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Auditor General of British Columbia

Report on the 1995/96 Public Accounts

Province of British Columbia

Financial Unit

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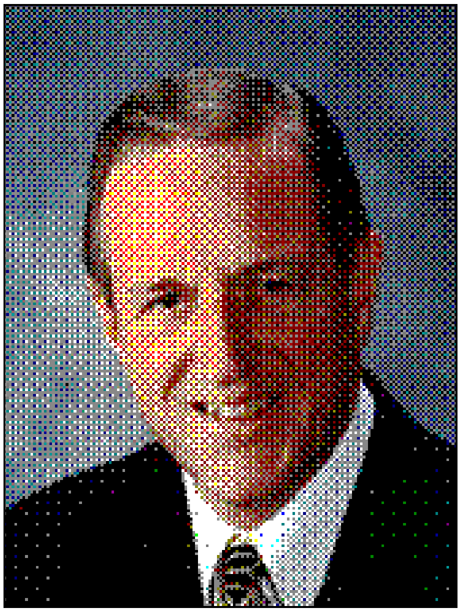


The Public Accounts are the documents by which the government accounts for its financial activities. As such, they are the most important financial accountability documents provided by the government. Accordingly, the audit of the Public Accounts is the focus of much of my staff's energy over the year.

In this report I comment on the recently published Public Accounts for the 1995/96 fiscal year.

I also comment on matters that might further improve government accounting processes and controls. In this regard, I would especially note the urgent need to deal with an obsolete central accounting system and the related Year 2000 issue, and to improve controls over the collection of stumpage revenue from our forests. As well, I provide information that will be helpful to the reader in understanding the financial information provided by the government on Province's revenues, expenses, deficit, and management of provincial debt.

The release of this report must necessarily await the issuance of the Public Accounts by the government. As the 1995/96 Public Accounts were not made public until tabled in the Legislative Assembly in April 1997, the release of this report has had to be delayed pending such tabling.

Comment About Financial Accountability

Significant Progress Has Been Noted

This year the government has taken perhaps the two most significant steps in many years toward improving its accountability. It included within its 1995/96 financial statements the full range of public sector organizations for which it is responsible, and it capitalized and depreciated the physical assets employed in its programs. Both these actions enhance complete financial reporting of government activities and provide a sound basis from which the government can report on its program costs and performance.

Major Issues Require Attention

Timeliness of the Public Accounts Needs Improvement

For many years I have encouraged the government to produce its Public Accounts on a timely basis, and improvements in this regard have been occurring. I am therefore disappointed this year at the lateness of this information, with the full Public Accounts being published over a year after the end of the year being reported. I recognize the difficulties faced with the inclusion of 252 new organizations and the change in the recording of physical assets. However, I urge the government to give priority to ensuring that the Public Accounts are issued soon after each fiscal yearend.

Confusion Arises from Using Two Sets of Financial Statements for Financial Reporting

At present the government produces and reports on two sets of financial statements: the summary level statements, which account for all government activities, and the Consolidated Revenue Fund statements, which account only for the activities of central government. The government's Annual Report, the Public Accounts, and the government's annual debt management report all focus on information contained in the summary level financial statements. However, when reporting its annual surplus/deficit or when preparing its budget, the government refers to information based on Consolidated Revenue Fund transactions. I believe this to be confusing and urge the government to take the necessary steps—legislative or otherwise—to report its operating results only in the context of the summary level statements.

More Information Needs to Be Provided to Assess the Debt Management Plan

In its Budget '95 the government produced a Debt Management Plan. In 1996 I audited information on debt measures, performance indicators and benchmarks reported by the government as of March 31, 1996. Given the importance of information on debt and its management to the taxpayers of British Columbia, I commend the government for this reporting initiative.

The government missed making its direct debt repayment of $414 million scheduled for the 1995/96 fiscal year. Further, Budget '96 deferred most of the debt repayment planned for the 1996/97 fiscal year. The revised schedule raised the debt repayment target for the next 3 years by $623 million.

It is not clear what makes the expectation of enhanced future debt repayments plausible. Therefore, although I do not audit the plan itself, I have included comments in this report on how the public's understanding of the government plan to manage debt can be enhanced. In particular, I believe the plan must discuss the sensitivity of assumptions and outline contingency plans to deal with changes to those assumptions. Also important is the need for clear information on capital spending and how the government expects to meet public infrastructure requirements over the period covered by the plan.

Comments About Government's Accounting, Processes and Controls

Throughout my report I comment not only about ways to enhance financial accountability, but also about where improvements are needed to government's accounting, processes, and controls. As I raise only matters I deem to be substantive, all the points presented in this report warrant careful consideration. However, two matters in particular need to be highlighted: the state of the government's accounting systems and the Ministry of Forests' controls over forest stumpage revenue.

The Obsolete Government Accounting System Is Putting the Government at Risk

In earlier reports I have followed the progress, or lack of it, in the government's replacement of the old central accounting system with a new Corporate Accounting System (CAS), and have also commented on the related Year 2000 issue—that is, the need for all systems to be able to process dates in 2000 and beyond. In this report I again comment on CAS, noting that little progress was made in developing the system over the past year. Furthermore, despite being now one year closer to the year 2000, corrective work has still not yet begun in many systems critical to government operations. Such systems must be dealt with before April 1, 1999, the start of the 1999/2000 fiscal year.

Last year I expressed some urgency in the need to replace the old central accounting system. I now recommend that the government give special priority to both CAS and the Year 2000 problem.

Controls Over Forest Stumpage Revenue Needs Improvement

In 1989 I reported that substantial improvement was needed in controls over the completeness and accuracy of information received by the Ministry of Forests on the volume and species of timber removed from Crown lands. This year, given the importance of forest revenues to the Province of British Columbia, I again looked at controls in this area. I noted that, since my last report, the ministry has made many improvements to its control processes. However, I remain convinced that timber may be harvested but unreported, and that incomplete and inaccurate data may still be received by the ministry without detection.

This is my sixth report to the Legislative Assembly for the 1996/97 fiscal year. I believe this report provides valuable insights into matters reported in the 1995/96 Public Accounts, and important recommendations as to how government financial accountability and processes may be further improved.

I wish to acknowledge the outstanding work of my staff, which has resulted in the issuing of this report. I thank them for their hard work, professionalism, and dedication.

George L. Morfitt, FCA
Auditor General

Victoria, British Columbia
April 1997

introduction

introduction

The Auditor General is required, under the provisions of the *Auditor General Act,* to examine the government's accounts and records and to report annually to the Legislative Assembly on the Financial Statements of the Province. In these reports, the Auditor General must state whether all the information and explanations required have been received; whether the statements present fairly the financial position, results of operations, and changes in financial position of the Province; and whether the statements have been prepared in accordance with the accounting policies stated in them, 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 Financial Statements of the Province of British Columbia.

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 to the Legislative Assembly an assessment as to whether the financial statements of the government have been prepared in accordance with the most appropriate basis of accounting for the purpose of fair presentation and disclosure.

The Auditor General's mandate provides for comment on whether government 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 performance and compliance-with-authorities audit reports.

This report contains comments and observations arising during the Auditor General's audit of the Financial

Statements of the Province for the fiscal year ended March 31, 1996. 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.

province's financial statements and public accounts

province's financial statements and public accounts

The Financial Statements of the Province 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 either 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 1995/96 fiscal year were published in three volumes in April 1997.

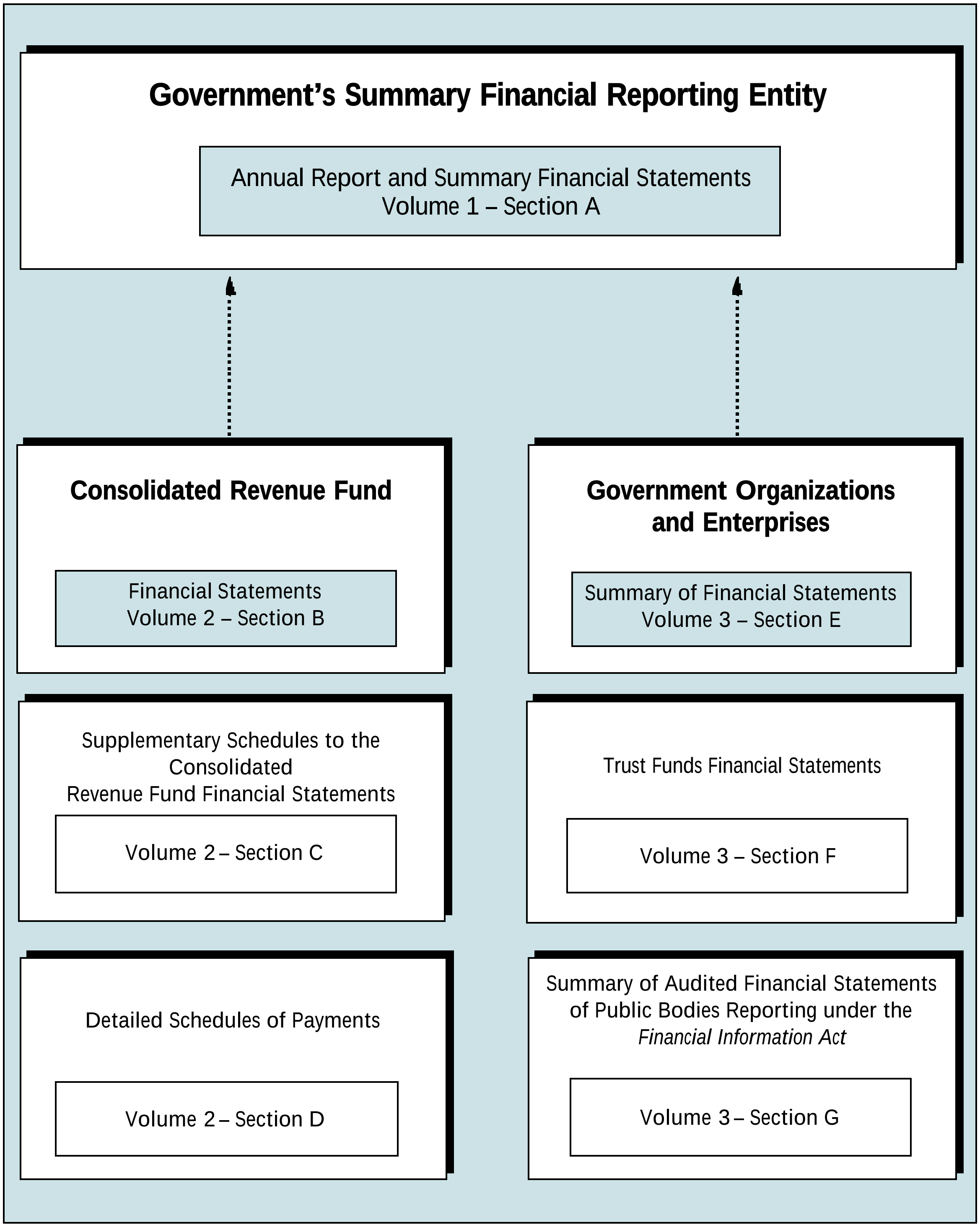
Volume 1 (Section A), titled *Annual Report,* provides a brief commentary by government on the numbers reported in the Summary Financial Statements. The audited Summary Financial Statements of the Province, providing information on the financial affairs and resources for which the government is responsible, are included in this volume.

Volume 2 (Sections B to D), titled *Financial Statements and Schedules of the Consolidated Revenue Fund,* contains the audited financial statements of the Consolidated Revenue Fund, together with unaudited 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.

Volume 3 (Sections E to G), titled *Other Government Financial Statements and Information,* contains the summary of audited financial statements of government organizations and enterprises, the latest audited financial statements of certain trust funds administered by the government, and the summary of financial statements of public bodies to which the *Financial Information Act* applies.

Exhibit 1.1

Financial Reporting in the 1995/96 Public Accounts



Source: The Public Accounts

In December 1996 the government also issued a document titled *1995/96 Public Accounts Financial Statements*. It contains the Province's audited financial statements, together with some of the supplementary information normally included in the Public Accounts.

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

Summary Financial Statements

The Summary Financial Statements of the Province provide the most complete information about the operating results and financial position of the Province of British Columbia. They aggregate entities owned or controlled by the Province by combining the financial position and results of operations 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 pages A46 and A47 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 associations, boards, foundations, 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 entities that earn almost all their revenue from being in business primarily with the public.

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 the original cost of investment of the government in these business enterprises is adjusted each year 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.

In prior years, the government, within its summary financial reporting entity, recorded the cost of capital assets and consumable inventories as expenditures in the fiscal year they were acquired, rather than in the year in which they were consumed or in which the benefits from their acquisition were realized. This meant that assets recorded in the Summary Financial Statements did not include the cost of land (except land for lease or resale), roads and bridges, buildings, equipment, fixtures, and furniture owned by the Province. In the 1995/96 fiscal year, the government started to capitalize its acquired capital assets in the Summary Financial Statements regardless of the date of acquisition and to amortize them over their useful lives. Recording tangible capital assets will take three years to complete. In this first year of transition, the government recorded land, buildings, major computer systems, and vehicles at historical cost and then amortized them.

Consolidated Revenue Fund Financial Statements

The Consolidated Revenue Fund is established in accordance with the *Financial Administration Act*, and its financial statements account for the financial activities of central government.

This 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, and include the accounts of the General Fund, British Columbia Endowment Fund (dissolved in the 1995/96 fiscal year), and the Natural Resource Community Fund. The Consolidated Revenue Fund Financial Statements provide a comparison of the actual results of the fund operation with the intended results as approved by the Legislative Assembly in the Estimates of revenue and expenditure. They are the only operating fund statements of the government on which the Auditor General provides an auditor's report.

This fund statement 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, 1996, contains these two additional opening paragraphs:

I am required by the Financial Administration Act *to provide my report on these Consolidated Revenue Fund financial statements, which reflect only the transactions and balances of the Province's General Fund and Special Funds. Other significant financial activities of the Province occur outside the Consolidated Revenue Fund and are not included in these fund statements. These additional activities are reflected in the Province's Summary Financial Statements which consolidate all organizations, including the Consolidated Revenue Fund, and enterprises for which the government is responsible.*

To understand and assess the government's management of public financial affairs and resources as a whole, readers should refer to the Province's Summary Financial Statements.

To clarify the significant differences in financial results between the government reporting entity and the Consolidated Revenue Fund reporting entity, relative financial results and balances for the fiscal year ended March 31, 1996, are shown in Exhibit 1.2.

Exhibit 1.2

Comparative Summary of Financial Results and Balances for the Year Ended March 31, 1996

($ Millions)

	Government Reporting Entity	CRF Reporting Entity
Liabilities, end of year:		
Public debt	26,932	25,857
Other	7,118	5,928
	34,050	31,785
Financial assets, end of year	16,924	14,461
Net liabilities, end of year	17,126	17,324
Net expenditure, for the year	(261)	(347)
Guaranteed debt, end of year	1,609	2,683

Source: The Public Accounts

Special Funds

British Columbia Endowment Fund

A 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, the purpose of the fund was to hold its assets in perpetuity and keep them invested to produce revenue and economic benefit for British Columbia. On June 2, 1994, the *British Columbia Endowment Fund Act* was repealed. As scheduled in the Act, the Endowment Fund was dissolved on June 30, 1995, by which date all its remaining assets, valued at $562 million, were transferred to the General Fund.

Natural Resource Community Fund

Effective April 1, 1992, the Natural Resource Community Fund was established under the *Natural Resource Community Fund Act*. This special fund was established to assist communities largely dependent on a single resource industry to adjust to severe economic declines that result in business closures or industry workforce reductions.

The fund receives as income 0.5% of all revenues, other than fines, collected under a number of Acts dealing with natural resources. Its value is not to exceed $25 million. During the 1995/96 fiscal year, the fund received $9 million from natural resource revenues and earned $2 million in income from investments. In the same period, it provided $50,000 in assistance to eligible communities and transferred $11 million back to the General Fund. The balance of the Natural Resource Community Fund as at March 31, 1996, stood at its $25 million limit, as it also did at March 31, 1995.

The Auditor General's Reports Resulting from Financial Statement Audits

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, 1996, and on the financial statements of entities whose fiscal yearends occurred on that date or during that fiscal year.

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 roles of management and the auditor with respect to the statements.

The recommended report, where there is no reservation of opinion, 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. The Auditor General's reports on the Financial Statements of the Province and financial statements of trust funds held and administered by the government appear with their respective statements published in the Public Accounts. Reports containing the Auditor General's opinions on the financial statements of government entities are similarly appended to the statements in each entity's annual report.

Summary Financial Statements

The Auditor General's report on the Summary Financial Statements for the fiscal year ended March 31, 1996, was issued without a reservation, or qualification, as to the fair presentation of those statements.

Consolidated Revenue Fund Financial Statements

Unlike the Summary Financial Statements, the Auditor General's report on the Consolidated Revenue Fund Financial Statements contains both a preamble and reservation. The two preamble paragraphs explain the specific purpose of those statements and refer to other significant financial activities of the Province that occur outside the Consolidated Revenue Fund. The two reservation paragraphs explain why the Auditor General has expressed a qualified opinion on these financial statements. These two paragraphs are as follows:

The net operating expense for the year ended March 31, 1996, of $347 million, and the net deficiency as at March 31, 1996, of $11,381 million have been determined by accounting for certain loans and guaranteed debts on a basis consistent with prior years. In this regard, the government has recorded as assets of the Consolidated Revenue Fund the amounts described in the statement of financial position as 'loans for purchase of assets, recoverable through future appropriations' of $5,069 million ($4,493 million for 1995). Because these loans are recoverable through future appropriations, they should be accounted for as an expense of the Consolidated Revenue Fund of the period in which each was incurred. Similarly, the debts of government organizations guaranteed by the Province, to the extent their repayment depends on future appropriations, totaling $823 million ($941 million for 1995), should be accounted for as a direct liability of the Consolidated Revenue Fund.

Had the above-noted loans been expensed and guaranteed debt been recorded as a direct liability of the Consolidated Revenue Fund, the net deficiency as at March 31, 1996, would increase by $5,892 million ($5,434 million for 1995), liabilities as at March 31, 1996, would increase by $823 million ($941 million for 1995), and expenses for the year ended March 31, 1996, would increase by $458 million ($682 million for 1995).

We have commented in greater detail about loans and guaranteed debts repayable through future government funding on page 34 of this report.

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 having 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 Financial Statements of the Province.” Those relating to our audit of government entities are contained in a subsequent report section titled, “Audit of Financial Statements of Government Entities, Trust Funds, and Other Organizations.”

audit of the financial statements of the province

audit of the financial statements of the province

Changes in the Summary Financial Reporting Entity

Government accounting policies define what should be included in the Summary Financial Statements of the Province. The statements are intended to include all 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 are owned or controlled by the government.

A detailed schedule of organizations and enterprises included in the government reporting entity is shown in Appendix D on pages A46 and A47.

Under the direction of Treasury Board, the composition of the government reporting entity for the 1995/96 fiscal year was significantly expanded to include 25 universities, colleges, and other advanced educational institutions, 75 school districts, 29 regional hospital districts, and 120 hospital societies. These changes appropriately address our concerns expressed in previous years' reports as to the inclusiveness of the government's summary financial reporting entity. We are also pleased to note that the government accounting policies as to what should be included in the Summary Financial Statements of the Province are now consistent with the recommendation of the Public Sector Accounting and Auditing Board of the Canadian Institute of Chartered Accountants.

Other changes to the composition of the government reporting entity during the 1995/96 fiscal year are summarized below:

- British Columbia Securities Commission, Columbia Basin Trust, and West Coast Express Limited were created and added to the reporting entity. Before April 1, 1995, the British Columbia Securities Commission was part of the Ministry of Finance and Corporate Relations and was included in the Consolidated Revenue Fund.
- The B.C. Summer and Winter Games Society was renamed B.C. Games Society and was retained in the reporting entity.

- British Columbia Petroleum Corporation was wound up effective September 30, 1994. All assets and operations were transferred to the Ministry of Energy, Mines and Petroleum Resources (now part of the Ministry of Employment and Investment).
- Pacific Racing Association was removed from the reporting entity because of an amendment made to its statute.

Composition of the Government Reporting Entity

The government has adopted the criteria recommended by the Public Sector Accounting and Auditing Board of the Canadian Institute of Chartered Accountants for determining which organizations should be included in the government's financial reporting entity. These criteria, set out in note 1(a) of the Summary Financial Statements, call for the inclusion in the Province's financial statements of those 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.

Over the last few years, we commented in our reports on the completeness of the composition of the government reporting entity. In the 1995/96 Public Accounts, the government made a significant change, addressing the issues we have raised by including in the government's financial reporting entity:

- public universities, colleges, and other advanced education institutions;
- school districts;
- public hospitals; and
- regional hospital districts.

To demonstrate the impact of the "expanded reporting entity" on reporting government operations, we have compared the main components of the summary statement of financial position and summary statement of operations, as currently presented, with similar components of pro forma financial statements prepared on the assumption that the change did not take place (Exhibit 2.1). The main effects of including the above organizations in the government reporting entity are as follows:

Exhibit 2.1

Effect of expanding the government reporting entity to include public universities, colleges, other advanced education institutions, school districts, public hospitals, and regional hospital districts

($ Billions)

Condensed Summary Financial Statements
Province of British Columbia
March 31, 1996

Statement of Financial Position

	Existing[1]	Pro Forma[2]
Liabilities		
Other liabilities	7.1	6.3
Public debt	26.9	26.9
	34.0	33.2
Assets		
Equity in government enterprises	3.0	3.0
Other financial assets	13.9	12.9
	16.9	15.9
Net liabilities	17.1	17.3
Net liabilities represented by:		
Loans for purchase of assets, recoverable from future appropriations	–	4.9
Tangible capital assets	11.1	4.1
Net deficiency	6.0	8.3
	17.1	17.3

Statement of Operations

	Existing[1]	Pro Forma[2]
Revenue	23.6	22.5
Expense	23.9	22.9
Net operating expense for the year	0.3	0.4

[1] Existing summary reporting entity: government organizations, including public universities, colleges, other advanced education institutions, school districts, public hospitals, and regional hospital districts, are recorded on a full consolidation basis; government enterprises are recorded on the modified equity basis.

[2] Existing summary reporting entity, excluding public universities, colleges, other advanced education institutions, school districts, public hospitals, and regional hospital districts.

Source: The Public Accounts and financial statements of organizations comprising the government's reporting entity

- The tangible capital assets have increased by approximately $7 billion. This amount represents physical assets acquired by advanced education institutions, school districts, and public hospitals that otherwise would not have been accounted for in the Summary Financial Statements of the Province. Including capital assets and amortizing them will provide better information about the total costs of government programs and enhance the stewardship over tangible capital assets owned by the government. We have further discussed this change in the section of this report titled, "Tangible Capital Assets," page 29.

- The $4.9 billion of amounts receivable has been completely eliminated. This represents the outstanding balance of loans made over the years by various financing authorities to advanced education institutions, school districts, and public hospitals for purchase of capital assets.

  We have commented in our previous reports that these loans, made under the Fiscal Agency Loan Program, had no value to the Province as assets. We said that although these loans were made to agencies then residing outside the government reporting entity, their repayments depended on government's future payments to the borrowing agencies. One result of the change in composition of the government reporting entity is that we no longer need to be concerned about accounting for these loans in the Summary Financial Statements of the Province. Including these agencies in the government reporting entity means that all assets and liabilities of these agencies are combined with other assets and liabilities of the province. Therefore, any debt of these organizations to the province is eliminated against the corresponding loans made by the Consolidated Revenue Fund.

  This, of course, does not affect the accounting for these transactions in individual agencies, financing authorities, or the Consolidated Revenue Fund, as each of these organizations is a separate reporting entity and any assets or liabilities should be properly accounted for in their individual financial statements.

- Both "other liabilities" and "other financial assets" have increased by approximately $0.8 billion and $1 billion, respectively. These amounts reflect the other liabilities and assets of advanced education institutions, school districts, and public hospitals—liabilities and assets that otherwise would not have been included in the Summary Financial Statements of the Province.

Consequently, the net deficiency (accumulated deficit) of the Province has decreased by $2.3 billion, from $8.3 billion to $6.0 billion.

Government Accounting Policies

Tangible Capital Assets

In 1980 the government took a significant first step in updating its accounting policies from traditional cash-based financial reporting to “modified accrual accounting.” This meant that the government began to recognize, in the annual surplus or deficit in its budget estimates and financial statements, the effect of expenses incurred but not paid for and revenues due but not received. However, as is required with modified accrual accounting, the government continued to expense capital assets when acquired rather than recognizing the expense over the useful life of the asset. In the 1995/96 fiscal year, the modified accrual basis of accounting changed to a full accrual basis. Now the government capitalizes costs of capital assets and amortizes those costs over the useful life of each asset. This is a significant improvement in public sector accounting and is in line with the current thinking of the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants.

Crown corporations and other government agencies that follow generally accepted accounting policies in Canada have always used the full accrual method of accounting, and so accounted for their capital assets. Up to and including the 1994/95 fiscal year, the government always had to convert financial reports of all those government organizations to the modified accrual basis used in the preparation of both the Summary and the Consolidated Revenue Fund Financial Statements.

Starting in the 1995/96 fiscal year, this conversion is no longer required. Instead, the financial statements of government organizations not yet following the full accrual basis (such as school districts and some advanced education institutions) have been adjusted to this basis for inclusion in the Summary Financial Statements.

In the case of the Consolidated Revenue Fund, the government is going to require time to ensure that the information resulting from the adjustment is accurate enough to withstand the rigors of audit. The government has therefore decided that the task of identifying and valuing the numerous and often poorly recorded capital assets used in its central activities will be done over a three-year period. Phasing in the inclusion of capital assets is an approach that is also in line with PSAAB's current thinking, and recognizes the difficulties faced by government in taking such actions.

In its 1995/96 financial statements, the government capitalized and amortized:

- computer systems (hardware and software) with a cost of $100,000 or more;
- land for which historical cost or a reasonable estimate of historical cost could be obtained;
- light vehicles regardless of cost;
- buildings with a cost of $50,000 or more; and
- work in progress on the above assets.

The cost of tangible capital assets of government organizations included in the summary reporting entity, excluding the cost of the B.C. Transportation Financing Authority's (BCTFA) highways of approximately $745 million, are recorded in the 1995/96 Summary Financial Statements. The BCTFA's highways will be capitalized along with other highways and bridges when they are capitalized in the Consolidated Revenue Fund. This accounting treatment is consistent with PSAAB guidance where, during a transition period for inclusion of tangible capital assets, all assets of the same class are expected to be capitalized together.

Tangible capital assets reported in the Summary Financial Statements of the Province do not include those of the commercial enterprises accounted for on a modified equity basis. Some of the more significant enterprises whose tangible capital assets are not reported include British Columbia Ferry Corporation, British Columbia Hydro and Power Authority, British Columbia Railway Company, the Provincial Capital Commission, the Insurance Corporation of British Columbia, and the Liquor Distribution Branch. These entities own ferries, railways, land, buildings, vehicles, computers, and other tangible capital assets with a book value of over $11 billion. Information about these assets is included in a supplementary statement accompanying the Summary Financial Statements, titled "Statement of Government Enterprises, Summary of Financial Position as at March 31, 1996."

Land

Although the Crown owns about 93% of all land in the Province, Crown lands acquired by right carry no acquisition cost to the government. For the purpose of the Financial Statements of the Province the asset value of land is based only on the cost to the Province of those lands that the government has acquired in some other manner. This includes purchased lands, lands forfeited for non-payment of taxes or fines, and escheated lands. Crown lands held for development or resale are also not included because they are recorded as inventory in the government's financial statements.

The government was initially able to identify its title to approximately 70,000 plots of land, using records kept in the Land Titles Office and the B.C. Assessment Authority, and it felt that the value of these lands should be recorded in the Summary Financial Statements of the Province. Subsequently, however, it was only able to verify with certainty its ownership and date of acquisition of approximately 16,000 plots, costing $702 million.

The historical cost of lands has not always been recorded in government books. In the past, the land title information and assessed values were considered to be the more important information to maintain for managing government programs. Where the historical costs of the acquired lands were not available, the government computed costs based on the current assessed land values and inflation factors, using Statistics Canada's published data.

We recommend that the government complete the process of identifying all lands that it has purchased or otherwise acquired, and to account for them in the 1996/97 Summary Financial Statements of the Province.

Site Improvement Costs

Some universities, colleges, and school districts are including site improvement costs as part of their land costs. Included among site improvement costs are expenditures on such items as parking lots, landscaping, and lights. Because, unlike land, site improvements have a limited life and will be consumed over time, we believe their costs should be amortized. This means that the two, land and site improvement costs, should be capitalized separately.

We recommend that the government separately capitalize and amortize its site improvement costs.

Infrastructure Assets

In 1996/97, the second phase of capitalization of tangible capital assets of the government will start. During this phase, the government intends to capitalize its infrastructure assets.

In 1995/96, highway buildings, such as rest stops and control buildings, have been capitalized as buildings, but highways, roads, bridges, and other infrastructure assets such as dams were not valued for inclusion in the Financial Statements of the Province.

We recommend that the government determine the costs of the Province's highway system, including any land acquired for highway construction, for inclusion in the 1996/97 Financial Statements of the Province. Also, we recommend that the method of amortization of highways, roads, bridges, and other infrastructure assets such as dams be clearly stated.

Heritage Assets

The government was not able to include the Province's heritage buildings (such as the Legislative Buildings and Government House) and other heritage assets (such as works of art and books) in the 1995/96 Financial Statements of the Province, because all of these items need to be identified and valued.

We recommend that the government determine how it will account for its heritage assets.

Donated Land

The Province has, over time, donated Crown lands to government organizations such as universities, colleges, and British Columbia Buildings Corporation. These organizations have normally recorded these donated assets at their market value on the date the land title is transferred to them. At present, these donated lands amount to more than $60 million. While this accounting treatment is appropriate for individual organizations receiving land donations, we think the land should be accounted for at its original cost when financial positions of those organizations are consolidated in the Summary Financial Statements of the Province.

We recommend that the government identify Crown lands donated to government organizations in order to record them at their original costs when preparing the Summary Financial Statements of the Province.

Interest and Other Financing Costs

During the development phase of their major projects, government organizations capitalize their financing costs, such as interest and charges. A clearly stated accounting policy for capitalizing these costs will improve accountability for tangible capital assets.

We recommend that the government clearly state its accounting policy for capitalizing financing costs and charges in the Summary Financial Statements of the Province.

Computer Hardware and Software

All computer systems of government organizations (except those systems in government ministries with a cost of less than $100,000) were capitalized and amortized in the 1995/96 Summary Financial Statements of the Province. These systems represent government's investment in information technology to help it manage its varied and complex programs such as building highways, administering land titles, planning forest resources, and providing social assistance.

The smaller computer systems (those costing less than $100,000 individually, such as Local Area Networks and personal computers) will start being recorded in the 1996/97 Financial Statements of the Province.

In 1995/96, government ministries spent about $30 million in new mainframe and minicomputer hardware and software for such systems as a land title database, a government-wide payroll and personnel system, a corporate accounting system, and several other management information systems. We noted significant inconsistencies in accounting for, among others, staff payroll and overhead costs associated with the development of these systems.

We recommend that the government provide guidance to all its organizations on how development costs for computer systems should be capitalized.

Vehicles

The cost of all government vehicles was capitalized and amortized in the 1995/96 financial statements of the government. Not capitalized were the heavy vehicles. In the 1996/97 fiscal year, we understand that the government plans to capitalize and amortize central government's buses, heavy duty trucks, ambulances, and similar vehicles and include them in a separate category under "equipment."

We recommend that the government ensure that vehicles of all kinds be accounted for in a consistent manner throughout the government reporting entity.

Loans and Guaranteed Debts Repayable Through Future Government Funding

In our 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 expected to be recovered through future government appropriations be written off as expenditure in the periods these loans were made.

As explained on page 28, the inclusion of the public advanced education institutions, health care facilities, and schools in the government reporting entity has eliminated our concern about reporting these loans in the Summary Financial Statements of the Province. However, this is not the case with the Consolidated Revenue Fund (CRF) Financial Statements, because the CRF is unaffected by the composition of the government reporting entity. We believe that as long as the government continues to pay certain organizations from the CRF to enable them to repay their debt to the CRF (and while no other source of funding outside the CRF has been specified for repayment of these loans), they should not be considered as assets of the CRF. The accounting for $5,069 million ($4,493 million for 1995) representing these amounts as assets of the CRF is, consequently, inappropriate.

Similar to loans that are expected to be recovered through future government appropriations, the Province has also guaranteed the debts of dependent government organizations for $823 million ($941 million for 1995). The repayment of these guaranteed debts, are expected to be made from resources mainly available to the government organizations from the CRF in the future.

Because these amounts are so significant, inappropriate accounting of them produces a misleading picture of the CRF financial position and operations. Consequently, the Auditor General's opinion on the Consolidated Revenue Fund Financial Statements of the province was qualified. The text of the two reservation paragraphs of the Auditor General's opinion about these loans and guaranteed debts can be found on page 20 of this report.

We recommend that the government change its accounting treatment of loans recoverable and guaranteed debts repayable through future appropriations. These amounts should be charged to the period in which loans or guarantees were made.

Liability for Post-retirement Benefits

Many retired members of the Public Service Superannuation Plan and other government–funded pension plans receive benefits that are paid for by their employers. For example, provincial government employers may pay all or a portion of the pensioners' premiums for the Medical Services Plan (MSP) and the premiums for extended health care plans.

