June 2020

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

NOVA SCOTIA

Nova Scotia Liquor Corporation – Phase I

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June 23, 2020

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,

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Overall Conclusions

- NSLC does not have an adequate strategic plan for supporting the local beverage alcohol industry.
- Certain measures to support the local beverage alcohol industry were not properly planned, including identification and assessment of risks.
- NSLC is not adequately monitoring responsible retailing programs or reporting against established performance measures for programs promoting responsible drinking.
- NSLC has a plan for improving the retail store network and follows a defined procurement process; only minor issues identified.
- NSLC has signed agreements with clear terms and conditions for the agency store program.

Why We Did This Audit

- NSLC is significant to the provincial economy.
- In 2018-19, NSLC had $662 million in sales and $237 million in earnings.
- The local alcohol manufacturing industry in the province has grown rapidly, which has a significant impact on NSLC as the main retailer of alcohol in the province and the issuer of manufacturing permits.
- The responsible sale of alcohol is important to Nova Scotians to ensure it does not end up in the hands of minors or other high-risk consumers.
- We have not completed a stand-alone audit of NSLC since 2000.

Local Industry

- NSLC does not have a long-term plan with specific and measurable goals and objectives detailing how they aim to support the local beverage alcohol industry
- Poor accountability for the strategies in place, as actions taken are not well planned or monitored for completion
- NSLC supports the local beverage alcohol industry through various methods. However, there are several issues identified with the approaches used, including:
  - markup structures for locally manufactured alcohol are not adequately planned, evaluated, or documented, including completing a detailed risk analysis for compliance with trade agreements
  - processes are not defined, such as how to have product listed as Proudly Nova Scotian or the number of stores a manufacturer must be able to supply to be carried through NSLC
  - implementation and impact of an agreement between NSLC and Alcool New Brunswick Liquor (ANBL) on beer trade is unclear
  - NSLC does not assess reasonableness of self-reported payments required from local manufacturers
  - NSLC communicates with local manufacturers through several channels, however it is often not documented, and there is no consultation policy

Responsible Drinking

- Responsible Retailing training is not completed in a timely manner in corporate stores, or as required by agency stores
- NSLC did not adequately address issues identified through the We ID compliance program which requires staff to request valid identification to verify the age of those appearing under the age of 30
- Most local alcohol manufacturers' operating retail stores are excluded from monitoring compliance with age verification requirements, and the four breweries included in the program have the lowest compliance scores
- NSLC has established a framework for corporate social responsibility, however performance measures are not monitored for the programs that promote responsible drinking

Capital Planning and Procurement

- NSLC has completed a full review of the condition of its corporate retail stores and has a store improvement plan
- NSLC's plans to change corporate stores to agency stores have not been implemented due to uncertainty around the authority to do so
- Our testing showed that NSLC generally followed its defined procurement process; only minor deficiencies were identified

Agency Store Network

- Agency store agreements have clear terms and conditions and are signed by all required parties
- Internal audits of agency stores cover most areas of operations and audit results are reported to senior management and the board of directors
- The internal audit mandate for agency stores does not include monitoring or enforcing the Responsible Retailing training or the We ID program

Recommendations at a Glance

Recommendation 1.1
The Nova Scotia Liquor Corporation should clarify its role in supporting the local beverage alcohol industry and establish long-term goals and objectives that are specific and measurable.

Recommendation 1.2
The Nova Scotia Liquor Corporation should establish clear roles and responsibilities for its strategy to support the local beverage alcohol industry, including accountability for specific tasks, monitoring of progress, and evaluation of results.

Recommendation 1.3
The Nova Scotia Liquor Corporation should review, evaluate, and document each reduced markup structure, defining the goals and objectives, assessing the appropriateness of the markup rate and conducting a thorough risk assessment, including compliance with trade agreements.

Recommendation 1.4
The Nova Scotia Liquor Corporation should establish a process, including qualifying requirements, for marketing products as Proudly Nova Scotian.

Recommendation 1.5
The Nova Scotia Liquor Corporation should review and evaluate the agreement on beer trade to assess the benefit to Nova Scotia's manufacturers and establish a policy which ensures fair and balanced implementation that does not favour out-of-province manufacturers over those from Nova Scotia.

Recommendation 1.6
The Nova Scotia Liquor Corporation should implement a quality assurance process to ensure amounts paid by local manufacturers through the retail sales markup allocation are reasonable.

Recommendation 1.7
The Nova Scotia Liquor Corporation should develop a policy on consultation, to clarify and set the expectations of the local industry.

Recommendation 1.8
The Nova Scotia Liquor Corporation should conduct a risk analysis and assess the controls in place over the manufacturer's permit process, including segregation of duties and document retention standards.

Recommendation 1.9
The Nova Scotia Liquor Corporation should review the current process for monitoring training and determine changes needed to ensure all training is completed in a timely manner.

Recommendation 1.10
The Nova Scotia Liquor Corporation should review the mystery shop program to assess which retailers should be included and define how results are to be used, including roles and responsibilities for analysis, communication, documentation, and enforcement of retraining.

Recommendation 1.11
The Nova Scotia Liquor Corporation should establish reporting expectations for the performance measures in the Corporate Social Responsibility framework, including timelines and regular reporting intervals for each performance measure.

1 Nova Scotia Liquor Corporation – Phase I

Support For Local Alcohol Manufacturing Industry

1.1 Participation in the local alcohol manufacturing industry has been on a significant rise in Nova Scotia for the past several years, with increasing numbers of manufacturers across all main product categories and increased local product sales through the Nova Scotia Liquor Corporation.

