AUDITOR GENERAL

1993/94: REPORT 3

REPORT ON THE 1992/93 PUBLIC ACCOUNTS, PROVINCE OF BRITISH COLUMBIA

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The Honourable Joan Sawicki
Speaker of the Legislative Assembly
Province of British Columbia
Parliament Buildings
Victoria, British Columbia
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Madam:

I have the honour to transmit herewith my report to the Legislative Assembly of British Columbia on the 1992/93 Public Accounts.

George L. Morfitt

George L. Morfitt, FCA
Auditor General

Victoria, British Columbia
December 1993

copy: Mr. E. George McMinn, Q.C.
Clerk of the Legislative Assembly

Report on the 1992/93 Public Accounts, Province of British Columbia

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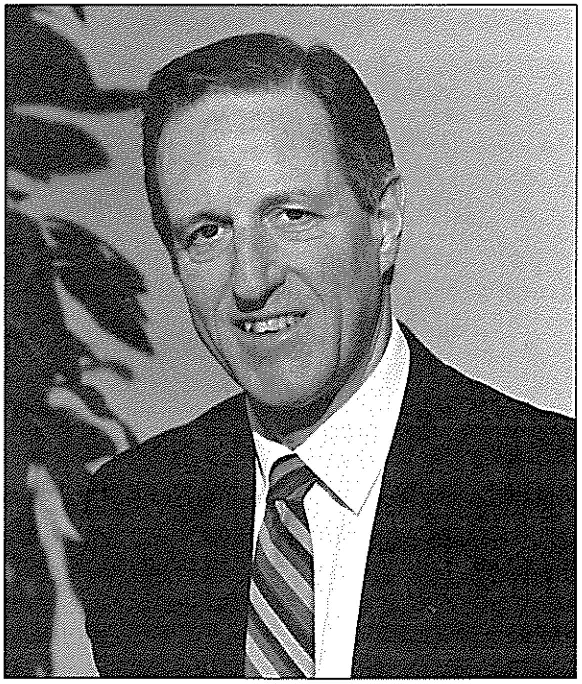


"If you think...that anything like a romance is preparing for you, reader, you were never more mistaken. Do you anticipate sentiment, and poetry, and reverie? Do you expect passion, and stimulus, and melodrama? Calm your expectations, reduce them to a lowly standard. Something real, cool and solid lies before you, something unromantic as Monday morning, when all who have work wake with the consciousness that they must rise and betake themselves thereto."

Charlotte Bronte

The annual Public Accounts of the Province of British Columbia—I wonder how many British Columbians actually read them?

Two thick volumes; almost 900 pages. No pictures, no graphs. All in all, pretty dry reading. And yet they may be the singular most important accountability documents produced by the government. They detail the taxes and other revenues collected by the government, and how that money was spent.

For me and my staff, the Public Accounts are the focus of our interest and energy for much of the year. We examine them from a variety of perspectives—fairness and accuracy, appropriateness, completeness, consistency, timeliness—and I then report our findings to the Legislative Assembly and the public.

While I consider the recently-published Public Accounts for the 1992/93 fiscal year to contain a wealth of good information, there continue to be some more important financial accountability issues of concern to me. These include:

- The recording as government assets of some $3.6 billion in loans receivable that borrowers can only repay from future government funding.

- The existence of $3.3 billion of unfunded liabilities of public sector pension plans that needs to be dealt with.
- The need to report the full extent of the government's activities and financial position in a more meaningful and informative manner.

Regarding the loans receivable, I have received assurances from government officials that they will address my concerns as a part of a larger project which will also deal with the recording and depreciation of physical assets. This is a project with which I concur, as it will provide a base of information which should prove useful in the future measurement of the full cost of government services.

As for the pension plans, there is no clear assignment of responsibility in legislation for the unfunded liabilities of the Teachers' Pension Plan and the Municipal Superannuation Plan which have unfunded liabilities that are not recognized in the financial statements of either the respective employer groups or the provincial government. I believe there is a strong case for including some portion of these unfunded liabilities in the province's financial statements. I urge the government to resolve this issue and, in the meantime, to provide in its financial statements full note disclosure about these liabilities.

Concerning disclosure in the Public Accounts of the government's financial affairs, I have, in this report, made a number of suggestions as to how the present Public Accounts documents might be improved.

In my report sections entitled Provincial Debt and Financial Highlights, I discuss financial information, trends and key indicators which could usefully be provided by the government along with the Public Accounts, perhaps in the form of an Annual Report. Of course, to provide a full reporting on the operations of government, such an Annual Report should include not only financial information, but also information with respect to what was actually achieved for British Columbians as a result of government activity. To this end, I am currently studying the kind of comprehensive accountability information about its operations that should be provided by government to the Legislative Assembly. The resultant report is planned to be issued next year.

In the course of my audit work, I look not only at selected expenditure and revenue transactions but also at the systems of internal control established by the government to ensure that all transactions are properly handled. As staff resources allow, I periodically carry out in-depth reviews of selected systems and in this report I have included comments on four such reviews.

In general, I believe the government has established adequate systems of internal control; however, these systems can often be improved upon. Our recommendations are an important part of this improvement process.

I believe this report will be of significant value to Members of the Legislative Assembly and the public by providing informed opinions and observations regarding British Columbia's Public Accounts for the 1992/93 fiscal years.

Who knows—it might also have appealed to Charlotte Bronte.

This is my third report for 1993/94. The first two reports, issued in November 1993, related to value-for-money audits undertaken by my Office on matters relating to higher education and the environment. I wish to acknowledge the outstanding work undertaken by my staff, which has resulted in the production of these reports, and to thank them for their professional dedication and application.

George L. Morfitt

George L. Morfitt, FCA
Auditor General

Victoria, British Columbia
December 1993

Introduction

Introduction

The Auditor General is required, under the provisions of the *Auditor General Act*, to examine the accounts and records of the government and to report annually to the Legislative Assembly on the government financial statements. In these reports, the Auditor General must state whether all the information and explanations required have been received, and whether the statements present fairly the financial position, results of operation, and changes in financial position of the government in accordance with its stated accounting policies, consistently applied. If the Auditor General is unable to express an opinion without reservation, the reason why should be stated.

The Auditor General is also eligible to be appointed auditor of any Crown corporation, Crown agency, or public body. The Act does not specify what is required of the Auditor General in the conduct of such audits. In the absence of special direction, the work is carried out in a manner and with the same objectives as those applied to the audit of the government's accounts.

The Auditor General may also call attention to anything resulting from his or her examination that he or she considers should be brought to the attention of the Legislative Assembly. The Act directs that the Auditor General should comment where he or she believes that accounting records are not sufficient or properly kept or that internal controls are not adequate to protect the assets of the Crown, the collection of revenue, or the making of expenditures. He or she may also provide an assessment as to whether the financial statements of the government are prepared in accordance with the most appropriate basis of accounting for the purpose of fair presentation and disclosure.

The Auditor General's mandate also provides for comment on whether programs are being administered economically and efficiently, and whether there has been compliance with laws and regulations. The Auditor General reports separately on these matters in value-for-money and compliance-with-authorities audit reports.

This report contains comments and observations arising from work undertaken in the Auditor General's audit of the financial statements of the government for the fiscal year ended March 31, 1993. It also relates to audits of the financial statements of various Crown corporations and other public bodies, in particular those for which the Auditor General is the appointed auditor.

Government Financial Statements and Public Accounts

Government Financial Statements and Public Accounts

The government financial statements are an important link in an essential chain of public accountability. They are the principal means by which the government reports to the Legislative Assembly, and to all British Columbians, on its stewardship of public funds.

Public Accounts

The Public Accounts, prepared pursuant to the *Financial Administration Act*, contain the financial statements and other information that the government is required or chooses to include in the publication. The form and content of the Public Accounts, as well as the accounting policies used in the preparation of the financial statements, are determined by Treasury Board.

The Public Accounts for the 1992/93 fiscal year are published in two volumes.

Volume I (Sections A to E), titled *Consolidated Reporting Entity, Trust Funds and Summaries of Financial Information Reports*, provides an overview of the total financial affairs and resources for which the government is responsible. It contains the government Summary Financial Statements, the latest audited financial statements of government organizations and enterprises and of certain trust funds administered by the government, and summarized financial information of corporations and entities to which the *Financial Information Act* applies.

Volume II (Sections F to I), titled *Financial Statements and Schedules of the Consolidated Revenue Fund*, contains the audited financial statements of the Consolidated Revenue Fund, together with supplementary schedules to the financial statements and detailed schedules of payments. This volume is intended to serve as the government's accountability report to the legislature on revenues raised and expenditures made as authorized by the *Supply Act* and other statutory spending authorities.

The structure of the government's financial reporting in the Public Accounts is outlined in Exhibit 1.1.

Exhibit 1.1

Financial Reporting in the Public Accounts

Government Summary Financial Reporting Entity

Public Accounts:
Introduction - Section A
Financial Statements - Section B

Consolidated Revenue Fund
(Consisting of the General Fund and Special Funds)

Public Accounts:
Introduction - Section F
Financial Statements - Section G

Government Organizations and Enterprises

Public Accounts - Section C

Supplementary Schedules to the Consolidated Revenue Fund Financial Statements

Public Accounts - Section H

Trust Funds

Public Accounts - Section D

Detailed Schedules of Payments

Public Accounts - Section I

Summaries of Financial Statements of Corporations and Agencies to which the *Financial Information Act* applies

Public Accounts - Section E

Source: The Public Accounts

Summary Financial Statements

The Summary Financial Statements provide the most complete information about the operating results and financial position of the Province of British Columbia. They aggregate most, but currently not all, entities owned or controlled by the province by combining the financial position and results of operation of the province's general and special funds, collectively referred to as the Consolidated Revenue Fund, with the financial position and operating results of the government entities listed on page B26 of Appendix D of this report.

A copy of the Summary Financial Statements, together with the Auditor General's report on them, appears in Appendix D of this report.

Depending on the nature of their operations, these aggregated entities are referred to as either "government organizations" or "government enterprises." In addition to the Consolidated Revenue Fund, government organizations include foundations, associations, societies, and similar entities which are separated from the operation of central government mainly for administrative reasons. Government enterprises, on the other hand, are usually business-oriented entities whose primary customers are not government related.

The account balances of government organizations are fully consolidated with the central government's accounts on a line-by-line basis after they are adjusted for compliance with the government's stated accounting policies. Government enterprises are consolidated on a modified equity basis. This means that each year the original cost of investment of the government in these business enterprises is adjusted to include the net earnings or losses and other net equity changes of each enterprise. These enterprises follow accounting policies generally accepted for commercial operations.

The government, within its summary financial statements reporting entity, records the cost of capital assets and consumable inventories as expenditure in the fiscal year they are acquired, rather than in the year in which they are consumed or in which the benefits from their acquisition are realized. This means that the assets recorded in the summary financial statements at March 31, 1993, do not include the cost of land (except land for lease or resale), roads and bridges, buildings, equipment, fixtures, and furniture owned by the province.

Consolidated Revenue Fund Financial Statements

Next in order of completeness are the financial statements of the Consolidated Revenue Fund. This fund, established in accordance with the *Financial Administration Act*, accounts for all the financial activities of central government. The Consolidated Revenue Fund is the fund into which all public money of the government, other than trust funds, must be paid. Accordingly, its financial statements also constitute an important accountability document. The Consolidated Revenue Fund Financial Statements include the accounts of the General Fund, British Columbia Endowment Fund, and the Natural Resource Community Fund. The Consolidated Revenue Fund Financial Statements are the only operating fund statements of the government on which the Auditor General provides an auditor's report.

The financial statements of the Consolidated Revenue Fund could be used mistakenly for reviewing the province's overall financial position and results of operation. To prevent any misunderstanding, the Auditor General's Report on the Consolidated Revenue Fund Financial Statements for the year ended March 31, 1993, contains this additional paragraph:

As described in note 1(a), these financial statements reflect only the transactions and balances of the Consolidated Revenue Fund, which consists of the General Fund and Special Funds. Other significant financial activities of the Government occur outside this reporting entity. These additional activities are reflected in the Summary Financial Statements of the Government, included in Volume I of the Public Accounts, which consolidate the Government organizations, including the Consolidated Revenue Fund, and enterprises to provide an accounting of substantially the full nature and extent of the financial affairs and resources for which the Government is responsible.

To clarify the significant differences in financial results between the government summary financial reporting entity and the Consolidated Revenue Fund, relative financial results and balances for each of the past two fiscal years are shown in Exhibit 1.2.

Exhibit 1.2

Comparative Summary of Financial Results and Balances
($ Millions)

	Summary Financial Reporting Entity		Consolidated Revenue Fund	
	1992/93	1991/92	1992/93	1991/92
Accumulated deficits, beginning of year	4,963	2,800	6,326	3,971
Net expenditure for the year	1,667	2,163	1,877	2,355
Accumulated deficits, end of year	6,630	4,963	8,203	6,326
Assets, end of year	15,821	13,296	12,694	10,216
Liabilities, end of year:				
Public debt	19,835	15,750	18,458	14,204
Other	2,616	2,509	2,439	2,338
	22,451	18,259	20,897	16,542
Guaranteed debt, end of year	3,435	4,109	4,837	5,729

Source: The Public Accounts

Special Funds

British Columbia Endowment Fund

A new special fund, the British Columbia Endowment Fund, was established on April 1, 1992, under the *British Columbia Endowment Fund Act,* at which time the balance of the Privatization Benefits Fund was transferred to it. As with its predecessor, its purpose is to hold the assets of this fund in perpetuity and keep them invested to produce revenue for the economic benefit of British Columbia. Since April 1, the Fund has received $14 million in net proceeds from the disposition of assets and $35 million in interest from investments. It paid $15 million to the Natural Resource Community Fund. The market value of net assets of the Fund at March 31, 1993, was $625 million (cost $561 million).

Natural Resource Community Fund

Effective April 1, 1992, the Natural Resource Community Fund was established pursuant to the *Natural Resource Community Fund Act*. Subsequently, $15 million was transferred into it from the British Columbia Endowment Fund. The Natural Resource Community Fund was established to assist communities that are largely dependent on a single resource industry to adjust to severe economic declines that result in business closures.

The Fund receives as revenue 0.5% of all revenues, other than fines, collected under a number of acts dealing with natural resources. In 1992/93, it received $3 million in revenue from these sources and $1 million from its investments. The balance of the Fund as at March 31, 1993, was $19 million.

The Auditor General's Reports

Auditor's Reports on Financial Statements

As a result of the examinations carried out, the Auditor General has provided auditor's reports on the Summary Financial Statements and the Consolidated Revenue Fund Financial Statements prepared by the government for the fiscal year ended March 31, 1993, and on the financial statements of 46 government entities (including 13 government organizations and enterprises and 33 other government entities) whose fiscal yearends occurred on that date or during that fiscal year.

The Auditor General's reports on the Summary Financial Statements and the Consolidated Revenue Fund Financial Statements for the fiscal year ended March 31, 1993 were issued without a reservation, or qualification, as to the fair presentation of those statements. They appear with the respective statements published in the Public Accounts. Reports containing the Auditor General's opinions on financial statements of government entities are similarly appended to the statements of each entity.

The Auditor General reports in the format of the standard auditor's report recommended by the Canadian Institute of Chartered Accountants (CICA). The wording adopted by the CICA emphasizes the role of management and the auditor with respect to the statements.

The recommended report contains three paragraphs. The first identifies the financial statements that have been audited, and points out that management is responsible for preparing those statements and the auditor for expressing an opinion on them.

Next is a paragraph which describes the nature and extent of the auditor's work and the degree of assurance that the auditor's report provides. It refers to generally accepted auditing standards and describes some of the important procedures the auditor undertakes. The final paragraph contains the auditor's conclusion based on the audit conducted.

Further comments on the significance of the auditor's opinion, and on the process employed in reaching that opinion, appear in Appendix A of this report.

Other Reports

While conducting our financial statement audits, we encounter numerous items that call for study and corrective action by the ministries, central agencies, and government entities concerned. We deal with these matters by direct contact with officials of these organizations. Some issues, however, are considered of sufficient significance to warrant the attention of the Legislative Assembly and are included in this report. Those arising as a result of our audit of the government financial statements appear in a section of this report titled, "Audit of the Government Financial Statements." Those relating to our audit of government entities are contained in a subsequent report section titled, "Audit of Financial Statements of Government Entities and Trust Funds."

Audit of the Government Financial Statements

Audit of the Government Financial Statements

Defining the Government Reporting Entity

According to the stated accounting policies used in the preparation of the Summary Financial Statements, the reporting entity for those statements includes the accounts of organizations that are accountable for the administration of their financial affairs and resources either to a minister of the government or directly to the legislature, and that are owned or controlled by the government.

A detailed schedule of organizations and enterprises included in the government consolidated reporting entity is shown on page B26, Appendix D.

Changes to the composition of the consolidated reporting entity are discussed on page 123 of this report in a section titled, "Audit of Financial Statements of Government Entities and Trust Funds." In summary:

- the Medical Services Commission of British Columbia is no longer considered a separate entity;
- the Hospitals Foundation of British Columbia is added; and
- two entities, the British Columbia Housing and Employment Development Financing Authority and the British Columbia Year of Music Society, were dissolved during the 1992/93 fiscal year.

We have commented on the composition of the consolidated reporting entity on page 39 of this report, and have prepared pro forma financial statements consolidating the entities that we believe should be included. In that section we also have reiterated our views on the need to include the universities, advanced education institutions, and public hospitals controlled by the government, as well as the Workers' Compensation Board of British Columbia (WCB).

We again recommend that the province's public universities, colleges and institutes, as well as the Open Learning Agency, be included in the government's financial reporting entity.

In last year's report we suggested that the ownership and control of public hospitals be studied by the government to determine which of them should be consolidated in the government financial statements. We note that no change has occurred to date.

Amounts Recoverable Only Through Future Government Funding

In our two previous reports on the government's annual Public Accounts, we discussed the loans made to public sector organizations through the Fiscal Agency Loan Program that are included as assets in the financial statements of the government. We recommended that those loans which are expected to be recovered only through future government appropriations be reduced in value, through the establishment of valuation allowances, to the amounts estimated to be realizable from sources outside the government financial reporting entity.

At the Summary Financial Statement level the total loans of public sector organizations (from the Consolidated Revenue Fund and other sources) exceeded $10 billion as at March 31, 1993. Approximately $3.6 billion of these loans are expected to be recovered through future appropriations provided by government to the borrowing organizations. Exhibit 2.1 shows the break-down of these amounts. Exhibit 2.2 shows similar details for loans made only by the Consolidated Revenue Fund and that have accordingly been included in the Consolidated Revenue Fund Financial Statements.

There has been no change in the government's accounting for, and financial statement disclosure of, these loans in the 1992/93 fiscal year. The loans were reported on the balance sheet as assets, without any valuation adjustment applied to them, and a listing of the loans was included in a note to the statements.

The basis of accounting used in the preparation of the financial statements of the government provides an accounting of the difference between liabilities and financial assets. Financial assets are assets on hand at the end of an accounting period which could provide resources to discharge existing liabilities or to finance future government operations. The loans made through the Fiscal Agency Loan Program that are to be repaid in future from resources provided by the government itself cannot be used either to discharge liabilities or to finance future operations. They should not, therefore, be considered financial assets of the government.

The Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants (CICA) issued, in 1986, its Accounting Statement 3, "General Standards of Financial Statement Presentation for Governments." One of the few recommendations in that statement not yet complied with in British Columbia is the valuing of financial assets:

> *Valuation allowances should be used to reflect financial assets at their net recoverable or other appropriate value.*

In April 1993, PSAAB also issued its Accounting Statement 9, "Accounting for Loans Receivable in Government Financial Statements." This statement included the following recommendation about repaying loans through future appropriations:

Exhibit 2.1

Amounts Recoverable Through Future Government Funding Included in the Summary Financial Statements

An estimate of the government commitment towards repayment of loans made to public sector entities ($ Millions)

Entity	Estimated Government Committment Towards Repayment %	Fiscal Agency Loan Program as at March 31, 1993	Estimated Government Committment Towards Repayment as at March 31, 1993
BC Transit	43	1,142	491
BC Hydro and Power Authority		4,756	
BC Ferry Corporation		300	
BC Pavilion Corporation[1]		-	
W.L.C. Developments Ltd.[1]		-	
BC Assessment Authority		5	
BC Railway Company		93	
BC Housing Management Commission		9	
Subtotal, government enterprises		6,305	491
Regional Hospital Districts	63	957	603
School Districts	100	1,404	1,404
Advanced Education Institutions:			
- Loans from Capital Financing Authority	100	762	762
- Loans from Consolidated Revenue Fund		118	
Greater Vancouver Sewer & Drainage		162	
Greater Vancouver Water District		102	
Improvement districts		3	
Capital Project Certificate of Approval Program	variable	367	351
Thompson/Nicola District		1	
Subtotal, other entities		3,876	3,120
Total - as at March 31, 1993		10,181	3,611
Total - as at March 31, 1992		8,521	3,021

[1] Loan paid off during 1992/93 fiscal year

Sources: The Public Accounts; Debentures and other instruments

Exhibit 2.2

Amounts Recoverable Through Future Government Funding Included in the Consolidated Revenue Fund Financial Statements

An estimate of the government commitment towards repayment of loans made to public sector entities ($ Millions)

Entity	Estimated Government Committment Towards Repayment %	Fiscal Agency Loan Program as at March 31, 1993	Estimated Government Committment Towards Repayment as at March 31, 1993
BC Transit	43	1,142	491
BC Hydro and Power Authority		4,756	
BC Ferry Corporation		300	
BC Pavilion Corporation [1]		-	
W.L.C. Developments Ltd. [1]		-	
BC Assessment Authority		5	
BC Railway Company		93	
BC Housing Management Commission		9	
Subtotal, government enterprises		6,305	491
Educational Institutions Capital Financing Authority	100	498	498
Regional Hospital Districts Financing Authority	63	555	350
School Districts Capital Financing Authority	100	919	919
BC Systems Corporation		14	
BC Buildings Corporation		464	
Subtotal, government organizations		2,450	1,767
Advanced Education Institutions		118	
Greater Vancouver Sewer & Drainage		162	
Greater Vancouver Water District		102	
Improvement districts		3	
Capital Project Certificate of Approval Program	variable	367	351
Thompson/Nicola District		1	
Subtotal, other entities		753	351
Total - as at March 31, 1993		9,508	2,609
Total - as at March 31, 1992		7,613	1,877

[1] Loan paid off during 1992/93 fiscal year

Sources: The Public Accounts; Debentures and other instruments

When a direct relationship can be established between the repayment of a loan and a government's funding to the borrower, the portion of the loan that is expected to be recovered from future appropriations should be accounted for as an expenditure.

In several provinces where similar types of loans exist, the accounting for such loans has been adjusted and the amounts paid recorded as an expenditure of government. In other provinces, such an adjustment has not yet been made.

Accounting Statement 9 should have been applied for the valuation of government's loans receivable. Accordingly, the current valuation of fiscal agency loans has misstated the financial position of the government. However, since the 1992/93 fiscal year was the first year Accounting Statement 9 was in place, and in recognition of the government's commitment to address and resolve this issue (along with two other important accounting issues—the recording of physical assets and the composition of the consolidated reporting entity), the Auditor General decided not to include a reservation in his auditor's reports on both the Summary Financial Statements and the Consolidated Revenue Fund Financial Statements for the 1992/93 fiscal year.

The following assertion was received from the Deputy Minister, Ministry of Finance and Corporate Relations, on this issue:

We have been concerned about the limited basis of government accountability that uses the 'net debt concept' as the sole focus of the balance sheet. We believe that this is an important measure, although one that needs refinement, but it is not the only measure.

Serious consideration is being given to the recording and depreciation of the government's physical assets. This consideration includes a review of the best way in which to report our Fiscal Agency Loans and Capital Grants which are made for the purpose of obtaining physical assets for organizations not currently part of our consolidated entity. This, naturally, also leads to review of the entity.

We anticipate that a recommendation on these matters will be made to Treasury Board before the middle of the next fiscal year.

The Auditor General will be closely following government's progress in resolving the issue of valuation of its loans receivable assets. There will not be a reservation in the Auditor General's report on 1993/94 fiscal year's financial statements for this issue if the matter is satisfactorily resolved.

Pension Liabilities

Public Service Superannuation Plan Liability Should Be Calculated Differently

In the Auditor General's reports to the Legislative Assembly for each of the years 1988-1992, we recommended that the government record its unfunded pension liability in its accounts and financial statements. Last year, the government responded by recording (as at March 31, 1992) a liability for the unfunded pension obligations of the Public Service Superannuation Plan. Although we applauded this action, at the same time we expressed concern that the government had chosen to account for this liability with accounting policies and disclosures that did not follow the recommendations of the CICA.

Public Sector Accounting Statement 5 from the CICA requires that a single actuarial cost method—specifically, the "accrued benefit method"—be used to determine the pension liability and associated pension costs. The government, however, has adopted a different actuarial cost method in calculating the liability. It uses the "level contribution method," a method traditionally followed by actuaries to ascertain whether current funding levels are adequate. Under this method, the unfunded liability calculation includes significant amounts for employee benefits and employee and employer contributions to be earned or made in future years, a circumstance which is not consistent with accrual accounting principles.

The CICA recommendations also require that, where actuarial valuations are not performed annually, an extrapolation can be used to compute the expected liability and related pension costs for the years between valuations. In these circumstances, the recommendations indicate that management should review such things as changes to the plan, the employee group or fund performance, and obtain actuarial advice to determine whether such changes necessitate adjustment to the extrapolations. When the effect of any change is significant, a complete valuation may be necessary.

Since the most recent valuation of the Public Service Superannuation Plan was performed as at March 31, 1990, an extrapolation was necessary to compute both the expected liability as at March 31, 1992, and the associated pension costs for the 1991/92 fiscal year. The government, however, accounted for the pension liability based on the 1990 valuation and recorded the year's cash contributions as its 1991/92 fiscal year expense.

Again this year, the government has not changed its policy and so continues not to follow CICA recommendations. We note that a new valuation as at March 31, 1993, is currently being performed but not yet completed. Our understanding is that this valuation indicates significant estimation adjustments (due to experience gains and losses or to changes in actuarial assumptions) are forthcoming and consequently an extrapolation from the March 31, 1990 valuation would be misleading. Therefore, we are unable to estimate the effect on the 1992/93 fiscal year expenditures or the unfunded liability as at March 31, 1993 by not following the CICA recommendations.

We continue to recommend that the government follow the CICA recommendations for calculating the liability and expenditure of the Public Service Superannuation Plan for the purpose of recording the liability of the government in its financial statements. These recommendations include a requirement that estimation adjustments be deferred and amortized over a reasonable future period such as the expected average remaining service life of the related employee group.

Liability for Pensions of the Members of the Legislative Assembly Should Be More Accurate

We recommended in each of our 1991, 1992, and 1993 reports that the government calculate its liability for MLA pensions following CICA recommendations. In the 1991/92 fiscal year, the government recorded a $6.5 million liability for this obligation. This amount, however, was a rough estimate, not calculated according to CICA recommendations, and we were unable to determine how reasonable it was because of the arbitrary nature of the calculation.

For the current fiscal year, the liability remains at $6.5 million. The charge to current expenditures consists of the year's cash contributions, rather than the cost of pension benefits earned by the Members during the year. The latter, historically, has been much greater.

The government's current position of not performing an actuarial valuation of MLA pensions lies in the difficulty with deriving underlying assumptions about turnover, eligibility, and retirement age. Continuation of pensionable service often depends on election results and not on the will of the individual Member. Consequently, historical information may not be a reasonable basis on which to predict trends for those currently in office.

Although we understand the problem, our research indicates that most other provincial jurisdictions currently perform periodic actuarial valuations on their Members' pension plans.

We encourage the government to pursue this matter with the goal of producing and recording a pension liability that more accurately reflects the reality of its obligation to Members of the Legislative Assembly.

Other Statutory Pension Plans: Whose Responsibility Are They?

The provincial government maintains three other statutory pension plans—the Teachers' Pension Plan, the Municipal Superannuation Plan, and the College Pension Plan—for public sector employees working in entities that receive significant funding from the province. Under existing legislation for these plans, there are no provisions specifying who is responsible for funding the unfunded pension liabilities.

work. Unlike most other employers, however, who pay periodic assessments to meet any obligations for claims, the WCB considers the provincial government to be in a "self insured" class. This means that as the WCB makes the required payments to the injured employee, the government reimburses the WCB for payments it makes.

In its financial statements, the WCB has included an actuarially calculated liability of approximately $40 million to record the obligation to injured government employees. It recognizes this amount as being recoverable from the government, and so has booked an amount receivable from the provincial government.

We recommend that the government recognize the liability for injured government employees in its financial statements.

An Estimate of the Liability for the Criminal Injury Compensation Program Required

The Criminal Injury Compensation Program provides compensation for the personal injury or death of victims of crime in British Columbia and for persons injured or killed while trying to prevent a crime, make an arrest, or assist a police officer in making an arrest. The program is administered by the WCB and funding is provided by the province under the *Criminal Injury Compensation Act.*

The WCB may award compensation in the form of either periodic payments or lump sum payments to a maximum of $50,000. The actual amount paid out each year is included in expenditures recorded in the Public Accounts. For 1992/93 these expenditures amounted to $20.4 million (1991/92, $10.4 million). However, government financial statements did not include any estimate for future periodic payments already committed or for claims received but not yet finalized.

With the monetary value of outstanding claims increasing, we believe that an estimate of the cost of all outstanding and continuing claims should be made and recorded in the financial statements.

We recognize that quantifying this liability is difficult. However, we have been informed that an attempt will be made to value the outstanding liability of the program and that an amount will be recorded in the 1993/94 financial statements. We welcome and support this initiative.

Accounting for Government Transfers

The accounting treatment of monies transferred by the government to individuals, organizations, and other governments has been the subject of study by the government since 1991, after the CICA Public Sector Accounting Statement 7, titled Accounting for Government Transfers, was issued in November 1990.

We reported on this issue in the Auditor General's report to the Legislative Assembly in January 1993. We said that although we noted progress during the 1991/92 fiscal year, no changes to accounting policies resulted. Discussions continued during the 1992/93 fiscal year, but no conclusion was reached. We believe Statement 7 provides important guidance as to a more meaningful and consistent recognition of some $13 billion of government expenditure.

We urge the government to adopt the recommendations of CICA Public Sector Accounting Statement 7 as soon as possible.

Improved Accountability Through Better Information

Improved Accountability Through Better Information

Comments on the Completeness of the Government Summary Financial Statements

The Summary Financial Statements of the government are intended to provide the Legislative Assembly and the public with a comprehensive accounting of the financial position and results of operations of all government owned or controlled organizations. But do these statements in fact provide all of the financial information they should?

In this section we discuss two matters which bear on this question:

- the inclusion in the Summary Financial Statements of government enterprises on a modified equity, rather than a full consolidation, basis; and
- the exclusion from the Summary Financial Statements of some government owned or controlled organizations, such as advanced education institutions and public hospitals.

We have prepared pro forma financial statements which illustrate how the matters raised affect the government financial statements. However, we must stress that there are a number of important unresolved accounting issues which are not dealt with in the pro forma financial statements though they will eventually affect the final contents considerably. These are issues such as the amounts to be recovered from future government funding, and the treatment of physical assets.

For the purpose of preparing these pro forma financial statements, the loans to public sector organizations outside government are included at the same value as they are in the current financial statements (although they include amounts recoverable from future government funding). Physical assets have been included at the same book value as they are recorded in the financial statements of the government enterprises, advanced education institutions, and public hospitals, consolidated into the pro forma statements.

An Alternative Way of Consolidating Government Enterprises

The *Financial Administration Act* of British Columbia requires that the financial statements of the government be prepared annually by the Comptroller General under the direction of Treasury Board. Treasury Board, a committee of the Executive Council, decides what should constitute these financial statements and how they should be prepared.

Currently, two sets of statements are prepared: the Summary Financial Statements and the Consolidated Revenue Fund (CRF) Financial Statements. The Summary Financial Statements account for the CRF as well as various government entities; the CRF Financial Statements account for the activities of central government as they relate to the annual expenditure appropriations. As discussed in previous Auditor General's reports, we believe that the Summary Financial Statements are the main statements of the government, as they disclose financial information not only about the operations of central government, but also about most entities the government owns and controls.

According to existing government accounting policies, entities making up the consolidated reporting entity are grouped into two distinct categories: "government organizations" and "government enterprises." Both of these two groups are defined in Note 1 of the Summary Financial Statements.

Government organizations, which include the CRF, are fully consolidated. This means that, after eliminating transactions occurring between these organizations—to avoid double accounting—all revenues, expenditures, assets, and liabilities of the organizations are aggregated according to the government accounting policies, line-by-line, into the Summary Financial Statements. The accounting effect is as if they were all one organization and did not exist as separate entities.

The 23 government enterprises are not accounted for in the same manner, but are brought into the Summary Financial Statements on the "modified equity" basis of accounting. This means that only the cost of government's investment in the government enterprises, adjusted for any increase and decrease in their net assets, is included in these financial statements.

The accounting policies as stated in the Note 1 to the Summary Financial Statements allow for both the accrual and the gross bases of accounting to be used in the preparation of the statements. The gross basis of accounting means that the financial statements should disclose the essential underlying components of each economic activity, rather than showing merely the net result of that activity.

