



November  
2015

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



Financial

Independence • Integrity • Impact



October 23, 2015

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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# Office of the Auditor General

## Our Vision

A relevant, valued and independent audit office serving the public interest as the House of Assembly's primary source of assurance on government performance.

## Our Mission

To make a significant contribution to enhanced accountability and performance in the provincial public sector.

## Our Priorities

Conduct and report audits that provide information to the House of Assembly to assist it in holding government accountable.

Focus our audit efforts on areas of higher risk that impact on the lives of Nova Scotians.

Contribute to a better performing public service with practical recommendations for significant improvements.

Encourage continual improvement in financial reporting by government.

Promote excellence and a professional and supportive workplace at the Office of the Auditor General.



## Who We Are and What We Do

The Auditor General is an independent nonpartisan officer of the Legislature, appointed by the House of Assembly for a ten-year term. He or she is responsible to the House for providing independent and objective assessments of the operations of government, the use of public funds, and the integrity of financial reports. The Auditor General helps the House to hold the government to account for its use and stewardship of public funds.

The Auditor General Act establishes the Auditor General's mandate, responsibilities and powers. The Act provides his or her Office with a modern performance audit mandate to examine entities, processes and programs for economy, efficiency and effectiveness and for appropriate use of public funds. It also clarifies which entities are subject to audit by the Office.

The Act stipulates that the Auditor General shall provide an opinion on government's annual consolidated financial statements; provide an opinion on the revenue estimates in the government's annual budget address; and report to the House at least annually on the results of the Office's work under the Act.

The Act provides the Office 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 and district health authorities, as well as funding recipients external to the provincial public sector. It provides the Auditor General with the authority to require the provision of any documents needed in the performance of his or her duties.

In its work, the Office of the Auditor General is guided by, and complies with, the professional standards established by CPA Canada. We also seek guidance from other professional bodies and audit-related best practices in other jurisdictions.





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# 1 Message from the Auditor General

## Introduction

- 1.1 I am pleased to present my November 2015 Report to the House of Assembly. This report focuses on financial reporting issues and includes work completed by my Office during the past year.
- 1.2 I wish to acknowledge the efforts of my staff in completing this work. I would also like to acknowledge the cooperation and courtesy extended to my Office by staff in departments and agencies throughout government. Our audit questions were answered on a timely basis and we were provided with the information we needed to complete our work.

## Overview of Report

- 1.3 The Auditor General Act prescribes two significant legislated responsibilities: a report, including an opinion, on the fair presentation of government's annual consolidated financial statements; and a review engagement report, including an opinion, on the reasonableness of government's revenue estimates in its annual budget. The Act also allows us to review the audit opinion and management letter provided by external auditors of agencies included in the government reporting entity, and report matters of interest to the House of Assembly.
- 1.4 Other provincial legislation requires the Auditor General to perform the following.
  - An audit of the financial statements of four provincial agencies.
  - An audit of controls and compliance with respect to the House of Assembly Management Commission Act.
- 1.5 In addition, the Auditor General Act allows that we may conduct audits of other entities within government. Under this authority, we will be the first auditor of the newly-created Nova Scotia Health Authority which was formed on April 1, 2015. As this new entity consolidates the operations of the nine former district health authorities, it will be the single largest government organization, accounting for approximately 20% of government expenditures. We are currently completing the planning phase of the audit and will begin transaction testing shortly.



- 1.6 This report includes three chapters in addition to this introduction.
- 1.7 Chapter 2 describes the results of our audit of the province's consolidated financial statements, included in Volume 1 of the province's Public Accounts, and the results of our review of the revenue estimates included in the province's 2015-16 budget. Both opinions were unqualified. We made recommendations in each engagement including the need to improve processes for estimating tax revenues, and to improve government reporting of contaminated sites and other contingencies and contractual obligations. We also reported the results of our limited testing of senior government executives' hospitality and vacation use. We recommended that the Department of Internal Services update government's hospitality policy to reflect public expectations of such policies, and that travel and hospitality expenses of senior personnel should be publicly disclosed.
- 1.8 Chapter 3 includes the results of our audit of four government agencies, and the results of our review of the audit opinions and management letters provided to boards and management of agencies within the government reporting entity. We limited our detailed review to 21 significant entities across government, including district health authorities and school boards. We continue to be concerned with the number of auditor recommendations that are not implemented in these agencies, and have recommended that the Department of Finance and Treasury Board track the implementation rate of these agencies and seek explanations for repeated recommendations.
- 1.9 Our comments on the financial condition of the Province of Nova Scotia are included in chapter 4, and are as a result of our analysis of several indicators related to the sustainability, flexibility, and vulnerability of the province's finances. While there was an improvement in the financial results of the province during 2015-16, unfavourable trends continue. The province's per capita debt ratio has climbed to \$15,944 per person. The province's net debt position limits its ability to expand programs and reduce taxes, and restricts the use of future revenues.
- 1.10 Departmental responses to recommendations have been included in the appropriate chapter. We will follow up on the implementation status of our recommendations in two years, with the expectation that significant progress will have been made.



## Chapter 2: Results of Public Accounts Audit and Review of Revenue Estimates

### Why we did this work:

- The Auditor General is responsible for:
  - reporting on the reasonability of the province's revenue estimates
  - providing an audit opinion on the province's annual consolidated financial statements
- Nova Scotians count on our independent opinion
- To enhance accountability of financial reports
- Elected officials use financial information in allocating scarce resources

### Overall comments:

- 2015-16 revenue estimates of \$9.9 billion used to present the budget were reasonably calculated
- The 2015 consolidated financial statements fairly show Nova Scotia's financial situation including its \$9.3 billion in accumulated deficits
- We made 12 recommendations

### What we found:

- Not all assumptions used to estimate tax are reviewed
- Petroleum royalty estimate assumptions are not reviewed regularly
- Liability for environmental issues of SYSCO may be too high as it is based on old information
- Errors in support for obligations under contract caused audit inefficiencies
- Exceptions noted in SAP Service Management audit report to be addressed
- No written procedures to identify contaminated sites across the province
- Process to evaluate changes to the tax revenue estimation process is inadequate
- Government working on strengthening its internal control over financial reporting
- Government hospitality policy needs updating
- Government not publicly disclosing travel and hospitality expenses for senior bureaucrats



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## 2 Results of Public Accounts Audit and Review of Revenue Estimates

### Background and Chapter Objective

- 2.1 There are two components to government financial reporting – reporting on financial condition, and reporting on financial performance. Both components are included in Volume 1 of the Public Accounts, which includes the province’s consolidated financial statements.
- 2.2 Financial condition provides information on government’s financial health at a point in time. The government’s statement of financial position is one of the most significant indicators of its financial condition at fiscal year end. The statement of financial position provides two key measures of government’s health: net debt and accumulated surplus. Net debt is used to define the deficiency between financial assets and liabilities, and informs the extent to which government can honour its future obligations through realizing its financial assets. Accumulated surplus or deficit is the result of subtracting non-financial assets from net debt. In other words, accumulated surplus or deficit shows how much of net debt was used to purchase assets that will be used to provide government services.
- 2.3 The statement of operations provides summary level information on financial results. This statement includes the government’s approved budget for the year along with actual results, enabling users to evaluate the extent to which the government has met its fiscal plan. The statements of changes in net debt and changes in cash flow provide additional information on how government has financed its operations and capital acquisitions.
- 2.4 The province’s consolidated financial statements also serve the following purposes.
  - Elected officials use financial information to make decisions regarding the allocation of scarce resources.
  - Taxpayers use financial reports to assess government’s stewardship over the resources entrusted to them.
  - Other users, such as lenders and credit rating agencies, use financial reports to meet their specific needs.
- 2.5 The Nova Scotia Finance Act specifies financial reporting requirements for the province which includes tabling of the Public Accounts. Other requirements are the annual estimates (budget) and the periodic forecast updates comparing forecasted results at a point in time during the year with



the budget. These reporting requirements are part of the government's accountability framework and contribute to oversight of the use of resources.

- 2.6 Under section 19 of the Auditor General Act, this Office is the legislated auditor of the province's Public Accounts. Further, 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.
- 2.7 In addition to the above, the Auditor General is the legislated auditor of four government entities and conducts two other annual audits; the results of these audits are discussed in chapter 3.

## Significant Observations

### Review of 2015-16 Revenue Estimates

#### Conclusions and summary of observations

We issued an unqualified review report on the 2015-16 revenue estimates of \$9.9 billion included in the government's \$10 billion budget. We repeated two prior year recommendations. The Taxation and Federal Fiscal Relations Division of the Department of Finance and Treasury Board should develop a process to review all tax model assumptions on a periodic basis, especially those that are not subject to annual review as part of the estimate process. The Department of Energy should develop a process to review inputs and calculations used in the models to estimate petroleum royalties. Both recommendations were repeated to ensure these revenues reflect management's best estimate.

#### ► Unqualified report on 2015-16 revenue estimates

- 2.8 *Unqualified opinion* – Under section 20 of the Auditor General Act, the Auditor General is required to provide an opinion on the reasonableness of the revenue estimates included in the annual budget tabled with the House of Assembly. We issued an unqualified opinion on the 2015-16 revenue estimates which was then included in the April 9, 2015 budget address provided by the Minister of Finance and Treasury Board.
- 2.9 The review opinion covers the 2015-16 revenue estimates, including all those components of the budget that meet the definition of revenue for purposes of financial reporting in accordance with Canadian generally accepted



accounting principles (GAAP). Under this definition, the 2015-16 revenue estimates encompass the following components included in the government's budget:

- a) ordinary revenues;
- b) sinking fund earnings;
- c) recoveries and fees;
- d) revenue of government units included in the Consolidation and Accounting Adjustments for Government Units section of the budget summary; and
- e) net income from government business enterprises.

► Not all tax model assumptions thoroughly reviewed

2.10 *Assumptions* – Personal income tax, corporate income tax, harmonized sales tax, and petroleum royalties are estimated using statistical models. Economic assumptions are used as part of the process to estimate these revenues. These assumptions include, among others, gross domestic product, employment rate, the consumer price index, and interest and exchange rates. Other assumptions are based on past events such as results of prior year tax filings and the growth in tax rebates. Some of these are updated annually, while others are not.

2.11 We recommended last year that the Department of Finance and Treasury Board's Taxation and Fiscal Policy Division, now the Taxation and Federal Fiscal Relations Division, should develop procedures to review all tax model assumptions, particularly those not subject to annual consideration. The department agreed with our recommendation at that time. We are aware that some changes have been made to elasticity and calibration assumptions since then. However, a process has not been established to review all assumptions, and we continue to recommend this be done.

**Recommendation 2.1**

Taxation and Federal Fiscal Relations (a division of the Department of Finance and Treasury Board) should review all tax model assumptions on a periodic basis.

