

## 15.

### REVIEW OF FINANCIAL STATEMENTS AND MANAGEMENT LETTERS

#### INTRODUCTION

**15.1** The financial statements of crown corporations and agencies of the government of Nova Scotia are in some cases audited by the Office of the Auditor General and in other cases by private sector auditors. A complete listing of crown corporations and agencies that have been audited is included in Appendix II.

**15.2** Section 17 of the Auditor General Act permits this Office to conduct additional reviews of those crown corporations and agencies audited by the private sector. This section of our Report contains comments on audits conducted by the private sector and by this Office.

#### AUDITS BY THE PRIVATE SECTOR

**15.3** We reviewed the financial statements and reports received from private sector auditors, being principally interested in whether:

- there was any indication of inadequate financial controls and records mentioned in letters to management or indicated by reservations of audit opinion on the financial statements;
- there was timely preparation and audit of annual financial statements;
- there were notes to the financial statements outlining the legislative mandate of the entity; and
- there was adequate disclosure of the entity's audited financial statements, preferably in the *Public Accounts*.

**15.4** The following are the observations resulting from our review.

#### *Reservations of Opinion*

**15.5** A qualification of opinion was expressed in the audited financial statements of two corporations.

**15.6** *Nova Scotia Resource Recovery Fund* - The auditors issued a qualification of opinion as they were unable to verify the completeness of Fund revenue. Agreements between the Minister of the Environment and external parties require payment to the Fund of a fixed fee or a fee based on production volumes or sales amounts. Fund management does not verify production volumes or sales amounts, and the auditors were not able to verify these by other means.

**15.7** *Nova Scotia Resources Limited* - The auditors qualified their audit opinion due to the failure of the Corporation to defer and amortize foreign exchange gains and losses on long-term monetary

items over the term of the related debt. If they had been deferred and amortized, net earnings would have decreased by \$7.5 million, the opening deficit would have been reduced by \$14.3 million, and unamortized foreign exchange losses carried forward would be \$6.8 million.

### ***Financial Controls and Records***

**15.8** As a result of the private sector audits, weaknesses in internal control were discovered in certain corporations and agencies. These were noted in letters from the auditors to management. Although most were not serious enough to include in this Report, observations in letters to management at the Queen Elizabeth II Health Sciences Centre, the Waterfront Development Corporation Limited, and the Workers' Compensation Board of Nova Scotia are appropriate to report.

- The auditors of the Queen Elizabeth II Health Sciences Centre noted weaknesses in control over payables which were caused by inadequate segregation of duties and reconciliation procedures. Weaknesses were found in the recording and reporting of sponsored research programs. In addition, the auditors noted computer password control weaknesses and a lack of formal change management procedures to monitor and control changes to the Centre's application software. They also identified the need for a formal disaster recovery plan and business continuation plan.
- The auditors of the Waterfront Development Corporation Limited noted that bank and general ledger reconciliation procedures were not being completed.
- The auditors of the Workers' Compensation Board of Nova Scotia reported weaknesses in control over accounts payable and computer security. They also noted weaknesses in the method for determining the allowance for doubtful accounts and in the monitoring of investment schedules. Management has indicated to us that it has addressed each of these weaknesses.

### ***Timeliness of Financial Reporting and Release of Management Letters***

**15.9** Preparation, audit and release of financial statements and related management letters within six months of year-end are considered to be satisfactory. This was achieved by all crown corporations and agencies with the exception of Sydney Steel Corporation.

**15.10** As of February 1997, the audit of Sydney Steel Corporation had not been completed and the financial statements had not been released for the year ended December 31, 1995. The status of certain matters pertinent to the *Joint Operation, Sale and Long-Term Agreement* between the Province and China National Metals & Minerals Import and Export Corporation, particularly those related to concurrence on the Corporation's financial position at the commencement of the Agreement, have not been resolved.

**15.11** As a consequence, the financial statements of Sydney Steel Corporation will not be included in the March 31, 1996 *Public Accounts of the Province of Nova Scotia*.

### ***Legislative Mandate***

**15.12** It is important for the reader of financial statements to be aware of the legislative mandate under which the entity operates. This is most conveniently communicated as a note to the financial

statements, but can also be shown in an entity's annual report. It is recommended that all crown corporation and agencies include such a note in their financial statements.

**15.13** We noted only two agencies that did not include this information in a note to their most recent financial statements, and they did discuss their legislative mandate in their annual report.