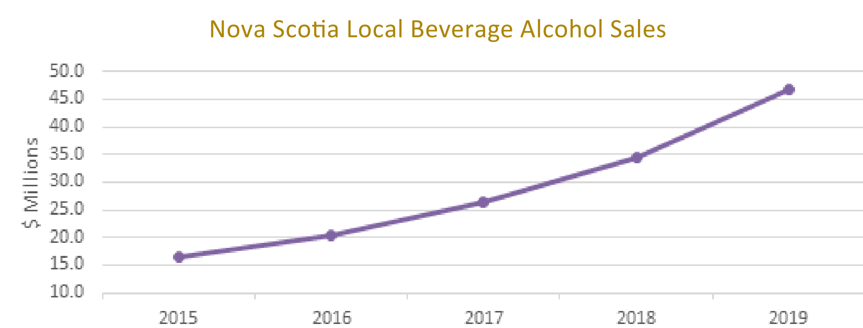
1.2 The number of local alcohol manufacturers has more than doubled over the last five years, from 64 to 141, with the largest increase being breweries.

Year	Breweries	Wineries	Distilleries	Total
2015	31	23	10	64
2020	86	31	24	141
Increase	**55**	**8**	**14**	**77**

Note: Cideries are classified as either a brewery or winery based on permit qualifications.

Source: Unaudited - information provided by NSLC management

1.3 Sales of local beverage alcohol products through the Nova Scotia Liquor Corporation have risen significantly, from $16.5 million in 2015 to $45.3 million in 2019.



Source: Unaudited - compiled by OAG from NSLC 2019-20 Business Plan and 2018-19 Annual Report

1.4 Part of NSLC's legislated mandate is to promote the industrial and economic objectives of the beverage alcohol industry in the province (see Appendix II). This is in addition to acting as the regulator of the local industry, as the issuing body for manufacturing and various other permits, and as the main retailer of alcohol in the province.

1.5 Although the industry is clearly growing, the following paragraphs provide several examples which indicate an overall lack of adequate planning, evaluation, and clarity around how NSLC supports the local alcohol manufacturing industry.

1.6 While this chapter focuses on the overall strategy and approach to the local industry, we are currently completing the second phase of our audit of the Nova Scotia Liquor Corporation, which will look at NSLC's product procurement and promotion processes, including local products, as well as a detailed look at governance of the organization.

Strategic plan for the local industry not adequate

1.7 Management and the board failed to adequately plan for NSLC's role in the local industry. An appropriate strategic plan would align with NSLC's mandate and include clear goals and objectives for the local industry, including action plans with measurable targets to determine success.

1.8 The one goal established for the local industry in the five-year strategic plan (2015-20) is to provide an engaged and collaborative business environment for local manufacturers. While there are five broad strategies for the local industry included in the plan, we found they were not specific enough to clearly outline what is trying to be achieved and to hold NSLC accountable. Action items and tasks were not established when the strategic plan was developed, and no meaningful performance measures exist.

1.9 The only performance measure for the local industry included in the plan is growth in local product sales through NSLC's retail network. This measure is reported annually. However, there is no specific target.

1.10 While local product sales increased during the first four years of the plan, there is no clear link between the strategy and this growth. As noted later in this chapter, some of the increase in the number of local manufacturers and sales may be attributed to steps taken that were not adequately planned and have not been subsequently reviewed or evaluated, and which may have long-term negative consequences for the industry.

Annual action items not appropriately planned or monitored

1.11 Action items related to the strategic goal for the local industry are published in the annual business plan which is approved by the Board of Directors. However, we found the approach to planning was not sufficiently detailed, accountability measures were lacking, and management oversight was poor.

1.12 There is no clear ownership of the local industry strategy within NSLC and there is no one within the organization with a role dedicated to the local industry. Efforts to support the local beverage alcohol industry are a small part of the roles of many staff. In order to move the strategy forward, clear responsibility and accountability for the supervision of its progress, and completion of specific tasks, is necessary.

1.13 We obtained more detailed internal business plans for the first four years of the strategy and found that the process for establishing action items and related tasks was not comprehensive or strategic. Tasks were not sufficiently detailed to be able to adequately assess if they were completed to meet the purpose and expectations of senior management. Status updates therefore were often equally lacking detail. The internal business plans are approved annually by the senior executives.

1.14 We found multiple instances in which tasks were marked as complete but upon further enquiry, we determined they were not complete. For example, in fiscal 2017-18, the *"development of guidelines to define NSLC's support for local partners to ensure transparency and expectations on partnership"* was assessed as complete. Management confirmed to us that these guidelines are still in draft and had not been completed at the time of our audit. Similarly, in the same fiscal year, a *"summary of the promotions and policy guides specific to the local industry"* was also recorded as complete. However, no summary document exists.

1.15 We also identified a lack of continuity in the annual planning process. For example, one task established in fiscal 2017-18 was to provide clarity on the agreement on beer trade with New Brunswick. The status of the task was assessed as in progress, but it was not carried forward to fiscal 2018-19. The status update noted that clarity was received; no details were included except that NSLC was waiting for feedback from the Minister to address the concerns of local manufacturers. As noted later in this chapter, we found that no changes or progress had been made, and the local industry is still concerned with the implementation of this agreement.

1.16 It is concerning that a task was dropped without questions from senior management or the Board of Directors when the most recent status clearly noted it was still in progress, and that an item was marked as complete without sufficient due diligence to ensure it was in fact complete and met expectations. If these tasks are strategic in nature and intended to improve and move the local industry forward, then ensuring completion of them should be a priority. These issues raise larger organizational concerns regarding governance and oversight, including the quality of reporting to senior management and the Board of Directors. Governance practices will be examined in more detail in the second phase of our audit of NSLC.

Recommendation 1.1

The Nova Scotia Liquor Corporation should clarify its role in supporting the local beverage alcohol industry and establish long-term goals and objectives that are specific and measurable.