We note that the accounting policy for consolidating government enterprises on a modified equity basis seems to be inconsistent with the gross basis of accounting, which is fundamental to the Summary Financial Statement preparation. The modified equity basis requires the net assets of the commercial entity, rather than the economic substance of its underlying components, to be aggregated with other economic activities of the government. Consequently, the significant revenues, expenditures, assets, and liabilities of government enterprises are not disclosed in the financial statements of the government's consolidated reporting entity.

To demonstrate the significance of the information currently excluded from disclosure in the Summary Financial Statements, we have compared the main components of the summary balance sheet and summary statement of revenue and expenditure, as currently presented, with pro forma financial statements prepared on the assumption that all components of the consolidated reporting entity are consolidated on a line-by-line basis (Exhibit 3.1).

Physical assets of government enterprises (ferries, for example) are generally used to generate revenue from sources outside government, and are capitalized and depreciated in the accounts of these enterprises. These "users'" physical assets are presented at their depreciated value on the pro forma summary balance sheet of the government.

The pro forma statement in Exhibit 3.1 is intended to provide a reasonably accurate picture of the effects of accounting for government enterprises using the full consolidation method. We did not attempt to eliminate inter-government transactions of government enterprises.

In addition to the users' physical assets, several significant differences should be noted between the modified equity and the full consolidation bases of accounting.

- The decrease in the fiscal agency loans receivable is $6.3 billion dollars, representing loans to government enterprises, which are eliminated.
- The increase in public debt is due to some $3 billion dollars of debt owed by government enterprises to outside parties which, under the current method of consolidation, are not recorded in the summary balance sheet of the government.
- The increase in both "other assets" and "other liabilities" of approximately $4.7 billion and $5.3 billion, respectively, reflect the other assets and other liabilities of government enterprises, currently not disclosed in the government Summary Financial Statements.

These differences show the significance of relevant information currently excluded from disclosure in the government financial statements.

The manner in which government enterprises are accounted for in the Summary Financial Statements of the government meets the standards recommended by the Public Sector Accounting and Auditing Board (PSAAB) of the Institute of Chartered Accountants (CICA). However, after issuing the PSAAB recommendations, the CICA changed its recommendations pertaining to the private sector, requiring that all subsidiaries be fully consolidated rather than recorded as an investment accounted for by the equity method.

Accounting authorities in other jurisdictions, such as the United States Financial Accounting Standards Board (FASB), have similarly set standards for the full consolidation of all subsidiaries. While both the CICA

Exhibit 3.1

Pro Forma Summary Balance Sheet (Condensed)
Government of British Columbia
March 31, 1993
($ Millions)

	Existing[1] Reporting Entity	Existing Reporting Entity on a Full Consolidation Basis
Assets		
Equity in government enterprises	3,021	-
Fiscal Agency Loan Program	10,181	3,876
Users' physical assets (depreciated)		
BC Hydro and Power Authority	-	8,954
BC Ferry Corporation	-	640
BC Railway Company	-	1,280
BC Transit	-	1,480
Other government enterprises	-	482
Other assets	2,619	7,308
	15,821	24,020
Liabilities		
Other liabilities	2,616	7,877
Public debt	19,835	22,819
	22,451	30,696
Accumulated deficit	(6,630)	(6,676)
	15,821	24,020

Pro Forma Summary Statement of Revenue and Expenditure (Condensed)
Government of British Columbia
For the Year Ended March 31, 1993
($ Millions)

	Existing Reporting Entity	Existing Reporting Entity on a Full Consolidation Basis
Revenue	17,701	24,473
Expenditure	19,368	26,125
Deficit for the year	(1,667)	(1,652)

[1] Government enterprises are currently consolidated on the modified equity basis in the existing consolidated reporting entity

and FASB recommendations are primarily for private sector accounting, we believe the rationale supporting full consolidation is applicable to public sector accounting, and that the current basis of consolidation could be improved upon if government enterprises were to be fully consolidated.

Entities That Should Be Included in the Government Financial Statements

Another important aspect of completeness of financial reporting by the government through its Summary Financial Statements is the composition of its reporting entity. While the consolidated reporting entity currently includes almost all government organizations and entities, we believe the content of the government's summary statements should be expanded to include advanced education institutions, public hospitals, and perhaps the Workers' Compensation Board.

According to Sections 4(a) and 8(2) of the *Financial Administration Act,* Treasury Board establishes government accounting policies and practices, including the form and content of the Public Accounts. Although not specifically referred to in the Act, it is understood that establishing the form and content of the Public Accounts includes determining the composition of the government's consolidated reporting entity. That entity is intended to comprise all of the provincial government, including government ministries, Offices of the Legislature, Crown corporations, commissions, authorities, and other government organizations.

The government, in describing its consolidated reporting entity, states:

> *These financial statements include the accounts of organizations which are accountable for the administration of their financial affairs and resources either to a minister of the government or directly to the Legislature, and are owned or controlled by the government.*

We believe that advanced education institutions (the province's public universities, colleges and institutes, and the Open Learning Agency), certain public hospitals, and perhaps the Workers' Compensation Board meet the requirement for inclusion in the consolidated reporting entity.

We have reported on this matter in prior reports of the Auditor General to the Legislative Assembly, relating to the 1990/91 and 1991/92 Public Accounts. Here we again set forth our views on this issue.

Advanced Education Institutions

Government officials have, since 1991, agreed that colleges and other post-secondary education institutions, including the Open Learning Agency, meet the criteria set out by the Public Sector Accounting and Auditing Board of the CICA for inclusion in the government reporting entity. However, the financial positions and results of operations of these institutions have not been included in the government's 1992/93 fiscal year Summary Financial Statements. In fact, the Public

Accounts currently disclose only a financial overview of advanced education institutions.

Officials of the government have said that including these institutions in the consolidated reporting entity would not provide meaningful information, since resolving the issue of accounting for physical assets is prerequisite to consolidating colleges and other advanced education institutions. Considering similar cases in other jurisdictions, we do not believe that this reason alone justifies postponing the inclusion of these organizations in the government's financial reporting entity.

Another argument made by the officials is that universities should not be included, because any legal rights of control of those institutions by government are not expected to be exercised in practice. Under the *University Act,* the government can appoint 8 out of 15 members of each university board of governors, but two of the government appointments to each board must be from among persons nominated by the alumni associations. We think it highly unlikely that the alumni associations would refuse the privilege they earned to nominate members for the boards and so reduce the government appointments to less than a majority.

In our view, the inclusion of the advanced education institutions, including universities, in the government Summary Financial Statements is appropriate and should be undertaken.

Public Hospitals

In previous Auditor General reports, we asked that the government further analyze the questions of accountability, control, and, in particular, ownership of the province's public hospitals before deciding whether or not this large group of provincial organizations should be included in the government's consolidated reporting entity.

Recent events, which led to the decision by the government to curb the activities of one health care facility and to close another, suggest the government has effective control over these organizations. In our analysis of "control," however, we tend to distinguish between this type of overall control—which is usually included in the legislated powers of ministers responsible for the funding of public organizations—and administrative control. For those public hospitals in which the majority of Board members are government appointees, we believe that not only overall control but administrative control by government exists and, consequently, that those hospitals should be included in the government's consolidated reporting entity.

Workers' Compensation Board

We have further analyzed legislation relating to the Workers' Compensation Board (WCB) and have concluded that, according to existing guidelines, the WCB could equally be regarded as a government agency or as a private enterprise. The government controls the management of the WCB but has no call on its assets, and WCB is primarily accountable to its contributors.

We therefore believe that further criteria must be developed before final determination can be made as to whether the WCB should be included in the government's summary statements.

To date, the government has not changed its position on the composition of its consolidated reporting entity, and so has not included the advanced education institutions, public hospitals, or the WCB in its Summary Financial Statements.

To be an effective component of government accountability to the public, summary financial statements should provide a complete financial picture of the government's operations. To emphasize the major differences that the exclusion of advanced education institutions and public hospitals make in reporting government operations, we have prepared pro forma financial statements based on a consolidated reporting entity in which advanced education institutions and public hospitals are included. Exhibit 3.2 shows a pro forma balance sheet and a pro forma Statement of Revenue and Expenditure for the "expanded reporting entity" compared with the existing reporting entity accounted for on the current basis and on a full consolidation basis.

The pro forma below is intended to provide a reasonably accurate picture of the outcome of including both advanced education institutions and public hospitals, the majority of whose board members are appointed by the government. We did not attempt to eliminate inter-government transactions of government enterprises.

In addition to the additional users' physical assets, several significant differences should be noted between the existing reporting entity on the basis of full consolidation and the expanded reporting entity.

- The decrease in the fiscal agency loans receivable is $0.8 billion dollars, representing loans to advanced education institutions and public hospitals included in the expanded reporting entity, which are eliminated.
- The incremental increase in public debt is due to some $0.2 billion dollars of debt held by advanced education institutions and public hospitals which, under the current method of consolidation, are not recorded in the summary balance sheet of the government.
- The increase in both "other assets" and "other liabilities" of approximately $1 billion and $0.9 billion, respectively, reflect the other assets and other liabilities of advanced education institutions and public hospitals, currently not disclosed in the government Summary Financial Statements.

Exhibit 3.2

Pro Forma Summary Balance Sheet (Condensed)
Government of British Columbia
March 31, 1993
($ Millions)

	Existing[1] Reporting Entity	Existing Reporting Entity on a Full Consolidation Basis	Expanded Reporting Entity on a Full Consolidation Basis
Assets			
Equity in government enterprises	3,021	-	-
Fiscal Agency Loan Program	10,181	3,876	3,114
Users' physical assets (depreciated)			
BC Hydro and Power Authority	-	8,954	8,954
BC Ferry Corporation	-	640	640
BC Railway Company	-	1,280	1,280
BC Transit	-	1,480	1,480
Other government enterprises	-	482	482
Universities	-	-	1,371
Colleges and institutions	-	-	1,077
Public hospitals[2]	-	-	391
Other assets	2,619	7,308	8,284
	15,821	24,020	27,073
Liabilities			
Other liabilities	2,616	7,877	8,789
Public debt	19,835	22,819	23,047
	22,451	30,696	31,836
Accumulated deficit	(6,630)	(6,676)	(4,763)
	15,821	24,020	27,073

Pro Forma Summary Statement of Revenue and Expenditure (Condensed)
Government of British Columbia
For the Year Ended March 31, 1993
($ Millions)

	Existing Reporting Entity	Existing Reporting Entity on a Full Consolidation Basis	Expanded Reporting Entity on a Full Consolidation Basis
Revenue	17,701	24,473	25,412
Expenditure	19,368	26,125	27,154
Deficit for the year	(1,667)	(1,652)	(1,742)

[1] Government enterprises are currently consolidated on the modified equity basis in the existing consolidated reporting entity
[2] Public hospitals are those hospitals whose board members are all, or virtually all, government appointees

More Can Be Done to Make Government Financial Information Understandable

For government financial information to be useful, it must be capable of being understood by users. How well the public understand how the government has discharged its stewardship responsibility is an important indicator of the government's success in providing accountability information through its financial publications.

In this section we talk about two areas where we believe British Columbians may find the province's financial information difficult to understand or confusing.

Information from the Summary Financial Statements Should Be Used to Communicate the Government's Financial Position

As discussed in page 13, the Summary Financial Statements provide the most complete information as to the financial position and operating results of the province. We believe they are the main financial statements of the government. However, in many of its important publications—such as the Public Accounts Digest or the British Columbia Economic and Statistical Review—the government rarely uses summary financial statements as the basis for the financial information provided to the public. Instead, it usually refers to information taken from the Consolidated Revenue Fund Financial Statements, which account only for the financial activities of central government.

We believe that using the information from that source in government publications could be misleading, as it does not reflect the government's total operations. For example, the government's frequent reference to the deficit taken from the Consolidated Revenue Fund Financial Statements likely causes considerable misunderstanding amongst the public as to what the government deficit really is.

We therefore believe that, in all its financial publications other than that part of the Public Accounts dedicated to accounting for the Consolidated Revenue Fund, the government should communicate its fiscal position using information extracted from the Summary Financial Statements.

Financial Statements Should Be Easier to Understand

Use of complicated presentation formats and cumbersome terminology can also make financial statements difficult to understand. The balance sheet, statement of revenue and expenditure, and most notes and supplementary statements of the government's Summary Financial Statements are generally clear and reasonably free of complications. (Some minor exceptions are the uses of the phrases "net revenue" or "net expenditure" where "surplus" or "deficit" are more easily understood.) However, we are concerned that one important statement, the Statement of Changes in Cash and Temporary

British Columbia Economic and Statistical Review.

We believe that both the readers of these reports and the government would benefit if the Auditor General reviewed the accuracy and completeness of such reporting. Accordingly, we are currently reviewing our office resources to see whether we can soon undertake this additional work.

Prospectuses Issued to Support Provincial Borrowing

The province is exempt from filing its prospectuses with securities commissions in Canada. This, often, is not the case with securities regulatory authorities elsewhere.

For example the B.C. Prospectus "package," filed by the government with the United States Securities and Exchange Commission, is made up of three documents:

- The "B.C. Prospectus" sets out the aggregate principal amount of debt securities the province may offer. It also provides general information about the province and a description of the securities. It closes with a statement from the Minister of Finance that all financial and statistical information on the province included in the report has been taken or derived from the records of the province, including the Public Accounts.
- The "B.C. Prospectus Supplement" is issued with each bond issue. It sets out the terms of the securities offered, including specific designations, aggregate principal amount, currency of denominations and payments, denominations, maturity, rights and times of payment of interest, terms for redemption, and the initial public offering prices. The Supplement refers to the B.C. Prospectus' Annual Report.
- The "B.C. Prospectus' Annual Report" is voluntarily filed with the U.S. Securities and Exchange Commission. The annual Estimates and the British Columbia Economic and Statistical Review are also filed as accompanying exhibits. The Annual Report contains the following financial schedules:
  - three-year history of direct funded debt;
  - consolidation of direct and guaranteed funded and unfunded debt;
  - unaudited maturity schedule of direct funded debt;
  - unaudited maturity schedule of guaranteed funded debt;
  - statement of direct funded debt;
  - statement of guaranteed funded debt; and
  - consolidated funded debt.

Other financial information includes discussion on other significant financial matters such as changes in accounting policy, contingent liabilities and commitments, and discussions of pension funds and labor relations legislation.

The prospectus document makes no mention of which information within it has been audited by the Auditor General. In fact, based on our review, references to the information as having been audited are frequently poorly organized with:

- some schedules marked as "unaudited," leaving the reader to assume that the other schedules were audited;
- the text referring to an "audited" net debt figure; and
- only three of the four notes for contingent liabilities and commitments being described as audited.

In all of the documents constituting the B.C. prospectus package, references to audited information have been made without any consultation with or consent of the Auditor General, and the Auditor General does not issue a "comfort letter" for inclusion in prospectus. This comfort letter, when issued by the provincial auditor, states that, in his or her view, the financial information contained in the prospectus is consistent with financial statements. It also states that there has been no material adverse change in the financial position of the province since the date the audited financial statements contained in the prospectus.

The extent of involvement of legislative auditors in prospectus documents varies across Canada. Legislative auditors in four provinces are currently providing comfort letters to users of the prospectuses; in at least four other provinces, they have no involvement at this time with the government's prospectuses.

The Auditor General of British Columbia is associated with financial information included in prospectuses that is derived from the financial statements upon which the Auditor General has reported or that is within his or her knowledge as a result of his or her audit of such financial statements. We believe that when the issuance of a comfort letter is not required by securities regulatory authorities, the Auditor General's consent should be sought and be included in the prospectus document as a normal government procedure.

Provincial Debt: Comments on Its Reporting

Provincial Debt: Comments on Its Reporting

Background

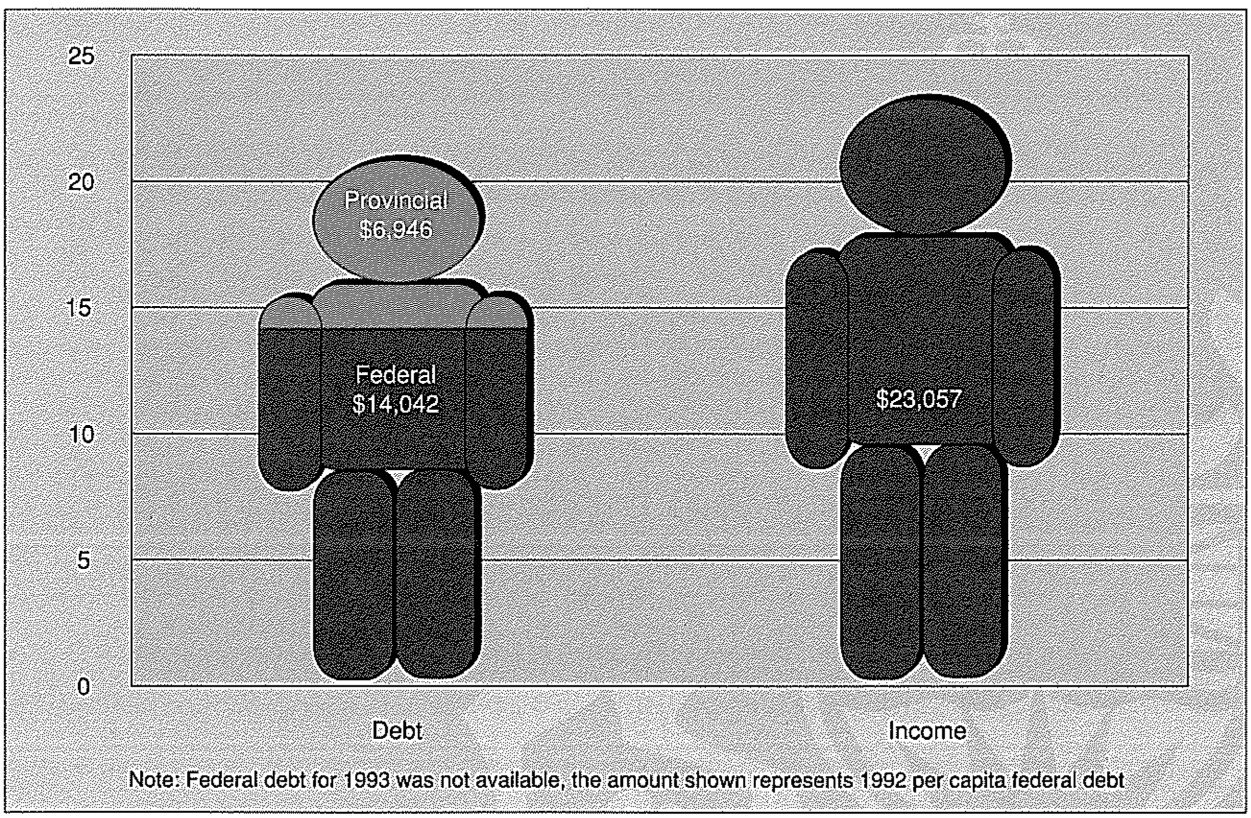
The Province of British Columbia currently has a debt of over $23 billion. This obligation is significant and is likely to continue for some time into the future.

In 1993, each British Columbian's share of the provincial debt was approximately $7,000 ($6,100 in 1992). If this amount were added to the per capita federal debt, each British Columbian's share of the combined government debt would be equal to over 90% of his or her average annual income (Exhibit 4.1). Additionally, each resident of British Columbia has a current level of average personal debt of $14,900.

Exhibit 4.1

Per Capita Debt to Income in British Columbia, 1993

Average share of provincial and federal government debt of a person living in British Columbia compared to the same person's average income



Sources: Statistics Canada, The Public Accounts of British Columbia, Public Accounts of Canada

In the government's most recent budget, the provincial debt is projected to be $26.4 billion at the end of the 1993/94 fiscal year.

The province's total debt is the combination of its debt directly attributed to the operation of the central government (direct debt), and amounts representing the debt of Crown corporations and government agencies (other debt).

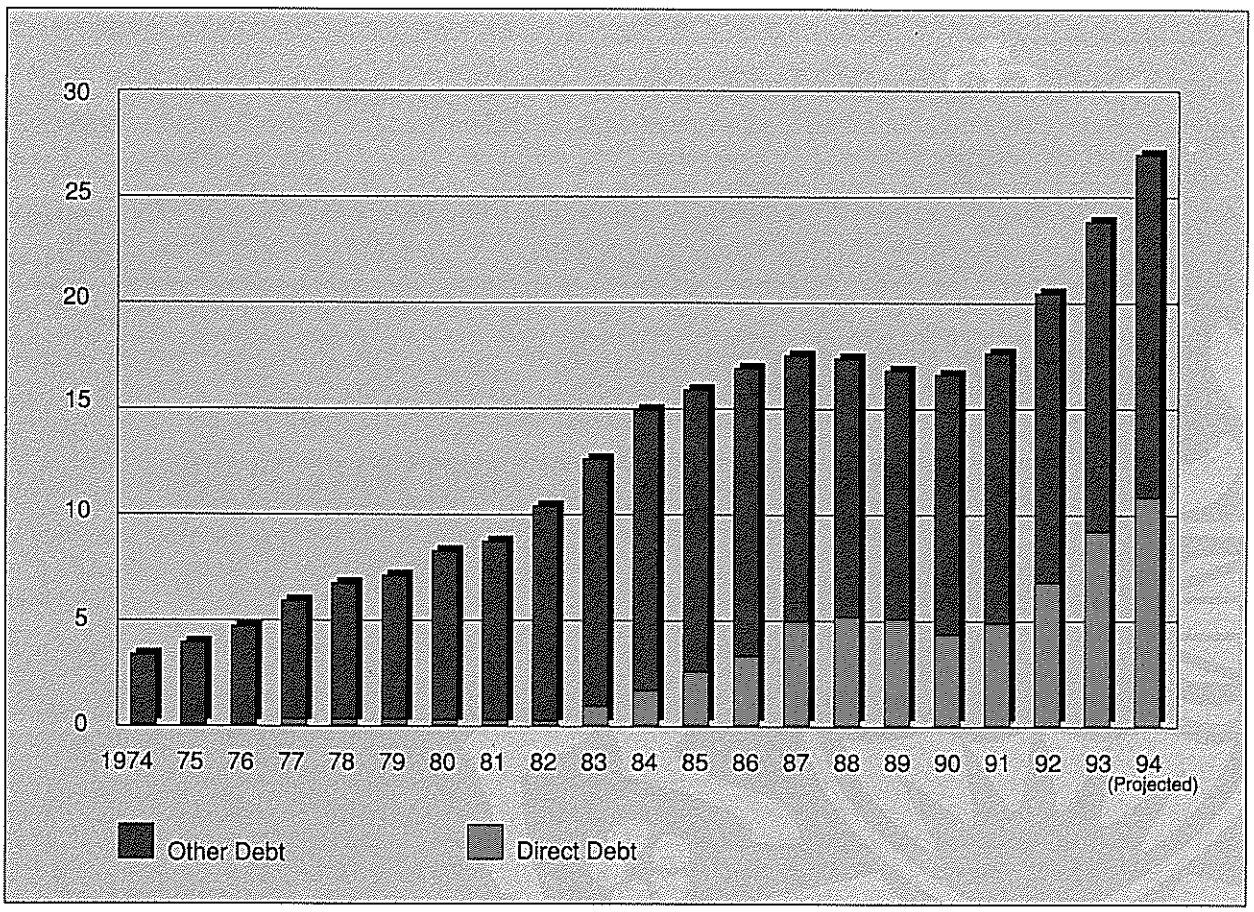
Exhibit 4.2 shows the balance of provincial debt at the end of each of the 20 fiscal years to 1993/94, divided between direct and other debt.

Exhibit 4.3 summarizes the accumulation of provincial debt since 1974. Prior to 1974, the province had virtually no direct debt and a maximum of $3 billion of debt incurred by Crown corporations.

Exhibit 4.2

Provincial Debt

Direct and other debt for each of the 20 fiscal years ending 1993/94 ($ Billions)



Sources: The Public Accounts, Budget '93, Economic and Statistical Review reports

Exhibit 4.3

History of Provincial Debt

A concise history of the accumulation of debt by the Province of British Columbia between 1974 and 1993

Amount in $ Billions

Major debt activities	Direct debt	Other debt	Total debt
Debt as at March 31, 1974	Nil	3.3	3.3
In 1977, for its own direct use the central government issued debt amounting to $0.3 billion. This was to be repaid, in equal sinking fund installments, over a 10-year period starting in 1980. For the first three years, the annual redemption requirements were met by the province. In 1983, the province borrowed more to finance its operations and to pay for the sinking fund installment. In other words, there was no reduction in the earlier debt.			
Between the mid-1970s and the mid-1980s, the debt of the Crown corporations increased as a result of capital projects. BC Hydro was engaged in a number of major projects including construction of the Revelstoke dam ($1.8 billion), the laying of cable to Vancouver Island ($0.6 billion), expansion of electric service transmission ($1.0 billion), electric service transformation ($0.9 billion), and electric service distribution ($0.9 billion). BC Transit's rapid transit project also took place during this period ($0.9 billion).			
Debt as at March 31, 1984	1.6	13.0	14.6
In the 1980s, the province assumed significant portions of debt from two then-struggling Crown corporations, BC Railway Company, and British Columbia Enterprise Corporation. In this period, the province diversified its debt portfolio and entered the international debt market.			
BC Hydro was officially told by the government to lower its debt load starting in 1984. BC Hydro sold its interest in Mainland Gas Service, the Rail Service, and Victoria Gas Service and undertook fewer capital projects. The cash flows so generated were used to extinguish its debt.			
Debt as at March 31, 1990	4.2	12.0	16.2
In the 1990s, there was a large growth in the government's expenditures, especially in income assistance, health, education, and debt servicing. At the same time, revenue growth slowed as a result of the recession. This resulted in cash shortages from the government's direct operations, which were financed through increased debt.			
During this period, other debt increased. BC Ferry Corporation acquired two super-ferries and underwent large capital improvements ($0.3 billion). Amounts borrowed and lent to school districts, hospital districts, universities, and colleges, through financing authorities and the Certificate of Approval Program, increased by $1.4 billion. The BC Home Mortgage Assistance Program, introduced in the 1989/90 fiscal year, had a guaranteed debt of $0.3 billion by the end of that fiscal year.			
Debt as at March 31, 1993	9.0	14.4	23.4

Sources: The Public Accounts, Economic and Statistical Review reports, Crown corporation annual reports

Exhibit 4.4

Deficits and Debt

In many general discussions about the province's financial position, the terms "debt" and "deficit" are often used indiscriminately. To clarify their meaning, we explain them below.

Debt

One clearly identifiable aspect of a province's financial condition is the magnitude of its debt. This is the total balance of money borrowed by the province, minus sinking fund investments, to finance its operations and acquire capital assets.

A sinking fund may be established so as to amass funds over the term of a borrowing in order that funds are available to repay the debt when it becomes due. Since assets of sinking funds are earmarked to repay debt, the debt liability in the financial statements is reduced by sinking fund assets. Consequently, the provincial debt of $23.4 billion as at the end of March 31, 1993, is the total amount owed by the government to lenders, less government's sinking fund investments established for the eventual repayment of the debt.

Deficit

The annual deficit is the amount by which the government's expenditures exceed revenues for a fiscal year. The accumulated deficit is the amount by which current and past years' expenses have exceeded revenues.

Deficit, too, is a useful indicator of the province's financial performance. However, its determination depends on the accounting policies of the government. For example, if expenditures are capitalized as assets, deficits are effectively reduced. Nevertheless, the costs of those assets, whether capitalized or not, would likely increase debt. Because provincial deficits are calculated according to accounting policies, they are subject to greater variations than are the determinations of provincial debt.

Reporting on Debt Could Be Improved

Although considerable information reflecting various aspects of the provincial debt is available to the public, the information is scattered and not easily comprehensible except to persons with financial expertise. We believe that the government should disclose key information, including performance indicators and trends on provincial debt, including that of Crown corporations, in a way that allows the public to better understand provincial borrowing and its fiscal impact. Accordingly:

We recommend that the government look at ways of providing comprehensive information on the provincial debt. This should include a "Statement of Total Debt and Changes in Debt" within its financial statements, showing the total provincial debt (including all debts of government enterprises and third-party debts directly *guaranteed by the province) and highlighting the reasons for changes in debt during the year. The total annual cost of borrowing should also be disclosed.*

We also recommend that the government include in the Public Accounts key performance indicators to show trends in provincial debt, some of which are discussed in this report.

To help the public properly understand provincial debt, we believe information should be provided on:

- the total provincial debt;
- the financial well-being of the province;
- the purposes for which money has been borrowed; and
- the cost of borrowing.

Total Provincial Debt

To improve accountability on the provincial debt, the government's financial statements should disclose the total debt of the province.

Exhibit 4.5 shows the details of the total provincial debt. Although these details are available in the Budget and in the Economic and Statistical Review, total provincial debt is not disclosed separately in the province's financial statements. Debt information concerning individual Crown corporations is available from the corporations' separate financial statements, which are included in the Public Accounts.

The debt of "government enterprises" is included in the government's financial statements only to the extent that it is borrowed through the province's fiscal agency loan program. However, these enterprises, in total, have approximately $3 billion in debt that was not borrowed through the program. This debt should be regarded as the province's. We have discussed completeness of information in the Summary Financial Statements elsewhere in this report.

A key indicator that shows relative changes in total provincial debt is the ratio of debt to annual revenue. Total provincial debt was $23.4 billion at the end of the 1992/93 fiscal year. This is equivalent to slightly less than the provincial revenue from all sources, including the province's commercial enterprises, for a year. The ratio of debt to revenue is a valuable and easily comprehensible indicator of the debt burden. To improve accountability on provincial debt, we believe the Public Accounts should show this indicator.

A further useful indicator is the debt per capita, which reflects the burden of debt on individual British Columbians. For improved accountability on provincial debt, we believe the Public Accounts should also disclose this indicator.

At present the debt per capita reported in the Public Accounts Digest covers only the direct debt.

Financial Well-being of the Province

Just like a family's mortgage payment, debt servicing (being non-discretionary) is a first charge against income. As more money goes to pay the interest on debt, there is less money left over to pay for government programs. This "crowding out" effect can seriously hamper fiscal decision-making and become an obstacle to meeting government policy objectives. To continue its programs, the government must then borrow further, or increase its revenue if further borrowing is to be avoided. Higher debt results in correspondingly higher debt servicing costs.

In this section we discuss three considerations that relate to financial well-being: the interest bite, debt servicing, and sources of borrowings.

Exhibit 4.5

Details of Provincial Debt as at March 31, 1993
($ Millions)

Direct debt		**8,970**
Other debt		**13,799**
BC Assessment Authority	6	
BC Buildings Corporation	578	
BC Ferry Corporation	346	
BC Hydro and Power Authority	7,205	
BC Lottery Corporation	5	
BC Railway Company	236	
BC Systems Corporation	29	
BC Transit	1,355	
Capital Project Certificate of Approval Program	367	
Duke Point Development Limited	3	
Educational institutions	874	
Greater Vancouver Sewer and Drainage District	162	
Greater Vancouver Water District	102	
Improvement districts	4	
Provincial Rental Housing Corporation	85	
Regional hospital districts	1,049	
School districts	1,392	
Thompson-Nicola District	1	
Third-party guaranteed debt		**591**
Total provincial debt		**23,360**

Debt includes regular borrowings, capital leases, notes payable, and minority interests

Source: The Public Accounts

Interest Bite

The ratio of total debt servicing cost to total revenue, often referred to as the "interest bite," can provide basic information on the province's fiscal flexibility.

In British Columbia, the interest bite rose from 7.7 cents per dollar in 1991/92 to 8.1 cents per dollar in 1992/93. This means that the province's fiscal flexibility to increase program expenditures has been affected by the increase in debt and cost of debt servicing.

To improve accountability on provincial debt, we think the government financial statements should disclose the "interest bite." This important ratio has not been disclosed in the Public Accounts. Because total revenue and the total debt servicing cost have not been readily available from government financial publications, the reader cannot easily compute this ratio.

Debt Servicing

In addition to paying off interest on debt, the servicing of the provincial debt includes making installments to sinking funds and retiring the debt when it becomes due. As the province continues to borrow, it must continue, at the same time, to be able to service its debt. Just as for any borrower, the lower the province's credit risk, the lower the interest it pays on borrowed funds. Major credit rating agencies continually evaluate the fiscal integrity of the province, assigning it a "rating." Institutional investors use the rating in their decisions to invest in bonds, debentures, and promissory notes of the province.

The province's ability to service its debt primarily relates to both its economy and the magnitude of its debt.

Gross Domestic Product (GDP) is a calculation of economic production. If the province's economy continuously grows faster than its debt, the provincial debt becomes less of a concern. An indicator of the financial well-being of the province is the ratio of the provincial debt to the province's GDP. Exhibit 4.6 shows the debt to GDP ratio since 1980 for the province.

We think that, to improve accountability on provincial debt, the government's financial information should disclose the total debt to GDP ratio indicator, preferably with the audited financial statements. Information on this ratio is widely available in various government financial publications, but to differing extents. It is not complete in the Public Accounts, as information there refers only to the Consolidated Revenue Fund debt.

Sources of Borrowings

The province has borrowed primarily by issuing medium- and long-term bonds, debentures, and promissory notes. Exhibit 4.7 shows the distribution of this provincial borrowing.

Some British Columbia taxpayers have a concern with foreign borrowing, although such borrowing has allowed the province to benefit from a diversified debt portfolio and a lower cost of borrowing. For improved accountability on provincial debt, we think that the government financial statements should disclose the extent of the province's foreign borrowing.

