January
2014

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

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NOVA SCOTIA

January 2, 2014

Honourable Kevin Murphy
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

JACQUES R. LAPOINTE, CA, CPA
Auditor General

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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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 January 2014 Report to the House of Assembly. This Report focuses on financial reporting issues and includes work completed by my Office during 2013.

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. The opinion on the revenue estimates was unqualified for the first time in 13 years; this is a significant improvement in government financial reporting. We provided an unqualified opinion on the province's consolidated financial statements. We made several recommendations to improve financial controls and financial management in government. We also commented on our audits of four provincial agencies, and provided information on the recommendations for improvement we made to the boards and management of those agencies.

1.7 We were unable to verify the accuracy of benefit payments to retired individuals at two of the largest employers which contribute to the Public Service Superannuation Plan – the Province of Nova Scotia and Capital Health. We identified concerns with the retention policies for each of these employers and have recommended that adequate support be maintained to verify benefits while pensions are being paid. We reviewed the process to make changes to the Plan and to revise the asset mix used by the Plan to achieve its funding objectives. We recommended the new Public Service Superannuation Plan Trustee Inc. make the Plan's Statement of Investment Policies and Goals, which describes the risk and investing philosophy, including the approved asset mix, available to all Plan members.

1.8 Our chapter on financial indicators provides financial information and analysis related to the sustainability, flexibility and vulnerability of government finances, and provides information on budget to actual variances for both operating and capital expenditures.

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 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.

1.10 The implementation rate of our 2010 recommendations has improved from 67% to 77% this year. This is due in part to the implementation of a long-outstanding recommendation that the revenue estimates included in government's annual budget be prepared on a consolidated basis. Recommendations related to internal controls and roles and responsibilities for these controls have not been implemented to date despite being recommended in successive Reports of the Auditor General.

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.

2 Results of Financial Audits and Reviews

Summary

The review opinion on the 2013-14 revenue estimates was unqualified for the first time in 13 years. This is a significant improvement in government financial reporting. Government implemented a recommendation made by this Office and an independent consultant that the revenue estimates include revenue from all entities included in the consolidated financial statements as required by generally accepted accounting principles.

We perform the annual audit of the Province's consolidated financial statements. The audit opinion on the 2012-13 consolidated financial statements was unqualified. The Public Accounts were released on July 31, 2013. Our audit resulted in numerous recommendations to improve financial controls, enhance management accountability for the preparation of the consolidated financial statements, and improve the audit process.

We issued unqualified audit opinions in three of four audits of government agencies we conducted for the year ended March 31, 2013. The audit opinion on Trust Funds Administered by the Public Trustee was qualified due to the inability to verify that all assets, or income related to those assets, that came under administration were recorded by the Public Trustee. We issued management letters for each audit. These letters include recommendations for improvement and we will follow up their implementation status during our audit next year.

We recommended that the Public Trustee obtain an accounting system to support the administration of the $45 million in estates and trusts under that Office's control. We also identified issues with how the Public Trustee pays interest on clients' investments. The current practice is to pay interest at a prescribed rate which may be different from the actual rate; we recommended interest be paid at the actual rate earned. Additionally, the Public Trustee has been transferring interest revenue from its reserve fund to the Province each year. We recommended this practice be discontinued. These changes will increase transparency in administering estates and trusts.

We recommended that the Nova Scotia Crop and Livestock Insurance Commission establish an audit committee, and develop additional internal controls to check inputs to the process used to calculate insurance premiums and issue insurance certificates. We also made recommendations for changes in processes to prepare year-end financial statements at the Nova Scotia Legal Aid Commission, including the process to estimate unbilled legal fees.

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. 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 and Treasury Board'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 The Auditor General is also the legislated auditor of four government entities.

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

2.3 In addition to the above entities, on December 19, 2012, the Auditor General was appointed auditor of the House of Assembly for the year ended March 31, 2013. The Auditor General also conducted an audit under Section 23 of the House of Assembly Management Commission Act during fall 2013.

Background

2.4 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 satisfies its accountability responsibilities for the use of public funds.

2.5 The Province's 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 and the efficient use of resources.

2.6 *Budgets* – Government uses the budget process to inform stakeholders of its fiscal plan and priorities for the upcoming year, including borrowing and tangible capital asset requirements, and to ensure approval of the plan by Members of the House of Assembly, 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.

2.7 *Forecasts* – The Finance Act requires that financial forecasts be prepared and tabled in the Legislature by the Minister of Finance 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.

2.8 *Public Accounts* – The annual Public Accounts, including the Province's consolidated financial statements, are prepared by the controller on behalf of the Minister and Deputy Minister of the Department of Finance and Treasury Board. 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, 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 a 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 analysing government's financial performance, condition and indicators of financial position.

2.9 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.

2.10 *Audit of government agencies* – In addition to the Public Accounts, many government agencies, boards and commissions produce annual budgets and provide audited financial statements.

Chapter Objective

2.11 The objective of this chapter is to provide summary comments and recommendations on government financial reporting.

- Results of our review of the revenue estimates for the year ended March 31, 2014, included in the April 4, 2013 budget address
- Information resulting from our audit of the Province's March 31, 2013 consolidated financial statements
- Results of financial statement audits conducted by this Office at certain government agencies

2.12 Since the completion of the audit, the Department of Finance and Treasury Board Office have been combined as the Department of Finance and Treasury Board. We have identified audit findings as related to each former entity but have made our recommendations to the combined Department.

Review of the 2013-14 Revenue Estimates

Conclusions and summary of observations

We are pleased to report that the review opinion on the 2013-14 revenue estimates was unqualified – the first time this has occurred in 13 years. This is a major achievement and a significant improvement in government financial reporting. Government implemented a recommendation made by this Office and an independent consultant that the revenue estimates include revenue from all entities included in the consolidated financial statements as required by generally accepted accounting principles. In addition, we recommended that the Department of Finance and Treasury Board establish guidelines for determining which current and future economic projects and events will adjust the preliminary economic forecasts used to prepare the revenue estimates. This would help better reflect expected revenues in the upcoming year. We further recommended that a threshold be established to assess the reasonableness of the impact of changes to tax calculations during the preparation of the revenue estimates.

2.13 *Unqualified opinion* – Under Section 20(1) 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. An unqualified opinion was issued on the 2013-14 revenue estimates and included in the April 4, 2013 budget address provided by the then Minister of Finance.

2.14 This is the first time our Office has issued an unqualified opinion on the revenue estimates since 2001. In that year, generally accepted accounting principles for the public sector were revised to require consolidation of entities controlled by government. Accordingly, the operating and financial results of school boards, district health authorities and other entities were to be included with those of departments to produce fully consolidated financial statements. Under generally accepted accounting principles, the revenue estimates should be prepared on the same basis as the consolidated financial statements. Our opinion on the revenue estimates had been qualified for two reasons: revenues from the consolidated entities were excluded from the revenue estimates; and, we were not able to determine the amount of the excluded revenue.

2.15 We have recommended each year since 2001 that the revenue estimates be expanded to include all revenue in the consolidated entity. In 2009, Government hired a consultant to propose a solution to resolving the qualified opinion. The consultant's recommendation was consistent with ours. More recently, senior management at the Department of Finance explored ways to produce fully consolidated estimates. We are pleased to report that this led to an unqualified opinion on the 2013-14 revenue estimates.

2.16 *Error cut-off date* – We recommended in our February 2013 Report of the Auditor General (Recommendation 2.2, Chapter 2) that a cut-off date be established for correction of nontrivial errors found during the revenue estimates review. Department of Finance senior management agreed with this recommendation and it was fully implemented for the 2013-14 revenue estimates engagement. We commend the Department for its quick response to this recommendation. The list of requirements and deadlines, including a reasonable cut-off date to consider economic data and error correction, facilitated our review, and improved the budget preparation process.

2.17 *Economic shocks* – Each year, economic forecasts are produced from economic models. Preliminary economic indicators are prepared from historical Statistics Canada information. As part of the revenue estimates process, the impact of certain recent or upcoming projects and events is then considered. These can range from major construction projects to the impact of distressed industries. The impacts of these economic events are considered shocks to the preliminary economic forecasts. We believe that including these events is a good practice in the economic forecasting process and should provide for more accurate revenue estimates.

2.18 The only established criterion with respect to the projects and events to be considered is that there is certainty; the impact of speculative projects is not considered due to their unpredictability. Further guidelines should be developed in determining which known projects and events are included. Those guidelines should include a process to consider, for example, the impact of emerging new industries.

Recommendation 2.1
The Department of Finance and Treasury Board should establish guidelines for determining those economic projects and events whose impact on preliminary economic forecasts should be considered before finalizing estimated revenues.

Department of Finance and Treasury Board Response:
Agreed. The Department will develop an initial set of these guidelines prior to the 2014-15 Budget Estimates. Over the course of a number of forecasts, revisions may arise from the experience with implementing these guidelines, and such revisions will be reviewed and adjusted as necessary.

2.19 *Revenue models* – Certain revenues are estimated by models prepared by the Department of Finance and Treasury Board. Data from sources such as Statistics Canada and Canada Revenue Agency, as well as economic forecasts from the Department's Economics and Statistics Division, are entered into the models.

2.20 During the planning phase for the review of the 2013-14 revenue estimates, we were advised by staff in the Taxation and Fiscal Policy Division of the Department of Finance that there was a coding change in the process used to forecast personal income tax revenue, as well as a change in the calculation for certain non-refundable tax credits.

2.21 In each of the past three years, our management letters resulting from the review of revenue estimates have included an overview of change management best practices when there are changes in models to calculate tax revenue or when a new application is adopted. Such practices provide a management trail that helps to establish that models used to produce certain revenues reflect approved changes that have been tested. This helps to ensure the integrity of revenue estimates, periodic forecast updates, and the Public Accounts.

2.22 The Taxation and Fiscal Policy Division provided results of the testing conducted to determine the reasonableness of the changes made during the current year; however, the testing did not support that changes produced the intended results. We performed alternate procedures and discussed with Division staff the need for improved change management procedures.

2.23 Taxation and Fiscal Policy staff assessed the reasonableness of process changes. However, management had not developed specific thresholds against which to assess reasonableness. We recommended that the Division develop specific thresholds. Thresholds should consider the significance of any revenue determined through the use of models, as well as the impact of a change on the total operating results of the Province.

Recommendation 2.2
The Department of Finance and Treasury Board's Taxation and Fiscal Policy Division should establish a threshold to assess the reasonableness of the impact of changes to tax calculations.

Department of Finance and Treasury Board Response:
Agreed. The Taxation and Fiscal Policy Division will implement changes to revenue model update procedures.

2.24 *Economic assumptions* – Multiple versions of economic assumptions were provided by the Economics and Statistics Division to correct errors identified by Division staff or by staff of this Office. We noted the need for improved processes in preparing the economic models to ensure inputs and calculations are accurate. For example, a change to an input due to revised data could be reviewed by another individual once the model has been updated. Division management suggested that procedures focus on areas with the greatest sensitivity and impact to the forecasts. This appears to be a reasonable approach if it is supported by an analysis of which inputs should be subject to specific review.

Recommendation 2.3
The Department of Finance and Treasury Board's Economics and Statistics Division should improve existing processes to ensure the accuracy of inputs and calculations used in the economic models.

Department of Finance and Treasury Board Response:
Agreed. With the full historical revision and restructuring of Statistics Canada's Provincial Economic Accounts, the Economics and Statistics Division will have to undertake a number of model revisions. These revisions should obviate many of the sources of input error and adjustments required because of Statistics Canada's partial historical revision and restructuring of this key data source.

Audit of the March 31, 2013 Consolidated Financial Statements

Conclusions and summary of observations

The audit opinion on the 2012-13 consolidated financial statements was unqualified. The Public Accounts were released on July 31, 2013. We experienced issues in completing the audit engagement due to delays in receiving requested information and a lack of adequate and accurate supporting documentation. We have made recommendations that should result in improvements to the audit process. Our audit also resulted in numerous recommendations to improve financial controls and to enhance management accountability for the preparation of the consolidated financial statements.

2.25 *Introduction* – Our Office is the legislated auditor of the Province's consolidated financial statements. We are required by Section 19 of the Auditor General Act to perform the annual audit 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.

2.26 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.

2.27 A management letter was provided to the Minister of Finance and Treasury Board in November 2013. It included detailed audit findings, recommendations and other comments related to the March 31, 2013 Public Accounts. The more significant information included in that management letter is noted below under the following headings.

- Audit completion
- Internal control
- Other matters

Audit Completion

2.28 *Results and significant findings* – The consolidated financial statements were released on July 31, 2013. We issued an unqualified audit opinion dated July 25, 2013.

2.29 Canadian Auditing Standards require that we communicate to those charged with governance, such as the Minister of Finance and Treasury Board or Executive Council, the following information:

- significant matters, if any, arising from the audit that were discussed or subject to correspondence with management; and,
- other matters, if any, arising from the audit that, in the auditor's professional judgment, are significant to the oversight of the financial reporting process.

2.30 Issues that directly impacted audit completion and that, in our judgment, are important to oversight of the financial reporting process are noted below.

2.31 *Restructuring accounts* – The Province's general ledger includes two restructuring accounts which are used to reflect the expense and accrual related to salary negotiations. Adjustments should be made to recorded balances each year to ensure: the expense and liability related to ongoing contract negotiations are recorded in the year to which they relate; and, the liability for these amounts is reduced when contracts are settled and retroactive amounts paid.

2.32 Certain audit support relating to restructuring expense and the liability was not provided to our Office by the required due date. In addition, when we did receive the support, some of it was not complete or accurate. In order to meet Government's established release date for the Public Accounts, and to ensure the most efficient use of our resources, it is important that we receive accurate and complete information as noted in Government Accounting's schedule of audit deliverables.

Recommendation 2.4
The Department of Finance and Treasury Board should ensure all documentation provided as audit support for the restructuring accounts is complete, accurate, and timely.

Department of Finance and Treasury Board Response:
The Department agrees with this recommendation and will ensure that all documentation provided as audit support will be accurate, complete and timely.

2.33 *Tax revenue* – In 2012-13, $4.3 billion, or 42.6%, of total consolidated revenue of $10.1 billion related to certain tax revenues calculated using complex spreadsheets and models. The corporate income tax and harmonized sales tax models we initially received for the audit had not been updated from those provided during the 2013-14 revenue estimates assignment, and therefore did not reflect management's best estimates for preparation of the Public Accounts. In addition, the models were not prepared on a basis consistent with the prior year.

2.34 The Taxation and Fiscal Policy Division had previously prepared a document describing the nature and timing of certain inputs for the various models, and procedures for preparing and approving the models. The detailed process was not followed in preparing the initial corporate income tax model provided to us.

2.35 Continuing inconsistencies in determining tax revenues indicate weaknesses still exist in internal controls for estimating certain tax revenues. Internal controls, including those related to model input, review and approval are not all being performed.

Recommendation 2.5
The Department of Finance and Treasury Board, Taxation and Fiscal Policy Division, should follow its documented processes and procedures for the preparation and review of model-determined revenues.

Department of Finance and Treasury Board Response:
The Department agrees with this recommendation.

2.36 We also found the procedures noted in the document for preparing the harmonized sales tax model are incomplete because they do not include the frequency and source of inputs used to prepare the estimate.

Recommendation 2.6
The Department of Finance and Treasury Board, Taxation and Fiscal Policy Division should update the procedures for estimating harmonized sales tax revenue to include the nature and timing of inputs used in the estimation process.

