



October 2018

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



Financial

**Independence • Integrity • Impact**





October 2, 2018

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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# Chapter 1

## Financial Audit Work Results

### Key Messages:

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

### Reasons Supporting Key Messages

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

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

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

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

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

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

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

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

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

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



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

Key Matter	Resolution
<ul style="list-style-type: none"><li>• Boat Harbour clean-up costs which increased by \$75 million to \$205 million (2017 – \$130 million)</li><li>• \$232 million extra revenue from petroleum royalty arbitration</li></ul>	Accounted for correctly as estimates based on Province of Nova Scotia assumptions and disclosed in the financial statements as subject to change due to uncertain nature
<ul style="list-style-type: none"><li>• NS Internet Funding Trust – \$193 million expense</li><li>• Research NS Trust – \$20 million expense</li></ul>	Accounted for correctly as expenses and the trust funds are not included in the Province's financial statements because the Province does not have decision making authority over these trusts

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

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



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# 1 Financial Audit Work Results

## Reporting on Financial Audit Results

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

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

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

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

➡ Government organizations are not fixing financial control weaknesses quickly enough

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



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

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



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

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

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

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

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

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

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

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



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

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

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

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

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



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

### **Recommendation 1.1**

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

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

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

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

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



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

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



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

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


 \$232 million extra revenue from petroleum royalty arbitration

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

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

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

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

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

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

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



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

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

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

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



## Who We Are and What We Do

### Who are we?

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

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

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





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

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





## Chapter 2

# Nova Scotia's Finances from 2018 Public Accounts

### Key Messages:

- Chapter provides highlights to encourage public discussion on the Province's financial results. This is not a commentary on government policy or decisions. More analysis is provided in the Public Accounts of Nova Scotia.
- For the last 10 years, financial indicators show a worsening position; indicators for the last 5 years show that these worsening results continue but the decline has slowed.
- The Province's expenses increased by 32% over the past 10 years to deliver services to roughly the same population (2% increase). These numbers can generate valuable public discussion on NS's future finances.

### Financial Condition of the Province of Nova Scotia

One picture of a government's financial condition is the use of ratios and analysis to generate discussion on sustainability, flexibility, and vulnerability. These elements of financial condition are those suggested by Canada's Public Sector Accounting Board.

Sustainability indicators are meant to show the Province's ability to maintain existing services and financial requirements without needing to increase revenues or debt

#### 10-year trend

- cumulative net deficit of \$663 million
- net debt increased by \$2.9 billion
- net long-term debt increased by \$4.1 billion

#### 5-year trend

- cumulative net deficit of \$453 million
- net debt increased by \$1.1 billion
- net long-term debt increased by \$500 million

Overall: The past decade shows a trend of worsening sustainability. However, the past 5 years has been less so with long-term debt increasing by only 4% as opposed to a 44% increase over 10 years. The current net debt per Nova Scotian increased over the past 10 years from \$12,946 to \$15,682.

Flexibility indicators are meant to show the Province's ability to increase revenues or debt borrowings within its economy

#### 10-year trend

- interest on long-term debt constant at an average of \$742 million annually; no significant increase or decrease
- interest on long-term debt per capita ranged between \$744 and \$825 per Nova Scotian

#### 5-year trend

- interest on long-term debt decreased from \$756 million to \$719 million per year
- interest on long-term debt per capita decreased from \$802 to \$754 per Nova Scotian

Overall: Interest paid on long-term debt has remained relatively constant over 10 years. The Province paid over \$7.4 billion in interest during the last decade.

Vulnerability indicators demonstrate how reliant the Province is on revenues outside its control. A key measure is federal transfers as a percent of total revenues, demonstrating the Province's reliance on the federal government.

#### 10-year trend

- Federal government transfers as a % of total Provincial revenues decreased slightly
- Nearly \$1 of every \$3 of the Province's revenue comes from the federal government

#### 5-year trend

- Federal government transfers as a % of total Provincial revenues decreased slightly
- Nearly \$1 of every \$3 of the Province's revenue comes from the federal government

Overall: Nova Scotia continues to rely on equalization payments and other federal transfers.



## Selected Financial Highlights

### Expenses

### Highlights

#### Overall

- Annual expenses up \$2.9 billion (32%) since 2008 to provide services to a population that increased by 2% in the decade
- Spending \$12,318 per Nova Scotian in 2018 (2008 - \$9,488); up 30%
- Executive Council approved an additional \$479 million in expenses above the 2017-18 budget

#### Health and Wellness

- Increased \$1.4 billion (42%) over the past 10 years
- 39% of the Province's 2018 expenses (2008 - 37%)
- \$4,825 per Nova Scotian in 2018 (2008 - \$3,471); up 39%
- 52% of healthcare costs<sup>1</sup> are for the 20% of Nova Scotians aged 65+

#### Education and Early Childhood Development

- Increased \$335 million (25%) over the past 10 years
- 14% of the Province's 2018 expenses (2008 - 15%)
- \$1,751 per Nova Scotian in 2018 (2008 - \$1,427); up 23%
- Student enrolment declined 12% over the past 10 years

### Revenues

### Highlights

#### Overall

- Annual revenues up \$2.7 billion (29%) over the past 10 years and there was a cumulative annual deficit of \$663 million over this same period
- Revenue growth mainly from increased tax revenues
  - Tax revenues increased by \$1.8 billion (46%) over the past 10 years
  - Personal tax filers pay on average 45% more personal income tax than 10 years ago
- Federal transfers increased by \$685 million (22%) over the past 10 years

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

1. What do the financial indicators mean for the Province going forward in terms of revenue and expense plans?
2. How will the increasingly aged population of Nova Scotia impact future revenues and spending on healthcare and other costs?
3. How do healthcare costs of \$4,825 per Nova Scotian compare to other provinces and what does this mean for the future?
4. What did Nova Scotia get for \$4.1 billion more in net long-term debt over the past 10 years?
5. How much of the income tax increases over the past 10 years relates to income growth, tax policy change, and inflation?

<sup>1</sup> Canadian Institute for Health Information – 2015 Health spending data tables


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## 2 Nova Scotia's Finances from 2018 Public Accounts

### Purpose

- 2.1 The Province's finances are an area that all Nova Scotians likely have an interest in. The purpose of this chapter is to inform Nova Scotians on some aspects of the Province's finances to promote discussion. Of course, numbers and indicators are only one aspect to inform a discussion.
- 2.2 We look at the numbers from the perspective of sustainability, flexibility, and vulnerability and provide information on the current level of revenues, expenses, and population changes against levels from 10 years ago to provide insight into the Province's financial condition. We are not commenting on the financial decisions made by Government. The information presented below is only part of the story and does not consider such factors as policy decisions, actual programs and services, inflation, performance of the provincial economy, and other elements that may impact revenues and expenses. Additional information and context, including economic highlights, is presented in the Financial Statement Discussion and Analysis section in Volume 1 of the 2018 Public Accounts of Nova Scotia where there are 55 pages of detailed analysis and explanations.

### Financial Indicators

 Indicators show the Province's financial condition has worsened over the past 10 years; however, the rate of worsening has slowed in the last 5 years

- 2.3 There are various indicators that can be used to assess the Province's financial condition. The indicators we have included in this chapter are among those recommended for reporting by the Public Sector Accounting Board's Statement of Recommended Practice 4: Indicators of Financial Condition. The indicators reported are meant to provide additional information on the Province's financial condition but are not intended as commentary on the financial impact of government policies.
- 2.4 The Statement of Recommended Practice recommends that, at a minimum, indicators related to sustainability, flexibility, and vulnerability be considered. We have included these types of indicators, along with other information we feel is useful in demonstrating the Province's financial condition. These are tools that can assist users of the Province's consolidated financial statements to interpret its financial information.
- 2.5 The financial indicators presented below provide an overview of the Province's financial performance for the 10-year period ending March 31, 2018. The



following table presents overall financial indicators to give a picture of the Province's financial condition. The table shows the condition has worsened over the past 10 years, but the rate of decline has slowed over the past five years.