**Department of Finance and Treasury Board Response:** The Taxation and Federal Fiscal Relations Division is amending its methodology for reviewing Revenue Forecast Model Modules, which reflects management's decision to prepare a risk assessment analysis to identify aspects of the revenue forecast methodology, including, but not limited to assumptions, equations, and processes, that will be subjected to a more formal review. The risk assessment will help identify and prioritize particular areas of the methodology and models to be reviewed.



- 2.12 Management informed us that since May 2015 division staff have begun incorporating processes for periodic model review into their work plan, and will formalize the timing of this model review in an updated plan.

► Petroleum royalty model inputs not regularly reviewed

- 2.13 *Petroleum royalties* – During last year’s engagement, we noted several issues with the preparation of models used to estimate petroleum royalties. Assumptions used to prepare the models, such as inflation rate and natural gas prices, were inaccurate. During this year’s engagement, there were fewer instances in which the model assumptions were in error. However, we noted the following deficiencies.

- The exchange rate did not agree with the rate approved by Treasury and Policy Board.
- The natural gas price assumption was not internally consistent between the models. The price calculated by the model used to determine current natural gas prices was not carried forward to the individual producers’ royalty calculation files.

- 2.14 Although both of these deficiencies resulted in a trivial error and did not require correction, we have reported in the past the need to review inputs used in the models to determine petroleum royalties. This would ensure assumptions are current and reflect factors approved for use in the models. The review should also include a review of model calculations. This would confirm the accuracy of amounts included in the final revenue estimates presented in the budget. We repeat the recommendation made in prior years.

**Recommendation 2.2**

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

**Department of Energy Response:** The Department of Energy has put in place a process to review the inputs and calculations of the forecast models. The models will be peer reviewed and a formal checklist will be signed off.

- 2.15 *Tax model change management* – Changes made to tax models during the year were well-documented and supported. Changes included adjustments to the tax elasticity factor used to estimate personal income tax, and to the calibration factor used to refine the federal Department of Finance’s harmonized sales tax revenue estimates. However, we recommended that changes impacting financial reporting should be reviewed by the Government Accounting Division to assess their potential impact on the Public Accounts. This matter is discussed further later in this chapter because it also impacted our audit of government’s financial statements.



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## Audit of the March 31, 2015 Consolidated Financial Statements

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### Conclusions and summary of observations

We issued an unqualified audit opinion on the Province of Nova Scotia's 2014-15 consolidated financial statements. However, we identified issues and made recommendations on several matters. The liability to remediate the former SYSCO site is overstated and more current information is needed. We encountered issues related to completeness and accuracy of contractual obligations. Although all errors were corrected, there were audit inefficiencies in working with the incorrect information. We also found deficiencies in both the process to compile the listing of contaminated sites and the process to evaluate changes to the estimation process used to calculate tax revenues. We noted auditors of the province's general ledger system identified concerns with general computer controls which should be addressed.

We also performed specific testing of executive compensation, vacation, travel and hospitality expenses and recommended a modern, government-wide hospitality policy be implemented and monitored. To enhance openness and transparency, we have also recommended the Department of Finance and Treasury Board require senior management of government departments, and agencies, boards and commissions to publicly disclose their travel and hospitality claims.

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2.16 *Background*—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 that 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.

► The province's March 31, 2015 consolidated financial statements were fairly stated

2.17 *Unqualified audit opinion*—We issued an unqualified opinion on the province's March 31, 2015 consolidated financial statements. 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 Chartered Professional Accountants of Canada (CPA Canada). The unqualified audit opinion also indicates there were no quantitative findings, either individually or cumulatively, which were material enough to impact the opinion.



2.18 Our Office provided a letter to the Minister of Finance and Treasury Board on July 30, 2015. It included required communications to those charged with governance under Canadian Auditing Standards, and other matters that came to our attention during the course of the audit, of which we believe the Minister should be aware. We also provided a management letter to the Deputy Minister of Finance and Treasury Board in October 2015. This communication included detailed audit findings, recommendations and other comments related to the March 31, 2015 public accounts. The more significant information included in the management letter is noted below under the following headings.

- Audit Completion
- Internal Control
- Other Matters

### Audit Completion

2.19 *Results and significant findings* – The consolidated financial statements were released on July 30, 2015. We issued an unqualified audit opinion dated July 23, 2015.

2.20 Canadian Auditing Standards require that we communicate to those charged with governance 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.

2.21 We communicated these matters to the Minister of Finance and Treasury Board.

2.22 As part of the audit we also provide specific information about the findings of our audit in a management letter to the Deputy Minister of Finance and Treasury Board. The management letter communicates detailed audit findings, difficulties encountered during the audit, and any other matters arising from the audit that we feel should be communicated to management. Issues that directly impacted audit completion and that, in our judgment, are important to oversight of the financial reporting process are noted below.



Liability for former SYSCO site may be too high as it is based on old information

- 2.23 *Department of Transportation and Infrastructure Renewal – SYSCO* – The liability to complete the remediation and monitoring of the former Sydney Steel Corporation and adjacent sites, including the Sydney Tar Ponds, is a provision based on management’s best estimate. The estimated costs are reviewed each year and the provision is assessed to ensure it is sufficient. The provision at March 31, 2015 totaled \$73 million. Management’s best estimate is supported by two documents – a contract with the federal government for monitoring the Sydney Tar Ponds site, and a consultant’s report related to future monitoring and further remediation of SYSCO.
- 2.24 As part of the audit, the Department of Finance and Treasury Board’s Government Accounting Division staff prepared an analysis of outstanding contracts and of expected monitoring costs for the next several years and determined that the provision was overstated by \$6.4 million. In addition, we identified two misstatements, including the need to factor inflation costs into the remediation cost estimates as required by accounting standards. The net result is that the provision is overstated by \$5.1 million and should be adjusted to reflect this revised amount.
- 2.25 As noted above, a consultant’s report supports a portion of the total provision. The report is dated 2011 and addresses future remediation and monitoring costs. We are not aware of industry standards for updating such reports or conducting new studies. However, given the significance of the provision, we believe the Department of Transportation and Infrastructure Renewal should assess the need for a new or updated report. This would help ensure the estimated costs for the site are current, and better support the recorded amount.

**Recommendation 2.3**

The Department of Transportation and Infrastructure Renewal should remeasure the liability for the estimated future costs for remediation of the tar ponds and obtain an update to the consultant’s report used to measure the liability.

**Department of Transportation and Infrastructure Renewal Response:** This liability will continue to be utilized for future long-term maintenance and monitoring activities essential to the remediation of the SYSCO and Tar Ponds sites. Based on currently available information, the provision, in aggregate, is sufficient to cover the estimated costs to remediate and monitor these sites. Transportation and Infrastructure Renewal (TIR), along with Government Accounting, will continue to assess the liability for remediation at each year-end to ensure it is fairly stated in the Province’s Public Accounts. Government Accounting obtains from TIR senior management periodic status updates and cost updates on the SYSCO Remediation Project.



The Tar Ponds sites have entered a maintenance and monitoring phase, but the SYSCO site still has a number of outstanding uncertainties that have yet to be confirmed. Until the project is fully complete and signed off, the full costs of remediation will not be truly known. Therefore, our position remains to make no adjustments to the provision until all known projects are complete due to the uncertain nature and complexities of the remaining work and their costs.

Although TIR does not foresee any of the major assumptions changing in the report dated 2011, the department has agreed to arrange for an update of the consultant's report relating to remediation and monitoring of SYSCO in fiscal 2016.

## Internal Control

- 2.26 *Responsibility for internal control* – The Nova Scotia Finance Act includes general references to the roles and responsibilities of the Minister and Deputy Minister of the Department of Finance and Treasury Board 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 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.*”
- 2.27 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.
- 2.28 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 and strengthen financial reporting. There were no significant deficiencies noted during the audit that required communication with those charged with governance, as would be required by Canadian Auditing Standards.

### ► Errors in support for obligations under contract caused audit inefficiencies

- 2.29 *Various departments – contingencies and contractual obligations* – During our testing of contractual obligations, we encountered many issues related to



the completeness and accuracy of amounts disclosed in the draft consolidated financial statements provided to us for audit purposes. Departmental listings of contractual obligations were not complete and did not include obligations from the prior year that remained obligations in the current year.

2.30 All errors in the contingencies and contractual obligations schedules were eventually corrected and we concluded disclosure of these amounts was fairly stated. The following are the more significant deficiencies, eventually corrected, which we identified during the audit.

- The Department of Transportation and Infrastructure Renewal provided details of the obligation related to the new convention centre. However, the obligation did not include the net present value of the lease payments the province will be required to make for the facility. This resulted in a \$43.7 million understatement of contractual obligations included in the draft consolidated financial statements.
- Executive Council had contracts due to expire in future years but the Department of Internal Services did not include these on their contractual obligations listing. Responsibility for these contracts had changed to the Department of Internal Services but we were informed the department was unaware of this. The department revised its listing to reflect this transfer of responsibility.

2.31 Departments are responsible for the accuracy and completeness of information provided to Government Accounting for preparation of the consolidated financial statements. We were informed that Government Accounting has provided guidance to departmental financial staff on identifying and measuring contingencies and contractual obligations. It is evident from our findings that more attention is needed.

#### **Recommendation 2.4**

Government Accounting (a division of the Department of Finance and Treasury Board) should provide additional training to departmental financial staff on accounting for and disclosing contingencies and contractual obligations. In addition, Government Accounting should review schedules submitted for significant and unexpected variances and investigate any unexpected variances.

**Department of Finance and Treasury Board Response:** Numerous controls have been implemented over the past few fiscal years to help with the accuracy and completeness of reported contingencies and contractual obligations. With the recent change to shared services within the Department of Internal Services, Government Accounting will continue to work with departments and offer training to ensure that they understand their review and reporting responsibilities, as well as formally document a post-submission review process, which will include relevant procedures in an effort to mitigate any errors in the completeness, existence, and



accuracy of the contingencies and contractual obligations schedules. In addition, Government Accounting will continue to review schedules submitted for significant and unexpected variances, and any significant variances will be investigated further.

► Exceptions noted in SAP Service Management audit report

- 2.32 *SAP Service Management (SAPSM) – CSAE 3416* – The SAP Service Management Division manages the SAP system. Auditors of the SAP Service Management’s description of its infrastructure and application support services for the period April 1, 2014 to March 31, 2015 issued a qualified opinion. The qualification was based on the results of testing whether or not logical access to SAP systems is appropriately restricted to authorized users.
- 2.33 We also obtained the CSAE 3416 report for IBM Canada because SAP application management services are outsourced to IBM. Both reports are needed to obtain a full understanding of the SAP general control environment. The independent auditors’ report for IBM Canada was unqualified. However, in both reports – SAPSM’s CSAE 3416 and IBM’s CSAE 3416 – the respective auditors noted that complementary controls needed to be operating effectively. In other words, notwithstanding the unqualified opinion on the IBM CSAE 3416 report, both auditors are indicating that in order for the general control environment to be operating effectively, controls at both IBM and the province need to be operating as they should be.
- 2.34 A qualified opinion is a serious deficiency. Although the qualified opinion had no impact on our procedures or our overall audit conclusion, such a qualification reflects poorly on the overall control environment. Unauthorized access can result in inappropriate transactions and/or access to confidential information. Although the qualification does not indicate there was any such breach, and the controls in place collectively provide an appropriate foundation for the control environment, the controls to monitor access were unavailable for two periods during the year. This means that management was unable to monitor access as part of an overall control environment and respond to issues as needed.