Department of Finance and Treasury Board Response:
The Department agrees that the procedures for preparing Harmonized Sales Tax Revenue Estimates and Forecasts should include the nature and timing of inputs. However, certain inputs (e.g., unofficial estimates) are not always provided to the Department by the federal government and that the use of some inputs can be discretionary as they may not reflect management's professional judgement of the best information available.

2.37 Responsibility for monitoring of these internal controls should be assigned to ensure they are operating effectively. Monitoring of controls should be the responsibility of staff who are not part of the data input function or the review process. We include additional comments regarding the control framework in the Taxation and Fiscal Policy Division when we discuss monitoring of internal controls later in this chapter.

2.38 *Departmental responsibility* – An observation in last year's audit was the need for additional guidance on roles and responsibilities for internal controls, including the responsibility for providing accurate and timely information related to the consolidated financial statements. To help address this, we recommended in our February 2013 Report (Recommendation 2.10, Chapter 2) that responsibility for compliance with public sector accounting standards be assigned. We further recommended that should the responsibility be assigned to departments, each department should be required to acknowledge that the information provided to support balances and disclosures complies with public sector accounting standards. The Controller's Office addressed this recommendation by requiring the senior financial executive and deputy minister of each department to sign a statement of management responsibility indicating that amounts and disclosures contained in the audit submission were in accordance with the accounting principles recommended by the Public Sector Accounting Board.

2.39 Within the Department of Finance and Treasury Board, the Taxation and Fiscal Policy, Capital Markets Administration, and Liability Management and Treasury Services divisions, and now the division performing Treasury Board Office functions, are responsible for significant amounts and disclosures in the consolidated financial statements. Given the continuing difficulties we experience in obtaining consistently-prepared revenue models as well as the difficulties we have encountered in obtaining accurate and complete audit support from other divisions within the Department of Finance, we believe there should be separate signed statements of responsibility for those divisions.

Recommendation 2.7
The Department of Finance and Treasury Board's Capital Markets Administration, Taxation and Fiscal Policy, and Liability Management and Treasury Services divisions, and the division responsible for Treasury Board functions, should each sign a statement of management responsibility that the information submitted for audit by their respective divisions is complete, accurate and in accordance with public sector accounting standards. These statements should also be signed by the Deputy Minister of Finance and Treasury Board.

Department of Finance and Treasury Board Response:
In 2012-13, the Department implemented a process of having a Statement of Management Responsibility signed by the senior financial executives and Deputy Ministers of the departments. The Department agrees that the Deputy Minister of Finance and Treasury Board will require assurances from significant financial reporting divisions within the department in order to sign the Statement of Management Responsibility. The Deputy Minister, in consultation with the Controller's Office, will review the process of obtaining assurances from significant financial reporting divisions within the department.

2.40 *Consolidated financial statement responsibility* – The March 31, 2013 consolidated financial statements include a statement of responsibility which indicates the financial statements are prepared on behalf of the Minister and Deputy Minister of Finance (at March 31, 2013) by the Controller in accordance with public sector accounting standards. The Controller's Office is therefore responsible for ensuring the consolidated financial statements are in accordance with public sector accounting standards.

2.41 We encountered difficulties this year in obtaining analyses supporting certain deferred revenue balances as at March 31, 2013. Revised accounting standards implemented this year required that balances be reviewed and assessed against the revised standard to ensure continued deferral was appropriate. Any amount for which deferral was no longer appropriate was to be recognized as revenue.

2.42 Certain departments did not provide an analysis to support that deferral was in compliance with public sector accounting standards. The Government Accounting Division amended or prepared the necessary analysis. We acknowledge that departments have responsibility for their transactions and recorded balances. However, in the absence of analysis by departments to support balances, the Controller's Office should ensure balances on the consolidated financial statements are in accordance with public sector accounting standards.

Recommendation 2.8
The Controller's Office, in conjunction with Government Accounting, should ensure balances, transactions and disclosures, including deferred revenue amounts, included in the General Revenue Fund and consolidated financial statements are supported and in accordance with public sector accounting standards.

Controller's Office Response:
The Department does not believe that this recommendation has merit. Government Accounting viewed the three deferred revenue balances that came to our attention during the audit as insignificant on a deferred revenue balance of $245.3 million. Based on informal discussions with departments and reviews of the corresponding agreements, Government Accounting was comfortable that unspent amounts for two of the balances in question met the criteria for deferral. In our opinion, there was little ambiguity about the items; therefore, formal accounting opinions were deemed unnecessary. To maintain operational efficiency, formal accounting analyses are provided only in relation to material financial statement items that require a degree of professional judgment.

Government Accounting intends to provide training to financial managers in 2013-14 on how to prepare formal accounting positions. This step should help departments in achieving completeness and accuracy of their account balances as well as responding to OAG inquiries in sufficient detail.

Internal Control

2.43 *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 the Department of Finance (now the Department of Finance and Treasury Board) 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."*

2.44 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.

2.45 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 and Treasury Board in a management letter. Implementation of the recommendations in the management letter and this chapter will facilitate preparation of the consolidated financial statements.

2.46 *Risk assessments related to the consolidated financial statements* – A strong internal control framework includes control and governance practices and other processes that enable the organization to achieve its objectives. One identified element is risk assessment. Each year, we enquire about risk assessment practices, specifically those risks that relate to preparation of the consolidated financial statements.

2.47 Financial reporting risks include the risks of fraud and error in the consolidated financial statements, including notes and other disclosures. Risks may be reduced by standard management practices such as documented policies and procedures and monitoring of internal controls. However, the risks of fraud and error to the consolidated financial statements first have to be identified and assessed before controls can be designed and implemented to mitigate risks. A risk assessment relevant to the consolidated financial statements is management's responsibility and is critical in ensuring the appropriate controls are implemented to mitigate the identified risks. An appropriate risk assessment process would assist government in achieving its financial reporting objectives, including fair presentation of the consolidated financial statements.

2.48 We have reported in the past that several departments were not assessing the risks to the financial statements; therefore, we asked the Controller's Office if management had a documented risk assessment process to identify the significant risk areas to the financial statements of the general revenue fund as well as the consolidated financial statements. The Controller's Office response referenced a risk assessment that had been completed in a prior year. This assessment did not identify or assess risks to the consolidated financial statements and no consideration was given to mitigating risks; therefore, it was inadequate. Last year, we recommended that the Controller's Office oversee the preparation of departmental assessments of the risk of material misstatement to the consolidated financial statements. However, this year, we identified deficiencies in departmental assessments and in the risk assessment referenced by the Controller's Office. Given these issues, we feel the Controller's Office should assess the risks to the consolidated financial statements.

Recommendation 2.9
The Controller's Office should prepare an appropriate and effective assessment of the risk of material misstatement to the consolidated financial statements, due to fraud or error. This assessment should include identifying risks of fraud and error, estimating the significance of each risk, assessing the likelihood of each risk, and documenting the action, if any, required to address the identified risks.

Controller's Office Response:
The Department agrees with this recommendation. The Controller's Office has commenced a top-down risk assessment for the 2013-14 fiscal year as part of its annual Internal Controls Over Financial Reporting program. The Internal Audit Centre has also commenced the process of preparing fraud risk assessments for certain larger departments with two more planned in the near future.

2.49 *Monitoring of internal controls over financial reporting* – Monitoring of internal controls helps ensure those controls are operating effectively and continue to mitigate identified risks to the consolidated financial statements. The benefits of monitoring include identifying and correcting internal control issues on a timely basis which will result in more accurate and reliable information for use in decision-making and financial reporting. Monitoring is the final element in an effective internal control framework.

2.50 During the audit, we identified a weakness in the processes to determine certain tax revenues. If a process had been in place to monitor internal controls over model-determined revenues, it is likely someone would have detected that controls were not operating as designed.

2.51 The Controller's Office should prepare a description of the process for monitoring internal controls to be included in the Government's Management Manuals. The description should include assignment of responsibility, guidance on how to determine which controls to monitor, a description of the procedures to perform, and timing of monitoring. Any control deficiencies identified as a result of monitoring should be addressed on a timely basis.

Recommendation 2.10
The Controller's Office should prepare a description of the process for monitoring of internal controls to be included in Government's Management Manuals. The results of monitoring activities should be communicated to the Province's Audit Committee. Any control deficiencies identified as a result of monitoring should be addressed on a timely basis.

Controller's Office Response:
The Department agrees with this recommendation and is in the process of designing support material on internal controls over financial reporting, including monitoring of internal controls, that will provide assistance to departments. This material will then help to form the basis of an internal control policy that will be included in Management Manual #200. The implementation of the departmental Statement of Management Responsibility in 2012-13 was an initial step in successfully meeting this recommendation.

Other Matters

2.52 *Required communication of audit results* – 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 (such as the Minister of Finance and Treasury Board, and Executive Council) 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. As well, it 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.

2.53 *New accounting standards* – Some of the more significant issues on which the Public Sector Accounting Board has recently released new pronouncements include liability for contaminated sites, foreign currency translation and financial instruments. New standards 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.

2.54 *Liability for contaminated sites* – The liability for contaminated sites standard provides guidance on how to account for and report a liability associated with the remediation of contaminated sites and is effective for fiscal years beginning on or after April 1, 2014. Management has advised no significant impact on future financial reporting is expected as a result of adopting this standard.

2.55 *Foreign currency translation and financial instruments* – The most significant change related to new standards for foreign currency translation and financial instruments is the requirement for a new financial statement, the statement of remeasurement gains and losses. This will include gains and losses from holding items denominated in a foreign currency at year-end, as well as certain other financial instruments. These sections are effective on April 1, 2015 for governments.

Audit of Government Agencies

Conclusions and summary of observations

We issued unqualified audit opinions for three of four audits we conducted in Government agencies for the year ended March 31, 2013. The audit opinion on Trust Funds Administered by the Public Trustee was qualified due to the inability to verify that all assets, or income related to these assets, that came under the Public Trustee's

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administration, were recorded by the Public Trustee. Asset verification was limited to recorded amounts. We recommended that the Public Trustee obtain an accounting system to support the administration of the $45 million in estates and trusts under that Office's control, and that the interest rate prescribed for common fund investment earnings be set to equal interest actually earned in that fund. We further recommended that the Public Trustee cease transferring excess interest from the special reserve fund to the Province each year. We recommended that the Nova Scotia Crop and Livestock Insurance Commission establish an audit committee and evaluate its current board members' financial expertise in order to determine whether additional non-Board members should be appointed to the new audit committee to fill any gaps in financial literacy. Additional internal controls are needed over the process to calculate insurance premiums and to issue insurance certificates. Processes over the preparation of year-end financial statements at the Nova Scotia Legal Aid Commission require improvement, including the process to estimate unbilled legal fees. Since the House of Assembly Management Commission has been re-established, we anticipate issuing our opinions on compliance and other matters under Section 22 and 23 of the House of Assembly Management Commission Act in due course.

2.56 *Introduction* – The Auditor General is the legislated financial statement auditor of the following four government agencies.

- Nova Scotia Provincial Lottery and Casino Corporation (formerly Nova Scotia Gaming Corporation)
- Nova Scotia Legal Aid Commission
- Nova Scotia Crop and Livestock Insurance Commission
- Trust Funds Administered by the Public Trustee

2.57 Audits of other government agencies are conducted by private sector auditors. The results of those audits and our comments on the recommendations made by their auditors are included in chapter 5 of this report.

2.58 In addition, the Auditor General was appointed auditor of the financial statements for the House of Assembly for the year ended March 31, 2013. As well as issuing an opinion on the financial statements, the Auditor General was also engaged to provide an opinion on the effective operation of internal controls, and the Chief Clerk's assessment thereof, and on compliance of expenses incurred with legislation and public service policies.

2.59 We also completed the fieldwork for a compliance audit under Section 23 of the House of Assembly Management Commission Act. This audit must be performed and completed at least once during every General Assembly. The Auditor General must express an opinion on whether there has been compliance with criteria specified in the Act such as that public monies have been fully accounted for, public money has been disbursed for the purposes for which it was authorized, and that accounts have been faithfully and accurately maintained.

2.60 *Audit results* – Unqualified audit opinions were issued in three of the four agencies we audited. The audit opinion of the Trust Funds Administered by the Public Trustee was qualified because it is not possible to verify that all assets, or income related to these assets, that came under the Public Trustee's administration, were recorded by the Public Trustee. Audit verification was therefore limited to assets recorded in the records.

2.61 When this chapter was written, none of the opinions related to our audits under the House of Assembly Management Commission Act had been issued. The audited financial statements of the House of Assembly must be approved by the House of Assembly Management Commission before being issued. The Commission has been re-established, and we anticipated our audit opinions and results to be issued in due course.

2.62 *Audit findings and observations* – We issue a letter to management or, if applicable, to the chair of the board or audit committee, in each of the agencies we audit which details our audit findings, observations, and recommendations for improvement. We seek input from management to ensure that recommendations can be implemented, and we follow up the implementation status of these recommendations during the subsequent year's audit. The following paragraphs describe the findings and observations from each audit as well as the recommendations made.

Nova Scotia Provincial Lotteries and Casino Corporation

2.63 We provided a management letter to the audit committee chair of the Nova Scotia Provincial Lotteries and Casino Corporation in July 2013, and reported that we found no significant errors or deficiencies during our audit. We suggested that consideration be given to appointing an independent member to the Board as all current members come from the Nova Scotia public service.

Nova Scotia Legal Aid Commission

2.64 We provided a management letter to the Audit Finance Committee of Nova Scotia Legal Aid Commission in September 2013 in which we noted difficulties we encountered while performing the audit.

2.65 *Transition to public sector accounting standards* – The Nova Scotia Legal Aid Commission was required to adopt generally accepted accounting principles for the public sector for the year ended March 31, 2013. This required adjustment to comparative balances so that the financial statements would reflect public sector accounting standards for all years presented on the financial statements. We understand the Commission consulted with an accounting firm which provided assistance on certain aspects of the transition, including the note disclosure required to explain the transition to public sector accounting standards. However, during our audit we discovered several deficiencies related to the presentation and disclosure of other sections of the financial statements.

2.66 Accounting standards are always subject to change and new or revised standards may be applicable in any given year. We recommended that Commission management should evaluate financial accounting issues against criteria in the Public Sector Accounting Handbook to assist in determining the proper accounting treatment and to ensure financial statement presentation and disclosure is accurate and in compliance with public sector accounting standards.

2.67 *Certificate liability* – The Commission issues a work order, or certificate, for each case undertaken by a private sector solicitor working for the Commission. We recommended that the Commission test the reasonableness of the system used to estimate its liability for legal services performed on these cases but not billed at year end. Although the Commission had previously conducted an overall review of the system, we recommended comparing the system estimate to actual costs to determine whether the system produced a reasonable estimate or whether changes were needed.

Nova Scotia Crop and Livestock Insurance Commission

2.68 We provided a management letter to the commission chair of the Nova Scotia Crop and Livestock Insurance Commission in November 2013. We identified several issues related to internal controls and the resulting errors in insurance premiums found during the audit.

2.69 *Audit committee* – We recommended that the Commission Board establish an audit committee to provide additional oversight of the financial reporting process and to ensure that our recommendations are being addressed. We recommended that the Board evaluate its current level of financial expertise and ensure the audit committee collectively possesses adequate financial literacy. Independent individuals who are not Board members should be appointed to the audit committee to address any deficiencies.