Financial Highlights		
Indicator	10-Year Trend	5-Year Trend
<b>Sustainability</b>		
Annual surplus or deficit	Fluctuating	Improving
Net debt	Increasing	Increasing
Net debt per capita	Increasing	Increasing
Net long-term debt	Increasing	Slightly increasing
Net long-term debt per capita	Increasing	Slightly increasing
<b>Flexibility</b>		
Interest on long-term debt	Constant	Decreasing
Interest on long-term debt per capita	Constant	Decreasing
<b>Vulnerability</b>		
Federal government transfers as a percentage of total revenues	Slightly decreasing	Slightly decreasing

### Sustainability

2.6 Sustainability measures the ability of a government to maintain its existing programs and services, including maintaining its financial obligations to creditors, without having to introduce revenue and expenditure adjustments, such as increased debt or tax rates. Sustainability indicators provide insight into how a government balances its commitments and debts.

➡ 10-year sustainability indicators worsened but less so over the past 5 years

2.7 The financial indicators related to government sustainability demonstrate that the overall financial condition of the Province has worsened over the past 10 years, but that the rate of decline has slowed in the past 5 years. Worsening sustainability is primarily caused by a government taking on more debt.

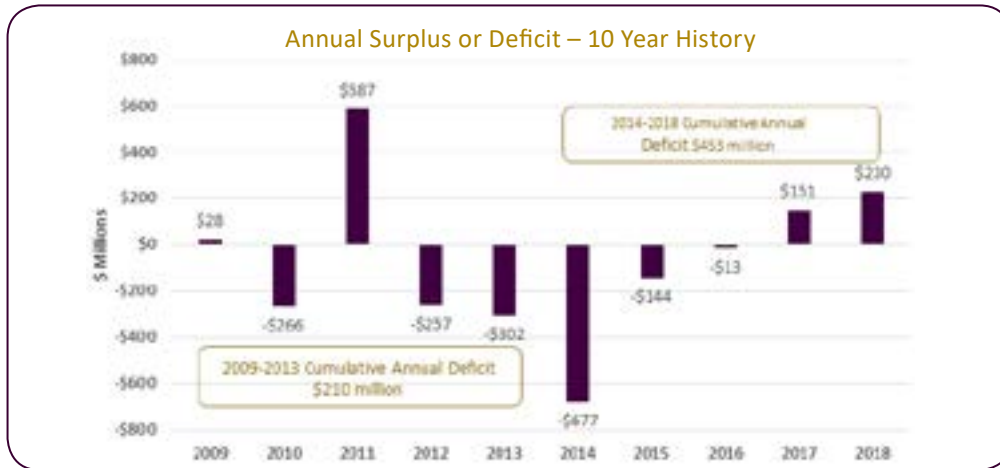
➡ Over the past 10 years, the net of all annual financial results (annual surplus or deficit) is a \$663 million deficit

2.8 The annual surplus or deficit indicates the extent to which revenues are more or less than yearly expenses. A surplus occurs when revenues exceed expenses. The Province reported a surplus of \$230 million in 2018. Changes in revenues and expenses are discussed in detail in Volume 1 of the Public Accounts.

2.9 Although the Province realized a \$230 million surplus in 2018, the cumulative annual surpluses and deficits over the past 10 years show a net deficit of \$663

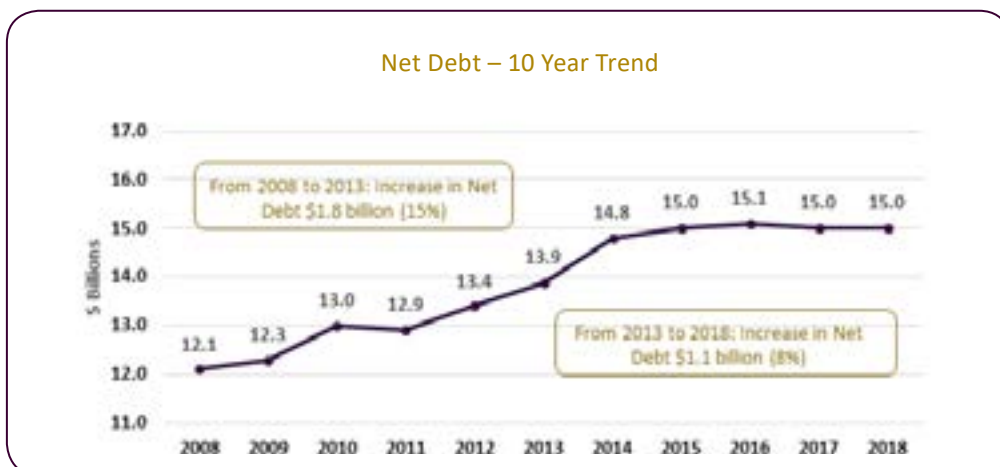


million. This 10-year cumulative annual deficit may impact sustainability, as it shows that the Province's revenues have not kept pace with its expenses.



2.10 Net debt is used to define the difference between financial assets and liabilities and informs the reader as to whether there are enough financial assets to cover the liabilities for future generations. In other words, it is the amount of future revenue that is needed to pay for past transactions. Further information about net debt is provided on pages 13 and 14 of the Financial Statement Discussion and Analysis section of Volume 1 of the Public Accounts.

2.11 While net debt in 2018 did not increase from 2017, net debt has increased by \$2.9 billion (24%) since 2008. The following chart shows that in the 2008 to 2013 period, net debt increased by \$1.8 billion, and in the 2013 to 2018 period net debt increased by an additional \$1.1 billion.



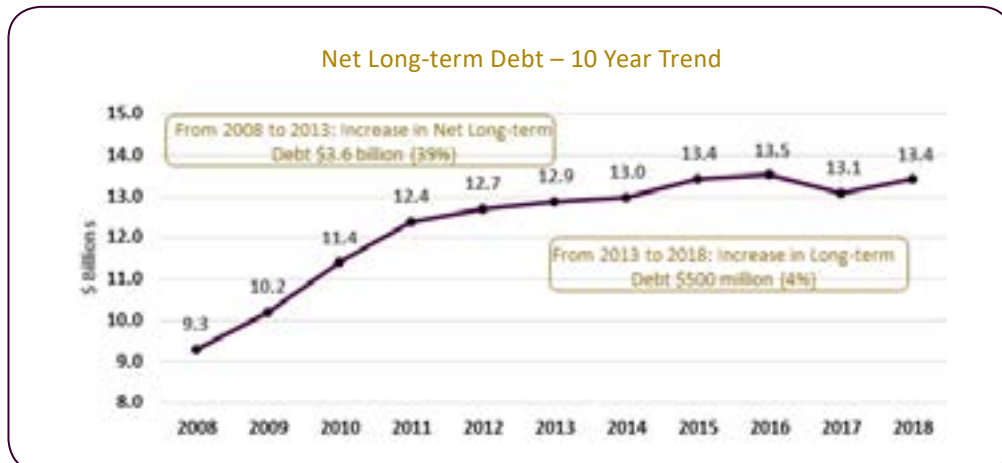
2.12 Net debt per capita shows the amount of net debt attributable to each person living in Nova Scotia. The Province owes \$15,682 for each Nova Scotian from past decisions that resulted in spending exceeding revenues. Despite a marginal reduction in net debt per capita in the current year, since 2008, net



debt increased \$2,736 per capita, with 34 percent of this increase occurring in the 2013 to 2018 period and the remaining 66 percent occurring in the 2008 to 2013 period.



