditors noted the entity has addressed the deficiency related to user access to accounting software but has not changed the way in which HST is reported between the Board and the Fund.

5.39 *Trade Centre Limited* – The absence of formal process and policy documentation surrounding IT general controls was noted by the auditors, as well as two instances in which purchase orders were approved after the invoice was received and three instances in which disbursements were made to hourly employees without evidence of approval.

Audits Conducted by the Office of the Auditor General

5.40 *Nova Scotia Gaming Corporation* – There were no matters to bring to the attention of management or the Corporation's Board as a result of the audit.

5.41 *Nova Scotia Crop and Livestock Insurance Commission* – The Commission continues to use spreadsheets to calculate premium revenues and implemented a tracking system to track changes to the spreadsheet. We recommended the Commission review the changes to ensure the spreadsheet modifications are valid. We also recommended the Commission assess its information technology needs. The Commission has not conducted an overall formal risk assessment and a key control to ensure cash is deposited in full and on a timely basis was not performed for the majority of the year. We also recommended the Commission enforce a due date for receipt of premium revenue and cancel coverage if premiums are not paid within this timeframe.

5.42 *Nova Scotia Legal Aid Commission* – Again we recommended that management review the system to estimate certificate liabilities to ensure the resulting liability provides a reasonable estimate of the cost to complete future cases. The Commission should have standard processes for approving journal entries, reviewing security logs and monitoring internal controls which include documenting evidence of the approval or review. The Commission should also adjust unsupported balances in the accounts payable subledger to operating results.

5.43 *Public Trustee Trust Funds* – We continued to recommend that the Office of Public Trustee obtain a recognized and comprehensive financial accounting and reporting system. We have also recommended changes to the accumulation of amounts in the Special Reserve Fund.

5.44 *House of Assembly* – Observations and recommendations resulting from the March 31, 2011 and March 31, 2012 financial statement audits of the House of Assembly, as well as compliance and internal control audits, are included in Chapter 3 of this report.

Late Entities

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. The number of entities submitting late financial statements decreased in 2011-12, and has decreased significantly over the last six years. APSEA has met the June 30 submission deadline only once in the past six years.

5.45 *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).

5.46 Although the number of entities submitting financial statements after the deadline continues to decline, some entities still submit statements late. In 2011-12, four entities were not successful in providing audited financial statements and requested information by the June 30 deadline. Of these entities, the Atlantic Provinces Special Education Authority was also late in providing the requested information in 2010-11 and had not yet provided the 2011-12 information when this chapter was written. The Atlantic Provinces Special Education Authority 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 the use of inaccurate information for decision-making purposes. The following agencies were late providing information for 2011-12.

- AgraPoint International Inc.
- Atlantic Provinces Special Education Authority
- Nova Scotia E911 Cost Recovery Fund
- Nova Scotia Power Finance Corporation

5.47 The Province's March 31, 2012 consolidated financial statements were released on August 2, 2012, meeting the reporting requirement set out in the Provincial Finance Act.

6 Follow-up of 2007 to 2010 Financial Recommendations

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Summary

The overall rate of implementation of our recommendations related to financial reporting from our 2007 to 2010 audits is 67%. This rate is essentially unchanged from the prior year. A number of recommendations have been outstanding for many years, and a more timely response is needed.

Progress is being made on one long-outstanding recommendation. Since 2006, we have recommended that the revenue estimates included in the province's annual budget be prepared on a consolidated basis. We provide an opinion on the revenue estimates and that opinion has been qualified each year since 2001 because certain revenues are excluded and we cannot quantify the amount of the exclusion. We are pleased to report that progress is being made and that government now intends to implement this recommendation. We recommended in Chapter 2 of this report that it be implemented for the 2013-14 Budget.

Ten of 17 (59%) outstanding recommendations relate to internal controls. We continue to recommend that the Department of Finance establish and document internal controls for government, and that roles and responsibilities related to these controls be assigned. Government needs to take action on these recommendations, some of which have government-wide impacts.

6 Follow-up of 2007 to 2010 Financial Recommendations

Background

6.1 Financial reporting is an essential element in determining an entity's overall financial performance. It allows Nova Scotians to assess the government's performance, as well as its administration of public funds. We make recommendations each year in our chapters related to financial reporting which result from our legislated audit and review work. We believe these will strengthen government's financial reporting processes. This is the second year we have provided a chapter addressing the implementation status of financial recommendations only. The implementation status of recommendations resulting from performance audits conducted between 2007 and 2010 will be reported in the May 2013 Report of the Auditor General.

