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# 5 Review of Audit Opinions and Management Letters



## Summary

Auditors communicate audit results in letters to management and boards. These management letters provide details on internal control-related issues and other matters for entities included in the consolidated financial statements of the Province. Each year, we conduct a review of management letters issued by private sector auditors and report matters of interest. Comments and observations from the 2013 financial statement audits conducted by this Office are noted in chapter 2 of this report.

Most entities in the government reporting entity receive an unqualified audit opinion on their financial statements. The majority of those opinions which include qualifications relate to the inability of the auditors to verify the completeness of revenues. This qualification is common for entities that derive revenue from donations or other contributions; it is difficult for auditors to determine whether those revenues are complete.

Auditors have identified numerous control-related issues and other matters which merited reporting to management and boards. Approximately one-third of the 96 internal control-related issues are specific to information technology. The majority of the information technology issues related to inappropriate access by individuals to systems, applications or accounts that were not required to be accessed in fulfilling their duties.

We found that 31% of the internal control-related issues identified in the current year had also been reported in prior years and two-thirds of those had been reported as far back as 2009-10. By not addressing the issues reported in auditor's management letters on a timely basis, management and boards of directors of certain entities are not fulfilling their responsibilities to correct deficiencies identified in their operations. We have recommended that the Department of Finance and Treasury Board communicate with boards of directors of all government agencies that issues and deficiencies identified by their auditors should be addressed on a timely basis, and improvements made as required.



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# 5 Review of Audit Opinions and Management Letters

## Background

- 5.1 The financial statement audits of most crown corporations and agencies, funds of the Government of Nova Scotia, and trusts administered by the Government of Nova Scotia, are conducted by private sector auditors. The Office of the Auditor General is the legislated auditor for the remaining entities and for the annual audit of the consolidated financial statements of the Province of Nova Scotia.
- 5.2 Section 23 of the Auditor General Act permits our Office to conduct additional reviews of those agencies in which financial statement audits are conducted by private sector auditors. These auditors provided us with their auditor's report, and related opinion, and their final communication of audit results. This chapter includes comments on our review of these documents.
- 5.3 Comments and observations from the audits of the 2013 financial statements conducted by this Office, including the audit of the consolidated financial statements of the Province, are noted in chapter 2 of this report.

## Chapter Objective

- 5.4 The objective of this review of the audit opinions and management letters of government agencies, boards and commissions is to identify matters of interest to the House of Assembly.

## Significant Observations

### Review of Audit Opinions

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#### Conclusions and summary of observations

Qualified audit opinions were issued on the 2012-13 financial statements for ten entities. In some instances, the opinions were qualified due to the inability of the auditors to verify the completeness of certain revenues. This is a common qualification for entities with revenue from donations or other contributions. In other agencies, qualified opinions were due to insufficient evidence or departures from generally accepted accounting principles. Where possible, management should correct matters that lead to qualified opinions.

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- 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 include accounting principles issued for the public sector. Where there are qualified audit opinions 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; it may not be possible to audit the completeness of this information. As a result, the audit opinions for these agencies are qualified. This is a common 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
  - 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 due to departures from generally accepted accounting principles. Qualified audit opinions were also issued by the auditors of the following entities.
- Harbourside Commercial Park Incorporated – The financial statements were prepared on a nonconsolidated basis with the investment in the wholly-owned subsidiary company, Sydney Utilities Limited, recorded at cost. Under generally accepted accounting principles, the results of Sydney Utilities Limited should be consolidated with those of its parent company.
  - Nova Scotia E911 Cost Recovery Fund – The completeness of expenses was not subject to satisfactory audit verification.
  - Nova Scotia Fisheries and Aquaculture Loan Board – Generally accepted accounting principles for the public sector were not followed; the full amount of the provision for loan impairment was recorded in the current year rather than restating prior year amounts. This resulted in an overstatement of bad debt expense of \$1.5 million for the year ended March 31, 2013.



- 5.8 The March 31, 2013 financial statements and management letters for Atlantic Provinces Special Education Authority and Nova Scotia Power Finance Corporation had not been issued when this chapter was written.
- 5.9 The March 31, 2012 financial statements for Atlantic Provinces Special Education Authority were not available when the prior year's chapter was written. They were issued on March 19, 2013 and were qualified as the liability for compensated sick leave had not been recorded. The information required for calculating the liability was not available at the date of the audit report.
- 5.10 *Accounting framework for government not-for-profit entities* – Government's Management Manuals state that it is the policy of the Province of Nova Scotia that government not-for-profit organizations apply public sector accounting standards. When we reviewed the audit reports for two not-for-profit organizations – Gambling Awareness Foundation of Nova Scotia and Nova Scotia Health Research Foundation – we noted that both were using an accounting framework which is contrary to this policy. We advised Government Accounting of this and understand that, as a response, Government Accounting has since addressed the issue of noncompliance and expects the financial statements of these entities will now be prepared in accordance with government policy.

