

# Chapter 1

## Financial Audit Work Results

### Key Messages:

- Nova Scotians can rely on the accounting information their government provides
- Significant control deficiencies exist at four organizations, including the IWK with a repeat significant deficiency
- Significant control deficiencies (reported in 2017) fixed at Housing NS and the NS Health Authority
- Weaknesses in financial controls going unfixed in some organizations
- Lack of policy guidance for the accounting of internal meeting, employee social event, and hospitality expenses
- Key matters requiring our attention found to be accounted for properly

### Reasons Supporting Key Messages

#### **Nova Scotians can rely on the Province's financial reporting:**

- 18 years in a row Province has clean financial statements
- Budgeted revenues for 2018-19 received an unqualified limited assurance report from the Auditor General

#### **Significant control deficiencies exist in financial controls at four organizations:**

- IWK: poor restrictions and monitoring of user access to accounting system (2017 repeat) and not reconciling billings
- Halifax-Dartmouth Bridge Commission: poor segregation of duties within finance management and information technology
- Cape Breton-Victoria Regional School Board: weak controls over school-based funds of \$4.3 million (2017 repeat)
- Strait Regional School Board: weak controls over school-based funds of \$1.7 million and poor segregation of duties in accounting (2017 repeat)

#### **Significant control deficiencies in financial controls reported in 2017 fixed at:**

- Housing NS: improvements to user access to systems and to journal entry approval
- NS Health Authority: improvements to policies and procedures to fix weak controls over procurement, payment processing, and payroll processing

#### **Weaknesses in financial controls remain unfixed year after year at:**

- Harbourside Commercial Park Inc.: no capital asset listing; no reconciliation or support for certain journal entries
- NS Health Authority: not reviewing and approving timesheets; key business processes and policies not finalized
- NS Lands Inc. and Sydney Utilities Limited: no reconciliation or support for certain journal entries

#### **Lack of guidance for internal meeting, employee social event, and hospitality expenses at:**

- NS Health Authority - \$8,483 staff Christmas party and \$889 staff farewell party: lacked clear and approved policy direction and documentation meaning it was unclear if expenses met health authority expectations
- Legislative Services - \$3,580 Speaker's annual Christmas reception: lacked policy direction and classified as a meeting expense but in substance it was a social event that should have been accounted for as hospitality



#### Key Matters Dealt With During the Audit and Accounted for Correctly by the Province of Nova Scotia

##### Key Matter

- Boat Harbour clean-up costs which increased by \$75 million to \$205 million (2017 – \$130 million)
- \$232 million extra revenue from petroleum royalty arbitration

##### Resolution

Accounted for correctly as estimates based on Province of Nova Scotia assumptions and disclosed in the financial statements as subject to change due to uncertain nature

- NS Internet Funding Trust – \$193 million expense
- Research NS Trust – \$20 million expense

Accounted for correctly as expenses and the trust funds are not included in the Province's financial statements because the Province does not have decision making authority over these trusts

#### 5 Questions Nova Scotians may want to ask:

1. Why does the IWK continue to have a significant deficiency if they said in our last year's report they would fix it by December 2017?
2. Why are costs like internal meeting, employee social event, and hospitality expenses not already fully addressed given comments in previous Reports of the Auditor General?
3. Why are organizations not fixing their internal control weaknesses and who is holding them responsible to do so?
4. Why did the Province set up trusts outside government control and what does that mean for future accountability for the funds?
5. What will happen to the Province of Nova Scotia's financial position if accounting estimates like Boat Harbour have more changes in the future?

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# 1 Financial Audit Work Results

## Reporting on Financial Audit Results

➡ Government provided Nova Scotians with financial information they can rely on

1.1 For the 18th year in a row, the Province of Nova Scotia received an unqualified opinion on the consolidated financial statements from the Auditor General of Nova Scotia. An unqualified opinion, or clean audit opinion, means that an auditor has no significant concerns about the quality of the information reported in the financial statements. The reader can rely upon the fact that the consolidated financial statements are fairly presented in accordance with Canadian public sector accounting standards. This is an accomplishment that governments over the past 18 years should be proud of and is now an expectation of all Nova Scotians, including elected officials and other users of the Province's financial statements.