In its financial statements, the provincial government accounts for post-retirement benefits only to the extent they are paid. However, because the benefit entitlements are earned throughout an employee's service life, we believe they should be recognized as a liability even though they may not be paid until retirement. This position is consistent with the current thinking of the Canadian Institute of Chartered Accountants, which is to formally issue an exposure draft on the matter in 1997. At present, neither the liability for unpaid benefits earned by retired employees nor the amount required to fund benefits for current employees is recorded in the financial statements.

Note 24 of the Summary Financial Statements of the Province states that, under current pension agreements, the government is responsible for payment of the pensioners' Medical Services Plan and extended health care premiums, which are recorded when due. Although this disclosure clearly places the responsibility for this liability, it does not quantify it. We believe this liability should be valued and recorded in the Summary Financial Statements of the Province.

This matter was examined by the Select Standing Committee on Public Accounts on November 8, 1996. In their discussions with the committee, government representatives concurred that a liability existed, but that, because of funding concerns, the liability had not been estimated by actuarial calculation or otherwise.

We again recommend that a valuation of post-retirement benefits be prepared, and the estimated liability be accounted for in the Summary Financial Statements of the Province.

Comments on Specific Audit Findings

Corporation Capital Tax

In our report on the 1994/95 Public Accounts, we commented that government assessment and audit procedures needed improvement for corporate capital tax. As of October 1995, the Corporation Capital Tax Branch of the Ministry of Finance and Corporate Relations had a backlog of 36,755 unassessed returns and had conducted only 14 field audits.

At a meeting of the Select Standing Committee on Public Accounts in November 1996, officials from the Ministry of Finance and Corporate Relations reported that the backlog of returns had been reduced by half as a result of the implementation of an automated assessment system.

In our audit of the 1995/96 Financial Statements of the Province, we re-examined the status of tax returns in the Corporation Capital Tax Branch. Between October 1995 and the end of December 1996, the assessment activities were as follows:

Unassessed returns, as of October 31, 1995:		36,755
Tax returns received between November 1, 1995, and December 31, 1996:		27,271
		64,026
Assessments between November 1, 1995, and December 31, 1996:		
Manual assessment	10,343	
Automated assessment	44,640	
		54,983
Unassessed returns, as of December 31, 1996:		9,043

Management's objective for the audit function is to examine about 2% of the corporation capital tax base. However, the branch has been able to audit only about 0.5%. It is estimated that each additional auditor needed for the task would generate an average of about $500,000 in recoveries per year.

Despite the progress being made by the branch, we are still concerned that other important functions (such as the identification of new and delinquent taxpayers) are not currently allocated sufficient resources. This, we believe, is resulting in a potentially significant loss of tax revenue and potentially reduced taxpayer compliance.

Although we are pleased to note that the ministry has succeeded in reducing the number of unassessed returns and been able to perform more audits, we believe much more still needs be done.

We again recommend that the ministry secure resources and improve its systems and procedures for identifying delinquent taxpayers and conducting adequate field audits.

Insurance Risk Management

The government, through the Consolidated Revenue Fund (CRF), insures risks of various classes of persons and many government organizations such as hospitals, regional health boards, schools, colleges, and universities. The transactions related to these self-insurance activities of the government are recorded in a special account.

Because this special account is a part of the CRF, its transactions and balances are included in the operating results and financial position of the CRF. When a claim is registered with the government risk management office and accepted by it, the government's liability is calculated and recorded. Any payment against claims is also accounted for as a reduction of the liability. To show its insurance liability, therefore, the government considers the balance of this account to represent its liability for known claims.

Under this accounting method, any further insurance liabilities resulting from accidents that have occurred at the date of the financial statements but not yet been registered with the risk management office (or, if registered, not settled) will not be included in that balance. These further liabilities must be calculated separately, and be included in the Summary Financial Statements of the Province.

We recommend that the government account for third-party insurance claims that are incurred but not recorded.

summary of recommendations

Recommendations made in the section of this report titled *Audit of the Financial Statements of the Province* are listed below for ease of reference. They should be regarded in the context of the report.

The Office of the Auditor General recommends that:

Tangible Capital Assets

- *The government complete the process of identifying all lands that it has purchased or otherwise acquired, and to account for them in the 1996/97 Financial Statements of the Province.*
- *The government separately capitalize and amortize its site improvement costs.*
- *The government determine the costs of the Province's highway system, including any land acquired for highway construction, for inclusion in the 1996/97 Summary Financial Statements of the Province. Also, we recommend that the method of amortization of highways, roads, bridges, and other infrastructure assets such as dams be clearly stated.*
- *The government determine how it will account for its heritage assets.*
- *The government identify Crown lands donated to government organizations in order to record them at their original costs when preparing the Summary Financial Statements of the Province.*
- *The government clearly state its accounting policy for capitalizing financing costs and charges in the Summary Financial Statements of the Province.*
- *The government provide guidance to all its organizations on how development costs for computer systems should be capitalized.*
- *The government ensure that vehicles of all kinds be accounted for in a consistent manner throughout the government reporting entity.*

Loans and Guaranteed Debts Repayable Through Future Government Funding

- *The government change its accounting treatment of loans recoverable and guaranteed debts repayable through future appropriations. These amounts should be charged to the period in which loans or guarantees were made.*

Liability for Post-retirement Benefits

- *A valuation of post-retirement benefits be prepared, and the estimated liability be accounted for in the Summary Financial Statements of the Province.*

Corporation Capital Tax

- *The ministry secure resources and improve its systems and procedures for identifying delinquent taxpayers and conducting adequate field audits.*

Insurance Risk Management

- *The government account for third-party insurance claims that are incurred but not recorded.*

improved accountability through better information

improved accountability through better information

Comments on the Government Annual Report for the 1995/96 Fiscal Year

Last year, in our report on the 1994/95 Public Accounts, we commended the government for starting a process of further improving its financial accountability by including its annual report as well as its financial statements in the Public Accounts. The annual report, though very concise, included an overview which provided financial analysis and written commentary on financial results and accomplishments at the government's summary financial reporting entity level. We expected the government to provide further valuable accountability information in its 1995/96 annual report.

This year, the annual report contains only a summary overview of the 1995/96 fiscal year's operations and a brief overview of provincial financial reporting. We found the slight information the government has chosen to publish in its annual report to British Columbians disappointing.

The government, annually, issues a number of other financial accountability publications. For example, in the 1996/97 fiscal year it published the 56th edition of the "British Columbia Financial and Economic Review" containing information on a wide variety of aspects of the province's economy and finances including its people, industries, government, major programs, and Crown corporations. The government also published, along with the Budget 97, the "Debt Statistics 1995/96" which includes information on provincial debt, and debt management operations. The "Debt Statistics 1995/96" also includes three audited statements on debt: the summary of provincial net debt as at March 31, 1996, the key indicators of provincial debt for the fiscal year ended at March 31, 1996 and the summary of key benchmarks of debt management for the fiscal year ended March 31, 1996.

A copy of these statements and the Auditor General's report on them are provided in this report in Appendix E.

These scattered specialized publications are both interesting and useful to the public, and perhaps collectively provide some of the information expected to be found in an annual report. They do not, however, replace the annual report of the government to the public.

As an accountability document, the government annual report should ideally be presented, at the summary level of reporting, in the same format as the budget document. It should explain how matters outlined in the related budget report were dealt with over the fiscal year, and how services provided by government programs measured up against goals set in the budget documents.

In our opinion, the existing annual report of the government fails to meet expectations.

Comments on Information Contained in Notes to Financial Statements of the Province

Notes and supplementary statements form an integral part of the financial statements. They present important accountability information and explanations. However, most readers focus their attention on the financial statements and may miss important information included in the notes. In this section of the report we comment on specific matters, disclosed in notes and supplementary statements, that may significantly affect the future financial position of the province.

Accounting for Government Enterprises

The summary financial statements disclose financial information not only about the operations of central government, but also about other entities the government owns and controls. Note 1 in the Summary Financial Statements of the Province outlines two points of importance. First is that the gross basis of accounting is fundamental to the preparation of these statements. This means that the financial statements should disclose the essential components of each economic activity, not just the net result of that activity. Second is that entities making up the consolidated reporting entity are divided into government "organizations" and government "enterprises."

Government organizations, which include the Consolidated Revenue Fund, are fully consolidated. This means that their revenues, expenses, assets, and liabilities are aggregated according to government accounting policies, line-by-line, in the Summary Financial Statements. The accounting effect is as if they all operated as one organization.

Government enterprises, on the other hand, are recorded on the "modified equity" basis of accounting. This means that only the cost of government's investment in these entities (adjusted for any increase or decrease in the value of that investment) is included in the Summary Financial Statements. The summary of financial position and results of operations of government enterprises is provided separately in supplementary statements of the Summary Financial Statements. The latter, however, include only the net result of these enterprises, and therefore provide little indication of the significant amount of total assets owned, liabilities incurred, revenues collected, and expenses made by the government.

We believe that recording only the adjusted value of the Province's investment in government enterprises in the Summary Financial Statements is inconsistent with the gross basis of accounting and results in obscuring the significant effect these enterprises have on total assets, liabilities, revenues, and expenses under government stewardship.

Improved disclosure would be to consolidate, line-by-line, financial details of commercial enterprises with assets, liabilities, revenue and expenses of other activities of the government.

There is another reason, too, for why we believe that government enterprises should be accounted for on a line-by-line consolidation. These enterprises, although they carry out commercial activities, are often given the responsibility to implement major public policies, making them essentially equivalent to other government programs captured and reported in the Summary Financial Statements. In most cases, making profit is not the main reason that a government enterprise exists. Furthermore, activities that are carried out by government ministries are sometimes transferred to these enterprises. During the 1996/97 fiscal year, for example, operations of the Motor Vehicle Branch have been transferred to the Insurance Corporation of British Columbia. Therefore, accounting for these enterprises as if they are merely a business investment is not, in our view, appropriate.

In the fiscal year 1995/96, the government did make some improvements by fully consolidating a number of enterprises previously accounted for on a modified equity basis. These were commercial enterprises that needed government funding in order to operate (for example, B.C. Pavilion Corporation, British Columbia Transit, and Provincial Rental Housing Corporation). Others, however, remain recorded on a modified equity basis on the grounds that they do not regularly receive government subsidy, or that they have a plan to be self-sufficient within a reasonable period of time. These include a number of large corporations such as British Columbia Hydro and Power Authority, British Columbia Ferry Corporation, British Columbia Railway Company, and the Insurance Corporation of British Columbia.

The accounting decision government has made in this regard is in line with current recommendations of the Public Sector Accounting and Auditing Board of the Canadian Institute of Chartered Accountants. Nevertheless, we believe that the fundamental requirement for the gross basis of accounting, as well as the significant responsibility for implementing public policies, are compelling reasons for the line-by-line consolidation of all government enterprises in the summary financial statements. To show the significance of the information not being disclosed in the Summary Financial Statements of the Province, we have compared the main components of the 1995/96 statements with similar components of pro forma financial statements prepared on the assumption that all government enterprises are consolidated on a line-by-line basis (Exhibit 3.1).

Effects of Capitalization of Tangible Capital Assets on the Financial Statements of the Province

In fiscal years prior to 1995/96, the government recorded the cost of tangible capital assets acquired during a year as an operating expense of that year. Starting in 1995/96, the government began deferring such costs and recording as an annual expense only the amortization of those assets. The effects of this change in the government accounting policy (explained in note 2 of the Summary and Consolidated Revenue Fund Financial Statements) extend to both the annual deficit and the accumulated deficit.

One might think that such a change in accounting policy would result in a reduction in annual operating expenses. In fact, however, since every year’s amortization expense is calculated on all previously acquired tangible capital assets, one year’s amortization expense could approximate, in some circumstances, one year’s total cost of acquired tangible capital assets. This is more or less what happened in the 1995/96 Consolidated Revenue Fund Financial Statements. The difference between the annual deficit on the old “expenditure” basis (where the total cost of assets acquired in the year was charged to expenditure) and the new “expense” basis (where only the annual amortization of tangible capital assets is charged to expense) was a decrease of only $22 million. However, the Province’s accumulated deficit was reduced by the capitalization of tangible capital assets, and will be further reduced in the

Exhibit 3.1

Effect of Reporting the Government Enterprises on a Full Consolidation Basis

Current accounting of 10 commercial enterprises on a modified equity basis leaves significant assets, liabilities, revenue, and expenditures out of the Summary Financial Statements ($ Billions)

Condensed Summary Financial Statements
Province of British Columbia
March 31, 1996

Statement of Financial Position

	Existing[1]	Pro Forma[2]	Difference
Liabilities			
Other liabilities	7.1	13.7	6.6
Public debt	26.9	28.3	1.4
	34.0	42.0	8.0
Assets			
Equity in government enterprises	3.0	—	3.0
Other financial assets	13.9	13.5	0.4
	16.9	13.5	3.4
Net liabilities	17.1	28.5	11.4
Net liabilities represented by:			
Tangible capital assets	11.1	22.5	11.4
Net deficiency (surplus)	6.0	6.0	—
	17.1	28.5	11.4

Condensed Summary Statement of Operations

	Existing[1]	Pro Forma[2]	Difference
Revenue	23.6	31.6	8.0
Expense	23.9	30.8	6.9
Net operating revenue (expense) for the year	(0.3)	0.8	1.1

[1] Government organizations are currently recorded on a full consolidation basis, and government enterprises on the modified equity basis.
[2] Government organizations and enterprises are all accounted on a line-by-line consolidation basis.

Source: The Public Accounts and financial statements of government's commercial enterprises next two years as billions of dollars more of tangible capital assets for highways, buildings, etc., are capitalized.

Depending mainly on the size of the historical costs of highway systems and other tangible capital assets that have not been recorded in 1995/96, the current accumulated deficit of this province could, in 1996/97, change to an accumulated surplus. This change would be a by-product of the improvement in accounting for the full cost of government programs and services. It would not, however, have any effect on the total provincial debt. It is important that members of the Legislative Assembly and the public understand this point. Any accumulated surplus that might result from this new policy must not be interpreted as a measure of abundance; rather, it is as an indication of the wealth resulting from past and present governments' stewardship of the Province's financial resources. Thus, to understand the financial position of the Province, one should consider this indicator along with the result of government operations (that is, the annual surplus or deficit) and the "net liability," an indicator of future financial requirements, including what is needed to repay the province's debt.

The government of British Columbia is among the first senior governments in Canada to capitalize and amortize tangible capital assets. Others, including the federal government, have been considering it for several years.

The Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants is in the process of recommending this accounting treatments to all federal, provincial, and territorial governments. It is anticipated that PSAAB's pronouncements will be issued in early 1997 and that, over time, all senior Canadian governments will follow these recommendations.

Definition and Importance of Tangible Capital Assets

Tangible capital assets include those assets having physical substance, such as buildings, highways, dams, land, equipment, computers, and vehicles. They are also defined as being items that:

- are used to provide goods and services;
- have useful lives of more than one year or accounting period; and
- are items not held for sale under normal circumstances.

Tangible capital assets are important to the government for several reasons. First, investments in capital assets often involve significant government expenditures, directly through acquisitions (approximately $550 million in 1995/96) and indirectly through operation and maintenance expenditures. As well, tangible capital assets contribute to the achievement of program objectives and results, and they can also be used to further the government's socio-economic objectives and distribute benefits across the province. Recording these assets can help the government account as expense only the costs associated with their use, and anticipate future replacement needs to maintain an acceptable level of infrastructure for the province.

Capitalization and Amortization of Tangible Capital Assets

Before the change in the government's accounting policy, tangible capital assets were expensed when acquired or constructed. An office building built for $20 million, for example, was treated as an expense, which directly reduced the annual surplus or added to the annual deficit. However, the office building continues to provide benefits to the government over its useful life. Therefore, to determine the true cost of government services, the building cost should more properly be treated as an expense over the years that it continues to provide services. Capitalizing and amortizing tangible capital assets provides a means of measuring and allocating the costs of services to the public over the time that these services and goods are provided.

Capitalizing an asset usually indicates that the asset has a future benefit and that throughout its remaining life it is not a "free good." As such, the asset will attract an appropriate level of management controls, accountability, and audit scrutiny.

Information Needs of the Users of the Government's Financial Statements

The users of the government's financial statements are the legislature, government officials, the public, the media, financial analysts, investors, and security rating agencies. These users are, to varying degrees, interested in government's expenditures on tangible capital assets. They want to know:

- what is included in capital expenditures and what is included in operating expenditures;
- how large the government's stock of tangible capital property is;
- what kind of property it is and whether it is useful and usable;
- how the property is being used and whether it is being used effectively;

- how well the property been maintained;
- when it will need to be replaced;
- how capital acquisitions are financed;
- what the ongoing operating costs associated with the property are;
- whether provision has been made for financing major replacements; and
- how large the total costs of, and commitments for, major projects are.

Three-year Phasing-in Period

Because of the difficulty of identifying, valuing, and accounting for all of its assets at once, the government of British Columbia will be using a three-year phase-in approach to capitalize its tangible capital assets. In the past, tangible capital assets were expensed and separate records of assets not always kept or, if records were kept, they did not always contain complete cost information. One problem that the government faces is not having an appropriate accounting system to maintain records of tangible capital assets. It is important that it develop such a system, so that it can track activities affecting these assets whose useful lives may be as long as 100 years.

We recommend that the government develop accounting systems to capture complete and accurate information about Province's tangible capital assets, and be able to record asset additions, disposals, sales, remaining value, and amortization.

Comparison to the Estimates

The 1995/96 fiscal year is the first year that the government began to record as tangible capital assets those items it felt were readily identifiable and for which historical costs or estimates of costs could be easily obtained.

The 1995/96 Estimates did not anticipate the capitalization and amortization of tangible capital assets. Consequently, to compare actual results of the Province's main operating fund with the 1995/96 Estimates, the government presented its 1995/96 Consolidated Revenue Fund Financial Statements in the "expenditure basis" as well as the "expense basis" of accounting.

We recommend that, starting in its 1997/98 Estimates, the government include amortization expenses in Votes.

Contingencies

The Summary and Consolidated Revenue Fund Financial Statements include disclosures of possible liabilities that depend on the outcome of future events such as court rulings, negotiations, or ratification of agreements-in-principle. These contingent liabilities are deemed to arise from events that occurred before the date of the statements but which are not quantifiable with a reasonable degree of certainty. Therefore, the liability is not recognized directly in the financial statements.

For the 1995/96 fiscal year, three disclosures merit comment. The first surrounds the Kemano Completion Project, the second touches on the issue of aboriginal land claims, and the third is about the Rate Stabilization Reserve Fund of the Insurance Corporation of British Columbia.

The Kemano Completion Project

In the Summary Financial Statements, reference is made to continuing discussions between the provincial government and Alcan Aluminum Ltd. over outstanding issues relating to the cancellation of the Kemano Completion Project in 1991. The project involved the installation of additional generating capacity for hydroelectric power within British Columbia. Opposition from community, aboriginal, and environmental groups led to the 1993 public review of the project by the British Columbia Utilities Commission. The report of the commission, released in January 1995, recommended certain changes to the project.

Soon after, the government of British Columbia announced its decision to prevent Alcan from proceeding with its expansion project, indicating that it was prepared to enforce its decision through legislation. Talks between the two parties began and the possibility of a negotiated settlement was explored. By July 1995, a framework to govern future negotiations was agreed on. The agreement committed both parties to making their best effort to reach a settlement. The deadline noted in the agreement was March 1996. Although no settlement was reached by then, both sides have made public their intent to continue negotiations. The government has therefore taken the position that since negotiations are ongoing, no provision for liability is necessary and disclosure by note in the financial statements is sufficient.

In acknowledgment of the fact that the project could not be completed because of the government's prohibition, and that any settlement value would be contingent on future events, Alcan expensed part of the cost of its investment in the Kemano Completion Project during the third quarter of its 1995 fiscal year. Alcan had invested approximately $500 million in the project, of which $60 million related to existing operations. After allowing for estimated disposal proceeds and site restoration costs, the amount of the write-down was $420 million, resulting in an extraordinary loss of $280 million on an after-tax basis. Alcan noted in its financial statements that it would treat any negotiated compensation from the government as an extraordinary gain.

According to a protocol signed between Alcan and the Province of British Columbia on September 13, 1996, the two parties agreed to negotiate and prepare a draft agreement for approval during December 1996. To preserve certain rights of action against the Province in respect of the cancellation of the project, Alcan also filed a writ of summons on January 22, 1997, in the Court Registry. Negotiations continue.

Aboriginal Land Claim Negotiations

Both the Summary and Consolidated Revenue Fund Financial Statements have made extensive reference to the contingent liabilities arising from aboriginal land claims. The process for negotiating modern-day treaties was formalized with the establishment of the Treaty Commission in late 1993. Instead of the litigation process, settlement of land claims now involves tripartite negotiations among the provincial government, the federal government, and the aboriginal groups.

Pre-dating this formal process, negotiations with the Nisga'a Tribal Council have progressed the furthest and, on February 15, 1996, negotiators announced an agreement-in-principle on British Columbia's first modern-day treaty. The agreement outlines total cash payments of $190 million, of which $14.5 million would be paid by the provincial government over a number of years.

No provision has been accrued in the 1995/96 financial statements of the province, as the government has taken the position that the agreement-in-principle has yet to be ratified. Note disclosure was again deemed to be sufficient.

As more of these treaties are settled, clear policy for the recognition of liabilities will help to ensure that the government's financial statements fully and accurately reflect its true liabilities.

Insurance Corporation of British Columbia

Note 24 of the Summary Financial Statements says that "the Insurance Corporation of British Columbia (ICBC) is anticipating a serious erosion of its Rate Stabilization Reserve Fund during the coming year. Factors contributing to this erosion are the rate freeze and an adverse claim record during the first six months of this year. The corporation's management is taking steps to mitigate this shortfall, so the government's ultimate liability cannot be determined."

It is estimated that if nothing changes, the Rate Stabilization Reserve Fund would be largely depleted over a two-year period, possibly forcing a significant jump in premiums at that time. The government has not yet announced how management plans to mitigate the shortfall.

We agree with the sufficiency of information about these and other contingencies and commitments disclosed in the 1995/96 Summary and Consolidated Revenue Fund Financial Statements. We are, however, concerned that the government does not follow a consistent approach in recognizing contingencies in its financial statements. In previous years, for instance, it accrued its obligations based on a Vancouver Island Gas Pipeline agreement-in-principle that was not finalized until the following year. It also established an accrual for the clean-up liability of the Expo '86 site, even though it was not certain about the accuracy of the liability estimated.

We recommend that the government review and clarify its policy for the recognition of liabilities, including contingencies, to ensure consistency in their accounting treatment.

Implicit Expenditures: Update

What Are Implicit Expenditures?

The government can achieve its social and economic objectives in several ways. The most visible is through the direct spending and payment of grants and subsidies that carry out programs. Other, less visible methods include implementing policies and programs by providing financial assistance through the tax system (e.g., by granting special exclusions, deductions, credits, or special rates for a favored activity or group). The government may also provide loan guarantees or charge preferential rates for the goods or services it provides. All of these concessions generally result in forgone revenue for the government and represent an alternative form of government financial assistance. They also have implications similar to those of direct expenditures. We refer to them collectively as “implicit expenditures.”

Control and Accountability of Implicit Expenditures

Implicit expenditures are used by governments because they often involve less government intervention and administration than direct expenditure programs. As they are less visible, these “expenditures” are not subject to the same controls and accountability standards as direct spending. That is why they are sometimes referred to as “hidden expenditures.”

The existing government financial reporting system focuses on budgetary expenditures and, while there is some reporting of tax expenditures, there is little reporting of other implicit expenditures such as subsidies (preferential rates for use of government goods or services). As a result, information about government’s implicit expenditures is incomplete. All government programs, including those delivered through implicit expenditures, should be subject to the same controls and accountability standards as direct spending.

Reporting Practice in British Columbia

At present the government reports tax expenditures that are “tax preferences and transfers which are close equivalents of spending programs and are amounts that are greater than $2 million.” The tax expenditure report in Budget ’96 outlined all major tax expenditures in the province, resulting from federal income tax measures and provincial tax legislation. This report is not complete, in that it is devoted to tax expenditures only. There are other important implicit expenditures, in nature similar to those listed, which are not being included there.

There are a number of areas where individuals or entities are subsidized, but not all are treated the same in the government’s financial accountability documents. For example, one of the items reported in the Estimates and accounted for in the Financial Statements of the Province is the Home Owner Grant. In substance the Home Owner Grant is little different from allowances that enable individuals to pay lower rates for medical premiums, different rates for transportation, or reduced rates for water consumption. However, neither the Estimates nor the Public Accounts includes any information on these important subsidies.

Conclusion and Recommendation

Identifying and determining all of the implicit subsidies provided by the government requires further study and in-depth familiarity with the public policies behind government decisions for establishing specific preferential treatment.

While the government has improved its reporting of tax expenditures in the last several years, we feel that further improvements must be made in quantifying and reporting implicit expenditures. More information should be available to the Legislative Assembly about implicit expenditures to enable members and the public to evaluate whether the government is achieving its objectives. In addition to providing information on tax expenditures, information about other significant implicit expenditures should be provided both in the government's Estimates of Revenue and Expenditures and in the Public Accounts.

We recommend that the government continue to improve its procedures for identifying and quantifying all significant implicit expenditures, and to report them in its financial accountability documents, including the Estimates and the Public Accounts.

summary of recommendations

Recommendations made in the section of this report titled *Improved Accountability Through Better Information* are listed below for ease of reference. They should be regarded in the context of the report.

The Office of the Auditor General recommends that:

Effects of Capitalization of Tangible Capital Assets on the Financial Statements of the Province

- *The government develop accounting systems to capture complete and accurate information about Province's tangible capital assets, and be able to record asset additions, disposals, sales, remaining value, and amortization.*
- *Starting in its 1997/98 Estimates, the government include amortization expenses in Votes.*

Insurance Corporation of British Columbia

- *The government review and clarify its policy for the recognition of liabilities, including contingencies, to ensure consistency in their accounting treatment.*

Implicit Expenditures

- *The government continue to improve its procedures for identifying and quantifying all significant implicit expenditures, and to report them in its financial accountability documents, including the Estimates and the Public Accounts.*

provincial debt: comments on its reporting

provincial debt: comments on its reporting

The total debt of the Province of British Columbia has increased by approximately $11.5 billion over the last five years. This is a significant change, representing an average annual increase in debt of $2.3 billion. Each year, since the 1991/92 Auditor General's Report on the Public Accounts, we have commented on the government's reporting of public debt. During this time, we have stated that if information about debt were better reported, the public would be better able to understand provincial borrowing and how it affects them. We also made several recommendations as to how the reporting of debt information could be improved, one of which was that the government include 10 key measures and performance indicators to show trends in provincial debt.

Last year the government reported on most of the 10 measures and indicators we recommended. Information on several of them was first published in the government's Budget '95 documents. It was also in Budget '95 that the government introduced its debt management plan and a commitment to produce an audited annual debt management progress report. The progress report was to provide information on debt measures and performance indicators, and match the provincial debt to the benchmarks set in the debt management plan.

The Auditor General's audit opinion on the base-year information as at March 31, 1995, was attached to the 1994/95 Debt Management Progress Report, which was published along with the 1994/95 Public Accounts in December 1995. The second progress report as at March 31, 1996, was published in a document titled "Debt Statistics 1995/96" in March 1997.

In Exhibit 4.1, we summarize the 10 items we recommended for disclosure.

Exhibit 4.1

Measures and Indicators Recommended for Disclosure in the Public Accounts

1. Debt to revenue	6. Sources of borrowing
2. Total provincial debt	7. Interest bite
3. Debt per capita	8. Debt to Gross Domestic Product
4. How debt changed	9. Total cost of debt servicing
5. Why debt changed, including the operating deficit	10. Rate of interest

Exhibit 4.2

Annual and Accumulated Direct Debt Repayment Forecasts

Government's commitment over the first five years of its plan to reduce direct debt ($ Millions)

	1995/96	1996/97	1997/98	1998/99	1999/2000
Revenue	20,300	20,235	20,550	20,945	21,830
Expenditure	20,186	20,210	20,510	20,820	21,330
Surplus	114	25	40	125	500
Debt repayment from investments	300	200	0	0	0
Total annual direct debt repayment	414	225	40	125	500
Accumulated direct debt repayment	414	639	679	804	1,304

Source: Budget '95 documents

- The debt management plan further separates taxpayer-supported debt into two categories: debt incurred as a result of operating deficits (operating debt) and debt incurred as a result of the building of the provincial infrastructure (capital debt). While one of the plan's benchmarks is the elimination of the $10.2 billion of operating debt, we noted that a portion of this debt was in fact borrowed for the building of capital projects—in particular, the construction of highways. As such, the operating deficit is overstated. We also noted that current accounting practices for capital costs are not standard in the government, and therefore inconsistencies could occur in accounting for borrowing for capital versus operating purposes. Therefore, we recommended that the government establish a consistent baseline and continue to record monies borrowed for capital and operating purposes separately.
- More detailed information is required in the debt management plan, including that on the types of contingencies that might exist if the main assumptions fall significantly short of the government's expectations. In addition, the plan should clearly indicate future financing needs to maintain the province's infrastructure.

This last point is the most important of the three and warrants further discussion.

Budget '96, which was published on April 30, 1996, before the 1996 provincial election, reported a projected $16 million surplus in the Consolidated Revenue Fund for the 1995/96 should provide more detailed contingency plans as to how the government will deal with changes in forecasts as they occur. If the public is made more aware of what issues could affect the plan, and how the government might respond to those issues, then it will be in a better position to judge the reasonableness of the plan.

One matter that may negatively impact the debt management plan, for example, is revenue from the sale of Columbia River downstream benefits. The Budget documents have stated that, beginning in 1998, revenue from the downstream benefits would be partially used to repay direct debt. However, recent issues surrounding energy prices and the transport of power to southern markets may affect the level of certainty with which this revenue can be accounted for.

Alternative Financing

The government has alluded to—but not discussed in detail—methods by which the Province could reduce current debt or decrease the need to borrow in the future. These methods involve debt defeasance, the sale of Crown assets, and other alternative financing proposals. While they were mentioned only briefly in the government's budget documents, these methods may have a large influence on how the government reduces debt and finances the purchase of physical assets in the future.

Debt Defeasance

Budget '96 disclosed that provincial borrowings which were previously loaned under the Fiscal Agency Loan Program to the Greater Vancouver Sewerage and Drainage District (GVSD) and the Greater Vancouver Water District (GVWD) were defeased as of April 1, 1996. Defeasing debt means that sufficient funds have been set aside in sinking funds to repay all interest and principal when debt repayment comes due. The defeased debt is then removed from the accounts of the government for reporting purposes.

In fact, what occurred in this case was that the GVSD and GVWD borrowed funds through the Municipal Financing Authority in order to repay the loan to the Province. Therefore, while the total provincial debt has decreased by approximately $300 million, no change was made in municipalities' debt load, as they simply changed their lenders. This debt should probably not have been included in the Province's total debt in the first place.

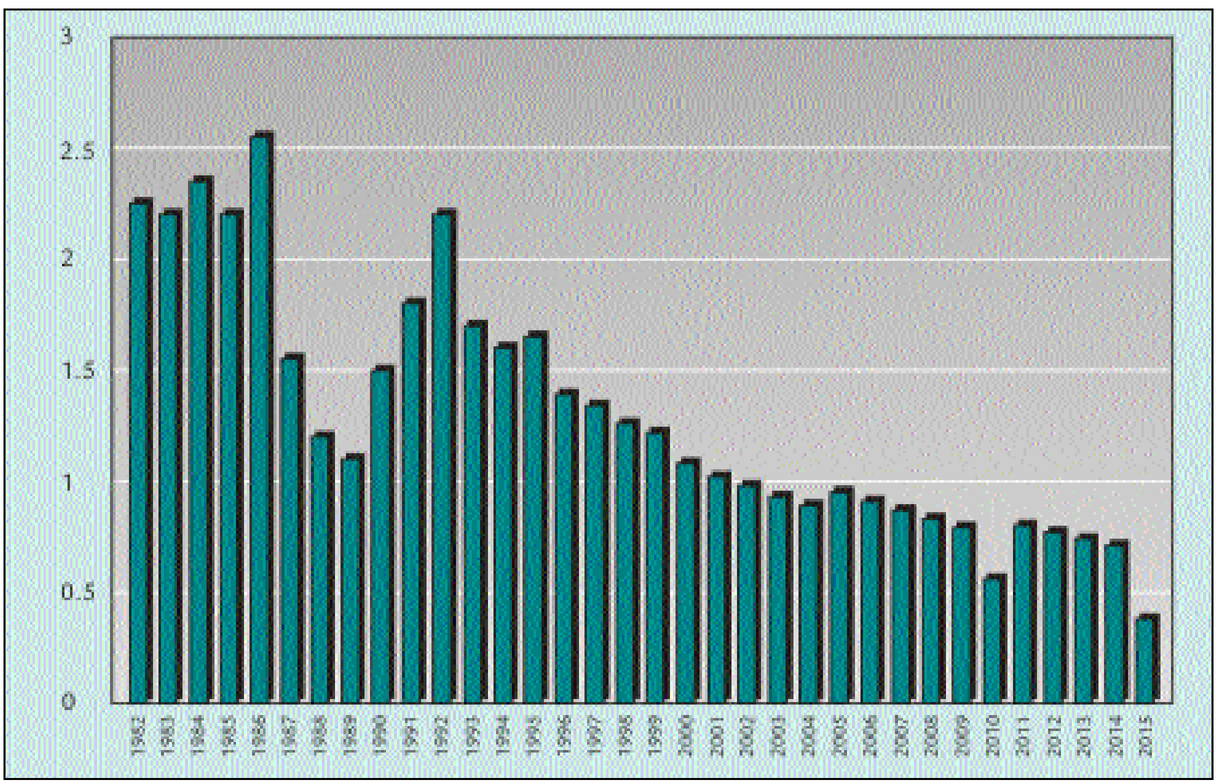
With little information to explain how the infrastructure of the province will be sustained, the plan to reduce government spending on capital projects may appear alarming to many readers. Exhibit 4.4 shows the actual trend in infrastructure spending as a percentage of the GDP from 1982 to 1995, and the projections based on information in government's debt management plan from 1996 to 2015.

