February
2015

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

Independence • Integrity • Impact

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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.

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1 Message from the Auditor General

I am pleased to present my February 2015 Report to the House of Assembly. This Report includes work completed in the financial audit portfolio of my Office during 2014.

One of the priorities of my Office is to encourage continual improvement in financial reporting by government. Sound financial reporting is a key component of accountability and stewardship of public resources. As an independent, non-partisan officer of the House, I and my Office help to hold the government to account for its management of public funds and contribute to a well-performing public sector.

This report presents the results of our legislated work on the province's consolidated financial statements and revenue estimates. It also includes the results of our audits in four government agencies, as well as information on other matters such as retirement benefits and accountability reporting. Where appropriate, we have made recommendations for improvements to government financial management and accountability practices. Department response have been included in the appropriate chapter. We will follow up on the implementation status of our recommendations in two years, with the expectation that significant progress will have been made.

2 Information on Unfunded Employee Retirement Benefits and Compensated Absences

Employee retirement benefits and compensated absences have existed for many years and have accumulated over time. These benefits and compensated absences represent a significant liability and pose major risks to Nova Scotia; the sustainability of these plans should be assessed on an ongoing basis.

As at March 31, 2014, the liability related to these plans totaled approximately $1.8 billion. These obligations are unfunded, meaning money has not been set aside by the province to pay for benefits. Payments made under these plans will have to be paid through future taxes and other revenues.

The obligation is subject to risks, including borrowing rates and rising health care costs. These risks impact the future finances of Nova Scotia as assumption changes can have a significant impact on the obligations and annual costs associated with these plans.

The liability for retirees' health benefits is the most significant component of the employee retirement benefits obligation. It represents $1.1 billion of the total $1.8 billion obligation. There are variances in the benefits across public service sectors. For example, the province pays 100% of retirement health benefit premiums for retired teachers but pays a portion of premiums for retired civil servants.

Retiring allowances accrued for both union and non-union management and staff in the public sector totaled $373 million and are fully paid by the province. Long-term workers could receive a significant one-time payment of as much as one half-year of pay upon retirement, in addition to their pension entitlements. There are differences in retiring allowances provided to retirees in the public service sector, health sector and education sector.

There is also a liability for earned, but unused, sick time in the health and education sectors, although the amount of unused sick time that may be carried over varies by sector. This obligation totaled $202 million at March 31, 2014. Although there is no cash payment associated with use of accumulated sick time, and unused amounts expire on retirement, there is still an obligation for these amounts that must be recognized while the individual is employed with the province.

Our intent with this chapter is to provide information to Nova Scotians on the details of benefits received by employees, how benefits are earned, and the risks and costs associated with providing these obligations.

3 Indicators of Financial Condition

The purpose of this chapter is to provide further information on the province's financial health by reporting on certain accepted indicators of financial condition. Although the province's consolidated financial statements provide a fair snapshot of its financial position at its fiscal year end (March 31) and the results of its operations for that year, they do not provide a complete indication of the province's health nor how well it is performing in relation to its economic and fiscal environment. The indicators reported in this chapter are meant to provide additional information on the province's financial condition, but are not intended to comment on the impact of government policies on financial results.

Ten key indicators show that Nova Scotia is in poor financial condition. There was a serious decline in the financial position of the province from the prior year, particularly with respect to budget to actual operating results. Budget to actual results is a measure of financial performance and shows the extent to which government adhered to its fiscal plan as detailed in its budget. The province's deficit of $679 million for the year ended March 31, 2014 was a $695 million variance from the $16 million surplus included in the 2013-14 budget. Of this variance, $318 million was attributed to changes in the governance structure of the Public Service Superannuation Plan which resulted in the removal of the liability for the Plan from the province's consolidated financial statements. This necessitated the one-time recognition of previously deferred Plan losses. The variance can also be explained by a $313 million downward revision in estimated tax revenue.

Net debt continues to increase. Since 2011, net debt has increased by $2 billion, or 16%. Net debt per capita also increased by 6% to $15,659 per capita, the largest annual increase in the past five years. Further, there was a significant increase during the year in the percentage of net debt to total revenue, going from 138% in 2013 to 147% in 2014, a concerning increase of 9%. Finally, because provincial net debt is at 38% of the province's GDP, it is placing an increasing burden on the economy. These sustainability indicators demonstrate that there are real risks to future programs and services provided to Nova Scotians.

Although debt servicing costs as a percentage of total revenue have remained fairly constant over the past five years, Nova Scotia's debt servicing costs – to – revenues compares unfavourably to four of the five jurisdictions we selected for comparison purposes. The level of debt servicing costs is an indicator of government's limited flexibility in improving programs and services because of the annual impact of outstanding debt.

