

January
2014

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



Independence • Integrity • Impact



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.

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1 Message from the Auditor General

Introduction

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.

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

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.

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.

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

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.

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.

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.

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.

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.

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

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.

Recommendations

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.

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.

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.

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.

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.

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.



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.

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.

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.

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.



3 Public Service Superannuation Plan

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.



Recommendations

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.

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.

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.

Recommendation 3.4

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

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.

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.

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.



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.

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.



4 Indicators of Financial Condition

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.



5 Review of Audit Opinions and Management Letters

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.



Recommendation

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.



6 Follow-up of 2010 Financial Recommendations

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.