Nova Scotia Liquor Corporation Response: The NSLC agrees with this recommendation. According to the Liquor Control Act, the NSLC mandate is to promote industrial or economic objectives regarding the beverage alcohol industry in the Province. It is not the intent of the NSLC to establish sector economic objectives. Support of Local Industry is one of the key focus areas in the 2020-2025 NSLC strategic plan. The NSLC will clarify their role and establish goals and objectives that are specific and measurable but within their capacity as a retailer and within their span of regulatory control. Timing: Implementation January 2021.

Recommendation 1.2
The Nova Scotia Liquor Corporation should establish clear roles and responsibilities for its strategy to support the local beverage alcohol industry, including accountability for specific tasks, monitoring of progress, and evaluation of results.

Nova Scotia Liquor Corporation Response: The NSLC agrees with this recommendation and will establish clear roles and responsibilities for their strategy to support the local beverage industry. Accountability for specific tasks and timing will be established and progress will be monitored. Timing: Implementation July 2020.

Markup structures for alcohol not adequately planned or evaluated

1.17 NSLC applies standard markup rates to all alcohol it purchases to determine the in-store retail price customers pay for the product. These markup rates vary by product category, and in certain categories, NSLC applies a lower markup rate to locally manufactured or otherwise specified products. Through this approach, local manufacturers are paid more than outside manufacturers for a similar product that sells for the same price in an NSLC store. We found this approach was not adequately planned, documented, monitored, or evaluated.

1.18 A summary of markup structures applied to local products is found in Appendix III.

1.19 NSLC does not have policies or support for markup structures applied to Nova Scotia manufactured craft beer or cider, including no approvals of the rates by the Board of Directors. The Nova Scotia craft beer markup has been applied for over a decade with no policy in place.

1.20 The corporation has policies for markups on products from Nova Scotian craft distilleries and wine from areas that qualify as an emerging wine region. Wines produced in Nova Scotia fall into the emerging wine region category if the region produces less than fifty thousand hectolitres of wine annually.

1.21 No internal risk analysis was completed in advance of implementing the markup rates. A proper risk analysis would identify potential risks, including unintended consequences, and help demonstrate that NSLC had completed some due diligence that it was operating in compliance with various applicable trade agreements, which is ultimately in the best interest of manufacturers in the long term. These agreements include, for example, the Canadian Free Trade Agreement and the General Agreement on Trade and Tariffs. Both agreements have seen recent or ongoing challenges to local pricing structures across Canada.

1.22 The Government of Alberta was challenged under the former Agreement on Internal Trade, which has since been replaced by the Canadian Free Trade Agreement, regarding a reduced small brewer markup which was only applicable to Alberta, Saskatchewan, and British Columbia, while other small brewers were charged the full commercial markup rate. Alberta was found to be not in compliance with the Agreement on Internal Trade and the Constitution Act of 1867, and was required to amend the program, which it has done.

1.23 Nova Scotia is currently involved in a dispute settlement panel established by the World Trade Organization. The dispute involves wine measures and is the result of a complaint filed in January 2018 against Canada which references measures in several provinces. The complaint contends that Nova Scotia implemented wine measures that provide reduced product markup for local manufacturers and preferences through supplier competitions, and price bands which are not in compliance with the General Agreement on Trade and Tariffs. NSLC has not prepared an analysis to show that all current markup structures are compliant. The panel's decision on the issues under review had not been made when we completed our fieldwork in March 2020.

1.24 These examples demonstrate the importance of assessing all markups and other relevant pricing measures, which provide preference based on geographic region, against applicable trade agreements, and other commitments of the Province.

1.25 Nova Scotia is home to a growing local industry, an unknown portion of which is dependent on the current markup structures. The effect of any changes to the markup structures is difficult to assess because NSLC has not completed any evaluations of the reduced markup structures to assess the impact since their implementation; whether they continue to be appropriate, or whether they are achieving the intended objectives.

1.26 However, if a reduced markup structure were found to be noncompliant and changed to current standard markup levels, local manufacturers would see a significant decrease in revenue from NSLC, and this would likely have a considerable impact on the industry.

Recommendation 1.3

The Nova Scotia Liquor Corporation should review, evaluate, and document each reduced markup structure, defining the goals and objectives, assessing the appropriateness of the markup rate, and conducting a thorough risk assessment, including compliance with trade agreements.

Nova Scotia Liquor Corporation Response: The NSLC agrees with this recommendation and will ensure all reduced markups are appropriately documented in their published manufacturing policies. Definition of goals and objectives of the reduced markups, an assessment of the current markup rates, and compliance with trade agreements will in part depend on sector objectives as well as the outcome of the current WTO complaint with Australia. This requires consultation with external stakeholders. Timing: Implementation August 2021.

No defined criteria for Proudly Nova Scotian product classification

1.27 NSLC does not have a policy specifying the requirements for a product to be marketed as Proudly Nova Scotian. As an initiative to support the local industry, locally manufactured products are marketed as Proudly Nova Scotian on NSLC's website and within retail stores.

1.28 Management told us any products manufactured in Nova Scotia that qualify for a reduced markup receive the Proudly Nova Scotian branding. NSLC does not verify eligibility, and the only information about manufacturing location is directly supplied by the manufacturer. NSLC does not monitor the Proudly Nova Scotian branding program and has no rationale for why only small manufacturers qualify for this promotion.

1.29 We identified one product listed as Proudly Nova Scotian that did not qualify for a reduced markup although it was manufactured in Nova Scotia. NSLC has since removed the branding from this product.

1.30 Without defined eligibility criteria, manufacturers are uncertain on what qualifies as a Proudly Nova Scotian product, and consumers are not well informed on what the branding represents.