Finally, federal government transfers as a percentage of total provincial revenues have stayed constant over the past five years. Although stable, this demonstrates that Nova Scotia is vulnerable to changes in federal policies which may change the amount and timing of these transfers.

4 Agencies, Boards and Commissions: Accountability Reporting

Accountability reporting provides information to government and other users on what provincial agencies want to achieve in the upcoming year, and a corresponding evaluation of what has been accomplished. We observed that not all legislation requires accountability reports including business plans and annual reports be prepared, and we suggested that government review each entity's legislation and address this, or expand the Finance Act to provide increased authority to obtain accountability reports from all entities within the government reporting entity.

Annapolis Valley Health's and the IWK Health Centre's accountability reporting is not currently providing the required information for a user to determine if these entities are fulfilling their mandate. Both entities followed Department of Health and Wellness guidance in preparing their 2013-14 business plans. However, that guidance is not sufficient to ensure robust accountability reporting and we recommended the Department improve this process. Neither entity's business plan included specific and measurable goals, and neither reported on outcomes or impacts expected during the current year, and only reported activities. We note that the IWK Health Centre reports on key performance indicators in a quarterly public report. The IWK should include realistic and achievable targets for each of these indicators so that performance against these can be evaluated later.

We examined the 2013-14 business plans of the South Shore Regional School Board and the Cape Breton-Victoria Regional School Board and noted that not all priorities were student-focused making it difficult to assess whether each board is fulfilling its mandate. Both business plans included targets for improved education results.

The Department of Education and Early Childhood Development provides business plan and annual report guidance to school boards that generally captures key components of accountability reporting. We recommended the guidance be strengthened to require boards to report on common goals in education such as student achievement.

The Department of Finance and Treasury Board provides clear business plan and annual report guidance to crown corporations

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and other agencies. This guidance promotes strong accountability reporting. Reported outcomes are to be specific, measurable, achievable, relevant, and time bound.

We examined the business plans and annual reports of an additional seven entities and found that most reported outcomes were not specific and measurable. However, minor changes in outcome reporting by the Nova Scotia Farm Loan Board, Film and Creative Industries Nova Scotia and the Art Gallery of Nova Scotia would result in improved reporting on the extent to which these entities are fulfilling their mandate. Trade Centre Limited's business plan included targets, but the targets were for negative growth, and the plan lacked sufficient explanation. Nova Scotia Lands Inc. and the Halifax Dartmouth Bridge Commission included several activities as their 2013-14 outcomes; however, activity-based reporting does not demonstrate the impact of an entities' actions to stakeholders. Finally, the Nova Scotia Legal Aid Commission is not legislated to prepare a business plan but is required to complete an annual report. We recommended that the Department of Justice require the Commission prepare an annual business plan, including outcomes and performance measures to be evaluated in a subsequent accountability report.

Recommendations

Recommendation 4.1
The Department of Education and Early Childhood Development should improve accountability guidance provided to school boards by requiring that each board report on common goals in education, such as student achievement.

Recommendation 4.2
The Department of Health and Wellness needs to develop business plan and accountability reporting guidance to district health authorities and the IWK Health Centre that requires these entities to develop and report on specific and measureable outcomes for their core business activities.

Recommendation 4.3
The Department of Health and Wellness should request that annual reports be prepared by district health authorities and the IWK Health Centre.

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Recommendation 4.4
The Department of Justice should require that the Nova Scotia Legal Aid Commission prepare an annual business plan. The business plan should include goals for the upcoming year and targets to achieve these goals. The Department should require that the Commission's annual report reflect progress toward achieving these goals.

5 Results of Audits and Reviews

The review report on the 2014-15 revenue estimates was unqualified. Nova Scotia is the only province in Canada to have an annual review report on its revenue estimates, an accomplishment for the province of Nova Scotia. However, we found that certain tax model assumptions are not subject to periodic review. We recommended that the Department of Finance and Treasury Board develop a process to review all tax model assumptions on a periodic basis, especially those that are not subject to annual review as part of the estimate process. We also found that petroleum royalty inputs were not adequately reviewed for accuracy; we recommended that the Department of Energy develop a process to review inputs and calculations used in estimating petroleum royalties to ensure assumptions are the most current.

During the year, the Department of Finance and Treasury Board's Taxation and Fiscal Policy Division kept us informed of changes in models to calculate tax revenue and we found significant improvement in their change management process.

The audit opinion on the province's 2013-14 consolidated financial statements was unqualified. However, we experienced issues in completing the audit engagement as efficiently as we would like due to a lack of accurate supporting documentation for debt servicing costs. We have made recommendations to improve the audit process. We are pleased to report no significant deficiencies were identified in internal controls during the audit.