**Recommendation 2.5**

SAP Service Management (a division of the Department of Internal Services) should address the exceptions identified in the CSAE 3416 report.

**Department of Internal Services Response:** The SAP Service Management Division of the Department of Internal Services has addressed these exceptions, and all items have been completed as recommended.

- 2.35 As noted, SAP Service Management staff state these deficiencies have been addressed. We have not audited the actions taken but are encouraged that the issues raised appear to have been addressed on a timely basis.



## Other Matters

- No written procedures to identify contaminated sites across the province
- 2.36 *Contaminated sites* – Public Sector Accounting Standard (PSAS) 3260 came into effect April 1, 2014. This standard establishes the recognition and measurement of liabilities associated with remediation of contaminated sites.
- 2.37 As part of our audit, we met with staff of the Departments of Transportation and Infrastructure Renewal and Natural Resources in order to obtain an understanding of the process each department used to compile its listing of contaminated sites. The process used by both departments included reviewing contamination reports from field staff, analyzing related site expenses, and considering Occupational Health and Safety reports which reflect contamination. In our view, these processes were sufficient to mitigate the risk of materially misstating the consolidated financial statements through nondisclosure of contaminated sites.
- 2.38 However, the process discussed at each department was not documented, was fragmented, and roles and responsibilities had not been established. A documented process would help ensure completeness and accuracy of the contaminated sites listing reported to Government Accounting for the purposes of preparing the consolidated financial statements.
- 2.39 We selected these two departments as together they are responsible for provincial assets which pose the most significant contamination risk. We did not review or discuss the process for identifying contaminated sites in other departments. In order to ensure liabilities for contaminated sites are complete and accurate, there should be an appropriate management trail to support recorded amounts or to confirm that a liability does not exist. Government Accounting should work with departments to ensure processes exist and are documented fully, and that the result of such processes ensures compliance with the accounting standard.

### **Recommendation 2.6**

Government Accounting (a division of the Department of Finance and Treasury Board) should assist departments in determining how to identify and assess contaminated site liabilities, including establishing roles and responsibilities.

**Department of Finance and Treasury Board Response:** Departments have established risk-based processes to identify and assess contaminated sites. On a collective basis, these processes provide for a complete and accurate consolidated listing that meets the accounting requirements set out in PS 3260. Government Accounting will work with the departments to ensure their processes are appropriately documented in sufficient detail, including the assignment of individual roles and responsibilities.



- 2.40 In addition, during the audit, in response to our questions on the completeness of contaminated site listings, Government Accounting asked the Department of Environment for their internal list of contaminated sites. In comparing this list to the original listing provided by the department to Government Accounting we identified an additional four sites. This comparison should have been undertaken by Government Accounting prior to the audit.
- 2.41 We also noted that ten sites maintained by the Department of Transportation and Infrastructure Renewal were identified as contaminated, but no liability had been recorded. These sites were the same as 19 other sites used for similar purposes, and for which liabilities were recorded; we therefore suggested that contamination was likely. We further suggested that a reasonable estimate of the liability could be made based on the liability recorded for the 19 other sites. Government Accounting agreed with our analysis and a liability was recorded for these ten additional sites.

► Inadequate evaluation of changes to revenue estimation

- 2.42 *Corporate income taxes* – The revenue model used to estimate and forecast Corporate Income Taxes includes an adjustment for Nova Scotia’s economic circumstances (the Nova Scotia Economic Adjustment factor). This factor is based on a formula, and is an assumption in the process to determine tax revenues. We have recommended in the past that this factor be subject to periodic review.
- 2.43 In the process of updating the Corporate Income Tax model for the March 31, 2015 Public Accounts, Taxation and Federal Fiscal Relations Division staff noted that maintaining the adjustment factor at its current level had a minor impact on March 31, 2015 results, but had a significant impact on the March 31, 2016 forecast update which was issued in September 2015. Division staff felt the latest information from the federal Department of Finance on 2014 and 2015 Canadian corporate results, used as an input to the estimation process, was optimistic. As a result, the division reduced the Nova Scotia Economic Adjustment factor to zero in an effort to normalize the 2015-16 forecast.
- 2.44 For accounting purposes, changes to the estimation process used to calculate tax revenues need to be evaluated to determine if the changes result in better financial reporting and whether disclosure of the change is required. In response to our request to support the decision made, division staff explained the large forecasted variability, but did not provide adequate detail as to why this change resulted in better financial reporting. Such an explanation is needed when there is a change in an estimate; that is, the new method results in a better estimate on a go-forward basis. Methods used to estimate financial statement items should be applied consistently. Therefore, if this new factor (now at nil) is the best estimate, it should not be adjusted in future without adequate support.



- 2.45 In the management letter resulting from our review of 2015-16 revenue estimates, we recommended that changes to estimates used in calculating tax revenues be approved by senior management within the Department of Finance and Treasury Board to support that such changes result in improved financial reporting. We further recommended that these changes be communicated to the Government Accounting Division to determine whether disclosure is required in the public accounts.
- 2.46 In response to that recommendation, we were informed the revised practice would be that such changes would be approved. We were provided evidence that both the Director of Taxation and Federal Fiscal Relations and the Executive Director of Fiscal Policy, Economics and Budgetary Planning retroactively reviewed and approved recommended changes to the models used to prepare the revenue estimates, in support of this revised practice. The procedure to approve changes made during our audit of the province's public accounts was through discussions that included Government Accounting along with senior management of the Taxation and Federal Fiscal Relations Division. The Executive Director of Fiscal Policy, Economics and Budgetary Planning provided implicit approval of the changes made as one of the recipients of the support provided to us which explained the large forecasted variability. If the Department of Finance and Treasury Board's Taxation and Federal Fiscal Relations Division is comfortable with this procedure, it should be included in their process documentation.

**Recommendation 2.7**

Taxation and Federal Fiscal Relations (a division of the Department of Finance and Treasury Board) should update process documentation to include the procedure followed to approve changes made to tax revenue models.

**Department of Finance and Treasury Board Response:** The Department of Finance and Treasury Board agrees that process documentation should be updated to include the procedures for approving tax revenue model changes.

- 2.47 There was no evidence that changes made to the estimation process resulted in better estimates either currently or in the future. We also found that changes made to the estimation process used in calculating tax revenues were not evaluated by Government Accounting in order to determine whether disclosure is required in public accounts. Government Accounting should analyze such decisions as they have the expertise to determine whether these decisions have an impact on the public accounts. Therefore, we have included a similar recommendation, to that made during the revenue estimates review, as a result of our audit of the March 31, 2015 consolidated financial statements.

**Recommendation 2.8**

Taxation and Federal Fiscal Relations (a division of the Department of Finance and Treasury Board) should demonstrate that changes made in determining taxation revenue improve financial reporting. Also, Government Accounting Division staff should determine whether changes in estimating tax revenues will impact the government's consolidated financial statements.

**Department of Finance and Treasury Board Response:** The Department of Finance and Treasury Board believes sufficient support was provided to show that the tax model change would result in better revenue estimates. As stated in the memo provided to the Office of the Auditor General in July 2015, assumptions about corporate net operating surplus (CNOS) are not well-suited to estimating taxable income. CNOS was used as a variable to estimate corporate taxes when Statistics Canada eliminated the collection of the 'corporate profits' variable. Unlike Finance Canada for national corporate taxes, Nova Scotia is unable to estimate corporate profits for the Province due to a lack of historical data.

The limitations in CNOS became especially apparent when its use led to the result that the value of oil and natural gas exports was generating significantly greater growth in net operating surplus in Nova Scotia than was expected for Canada. The Province's share of national corporate taxable income is highly sensitive to the adjustment factor and it is well known that oil and natural gas exports do not generate significant taxable income for the Province. It was unreasonable to estimate corporate income tax revenues using the adjustment factor and staff exercised their professional judgment to reduce an over-optimistic result by employing a 3-year average share approach to the adjustment factor. The tax model change and the rationale were discussed by the Taxation and Federal Fiscal Relations Division with Government Accounting, the Controller, and the Associate Deputy Minister.

The Department of Finance and Treasury Board agrees that there is always room for increased and enhanced communication with Government Accounting concerning tax revenue model changes and will ensure that Government Accounting is kept apprised of tax model changes so they may determine the impact on the Public Accounts. Tax model process documentation will be updated to reflect the inclusion of Government Accounting in the notification of tax model changes.

► Internal control over financial reporting project adds value but needs attention

2.48 *Internal control over financial reporting* – The Department of Finance and Treasury Board implemented a project, Internal Control over Financial Reporting (ICFR), approximately six years ago. The project is part of an overall governance objective that includes other projects such as Enterprise Risk Management and the implementation of the SAP Governance, Risk and Compliance module. The objective of the ICFR project is for management



to assess their internal controls on a periodic basis and report the results to the Controller, in order to support the statement of responsibility for internal controls included in Volume 1 of the Public Accounts.

- 2.49 We met with management of the Department of Finance and Treasury Board in August 2015 to determine the current status of the project. At that time, management had completed the documentation and testing of entity level controls. Certain key corporate process controls, such as those relating to estimating provincial revenue, have been identified, documented and are being updated and tested on an annual basis.
- 2.50 An overall risk assessment of departments and entities included in the government reporting entity is complete. From this risk assessment, a multi-year plan has been developed to determine the cycle for reviewing controls at certain departments and entities. The extent of review at each entity is determined based on its assessed risk. It is anticipated that this project will take a number of years to complete.
- 2.51 Business processes have not been documented at departments and entities. Generic risk control checklists for entity level controls have been provided to departments to complete. These checklists are to be completed for the following areas: control environment; risk assessment; information and communication; and monitoring. They are not specific to each department and the controls noted are not necessarily relevant to the public sector (for example, controls include those related to collecting cash, a process which is not relevant to all departments). The intent of the checklists is to familiarize departmental financial staff with controls so that department-specific controls can be identified in due course.
- 2.52 The Department of Internal Services was established during the past year and is (or will be) responsible for providing the following services to all departments:
- Vendor master file maintenance
  - Accounts payable data entry
  - Vendor payments from SAP
  - Enquiries and exception handling
  - Accounts receivable (centralized with SAP as possible)
  - Procurement
  - General accounting (general ledger and subsystem reconciliations, month-end close, master file maintenance)



- 2.53 As a result, it is anticipated that business processes related to these services will be developed and formalized by that department.
- 2.54 We have recommended in past reports that internal controls be identified and documented, and that roles and responsibilities for these controls be formally assigned. Once achieved, the outcome of the Internal Controls over Financial Reporting project will likely address this recommendation. Whether controls are identified by the Department of Internal Services or individual departments, we believe this project adds value and that resources should be allocated to its completion.