## Review of Management Letters

### Conclusions and summary of observations

The overall number of internal control-related issues identified increased by 32% over the previous year with 66 new internal control-related issues identified in 2012-13. Approximately one-third of the 96 issues reported this year were also reported in prior years. By not addressing the issues reported in management letters on a timely basis, management and boards of directors of certain entities are not fulfilling their responsibilities to correct deficiencies. We recommended that the Department of Finance and Treasury Board communicate with all government agencies that issues and deficiencies identified by their auditors should be addressed on a timely basis, and improvements made as required.

- 5.11 *Background* – Auditors must communicate significant deficiencies in internal control identified during financial statement audits to those charged with governance. In government agencies, governance is typically provided by an independent board or other oversight body. Auditors are also responsible to report significant difficulties encountered during the audit and other matters that are significant to the oversight of financial reporting. These findings are typically communicated in documents discussed with management and boards.
- 5.12 *Overall results* – Audits were completed for 69 of the 73 government agencies and trusts during the past year. Four of those entities are audited by this Office and the results of their audits are discussed in chapter 2 of this report. Management



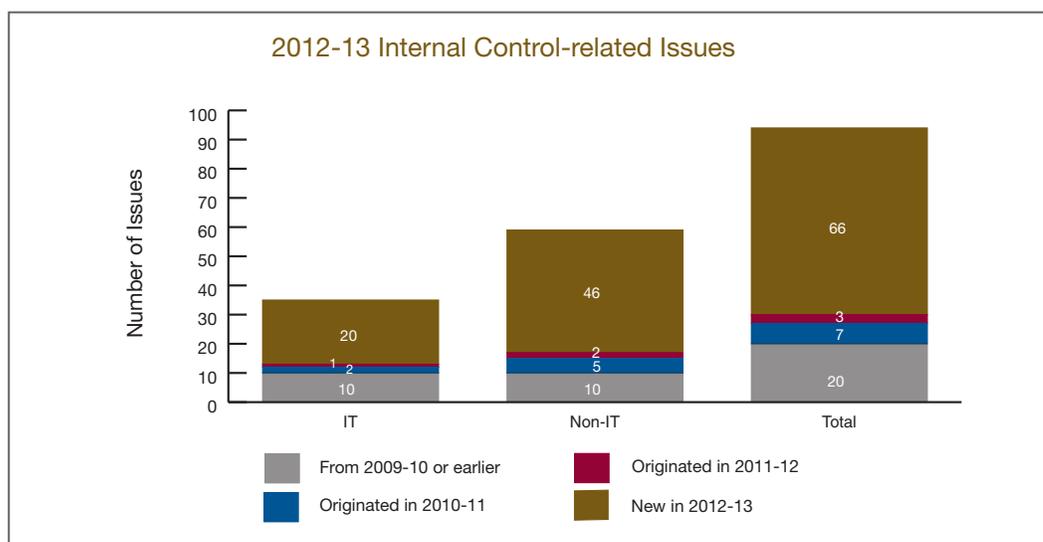
letters were issued to 53 of the remaining 65 audited entities. We were informed by the auditors of the remaining entities that they did not issue a management letter.

5.13 96 internal control-related issues and an additional 46 other matters were identified in 37 of the entities that received management letters. There were no internal control-related issues or other matters to report for the remaining 16 entities. The following table illustrates the number of issues found in the communications of audit results.

| Number of Government Entities with: | 2012-13 |
|-------------------------------------|---------|
| Five or more issues                 | 9       |
| One to four issues                  | 28      |

5.14 We have reported previously our concern with the number of recommendations that are not addressed and continue to be reported. Responding to issues identified by auditors is management’s responsibility, and it is the responsibility of boards of directors to ensure these matters have been addressed by management. The number of issues that remain outstanding from one year to the next in several agencies is increasing. In 2012-13, nine entities had five or more issues identified by their auditors in management letters. For the Cape Breton District Health Authority, eight issues were reported in 2011-12 and again in 2012-13.