### ***Reporting***

**15.14** Previous Reports of the Auditor General have noted that the *Public Accounts of the Province of Nova Scotia* should strive to present full disclosure of the financial position and operating results of all entities which are owned or controlled by government.

**15.15** We have been informed that the March 31, 1996 *Public Accounts* will not contain the financial statements prepared for the following entities:

Art Gallery of Nova Scotia  
Halifax-Dartmouth Bridge Commission  
Law Reform Commission of Nova Scotia  
Nova Scotia Credit Union Deposit Insurance Corporation  
The Public Archives of Nova Scotia  
Sydney Tar Ponds Clean-Up Inc.  
Workers' Compensation Board of Nova Scotia

**15.16** In addition, the financial statements of joint operations with other governments are not included in the *Public Accounts*. These include the Atlantic Lottery Corporation Inc., Canada-Nova Scotia Offshore Petroleum Board and the Council of Maritime Premiers.

### **AUDITS BY THIS OFFICE**

**15.17** The following observations resulted from our audit assignments.

### ***Reservations of Opinion***

**15.18** This Office has responsibility for the annual financial statement audit of 27 crown corporations and agencies (Appendix II). An audit opinion is expressed on whether these statements present fairly the financial position of the entity at its fiscal year-end and the results of its operations for the year then ended. Where there are qualifications of audit opinion, or situations in which it was not possible to render an opinion, we believe it appropriate to report such to the House of Assembly.

**15.19** This year there was only one case where it was necessary for our Office to express a qualification of opinion.

**15.20** *Nova Scotia Gaming Corporation* - The Auditor General is appointed auditor of the Nova Scotia Gaming Corporation under Section 31(1) of the Gaming Control Act, which received Royal Assent on February 6, 1995. The first year of operations ended on March 31, 1996.

**15.21** As a result of our review we qualified our opinion on the financial statements as follows:

*"The Nova Scotia Gaming Corporation has prepared the financial statements related to casino gaming based upon their interpretation of the Operating Contract between*

*the Corporation and Metropolitan Entertainment Group. This interpretation results in the adoption of an income allocation approach which does not reflect the shortfalls referred to in Note 3(h) as an expense for the period. In my opinion, generally accepted accounting principles require that these shortfalls be recognised as an expense for the period. If these expenses had been recognised, income of the Corporation would have been reduced by \$2,143,409.”*

**15.22** Note 3(h) to the financial statements states:

*“During the year, the income was insufficient to allocate to the operator the maximum allocation to which the operator is entitled with reference to their capital investment. In the three month period ended March 31, 1996 the Operator shortfall amounted to \$459,799 in Halifax, and in the eight month period ended March 31, 1996 the Operator’s shortfall amounted to \$1,683,610 in Sydney. These amounts are not expenses of the Corporation and accordingly, have not been recorded in the financial statements. These amounts will be eligible for allocation to the Operator from income in subsequent years as the income is earned and will be accounted for at that time.”*

### **System Weaknesses**

**15.23** We noted situations during our audits where accounting and financial systems and procedures were deficient. Although they were not of a magnitude to require reservations of audit opinion, a number of these situations are significant enough to report to the House of Assembly.

**15.24** *Atlantic Provinces Special Education Authority* - We found several control weaknesses in the administration of trust funds for the visually impaired. Accounting records for these funds were not updated in a timely manner and inter-fund balances were not reconciled and cleared on a timely basis. We also noted deficiencies in maintaining current documentation in the personnel files which support payroll expenditures.

**15.25** *Department of Finance Pension Fund Administration* - Last year we commented on the need for formalized policies and procedures with respect to the use and control of alternative financial instruments (i.e., derivatives). This year we noted an increase in activity in this area, but there is still a need for formalized policies and procedures, and a system for recording complete information on derivative transactions. The Department of Finance has informed us that a draft policy on derivatives has been prepared, and is in the process of being finalized, once consultations are complete.

**15.26** *Housing Development Fund* - In 1995 we reported accounting and control weaknesses associated with the system used to capitalize interest costs to land development projects. We observed several of the same weaknesses again this year. We also noted the need to implement a process of scheduled, periodic assessments to ensure the accurate valuation of land development projects.

**15.27** *Insured Prescription Drug Plan Trust Fund (PTF)* - This fund is used to accumulate contributions from seniors and the Province, and to pay for the costs of the Seniors’ Pharmacare Program. This was the first year of operation for the PTF and the first audit of the financial statements by our Office. We support management’s efforts to improve verification of seniors’ income for those who receive a low income credit.