1.2 The Province's budget document dated March 20, 2018 received an unqualified limited assurance report on the 2018-19 Revenue Estimates from the Auditor General. Based on our work, the 2018-19 Revenue Estimates of Nova Scotia were prepared, in all material respects, in accordance with the following criteria:

- the 2018-19 Revenue Estimates of Nova Scotia were prepared on a basis consistent with the accounting policies used by the Province in its consolidated financial statements which are prepared in accordance with Canadian public sector accounting standards; and
- the assumptions underlying the 2018-19 Revenue Estimates of Nova Scotia reflected a reasonable set of economic conditions and the Province's planned courses of action for fiscal year 2018-19.

➡ Government organizations are not fixing financial control weaknesses quickly enough

1.3 Most government organizations received clean audit opinions on their 2017-18 financial statements. However, significant deficiencies in internal controls were reported by auditors in four government organizations. We noted that many were repeat deficiencies from the previous year that did not get addressed by the organization during the year. This is concerning because significant deficiencies are serious issues relating to inadequate or ineffective internal controls. To strengthen financial management and controls, the weaknesses need to be addressed in a timely manner.



1.4 We summarized the significant deficiencies presented to those charged with oversight of these organizations in the table below.

<b>Government Organizations with Significant Deficiencies</b>			
<b>Organization</b>	<b>Deficiency</b>	<b>Potential Impact</b>	<b>Reported in 2017</b>
<b>IWK</b>	<ul style="list-style-type: none"> <li>Poor restrictions in and monitoring of user access to accounting system</li> </ul>	Could result in unauthorized or inappropriate access by users	Yes
	<ul style="list-style-type: none"> <li>No reconciliation of billings relating to out-of-province patients</li> </ul>	Increased risk of inappropriate revenue accounting	No
User access review more complex than originally anticipated and now expected to be completed by March 31, 2019. Reconciliation of billings process implemented in June 2018 with planned completion by December 2018. <i>(Management response unaudited)</i>			
<b>Halifax-Dartmouth Bridge Commission</b>	<ul style="list-style-type: none"> <li>Lack of segregation of duties within finance management</li> </ul>	Increased risk of errors, fraud, or management override of internal controls	No
	<ul style="list-style-type: none"> <li>Lack of segregation of duties within key IT related functions</li> </ul>	Increased risk of unauthorized and fraudulent transactions	No
Further changes to improve segregation of duties and additional compensating controls are to be implemented in September 2018. <i>(Management response unaudited)</i>			
<b>Cape Breton-Victoria Regional School Board</b>	<ul style="list-style-type: none"> <li>Weak controls over school-based funds (\$4.3 million):                             <ul style="list-style-type: none"> <li>cash deposits not prepared timely and used for purchases</li> <li>lack of appropriate documentation over cash received</li> <li>insufficient proof of purchase</li> <li>cash activity not reconciled to cash floats</li> <li>reimbursement to employee over \$1,000 contrary to purchasing policy</li> </ul> </li> </ul>	Increased risk of errors or fraud going undetected	Yes
			No
Administrators are now held accountable for school-based funds through their formal evaluation process, training will be provided at the beginning of the school year, and online payment options are available to reduce the amount of cash received. <i>(Management response unaudited)</i>			
<b>Strait Regional School Board</b>	<ul style="list-style-type: none"> <li>Improper cash handling over school-based funds (\$1.7 million)</li> </ul>	Increased risk of errors or fraud going undetected	Yes
	<ul style="list-style-type: none"> <li>Lack of segregation of duties for accounting personnel</li> </ul>	Increased risk of management override of internal controls	Yes
School-based funds training to be provided to staff by October 31, 2018 and internal audits will take place throughout the year. Currently taking steps to reduce segregation issues. <i>(Management response unaudited)</i>			



➔ Housing Nova Scotia and Nova Scotia Health Authority made progress on improving their financial controls

- 1.5 Last year, we reported significant deficiencies at Housing Nova Scotia and the Nova Scotia Health Authority. During the year, these organizations took action and we are pleased to report that the following significant deficiencies are no longer present.