Recommendation 1.4

The Nova Scotia Liquor Corporation should establish a process, including qualifying requirements, for marketing products as Proudly Nova Scotian.

Nova Scotia Liquor Corporation Response: The NSLC agrees with the recommendation. The NSLC will develop and implement a clear definition of product being labelled as "Local". The NSLC will work closely with industry and sector stakeholders with an attempt to clearly align and define Proudly Nova Scotian and its marketing to our customers. Timing: Implementation April 2021.

Implementation and impact of agreement on beer trade unclear

1.31 In 2007, the CEOs of NSLC and Alcohol New Brunswick Liquor (ANBL) signed an agreement which states that each province will treat breweries producing less than 15 thousand hectolitres in the other province equal to their own breweries. The agreement includes reference to equal treatment in such areas as listing requirements, pricing, access to point of sale, and fees. NSLC does not have policy or processes in place to guide the application of the agreement to align the treatment of New Brunswick's products with those produced locally.

1.32 NSLC gives breweries from Prince Edward Island the same preferential treatment as those from New Brunswick. However, Prince Edward Island has never been part of the formal agreement, and no policy or other explanation for the change was provided.

1.33 As identified by local manufacturers, the agreement is currently applied in Nova Scotia in a manner that is more advantageous to breweries from New Brunswick and Prince Edward Island than breweries located in Nova Scotia. Craft breweries in Nova Scotia that sell kegs directly to bars and restaurants are required to pay a retail sales markup allowance of five percent of wholesale cost of sale to NSLC, while craft breweries from New Brunswick and Prince Edward Island pay no retail sales markup allowance. Therefore, it costs Nova Scotia's breweries more to sell their product to these establishments than a brewery from the other two provinces who do not pay the fee.

1.34 NSLC has also not assessed New Brunswick's compliance with the agreement or evaluated the overall benefit to Nova Scotia of participation in the agreement. Therefore, it is unknown what impact this agreement has on Nova Scotia's breweries when they sell in New Brunswick or Prince Edward Island.

Recommendation 1.5
The Nova Scotia Liquor Corporation should review and evaluate the agreement on beer trade to assess the benefit to Nova Scotia's manufacturers and establish a policy which ensures fair and balanced implementation that does not favour out-of-province manufacturers over those from Nova Scotia.

Nova Scotia Liquor Corporation Response: The NSLC agrees with this recommendation and, as part of its current policy review, will evaluate the terms of the beer trade agreement letter between ANBL and the NSLC, including an assessment of whether a specific agreement exclusively between two provincial liquor jurisdictions is appropriate. Implementation of any changes to the agreement letter will be dependent on external parties. Timing: Implementation August 2021.

Retail sales markup allocation payments not assessed for reasonableness

1.35 Manufacturers are required to pay five percent of wholesale cost on sales completed outside of the NSLC retail network. This payment is called the retail sales markup allocation and includes any alcohol sold on their premises, at markets, or at other non NSLC offsite locations.

1.36 NSLC clearly outlines the process in documents it provides to all newly permitted manufacturers. However, information submitted by manufacturers to determine their required payment is self-reported and not verified or otherwise assessed for reasonability by NSLC.

1.37 NSLC earned $1.6 million in 2018 and $1.7 million in 2019 from these payments, but it is unknown whether these are the correct amounts owing from manufacturers due to the lack of assessment processes. NSLC may not be receiving the full amounts owed, which although it is not significant to NSLC's overall revenue, is significant to manufacturers.

Recommendation 1.6
The Nova Scotia Liquor Corporation should implement a quality assurance process to ensure amounts paid by local manufacturers through the retail sales markup allocation are reasonable.

Nova Scotia Liquor Corporation Response: The NSLC agrees with this recommendation and will ensure a program is developed. This would support a quality assurance process and ensuring proper producer categorization for RSMA calculation and markup. Timing: Assessment: October 2020; Readiness (communicate with Producers): Winter 2021; Implementation: April 2021.

Minimum requirements to sell products through the NSLC unclear

1.38 NSLC does not have a policy defining the minimum number of stores that a manufacturer must be able to supply in order to qualify to get a product on NSLC shelves. Several local manufacturers we interviewed told us that NSLC has minimum listing requirements, and in addition to being unclear, those requirements can be a challenge for new manufacturers.

1.39 NSLC management confirmed that each category of beverage alcohol has minimum supply requirements for listing, but they were unable to provide documentation of the minimums or to show how and why they were determined. NSLC should have clearly documented listing requirements to ensure consistent application and be transparent for why the requirements are what they are.

1.40 In relation to this, NSLC identified a need to support local manufacturers by making it easier for smaller manufacturers to get product in NSLC stores. In

2019, NSLC piloted the Hyper Local program to address this need. The pilot offered breweries within a specific region the opportunity to list one product at a small number of local NSLC retail stores.

1.41 Success measures for participants and the program overall were established in advance of the pilot. This approach provides transparency and a clear method to guide future decisions. As we were conducting our fieldwork, NSLC was evaluating the success of the pilot with the intention of expanding it to other regions of the province based on the results.

NSLC communicates with the local beverage alcohol industry

1.42 NSLC tries to meet annually with each local manufacturer to discuss plans for the upcoming year and provide feedback regarding performance of the manufacturer's current products sold at NSLC retail locations. Management stated these meetings happen during the category review process when NSLC assesses the product assortment list. Our comments and observations on the category review process will be reported in the second phase of our audit of NSLC.

1.43 NSLC was unable to provide documentation affirming that annual meetings with local manufacturers regularly occurred. There was no formalized schedule and no reliable records of what was discussed during the meetings. If a manufacturer were to raise concerns in these meetings, there would be no record or clear communication channel to address the issue or consider it in future strategic planning.