2.70 *Internal controls* – In each of the past three years, our management letters to the Commission Board have identified audit findings related to the calculation of insurance premiums and the preparation of the related insurance certificate. Again this year, we identified numerous errors when testing a sample of these certificates. This caused audit delays as each error needed to be evaluated to determine whether the error in our sample might exist in all certificates. We recommended that management determine the cause of the errors throughout the process of calculating premium revenues and issuing insurance premium certificates. Additional controls should be implemented to reduce the possibility of error and the Board should monitor progress in reducing errors.

Trust Funds Administered by the Public Trustee

2.71 We provided a management letter to the Public Trustee in December 2013 in which we noted issues related to the financial reporting system as well as the common fund and special reserve fund.

2.72 *Financial accounting system* – In a prior year's management letter and in our May 2012 Report of the Auditor General, we recommended that the Public Trustee obtain an accounting system. This is necessary for an entity administering over $45 million in estates and trusts, many of which have monthly activity. The output from the Public Trustee's client management system is used to produce financial information, but this system is not an accounting system. It does not include a general ledger or produce a trial balance.

2.73 The Public Trustee is considering the feasibility of amending the client management system to include the key components of an accounting system, such as a general ledger and trial balance. We have repeated our recommendation that there is immediate need for an accounting system, and have recommended that the Office's budget request for 2014-15 ask for funding to ensure the system is implemented.

2.74 *Common fund and special reserve fund* – The common fund serves as a general bank account for clients and is used for disbursements of estates as required. Excess funds are invested to earn interest. Interest earned is added to the fund and paid to clients at a prescribed rate. If market rates fall below the prescribed rate or if interest earned is greater than the prescribed rate, excess interest is transferred to the special reserve fund. The special reserve fund is intended to act as insurance to secure the balance in the common fund in the event that the common fund balance is insufficient to meet its obligations. The special reserve fund is used to purchase investments. Interest earned is transferred to Government at the discretion of the Public Trustee and the Deputy Minister of Finance and Treasury Board.

2.75 Over the past ten years, the common fund has grown from $2 million to $2.9 million (as at March 31, 2013), and over $1.2 million has been transferred from the common fund to the special reserve fund. Over the same period, the special reserve fund has grown from $1.5 million to $2.4 million and close to $0.9 million has been transferred from the special reserve fund to the Province.

2.76 At any point in time, the balance in the special reserve fund should reflect an amount required to meet deficiencies in the common fund. Given that the balance in the special reserve fund is increasing each year, and is now almost equal to the common fund, it is clear it has exceeded its intent as insurance to the common fund.

2.77 Further, the annual transfer from the common fund to the special reserve fund, and then to the Province of Nova Scotia, imposes an additional fee on those clients with investments in the common fund. There is no justification for this hidden fee. We are concerned by the lack of transparency of a process which results in certain clients not receiving full interest on their investments.

2.78 The following recommendations from our management letter address these issues.

- The interest rate prescribed for transactions of the common fund should be set by regulation at approximately the same rate as interest earned in the common fund. The rate should be reviewed on a regular basis.
- The Office of the Public Trustee should immediately cease payments from the special reserve fund to the Province.
- The administration fee of the Office of the Public Trustee should be reviewed to ensure it reflects the costs the Province wants to recover in providing the services of the Public Trustee.

3 Public Service Superannuation Plan

Summary

Two of the largest employers who contribute to the Public Service Superannuation Plan do not have any means by which to verify that pension benefits paid to retirees are accurate. We were unable to verify the accuracy of benefit payments at either the Province of Nova Scotia or Capital Health. We have recommended that the Provincial Public Service Commission and Capital Health ensure that appropriate support is available to allow subsequent verification of benefits. Support should be maintained until the pension is no longer being paid. We further recommended that the Public Service Commission establish controls to determine whether it has received and properly stored all retiree files from departments, and that Capital Health review and improve controls to ensure employment information is received and filed in employee files.

Recent changes to the Public Service Superannuation Plan's governance structure and funding strategies were made following stakeholder and consultant input. As a result of changes to the Plan, and limits in the Auditor General Act, the Office of the Auditor General is no longer able to conduct independent audits of any aspect of the Plan, including such matters as governance and investment performance of the Plan. We recommended that the new Board of Trustees undertake nonfinancial statement audits for the Plan. Auditors should be engaged and results reported directly to the Board or its Audit and Actuarial Committee.

The Nova Scotia Pension Services Corporation is responsible for administering the Public Service Superannuation Plan. The Corporation should prepare an operational risk assessment for the Plan to help ensure risks have been considered. In addition, the Plan's Statement of Investment Policies and Goals is noted as being confidential and we have recommended this Statement be made available to Plan members. We also recommended that the new Board of Trustees of the Plan establish the timing of a periodic review of the Plan's asset mix. We tested the Corporation's processes for monitoring investment performance and concluded these were adequate. We also found that the Corporation has adequate processes to hire investment managers and assess their performance on a regular basis.

3 Public Service Superannuation Plan

Background

3.1 The Public Service Superannuation Plan is a defined benefit pension plan which provides retirement benefits for individuals working in the Nova Scotia public sector. It is jointly funded with matching contributions from employees and employers. Employers in the Plan include the Province of Nova Scotia, district health authorities, and other agencies, boards and commissions.

3.2 As at December 31, 2012, the Plan provided benefits to 13,787 pensioners and survivors, and received contributions from 16,409 members.

3.3 The Plan's March 31, 2013 audited financial statements disclose a fair value of net assets available for benefits of $4.7 billion (March 31, 2012 – $4.4 billion). The accrued pension benefit obligation was $4.7 billion (2012 – $4.5 billion), leaving a funding surplus of $23 million (2012 – $171.8 million deficiency). Plan assets are composed of fixed income securities, real assets, equity investments, hedge funds and commodities.

Audit Objectives and Scope

3.4 In winter 2013, we completed a performance audit of the Public Service Superannuation Plan. We wanted to determine whether pension assets are adequately managed to meet Plan objectives and whether service accruing to current members and benefit payments made to retired members are accurate. The audit was conducted in accordance with Sections 18 and 21 of the Auditor General Act and auditing standards adopted by the Chartered Professional Accountants of Canada.

3.5 Our audit objectives were to determine whether:

- benefits paid have been calculated accurately;
- the pension system includes accurate information on current members;
- investment performance is monitored and reported on a regular basis;
- investment manager performance is monitored on a regular basis, including monitoring compliance with investment manager contracts; and
- changes to the Public Service Superannuation Plan were made as a result of due process.

3.6 Criteria were developed specifically for this engagement. Criteria related to investment and investment manager monitoring are similar to those used during our 2004 audit of the Plan. The objectives and criteria were discussed with, and considered appropriate by, senior management of the Nova Scotia Pension Services Corporation.

3.7 Our audit approach included interviews with management and staff of the Nova Scotia Pension Services Corporation, and testing of investment performance reports to source documents. In addition, we tested benefit payments and contributions for a sample of current contributors and retirees, and tested the processes to monitor investment managers' performance and compliance with contracts. We also examined documentation and meeting notes related to changes to the Plan. Our work covered the period January to December 2012.

3.8 On April 1, 2013, the Nova Scotia Pension Agency became the Nova Scotia Pension Services Corporation. We refer to the entity by its new name throughout this chapter.

Significant Audit Observations

Contributions and Benefits Testing

Conclusions and summary of observations

Two of the largest employers who contribute to the Public Service Superannuation Plan do not have any means by which to verify that pension benefits paid to retirees are accurate. We were only able to verify the accuracy of benefit payments for eight percent of retirees from Capital Health and the Province of Nova Scotia. We recommended that the Public Service Commission define how pay information is maintained in employee personnel records to ensure that information can be verified in the future. We also recommended that the Public Service Commission establish controls to determine whether it has received all retiree files from departments, and that files have been correctly labelled and sent to storage as required. And we recommended that Capital Health review and improve controls to ensure employment information is received and filed in employee files. Finally, we recommended that both the Public Service Commission and Capital Health revise their file retention policy to maintain retiree files as long as related pensions are being paid.

3.9 *Introduction* – The Nova Scotia Pension Services Corporation receives information from employers on current contributors and enters this into the pension administration system (PENFAX). PENFAX is intended to accurately record and store each plan member's employment history, including pension contributions, salary and service history, and to calculate the pension, and other information as required. Corporation management told us that it is the recipient

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of all information but is not responsible for its completeness and accuracy; that is the responsibility of the employer.

3.10 The Province pays pension benefits monthly and the Corporation is invoiced for these amounts.

3.11 *Reconciliations* – During each pay cycle, employers upload information to PENFAX on all new employees as well as any changes to current employees. The Corporation reconciles this information and ensures all discrepancies are cleared, providing explanations for any variances. The reconciliation confirms that PENFAX employee information is correct and ensures funds transferred from employers to the Corporation reconcile to the amount owing per PENFAX.

3.12 *Reconciliation testing* – We examined uploads from six employers to determine whether discrepancies were cleared with sufficient support. We also tested ten reconciliations to determine if employer contributions agreed to PENFAX anticipated contributions.

- All samples had adequate documentation to clear PENFAX-generated errors and warnings.
- All samples had adequate documentation to explain variances between employer contributions and PENFAX-anticipated contributions.

3.13 *Benefits* – The Public Service Superannuation Plan Regulations calculate retirement benefits as two percent of an individual's years of service multiplied by the individual's five years of highest salary. An individual who partakes in the Plan cannot collect pension benefits before age 50 if employment started prior to April 6, 2010, or age 55 if employment began on or after April 6, 2010. In some cases, an employee may obtain the required years of service before reaching the specified age; in those instances, the employee would not qualify for an unreduced pension.

3.14 *Benefits testing* – We selected a sample of 60 benefit recipients from August, 2012. Our testing objective was two-fold:

- to determine whether benefit payments were accurate based on information in the PENFAX system; and
- to determine whether information in PENFAX was accurate based on the retiree's salary and service history, and any other relevant factors used to determine the amount paid.

3.15 We extracted information from PENFAX on the salary and service history for each of our sample items and determined what the pension should be based on the Public Service Superannuation Plan Regulations. We also applied the appropriate indexing factor. Each amount was then compared to what was paid in August 2012. We concluded that all payments were accurate.

3.16 We then attempted to verify the accuracy of the information in PENFAX for our sample items.

- Thirty-six items were from government departments and we could not verify benefit payments for any sample items.
- Twelve items were from Capital Health and we were able to verify benefit payments for one individual.
- One item was from Nova Scotia Business Inc. and 2 items were from the Nova Scotia Liquor Corporation. We were able to verify these three sample items from retirees' paper files at either organization.

3.17 The remaining nine of 60 sample items related to retirees from entities outside the consolidated group. We anticipated there would be difficulties in verifying information for these individuals (for example, in one instance, the entity no longer exists) and we considered selecting an additional nine sample items from the consolidated entity. However, because we had already encountered significant difficulties in attempting to verify information in retiree files tested, as noted above, we concluded it was inefficient to select an additional nine items as we had already concluded we could not achieve our audit objective.

3.18 In total, we were able to verify benefit payments for four of 51 sample items, or eight percent, because information was unavailable or incomplete. It is not possible to conclude on our audit objective. Lack of information to verify the accuracy of benefit payments results in a scope limitation in our audit.

3.19 *Testing at government departments* – We were unable to verify benefit payments for any of the sample items related to government departments. Of the 36 sample items, employee files could be located for only 19 retirees. None of these paper files contained sufficient information to verify that the salary details in PENFAX used to calculate pension benefit payments were complete and accurate.

3.20 We requested paper files from the Public Service Commission for each of our sample items. According to the government's employee personnel record policy, there should be a paper file for all retired employees with information on such matters as performance appraisals, disciplinary measures and long-term disability benefits. These files are to be stored for 60 years. As noted, only 19 files could be located.

3.21 The paper file should also include hard copy of employee pay records created prior to April 1990. Four of the individuals in our sample began working with the Province and retired before this date. In each instance, there should have been a paper file containing pay information for the entire length of employment with the Province. Paper files could not be located for any of these individuals.

3.22 Twenty-eight individuals began work prior to April 1990 but retired subsequent to this date. Each of these individuals should have had a paper file with the required master record information, but the Commission was only able to locate 18 of these files. However, because the policy allows pay records subsequent to April 1990 to be captured in the Province's human resources IT system once an individual has retired from, or is no longer employed with, the Province, there was no support in these files for pay subsequent to April 1990. We could not verify that the information in PENFAX represented the individuals' highest salaries for benefit calculation purposes.

3.23 Four of the 36 individuals started work with the Province subsequent to April 1990. Although these individuals pay records should be captured in the Province's human resources or general ledger system, each individual should also have had a stored paper file containing master record information. Only one file could be located. Since all pay information is only stored electronically subsequent to retirement or employment, there was no support in the file for the information in PENFAX.

3.24 The lack of historical salary information is a serious deficiency. Information should be available for retirees to verify that their benefits are accurate. In addition to the lack of files for 17 of our 36 sample items (47%), the Public Service Commission's policy allows for electronic records only for pay information subsequent to April 1990. However there is no requirement to indicate in the master record whether the pay information in government's human resources system has been verified. Pay information has not been scanned and maintained meaning there is nothing to support that the pay information on which pension benefits are calculated is accurate.

3.25 *Capital Health testing* – The inability to verify benefit payments at Capital Health is equally concerning. We were only able to verify one sample item from our testing. Capital Health's current retention policy has been in place since 2007 and specifies what is to be maintained in a retired employee's file. Management told us that there was no official Capital Health document retention policy prior to 2007.

3.26 Four of the 12 sample items at Capital Health related to individuals who retired prior to 1989, before the creation of Capital Health. We were informed that the personnel files of the legacy hospitals had been destroyed. Four of the retirees we selected for sample testing retired between 1989 and 2007. Four paper files were located, although none contained sufficient information to enable us to determine that the benefit payments were accurate.

3.27 Paper files were available for the remaining four individuals in our sample. However, only one file, or 8% of our sample, contained sufficient information to allow us to determine that benefit payments were accurate.

3.28 *Records management* – We did not conduct an audit of records management or retention policies. However, staff in the Province's Corporate Information

Management Program Office gave us an overview of these policies. Records management and retention policies are either administrative policies that apply to all departments (referred to as STAR), or records management and retention policies which apply to each department based on its business needs (STOR policies).

3.29 While individuals work for the Province of Nova Scotia, employee personnel records fall under the STAR policy. While an individual works for the Province, pay information is maintained in hard copy in the respective department. However, once an individual is no longer employed, their file is sent to the Public Service Commission and separated to be filed under the Public Service Commission's STOR policy. Certain information from the employee master record must be maintained in hard copy, but pay-related information is destroyed and subsequently only available in summary form in the Province's electronic pay records. Therefore, adequate support is not retained for pay information to facilitate verification once an individual retires. The current policy provides that pay information forming part of the employee master record (a sub-record of the employee personnel record) is to be stored electronically in the Province's general ledger and human resources system once the individual retires or no longer works for the Province.

3.30 This STOR policy needs to be reviewed to ensure it meets the future needs of retirees. There are only two ways to allow retirees to verify benefit calculations – either maintain a paper record, or scan paper records and keep electronic copies which would then allow hard copies to be destroyed.

3.31 The Province's STOR policy should be revised so that pay information can be verified by employees once they have retired. Pay records should be maintained to ensure verifiable information is stored to recalculate pensions paid.