Significant Deficiencies Addressed by Government Organizations	
<b>Housing Nova Scotia</b>	<ul style="list-style-type: none"> <li>• Poor monitoring of user access and access not properly limited</li> <li>• Finance staff can make and approve journal entries</li> </ul>
<b>Nova Scotia Health Authority</b>	<ul style="list-style-type: none"> <li>• Improvements to policies and procedures needed</li> <li>• Weak controls over:               <ul style="list-style-type: none"> <li>• procurement</li> <li>• payment processing</li> <li>• payroll processing</li> </ul> </li> </ul>

➔ Year after year, other weaknesses in internal control continue to not be fixed

- 1.6 Four government organizations had observations that were first reported to management over two years ago. Internal control weaknesses that remain outstanding can diminish the effectiveness of the control environment. Good financial management controls would suggest that all internal control weaknesses identified by a government organization's auditor be appropriately addressed as quickly as possible, and in our view within two years.

Government Organizations with Repeat Internal Control Observations Not Getting Addressed	
<b>Harbourside Commercial Park Inc.</b>	<ul style="list-style-type: none"> <li>• No comprehensive listing of the cost of capital assets</li> <li>• Journal entries processed by the Province are unsupported and the balance owing to the Province is not reconciled on a regular basis</li> </ul>
<b>Nova Scotia Health Authority</b>	<ul style="list-style-type: none"> <li>• Timesheets not reviewed and approved before processing</li> <li>• Key business processes and procedures incorporating internal controls not finalized (e.g., capital assets)</li> <li>• Policies not approved and implemented in some areas (e.g., investment)</li> </ul>
<b>Nova Scotia Lands Inc.</b>	<ul style="list-style-type: none"> <li>• Journal entries processed by the Province are unsupported and the balance owing to the Province is not reconciled on a regular basis</li> </ul>
<b>Sydney Utilities Limited</b>	<ul style="list-style-type: none"> <li>• Journal entries processed by the Province are unsupported and the balance owing to the Province is not reconciled on a regular basis</li> </ul>

➔ Clarification needed over costs related to internal meetings, employee social events, and hospitality

- 1.7 As part of our audit, we performed unpredictability tests of transactions as required under Canadian Auditing Standards, which means auditing items



people might not expect us to. In 2018, we reached beyond the typical high-dollar risk areas usually audited and examined internal meeting expenses to determine if these expenses complied with existing policies and were appropriately supported. We also wanted to determine if external hospitality-type expenses, which are subject to public disclosure requirements, were incorrectly classified as meeting expenses and therefore possibly not considered for disclosure requirements.

1.8 We noted a lack of formalized policy across government in the areas of internal meetings and employee social events, and some consideration is needed over hospitality expenses. Consequently, employees authorizing such expenditures may not have adequate direction on the accounting and appropriateness of these costs. Also, the definition of hospitality expenses under the Province’s hospitality policy does not cover internal social events and has led to certain events being accounted for as meeting expenses when in substance they appear to be more hospitality in nature, such as a Christmas celebration.

1.9 We note a few examples that show why this needs attention.

Examples from Audits of Internal Meeting and Employee Social Event Expenses			
2018 Audit	Nature of the Expense	Issue	Amount
Nova Scotia Health Authority	Staff farewell party (35 people)	<ul style="list-style-type: none"> <li>Lacked policy direction and documentation (e.g., attendees, business rationale, approvals)</li> </ul>	\$889
	Staff Christmas party (146 people)	<ul style="list-style-type: none"> <li>Lacked policy direction and documentation (e.g., attendees, business rationale, approvals)</li> </ul>	\$8,483
Province of Nova Scotia Consolidated Financial Statements	Senior executive dinner with external parties (5 people)	<ul style="list-style-type: none"> <li>Classified as a meeting expense but hospitality in nature and should have been publicly disclosed</li> <li>Lacked documentation (e.g., attendees, business rationale, approvals)</li> </ul>	\$304
House of Assembly (Legislative Services)	Speaker’s annual Christmas reception (invites to numerous government officials)	<ul style="list-style-type: none"> <li>Lacked policy direction</li> <li>Classified as a meeting expense but social event in nature (subsequently disclosed as hospitality after our Office raised the issue with management)</li> </ul>	\$3,580

1.10 As this was not a performance audit or a full examination of accounting for these costs, we do not conclude on all such expenses. Also, we point these areas out as needed for policy improvement, not to indicate what the policy should be or if the expenses should be made.