Dependence on major sources of funds in Canada also may concern some taxpayers, and we believe that this too should be disclosed. The government has, in its financial statements for the year ended March 31, 1993, disclosed the extent of borrowing from the Canada Pension Plan only.

Purposes for Which Money Was Borrowed

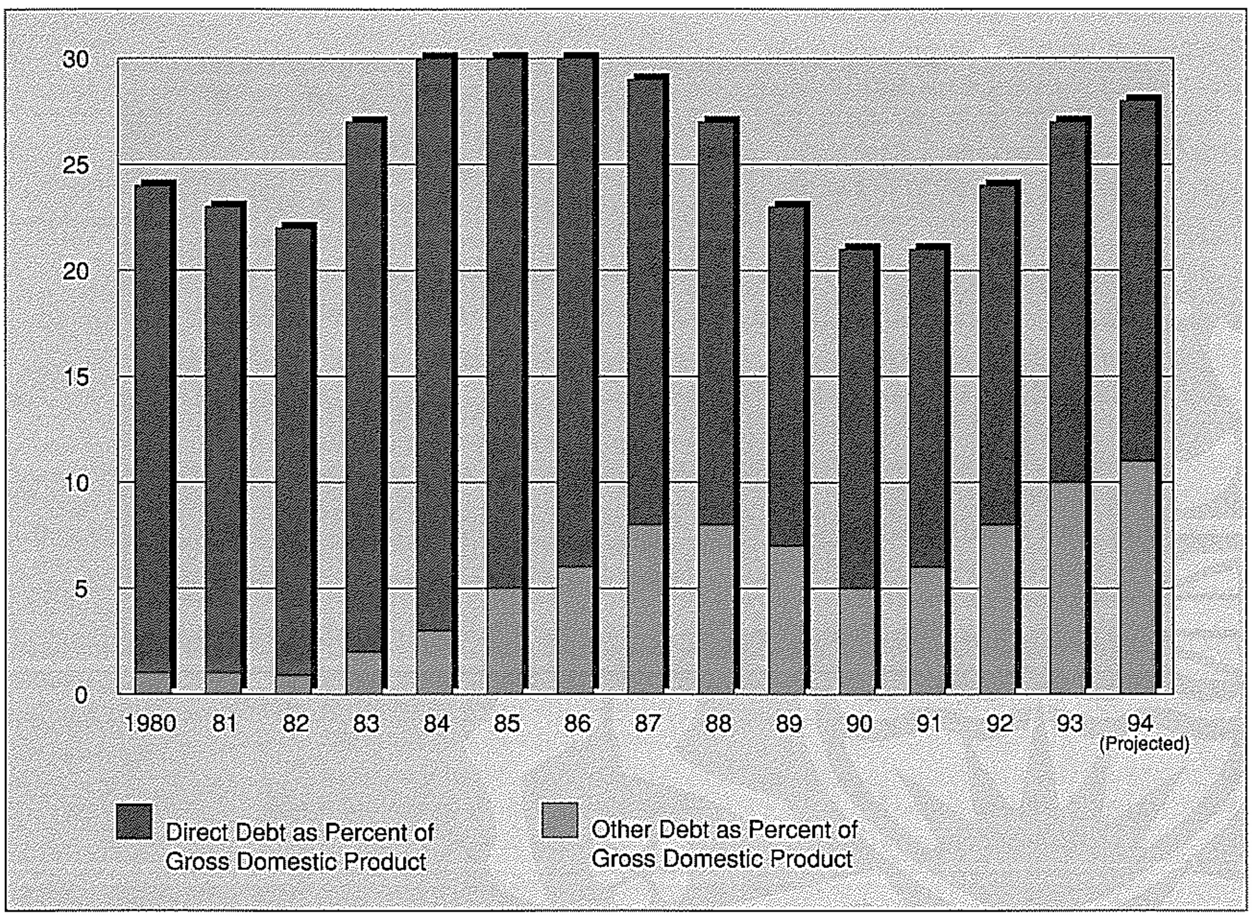
In the Auditor General Report on the 1991/92 Public Accounts we commented that:

> *Governments may find it necessary, in some years, to spend in excess of the revenue for that year. Part of the deficiency could conceivably be attributed to specific outlays of funds for building the economic infrastructure*

Exhibit 4.6

Debt to Gross Domestic Product (GDP) ratio

Provincial debt as a % of GDP in British Columbia, 1980 to 1994



Sources: The Public Accounts, Budget '93, Statistics Canada *which primarily benefits future generations. Other parts could be related to acquisition of physical assets with shorter term future economic benefits or to the general expenditure of the government.*

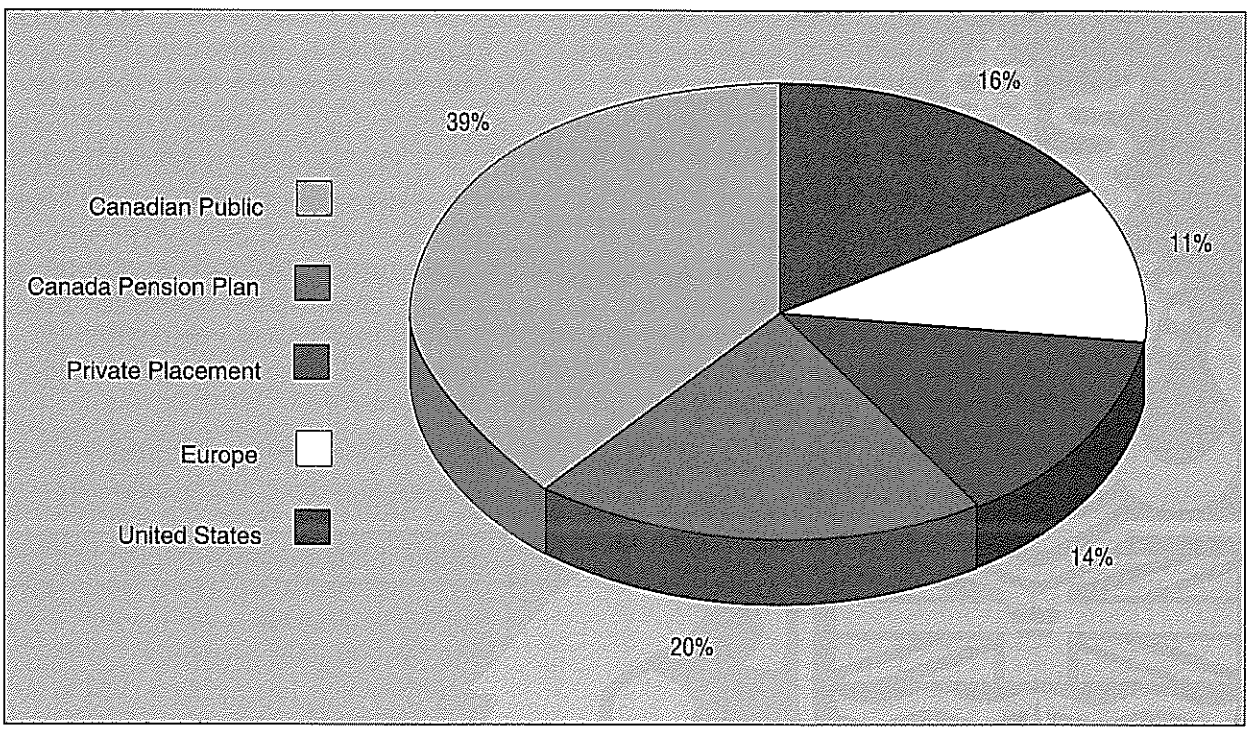
Most governments, including the government of British Columbia, are determined to control the deficiency and, if possible, to prevent the transferring of the unfair financial burden of deficits onto future generations. It seems that the most unfair debt burden that could be transferred to future generations is that caused by expenditure with very little or no future economic benefits. This may be loosely referred to as the "operating deficit". If primary efforts are to be focused on controlling and eradicating the operating deficit, it would be important to account for it separately.

Financing the deficit resulting from the acquisition of physical assets is often the main purpose for

Exhibit 4.7

Outstanding Debt by Source

Provincial borrowing from the Canadian public, Canada Pension Plan, private sources, Europe, and the United States



Source: Budget '93

which monies are borrowed. Thus, to be effectively accountable, the government's financial information should separately disclose the "operating deficit," as explained above.

Neither the Estimates of expenditures of the province nor the Public Accounts distinguish between capital and operating budgets. Since 1991, following a recommendation by the Public Sector Accounting and Auditing Board of the CICA, the accounts of the government have disclosed annual expenditures related to physical assets, but no annual "operating deficit" is reported.

Change in debt may be caused by a number of factors, including the size of the operating deficit and the acquisition of physical assets. Changes in financial assets and liabilities, including issuance or repayment of debt, can also account for changes in debt. An explanation of the causes of change of debt would therefore point to important economic events affecting the financial position of the province.

Again, to improve accountability on provincial debt, we think that the government financial statements should disclose why provincial debt changed and how the change was effected during the year. At present, such information is either not clearly presented or not presented at all. The Statement of Changes in Cash and Temporary Investments identifies only the change in debt for the year.

Cost of Borrowing

The ratio of total cost of borrowing as a percentage of total debt can provide basic information on the effective rate of interest on debt.

Cost of borrowing, or interest paid on debt minus sinking funds investment income, is a debt burden. To the extent that it cannot be paid from the revenues of commercial activities of the government, this burden falls upon the general taxpayer. It is therefore important that this cost be separated in the accounts of the government.

Debt servicing, as reported in the Summary Financial Statements, increased from \$1,523 million in 1992 to \$1,767 million in 1993. However, amounts reported on the government financial statements as "debt servicing" are not a total annual cost of borrowing, as they do not include part of the cost incurred by government enterprises. We have calculated the total cost of borrowing, including government enterprises, to have increased from \$1,757 million in 1992 to \$2,025 million in 1993.

The annual cost of provincial borrowing not paid out of revenues from commercial activities of government enterprises is not easily computable, nor is it shown with information currently presented in government publications.

To improve accountability on provincial debt, we believe the government's financial information should disclose the total annual cost of borrowing, the annual cost of borrowing not paid out of commercial activities of government enterprises, and, for each of these, the ratio of cost of borrowing to debt.

Financial Highlights

Financial Highlights

The Auditor General's Report to the Legislative Assembly on the 1991/92 Public Accounts released in January 1993, referred to the government's commitment to deficit reduction through the capping and gradual elimination of the structural deficit. Again this year, in the budget speech delivered on March 30, 1993, in the Legislative Assembly, the Minister of Finance and Corporate Relations reiterated the government's continued commitment to reducing the deficit in a planned and balanced manner.

The government's annual deficit for the year ended March 1993 was reduced to $1.7 billion from $2.2 billion for the previous year, a decrease of approximately 23%.

The government reported that slower-than-expected economic growth and a reduction in a mid-year federal government's revenue forecast in the 1992/93 fiscal year were two of the factors creating pressure on the deficit reduction strategy for that year. According to the government, the outlook for 1993/94 is expected to be an overall economic growth of 3.2%, resulting in some 35,000 new jobs in British Columbia. On the basis of these expectations, the government is setting its target for the structural deficit—deficit adjusted for changes in economic conditions—to be reduced to between $400 and $800 million in 1993/94.

The financial information highlighted in this section is intended to provide background to, and serve as a point of reference for, our comments on the state of the province's debt and deficit. The comments are made in keeping with Section 8(1) of the *Auditor General Act* to highlight certain important financial information contained in those statements. Financial data are taken from the summary level financial statements, included in the Public Accounts of the relevant years, and are restated to include the effects of any prior period adjustments. They are not adjusted for changes in the Consumer Price Index (CPI). Population figures are as at March 31.

Revenue

Taxes are the most significant source of revenue for the government of British Columbia. In recent years, personal taxes have accounted for between 42 cents and 46 cents of every dollar of the province's taxation revenue. Compared with all other major sources of revenue, personal taxes have had the highest dollar increase over the past five years, increasing by $1.0 billion. Property taxes have had the highest percentage increase over that period, increasing by 89%.

The largest dollar increases for the 1992/93 fiscal year were for "other revenues" and "contributions from the federal government." Other revenues increased from $3.7 billion to $4.3 billion, an increase of 17%. The increase in other revenues was primarily as a result of contributions, both received and unremitted, from government enterprises. These rose from $0.7 billion to $1.1 billion.

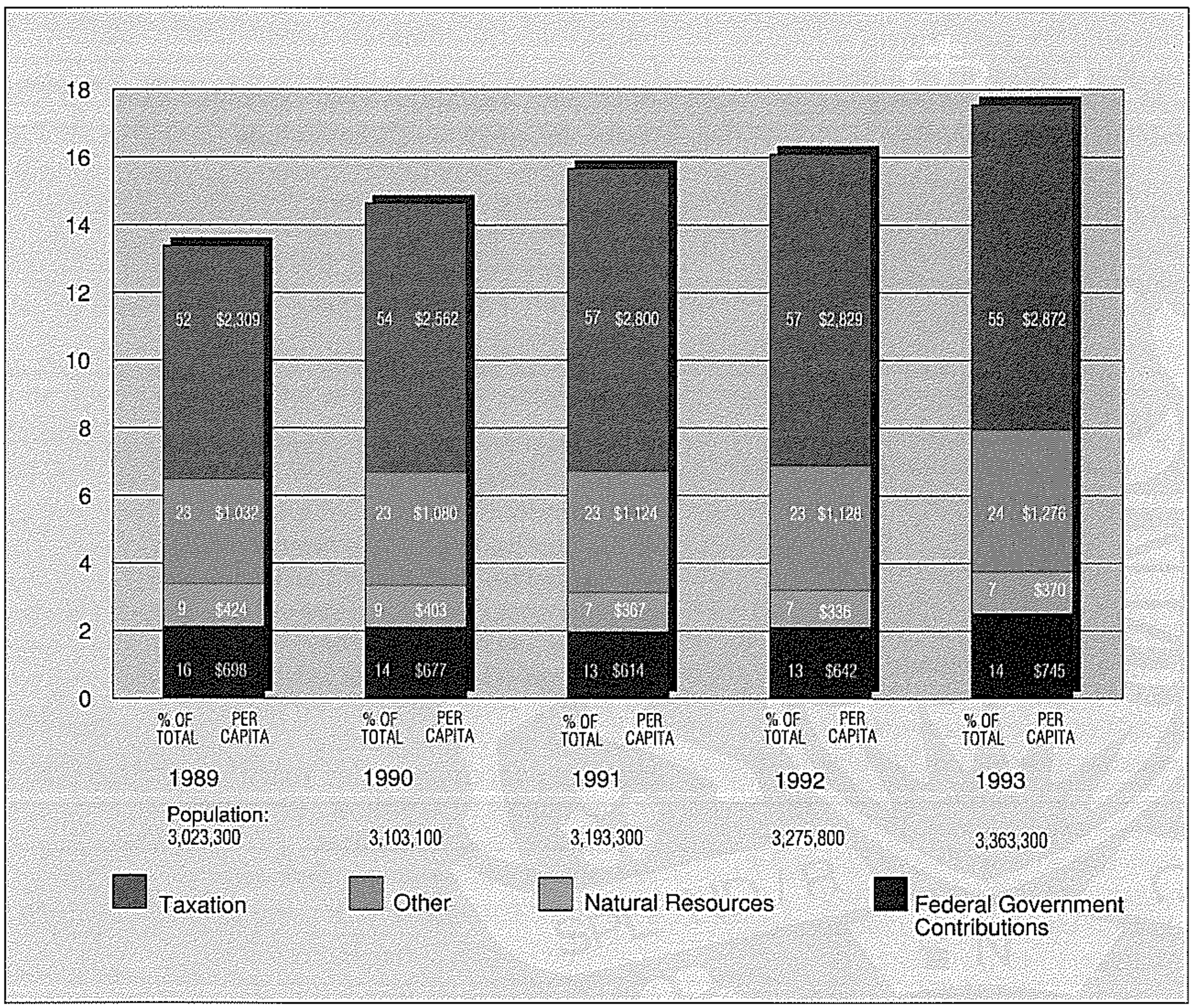
Contributions from the federal government increased from $2.1 billion to $2.5 billion, an increase of 19%.

Exhibit 5.1 shows total revenue of the province in each of the years, 1989 to 1993. From 1989 to 1992, revenue other than

Exhibit 5.1

Revenues, 1989 to 1993

Total revenue by main sources over the past five years ($ Billions)



Sources: The Public Accounts for financial figures, Statistics Canada for population statistics

taxation either stayed relatively unchanged or changed only slightly. In 1993, contributions from the federal government and other revenues increased dramatically. Taxation revenue has increased significantly from $7 billion in 1989 to $9.7 billion in 1993. In other terms, the average taxation revenue generated by each resident of British Columbia (per capita taxation revenue) has increased from $2,309 in 1989 to $2,872 in 1993.

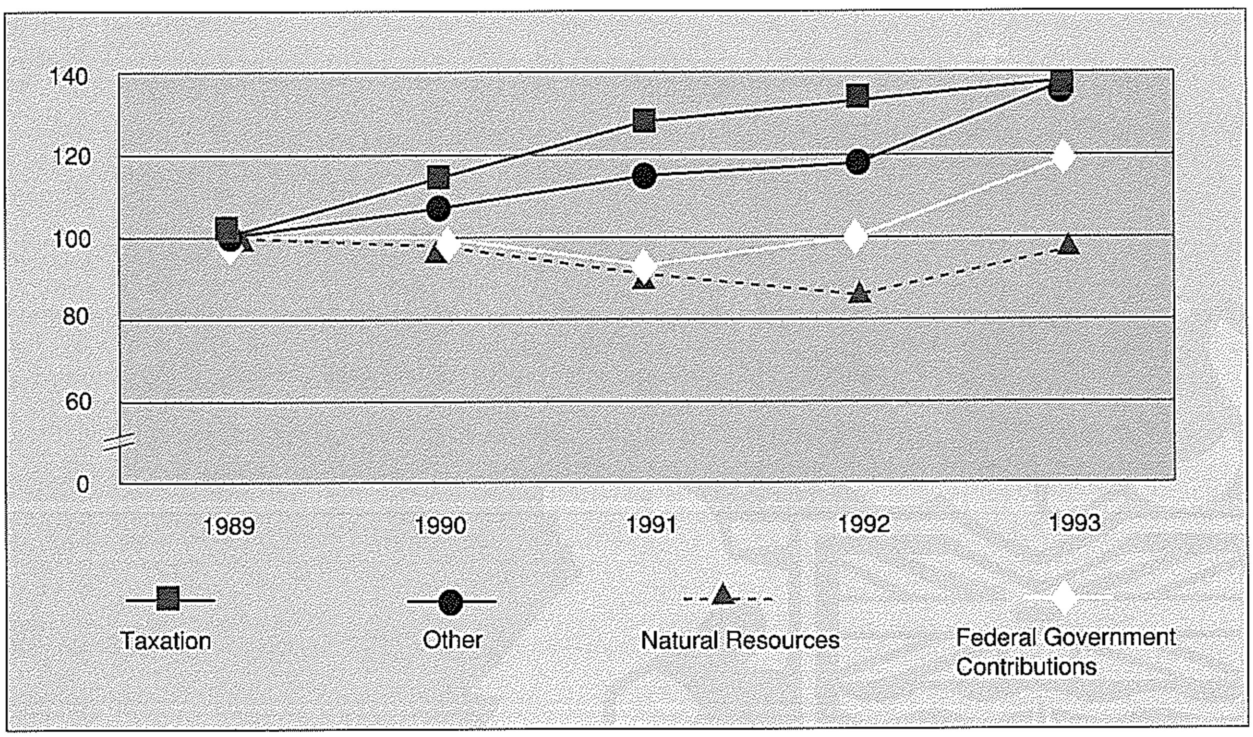
The revenue category referred to as "other" includes all fee and license collections, earnings from investments, contributions from government enterprises, recovery of monies from sources outside government, and some miscellaneous revenue.

Exhibit 5.2 shows the rate of change in revenue over the last five years by main sources. The base year in this exhibit is 1989. Revenue for each main source in the four years that follow 1989 have been shown as a percentage of the base year. Note that in 1990 the school tax component of property taxes became direct revenue of the province rather than of the various municipalities. The large percentage increase from 1990 to 1991 in taxation revenues

Exhibit 5.2

Change in Revenues, 1989 to 1993

Rate of change in revenue by main sources, indexed to 1989, over the past five years (1989 = 100)



Sources: The Public Accounts for financial figures, Statistics Canada for population statistics

(12.5%) can be partially (3.9%) attributed to this administrative change in property taxes. Education expenditures increased correspondingly in 1991.

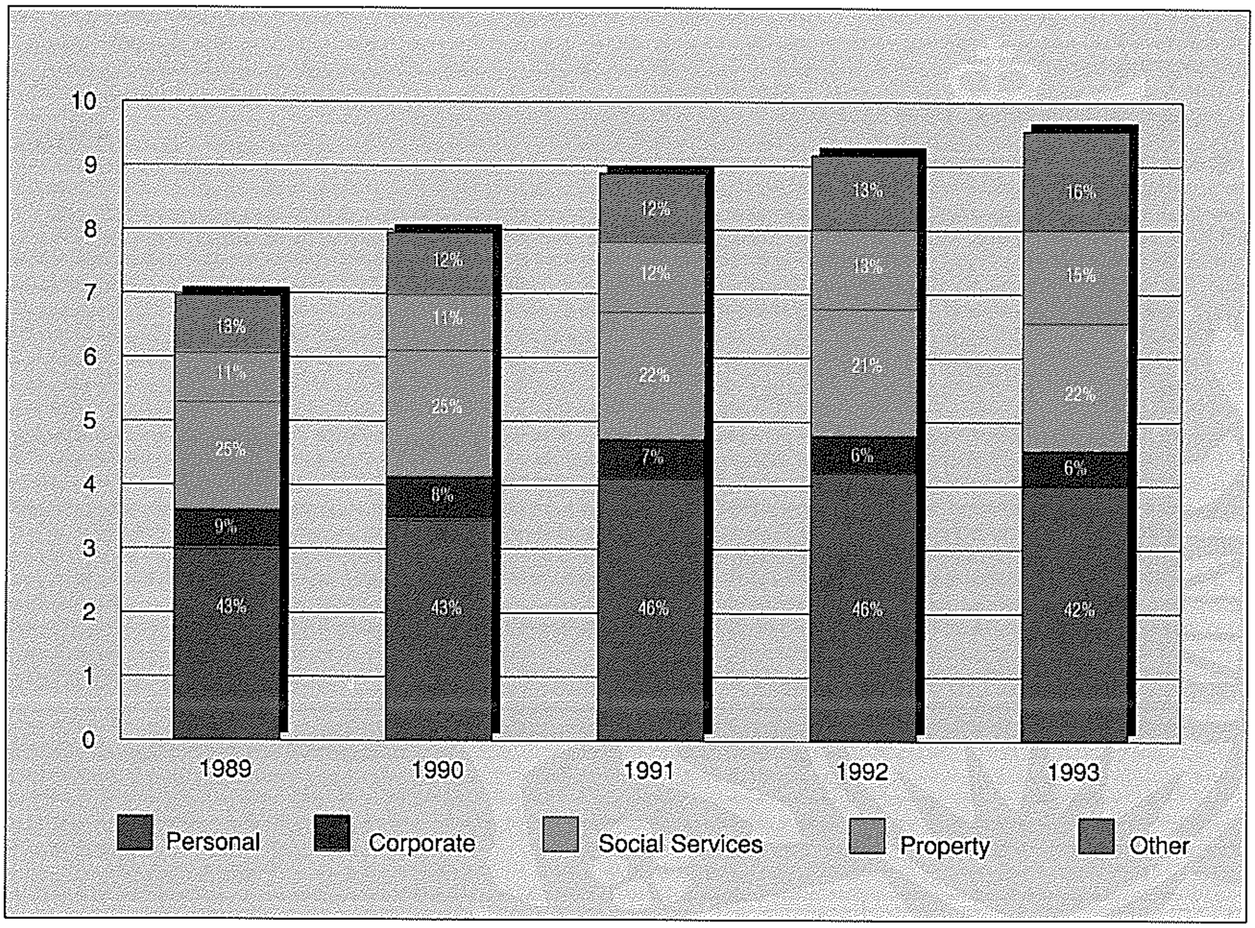
Exhibit 5.3 shows the taxation revenue by source over the five-year period from 1989 to 1993, and the ratio of revenue from each of the main taxation sources to the total taxation revenue of the province.

The government collects taxes from many sources. The most important of these taxes include those relating to personal and corporate income, property, and sales. In the figures presented in the graph, the taxes denoted as coming from property include residential, business, and rural property taxes, as well as the Property Purchase Tax. The Social Services Tax is more commonly known as the provincial sales tax.

Exhibit 5.3

Taxation Revenue, 1989 to 1993

Taxation revenues by source over the past five years ($ Billions)



Sources: The Public Accounts for financial figures, Statistics Canada for population statistics

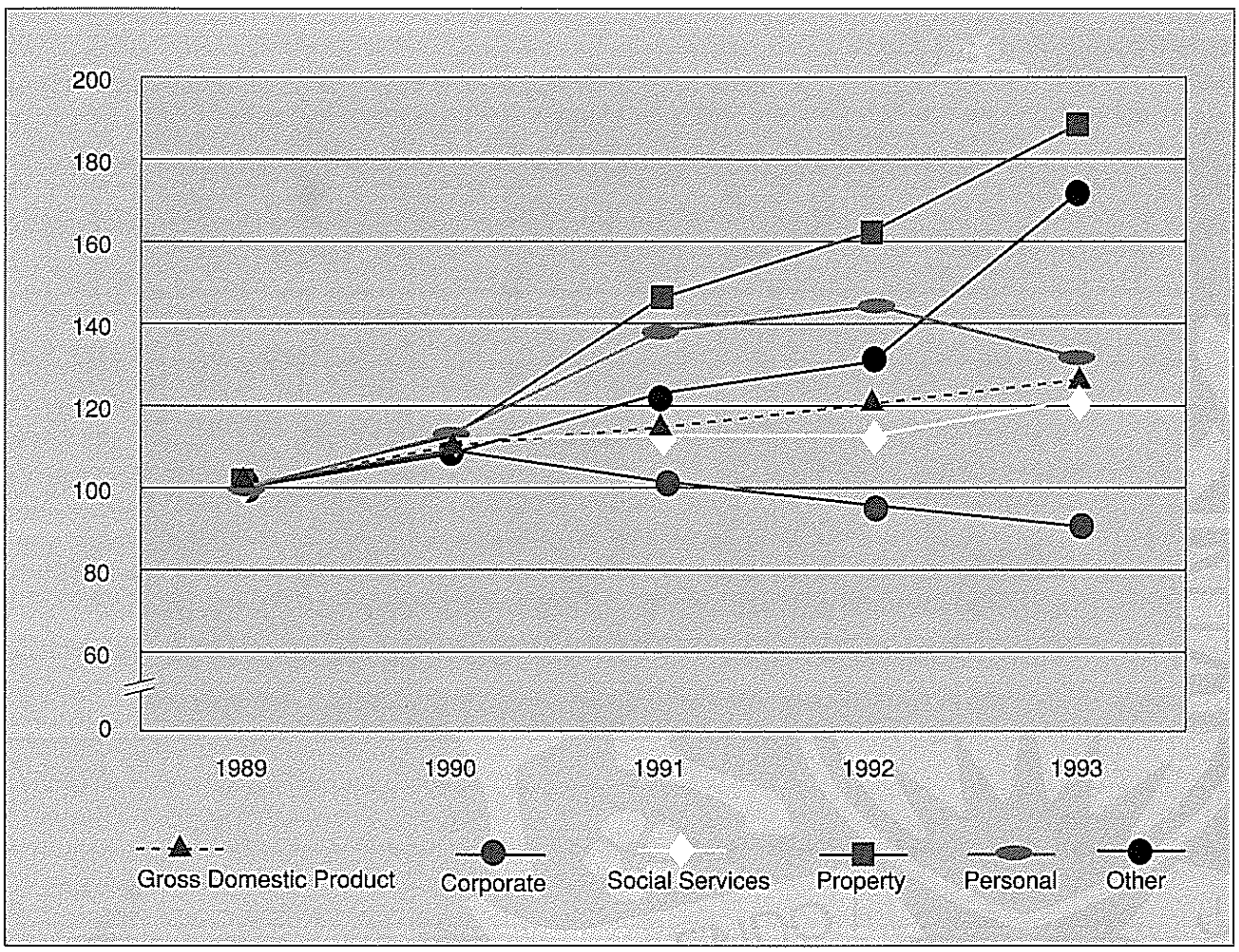
The "other" source includes fuel, tobacco, and insurance premium taxes, in addition to hotel room, corporation capital, and horse racing taxes.

Exhibit 5.4 shows the rate of growth in major categories of taxation revenue compared with the rate of growth in the province's Gross Domestic Product (GDP) over the years, 1989 to 1993. The GDP is used in this figure as an indicator of the province's economy. As in Exhibit 5.2, 1989 is taken as the base year for the comparison. The GDP data are for each calendar year ended in the respective government fiscal year.

Exhibit 5.4

Change in Taxation Revenue, 1989 to 1993

Rate of change in taxation revenue by major categories compared to Gross Domestic Product (GDP), indexed to 1989 (1989 = 100)



Sources: The Public Accounts for financial figures, Statistics Canada for the province's GDP figures

Expenditure

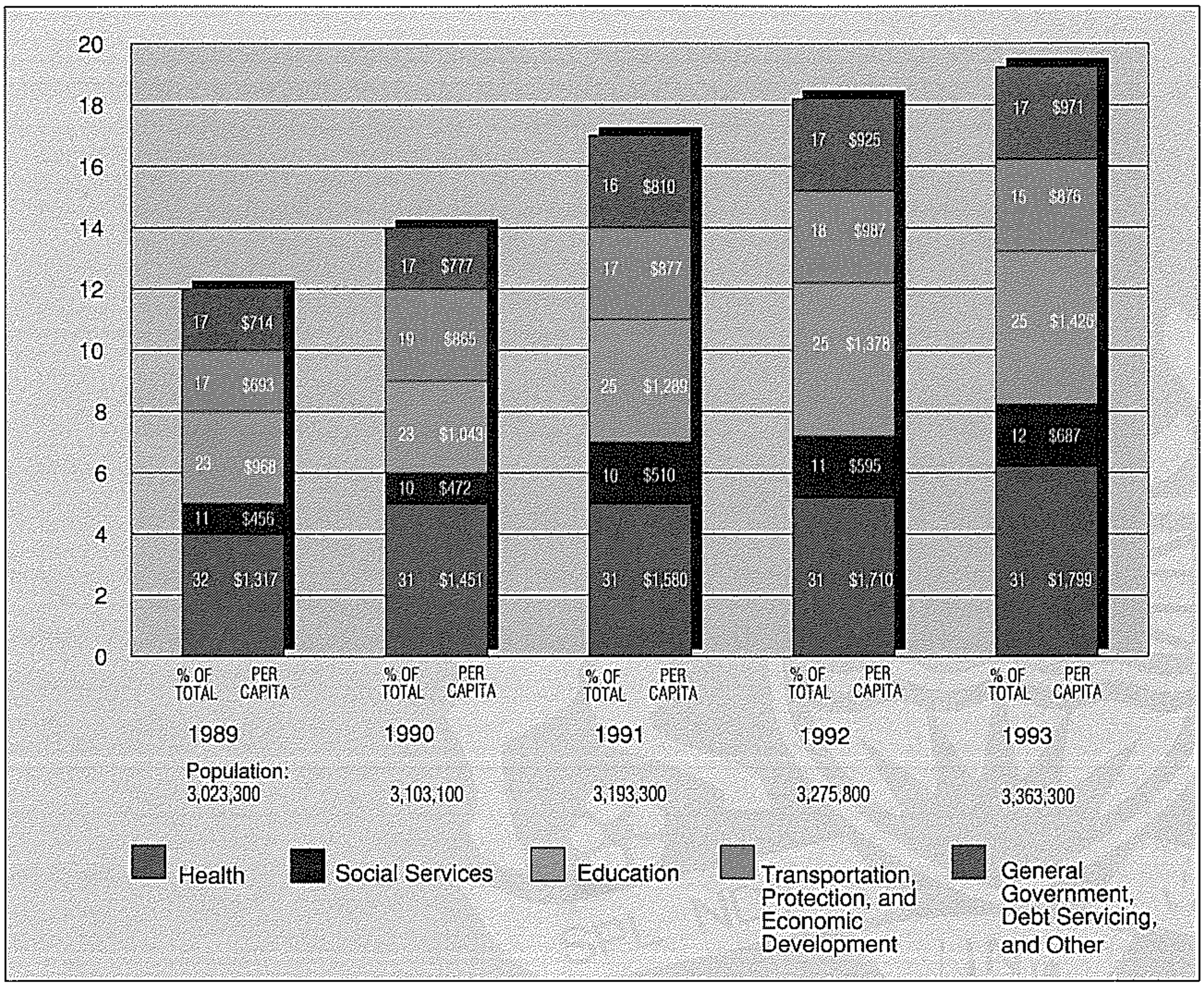
In the last five years, health, education, and social services combined have accounted for an average of 66% of the total expenditure of the province:

- Health costs have increased from $4.0 billion in 1989 to $6.1 billion in 1993, an increase of 52% over the past five years. In the 1992/93 fiscal year, the increase slowed to 8% over the previous year.
- The cost of educating our students has increased from $2.9 billion in 1989 to $4.8 billion in 1993, an increase of 64% over the past five years. In the 1992/93 fiscal year, the increase slowed to 6% over the previous year.

