February
2013

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

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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.

1888 Brunswick Street
Suite 302
Halifax, NS B3J 3J8
Telephone: (902) 424-5907
Fax: (902) 424-4350
E-mail: oaginfo@gov.ns.ca
Website: http://www.oag-ns.ca

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1 Message from the Auditor General

Introduction

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.

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.

Significant Issues

Internal Controls

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.

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.

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.

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.

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.

Changes to the Public Service Superannuation Plan

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.

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.

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.

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

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.

My concern regarding this issue has not abated.

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.

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.

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

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.

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.

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

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.

Recommendations

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.

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.

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.

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.

Recommendation 2.5
The Department of Community Services should account for the Nova Scotia Housing Development Corporation as a separate agency of government.

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.

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.

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.

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.

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.

Recommendation 2.11
The Controller's Office should develop a process to identify, evaluate and monitor complimentary user entity controls in government departments using external service organizations.

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.

Recommendation 2.13
Government Accounting should record all accumulated sick leave benefits liabilities for the March 31, 2013 consolidated financial statements.

Recommendation 2.14
The Minister of Finance should directly communicate all significant proposed changes to the Public Service Superannuation Plan to its members.

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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.

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

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.

Recommendations

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

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.

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.

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.

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.

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

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.

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

4 Indicators of Financial Condition

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.

5 Review of Audit Opinions and Management Letters

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.

Recommendation

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.

6 Follow-up of 2007 to 2010 Financial Recommendations

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.