**15.28** *Nova Scotia Farm Loan Board* - The allowance for doubtful accounts was calculated using information relating to the collectibility of receivables and in a manner consistent with the previous year. However, we noted it was subsequently adjusted downward by Corporate Services Unit staff, apparently to meet Departmental budgetary objectives, without prior consultation with Farm Loan Board management. Allowance for doubtful accounts should be based solely on the collectibility of accounts receivable, and on no other considerations.

**15.29** *Nova Scotia Film Development Corporation* - We noted the Corporation was responsible for approximately \$6.8 million of equity investments, but had not conducted any audits to verify whether repayments were due to the Corporation. We also suggested the requirement for audited cost reports from funded projects should be reduced to an amount below the current \$500,000 threshold. We further recommended better monitoring and collection of approximately \$134,000 of demand promissory notes issued in 1992.

**15.30** *Nova Scotia Grain and Forage Commission* - The government entered into an agreement with the Nova Scotia Grain Marketing Board to privatize the operations of the Commission. Last year we reported that the joint management agreement did not assign responsibility for the accounting function of the new entity formed, nor did it address grant repayment requirements in the event of termination of the agreement. This year we found that there was still no resolution of these issues. We also noted terms of the agreement were not fully met with respect to the refunding of unspent portions of government payments for capital improvements and personnel costs.

**15.31** *Nova Scotia Hospital* - We observed that approximately 50% of the Hospital's receivables were in the non-current category at year end and that second notices are not issued until an account is outstanding for 90 days. We recommended that all accounts outstanding for more than 30 days be followed up. We also noted a control weakness in the cash receipts system for patient trust funds and recommended better segregation of duties to improve the situation.

**15.32** *Nova Scotia Innovation Corporation* - The Corporation made significant fixed asset purchases during the year, and on April 1, 1996 it took title to the fixed assets of the Nova Scotia Research Foundation Corporation. We noted the need to establish a fixed asset subledger to facilitate control over the Corporation's fixed assets.

**15.33** *Nova Scotia Legal Aid Commission* - The 1995-96 budget of the Commission was never formally approved by the Commission. It was reviewed by its Executive Committee, but was not approved by the Committee until approximately nine months into the fiscal year.

**15.34** *Nova Scotia Research Foundation Corporation* - We noted that the Corporation provided interim financing to a third party. The amount was provided interest free with no specified terms of repayment and was not secured. This arrangement was not approved by the Corporation's Board, although the Board was aware of its terms. In our view, the financing arrangement resulted in an unacceptable level of risk for the Corporation, and subsequently for the Nova Scotia Innovation Corporation when the Nova Scotia Research Foundation Corporation was dissolved and all rights, title, interest and obligations were transferred to the Nova Scotia Innovation Corporation.

### ***Legislative and Policy Compliance Weaknesses***

**15.35** We noted situations where there was lack of compliance with legislation or policy. Although they were not of a nature to require a reservation of audit opinion, five of these situations should be brought to the attention of the House of Assembly.

**15.36** *Nova Scotia Business Development Corporation* - Under the regulations of the Business Development Corporation Act, and subject to the approval of the Minister, the Nova Scotia Business Development Corporation Board can change the existing terms and conditions of loans authorized by the Executive Council without further Executive Council approval. In 1994 and 1995 we recommended that, where Executive Council approved assistance and subsequent events required a significant change to the terms of the assistance, Executive Council be requested to approve the changes. We observed two cases this year where approval of significant changes had not been requested of Executive Council.

**15.37** *Nova Scotia Film Development Corporation* - We noted several cases where total funding on a project exceeded the level approved by the Program Committee or the Board of Directors. In addition, the full Board was not always advised when a project's funding was increased. We also noted cases where a loan was not collected when due and a loan was advanced before the contract was signed.

**15.38** *Nova Scotia Hospital* - An amendment to Section 23 of the Hospitals Act stipulates that, 30 days after receiving a written notice of discharge, a patient is solely liable for his or her cost of maintenance as long as the individual continues to stay in a hospital. Nova Scotia Hospital staff were directed by the Hospital Board of Management in July 1995 not to issue invoices for these costs and, subsequently, 30 day notices were no longer issued to patients. We were informed that the vast majority of the individuals are financially incapable of paying these costs. The Department of Health gave approval for the Hospital's non-compliance with the amendment to the Hospitals Act. This practice also contravenes Section 23(1) of the Provincial Finance Act which requires the Executive Council to approve write-offs or settlements of Provincial claims against a person.