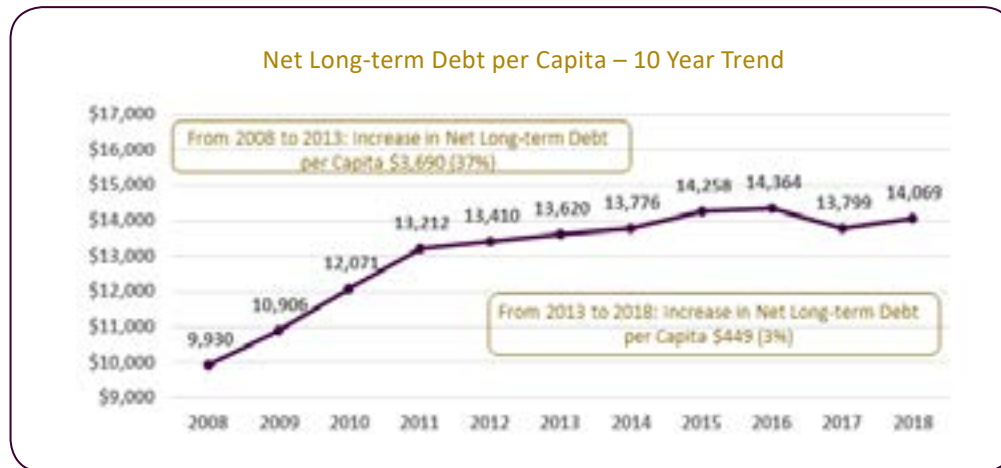
- 2.13 Unmatured debt is the total debt the Province owes to outsiders and consists primarily of debentures and long-term loans. Net long-term debt is the Province's unmaturred debt less the amount that is set aside to fully fund specific debt when it becomes due. Schedule 4 in Volume 1 of the Public Accounts contains more details on unmaturred debt.
- 2.14 We have commented in prior years that the increasing trend in net long-term debt is a significant indicator of fiscal sustainability because the costs of servicing this debt takes priority over program expenses and reduces the Province's ability to expand services or reduce taxes.
- 2.15 Net long-term debt increased by \$300 million over the prior year; however, over the past 10 years, net long-term debt increased by \$4.1 billion (44%). 88 percent of this \$4.1 billion increase in net long-term debt occurred in the 2008 to 2013 period.







- 2.16 Net long-term debt per capita measures the burden of the Province's debt owing to third parties attributable to each Nova Scotian. Net long-term debt per capita increased in 2018 by \$270 to \$14,069 per person. Over the past 10 years, net long-term debt per capita increased by \$4,139 (42%) per Nova Scotian with 89 percent of this increase occurring in the 2008 to 2013 period.

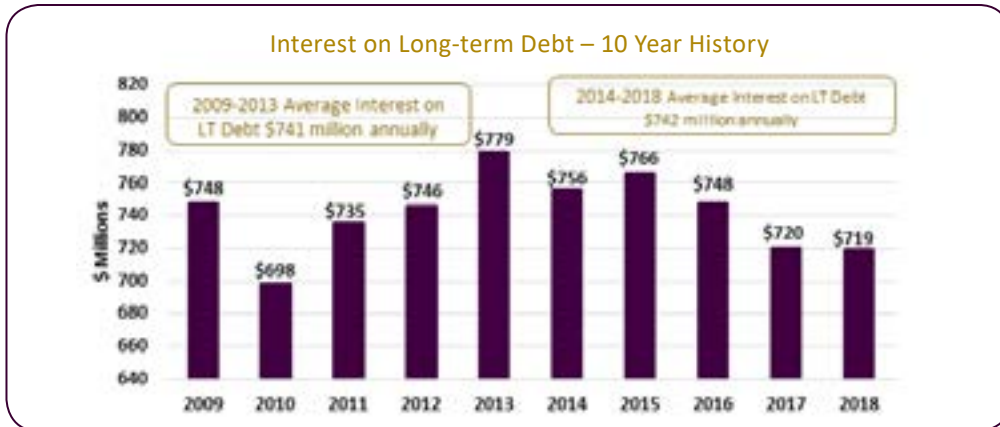


## Flexibility

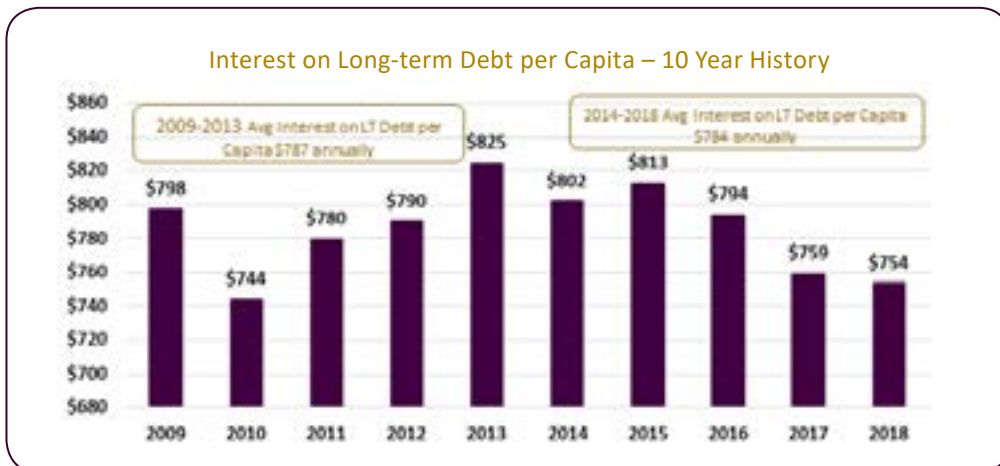
- 2.17 Flexibility is the degree to which a government can change its debt burden or raise taxes within its economy to meet its existing financial obligations. Flexibility provides insights into how a government manages its finances. Increasing debt obligations and interest costs reduce a government's future flexibility and ability to respond to changing circumstances.

### ➡ Costs to service long-term debt constant over the past 10 years

- 2.18 Interest on long-term debt assists in assessing flexibility, as it is the cost associated with servicing past borrowing decisions. These costs represent a fixed cost once debt is issued. Failure to pay interest impacts the ability to raise future debt and would further increase costs of borrowing. Interest on long-term debt represents funds which cannot be used for general operations, such as providing programs and services to Nova Scotians. The Province has paid over \$7.4 billion in interest on long-term debt in the past 10 years.
- 2.19 Although the following chart shows fluctuations in the annual interest on long-term debt over the past 10 years, the amount of interest paid in the last 5 years is about the same as what was paid between 2009 and 2013. However, the annual interest on long-term debt, for the most part, declined in each of the last five years.



2.20 Interest on long-term debt per capita represents the interest the Province pays for every Nova Scotian each year on unmatured debt. In the current year, the Province paid \$754 in interest costs on long-term debt for every Nova Scotian.



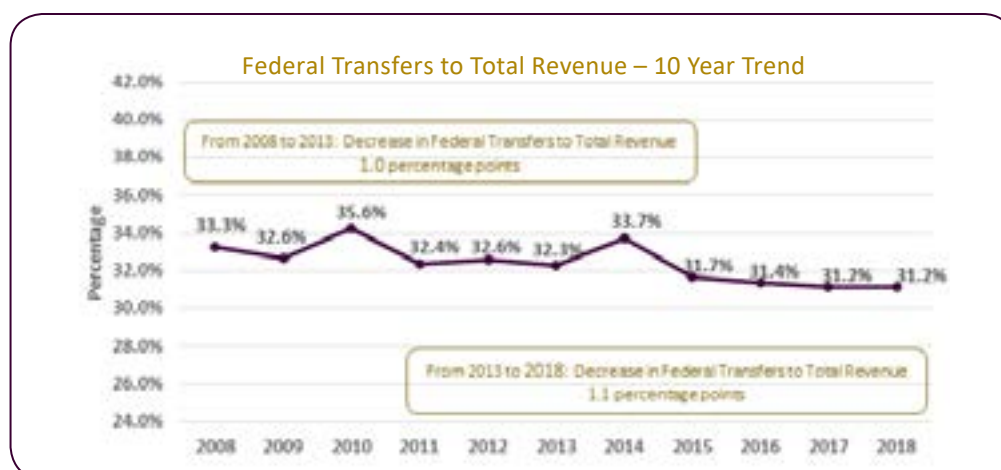
### Vulnerability

2.21 Vulnerability indicators measure the amount a government is dependent on sources of revenue outside its control and its exposure to risks which might affect a government's ability to meet its commitments. The more a government relies on revenue from other sources, the more dependent it is on the fiscal decisions of others.



Dependency on federal government transfers slightly decreasing over the past 5 and 10-year periods

2.22 As illustrated below, Nova Scotia continues to rely on federal government equalization payments and other transfers. Nearly \$1 in every \$3 dollars of the Province's revenue comes from the federal government.