- 1.11 In response to this, the Province indicated they will be issuing communication to senior executives that will provide guidance on meeting expenses to ensure these expenses are supportable and well documented.
- 1.12 The Nova Scotia Health Authority has subsequently implemented a more rigorous process for review and approval of internal meeting and employee social expenditures and developed two new policies in this area which will be presented to their board for approval in the fall of 2018. The Authority also plans on implementing an education strategy that will provide clear direction to staff authorizing these types of expenditures.
- 1.13 While internal meeting and employee social event expenses are relatively small to the Province's overall expenditures, there is an expectation that these types of expenses are well managed.

### **Recommendation 1.1**

The Executive Council should provide guidance on internal meeting and employee social event expenses that clarifies the nature and accounting of acceptable costs to ensure these expenses meet public expectations, are supportable, and well documented.

This should include clear direction on what hospitality and meeting expenses are, referring to the nature and reason for the expense.

Executive Council Response: Executive Council Office will provide guidance to Deputy Ministers, Associate Deputy Ministers, CEO's of controlled entities, and the Senior Financial Executive Forum (SFEF) regarding appropriate expenditures for internal meetings and social events. Government's recently updated Hospitality Policy outlines the expectations around hospitality related expenses.

### **Significant Matters from 2018 Audits Requiring our Attention**

- 1.14 During the year, we identified certain matters that required extra attention due to the nature of the expense or the financial significance and the degree to which management had to make additional professional judgements. While the matters required additional attention, we are comfortable that they are appropriately accounted for in the Province's financial statements.



#### **Boat Harbour – \$75 million increase in environmental liability**

- 1.15 The Province's estimate of the liability for Boat Harbour at March 31, 2018 is \$205 million – an increase of \$75 million over the prior year. During the year, the Province hired an external consultant to produce a report on a remediation plan and increased the liability estimate based on the consultant's report and management's experience with similar site cleanup projects.



After reviewing the consultant's report, other supporting documentation, and management's assumptions, we concluded that the estimated environmental liability for Boat Harbour represents management's best estimate given the current information available.

- 1.16 The Province continues to assess the remediation project to ensure the best possible solution. As a result, the estimated costs are expected to change as new information is obtained.

➡ \$232 million extra revenue from petroleum royalty arbitration

- 1.17 Predicting tax and royalty revenues requires estimation and involves a high degree of measurement uncertainty because actual revenues are not known until returns are filed and data is received by the Province. As a result, the Province is required to make estimates to determine its tax and royalty revenues and regularly adjust as new information becomes available.

- 1.18 During 2018, the Province adjusted its 2018 tax and royalty revenues for the following significant items:

- Petroleum royalties – An arbitration ruling impacted the treatment of transportation costs on the Sable Offshore Energy Project resulting in a positive adjustment of \$232 million.
- Personal income tax – Net negative adjustment of \$29 million resulting from changes in tax filer activity (-\$128 million) and tax credits payable (+\$99 million).

- 1.19 We assessed management's treatment of these adjustments under Canadian public sector accounting standards and agreed that these items should be recorded as 2018 revenue. As well, we are pleased to note the enhanced disclosure of these items in Note 6 of the Province's consolidated financial statements.

➡ \$238 million funded to two trusts properly expensed because the Province does not control trusts

- 1.20 The Province uses various types of government organizations to meet its mandate and provide services to Nova Scotians, one of which is trusts. The Province establishes trusts to fulfill a specific objective and these assets are managed by a trustee.

- 1.21 Some trusts are controlled or administered by the Province and are therefore reported in the Province's consolidated financial statements. Other trusts established by the Province are neither controlled nor administered by the Province and are not reported in the Province's consolidated financial statements. The Research Nova Scotia Trust and the Nova Scotia Internet



Funding Trust are recently created trusts excluded from the government reporting entity as a result of not being controlled or managed by the Province.