**Recommendation 2.9**

The Department of Finance and Treasury Board should have timeframes for departments to complete their documentation of controls and ongoing monitoring.

**Department of Finance and Treasury Board Response:** The departments are required to submit their Statement of Management Responsibility to Government Accounting by May 5th for the immediately preceding fiscal year. This Statement is senior management's acknowledgement of the accuracy and reliability of their financial records and the effectiveness of their system of internal controls over financial reporting. Departments are also requested to submit to Government Accounting their Risk Control Checklists, which identify specific control activities that address certain control objectives related to accounts receivable, accounts payable, inventory, and tangible capital asset processes. These checklists also include Entity Level Controls (ELC) at the department level, which include monitoring controls.

- 2.55 In addition, based on discussions with management, the project does not currently include monitoring of controls. Monitoring of internal controls is an integral part of a strong control framework. The objective of monitoring these controls is to ensure they are effective and operating as intended and responding to identified deficiencies. Monitoring is to be performed by individuals independent of the control; for example, an individual who has oversight for a monthly approval process. The Department of Finance and Treasury Board should provide information to departments on establishing a process to monitor controls, including a system to provide results of monitoring to departmental senior management.

**Recommendation 2.10**

The Department of Finance and Treasury Board should include monitoring of internal controls in the Internal Controls over Financial Reporting project.

**Department of Finance and Treasury Board Response:** The Department of Finance and Treasury Board is following the COSO Framework to effectively and efficiently develop a system of internal controls over financial reporting (ICFR) for



the Province. One of the components of this framework is monitoring activities. Ongoing evaluations, separate evaluations, or some combination of the two will be used to ascertain whether internal controls exist and are operating effectively. Departments will be provided additional guidance on the key monitoring activities that should be included in their ICFR system. The results of testing will be reported to senior management and provide supporting documentation for the Statements of Management Responsibility.

► Government hospitality policy needs updating

2.56 *Specific testing* – As part of our audit of the province’s March 31, 2015 consolidated financial statements, we performed limited work on executive compensation, vacation, travel and hospitality expenses. We made the following two recommendations as a result of this work.

**Recommendation 2.11**

The Department of Internal Services should put in place a government hospitality policy that captures modern public sector expectations, and monitor that this policy is being met.

**Department of Internal Services Response:** The Department agrees that more clarity is required around expenditures related to public sector meetings, conferences, and other events. The Province will conduct a policy review to determine if more clarity can be provided within an existing policy, or whether a new policy is required.

► No reporting of senior bureaucracy travel and hospitality expenses

**Recommendation 2.12**

To enhance openness and transparency, the Department of Finance and Treasury Board should require senior management of government departments, agencies, boards and commissions, to publicly disclose travel and hospitality claims.

**Department of Finance and Treasury Board Response:** The Department of Finance and Treasury Board agrees with this recommendation and will work on this initiative with the Department of Internal Services as part of their policy review as mentioned in 2.11 above.

2.57 *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 (in effect for the current year), 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.

- 2.58 *Foreign Currency Translation and Financial Instruments* – The most significant impacts of these sections are the requirement for a new financial statement (Statement of Remeasurement Gains and Losses) and the removal of hedge accounting provisions. The Statement will include unrealized foreign exchange gains or losses and unrealized changes in the fair value of certain financial instruments. Unrealized amounts will be reversed when balances have been settled in a future period and realized gains or losses are recognized. These sections were to be effective for fiscal periods beginning on or after April 1, 2016. However, the Public Sector Accounting Board recently extended the effective date to April 1, 2019. Corresponding amendments have been made to PS 3040 Portfolio investments (now PS 3041).
- 2.59 In addition, the following sections are effective April 1, 2017.
- 2.60 *Related Party Disclosures and Inter-Entity Transactions* – These sections define related parties and establish related disclosure requirements and standards on accounting for inter-entity transactions. No significant impact is expected when these new standards are implemented as most related party and inter-entity transactions are eliminated upon consolidation.
- 2.61 *Assets, Contingent Assets and Contractual Rights* – These three sections define assets and contractual rights and establish related disclosure requirements. The impact of implementing these standards has not yet been assessed.





## Chapter 3: Results of Audits in the Government Reporting Entity

### Why we did this work:

- To summarize matters reported to management and boards
- There are about 100 entities outside of core government
- These 100 entities account for about 40% of government's annual expenses
- Health authorities, IWK Health Centre, school boards, Housing Nova Scotia, Nova Scotia Community College, and Nova Scotia Liquor Commission are significant entities

### Overall comments:

- Nova Scotians can be confident that the majority of entity financial statements were fairly stated
- Qualified opinions were rare and not concerning given nature of entities
- Too many government entities are not promptly addressing weaknesses
- The Department of Finance and Treasury Board should hold government entities accountable to correct weaknesses in a timely manner
- We made one recommendation

### What we found:

- Qualified audit opinions were few, consistent with prior years, and in line with expectations
- Seventeen control weaknesses were new
- Thirty-six control weaknesses were repeated from prior years with 40% of these dating back to 2009-10
- Three DHAs (Cape Breton, Colchester, and Pictou) and Housing Nova Scotia have many deficiencies outstanding for years
- Provincial IT issues impact other organizations using same systems
- Controls over \$41 million in school-based funds continue to be deficient
- Two DHA's expense budgets are inaccurate as province will not allow DHAs to budget for deficits
- Gambling Awareness Foundation of Nova Scotia received \$1.2 million from gaming profits to be used to fund gaming-related research but granted \$0.2 million



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## 3 Results of Audits in the Government Reporting Entity

### Background

- 3.1 The Auditor General is the legislated auditor of four government entities.
- Nova Scotia Crop and Livestock Insurance Commission
  - Nova Scotia Legal Aid Commission
  - Nova Scotia Provincial Lotteries and Casino Corporation
  - Trust Funds Administered by the Public Trustee
- 3.2 Our Office also conducts an annual audit under section 22 of the House of Assembly Management Commission Act. The purpose of this audit, the results of which must be reported by November 30 each year, is to express opinions on:
- whether expenses incurred by the Assembly are in accordance with the policies of the Commission and, where applicable, the policies of the public service of the Province; and
  - whether the Chief Clerk's assessment of the effectiveness of internal controls of the House of Assembly is fairly stated and whether the internal controls are operating effectively.
- 3.3 In addition, we will also be performing the annual audit of the newly-formed Nova Scotia Health Authority. This audit, conducted under section 23(1) of the Auditor General Act, will be undertaken for the first time for the year ended March 31, 2016. The planning phase of the health authority audit is near completion and transaction testing will begin shortly.
- 3.4 We issue a letter to management or to the chair of the board or audit committee (if applicable) in each of the entities we audit. The letter 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 on the implementation status of these recommendations during the subsequent year's audit.
- 3.5 Under section 23 of the Auditor General Act, we also review the audit opinions and related management letters issued by private sector auditors for entities within the government reporting entity, and report matters of interest in this chapter. These management letters provide details on internal control-related issues and other matters. We consider those results, as well



as the audit results from the four government entities that we examine, when auditing the consolidated financial statements of the province.

- 3.6 In prior years, our Office reviewed and reported on the audit opinions and communications of all entities in the government reporting entity audited by private sector auditors and provided statistics on the deficiencies reported. This year we reviewed and reported on all entities audited, but show current year statistics only for the more significant entities within the government reporting entity. The more significant entities were singled out as they are more financially significant to the government reporting entity, or have significant operations, and audit findings may identify risk areas to the consolidated results.
- 3.7 For the year ended March 31, 2015, the more significant entities audited by private sector auditors include the health authorities, regional school boards, and certain other entities. Specifically, they are:
- nine district health authorities and the IWK Health Centre
  - seven regional school boards and the Conseil scolaire acadien provincial
  - Housing Nova Scotia
  - Nova Scotia Community College
  - Nova Scotia Liquor Corporation
- 3.8 With the amalgamation of the nine district health authorities into the Nova Scotia Health Authority as of April 1, 2015, future reporting of results in the health sector will include the Nova Scotia Health Authority and the IWK.

## Chapter Objectives

- 3.9 The objectives of this chapter are to provide summary comments on the results of audits conducted by our Office, and identify matters of interest which have been reported by private sector auditors to management and boards of directors.



## Significant Observations

### Audits of Government Entities Conducted by the Auditor General

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#### Conclusions and summary of observations

We issued unqualified audit opinions for three of the four audits we conducted in government entities for the year ended March 31, 2015. Our audit opinion on Trust Funds Administered by the Public Trustee was qualified again this year due to the inability to verify that all assets that came under the Public Trustee's administration, or income related to these assets, were recorded by the Public Trustee. In addition, our report on the audit of the Nova Scotia Provincial Lotteries and Casino Corporation, while unqualified, included a paragraph to highlight for users of the statements the outstanding issue of the Corporation appealing taxes related to certain video lottery revenues. Both the Nova Scotia Crop and Livestock Insurance Commission and the Nova Scotia Provincial Lotteries and Casino Corporation implemented recommendations resulting from the March 31, 2014 audits. There were no new recommendations resulting from the March 31, 2015 audits of these entities. We acknowledge Nova Scotia Legal Aid Commission's positive step towards monitoring of the control environment. However, we have again recommended that a review process to monitor operating effectiveness of controls be established. We recommended that the Public Trustee put in place an accounting system to support the administration of the \$55 million in estates and trusts under that office's control. We also repeated prior year recommendations with respect to the Common and Special Reserve Funds administered by the Public Trustee. A new recommendation regarding the need for file reviews was made to the Public Trustee this year.

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3.10 *Background* – We completed financial statement audits of four government entities for which the Auditor General is the legislated auditor, and are currently in the process of completing an audit under section 22 of the House of Assembly Management Commission Act to express two separate opinions on House of Assembly controls and compliance. The Office has yet to complete its first annual audit of the newly-formed Nova Scotia Health Authority. Planning and initial transaction testing for this audit are in progress.

▶ Three of four entities audited by the Auditor General received unqualified audit opinions

3.11 *Audit opinions* – As in the prior year, we issued unqualified audit opinions to three of the four entities 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. This



qualification is standard given the nature of the Public Trustee's operations and does not reflect a shortcoming in the financial statements or operations of the Public Trustee.