Although we expect alternative financing to play a significant role in financial planning in the future, Budget '96 provides little information as to the level of such financing required to achieve the government's infrastructure spending and program objectives for future years. In our opinion, the government should discuss its goals related to alternative methods of financing and project their use in the future development of British Columbia's infrastructure. Our Office intends to monitor closely significant cases of alternative

Exhibit 4.4

Projections of Government's Direct Infrastructure Expenditures as a Percentage of GDP, 1996 to 2015, Compared with Actual Amounts, 1982 to 1995

To maintain the past level of capital spending on the province's infrastructure, the government must find significant alternative financing



Source: 1982 to 1995 from Budget '95 Reports, page 53; 1996 to 2015 calculated by OAG staff based on information in Budget '96

To compare the most recent two years of financial information, the 1994/95 information has been restated so that the significant changes that occurred in 1996 are properly reflected.

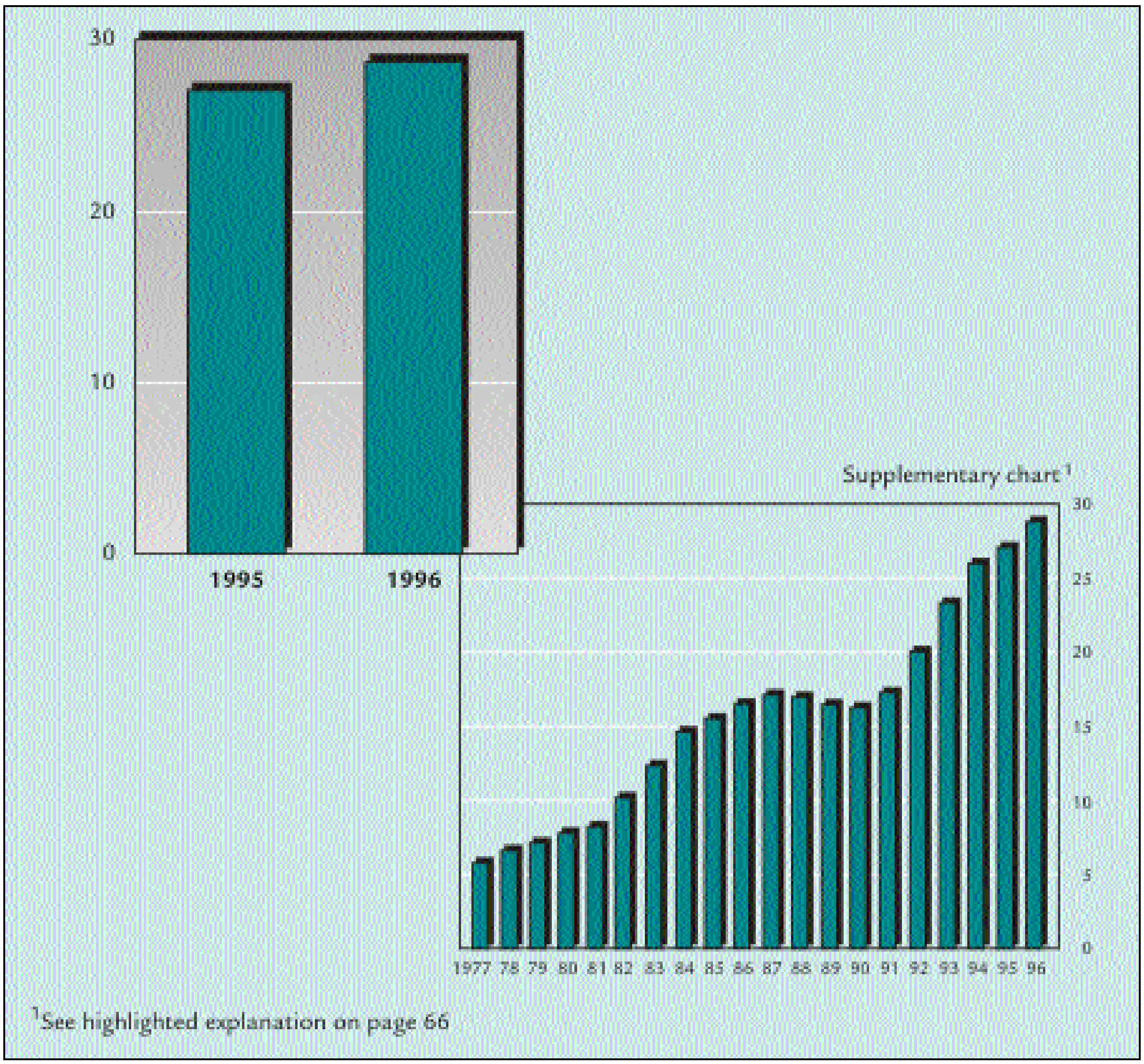
Total Provincial Debt

The total debt of the Province of British Columbia increased from $27.1 billion in 1995 to $28.8 billion in 1996, an increase of 6.1% in one year. Exhibit 4.5 shows the total

Exhibit 4.5

Total Provincial Debt

Total debt for the two years, 1995 and 1996 ($ Billions)



Source: The Public Accounts; Ministry of Finance and Corporate Relations, Debt Management Branch provincial debt for the two years ending March 31, 1995 and 1996. The increase in total provincial debt due to the change in the government reporting entity was approximately $69 million in 1995/96 ($80 million in 1994/95).

The total debt of the Province is composed of amounts borrowed for the operation of the central government (direct), for the warehouse borrowing program, for government agencies, and for third-party debt guaranteed by the government. Exhibit 4.6 shows a breakdown of direct, warehouse, agency, and third-party guaranteed debt as at March 31, 1996. Total provincial debt at that date was $28.8 billion, and consisted of the $27.1 billion in debt reported in the Summary Financial Statements, together with $1.4 billion in additional debt of "government enterprises" and $0.3 billion in third-party guaranteed debt.

Two important indicators of trends in provincial debt are "debt per capita" and "debt to revenue."

Debt Per Capita

As a performance indicator, the debt per capita shows the average amount of provincial debt owing by each British Columbian. It is calculated by dividing the total debt of the Province by the population of the province.

Each British Columbian's share of the provincial debt increased from $7,390 to $7,641 between 1995 and 1996. Debt per capita has increased every year since 1990. Exhibit 4.7 shows the debt per capita for the two years ending March 31, 1995 and 1996. The increase in debt per capita due to the change in entity is approximately $20 in each year.

Debt to Revenue

Another frequently used indicator is debt to revenue. Calculated as the ratio of debt outstanding at yearend compared to revenue from all sources for that year, it indicates how many years of revenue it would take to repay the provincial debt. Comparing this ratio for the 1994/95 fiscal year (91%) to that of the 1995/96 fiscal year (94%) shows that in 1995/96 the rate of increase in debt was higher than the rate of increase in revenue.

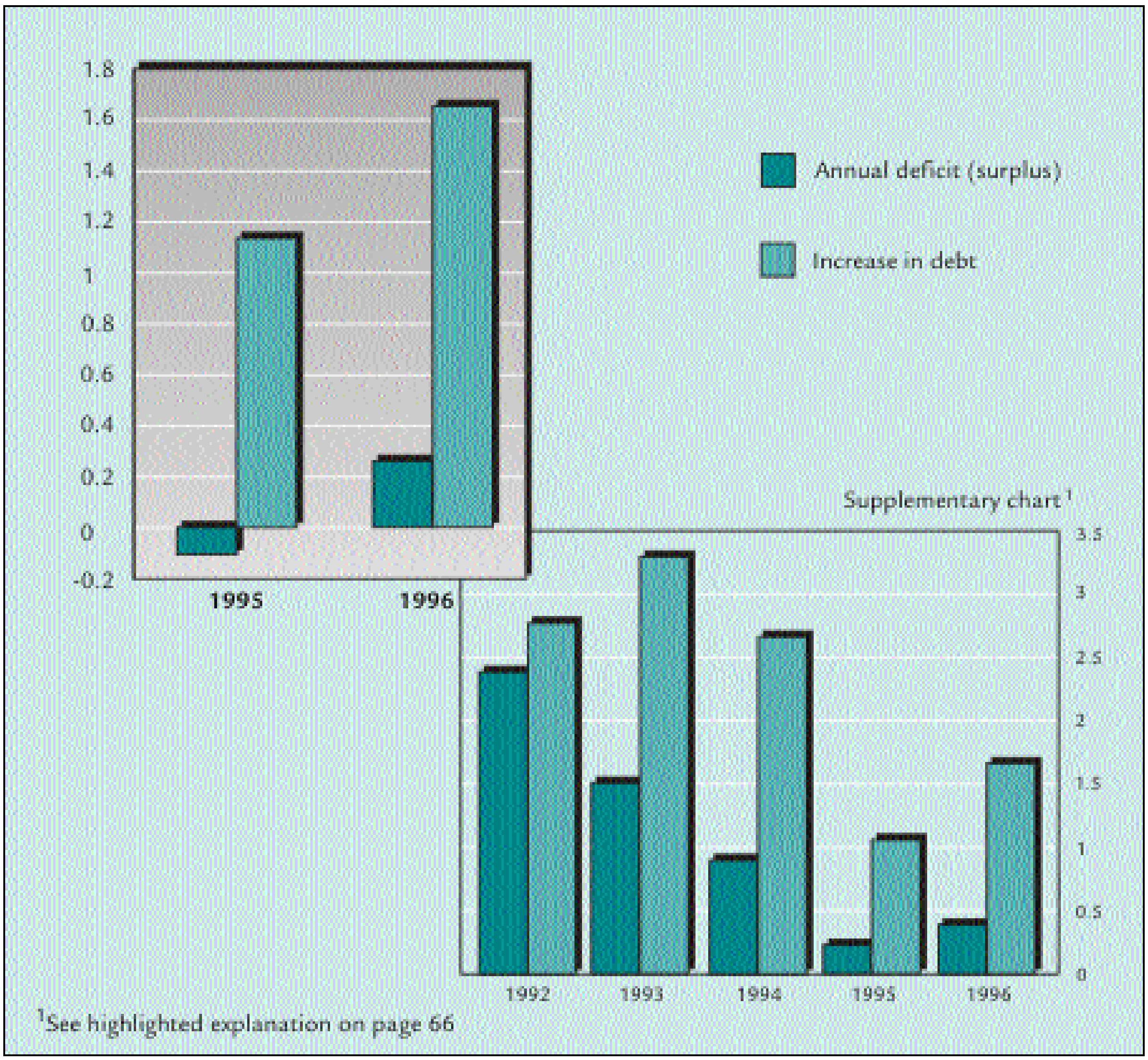
could be the financing of the annual deficit of the government. In addition, a government may borrow to finance capital asset acquisition, new investment, and lending, or simply to have funds available for future needs.

Exhibit 4.8 shows the annual change in total provincial debt compared to the annual deficit.

Exhibit 4.8

Deficit Compared to Debt

Annual deficit (surplus) compared to the annual increase in total provincial debt, 1995 and 1996 ($ Billions)



Source: The Public Accounts

Exhibit 4.9

Changes in Total Provincial Debt

Detailed list of change in total provincial debt in the 1995/1996 fiscal year ($ Millions)

	Net Debt as at March 31, 1996	Net Debt[1] as at March 31, 1995	Increase/ (Decrease) in Net Debt
Direct debt of Consolidated Revenue Fund	**10,237**	**10,181**	**56**
Debt of Warehouse Borrowing Program	**895**	**0**	**895**
Debt of government agencies			
BC Transportation Financing Authority	590	276	314
British Columbia Assessment Authority	7	6	1
British Columbia Buildings Corporation	719	698	21
British Columbia Ferry Corporation	502	433	69
British Columbia Housing Management Commission	25	18	7
British Columbia Hydro and Power Authority	7,592	7,662	(70)
British Columbia Lottery Corporation	5	5	0
British Columbia Railway Company	346	334	12
British Columbia Systems Corporation	22	26	(4)
British Columbia Transit	1,506	1,451	55
Capital Project Certificate of Approval Program	311	319	(8)
Educational Institutions	1,436	1,324	112
Greater Vancouver Sewerage and Drainage District	175	187	(12)
Greater Vancouver Water District	131	137	(6)
Improvement Districts	3	3	0
Liquor Distribution Branch	3	3	0
Pacific National Exhibition	2	11	(9)
Pacific Racing Association	6	6	0
Provincial Rental Housing Corporation	99	92	7
Regional Hospital Districts	1,359	1,299	60
School Districts	2,516	2,261	255
Victoria Line	2	0	2
	17,357	**16,551**	**806**
Third-party guaranteed debt	**287**	**390**	**(103)**
Total provincial debt	**28,776**	**27,122**	**1,654**

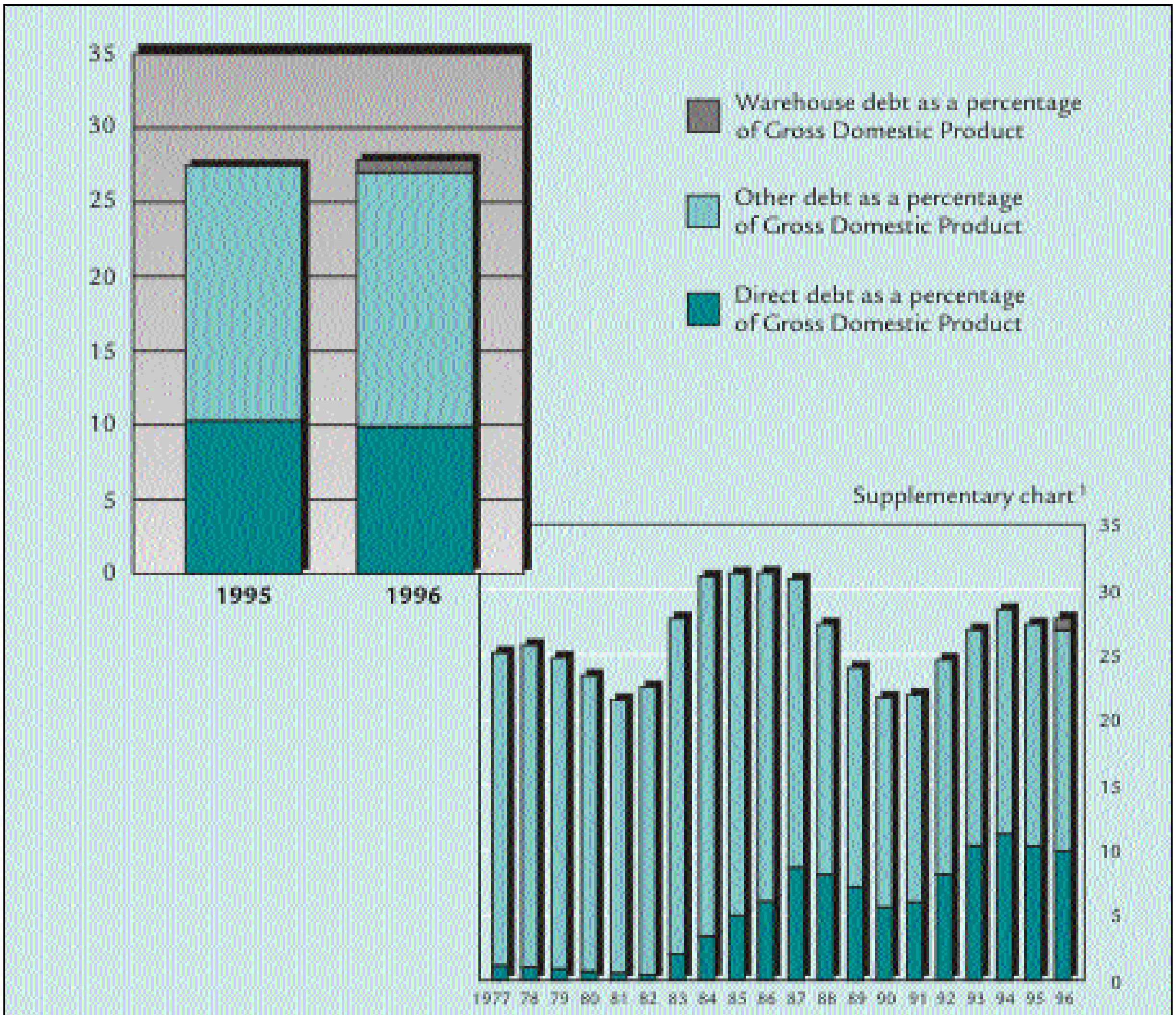
[1]Net debt as at March 31, 1995, has been restated from the amounts shown in the 1995/96 Auditor General's Report on the Public Accounts. This restatement is due to a change in the government reporting entity, a change in the source of debt information, and the financing of a Liquor Distribution Branch capital lease.

Source: The Public Accounts; Ministry of Finance and Corporate Relations, Debt Management Branch

Exhibit 4.10

Debt to Gross Domestic Product (GDP) Ratio

Provincial debt as a percentage of GDP in British Columbia, 1995 and 1996



[1]See highlighted explanation on page 66

Source: The Public Accounts for debt; B.C. Statistics for B.C. GDP (calendar year ending in the fiscal year)

financial highlights

financial highlights

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 the direction provided by Section 8(1) of the *Auditor General Act*.

Financial data are taken from the summary level financial statements included in the Public Accounts of the relevant years.

For the 1995/96 Public Accounts, the summary reporting entity was expanded to also include universities, colleges, other advanced education institutions, school districts, regional hospital districts, and hospital societies. The government also changed its accounting policies so that it now capitalizes tangible capital assets and amortizes them over their useful lives. These changes have resulted in a different base for reporting assets, liabilities, revenues, and expenses compared with that in prior years. Now being reported as revenue, for example, are federal government contributions to universities and colleges, student tuition fees, income from food and residence services, fee revenue and investment income earned by school districts, patient fees, municipal taxes and miscellaneous revenues collected by hospital societies.

To compare the most recent two years' financial information, we have restated the 1994/95 Summary Financial Statements to reflect the significant changes in accounting policies that occurred in 1996.

As in previous years, financial data are not adjusted for changes in the Consumer Price Index (CPI). Population figures are from statistics as at July 1 of each year. Otherwise, all "year" references in this section are to the fiscal year ended March 31 of the year noted.

In its 1996 Budget, the government reported an overall provincial economic growth in 1995 of 2.7%, down from 4.3% in 1994. For 1996, the government again projected an economic growth of 2.7%, expected to result in some 40,000 new jobs in British Columbia. The government also predicted a modest budget surplus in 1996/97.

This year, we have chosen to include two charts in each exhibit in this section. The main chart of each compares the current year's highlighted financial information with last year's information, both reflecting current government accounting policies. The supplementary chart, in the background, compares the five-year financial highlights on the basis of the accounting policies in place before the change in composition of the reporting entity and accounting for tangible capital assets occurred.

In its *Economic Review and Outlook*, published in September 1996, the government revised its projections. The outlook now is for an economic growth of 1% in 1996/97. The government has also stated that it may not be able to meet its budget surplus projection.

Revenue

Taxes are the most significant source of revenue for the government of British Columbia. Last year, they accounted for 54 cents of every dollar of the provincial revenue. Compared with all other taxes, personal taxes are the largest source. From 1995 to 1996, personal taxes rose from $4,706 million to $4,992 million, an increase of $286 million.

Exhibit 5.1 shows total revenue of the Province for the years 1995 and 1996. For the year 1996, the largest percentage increase in revenue by main source was in "taxation revenues." These increased 4.7% from $12,256 million in 1995 to $12,826 million in 1996. Expressed in other terms, this means that the average taxation revenue generated by each resident of British Columbia (per capita taxation revenue) has increased from $3,340 in 1995 to $3,406 in 1996.

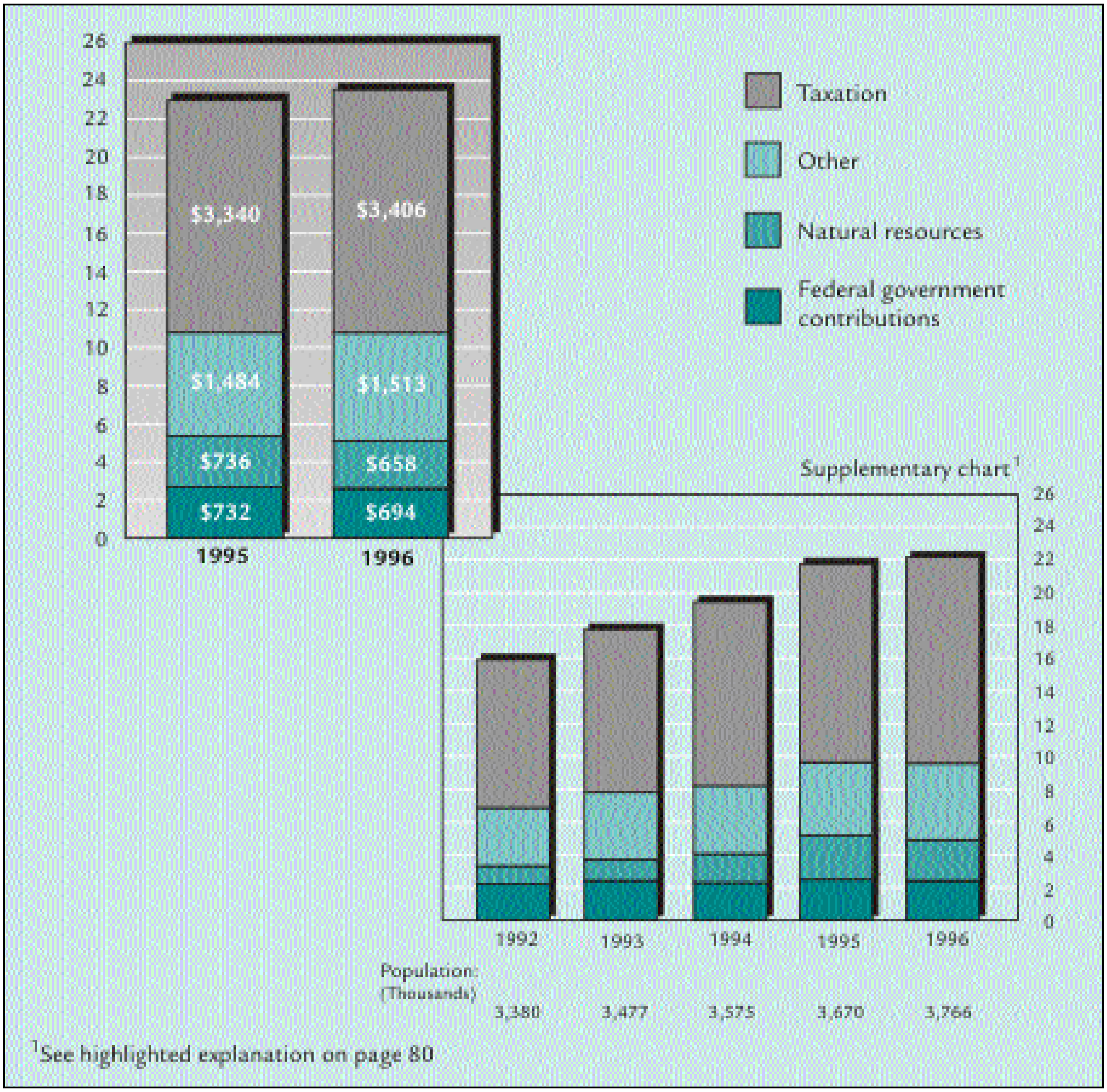
The revenue category referred to as "other" includes all fee and license collections, earnings from investments, contributions from government enterprises, recovery of monies from sources outside government, and some miscellaneous revenue.

Exhibit 5.2 shows the rate of change in revenue over the last two years by major sources. The base year in the main chart is 1995. Revenue for each major source in the 1996 year has been shown as a percentage of the base year.

Exhibit 5.1

Revenues, 1995 to 1996

Total and per capita revenue by main sources over the past two years ($ Billions)



Source: The Public Accounts for financial figures; Statistics Canada for population statistics as at July 1

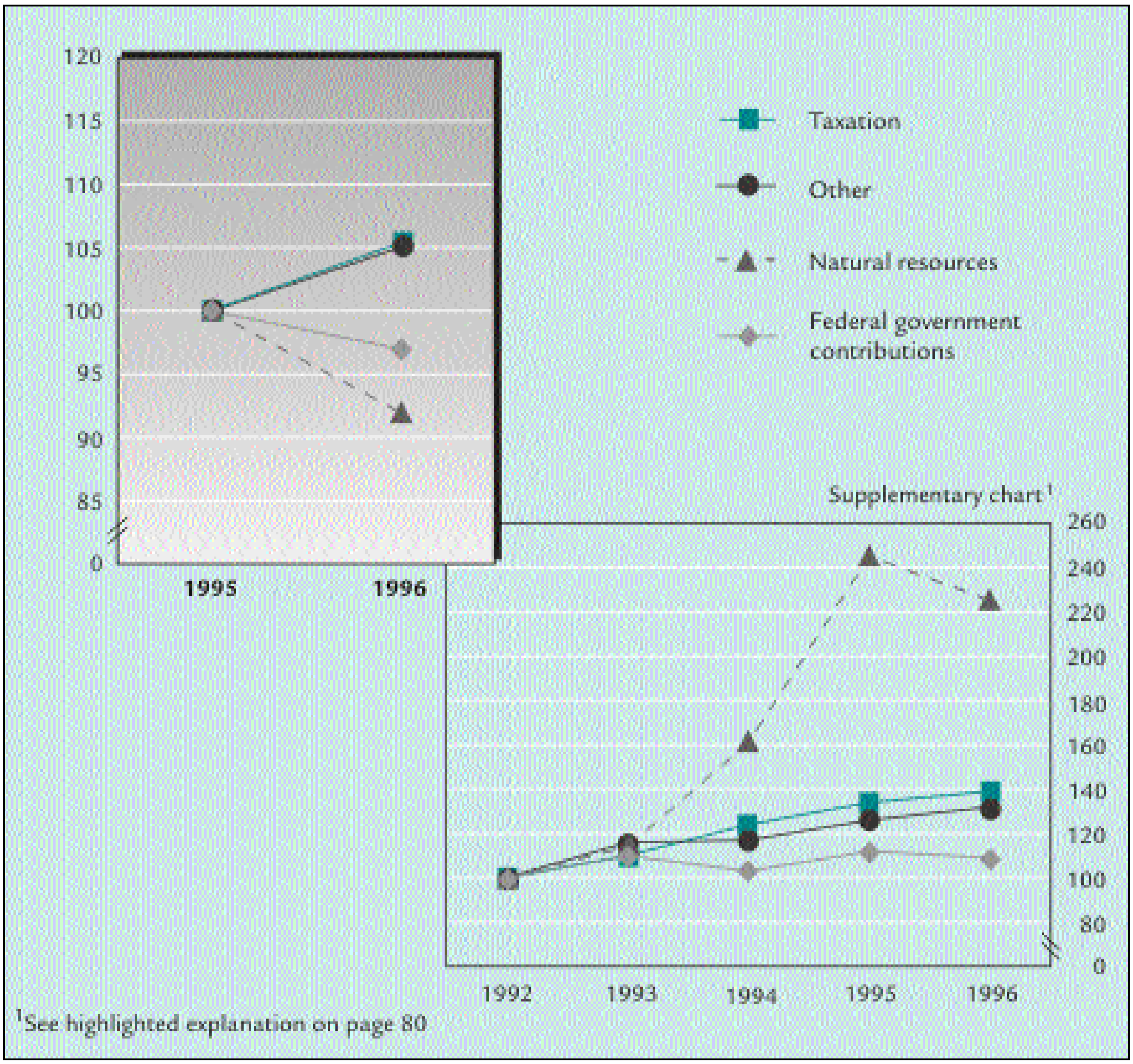
Exhibit 5.3 shows the taxation revenue by source over the years 1995 and 1996, and the ratio of revenue from each of the major taxation sources to the total taxation revenue of the Province.

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

Exhibit 5.2

Change in Revenues, 1995 to 1996

Rate of change in revenue by main sources, over the past two years (1995 = 100)



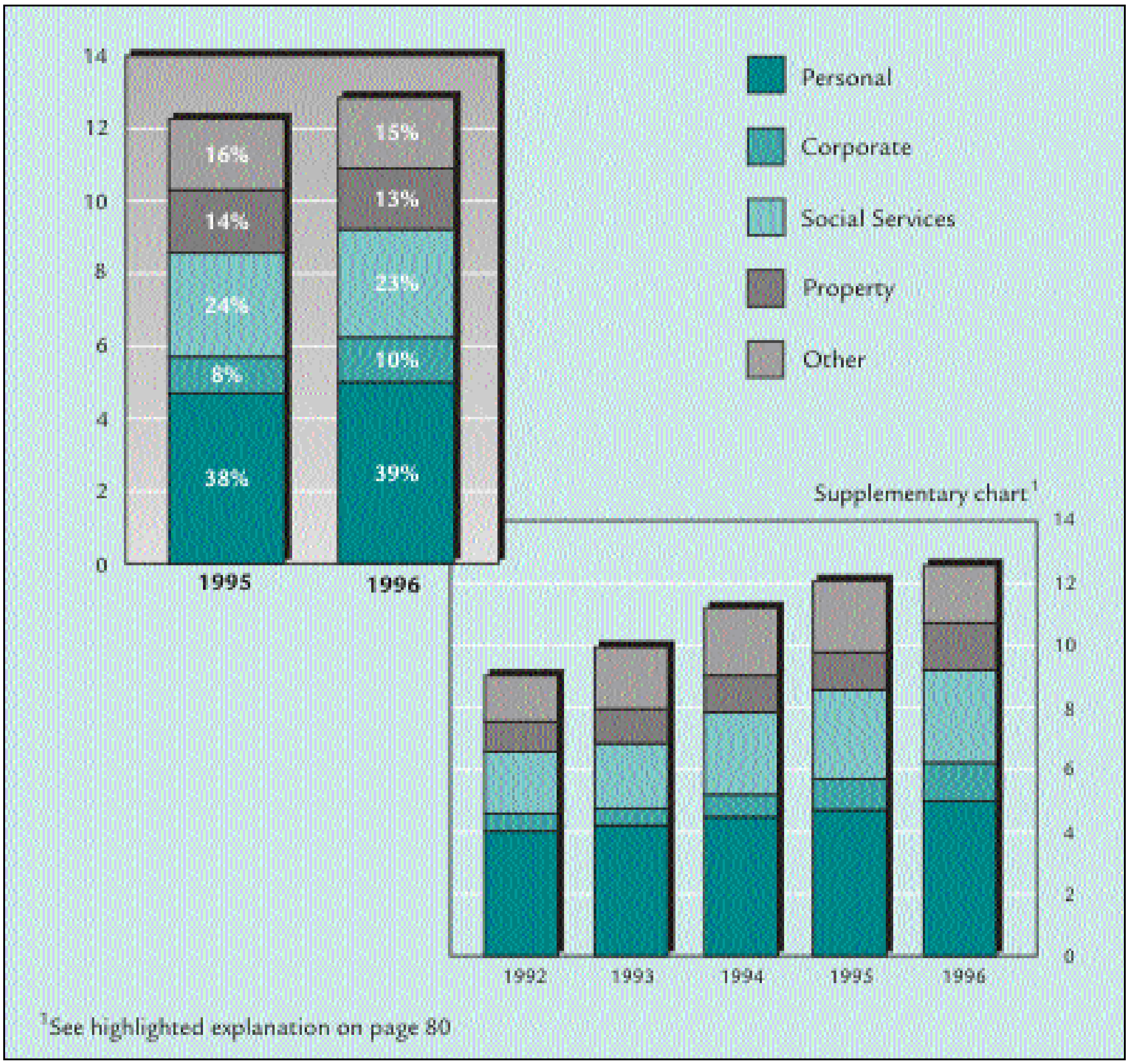
Source: The Public Accounts

presented in Exhibit 5.3, the taxes denoted as coming from property include residential, business, and rural property taxes. The Social Services Tax is more commonly known as the provincial sales tax. The "other" source includes property transfer, fuel, tobacco, and insurance premium taxes, in addition to hotel room, corporation capital, and horse racing taxes.