- 1.22 The Research Nova Scotia Trust was created to support research projects put forward by the Province's universities and community colleges in the areas of technology, health and wellness, and social innovation. The Nova Scotia Internet Funding Trust was established with the objective of improving high-speed internet services for rural Nova Scotians. Over the past two years, these two trusts received a significant amount of funding.

	<b>Research NS Trust</b>	<b>NS Internet Funding Trust</b>	<b>Total</b>
2016-17	\$25 million	-	\$25 million
2017-18	\$20 million	\$193 million	\$213 million
<b>Total</b>	<b>\$45 million</b>	<b>\$193 million</b>	<b>\$238 million</b>

- 1.23 The Province's decision not to include these trusts in its consolidated financial statements was based on the determination that these trusts are independent and not controlled by the Province. As part of our audit of the Province's consolidated financial statements, we assessed if the Province controlled the Research Nova Scotia Trust and the Nova Scotia Internet Funding Trust under Canadian public sector accounting standards.
- 1.24 In our view, the Province's position that it does not control these trusts was accurate and in accordance with accounting standards. The trusts are not controlled by the Province, as the trustees, not the Province, are ultimately responsible for decision making over disbursement of funds from the trusts. Therefore, it was appropriate accounting to expense the funding to these trusts and not include the trust funds in the Province's consolidated financial statements. However, while these trusts may be outside government, we are of the view that this does not prevent our Office from conducting financial or performance audits of these trusts in the future.



## Who We Are and What We Do

### Who we are?

1. The Auditor General is an independent nonpartisan officer of the Legislature, appointed by the House of Assembly for a 10-year term. The current Auditor General, Michael A. Pickup, CPA, CA, began his 10-year term on July 4, 2014. He is responsible to the House for providing independent and objective assessments of the operations of the Province, the use of public funds, and the integrity of financial reports. The audit work of the Office of the Auditor General helps the House hold the Government to account for its use and stewardship of public funds.

### What financial audit work does the Office of the Auditor General do?

2. The Auditor General Act (the Act) establishes the Auditor General's mandate, responsibilities, and powers. The Act also provides the Office with 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, as well as funding recipients external to the provincial public sector. In addition, other legislation appoints the Auditor General, or a person designated by the Auditor General, as the auditor of an entity's financial statements.
3. Sections 19 and 20 of the Act stipulate that the Auditor General shall audit the annual consolidated financial statements of the Province; and conduct a review of the estimates of revenue used in the preparation of the budget address of the Minister of Finance and Treasury Board.
4. The consolidated financial statements of the Province are an accumulation of the assets, liabilities, revenue, and expenses of all the activities that it controls. This includes many parts of the provincial public sector. Schedule 10 of the consolidated financial statements lists the Province's departments and public service units, special operating agencies, special purpose funds, governmental units, government business enterprises, and government partnerships.
5. In its work, the Office of the Auditor General is guided by, and complies with, the professional standards established by Chartered Professional Accountants (CPA) Canada. We also seek guidance from other professional bodies and audit-related best practices in other jurisdictions.
6. The Office of the Auditor General audits the consolidated financial statements of the Province. We provide an audit opinion which lets users know that



the financial statements are fairly presented. In addition, as auditors, we make recommendations to improve or strengthen internal controls. Internal controls are important as they may reduce the risk of asset loss, improve the completeness and accuracy of financial information, or ensure that the organization complies with laws and regulations.

7. The Province's audited consolidated financial statements add value and serve the following purposes.
  - Elected officials use financial information to make decisions, including the allocation of scarce resources.
  - Nova Scotians and elected officials use this information to assess the Government's stewardship over the resources entrusted to it.
  - Other users, such as lenders and credit rating agencies, use financial reports to meet their specific needs.
8. The Auditor General also issues a limited assurance report on the reasonableness of the estimates of revenue used in the preparation of the annual budget address of the Minister of Finance and Treasury Board to the House of Assembly.