1.44 Sales data is communicated to all manufacturers regularly to facilitate the manufacturer's ability to continually evaluate the performance of their products. NSLC also holds regular industry days to which all local manufacturers are invited. These events focus on communicating information about NSLC's plans for the upcoming year, new trends, and other strategic initiatives.

No consultation policy for the local industry

1.45 NSLC does not have a specific policy around consulting with the local industry on changes to operations which may have an impact on manufacturers. When requested, it engages with local manufacturers through industry associations, such as the Craft Brewers Association of Nova Scotia, the Winery Association of Nova Scotia, and the Craft Distillers Association of Nova Scotia. However, the intent of that participation and expectations are not clear.

1.46 When NSLC made a significant change to the Craft Distillery policy in April 2018 it did not consult with local industry manufacturers other than those whose concerns led to the change. Some members of the local industry felt this was not appropriate.

1.47 The change expanded the reduced markup structure to higher production levels; a change which could have a broader impact on the craft distilling industry in the province. However, no feedback from the rest of the industry was sought. This lack of policy around consulting further supports the lack of planning for the markup structures as discussed previously in this chapter.

Recommendation 1.7
The Nova Scotia Liquor Corporation should develop a policy on consultation, to clarify and set the expectations of the local industry.

Nova Scotia Liquor Corporation Response: The NSLC agrees with this recommendation and will develop a consultation policy that takes into account known external stakeholders. Timing: Implementation August 2020.

No segregation of duties or documentation standards for manufacturers' permits

1.48 NSLC is responsible for issuing permits for the manufacturing of beverage alcohol in Nova Scotia. The permit application process includes review of items such as facility floor plans, approach to quality control, and confirmation that liability insurance requirements are met. All manufacturers must renew their permit annually.

1.49 One person reviews, approves, and issues permit applications. There is no additional monitoring or review by a second person at any step of the process. This is an inappropriate approach which places too much responsibility and autonomy with one staff member and exposes the organization to unnecessary risk of permits being issued when conditions are not met.

1.50 We also have concerns with how the records of these applications are maintained. While there is no guidance for staff on what documentation should be kept, and how and where it should be stored, the current practice of maintaining records in an employee's work email account is not appropriate. Our concern is further magnified when the records are maintained in the email accounts of whichever individual reviewed, approved, and issued the permit in the absence of the regularly assigned staff member.

1.51 This practice makes information inaccessible to others within the organization, increases potential for information loss, and raises potential confidentiality concerns. For example, an employee who issued one of the permits we selected for testing was no longer with NSLC. We had to obtain assistance from the IT department to access the former employee's email records in order to locate the documentation for our testing. If the staff member who regularly issues the permits were to leave the organization unexpectedly, the information in their email account would be similarly difficult to access.

1.52 We tested 30 local manufacturers to determine if a valid permit was issued and found that 29 permits had all required supporting documents on hand, while 1 did not. NSLC was unable to provide a copy of the liability insurance for one permit. It is unknown whether this manufacturer had adequate liability insurance in place.

Recommendation 1.8
The Nova Scotia Liquor Corporation should conduct a risk analysis and assess the controls in place over the manufacturer's permit process, including segregation of duties and document retention standards.

Nova Scotia Liquor Corporation Response: The NSLC agrees with this recommendation and will conduct a complete review and risk analysis of the permit process. Timing: Target completion is August 2020.

Responsible Drinking

Training for new hires not completed in a timely manner

1.53 Responsible Retailing training is not completed in a timely manner when employees are hired. The Responsible Retailing training program is supposed to be completed within the first 30 days of employment, and covers topics such as age verification requirements, dealing with minors, and other difficult situations such as intoxicated customers.

1.54 We tested 30 retail employees (20 new hires and 10 rehires) to determine if training was completed as required when hired. 20 of 30 employees tested did not complete the Responsible Retailing training within 30 days of starting work. Four of those 20 employees never completed the training at all.

1.55 Information systems to provide management at all levels of the organization with adequate information on training completion are in place and required information to monitor completion is distributed regularly to management to facilitate monitoring. However, training is still not being completed as required. The average time to complete the training for the 20 new hires tested was 119 days, with 2 new hires not completing the training until a year after they started work.

1.56 NSLC does not monitor training completion for new hires at agency stores, although agency store employees have access to the training program and are responsible to complete it, as required in the agency store agreement.

1.57 Responsible Retailing training provides necessary guidance for challenging situations. Ensuring that all staff complete this training is important to set the tone of the organization regarding the value placed on responsible retailing practices.

Recommendation 1.9
The Nova Scotia Liquor Corporation should review the current process for monitoring training and determine changes needed to ensure all training is completed in a timely manner.

Nova Scotia Liquor Corporation Response: The NSLC agrees with this recommendation. The NSLC has recently created a sustainable training and monitoring approach. Non-compliant employees are being dealt with promptly. Timing: Completed as of May 2020.

Results of the age verification compliance program not adequately addressed

1.58 The Liquor Control Act specifies that all customers purchasing beverage alcohol in Nova Scotia must be at least 19 years of age. NSLC operates an age verification program called We ID where all customers that appear to be less than 30 years of age are asked for valid identification. At some retail locations, NSLC did not adequately monitor and address compliance with the program.

1.59 To monitor the program, NSLC employs a third-party company to conduct mystery shops at retail outlets across the province. A mystery shop uses anonymous participants ranging in age from 19 to 23 who visit stores to purchase an item and document whether staff verify their identification. The program includes visits to NSLC's corporate stores, agency stores, the four private wine and spirit stores, and four of the larger breweries in the province. NSLC provides clear guidance to participants of the We ID mystery shop program on how to perform the task.

