2 Results of Financial Audits and Reviews

Summary

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

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

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

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

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

2 Results of Financial Audits and Reviews

Introduction

2.1 Under Section 19 of the Auditor General Act, this Office is the legislated auditor of the Province's Public Accounts. Under Section 20 of the Act, the Auditor General conducts a review of the estimates of revenue used in the preparation of the Minister of Finance and Treasury Board's budget address to the House of Assembly. The primary purpose of this chapter is to provide the results of our legislated requirements with respect to government financial reporting, and to make recommendations for improvements to government processes related to financial reporting.

2.2 The Auditor General is also the legislated auditor of four government entities.

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

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

Background

2.4 Government financial reporting serves many purposes and is provided to stakeholders in various forms. Reports may be prepared which meet the needs of specific users, such as credit rating agencies and lenders. Individual entities may produce reports, such as annual reports, to demonstrate how they have complied with legislation throughout the year, and to measure and report on their financial condition, and on the performance of funds, programs and activities. Whatever the format or purpose, financial reports prepared by government are designed to provide information to a variety of users for numerous reasons, on past or future activities. In general, financial reports are a means through which government satisfies its accountability responsibilities for the use of public funds.

2.5 The Province's Finance Act provides certain financial reporting requirements for the Province including annual estimates (budget), regular forecast updates, and tabling of the Public Accounts. These reporting requirements are part of the government's accountability framework and contribute to oversight and the efficient use of resources.

2.6 *Budgets* – Government uses the budget process to inform stakeholders of its fiscal plan and priorities for the upcoming year, including borrowing and tangible capital asset requirements, and to ensure approval of the plan by Members of the House of Assembly, the representatives of the people of Nova Scotia. The budget is a key policy document and forms the basis for the legal authority to spend throughout the year, which is established through the Appropriations Act. It is a critical component of government accountability against which forecast updates and actual performance are compared.

2.7 *Forecasts* – The Finance Act requires that financial forecasts be prepared and tabled in the Legislature by the Minister of Finance during the year. Forecasts provide a comparison of activity to date to the approved budget for the year, and estimate the surplus or deficit for the year based on results to date. The Province's forecast updates also include an analysis of significant variances and may provide current information on the Province's economic performance and outlook. Forecast updates are an important element of accountability; they enhance transparency by providing current information on the government's financial situation, and contribute to effective management of public funds. In order to be an effective accountability tool and to provide appropriate information for decision-making purposes, forecasts must be timely, accurate and complete.

2.8 *Public Accounts* – The annual Public Accounts, including the Province's consolidated financial statements, are prepared by the controller on behalf of the Minister and Deputy Minister of the Department of Finance and Treasury Board. The Finance Act requires that the Public Accounts be tabled no later than September 30 after year end. Volume 1 of the Public Accounts includes a financial statement discussion and analysis, and the audited consolidated financial statements. The financial statement discussion and analysis provides comparative financial highlights of the statements and information on certain financial indicators. The consolidated financial statements provide audited financial information for two years as well as a comparison of actual results to the budget. As the budget reflects the plan approved by the House, the comparison of budget to actual enhances transparency and enables assessment of government's performance. The information provided in the Public Accounts can be used for a variety of purposes, including to:

- evaluate the government's performance for the year as compared to budget and prior year; and
- form the basis of analysing government's financial performance, condition and indicators of financial position.

2.9 The release of the Public Accounts is a key component in the accountability framework of the government and provides important information to all stakeholders, including taxpayers and members of the House.

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

Chapter Objective

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

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

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

Review of the 2013-14 Revenue Estimates

Conclusions and summary of observations

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

2.13 *Unqualified opinion* – Under Section 20(1) of the Auditor General Act, the Auditor General is required to provide an opinion on the reasonableness of the revenue estimates included in the budget tabled with the House of Assembly. An unqualified opinion was issued on the 2013-14 revenue estimates and included in the April 4, 2013 budget address provided by the then Minister of Finance.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Audit of the March 31, 2013 Consolidated Financial Statements

Conclusions and summary of observations

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

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

- obtain reasonable, but not absolute, assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error; and
- report on the consolidated financial statements, and communicate our audit findings, as required by Canadian Auditing Standards.