Exhibit 5.3

Taxation Revenue, 1995 and 1996

Total, and percentage of total, taxation revenue by source over the past five years ($ Billions)



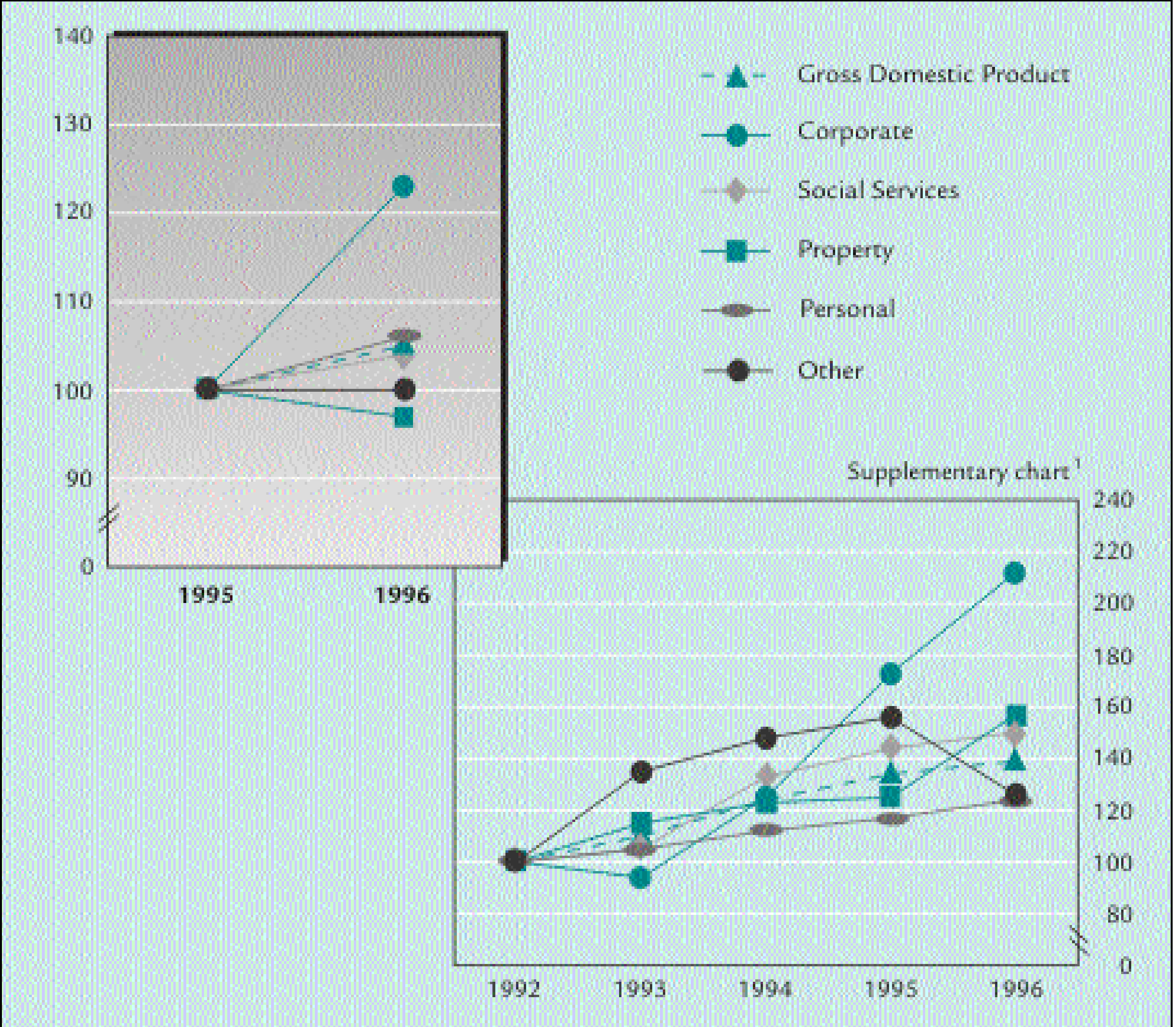
Source: The Public Accounts

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 1995 and 1996. The GDP is used in this exhibit as an indicator of the Province's economy. As in Exhibit 5.2, 1995 is taken, in the main chart, as the base year for the comparison. The GDP data are for each calendar year ended in the related government fiscal year.

Exhibit 5.4

Change in Taxation Revenue, 1995 to 1996

Rate of change in taxation revenue by major categories, compared to Gross Domestic Product (1995 = 100)



[1]See highlighted explanation on page 80

Source: The Public Accounts

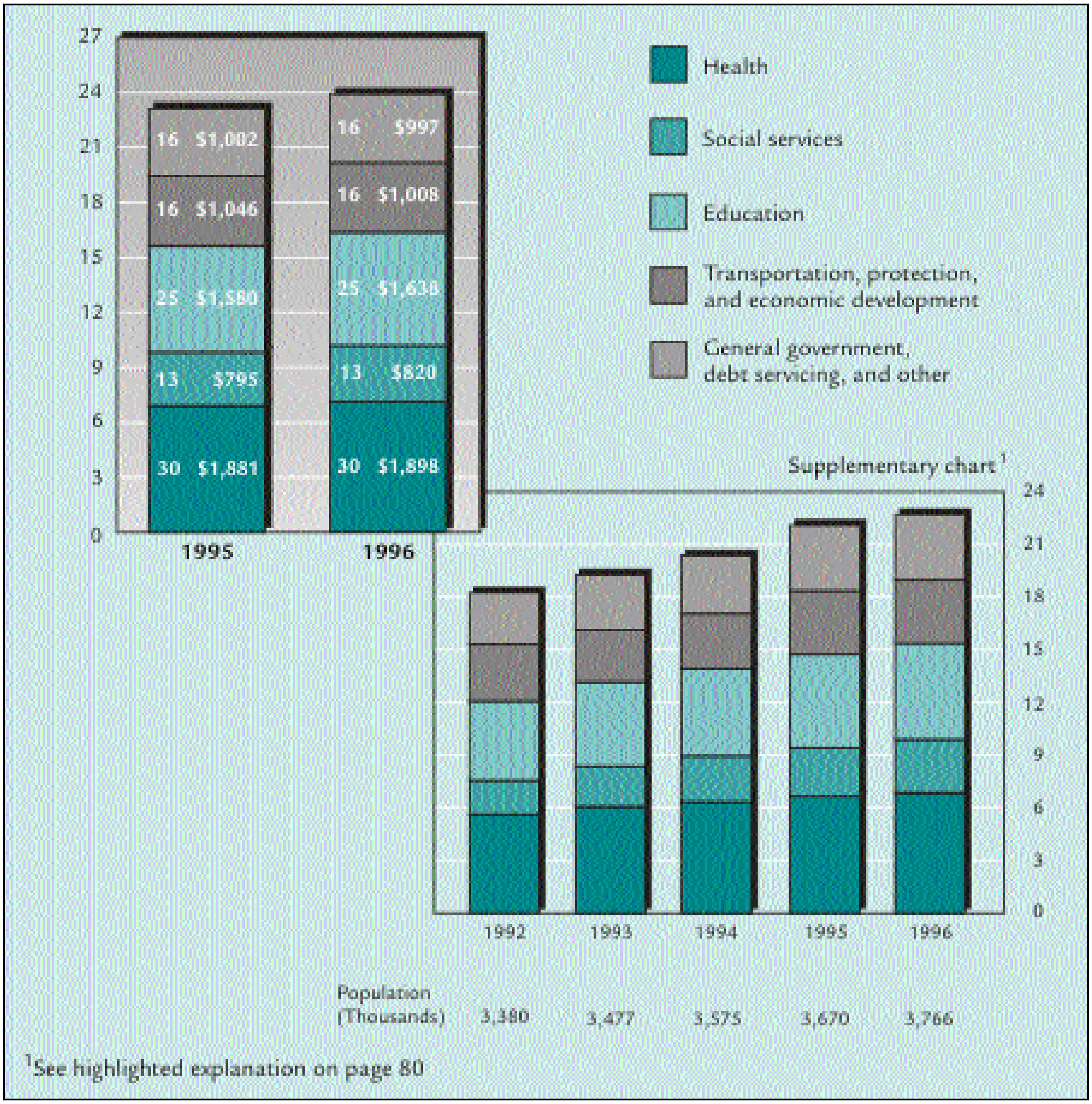
Expense

Exhibit 5.5 shows the Province's total expense for the 1995 and 1996 years. Expense is divided into five groups based on "functions." The three major functions—health, social services, and education—are shown separately. Transportation, protection, and economic development

Exhibit 5.5

Expenses, 1995 and 1996

Total, percentage of total, and per capita expenses by function group ($ Billions)



Source: The Public Accounts

functions are grouped, as are the general government, debt servicing, and all other functions. Exhibit 5.5 also provides information on average expense per resident of British Columbia (per capita expense) in each function group. For each group, the percentage of expense in that group to the total government expense is also shown.

In each of the last two years, health, education, and social services combined have accounted for about 68% of the total expense of the Province:

- Health costs increased from $6,901 million in 1995 to $7,149 million in 1996, an increase of 3.6%.
- The cost to the Province of educating our students increased from $5,799 million in 1995 to $6,169 million in 1996, an increase of 6.4%.
- The cost of social services increased from $2,919 million in 1995 to $3,087 million in 1996, an increase of 5.8%.

In the same two-year period, the province's population increased by 2.7% from 3.7 million to 3.8 million, and its GDP grew by 4.6% from $98,910 million to $103,433 million.

Exhibit 5.6 shows the rate of change in per capita expense over the last two years for social services, education, and health. To show the change over the two-year period, the per capita expense in each category has been indexed to the year 1995. The expense is in actual dollars and has not been adjusted for inflation. However, the British Columbia CPI is plotted in Exhibit 5.6 to show the general increase in prices in the province, indexed to 1995, for comparison.

Deficit

The consolidated net expense (known as the annual deficit) of the Province—the excess of expense over revenue—is an important indicator of the Province's financial performance. The annual deficit for 1996 was $261 million, or a little over 1% of the year's total revenue of $23,616 million. For the previous year a $106 million surplus was recorded. The accumulated deficit of the Province—the total of all government deficits and surpluses to date—amounted to $5,991 million at the end of the 1996 year.

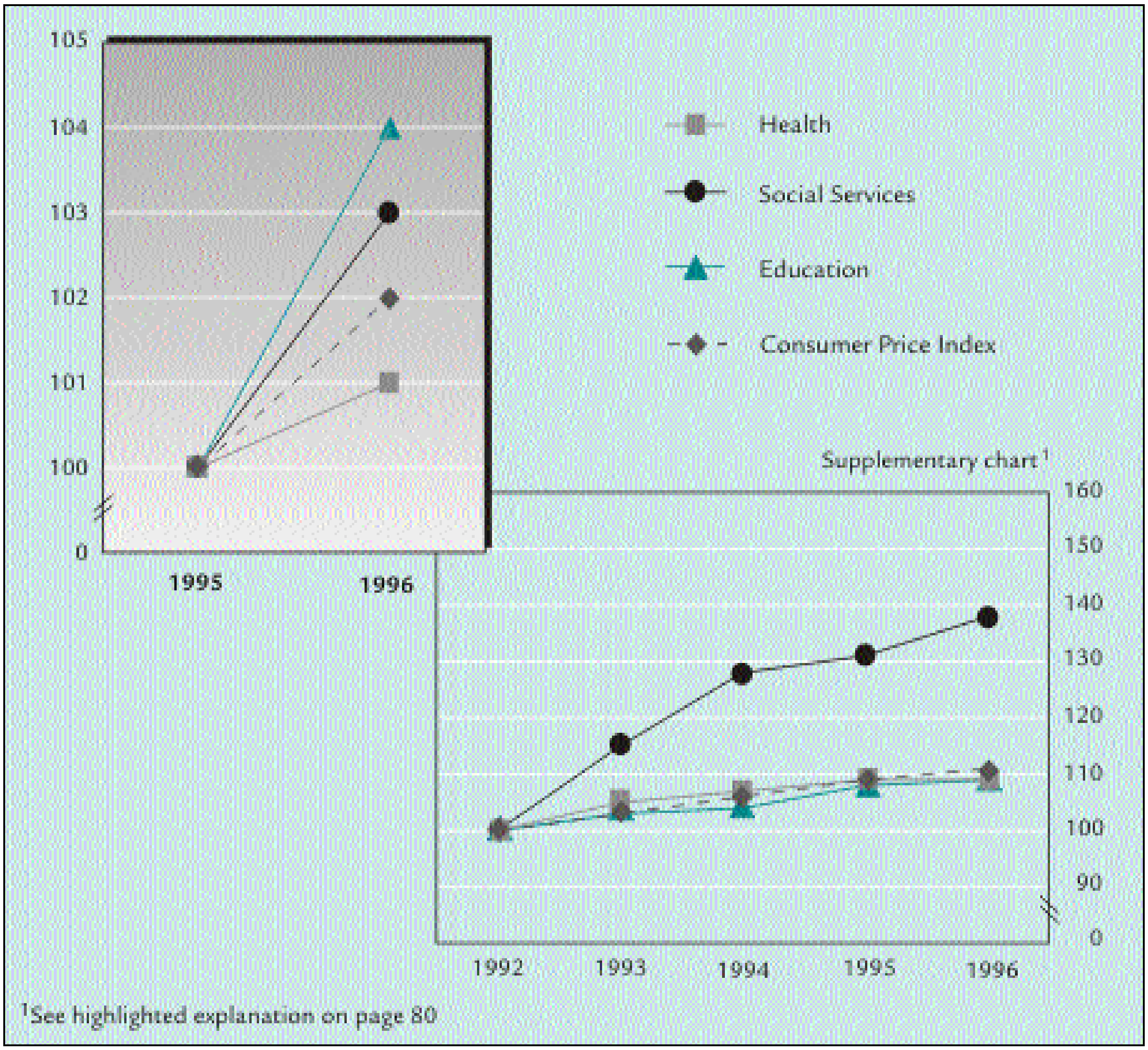
Starting in 1993/94, in addition to debt and accumulated deficit, a third financial indicator was added to the financial statements: net liabilities.

The term “net liabilities” represents the difference between total liabilities and financial assets. In order to pay liabilities when they come due, this difference will need to be financed by either ensuring future revenues exceed expenses (that is, having a surplus) or borrowing more (incurring new debt). The liabilities amount is an indicator of the Province’s financial indebtedness.

Exhibit 5.6

Change in Expenses, 1995 to 1996

Rate of change in per capita expenses for social services, education, and health, and in the Consumer Price Index (1995 = 100)



Source: The Public Accounts for financial figures; Statistics Canada for population statistics as at July 1

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

The net effect of the expanded reporting entity and the decision to move to capitalize tangible capital assets is very noticeable on the Province's accumulated deficit, but less so on government's annual operations. The changes in government accounting policies resulted in two significant adjustments to the accumulated deficit, which otherwise would be approximately $10,456 million. The first increased it by about $6,670 million ($6,172 million for 1995). This increase came about because the outstanding balance of debt owed to government by public health care and educational organizations (previously regarded as loans receivable) was eliminated when these organizations became part of the government reporting entity. The second adjustment reduced the accumulated deficit by $11,135 million in 1996 ($10,520 million for 1995), representing the book value of capitalized assets.

Exhibit 5.7

Accumulated Deficit, 1995 and 1996

Accumulated deficit over the past two years ($ Millions)

Year ended March 31	1995	1996
Accumulated deficit, beginning of year	(5,836)	(5,730)
Surplus (deficit) for year	106	(261)
Accumulated deficit, end of year	(5,730)	(5,991)

Supplementary Chart[1]

Year ended March 31	1992	1993	1994	1995	1996
Accumulated deficit, beginning of year	(5,057)	(7,442)	(8,951)	(9,850)	(10,078)
Surplus (deficit) for year	(2,385)	(1,509)	(899)	(228)	(378)
Accumulated deficit, end of year	(7,442)	(8,951)	(9,850)	(10,078)	(10,456)

[1]See highlighted explanation on page 80

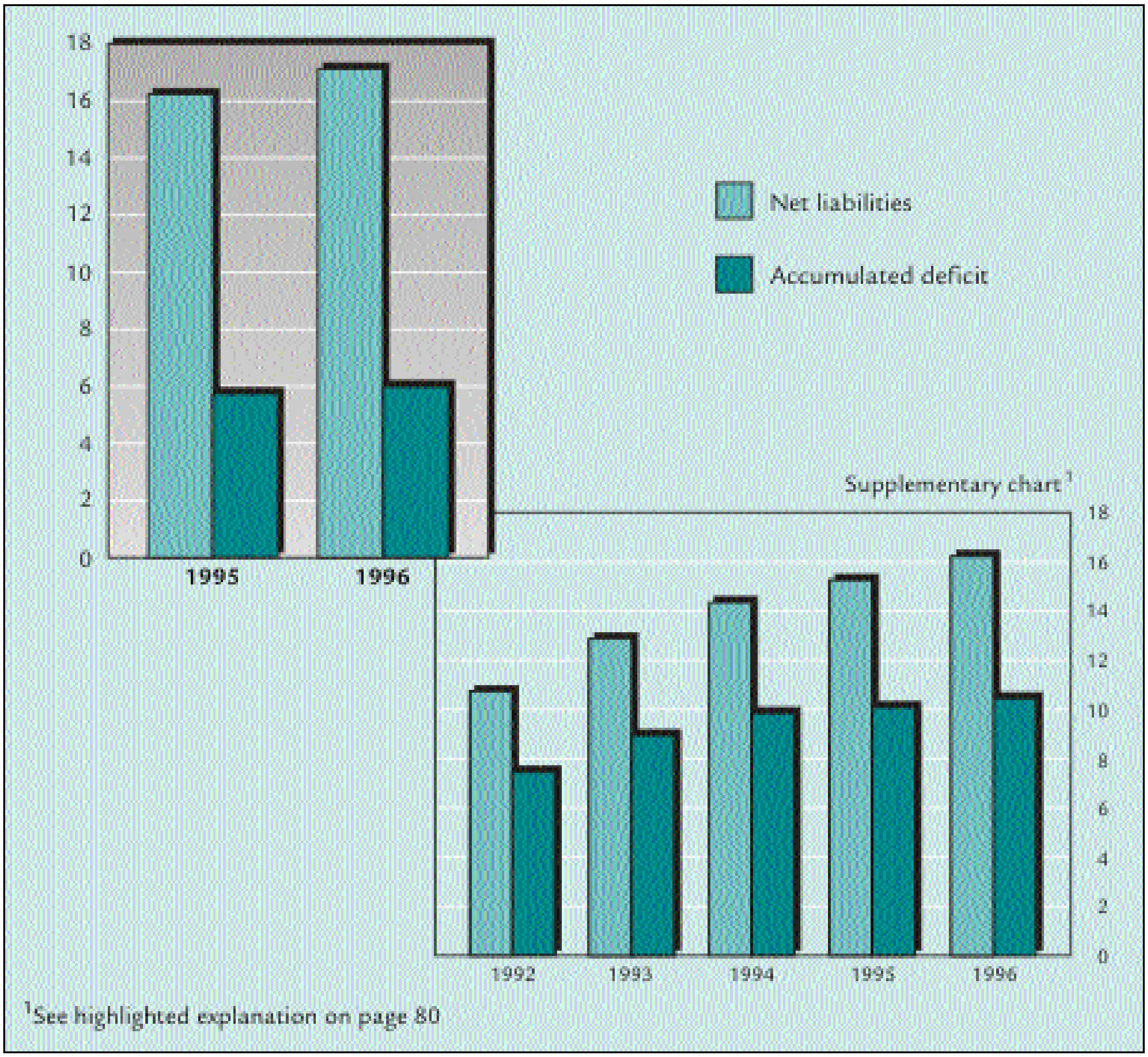
Source: The Public Accounts

Exhibit 5.8 provides information on the accumulated deficit and net liabilities over the past two years. During this period, the accumulated deficit increased by 4.6% from $5,730 million in 1995 to $5,991 million in 1996. The net liabilities increased by 5.5% from $16,237 million in 1995 to $17,126 million in 1996.

Exhibit 5.8

Accumulated Deficit and Net Liabilities, 1995 and 1996

Comparison of accumulated deficit and net liabilities at the end of the past two fiscal years ($ Billions)



Source: The Public Accounts

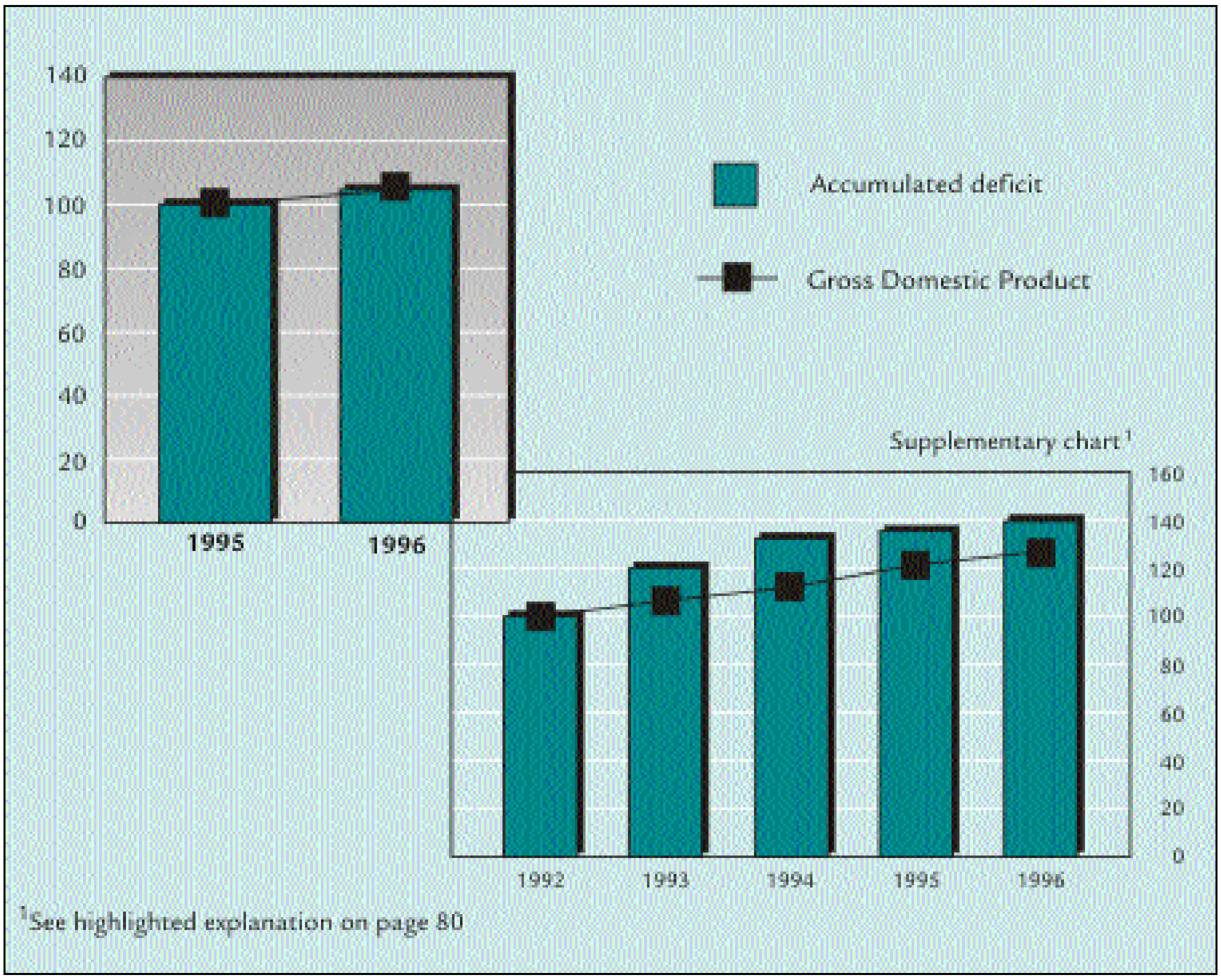
Exhibit 5.9 shows the rate of change in the province's GDP compared with the rate of change in accumulated deficit at each yearend, 1995 and 1996, indexed to 1995. During the past two years, the accumulated deficit increased by 4.6%. The GDP, meanwhile, grew by 4.6% and the population by 2.7%.

Exhibit 5.10 shows the annual result of operations compared to the growth in the provincial economy represented by the percentage change in GDP from the previous year. There was a 4.6% growth in the economy from 1995 to 1996. In that period the result of operations of the government changed from a surplus of $106 million in 1995 to a deficit of $261 million in 1996.

Exhibit 5.9

Accumulated Deficit and Gross Domestic Product (GDP), 1995 to 1996

Rate of change in accumulated deficit and in GDP (1995 = 100)



Source: The Public Accounts

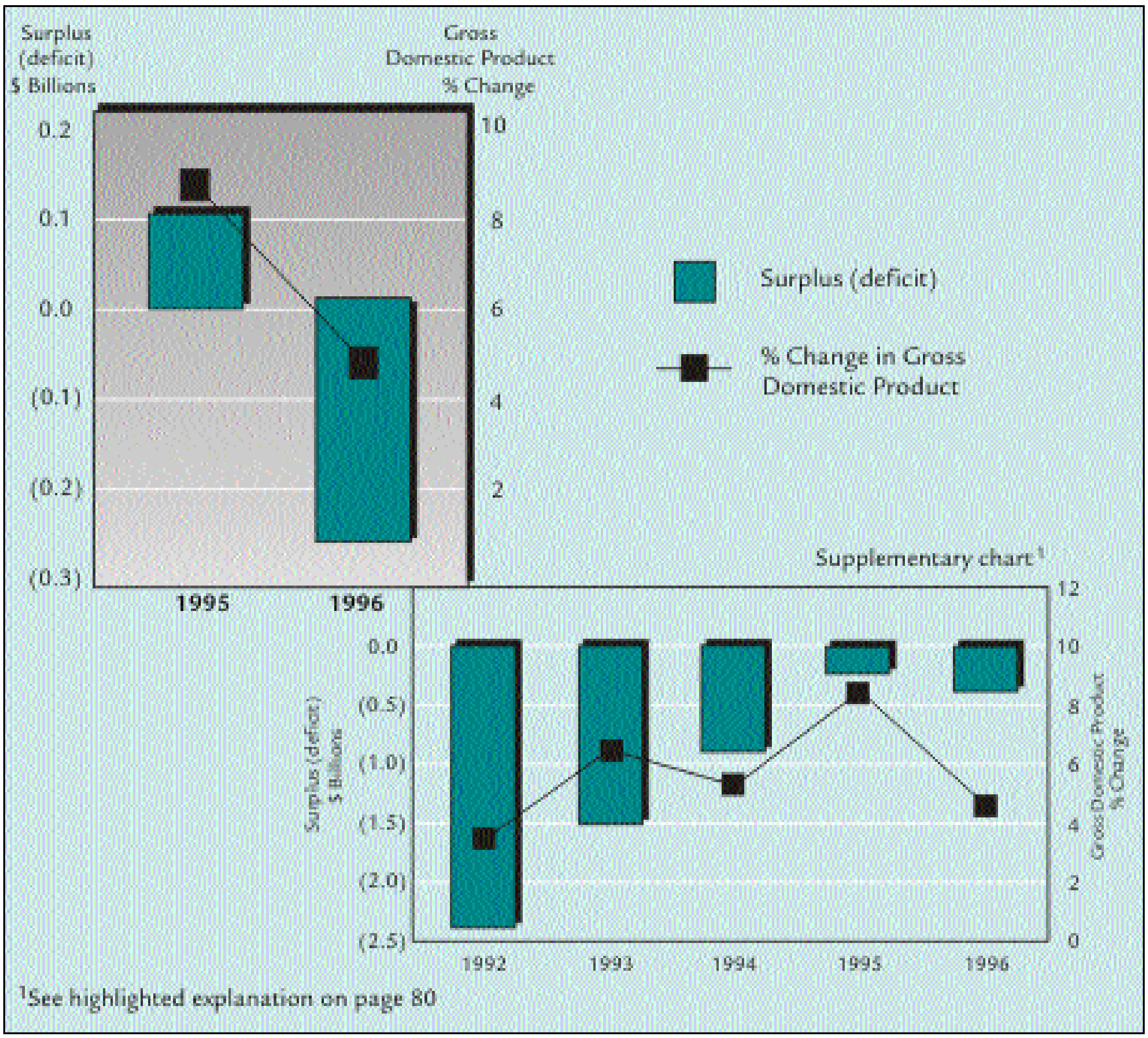
Public Debt

The Province has been borrowing in the capital market for three purposes: first, for its own current needs; second, for its own anticipated needs in the future; and third, to lend funds through its Fiscal Agency Loan Program to various government and other public sector entities, mostly for purchase of assets. A list of the entities receiving funds through the Fiscal Agency Loan Program, and which will repay these funds through their operations, is presented in note 20 of the Summary Financial

Exhibit 5.10

Annual Surplus (Deficit) and Gross Domestic Product (GDP), 1995 to 1996

Annual deficit compared to percentage change in GDP for each of the past two fiscal years



Source: The Public Accounts

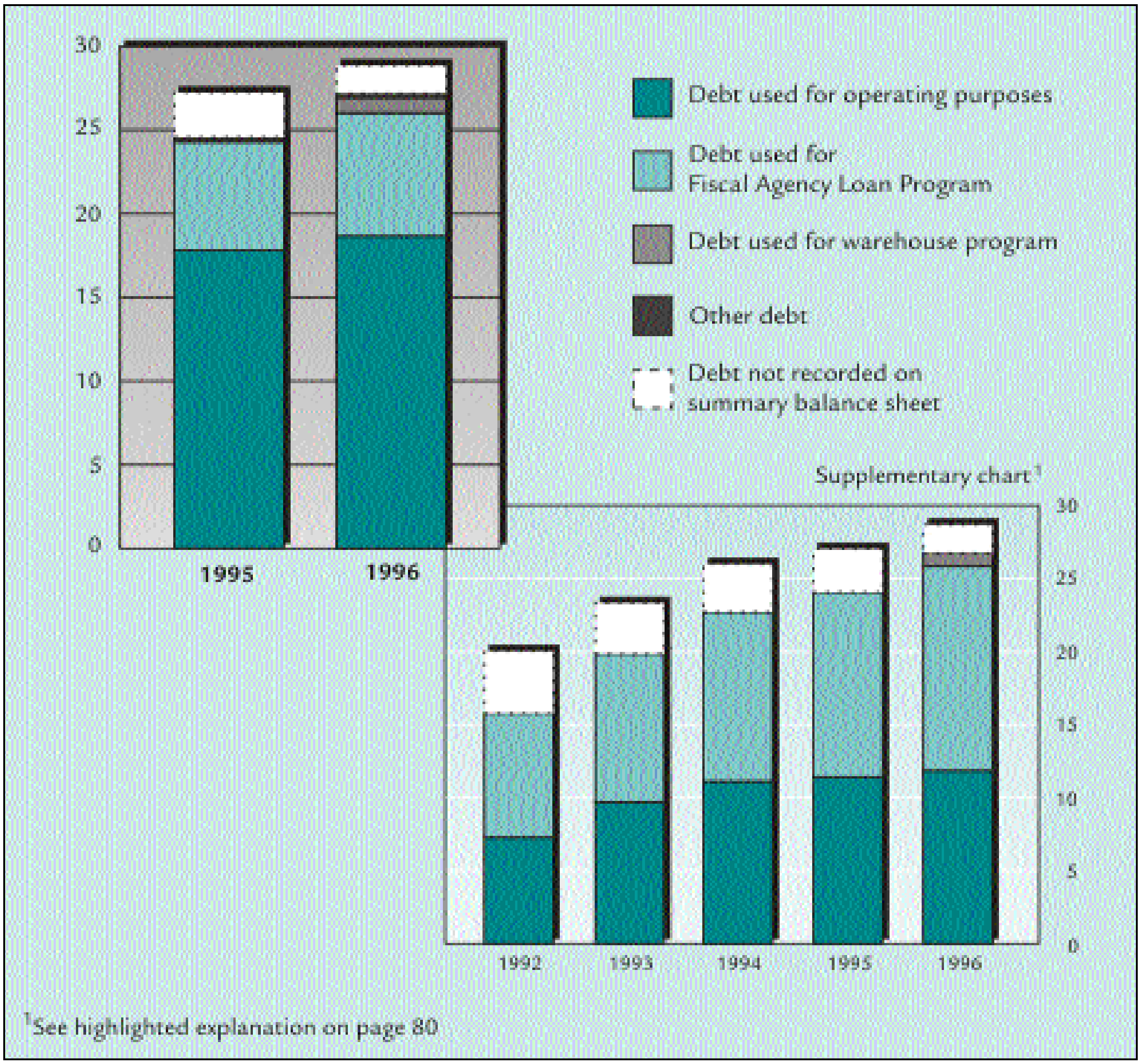
Statements. Loan recipients include British Columbia Railway Company, British Columbia Hydro and Power Authority, British Columbia Ferry Corporation, Greater Vancouver Sewerage and Drainage District, and the Greater Vancouver Water District.