### Financial Highlights

2.23 The financial information presented below does not consider such factors as policy decisions, actual programs and services, inflation, performance of the provincial economy, and other elements that may impact revenues and expenses.

➡ Province's annual expenses up \$2.9 billion (32%) from 10 years ago; revenues up \$2.7 billion (29%)

2.24 The Province's annual expenses increased by 32 percent over the past 10 years from \$8.9 billion in 2008 to \$11.8 billion in 2018 and revenues increased by 29 percent from \$9.3 billion to \$12.0 billion. The Province is spending \$2.9 billion (32%) more than 10 years ago to provide services to roughly the same number of Nova Scotians (Appendix I Nova Scotia's Population).

➡ Health and Wellness accounts for 39 percent of the Province's total expenses

2.25 \$7.4 billion of the Province's \$11.8 billion annual expenses are incurred by Community Services, Education and Early Childhood Development, and Health and Wellness. Health-related expenses account for 39 percent (2008 - 37 percent) of the Province's total expenses, while education-related expenses account for 14 percent (2008 - 15 percent).

<b>Change in Total Expenses from 2008 to 2018</b>				
<b>Expenses</b>	<b>2008 \$ millions</b>	<b>2018 \$ millions</b>	<b>Change \$ millions</b>	<b>Change %</b>
Community Services	\$892	\$1,098	\$206	23%
Education and Early Childhood Development	\$1,335	\$1,670	\$335	25%
Health and Wellness	\$3,248	\$4,602	\$1,354	42%
Remaining departments	\$2,267	\$3,291	\$1,024	45%
Other non-departmental costs	\$1,136	\$1,089	-\$47	-4%
<b>Total Expenses</b>	<b>\$8,878</b>	<b>\$11,750</b>	<b>\$2,872</b>	<b>32%</b>



2.26 The preceding table shows health-related expenses increased by \$1.4 billion (42%) since 2008. The increase in expenses is noteworthy given that the total number of Nova Scotians is roughly the same as in 2008. Also, education-related costs have increased by 25 percent over the past 10-year period while student enrolment declined 12 percent over the same period.

➤ Increasing financial challenges as Nova Scotia’s population ages

2.27 With demographic trends pointing to a growing number of individuals over the age of 65, the Province will face financial challenges. This demographic makes up 20 percent of the Province’s population (Appendix I Nova Scotia’s Population) and accounts for 52 percent of healthcare costs<sup>1</sup>. By the year 2030, the Province expects that more than 1 in 4 Nova Scotians will be aged 65 and over. Also, tax filers over the age of 65 often pay less personal income tax due to lower income after retirement and the availability of additional tax credits. This information can generate a worthwhile discussion of the challenges facing Nova Scotia in the future.

➤ Expenses per Nova Scotian up 30 percent over the past 10-year period

2.28 The Province’s expenses per Nova Scotian have increased by \$2,830 (30%) from 2008 and now total \$12,318 per capita. This increase per capita was primarily driven by spending increases, since Nova Scotia’s population only increased by 2 percent since 2008. Healthcare costs of \$4,825 per Nova Scotian represents an increase of 39 percent from 10 years ago.

Expenses per Capita from 2008 to 2018				
Expenses	2008 \$ millions	2018 \$ millions	Change \$ millions	Change %
Community Services	\$953	\$1,151	\$198	21%
Education and Early Childhood Development	\$1,427	\$1,751	\$324	23%
Health and Wellness	\$3,471	\$4,825	\$1,354	39%
Other	\$3,637	\$4,591	\$954	26%
<b>Total Expenses</b>	<b>\$9,488</b>	<b>\$12,318</b>	<b>\$2,830</b>	<b>30%</b>

➤ Increase in revenues over past 10 years lower than increase in expenses; cumulative net deficit

2.29 The table below shows revenue by type for 2008 and 2018. The Province’s revenues increased by \$2.7 billion (29%) from 2008. This 29 percent increase in revenue growth is not keeping pace with the 32 percent increase in expenses and resulted in a cumulative net deficit of \$663 million over the 10-year period, which has been financed partially through an increase in long-term debt.

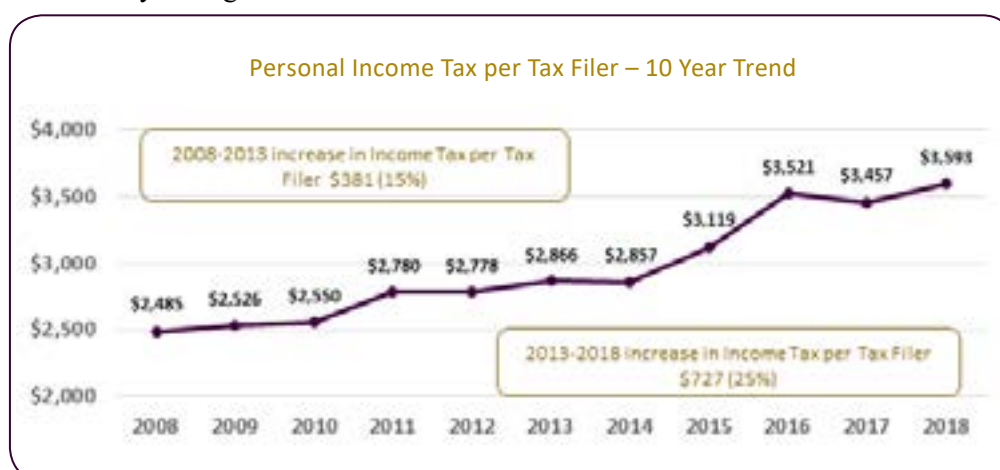
<sup>1</sup> Canadian Institute for Health Information – 2015 Health spending data tables



Change in Total Revenue from 2008 to 2018				
Revenue Type	2008 \$ millions	2018 \$ millions	Change \$ millions	Change %
Personal Income Tax	\$1,806	\$2,739	\$933	52%
Corporate Income Tax	\$500	\$563	\$63	13%
HST and Other Taxes	\$1,628	\$2,432	\$804	49%
Other Revenues	\$2,315	\$2,513	\$198	9%
Federal Transfers	\$3,048	\$3,733	\$685	22%
<b>Total Revenues</b>	<b>\$9,297</b>	<b>\$11,980</b>	<b>\$2,683</b>	<b>29%</b>

➔ Personal tax filers pay on average 45 percent more personal income tax than 10 years ago

2.30 Personal income tax revenue per capita is the average amount of personal income tax collected from each tax filer. During 2018, the Province earned, on average, \$3,593 from each tax filer, which is a 45 percent increase from 10 years ago.



Source: Tax filer data provided by the Department of Finance and Treasury Board

### Other Observations

➔ Executive Council approved an additional \$479 million in expenses above the 2017-18 budget

2.31 Public sector entities are held to a high standard of accountability, as they spend funds raised from taxpayers to provide public services. As a result, the public counts on the use of those funds to be transparent.

2.32 An Appropriations Act of Nova Scotia is passed each year and details what the Province is authorized to spend during the fiscal year. When an original budget appropriation is determined to be insufficient, the Finance Act of Nova Scotia requires that an additional appropriation be obtained. While the original budget is presented to, and challenged by, members of the Legislature, additional appropriations only require Executive Council



approval. Requesting additional appropriations is a normal part of the process.

2.33 Executive Council approved additional appropriations totaling \$478.8 million for the year ended March 31, 2018. The table below details \$442.4 million of the \$478.8 million in additional appropriations and the primary reasons why the departments required additional funding. Further details are found in the Financial Statement Discussion and Analysis section of Volume 1 of the 2018 Public Accounts.