Recommendation 3.1
The Public Service Commission, working with the Province's Corporate Records Management Group, should define how pay information is maintained in employee personnel records once they retire or no longer work for the Province to ensure there is appropriate support to recalculate pension benefit payments in the future. This revised STOR policy should be communicated to, and implemented by, all departments.

Public Service Commission Response:
The Department agrees with the recommendation. The Public Service Commission will review its current practices and work with the Department of Finance's Payroll Client Relations group, to clarify the roles and responsibilities regarding the maintenance of pay information in employee personnel records and amend its STOR policy appropriately.

3.32 When an individual retires, the separated employee master record discussed above along with a summary form listing what had been in the main personnel record, is to be kept for 60 years. It is evident that the existing policy is not being followed. Paper files could only be located for 53% (19 of 36) of our sample items. Controls need to be established within the Public Service Commission to strengthen implementation of this policy.

3.33 Once an individual starts receiving a pension, the last department with the employee master record is required to send it to the Commission. The Commission could determine that it has received the retiree files by working with the Nova Scotia Pension Services Corporation to obtain a list of new retirees. This could be compared to files received from departments to ensure information is complete. Once the files have been received, the Commission must ensure they are sent intact to storage. A control should be established to ensure there is a complete list of records sent for storage.

Recommendation 3.2
The Public Service Commission should establish controls to determine it has received all retiree files from departments, and that they have been correctly labelled and sent to storage as required.

Public Service Commission Response:
The Department agrees that existing controls are not sufficient. The Public Service Commission will take steps to review and improve current controls regarding the transfer of all retiree personnel files from HRU's to the PSC central registry, their content, labelling and storage in accordance with the department's STOR.

3.34 Further, we have concerns about the length of time employee records are to be held by the Commission. While pensions are being paid, either to members, spouses or dependents, the benefit paid should be verifiable. The Public Service Commission has determined its retention policy for employee master files is 60 years. The criterion should not be a number of years but rather whether the pension is still being paid. We believe a process could be established with the Pension Services Corporation to notify the Commission when a pension is no longer paid.

Recommendation 3.3
The Public Service Commission should revise its file retention policy for retiree files to ensure files are maintained until pensions are no longer paid.

Public Service Commission Response:
The Department neither agrees nor disagrees with this recommendation. The Public Service Commission will work with the Pension Services Corporation to determine the efficacy of changing its current practice regarding the retention of Employee Master Records in light of this recommendation.

3.35 We have similar concerns with respect to the records management policy related to personnel records at Capital Health. The human resources and benefits divisions receive employment information and supporting documentation, and file these in employment records as employment events occur. These files are maintained in accordance with the Employment Information on Record Policy.

3.36 We reviewed the policy and concluded that, if followed, there should be sufficient information in retiree files to confirm their benefit payments at a later date. However, we were only able to verify one of four benefit payments during our testing for retirees whose files were maintained under this policy.

Recommendation 3.4
Capital Health should review and improve controls to ensure information to be included in employee records is received and maintained.

Capital Health Response:
Capital Health agrees with this recommendation and will review its current processes for obtaining information on employment events and filing these in employee records.

3.37 Appendix A of the policy specifies information to include in employee records. The policy notes that information is to be maintained in paper and electronic format. We discussed with management that the policy should be clarified to indicate that information that originates in paper format should be maintained in hard copy until pensions are no longer being paid. Capital Health management agreed with this clarification.

3.38 Further, the current policy provides that sensitive information related to employee medical leave be maintained in central human resources records storage at Capital Health. Management agreed that it would be efficient to cross-reference this information to the applicable employee record. This would facilitate verification of such leave at a later date.

3.39 The current retention schedule at Capital Health is 35 years. Thirty-five years may not be adequate for an individual who leaves the employ of Capital Health. For example, an individual who worked with Capital Health from age 25 to 35 will likely still be collecting benefits at age 70, but no record of employment will be kept past this age. This limits the timeframe a pensioner can verify their benefits.

Recommendation 3.5
Capital Health should revise its file retention policy for retiree files to ensure files are maintained until pensions are no longer paid.

Capital Health Response:
Capital Health agrees with this recommendation and intends to implement it. Capital Health will amend its policy to identify those employees terminating due to retirement and will maintain their files until such time that their pension is no longer in payment. On a go-forward basis, these files will be held offsite and will be divided into retirements, deaths and terminations until such time as these files can be scanned and maintained electronically and no longer in paper versions.

3.40 *Current contributors* – We selected 60 current contributors from the Province's payroll module for November 17, 2012. We compared information in PENFAX to each employee's master file maintained by their employer. We verified the employee's date of birth, employment start date, full-time or part-time status, and other relevant information to supporting records. We did not find any errors in our sample.

3.41 *Pension statement testing* – The Corporation provides Plan members with an annual statement which includes information such as employment start date and years of service. For the 60 current contributors we tested, we compared the information contained in the annual pension statement to information held in PENFAX and in employer files. No discrepancies were noted.

3.42 In addition, we recalculated the years of service to date, the earliest reduced pension retirement date, and earliest unreduced pension retirement date to ensure that information regarding when an employee could retire with reduced and full pension was accurate.

- In 58 of 60 samples, we were able to accurately recalculate the years of service to date, the earliest reduced pension retirement date, and the earliest unreduced pension retirement date
- Two of the 60 employees in our sample started work with the Province after January 1, 2011 and accordingly, had not received an annual statement at the time we completed our work.

Changes to the Public Service Superannuation Plan

Conclusions and summary of observations

Recent changes made to the Public Service Superannuation Plan were as a result of due process. A working group was established which provided input to the former Minster of Finance, as sole trustee of the Plan, on changes in governance and funding strategies. As a result of changes to the Plan, and limits in the Auditor General Act, this Office is no longer able to conduct independent audits of such matters as governance and investment performance of the Plan. We have recommended that the new Board of Trustees undertake nonfinancial statement audits for the Plan. Auditors should be engaged and results reported directly to the Board or its Audit and Actuarial Committee.

3.43 *Introduction* – Prior to April 1, 2013, the Minister of Finance was the sole trustee of the Plan. On April 1, 2013 the Minister of Finance transferred responsibility for the Plan to the Public Service Superannuation Plan Trustee Inc., moving the Plan from sole trusteeship to joint trusteeship. Joint trusteeship was established by an appointed board consisting of equal employee and employer members. In addition to this change in governance, the Province removed its guarantee of the Plan.

3.44 The board has the power to designate an administrator which runs the day-to-day operations of the Plan. The designated administer is the Nova Scotia Pension Services Corporation, formerly the Nova Scotia Pension Agency.

3.45 In Chapter 2 of our February 2013 Report of the Auditor General, we provided detailed observations on enacted and proposed changes to the Public Service Superannuation Plan, including the following.

- The removal of the Province's guarantee significantly shifts the risks of the Plan from the Province to the members of the Plan and this should have been adequately communicated.
- The accounting implications of the changes in the Plan structure should have been discussed with the Department of Finance's Government Accounting Division.
- It is inaccurate to describe the removal of indexing of Plan benefits as other than a reduction in benefits.
- We are concerned that the revised governance structure (as of April 1, 2013) includes only one retired member on the new board of trustees.

3.46 We recommended that the Minister of Finance directly communicate all significant proposed changes to the Plan to its members. In its response, the Department of Finance told us that it disagreed with our recommendation. Department management noted that they believed such changes had been sufficiently communicated.

3.47 *Working group* – A working group was established in the summer and fall of 2010 to provide input to the Minister of Finance, as sole trustee of the Plan, on changes to be made. The group consisted of nine members including:

- a representative from each of the Nova Scotia Government and General Employees Union, the Canadian Union of Public Employees, and the Nova Scotia Government Retired Employees Association;
- government representatives, including an individual who represented the interests of nonunionized provincial employees;
- senior management of the Nova Scotia Pension Services Corporation; and

- a consultant hired by government, through a competitive process, to provide input on governance practices in Canadian public sector pension plans.

3.48 Stakeholders were asked to put forward their representatives for the group. The Public Service Commission was not considered a stakeholder despite the potential impact of Plan changes on recruitment and retention in the civil service. We were informed various aspects of the working group deliberations were discussed with senior staff at the Commission, but there is no documentation to support this.

3.49 There were no terms of reference for the working group. However, meeting minutes indicate members were told that the Minister of Finance wanted the group to provide input to changes to the Plan, but that all decisions would be made by the Minister as sole trustee.

3.50 There were communications with the Minister regarding the group's progress, some of which was documented in memos. Meetings were held periodically between the Minister, the consultant and senior management of the Corporation. The results of these minutes were communicated to the working group and documented in the meeting minutes.

3.51 Corporation senior management indicated that the working group provided recommendations to the Minister of Finance on two significant changes to the Public Service Superannuation Plan – governance structure and a revised funding formula.

3.52 *Governance structure* – Working group meeting minutes indicate there was considerable discussion regarding the structure of the new board of trustees. The prospect of joint trusteeship had been established by 2010 Plan amendments but the specific composition of the board had not been determined.

3.53 The consultant provided information to the group on the governance structure in 14 Canadian public sector pension plans. The group discussed various governance models, including whether there should be representation from retired members and whether the board should include someone to represent the interests of nonunionized employees who represent about 20% of the current civil service.

3.54 The consultant reported back to the group that, after discussions with the Minister, the government, as employer, must be allocated 50% of the trustee seats, and that nonunionized employees must have one seat (to be allocated from the employees' representation).

3.55 Ultimately, a newly created body known as the Public Service Superannuation Plan Trustee Inc. assumed responsibility for the Plan when they were appointed as the trustee to replace the Minister of Finance as sole trustee on April 1, 2013.

3.56 The Trustee's board is composed of directors representing employers, employees, and retirees.

- Three directors as designated by the Nova Scotia Government and General Employees Union
- One director as designated by the Canadian Union of Public Employees Local 1867
- One director representing non-unionized employees
- One director representing retirees
- Six directors as designated by the government

3.57 An independent chair has been appointed by the board of directors. An appeals committee chair has been appointed and additional committee members will be appointed each time an appeal is to be considered.

3.58 *Funding formula* – Minutes from the working group meetings reflect discussions held with the Minister, including the following comments about the nature and extent of the funding formula which now forms part of the Plan.

- The Minister wanted the funding formula to be established in legislation to the extent possible. This would take much of the decision-making out of the hands of the Board of Trustees.
- Changes to the Plan are meant to establish its long-term sustainability.
- The future liability to the Province is to be minimized.

3.59 The consultant provided the funding targets and related action plans that are now included in the Public Sector Superannuation Plan Act. There is still room for decision-making by the Board of Trustees with respect to the range of possible contribution rate and benefit changes. To the extent guidelines can be developed to assist in future changes, such as a range of contribution increases given a particular funding level, these should be established by the new Board.

3.60 *Process for Plan changes* – Changes made to the Public Service Superannuation Plan were the result of an established process which met its objective.

3.61 *Future audit of the Plan* – Section 50(2) of the Public Service Superannuation Act states:

> *"Where a replacement Trustee is appointed ... and, notwithstanding the Auditor General Act or any other enactment, the Trustee shall annually appoint an auditor who shall audit the accounts and investments of the Superannuation Fund..."*

3.62 The Auditor General Act specifically excludes trust funds which are subject to joint trusteeship. Therefore, as of April 1, 2013, this Office can no longer audit any aspect of the Public Service Superannuation Plan.

3.63 The annual financial statement audit will provide assurance on the fair presentation of the assets and liabilities of the Fund. However, the new Board of Trustees should develop processes to provide for future audits of operations, including investment performance, and governance. This would assist the Board in fulfilling its responsibilities by identifying processes that require improvement. These audits would also provide further assurance to Plan members that their investments are well-managed and that their future benefits are secured.

3.64 There are many ways in which the Board could obtain additional audit services. The Plan's financial statement auditors could be asked to expand their annual audit processes to include compliance testing. Other private sector auditors could be engaged to perform these audits. Alternatively, the Board may wish to establish an internal audit function to provide such assurances. Auditors should be engaged through the Board's Audit and Actuarial Committee and audit results should be reported directly to this Committee or the Board. This helps to ensure audit processes remain independent of management, and also facilitates the Committee's oversight of timely implementation of audit recommendations by management.

Recommendation 3.6
The Public Service Superannuation Plan Trustee Inc. should develop a process to undertake nonfinancial statement audits for the Plan. Auditors should be engaged and results reported directly to the Board or its Audit and Actuarial Committee.

Public Service Superannuation Plan Trustee Inc. Response:
The Public Service Superannuation Plan Trustee Inc. accepts Recommendation 3.6 and has received a commitment from the Nova Scotia Pension Services Corporation to have a Controls Audit performed on the Corporation's operations by an external party. Implementation shall be completed by March 31, 2016.

However, The Compliance Officer, as detailed in the Compliance Monitoring Manual, is responsible for the internal audit of operations as well as the audit of the internal policies and procedures. In addition, on April 1, 2013, an Audit, Actuarial & Risk Committee derived from members of the new PSSPTI board was implemented. The Compliance Officer has a direct reporting line to the Audit, Actuarial & Risk Committee. On a minimum basis, the Compliance Officer meets with the Committee quarterly.

Investment Performance

Conclusions and summary of observations

The Nova Scotia Pension Services Corporation needs to prepare an operational risk assessment for the Public Service Superannuation Plan. The Corporation should use the assessment results to ensure its policies and procedures provide controls to mitigate identified risks. The investment philosophy and risks are detailed in the Plan's Statement of Investment Policies and Goals but the Board of Trustees considers the Statement to be confidential. We have recommended that this information be made available to Plan members. We have further recommended that the timing of a periodic review of the Plan's asset mix, included in this Statement, be established by the new Board. We tested the Corporation's processes for monitoring investment performance and concluded these were adequate. We found the Corporation has adequate processes to hire investment managers and assess their performance on a regular basis.

3.65 *Risk assessment* – The most significant risk of any defined benefit pension plan is whether there are sufficient resources to meet the obligations of the plan. This risk is mitigated through adequate contributions, and investment strategies that serve to optimize risk and return over the life of the plan.

3.66 Investments that yield high returns may carry an unacceptably high risk. The Plan's Statement of Investment Policies and Goals documents its investment risk tolerances. This Statement contains information on the parameters used to manage the Fund and provides guidance to the Corporation, and to external parties who may provide services to the Fund. The Statement includes the approved asset mix, as well as an acceptable variance from those ratios. It also identifies key risks to the Plan such as market risk, interest rate risk, and credit risk. The Statement notes that these risks are mitigated through investment policies, including the asset mix, and operational policies and procedures, including internal controls.

3.67 The Corporation has a Risk and Compliance Manual. It includes a schedule of identified controls which are to be tested for compliance with Corporation policies and procedures. Corporation management noted that the Manual was the result of a risk assessment process; however, there is no documented risk assessment.

3.68 A risk assessment is a process to evaluate possible risks that could impact on achieving an organization's goals and objectives. These risks could be external to the entity and beyond its control, such as economic downturns. Risks could also be internal risks such as having an inadequate succession plan if key personnel leave the organization. In order to manage risks, they must be identified and evaluated.

3.69 There should be a documented risk assessment to support the operations of the Pension Services Corporation in administering the Public Service Superannuation Plan. In addition, the newly-established Board may have different views of risk than the Minister did as sole trustee. We provided the Corporation with our finding on this matter and they informed us that they intend to enhance the compliance program by performing a risk assessment by June 30, 2014. The risk assessment should be the source of information for the compliance manual, not a byproduct of it. Management told us that they plan to revise the compliance program after the risk assessment has been completed.