Exhibit 5.5

Expenditures, 1989 to 1993

Expenditures by function groups, in total, % of total, and per capita ($ Billions)



Sources: The Public Accounts for financial figures, Statistics Canada for population statistics

- The cost of social services has increased from $1.4 billion in 1989 to $2.3 billion in 1993, an increase of 68% over the past five years. In the 1992/93 fiscal year, the increase accelerated to 18% over the previous year.

In the same five-year period, the province's population increased by 12% from 3 million to 3.5 million, and its GDP grew by 24% from $70 billion to $87 billion.

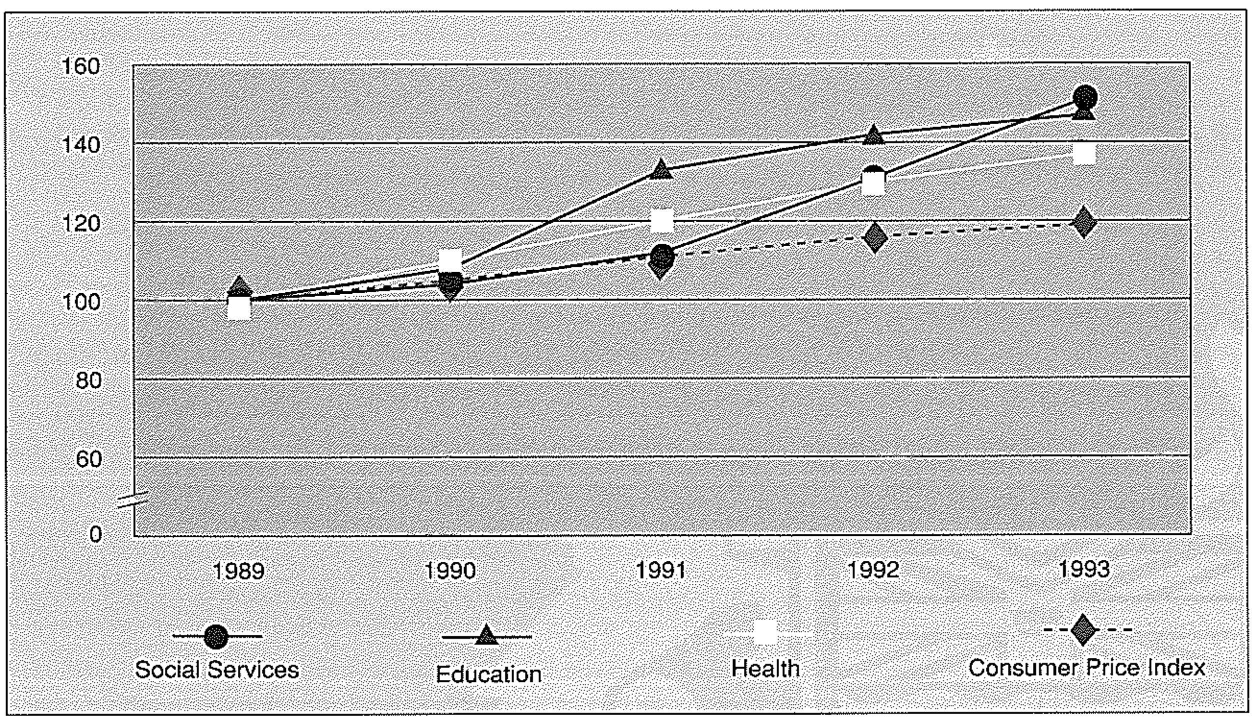
Exhibit 5.5 shows the province's total expenditure for each of the last five years. Expenditure is divided into five groups based on "functions." The three major functions—health, social services, and education—are shown separately. Transportation, economic development, and protection of persons and property functions are grouped, as are the general government, debt servicing, and all other functions. Exhibit 5.5 also provides information on average expenditure per resident of British Columbia (per capita expenditure) in each function group. For each function group, the percentage of expenditure in that group to the total government expenditure is shown.

Exhibit 5.6 shows the rate of change in expenditure per capita over the last five years for health, education, and social services.

Exhibit 5.6

Change in Expenditures, 1989 to 1993

Rate of change in per capita expenditure for health, social services, and education, and in the Consumer Price Index (CPI), indexed to 1989 (1989 = 100)



Sources: The Public Accounts for financial figures, Statistics Canada for population statistics and CPI

These three functions together accounted for 68% of the province's expenditures in 1993 (66% in 1992). To show the change over the five-year period, the expenditure in each category has been indexed to the year 1989. The expenditure is in actual dollars and has not been adjusted for inflation. However, the British Columbia Consumer Price Index is plotted in Exhibit 5.6 to show the general increase in prices in the province, indexed to 1989, for comparison purposes. The information has not been adjusted for the change in administration of property taxes which is explained in our discussion about Exhibit 5.2. As a result of this change 1991 shows a $307 million, or 10%, increase over two years based on 1989 expenditures.

Deficit

The consolidated net expenditure (known as the annual deficit) of the province—the excess of expenditure (operating and capital) over revenue—is an important indicator of the province's financial performance. The annual deficit for 1993 was $1.7 billion, or 9% of the year's total revenue of $17.7 billion. The accumulated deficit of the province—the total of all government deficits and surpluses—amounted to $6.6 billion at the end of the fiscal year 1993.

Exhibit 5.7 shows changes in British Columbia's accumulated deficit over the past five fiscal years.

Exhibit 5.8 provides additional information on the accumulated deficit, based on information in the Exhibit 5.7.

Exhibit 5.9 shows the rate of change in the province's GDP compared with the rate of change in accumulated deficit at each fiscal year end, 1989 to 1993, indexed to 1989.

Exhibit 5.7

Accumulated Deficit, 1989 to 1993

Accumulated deficit over the past five years ($ Millions)

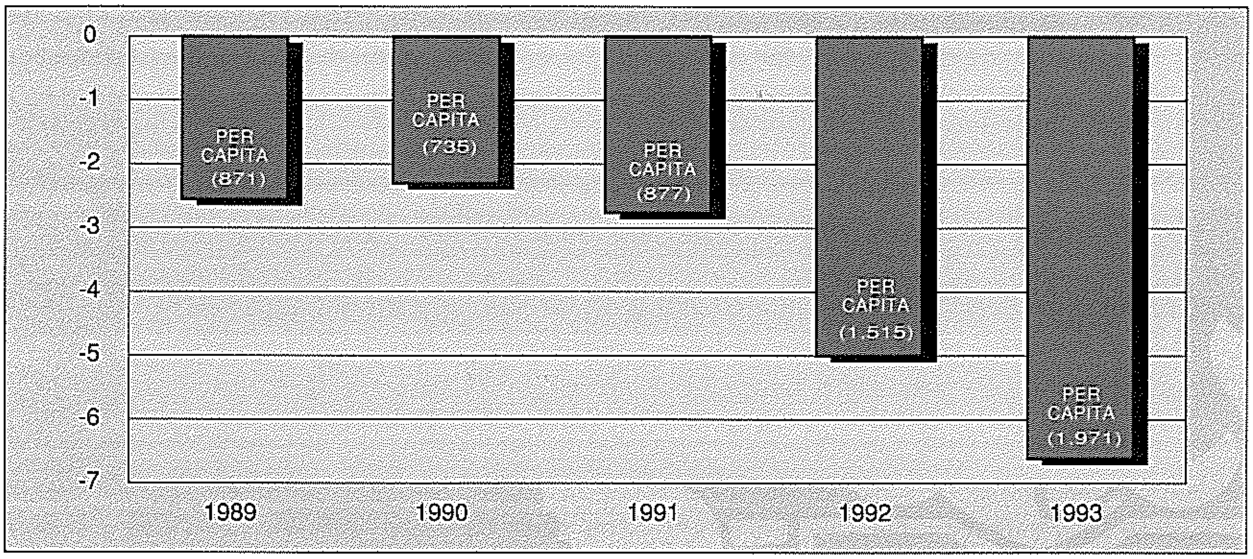
Year ended March 31	1989	1990	1991	1992	1993
Accumulated deficit, beginning of year	(3,483)	(2,632)	(2,281)	(2,800)	(4,963)
Surplus/(deficit) for year	851	351	(519)	(2,163)	(1,667)
Accumulated deficit, end of year	(2,632)	(2,281)	(2,800)	(4,963)	(6,630)

Source: The Public Accounts

Exhibit 5.8

Accumulated Deficit, 1989 to 1993

Accumulated deficit including per capita amount over the past five years ($ Billions)

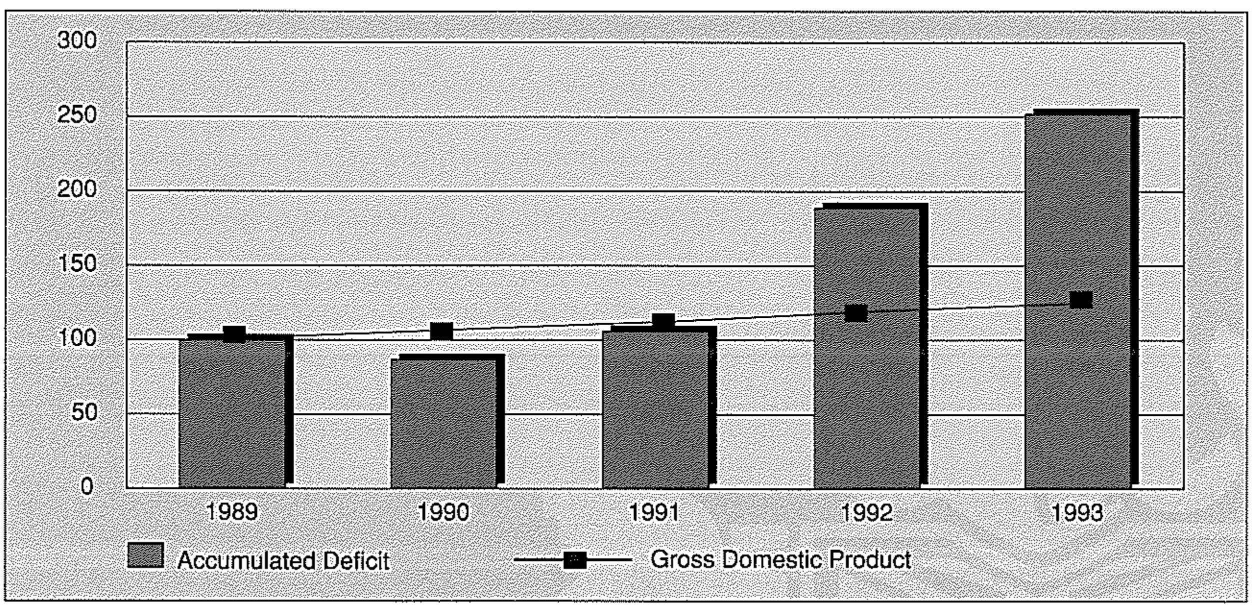


Sources: The Public Accounts for financial figures, Statistics Canada for population statistics

Exhibit 5.9

Accumulated Deficit and Gross Domestic Product (GDP), 1989 to 1993

Rate of change in accumulated deficit and in GDP, indexed to 1989 (1989 = 100)



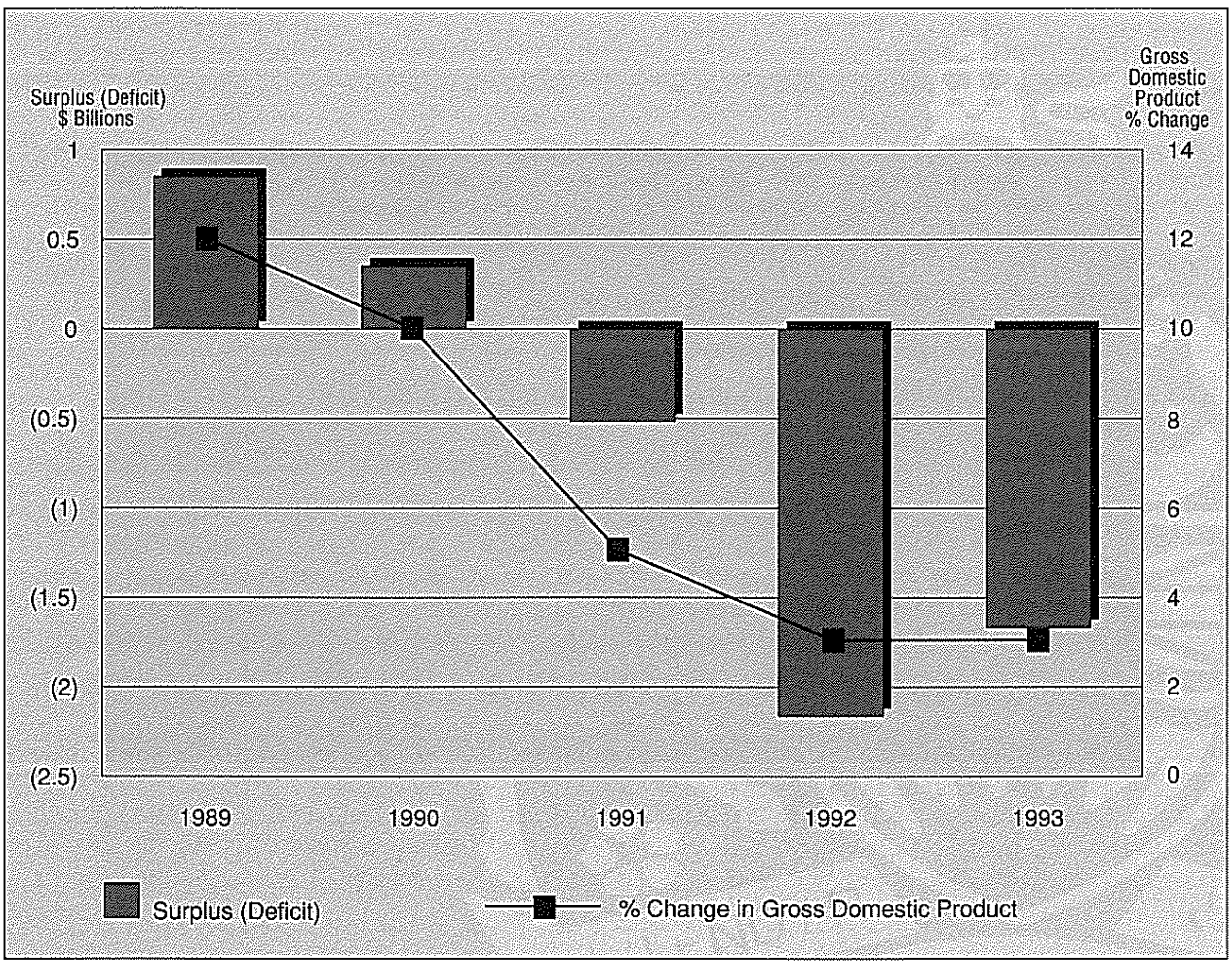
Sources: The Public Accounts for financial figures, Statistics Canada for the province's GDP figures

Exhibit 5.10 shows the annual deficit compared to the growth in the provincial economy represented by the percentage change in GDP. From 1989 to 1992, the annual growth in the provincial economy dropped from 11.4% to 3.0%. Also during this period, the annual results of government operations worsened to the point that, whereas the government had a surplus of $0.9 billion in 1989, it had a deficit of $2.2 billion in 1992. In 1993, there was only a slight change in economic growth, but a smaller deficit compared with that in 1992. This suggests that the structural deficit has been reduced.

Exhibit 5.10

Annual Surplus (Deficit) Compared to Change in Gross Domestic Product (GDP), 1989 to 1993

Annual surplus (deficit) compared to percentage change in GDP ($ Billions)



Sources: The Public Accounts for financial figures, Statistics Canada for the province's GDP figures

Public Debt

The province has been borrowing in the capital market for two purposes: first, for its own needs and second, to lend funds through its Fiscal Agency Loan Program to government and other public sector entities. A complete list of the entities receiving funds through the loan program is presented in Note 9 of the Summary Financial Statements.

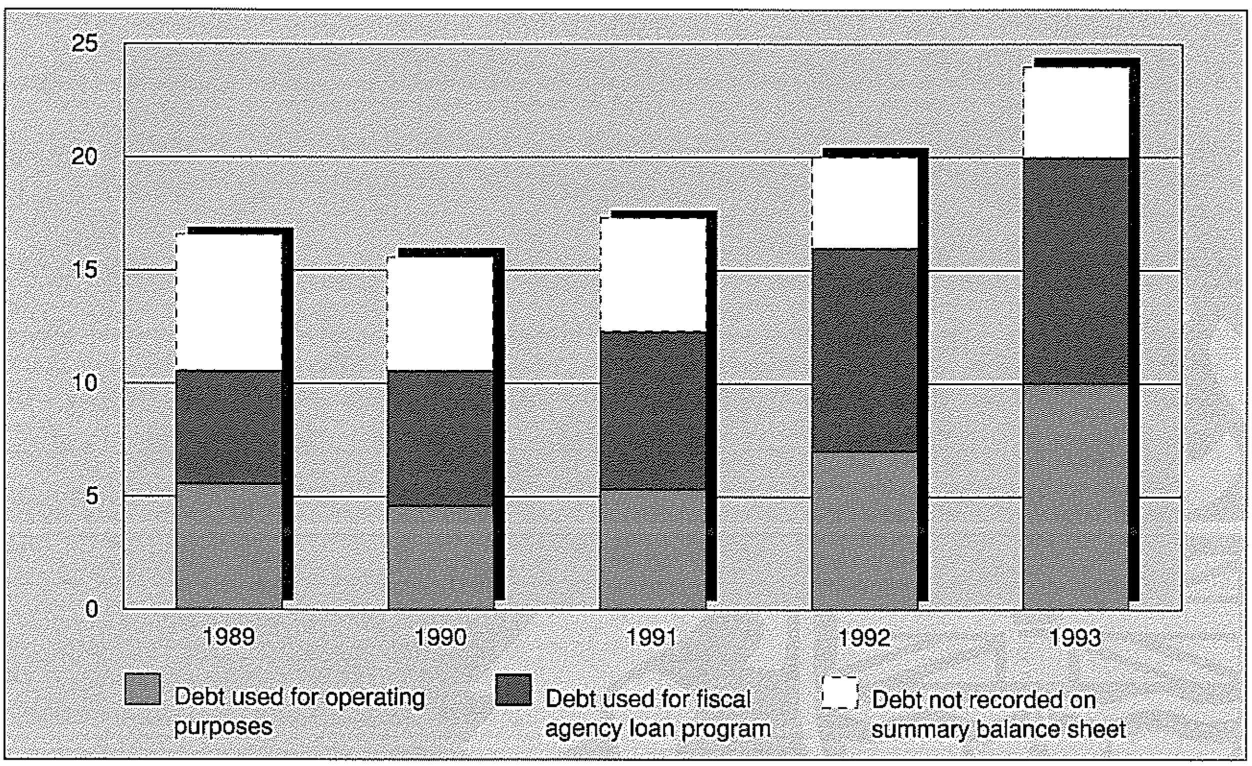
Loan recipients include British Columbia Transit, British Columbia Hydro and Power Authority, British Columbia Ferry Corporation, school districts, regional hospital districts, and advanced education institutions.

Exhibit 5.11 shows the amount of public debt at March 31 for each of the years, 1989 to 1993. During the last five years, the total funds borrowed by the province and recorded as public debt in the Summary Financial Statements has increased 83.1% from $10.8 billion in 1989 to $19.8 billion in 1993. These amounts do not include amounts borrowed by the province's Crown corporations from sources outside the government (also shown in Exhibit 5.11).

Exhibit 5.11

Total Public Debt, 1989 to 1993

Debt by category, including debt not recorded in the Summary Financial Statements, over the past five years ($ Billions)



Sources: The Public Accounts for financial figures, Statistics Canada for the population statistics

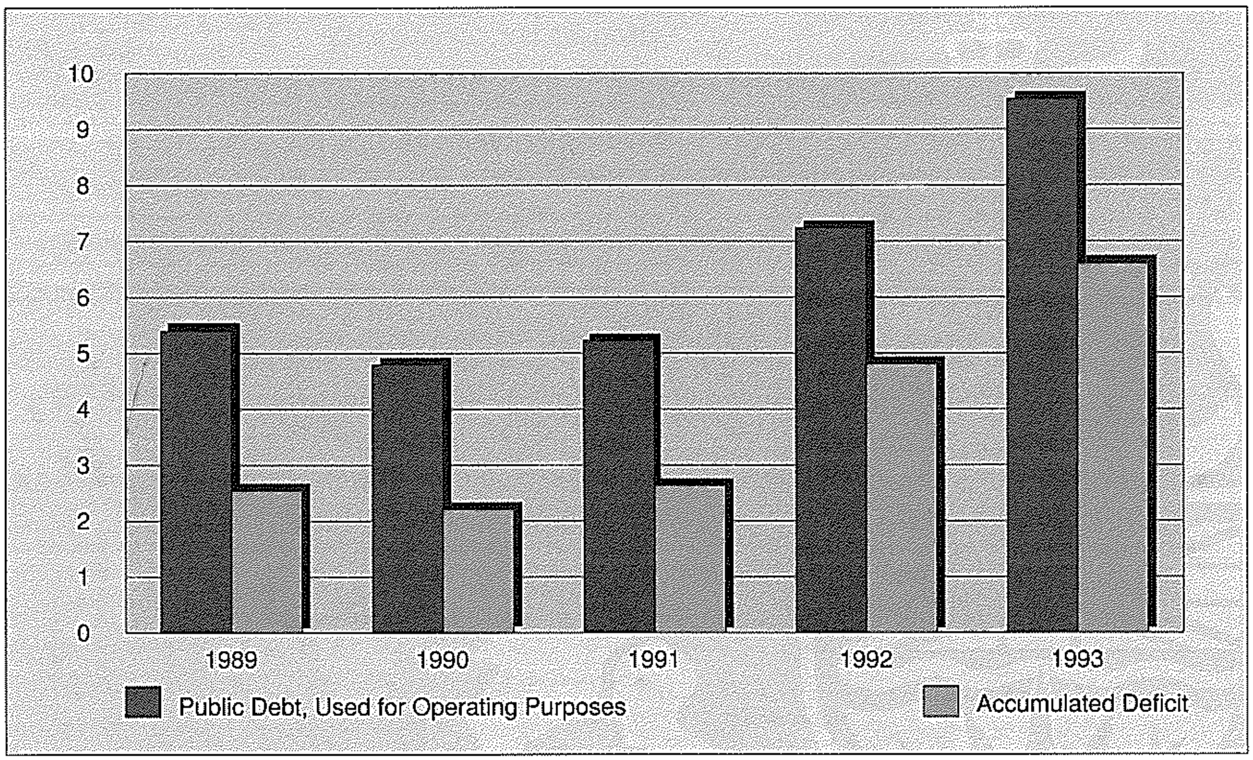
Exhibit 5.12 shows the balance of monies borrowed for government operating purposes at the end of each of the last five fiscal years, compared with the accumulated deficit balances at the same dates.

The province's debt for operating purposes exceeds the accumulated deficit. In addition to financing its deficits, the government uses borrowed funds for other purposes.

Exhibit 5.12

Operating Debt and Accumulated Deficit, 1989 to 1993

Public debt used for operating purposes and the accumulated deficit ($ Billions)



Source: The Public Accounts

Comments on Internal Control and Other Reviews

Comments on Internal Control and Other Reviews

Contents

New Corporate Accounting System

Office of the Comptroller General

A review of the adequacy of the internal controls built into the new corporate accounting system

Review Purpose and Scope

We assessed controls built into the Corporate Accounting System (CAS) to ensure the integrity and accuracy of transactions processed by the general ledger and accounts payable applications for the Office of the Comptroller General and pilot ministries. We wanted to find out if adequate controls were in place to ensure that:

- only appropriate data are accepted; and
- deterioration, manipulation, and loss of accepted data are prevented.

We also reviewed the controls in, and implementation procedures of, the new interface connecting the non-pilot ministries to CAS, as well as the overall status of the project to the date of our review. Our aim was to assess, based on our observations of the project's success, what further work we should undertake before relying on the controls in CAS for our audit of the government financial statements.

We conducted this review in the month of August 1993.

Overall Conclusion

We concluded that the controls built into the CAS applications completed to the date of our review (the new general ledger and accounts payable) are adequate. We also concluded that the controls in the design of the new interface program are appropriate, although procedures established to ensure its proper implementation had not, in all cases, been adhered to.

As CAS is nearing completion of its first significant phase (completion of the general ledger, accounts payable, purchase order, and encumbrance accounting applications), we believe that a complete post-implementation review should be undertaken to confirm the future direction of CAS.

Introduction

The Corporate Accounting System (CAS) is an information system designed to record and process the financial transactions of the Government of British Columbia and to produce financial reports for ministry management and the Office of the Comptroller General. It was envisaged to be a system widely used in the government of British Columbia, simple to operate, responsive to business needs, and capable of being integrated with the normal work process.

The system is still under development. Once it is in place, any authorized transaction entered anywhere in the province will update the system—including the government general ledger maintained by the Office of the Comptroller General—to reflect the new financial status. When completed, it is planned that CAS will perform the following functions:

- expenditure management, including project costing, commitment control, expenditure processing, and payment processing;
- revenue management, including accounts receivable and revenue processing;
- asset control;
- liability management; and
- data extraction and reporting support, including financial management reporting and financial statement presentation.

At the time of our review, the conversion of the old general ledger to the new general ledger was complete. The few ministries and special offices (together referred to as pilot ministries) that were the initial on-line users of the CAS general ledger, accounts payable, purchase order, and encumbrance applications were directly linked to the system and its accounts payable payment component. Also, under way during our review was the implementation of a new interface to connect all other ministries (non-pilot) to CAS.

Exhibit 6.1 shows the conversion phases from the old Central Accounting System to the new Corporate Accounting System.

Summary of Findings

A new general ledger was installed in the Office of the Comptroller General (OCG) in 1987 as the first of the CAS applications. It enhanced the OCG's process of preparing the government financial statements. However, the new general ledger continued to be updated by the remaining parts of the old "batching" system until 1993, when the development of the accounts payable application of CAS was completed and pilot ministries were given on-line access.

The new general ledger and accounts payable applications are currently in operation at the corporate level, in both the OCG and the pilot ministries. We examined the controls designed in these applications and found them to be adequate.

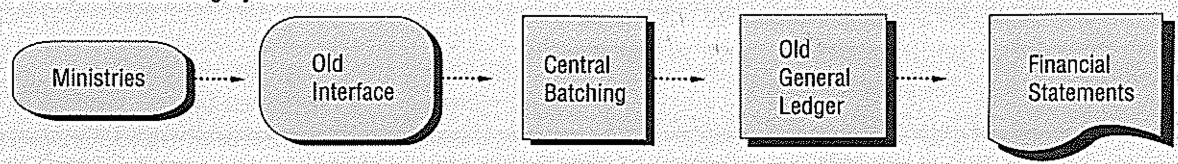
The CAS project had planned for a new interface to be created to allow the remaining ministries to be directly connected to the new

Exhibit 6.1

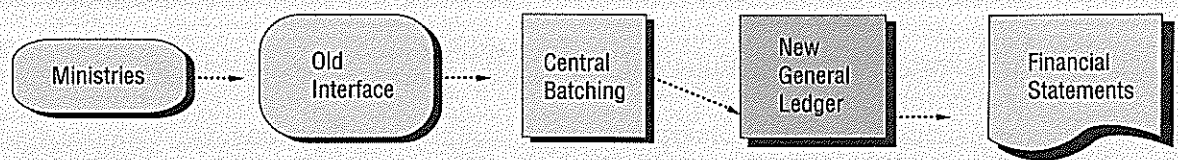
Government Accounting System

The transition from the old Central Accounting System to the new Corporate Accounting System (CAS)

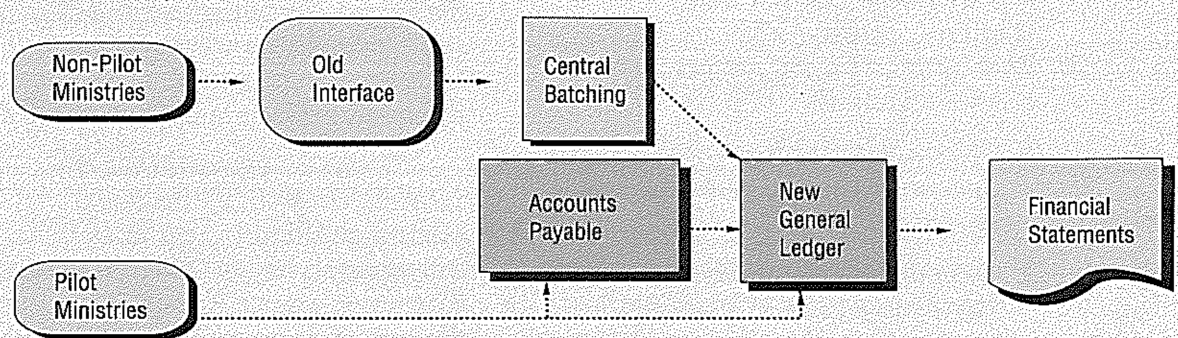
1. The Old Accounting System Before 1987



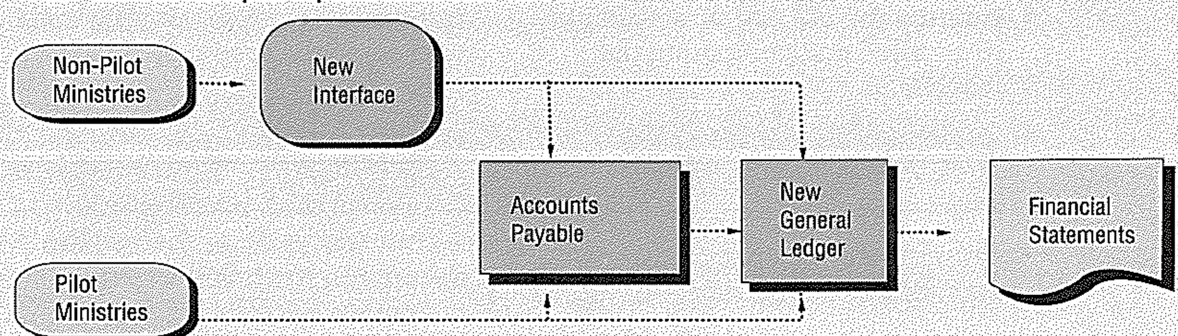
2. Introduction of the New General Ledger 1987



3. Pilot Ministry Implementation April 1993



4. New Interface Attempted Implementation June 1993



Source: Information obtained from the CAS office accounts payable and general ledger. As the interface was not operational at the time of our review, we based our initial assessment of its processing controls on the system design. We found these controls adequate, too. However, when the new interface was implemented, many problems were encountered and implementation was postponed.

The procedures used for the implementation we found to be adequate but not always adhered to. This adversely affected the progress of the CAS project and compromised the reliability of the data entered by non-pilot ministries into CAS files during the attempted implementation. We believe that proper and adequate application of controls could have significantly reduced the implementation problems encountered by the project. These controls include:

- obtaining written acceptance at the completion of each stage of the project;
- ensuring adequate change control procedures to be in place before implementation;
- running a full "cradle-to-grave" test for each ministry;
- running the old and new systems in parallel, and comparing the results;
- implementing the system in more manageable or smaller stages; and
- communicating effectively with appropriate user groups.

We also noted a few incidents of inadequate user documentation and training, weak system security and access controls, and inadequate testing, especially for the interface with non-pilot ministries.

In general, we believe, the CAS project team followed a well thought-out process, put together in the original government accounting strategic plan and its 1992 revision, for producing a quality system on time. Time constraints, limitations placed on the project resources before identifying system requirements, and, eventually, administrative pressures may have contributed to the initial failure of the implementation process connecting non-pilot ministries to the new CAS applications.

Background

With the passage of the *Financial Administration Act* in 1981, ministries were given increased responsibility for financial management and control.

It was recognized that the existing centralized financial system could not meet the information needs of all ministries. Therefore, the OCG began a process of decentralizing financial systems while retaining functional responsibility for these systems. Ministries were given the responsibility of developing their own financial systems.

A wide variety of financial systems resulted from decentralization. Most ministries developed their own financial accounting system, such as the Sakamoto, Rock and Brown - Budgetary Accounting System (SRB-BAS), and the Government Management Accounting and Control System (GMACS). These

Exhibit 6.2

History of the Corporate Accounting System (CAS) Project

Synopsis of the main events and decisions that affected the progress of the project

1984

The Walker Interactive Integrated accounting package was acquired by the Office of the Comptroller General (OCG). It was to be implemented in three stages. The Office of the Auditor General made recommendations about its proposed development and implementation in a management letter to the Minister of Finance.

1987

The Walker general ledger implementation was complete at OCG. Implementation of the remainder of the package was discontinued because of high costs, lack of timely information, and excessive storage requirements.

1988 December

A Task Force was established in response to general dissatisfaction among ministries over the timeliness and quality of financial information. Its mandate was to develop a strategic plan for government financial systems (GASSP).

1989 January

The Task Force identified financial software in use, ministries' financial systems plans, and the direction of decentralization within government. The recommended strategy was to introduce a government-wide accounting and financial program based on a common database and supported by a single packaged software solution.

1989 April

Treasury Board approved the Task Force report. The GASSP project was created to carry out the recommendations of the report. The project was granted $350,000 from the Contingencies Vote for 1989/90.