Departments Requiring Additional Appropriations		
Department/Appropriation Area	Additional Funding	Why additional appropriation needed
Business	\$170.6 million	<ul style="list-style-type: none"> <li>• \$180.0 million for NS Internet Funding Trust for rural highspeed internet</li> <li>• \$11.1 million for international air service to improve connections to key markets</li> <li>• Offset by \$20.5 million savings in other projects and investments</li> </ul>
Transportation and Infrastructure Renewal	\$93.0 million	<ul style="list-style-type: none"> <li>• \$82.0 million for Boat Harbour remediation</li> <li>• \$11.0 million for snow and ice removal, Yarmouth Ferry, and other work</li> </ul>
Health and Wellness	\$64.3 million	<ul style="list-style-type: none"> <li>• \$64.1 million to health authorities for various healthcare services</li> <li>• \$11.6 million in physician services</li> <li>• Offset by \$11.4 million savings in home care and other programs</li> </ul>
Assistance to Universities	\$42.8 million	<ul style="list-style-type: none"> <li>• \$20.0 million for Research NS Trust for post-secondary research</li> <li>• \$11.0 million for Saint Mary's Entrepreneurship, Discovery and Innovation Hub</li> <li>• \$11.8 million in other investments</li> </ul>
Pension Valuation Adjustment	\$33.6 million	<ul style="list-style-type: none"> <li>• \$25.6 million for early service payout of retirement allowance</li> <li>• \$8.0 million in changes in actuarial assumptions</li> </ul>
Energy	\$23.9 million	<ul style="list-style-type: none"> <li>• \$12.2 million for energy efficiency programs</li> <li>• \$11.7 million for Offshore Growth Strategy initiatives</li> </ul>
Communities, Culture and Heritage	\$14.2 million	<ul style="list-style-type: none"> <li>• \$13.8 million for community infrastructure</li> <li>• \$.4 million in other areas not identified</li> </ul>
<b>Total</b>	<b>\$442.4 million</b>	



Pension and other benefit reporting enhanced with sensitivity analysis

2.34 Sensitivity analysis is an effective way to show how different events or variables can impact the financial health of a government. Some governments



demonstrate how different rate changes in GDP, interest, discount rates, and inflation will impact their budget and fiscal health.

- 2.35 We are pleased to report that the Province included sensitivity analysis in their 2018 financial reporting to show the impact of changes in certain assumptions on pension and other benefit obligations. The Province's pension obligation is a significant amount and we commend the Province for including sensitivity analysis for this obligation, but also urge them to consider sensitivity analysis in other areas.



### Nova Scotia's Population

Nova Scotia's population remains relatively unchanged with an increase of 2 percent from 2008; however, the age demographics have shifted.

Change in Population from 2008 to 2018 (000s)				
Population	2008	2018	Change in Population from 2008	% Change in Population from 2008
0 to 17 years	180	162	(18)	(10%)
18 to 64 years	613	601	(12)	(2%)
65+	143	194	51	36%
<b>Total</b>	<b>936</b>	<b>957</b>	<b>21</b>	<b>2%</b>

Source: Department of Finance and Treasury Board

Shift in Age Demographic from 2008 to 2018 (%)			
Population	% of 2008 Total	% of 2018 Total	Shift in Age Demographic
0 to 17 years	19%	17%	(2%)
18 to 64 years	66%	63%	(3%)
65+	15%	20%	5%
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>0%</b>



# Chapter 3

## Follow-up of Prior Year Observations and Recommendations

### Key Messages:

- Government departments and organizations are not acting fast enough to manage fraud risks
- Overall, government organizations disclosing travel and hospitality expenses as required by directive
- Five public service units not disclosing travel and hospitality expenses until we raised it with them
- Some organizations expanded their travel and hospitality disclosures
- Action taken to fill board vacancies, but some vacancies remain
- NS Teachers' Pension Plan deficit continues to threaten its long-term financial sustainability
- There is no formal plan on how the Province and NSTU will address the NSTPP's \$1.4 billion deficit

### Reasons Supporting Key Messages

#### Slow Action on Fraud Risk Management in Government Departments and Organizations

Observations	Examples
<ul style="list-style-type: none"> <li>• Nearly 80% have not completed fraud risk assessments</li> </ul>	<ul style="list-style-type: none"> <li>• Education and Early Childhood Development (budget of \$1.7 billion)</li> <li>• Internal Services (budget of \$189 million)</li> <li>• NS Business Inc. (budget of \$57 million)</li> </ul>
<ul style="list-style-type: none"> <li>• 35% of government organizations do not have an approved fraud policy</li> </ul>	<ul style="list-style-type: none"> <li>• IWK (budget of \$283 million)</li> <li>• Most school boards (budgets totaling \$876 million)</li> </ul>
<ul style="list-style-type: none"> <li>• 55% of government organizations have not evaluated the need for a fraud tip hotline</li> </ul>	<ul style="list-style-type: none"> <li>• All school boards except the Halifax and Strait Regional School Boards (budgets totaling \$795 million)</li> </ul>

#### Travel and Hospitality Disclosure in Government Organizations

Observations	Examples
<ul style="list-style-type: none"> <li>• 5 public service units that did not disclose began to disclose when we raised the requirement with them</li> </ul>	<ul style="list-style-type: none"> <li>• Human Rights Commission</li> <li>• Legislative Services (which includes the Office of the Legislative Counsel and Office of the Speaker)</li> <li>• NS Police Complaints Commissioner</li> <li>• NS Securities Commission</li> <li>• Office of the Ombudsman</li> </ul>
<ul style="list-style-type: none"> <li>• 7 of 8 organizations not disclosing in 2017 are now doing so</li> </ul>	<ul style="list-style-type: none"> <li>• Harbourside Commercial Park Inc., NS Farm Loan Board, NS Fisheries and Aquaculture Loan Board, NS Lands Inc., NS School Insurance Exchange, NS School Insurance Program Association, Sydney Steel Corporation</li> </ul>
<ul style="list-style-type: none"> <li>• Disclosure expanded at two large organizations to multiple positions</li> </ul>	<ul style="list-style-type: none"> <li>• IWK: Chief Executive Officer, Chief Operating Officer, Chief Communications, General Counsel, All Vice Presidents</li> <li>• NS Health Authority: Chief Executive Officer, Chief Financial Officer, Chief Nursing Officer, All Vice Presidents</li> </ul>



## Board Vacancies – Vacancies remain in some organizations

Observation	Number of Vacancies March 31, 2018
<ul style="list-style-type: none"> <li>• Board vacancies continue at:               <ul style="list-style-type: none"> <li>• Halifax-Dartmouth Bridge Commission*</li> <li>• NS Crop and Livestock Insurance Commission*</li> <li>• NS Health Research Foundation</li> <li>• NS Legal Aid Commission (vacancies are intentional due to new legislation expected in the fall of 2018)</li> <li>• Public Archives of NS*</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>2 of 9 (22%)</li> <li>4 of 6 (67%)</li> <li>4 of 10 (40%)</li> <li>4 of 17 (24%)</li> <li>2 of 8 (25%)</li> </ul>

\* Some or all vacancies filled after March 31, 2018

## Public Sector Pensions

Observation	Examples
<ul style="list-style-type: none"> <li>• NS Teachers' Pension Plan remains in serious financial condition</li> <li>• Since 2008, teachers retiring on or after August 1, 2006 have not received a pension increase</li> </ul>	<ul style="list-style-type: none"> <li>• 78.4% funded (2016 – 77.7%)</li> <li>• Deficit of \$1.4 billion</li> <li>• An extra \$57 million paid by Province over the past five years</li> </ul>
<ul style="list-style-type: none"> <li>• NS Health Employees' Pension Plan continues to have larger surplus</li> </ul>	<ul style="list-style-type: none"> <li>• 139.5% funded (2016 – 131.7%)</li> </ul>
<ul style="list-style-type: none"> <li>• NS Public Service Superannuation Plan maintains smaller surplus</li> </ul>	<ul style="list-style-type: none"> <li>• 103.4% funded (March 31, 2017 – 104.1%)</li> </ul>

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

1. Why does a government that collects and spends nearly \$12 billion a year not have its fraud risks fully assessed and managed?
2. Given the Auditor General's past attention to travel and hospitality, why are organizations slow to expand travel and hospitality disclosures?
3. Why were government organizations such as Legislative Services which accounts for Speaker's Office expenses not aware of the need to disclose travel and hospitality?
4. Why do board vacancies take so long to get filled and what is the impact of these vacancy rates?
5. How did the Nova Scotia Teachers' Pension Plan get in such bad financial condition and why is there no formal plan to get in better shape?