Recommendation 3.7
The Nova Scotia Pension Services Corporation should conduct a risk assessment and map the results to existing policies and procedures. Any gaps should be addressed with new or revised policies and procedures. The Risk and Compliance Manual and its related monitoring program should be updated.

Nova Scotia Pension Services Corporation Response:
Nova Scotia Pension Services Corporation accepts Recommendation 3.7 and intends to complete a risk assessment and subsequently update the current Risk and Compliance Manual. Completion date shall be June 30, 2014.

The current Risk and Compliance Manual documents the risks and the procedures in place to mitigate them. The limits and tolerances for risks are identified in internal policies and procedures. The Compliance Program is designed to ensure that these policies and procedures are being followed. The Compliance Program is re-evaluated on an on-going basis. In addition, a strategic risk assessment of Nova Scotia Pension Services Corporation's enterprise risks is carried out no less than quarterly by the Enterprise Risk Committee. The Committee takes a risk based approach to mitigating the strategic and operational risks faced by the corporation.

3.70 *Asset mix* – The Plan consists of investments in fixed income and real estate, infrastructure, equities, commodities and hedge funds. The asset mix was approved by the then Minister of Finance in October 2010 as part of the approval of a revised Statement of Investment Policies and Goals.

3.71 The approved mix resulted from an independent asset allocation study prepared by a consultant engaged by the Corporation in fall 2010. The consultant's recommended mix was confirmed through the Corporation's internal analysis as well as a second consultant.

3.72 The historical asset mix was a more traditional combination of fixed income and equity holdings. This changed in 2007 with the introduction of a new inflation-linked asset class (an example of which is real estate). That change was intended to help improve the match between the Plan's liabilities and assets.

3.73 More recently, further changes to the asset mix were considered necessary to address two factors: market declines in 2008-09; and Plan changes in 2010. A memo from senior staff of the Pension Services Corporation to the Minister dated October 20, 2010 which recommends the revised asset mix notes *"The objective*

...is to establish a new asset mix that will reduce the Fund's exposure to equities and thereby reduce the expected volatility of investment performance without diminishing expected returns."

3.74 Our audit objective was to assess whether the revised mix was the result of a reasonable process. We did not assess the appropriateness of the approved asset mix. Senior management at the Corporation noted that the move to the new asset mix will take place over time; this is anticipated to take a few years.

3.75 The Corporation has an internal Asset Allocation Committee that meets biweekly and whose purpose is to review the current asset mix and consider whether action is needed to bring the assets more in line with the approved mix. The Committee may choose to leave the mix and allow the assets to balance over time, or the Committee may recommend that action be taken to rebalance the mix. However, the terms of reference do not include a timeframe for review of the approved asset mix. Periodic review would help ensure that the approved mix continues to enable the Plan to meet its objectives.

Recommendation 3.8
The Public Service Superannuation Plan Trustee Inc. should establish timeframes for the review and update of the Plan's asset mix to ensure it continues to meet Plan objectives.

Public Service Superannuation Plan Trustee Inc. Response:
The Public Service Superannuation Plan Trustee Inc. agrees with and has already implemented Recommendation 3.8. The Statement of Investment Policies and Goals, approved by the Trustee April 1, 2013 stipulates the periods of time for strategic reviews of the Fund's policy asset mix.

3.76 *Reporting investment performance* – The Corporation prepares a quarterly investment report for Plan members and provides this information through its website. An annual report is also prepared which includes the Plan's audited financial statements. Although our audit objectives did not consider the quality of information provided to members and other users, we identified a reporting issue during our work which we consider necessary to report.

3.77 Each of the quarterly and annual reports includes information on investment performance. Summary comments on market performance and issues are noted in the quarterly report. Detailed and comparative information on investment performance is included in the annual report, as well as details of the Plan's funded status and membership.

3.78 The revised asset mix was included in the Plan's annual report for the years ended March 31, 2011 and March 31, 2012. However, the asset mix reported in the March 31, 2013 annual report is the actual mix as of that date (and as reported in the audited financial statements). There is no information on the approved asset mix, and therefore members and users were unable to compare actual results to the approved asset mix.

3.79 Further, neither the annual report nor the Corporation's website includes the Statement of Investment Policies and Goals. We reviewed the document as part of our audit and noted that it is marked as confidential. The Plan's March 31, 2013 annual report notes:

> *"The [Statement of Investment Policies and Goals] sets out the parameters within which the investments may be made. These parameters include permissible investments and the policy asset mix of the four main asset classes ... The Investment Beliefs ... state the general principles upon which the investments are made."*

3.80 Two significant public sector pension plans – the Ontario Teachers' Pension Plan and the Canada Pension Plan – disclose their targeted asset mix on their websites. Since the Statement provides valuable information on the Plan's risk management practices and on the Corporation which administers the Plan, the Statement should be provided to members. It serves as both a governance and accountability document.

Recommendation 3.9
The Public Service Superannuation Plan Trustee Inc. should make its Statement of Investment Policies and Goals, including the approved asset mix and permissible investments, available to current and retired members of the Public Service Superannuation Plan.

Public Service Superannuation Plan Trustee Inc. Response:
The Public Service Superannuation Plan Trustee Inc. agrees with and intends to implement Recommendation 3.9 by making available the Statement of Investment Policies and Goals on the Plan's website. Implementation shall be completed by March 31, 2014.

However, the approved targeted asset mix was published in the 2011 and 2012 annual reports of the Public Service Superannuation Plan.

3.81 *Monitoring investment performance* – The Nova Scotia Pension Services Corporation has contracts with numerous external investment managers who are responsible for investing, or providing advice on investments, in a particular asset class. Each contract usually specifies the type of asset for which the manager is responsible (for example, Canadian equity or fixed income) and a benchmark against which the manager's performance will be measured (for example, the TSX). We discuss investment manager contracts in greater detail later in this chapter.

3.82 The Corporation has monthly and quarterly procedures to monitor investment performance and report results. Each of these procedures is included in the Investment Policies Manual. There are timeframes in which procedures are to be completed, and a review and approval process for monthly and quarterly reporting. The procedures also specify acceptable deviations when differences occur during certain reconciliation processes.

3.83 We tested compliance with monthly and quarterly procedures for monitoring investment performance for June and September 2012 and found procedures were followed. We identified areas for improvement such as the need to update procedures to reflect that tolerable deviation thresholds vary by asset class as opposed to one overall threshold, and that the procedures in the manual should be accessible to staff in read-only format. Management has indicated improvements will be made by June 30, 2014, and has assigned responsibility for the tasks.

3.84 *Investment manager selection* – The Corporation has an investment manager search and selection procedure in its Investment Procedures Manual. This provides guidance in selecting an investment manager including developing a list of candidates; preparing a request for proposals; and generating a short list of managers. These managers are then subject to further due diligence.

3.85 This due diligence includes collecting background information on the investment manager including its compliance processes, code of conduct, operational information such as risk management and insurance details. Corporation senior management conduct conference calls and onsite visits which they told us provide a better sense of the manager's strategy and fit with the Corporation.

3.86 We reviewed the documentation supporting the hiring process for one investment manager and noted that the information required by the procedures had been collected through conference calls and onsite visits.

3.87 Contracts with investment managers follow a standard format. Terms may be modified as negotiations with the managers proceed. The template covers such basics as reporting requirements, duty of care, termination, and privacy and confidentiality. Contracts also include the mandate of the investment manager and the benchmark against which the manager's performance will be measured. Previously, contracts were signed by the Minister of Finance as sole trustee of the Plan.

3.88 The Corporation's manual requires that agreements be reviewed annually but this has not been done. When a new agreement is signed with terms that differ from the template, existing contracts may be reviewed to assess whether changes are required. Management has indicated they will revise the procedure to reflect the current practice.

3.89 *Investment manager monitoring* – The Corporation has developed portfolio compliance and monitoring procedures for investment managers, including the commodities' advisor; hedge funds; and real assets.

3.90 Procedures differ for each type of investment. Investment managers who are responsible for managing more traditional investments such as equities and fixed income instruments are subject to monthly, quarterly, annual and biennial procedures. For example, quarterly procedures include receipt of manager's quarterly performance report, and quarterly compliance attestation. If there are concerns that a manager is not meeting performance targets, that manager may be placed on a watch list. There are different procedures for hedge funds; several procedures focus on the monitoring performed by the Corporation's Hedge Fund Committee which meets monthly. Regular conference calls are held with the hedge fund advisor and an annual call or site visit is also held with individual hedge fund managers.

3.91 We concluded that the Corporation has adequate processes to monitor investment managers' and advisor's performance. We tested the monitoring program for each asset class by selecting one or more investment managers or advisors within each class and comparing procedures performed to required procedures. We noted that there was no documentation to support that monthly and quarterly conference calls were held with the hedge fund advisor or the commodities investment managers. However, staff indicated the customized performance reports provided by these investment managers or advisors address several of the required topics (review of individual hedge fund managers; and firm updates, changes in assets, changes in key personnel, etc, for commodity investment managers). We agree additional documentation is not required in these instances.

4 Indicators of Financial Condition

Summary

The consolidated financial statements provide a snapshot of the Province's financial position at its fiscal year end and the results of its operations, and changes in both cash flow and net debt for the preceding fiscal year. For the past four years, this Office has provided information on certain indicators of financial condition not included in the consolidated financial statements including comparative indicators for other provinces and territories. Several of these demonstrate the Province's financial sustainability, flexibility, and vulnerability, and are recommended for reporting in the Public Sector Accounting Board's *Statement of Recommended Practice 4: Indicators of Financial Condition*.

The indicators selected are for information purposes only. There was no significant change in nine of the 17 indicators we analyzed. There were changes in budget to actual variances in both operating results and capital expenditures.

The estimated deficit of $211.2 million for the year ended March 31, 2013 increased by 43.2% to $302.5 million. Lower than anticipated federal transfers were offset by increased Provincial source revenue. This was reduced by increased expenditures, especially in the Department of Health and Wellness. In addition, the net debt of the Province at March 31, 2013 increased from an estimate of $13.7 billion to an actual balance of $13.9 billion – a 5.3% increase. The Province's net long term debt also increased from $12.7 billion at March 31, 2012 to $12.9 billion at March 31, 2013.

We examined estimated and actual capital asset expenditures by department. Capital expenditures in each of the Departments of Education, Health and Wellness, and Transportation and Infrastructure Renewal were under budget by an average of 15.5 %. The Department of Natural Resources' capital expenditures exceeded budget by 2100%.

Net debt per capita continues to increase and remains the second-highest of all jurisdictions we compared. It increased from $14,161 in 2012 to $14,832 in 2013. We examined several other sustainability indicators in addition to net debt per capita and observed that four of the ten indicators had an unfavourable variance between 2012 and 2013.

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 four 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 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 2009 to 2013 for all provinces except for Newfoundland and Labrador and Prince Edward Island which have not yet released public accounts for the year ended March 31, 2013.

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 sustainability, flexibility and vulnerability 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, 2013.

Summary of Financial Indicators

Type	Indicator	One-year Trend	Five-year Trend	Page #
Financial Performance	Budget-to-actual Variance	Unfavourable	A five-year trend is not applicable because the purpose of these indicators is to compare current year to the prior year.	52
Financial Performance	Capital Expenditures Variance	Unfavourable		54
Financial Performance	Actual-to-actual Variance	N/A		52
Financial Performance	Expenses by Department or type as a Percentage of Total Expenses	The trend differs by department	The trend differs by department.	53
Sustainability	Long-term Debt	Unfavourable	Unfavourable	55
Sustainability	Net Debt	Unfavourable	Unfavourable	55
Sustainability	Net Debt Per Capita	Unfavourable	Unfavourable	56
Sustainability	Net Debt as a Percentage of Total Revenues	Stable	Unfavourable	57
Sustainability	Annual Surplus or Deficit	Unfavourable	Unfavourable	58
Sustainability	Assets-to-liabilities Ratio	Stable	Favourable	59
Sustainability	Financial Assets-to-liabilities Ratio	Stable	Stable	60
Sustainability	Net Debt as a Percentage of Provincial GDP	Stable	Unfavourable	61
Sustainability	Accumulated Deficit as a Percentage of Provincial GDP	Stable	Stable	61
Sustainability	Total Expenses as a Percentage of Provincial GDP	Stable	Unfavourable	62
Flexibility	Debt Servicing Costs as a Percentage of Total Revenues	Stable	Stable	63
Flexibility	Net Book Value of Tangible Capital Assets as a Percentage of Costs of Capital Assets	Stable	Unfavourable	64
Vulnerability	Federal Government Transfers as a Percentage of Total Revenues	Stable	Unfavourable	65

Favourable/Unfavourable – theoretical concept due to nature and direction of indicator, not a comment on performance

N/A – increase or decrease of this indicator is not considered indicative of either favourable or unfavourable.

Stable – a change of 1% or less

Financial Performance 2012-13

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, 2013, the Province of Nova Scotia estimated a deficit of $211.2 million. The actual deficit was $302.5 million, an unfavourable variance of $91.3 million. The following table provides an overview of the variance by significant financial element that contributed to this negative result.

Budget-to-actual Variance ($ millions)			
Element	**2012-13 Estimate**	**2012-13 Actual**	**Variance**
Provincial Source Revenue	$6,272.1	$6,487.0	$214.9
Federal Source Revenue	$3,325.2	3,262.8	(62.4)
Expenses	($10,159.5)	($10,404.4)	($244.9)
Government Business Enterprises (Net Income)	$351.0	$352.1	$1.1
Deficit	($211.2)	($302.5)	($91.3)

4.6 There was a $214.9 million increase in Provincial source revenue, and a $244.9 million increase in the Province's expenses, resulting in a negative variance of $30 million, or approximately one-third of the increased deficit.

4.7 The other two-thirds of the deficit increase is attributable to a decrease in federal-source revenue, a source which cannot be directly controlled by the Province. The Province's vulnerability to this source of revenue is discussed later.

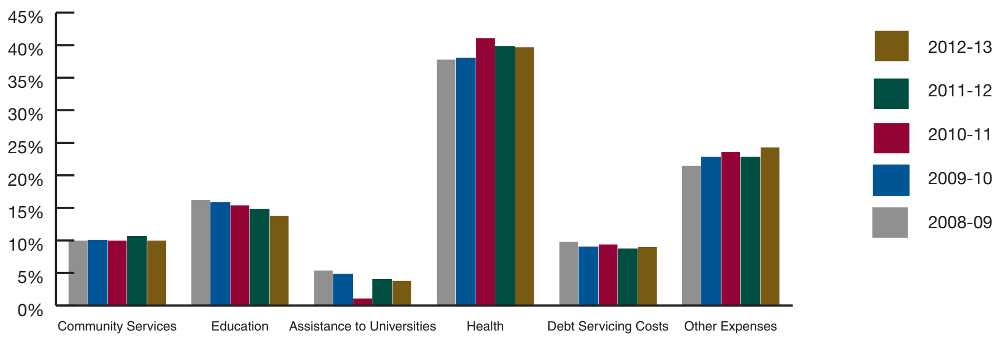
4.8 Budget-to-actual variances are impacted by many factors. Two significant factors for the year ended March 31, 2013 were a change in accounting standards that had not been budgeted for, and the correction of prior years' errors. Budget variances as a result of these matters do not indicate that the Province has not adhered to its fiscal plan. However, the net impact of these changes was a $73 million reduction in the deficit. Had these changes not occurred, the actual deficit variance would have been $164.3 million.