► Provincial Lotteries and Casino Corporation opinion includes comments on a \$38 million video lottery tax assessment

- 3.12 The audit opinion on the Nova Scotia Provincial Lotteries and Casino Corporation's March 31, 2015 consolidated financial statements included an emphasis of matter paragraph, which is a paragraph, per Canadian Auditing Standards, that highlights matters for the financial statement user's attention, but which have no impact on the fairness of the financial statements. For the Corporation, the matter identified related to the Corporation's appeal of a tax assessment by the Canada Revenue Agency on certain video lottery revenues. The Corporation has remitted \$38 million relative to this matter.
- 3.13 *Audit findings and observations* – There were no findings resulting from our audits of the Nova Scotia Crop and Livestock Insurance Commission and Nova Scotia Provincial Lotteries and Casino Corporation. We noted that recommendations made as a result of the March 31, 2014 audits had been fully implemented.
- 3.14 *Nova Scotia Legal Aid Commission* – We provided a management letter to the chair of the Audit Finance Committee of the Nova Scotia Legal Aid Commission in August 2015. Based on the results of the prior year audit, we recommended that the Audit Finance Committee establish a process to monitor internal controls. While efforts were made to address the recommendation, there is still the need for a periodic review of controls to ensure they are operating as intended. We have therefore recommended a process to monitor controls be established and the results of this process be reported to the Commission on a periodic basis.
- 3.15 *Trust Funds Administered by the Public Trustee* – In October 2015, we provided a draft management letter to the Public Trustee. In prior years and in our May 2012 Report of the Auditor General, we recommended that an accounting system be acquired due to the value of estates and trusts under the Public Trustee's administration. This value has grown to over \$55 million. We have been informed that progress has been made towards implementing this recommendation. We continue to recommend that the Public Trustee develop and implement a fully-functioning and comprehensive accounting system.
- 3.16 We further recommended that the Public Trustee implement the recommendations made in past years with respect to the Common and Special Reserve Funds that the office administers. The Common Fund acts as a general bank account for clients and is used as required for disbursements



of estates. The Special Reserve Fund is intended to act as insurance to meet deficiencies in the Common Fund. These two funds, both with balances of about \$3 million as at March 31, 2015, are equal and therefore we believe the Special Reserve Fund has exceeded its intent as insurance to the Common Fund.

- 3.17 Finally, we made one new internal control recommendation to the Public Trustee. This recommendation highlighted the need for a file review process for files under the administration of trust lawyers. Such a process currently exists for files administered by trust officers and should be extended to trust lawyers as well.

### Audit Opinions – Private Sector Auditors

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#### Conclusions and summary of observations

Nine district health authorities, the IWK, seven regional school boards, the Conseil scolaire acadien provincial, Housing Nova Scotia, Nova Scotia Community College, and the Nova Scotia Liquor Corporation were all issued unqualified audit reports by their respective external auditors. Qualified opinions were issued for three other government entities but these qualifications were consistent with prior years and in line with expectations given the nature of those entities' operations. The audit report for the Nova Scotia Primary Forest Products Marketing Board drew attention to the Board's annual operating deficits in each of the last three years and the auditor's concern of the Board's ability to continue as a going concern.

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- 3.18 *Background* – The result of an audit is an opinion on whether financial statements present fairly, in all material respects, the financial position of the entity at its fiscal year end, and the results of its operations for the year then ended, in accordance with Canadian generally accepted accounting principles, which include accounting principles issued for the public sector. Generally, auditors issue an unqualified opinion when they conclude that the financial statements are fairly presented or they issue a qualified opinion when they conclude the financial statements are not fairly presented, or they are not able to determine if the financial statements have been fairly presented. Auditors will emphasize certain matters if there are matters to bring to the attention of the financial statement user. We believe it is appropriate to comment on these qualified opinions and matters of emphasis.

► Financial statements of significant entities presented fairly

- 3.19 *Audit opinions of significant entities* – Consistent with the prior year, unqualified audit opinions were issued by the private sector auditors of the more significant entities within the government reporting entity. These



entities include all nine district health authorities and the IWK, the seven regional school boards, Conseil scolaire acadien provincial, Housing Nova Scotia, Nova Scotia Community College, and the Nova Scotia Liquor Corporation. We identified these entities as significant due to their financial results and the programs they deliver.

- 3.20 *Qualified audit opinions* – Qualified audit opinions were issued to the Art Gallery of Nova Scotia and Nova Scotia Primary Forest Products Marketing Board, both due to an inability to audit the completeness of revenue, including revenue from donations or other contributions. These qualifications were consistent with the prior year. The audit opinion for the Nova Scotia Primary Forest Products Marketing Board also drew attention to the Board’s annual operating deficits in each of the last three years and the auditor’s concern of the Board’s ability to continue as a going concern.
- 3.21 Nova Scotia E911 Cost Recovery Fund was issued a qualified audit opinion due to the completeness of expenses not being subject to satisfactory audit verification. This qualification is consistent with the prior year.

### Communications of Audit Results – Private Sector Auditors

#### Conclusions and summary of observations

A total of 53 internal control-related issues were noted across all district health authorities and the IWK, school boards, Housing Nova Scotia, Nova Scotia Community College, and the Nova Scotia Liquor Corporation. This represents a 9% decrease in issues raised in the previous year. Of the 53 issues, only 17 (32%) were newly identified in 2014-15. We noted that 36 (68%) of the internal control-related issues identified in the current year have been reported in prior years, and 14 (39%) of those had been reported as far back as 2009-10 or earlier. Many of the issues that have been repeated year after year are IT deficiencies with some being specific to the entity, but there were also several deficiencies identified during an external audit of general computer controls across several entities that share the provincial infrastructure and application support services. Notable non-internal control related deficiencies were highlighted as well. Auditors of certain district health authorities identified important deficiencies in DHA budgeting processes, while auditors of Gambling Awareness Foundation Nova Scotia reported concerns regarding the entity’s fulfillment of its mandate.

- 3.22 *Background* – Auditors must communicate significant deficiencies in internal control identified during financial statement audits to those charged with governance. Other deficiencies reported include matters related to financial reporting and governance. In government entities, governance is typically provided by an independent board or other oversight body. Auditors are



also responsible to report significant difficulties encountered during the audit and other matters that are significant to the oversight of financial reporting. These audit results are usually communicated in documents presented to and discussed with management and boards.

3.23 *Overall results of significant entities* – We reviewed the management letters issued by the external auditors of the 21 more significant entities. These management letters reported deficiencies in several of the entities.

3.24 The following table illustrates the number of issues reported in the communications of audit results, along with those reported in the prior year.

<b>Number of Significant Government Entities with:</b>	<b>2014-15</b>	<b>2013-14</b>
Five or more issues	8	6
One to four issues	11	13
No issues	2	2
<b>Total</b>	<b>21</b>	<b>21</b>



Four significant entities have five or more repeated audit issues

3.25 The following four entities, of those we examined in detail, continue to exhibit numerous internal control or other deficiencies, many of which have existed for several years.

- Cape Breton District Health Authority
- Colchester East Hants Health Authority
- Housing Nova Scotia
- Pictou County Health Authority

3.26 We have previously expressed our concern with the number of recommendations that are not addressed and continue to be reported. Deficiencies that remain outstanding for multiple years can hinder the ability of an entity to achieve its objectives. In addition, by not addressing the issues reported in the audit communications on a timely basis, management and boards of directors of these entities are not fulfilling their responsibilities related to internal controls, external financial reporting, and oversight.

3.27 We recommended in our January 2014 report that the Department of Finance and Treasury Board communicate to boards of directors that issues and deficiencies identified by auditors should be addressed on a timely basis and improvements made as required. In response to our recommendation, the department indicated that it now makes such communications annually as part of the year-end consolidation process. However, entities continue to have repeated year-over-year weaknesses. It is evident that additional



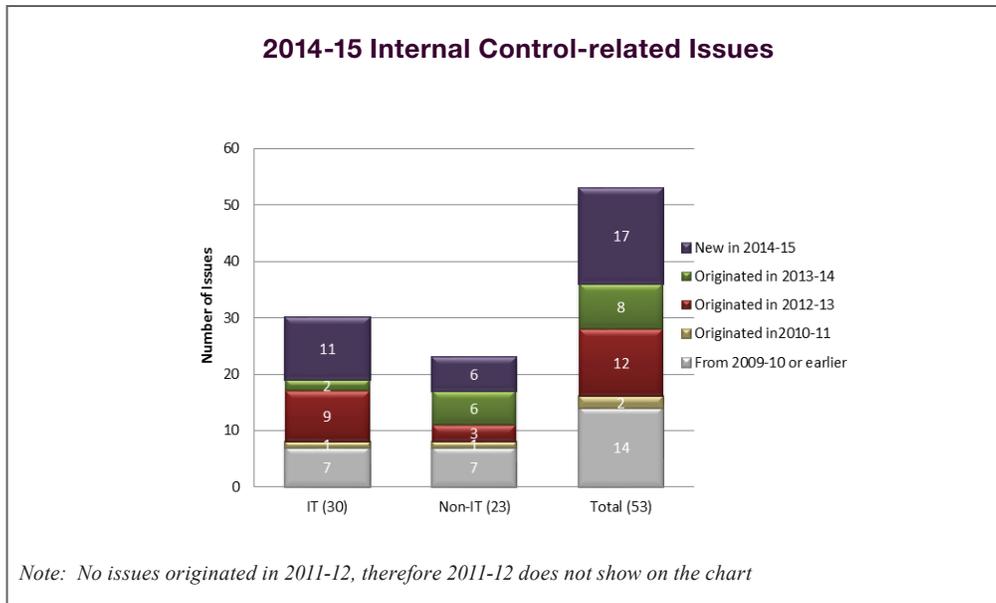
accountability is needed for ensuring recommendations are implemented on a timely basis.

**Recommendation 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.

**Department of Finance and Treasury Board Response:** The Department agrees with this recommendation and will work with the TAGR Steering Committee to address this issue. As part of the year-end financial reporting process, Government Accounting requests an update from the entities on their progress in addressing their audit issues and deficiencies. We will continue to request these updates and consider formalizing the monitoring process.

3.28 *Outstanding deficiencies* – Internal control deficiencies are of particular concern as poor internal controls, including those related to IT operations, can result in prolonged exposure to business and financial reporting risks. The following chart shows when the internal control issues reported this year were originally identified and reported by the auditors of the selected entities.