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## 3 Follow-up of Prior Year Observations and Recommendations

### Purpose

3.1 The purpose of this chapter is to follow up on the matters that we reported in our October 2017 Financial Report in relation to:

- Fraud risk management
- Disclosure of travel and hospitality expenses
- Board vacancies
- Public sector pensions
- Recommendations from prior years

3.2 To determine the status of progress in these areas as at March 31, 2018, we asked management of government departments and organizations and reviewed other information on their websites. Management's responses to the matters noted above have not been audited, but we have cleared this chapter with the named organizations.

### Fraud Risk Management

3.3 *Background* – Fraud within the public sector is concerning because it can result in the loss of public monies and reduce the public's confidence in the Province's financial reporting and its ability to safeguard public assets. It is important for the Province to have mechanisms in place to appropriately manage the risk of fraud.

3.4 In 2017, the Government adopted a fraud policy with the objectives of aiding in the prevention and detection of government fraud, and in promoting consistency across government. As part of adopting this policy, mandatory online training was required to be completed by all civil servants. This policy directly applies to all government departments and crown corporations, and although not required, it is recommended that other government organizations embrace the intent of the policy.

3.5 As indicated in the policy, specific components of the Province's fraud risk management program include:

- fraud policies and procedures
- fraud risk assessment
- fraud awareness education and training




- fraud prevention and detection techniques
- well-documented framework for reporting and investigating allegations of fraud


3.6 In 2017, we inquired with government departments and organizations on the status of certain aspects of a fraud management program and noted that all government departments had in place a fraud policy and 17 percent had completed a fraud risk assessment. Within government organizations, we found that 29 percent had a fraud policy in place and 12 percent had completed a fraud risk assessment.

3.7 Although research shows that tips account for about 40 percent of all fraud discoveries<sup>1</sup>, we noted in 2017 that no government department had a fraud tip hotline in place and that the Nova Scotia Liquor Corporation was the only government organization using a hotline.

3.8 As a result, last year we recommended that the Province address the weaknesses and risks related to fraud management. Executive Council agreed that those responsible for oversight of government departments and organizations should continually address weaknesses and risks to the Province.

 Nearly 80 percent of government departments have not completed fraud risk assessments

3.9 *2018 follow-up* – As at March 31, 2018, 14 (78%) government departments had yet to complete fraud risk assessments, including many sizeable departments such as Education and Early Childhood Development and Internal Services with budgets of \$1.7 billion and \$189 million, respectively. Only one additional department, Public Service, completed a fraud risk assessment in fiscal 2018.

 35 percent of government organizations do not have an approved fraud policy and 80 percent have not completed fraud risk assessments

3.10 Our 2018 follow-up of government organizations indicated that although 19 additional government organizations adopted a fraud policy, most school boards (budgets totaling \$876 million) and the IWK Health Centre (budget of \$283 million) have yet to develop a fraud policy.

3.11 Four organizations completed fraud risk assessments in 2018, but most school boards (budgets totaling \$1.3 billion) and Nova Scotia Business Inc. (budget of \$57 million) are examples of sizeable government organizations that have not yet completed fraud risk assessments.

3.12 Overall results as at March 31, 2018 with comparison to the prior year are summarized in the following table.

<sup>1</sup> Report to the Nations on Occupational Fraud and Abuse – 2014 Global Fraud Study, Association of Certified Fraud Examiners



Fraud Management Responses Comparison								
Fraud Management Component	Government Departments				Government Organizations			
	2018 18 Responses		2017 18 Responses		2018 51 Responses		2017 48 Responses	
	Yes	No	Yes	No	Yes	No	Yes	No
Approved fraud policy in place	18 100%	-	18 100%	-	33 65%	18 35%	14 29%	34 71%
Fraud risk assessment completed	4 22%	14 78%	3 17%	15 83%	10 20%	41 80%	6 12%	42 88%

3.13 Nearly \$11 billion is spent annually by government departments; therefore, the Province should satisfy itself that fraud risk is being managed. Departments with no fraud risk assessments should consider ways to complete their assessments on a timely basis.

➡ Fraud tip hotline being implemented by the Province

3.14 We followed up to determine whether government departments and organizations evaluated the usefulness of implementing fraud tip hotlines into their fraud management strategies. In 2017-18, the Province reviewed best practices and decided to implement an externally managed fraud/whistleblower hotline that will provide services to all government departments. The hotline is expected to be in place by December 31, 2018.

➡ 55 percent of government organizations have not considered a fraud tip hotline

3.15 Our enquiry of government organizations revealed that 28 of 51 (55%) have not considered the usefulness of a fraud tip hotline. This includes most school boards (budgets totaling \$795 million). Given that the Province considered the need and is implementing a fraud tip hotline for all government departments, all government organizations should also evaluate the usefulness of a fraud tip hotline.

3.16 Refer to Appendices I and II for management's responses regarding certain aspects of their organization's fraud management programs.

### Disclosure of Travel and Hospitality Expenses

3.17 *Background* – In September 2016, in response to an Auditor General recommendation to enhance openness and transparency through reporting, the Department of Finance and Treasury Board issued an administrative directive to agencies, boards, and commissions requiring senior management to disclose travel and hospitality expenses. By December 31, 2016, all departments and government organizations were required to publicly disclose travel and hospitality expenses of their senior management retroactive to April 1, 2016.




3.18 Last year, we reported that eight government organizations were not disclosing travel and hospitality of senior management as at June 30, 2017. We also noted that under the directive, senior management is defined as including “*Deputy Ministers, Associate Deputy Ministers, Deputy Heads, Chief Executive Officers and any other like position*” and that in several organizations only the travel and hospitality expenses of the most senior person were disclosed. As a result, we recommended that the directive be evaluated to consider other executive-type positions. We also suggested that government organizations review their assessments on what constitutes senior management to ensure that their disclosures meet the spirit of openness and transparency.

 Nearly all government organizations disclosing travel and hospitality expenses except one

3.19 *2018 follow-up* – We followed up with the eight organizations previously reported as not disclosing travel and hospitality expenses and noted that seven of these entities are now disclosing as required.

- Harbourside Commercial Park Inc.
- Nova Scotia Farm Loan Board
- Nova Scotia Fisheries and Aquaculture Loan Board
- Nova Scotia Lands Inc.
- Nova Scotia School Insurance Exchange
- Nova Scotia School Insurance Program Association
- Sydney Steel Corporation

3.20 As of August 2018, Arts Nova Scotia is the only organization yet to publicly disclose the travel and hospitality expenses of their senior management. We encourage Arts Nova Scotia to disclose in accordance with the administrative directive and to follow the same reporting process of all other government organizations.

 Travel and hospitality expenses disclosures expanded at the IWK Health Centre and the Nova Scotia Health Authority

3.21 We reviewed the travel and hospitality disclosures of nine large government organizations to determine their level of senior management disclosure. All nine organizations complied with the administrative directive; however, the following table highlights the differences in the level of disclosure between them as at March 31, 2018. Although, the definition of senior management was not expanded in 2018, we are pleased to report that both the IWK Health Centre and the Nova Scotia Health Authority now disclose more than just their CEOs’ travel and hospitality expenses.



<b>Senior Management Expense Disclosure at Large Government Organizations as at March 31, 2018</b>	
<b>Government Organization</b>	<b>Positions Disclosed</b>
Izaak Walton Killam Health Centre	President and Chief Executive Officer Chief Operating Officer Chief, Communications and Public Affairs General Counsel All Vice Presidents
Nova Scotia Health Authority	President and Chief Executive Officer Chief Financial Officer Chief Nursing Officer All Vice Presidents
Annapolis Valley Regional School Board	Superintendent
Cape Breton-Victoria Regional School Board	Superintendent
Halifax Regional School Board	Superintendent
Halifax-Dartmouth Bridge Commission	Chief Executive Officer General Manager All provincial appointed members of the Board
Housing Nova Scotia	Chief Executive Officer
Nova Scotia Business Inc.	President and Chief Executive Officer Chief Operating Officer Vice President, Sales and Strategic Marketing
Tourism Nova Scotia	Chief Executive Officer Chief Operating Officer

3.22 We continue to encourage the definition of senior management within the directive be expanded to include other executive-type positions with senior management responsibilities. We also encourage government organizations to voluntarily review their assessments on what constitutes senior management and consider expanding their travel and hospitality disclosures to ensure they meet the spirit of accountability behind the directive.