July

Sierra Systems Consultants Inc. was engaged by OCG to put together a list of general requirements for the corporate function, and to develop appropriate evaluation criteria for the software vendor selection.

September

The Sierra report was received and reviewed. DMR Consultants were contracted to complete the requirements model by highlighting necessary, basic architectural and design features.

1990 January

The General Requirements document was distributed to all ministries and signed-off by a majority of them.

April

GASSP was given the go-ahead to begin the software selection process

May

Deloitte & Touche Management Consultants were selected to carry out the selection process. The Master Project Plan was completed.

August

Deloitte & Touche Management Consultants recommended Walker Interactive Integrated software.

1990 November
The GASSP project was discontinued after a Treasury Board decision to freeze funding for certain projects.

1991 May
A budget of $3,360,000 for 1991/92 was approved to begin the implementation phase ($450,000 from the Ministry of Finance and Corporate Relations' budget allocation; and $2,910,000 from the Contingencies Vote).

1991 September
GASSP project was again under way.

1992 March
An amount of $5,950,000 included in the Ministry of Finance and Corporate Relations' budget for 1992/93 was approved to complete the on-line pilot implementation.

1992 April
A Request for Proposal (RFP) was issued to identify a contractor who would develop detailed business requirements and design specifications, customize and implement the previously acquired Walker Interactive Integrated modules, and provide systems analysis and technical resources.

May
Amongst proposals received, Synerlogic (an Andersen Consulting Company) was declared the winning vendor. The winning bid for all phases was approximately $1.2 million. At the request of OCG, a Status Report was prepared by British Columbia Systems Corporation (BCSC). The report concluded that while the business vision was good, there was not general acceptance of the technical strategy to implement the vision. The recommendation was to bring into the project a management team that would provide strong direction in defining benefits, deliverables, acceptance, etc. It recognized the fact that in an environment where funding was uncertain and many user ministries were involved, the project had to take a realistic view of what was achievable.

June
Project management and coordination responsibility was transferred from OCG to BCSC, which was engaged to act as general contractor.

July
Synerlogic was subcontracted for the work outlined in the RFP.

August
Treasury Board approved the contract with Synerlogic. The contract was funded from the Ministry of Finance and Corporate Relations' Vote. The Implementation Strategy, including implementation deadlines, was set and approved by the Corporate Accounting System (CAS) Executive Steering Committee.

December
After the business requirements and specifications were finalized, it was determined that there were insufficient resources to complete the implementation work plan according to the original deadlines. To avoid compromising good systems implementation practices as a result of time and resource shortages, implementation deadlines were postponed, with the approval of the CAS Executive Steering Committee.

1993 February
The Walker general ledger module was implemented at OCG.

1993 March

A $3,801,000 budget was approved for 1993/94 to complete the on-line pilot implementation, conduct the post-implementation review, and fund the operating costs for the on-line pilot ministries. The funds were provided for in the Ministry of Finance and Corporate Relations' Vote.

April

The Walker accounts payable module was implemented at OCG. Walker financial systems were implemented at the on-line pilot ministries.

May

An attempt to interface with other ministries was aborted because of a BCSC labor disruption.

June

An attempt to interface with other ministries failed. Numerous significant problems arose during the five days that the new CAS was in production.

July

OCG, along with the CAS project management, addressed ministry concerns and problems. Together they presented the group with an action plan to "clean up" the immediate problems and to set up the preparation for the next implementation.

Currently

Two systems are in operation. The old "batching" system continues to update the new Walker general ledger and make payments for most ministries; the new system processes purchase orders, invoices, and payments for on-line pilot ministries and maintains the general ledger at OCG.

Sources: CAS Project Management Executive Steering Committee and Corporate Implementation Committee minutes

individual systems were linked to the central accounting system maintained by the OCG through different interface programs. The central accounting system was also linked to the new general ledger which produced the Public Accounts. In this environment, financial information was processed and recorded, on a cash basis, in three different places: the ministry, OCG's central accounting system, and OCG's new general ledger reporting system.

The original vision for the government accounting system strategic plan was to develop a corporate accounting system that would eliminate duplication of effort, provide timely information on an accrual basis, and accommodate the unique management information and reporting needs of individual ministries. To date:

- The new general ledger and accounts payable applications are in operation at the OCG.
- The Ministry of Government Services, Ministry of Women's Equality, Premier's Office, Information and Privacy Commissioner's Office, and Ministry of Labour and

Consumer Affairs are linked, on-line, to all new applications.

- An interface is under development to link non-pilot ministry systems directly to the new general ledger and accounts payable.

Exhibit 6.2 shows the history of CAS development.

Detailed Findings, Conclusions, and Recommendations

Our findings are summarized, where appropriate, both by type of control examined in the review and by:

- The new general ledger and accounts payable applications.
- The new interface for non-pilot ministries.
- General development.

Processing Controls

Processing controls are required to ensure that computer applications will only act when complete, accurate, and acceptable data are received, and to ensure that data being acted on are traceable.

The New General Ledger and Accounts Payable Applications

We began our examination of the processing controls in the new general ledger and accounts payable applications by identifying the minimum controls required to provide assurance that all transactions are authorized, recorded, and processed completely, accurately, and on a timely basis. To establish what controls were needed, we assessed the risk of errors that could occur, such as the risk of accepting the same authorized transaction twice. We found that the controls we determined to be required had been identified for inclusion in the system.

Next, we reviewed the CAS' Design Specification Manual to ensure that it included instructions or computer programs to detect and identify errors. We especially focused on key controls that would prevent or detect an error even if other controls failed. We found the preventive and detective controls to be adequate.

The new general ledger and accounts payable applications had been in use by the on-line pilot ministries since April 1993. This allowed us to determine if the designed controls were effective in operation. We examined the input of source documents in the production environment for both the general ledger and accounts payable applications, and tested key edit checks by comparing the anticipated error message with the actual error message. We also reviewed output documents to ensure the data were correctly posted. The edit checks on the implemented applications appeared to be adequate.

Overall, our review of the general ledger and accounts payable applications in the on-line pilot ministries indicated that key controls were in place to ensure that all transactions are authorized, recorded, and processed completely, accurately, and on a timely basis.

On-line pilot ministries are test cases for the system. Although transactions processed for these ministries account for a very small percentage of the government's transactions, it is reasonable to assume that this evaluation could be extended to all other ministries following a similar operation. At this time, however, our findings about the adequacy of processing controls relate only to the on-line pilot ministries.

The New Interface for Non-Pilot Ministries

The timing of the implementation of the new interface limited our ability to examine the new interface's processing controls in the same way that we examined the applications already in operation. We did, however, review the designed controls, focusing in particular on high risk areas such as the electronic transfer of journal vouchers, cheque requisitions, and deposits through the interface. We were satisfied that the designed processing controls in the new interface were adequate to prevent errors.

Access Security and Change Controls

Access security controls are required to ensure that only authorized data are processed.

Change controls are required to ensure that only authorized, tested, and documented changes are made during maintenance of the system.

General Development

We found the security process used to control user access to the new system to be adequate.

Any potential user must be granted appropriate access permit to the system. The security administrator reviews the records of access made to the system each month and issues appropriate reports for ministries' review.

We tested the limitations of user access. At one ministry we found that a data entry clerk was capable of posting transactions from a screen that should have been accessible only to a person with payment authority. We determined that adequate controls to establish and monitor user access were built into the system, but the ministry did not follow the required procedures.

Having user groups determine criteria for controlling access has established a reasonable division of duties.

We recommend that at this stage, access privileges of user group members be reviewed to ensure the access allowed to individuals in each group is appropriate.

Procedures controlling changes to the system we found to be inadequate. They need to be improved and formalized.

We recommend that all requests for change, and their authorization and final acceptance, be recorded and any changes made be documented before implementation; the transfer of a changed system into the production library be authorized by persons independent of those responsible for making the change; and emergency change procedures be developed and adhered to.

Documentation Controls

Documentation controls are required to ensure that computer applications, programs, and instructions are adequately described in writing, maintained securely, and protected from unauthorized change.

General Development

Documentation for CAS is adequate, though it has not yet been consolidated. The original plan calls for consolidation in a later stage of the system's development. User procedure manuals were not ready before implementation.

We recommend that appropriate instructions for restarting the system, recovering data, and carrying on normal operation of system be issued as soon as possible. We also recommend that live production not be attempted unless adequate training has been provided and procedures have been documented.

Testing Controls

Testing controls are required to ensure that computer applications are subjected to appropriate, complete, and objective evaluation of their ability to handle all situations correctly, and to ensure that all identified deficiencies are reviewed and resolved before implementation.

The New General Ledger and Accounts Payable Applications

Adequate testing of the new general ledger and accounts payable applications was performed for the pilot ministries.

The New Interface for Non-Pilot Ministries

We found that the test plans for the new interface were adequately prepared, but the time allowed for testing was unrealistic.

In any systems development project, testing is performed to provide a high level of assurance that the final system complies with the agreed requirements and design specifications. To attain such assurance, every functional area of the system must be tested, usually with users. We believe that the tests performed were insufficient to provide an adequate level of assurance about the interface.

Communication Procedures

Effective communication throughout the development of a system is important to ensure that all valid concerns from senior management, systems development staff, and users are considered. Involvement from all groups promotes acceptance.

The New General Ledger and Accounts Payable Applications

Communication with on-line pilot ministries was more open than for other ministries for the general ledger and accounts payable applications. Memoranda of understanding were developed for on-line pilot ministries, clearly defining each party's responsibility.

The New Interface for Non-Pilot Ministries

Throughout the development of the new interface, communication was neither effective nor consistent. To improve communication, project management attempted, but unsuccessfully, to strike a balance between ministry involvement and making use of project staff.

Focus groups were formed to facilitate communication, but without clear formal terms of reference failed to be effective. No memorandum of understanding exists for non-pilot ministries.

The complete CAS is a government-wide project and requires a mechanism, perhaps more elaborate than that used in the pilot ministries, to coordinate the flow of development information amongst all parties involved.

We recommend that for all large-scale undertakings in the future, project management develop a communication strategy and ensure it is carried out effectively.

Implementation Procedures

The development process involves a series of controlled procedures that must be followed during the implementation of a system. Adherence to the process ensures that new systems will provide all required information and be operational; that systems development will be completed on time and within budget; and that users of new systems will be able to rely on the system.

General Development

We noted significant control weaknesses during the system's implementation process, including:

- lack of formal acceptance of completion at each stage of implementation;
- the use of fixed-price contract for work that covered interdependent phases of implementation; and
- poor projection and monitoring of costs, benefits, and net savings.

Formal Acceptance

The sign-off and approval process is an important control for monitoring progress and assigning accountability.

We found that requirements for signing off at certain stages were adequately planned but loosely followed. Verbal approval or acceptance should have been ratified in writing as soon as possible. Formal, written sign-off took place only in a few cases throughout the development process.

We recommend that a formal acceptance process be followed and enforced for the remainder of the project.

Service Contracts

The Request for Proposal (RFP) for consulting services to implement CAS called for an all-inclusive price to supply a team that would produce the required results within a specified time. Because the RFP also called for a re-examination of requirements and specifications, which would be used to determine the nature and extent of the work to be done on the next stage, the fixed price also covered work to produce results largely unknown. This, in our opinion, is unwise. If unexpected results turned up and additional efforts were needed to address them, the temptation under a fixed-price contract might be to adhere to contracted costs and target dates at the expense of quality control.

We recommend that, in order to sustain good implementation practices, future fixed-price contracts not be entered into for *deliverables covering more than one stage of development.*

Cost-Benefit Analysis

Cost-benefit analysis is used to provide quantifiable justification for adopting a development or acquisition project. It is also used to monitor the continued economic viability of a project.

After the software selection process in this project, an attempt was made to estimate the net savings that could be achieved by implementing the government accounting system strategic plan. We found these estimates to be very preliminary. They were not continuously refined as the project progressed.

We recommend that, for future project development, adequate analysis of costs and benefits be done at the earliest stages and continuously updated throughout the development cycle.

The New Interface for Non-Pilot Ministries

For the new interface, we noted two important weaknesses that contributed to the failure of its implementation. These were poor communication and inadequate implementation resources. The former has already been discussed (under "Communication Procedures"); the latter is discussed below.

Implementation Resources

Adequate resources are necessary to ensure properly controlled implementation.

For this project, we found that management did not plan sufficient resources for implementing the interface. The CAS team encountered difficulties in defining requirements for the interface because of (1) different requirements among ministries and (2) in some cases, poor ministry interface documentation. To meet implementation deadlines, some controls were relaxed during the project. This caused errors, especially in the supplier file and in the interface process.

At the time of our review, ministries had not been able to reconcile financial data from the central system with their own records since May 1993. The province's bank accounts had also not been reconciled since May 1993, primarily because duplicate cheques were issued. We are concerned that without these fundamental controls, the integrity of the new general ledger and accounts payable data may be seriously at risk.

We recommend that the CAS office and the ministries continue to focus their efforts on the cleanup and reconciliation process. We also recommend that, for the remaining work on this large system, a phased implementation strategy be adopted to minimize the risks involved in any single step implementation.

Future Direction

The original Task Force recommendation called for a shared database and common software to be implemented by March 1994. At the time of our review, only parts of the system had been successfully implemented at OCG, the on-line pilot ministries, and a few special offices. Less than 2% of the government's total expenditures have been processed through the accounts payable component of the system; the remaining 98% continues to be processed through the old central batching system. We understand that the government is considering, as an alternative, to maintain the central batching system rather than allocating further resources to expand the link to the CAS.

In the months ahead, the project may begin expanding the link between the CAS and all ministries (other than those already linked) in order to process commitments, purchase orders, and invoices and to record accounts payable. Longer range plans include adding other business functions such as the management of revenue, accounts receivable, and fixed assets. Work has already started in these areas. Implementation plans have not been approved, but it is expected to be a phased process (ministry by ministry).

After four years, the current status of the project falls short of the original vision described in the 1989 Task Force report. The direct cost of the project has been $10 million, which does not include the hidden costs associated with it, such as for payroll and overhead costs of information technology personnel from participating ministries. Estimating the hidden cost is difficult, but it may exceed $500,000.

The original cost estimate for completing the project was $13.6 million. Significant funding is still required to complete the interface and to bring the remaining ministries onto the new system. Migration of existing systems onto the new system was originally budgeted to cost $6 million. We believe this to be a conservative estimate, given the significant number of financial systems and subsystems that may have to be modified.

At the time of our review, a post-implementation review of the on-line pilot system was scheduled to take place approximately six months after its implementation. The results of this review will determine future funding and resources for the project.

We encourage the government to reexamine all costs associated with completing the system according to the stated vision of the project or an acceptable alternative goal. This is the only way it can ensure that the overall benefits arising from the completed system justify continued work on it. We suggest, too, that all future significant system developments or enhancements proposed for ministries be evaluated with the government's overall corporate accounting initiative in mind.

Response of the Office of the Comptroller General

New Corporate Accounting System

The development and piloting of a corporate accounting system for government has been a complex and lengthy process. Financial information is an integral and essential part of the management of all government programs and as such is vitally important to good government. Financial systems represent a significant investment of resources.

The new system is designed to meet new requirements in government accounting, to reduce the current duplication of effort and to provide much needed flexibility in meeting managers' needs for information.

It is very timely that the Auditor General has reviewed the system, as it is currently operating in the pilot sites, for its controls and integrity.

In our opinion, the problems that were encountered in the attempt to interface existing ministry financial systems to the new corporate system underscore the importance of the strategy. The only interfaces that should be necessary are between program systems and the financial system. Given a common financial system, the interfaces between it and the programs remain the same regardless of which ministry administers them. Government reorganizations become less costly to accomplish.

The Auditor General has noted that some bank account reconciliations were delayed due to the problems. These are now up to date.

We are currently performing a complete review of the system including the benefits and the costs associated with it. It should be noted that the original cost figures quoted in the Report were estimated in 1989 dollars.

Continued implementation will, of course, depend upon a satisfactory review, but it is clear that the original plan will be carefully assessed particularly with respect to whether to continue work on the new interface or to concentrate our efforts in directly converting ministries to the new system.

Detailed comments on the "Detailed Findings, Conclusions, and Recommendations:" are set out below.

Access Security and Change Controls

All system changes are now documented and authorized by user management prior to implementation.

Recent staff acquisitions have enabled management to properly segregate conflicting duties. Changes introduced into the production library are now carried out by a person independent of those who made the change.

Emergency change procedures have been developed and are being followed.

Documentation Controls

User procedure manuals in final draft form have been provided to ministries.

Operations documentation is currently being finalized.

Testing Controls

Management agrees. The implementation strategy of converting all interface ministries at once was a contributing factor in testing deficiencies.

Communication Procedures

Management agrees. Regular communication of planned activities affecting interface ministries have been improved. Future *implementation plans will include a communications component, with roles and responsibilities of all parties clearly defined.*

Implementation Procedures

Formal Acceptance:

Current project management felt that, with some exceptions, formal written sign-off procedures were followed. However, the original sign-off matrix, prepared in 1990, will be reviewed and updated to reflect current requirements.

Service Contracts:

Management agrees.

Cost-Benefit Analysis:

A Post Implementation Review of the project is currently underway with a target completion date of December 31, 1993. An up-to-date cost benefit analysis will be provided in the report.

New Interface for Non-Pilot Ministries

Implementation resources:

All accounts have now been reconciled. Duplicate cheques issued were limited to one ministry and involved $33,022.96. Steps to recover funds have been taken.

A phased, ministry by ministry, implementation strategy will be followed in any future initiatives.

Future Direction

All costs are being re-examined, as part of the post-implementation review, in order to ensure that the overall benefits arising from the completed system will justify the continued work on it.

Revenue Accounting Policies

Office of the Comptroller General

A review of the appropriateness of the policies used to account for revenue in the government financial statements

Review Purpose and Scope

As part of our audit of the annual Public Accounts, we examine the government's revenue to obtain reasonable assurance that all revenues are:

- identified;
- appropriately calculated;
- recorded properly in the government's accounts; and
- presented in the Public Accounts in accordance with the government's stated accounting policies.

Under the *Auditor General Act*, we may also comment about whether the financial statements are prepared according to the most appropriate basis of accounting, for the purpose of fair presentation and disclosure. In this report, we have assessed the appropriateness of the stated revenue accounting policies as they apply to the major revenue sources in the Consolidated Revenue Fund.

Overall Conclusion

In our opinion, although the overall accounting policies for recording revenue in the government's financial statements are appropriate, the government should review its practice of recognizing income tax revenue on the cash basis. It should also provide additional guidance to ministries for a number of revenue sources where the basis for recognizing and recording revenue is currently unclear.

Background

The government's accounting policies state that:

All revenues are recorded on an accrual basis except where the accruals cannot be determined with a reasonable degree of certainty or where their estimation is impracticable. The exceptions, which normally relate to certain payments to the province under the Federal-Provincial Fiscal Arrangements and Federal Post-Secondary Education and Health Contributions Act, 1977, *are recorded on a cash basis.*

Revenues from government enterprises are recognized when cash transfers are received or when dividends are declared.

Deferred revenue represents amounts received or receivable prior to the year-end relating to revenue that will be earned in subsequent fiscal years.

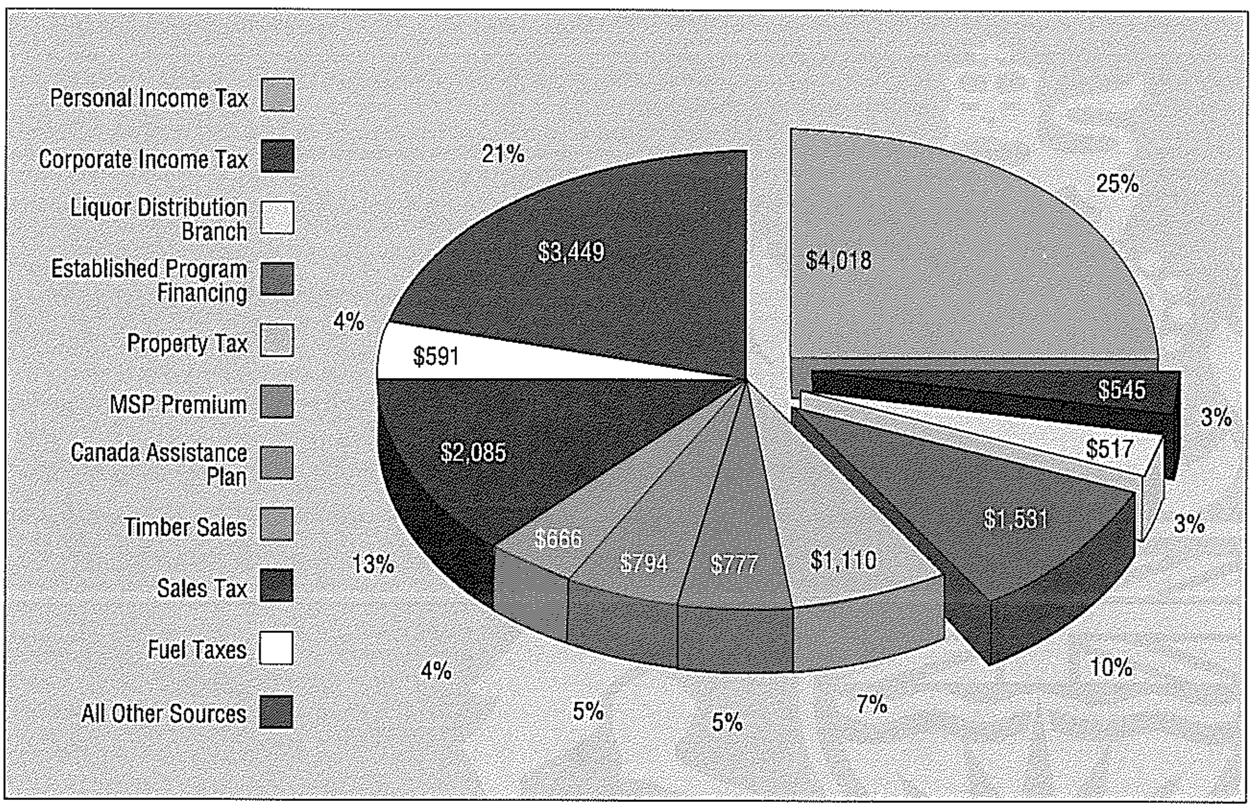
Government Revenues

Exhibit 6.3 illustrates the major sources of revenue and the bases of revenue recognition in the Consolidated Revenue Fund Financial Statements. In the 1992/93 fiscal year, $12.6 billion

Exhibit 6.3

Consolidated Revenue Fund: $16.1 Billion of Revenue

Sources of revenue and bases of revenue recognition, 1992/93 fiscal year ($ Millions)



Source: The Public Accounts

(78%) of the $16.1 billion of revenue in the Consolidated Revenue Fund came from only 10 sources. Four of the 10 ($6.6 billion or 41% of total revenue) are recognized on a cash basis. The other six ($6.0 billion or 38% of total revenue) are recognized on an accrual basis. The remaining revenue, from all other sources, is $3.5 billion (21% of total revenue), and is composed of smaller revenue streams primarily recorded on an accrual basis.

Revenue Recognition

The choice of when revenue is recognized affects both the annual operating surplus or deficit, and the amount of financial assets on hand to meet liabilities and future expenditures—indicators of government's fiscal management. The cash basis recognizes revenue only when cash is received. The accrual basis recognizes all revenues attributable to the period when the transaction occurs and revenue is "earned." Therefore, the cash received is adjusted for amounts received in advance and for amounts still to be collected.

In 1981, British Columbia was a leader in adopting accrual accounting. Since that time, accounting standards relating to revenue recognition have evolved and methods of measurement have improved. However, a significant portion of the government's revenue is still recognized on a cash basis.

In the private sector, accrual accounting is practiced, with the recognition of revenue being triggered by an exchange of goods or services of value. For example, the revenue from a property sale transaction would be recognized when title transfers to the new owner, while the revenue from the rental of an asset would be recognized over the period of the rental agreement. It has taken the private sector many years to develop standards to determine when an exchange has been completed and revenue earned. As time and use have led to their acceptance, these standards have been adopted as part of generally accepted accounting principles.

Only in the last few years have standard-setters paid attention to the government sector and the unique nature of its revenues. Unlike those in the private sector, government revenues are often not triggered by a direct exchange of goods or services of value. Therefore the timing of revenue recognition is more difficult to determine.

In 1986, the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants issued general guidance on when government revenues should be recognized. In 1990, the Government Accounting Standards Board (GASB) in the United States came out with more detailed guidance, classifying government revenues as either exchange transactions or non-exchange transactions, and discussing factors relating to the consistent and appropriate recognition of revenue.

According to GASB, revenue recognition for exchange transactions is straightforward. Revenue is recognized as "earned" when the government has done what it must do to complete its side of the transaction. For example, when the government sells Crown land, the exchange is completed at the time title transfers to the purchaser. For Medical Service Plan premiums, the exchange is completed over time, and revenue is earned as the coverage is provided. As a result, if premiums are received in advance, revenue not earned is deferred; if premiums are received in arrears, revenue earned is accrued.

Where there is no exchange involved, revenue recognition is more complicated. The government is usually not required to do anything to "earn" this revenue. For non-exchange transactions, such as some fees and licenses, the point of recognition can be open to interpretation. This can lead to the inconsistent recognition of revenue among government entities and year-to-year within entities. Therefore, the point of recognition needs to be clearly understood or defined.

Even when the point of recognition is determinable, it may not be possible to accrue some types of revenue. In such cases, the cash basis represents the only option. However, we believe that when a reasonable estimate of revenue can be made, the accrual basis should be used.

Comments on Revenue Recognized on a Cash Basis

Personal Income Taxes

Personal income tax is the largest single revenue source of the government, making up 25% of the province's revenue ($4 billion). This tax is assessed and collected by the Government of Canada and remitted to the province under a federal-provincial tax collection agreement.

Throughout each year, income tax collected by the Government of Canada is shared between the federal and provincial governments on an estimated basis. The province's tax entitlements, over the years, have not been finalized by the Government of Canada until 12 months after the close of each fiscal year. Consequently, except for relatively small determinable amounts, the province has recorded, as tax revenue in each fiscal year, only the cash it receives in that year.

However, starting in 1992, the Government of Canada, for its own financial purposes, has re-estimated the split between federal and provincial income tax shares on the basis of assessment data to the end of August, and adjusted its preceding fiscal year's financial statements accordingly. This accrual process by the federal government presents an opportunity for the province, with the cooperation of federal officials, to record income tax revenues on a similar accrual basis. This would help minimize the significant adjustments to income taxation settlements between the Government of Canada and the province, which are made more than a year after each taxation year to which the settlements apply.

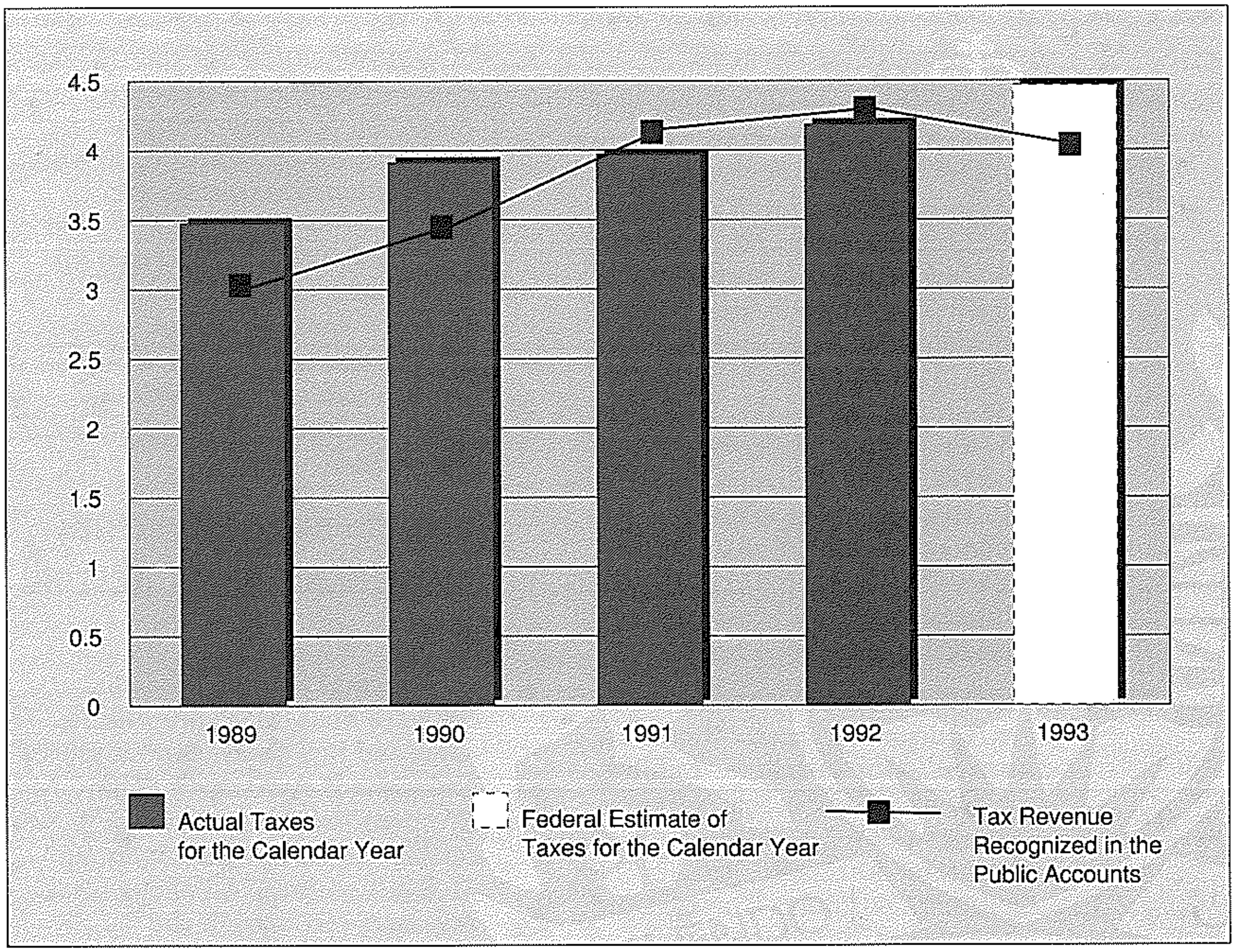
In Exhibit 6.4, the line graph shows the amount of revenue recognized in the Public Accounts for each of the government's fiscal years, 1989 to 1993. This is equal to the cash received from the federal government in each fiscal year. The bar graph represents the final tax revenue ultimately collected for each calendar year. Clearly, recording this revenue on a cash basis does not provide an accurate reflection of revenue for the period.

We urge the government to work with the federal government to arrive at the latest and best estimate of taxes collectable for each fiscal year, and to include this estimate in the annual financial statements of the government.

Exhibit 6.4

Personal Income Taxes, Each of Years Ended March 31, 1989 to 1993

Personal income taxes recognized in the Consolidated Revenue Fund compared to taxes collected for the calendar year ($ Millions)



Sources: The Public Accounts; Second estimate of payments under the tax collection agreements for the 1993 taxation year

Government Enterprises

A government enterprise is a public sector organization, owned or controlled by the government, that conducts a business of selling goods and services principally to non-government purchasers.

The stated accounting policy, for purposes of the Consolidated Revenue Fund, is to recognize revenue from government enterprises, "when cash transfers are received or when dividends are declared." This policy is very broad. In any fiscal year, a government enterprise may transfer to the consolidated revenue fund its entire earnings, a portion of its earnings, or nothing at all.

For some entities, legislation requires that, effectively, they must transfer their net income to the province. For example, the *Liquor Distribution Act* requires, for the British Columbia Liquor Distribution Branch, that any balance remaining, after administration costs are paid, be paid promptly into the consolidated revenue fund of the government. The *Lottery Corporation Act* states that the net profits of the corporation after provision for prizes and the payment of expenses of operations shall be paid into the consolidated revenue fund.

However, not all enterprises are required to transfer their net income to the province. Exhibit 6.5 compares the combined net incomes of British Columbia Hydro and Power Authority, British Columbia Buildings Corporation, and British Columbia Railway Company to the amounts transferred to the province in each of the last five years. The exhibit illustrates how the choice of when these cash transfers are made to the province affects both the annual revenue and, the annual operating deficit recorded in the Consolidated Revenue Fund Financial Statements.

At the same time, it should be noted that the annual deficit recorded in the government's Summary Financial Statements includes the operating results of all government organizations and enterprises. Accordingly, these summary statements are the most comprehensive financial statements of the government.

We believe that the accounting policy for the Consolidated Revenue Fund Financial Statements should be expanded to explicitly state which government enterprises are required to pay their annual net income to the province, and for which ones only dividends received are included as revenue. This would help clarify the basis of revenue recognition for government enterprises in the Fund statements.

Comments on Revenue Recognized on an Accrual Basis

Property taxes, Medical Services Plan (MSP) premiums, sales and fuel taxes, timber sales, and Canada Assistance Plan (CAP) revenues are the six sources referred to earlier that make up $6.0 billion (or 37%) of the total revenues recorded in the Consolidated Revenue Fund in the 1992/93 fiscal year. As mentioned, these are recognized on the accrual basis.

For MSP premiums and timber sales, revenue is recognized over the time the service is provided or at the point in time the sale takes place. Similarly, for the CAP program, revenue is recognized as the service is provided. The taxes on sales and fuel are unique to government and the revenue is recognized at the time the underlying transaction takes place.