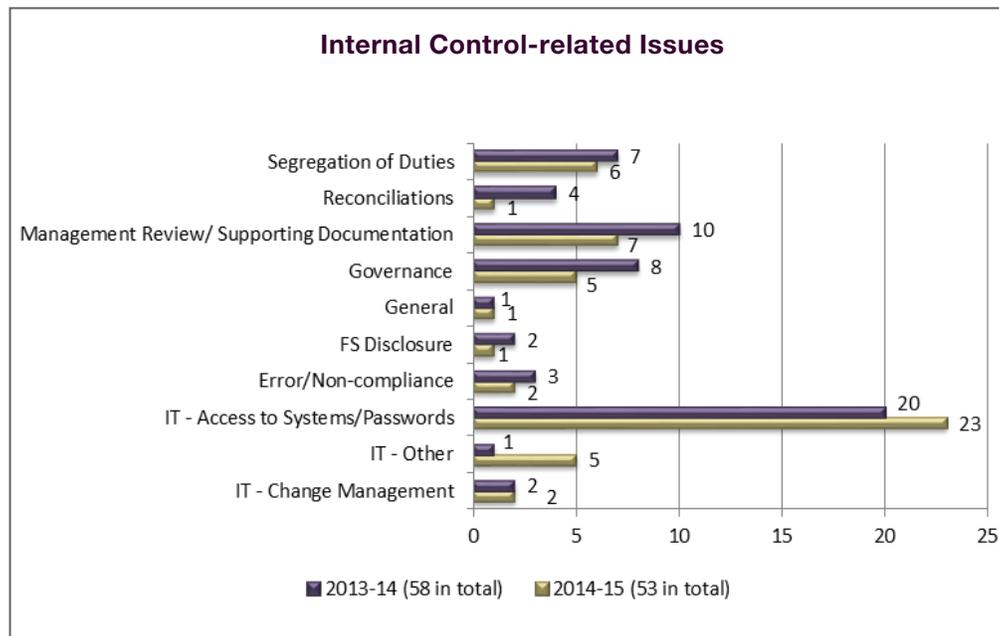


3.29 No internal control-related issues or other matters were reported by the auditor of the Halifax Regional School Board in the current year, and none were reported to the Nova Scotia Community College by its auditor in either the current or prior year.



Sixty-eight per cent of March 31, 2015 reported internal control issues in significant entities reported in the past

3.30 Management letters noted situations in which accounting and control systems or procedures, including those related to information technology systems, were deficient. Seventeen (32%) internal-control related issues were identified and reported in 2014-15 for the first time. The remaining 36 (68%) relate to matters that had been previously reported and remain unresolved. Nine of those matters are issues with the results of the CSAE 3416 report in the health authorities, school boards and other entities. Auditors reported CSAE issues to 12 of the 21 entities of significance, as discussed in more detail below. The following chart shows 2014-15 internal control-related issues by type compared to 2013-14 for the 21 selected entities.



3.31 The overall number of internal control-related issues decreased by 5 (9%) over 2013-14, but the number of IT-related controls increased. General IT internal control deficiencies increased by four (five from one) and IT access-related deficiencies increased by three (23 from 20) to account for an overall increase of seven in IT-related controls.

► Province’s general ledger IT-related issues impact other entities

3.32 The increase in the number of IT-related deficiencies in the health authorities, including the IWK, and school boards is related to issues with the results of the CSAE 3416 report. The CSAE 3416 report is meant to provide comfort with respect to controls operating at an external organization when the services of this organization are used in the financial reporting process. The practitioner issuing this report is required, under auditing standards,



to perform an examination of the infrastructure and application support services and provide an audit opinion on the fairness of the presentation of the description and suitability of the design and operating effectiveness of the controls implemented to achieve the related control objectives.

- 3.33 The province uses an external organization to provide system development, maintenance, support and configuration services to its general ledger system. We reported the results of the CSAE 3416 report on the general ledger in chapter 2. The general ledger system is also made available to health authorities and school boards, as well as several other entities. The auditor issued a qualified opinion related to testing the operating effectiveness of the logical access to the system. Where the system is shared with the health authorities, school boards, Housing Nova Scotia, and Nova Scotia Liquor Corporation, this issue was also reported by the auditors of those entities.
- 3.34 *Responsibility for addressing issues identified by auditors* – Management has the responsibility for addressing issues identified by their auditors and reporting progress of such to their boards or other governing body.
- 3.35 In prior years we recommended that government develop a process to monitor the implementation rate of recommendations made by entity auditors. We continue to maintain that this is a needed function to ensure entities are implementing those recommendations. It speaks to the significance and importance of issues that auditors repeat recommendations and we believe government should hold those entities accountable to ensure there are no significant control deficiencies that could unnecessarily increase their business risk.
- 3.36 *District health authorities and the IWK Health Centre* – IT-related issues including other matters of interest continue to be reported by the auditors of the Cape Breton, Colchester East Hants, and Pictou County Health Authorities, and the IWK.

► 2014-15 budgets in two health authorities did not represent expected activity

- 3.37 In 2014-15, the auditors of both the Colchester East Hants and the Pictou health authorities noted there were several expense budget line items included for comparative purposes on the entities' financial statements which were budgeted to show significant cost savings. In their discussions with management, the auditors understood that these expense projections had been reduced during the 2014-15 budget process to amounts well below the anticipated expenditures for the year in order to submit a balanced budget to the province, because the province does not accept deficit budgets. The auditors reported that the budgeted cost savings had not been realized and resulted in significant variances between actual and budget amount, and that



the 2014-15 budget was inaccurate in that it did not represent the expected activity of the health authority.

- 3.38 *Colchester East Hants Health Authority* – The auditors of the Colchester East Hants Health Authority identified and reported a number of issues for the first time in 2014-15. They reported that several discrepancies had been noted during the year-end pharmacy inventory count and recommended that management review its count procedures.
- 3.39 *Cumberland Health Authority* – Cumberland Health Authority auditors identified and reported new issues in 2014-15. They identified that certain review and monitoring controls were not operating due to finance staff shortages which also contributed to a lack of segregation of duties. They also identified an inherent weakness in the electronic funds transfer process which increases the risk of inaccurate or inappropriate funds transfers.
- 3.40 *IWK Health Centre* – The Centre’s auditors continue to note that departmental managers do not consistently review attendance data, an issue that has been reported since 2009-10. During the current year, the auditors identified a weakness in the patient billing system. The system allows the input of invalid data and, as a result, an out-of-country patient was not charged for the billable fees related to their stay at the hospital.
- 3.41 We noted that no internal control-related issues were identified either in 2014-15 or 2013-14 for Annapolis Valley Health, Capital District Health, South Shore Health and South West Nova Health.

► Controls over school-based funds are not operating effectively in five school boards

- 3.42 *School boards and Nova Scotia Community College* – School-based funds are amounts collected from students (or donated to the school) and managed by a school or school group for the benefit of these students. They include, among other things, fees for student teams and associations, cafeteria earnings, and school-based fundraising. There continue to be issues related to internal controls surrounding school-based funds.
- 3.43 Revenues from school-based funds in all school boards totaled \$41 million during the fiscal year and the balance held in trust at March 31, 2015 totaled \$21 million. These are significant amounts. Each board requires appropriate internal controls and monitoring processes to ensure that amounts received are recorded, that disbursements made are for authorized and appropriate expenditures, and that the status of each fund is accurately reported in financial statements.



- 3.44 While some boards have made progress in addressing school-based funds control deficiencies, others still have deficiencies to address. The auditors of Annapolis Valley, Cape Breton Victoria, South Shore and Tri-County school boards, as well as the Conseil scolaire acadien provincial, reported issues related to school-based funds (e.g., purchases were contrary to board policy or there was no board policy for the use of the funds, documentation of receipt transactions was limited and not adequate to provide assurance that all receipts were deposited). Some of these issues date back to 2009-10 and have still not been fully addressed.
- 3.45 *Housing Nova Scotia* – In the 2014-15 communication of audit results, the auditors of Housing Nova Scotia repeated several recommendations from prior years. These relate to IT deficiencies, including system access and monitoring issues. Other issues raised related to general internal control matters including the following.
- Senior financial personnel at the housing authorities have the ability to record general journal entries. These personnel are also in a position to review and approve transactions, creating a risk that duties are not properly segregated.
  - Supporting documentation for some expenditures relating to housing renovations was not adequate. There were instances where the supporting documentation provided to the auditors showed only that the expense had been incurred for labour and materials; it did not provide a breakdown of labour or materials or the nature of the work. Additionally, the support lacked an HST number, which prevents Housing Nova Scotia from claiming input tax credits on its HST expense.
- 3.46 *Nova Scotia Liquor Corporation* – With the exception of the issues in the province's general ledger IT system described earlier in this chapter, the auditors of Nova Scotia Liquor Corporation identified no other internal control matters in the management letter. The auditors indicated that IT and segregation of duties deficiencies reported in the prior year had been fully resolved.
- 3.47 *Other entities in the government reporting entity* – In addition to reviewing and reporting on the audit opinions and communications and providing statistics of the results only for the more significant entities, we reviewed the communications of the other entities in the government reporting entity audited by private sector auditors. Below are the more critical deficiencies and other matters of interest.



- 3.48 *Nova Scotia Farm Loan Board* – The auditors of the Nova Scotia Farm Loan Board identified and reported control deficiencies which had not been reported in prior years. They reported that loan approvals are not consistently supported by appropriate documentation including appraisal reports, loan checklists, and official external lenders documents; and approval controls have been circumvented, at times, through the unauthorized use of the risk officer’s seal.
- 3.49 *Gambling Awareness Foundation of Nova Scotia* – The auditors of the Gambling Awareness Foundation of Nova Scotia reported two matters of interest in their management letter. The Foundation had in excess of \$1.3 million in its chequing account, and a balance of over \$920,000 owing to the Department of Health and Wellness. This demonstrates poor cash management as the excess cash balance is not earning interest or providing other value to Nova Scotians. The second matter of interest relates to compliance with stated objectives. In the last two years, the entity has received over \$1.2 million in funding, and has awarded grants totaling less than \$200,000, none of which was awarded in the 2014-15 fiscal year. The auditors noted that this raises a concern that the entity is not fulfilling its stated mandate to disburse monies in support of gambling research, education, treatment and the remediation of the effects of gambling.
- 3.50 *Nova Scotia Public Service Long Term Disability Plan Trust Fund* – Again in 2014-15, the auditor of the Nova Scotia Public Service Long Term Disability Plan Trust Fund reported that the contracted external accountant has full access to all aspects of the general ledger, including accounts payable and accounts receivable processes, and banking. This segregation of duties issue has existed since 2010-11 and increases the risk of undetected unauthorized financial transactions.
- 3.51 *Sherbrooke Restoration Commission* – Sherbrooke Restoration Commission auditors reported a number of internal control deficiencies that have been outstanding for several years.
- The Commission has a number of duties that are not adequately segregated.
  - There are currently limited controls over inventory including controls over valuation and counts.
  - The Commission does not have a formal review and approval process surrounding its financial transactions and records.