We issued unqualified audit opinions for three of four audits we conducted in government agencies for the year ended March 31, 2014. The audit opinion on Trust Funds Administered by the Public Trustee was qualified due to the inability to verify that all assets that came under the Public Trustee's administration, or income related to these assets, were recorded by the Public Trustee. This is because clients referred to the Public Trustee can be accepted prior to the physical transfer of such assets to that Office. Therefore, asset verification was limited to recorded amounts.

We recommended again that the Public Trustee put in place an accounting system to better support the administration of the $45 million in estates and trusts under that Office's control. We also recommended that the Public Trustee implement our prior year recommendations on the administration of the Common Fund and the Special Reserve Fund.

We recommended that the Nova Scotia Crop and Livestock Insurance Commission discuss with government officials the appropriateness of its processes to ensure members, many who are also producers, avoid conflicts of interest in performing their duties. Management should ensure the operations manual is kept up to date to ensure federal portion of premium revenue is collected on a regular basis.

We acknowledged the efforts of the Nova Scotia Legal Aid Commission's review of six key areas of the process to estimate legal fees, addressing our prior year recommendation of testing the reasonableness of the system. Management suggested more review and analysis be done and we recommended a complete review be conducted to ensure the liability reflects management's best estimate.

We recommended to the Nova Scotia Provincial Lotteries and Casino Corporation that the statement of retained deficit be expanded to detail all changes in equity. As part of our audit on compliance and controls related to members' expenses at the House of Assembly, we recommended that improvements be made in the systems and controls over Commission assets.

Recommendations

Recommendation 5.1
The Taxation and Fiscal Policy Division should develop a process to periodically review all tax model assumptions to ensure model-derived revenues reflect management's best estimate, especially those assumptions which are not subject to annual review as part of the estimates process.

Recommendation 5.2
The Department of Energy should develop a process to review inputs and calculations used in the models to estimate petroleum royalties.

Recommendation 5.3
The Department of Finance and Treasury Board's Capital Markets Administration Division should verify the accuracy of supporting schedules provided as audit evidence.

Recommendation 5.4
The Department of Finance and Treasury Board's Capital Markets Administration Division should increase the extent to which support for transactions is reviewed for accuracy and appropriateness.

Recommendation 5.5
The Department of Community Services should reassess eligibility of clients as required by the Department's procedures to ensure ongoing validity of payments.

Recommendation 5.6
Department of Community Services' management should monitor the operating effectiveness of controls to reassess client eligibility on a regular basis.

Recommendation 5.7
The Department of Health and Wellness should obtain all auditor correspondence resulting from the audit of the medical services insurance program. The Department of Health and Wellness should follow up with the service provider (Medavie) to ensure internal control deficiencies identified by the auditor are addressed on a timely basis.

6 Review of Audit Opinions and Management Letters

As part of their communication of audit results, auditors provide significant information on internal control-related issues they identified during the audit. This communication is provided to management and those charged with governance, such as boards of directors. Each year, we conduct a review of these communications by private sector auditors under section 23 of the Auditor General Act and report matters of interest. Comments and observations from the 2014 financial statement audits conducted by our Office are noted in chapter 5 of this report.

We are pleased to report an overall improvement in the results of our review of independent auditors' reports, as the number of qualified audit opinions has reduced. Qualified audit opinions were issued on the 2013-14 financial statements for six agencies, down from the prior year in which ten agencies were issued qualified opinions. The significant improvement is due to unqualified opinions at five school boards; these entities received qualified opinions in the prior year due to the inability to verify completeness of certain revenues.

A total of 86 internal control-related issues were identified, only 41 of which were identified and reported in 2013-14 for the first time. The overall number of internal control-related issues identified decreased 10% from 2012-13. Despite a decrease in new internal control issues, the number of deficiencies that remain outstanding from one year to the next in several agencies is increasing. As we have reported previously, responsibility for addressing the issues reported in communication of audit results rests with management of these entities.

7 Finance Follow-up

The overall implementation rate of the recommendations from our January 2012 report is only 70%. This is a decline from the 77% implementation rate for 2010 financial recommendations reported in the January 2014 Report of the Auditor General, and it is disappointing that the overall implementation rate has decreased. Of 27 recommendations made in that report, 19 have been fully implemented.

We disagree with the implementation status reported by the Department of Finance and Treasury Board for two recommendations, both of which relate to internal control. One is to assess the design and effectiveness over model-based tax revenue processes and the other is to complete a risk assessment of roles and responsibilities in three divisions within the Department and to ensure controls exist to mitigate the identified risks. Based on review of the documentation we were provided, we disagree with the Department's view that implementation of these recommendations is complete. We intend to meet with the Department to provide additional information on what is required to fully implement these recommendations.

Details of all financial recommendations included in our January 2012 report along with their current status can be found on our website at oag-ns.ca.