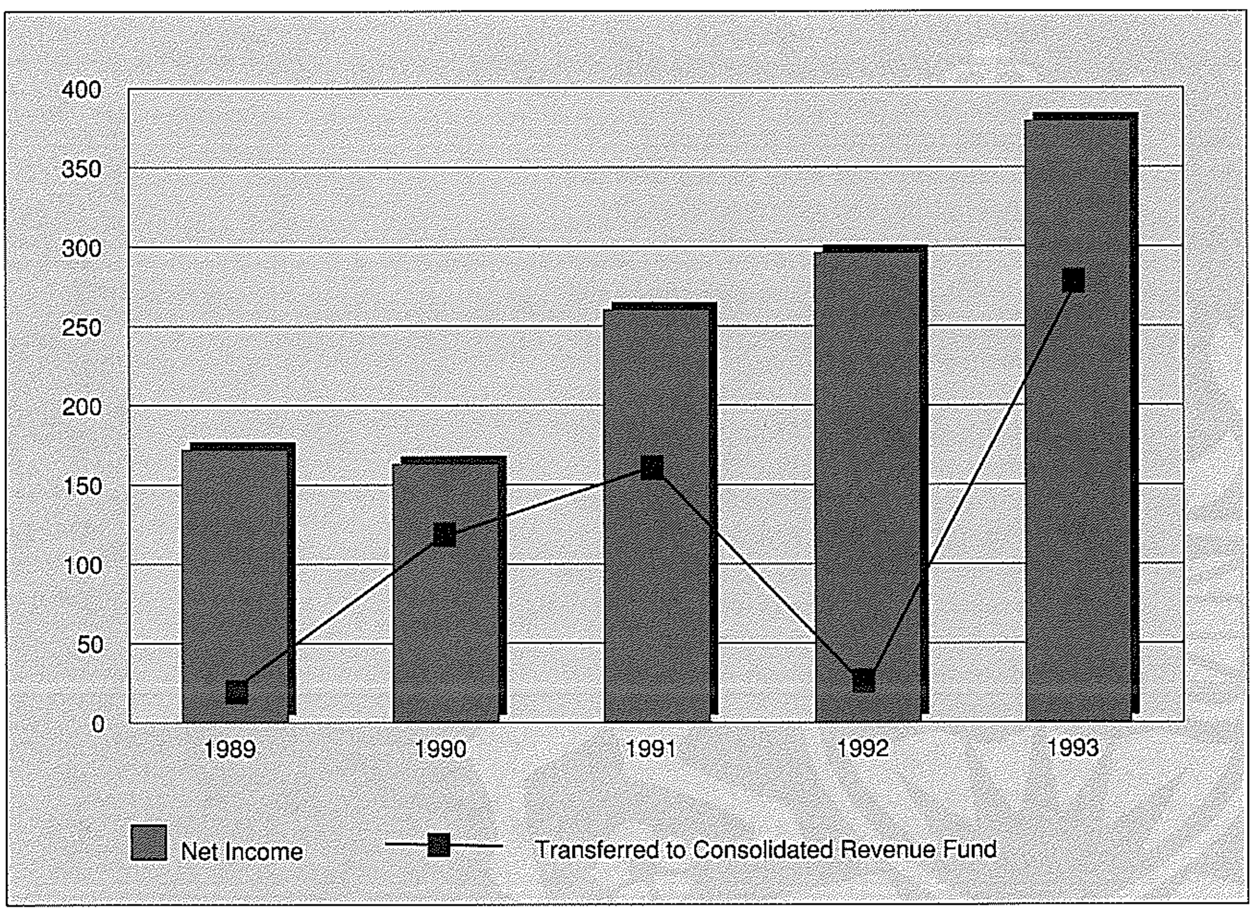
For many other forms of government revenue, pinpointing the time at which revenue is "earned" is less simple. Examples of such revenues are licenses, permits, and property taxes.

The concept of "earned" is unclear for any tax for which there is no underlying transaction. For most taxes there is the occurrence of an event, such as, for sales tax, a sale which triggers the tax.

Exhibit 6.5

Net Income and Payment to Consolidated Revenue Fund in Selected Government Enterprises

Comparison of net income to amounts included in the Consolidated Revenue Fund Financial Statements for BC Hydro and Power Authority, BC Buildings Corporation, and BC Railway ($ Millions)



Source: The Public Accounts

Property taxation is imposed without being triggered by a related event or transaction. Arguments can be made for recognizing property taxes as revenue in a number of ways within the current revenue accounting policy. These include: allocation over the fiscal year, as is presently done; when levied and due; or as the "services" are delivered. An example of the latter, would be to recognize the school tax portion of property taxes over the course of the school year, which runs from July 1 to June 30.

Various licenses and permits sold by the province have terms that extend beyond the current year. These licenses and permits are paid "up front." If the license or permit serves merely as an "admission fee," it may be appropriate to recognize the full payment as revenue when the license or permit is purchased. Alternatively, it may be appropriate to recognize the revenue over the term of the license or permit.

When licenses and permits are purchased, the government has no liability for any directly related service or payment, other than minimal refunds. Deferring this revenue and recording it over the period of the permit or license may be inappropriate. A deferral implies that there is some action to be taken or some service to be performed by the government before the revenue can be recognized.

Deferred revenue recorded for licenses and permits for the 1992/93 fiscal year approximates $100 million. Had there been no deferral, this $100 million would have been included in revenue and would have reduced the government's accumulated deficit.

Because the present accounting policies and procedures do not provide clear guidance as to when certain types of revenue should be recognized in the accounts of the province, we recommend that the government review its guidance in this area.

Response of the Office of the Comptroller General

Revenue Accounting Policy

As the Report notes, it is only recently that the federal government has prepared an estimate of personal income tax payable to the provinces in time for an accrual to be made in our statements. In our experience, tax estimates made early in the year have not been very accurate and so we have chosen to retain the cash basis of accounting until we have confidence in the estimates. However, it is our intention to follow our accounting policy and accrue this revenue when we are satisfied that there is a reasonable degree of certainty in the amount accrued. We will be assessing this issue for possible implementation for the fiscal 1994 financial statements.

We agree that the Consolidated Revenue Fund Financial Statements should disclose which government enterprises are required to pay their net income to the province. However, this is a disclosure (of statutory requirements) rather than an accounting policy, therefore, note disclosure would be the appropriate method of disclosing this information. Note disclosure will be made of requirements for government enterprises to pay or not pay their net income to the province.

The way in which revenue from licenses and permits is recorded depends, as the Report notes, on a number of factors and it is our practice to review these in order to provide the most accurate statement presentation. We will review practices and policy in this area and issue further guidance to ministries on revenue recognition where required before March 31, 1994.

Pension Information and Payment System

Superannuation Commission

A review of controls over the disbursement of pension benefits to retired public sector employees

Review Purpose and Scope

We conducted this internal control review at the Commission to assess the adequacy of those control elements that address the major risks associated with the disbursement of pension benefits. Accordingly, we examined the framework of policies and control procedures established by the Commission, which provide reasonable assurance to management that only eligible individuals receive pensions, and in the correct amount.

We reviewed and tested, to the extent we considered necessary, selected general computer controls at the Commission, application controls within the Pension Information and Payment System (PIPS), and certain financial accounting and administrative controls designed around the pension payment function. We obtained our information by observation, examination, testing, and interviews with Commission staff during the 1992 calendar year.

Overall Conclusion

An entity's framework of policies and control procedures should provide reasonable assurance to management that only eligible individuals receive pensions, and in the correct amount.

Although the Commission has developed a fairly comprehensive set of control procedures within the PIPS application, improvements are needed in the segregation of certain key duties, such as the processing of transactions setting up new allowances, and in the monitoring of the continued effectiveness of controls in the system.

We also noted that significant reliance is being placed on programmed control procedures. While our compliance testing verified that programmed control procedures were operating as planned during our review, we have concluded that the adequacy of general computer controls cannot be relied on to provide assurance of the ongoing effectiveness of programmed controls. Consequently, we believe that the Commission needs to strengthen its general computer control environment and, where necessary, enhance its user control procedures, such as the reperformance of critical program functions. The aim of the Commission should be to create an environment in which management has reasonable assurance that programmed controls will continue to operate as intended.

Background

The Superannuation Commission (the Commission) of the Ministry of Finance and Corporate Relations is responsible for administering eight British Columbia public sector pension plans: BC Rail Ltd. Pension Plan, British Columbia Hydro and Power Authority Pension Plan, College Pension Plan, Members of the Legislative Assembly Superannuation Account, Municipal Superannuation Plan, Public Service Superannuation Plan, Teachers' Pension Plan, and Workers' Compensation Board Superannuation Plan.

The Commission serves approximately 700 public sector employers and 200,000 plan members, and disburses some $700 million annually to 55,000 pensioners. To improve the management of the pension payment function, the Commission implemented the PIPS in May 1989. This on-line system replaced the Pension Payments System (PPS), a batch system that had operated since 1974.

Detailed Findings, Conclusions, and Recommendations

An entity's internal control system is a process to help management obtain reasonable assurance that business is conducted in an orderly and efficient manner. It comprises the overall controls affecting the computer environment (referred to after this as "general computer controls"), the specific controls over the accounting applications ("application controls"), and the controls over the safeguarding of assets and the reliability of the financial records ("financial accounting controls"). While controls are not perfect solutions to problems, they generally provide reasonable assurance that an entity's objectives will be achieved.

Application controls are established at the user level to provide assurance that all transactions are authorized, recorded, and processed completely, accurately, and promptly. Two types of procedures contribute to control over applications: user control procedures and programmed control procedures.

User control procedures are manual and do not depend on the reliability of general computer controls. Examples include the checking of computations and the approval of computer-produced cheques. User control procedures are performed outside the information systems processing environment and provide management with the highest level of assurance of the system's reliability.

Accounting and control procedures designed to operate in computer programs within financial applications are called programmed control procedures. These automated procedures depend on the correct operation of the programs in which they are embedded. Those programs, in turn, depend on the reliability of the general computer controls. General computer controls include procedures that provide security and control over the computer programs, data, and hardware facilities. They therefore have a pervasive influence on the overall effectiveness of automated financial applications, such as the PIPS.

Because controls in a computer environment consist of a series of procedures to reduce the risk of error and fraud, specific recommendations on procedures are difficult to put forward. The entire operating environment must be considered before a decision can be made about which control techniques to implement. This is particularly true for decisions about whether to implement general computer controls or user application controls. Generally, a strong general computer control environment requires fewer user controls in the application environment, and vice versa.

General Computer Controls

Our review was limited to covering activities at the Commission. We did not consider the general computer controls at the British Columbia Systems Corporation (BC Systems) Computer Centre. Although general computer controls at BC Systems do have a pervasive effect on the PIPS (because PIPS information resides on the IBM mainframe at BC Systems), a Third Party Report on the BC Systems Computer Centre, prepared by Deloitte and Touche in February 1992, concluded that control practices and procedures were sufficient to provide reasonable assurance that control objectives were achieved. However, the report did identify some control deficiencies that could result in undetected errors or irregularities, unless users had practices and procedures in place to catch these.

We recommend that the Commission ensure its user controls address deficiencies noted in the Third Party Report.

Maintenance and Change Control

It is essential that an organization's applications receive authorization, meet the criteria for which they were designed, and perform only their authorized functions. During the life span of an application, the maintenance effort is likely to be greater than the original development effort. Applications are not static, but must change continually to meet user needs for new functions and additional reports, and to correct software and processing problems. An effective method of maintenance and change control is therefore necessary if an organization is to have a stable and reliable application environment.

Control procedures should be in place to ensure that program modifications are appropriately verified, approved, tested, and documented before they are used in the production environment. We found that the Commission's procedures for initiating and testing program changes were generally satisfactory. However, there is a significant weakness in how changes are transferred into the production environment. This task is performed by the PIPS development programmer or his or her backup. In our opinion this represents a potential problem because programmers with easy access to the production environment are well positioned to engage in unauthorized activities. Erroneous, improper, or unauthorized changes may be made and remain undetected.

We recommend that a division of duties be adopted, segregating those persons who develop and change application programs from those who may access the production library.

In any application, situations are likely to arise where it is necessary to make changes on an emergency basis with no time to follow the normal change process. For example, if a critical application program fails during a night-time production run and requires a change to the program that same night, there is no time to follow the normal change control process including review, documentation, and authorization. Policies are therefore needed to define when emergency changes can be made and the procedures to be followed in those circumstances.

We recommend that the Commission develop policies and procedures for any program changes required on an emergency basis.

Control procedures are also needed to ensure that the most recent authorized versions of programs are being used in the production environment. We found no check being performed at the Commission to do this.

We recommend that periodic checks of critical programs be made to ensure that up-to-date versions are being used and that only authorized changes have been effected.

Information Systems Processing

The primary responsibility for the completeness and accuracy of data rests with the user departments. However, control procedures should also be applied by the information systems group to ensure that day-to-day processing is complete, accurate, and timely, and that it continues to meet the ongoing requirements of the user departments. We found that the current standards, practices, and operating procedures of the information systems group are generally adequate to ensure the satisfactory conduct of most information processing activities. For example, there are guidelines and scheduling procedures to help operators run and control production jobs in an organized manner, and to resolve most processing problems promptly. Nevertheless, the existing standards and operating procedures are incomplete. For example, there are no standards for segregation of duties, electronic access security, or system backup and recovery.

We recommend that standards to ensure the efficient and effective control of daily systems processing be reviewed and completed.

Another problem we found is the lack of any formal monitoring and supervisory review of computer logs to identify unusual activity or poor system performance. As a result, there is a risk that security access violations or processing problems might not be detected quickly.

We recommend, therefore, that formal procedures be established for reviewing and monitoring computer activity logs.

Electronic Access Security

Electronic access security refers to the procedures that provide protection against accidental or unauthorized disclosure, modification, loss, or damage to data and software. Security procedures include those controls that are used to ensure the logical segregation of duties.

BC Systems has implemented the security software package called Resource Access Control Facility (RACF). Using RACF, the Commission has described in user profiles what transaction processing and information access it permits to individuals or groups of individuals. The software validates the user and grants the defined access to the systems, thus protecting against the risk of unauthorized access to data and software files.

We reviewed reports from BC Systems' security services showing how RACF was set up and being used by the Commission. We found only one weakness in the assigned authorization of this security software. The development programmer and his or her backup are members of the RACF group "SCPSPZ" which allows "update, create and delete" access to the production library. This gives the programmers the ability to move into production those programs they have developed or modified themselves. Apart from this matter, we believe the implementation of RACF was completed appropriately.

Besides the use of RACF, there are other procedures at the Commission to ensure access to information is controlled. For example, sensitive data files and programs are identified and protected to an appropriate level of security. As well, access to critical forms is restricted to personnel who initiate transactions reports, are distributed only as authorized, and sensitive data are locked up.

Backup and Recovery Security and Contingency Planning

Interruptions to information systems processing may be temporary (for example, when there is a power surge or equipment failure) or lengthy (for example, when there is a loss of facilities due to fire, an earthquake, or other disaster). It is important in all instances that essential programs, data, and records can be recovered promptly, so that processing can resume with a minimum of delay. A sustained loss of the Commission's computer systems would seriously disrupt or prevent payment of pension amounts to pensioners. The effects on recipients could range from inconvenience to real suffering.

Our overall conclusion about backup and recovery security and contingency planning at the Commission is that current control procedures do not provide reasonable assurance that the information systems processing could be recovered and resumed after operations were interrupted. In addition, there is no assurance that critical user activities could be maintained and recovered following interruptions to normal operations. This is because the Commission has prepared neither formal backup plans, nor a detailed recovery plan to help the users of the PIPS resume operations after an interruption.

We recommend implementation of a disaster recovery plan that addresses all backup and recovery requirements of the Commission. This should include a formal agreement with BC Systems that specifies the backup and recovery procedures for the Commission's data and application systems and programs residing at the Computer Centre. We also recommend that management formally assess the need for departmental fall-back plans for the PIPS.

PIPS Application Controls

Controls over Pensioner and Allowance Information

Our detailed report includes recommendations on the management of pensioner information. This function ensures that the records maintained by the Commission are an accurate reflection of the current state of the pensioners and their allowances. Adequate controls are therefore necessary to ensure and maintain the integrity of the basic information and changes to it. Controls over basic information are particularly important since these data will be used repetitively during the processing of allowance payment transactions.

One of the most fundamental elements of internal control is the segregation of key duties. Duties that, if performed by the same employee, would enable the employee both to perpetuate and conceal errors or irregularities, are said to be incompatible. Ideally, the flow of information should be designed so that the work of one person is either independent of, or serves as a check on, the work of another person. For the most part, key duties in the management of pensioner information are adequately segregated, although we noted some instances where improvements could be made. For example, we found that one employee has end-to-end control over the input, processing, and output of transactions that terminate pension allowances. Consequently, management does not have reasonable assurance that all deceased pensioners are effectively removed from the system. We found similar weaknesses in the processing of transactions that set up new allowances and of transactions that provide non-routine payments to pensioners.

We recommend that incompatible duties be segregated so that no one individual has exclusive control over all stages of processing transactions.

We understand that the Commission is considering a major reorganization in the near future. If it does this, we recommend that it ensure that all key duties in the new organization are adequately segregated to minimize the exposure to errors or irregularities.

An important aspect of management supervision is the monitoring of the continued effectiveness of all other controls in the system. One specific method of monitoring is to analyze all errors detected routinely by the controls within the system. Analysis and control of detective controls is particularly important in computerized systems such as the PIPS because of the complexity and technical nature of the required computer controls. We found that the management review of PIPS "exception reports" is insufficient to identify those conditions that might reflect poor system performance or unusual activity. We also found that some exception reports are too lengthy to be of much use for review activity.

We recommend that a review of exception reports produced by PIPS be undertaken to determine where modifications are necessary. We also recommend that the content of exception reports be monitored and reviewed by management promptly to identify unusual activity.

Comparison of manually annotated listings (or original documentation) to computer-produced reports can be used to ensure changes are properly applied to semi-permanent data, such as pensioner allowance records. We observed that this procedure was not being performed on transactions that amend pensioner records. Consequently, management does not have assurance that all changes to pensioner records are proper and complete.

We recommend that the Commission implement review procedures that verify the authorization of on-line input, as well as provide assurance that all changes to pensioner records are entered.

Financial Accounting Controls

Policies and Procedures

Documentation of policies and procedures is an important internal control to help ensure that employees have a clear understanding of their duties and responsibilities. The initial development of a policies and procedures manual has been undertaken by the Commission, but has not been completed to date.

We recommend that the Commission complete the policies and procedures manual and provide adequate resources to maintain its relevance.

Imprest Bank Account

All pensions are paid from an imprest bank account maintained by Pensioner Services and, although bank reconciliations are being performed on this account, they are approximately six months behind. In addition, they are not being reviewed on a regular basis by management.

We recommend that bank reconciliations be brought up to date and continued more promptly, and that they be subject to timely management review.

Response of the Superannuation Commission

Pension Information and Payment System

We are pleased to receive the report of the Auditor General on the Pension Information and Payment System (PIPS), and to note that the Auditor General has concluded that the Commission has developed a fairly comprehensive set of control procedures within the PIPS application. That improvements can be made is fair comment. From a management perspective, it is always useful to receive an independent assessment of the adequacy of systems, controls and procedures, as we continually look for ways to improve. Also, recommendations regarding user and application controls are important for us to consider in the light of a major redesign of our business processes and our organization (including pension payment functions), which began this year and will continue over future months, and the planned redesign of our computer systems over the next several years. Specifically, we have the following response to those issues raised by the Auditor General as areas where improvement could be made:

General Computer Controls

Maintenance and Change Control:

It is difficult to deal with segregation of duties issues in a systems support group as small as that which supports PIPS. However, to address the Auditor General's concerns regarding segregation of duties for change management functions and for the migration of programs into the production environment, we are considering the transfer of certain responsibilities to an independent quality assurance officer within the Information Systems Group. We are also taking steps to ensure that program library source code is reviewed before and after programming changes are migrated into production. While some emergency program change policies are in place and are well understood by current systems support staff, we agree that more formally documented procedures would be desirable.

Information Systems Processing:

Complete production control procedures have now been established for all critical jobs run by Superannuation production control staff. BC Systems Corporation reports on security access are now being reviewed by the Group Data Security Administrator of the Commission.

Back-up and Recovery Security and Contingency Planning:

There are well-understood, practical back-up and recovery procedures in place to ensure that pensioners get paid, should disasters such as system failure, fire, etc. occur. However, we agree that a comprehensive, formal backup and recovery plan for the Commission, as a whole, needs to be completed, and we are already taking steps to create such a plan.

Application Controls

Controls over Pensioner and Allowance Information:

We agree that better transaction and exception reports from the Universal Contributor System (UCS) and PIPS are required, and that such reports should be reviewed by persons independent of the pension allowance initiation or change functions. We are currently assessing the most cost-effective reporting and procedural alternatives, in conjunction with our review of the redesign of the pensioner services business function, and the *planned replacement of the UCS system.*

Financial Accounting Controls

Policies and Procedures:

We agree that while PIPS user procedures and PIPS functionality are documented in a number of places, that a comprehensive, up-to-date policies and procedures manual regarding the pension payments process should be in place. As part of our review of, and potential redesign of the pension payment function, we will ensure that consolidated documentation of financial policies, controls and procedures is prepared.

Imprest Bank Account:

Responsibility for the bank reconciliation process has recently been transferred to the Finance Branch, and steps are currently being taken to bring reconciliations up-to-date, with appropriate management review.

Improving the Financial Accountability of School Districts

Ministry of Education

A review of the instructions provided to school districts for preparing their annual financial statements and of the process for appointing their auditors

Review Purpose and Scope

Increasingly, governments, their agencies, and other entities in the public sector are being called upon to be more accountable for how they use resources and what results they achieve.

The Ministry of Education is actively working to improve the accountability of school districts to the government and the public. In one project, it is reviewing the accounting instructions it issues to the school districts. These instructions advise the school districts how to present their financial reporting and what to include in it. Through the review, the ministry hopes to identify additions or revisions that may enhance the quality and consistency of the reporting. As well, the ministry is considering ways of better demonstrating the independence and objectivity of appointments of school district auditors.

As part of these projects, the ministry asked us for our comments and suggestions for improving the reporting of financial information and arranging for the auditing of that information. Our report summarizes the major elements in our response to the ministry on these issues.

Overall Conclusion

The ministry has provided extensive instruction for financial reporting by school districts. However, we believe that there are some further steps that the ministry should consider which would strengthen even further the fiscal accountability of the districts.

We suggested that having districts use only the accrual basis for measuring expenditures would result in improved disclosure of each district's costs, and would enable more meaningful comparisons among districts of fiscal and related performance information. We also believe that the ministry should explore the use of the annual report produced by each school district to provide summarized financial information to complement the district's assessment of the general effectiveness of its educational programs.

We have further suggested that although the responsibilities for appointing an auditor set out in the School Act are appropriate, in order to enhance the auditor's independence, the ministry might wish to make changes to the appointment process.

The Need for Accountability

Financial reporting is a key element of accountability. It gives legislators, governments, and the public information on the cost of the services delivered by the reporting entities, and thereby enables those reviewers to assess whether the quantity and value of services produced are commensurate with the costs of providing those services. It also provides an accounting of how management has discharged its fiduciary responsibilities for properly administering the resources given to it.

In British Columbia, the public has been increasingly concerned about whether or not the school system is providing good value for the resources it consumes. The government, through the Ministry of Education, has budgeted about $3.5 billion to fund schools for the fiscal year ended March 31, 1994. The school districts therefore account for a significant portion of public sector expenditures.

Given the extent of this funding, the assessments formed by the ministry, the public, and their legislative representatives as to how well the school system is performing should be derived from relevant and fairly presented information, including financial information. The challenge is to provide information that is both relevant and credible to all major interested parties.

Accountability expectations for the use of school district financial resources are established in a number of ways. The *School Act* requires each school board to prepare an annual financial statement, which is examined by an independent auditor, and an annual report. The Act deals broadly with the format, content, and timeliness of the financial statements; the ministry issues more detailed financial instructions and guidance for the school districts to follow. As well, the *Financial Information Act* contains certain requirements for financial accountability, one of which is that districts must make publicly available employee and supplier payment schedules.

Findings

Audit Appointments

The *School Act* gives the school district responsibility for appointing an independent auditor. However, under the Act, the Minister of Education can appoint an auditor if the school district fails to do so, and can intervene in certain situations to protect the integrity of the audit. We believe that this allocation of responsibilities is reasonable.

Although responsibilities for making the appointment are clear in the Act, no method is set out in either the Act or ministry directives for making the appointment, and so a variety of practices could be followed by school districts in appointing their auditors. We set out for the ministry's consideration some ways of improving the appointment procedures so as to enhance the auditor's independence. For example, the school districts could be required to follow a tendering process for audit services, or the ministry could be involved in the selection process.

Reporting Financial Information

The ministry, over the years, has developed comprehensive guidelines and a detailed format for school district financial reporting. It has been responsive to the evolution of accounting theory and practices in the government sector, and this is reflected in many of the materials it has developed. We feel that the existing guidelines provide a sound basis for further development.

Our comments to the ministry on financial reporting matters focused on two areas: first, the accounting policies to be used by the school districts and, second, the format and content of the financial statements and other financial accountability information provided by the districts.

Accounting Policies

Users of the financial statements can draw meaningful financial comparisons among school districts if all districts are required to measure the results of their transactions in a consistent manner. This involves all districts using the same accounting criteria to determine when transactions should be recognized and how the financial effect of them should be allocated among accounting periods.

Guidance currently provided by the ministry promotes consistency in many areas, but it does not ensure that all costs are recognized and measured in the same way. The existing expenditure accounting instructions allow school districts to use cash or accrual accounting for payroll expenses, and cash, accrual, or encumbrance accounting for supplies and services. Our review of the accounting practices now used by school boards confirmed that there is no unanimous choice among these policies for recognizing expenditures. This makes it difficult for the government and the public to compare the financial statements of one school district with those of others, and to draw conclusions as to the relative performance of each.

We believe that the most meaningful expenditure information is that which measures the full cost of the services provided during the period under review. This information gives a fair and relevant base against which the financial performance and accomplishments of the school districts can be assessed. It also conforms with generally accepted accounting principles in both the public and private sectors.

We recommended to the ministry that the instructions for preparing school district financial statements be amended to permit the use of only the accrual basis of expenditure accounting.

In the longer term, the ministry should continue to monitor the initiatives under way in the accounting profession to develop appropriate accounting standards for governmental and not-for-profit organizations. Professional bodies involved in such initiatives include the Public Sector Auditing and Accounting Board (PSAAB) and the Accounting Standards Board (ASB), both of the Canadian Institute of Chartered Accountants, and the Governmental Accounting Standards Board in the United States.

We believe that the work of PSAAB, in particular, is relevant to school district financial reporting. In November 1990, PSAAB issued the first of a series of statements of recommended accounting practices for local governments. It indicated that the recommendations could be suitable for entities such as school boards, although it did not mandate the application of the recommendations to them.

Local governments and school districts have many characteristics in common, such as their accountability relationships and the needs of the users of their financial reporting. This PSAAB statement and expected future pronouncements for local governments should therefore provide much useful material to assist the ministry in developing accounting guidance for school districts. We therefore encouraged the ministry to continue to monitor PSAAB pronouncements closely.

Financial Statement and Other Financial Accountability Information

Since the ministry is the major funder of the school system, it is understandable that the existing financial reporting format focuses on meeting the ministry's information needs. However, the report of the Education Funding Review Panel (the Spangelo Report) commented on the public's concern that existing financial reporting from school districts is difficult to understand.

Internationally, this decade is likely to see many developments in the format and content of accountability information for public sector organizations. The thrust of these initiatives will be to provide more meaningful and complementary information about financial, operational, and compliance performance. In some cases, for example, such information may be provided in a package of related reports, as is required of some federal government agencies in the United States under the *Chief Financial Officer Act*. In other cases, existing formats for general purpose financial reporting may be expanded to include information about performance measures and accomplishments, as is currently being researched by the Governmental Accounting Standards Board in the United States.

Under Section 98 of the *School Act*, each school district must produce an annual report. Neither the Act nor the ministry currently specifies the content required in the annual report. We feel that reformatted or summarized financial information relevant to the needs of the public could be presented through it. Doing so would enable school districts to provide information on finances and performance in the same accountability document, so that one can be explained in the context of the other.

We therefore recommended that the ministry consider using the annual report to provide more and better accountability information to the public.

We commented to the ministry on another issue as well. Where various pieces of financial accountability information are required under different statutes or directives, they may not all be prepared using the same accounting conventions or principles. This can confuse readers who may not understand the reason for this variation. For example, schedules of payments produced by the school districts under the *Financial Information Act* are prepared on a cash basis. They do not include the value of amounts due but unpaid which would be included in expenditures disclosed in school district financial statements prepared on an accrual basis.

To reduce the risk of misunderstandings, we suggested to the ministry that, in preparing the Financial Information Act *payment schedules, school districts include a reconciliation of the payments with the expenditures shown in the district's financial statements.*

Response of the Ministry of Education

Improving the Financial Accountability of School Districts

The Ministry of Education appreciates the ongoing advice of the Office of the Auditor General and work is currently underway to address many of the comments in this report.

Updated accounting instructions will be issued for 1994/95 to improve the consistency and comparability of financial reporting.

Encumbrance accounting is no longer acceptable for reporting of expenditures in the fiscal year 1994/95. The Ministry of Education agrees that all expenditures should be recorded on an accrual basis rather than cash or encumbrance. In some cases modified accrual may be more appropriate than full accrual. In this regard, the Ministry continues to monitor the work of PSAAB for any accounting principles that should be followed in reporting by school districts.

A committee reviewing financial reporting and accountability will be recommending inclusion of financial information in the annual report of school boards.

Audit of Financial Statements of Government Entities and Trust Funds

Audit of Financial Statements of Government Entities and Trust Funds

General

The government Summary Financial Statements reporting entity for the 1992/93 fiscal year includes the results of the financial activities and operations of consolidated revenue fund and 43 other government organizations and enterprises. The latter are owned or controlled by the government and are accountable in the administration of their financial affairs and resources either to a minister of the government or directly to the legislature.

In the 1992/93 fiscal year, the assets and expenditures of these 43 government organizations and enterprises (collectively referred to in this section as government entities) amounted to $22.4 billion and $7.7 billion, respectively. Exhibit 7.1 shows the asset and expenditure amounts of these government entities from 1989 to 1993. The decrease in expenditures from 1992 to 1993 is primarily the result of the Medical Services Commission of British Columbia no longer being considered a separate entity for the purpose of preparing the government's Summary Financial Statements. Under the new *Medical and Health Care Services Act*, the Commission is a division of a government ministry. As a result, expenditures of $1.5 billion recorded in the Commission's accounts are included directly in the results of the financial activities and operations of central government.

The number of government entities increased from 28 to 43 over the five years to 1993. Ten newly incorporated entities were added and two were removed because they had ceased operations. A further nine entities were added and two were removed when the government reporting entity criteria were applied to the government organizations and enterprises, as part of the government's ongoing review to determine the composition of the summary financial statements reporting entity.

The Hospital Foundation of British Columbia was included in the government's 1992/93 Summary Financial Statements for the first time. Two entities, the British Columbia Housing and Employment Development Financing Authority and the British Columbia Year of Music Society, were dissolved during the year. The financial results of their operations to the date of dissolution are included in the 1992/93 Summary Financial Statements. A further change in the government reporting entity in 1993 related to the Medical Services Commission of British Columbia, as mentioned earlier.

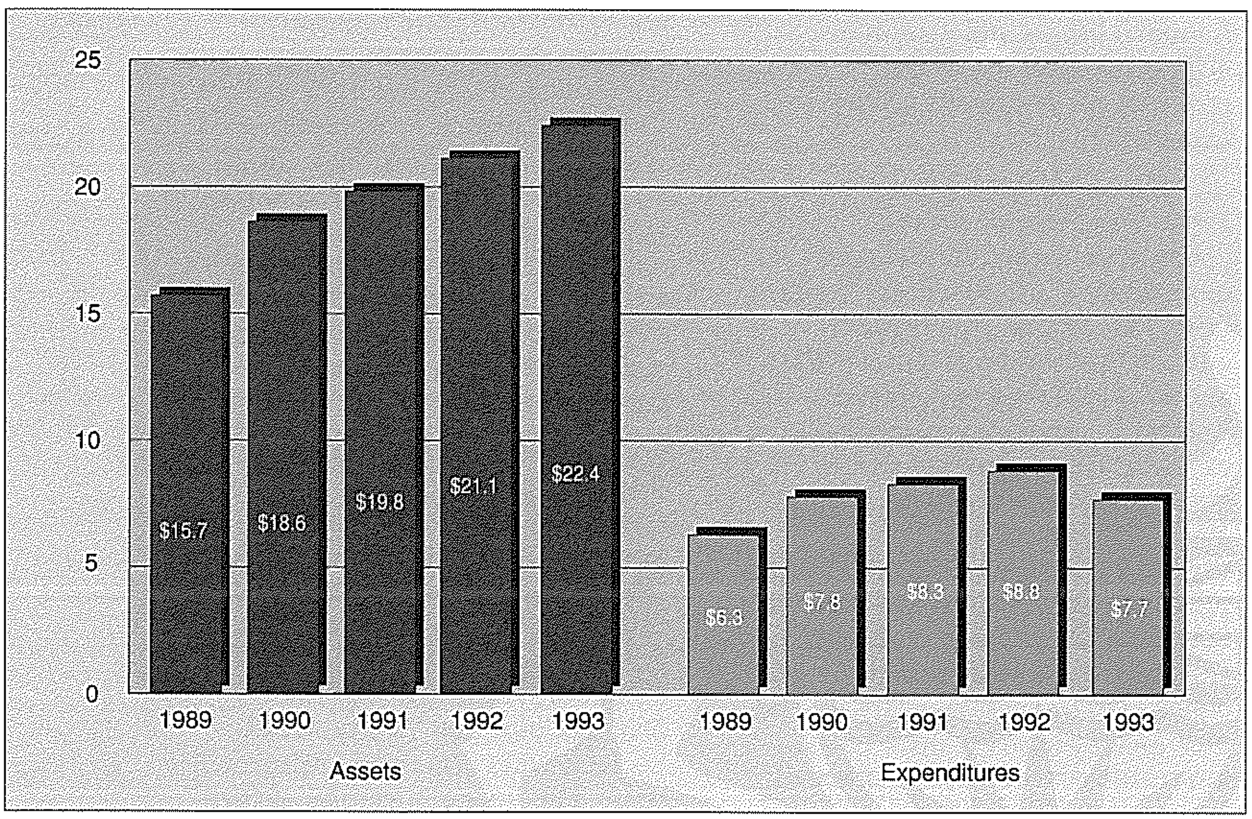
Exhibit 7.2 shows, for the government entities included in the 1992/93 Summary Financial Statements, the asset and expenditure amounts audited by private sector accounting firms and those audited by the Auditor General. Private sector accounting firms audited 27 government entities, which had combined assets of $18.8 billion and expenditures of $6.3 billion. The Auditor General audited 13 such entities, with total assets of $3.6 billion and expenditures of $1.4 billion. Three small entities were not audited.