5.15 Internal control deficiencies are of particular concern as poor internal controls, including those related to information technology operations, can hinder the ability of an entity to achieve its objectives. The following exhibit shows when the issues reported this year were originally reported by entity auditors. Thirty-one percent were reported by entity auditors in prior years, with two-thirds of those issues reported as far back as 2009-10.



5.16 *Responsibility for addressing issues identified by auditors* – Management has the responsibility for addressing issues identified by their auditors and reporting progress to their boards or other governing body.

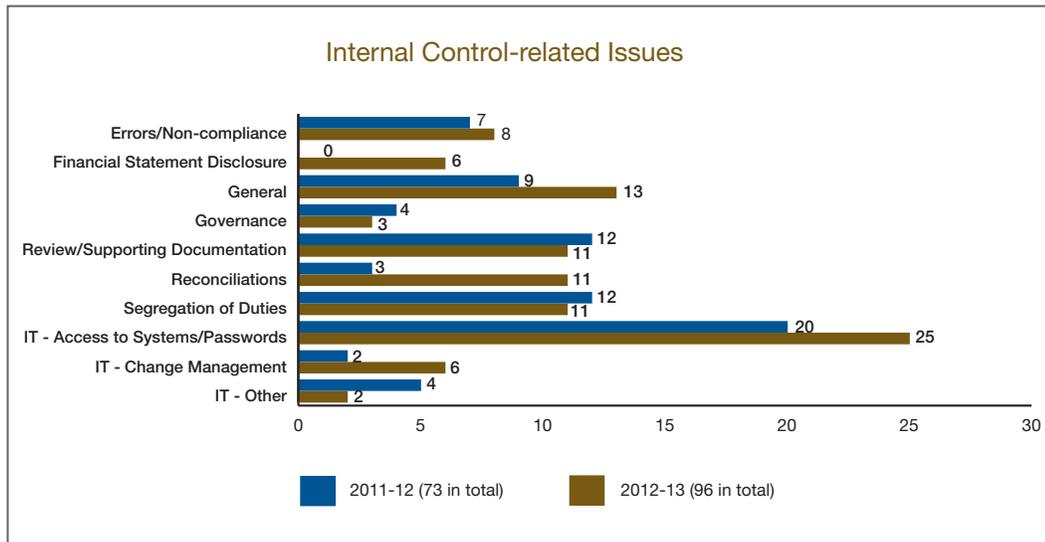


- 5.17 In chapter 2, we note government’s response following recommendations made as a result of our audit of government’s financial statements, as well as their plans for implementing the recommendation. We conduct follow-up on these recommendations after two years.
- 5.18 There is no similar process for reporting on the status of recommendations made to government agencies by their auditors or for the smaller entities audited by this Office. We have not determined if the entities themselves have such a reporting process. With the number of internal control-related issues and the fact that many are repeated year after year, there should be a process to hold those entities to account for addressing issues reported by their auditors. This process, which should be administered centrally, would also ensure that boards of directors are fulfilling their responsibilities.

**Recommendation 5.1**  
 The Department of Finance and Treasury Board should communicate to the boards of directors of all government agencies that issues and deficiencies identified by their auditors should be addressed on a timely basis, and improvements made as required.

***Department of Finance and Treasury Board Response:***  
*The Department agrees with the recommendation and will work with responsible Departments to communicate the need for government agencies to address these issues.*

5.19 *Internal control-related issues* – Auditors reported issues with internal control-related systems or procedures, including those related to information technology systems. Approximately one-third of the internal control-related issues were specific to information technology. The following exhibit shows 2012-13 internal control-related issues by theme compared to 2011-12.





- 5.20 The overall number of internal control-related issues identified increased by 32% over 2011-12. Sixty-six issues were identified and reported in 2012-13 for the first time.
- 5.21 Increases in the number of general internal control deficiencies and IT-related issues account for most of the increase. The majority of the increase relates to the Nova Scotia Housing Development Corporation. Their auditors identified 14 issues in the current year; nine were general control deficiencies and five related to system access. These issues are discussed later in this chapter.
- 5.22 *School-based funds* – Last year we repeated a recommendation from our January 2012 Report that the Department of Education (now the Department of Education and Early Childhood Development) 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 to achieve compliance by March 31, 2014.
- 5.23 There continue to be numerous findings related to internal controls surrounding these funds. Revenue from school-based funds in all school boards totaled \$42 million during the fiscal year, and \$19 million remained in school boards' accounts at March 31, 2013 year end. This is a significant amount and often results from students' community fundraising activities. There should be appropriate internal controls in each board to reduce the risk that: amounts received are not recorded; disbursements made are not authorized and controlled; the year-end balance in a student's or the school's account does not reconcile to records and the bank; and amounts are recorded on an accrual rather than cash basis. Where auditors have identified weaknesses in controls related to these funds, management should ensure any corresponding recommendations are implemented on a timely basis.
- 5.24 The following paragraphs summarize internal control-related issues and other matters of interest reported by external auditors.