**15.39** *Nova Scotia Legal Aid Commission* - The Legal Aid Act establishes the Commission and defines the number of directors and their terms of office. We noted that several directors agreed, upon request, to continue to participate in the deliberations of the Commission although their terms had expired. Their participation included voting on Commission decisions. We were informed that this practice was the result of delays in having new director nominations approved by the government.

**15.40** *Upper Clements Family Theme Park Limited* - Upper Clements Family Theme Park Limited entered into an agreement with another private sector business for the provision of certain attractions at the park. We noted that the crown corporation may not have fully complied with certain terms of the agreement with respect to advertising.

### ***Financial Statement Audit Delays***

**15.41** We consider the readiness of the auditee to be a critical factor in the timely completion of financial statement audits. We encountered difficulty in completing the audit of one entity on a timely basis.

**15.42** *Nova Scotia Grain and Forage Commission* - The audit for 1995-96 was significantly delayed due to inadequate accounting records and a lack of audit preparedness. The delay was mainly attributable to the absence of assigned responsibility for maintaining the books and records of the Commission.

### *Other Matters*

**15.43** In the fall of 1996 we performed a follow-up review from our 1995 financial statement audit of the Schooner Bluenose Foundation. As part of this review we also assessed the controls in place to ensure the Schooner Bluenose is appropriately used and protected and that the annual funds provided to the Bluenose II Preservation Society are spent for the purposes intended.

**15.44** *Schooner Bluenose Foundation* - Traditionally, we have audited the annual financial statements of the Foundation. The last audit completed was for the fiscal year ended March 31, 1995. As of March 31, 1995, the Foundation was inactive and we understand that it continues to be inactive. We had an outstanding concern resulting from our last audit and we performed a follow-up review during the fall of 1996.

**15.45** Our concern was with the public trust funds which had been administered by the Foundation. In 1994 a separate entity, also named the Schooner Bluenose Foundation (the Society), was established as a charitable organization under the Societies Act. During the 1995 fiscal year, payments totalling \$294,454 were made to the Society by the Foundation. These payments were based on invoices submitted by the Society and a final payment of approximately \$135,000 to transfer the remaining funds of the Foundation when it became inactive. These payments were approved by the then Minister of the Nova Scotia Economic Renewal Agency (NSERA) in his role as Chairman and President of the Foundation.

**15.46** We understand that the operations of the Society were (and still are) placed on hold after the Bluenose II Preservation Trust Society assumed control of the refurbishment and operation of the schooner in the fall of 1994.

**15.47** We recognize the funds involved may be seen as immaterial in relation to other Provincial activities or expenditures, but we see the use of these public trust funds as a matter of some significance. In our view, the Foundation has a responsibility to ensure the transferred funds have been and are used appropriately, with due regard for economy and efficiency and in accordance with the Schooner Bluenose Foundation Act.

**15.48** Staff of the Nova Scotia Economic Renewal Agency receive the annual audited financial statements of the Society which do provide summary information on the status and use of these funds. Information available to us indicates that the public trust funds disbursed by the Foundation were the Society's major source of funds.

**15.49** The Society's December 31, 1995 statements indicate that approximately \$44,000 of the transferred funds was unspent. They also indicate there is property and equipment, with a net book value of approximately \$22,800, which belong to the Society. Staff of the NSERA have indicated that because the Society is an independent non-profit organization, they are unable to determine where those assets are located now and whether they are being used for purposes consistent with the mandate of the Foundation. They are also unable to determine if the transferred funds were used with due regard for economy and efficiency.

**15.50** *Schooner Bluenose* - Part of the mandate of the Nova Scotia Economic Renewal Agency is to maintain the Schooner Bluenose II, which is a crown asset. There is an agreement between the Province and the Bluenose II Preservation Trust Society (BPTS) for the operation and maintenance of the vessel. The Province provides funding to the BPTS based on a mutually agreeable percentage of operating costs as contained in the annual budget of the BPTS. In 1995-96 the Province provided \$521,800 towards the operating costs of the BPTS. This represented 84% of the BPTS budget for that year. Part of the operating expenditures of the BPTS include the salary of a NSERA employee who was seconded to the BPTS as the operations manager. As well, the Province paid \$90,000 to

the BPTS during 1995-96, through the Canada/Nova Scotia Cooperation Agreement on Economic Diversification, to repair the Schooner Bluenose II for use in the G7 Summit.

**15.51** We found there are controls in place to ensure this crown asset is appropriately used and protected, and that the annual funds provided to the Bluenose II Preservation Trust Society are spent for the purposes intended.

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