6.2 As in prior years, we requested that Government management complete a self-assessment of their progress towards implementing the incomplete recommendations in Treasury Board Office's Tracking Auditor General Recommendations system. As well, we asked management to provide us with documentation supporting the self-assessment provided. Our review process focused on whether information provided by management, as well as the self-assessments, were accurate, reliable and complete. Details of these recommendations and their status can be found on our website at oag-ns.ca.

Review Objective and Scope

6.3 The objective of this assignment was to assess and report on the implementation status of recommendations concerning financial reporting and other financial management issues included in Reports of the Auditor General from 2007 to 2010.

6.4 Each department provides its self-assessment of progress on the implementation of our Office's recommendations in the Tracking Auditor General Recommendations system. Our review was based upon information included in that system as of October 18, 2012.

6.5 Our review was based on representations made by government management which we substantiated through enquiries of management and staff, as well as inspection of documentation. Moderate assurance, in the context of this assignment, means performing sufficient work to satisfy ourselves that the implementation status as described by government is plausible in the circumstances. Further information on the difference between high and moderate assurance is available in the Canadian Institute of Chartered Accountants Handbook, Section 5025 – Standards for Assurance Engagements other than Audits of Financial Statements.

6.6 The criteria we used were based on qualitative characteristics of information as described in the CICA Handbook. Management representations on implementation status were assessed against three criteria.

- Accurate and neither overstate nor understate progress
- Reliable and verifiable
- Complete and adequately disclose progress to date

Significant Observations

Conclusions and summary of observations

The overall implementation rate of our financial recommendations is essentially unchanged from the prior year. Several recommendations have been outstanding for many years and a more timely response is needed. Progress is being made in addressing our long-outstanding recommendation that the annual revenue estimates be prepared on a consolidated basis. Government needs to take action on other outstanding and repeat recommendations related to establishing and documenting internal controls and assigning responsibility for these.

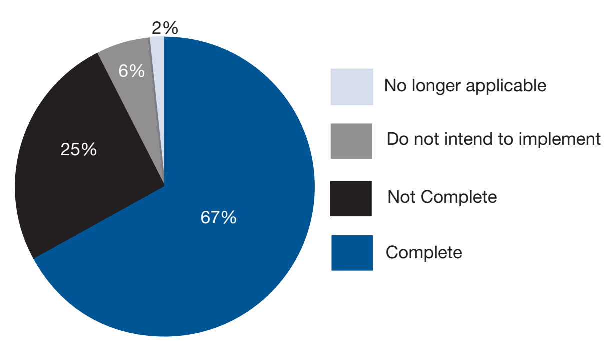
6.7 *Scope of review* – During this assignment we followed up the status of 67 recommendations primarily addressed to the Department of Finance. The remaining recommendations are the responsibility of the Departments of Health & Wellness and Transportation and Infrastructure Renewal.

6.8 *Review results* – 67 recommendations were made in reports from 2007 to 2010. To date, 45 (67%) have been implemented. This rate is essentially unchanged from the results reported in January 2012. The following exhibits summarize implementation results.

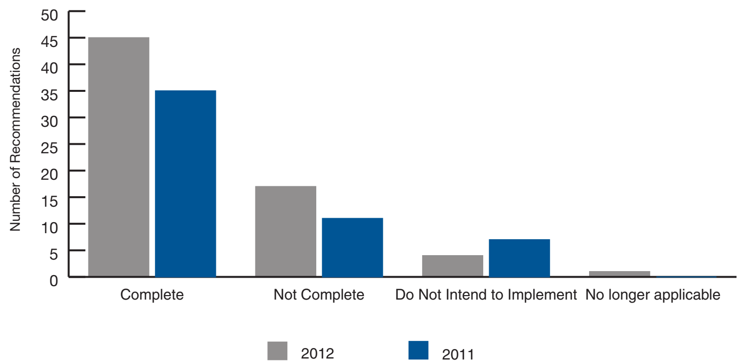
Report and Chapter	Entity	Complete	Not Complete	Do Not Intent to Implement	Action No Longer Applicable	Total
June 2007 Chapter 7: Government Financial Reporting	DOF		1			1
February 2008 Chapter 6: Government Financial Reporting	DOF	4				4