4.9 *Actual-to-actual variance* – The Province's March 31, 2012 financial statements showed a deficit of $259 million. During the year, this deficit increased to $302.5 million. The following table details variances in revenues and departmental expenses to explain this $43.5 million change in operating results.

Actual-to-actual Variance ($ millions)			
Revenues and Departmental Expenses	**Revenue**	**Expenses**	**Surplus (Deficit)**
2011-12 Deficit	**$9,760.3**	**$10,019.3**	**($259.0)**
Increased Provincial Tax Revenue	$249.7		
Increased Federal Revenue	$83.5		
Decreased Net Income from GBEs	($17.3)		
Increased Other Provincial Revenue	$26.5		
Decreased Investment Income	($0.8)		
Increased Economic and Rural Development Expenses		$53.1	
Decreased Education Expenses		($38.8)	
Increased Health and Wellness Expenses		$146.4	
Increased Restructuring Costs		$43.1	
Restructuring of Nova Scotia Agricultural College		$37.0	
Increased Pension Valuation Adjustment		$67.3	
Increased Debt Servicing Costs		$58.5	
Increased Other Expenses		$18.5	
2012-13 Deficit	**$10,101.9**	**$10,404.4**	**($302.5)**

4.10 *Expenses by department or type 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 any area indicates expenses for that area are increasing at a faster rate than total expenses. This trend may reduce funding available for other areas of Government spending.

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



Source: 1 (see end of chapter)

Expenses by Department or Type as a Percentage of Total Expense for Nova Scotia					
	2008-09	2009-10	2010-11	2011-12	2012-13
Community Services	9.9%	9.9%	9.9%	10.5%	9.9%
Education	16.1%	15.7%	15.3%	14.7%	13.7%
Assistance to Universities	5.3%	4.7%	1.0%	3.9%	3.7%
Health	37.7%	37.9%	41.0%	39.7%	39.6%
Debt Servicing Costs	9.7%	8.9%	9.3%	8.6%	8.9%
Other Expenses	21.3%	22.9%	23.5%	22.6%	24.2%
Total Expenses	100.0%	100.0%	100.0%	100.0%	100.0%

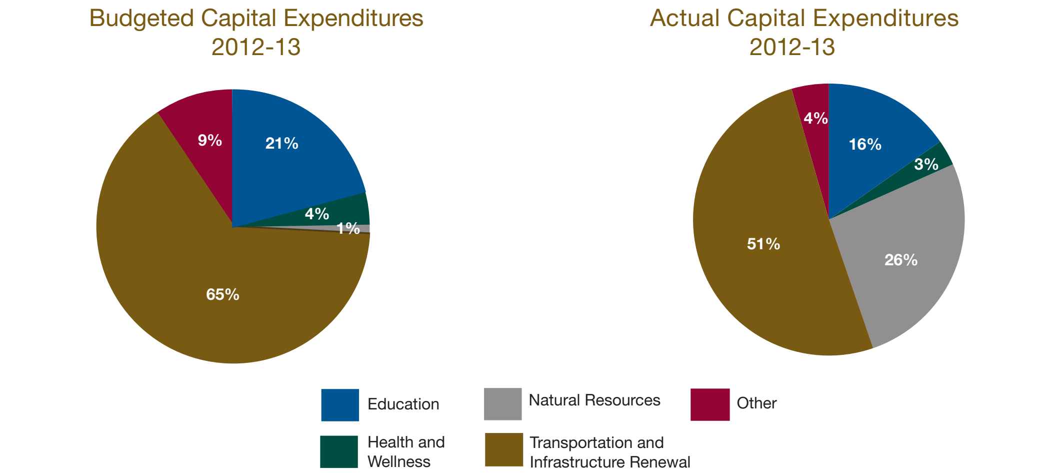
4.11 *Capital expenditures variance* – Capital planning is important to ensuring the Province can deliver its services and provide necessary and safe infrastructure to its citizens. Tangible capital assets, such as schools, buildings, highways and equipment, need to be repaired or replaced as they wear out or become obsolete. If government delays the repair and replacement of assets, they may need to be replaced earlier because the assets will have deteriorated to a level where they require extensive repair work, or are beyond repair and must be replaced. If delays become frequent and widespread, these costs could become burdensome. In order to afford this greater cost government will need to significantly increase debt, raise taxes or reduce services.

4.12 For the year ended March 31, 2013, the Province estimated capital expenditures to be $523.7 million, but actually spent $571.9 million. This variance of $48.1 million is detailed by significant departments in the following chart.

Budget-to-actual Variance in Capital Expenditures ($ thousands)				
Department	2012-13 Estimate	2012-13 Actual	Variance	Percentage
Education	$109,793	$88,441	($21,352)	(19.4%)
Health and Wellness	$19,692	$17,155	($2,537)	(12.9%)
Natural Resources	$6,600	$151,169	$144,569	2190.4
Transportation and Infrastructure Renewal	$338,939	$290,794	($48,145)	(14.2%)
Other	$48,665	$24,326	($24,339)	(50.0%)
Total	**$523,689**	**$571,885**	**$48,196**	**9.2%**

4.13 The table shows that the only department to see a significant increase in capital expenditures was the Department of Natural Resources. This increase of $144.6 million is primarily due to purchases of land for $20 million from NewPage and $118 million from Bowater Mersey.

4.14 Additional expenditures on land were largely offset by an overall reduction in capital spending of $96.4 million in other departments. The following pie charts illustrate the changes from the budget to actual expenditures, by comparing the percent of capital expenditures of departments to total capital expenditures.



Source: 1 (see end of chapter)

Indicators

Sustainability

4.15 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 revenue and expenditure adjustments such as increase debt or increase tax rates. Sustainability indicators provide insight into how a government balances its commitments and debts.

Indicators of Debt Position

4.16 *Long-term debt* – Details of the Province's long-term debt are noted in Schedule 4 of the March 31, 2013 Public Accounts. Gross long-term debt totaled $16.4 billion, an increase of $200 million or 1.2% during the fiscal year. This includes the debt of all entities in the government reporting entity. However, 93% of gross long-term debt ($15.3 billion) is debt issued by central Government.

4.17 Gross long-term debt is offset by sinking fund assets of $3.5 billion. The trend in net long-term debt is an indicator of fiscal sustainability. The exhibit below shows the actual growth of net long-term debt in the past ten years, with an increase of $3.6 billion since 2008.

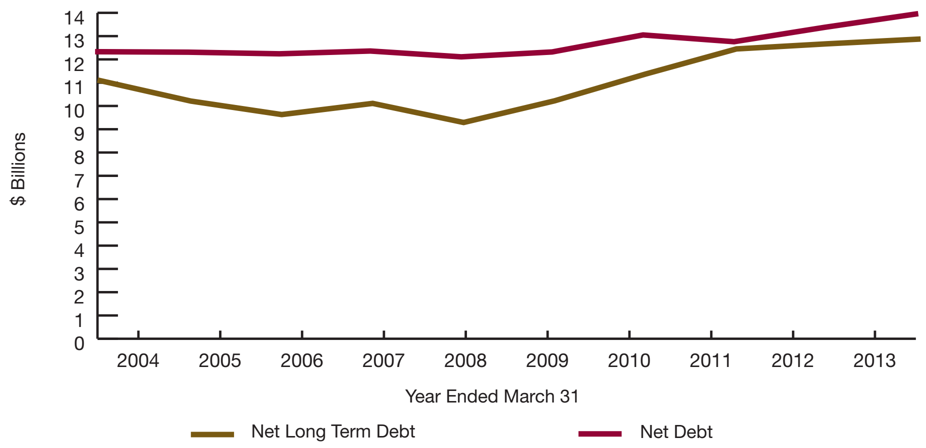
4.18 *Net debt* – Page 30 of the March 31, 2013 Public Accounts describes net debt.

> *"Net debt is the amount that current and past generations have accumulated through the incurrence of annual deficits and net investments in non-financial assets. Net Debt represents the liabilities needed 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."

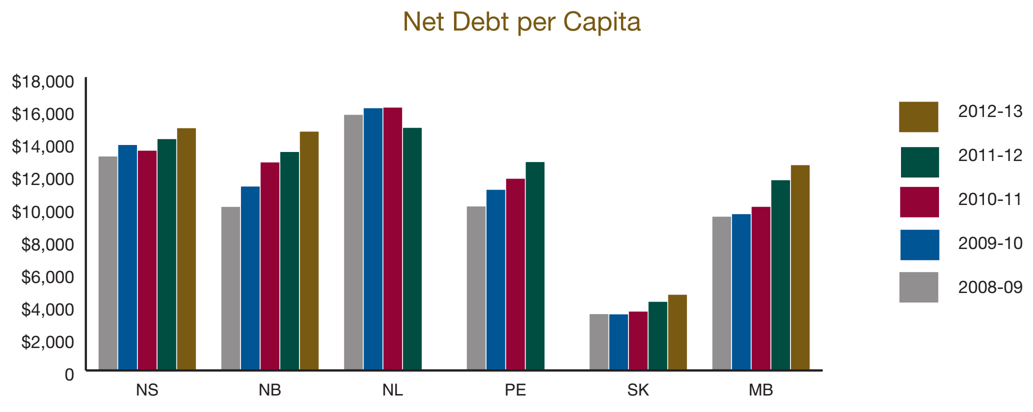
4.19 Net debt has increased by over 13% or $1.6 billion over the past ten years, including an increase of $571 million or 4.3% in the current year. The following exhibit also shows that net debt has grown each year since 2008 except for the year ended March 31, 2011. The surplus of $585 million reduced net debt in that year.

Net Long Term Debt and Net Debt



Source: 1 (see end of chapter)

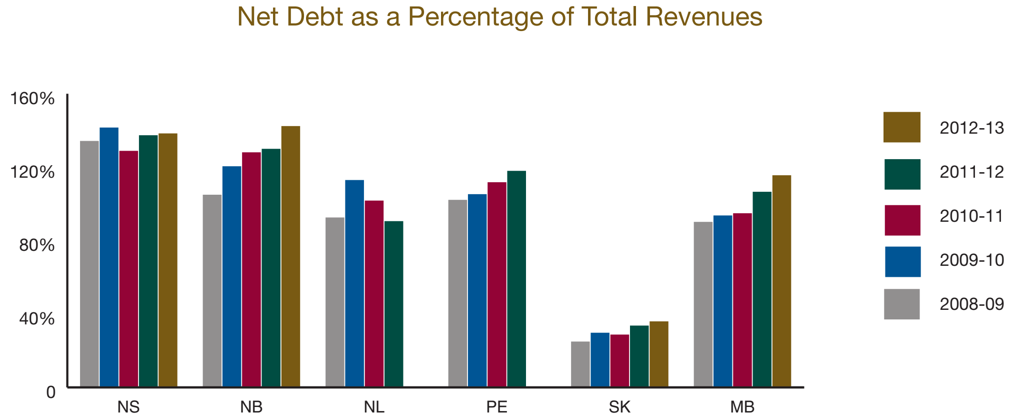
4.20 *Net debt per capita* – Net debt per capita shows the amount of net debt attributable to each person living in a province or territory. Nova Scotia consistently exhibits second-highest net debt per capita of the provinces we compared (see below). Net debt per capita is increasing in Nova Scotia because our population is not growing as much as net debt is increasing. Our aging population has the potential to add to this problem due to the combined impact of increased health costs and reduced employment income. Net debt per capita has increased every year over the past five years except 2011. It ranges from a low of $13,096 in 2009 to a high of $14,832 in 2013.



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

Net Debt per Capita (Nova Scotia)					
	2009	2010	2011	2012	2013
Net Debt ($ thousands)	$12,318,239	$13,045,146	$12,758,315	$13,382,946	$13,953,769
Population (thousands)	940.6	945.2	948.5	945.1	940.8
Net Debt per Capita	$13,096	$13,801	$13,451	$14,161	$14,832

4.21 *Net debt as a percentage of total provincial revenues* – Net debt provides a measure of future revenue 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.



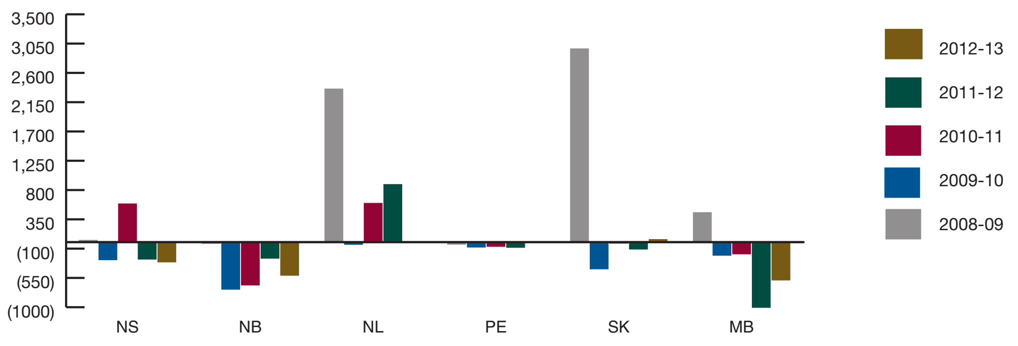
Source: 1, 2 and 3 (see end of chapter)

Net Debt as a Percentage of Total Revenues					
Year Ending March 31	**2009**	**2010**	**2011**	**2012**	**2013**
Net Debt ($ millions)	$12,318	$13,045	$12,758	$13,383	$13,954
Total Revenues ($ millions)	$9,196	$9,231	$9,919	$9,760	$10,102
Net Debt/Revenue	134.0%	141.3%	128.6%	137.1%	138.1%

4.22 *Annual surplus or deficit* – The annual surplus or deficit indicates the extent to which a 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.

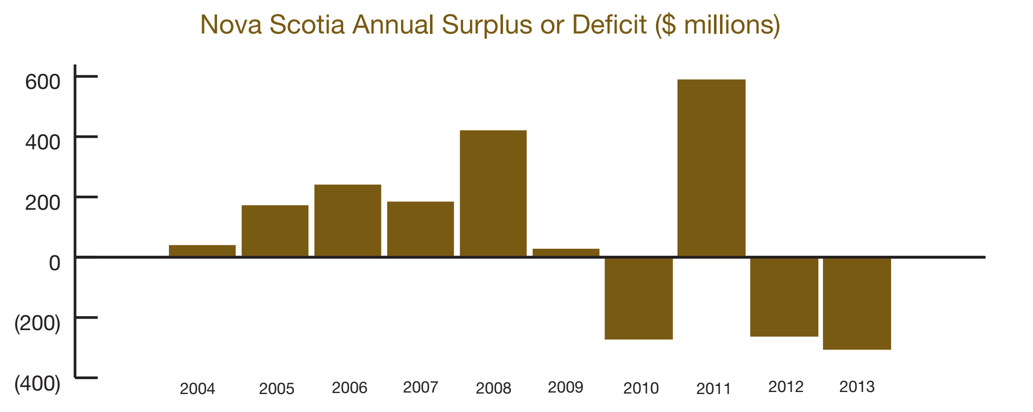
4.23 The following exhibit shows the fluctuation in jurisdictions' results or trends over the past five years. As can be seen, the two provinces with considerable natural resource revenue have the least deficit or greatest surplus position. The four remaining provinces, including Nova Scotia, have mostly been in a deficit position over the past five years.