#### ***Government Business Enterprises***

- 5.25 *Halifax-Dartmouth Bridge Commission* – The auditors noted that reconciliations were not being performed for a number of accounts throughout the year. Internal control-related issues reported in the prior year – segregation of duties and IT passwords – were not repeated in the current year.
- 5.26 *Highway 104 Western Alignment Corporation* – The management letter from the auditors of the Highway 104 Western Alignment Corporation did not note any internal control-related issues or other matters.
- 5.27 *Nova Scotia Liquor Corporation* – The Corporation uses a general ledger system – SAP – which is housed centrally by the province and made available to a number of users. The Corporation's auditors assessed the opinion of independent auditors



on the controls related to the centrally-housed SAP operations. The audit report on controls related to SAP identified that access was not appropriately restricted to authorized users. SAP password resets were also not subject to independent review during the year. The Corporation's auditors also noted that access rights to other applications were not reviewed annually.

***School Boards and the Nova Scotia Community College***

- 5.28 *School boards* – Management letters for five of the eight school boards discussed issues related to school-based funds, noting areas for improvements in internal controls and, in certain instances, the lack of an internal audit function. The auditors for the Halifax Regional School Board noted their professional services were provided again in fiscal 2013 in relation to a forensic review of certain school-based funds and the auditors of the Annapolis Valley Regional School Board noted theft had occurred because several controls over school-based funds had not been followed.
- 5.29 School boards use the SAP general ledger system which is housed centrally by the Province. Exceptions related to user access were noted and reported in four of the eight management letters issued.
- 5.30 Inadequate segregation of duties related to the accounts payable function previously reported in two boards continues in 2012-13 as well as inadequate segregation around the preparation of journal entries. The auditors again recommended that the Conseil scolaire acadien provincial continues work in the area of establishing procedures to document, test and evaluate internal controls as they do not have an internal audit group.
- 5.31 The management letter for the Annapolis Valley Regional School Board noted several schools had purchased items valued greater than \$1,000 directly from suppliers which is contrary to Board policy. The auditors of the Cape Breton-Victoria Regional School Board reported that the Board does not have insurance coverage for sexual misconduct situations. This was also reported in 2011-12.
- 5.32 *Nova Scotia Community College* – The management letter from the auditors of the Nova Scotia Community College did not note any internal control-related issues or other matters.

***District Health Authorities and the IWK Health Centre***

- 5.33 Exceptions related to user access and exceptions when testing system changes were identified by the auditors of three health authorities and the IWK. Several authority auditors also noted other system access issues and weak password controls.
- 5.34 Both the Cape Breton District and Colchester East Hants health authorities had information technology issues related to system access and change management.



The auditors of the Cumberland and Guysborough Antigonish Strait health authorities noted concerns with travel and expense claims not being reviewed while the auditor of the IWK noted concerns with managers not properly reviewing attendance reports. Auditors of four authorities reported issues with reconciliations not being performed on a timely basis.

- 5.35 The auditors of Pictou County Health Authority reported that they experienced several delays in obtaining information required for the completion of the audit. The auditors noted that the complete trial balance, several significant working papers, and a complete set of financial statements were not provided until several weeks following the date which was agreed upon between management and the auditors. Various issues related to internal controls, including information technology issues specific to system access and change management, were also included in the management letter.
- 5.36 We noted that no internal control-related issues were identified either in 2013 or 2012 for the following four of the nine authorities.
- Annapolis Valley Health
  - Capital Health
  - South Shore Health
  - South West Health

***Entities Providing Financial Assistance***

- 5.37 Auditors communicated findings and other reportable matters as a result of their audits of the following provincial agencies providing financial assistance.
- Nova Scotia Farm Loan Board
  - Nova Scotia Fisheries and Aquaculture Loan Board
  - Nova Scotia Housing Development Corporation
  - Nova Scotia Jobs Fund
- 5.38 Consistent with the prior year, there were errors in Nova Scotia Fisheries and Aquaculture Loan Board's manual calculation of interest expense and the auditors recommended increased diligence, investigation, and correction of differences. The auditors of the Nova Scotia Farm Loan Board reported that some new loans were being conditionally approved with no follow up to ensure the conditions are met.
- 5.39 For the Nova Scotia Farm Loan Board, Nova Scotia Housing Development Corporation, and Nova Scotia Jobs Fund, the auditors noted that management's annual reviews of loans were not always based on the most current financial information available from the borrowing entity.