Five public service units were not disclosing travel and hospitality expenses even though required

3.23 The administrative directive issued by the Department of Finance and Treasury Board in September 2016 applies to the Province's public service units which are listed in Schedule 10 of the 2018 Public Accounts. During our work in February 2018, we found that the following five public service units were not in compliance with the directive, as they were not publicly disclosing travel and hospitality expenses of their senior management even though required since 2016:

- Human Rights Commission
- Legislative Services (which includes the Office of the Legislative Counsel and Office of the Speaker)
- Nova Scotia Police Complaints Commissioner



- Nova Scotia Securities Commission
- Office of the Ombudsman

3.24 When we brought this to the attention of the organizations' management, they began to disclose travel and hospitality expenses. Management in these units indicated they were not aware of the requirement, as the Department of Finance and Treasury Board did not inform them of the administrative directive. However, all organizations are responsible for being aware of and adhering to government directives.

### Board Vacancies

3.25 *Background* – Vacant board positions within the Province's government organizations should be filled in a timely manner to achieve the level of oversight envisioned when the boards were established. In 2017, we surveyed government organizations and noted that 33 percent had board vacancies, and that on average, these positions were vacant for more than 13 months. Consequently, we recommended that Executive Council ensure that those responsible address the vacancy issue.



Action taken to support the filling of board vacancies, but some vacancies remain

3.26 *2018 follow-up* – We followed up with Executive Council to determine if progress had been made in filling board vacancies. Executive Council indicated that the following actions have been taken:

- launched an online application system
- expanded recruitment and outreach methods
- engaged with certain advocacy groups to improve the diversity on boards
- enhanced tracking of board vacancies

3.27 We followed up with the seven government organizations that in 2017 had a board vacancy rate of greater than 20 percent. With the exception of the Nova Scotia Crop and Livestock Insurance Commission, the other six organizations had the same number of or fewer vacancies on March 31, 2018 than on March 31, 2017. The following table shows the board vacancy status at March 31, 2017 and March 31, 2018.





Government Organization Board Vacancy Comparison		
Organization	Number of Vacancies March 31, 2018	Number of Vacancies March 31, 2017
Arts Nova Scotia	0 of 11 (0%)	3 of 11 (27%)
Halifax-Dartmouth Bridge Commission*	2 of 9 (22%)	3 of 9 (33%)
Invest Nova Scotia Board	0 of 9 (0%)	2 of 9 (22%)
Nova Scotia Crop and Livestock Insurance Commission*	4 of 6 (67%)	3 of 6 (50%)
Nova Scotia Health Research Foundation	4 of 10 (40%)	4 of 10 (40%)
Nova Scotia Legal Aid Commission**	4 of 17 (24%)	4 of 17 (24%)
Public Archives of Nova Scotia*	2 of 8 (25%)	4 of 8 (50%)

\* Some or all vacancies filled after March 31, 2018


\*\* Vacancies are intentional due to new legislation expected in the fall of 2018

### Public Sector Pensions

3.28 *Background* – In our October 2017 Financial Report, we highlighted the importance of pensions in Nova Scotia’s public sector. From employees in the public sector who are counting on their pensions being there when they retire, to the Province which assumes legal liability for some pension plans, all Nova Scotians have a direct or indirect interest in pensions.

3.29 This year, we provide an update on the funded status and indexing rates of the three largest public sector pension plans in Nova Scotia. The three largest plans are:

- Nova Scotia Health Employees’ Pension Plan (health care plan)
- Nova Scotia Public Service Superannuation Plan (public service plan)
- Nova Scotia Teachers’ Pension Plan (teachers’ plan)

 Nova Scotia Teachers’ Pension Plan remains in serious financial condition with a deficit of \$1.4 billion

3.30 *2018 follow-up* – The funded status of a pension plan is a primary indicator of a plan’s financial health. A fully funded pension plan means its plan assets can cover its pension benefit liabilities.

3.31 The following is an updated five-year funded status comparison of the three plans. As the table below shows, the three plans continue to have very different financial positions, and while the health care and public service plans stay positively funded, the teachers’ plan remains significantly underfunded.



Five-Year Comparison of the Pension Plans' Funded Status			
	Health Care	Public Service*	Teachers'
2017	139.5%	103.4%	78.4%
2016	131.7%	104.1%	77.7%
2015	132.1%	99.1%	76.7%
2014	126.4%	106.5%	77.3%
2013	118.5%	104.4%	75.0%

\*For fiscal periods March 31, 2014 through March 31, 2018

3.32 The funded status of the teachers' plan should be concerning to all Nova Scotians because the Province is responsible for half of the \$1.4 billion teachers' plan deficit. This means that the Province's share of the December 31, 2017 deficit was \$703 million (December 31, 2016 – \$705 million).



Teachers retiring on or after August 1, 2006 have not received a pension increase since 2008

3.33 Indexing allows pensioners to receive an increase in their pension payments to help keep up with the overall cost increases in goods and services. While all three pension plans include provisions for indexing, the terms under which indexing applies varies between the plans. In the case of the teachers' plan, indexing for teachers who retired on or after August 1, 2006 can only occur if the funded status of the plan is more than 90 percent. Because the teachers' plan remains in a funded status below the 90 percent threshold, teachers retiring on or after August 1, 2006 have not received a pension increase since 2008.

3.34 Pensioners in the other plans and teachers who retired before August 1, 2006 continue to have their pensions indexed in accordance with their plan provisions. The following table shows the indexing received by retirees over the past five years.

2014 to 2018 Actual Indexing Rates				
	Health Care	Public Service*	Teachers' Pre-2006**	Teachers' Post-2006
2018	1.60%	.85%	.60%	0%
2017	1.30%	.85%	.60%	0%
2016	1.00%	.85%	.30%	0%
2015	2.00%	1.25%	.70%	0%
2014	1.10%	1.25%	.20%	0%
<b>Total</b>	<b>7.0%</b>	<b>5.05%</b>	<b>2.40%</b>	<b>0%</b>

\* Rates set to 2020 by Public Service Superannuation Plan Trustee Inc.

\*\* Pre-2006 – for pensions with an effective date before August 1, 2006, indexing is available



➡ The Province has paid an extra \$57 million into the teachers' pension plan over the past five years due to the poor financial position of the plan

- 3.35 In addition to the annual mandatory contributions to the health care, public service, and teachers' plans, during 2018, the Province paid an additional \$14.8 million in special contributions to the teachers' pension plan. This special contribution is the result of the Province agreeing to make an additional contribution to the fund when the plan's liabilities exceed its assets by more than 10 percent.
- 3.36 The amount of this special contribution is based on the present value of forgone indexing for teachers retired on or after August 1, 2006, as determined annually by an actuary. This contribution increases plan assets and assists in improving the overall financial position of the teachers' plan.
- 3.37 Over the past five years, the Province paid \$57 million in special contributions to the teachers' plan. With a funded status of 78.4 percent at December 31, 2017, these special contributions are anticipated to continue until the plan reaches a funded status of 90 percent or greater.

➡ No formal plan on how the Province and the Nova Scotia Teachers' Union will address the \$1.4 billion deficit in the teachers' pension plan

- 3.38 To date, we have not conducted a performance audit of the teachers' plan and cannot comment on governance, oversight, and effectiveness of its systems and practices. We can however, raise the matter of the Province and the Nova Scotia Teachers' Union (NSTU) not having a formal plan in place to address the pension plan deficit. Without a plan, teachers, retirees, and Nova Scotians do not know how the \$1.4 billion deficit will be addressed.
- 3.39 In recent years, the Province and the NSTU have taken steps to deal with the deficit. These steps involved increasing monthly contributions of teachers, limiting inflation increases for teachers retiring on or after August 1, 2006, as well as special contributions from the Province. However, it is unknown what these changes are expected to achieve. Over the past five years, the teachers' pension plan deficit has decreased from \$1.7 billion to the current \$1.4 billion.
- 3.40 The financial position of the teachers' plan is in sharp contrast to the health care and public service plans. This raises excellent questions for discussion in the public sector, such as how the teachers' plan arrived at this position, and when will a plan be put in place to address the deficit.
- 3.41 The seriousness of the teachers' plan deficit continues to be addressed by the Trustee Chair. In the 2017 Annual Report, he states:



*“While there is no immediate risk that the Plan will be unable to meet its ongoing pension obligations, it is important to note that the Plan’s financial position could deteriorate going forward unless the Nova Scotia Teachers’ Union and the Province together take very significant steps.”*

3.42 The Province holds half the positions on the Teachers’ Pension Board; therefore, we recommend they initiate discussions with the NSTU to develop and implement a formal plan to address the deficit.