Exhibit 5.11 shows the amount of public debt, including amounts borrowed by Crown corporations and other organizations included in government reporting entity from

Exhibit 5.11

Total Public Debt, 1995 and 1996

Debt by category, including debt not recorded on summary balance sheet, over the past two fiscal years ($ Billions)



Source: The Public Accounts

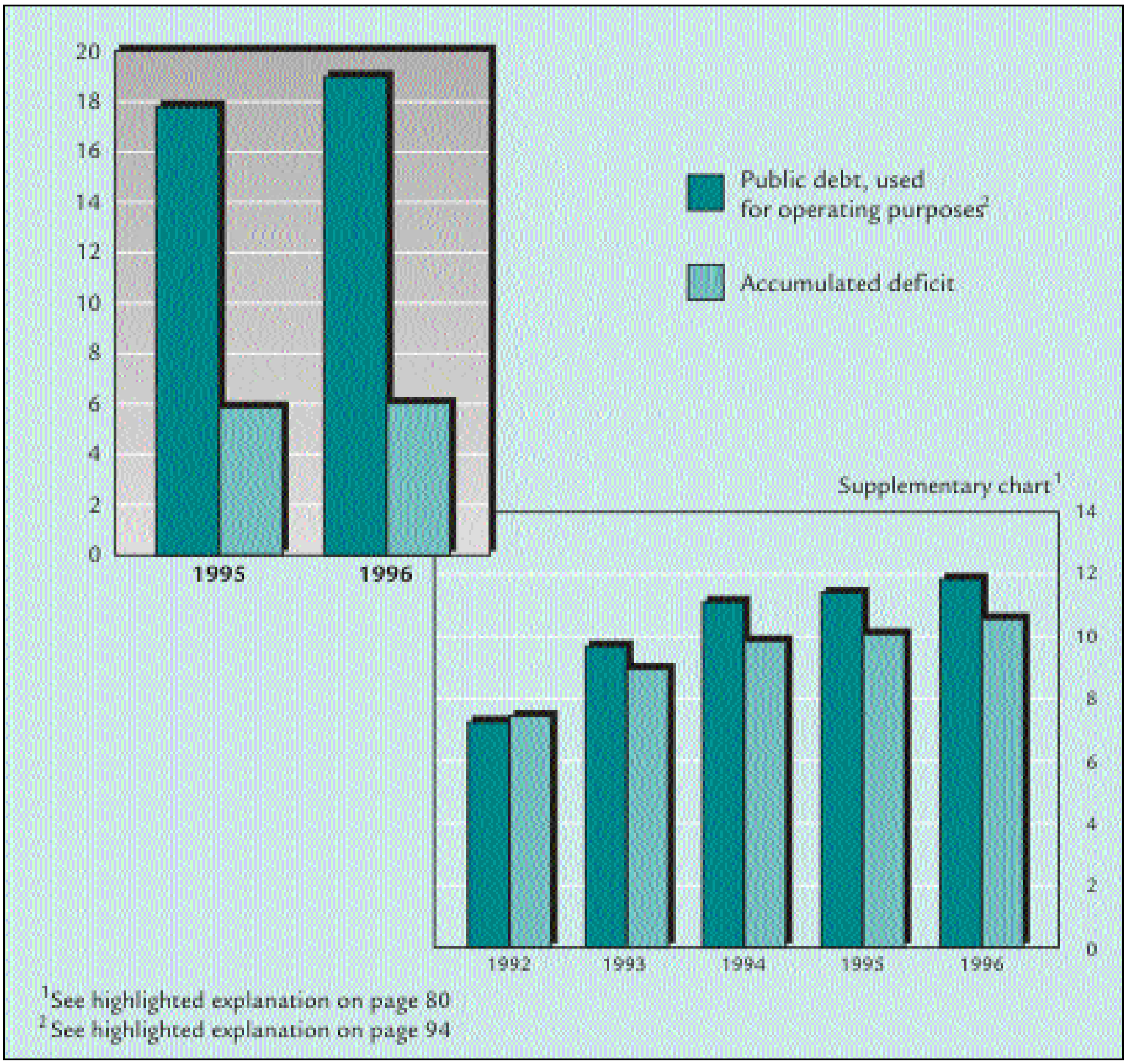
sources outside the government (not recorded in the Summary Financial Statements), at March 31 for each of the years 1995 and 1996. During the last two years, the total funds borrowed by the Province rose from $27,122 million in 1995 to $28,776 million in 1996, an increase of 6.1%.

Exhibit 5.12 shows the balance of monies borrowed for government "operating purposes" at the end of each of the

Exhibit 5.12

Operating Debt and Accumulated Deficit, 1995 and 1996

Comparison of public debt used for operating purposes[2] and the accumulated deficit at the end of each of the past two fiscal years ($ Billions)



Source: The Public Accounts

last two years, compared with the accumulated deficit balances at the same dates.

In government financial reporting, debt used for “operating purposes” means monies borrowed for use in all aspects of operation of ministries and all fully consolidated government organizations, including acquisition of assets.

The Province’s debt for operating purposes exceeds the accumulated operating deficit. In addition to using borrowed funds to finance its operating deficits, the government uses the funds for other purposes, such as purchasing or developing tangible capital assets or financing increases in temporary investments.

internal control and other reviews

internal control and other reviews

"Control comprises those elements of an organization (including its resources, systems, processes, culture, structure and tasks) that, taken together, support people in the achievement of the organization's objectives."

The Criteria of Control Board, Canadian Institute of Chartered Accountants

Introduction

Reliance on effective controls—those established by management to support the success of the organization—make eminent sense to an auditor. Reliable controls provide the auditor with the confidence that a risk of errors occurring is low, and that if they occur they will likely be detected quickly. In an environment such as this, the auditor can usually provide his or her audit assurance with less detailed testing of individual transactions. This is the essence of an efficient audit.

In our financial auditing, we have moved increasingly away from extensive and costly transaction-based examinations to more focused, risk-based evaluations. We have been able to do this where we note that government places appropriate emphasis on controls, including those over resources, systems, processes, organizational culture, structure, and tasks.

Only by constantly familiarizing ourselves with all aspects of government's business, and methodically assessing the risk of errors occurring and the effectiveness of controls to prevent and detect errors, are we able to determine how much we can rely on controls. Both maintaining sufficient knowledge of government's business and evaluating controls are therefore integral parts of our financial auditing. In this section we report to the members of Legislative Assembly and the public on matters of interest resulting from these tasks.

This year we comment on three topics having significant control implications for years to come.

They are:

We also include two reports of our specifically planned review of controls in ministries. These are:

new corporate accounting system: update

In our report on the 1994/95 Public Accounts, we expressed concern over slow progress in the planned replacement of the Central Batching System (CBS) with the Corporate Accounting System (CAS). The old system, we pointed out, requires technology that will soon be obsolete. Furthermore, it cannot handle transactions dated 2000.

The project has been going on for the last seven years and, according to a ministry internal report, has cost the government (as of March 1996) more than $32 million. This is the fourth consecutive year that we report on the development of CAS, and once again we express our concern that time is running short on this project.

Background

The CAS is an accounting, reporting, and financial management system designed to record and process the government's financial transactions and produce financial reports. When completed, its five fully integrated modules will include: general ledger, accounts payable/purchase order, accounts receivable/revenue, asset management, and project cost management. For these modules, CAS is planning to use Walker Integrated Interactive software.

Over the past year, there have been no significant additions or enhancements to CAS. One ministry (Finance and Corporate Relations) and one agency (Forest Practices Board) have joined the small group of on-line users. The majority of ministries still use CBS.

Originally developed in 1978, CBS is a collection of custom-written programs that are used to process expenditure transactions, make payments, and update the government's general ledger. The system is out of date, inefficient, and incompatible with several anticipated changes coming in the next few years. Unfortunately, the technology needed to run this system is so old that it is no longer supportable at a reasonable cost. It is also expected to become unavailable by the end of 1998—one fact alone that could render the system obsolete. Furthermore, like many other old systems, CBS is not capable of coping with the advent of the millennium. (See "Government Information Systems and the Year 2000 Problem" on page 108 in this report.)

Clearly, there is a significant risk in allowing further time to elapse. Since its inception in 1989, the CAS project has been hampered by doubts and problems and subjected to re-evaluation at least four times. Despite the years of work on the project and the money spent, the government is still years away from its objective of establishing a government-wide integrated accounting system.

Exhibit 6.1 provides an account of the major events affecting the CAS over the last seven years.

Development Since Our Previous Report

When we reported last year, CAS was implemented in four ministries and two government bodies using Walker accounts payable and general ledger modules. A new business model and business requirements documents had been developed. At that time, plans for the next few months included completion of the CAS by the end of October 1995, implementation of the system in the current on-line ministries by April 1, 1996, and implementation for the other ministries between April 1, 1996, and April 1, 1998.

In November 1995, project management announced that the necessary resources had not become available to complete these plans as scheduled and a new implementation schedule was drawn up. According to the new schedule, CAS was to be implemented in all ministries gradually between April 1, 1997, and April 1, 1999. Work continued on construction of CAS until April 1996.

In April 1996, there was another change in CAS ownership. The management of the project was transferred to the Assistant Deputy Minister of Provincial Treasury and the ownership to the newly formed Executive Steering Committee with cross-government representation and interest. The new management of the project initiated yet another review of CAS. This review was carried out by two individuals re-assigned from their regular duties and placed under the direction of the chair of the steering committee. Their *Report on the Corporate Accounting System Initiative* has come to be known as the CAS Independent Review.

Pending the outcome of this report, work on several components of CAS was put on hold. This included all work on modules other than the general ledger and accounts payable. At the same time, the CAS office initiated a short-term action plan for the project that included stabilizing the existing Walker system in several areas, reviewing the CBS, and completing all tasks necessary to upgrade Walker to its next version.

Exhibit 6.1

A Chronicle of Major Events Affecting the CAS Project, 1989 to 1995

Date	
1989	Ministry of Finance and Corporate Relations commissioned a task force to look into the government's accounting systems. The task force recommended a shared database and common accounts payable/general ledger software and estimated a five-year time frame for the project.
1990	Walker Integrated Interactive software chosen as the software product, and the scope expanded to include revenue, asset management, and project cost management. Project put on hold from November 1990 to September 1991 due to a freeze in funding.
1992	The Office of the Comptroller General (OCG) requested BC Systems Corporation (BCSC) to prepare a status report. It highlighted several concerns, including users' dissatisfaction with the choice of Walker because of its complexity and lack of functionality. Project management and coordination transferred from OCG to BCSC.
1993	Walker general ledger module and accounts payable module implemented at OCG, Government Services, Women's Equality, Labour and Consumer Affairs, Premier's Office, and Information and Privacy Commissioner's Office. An attempt to implement a new CAS interface for non-pilot ministries was unsuccessful, causing numerous and significant problems. This seriously undermined CAS credibility with its users.
1994	At the request of OCG, a consulting firm prepared a pilot implementation review. It concluded that: ■ not all ministries accepted the shared system approach; ■ the scope of the project was too broad; ■ the costs of implementation and ongoing operations had not been determined; and ■ the file storage capacity may not be adequate in the future. Ownership of CAS changed, with the overall leadership and direction transferring from BCSC to OCG.
1995	Ministry of Attorney General implemented CAS. The Chief Information Officer undertook another review of the project. The review recommended that project management issues be addressed and that a phased implementation approach be adopted, with new ministries coming on-line on a voluntary basis initially.

The report was released in October 1996. It made several important recommendations and the steering committee is currently seeking comments from the community of stakeholders before making a decision on the future direction of the project. Among the significant recommendations of the report were: scaling down the scope of the CAS project to general ledger and accounts payable; developing a flexible plan for implementing CAS in the remaining ministries; replacing the CBS by adding a new program to CAS to accept transactions which are batched by ministries; and completing detailed business requirements for all ministries.

The Executive Steering Committee intends to work towards the completion of a new CAS, based on the recommendations of this report. As part of its review and decision-making process it must secure the commitment of senior management to ensure that the new system can be developed within a reasonable time frame.

Update on Concerns Raised in Our Previous Report

Last year we reviewed the project development processes used by the CAS office. At that time we expressed concerns over a number of issues. During the current review, we looked at the present status of those issues.

Project Timing and Deadlines

There are two deadlines approaching that make the development of a new accounting system imperative. First, to retain technical support from IBM, the government is planning to change its mainframe operating system by October 1997. Once this is done the CBS will no longer be supported in the new environment. Second, the current CBS will not be able to handle transactions for the fiscal year ending 2000. We recommended that CAS management address the issues of timing to ensure alternative methods are available when both deadlines—the change by IBM to a different mainframe operating system and the arrival of the new millennium—occur.

Project management commissioned a review of these timing issues, and a report titled *Central Batching System Current Status Review* was released in July 1996. It recommended making only short-term changes to CBS, rather than making it compatible to the new operating system or the year 2000. At the same time, the report called for developing a generic interface between ministry financial systems and CAS. The CAS report referred to above also made a similar recommendation. To avoid what happened in 1993 when, due to the interface program, the project suffered numerous significant problems, management plans to develop a completely new interface this time that will allow ministry financial systems to provide input directly to CAS. When the interface becomes operational, CBS will no longer be required.

To ensure that the new interface is developed, tested, and made operational before April 1, 1999, we recommend that work on its development must start immediately.

Project Funding

This project has experienced funding problems for some time. In its early stages, there was no funding in certain years and, in more recent years, funding has been withdrawn on short notice. This has led to delays in completion of the project. In our report on the 1994/95 Public Accounts, we recommended that CAS be supported by a long-term funding arrangement. As of December 31, 1996, no such long-term funding commitment had been obtained.

At the request of the CAS Executive Steering Committee, all interested parties are currently reviewing the recently completed CAS report. The committee will then decide how CAS should proceed. It is anticipated that CAS management will prepare a Treasury Board submission for multi-year funding.

We again recommend that a long-term funding arrangement for the CAS project be sought, to allow uninterrupted financing for the project.

Assessment of Controls

Communication Controls

In our previous reports we recommended that communication between CAS project management and potential users be improved. During the year, a number of positive steps were taken to ensure that users are informed of the progress of the CAS project.

The CAS office hired a Communications Manager and established an Internet Web page which contains information about the CAS project, manuals, and the CAS newsletter.

The CAS office has also changed the focus of the newsletter it produces (CAS UPDATE) so that the information is more applicable to the users. Practical considerations such as the progress of the CAS project are featured now instead of business and technical perspectives on what CAS can achieve once fully implemented.

A further communication effort has been the introduction of a series of demonstrations to allow users to see first-hand some of the features of CAS and to have questions about the system answered.

We commend the effort management has put into this area to ensure users are kept aware of the changes that the project is undergoing.

Implementation Controls

Last year we recommended that adequate system testing, staff training, and documentation be completed before ministries are required to go onto the system.

The ministries that are currently using Walker are scheduled to be upgraded to the new version of the software on April 1, 1997. In anticipation of this, a testing strategy and system test plan have been designed to ensure that the transition to the new version goes smoothly. According to the testing schedule, systems testing should be completed by the end of November 1996 and user acceptance testing by the end of December 1996. This should allow enough time for any corrections to be made and re-tested before the ministries move to the new version of the Walker software.

A training coordinator was hired during the year and a training strategy approved. In addition, a group has been established to provide ministry input into the development and implementation of CAS user training.

During our discussion with ministry staff and CAS personnel, we were told that both groups were happy with the process and implementation was ahead of schedule.

summary of recommendations

Recommendations made in the report titled *New Corporate Accounting System: Update* are listed below for ease of reference. They should be regarded in the context of the report.

The Office of the Auditor General recommends that:

- *To ensure that the new interface is developed, tested, and made operational before April 1, 1999, work on its development must start immediately.*
- *A long-term funding arrangement for the CAS project be sought, to allow uninterrupted financing for the project.*

response of the ministry of finance and corporate relations

Corporate Accounting System Executive Steering Committee

The Auditor General's report seems a fair reflection of the history of the initiative, and the status at the time of the review. The CAS Executive Steering Committee (the Committee) appreciates the recommendations made, and the recognition of the progress achieved since the time of the previous review.

The Committee feels, however, that reference to the overall project cost to-date should separately identify the ongoing operational costs for CBS and CAS. Of the $32 million quoted, over 50 percent has been consumed by these essential activities during the life of the project, with the balance of $15 to 16 million being expended on development and implementation activities.

A number of the points raised in the report have now been more fully addressed and significant tangible progress has been made in the following areas:

- *The Committee has fully endorsed the recommendations of the Independent Review, following a series of focus group sessions and widespread solicitation of feedback from stakeholders.*
- *A new version of the CAS system (Release 2.0), based on the millennium-compliant Release 16.5.4 of Walker software, was implemented this month, ahead of the March 1997 target.*
- *User acceptance testing and training are presently being undertaken for the Ministries of Children and Families and Health, and these two major ministries will adopt CAS effective April 1, 1997.*
- *Treasury Board approval to contracting the design and development of the CAS Generic Interface was given in December 1996, and the project to eliminate CBS has commenced. The target completion of June 1998 obviates any Year 2000 risks associated with CBS.*
- *Continued operation and support for CBS, beyond the date for IBM's withdrawal of support to non-LE370 compliant systems, has been guaranteed by ITSD following an exhaustive testing program.*
- *A multi-year CAS Business Plan, based on the recommendations of the Independent Review, has been prepared, approved by the Committee, and distributed to Executive Financial Officers across government. The Committee expects this to go to Treasury Board early in the 1997/98 fiscal year.*

The Release 2.0 CAS implementation covered those components recommended by the Independent Review and identified by user ministries as being highest priority, namely: general ledger, accounts payable, commitment management, and financial reporting. Active user involvement has been present throughout the development, and feedback on the implementation indicates a high level of satisfaction with both process and results. The Risk and Controls Report for Release 2.0, completed by an independent consulting group, found "The overall risk assessment for these changes is low," and "The enforcement of coding and screen standards, the creation of documentation and training material, as well as a structured quality assurance process have reduced risks within the CAS environment."

The Committee has re-established the priority directions for the Initiative, secured this major implementation success, and significantly improved the buy-in and credibility of CAS with its users. The Committee now feels that it is properly positioned to address the millennium business disruption threat, and to ensure a timely and effective CAS roll-out across government.

government information systems and the year 2000 problem

What Is the Problem?

Historically, computer programs have made use of dates represented by only two digits for the year. The century was not entered. This was an important programming technique as it reduced data entry time, storage space, and processing time. It seems that no one anticipated that these programs would still be running in the year 2000!

Since the century was not coded, these programs cannot differentiate between years 1900 and 2000. Therefore, for years outside the range of 1900–1999, incorrect results are produced when programs perform arithmetic operations, compare data, or sort by date. The problem can exist in both mainframe and microcomputer hardware and software.

The “Year 2000” problem has been recognized for some time, yet little has been done to introduce corrective measures. The reason is simple: initiating a four-digit format for dates means changing many existing computer programs—a problem enough on its own, but particularly challenging, while the programs support present business activities.

We are encouraged by the government’s recent recognition of its responsibility to deal with the problem, and its formation of the Year 2000 Implementation Task Force. The problem, of course, is not limited to British Columbia, and we expect the task force, in seeking solutions, to work closely with similar organizations in other jurisdictions. Our responsibility is to provide assurance to the Legislative Assembly and the public that this work is being done without jeopardizing the controls on which the government relies in safeguarding public funds, and that the results of the operations will be properly accounted for. We intend to report on this issue further in our report on the 1996/97 Public Accounts.

The Impact on Government

Ministries are in the process of identifying their critical systems and evaluating the impact of the changing century on those systems. As of February 1997, according to the Year 2000 Implementation Task Force, 601 government systems will be affected by the Year 2000 problem. Of these, 263 were considered "mission critical," that is, they are essential systems that will come to a halt if the problem is not corrected.

Modifying all systems will, according to ministries' estimates, cost about $46 million. This amount includes the human resource costs of approximately 150 persons working on the project for a whole year. These figures may change as the ministries and the task force refine their estimates.

Government's Plan to Correct the Problem

Awareness of the Year 2000 problem is being raised at the executive, management, and developer levels. To correct the problem, the government must focus on understanding program code, planning and documenting the necessary changes, and then making and testing the changes. There are limited resources, and the costs and risks associated with correcting the problem are very high.

The task force has determined that the accountability for Year 2000 compliance must be at the ministry level. It has recommended that the Information and Technology Access Office clearly define the roles and responsibilities of its office, the Ministry Executive Financial Officers, the Ministry Information Systems branches, the Advisory Committee on Information Management, the Information Technology Services Division, and Treasury Board. The following roles and responsibilities have been recommended:

- The Executive Financial Officers are to provide leadership and take responsibility for Year 2000 initiatives in their ministries.
- The Information Systems branches are to carry out initiatives to make all ministry systems (and forms) Year 2000 compliant.
- The Advisory Committee on Information Management is to provide feedback on the Year 2000 task force recommendations to the Information and Technology Access Office, identifying implementation issues and providing support to this initiative.
- The Information and Technology Access Office is to provide a corporate perspective on government Year 2000 activities.
- The Information Technology Services Division is to provide the ministries with testing and production operating environments, along with available conversion tools.
- Treasury Board is to provide fiscal advice and support to ensure that ministry systems become Year 2000 compliant in a timely manner. Costs associated with Year 2000 initiatives will have to come from existing budgets.

Ministries have been directed to prepare a Year 2000 three-year plan that clearly identifies how they are addressing the problem. Every plan should reflect the ministry's strategy for each system. Financial systems working on an April-to-March fiscal year are to be compliant by March 31, 1998, in order to have one full year of operation before the final deadline of April 1, 1999, the start of the 1999/2000 fiscal year.

As We Approach 2000

The deadline for modifying the programs cannot be changed. In most cases that deadline is March 31, 1999. Some ministries have already taken steps to address the problem; others are just beginning.

Resources must be committed to develop, implement, and test a solution. Ignoring the Year 2000 problem could result in failures of mission-critical systems and disruptions in government business and services. It is not clear at this time if the government is liable should business functions fail on or before January 1, 2000.

new corporate human resource information and payroll system

In our 1989 and 1990 Auditor General Annual Reports, we commented on control weaknesses in the government's leave management systems, raising concerns about the completeness, accuracy, and timeliness of the information provided by ministries for inclusion in the central systems. In our 1992 Annual Report, we further questioned the level of adherence to payroll policies and procedures at the various ministry locations.

Over time, the government has significantly improved controls in these systems. However, the duplication resulting from each ministry maintaining separate systems suggests to us that the government's management of human resource information continues to have shortcomings. In this report we describe the government's progress in launching a recent initiative to improve its information base and the accounting and reporting of matters relating to its employees.

We focus here on implementation aspects of the new Corporate Human Resource Information and Payroll System (CHIPS).

The Origins of CHIPS

One of the goals of the Commission of Inquiry into the Public Service and Public Sector (Korbin Commission) was to determine whether the government was making efficient use of its human resources in the public service. The commission found that within the current structure there was limited overall government direction and inconsistent application of procedures related to matters such as recruitment, selection, and classification. As a result of the inquiry, the Public Service Employee Relations Commission (PSERC) was formed. One of its responsibilities was to establish and maintain a personnel management information system. With the help of ministries and other central agencies, CHIPS was developed.

Historically, each ministry has maintained a separate personnel and leave management system. Since none of these systems was connected to the other, extensive manual work was necessary wherever government-wide information had to be gathered for reporting and decision-making. CHIPS combines these functions of the government into one centralized integrated system.

On December 27, 1995, PSERC implemented the payroll part of CHIPS, a system that was designed to maintain human resource information, track leave management entitlements and transactions, and process payroll for the approximately 38,000 government employees.

Currently, CHIPS processes “employee benefits” as well as “payroll” and provides information used for managing employees, positions, and leave entitlements. Once fully implemented, CHIPS will also support human resource management functions such as the recruitment and selection of employees, the monitoring of employee numbers, the training and development of staff, and labor relations.

According to the current plan, the project should be substantially completed by December 1997.

Financial Impacts of CHIPS

Development and Implementation Costs

The combined 1994/95 and 1995/96 fiscal year budgets for developing the CHIPS prototype and implementing the system was set at $500,000 and $10,464,000, respectively.

The actual development cost of the prototype was $785,087. The excess of $285,087 was attributed to the salaries and benefits of the project team, costs that were not included in the initial estimate submitted to Treasury Board. The project team was formed with members seconded from other ministries. The implementation budget was allocated at $6,564,000 for central costs and $3,900,000 for ministry costs. The latter funds were to offset any network and computer enhancements required to implement and run CHIPS. The actual implementation cost has not been determined at this time.

To accommodate additional costs not considered in the initial projections, the 1996/97 budget of $2.8 million has been increased to $4.5 million.

Monetary Benefits

Combining the personnel and payroll functions into one centralized system is expected to eliminate 66 separate individual ministry systems operating within the government. It is anticipated that the resulting organizational changes, elimination of separate systems, and streamlining of business processes by integrating human resource and payroll information will eventually result in a significant reduction in overall operating costs. Starting in the 1996/97 fiscal year, the annual savings in ministries is expected to be about $3 million. Exhibit 6.2 details these cost savings.

Looking Ahead

Government policy on developing major systems stipulates that a post-implementation review of CHIPS must be done after each significant stage is completed. The Internal Audit Branch of the Office of the Comptroller General is conducting this review and expects to report on it before the end of the 1996/97 fiscal year.

The outstanding issue identified by the Korbin Commission (consistency in the hiring process) is also expected to be addressed through the implementation of the new system, as it relates to the recruitment and selection of employees. By using one centralized system, the government should be in a better position to promote consistency in its hiring activities.

As part of our internal control review in 1997/98, we intend to report on the adequacy of the financial and processing controls of CHIPS, including those needed to ensure appropriate changes are made when needed.

Exhibit 6.2

Anticipated Annual Financial Impact on Ministries of the New Corporate Human Resource Information and Payroll System

Decrease in annual cost of staff	1,250,300
Decrease in overtime, due to elimination of systems	150,000
Decrease in annual operating costs	2,379,700
Increase due to adjustments to systems retained	(630,000)
	3,150,000

Source: The CHIPS Project

build bc special account

A review of controls over expenditures from the Build BC Special Account

Review Purpose and Scope

This review looks at the Build BC Special Account, created by the *Build BC Act* in 1993 as part of the government's BC 21 strategic initiative. By funding new and innovative initiatives, the Special Account aims at creating jobs, providing training, enhancing resources, and improving the infrastructure of British Columbia. From its inception in the spring of 1993, to March 31, 1996, funding approval totaling $198 million has been given for 61 initiatives within the economic development component of the BC 21 strategy, as shown in Exhibit 7.1. This does not include the $40 million approved for Community Projects, which was the subject of a separate report in our 1995/96 Report 1.

In carrying out this review, we examined procedures for assessing and selecting initiatives to be funded from the Special Account, as well as procedures for monitoring, evaluating, and reporting the performance of the account. We focused on 12 initiatives approved in the 1993/94 and 1994/95 fiscal years. These accounted for $117 million of the total $198 million approved. Our objective was to determine whether internal controls over the Special Account are adequate to provide reasonable assurance that:

- proposals selected comply with the objectives of the *Build BC Act* and the Special Account;
- funds are used for the purposes approved; and
- information gathered is sufficient to enable management to evaluate and report on the results of the Special Account.

We conducted our review by interviewing staff of the Program Development Branch of the Ministry of Employment and Investment and staff of the lead agencies administering the 12 initiatives reviewed. We also examined documents and correspondence provided by the ministry and lead agencies.

Overall Conclusions

Because documented procedures were lacking, we were unable to determine how well the Build BC Special Account was managed in its first few months. However, we found that the Program Development Branch has since established a number of procedures for use in receiving and assessing initiatives and monitoring those approved for funding.

Although we found all Special Account funds were used for government purposes, we noted that some expenditures made were not in accordance with Special Account objectives as expressed by the government. Of the 12 Special Account initiatives examined, 2 initiatives, with a combined allocation of $21,400,000, were approved for activities normally funded from the lead agencies' own budgets. In another initiative, we found that while the expenditures were in accordance with Special Account objectives, a reduction in the lead agency's budget resulted in some Special Account funds being used for the lead agency's existing program.

We also noted that the BC 21 Committee does not document its reasons for recommending the initiatives selected. We believe that providing these reasons would enhance the consistency with which selection criteria are applied, and would assist the Program Development Branch in assessing new proposals.

The branch has summarized the results obtained by individual initiatives, although its planned overall evaluation of the achievements of the Special Account has not yet been done. We support the branch in its efforts to assess the success of the Special Account and encourage the branch to complete the evaluation without delay.

Background

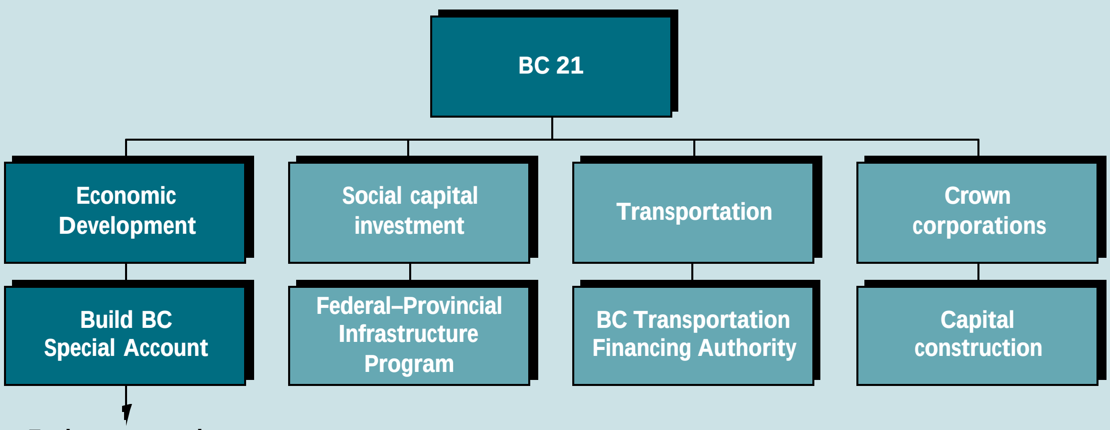
What Is a Special Account?

Most government expenditures are approved annually by the Legislative Assembly in the *Supply Act*. The approval for such an expenditure expires at the end of the fiscal year in which it applies. Legislative approval for special accounts, however, does not lapse but carries over from one fiscal year to the next, subject only to any restrictions set out in the

Exhibit 7.1

Components of the BC 21 Initiative

An illustration of where the Build BC Special Account fits within the overall BC 21 structure



- **Environment and resource programs**
- **Science and technology programs**
- **Community enhancement**
- Community Projects program (not covered in this report)

Economic development
Initiative programs with specific investment and job creation benefits are funded from the Build BC special account. The projects are managed and delivered through partnerships with other ministries, Crown corporations, and the private sector. Spending priorities for the Build BC special account include: community enhancement programs; BC 21 community grants; and environment and resource programs.

Social capital investment
Funding is provided to support public services like health care, education, and justice in the construction of capital facilities. The infrastructure component is represented by a new federal–provincial funding program which targets water, sewer, and local transportation programs.

Transportation
A new authority, the BC Transportation Financing Authority, will finance new highway and other high–priority transportation projects. It will take a long–term approach to planning, developing, and financing transportation initiatives.

Crown corporations
Crown corporation capital construction is coordinated so that the spending will be focused to ensure it: is sensitive to regional needs; complements other government and private sector investment activities; encourages the use of provincial goods and services; and develops the skills of British Columbians.

enabling legislation. This makes special accounts particularly suitable for multi-year initiatives. Special accounts also make possible the grouping of activities with a common objective, even though these activities may be carried out by different ministries. This enhances coordination of those activities and the reporting of how well their objective has been achieved.

Although special account spending in general does not require annual legislative approval, transfers into the Build BC Special Account are subject to legislative scrutiny. The opening balance of $100 million was authorized by the *Build BC Act* when the Special Account was created. Subsequent amounts were transferred from funds voted to the Ministry of Employment and Investment in the annual *Supply Acts.*

The Purpose of the Build BC Special Account

The Build BC Special Account was created to provide funding for innovative projects and initiatives consistent with the purpose of the *Build BC Act*, as shown in Exhibit 7.2. The reason for funding these through the Special Account was to encourage lead agencies to try new ideas without putting pressure on their base budgets. Once an initiative proved successful, it would be funded by the lead agency in future years.

Exhibit 7.2

Objectives of the Build BC Special Account

The *Build BC Act* states that:

The purpose of this Act is to facilitate the expansion and diversification of the British Columbia economy by

(a) coordinating the government's activities to achieve overall economic development and job creation goals,

(b) ensuring that all regions of the Province benefit from economic expansion and diversification,

(c) encouraging public and private sector investment and job creation activities in an innovative manner,

(d) promoting training and investment in people as a significant component of public sector investment activity, and

(e) targeting activities under this Act toward traditionally disadvantaged individual and groups.

The Special Account may be used to fund projects and initiatives that are consistent with the purpose of the Act.

Excluding Community Projects, a total of 61 programs have been approved under the Special Account, for a total amount of $198 million. Thirty programs were approved in the 1993/94 fiscal year, 24 in the 1994/95 fiscal year, and 7 in 1995/96. The totals appropriated, allocated, and expended are shown in Exhibit 7.3.

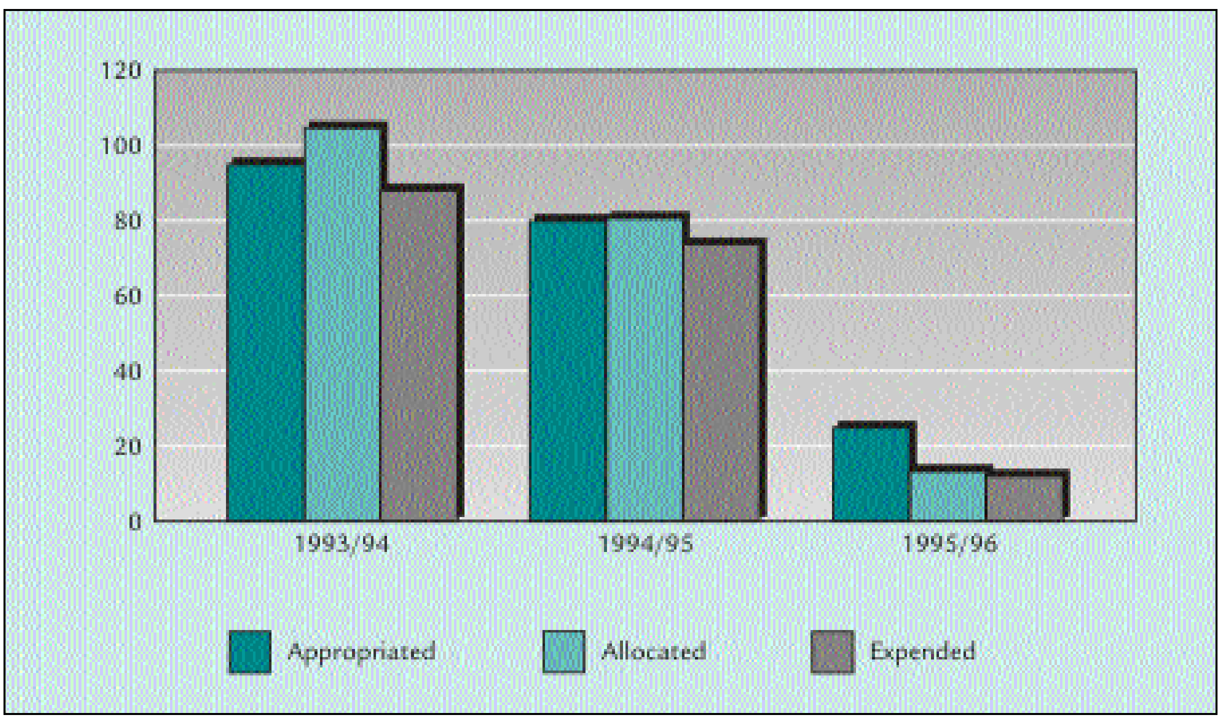
Responsibility for the Special Account

The *Build BC Act* also created the Committee on Building British Columbia's Future (commonly referred to as the BC 21 Committee), which is the committee charged with reviewing proposed projects and initiatives and making recommendations to Treasury Board as to which proposals should be funded. The committee currently consists of the Minister of Employment and Investment and three other members of the Legislative Assembly.