## Chapter 4: Nova Scotia's Financial Condition

### Why we did this work:

- To help Nova Scotians understand the Province's financial results
- To provide independent information on the Province's financial health

### Overall comments:

- Unfavourable five-year trend across key sustainability indicators continues
- Some indicators show modest improvement in financial shape in past year
- Interest on debt decreases flexibility in expanding programs or reducing taxes
- Net debt increasing faster than population
- Amount of future revenue needed to pay debt increasing
- Provincial net debt placing increasing burden on economy

### What we found:

- Provincial deficit \$135 million less than budgeted
- Tax revenue \$119 million more than planned in 2014-15 budget
- Expenses were \$93 million higher than planned
- Decrease in deficit from prior year due to \$451 million increase in provincial tax revenues
- Increased tax revenues in 2014-15 led to favourable results
- Ratio of debt to revenue decreased from \$1.47 in 2014 to \$1.41 in 2015
- Continuing reliance on federal government equalization payments and other transfers
- Net debt increased by \$2.3 billion or 18% over four years
- Government owes \$15,944 for each Nova Scotian



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## 4 Nova Scotia's Financial Condition

### Background

- 4.1 One resource in assessing the financial condition of government is the province's consolidated financial statements. The consolidated financial statements provide a snapshot of the province's financial position at its fiscal year end (March 31) and the results of its operations, and changes in both cash flow and net debt for the preceding fiscal year. However, the consolidated financial statements do not provide a complete indication of the province's health nor how well it is performing in relation to its economic and fiscal environment. Although there is information on the economy, including several indicators, in Volume 1 of the Public Accounts, we felt it important to include our own assessment of the indicators of financial condition as part of our reporting to Nova Scotians.
- 4.2 In prior years, our Office conducted a comparison with other jurisdictions. This year, because not all comparable jurisdictions' public accounts have been released, we have included indicators on Nova Scotia's performance only, including prior year comparisons where appropriate.
- 4.3 There are numerous indicators that can be used to assess a government'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 statement is not part of generally accepted accounting principles for the public sector, nor is there a requirement for government to implement its recommendations. The indicators reported in this chapter 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.
- 4.4 The Statement of Recommended Practice recommends that, at a minimum, indicators related to sustainability, flexibility and vulnerability are considered. We have included these types of indicators, along with other information we feel is useful in demonstrating the province's financial condition. Definitions of sustainability, flexibility and vulnerability follow, as well as the selection of indicators related to each.



## Chapter Objective

- 4.5 The objective of this chapter is to provide independent information on the province's financial health through reporting on certain indicators of financial condition.

## Significant Observations

### Overall Financial Condition

- Nova Scotia's financial condition improved last year but overall unfavourable five-year trend

- 4.6 The following table provides an overview of the province's financial performance for the year ended March 31, 2015, and a summary of the financial indicators included in this chapter. As can be seen, the trend in many of the indicators has improved favourably over the prior year. However, sustainability indicators from the past five years show an unfavourable trend.

Type	Indicator	1-year Trend	5-year Trend
Financial Performance	Budget-to-actual Variance	Favourable	N/A
	Actual-to-actual Variance	Favourable	
Sustainability	Net Long-term Debt	Unfavourable	Unfavourable
	Net Debt	Unfavourable	Unfavourable
	Net Debt Per Capita	Unfavourable	Unfavourable
	Net Debt as a Percentage of Total Revenue	Favourable	Unfavourable
	Annual Surplus or Deficit	Favourable	Unfavourable
	Net Debt as a Percentage of Provincial GDP	Stable	Unfavourable
Flexibility	Debt Servicing Costs as a Percentage of Total Revenue	Stable	Stable
Vulnerability	Federal Government Transfers as a Percentage of Total Revenues	Favourable	Stable

Favourable/Unfavourable – represents the direction of indicator; not a comment on performance or policy  
 Stable – a change of 1% or less  
 N/A – increase or decrease of this indicator is not considered indicative of either favourable or unfavourable



## Financial Performance 2014-15

Budget-to-actual Variance (\$ millions)			
Financial Element	Estimates	Actual	Variance
Provincial-source Revenue	\$6,700	\$6,904	\$204
Federal-source Revenue	\$3,367	\$3,380	\$13
Expenses	(\$10,686)	(\$10,779)	(\$93)
Government Business Enterprises (Net Income)	\$340	\$351	\$11
Deficit	(\$279)	(\$144)	(\$135)

4.7 *Budget-to-actual variance* – One measure of financial performance is the extent to which government adhered to the fiscal plan detailed in its budget. For the year ended March 31, 2015, the Province of Nova Scotia estimated a deficit of \$279 million. The actual result for the year was a deficit of \$144 million, a favourable variance of \$135 million. The table above provides an overview of the variance by significant financial element, after consolidation adjustments, that contributed to this positive result.

► Tax revenue higher than budget by \$119 million

4.8 Provincial-source revenue increased by \$204 million from the 2014-15 estimates, due mainly to a \$119 million upward adjustment to tax revenue estimates. The upward adjustment to tax revenue estimates is attributed to changes in estimates in consumption and national corporate profits.

4.9 Gross actual expenses were over budget by \$203 million. They were offset by cost savings in other areas, resulting in a net reported expense overexpenditure of \$93 million. Cost savings were mainly attributed to savings of \$89 million in estimated restructuring costs and \$13 million in the Department of Municipal Affairs due primarily to Build Canada Fund project delays and general operating savings.

4.10 Gross actual expenses were \$203 million over budget due to the following.

- Total increases of \$85 million at the Departments of Health and Wellness and Education and Early Childhood Development.
- \$40 million over budget at the Department of Internal Services, mainly due to \$35 million in environmental remediation costs.
- Economic and Rural Development and Tourism incurred \$32 million more in expenses than planned, of which \$11.5 is attributed to supporting the Yarmouth Ferry, along with \$18 million in the provision for credit losses at Nova Scotia Business Incorporated.
- The Department of Community Services was also over budget by \$26 million, the majority of which is due to increasing caseloads and client costs in the Disability Support program.



- Transportation and Infrastructure Renewal was over budget by \$20 million primarily due to increased snow removal costs.

4.11 *Actual-to-actual variance* – The following table details variances in revenues and departmental expenses to explain the \$533 million change in operating results between March 31, 2014 and March 31, 2015.

Actual-to-actual Variance (\$ millions)			
Revenues and Departmental Expenses	Revenues	Expenses	Surplus (Deficit)
<b>2013-14 Deficit</b>	<b>\$10,060</b>	<b>\$10,737</b>	<b>(\$677)</b>
Increased Provincial Tax Revenue	\$451		
Increased Other Provincial Revenue	\$140		
Net Decrease – Other Revenues	(\$16)		
Increased Economic and Rural Development Expenses		\$34	
Increased Education and Early Childhood Development Expenses		\$69	
Increased Health and Wellness Expenses		\$100	
Decreased Pension Valuation Adjustment		(\$310)	
Net Increase – Other Expenses		\$149	
<b>2014-15 Deficit</b>	<b>\$10,635</b>	<b>\$10,779</b>	<b>(\$144)</b>
<b>Change from prior year</b>	<b>\$575</b>	<b>\$42</b>	<b>\$533</b>

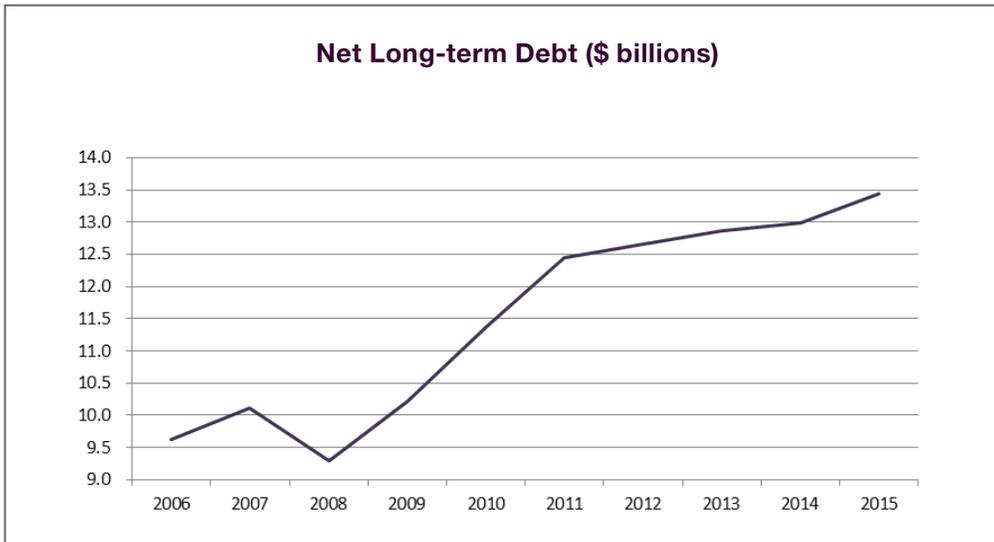
- Decrease in deficit from prior year due to \$451 million increase in provincial tax revenue and \$310 million reduced pension expenses

4.12 The province's March 31, 2015 deficit was \$144 million. This was a decrease of \$533 million over the prior year deficit of \$677 million. The more significant variances related to increased provincial tax revenue of \$451 million and increased other provincial revenue of \$140 million over the previous year. Increases in departmental expenses were offset by the decrease in the pension valuation adjustment. Last year's pension valuation adjustment included a one-time expense of \$318 million to reflect the accounting impact of changes to the province's Public Sector Superannuation Plan.

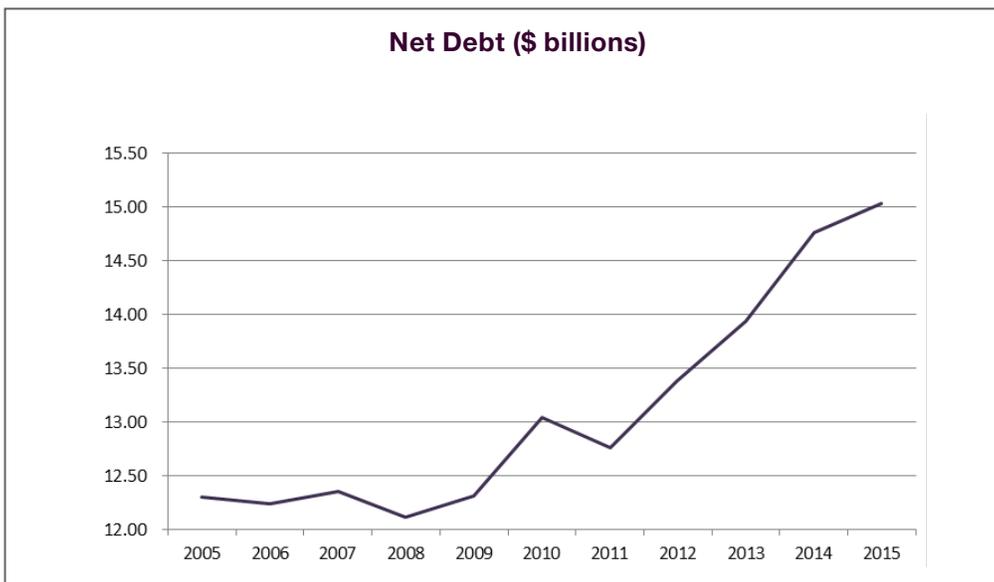
## Financial Indicators

### Sustainability

4.13 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. In the following paragraphs, we discuss the indicators we have selected to assess sustainability.