Annual Surplus or Deficit



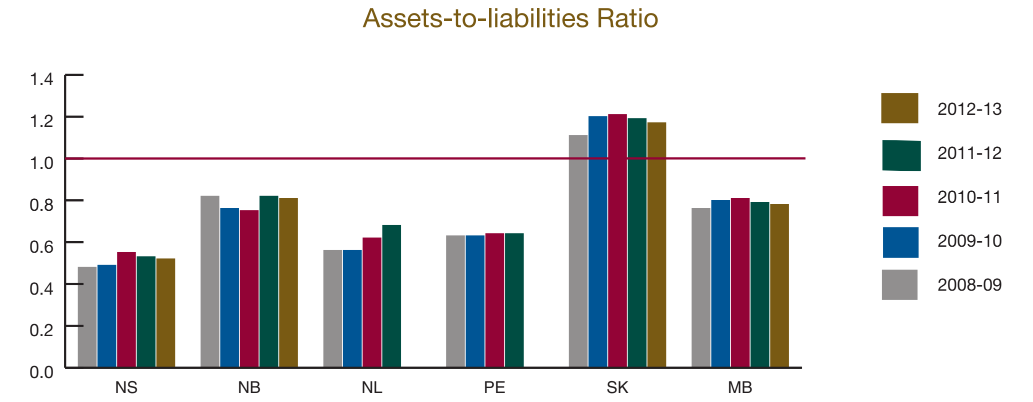
Source: 1, 2 and 3 (see end of chapter)

4.24 Over the past ten years, however, the Province of Nova Scotia has incurred a surplus in most years. There are fluctuations in the Province's annual results from 2004 to 2013, although the most significant variations have occurred in the past three years.



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

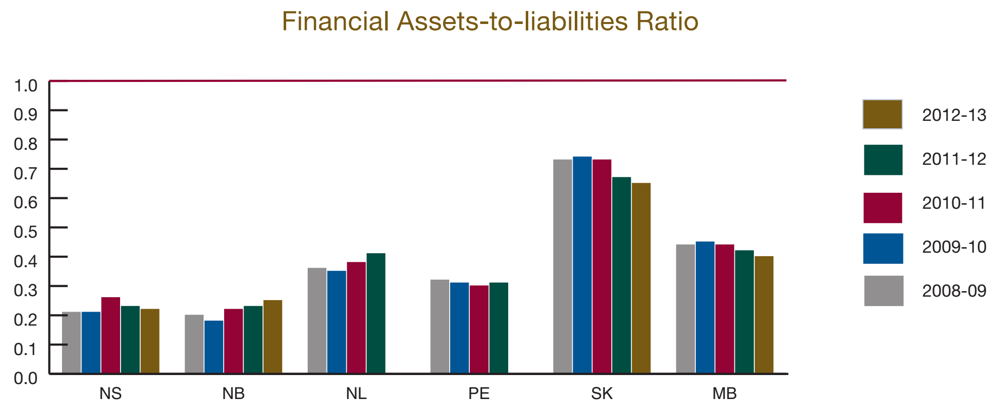
4.25 *Assets-to-liabilities ratio* – The assets-to-liabilities ratio measures the ratio of government's total assets, including capital assets, to its liabilities. A ratio greater than one shows assets are greater than liabilities and government has an accumulated surplus. A ratio less than one indicates 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 four provinces we compared for 2013 had increases in this ratio since 2008. Nova Scotia's ratio was at its highest in 2011 at 0.55, but has since declined to 0.52. Nova Scotia continues to be the lowest of all comparable jurisdictions.



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

Assets-to-liabilities Ratio (Nova Scotia)					
Year Ending March 31	**2009**	**2010**	**2011**	**2012**	**2013**
Assets ($ millions)	$7,393	$8,070	$9,349	$9,113	$9,341
Liabilities ($ millions)	$15,554	$16,500	$17,140	$17,292	$17,823
Assets/Liabilities	0.48	0.49	0.55	0.53	0.52

4.26 *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 0.21 in 2009 to a high of 0.26 in 2011. Since 2011 the trend has been decreasing, and in 2013 the ratio was 0.22, meaning there has been no significant overall change in the past five years. Three of the other provinces have experienced an overall decreasing trend with some fluctuations, while remaining jurisdictions show an overall increase in this ratio.



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

Financial Assets-to-liabilities Ratio (Nova Scotia)					
Year Ending March 31	**2009**	**2010**	**2011**	**2012**	**2013**
Financial Assets ($ millions)	$3,236	$3,455	$4,382	$3,909	$3,869
Liabilities ($ millions)	$15,554	$16,500	$17,140	$17,292	$17,823
Financial Assets/Liabilities	0.21	0.21	0.26	0.23	0.22

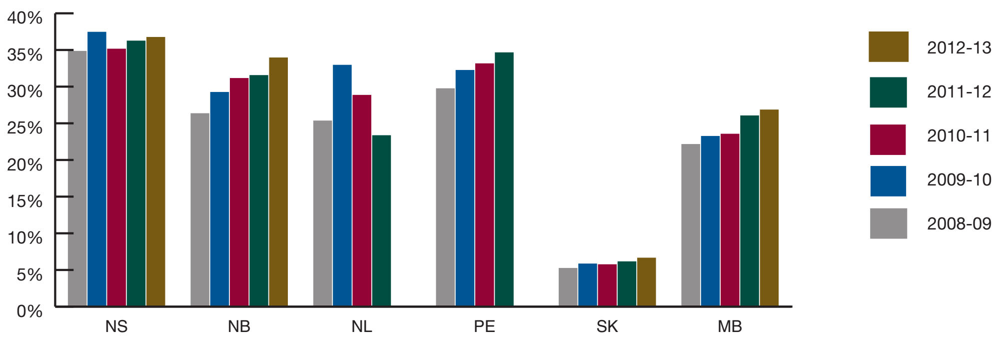
Sustainability Indicators Related to GDP

4.27 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 adding 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 approach). GDP values used in our analyses are expenditure-based.

4.28 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 negative growth is said to be in recession.

4.29 *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.

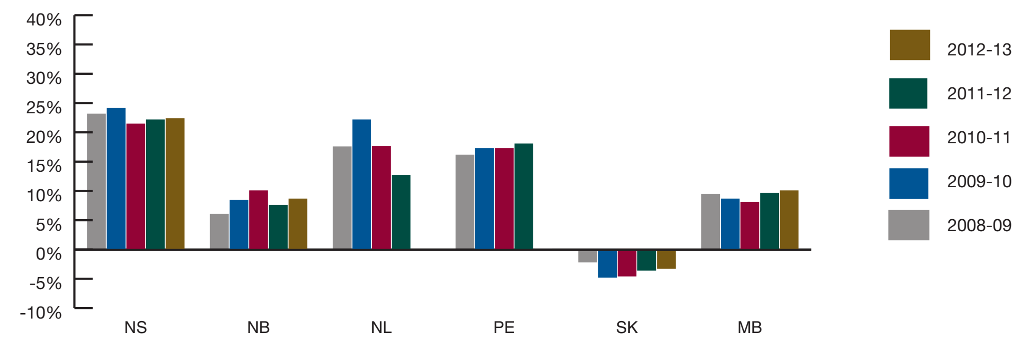
Net Debt as a Percentage of Provincial GDP



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

Net Debt as a Percentage of Provincial GDP (Nova Scotia)					
Year Ending March 31	**2009**	**2010**	**2011**	**2012**	**2013**
Net Debt ($ millions)	$12,318	$13,045	$12,758	$13,383	$13,954
Provincial GDP ($ millions)	$35,394	$34,921	$36,350	$37,015	$38,070
Net Debt/GDP	34.8%	37.4%	35.1%	36.2%	36.7%

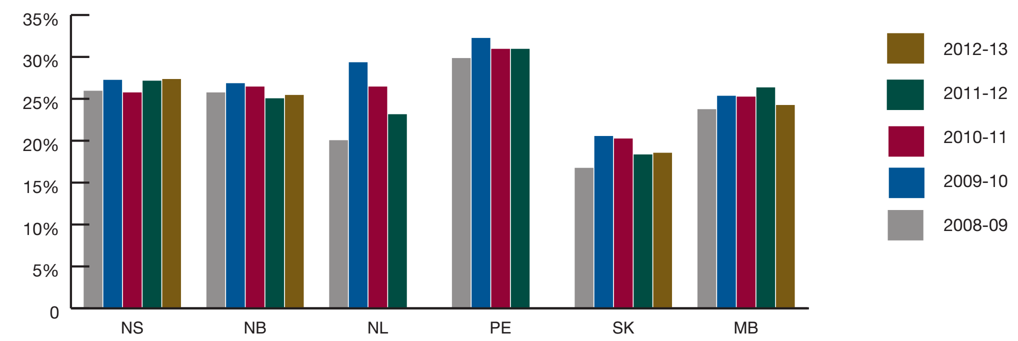
4.30 *Accumulated surpluses or deficits as a percentage of provincial GDP* – Accumulated surpluses or deficits are the total of all surpluses and deficits incurred to date. These measure the extent to which past revenues were sufficient or insufficient to cover the cost of past transactions. When accumulated deficits as a percentage of provincial gross domestic product (GDP) increase, 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 has fluctuated in the past five years from a high of 24.1% in 2010 to a low of 21.4% in 2011. Overall, Nova Scotia has experienced a decline from 23.1% in 2009 to 22.3% in 2013, meaning that the economy grew at a faster rate than the accumulated deficit.



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

Accumulated Deficit as a Percentage of Provincial GDP (Nova Scotia)					
Year Ending March 31	**2009**	**2010**	**2011**	**2012**	**2013**
Accumulated Deficit ($ millions)	$8,161	$8,429	$7,791	$8,179	$8,482
Provincial GDP ($ millions)	$35,394	$34,921	$36,350	$37,015	$38,070
Accumulated Deficit/GDP	23.1%	24.1%	21.4%	22.1%	22.3%

4.31 *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 27.3% in 2013. All other provinces experienced fluctuations in this indicator over the same period.



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

Total Expenses as a Percentage of Provincial GDP (Nova Scotia)					
Year Ending March 31	2009	2010	2011	2012	2013
Total Expenses ($ millions)	$9,170	$9,499	$9,334	$10,019	$10,404
Provincial GDP ($ millions)	$35,394	$34,921	$36,350	$37,015	$38,070
Expenses/GDP	25.9%	27.2%	25.7%	27.1%	27.3%

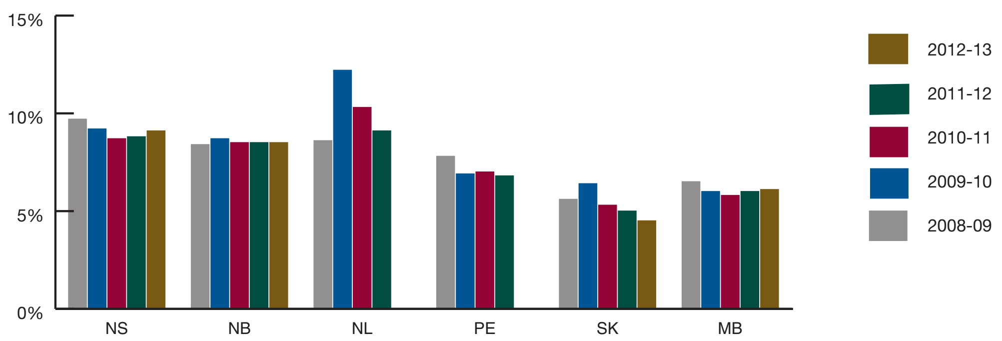
Flexibility

4.32 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.

4.33 *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.

4.34 The proportion of debt servicing costs to revenue 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 in the past five years from 9.7% in 2009 to a low of 9.1% in 2013, with its lowest point in 2011 at 8.7%. The ratio for Nova Scotia has been higher than four of the five other jurisdictions during this period.

Debt Servicing Costs as a Percentage of Total Revenues

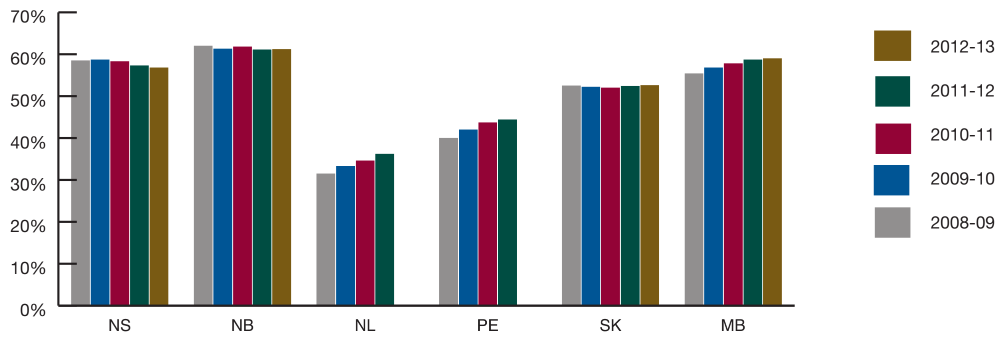


Source: 1, 2 and 3 (see end of chapter)

Debt Servicing Costs as a Percentage of Total Revenues (Nova Scotia)					
Year Ending March 31	**2009**	**2010**	**2011**	**2012**	**2013**
Debt Servicing Costs ($ millions)	$887	$850	$866	$863	$921
Total Revenues ($ millions)	$9,196	$9,231	$9,919	$9,760	$10,102
Debt Servicing Costs as a Percentage of Revenues	9.7%	9.2%	8.7%	8.8%	9.1%

4.35 *Net book value of tangible capital assets as a percentage of the 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 remaining 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 government to make changes in programs and services could be negatively impacted if the cost of repairing or replacing aging assets becomes too burdensome.

Net Book Value of Tangible Capital Assets as a 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	**2009**	**2010**	**2011**	**2012**	**2013**
Net Book Value ($ millions)	$4,070	$4,523	$4,877	$5,122	$5,400
Cost of Capital Assets ($ millions)	$6,974	$7,719	$8,383	$8,955	$9,523
Net Book Value of TCA as a Percentage of Cost of Capital Assets	58.4%	58.6%	58.2%	57.2%	56.7%

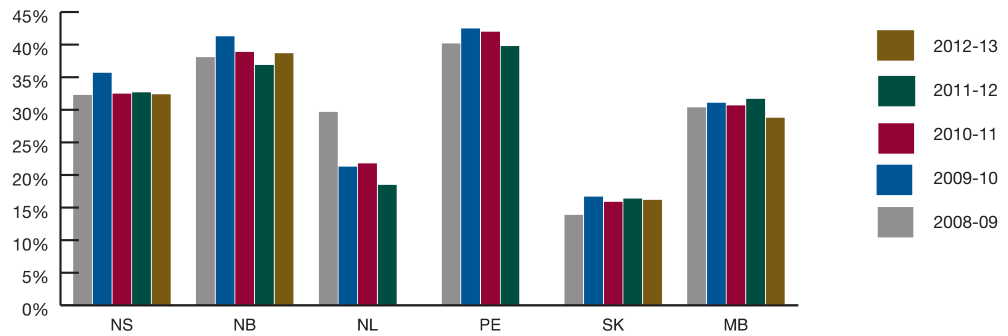
Vulnerability

4.36 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 the vulnerability.

4.37 *Federal government transfers as a percentage of total revenues* – Federal government transfers as a percentage of total revenues demonstrate 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 are outside the control of the provincial government.