In addition to the government entities, the Auditor General audited a further 33 organizations with assets of $32.8 billion and expenditures (including financing transactions) of $21.5 billion. Among these were 20 trust funds, including pension and

Exhibit 7.1

Changes in Assets and Expenditures

Assets and expenditures of government entities, 1989 - 1993 ($ Billions)



Source: Financial statements of government entities superannuation plans and investment funds administered by the government.

Appendix B of this report lists all government entities audited by the Auditor General. A new Province of British Columbia Pooled Investment Portfolio and the University of Northern British Columbia Pension Plan were added this year. Appendix C lists the government entities audited by private sector accounting firms, or unaudited, and whose financial statements are included in the Public Accounts.

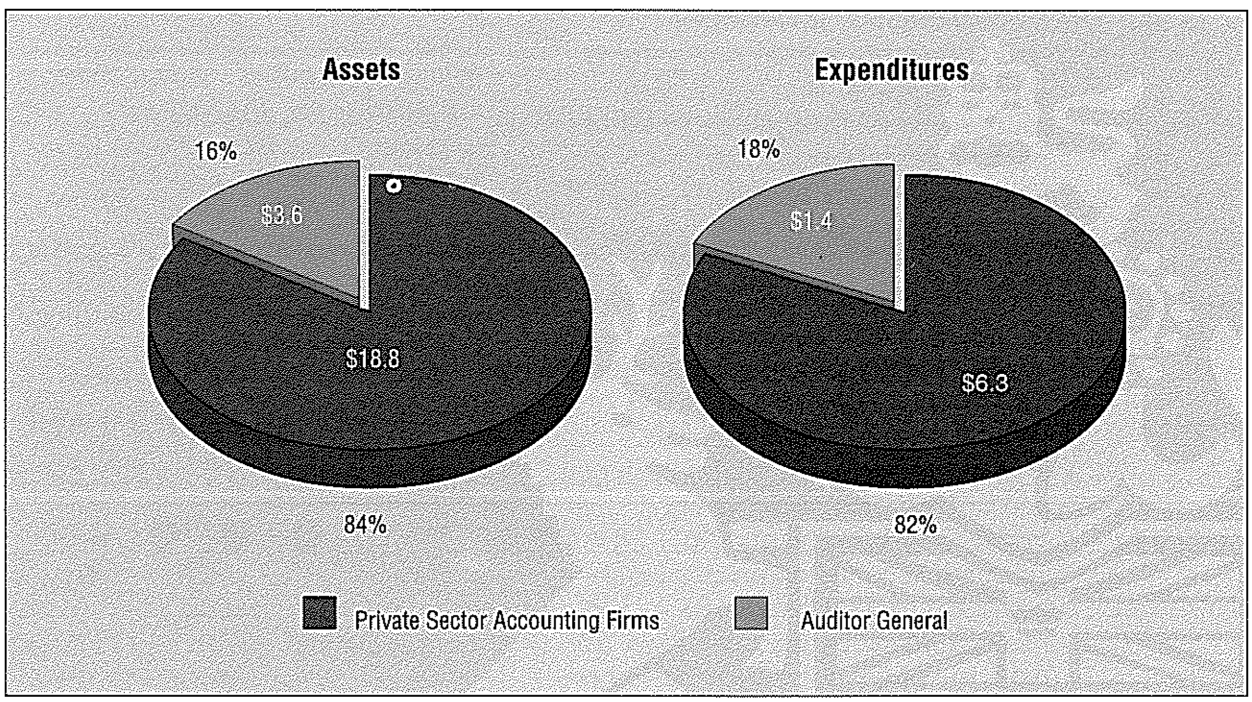
Audit Reporting on Government Entities

Both the management and the auditor of a government entity have responsibilities associated with that entity's financial statements. Management is responsible for preparing financial statements, establishing their form and content, and determining the accounting policies that are appropriate for the organization's activities. The auditor's responsibility is to express an opinion as to whether the financial statements present fairly, in all material respects, the financial

Exhibit 7.2

Distribution of Financial Statement Attest Audits

Asset and expenditure amounts audited by private sector accounting firms and by the Auditor General (for government entities), 1992/93 ($ Billions)



Source: Financial statements of government entities position and operating results of the entity in accordance with appropriate accounting principles.

During this past year, each auditor's report on the financial statements of government entities included in the government Summary Financial Statements was issued without reservation. In the case of one small entity, the auditor's report included references to the nature of revenue that was not susceptible to satisfactory audit verification.

When our annual audit work is finished, we write to the management of each government entity to advise them of any audit concerns we have. Where appropriate, we also make recommendations for remedial action. If a reported matter is considered to be significant, we may comment on that issue in our report to the Legislative Assembly, to help in the improvement of the management of government operations, programs, and systems. We can confirm that significant matters raised through these letters in the past year are being satisfactorily dealt with.

Accounting Standards for Non-Profit Organizations

In recent years, we have commented in our Annual Reports on the theoretical and practical difficulties facing some public sector entities, particularly colleges and universities, in adopting certain aspects of generally accepted accounting principles for non-profit organizations, as recommended by the Canadian Institute of Chartered Accountants (CICA). These difficulties largely arise where a non-profit organization, in deciding to present its financial activities on a funds-flow basis of accounting or on a basis designed to meet specific financial reporting directives of government funding agencies, follows accounting practices that are not wholly consistent with generally accepted accounting principles. To date, the main issues in this area have related to the recording and reporting of vacation pay, pension entitlements, and early retirement and other termination allowances.

The CICA is continuing to work with the profession and with users of financial statements to achieve an appropriate, comprehensive framework for financial reporting for non-profit organizations. Until these standards are completed, however, some Canadian universities will likely continue to emphasize a funds-flow basis of accounting to present their financial activities, rather than a basis that would better reflect the full cost of providing services. Under these circumstances, the auditor expressing an audit opinion in terms of generally accepted accounting principles might include a reservation in his or her report. For this reason, several Canadian universities, including one in British Columbia, received audit opinions with reservations on their 1992/93 fiscal year financial statements.

Funding of Statutory Pension Plans

We have discussed in our previous three Annual Reports our concerns with the funding of pension plans maintained in accordance with acts of the British Columbia legislature. Exhibit 7.3 provides information on these statutory plans. They are the Public Service Superannuation Plan, the Municipal Superannuation Plan, the Teachers' Pension Plan, the College Pension Plan, and the Members of the Legislative Assembly Superannuation Account. Together they have accumulated unfunded liabilities of approximately $3.7 billion.

We are still concerned that the provincial government is not adopting actuary recommendations to increase contributions to the plans. In each of the most recent actuarial valuations for the statutory plans, the actuaries have concluded that the current contribution rates are somewhat less than those required under the funding policy approved by the government. Under the government's funding policy, the unfunded liabilities of the plans are allowed to increase in relation to increases in pensionable payroll. However, in order to maintain the unfunded liabilities at levels contemplated under the funding policy, the actuaries of the plans continue to recommend increases in contributions. The government has taken no action in this regard.

Although the actuaries believe that, for all plans, there is little risk of plan failure, it remains that inadequate funding today may place an unfair cost burden on future contributors and taxpayers.

Exhibit 7.3

Summary of Public Service Statutory Pension Plans' Unfunded Liability

($ Millions)

	Valuation			Change	Additional
	Prior deficit	Latest deficit	Latest date	(decrease) increase	contributions recommended by the actuary[1]
Public Service Superannuation Plan	456	438	Mar. 31, 1990	(18)	.25%
Municipal Superannuation Plan	1,082	1,411	Dec. 31, 1991	329	1.49%
Teachers' Pension Plan	1,605	1,879	Dec. 31, 1990	274	1.53%
College Pension Plan	30	45	Aug. 31, 1991	15	1.81%

No valuation was performed on the Members of the Legislative Assembly Superannuation Account. Amounts contributed are transferred to the Public Service Superannuation Plan when MLAs retire. Any shortfall between amounts held in the account and the benefits earned by MLAs at the retirement date is paid by the government into the plan. Pension benefits are then paid to MLAs through the plan.

[1] Combined employer and employee rates

Sources: Plan financial statements and actuarial reports

Appendices

Appendix A

Financial Statement Audit Objectives and Methodology, Office of the Auditor General

Purposes of Financial Statement Audits

An independent audit of financial statements has several purposes. The main one is to add credibility to the statements, thus enhancing their value to the ultimate users. Evidence of this is provided in the form of an auditor's report which accompanies the financial statements, and in which the auditor's opinion expresses whether the statements are presented fairly in accordance with an appropriate, disclosed basis of accounting.

Another benefit of such an annual audit is that its very existence provides a constant stimulus to an organization to ensure sound financial management. In addition, the auditor is frequently able to provide helpful assistance and advice to an organization as a direct result of findings developed during the audit.

Reporting the Results of Audits

As noted above, a financial statement audit results in the issuance of a report on those statements. These reports are addressed to whoever appointed or engaged the auditor to do the work, such as the organization's owner, the shareholders, or some appropriate representative of those with a stake in the organization. In the case of the government financial statements examined by this Office, the Auditor General addresses his or her reports to the Legislative Assembly. The reports issued on the statements of Crown corporations and other government organizations are addressed to various parties, according to applicable appointment or engagement arrangements.

The auditor's report constitutes the auditor's professional opinion on the financial statements, and usually consists of three basic paragraphs.

The first paragraph identifies the financial statements that have been audited. It also points out that the statements are the responsibility of management, and that the auditor's responsibility is to express an opinion on the statements.

Next is the "scope" paragraph, which describes the nature and extent of the auditor's work, and the degree of assurance that the auditor's report provides. Also, it refers to generally accepted auditing standards and describes some of the important procedures which the auditor undertakes.

The third paragraph, frequently referred to as the "opinion" paragraph, contains the auditor's conclusion based on the audit conducted.

If the auditor is unable to provide an opinion without reservation on the financial statements, the report must include another paragraph. In that paragraph, which would appear between the scope and the opinion paragraphs, the auditor advises the reader as to the reasons for the reservation, and the effects or possible effects on the financial statements of the matters giving rise to the reservation.

Finally, should the auditor wish to present additional information or explanations concerning the financial statements—information that does not constitute a reservation in the audit opinion—this will appear in a further, explanatory paragraph to the report.

Auditing Standards

When undertaking examination procedures for the purpose of expressing an opinion on financial statements, auditors are expected to comply with established professional standards, referred to as generally accepted auditing standards. The principal source of these standards in Canada is the Canadian Institute of Chartered Accountants (CICA).

Generally accepted auditing standards consist of three main areas. There are general requirements that the auditor be properly qualified to conduct and report on an audit, and that he or she carry out the duties with an objective state of mind. Further standards outline the key technical elements to be observed in the conduct of an audit. Finally, reporting standards set out the essential framework of the auditor's report on the financial statements.

In addition to these broad standards, the CICA makes other, more detailed, recommendations related to matters of auditing practice. As well, the CICA, through its Public Sector Accounting and Auditing Board, makes recommendations that relate specifically to the audit of entities in the public sector.

Application of the Standards

We carry out extensive examinations of the accounts and records maintained by the ministries and central agencies of government, and by the Crown corporations and other public bodies of which the Auditor General is the auditor.

Also, with respect to Crown corporations which are audited by other auditors and which form part of the government's Summary Financial Statements, we obtain various information and assurances from those other auditors which enable us to rely on their work in conducting our audit of the government's accounts. This information is supplemented by periodic reviews by our staff of those auditors' working paper files and audit procedures.

Throughout these examinations, the Office of the Auditor General complies with all prescribed auditing standards in the conduct of its work. It must be realized, however, that the Auditor General's opinion on a set of financial statements does not guarantee the absolute accuracy of those statements. In the audit of any large organization it is neither feasible nor economically desirable to examine every transaction. Instead, the auditor, based on a knowledge of an organization's business, methods of operation, and systems of internal control, assesses the risk of error occurring and then designs audit procedures to provide reasonable assurance that any errors contained in the financial statements are not, in total, significant enough to mislead the reader as to the organization's financial position or results of operations.

When determining the nature and extent of work required to provide such assurance, we consider two main factors: *materiality*, which is expressed in dollar terms, and *overall audit assurance*, expressed in percentage terms.

- Materiality relates to the aggregate dollar amount which, if in error, would affect the substance of the information reported in the financial statements, to the extent that a knowledgeable reader's judgment, based on the information contained in the statements, would be influenced.

  In our audit of the government financial statements we have assumed that an error in the current year's deficit in excess of one-half of 1% of the gross expenditure of the government would be considered material. For our audits of government organizations, materiality is established based on the nature of the organization and an appropriate percentage, or combination of percentages, of expenditure, assets, or surplus/deficit.

- Overall audit assurance represents, in percentage terms, how certain the auditor wants to be that the audit will discover error in the financial statements which, in total, exceed materiality, should such total error exist.

  In our audit of the government financial statements, we planned our work so as to achieve an overall audit assurance of 97.5% that the audit would detect error in excess of materiality. For our audits of other government organizations, our planned overall audit assurance ranges between 95% and 97.5%. In choosing the level of assurance, we consider factors such as the expectations of the users of the financial statements and the nature of the audit evidence available.

In planning our audits of financial statements, we exercise professional judgment in determining the application of these two key factors. Professional judgment is influenced by our knowledge of the requirements of readers of the financial statements, and by what is generally accepted as being appropriate by auditors of similar organizations.

Appendix B

Government Entities and Trust Funds Audited by the Auditor General

Entities Included in the Summary Financial Statements

British Columbia Assessment Authority

British Columbia Educational Institutions Capital Financing Authority

British Columbia Enterprise Corporation

British Columbia Health Research Foundation

British Columbia Housing and Employment Development Financing Authority (dissolved June 1992)

British Columbia Liquor Distribution Branch

British Columbia Regional Hospital Districts Financing Authority

British Columbia School Districts Capital Financing Authority

Creston Valley Wildlife Management Authority Trust Fund

Duke Point Development Limited

Health Facilities Association of British Columbia

Provincial Capital Commission

W.L.C. Developments Ltd.

Other Entities

British Columbia Institute of Technology

Legal Services Society

Provincial Employees' Community Services Fund

Simon Fraser University

University of British Columbia

University of Northern British Columbia

University of Victoria

University Foundations:

- Simon Fraser University Foundation
- The University of British Columbia Foundation
- University of Northern British Columbia Foundation
- Foundation for the University of Victoria

University of Northern British Columbia Pension Plan

Workers' Compensation Board Superannuation Fund

Trust Funds

BC Rail Ltd. Pension Plan

British Columbia Hydro and Power Authority Pension Plan

British Columbia Public Service Long Term Disability Plan

College Pension Plan

Members of the Legislative Assembly Superannuation Account

Municipal Superannuation Plan

Province of British Columbia Pooled Investment Portfolios:

- Active Canadian Equity Fund
- Indexed Canadian Equity Fund
- Customized U.S. Equity Fund
- Managed International Equity Fund

- Passive International Equity Fund
- Corporate Bond Fund
- Real Return Bond Fund
- Fund ST1
- Fund ST2
- Fund ST3
- Realpool Investment Fund

Public Service Superannuation Plan

Teachers' Pension Plan

Workers' Compensation Board of British Columbia

Appendix C

Government Entities and Trust Funds Audited by Private Sector Auditors, or Unaudited, and Whose Financial Statements Are Included in the Public Accounts

Entities Included in the Summary Financial Statements

B.C. Festival of the Arts Society

B.C. Health Care Risk Management Society

B.C. Pavilion Corporation

B.C. Summer and Winter Games Society

British Columbia Buildings Corporation

British Columbia Ferry Corporation

British Columbia Hazardous Waste Management Corporation

British Columbia Heritage Trust

British Columbia Housing Management Commission

British Columbia Hydro and Power Authority

British Columbia Lottery Corporation

British Columbia Petroleum Corporation

British Columbia Railway Company

British Columbia Steamship Company (1975) Ltd.

British Columbia Systems Corporation

British Columbia Trade Development Corporation

British Columbia Transit

British Columbia Year of Music Society (dissolved March 1993) - *unaudited*

Cloverdale Historic Transportation Society of B.C. - *unaudited*

Downtown Revitalization Program Society of British Columbia

First Peoples' Heritage, Language and Culture Council

Hospitals Foundation of British Columbia

Insurance Corporation of British Columbia

Okanagan Valley Tree Fruit Authority

Pacific National Exhibition

Plain Language Institute of British Columbia Society

Provincial Rental Housing Corporation

Science Council of British Columbia

The Education Technology Centre of British Columbia

178561 B.C. Ltd. (formerly Pacific Coach Lines Ltd.) - *unaudited*

Trust Fund

Credit Union Deposit Insurance Corporation of British Columbia

Appendix D

Excerpts from the 1992/93 Public Accounts

The material which forms Appendix D is from the Public Accounts of British Columbia for the fiscal year ended March 31, 1993. It consists of the government Summary Financial Statements and the Auditor General's Report thereon.

Summary Financial Statements as at March 31, 1993

Contents

Supplementary Statements

Auditor General of British Columbia

AUDITOR GENERAL'S REPORT ON THE SUMMARY FINANCIAL STATEMENTS

To the Legislative Assembly
of the Province of British Columbia
Parliament Buildings
Victoria, British Columbia

I have audited the balance sheet of the Government of the Province of British Columbia as at March 31, 1993 and the statements of revenue and expenditure and changes in cash and temporary investments for the year then ended. These financial statements are the responsibility of the Government. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with generally accepted auditing standards. Those standards require that I plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. In the conduct of my audit, I have received all the information and explanations I have required.

I report in accordance with section 7 of the Auditor General Act. In my opinion these financial statements present fairly, in all material respects, the financial position of the Government as at March 31, 1993 and the results of its operations and the changes in its financial position for the year then ended in accordance with the stated accounting policies as set out in note 1 to these financial statements applied on a basis consistent with that of the preceding year.

George L. Morfitt, FCA
Auditor General

Victoria, British Columbia
August 16, 1993

Statement of Responsibility for Government Financial Statements

Responsibility for the integrity and objectivity of the government's financial statements rests with the government. The financial statements are prepared by the Comptroller General under the direction of the Treasury Board, pursuant to section 8(2) of the *Financial Administration Act*, in accordance with the government's stated accounting policies. Each financial statement covers the fiscal year of the government, which is from April 1 to March 31 of the following year.

To fulfill its accounting and reporting responsibilities, the government maintains systems of financial management and internal control which give due consideration to costs, benefits and risks, and which are designed to provide reasonable assurance that transactions are properly authorized by the Legislative Assembly, are executed in accordance with prescribed regulations, are properly recorded so as to maintain accountability of public money and safeguard the assets and properties of the Province of British Columbia under government administration. The Comptroller General of British Columbia maintains the accounts of British Columbia, a centralized record of the government's financial transactions, and obtains additional information as required from ministries, agencies and Crown corporations to meet accounting and reporting requirements.

The Auditor General of British Columbia provides an independent opinion on the financial statements prepared by the government. The duties of the Auditor General in that respect are contained in section 7 of the *Auditor General Act.*

Annually, the financial statements are tabled in the Legislature as a part of the Public Accounts, and are referred to the Standing Committee on Public Accounts of the Legislative Assembly. The Standing Committee on Public Accounts reports to the Legislative Assembly on the results of its examination together with any recommendations it may have with respect to the financial statements and accompanying audit opinions.

Approved on behalf of the Ministry of Finance and Corporate Relations:

Michael Costello

MICHAEL COSTELLO
Deputy Minister of Finance and Corporate Relations

Alan J. Barnard

ALAN J. BARNARD
Comptroller General

Summary Financial Statements Balance Sheet as at March 31, 1993

	Note	1993 (In Millions)	1992 (In Millions)
Assets		$	$
Cash and temporary investments	2	159	85
Accounts receivable	3	1,328	1,163
Inventories	4	47	48
Amounts due from other governments	5	103	89
Equity in government enterprises	6	3,021	2,522
Loans, advances and other investments	7	777	702
Mortgages receivable	8	144	138
Fiscal Agency Loan Program	9	10,181	8,521
Other assets	10	61	28
		15,821	**13,296**
Liabilities and Net Equity (Deficiency)			
Liabilities:			
Accounts payable and accrued liabilities	11	2,155	2,027
Amounts due to other governments	12	84	105
Due to Crown corporations, agencies and trust funds	13	67	63
Deferred revenue	14	310	314
Public debt, used for government operating purposes	15	9,675	7,248
Public debt, used for Fiscal Agency Loan Program	16	10,160	8,502
		22,451	18,259
Net equity (deficiency)	17	(6,630)	(4,963)
		15,821	**13,296**
Physical assets	18		
Contingencies and commitments	19		

The accompanying notes and supplementary statements are an integral part of these financial statements.

Summary Financial Statements
Statement of Revenue and Expenditure
for the Fiscal Year Ended March 31, 1993

	In Millions 1993	In Millions 1992
Revenue	$	$
Taxation—personal income	4,018	4,287
Taxation—corporate income	545	577
Taxation—social service	2,085	1,991
Taxation—property	1,463	1,248
Taxation—other	1,548	1,165
Natural resources	1,245	1,101
Fees and licences—Medical Services Plan premiums	776	742
Fees and licences—other	768	725
Investment earnings	442	412
British Columbia Endowment Fund	47	
Privatization Benefits Fund		52
Miscellaneous	237	287
Contributions from government enterprises	769	465
Contributions from the federal government—Established Programs Financing	1,532	1,156
Contributions from the federal government—Canada Assistance Plan	794	767
Contributions from the federal government—other	179	180
Recoveries	952	795
Total revenue	**17,400**	**15,950**
Expenditure		
Health	6,051	5,601
Social services	2,309	1,949
Education	4,795	4,514
Protection of persons and property	797	705
Transportation	1,051	1,241
Natural resources and economic development	1,098	1,288
Other	586	572
General government	914	936
Debt servicing	1,767	1,523
Total operating expenditure (Note 20)	**19,368**	**18,329**
Net Operating Revenue (Expenditure) for the Year	(1,968)	(2,379)
Non–Operating Transactions		
Increase in unremitted earnings of government enterprises (Note 6)	301	216
Consolidated Net Revenue (Expenditure) for the Year (Note 21)	**(1,667)**	**(2,163)**

The accompanying notes and supplementary statements are an integral part of these financial statements.

Summary Financial Statements
Statement of Changes in Cash and Temporary Investments
for the Fiscal Year Ended March 31, 1993

	In Millions 1993 Receipts $	1993 Disbursements $	1993 Net $	1992 Net $
Operating Transactions				
Net operating revenue (expenditure) for the year			(1,968)	(2,379)
Non–cash items included in net expenditure:				
Concessionary loan adjustments increases			26	24
Provision for doubtful accounts increases			38	211
Unremitted equity of government enterprises increases			301	216
Other under $15 million			(24)	(2)
Public debt issue/discount (decreases) increases			21	(52)
Accounts receivable (increases)			(190)	(57)
Due from other governments (increases)			(14)	(25)
Accounts payable increases			128	185
Due to other governments (decreases)			(21)	(92)
Equity in government enterprises (increases)			(499)	(145)
Due to Crown corporations increases			4	10
Cash items applicable to future operations			(18)	20
Cash (used for) operations			(2,216)	(2,086)
Investment Transactions				
Loans, advances and other investments (issues)	18	134	(116)	12
Mortgages receivable repayments (issues)	9	1	8	6
Cash derived from (used for) investments	27	135	(108)	18
Total financial (requirements)			(2,324)	(2,068)
Financing Transactions[1]				
Increase in public debt	22,553	18,492	4,061	3,123
Used for Fiscal Agency Loan Program	(15,230)	(13,567)	(1,663)	(1,189)
Cash derived from financing	7,323	4,925	2,398	1,934
(Increase) decrease in cash and temporary investments			74	(134)
Balance—beginning of year			85	219
Balance—end of year			**159**	**85**

[1] Financing transaction receipts are from debt issues and disbursements are for debt repayments.

The accompanying notes and supplementary statements are an integral part of these financial statements.

Notes to Summary Financial Statements for the Fiscal Year Ended March 31, 1993

1. Significant Accounting Policies

(a) Reporting Entity

These financial statements include the accounts of organizations which are accountable for the administration of their financial affairs and resources either to a minister of the government or directly to the Legislature, and are owned or controlled by the government.

A detailed schedule of organizations included in these consolidated financial statements may be found on B26.

Advanced education institutions are excluded from consolidation. These organizations are dissimilar to other government organizations in terms of their objectives, operations and financial reporting practices. Trusts administered by a government or government organization are excluded from the government reporting entity.

(b) Principles of Consolidation

The accounts of the organizations, except those designated as government enterprises, are consolidated after adjusting them to a basis consistent with the accounting policies described below. Inter–organization accounts and transactions are eliminated upon consolidation.

A government enterprise has the financial and operating authority to carry on a business, including contracting in its own name, and sells goods and services to individuals and non–government organizations as its principal activity and source of revenue.

Government enterprises are recorded on the modified equity basis. Under this basis, the government's investment is initially recorded at cost and adjusted annually to include the net earnings/losses and other net equity changes of the enterprise without adjusting them to conform with the accounting policies described below. Since the government ensures the ongoing activities of government enterprises, full account is taken of losses in these enterprises, even where the cumulative losses exceed the original investment.

Inter–enterprise accounts and transactions are not eliminated. However, profit elements included in such transactions, including certain increases in contributed surplus, are eliminated.

Adjustments are not made to account for changes in organizations whose fiscal year–ends are not March 31, unless the effect of adjustment would be significant to the consolidated operating results.

(c) Basis of Accounting and Specific Policies

The governments Summary financial statements are prepared in accordance with the accounting policies described below and on a basis consistent with that of the preceding year:

Basis of Accounting

The accrual basis of accounting is used, which is specifically expressed as follows:

Revenue

All revenues are recorded on an accrual basis except where the accruals cannot be determined with a reasonable degree of certainty or where their estimation is impracticable. The exceptions, which normally relate to certain payments to the province under the *Federal–Provincial Fiscal Arrangements and Federal Post–Secondary Education and Health Contributions Act, 1977*, are recorded on a cash basis.

Expenditure

All expenditures, including the cost of fixed assets, are recorded for goods and services received during the year. Grants (which include forgivable loans) are recorded as expenditures when disbursement of the funds has been authorized. Contributions are recorded as expenditures at the earlier of:

(i) the date payment has been authorized; or,

(ii) the date on which performance conditions are achieved by the recipient under provisions of a statute, contract or agreement.

Authorized contributions relating to retroactive wage settlements are recorded as an expenditure of the period during which the services were provided.

Tax credits/offsets are accrued on the same basis as the associated tax revenues.

Assets

All assets are recorded to the extent that they represent cash and claims upon outside parties or items held for resale to outside parties as a result of events and transactions prior to the year–end. Rental payments for leases which transfer the benefits and risks incident to the ownership of certain assets, not including special purpose buildings, are reported as expenditures at the dates of inception of the leases.

Liabilities

All liabilities are recorded to the extent that they represent claims payable to outside parties as a result of events and transactions prior to the year–end, including: probable losses on loan guarantees issued by the government; contingent liabilities when it is likely a liability exists and the amount of the liability can be reasonably determined on an individual or portfolio basis; and, unfunded pension liabilities calculated using the Level Contribution Funding Actuarial Cost Method.

Changes in the unfunded liability for pension plans which arise as a result of estimation adjustments due to experience gains and losses and changes in actuarial assumptions are amortized over expected average remaining service life of the related employee group. Gains or losses arising as a result of plan amendments are recognized in full in the year of amendment.

Foreign Currency Translation

Monetary assets and liabilities denominated in foreign currencies are translated to Canadian dollars at the exchange rate prevailing at the year–end, and foreign currency transactions are translated at the exchange rate prevailing at the date of the transaction unless hedged by forward contracts which specify the rate of exchange. Adjustments to revenue or expenditure transactions arising as a result of foreign currency translation are credited or charged to operations at the time the adjustments arise. Unrealized foreign currency gains and losses on long–term, fixed–term monetary assets and liabilities are reported as deferred charges and amortized over the remaining terms of the related items on a straight line basis.

Non–monetary assets and liabilities are translated at historical rates of exchange.

Concessionary Loans and Mortgages

Loans and mortgages that are made at a rate of interest below the government's borrowing rate for an equivalent term are considered concessionary.

Concessionary loans and mortgages are recorded at their net present value (net of grant component) less any provision required for doubtful collection. Present value discounts are recorded as grant expenditures.

Principal repayments of concessionary loans and mortgages will first be applied to the reduced loan or mortgage balance (net present value) and then recorded as revenue (recovery of a grant) when received.

Valuation Allowances

Valuation allowances, such as provisions for doubtful accounts and provisions for reduction in value of investments, are included as expenditures on the statement of revenue and expenditure. Personal, corporate income and property tax are recorded net of tax credits and adjustments which are based upon revised assessments of actual tax revenue of previous taxation years. Tax credits and adjustments are not considered valuation allowances.

SPECIFIC POLICIES

Cash and Temporary Investments

Cash balances are shown after deducting outstanding cheques issued prior to the year–end. Cheques issued subsequent to the year–end relating to the previous year are included in accounts payable.

Temporary investments include short–term investments recorded at the lower of cost or market value. Temporary investments consist mainly of units in the Province of British Columbia Pooled Investment Portfolio money market funds. Units are carried at the lower of cost of acquisition adjusted by income attributed to the units, or market value.

Accounts Receivable

All amounts receivable (including any trade receivables from government enterprises) at the year–end for work performed, goods supplied or services rendered are recorded as revenue or recoveries of the fiscal year. Valuation allowances are provided where collectibility is considered doubtful.

Inventories

Inventories comprise items held for resale and are recorded at the lower of cost or net realizable value. Inventories of supplies are charged to the respective programs when the cost is incurred.

Property under development, which will eventually be sold to outside parties, is recorded at the lower of cost or net realizable value.

Amounts Due From Other Governments

Amounts due from other governments include loans and advances outstanding at the year–end.

Equity In Government Enterprises

Equity in government enterprises represents the government's investment (including long–term advances) in those government organizations at cost, adjusted for increases and decreases in the investees' net assets.

Loans, Advances and Other Investments

Loans, advances and other investments are recorded at cost less adjustment for any prolonged impairment in value.

Mortgages Receivable

Mortgages receivable are secured by real estate and are repayable over periods ranging up to thirty years. Valuation allowances are made where collectibility is considered doubtful.

Fiscal Agency Loan Program

Fiscal Agency Loan Program consists of loans made to government bodies, and cash and temporary investments set aside for the specific purpose of loaning to government bodies. Loans are recorded at maturity value less unamortized discounts and sinking fund balances. Discounts are amortized on an effective yield basis. These loans are recorded as assets even if they are only recoverable through future appropriations of the government.

Other Assets

Other assets include prepaid program costs. Prepaid program costs represent expenditures made during the fiscal year for work to be performed, goods to be supplied, services to be rendered or contractual obligations to be fulfilled by outside parties in a subsequent fiscal year. These costs also include inventories of operating materials held in the Purchasing Commission and Queen's Printer warehouses pending distribution in a subsequent fiscal year.

Also included in other assets are certain deferred charges.

Physical Assets

Disbursements for physical assets are recorded as expenditures in the year the assets are received. Consistent with the reporting of physical assets as expenditures, highways, bridges, wharves, ferries and ferry landings, buildings, office equipment, furniture, automobiles and Crown land comprised of parks, forests and all other publicly held land by the province, not including property under development, are recorded at a nominal value of $1.

Accounts Payable and Accrued Liabilities

All amounts payable (including any trade payables to government enterprises) for work performed, goods supplied, services known to have been rendered or for charges incurred in accordance with the terms of a contract are recorded as part of the expenditures of the fiscal year.

Amounts Due to Other Governments

Amounts due to other governments represent liabilities incurred due to advances and loans from other governments.