- 4.14 *Net long-term debt* – Details of the province’s long-term debt is included in Schedule 4 of the March 31, 2015 Public Accounts. Gross long-term debt is \$16.8 billion (2014 – \$16.4 billion). This includes the debt of all entities in the government reporting entity. The majority of this debt (\$15.9 billion, or 95%) is assumed by core government; that is, not through government agencies. Gross long-term debt is offset by sinking fund assets of \$3.4 billion.
- 4.15 We have commented in prior years that the increasing trend in net long-term debt is a significant indicator of fiscal sustainability because the cost of servicing this debt takes priority over program expenses and reduces the ability of government to expand services or reduce taxes. The chart above shows actual growth of net long-term debt over the past ten years, with an increase of approximately \$4 billion since 2008.





4.16 *Net debt* – Net debt is the difference between the province's financial assets and its financial liabilities. It is an indication of the government's current obligations that must be funded through future revenues, including taxation. Nova Scotia's net debt is approximately \$15 billion.

► Net debt increased by \$2.3 billion or 18% over four years

4.17 Net debt has increased by 18% or \$2.3 billion over the past four years, although the increase of \$269 million ( 2%) over the prior year is a significant improvement over past years' increases. Net debt has grown each year since 2008 except for the year ended March 31, 2011. The surplus of \$585 million reduced net debt in that year.

Net Debt per Capita					
	2011	2012	2013	2014	2015
Net Debt (\$ thousands)	\$12,758,315	\$13,382,946	\$13,942,372	\$14,761,747	\$15,030,615
% Increase in Net Debt		5%	4%	6%	2%
Population (thousands)	944.5	944.8	942.9	942.7	942.7*
Net Debt per Capita	\$13,508	\$14,165	\$14,787	\$15,659	\$15,944
% increase in Net Debt per Capita		7%	4%	6%	2%

\* Statistics Canada had not released the 2015 population figures as of September 2015; therefore, the last known population was carried forward for comparative purposes.

► Government owes \$15,944 for each Nova Scotian

4.18 *Net debt per capita* – Another indicator of sustainability is net debt per capita. This shows the amount of net debt attributable to each person living in the province. The increasing net debt per capita indicates net debt is increasing at a rate exceeding population growth, and therefore may not be sustainable. Essentially, the indicator shows that the Government of Nova Scotia owes \$15,944 for each Nova Scotian for past decisions that resulted in spending exceeding revenues.

4.19 Net debt per capita has increased every year over the past five years since 2011. The indicators show the amount of net debt per capita ranges from a low of \$13,508 in 2011 to a high of \$15,944 in 2015. Net debt per capita increased 2% during 2014-15.

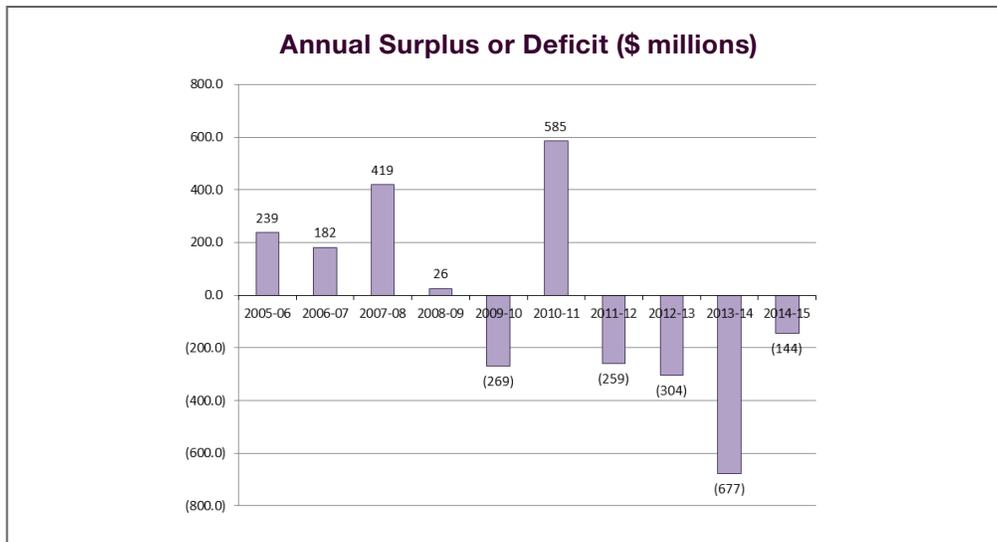


Net Debt as a Percentage of Total Revenue					
Year Ending March 31	2011	2012	2013	2014	2015
Net Debt (\$ millions)	\$12,758	\$13,383	\$13,942	\$14,762	\$15,031
Total Revenue (\$ millions)	\$9,919	\$9,760	\$10,104	\$10,060	\$10,635
Net Debt/Revenue	129%	137%	138%	147%	141%

4.20 *Net debt as a percentage of total revenue* – Increasing net debt as a percentage of total revenue means it will take longer to repay the debt than it had been in prior years. It also shows that debt is growing faster than revenues. This is a key indicator of sustainability.

► Percentage of net debt over total revenue decreased 6% in 2015

4.21 During 2015 the percentage of net debt over total revenue decreased by 6%. This was not as a result of a decrease in net debt but rather due to an increase in total revenue of \$575 million. This is a favourable change. In the prior year, there was \$1.47 of debt for every \$1 of revenue; in the current year this has been reduced to \$1.41 of debt for every \$1 of revenue.



4.22 *Annual surplus or deficit* – This annual result indicates the extent to which the government’s revenues are more or less than its expenses during the year. A surplus means revenues exceed expenses, while a deficit is a result of expenses exceeding revenues.

4.23 The chart shows there have been significant fluctuations in results over the past ten years. Nova Scotia has been experiencing deficit positions for five of the last ten years. We feel it is important to note that the annual surplus or deficit should be considered in relation to the amount of expenditures. Therefore, we are including the total expenses for the Province in the table below.



Total Expenses					
(in \$ billions)	2010-11	2011-12	2012-13	2013-14	2014-15
Total Expenses	9.3	10.0	10.4	10.7	10.8

- 4.24 There are significant fluctuations in the Province of Nova Scotia's annual results from 2006 to 2015, ranging from a surplus of \$585 million in 2011 to a deficit of \$677 million in 2014. The more significant deficits have occurred in recent years. During this time, expenses have steadily increased. In 2014, Nova Scotia had its largest deficit of \$677 million, although \$318 million was due to the one-time pension adjustment noted previously.
- 4.25 Gross domestic product (GDP) is one of the primary indicators used to measure a province's or country's economy. GDP can be measured by either summing the value of the income generated in an economy (income approach) or by the total dollar value of all goods and services purchased by households and the government (expenditure measure).
- 4.26 GDP is usually stated as a rate of change in a three-month period over the prior three-month period. An economy with two consecutive periods of reduced growth is said to be in recession. GDP values used in our analysis are expenditure-based.

Net Debt as a Percentage of Provincial GDP					
Year Ending March 31	2011	2012	2013	2014	2015
Net Debt (\$ millions)	\$12,758	\$13,383	\$13,942	\$14,762	\$15,031
Provincial GDP (\$ millions)	\$37,073	\$38,349	\$38,214	\$39,145	\$39,145*
Net Debt/GDP	34%	35%	36%	38%	38%

\* Statistic Canada had not released the 2014 GDP figures as of September 2015. The last known GDP was carried forward for comparative purposes.

### ► Provincial net debt placing increasing burden on economy

- 4.27 *Net debt as a percentage of provincial GDP* – Net debt as a percentage of provincial GDP provides insight into the ability of an economy to support government's debt. A higher percentage indicates that a government's debt is becoming an increasing burden on the economy and may not be sustainable. A stable or decreasing percentage shows the growth of the net debt is equal to, or less than, the growth of the economy and is likely sustainable. In theory, a larger economy should be able to absorb a higher amount of government debt. Nova Scotia's net debt as a percentage of provincial GDP has consistently increased to its highest rate in the past five years.

### Flexibility

- 4.28 Flexibility describes the extent to which a government can change its debt burden or raise taxes within its economy. Increasing debt and taxation reduces flexibility and the government's ability to respond to changing



circumstances. Assessing flexibility provides insights as to how government manages its finances. The following indicator has been selected to assess flexibility.

Debt Servicing Costs as a Percentage of Total Revenue					
Year Ending March 31	2011	2012	2013	2014	2015
Debt Servicing Costs (\$ millions)	\$866	\$863	\$921	\$886	\$896
Total Revenue (\$ millions)	\$9,919	\$9,760	\$10,104	\$10,060	\$10,635
Debt Servicing Costs as a % of Total Revenue	9%	9%	9%	9%	8%

4.29 *Debt servicing costs-to-revenues* – The ratio of debt servicing costs-to-revenues indicates the amount of current revenue that is required to service debt costs arising from past borrowing decisions and, as a result, is not available for current and future programs and services. Debt servicing costs are variable only to the extent they fluctuate with the amount of debt issued. However, once debt is issued, interest payments on that debt are a fixed cost of government and are its first commitment. Failure to pay interest impacts the ability to raise future debt, and can also increase government's borrowing rate. As debt increases, government is less able to respond to economic changes.

► Percentage of revenue needed to pay interest on debt at lowest point in five years

4.30 The proportion of debt servicing costs-to-revenues indicates the amount of current revenues that are required to service past borrowing decisions and, as a result, are not available for current and future programs and services. In Nova Scotia, this ratio has improved from 9% in 2014 to 8% in 2015, indicating that debt servicing costs have increased at a lower rate than revenue in the past year.

### Vulnerability

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

Federal Revenue as a Percentage of Total Revenue					
Year Ending March 31	2011	2012	2013	2014	2015
Federal Revenue (\$ millions)	\$3,212	\$3,179	\$3,263	\$3,392	\$3,380
Total Revenue (\$ millions)	\$9,919	\$9,760	\$10,104	\$10,060	\$10,635
Federal Revenue as a % of Total Revenue	32%	33%	32%	34%	32%



► Continuing reliance on federal government equalization payments and other transfers

4.32 *Federal government transfers as a percentage of total revenues* – This indicator demonstrates the level of federal government transfers compared to total government revenues. The higher the percentage, the more reliance the provincial government puts on receipt of funds from the federal government. These transfers are dependent on policy decisions at the federal level and outside the control of the provincial government. This ratio has remained stable over the past five years with a marginal decrease in 2015.

*Sources:*

1. *Nova Scotia – Public Accounts for March 31, 2006 – March 31, 2015*
2. *Statistics Canada – Gross domestic product, expenditure-based, by province and territory (2008-2013)*
3. *Statistics Canada – Population by year, by province and territory (July 2008 – July 2014)*

*Note: Income from Government Business Enterprises (GBE) has been included in the calculation of own-source and total revenue.*