Report and Chapter	Entity	Complete	Not Complete	Do Not Intent to Implement	Action No Longer Applicable	Total
November 2008 Chapter 2: Government-Wide: Payments to Vendors	DOF	8	3			11
Chapter 7: Government Financial Reporting	DOF	6	3	1		10
February 2010 Chapter 5: Government Financial Reporting	DOF	16	3	1		20
Chapter 5: Government Financial Reporting	DTIR	1				1
November 2010 Chapter 5: Government Financial Reporting	DOF	9	6	2	1	18
Chapter 5: Government Financial Reporting	DTIR	1				1
Chapter 5: Government Financial Reporting	DHW		1			1
Total Recommendations		45 67%	17 25%	4 6%	1 2%	67 100%
DOF DHW DTIR	Department of Finance Department of Health and Wellness Department of Transportation and Infrastructure Renewal					

Overall Results 2007 – 2010



Status of Financial Recommendations – 2012 Versus 2011



Source: TAGR and OAG

6.9 17 recommendations are not complete. Of these, three recommendations have been repeated at least three times and account for eleven of the total recommendations government intends to implement. These recommendations relate to revenue estimates and internal controls. They are discussed further below.

6.10 *Opinion on revenue estimates* – Since 2006, we have recommended that government prepare its revenue estimates on a basis consistent with generally accepted accounting principles. We have qualified our opinion on these estimates every year since 2001, including for the most recent year (2012-13), because the revenue estimates do not include all revenues of the consolidated entity. Specifically, no estimate is made of third-party revenues in certain government agencies.

6.11 We are pleased to report that progress is being made in improving this situation, as discussed in Chapter 2 of this report. The implementation status of this recommendation has changed from do not intend to implement to work in progress as government develops processes to estimate these revenues. We recommended in Chapter 2 that these revenues be estimated for the 2013-14 budget.

6.12 *Failure to implement* – In the May 2012 Report of the Auditor General – Chapter 2: Follow-up of 2005-2010 Performance Audit Recommendations – we concluded there was a failure to implement recommendations made in 2005 and 2006 that were still outstanding. We noted in the Report that we would conduct no further follow-up on those recommendations.

6.13 There are several recommendations included in this year's review of financial recommendations which date back to 2005 and 2006. One recommendation relates to the qualified opinion on the annual revenue estimates and is discussed above.

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6.14 Certain other recommendations have been made in numerous Reports of the Auditor General since 2005, and continue to be made in 2012. These result from issues related to internal controls identified during our audit of the province's consolidated financial statements and include the following:

- the need for government to clearly establish and document internal controls;
- the assignment of roles and responsibility for the design, implementation, operation and maintenance of these controls; and
- the strengthening of elements in the province's internal control framework, including preparation of risk assessments and a system for monitoring of internal controls.

6.15 Government needs to take action on these recommendations. Ten of 17 (59%) outstanding recommendations relate to internal controls. Since these concepts have government-wide impacts, implementation will continue to be assessed until we are satisfied these recommendations are fully implemented.

6.16 *Disagreement on implementation status* – We encountered difficulties in determining the implementation status of a recommendation made to the Department of Finance. It dealt with the need to conduct an independent review of the various inputs used in the models developed by the Department of Energy to estimate petroleum royalties.

6.17 The Department of Finance has indicated this recommendation has been fully implemented. However, our review of their support reveals that the Department of Finance conducts a review and challenge of broad assumptions used in the model but not other significant inputs. The Department of Finance does not intend to conduct this additional review, and accordingly, we assessed the status of this recommendation as do not intend to implement and have reported this as the status in our statistics.

6.18 *Other comments* – We have accepted as complete several recommendations related to the annual audit of the province's consolidated financial statements. Some of these recommendations resulted from deficiencies or errors identified during the audit which were corrected in the subsequent year. In other cases, the deficiency continues but the action recommended was completed. The most significant example of this is the continuing difficulties our Office encounters in the audit of commitments and contractual obligations. Although Government Accounting has implemented the recommendation by providing additional information to departments for identifying and reporting commitments and contractual obligations, significant audit adjustments are made each year to the draft information provided during the audit. We continue to recommend improvements to the processes to identify and disclose these amounts.

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6.19 *November Provincial Update* – On November 20, 2012, the Government issued its third Provincial Update on the Implementation Status of Auditor General Recommendations. Information for the Update was obtained from the Tracking Auditor General Recommendations system.

6.20 During this review, we assessed the implementation status of ten recommendations differently from what was indicated in the Tracking Auditor General Recommendations system. The status of six of these recommendations was adjusted in the system in time for accurate reporting in the November update. The remaining differences between our results and what was reported in the update were not significant. The status of eight of these recommendations changed from complete to not complete or do not intend to implement; two recommendations changed from not complete to complete.