### Recommendations from Prior Years



Four recommendations made over two years ago are still not complete

3.43 After two years, we routinely follow up and report on implementation of our audit recommendations made in Financial Reports. When we follow up, we expect government departments and organizations to have implemented 80 percent of the recommendations. We continue to follow up on the status of those recommendations initially reported as not complete and continue to follow up until the recommendation is complete or otherwise addressed (e.g., do not intend to implement, action no longer required). Below are the six recommendations we are following up on because they were last reported as not complete.

Recommendations Made Over Two Years Ago	
Report and Recommendation	Status
<p><b>January 2014</b></p> <p>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.</p>	Not Complete
<p>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.</p>	Not Complete
<p><b>November 2015</b></p> <p>3.1 The Department of Finance and Treasury Board should have a central tracking system to monitor external auditor recommendation implementation results in government agencies, boards and commissions. Entities with low implementation rates should be monitored and encouraged to fix the deficiencies.</p>	Complete
<p><b>February 2015</b></p> <p>4.2 The Department of Health and Wellness needs to develop business plan and accountability reporting guidance for district health authorities and the IWK Health Centre that requires these entities to develop and report on specific and measureable outcomes for their core business activities.</p>	Complete



Recommendations Made Over Two Years Ago	
Report and Recommendation	Status
<b>February 2015</b>	
5.5 The Department of Community Services should reassess eligibility of clients as required by the Department's procedures to ensure ongoing validity of payments.	Not Complete
5.6 Department of Community Services' management should monitor the operating effectiveness of controls to reassess client eligibility on a regular basis.	Not Complete

3.44 We made two of the above recommendations more than four years ago and they continue to not be implemented by the Controller's Office. We encourage government departments and organizations to complete the outstanding recommendations, as it will help improve performance and reduce exposure to known risks.



Appendix I

**Management's Responses from Government Departments Regarding Certain Aspects of a Fraud Management Program**

Of the 18 government departments listed in Schedule 10 of the 2018 Public Accounts, below is the March 31, 2018 status of certain aspects of a fraud management program.

<b>Government Department</b>	<b>Fraud Policy</b>	<b>Fraud Risk Assessment</b>
Agriculture	Yes	No
Business	Yes	No
Communities, Culture and Heritage	Yes	No
Community Services	Yes	No*
Education and Early Childhood Development	Yes	No
Energy	Yes	No
Environment	Yes	No
Finance and Treasury Board	Yes	No*
Fisheries and Aquaculture	Yes	No
Health and Wellness	Yes	Yes
Internal Services	Yes	No
Justice	Yes	Yes
Labour and Advanced Education	Yes	No
Municipal Affairs	Yes	No*
Natural Resources	Yes	No
Public Service	Yes	Yes
Seniors	Yes	No
Transportation and Infrastructure Renewal	Yes	Yes
<b>Total</b>	<b>18 Yes (100%)</b>	<b>4 Yes (22%) 14 No (78%)</b>

\* Management indicated progress is being made in this area (unaudited)



## Appendix II

### Management's Responses from Government Organizations Regarding Certain Aspects of a Fraud Management Program

Of the 53 active government organizations (governmental units, government business enterprises, government partnership arrangements) listed in Schedule 10 of the 2018 Public Accounts, below is the March 31, 2018 status of certain aspects of a fraud management program.

Government Organization	Fraud Policy	Fraud Risk Assessment	Evaluated Usefulness of Fraud Hotline
<b>Education Sector</b>			
Annapolis Valley Regional School Board	No	No	No
Atlantic Provinces Special Education Authority	No	No	No
Cape Breton-Victoria Regional School Board	No	No	No
Chignecto-Central Regional School Board	No	No	No
Conseil scolaire acadien provincial	No	No	No
Halifax Regional School Board	Yes	No	Yes
Nova Scotia Community College	Yes	No*	Yes
Nova Scotia School Boards Association	No	No	No
Nova Scotia School Insurance Exchange	No*	No	No
Nova Scotia School Insurance Program Association	No*	No	No
South Shore Regional School Board	No	No	No
Strait Regional School Board	No	Yes	Yes
Tri-County Regional School Board	No	No	No
<b>Health Sector</b>			
Izaak Walton Killam Health Centre	No	No*	No*
Nova Scotia Health Authority	Yes	No*	Yes
Nova Scotia Health Research Foundation	No*	Yes	No
<b>Sizeable Organizations</b>			
Art Gallery of Nova Scotia	Yes	No	Yes
Canada-Nova Scotia Offshore Petroleum Board	Yes	Yes	Yes
Halifax Convention Centre Corporation	Yes	No	Yes
Halifax-Dartmouth Bridge Commission	Yes	Yes	Yes
Harbourside Commercial Park Inc.	Yes	No*	Yes
Highway 104 Western Alignment Corporation	Yes	No	No
Housing Nova Scotia	Yes	Yes	Yes
Nova Scotia Business Inc.	Yes	No	No
Nova Scotia Crop and Livestock Insurance Commission	Yes	Yes	Yes
Nova Scotia Farm Loan Board	Yes	No	No
Nova Scotia Fisheries and Aquaculture Loan Board	Yes	No	No



Government Organization	Fraud Policy	Fraud Risk Assessment	Evaluated Usefulness of Fraud Hotline
<b>Sizeable Organizations</b>			
Nova Scotia Innovation Corporation	Yes	No	Yes
Nova Scotia Lands Inc.	Yes	No*	Yes
Nova Scotia Legal Aid Commission	Yes	No	No
Nova Scotia Liquor Corporation	Yes	Yes	Yes
Nova Scotia Municipal Finance Corporation	Yes	No	No
Nova Scotia Power Finance Corporation	Yes	Yes	Yes
Nova Scotia Provincial Lotteries and Casino Corporation	Yes	Yes	Yes
Nova Scotia Utility and Review Board	No*	No*	No
Public Archives of Nova Scotia	No	No	No
Tourism Nova Scotia	Yes	No	No
Waterfront Development Corporation Limited	Yes	No	No
<b>Others</b>			
Arts Nova Scotia	No	No	No
Canadian Sport Centre Atlantic	Yes	No	No
Council of Atlantic Premiers	Yes	No	Yes
Creative Nova Scotia Leadership Council	No Response	No Response	No Response
Gambling Awareness Foundation of Nova Scotia	Yes	No	Yes
Invest Nova Scotia Board	Yes	Yes	No
Law Reform Commission of Nova Scotia	Yes	No	Yes
Nova Scotia Primary Forest Products Marketing Board	No Response	No Response	No Response
Nova Scotia Strategic Opportunities Fund Incorporated	Yes	No	No
Perennia Food and Agriculture Incorporated	No	No	No
Resource Recovery Fund Board Inc.	No*	No	Yes
Schooner Bluenose Foundation	Yes	No	Yes
Sherbrooke Restoration Commission	Yes	No	No
Sydney Steel Corporation	Yes	No*	Yes
Sydney Utilities Limited	Yes	No*	Yes
<b>Total Responses</b>	<b>33 Yes (65%) 18 No (35%)</b>	<b>10 Yes (20%) 41 No (80%)</b>	<b>23 Yes (45%) 28 No (55%)</b>

\* Management indicated progress is being made in this area (unaudited)

Note: Although 3313086 Nova Scotia Limited was active during 2018, it was not surveyed on its fraud management program, as the organization was dissolved on April 17, 2018.



• • • **Office of the Auditor General** • • •

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