4.38 This ratio remained mostly stable for Nova Scotia over the past five years with a slight spike in the percentage of federal government transfers in 2010. For the year ended March 31, 2013, federal transfers were less than budgeted, and this accounts for a slight decline in this ratio. The Province relied less on federal transfers and more on its own-source revenue. Overall, federal transfers as a percentage of the total revenues have fluctuated slightly in four jurisdictions, and more significantly in one.

Federal Government Transfers as a Percentage of Total Revenues



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

Federal Government Transfers as a Percentage of Total Revenues (Nova Scotia)					
Year Ending March 31	**2009**	**2010**	**2011**	**2012**	**2013**
Federal Government Transfers ($ millions)	$2,964	$3,287	$3,212	$3,179	$3,263
Total Revenues ($ millions)	$9,196	$9,231	$9,919	$9,760	$10,102
Federal Government Transfers as a Percentage of Total Revenues	32.2%	35.6%	32.4%	32.6%	32.3%

Sources:

1. *Nova Scotia – Public Accounts for March 31, 2004 – March 31, 2013*

2. *New Brunswick, Saskatchewan and Manitoba – Public Accounts March 31, 2009 – March 31, 2013*

3. *Newfoundland and Labrador, and Prince Edward Island – Public Accounts March 31, 2009 to March 31, 2012 (2012-13 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)*

6. *Statistics Canada – Annual population estimates (July 2012 – July 2013)*

Note: Income from Government Business Enterprises (GBE) 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

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.

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

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.

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.

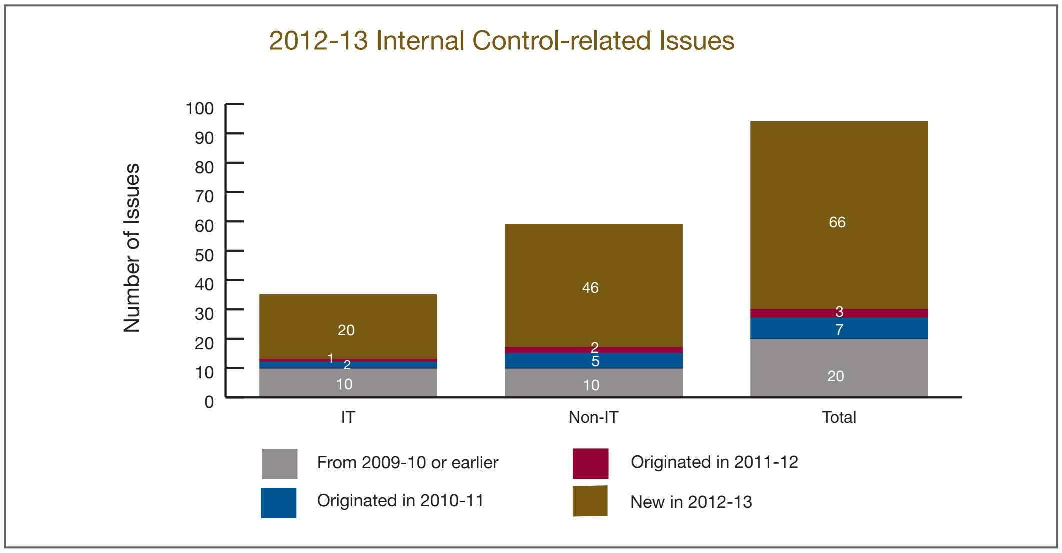
5.12 *Overall results* – Audits were completed for 69 of the 73 government agencies and trusts during the past year. Four of those entities are audited by this Office and the results of their audits are discussed in chapter 2 of this report. Management letters were issued to 53 of the remaining 65 audited 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.

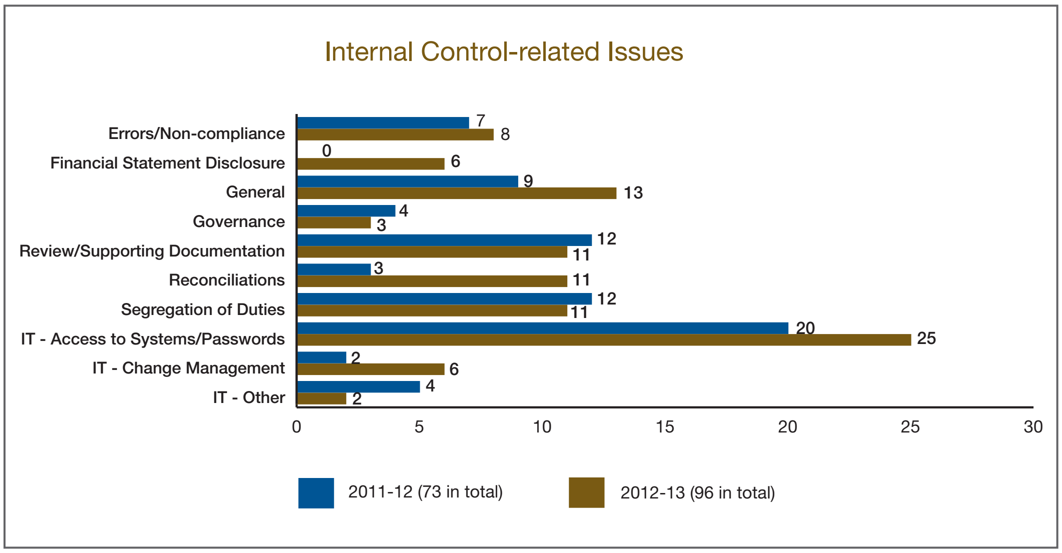
5.17 In chapter 2, we note government's response following recommendations made as a result of our audit of government's financial statements, as well as their plans for implementing the recommendation. We conduct follow-up on these recommendations after two years.

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

6 Follow-up of 2010 Financial Recommendations

Summary

Seventy-seven percent of our 2010 recommendations related to financial reporting have been implemented. This is a 10% increase in the implementation rate for 2010 recommendations reported last year.

During the past year, a long-outstanding recommendation that the revenue estimates included in the annual budget be prepared on a consolidated basis was implemented. Our review opinion had been qualified each year since 2001 when accounting standards for consolidated financial statements were issued for the public sector. This year, the revenue estimates included in the 2013-14 Budget Address were prepared on a consolidated basis.

Two other recommendations have been made in successive reports. We have recommended that internal controls in government be identified and related roles and responsibilities for these controls be assigned. Some progress has been made toward implementation of these recommendations; however, they remain incomplete. Internal controls have government-wide impacts, and need to be addressed.

Details of all financial recommendations for 2010 along with their current status can be found on our website at oag-ns.ca.

6 Follow-up of 2010 Financial Recommendations

Background

6.1 Financial reporting is a key component of government's accountability framework; it is a means through which government fulfills its accountability responsibilities regarding the use of public funds and demonstrates its stewardship over those funds. Our annual report on government financial reporting contains recommendations which we believe provide practical, constructive advice to address issues raised by our financial audits and reviews.

6.2 We follow up the implementation status of these recommendations after two years. We believe two years is sufficient time for auditees to address our recommendations.

6.3 This Chapter reports the status of recommendations concerning financial reporting and other financial management issues and how responsive departments and agencies have been in implementing the recommendations from our 2010 audits. In 2011, we did not make financial reporting recommendations as the timing of our reporting changed; recommendations related to 2011 were released in our January 2012 report.

6.4 We requested that government management complete a self-assessment of progress in implementing the outstanding 2010 recommendations. We also asked management to provide supporting information. Our review process focused on whether the self-assessment and information provided by management were accurate, reliable and complete. This chapter includes summary level information on implementation status; more detailed information, including specific recommendations can be found on our website at oag-ns.ca.

Review Objective and Scope

6.5 The objective of this assignment was to review and report on the implementation status of recommendations related to financial audits and reviews conducted by this Office in 2010.

6.6 Each department to which we made recommendations is expected to document its self-assessment of progress on implementing our Office's recommendations in government's Tracking Auditor General Recommendations system. Our review was based on information included in that system as of October 19, 2013.

6.7 We reviewed those recommendations which government had assessed as do not intend to implement and focused on the reasons why government had chosen not to implement. If the rationale appeared reasonable, we removed the recommendation from our statistics and will not conduct further follow up on it.

6.8 Our review was based on representations by government management which we substantiated through interviews and examination of documentation, and provides moderate assurance. Moderate assurance, in the context of this assignment, means performing sufficient work to satisfy us that the implementation status as described by government is plausible given the circumstances. Further information on the difference between high and moderate assurance is available in the CPA Canada Handbook – Assurance, Section 5025 – Standards for Assurance Engagements other than Audits of Financial Statements.

6.9 Our criteria were based on qualitative characteristics of information as described in the CPA Canada Handbook. Management representations on implementation status were assessed against three criteria.

- Accurate – 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 for financial recommendations made in 2010 increased from 67% to 77% during the past year. This is partly due to government's decision to implement a long-outstanding recommendation related to presentation of the revenue estimates included in the government's annual budget. Our review opinion on these estimates has been qualified each year since 2001 because the revenue estimates were not prepared on a consolidated basis as required under generally accepted accounting principles. However the 2013-14 revenue estimates were prepared on a consolidated basis.

6.10 *Review results* – We performed a review of departments' self-assessments including an evaluation of supporting documentation. We wish to emphasize that the work performed during this follow-up assignment is not an audit; therefore we provide only moderate assurance that these recommendations have been implemented. Only during a subsequent audit can we say, with high assurance, that the reported implementation status is accurate.

6.11 *Scope of review* – During this assignment, we followed up on the status of 40 recommendations, most of which were addressed to the Department of Finance. The remaining recommendations are the responsibility of the Departments of Transportation and Infrastructure Renewal, and the Department of Health and Wellness. The scope of our review was reduced this year; last year we reported on the implementation status of recommendations made between 2007 and 2010.

6.12 *Review opinion on revenue estimates* – Since 2006, our financial reporting recommendations have included a recommendation that the revenue estimates included in the government's annual budget be prepared on a consolidated basis. This is consistent with generally accepted accounting principles which require that the budget be prepared on the same basis as the Province's annual financial statements. The financial statements have been prepared on a consolidated basis since 2001 when public sector accounting standards were revised to require consolidated reporting.

6.13 In the past, third-party revenues of certain government units, such as ancillary operations in district health authorities and municipal funding in school boards, were excluded from the revenue estimates. Additionally, no estimate of these third-party revenues was made and therefore we were unable to determine their significance to the estimates. Government developed processes and the revenue estimates were presented on a consolidated basis for the 2013-14 revenue estimates. As a result, our review opinion on the revenue estimates was unqualified. We are pleased to report that this recommendation has now been fully implemented and we commend government for its action.

6.14 *Do not intend to implement* – Two recommendations were reported to us as do not intend to implement. We disagree with government's rationale for not implementing one of these recommendations.

6.15 Government does not intend to implement our recommendation to include variance analysis on the consolidated results in the financial statement discussion and analysis section of the annual Public Accounts. The existing analysis provides explanations for variances between budget and actual results for the general revenue fund only. However the Consolidated Statement of Operations and Accumulated Deficits includes budget and actual results for consolidated revenues and expenses. We believe additional information should be communicated to users on variances between consolidated actual and budgeted amounts. Variance analysis with related explanations for changes allows users to evaluate government results. It enhances transparency and supports government's stewardship over resources. We believe this is a valid recommendation and as such Finance should make every effort to implement it.

6.16 We have accepted government's decision not to implement our recommendation to change the Teachers' Pension Act to allow audits to be performed by this Office. The recommendation was made in February 2010 because it was unclear whether the Teachers' Pension Act allowed our Office to conduct performance audits of the Teachers' Pension Plan. However, in December 2010, the Auditor

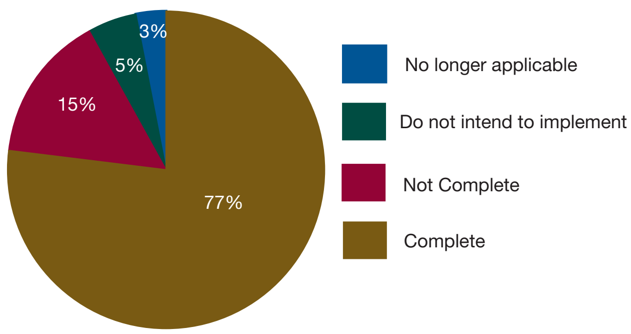
General Act was revised and we are no longer able to audit government trusts that are under joint trustee relationships. This is the governance arrangement of the Teachers' Pension Plan.

6.17 *Implementation status* – The following exhibit summarizes the implementation status of the 40 recommendations made in 2010.

Report and Chapter	Entity	Complete	Not Complete	Do Not Intend to Implement	Action No Longer Required	Total
February 2010 Chapter 5: Government Financial Reporting	DOF	17	2			19
Chapter 5: Government Financial Reporting	DTIR	1				1
November 2010 Chapter 5: Government Financial Reporting	DOF	12	3	2	1	18
Chapter 5: Government Financial Reporting	DTIR	1				1
Chapter 5: Government Financial Reporting	DHW		1			1
Total Number of Recommendations Made		**31**	**6**	**2**	**1**	**40**
		77%	15%	5%	3%	100%

DOF – Department of Finance
DTIR – Department of Transportation and Infrastructure Renewal
DHW – Department of Health and Wellness

Overall Results of 2010



6.18 The overall implementation rate this year is 77%, a 10% increase over last year's rate of 67%. This is partly due to the reduction of years reviewed.

6.19 *Disagreement on implementation status* – In 2010, we made a recommendation to the Department of Finance which dealt with the need to implement a formal and documented review and challenge of the assumptions used in the preparation of the petroleum royalties estimates. Currently, a staff member at the Department

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of Energy develops these estimates using inputs and assumptions. Due to the impact of accounting for future costs associated with site remediation, the net amount of this revenue has declined significantly. However, the gross amount of the revenue against which the accrued remediation costs are offset is still significant ($115 million for the year ended March 31, 2013). We believe the inputs and assumptions being used to generate these estimates should be subject to review by someone other than the individual preparing the estimate.

6.20 The Department of Finance told us that this recommendation was complete. Our review of their support indicates that the Department of Finance conducts a review and challenge of broad assumptions used in the model but not of other inputs. Through discussions with the Department, we determined that management does not intend to do any further review. They believe any further efforts to address this recommendation are the Department of Energy's responsibility. Discussion surrounding moving this recommendation to Energy was held during the prior year's follow-up engagement; however, to date, the Department of Finance has made no effort to work with government's Tracking Auditor General Recommendations steering committee to make this change. Accordingly, we have reported the status of this recommendation as do not intend to implement.

6.21 *Other comments* – Four of the six recommendations that remain incomplete for 2010 relate to internal controls over financial reporting. These recommendations include the following;

- the need for government to clearly establish and document internal controls; and
- the assignment of roles and responsibilities for the design, implementation, operation and monitoring of internal controls as part of the corporate policy manuals.

6.22 While progress has been made towards implementing these recommendations, Government needs to take action to ensure they are completed in a timely manner. To date, the Department of Finance's internal controls project has focused on the control environment without proper assessment of the risks to financial reporting and the controls in place to mitigate those risks. We noted our overall concern with the current risk assessment in chapter 2 of this report. Without proper identification of the risks inherent in financial reporting it is impossible for Government to properly evaluate and prioritize these risks in order to develop a plan that effectively minimizes, monitors, and controls the likelihood and impact of each risk.