Exhibit 7.3

Value of the Money Appropriated, Allocated, and Expended Under the Build BC Special Account Program, for the Fiscal Years 1993/94, 1994/95, and 1995/96, Excluding Community Projects

($ Millions)



Source: Program Development Branch

Initially, proposals were reviewed jointly by Treasury Board and the Planning Board, a policy committee of Cabinet that has since been discontinued. This enabled quick implementation of initiatives proposed before final passage of the *Build BC Act.* The BC 21 Secretariat was subsequently created to support the BC 21 Committee in managing the Special Account and assessing proposals for funding. In the government reorganization of September 1993, the BC 21 Secretariat's responsibility for managing the Special Account, under the direction of the BC 21 Committee, was transferred to the Ministry of Employment and Investment, which carries out this responsibility through its Program Development Branch. Recommendations for allocations to various initiatives are made by the BC 21 Committee and approved by Treasury Board.

Before the Ministry of Employment and Investment took over responsibility for the Special Account, 14 initiatives totaling $70.5 million had received approval. This total includes $49.6 million for the 1993/94 Forest Worker Development and the Small Business Forest Enterprise programs, both of which are referred to later in this report.

The Program Development Process

Both the BC 21 Committee and Treasury Board provide general direction and targets for Special Account expenditures. For example, in fiscal 1994/95, Treasury Board allocated $20 million for Community Projects, $20 million for new housing initiatives, and $10 million for programs aimed at traditionally disadvantaged groups. Of the $10 million targeted for the disadvantaged groups, Treasury Board directed that $7 million should be allocated to the Forest Worker Development Program.

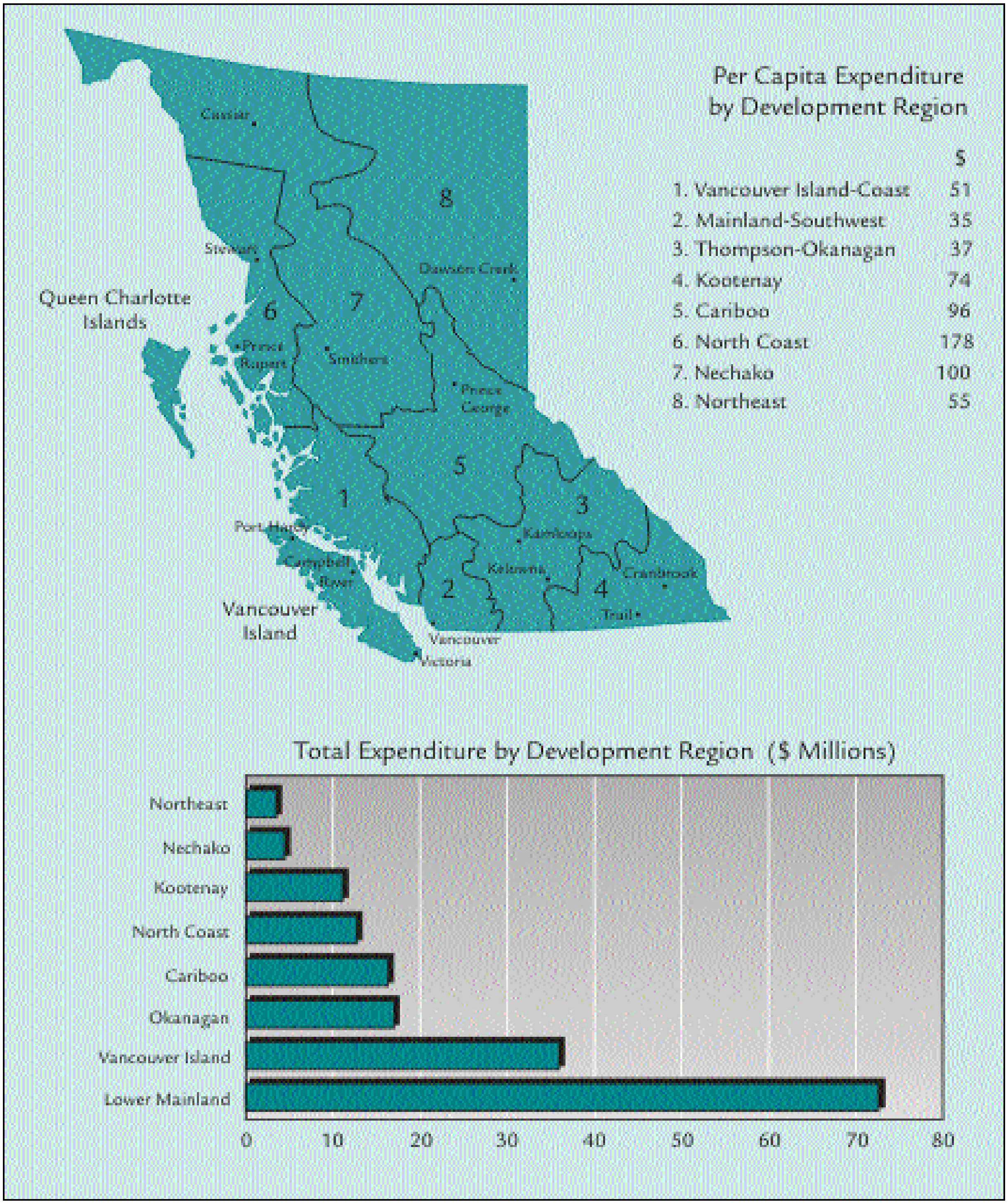
Using this general direction, the Program Development Branch contacts lead agencies—line ministries or provincial agencies with expertise in the targeted area—and works with them to develop specific program proposals. The branch then assesses each initiative against the BC 21 objectives and provides the BC 21 Committee with its evaluation. Each initiative is required to meet one or more of the BC 21 objectives.

The BC 21 Committee reviews the proposals and the branch's assessment and the committee Chair recommends approval to Treasury Board, where the final decision is made.

Initiatives are administered, monitored, and evaluated by lead agencies. The lead agencies may contract out part or all of the delivery of these, provided contracting was approved as part of the proposal.

Exhibit 7.4

Value of Build BC Special Account Expenditures for the Period from April 1, 1993, to March 31, 1996, Excluding Community Projects

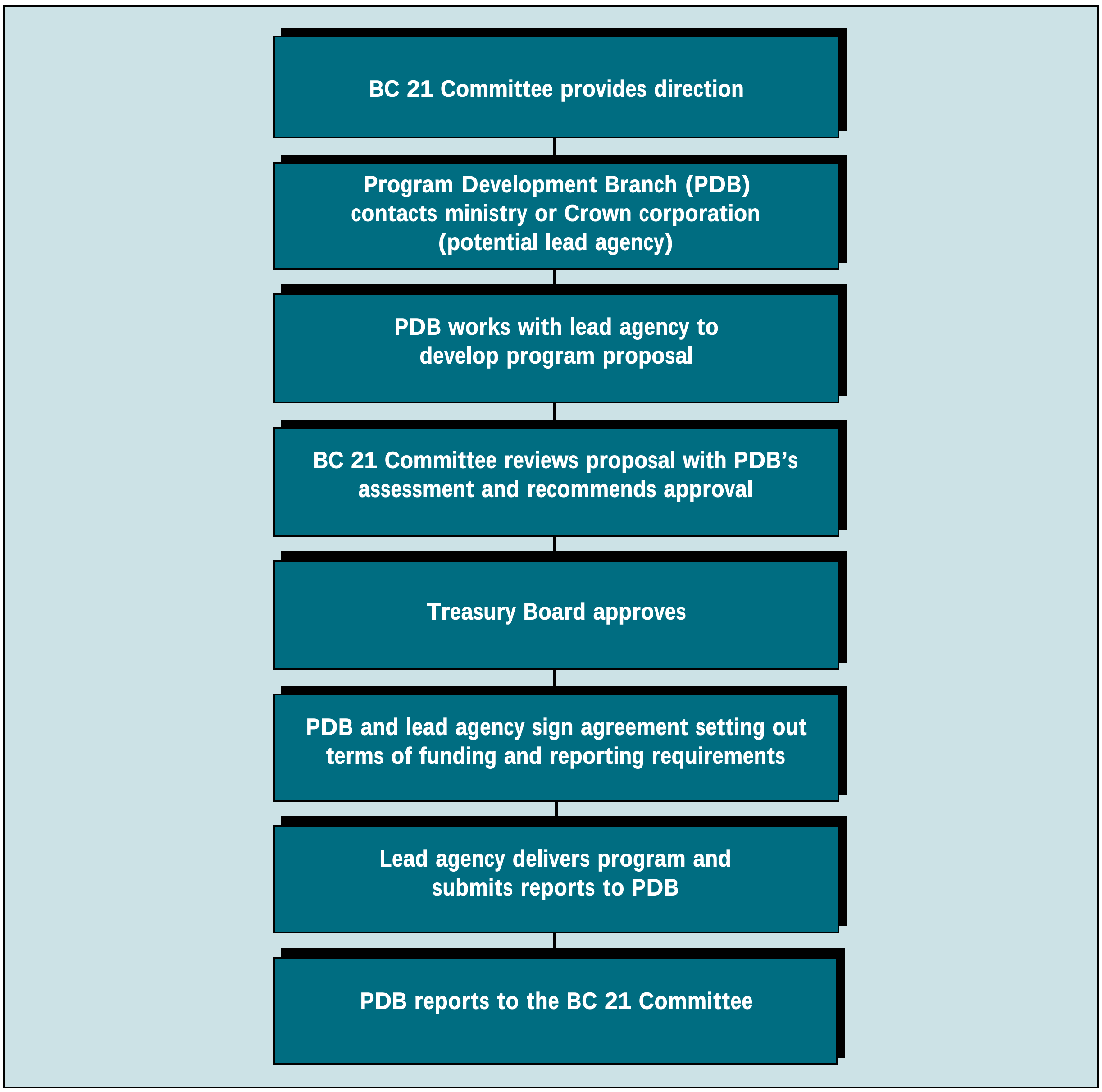


Source: Map of Economic Regions, Queen's Printer; Charts, Program Development Branch

Under protocol agreements with the Ministry of Employment and Investment, the lead agencies are required to make regular reports about how well the initiatives are meeting their Special Account objectives. Exhibit 7.5 shows the steps in the program development process.

Exhibit 7.5

The Build BC Program Process



Detailed Findings and Conclusions

Receiving Proposals

We expected to find procedures in place that would result in the submission of proposals that are likely to achieve the objectives of the Special Account. To this end, we expected that guidelines issued to the lead agencies would state those objectives clearly and establish priorities for funding. We expected that these guidelines would result in comparable proposals to aid the assessment process.

Although we were unable to identify any documented guidelines provided to lead agencies before the establishment of the Program Development Branch in the autumn of 1993, we did find that the general policy guidelines subsequently developed by the branch do clearly set out the objectives of the Special Account, and do show the desire of both Treasury Board and the BC 21 Committee that the account be used to maximize the achievement of those objectives.

We also found that the guidelines for proposals explained clearly: what information was required, including objectives that are measurable; the size of the initiative; administration needs, including implementation and communication plans; and the budget for the initiative. The guidelines also state that costs for additional staff, evaluation, and administration must be addressed and require that the unit cost per job created under the program be estimated.

Assessing Proposals

We expected that criteria would be developed to ensure that proposals met the Special Account requirements and could be compared and ranked. We also expected criteria that would: consider whether the initiative would take place without Special Account funding, resulting in activity in addition to that already planned by the lead agency; and would consider whether the budget is reasonable and conforms to the Special Account guidelines.

We found that the branch had developed appropriate criteria with which it could assess proposals based on the Special Account objectives. Information the branch prepared for the BC 21 Committee included a summary of the proposal which commented on how well the Special Account objectives would be met, and provided financial information on the program, such as other sources of funding. The number and duration of projected jobs, as well as the unit cost of jobs created, were also provided. The summaries present the information in a standardized format, to assist comparison between proposals.

We also found that budgets were required for all proposals and were reviewed by branch staff. Administration costs were generally restricted to 3% of the Special Account funding, as required by the guidelines, with the lead agency taking responsibility for any additional amount.

Selecting Proposals

We expected to find established criteria being used by the BC 21 Committee in selecting initiatives for recommendation to Treasury Board.

In fact, however, we were unable to determine how the BC 21 Committee arrives at its decisions. Minutes of its meetings are not retained. The only written record is the summary after each meeting about which initiatives were approved or rejected.

Documenting the reasons for its decisions would assist the BC 21 Committee in applying the criteria it used in the decision process consistently. It would also help the Program Development Branch work more effectively with the lead agencies to develop appropriate proposals, and it would help branch staff better assess future proposals.

The Build BC Act seeks to encourage investment and create jobs in an innovative manner. Although the Act does not state that only new and incremental activity is eligible for funding, during the debate in the Legislative Assembly preceding passage of the Act, the then Minister of Finance made it clear that this was the intention. Nevertheless, we found the following initiatives did not satisfy this criterion.

The BC Pavilion Corporation, for example, received its operating budget of $4.4 million from Build BC in 1993/94, a cost that would normally have been funded from the

Accounting for Transfers

A payment such as that from Build BC to the BC Pavilion Corporation, approved in the year before the funds are used, affects the expenditures reported in the Public Accounts. In accordance with the government accounting policy of recognizing such contributions when approved, the amount is recorded as an expenditure in the year of approval, even though the funds will not be expended by the corporation until the following year. As a result, expenditures are effectively overstated in the first year and understated in the second. The Office of the Auditor General has commented on this policy in previous reports, recommending that the government record transfers in the same period as the events giving rise to the transfers.

1994/95 base budget of the Ministry of Small Business, Tourism and Culture.

Another example is the Small Business Forest Enterprise Program (SBFEP), which received $17 million in 1993/94 from the Build BC Special Account. Through the program, the Ministry of Forests sells Crown timber to individuals and small businesses across the province. Although the forest program is self-financing and returns a dividend to the Crown each year, it still received funding. Program activities in 1993/94 included road building and silviculture, and the Special Account funding was allocated to these. The Ministry of Forests' proposal to BC 21 clearly stated that the program could contribute little toward the Special Account objectives due to the expertise required in road building and the fact that most silviculture contracts had already been awarded. The primary reasons for funding given in the proposal were that without the Special Account funding, SBFEP revenues—and therefore the dividend to be paid to the Crown—would be reduced, and that certain silvicultural operations required by the *Forest Act* would not be carried out. Neither of these reasons is consistent with objectives of the *Build BC Act*.

We recommend that the BC 21 Committee document its reasons for accepting or rejecting proposals for funding from the Build BC Special Account. This will help ensure consistency in selection and provide direction for the Program Development Branch in assessing future proposals.

We recommend that the use of the Build BC Special Account be restricted to those programs that provide additional benefits consistent with the goals of the Special Account. The approval of Special Account funds for programs that are normally funded from other sources does not further the goals of the account and the **Build BC Act.**

Monitoring Initiatives

We expected to find controls in place to provide reasonable assurance that funds were expended for their approved purposes in compliance with the terms and conditions of funding. Controls should include funding agreements and regular reporting on program activity and spending.

We found that the Program Development Branch had established controls to provide assurance that funds were spent as approved in most circumstances, and that lead agencies were in compliance with the funding agreements. However, as discussed later, in other circumstances it is possible for Special Account funding to be used indirectly for costs normally funded through the lead agency's base budget, without the knowledge of the Program Development Branch.

Although we found no evidence of central monitoring or reporting requirements for 1993/94 initiatives approved before the branch became involved, the branch has instituted funding agreements for all initiatives, including those already in place, clearly setting out the terms and conditions of funding and the reporting requirements for the lead agencies. These agreements require lead agencies to report financial and operational results, including progress made in meeting the Special Account objectives. They also require compliance with the *Financial Administration Act* and other financial administration policies and procedures of the Province. We found that these reports are followed up if not received on a timely basis, and are reviewed for completeness and reasonability.

Costs submitted are reviewed by the branch to ensure they are identified in the lead agency's report and are consistent with the program activities and approval terms. The costs are also compared to the budgeted figures and explanations sought for significant variances. The Senior Financial Officer of the lead agency must certify that the expenditures are for the approved purposes, that they comply with applicable policies and procedures, and that supporting documentation is available for review at the lead agency.

Among the initiatives we examined, we did not find any Special Account funds being used directly for other than approved purposes. However, as noted, we did find that Special Account funds could be used indirectly for activities normally financed from base budgets.

One example we noted was the Local Contracting component of the 1993/94 Forest Worker Development Program (FWDP), which received $18.5 of the total $32.6 million allocated to the FWDP from the Special Account. Local Contracting prepares the participant for normal competitive contracting in silviculture, and provides training and experience to improve the competitive advantage of newly established silviculture contractors.

The Ministry of Forests' budget for the 1993/94 fiscal year included $195.6 million for silviculture, not including the Special Account funding. Subsequently, the ministry was required to reduce costs by $26.7 million. Of this amount, $18.5 million was saved by freezing that amount of the ministry's budget to offset the Special Account funding.

We also noted that in a report on the Forest Worker Development Program in 1993/94, the Ministry of Forests stated that many districts had already planned silviculture projects with local contractors before the FWDP was announced, and in many cases Special Account funding intended for Local Contracting was allocated to these contracts. Although some of these contracts might have otherwise met the Local Contracting requirements, this allocation resulted in Special Account funds being expended on silviculture that was already planned, not on incremental activity as intended by the government. The ministry's report included no estimate of the amount of Special Account funding allocated in this manner.

In another initiative, we found potential for funds to be used for non-approved purposes. The lead agency delivering the initiative funded through the Special Account was also responsible for delivery of another program with similar objectives, funded from its base budget. Proposed contracts for certain projects meeting the Special Account requirements were re-allocated from the base budget program to the initiative funded through the Special Account. Overall, the planned level of spending was not decreased, but actual spending did decrease due to curtailment or underspending in individual projects. While we found no evidence of deliberate redirection of funds to non-approved programs, a real potential exists for manipulation between programs. Such manipulation would not be detected through the lead agency reports, as these address only the initiative funded by the Special Account and would not detect underspending in the similar program.

In both of these cases, Special Account funding was or could have been used for similar expenditures already planned by the lead agency—and, in the case of the Forest Worker Development Program, the decision to substitute Special Account funds was made by Treasury Board. Even though expenditures reported to the Program Development Branch may be made for activities approved by the BC 21 Committee by reducing the spending of funds already budgeted for the same or similar activities, lead agencies can effectively fund non-Special Account activities from the Special Account. Current reporting requirements do not bring this to the attention of the Program Development Branch.

We recommend that, in addition to certifying that Special Account funds were spent for the purpose approved the lead agency be required to certify that the expenditure of these funds was in addition to any ministry expenditures previously

budgeted for the same or similar activities. The funding agreements should provide for repayment of any funds which do not result in incremental activity, where this result was under the control of the lead agency.

Evaluating and Reporting on Results

The *Build BC Act* provides for the BC 21 Committee to develop criteria for evaluating (as well as reviewing and monitoring) expenditures from the Special Account. To date, no evaluation of the Special Account has been carried out, although, as noted, the Program Development Branch plans to do one. Such an evaluation will help the branch, the BC 21 Committee, and Members of the Legislative Assembly assess whether the Special Account has achieved what it was intended to do. This is important for meeting accountability requirements, as well as for providing information to improve the process in future.

To date, the branch has summarized the activities of individual initiatives, comparing these to the objectives set out in the proposals, and it plans to draw up an overall summary of activity for all initiatives. We support this effort by the ministry to determine whether the Build BC Special Account has achieved its objectives.

The ministry has identified certain barriers to a full evaluation of the Special Account and we share its concerns. The objectives of the Special Account are stated in qualitative rather than quantitative measurable terms, making it hard for someone to determine how well they have been achieved. Comparison of seemingly objective results between initiatives is sometimes difficult as well. For example, one initiative may quote the number of jobs created for a short period, while another may refer to the equivalent person-years of work created.

For any program to be effectively evaluated, a consistent assessment framework must be established at the outset. It should specify what is to happen as a result of the activities to be carried out, and what measures can be used to judge whether these goals have been achieved. Clear and measurable targets are necessary, and the same framework should be applied to all initiatives making up the program. The extent to which expectations have been achieved by lead agencies should be reported at least annually, and should be validated (at least on a test basis) by a third party.

Public reporting of the Special Account to date has consisted of budgeted amounts and a listing of programs approved and funded. We believe that public reporting should include more information on the results of activities, and should occur at regular intervals.

We recommend that a summary of the results of the Special Account be completed as soon as possible to help the BC 21 Committee assess whether the program is achieving its objectives. To improve evaluation of this and other programs in future, the Program Development Branch should design an assessment framework that includes measurable targets, predetermined success criteria, and consistent and regular reporting.

We also recommend that the results of expenditures under the Special Account be publicly reported on a regular basis, at least annually.

summary of recommendations

Recommendations made in the report titled *Build BC Special Account* are listed below for ease of reference. They should be regarded in the context of the report.

The Office of the Auditor General recommends that:

- *The BC 21 Committee document its reasons for accepting or rejecting proposals for funding from the Build BC Special Account. This will help ensure consistency in selection and provide direction for the Program Development Branch in assessing future proposals.*
- *The Build BC Special Account be restricted to those programs that provide additional benefits consistent with the goals of the Special Account. The approval of Special Account funds for programs that are normally funded from other sources does not further the goals of the account and the* Build BC Act.
- *In addition to certifying that Special Account funds were spent for the purpose approved the lead agency be required to certify that the expenditure of these funds was in addition to any ministry expenditures previously budgeted for the same or similar activities. The funding agreements should provide for repayment of any funds which do not result in incremental activity, where this result was under the control of the lead agency.*
- *A summary of the results of the Special Account be completed as soon as possible to help the BC 21 Committee assess whether the program is achieving its objectives. To improve evaluation of this and other programs in future, the Program Development Branch should design an assessment framework that includes measurable targets, predetermined success criteria, and consistent and regular reporting.*
- *The results of expenditures under the Special Account be publicly reported on a regular basis, at least annually.*

response of the ministry of employment and investment

Recommendation 1:

The Auditor General recommends that the BC 21 Committee document its reasons for accepting or rejecting proposals for funding from the Build BC Special Account. This will help ensure consistency in selection and provide direction for the Program Development Branch in assessing future proposals.

Response: The BC 21 Committee is a committee of Cabinet and, as such, is not required to make public its reasons for decisions made. The BC 21 Committee's decision-making is consistently guided by the Build BC Act *and its stated objectives. With regard to providing direction to the Program Development Branch (now called the Economic Partnerships Branch), the Committee provides the Branch with general direction and establishes spending priorities for the Account. The Branch then works with appropriate lead agencies to develop specific program proposals which are analyzed and presented to the Committee with documentation which consistently assesses each proposal against each of the objectives of the Act.*

Recommendation 2:

The Auditor General recommends that the use of the Build BC Special Account be restricted to those programs that provide additional benefits consistent with the goals of the Special Account. The approval of Special Account funds for programs that are normally funded from other sources does not further the goals of the account and the Build BC Act.

Response: The majority of programs funded under the Special Account since its inception represent incremental funding.

The Ministry is of the opinion that the $17.0 million in funding from the 1993/94 Special Account for the Small Business Forest Enterprise Program was for an enhanced portion of the program and was deemed to be incremental spending.

Recommendation 3:

The Auditor General recommends that, in addition to certifying that Special Account funds were spent for the purpose approved, the lead agency be required to certify that the expenditure of these funds was in addition to any ministry expenditures previously budgeted for the same or similar activities. The funding agreements should provide for repayment of any funds which do not result in incremental activity, where this result was under the control of the lead agency.

Response: The Ministry will take this recommendation into consideration when entering into future protocol agreements with lead agencies.

Recommendation 4:

The Auditor General recommends that a summary of the results of the Special Account performance be completed as soon as possible to help the BC 21 Committee assess whether the program is achieving its objectives. To improve evaluation of this and other programs in future, the Program Development Branch should design an assessment framework that includes measurable targets, predetermined success criteria, and consistent and regular reporting.

Response: The Ministry confirms that an interim 1994/95 Program Assessment report (based on completed programs to date) was presented to the BC 21 Committee on January 27, 1997. It is the intent of the Branch to continue updating this report as the remaining 1994/95 funded programs are completed. Assessments will continue as files close in subsequent fiscal years.

Recommendation 5:

The Auditor General recommends that the results of expenditures under the Special Account be publicly reported on a regular basis, at least annually.

Response: Public reporting of the Special Account is done on an annual basis through the Ministry of Employment and Investment's Annual Report and on a regular basis through reports published by the Ministry of Finance and Corporate Relations such as the Quarterly Reports. Other forms of reporting are press releases announcing individual initiatives receiving funding under the Account. In the past, the Ministry of Employment and Investment also has published status updates on BC 21.

forest revenue system

A review of controls over the stumpage revenue process for harvested Crown timber

Review Purpose and Scope

The Ministry of Forests billed forest companies over $1.6 billion in 1995/96 for timber harvested in British Columbia. More than 108,000 invoices are issued to licensees each year for timber harvested from 43 provincial forest districts. This represents the third largest source of revenue to the government.

The revenue system relies heavily on industry: whereby companies licensed to harvest are also responsible for the weighing, measuring, and grading of timber. The companies then report this information to the ministry, which bills the companies for the amounts reported.

We conducted our review to assess whether the system of internal controls over revenue established by the ministry is effective in providing reasonable assurance that:

- timber harvested is being properly authorized by the ministry;
- timber harvested by forest companies is being accurately measured, graded, and reported for billing purposes; and
- data is being collected, summarized, and input accurately into the ministry's harvest database system, resulting in complete and accurate invoices.

We looked at the revenue cycle, concentrating on the point in time when the ministry authorizes the cutting of trees, through to the time it issues the bill for the trees that were cut. We did not examine the process of setting prices for harvested timber, or ministry measures to enforce collection of outstanding invoices.

Our previous study of the stumpage system, reported in our March 1989 Annual Report, looked at whether there was a risk of the data received by the ministry on volumes and species of timber removed from Crown lands being incomplete or inaccurate. Exhibit 8.10 provides a summary of our conclusions from that report.

Overall Conclusion

The Ministry of Forests operates in an environment where the forest industry is responsible for the harvesting and scaling of timber, and Crown forests are easily accessible to the public and therefore vulnerable to illegal cutting. Within this environment, the ministry is responsible for determining the amount of timber to be harvested (allowable annual cut) in a year and for authorizing forest companies to cut it. The ministry is also responsible for designing controls to ensure that timber harvested is correctly measured and reported.

Since our last report, the ministry has taken many positive steps to improve its internal controls. However, given the operating environment, we remain concerned that incomplete and inaccurate data may be received by the ministry because of some timber being cut but not reported.

We concluded that the ministry's internal control activities do provide assurance that only approved licensees are authorized to harvest timber and that invoices are accurately produced from data supplied to the ministry. We believe the ministry could implement additional controls and procedures in the key functional areas of harvesting, transporting, and scaling timber, to further reduce the risk of loss of revenue to the Province.

Background

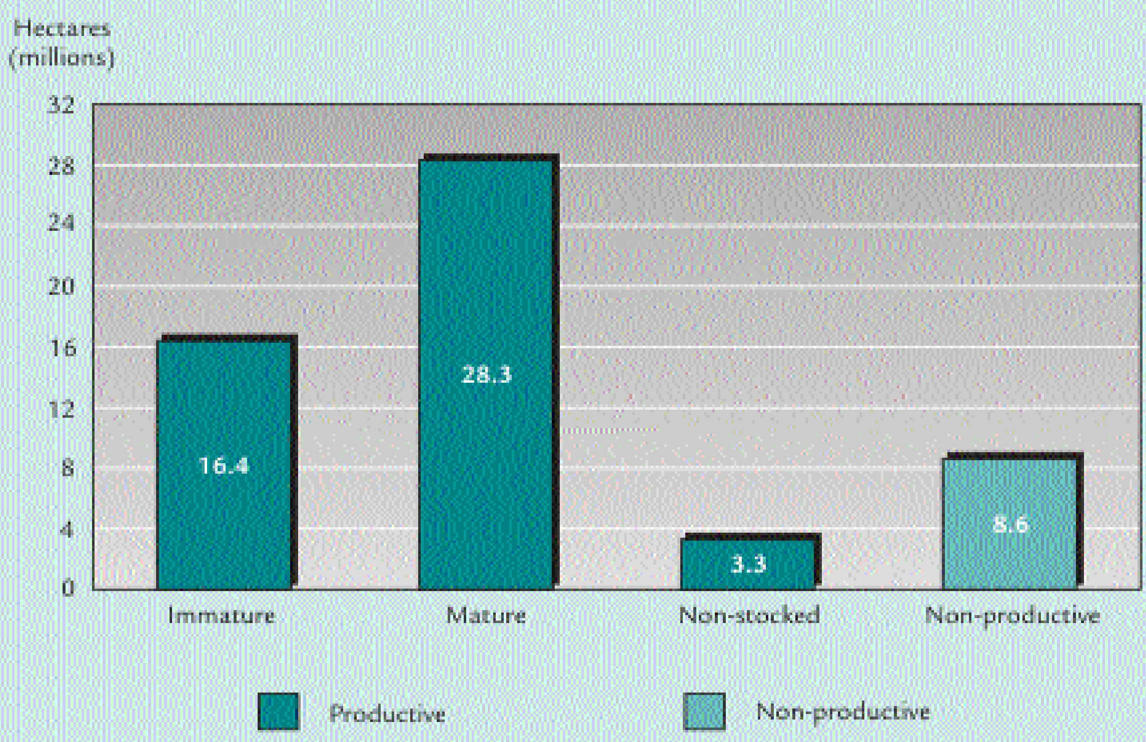
British Columbia's Timber Resource

British Columbia's forests are its most commercially valuable renewable resource. Provincial forests cover nearly 60%, or 57 million hectares, of the land base and approximately 85% of the forests are considered productive (Exhibit 8.1). The predominant species are western hemlock on the coast and spruce and pine in the interior.

Exhibit 8.1

Crown Forest Land Classification

Number of hectares of productive and non-productive Crown forest



Immature timber means stands of timber where the age of the leading species in a stand is less than the specified cutting age.

Mature timber means stands of timber where the age of the leading species in a stand is greater than the specified cutting age.

Not-satisfactorily-restocked (non-stocked) means productive forest land that has been denuded and has not been regenerated to the specified or desired free-growing standards for the site.

Source: B.C. Ministry of Forests, Resource Inventory Branch

British Columbia's forest industry provides about 106,000 direct jobs, approximately 6% of the provincial total. Roughly 34% are in forestry (logging and related activities), 44% in solid wood manufacturing, and 22% in paper and allied manufacturing.

Provincial forest land is managed by the Ministry of Forests. For these purposes the province is divided into six forest regions (Exhibit 8.2), which in turn are subdivided into 43 forest districts. Each region and district is administered by a manager and one or more supporting staff managers. One of their primary responsibilities is to ensure that timber is available to the forest industry at an approved rate of harvest, or allowable annual cut, which is determined by the Chief Forester of the Province. To this end, the Province is also divided into forest management units—37 timber supply areas (TSAs) and 34 tree farm licenses (TFLs). In 1995/96, the amount of timber harvested was nearly 70 million cubic metres.

Pricing Timber and Billing for Timber Harvested

The *Ministry of Forests Act (1979)*, Section 4, establishes the authority and responsibilities of the ministry, one of which is to "assert the financial interest of the Crown in its forest and range resources in a systematic and equitable manner."

In order to carry out this portion of its mandate, the ministry collects resource revenues from forest companies

Forest Management Units in British Columbia

Timber Supply Areas (TSAs)

Timber Supply Areas are geographical units, defined around existing communities and timber processing centers, which provide an administrative structure for forest planning and management throughout the province. Inside the boundaries of a TSA there are many kinds of land use, including town sites, highways, parks, and other forest management units (e.g., woodlot licenses). Within TSAs, forests are managed and rights to harvest Crown timber are allocated according to a forest management strategy that is appropriate for the area. The Ministry of Forests conducts timber supply reviews for TSAs; the Chief Forester determines allowable annual cuts for TSAs.