1.60 The results for the two-year period from April 1, 2017 to March 31, 2019 are as follows:

Retail Store Type	Number of Mystery Shops	Number Failed	Percentage Failed
Corporate	1,489	182	12%
Agency	910	174	19%
Private	51	19	37%
Brewery	95	60	63%

Source: Unaudited - compiled by OAG from third-party program data submitted to NSLC

1.61 The table above clearly shows some distinct areas of concern, yet only the corporate stores received detailed attention to address identified issues. NSLC does not have documented policies to provide guidance on communicating and following up on mystery shop results.

1.62 We found NSLC did not review the data received for private wine and spirit stores or breweries, and the results were not even communicated back to the retailers involved. Breweries had the highest fail rate for not verifying age – 63 percent, or 60 of the 95 mystery shops. Private wine and spirit stores had the second highest fail rate for not verifying age – 37 percent, or 19 of the 51 mystery shops.

1.63 Many of the 141 local manufacturers retail their own beverage alcohol products at their manufacturing locations. However, most are not part of this program. Permits issued by NSLC allow local manufacturers to operate these onsite retail stores, but mystery shops are limited to only four breweries. As noted earlier in the chapter, the local alcohol manufacturing industry is a fast-growing sector in Nova Scotia, and we found NSLC was not monitoring compliance with age verification requirements at the increasing number of local manufacturers.

1.64 Staff at both corporate and agency stores are expected to complete a Responsible Retailing training refresher when a mystery shop is failed. While mystery shop results are communicated to the relevant corporate or agency store manager to address failures, NSLC does not adequately follow up to ensure required actions are taken on failed mystery shops.

1.65 Agency stores failed the mystery shop 19 percent of the time (174 of 910). However, we found that the 10 agency stores with the highest fail rates only completed a total combined two instances of training during the two years under review. NSLC had not even followed up with the two agency stores which had failed 100 percent of their mystery shops between April 2017 and March 2019.

1.66 We also tested a sample of 30 corporate store employees who were required to complete a Responsible Retailing training refresher as a result of a failed mystery shop and found that 8 had not taken the training refresher as required.

1.67 Regional Managers are required to document and centrally record meeting with the employee to discuss the results and completion of training. However, this was not done for about half of the failed mystery shops tested (14 of 29). In eight instances the completed documentation was incorrect, as the documented date of training completion did not agree to training system records. This indicates that the manager did not actually verify training completion in the system.

Recommendation 1.10
The Nova Scotia Liquor Corporation should review the mystery shop program to assess which retailers should be included and define how results are to be used, including roles and responsibilities for analysis, communication, documentation, and enforcement of retraining.

Nova Scotia Liquor Corporation Response: The NSLC agrees with this recommendation and will review the program in all channels with objectives, process and expected results. This review will also include current agreements relating to agency and private wine and spirit stores (PWSS). Defining an approach with the local industry is dependent on the completion of a consultation process as defined in recommendation 7. Timing: Agency and PWSS completed January 2021. Local Producers completed April 2021.

Corporate social responsibility framework established but performance not monitored

1.68 NSLC prepared a corporate social responsibility framework as part of its five-year strategic plan. The framework outlines a balanced approach between responsible sales and responsible consumption; a recognition of NSLC's mandate to promote social objectives related to responsible drinking.

1.69 The corporate social responsibility framework outlines three main programs: Responsible Retailing (which includes We ID as discussed above), Cabbioke, and Keep it Social. The framework includes specific and measurable goals and objectives for each program. However, we found that NSLC did not adequately report on performance against these measures.

1.70 NSLC provided only one formal status update to the Corporate Social Responsibility Committee of the Board of Directors during our two-year audit period from April 2017 to March 2019 and this October 2018 update covered less than half of the measures established. While it is good that NSLC has a corporate social responsibility framework, to achieve its intended purpose it is important that NSLC provide complete regular reporting against all measures.

1.71 The Responsible Retailing and Cabiokee programs promote compliance with federal and provincial legislation by keeping beverage alcohol from being sold to minors and in communicating the message to not drive while impaired.

1.72 Keep it Social is NSLC's platform that partners with Nova Scotia's universities and colleges to increase awareness around responsible consumption with students. The program provides resources for students to deliver peer-to-peer educational opportunities and is based on Canada's Low Risk Alcohol Drinking Guidelines.

Recommendation 1.11
The Nova Scotia Liquor Corporation should establish reporting expectations for the performance measures in the Corporate Social Responsibility framework, including timelines and regular reporting intervals for each performance measure.

Nova Scotia Liquor Corporation Response: The NSLC agrees with this statement. 2020-2025 NSLC strategic plan is focused on improving our social responsibility framework. As part of this process, the NSLC is developing performance measures that will include timelines and regular reporting intervals for each performance measure. Timing: Implemented Fall 2020.

Capital Planning And Procurement

NSLC has a plan for renewing its retail network

1.73 NSLC's retail network includes 108 corporate stores either leased or owned by NSLC. It also currently includes 60 agency stores which are typically located in smaller or more remote areas.

1.74 An agency store is a business authorized to sell retail beverage alcohol products to the public through an agreement with NSLC. Agents purchase inventory from NSLC at a discount and are required to sell for the same price as established in NSLC's corporate stores.

1.75 NSLC has assessed the current state of its retail network and planned for future improvements. It completed a full capital condition review of all corporate retail stores in 2017 and developed a new prioritization matrix as a tool for planning future capital improvements.

1.76 NSLC has also developed a new branding strategy for its stores as part of its strategic plan, creating multiple distinct store classifications. The intent is to provide a consistent shopping experience and set the expectations of customers based on the store classification. For example, a Select store anywhere in the province should generally carry the same assortment of products. The rollout of this strategy has begun, with new store experiences launched in several stores that were renovated in recent years.