2.26 The unqualified audit opinion indicates the consolidated financial statements are presented fairly, in all material respects, in accordance with Canadian generally accepted accounting principles for the public sector, which are issued by the Public Sector Accounting Board of the Canadian Institute of Chartered Accountants. The unqualified audit opinion also indicates there were no quantitative findings, either individually or cumulatively, which were material enough to impact the opinion.

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

- Audit completion
- Internal control
- Other matters

Audit Completion

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Internal Control

2.43 *Responsibility for internal control* – The Finance Act includes general references to the roles and responsibilities of the Minister and Deputy Minister relating to internal control. The Controller prepares the consolidated financial statements of the Province of Nova Scotia on behalf of the Minister and Deputy Minister of the Department of Finance (now the Department of Finance and Treasury Board) as noted in the statement of responsibility for the consolidated financial statements for the Province of Nova Scotia. The statement of responsibility also notes *"The government is responsible for maintaining a system of internal accounting and administrative controls in order to provide reasonable assurance that transactions are appropriately authorized, assets are safeguarded, and financial records are properly maintained."*

2.44 Our audit is planned and conducted to enable us to express an audit opinion on the annual consolidated financial statements, not to express an opinion on the internal controls of government or to determine whether internal controls are adequate for management's purposes.

2.45 Certain matters which came to our attention during the conduct of the audit, related to internal controls and other financial reporting issues, were communicated to the Department of Finance and Treasury Board in a management letter. Implementation of the recommendations in the management letter and this chapter will facilitate preparation of the consolidated financial statements.

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

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

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

Recommendation 2.9

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

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

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

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

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

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

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

Other Matters

2.52 *Required communication of audit results* – The management letter issued to the Minister communicated certain matters as required under Canadian Auditing Standards. Those matters included identifying responsibilities of management and those charged with governance (such as the Minister of Finance and Treasury Board, and Executive Council) with respect to the preparation and oversight of the consolidated financial statements. The letter also communicated our responsibilities as auditors of the Province's consolidated financial statements, and included audit findings and recommendations for improvement. As well, it included conclusions on accounting estimates and the fair presentation of the consolidated financial statements in accordance with Canadian generally accepted accounting principles for the public sector.

2.53 *New accounting standards* – Some of the more significant issues on which the Public Sector Accounting Board has recently released new pronouncements include liability for contaminated sites, foreign currency translation and financial instruments. New standards or guidance in such areas could require changes to Government's financial reporting in the future. The nature and impact of required or planned accounting changes should be disclosed as soon as practical, ideally no later than during the presentation of the budget for the fiscal year in which the changes will take effect.

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

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

Audit of Government Agencies

Conclusions and summary of observations

We issued unqualified audit opinions for three of four audits we conducted in Government agencies for the year ended March 31, 2013. The audit opinion on Trust Funds Administered by the Public Trustee was qualified due to the inability to verify that all assets, or income related to these assets, that came under the Public Trustee's administration, were recorded by the Public Trustee. Asset verification was limited to recorded amounts. We recommended that the Public Trustee obtain an accounting system to support the administration of the $45 million in estates and trusts under that Office's control, and that the interest rate prescribed for common fund investment earnings be set to equal interest actually earned in that fund. We further recommended that the Public Trustee cease transferring excess interest from the special reserve fund to the Province each year. We recommended that the Nova Scotia Crop and Livestock Insurance Commission establish an audit committee and evaluate its current board members' financial expertise in order to determine whether additional non-Board members should be appointed to the new audit committee to fill any gaps in financial literacy. Additional internal controls are needed over the process to calculate insurance premiums and to issue insurance certificates. Processes over the preparation of year-end financial statements at the Nova Scotia Legal Aid Commission require improvement, including the process to estimate unbilled legal fees. Since the House of Assembly Management Commission has been re-established, we anticipate issuing our opinions on compliance and other matters under Section 22 and 23 of the House of Assembly Management Commission Act in due course.

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

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

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

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

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

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

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

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

Nova Scotia Provincial Lotteries and Casino Corporation

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

Nova Scotia Legal Aid Commission

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

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

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

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

Nova Scotia Crop and Livestock Insurance Commission

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

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

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

Trust Funds Administered by the Public Trustee

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

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

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

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

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

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

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

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

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