Tree Farm Licenses (TFLs)

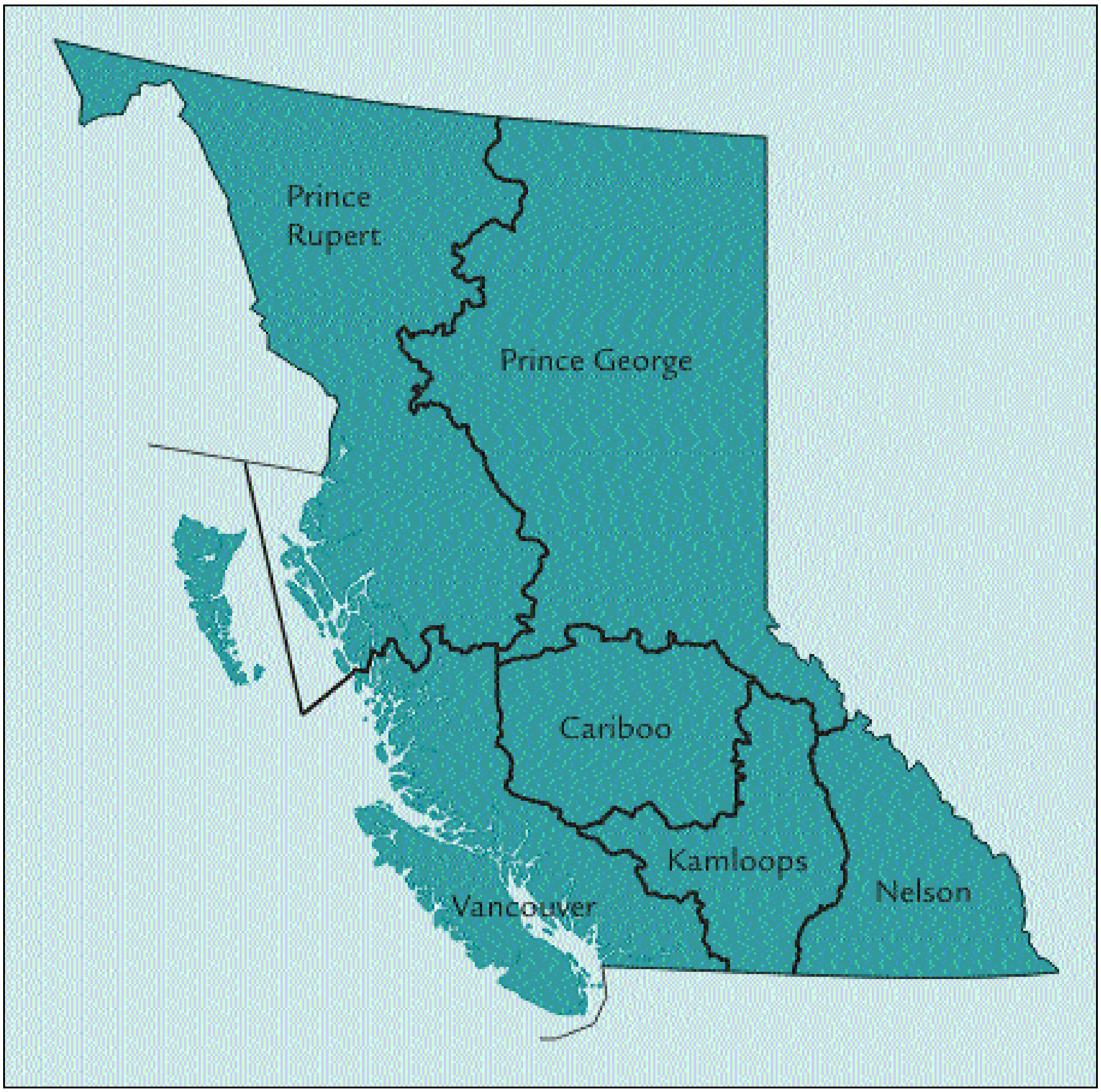
A Tree Farm License is a tenure for a specific geographic area that gives the license holder the right to harvest timber from the license area and the obligation to directly manage the forest land. As a term of the license agreement, the licensee must provide the Chief Forester with a review of the TFL's timber supply every five years. Based on a ministry review of the information provided by the license holder, the Chief Forester determines an allowable annual cut for the TFL.

operating on Crown forest land. The main form of revenue is stumpage. Stumpage is a charge for timber, calculated using the market prices for lumber and logs and estimates of delivered wood costs prepared from data supplied by the forest industry. Virtually all of the timber harvested from Crown land is subject to stumpage charges.

Exhibit 8.2

Forest Regions in British Columbia

Forest regions managed by the Ministry of Forests



Source: Ministry of Forests

In the 1995/96 fiscal year, the revenue generated from stumpage exceeded $1.6 billion. (Exhibit 8.3 shows the trend in Crown charges over the last nine years.)

The Revenue Cycle

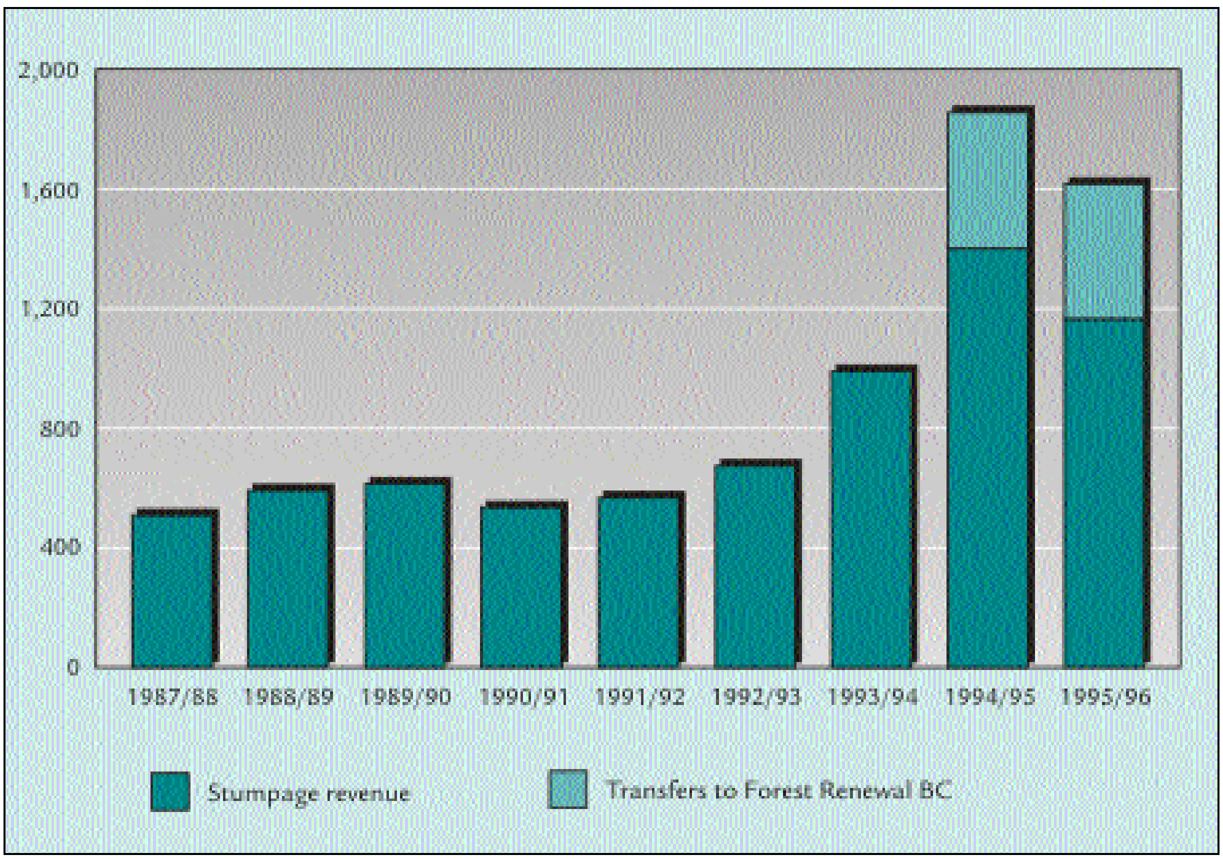
The Ministry of Forests is responsible for ensuring that all Crown timber harvested is identified, billed, and collected. Exhibit 8.4 shows the organizational structure of the revenue function.

In order to fulfill this responsibility, effective controls must be maintained throughout the revenue cycle. Exhibit 8.5 illustrates the various activities involved in the sale of Crown timber.

Exhibit 8.3

Nine-year Comparative Growth in Stumpage Revenue

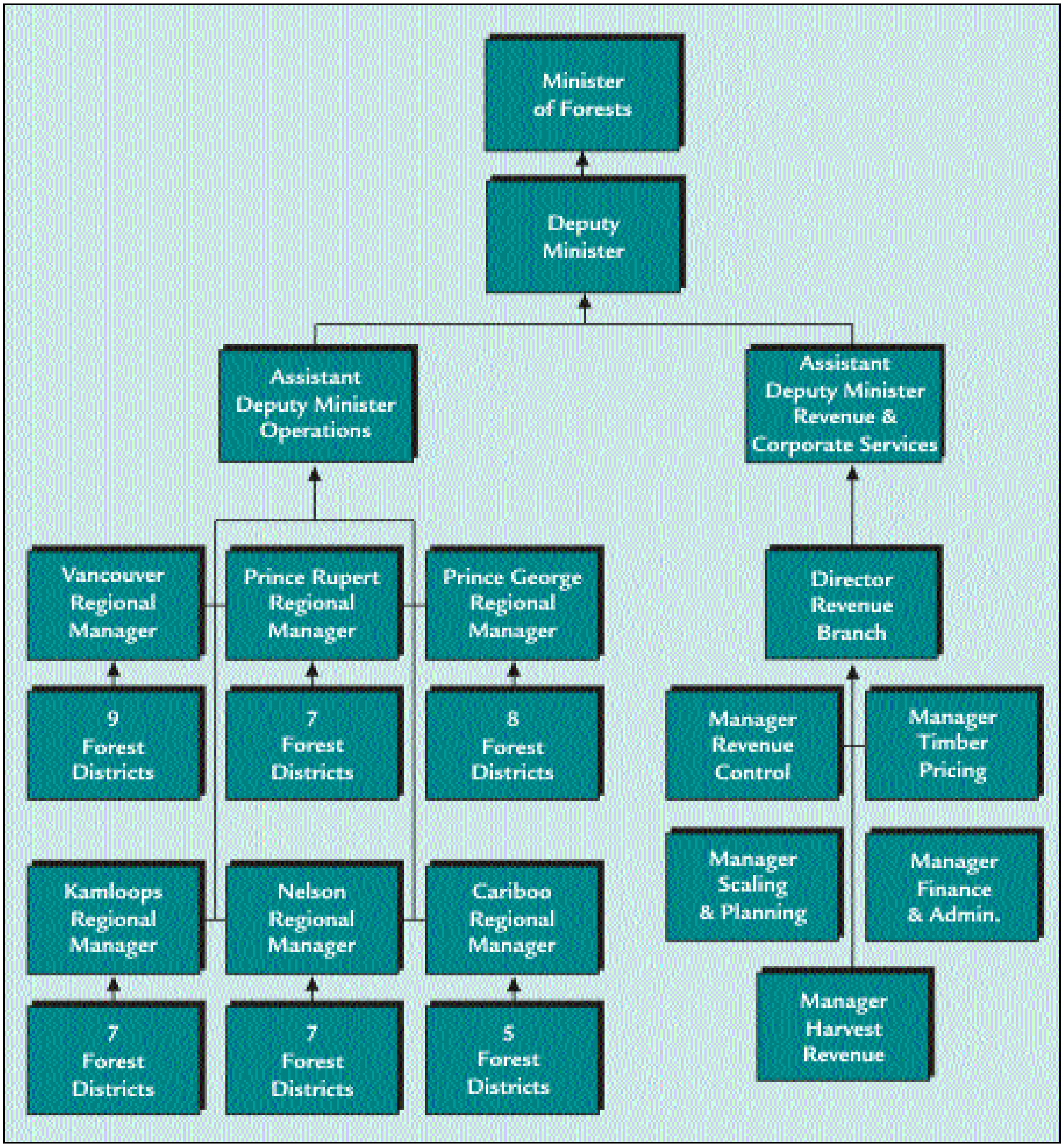
($ Millions)



Source: Ministry of Forests

Exhibit 8.4

Partial Organization Chart Depicting the Reporting Relationships for the Revenue Function



Source: Ministry of Forests

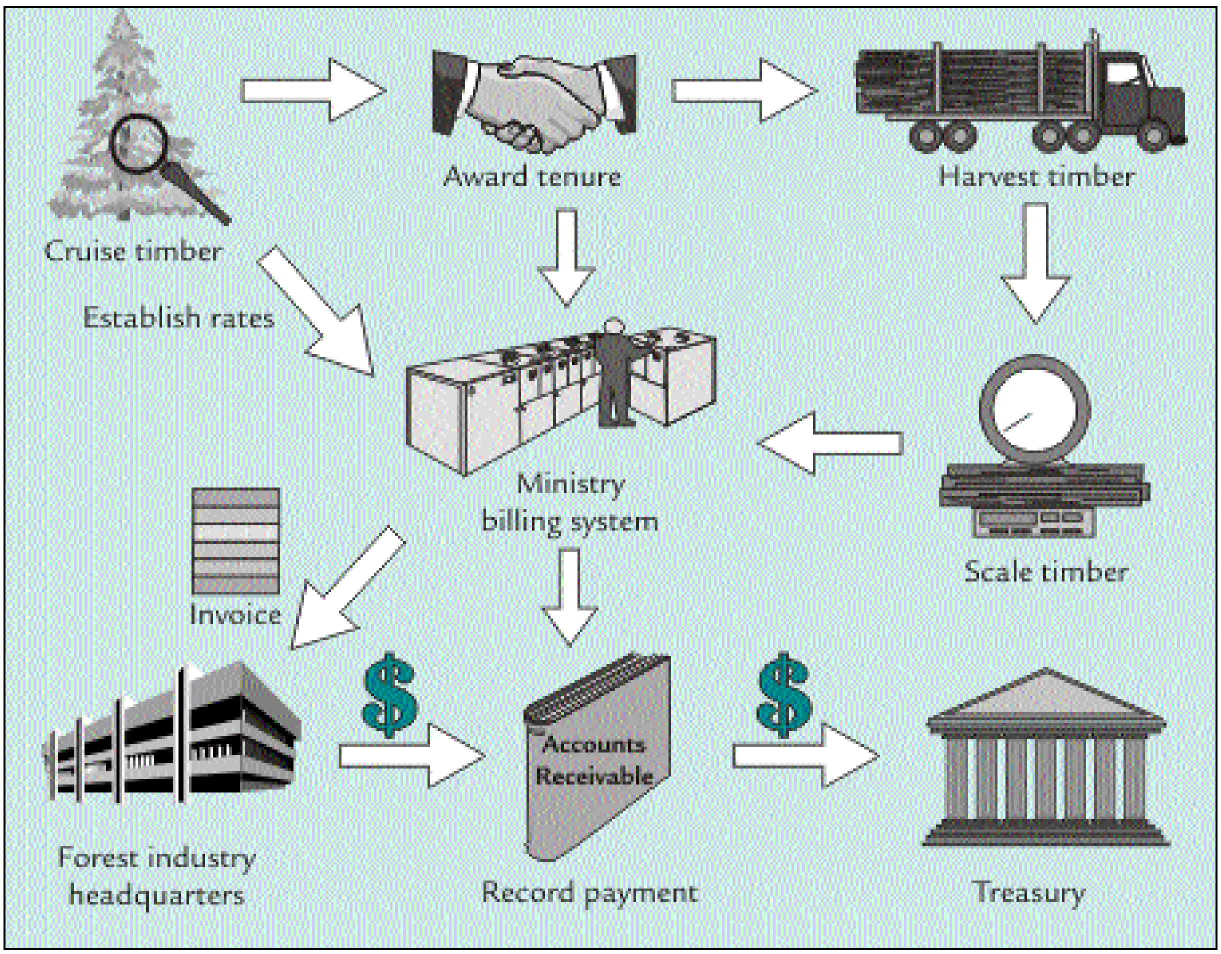
How the Revenue Cycle Operates

One of the primary goals of the Ministry of Forests, in particular the harvesting program, is to make timber available to the forest industry at approved rates of harvest. Once these base rates are established, the ministry grants harvesting rights to the forest industry through a licensing system.

In each of the areas where the ministry is going to authorize the harvest of timber, it first estimates—through a process known as timber cruising—the amount (in cubic metres), species, and quality of the trees growing there. From this information the ministry calculates the price of the timber for each license.

Exhibit 8.5

Ministry of Forests Revenue Cycle



Once the trees are harvested, they are transported by water, land, or air to a scale site. There the volume, grade, and species of the timber is determined. This process, known as "scaling" (Exhibit 8.6), is done by ministry-authorized and

What is a timber cruise?

A timber cruise is a method of estimating the volume of timber a particular area contains before it is harvested, based on the number, species, size, and condition of trees present. When an area is cruised, a sample of the trees is measured and the results of the sample are projected to the entire area.

Normally, a cruise is conducted by a private company and the results are checked by the ministry. Cruise data is the starting point for setting the rate of stumpage to be charged for the harvested timber and for determining how much timber is expected to be cut from the area.

Exhibit 8.6

Scaling Methods

Timber scaling is the process of identifying, measuring and grading all timber harvested in the province. It is done to determine the volume of timber harvested, its grade, and the type of wood. In British Columbia, two principal scaling methods are in place: piece scaling and weight scaling.

Piece scaling

Piece scaling (or stick scaling) is carried out for some 85% of coastal production and about 3% of interior production. The procedure involves measuring and grading every log, usually while they are spread out in a log yard or in a log boom floating in the water.

About 95% of the coastal piece scale production is done on dry land. Less than 5% is still scaled on the water. Dry land scaling is done on flat areas, usually paved, where loads are lifted out of the water or offloaded from logging trucks and spread onto the ground for scaling, grading, and subsequent sorting. For scaling, the identity of each load is retained for control purposes. A listing of scale details is also maintained for all logs scaled. Accurate scaling is greatly facilitated through dryland sorts, as the scaler can view almost the entire log. With scaling in the water, only a small portion of the log surface is available for inspection.

Weight scaling

Over 95% of timber harvested in the interior of the province is weight scaled. Instead of scaling each piece, weight scaling measures a sample of the total production. Based on the sample results, estimates are made about the total volume.

Weight scaling involves weighing each truckload of logs that arrives at a scaling station from a particular license. Loads are then randomly selected and piece scaled to determine the grade and volume of each species in the selected load. This data is used to determine a "volume/weight ratio" which is then used to calculate the volume of each truckload that is weighed from that cutting permit or license.

Logs spread for scaling, Vancouver Forest Region

licenced scalers, employed or contracted for by the forest industry. The data for each bundle of timber is sent to the ministry and forms the basis for the preparation of an invoice to the licensee. The ministry issues the invoice and is responsible for collecting the money due to the Province.

Reducing the Risk of Revenue Loss

One of the primary control objectives of the revenue system is to provide the ministry with reasonable assurance that Crown timber harvested is accurately reported for billing purposes. To understand the design of the procedures set up to help achieve this objective, it is important to consider the nature of the environment surrounding the revenue cycle.

Crown forests are inherently risky because they are large public areas with no access control or restrictions. In addition, the revenue system relies extensively on the honesty of industry because the ministry is not directly involved in the harvesting and scaling process. Instead, it grants licenses and cutting permits to forest companies, which allows them to cut the trees, transport the logs, and determine the volume and grade they will be billed for.

Exhibit 8.7

How Does the Ministry Define Revenue Losses?

Absolute loss

An absolute loss occurs where the Crown fails to receive those revenues that it should have in accordance with the legislation, policies, and procedures. For example, absolute losses can result from:

- unauthorized cutting of trees;
- lack of scaling;
- non-payment of invoices;
- incorrect marking of timber; and
- incorrect grading of logs.

Equity loss

An equity loss occurs where the Crown fails to receive the correct revenue from the responsible licensee, but the shortfall is compensated for by charging other licensees more through distributive forces.

For example, equity losses can result from:

- the incorrect grading of logs; and
- the submission of incorrect cruise or appraisal data to the ministry.

This means that the ministry must ensure that areas of risk in the process have been identified and effective controls are in place to reduce these risks to an acceptable level. To minimize absolute and equity losses (Exhibit 8.7) throughout the revenue cycle, the ministry has prepared revenue risk management plans at the branch, regions, and districts, and has implemented a system of control activities to limit its risk to an acceptable level. How well these activities reduce the risk of revenue loss to an acceptable level becomes a critical element in the sale of Crown timber.

It also means the ministry must rely extensively on forest companies to make honest and accurate representations of the timber they cut and to notify the ministry promptly if problems occur in the process. Under these conditions, there is a risk that some companies will act in a manner that undermines the trust placed upon them, and abuse or defraud the system.

Regional and district staff across the province are responsible for ensuring that harvested timber is properly scaled and billed in a timely fashion. The vastness of the province, the openness of the Crown forests, and the ministry's limited human resources make this a challenge. The goal of reducing the loss of revenue to an acceptable level requires that control systems be flexible and give staff discretion when monitoring industry compliance with the policies and procedures. At the same time, this flexibility raises the risk of errors or inconsistencies in how policies are interpreted and applied. Invariably, adherence to policies and procedures is enforced to varying degrees by regional and district offices.

It is, nonetheless, the responsibility of ministry management to determine the size and extent of these risks so that it can design effective control procedures to minimize their effects. In designing these procedures the ministry is faced with the challenge of selecting from appropriate controls that: prevent theft, abuse, and fraud; detect the extent of errors made in scaling, and in the submission of scaled data to the ministry; and ensure the minimization of waste left after the harvest.

The main processes that we covered in our review of controls over the revenue system for the sale of Crown timber are those of:

- timber harvesting;
- timber scaling; and
- invoicing.

Ensuring the Timber Harvest Is Authorized

The Ministry of Forests issues thousands of licenses and permits each year, authorizing forest companies to harvest Crown timber under set conditions. Through cutting permits, the ministry gives forest companies the right to harvest timber in designated areas referred to as cutblocks, and prescribes the harvesting methods the companies may use and the procedures for identifying and transporting the cut timber. It then monitors the activities of the forest companies.

The activities associated with the harvesting and transporting of logs are complex. One of the major problems faced by the ministry in monitoring these activities is the lack of a precise measure of volume of timber (inventory) on a cutblock. This hinders the ministry's ability to account for all volume harvested. Another problem is the openness of the Crown forests, which increases risk of theft of a public asset—the unauthorized cutting of trees.

By setting harvesting conditions in its plans and permits, and by monitoring and enforcing policies, the ministry seeks to minimize the risk of revenue loss to the Province and the reduction of waste left after the harvest.

It is essential that the ministry have procedures to ensure that harvesting activities are planned, monitored, and evaluated so that the forest resource is safeguarded from inappropriate use or loss.

We expected to find effective controls within the ministry to provide reasonable assurance of:

- authorized harvesting;
- marked timber leaving the harvest site;
- correctly marked timber leaving the harvest site;
- minimization of waste; and
- timely transportation of cut timber to the scaling sites.

Conclusion

The ministry has adopted many measures that are effective in reducing the risk of lost revenue from inappropriate harvesting activities. However, existing controls must be consistently applied in all forest districts.

Recently harvested cutblock, Vancouver Forest Region

Findings

Inaccurate Estimates of the Opening Inventory

The Ministry of Forests sells Crown timber to the forest companies. These companies cut down the trees and report the volumes, grades, and species to the ministry. Therefore, we expected the ministry to have a reliable estimate of the volume of timber before making a sale, so that the completeness of the reported information can be monitored and verified. Without this control, it is difficult for the ministry to be assured that all timber is properly accounted for.

Timber cruising is the method used by the ministry to estimate the volume of timber on a cutblock. The ministry has determined that, on average, timber cruise volumes should be statistically accurate to within plus or minus 15% of the actual standing timber. In addition, the volume determined from the cruise is one of the factors used to determine the price per cubic meter of the timber.

Usefulness of Cut-to-Cruise Comparisons

We found ministry statistics indicating that cruise volumes could vary by as much as 97.5% from the actual reported volume of cut timber (Exhibits 8.8 and 8.9). As a result, the usefulness of comparisons of the actual cut volume to the estimated cruise volume (cut-to-cruise) was questioned by some ministry staff.

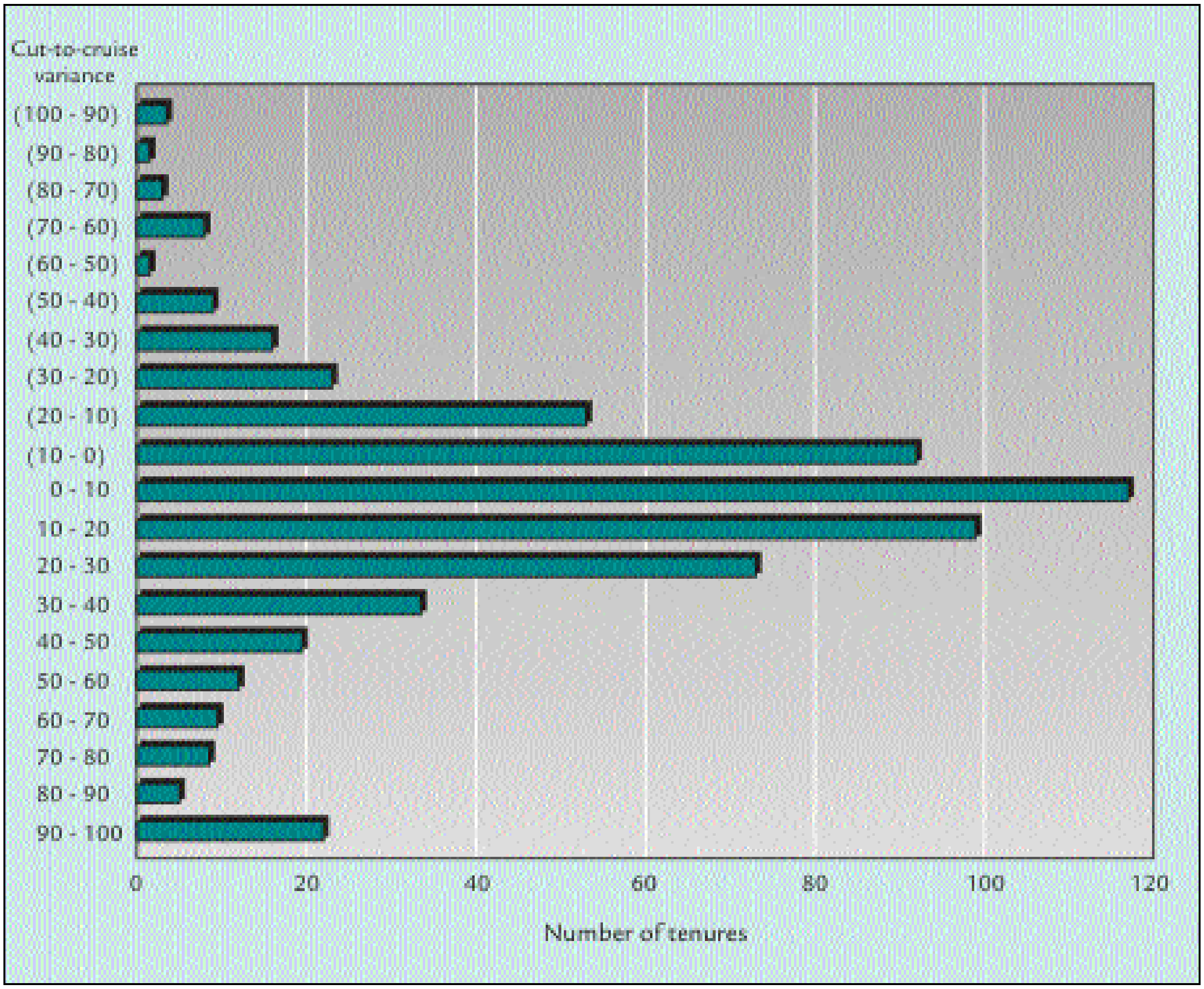
For sales to licensees, it is ministry policy that the cruise volume be compared to the reported volume of timber cut. We found that where significant variances were noted in the Small Business Forest Enterprise Program, ministry staff usually documented reasons for the variance. For the major licensees, who harvest approximately 85% of the timber sold, we found that such cut-cruise comparisons were not carried out consistently across the province.

We recognize that cut-cruise volume comparisons may not be useful in all circumstances. However, other reasonableness tests should be considered, such as comparing volumes per hectare, or comparing the estimated number of harvested loads to the actual loads billed. Whatever method is used, the results could be used to identify potential problem cutblocks for follow-up by ministry personnel. Among the problems which might be identified are the harvesting of timber outside the cutblock boundaries, incorrect marking, or unreported harvesting.

Exhibit 8.8

Cut-to-Cruise Variance for Small Business Forest Enterprise Program Tenures

(Percentage difference)



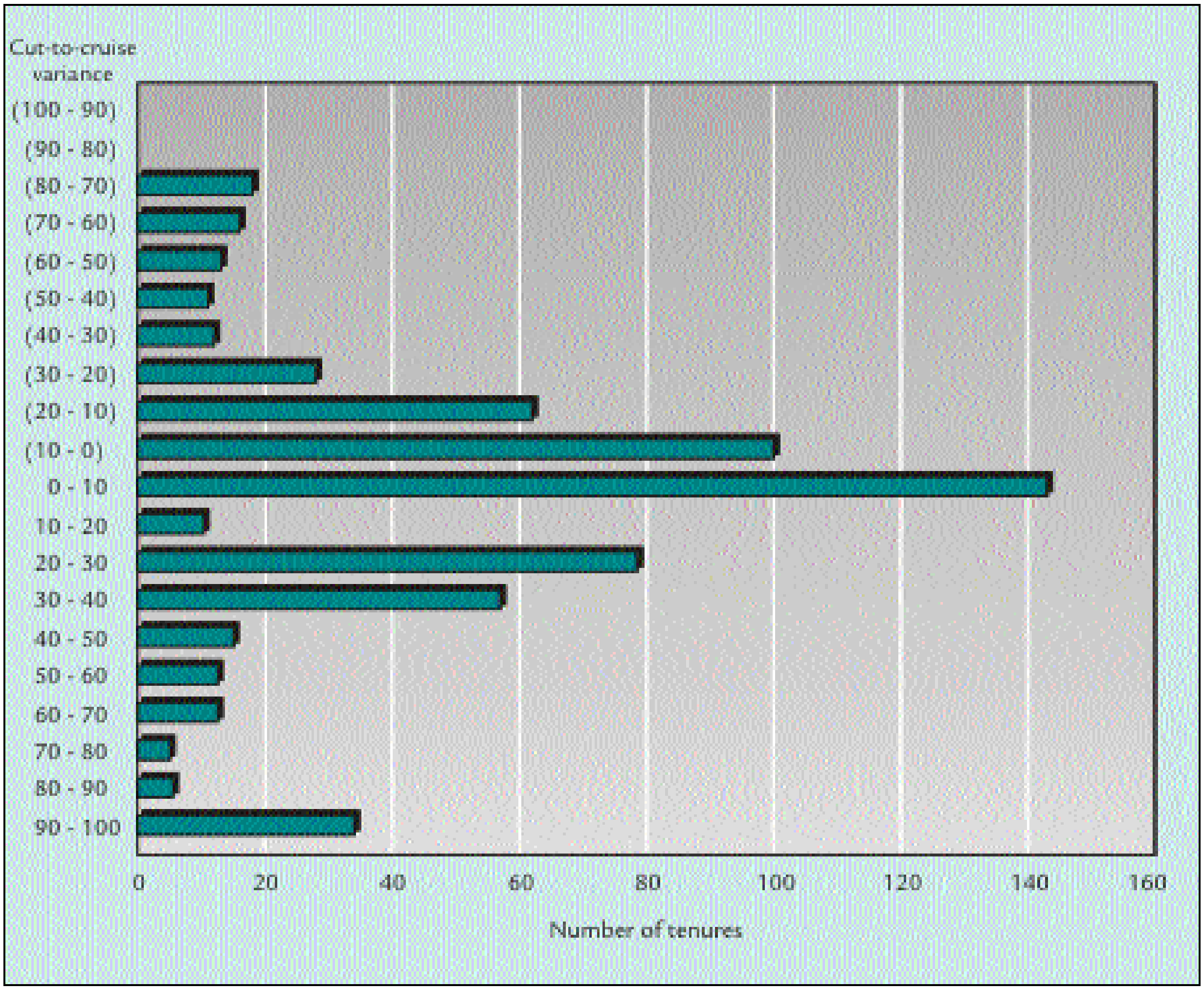
Source: Ministry of Forests

The ministry has recognized the need for accurate estimates of the timber to be harvested. A Provincial Cruising Advisory Committee was formed to address issues affecting timber cruising in the province. It issued a report in February 1996, recommending changes to the methodologies to measure and quantify estimates of the timber to be harvested. The ministry is in the process of implementing many of the recommendations of the report.

Exhibit 8.9

Cut to Cruise Variance for Major Tenures Completed in 1994

(Percentage difference)



Source: Ministry of Forests

We recommend that the ministry improve the accuracy of the timber cruising process in order to help ensure that revenue is received for all harvested timber. To do this it should continue to implement the recommendations of the Provincial Cruising Advisory Committee, which reviewed the appropriateness of the assumptions in the current cruising methodology and the training needed to enhance the cruising capabilities of contractors and ministry staff.

In addition, cut-cruise comparisons should be used as an analytical tool in all districts so that staff can identify and investigate potential problems.

Review of the Cruise

Timber cruises may be done by the ministry, by the licensee, or by contractors hired by either the licensee or the ministry. Because the ministry in most cases does not do the original cruise, it must check the cruise to ensure its design was appropriate, the measurements were accurate and the results were compiled properly. Ministry policy sets how many cruises should be checked and to what extent. These standards recognize the importance of the cruise estimates in setting the price of timber. Again, we found that many districts are not achieving the ministry's required coverage of the cruise function. As a result, there is a significant risk of inaccurate volume estimates on individual cutblocks. However, most are attempting to focus their cruise and "check cruising" efforts on the cutblocks or contractors perceived to be of highest risk.