Rural store network review recommendations not completed

1.77 In 2014, NSLC completed extensive analysis on rural stores in its retail network. The analysis provided insight into areas that were underperforming, so management proposed options for changes to the retail network to the Board of Directors to address this issue. Management's recommendation was expected to save NSLC up to an estimated $4.5 million a year.

1.78 NSLC recommended replacing corporate stores in some rural areas with an agency store. NSLC management told us businesses with an agency store generally see increased cash flow and net income from alcohol sales, as well as from attracting additional customers for the store's other offerings. This may be the difference of keeping a service, such as a grocery store, available in a community.

1.79 The proposal aligned with NSLC's goal of strategically maintaining profitability while leveraging opportunities with community partners, and the Board of Director's legislated responsibility to act as a commercial enterprise.

1.80 NSLC's Board of Directors supported the proposal, but as of January 1, 2020, the changes were not implemented. Management told us they did not get approval from government to proceed with the plan.

1.81 NSLC formally communicated the proposal to the Minister of Finance and Treasury Board for consideration in July 2014. Management provided documentation to us indicating that a presentation had been made to Executive Council and the CEO had responded to requests for information from the Minister following the presentation. No further communications were available.

1.82 The lack of progress on making these changes indicates a lack of clarity around approvals required for decisions related to NSLC's retail network. The Liquor Control Act states that the Governor in Council must approve the municipalities within which liquor may be sold. However, the Act does not speak to the operating structure under which it must be sold.

1.83 Due to the ambiguity related to retail network decision-making at NSLC, and the issues identified with policy development and strategy oversight earlier in the chapter, we will complete a more extensive audit of governance practices at NSLC. This work will be part of the second phase of our audit of NSLC and we reserve any recommendations on the retail network review until phase two has been completed.

NSLC follows a defined procurement process; only minor issues noted

1.84 NSLC has a defined procurement process aligned with the provincial policy and has clearly established signing authorities.

1.85 We tested 34 procurements, including capital items, agency store operators, and leases. Overall, there were no significant deficiencies noted with any of the items tested, although we do note a few issues with the process.

1.86 In 6 of 24 instances when an evaluation panel was required, the minimum required number of panelists did not evaluate the proposals. Four of those procurements had no documented evaluation of the submission as there was only one eligible supplier. While we saw no evidence that these departures from policy led to inappropriate decisions, defined policy should be followed in all cases.

1.87 Eight of 34 procurement files tested did not have a completed procurement checklist on file. The checklist is to be completed during the final stage of a procurement to ensure that the process has been followed. While there were no significant issues identified in the eight files without completed checklists, if the checklist is not completed, there is a higher risk that the procurement may not have followed the process.

Agency Store Program

Agency store agreements have clear terms and conditions

1.88 We tested 30 agency stores, and all had valid, signed agreements in place between NSLC and the agency store operator. The agreements all used a contract template which included clearly-defined terms and conditions for the operation of the agency store.

Internal audits of agency stores completed as intended

1.89 NSLC's internal audit group is responsible for conducting regular audits of agency stores. The goal is to complete an audit at each store every two years. 56 audits were completed during the two-year period from April 2017 to March 2019 and indicates the target was met.

1.90 All 30 of the agency store audits we tested followed the established agency store audit program. NSLC audits review key areas of compliance with the terms and conditions, such as accuracy of pricing and maintaining adequate inventory levels.

1.91 As we identified earlier in the chapter, key parts of the agency store agreement – compliance with the We ID program and Responsible Retailing training – are not adequately monitored. These areas are not part of the internal audit mandate.

1.92 Quarterly and annual reports on internal audit results were provided to senior management and the audit committee of the Board of Directors.

Appendix I

Reasonable Assurance Engagement Description and Conclusions

In June 2020, we completed an independent assurance report of select operational areas, consisting of the promotion of responsible drinking, local industry support, capital planning and procurement, and agency store contract management at the Nova Scotia Liquor Corporation. The purpose of this performance audit was to determine whether the Nova Scotia Liquor Corporation is effectively promoting responsible drinking and whether they have strategic and effective processes to support the distribution and sale of beverage alcohol in Nova Scotia.

This chapter is the first of a two-phase audit at the Nova Scotia Liquor Corporation. The second phase of the audit will consist of the areas of product management, including procurement and promotion, and governance practices.

It is our role to independently express a conclusion about whether operational areas, consisting of responsible drinking, local industry support, capital planning and procurement, and agency store contract management comply in all significant respects with the applicable criteria. Management at the Nova Scotia Liquor Corporation acknowledged their responsibility for operational areas, consisting of responsible drinking, local industry support, capital planning and procurement, and agency store contract management.

This audit was performed to a reasonable level of assurance in accordance with the Canadian Standard for Assurance Engagements (CSAE) 3001—Direct Engagements set out by the Chartered Professional Accountants of Canada; and Sections 18 and 21 of the Auditor General Act.

We apply the Canadian Standard on Quality Control 1 and, accordingly, maintain a comprehensive system of quality control, including documented policies and procedures regarding compliance with ethical requirements, professional standards, and applicable legal and regulatory requirements.

In conducting the audit work, we complied with the independence and other ethical requirements of the Code of Professional Conduct of Chartered Professional Accountants of Nova Scotia, as well as those outlined in Nova Scotia's Code of Conduct for public servants.

The objectives and criteria used in the audit are below:

Objective:
To determine whether the Nova Scotia Liquor Corporation is supporting the local beverage alcohol industry in line with its mandate and strategic plan.