Due to Crown Corporations, Agencies and Funds

Amounts due to Crown corporations, agencies and funds represent liabilities incurred, other than trade payables, which are payable in the following year.

Deferred Revenue

Deferred revenue represents amounts received or receivable prior to the year-end relating to revenue that will be earned in subsequent fiscal years.

Public Debt

Public debt represents direct debt obligations for the purposes of the Government of British Columbia, the Fiscal Agency Loan Program and direct debt obligations of consolidated Crown corporations. These obligations are recorded at principal less unamortized discounts and sinking fund balances where applicable. Discounts are amortized on an effective yield basis.

Guaranteed Debt

Guaranteed debt represents that debt of municipalities and other local governments, private enterprises and individuals, and debt and minority interests of provincial Crown corporations, which has been explicitly guaranteed or indemnified by the government, under the authority of a statute, as to net principal or redemption provisions. Valuation allowances are made where probable losses can be reasonably estimated.

A valuation allowance provision is established representing the probable losses on loan guarantees issued by the government. The amount of the provision is determined by the loss experience of the guarantee program and is sufficient to meet the expected payout of the guarantee to the lender. The provision is recorded as an expense in the year the guarantee is issued and is adjusted as necessary to ensure it equals the expected payout of the guarantee.

Commitments

Commitments represent future obligations of the government and government organizations and enterprises for capital contracts and extraordinary program commitments, to the extent of contracts and agreements in place at the year-end.

Notes to Summary Financial Statements for the Fiscal Year Ended March 31, 1993—Continued

2. Cash and Temporary Investments

	In Millions 1993 $	1992 $
Cash (cheques issued in excess of funds on deposit)	(150)	(100)
Temporary investments		
Units in Province of British Columbia Pooled Investment Portfolios	309	185
	159	**85**

3. Accounts Receivable

	In Millions 1993 $	1992 $
Taxes receivable	954	836
Trade accounts receivable	224	205
Accrued interest	266	236
Crown corporations and agencies	24	21
	1,468	1,298
Less provision for doubtful accounts	(140)	(135)
	1,328	**1,163**

4. Inventories

	In Millions 1993 $	1992 $
Property under development	46	47
Ministerial inventories	1	1
	47	**48**

5. Amounts Due From Other Governments

	In Millions 1993 $	1992 $
Government of Canada:		
Current	87	66
Other provinces:		
Current	14	2
Local governments:[1]		
Current	2	21
	103	**89**

[1] Local governments are municipal units established by the provincial government. They include regional and metropolitan municipalities, cities, towns, townships, districts, rural municipalities and villages.

Notes to Summary Financial Statements for the Fiscal Year Ended March 31, 1993—Continued

6. Equity in Government Enterprises[1]

	In Millions			
	1993			1992
	Investments and Amounts Due $	Unremitted Earnings $	Total $	Total $
B.C. Pavilion Corporation	154		154	157
British Columbia Assessment Authority		5	5	3
British Columbia Ferry Corporation		223	223	241
British Columbia Housing and Employment Development Financing Authority				1
British Columbia Housing Management Commission		8	8	8
British Columbia Hydro and Power Authority	237	1,188	1,425	951
British Columbia Liquor Distribution Branch		1	1	
British Columbia Lottery Corporation	9		9	20
British Columbia Petroleum Corporation		1	1	1
British Columbia Railway Company	258	701	959	903
British Columbia Steamship Company (1975) Ltd.		2	2	3
British Columbia Transit		118	118	116
Duke Point Development Limited		4	4	4
Pacific National Exhibition		31	31	32
Provincial Capital Commission		4	4	4
Provincial Rental Housing Corporation	49	6	55	60
W.L.C. Developments Ltd.		22	22	18
	707	2,314	3,021	2,522

[1] *See* B27 for details.

Change in Equity in Government Enterprises

	In Millions			
	1993			1992
	Investments and Amounts Due $	Unremitted Earnings $	Total $	Total $
Balance—beginning of year	509	2,013	2,522	2,377
Increase (decrease) for the year	198	301	499	145
Balance—end of year	707	2,314	3,021	2,522

Notes to Summary Financial Statements for the Fiscal Year Ended March 31, 1993—Continued

7. Loans, Advances and Other Investments[1]

	In Millions	
	1993	1992
	$	$
Agricultural Land Development Act	9	9
British Columbia Endowment Fund Act	535	
Crop Insurance Stabilization Act	14	15
Development Corporation Act	117	114
Downtown Revitalization Act	8	9
Financial Administration Act	46	37
Homeowner Assistance Act	3	4
Industrial Development Fund Act	6	20
Industrial Development Incentive Act	165	158
Low Interest Loan Agreement Revolving Fund Act	2	4
Ministry of Lands, Parks and Housing Act		1
Natural Resource Community Fund Act	19	
Privatization Benefits Fund Act		512
Vancouver Island Natural Gas Pipeline Act	15	7
Other	107	66
	1,046	956
Less provision for doubtful accounts	(269)	(254)
	777	**702**

[1]The act reference in this section is that under which the loan program was established.

8. Mortgages Receivable

	In Millions	
	1993	1992
	$	$
Crown Land—pursuant to the *Ministry of Lands, Parks and Housing Act*	14	17
False Creek land sale		
Note receivable	118	106
Public participation funding agreement	7	7
Provincial Regional Housing Corporation		1
Provincial Home Acquisition—pursuant to the *Provincial Home Acquisition Act, Home Purchase Assistance Act,* and the *Home Conversion and Leasehold Loan Act*	37	41
Other	2	2
	178	174
Less provision for doubtful accounts	(34)	(36)
	144	**138**

Notes to Summary Financial Statements for the Fiscal Year Ended March 31, 1993—Continued

9. Fiscal Agency Loan Program

	In Millions 1993	1992
Amounts recoverable substantially from future grant appropriations:	$	$
B.C. Pavilion Corporation		6
British Columbia Transit	1,142	1,087
Capital Project Certificate of Approval Program	367	250
Improvement Districts	3	2
Post Secondary Education Institutions	880	682
Regional Hospital Districts	957	897
School Districts	1,404	1,144
Thompson–Nicola District	1	1
	4,754	4,069
Amounts recoverable from sources other than future grant appropriations:		
British Columbia Assessment Authority	5	8
British Columbia Ferry Corporation	300	149
British Columbia Housing Management Commission	9	
British Columbia Hydro and Power Authority	4,756	4,077
British Columbia Railway Company	93	48
Greater Vancouver Sewerage and Drainage District	162	94
Greater Vancouver Water District	102	70
W.L.C. Developments Ltd		6
	5,427	4,452
	10,181	**8,521**

10. Other Assets

	In Millions 1993	1992
	$	$
Prepaid program costs	11	3
Deferred charges	50	25
	61	**28**

11. Accounts Payable and Accrued Liabilities

	In Millions 1993	1992
	$	$
Trade accounts payable and other liabilities	883	926
Accrued interest on public debt	544	402
Accrued employee leave entitlements	121	110
Provision for guaranteed debt payout	43	44
Other accrued liabilities[1]	119	100
Accrued pension liabilities[2]	445	445
	2,155	**2,027**

[1] Includes pending litigation, provision for clean up of Expo land site and other miscellaneous contingent liabilities.

[2] This is an estimated liability based on actuarial assumptions of future inflation rates, interest rates and wage increases made as of March 31, 1990, and also includes an estimated amount to cover M.L.A. pensions.

Notes to Summary Financial Statements for the Fiscal Year Ended March 31, 1993—Continued

12. Amounts Due to Other Governments

	In Millions 1993	1992
	$	$
Government of Canada:		
Current	35	74
Local governments:[1]		
Current	49	31
	84	**105**

[1]Local governments are municipal units established by the provincial government. They include regional and metropolitan municipalities, cities, towns, townships, districts, rural municipalities and villages.

13. Due to Crown Corporations, Agencies and Trust Funds

	In Millions 1993	1992
	$	$
Trust Funds	29	18
British Columbia Colleges and Institutes	19	17
British Columbia Hydro and Power Authority		10
British Columbia Liquor Distribution Branch		2
British Columbia Transit	4	4
Simon Fraser University		3
University of British Columbia	15	7
University of Victoria		2
	67	**63**

14. Deferred Revenue

	In Millions 1993	1992
	$	$
Motor vehicle licences and permits	97	91
Water rentals and recording fees	74	74
Petroleum, natural gas and minerals, leases and fees	21	21
Medical Services Plan premiums	53	56
Miscellaneous	65	72
	310	**314**

Notes to Summary Financial Statements for the Fiscal Year Ended March 31, 1993—Continued

15. Public Debt, Used for Government Operating Purposes

In Millions

	Year of Maturity	1993 Canadian Dollar Debt $	1993 U.S. Dollar Debt (CDN $) $	1993 Total Canadian Dollars $	1993 Weighted Average Coupon Rate Percent	1992 Total Canadian Dollars $	1992 Weighted Average Coupon Rate Percent
Short-term promissory notes	1992–1993					840	
	1993–1994	283	67	350		6	
		283	67	350		846	
Treasury bills	1992–1993					780	
	1993–1994	780		780			
		780		780		780	
Notes, bonds and debentures	1992–1993					346	8.19
	1993–1994	355	1	356	9.26	406	9.76
	1994–1995	532	13	545	8.56	505	9.23
	1995–1996	1,404	1	1,405	7.68	618	10.71
	1996–1997	923	4	927	9.30	916	9.33
	1997–1998	992		992	7.97	181	9.66
	1998–2003	3,173	931	4,104	9.47	2,814	10.52
	2003–2008	153		153	6.51	152	11.52
	2008–2013	828		828	8.77	557	9.78
	2013–2018	57		57	8.49		
	2018–2023	445		445	9.34		
		8,862	950	9,812	8.87	6,495	10.03
Total debt issued at face value		9,925	1,017	10,942		8,121	
Less:							
Sinking funds				(1,080)		(721)	
				9,862		7,400	
Unamortized discount				(172)		(147)	
				9,690		7,253	
Amount held in the Consolidated Revenue Fund				(15)		(5)	
				9,675		**7,248**	

Promissory notes outstanding at March 31, 1993 mature at various dates to September 2, 1993 at an annual average interest rate of 6.09%. During the year, $1.8 billion in notes were issued at interest rates which varied between 4.68% and 8.20%.

Treasury bills outstanding at March 31, 1993 mature at various dates to September 29, 1993 at an annual average interest rate of 6.45%. During the year, $2.4 billion in Treasury bills were issued at interest rates which varied between 4.53% and 8.70%.

The province had 167 series of notes and bonds outstanding at March 31, 1993.

Included in notes and bonds payable in Canadian currency are Japanese Yen notes totalling 14.4 billion Yen (1992: 26.2 billion Yen) which have been fully hedged to $116.7 million Canadian (1992: $194.2 million Canadian) through currency exchange agreements, and U.S. dollar notes totalling $300 million (1992: nil) which have been fully hedged to $365.6 million (1992: nil) through currency exchange agreements.

The province holds $15 million (1992: $5 million) of the bonds issued and outstanding at March 31, 1993. These have been eliminated from the balance sheet for reporting purposes.

The aggregate amounts of payments estimated to be required in each of the next five fiscal years to meet sinking fund and retirement provisions are:

In Millions

	Canadian Funds $	U.S. Funds $
1994	383	17
1995	668	24
1996	1445	17
1997	801	20
1998	938	16

Notes to Summary Financial Statements for the Fiscal Year Ended March 31, 1993—Continued

Under interest rate swap agreements relating to long and medium term debt with fixed rates, the fixed rate debt service payments are exchanged for variable rate payments for some of the notes, bonds and debentures. At March 31, 1993, $450 million (1992: nil) in Canadian dollar debt principal was subject to interest rate swaps. The agreements, which relate to three separate bond issues, mature at various dates up to January 9, 2002. Interest rate differentials range from 1.25% to 2.148%.

Under interest rate swap agreements relating to short term debt, variable rate debt service payments are exchanged for fixed rate payments for some of the short term promissory notes. At March 31, 1993, $85 million (1992: $45 million) in Canadian dollar debt principal was subject to interest rate swaps. The agreements mature at various date up to February 19, 2001. Interest rate differentials range from 4.726% to 5.166%.

16. Public Debt, Used for Fiscal Agency Loan Program

In Millions

	Year of Maturity	1993 Canadian Dollar Debt $	1993 U.S. Dollar Debt (CDN $) $	1993 Total Canadian Dollars $	1993 Weighted Average Coupon Rate Percent	1992 Total Canadian Dollars $	1992 Weighted Average Coupon Rate Percent
Short-term promissory notes	1992–1993					2,292	
	1993–1994	1,183	1,055	2,238			
		1,183	1,055	2,238		2,292	
Notes, bonds and debentures	1992–1993					42	13.53
	1993–1994	788		788	11.44	771	11.70
	1994–1995	242		242	9.68	232	9.85
	1995–1996	32		32	11.27	69	10.14
	1996–1997	231		231	9.19	308	9.14
	1997–1998	562		562	8.85	313	9.66
	1998–2003	2,430	442	2,872	10.68	2,187	11.62
	2003–2008	1,378		1,378	11.28	1,378	11.27
	2008–2013	2,062		2,062	10.12	1,809	10.22
	2013–2018	593		593	8.50		
	2018–2023	905		905	10.06	600	10.60
		9,223	442	9,665	10.49	7,709	10.92
Total debt issued at face value		10,406	1,497	11,903		10,001	
Less:							
Sinking funds				(1,657)		(1,430)	
				10,246		8,571	
Unamortized discount				(64)		(49)	
				10,182		8,522	
Amount held in the Consolidated Revenue Fund				(22)		(20)	
				10,160		**8,502**	

Promissory notes outstanding at March 31, 1993 mature at various dates to November 19, 1993 at an annual average interest rate of 5.04%. During the year, $13.2 billion in notes were issued at interest rates which varied between 3.65% and 8.99%.

The province had 361 issues of notes, bonds and debentures outstanding at March 31, 1993.

Included in notes, bonds and debentures payable in Canadian currency are Japanese Yen notes totalling 4.9 billion Yen (1992: 8.0 billion Yen) which have been fully hedged to $33.4 million Canadian (1992: $53.3 million Canadian) and U.S. dollar notes totalling $70 million (1992: nil) which have been fully hedged to $89.6 million Canadian (1992: nil) through foreign currency exchange agreements.

The province holds $22 million (1992: $20 million) of the bonds issued and outstanding at March 31, 1993. These have been eliminated from the balance sheet for reporting purposes.

Notes to Summary Financial Statements for the Fiscal Year Ended March 31, 1993—Continued

The aggregate amounts of payments estimated to be required in each of the next five fiscal years to meet sinking fund and retirement provisions are:

	In Millions	
	Canadian Funds	U.S. Funds
	$	
1994	928	4
1995	358	4
1996	176	4
1997	262	4
1998	452	4

Under interest rate swap agreements relating to long and medium term debt with fixed rates, the fixed rate debt service payments are exchanged for variable rate payments for some of the notes, bonds and debentures. For long and medium term debt with variable rates, the variable rate debt servicing payments are exchanged for variable rate payments calculated on a different basis. At March 31, 1993, $800 million (1992: $1,050 million) in Canadian dollar debt principal and $100 million (1992: nil) in U.S. dollar debt principal was subject to interest rate swaps. The agreements, which relate to five separate bond issues, mature at various dates up to February 5, 2003. Interest rate differentials range from 0.714% to 6.704%. Subsequent to March 31, 1993, two interest swap agreements totalling $275 million were closed out and buyout payments totalling $6.4 million were received.

Under interest rate swap agreements relating to short term debt, variable rate debt service payments are exchanged for fixed rate payments for some of the short term promissory notes. At March 31, 1993, $205 million (1992: nil) in U.S. dollar debt principal was subject to interest rate swaps. The agreements mature at various dates up to August 19, 2002. Interest rate differentials range from 3.28% to 3.915%.

Included in notes, bonds and debentures are Canada Pension Plan debentures totalling $4.4 billion at March 31, 1993. They mature at various dates to July 10, 2012, at an average interest rate of 10.52%. During the year, $222.6 million in debentures were issued at interest rates which varied between 9.17% and 9.45%.

Notes to Summary Financial Statements for the Fiscal Year Ended March 31, 1993—Continued

17. Net Equity (Deficiency)

	In Millions 1993 $	1992 $
Net equity (deficiency)—beginning of year	(4,963)	(2,800)
Net revenue (expenditure) for the year	(1,667)	(2,163)
Net equity (deficiency)—end of year	**(6,630)**	**(4,963)**

18. Physical Assets

Physical assets are recorded as expenditures in the year they are received. Expenditures for physical assets are classified in the books of the province as "Asset Acquisitions." An estimate of the value of the acquired physical assets, along with applicable depreciation, can be found on H11 in the unaudited section of the Public Accounts.

19. Contingencies and Commitments

(a) Guaranteed Debt

Guaranteed debt as at March 31, 1993 totalled $3.4 billion (1992: $4.1 billion).

	In Millions 1993 Net Outstanding $	1992 Net Outstanding $
Municipalities and other local governments	5	6
Health and education	182	153
Economic development	838	915
Utilities	2,504	3,149
Total	3,529	4,223
Less:		
Amounts included as investments within the consolidated entity	(51)	(70)
Provision for probable payout	(43)	(44)
	3,435	**4,109**

(b) Contingent Liabilities

(i) Pending litigation

The government is a defendant in legal actions which may give rise to future liabilities. Contingent liabilities are accrued in the financial statements when it is likely that a liability exists and the amount of the liability can be reasonably estimated on an individual or portfolio basis.

- Consolidated Revenue Fund—the total claimed in specific legal actions, where the estimated or known claim is or exceeds $100,000, amounts to approximately $207 million. See Note 19 to the Consolidated Revenue Fund Financial Statements section of the Public Accounts for details.

(ii) Other contingent liabilities

The government also has contingent liabilities in the form of indemnities, indirect guarantees and outstanding claims. Where indemnities are for explicit quantifiable loans, the amounts are included in the statement of guaranteed debt.

Under the *Criminal Injury Compensation Act*, the province is responsible for providing compensation to victims of crime in British Columbia, for offences described in the Act.

(iii) Aboriginal Land Claims

The absence of treaties relating to most of the territory constituting British Columbia has resulted in a number of outstanding aboriginal land claims across British Columbia. Some of these claims have resulted in litigation but most have simply been submitted to governments for negotiation. The province's position on these claims is that, although the province recognizes aboriginal rights including the inherent right of aboriginal people to self-government, the precise location, scope, and content of these rights should be established not through litigation, but by means of tripartite negotiations involving the federal and provincial governments and aboriginal groups. The province anticipates that these negotiations will result in modern day treaties defining the boundaries and nature of aboriginal lands and rights and ensure a more stable environment for resource development in British Columbia.

Notes to Summary Financial Statements for the Fiscal Year Ended March 31, 1993—Continued

19. Contingencies and Commitments—Continued

Twenty-one tribal councils and bands have had comprehensive land claims accepted for negotiation by the Government of Canada. The claim of Nisga'a Tribal Council in the Nass Valley in northwestern British Columbia is the only claim under active negotiation, although both the federal and provincial governments are committed to engaging in multiple negotiations over the next several years. The British Columbia Treaty Commission has been established to facilitate these negotiations in the future.

There is currently one major aboriginal rights case before the courts in British Columbia. It involves a claim by Hereditary Chiefs and the houses they represent to jurisdiction and control over approximately 5.5 million hectares located in mainly rural and wilderness areas of British Columbia. They also seek declarations which challenge the province's ownership and jurisdiction over the lands, mines, minerals, royalties, resources and all other matters within the claim area. They assert that the province's jurisdiction is subject to their right of ownership and further that the province cannot issue licenses or permits authorizing the use of any resources. They also seek damages from the province for wrongful appropriation and the use of the claim area. The claim was dismissed at trial on March 8, 1991. The trial judge held that all land-based aboriginal rights were lawfully extinguished in colonial times (pre 1871). The trial decision was appealed to the British Columbia Court of Appeal which rendered its judgment allowing the appeal in part on June 25, 1993.

The Court of Appeal dismissed the plaintiffs' claims of ownership and jurisdiction, but held that aboriginal rights had *not* been extinguished as a result of colonial legislation or actions of either the provincial or federal governments before or since 1871 (when British Columbia entered Confederation). The court held that because of the division of powers in the *Constitution Act, 1867*, the province was constitutionally incompetent to extinguish aboriginal rights after 1871, and could only legitimately displace or suspend such rights under section 88 of the *Indian Act* (Canada), which came into force in 1951.

While the Court of Appeal dismissed the plaintiff's claim for damages because it was based on their assertion of ownership and jurisdiction, the court left open the possibility of other claims for damages or other remedies associated with provincial interference with aboriginal rights, particularly between 1871 and 1951. However, the court also indicated that the validity of Crown grants and resource tenures issued before 1982 (when the then existing aboriginal and treaty rights of aboriginal peoples became constitutionally recognized and affirmed under the *Constitution Act, 1982*) could not now be called into question. Since 1982 any government interference with then existing aboriginal rights must be justified (in accordance with a test previously established by the Supreme Court of Canada) by the government authority so interfering.

Aboriginal rights were not specifically defined by the Court of Appeal other than as activities relating to use and occupation of land that an organized aboriginal society regarded as an integral part of their distinctive culture at the time of the declaration of British sovereignty (1846) over what is now British Columbia. However, the court did state that aboriginal rights are non-exclusive and are not necessarily incompatible with other types of land use. The court held that the precise scope, content and location of aboriginal rights and the reconciliation of those rights with other uses of lands and resources were left to be determined in trial proceedings properly framed to deal with those issues. However, the court also indicated throughout the judgment that those issues were "ripe for negotiation" and encouraged the parties to negotiate their differences.

The deadline for filing an appeal in this case to the Supreme Court of Canada is October 25, 1993. As at September 10, 1993, neither party has appealed or publicly announced an intention to appeal.

Seven other cases involving aboriginal rights issues were also recently decided by the Court of Appeal. These cases can be categorized as follows:

- hunting cases wherein an aboriginal right to hunt for sustenance and ceremonial purposes was held to exist and consequently certain Provincial statutory provisions were held to be inoperative in their application to aboriginal peoples;
- commercial fishing cases wherein the aboriginal right to fish for sustenance and ceremonial purposes was held not to extend to commercial fishing; and
- fishing cases wherein the right of native bands to establish bylaws with respect to reserve lands was held not to extend to regulation of fishing on rivers running through reserves.

No appeal has, at September 10, 1993, been taken by the parties with respect to any of those seven cases. The deadline for filing an appeal of those cases to the Supreme Court of Canada is also October 25, 1993.

(c) Commitments

At the end of each year, government has a number of commitments outstanding for capital contracts. Such future expenditures are charged to the appropriation in the year in which the work or service is performed. Year-end commitments for capital contracts totalled approximately $223 million (1992: $411 million).

Notes to Summary Financial Statements for the Fiscal Year Ended March 31, 1993—Continued

20. Expenditure by Group Account Classification

	In Millions 1993	1992
	$	$
Grants and contributions	13,582	12,570
Salaries and benefits	1,760	1,617
Operating costs	1,584	1,643
Asset acquisitions	420	611
Other	2,022	1,888
Total operating expenditure	**19,368**	**18,329**

Valuation allowances of $18 million (1992: $211 million) are included in the "Other" group account classification.

Notes to Summary Financial Statements for the Fiscal Year Ended March 31, 1993—Continued

21. Comparison of Planned and Actual Results

In Millions

	1993						1992
	Revenue		Expenditure		Net		Net
	Budget $	Actual $	Budget $	Actual $	Budget $	Actual $	Actual $
Consolidated Revenue Fund	16,191	16,083	17,980	17,960	(1,789)	(1,877)	(2,355)
B.C. Festival of Arts Society	1	1	1	1			
B.C. Health Care Risk Management Society	3	3	3	3			
B.C. Summer and Winter Games Society	3	3	3	3			
British Columbia Buildings Corporation	344	366	324	338	20	28	20
British Columbia Educational Institutions Capital Financing Authority		74		74			
British Columbia Hazardous Waste Management Corporation				1		(1)	
British Columbia Health Research Foundation	8	10	8	9		1	1
British Columbia Heritage Trust	3	2	3	3		(1)	
British Columbia Hospital Districts Financing Authority		107		107			
British Columbia School Districts Capital Financing Authority		123		123			
British Columbia Systems Corporation	183	186	176	174	7	12	18
British Columbia Trade Development Corporation	14	14	14	14			
British Columbia Year of Music Society							(1)
Cloverdale Historic Society of British Columbia							
Downtown Revitalization Program Society of British Columbia		1		2		(1)	
First Peoples' Heritage, Language and Culture Council	2	2	2	2			
Health Facilities Association of British Columbia		23		23			
Okanagan Valley Tree Fruit Authority	5	3	12	9	(7)	(6)	13
Science Council of British Columbia	19	14	19	19		(5)	
The Education Technology Centre of British Columbia	2	2	3	2	(1)		
Adjustments necessary to conform to government accounting policy, including expensing the purchase of fixed assets		383		501		(118)	(75)
		17,400		19,368		(1,968)	(2,379)
Organizations recorded on a modified equity basis—government enterprises		301				301	216
		17,701		**19,368**		**(1,667)**	**(2,163)**

Notes to Summary Financial Statements for the Fiscal Year Ended March 31, 1993—Continued

22. Expenses Due to Increases in Valuation Allowances

	In Millions	
	1993	1992
	$	$
Accounts receivable	5	54
Investments in and amounts due from Crown corporations and agencies		4
Loans, advances and other investments	15	155
Mortgages receivable	(2)	(2)
	18	**211**

These amounts are included in expenditure and represent the write down of assets in the above categories.

23. Trust Funds

Amounts held and administered in trust by the government at the end of the fiscal year totalled $27.6 billion (1992: $25.6 billion). *See* Note 23 to the Consolidated Revenue Fund Financial Statements for further details.

24. Comparatives

Certain of the comparative figures for the previous year have been reclassified to conform with the current year's presentation. Net student loan balances due to the province of $1 million have been reclassified from "Other Assets" to "Loans, Advances and Other Investments."

As a result of a legislative change that occurred July 24, 1992, Medical Services Commission for the year ended March 31, 1993 is included in the Consolidated Revenue Fund financial statements and is no longer a government organization.

For the current year sinking fund income of financing authorities has been deducted from investment earnings and debt servicing costs. Figures from the previous years have been restated.

These reclassifications have had no effect on the operating results or fund balances as previously reported.

25. Subsequent Events

Subsequent to the year-end, the province announced that the entire Tatshenshini–Alsek region of north–western British Columbia would become a Class A (Wilderness) provincial park. The province further stated that tenure holders would be fairly compensated by the government.

Summary Financial Statements
Statement of Organizations and Enterprises
Recorded on a Consolidated or Modified Equity Basis
for the Fiscal Year Ended March 31, 1993

GOVERNMENT ORGANIZATIONS
RECORDED ON CONSOLIDATED BASIS

Consolidated Revenue Fund

B.C. Festival of the Arts Society
B.C. Health Care Risk Management Society
B.C. Summer and Winter Games Society
British Columbia Buildings Corporation
British Columbia Educational Institutions Capital Financing Authority
British Columbia Hazardous Waste Management Corporation
British Columbia Health Research Foundation
British Columbia Heritage Trust
British Columbia Regional Hospital Districts Financing Authority
British Columbia School Districts Capital Financing Authority
British Columbia Systems Corporation
British Columbia Trade Development Corporation
British Columbia Year of Music Society
Cloverdale Historic Transportation Society of B.C.
Downtown Revitalization Program Society of British Columbia
First Peoples' Heritage, Language and Culture Council
Health Facilities Association of British Columbia
Okanagan Valley Tree Fruit Authority
Science Council of British Columbia
The Education Technology Centre of British Columbia

GOVERNMENT ENTERPRISES
RECORDED ON MODIFIED EQUITY BASIS

B.C. Pavilion Corporation
British Columbia Assessment Authority
British Columbia Enterprise Corporation
British Columbia Ferry Corporation
British Columbia Housing and Employment Development Financing Authority
British Columbia Housing Management Commission
British Columbia Hydro and Power Authority
British Columbia Liquor Distribution Branch
British Columbia Lottery Corporation
British Columbia Petroleum Corporation
British Columbia Railway Company
British Columbia Steamship Company (1975) Ltd.
British Columbia Transit
Creston Valley Wildlife Management Authority Trust Fund
Duke Point Development Limited
Hospitals Foundation of British Columbia
Insurance Corporation of British Columbia
Pacific National Exhibition
Plain Language Institute of British Columbia Society
Provincial Capital Commission
Provincial Rental Housing Corporation
W.L.C. Developments Ltd.
178561 B.C. Ltd. (Pacific Coach Lines Ltd.)

Statement of Government Enterprises
Summary of Financial Position and Operating Results
for the Year Ended March 31, 1993

In Millions

Financial Position	Utility	Insurance	Liquor	Trans-portation	Finance	Industry	Natural Resources	Housing	Total
	$	$	$	$	$	$	$	$	$
Assets									
Cash and temporary investments	59	3,078	9	7	52	8	4	13	3,230
Accounts receivable	364	108	6	98	10	4	3	24	617
Inventories	71		51	21		30			173
Loans and advances						4			4
Long-term investments				6				1	7
Fixed assets	8,954	133	7	3,521	23	185		220	13,043
Other assets	557	78		35	3	1		7	681
	10,005	3,397	73	3,688	88	232	7	265	17,755
Liabilities									
Accounts payable and accrued liabilities	483	2,605	72	235	68	12	2	23	3,500
Debt:									
—owing to government	4,756			1,509		3		18	6,286
—owing to others	2,449			429	5			67	2,950
Other long-term liabilities				5	1				6
Deferred liabilities	882	792		11		6		64	1,755
	8,570	3,397	72	2,189	74	21	2	172	14,497
Net assets (liabilities)	1,435	0	1	1,499	14	211	5	93	3,258
Adjustments and eliminations									
Unrealized inter-company profit	(9)							13	4
Unamortized asset appraisal increases				(123)				(84)	(207)
Unamortized gain on debt defeasance	(10)			(67)					(77)
Permanent debt/equity financing	8			(7)				42	43
Equity in government enterprises 1992/93	**1,424**	**0**	**1**	**1,302**	**14**	**211**	**5**	**64**	**3,021**
Equity in government enterprises 1991/92	**951**	**0**	**0**	**1,263**	**24**	**211**	**5**	**68**	**2,522**

Statement of Government Enterprises
Summary of Financial Position and Operating Results for the Year Ended March 31, 1993—Continued

In Millions

Results of Operations	Utility	Insurance	Liquor	Trans-portation	Finance	Industry	Natural Resources	Housing	Total
	$	$	$	$	$	$	$	$	$
Revenue									
From operations	2,178	2,083	1,377	891	797	60	27	99	7,512
Transfer from government				278		7		45	330
Total revenue	2,178	2,083	1,377	1,169	797	67	27	144	7,842
Expenses									
From operations	1,580	2,083	859	1,132	568	65	26	141	6,454
Transfers to government	303								303
Total expenses	1,883	2,083	859	1,132	568	65	26	141	6,757
Net income (loss) for the year 1992/93	**295**	**0**	**518**	**37**	**229**	**2**	**1**	**3**	**1,085**
Net income (loss) for the year 1991/92	**197**	**(55)**	**456**	**53**	**218**	**6**	**0**	**2**	**877**

Statement of Equity in Government Enterprises for the Fiscal Year Ended March 31, 1993

In Millions

	Utility[1]	Insurance[2]	Liquor[3]	Trans–portation[4]	Finance[5]	Industry[6]	Natural Resources[7]	Housing[8]	Total
	$	$	$	$	$	$	$	$	$
Balance—beginning of year	951	0	0	1,263	23	212	5	68	2,522
Net earnings (losses) for the year	295	0	517	37	229	3	1	3	1,085
Dividends paid				(10)					(10)
Capital transfers from (to) government	(9)		(514)		(238)		(1)		(762)
Changes in adjustments and eliminations	6			18				(6)	18
Prior period adjustments	181			2					183
Other adjustments			(2)	(8)		(3)		(2)	(15)
Increase (decrease) in equity of government enterprises	473	0	1	39	(9)	0	0	(5)	499
Balance—end of year	**1,424**	**0**	**1**	**1,302**	**14**	**212**	**5**	**63**	**3,021**

[1] Utility includes British Columbia Hydro and Power Authority.
[2] Insurance includes Insurance Corporation of British Columbia.
[3] Liquor includes British Columbia Liquor Distribution Branch.
[4] Transportation includes British Columbia Ferry Corporation, British Columbia Railway Company, British Columbia Steamship Company (1975) Ltd., British Columbia Transit and 178561 B.C. Ltd (formerly Pacific Coach Lines Limited).
[5] Finance includes British Columbia Assessment Authority, British Columbia Lottery Corporation, and Hospitals Foundation of British Columbia.
[6] Industry includes British Columbia Enterprise Corporation, B.C. Pavilion Corporation, Pacific National Exhibition, Duke Point Development Limited and W.L.C. Developments Ltd.
[7] Natural Resources includes Creston Valley Wildlife Management Authority Trust Fund, Provincial Capital Commission and British Columbia Petroleum Corporation.
[8] Housing includes British Columbia Housing Management Commission, Provincial Rental Housing Corporation of British Columbia, and British Columbia Housing and Employment Development Financing Authority.

Plain Language Institute of British Columbia Society is not included as its equity is less than $1 million.