- 5.40 The March 31, 2012 management letter for the Nova Scotia Housing Development Corporation was not available when the prior year chapter was written. It was issued to management in December 2012 with management’s responses provided to the auditor on March 1, 2013. The auditors noted that the year-end bank reconciliation included stale-dated cheques; certain staff had the ability to change mortgage information subsequent to information being entered into the mortgage management information system with no periodic review of changes to data; and management sign-off on year-end listings and reconciliations was not always evidenced.
- 5.41 In the 2013 management letter, the auditors of Nova Scotia Housing Development Corporation continued to note that business users have administrative level access to the mortgage management information system. As well, password controls may not be sufficient to restrict unauthorized access, and access privileges to a financial application are not reviewed on a regular basis to ensure access is appropriate.
- 5.42 The auditors of the Nova Scotia Housing Development Corporation also noted issues encountered during the 2013 year-end audit. The internal-control related issues that allowed such situations to occur are concerning.
- Certain detailed reports did not reconcile to summary reports or the general ledger.
  - There did not appear to be well-documented processes in place over consolidation of the housing authority information and the Corporation.
  - There were errors in presentation of land inventory and tangible capital assets which required adjustments.
  - Capital revenue and administration fees had to be restated as a result of an error in 2012.
  - Assistance was required for disclosures of financial instruments, retirement benefits, revenue recognition, and government transfers.

***Other Entities***

- 5.43 Other entities include trust funds under administration and entities in the government reporting entity not included in the broad sectors discussed above. Auditors provided findings and recommendations as a result of their audits of the following provincial entities.
- Art Gallery of Nova Scotia
  - Nova Scotia E911 Cost Recovery Fund
  - Nova Scotia Health Research Foundation
  - Nova Scotia Innovation Corporation



- Nova Scotia Public Service Long Term Disability Plan Trust Fund
- Nova Scotia School Insurance Program Association
- Perennia Food and Agriculture Inc.
- Provincial Drug Distribution Program
- Renova Scotia Bioenergy
- Resource Recovery Fund Board Incorporated
- Sherbrooke Restoration Commission
- Sydney Tar Ponds Agency
- Trade Centre Limited

5.44 Exceptions related to user access were reported to the Nova Scotia E911 Cost Recovery Fund. The auditors of Sydney Tar Ponds Agency again noted that Province of Nova Scotia staff have access to the Agency's general ledger and have the ability to post entries without the knowledge or consent of the Agency.

5.45 At the Nova Scotia Public Service Long Term Disability Plan Trust Fund, the contracted external accountant has access to all aspects of the general ledger, banking, accounts receivable and accounts payable. This has not changed since the prior year.

5.46 Poor controls over inventory were reported by the auditors of the Sherbrooke Restoration Commission and outstanding accounts receivable balances from as early as 2005 were reported by the auditors of Nova Scotia Innovation Corporation. Auditors of Nova Scotia Health Research Foundation, Nova Scotia Innovation Corporation and Nova Scotia School Insurance Program Association reported concerns with reconciliations either not being done or not being completed on a timely basis. The auditors of Nova Scotia Innovation Corporation, Sherbrooke Restoration Commission and Sydney Tar Ponds Agency expressed concerns over segregation of duties issues with journal entries or invoices not being approved by management.

5.47 There were no internal control-related issues or other matters of interest reported in the management letters by the auditors of the following entities.

- Canada-Nova Scotia Offshore Petroleum Board
- Gambling Awareness Foundation of Nova Scotia
- Harbourside Commercial Park Inc.
- Nova Scotia Community College Foundation
- Nova Scotia Credit Union Deposit Insurance Corporation



- Nova Scotia Lands Inc.
- Nova Scotia Public Service Superannuation Plan
- Nova Scotia Utility and Review Board
- Sydney Steel Corporation
- Sydney Steel Corporation Superannuation Plan
- Sydney Utilities Limited
- Waterfront Development Corporation