Criteria:
1. The Nova Scotia Liquor Corporation should actively consult with local industry stakeholders.
2. The Nova Scotia Liquor Corporation should have clearly-defined goals and objectives to support the local beverage alcohol industry, which consider the needs of the industry.
3. The Nova Scotia Liquor Corporation should have a plan in place to achieve its goals and objectives.
4. The Nova Scotia Liquor Corporation should complete action items as outlined in the plan.
5. The Nova Scotia Liquor Corporation should adequately monitor and assess the results of actions taken to support the industry.

Objective:
To determine if the Nova Scotia Liquor Corporation is promoting the social objectives regarding responsible drinking in line with its mandate.

Criteria:
1. The Nova Scotia Liquor Corporation should have clearly-defined goals and objectives for the promotion of the social objectives regarding responsible drinking.
2. The Nova Scotia Liquor Corporation should have programs and initiatives in place to promote social objectives regarding responsible drinking.
3. Programs and initiatives targeted towards the promotion of social objectives regarding responsible drinking should be based on risk analysis, industry research, and best practices.
4. The roles and responsibilities of all parties involved in the programs and initiatives targeted towards the social objectives regarding responsible drinking should be clearly-defined and communicated.
5. There should be a process to monitor and evaluate programs and initiatives in place to promote responsible drinking.

Objective:
To determine if the Nova Scotia Liquor Corporation conducts retail store capital planning and procurement to meet the demands of Nova Scotians in a fair and consistent manner.

Criteria:
1. The Nova Scotia Liquor Corporation should have a capital plan in place to support the long-term operations of its retail store network.
2. The capital planning process should align with the Nova Scotia Liquor Corporation's strategic goals and objectives.
3. The Nova Scotia Liquor Corporation should follow a defined procurement process for all capital procurement decisions.

Objective:
To determine whether the Nova Scotia Liquor Corporation is adequately managing the agency store Program.

Criteria:
1. The Nova Scotia Liquor Corporation should have signed agreements with agency store operators which include clearly-defined terms and conditions.
2. The Nova Scotia Liquor Corporation should monitor agency stores to ensure services are provided in compliance with contract terms and conditions
3. The Nova Scotia Liquor Corporation should act to address issues when agency stores are not in compliance with contract terms and conditions.

Generally accepted criteria consistent with the objectives of the audit did not exist. Audit criteria were developed specifically for this engagement. Criteria were accepted as appropriate by senior management of the Nova Scotia Liquor Corporation.

Our audit approach consisted of interviewing management and staff of the Nova Scotia Liquor Corporation and local stakeholders, reviewing policies and documents, and testing files. We examined relevant processes, plans, reports, and other supporting documentation. Our audit period covered April 1, 2017 to March 31, 2019. We examined documentation outside of that period as necessary.

We obtained sufficient and appropriate audit evidence on which to base our conclusions on June 3, 2020, in Halifax, Nova Scotia.

Based on the reasonable assurance procedures performed and evidence obtained, we have formed the following conclusions:

- NSLC does not have an adequate strategic plan for the local industry, as evidenced by an overall lack of planning and evaluation of methods used to support the industry.
- NSLC is not adequately monitoring responsible retailing programs or reporting against established performance measures for programs that promote responsible drinking.

- NSLC has a plan in place for improving the retail store network and follows a defined procurement process; only minor issues identified.

- NSLC has signed agreements with clearly-defined terms and conditions for the agency store program, and an internal audit process to assess compliance with most aspects of those agreements. However, NSLC is not adequately monitoring the agency store program in respect to responsible retailing.

Appendix II

Background Information on the Nova Scotia Liquor Corporation

The Nova Scotia Liquor Corporation's mandate is established in the Liquor Control Act. The Act outlines the objectives of NSLC as the:

- promotion of social objectives regarding responsible drinking;
- promotion of industrial or economic objectives regarding the beverage alcohol industry in the Province;
- attainment of suitable financial revenues to government; and
- attainment of acceptable levels of customer service.

NSLC is governed by a Board of Directors appointed by Order in Council. The Board is composed of nine voting members including a Chairperson and Vice Chair; and two non-voting members, the President and CEO of NSLC, and the Deputy Minister of Finance and Treasury Board.

The Board of Directors is accountable to the provincial government and must submit to the Minister responsible for NSLC a five-year strategic plan, and annual business plans for approval.

The Board of Directors is responsible for ensuring that the affairs of the Corporation are administered on a commercial basis and that all decisions and actions of the Board are based on sound business practices.

Appendix III

Reduced Markup Structures

Spirits

Spirit markups are defined in the Craft Distillery policy. If a manufacturer produces over 75 thousand litres of finished product in a year, they would qualify for the reduced markup as a Class B manufacturer. If they produce over 150 thousand litres of finished product, they do not qualify for the reduced markup.

NS Distilled Spirit with NS product	50%
NS Distilled Spirit	60%
NS Blended Spirit with NS product	70%
NS Blended Spirit	80%
NS Distilled Spirit Class B	110%
NS Blended Spirit Class B	120%
Standard Rate	160%

Wine

The Emerging Wine Regions policy defines the markup rate applied to wine from regions producing less than 50 thousand hectolitres annually, in addition to other qualifying factors. Commercial wine bottling operations in Nova Scotia also receive a reduced markup rate.

Emerging Region Wine (NS eligible)	43%
NS Bottled Wine	120%
Standard Rate	140%

Beer

There is no policy outlining beer markups. Management stated that reduced markups for the beer category are provided to craft breweries in Nova Scotia producing less than 15 thousand hectolitres of beer annually. The markups were obtained from the pricing system.

NS Beer	40%
NS Beer Keg	30%
Standard Beer	84.5%
Standard Beer Keg	60%

Cider

There is no policy outlining cider markups. The markups were obtained from the pricing system.

NS Cider	45%
NS Cider Keg	30%
Standard Cider	102%
Standard Cider Keg	60%

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