We also found significant variation between districts in the quality and extent of their review of the cruise data submitted by contractors. For example, some regions, such as Vancouver and Nelson, have developed procedures for recalculating cruise values and have adapted standard checklists to ensure reviews are complete and consistent. Other regions have done neither.

Given the importance of cruise estimates, we recommend that the ministry determine the reasons for districts not meeting the standards for check cruising. In addition, the ministry should develop and implement a standard checklist for the review of cruise data and compilations in all districts across the Province.

Unauthorized or Improper Harvesting of Timber

Unauthorized or improper harvesting of timber can result in revenue loss to the province. To reduce this risk, the ministry has developed numerous control procedures that occur prior to the approval of harvesting. These procedures are intended to provide guidance on: how each cutblock is to be logged, how cut timber is to be marked for identification, and where the timber is to be taken for scaling.

Harvest Plans

A licensee can only apply for approval to harvest trees after having prepared and submitted various working, development, and management plans for review by the ministry and other resource agencies. As part of the planning process, the ministry also approves the licensee's scaling, marking, and transportation plans, all of which have a direct impact on revenue.

We found that the ministry's procedures are effective in ensuring that both parties, ministry and licensee, are aware of the specific requirements attached to each cutblock before any harvesting.

Risk Analysis

During the planning stage, the ministry also determines the extent of monitoring required, based on a risk analysis of the plans.

Risks associated with harvesting fall into three major categories:

- First, there is the risk associated with the physical characteristics of each cutblock. For example, cutblocks with creeks or steep slopes are more vulnerable to soil damage than are cutblocks with flat, dry ground.
- Second, there are different levels of risk associated with different forest companies or licensees. Some licensees, for example, may lack experience with a particular type of logging, and therefore their activities need to be reviewed more frequently and thoroughly than is done for the activities of more experienced licensees.
- Third, there are trespass or mismarking risks associated with the cutting authority. For example, a cutblock may have a timber value that is significantly different from that of an adjacent cutblock.

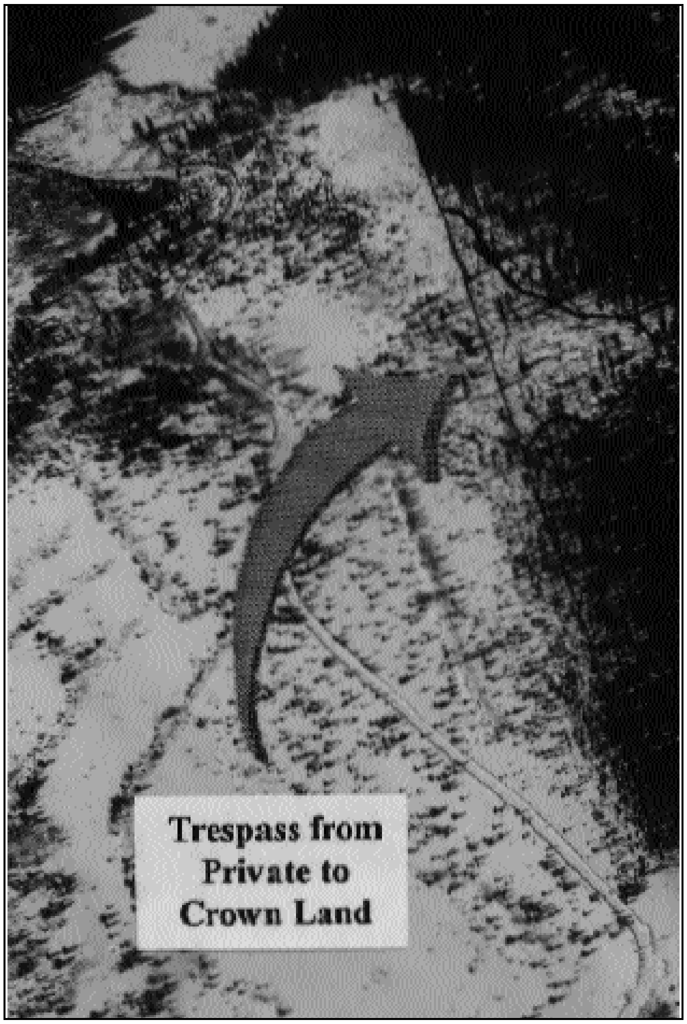
We expected all of these risks to be assessed by the ministry when it is determining the extent of its monitoring of harvest activities. Indeed, we found that all districts are doing a risk analysis of the cutblocks and assigning a risk rating to them. This rating, plus the size of the cutblock, determines the planned number of harvest inspections.

However, while all districts are performing a risk analysis of the cutblocks, we noted that the analysis is not always documented nor are all relevant categories considered.

We recommend that all districts document their risk analyses and clearly indicate that all three major categories have been assessed in arriving at the ratings.

Harvest Inspections

The ministry conducts field inspections to ensure that logging operations are carried out in compliance with the terms and conditions of the license. When performing the



Trespass from private to Crown land, Vanderhoof Forest District

inspections, ministry personnel check for proper use of timber marks, proper utilization (trees cut to the proper heights with no avoidable waste), no sign of unauthorized cutting of timber, and compliance with the license terms and conditions.

A major benefit of these inspections is the increased visibility of ministry personnel in the field. This encourages industry compliance with the ministry's requirements.

Harvest inspections are the ministry's main "eyes in the forest." Recognizing this fact, the ministry is taking some steps to increase its number of "eyes" by, for example:

- increasing the use of helicopters to travel to remote sites and to fly over cutblocks where the risk of trespass may be high;
- soliciting public input through the Crime Stoppers Program;
- establishing inter-ministry agreements which include joint inspection procedures and communication, between ministries about activity in the forests;
- conducting off-hour and weekend visits to harvest sites and scale sites; and
- inspectioning in-transit logs for timber marking and load documentation violations.

However, there are many offices where ministry staff do not work off-hours or weekends. The forest companies, meanwhile, often work extended hours, seven days a week. This means that a great deal of harvesting, timber transporting, and timber scaling occurs with little chance of an inspection by ministry staff.

Ministry policy requires that inspections be performed before, during and at the completion of logging operations.

Risk analysis, discussed above, helps to determine how many inspections are needed for the period when harvesting is occurring. Findings are communicated to the operator immediately and, if problems are noted, the number of planned inspections is increased.

We found that most of the offices we visited are not completing the planned number of inspections.

Not clear, however, is what types of cutblocks are not being inspected as planned—high or low risk, major company or small business licensee.

To further enhance its current efforts, we recommend that the ministry conduct more off-hour field inspections and encourage public involvement in the reporting of forest crimes. In addition, it should improve the reporting of harvest inspection activity to clearly indicate whether the planned objectives are being met and, if not, where the deficiency is occurring.

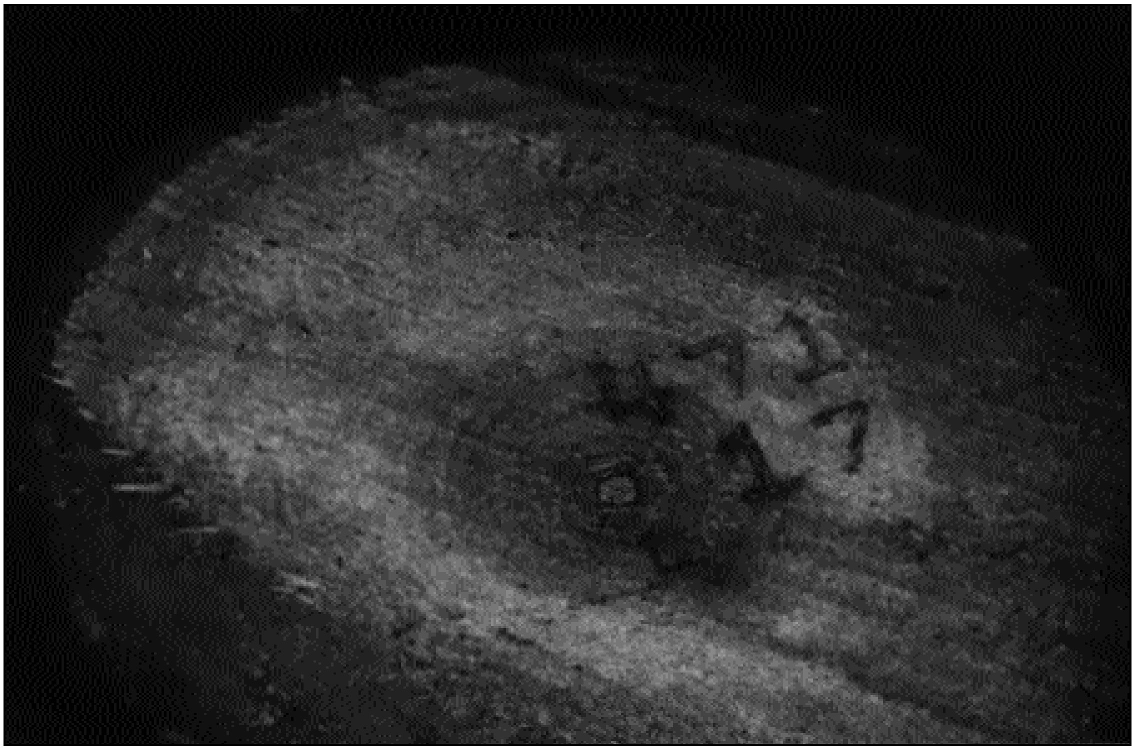
Timber Utilization

As discussed, a great deal of planning occurs before the harvesting of a cutblock begins. As part of this planning, the utilization of timber on the block is set. For example, the license will require that all stumps can be no taller than a specified height and that no logs can be left above a certain size. The adherence to these utilization standards is monitored during the harvest inspections.

After harvesting is completed, a waste survey is conducted by either the forest company or a contractor for the forest company to determine if the utilization was as planned and, if not, whether a billing for waste is necessary. These surveys are done for every cutblock where harvesting has been carried out and it is not uncommon to find merchantable timber left behind.

Ministry staff are required to check up to 25% of the completed surveys on site. In fact, we found that the ministry does not always conduct the required number of waste survey reviews. As a result, there is a risk of undiscovered and unbilled waste.

We recommend that the ministry ensure it is checking the required number of waste surveys.



Timber marked by a hammer indentation for identification purposes

Timber Marking

A licensee, as part of obtaining an approved cutting permit or license, is assigned a timber mark. This mark is unique to the license and identifies the source of the timber and therefore the price per cubic meter that should be charged. Loads of timber leaving a cutblock must be marked in designated ways because transporting of unmarked timber is an offense under the *Ministry of Forests Act (1979).*

There are various approved methods of timber marking in the province, each suited to particular sizes of timber and conditions of harvest and transporting. Marks may be made by hammer indentation, paint or crayon. Hammer marking has the advantage of being more durable while the others are more visible.

In some cases, all logs on a truck or in a log boom must be marked. In other cases, only a certain number need be marked. Different marking requirements between regions make it difficult to enforce the timber marking regulations. For instance, timber marked a certain way in the region where it was harvested may require remarking if it is to be transported into another.

Often timber is transported to a scale site, scaled, and then transported to its eventual point of processing. This timber is referred to as “previously scaled timber.” The timber is marked by the industry scaler as previously scaled before it leaves the scale site and bears the timber brand of the scale site that performed the original scale. In addition, a load description slip must accompany each timber load. Since a load inappropriately marked as previously scaled means the Crown could lose the revenue due on the harvested timber, it is important that the load documentation be sufficient to ensure that the certification of the load status was done independently.

At the time of our review, the ministry was in the process of drafting new marking regulations that address these problems.

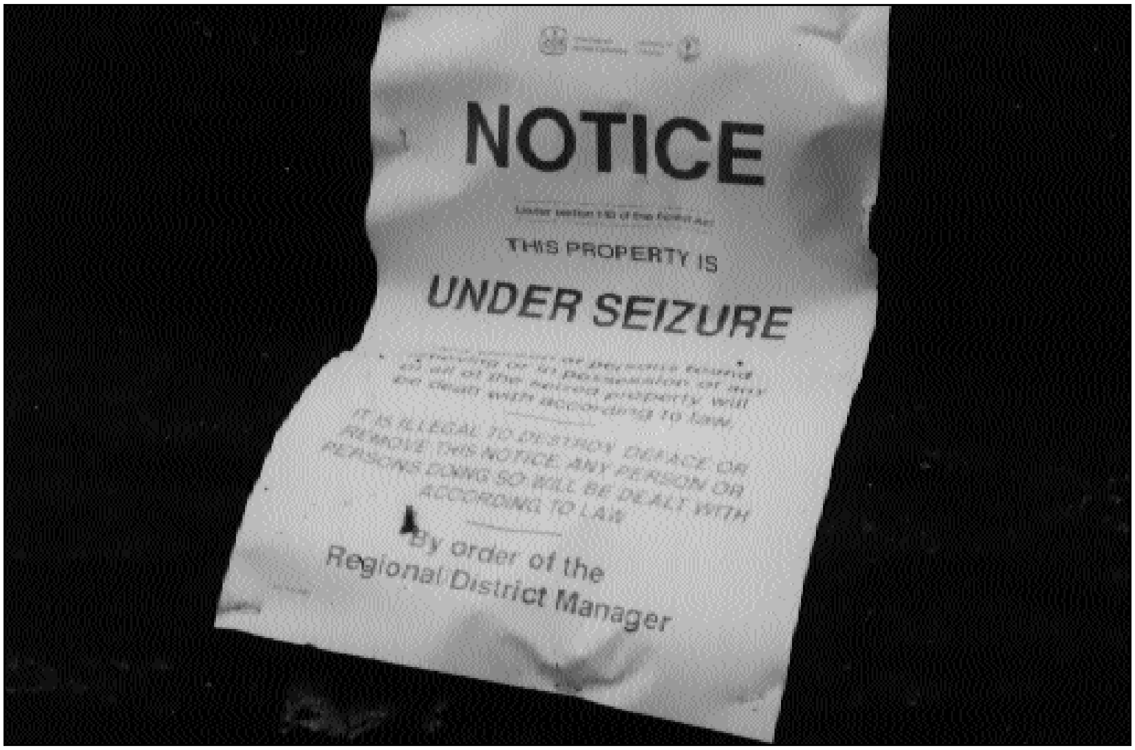
We recommend that the ministry proceed with the introduction of new regulations that will require consistent application of policies for the marking of timber throughout the Province. These standards should include hammer marking on the fronts and backs of timber loads in transit and paint marking on the sides. This will ensure both durability and visibility of the marking.

Timber Decking

Timber decking refers to the stacking of cut timber at the harvest site in preparation for transporting to scaling locations. Because these decks can be left unattended for a considerable period of time, there is a high risk of theft and therefore of revenue loss to the licensee and the Province. Some regions require that where timber is left decked for some time before transport to a scaling site, a certain number of the logs be marked. We believe that marking of decks should be a requirement throughout the province and that it should be done by hammer marking.

Another risk with leaving timber decked for a long time (perhaps because of weather, for example) is that grading of the timber becomes harder to do and can result in lost revenue. Therefore, it is imperative that the ministry be aware of the status of harvesting so that billing can occur as soon after harvest as possible even though scaling may not have taken place.

To deter companies from decking timber for extended periods of time, the ministry has implemented a billing procedure in which it estimates the volume of timber



Seizure notice issued

harvested but not scaled and bills the licensee for that volume. In addition, the ministry can enforce penalties under the regulations where scaling is not performed on a timely basis.

At the time of our review, the ministry was in the process of drafting new regulations that address these problems.

We recommend that the ministry set standards for the hammer marking of decked timber that are consistent throughout the province. In addition, the ministry should enforce penalties and bill forest companies where scaling is delayed.

Physical Movement of Timber

Once the trees are cut, effective controls are required over the physical movement of timber from cutblocks to scale sites in order to reduce the risk of some timber going unscaled. Since our 1989 report, the ministry has implemented several control procedures to deal with this movement. However, we believe further controls are still necessary to reduce the risk of lost revenue.

Weigh scale sample load not segregated and resting on a burn pile, Cariboo Region

Designating Scaling Location

In addition to assigning timber marks to each license, the ministry designates where the licensee must deliver the timber for scaling. Timber may not be scaled at unauthorized locations. This allows the ministry to monitor the movement of high-volume, high-value timber and any suspicious movement of timber. It also ensures that the timber is transported to a scale site with suitable resources to conduct an accurate scale, and allows the ministry to identify timber with invalid marks.

As discussed elsewhere in this report (see page 159), we observed instances where logs had been scaled at unauthorized locations.

We also found that the level of enforcement of mark site designations varied between districts and resulted in varying compliance by scale sites. Nevertheless, in general we believe that the mark site designation is an effective control.

Load Description Slips

Another control the ministry has implemented over the movement of timber is the requirement of a load description slip (LDS), a form that must accompany each load leaving a cutblock. The LDS provides important information about the timber being transported, including:

- the timber mark;
- the cutblock from which the timber was harvested;
- identification of the person transporting the timber;
- the date of transport;
- a description of the load; and
- the status of the load (whether the timber is being transported after having been scaled or it is being transported from the cutblock to a designated scaling station).

The LDS is the bill of lading for a cutting permit or timber sale. However, unlike in a commercial enterprise where a bill of lading would be prenumbered, accounted for, and used to generate an invoice, LDSs are often not numbered and the ministry, except in the Nelson and Vancouver regions, does not attempt to account for them or use them for billing purposes. As a result, the ministry does not have reasonable assurance that all loads of timber leaving the cutblocks are delivered to a scaling site and scaled.

In the Nelson Forest Region and selectively in the Vancouver Forest Region, the ministry does have a standard LDS which is prenumbered and is issued in consecutively numbered books. However, since forest companies are not required to use this form in the other forest regions, some use their own which may not be pre-numbered or provide adequate information of the load.

At the time of our review, the ministry was in the process of drafting new timber transportation regulations to address these problems.

We recommend that prenumbered Load Description Slips (LDS) be used to transport timber in the Province. Licensees should be required to account for all the forms used. If a licensee cannot do so, the ministry should bill the licensee based on the average load size for the license.

Ensuring Accurate Reporting of the Timber Harvest

To ensure that Crown timber cut in the province is properly identified and an accurate volume (expressed in cubic meters) and grade are determined, the ministry must have a process that allows it to monitor the scaling of timber.

We expected to find effective controls to reduce the risk of inaccurate measuring and grading and of incorrect timber marking.

Conclusions

The ministry recognizes the risks associated with timber scaling, given its operating environment, and has policies and procedures in place that it believes are designed to reduce the risks to an acceptable level. However, we believe that these policies and procedures cannot adequately address the risks in the current system because the ministry is not directly responsible for the measurement of the timber sold (the scaling function). As a result, there is still, and will continue to be, a significant risk that harvested Crown timber is improperly identified and inaccurately measured.

Findings

The Importance of Scaling

Accurate and meaningful scaling is extremely important for government and the forest industry. The government uses scale data to invoice forest companies for the timber they cut and to administer the amount of timber cut on an annual basis

In addition to the calculation of volume, log grading is also an integral part of the scaling function. Grading is used to determine the quality of the logs and their potential end use. It is also used to determine whether the timber must be included in the allowable annual cut for the Province.

Roles and Responsibility for Scaling

Licensed scalers determine the volume, species, and grade of all Crown timber harvested in the Province. These scalers are examined, licensed, and provided with training by the ministry. Up until 1985, provincial government employees carried out almost all of the scaling of Crown timber. This responsibility was transferred to the private sector. Today, scalers engaged and paid by the forest industry are responsible for scaling logs on behalf of the ministry. In accordance with their licensing status, they have a duty to accurately scale logs. At the same time, scalers know that it is in the interest of their employer, the forest company, to have logs scaled in their favor. This places scalers in a position where they may face a conflict of interest.

Monitoring Scaler Performance

The ministry relies primarily on its own “check scalers” to review the work of industry scalers and to see if it is carried out competently and according to ministry scaling requirements. Check scales remeasure loads of logs scaled by the original scalers and compare scale results in terms of volume and grade. If the check scale is different from the original scale by greater than 3%, the check scale may be used instead of the original scale results.

In determining which scale sites to visit and how often, check scaling staff in the districts assess the risks associated with the scale site such as: the experience of the industry scalers; the value of the timber arriving at the site; the location of the site: and results from previous check scales.

Ministry policy requires that check scales be performed at least once every two months on active industry scalers while logging is in progress. We found that check scales were performed this frequently in the districts we visited in the Vancouver and Prince George forest regions, but there was not the same consistency in the other four regions (although, some were better than others). Many of the districts indicated that they were unable to meet the minimum standard because they lacked sufficient scaling personnel.

We attempted to determine what percentage of timber harvested is check scaled each year. For 1995/96, our best estimate is that 1% of all piece scaled timber and 6.5% of weight scaled sample loads have been check scaled.

Ministry policy also requires the forest industry to leave the most recent scaled load per scaler spread on the ground at the scale site. This allows ministry staff to perform check scales whenever they arrive at the scale site. However, industry does not always do so and, during one of our site visits we noted that only one-half of the scaled load had been left on the ground, making it impossible for the ministry check scaler to verify the accuracy of the scale.

We also noted that while industry scalers may work between 6:00 a.m. and 8:00 p.m., six or seven days a week, ministry check scalers generally work 8:00 a.m. to 5:00 p.m., five days a week. This prevents the ministry from adequately monitoring the quality of scaling at all times, particularly at remote logging locations.

We recommend that the frequency of check scaler visits, the flexibility of check scaler working hours, and the imposition of penalties be reviewed by the ministry.

Computer Controls

Scale data is collected, processed, and summarized by the forest industry. Whenever the industry scalers piece scale the timber, they usually record the details of their measurements in hand-held computers which compile data on the volume, species, and grade of the timber harvested. Because this information is critical to ensuring that the ministry prepares accurate invoices, effective controls are required to ensure that the data produced by the hand-held computers is complete and accurate.

Hand-held computers are industry-owned and -operated, and the software has been designed to be flexible so that individual company's needs can be met. We therefore expected to find that hand-held computer hardware and software was tested by the ministry before operational use by industry scalers, to ensure that controls existed over computational accuracy and editing of data.

We found that although the ministry, in May 1995, did test the major software applications used in calculating approximately 75% of the scaled volume of timber it does not perform testing on a regular basis. There are a number of other risks as well, some of which were identified in a May 1995 report conducted by an external consulting firm. The report concluded that the controls in place at the time of our review were inadequate to address several significant risks such as:

- incomplete and inaccurate data;
- unauthorized changes to data;
- loss of data; and
- data not received on a timely basis.

The ministry has adopted many of the recommendations in the consultant's report and has included them in the scaling manual. In addition, the ministry, to address these risks, has implemented a number of province-wide controls, including check scaling, the maintenance of a field presence and the suspension of scaling licenses. However, these controls provide limited assurance: check scaling covers only a small percentage, of scaled timber; the other two controls are indirect. For example, once the chance of being check scaled has past, there is a risk that scaled data may be altered or deleted.

Monitoring of Scale Sites

Scale sites, the designated locations to which harvested timber is transported, are owned and operated by the forest companies and are usually associated with a lumber mill or other wood processing facility.

The scale site is the "warehouse" for harvested timber. Before starting operations, scale site owners must obtain authorization to do so from the ministry. Attached to the authorization are a number of conditions aimed at ensuring that timber transported to the site receives a complete and accurate scale.

Periodically, the ministry conducts random and unannounced site inspections. These are conducted to assess compliance with the scale site authorization and to ensure conditions at the scale site support an accurate and reliable scale.

We visited 28 scale sites throughout the Province during our audit and found that at 40% of the sites, one or more of the conditions in the scale site authorization were not being adhered to. These contraventions included:

- the mixing of scaled and unscaled logs;
- the processing of logs not designated for that scale site;
- the failure to scale a designated sample load from the weight scale system;
- a three-week delay in the scaling of logs; and
- the failure to advise the ministry of extended hours of operation.

We believe that the findings illustrate the inherent risks that exist given the environment under which the current scaling system operates. Although most regions are meeting provincial standards for site inspections and informing forest companies of violations, these controls are not effective enough in reducing the risk of inaccurate and unreliable scaling to an acceptable level.

In addition, as was the case in check scaling, we believe that ministry check scalers should be encouraged to work flexible schedules so they can conduct inspections outside normal working hours.

We recommend that the ministry ensure that the conditions under which a company is authorized to operate a scale site be enforced consistently throughout the Province. Site inspections should, at a minimum, include visits outside normal working hours, and the penalty system should be stringently applied, otherwise it will fail to provide an adequate deterrent.

Invoicing

To issue invoices for timber harvested from Crown land, the ministry extensively relies on complete and accurate data from the forest companies. The ministry must have a process to monitor the recording, processing, and transferring of this data, because once the volume and species of the timber is recorded, timber is moved directly into company inventories and production and cannot be tracked. In addition, once the data is received, the ministry must have a process to ensure that forest companies are billed for the timber harvested.

We expected to find control activities that are effective in ensuring that:

- industry scale data computations and summaries are accurate and reliable;
- scale data was submitted on a timely basis; and
- invoices are accurate, complete, and issued on a timely basis.

Conclusion

We concluded that the ministry has strong processing controls which result in complete and accurate invoices that are based on the scale data received from forest companies. However, improvements are needed in ensuring scale data is complete and volume compilations are accurate.

Findings

Data Collection from Forest Companies

Data on volumes, species, and grades of timber is recorded, processed, and summarized by forest companies before being submitted to the ministry. It is initially recorded at the time of scaling, either manually or electronically, for each load of timber. This information is summarized daily by load and then monthly by loads from the same cutting permit and sent to the ministry. The ministry therefore requires effective controls to ensure that the data is submitted on a timely basis, completely and accurately.

Completeness and Accuracy of Data Submissions

Summary information submitted by a forest company is used as the basis for billing the company. We expected the ministry to have effective control activities to provide assurance that the summaries are complete and accurate.

We found, in general, that the ministry did not reconcile the original scale data to the summary information. In addition, computer programs used to process and compile scale data were not checked on a regular basis to ensure that data produced was accurate.

We recommend that the ministry periodically reconcile a larger sample of original scale data to the summary information and more frequently check computer processing and compilation software used by the forest industry for accuracy.

Producing an Invoice

To ensure that forest companies are billed for the timber they harvest, scale data is input into the ministry billing system to produce an invoice. We found that the ministry has developed effective controls over the processing of the scale data once it is received from a forest company. Over 90% of the harvested timber reported was billed within the normal billing cycle of the ministry. Where delays occurred, the ministry made every effort to resolve the problem in a timely manner. In addition, where errors occurred in invoicing, the ministry corrected them on a timely basis.

Exhibit 8.10

Summary of the 1989 Report on the Stumpage and Royalty System

The overall objective of our report was to assess the risk of the Ministry of Forests receiving incomplete or inaccurate data on the volumes and species of timber removed from Crown lands, and thus the ministry issuing inaccurate billings.

We concluded that the risk was high.

In particular, we found that:

- inspections of harvesting operations were performed infrequently and, as a result, trees could be cut without harvesting data being collected and forwarded to the ministry;
- controls over the physical movement of timber were inadequate;
- check scaling was not given sufficient priority by the ministry even though it is the key control activity in the data collection phase;
- controls over all source documents and computer software used by licensees were poor; and
- responsibility for revenue data collection was not being adequately assigned to specific positions in the regions and districts.

summary of recommendations

Recommendations made in the report titled *Forest Revenue System* are listed below for ease of reference. They should be regarded in the context of the report.

The Office of the Auditor General recommends that:

- *The ministry improve the accuracy of the timber cruising process in order to help ensure that revenue is received for all harvested timber. To do this it should continue to implement the recommendations of the Provincial Cruising Advisory Committee, which reviewed the appropriateness of the assumptions in the current cruising methodology and the training needed to enhance the cruising capabilities of contractors and ministry staff.*

  In addition, cut-cruise comparisons should be used as an analytical tool in all districts so that staff can identify and investigate potential problems.

- *The ministry determine the reasons for districts not meeting the standards for check cruising. In addition, the ministry should develop and implement a standard checklist for the review of cruise data and compilations in all districts across the province.*
- *All districts document their risk analyses and clearly indicate that all three major categories have been assessed in arriving at the ratings.*
- *The ministry conduct more off-hour field inspections and encourage public involvement in the reporting of forest crimes. In addition, it should improve the reporting of harvest inspection activity to clearly indicate whether the planned objectives are being met and, if not, where the deficiency is occurring.*
- *The ministry ensure it is checking the required number of waste surveys.*
- *The ministry proceed with the introduction of new regulations that will require consistent application of policies for the marking of timber throughout the Province. These standards should include hammer marking on the fronts and backs of timber loads in transit and paint marking on the sides. This will ensure both durability and visibility of the marking.*
- *The ministry set standards for the hammer marking of decked timber that are consistent throughout the Province. In addition, the ministry should enforce penalties and bill forest companies where scaling is delayed.*

- *That prenumbered Load Description Slips (LDS) be used to transport timber in the province. Licensees should be required to account for all the forms used. If a licensee cannot do so, the ministry should bill the licensee based on the average load size for the license.*
- *The frequency of check scaler visits, the flexibility of check scaler working hours, and the imposition of penalties be reviewed by the ministry.*
- *The ministry ensure that the conditions under which a company is authorized to operate a scale site be enforced consistently throughout the province. Site inspections should, at a minimum, include visits outside normal working hours, and the penalty system should be stringently applied, otherwise, it will fail to provide an adequate deterrent.*
- *The ministry periodically reconcile a larger sample of original scale data to the summary information and more frequently check computer processing and compilation software used by the forest industry for accuracy.*

response of the ministry of forests

We agree with the Auditor General that, in view of the operating environment and the significance of forest revenue, additional controls should be implemented.

The recommendations of the Auditor General are helpful. The ministry will address all of the recommendations, except as noted below, and will continue to consult with the Office of the Auditor General as the work proceeds.

Two of the recommendations require further analysis by the ministry before decisions regarding implementation can be made.

- *Waste assessments: Before the ministry increases its checks of licensee waste surveys, the policy regarding course woody debris needs to be resolved.*
- *Hammer marking: The additional cost of hammer marking logs in the interior (as opposed to paint or crayon) needs to be assessed against the control benefits of the permanence of hammer marks.*

The ministry is pleased that the Auditor General has recognized the positive steps that have already been taken and greater emphasis that has been placed on revenue. The ministry intends to continue to improve revenue control, and the work of the Auditor General is therefore of value.

updated responses to last year's internal control and other reviews

updated responses to last year's internal control and other reviews

Ministry of Finance and Corporate Relations

New Corporate Accounting System: Update

An update on the development of the government's new corporate accounting system (CAS)

Page 99 of this report contains this year's comments on CAS, in a section titled *New Corporate Accounting System: Update*. Because of the significant effect that CAS will have on government financial accounting processes and reporting, we believe it is important that we monitor the system as it is being developed. A response from the Chair of the CAS Executive Steering Committee is included with that report, on page 106.

Ministry of Human Resources

Income Assistance Payment System

A review of controls over the income assistance payment system

This is an update on the progress the Ministry of Human Resources has made in addressing the recommendations made in your report, *Income Assistance Payment System*.

As previously stated, the ministry agrees with all the recommendations contained in the report. An action plan was developed to address all 25 recommendations that were made. We are pleased to say that by the end of December 1996, the ministry had completed its planned action to address 14 of the recommendations. An additional nine recommendations are to be fully addressed by the end of March 1997, and action on the two remaining issues will be completed by July 1997.

The *Guaranteed Available Income for Need (GAIN) Act*, which was the governing statute when your audit work was conducted, has been replaced with the new BC Benefits Legislation. The introduction of this new legislation provided an opportunity and a requirement for the ministry to undertake a major review of many of our policies governing the Income Assistance Program.

Your report focused on four core areas of activity. Rather than responding to each of your specific recommendations, we would like to summarize the ministry initiatives in each of the four areas as follows:

1. **Assessing Eligibility of Applicants and Recipients**. Income Assistance Program policies have been reviewed and clarified or strengthened in key areas relating to the requirements for applicants to provide appropriate identification when applying for income assistance and also to ensure that those not complying receive only hardship benefits with their cases subject to strict monitoring procedures.

    The policy has also been reviewed and clarified with respect to residency requirements and the responsibility and obligations of sponsors for immigrants. The ministry has worked with Human Resources Development Canada to develop a Memorandum of Understanding which will allow both parties to take a more pro-active approach to sponsorship break down.

    The core training program for Financial Assistance Workers and District Supervisors was reviewed to ensure that policy requirements were clearly articulated and that compliance expectations were established. The training was also modified to include sessions dealing with the Prevention, Compliance and Enforcement Initiatives which the ministry has introduced.

    The ministry has also introduced Eligibility Officers and Verification Officers who support Financial Assistance Workers by reviewing files to ensure that eligibility criteria were correctly assessed at the time of application, and that they could continue to be met. Verification Officers have worked on a variety of early detection projects throughout the province to assess specific eligibility criteria and monitor compliance. In areas with high volumes of new applicants, specialized intake workers have been introduced to focus on ensuring that all eligibility criteria are met at the time of initial application.

    Finally, clear expectations with respect to policy compliance and accountability have been provided to all staff.

2. **Detecting and Reducing Errors, Abuse and Fraud**. The ministry has developed computer tools which allow us to search our data base for any duplicate registrations. Standards have been developed for the regular production

of this report and to identify appropriate follow-up action. Several utilities have been developed within the ministry's Management Information System to permit the monitoring and evaluation of the activities of the Prevention, Compliance and Enforcement Program and to follow up on the results of their investigation activities and recommendations which flow from their work. A performance measurement framework is being developed for both field managers and program compliance and enforcement staff and is planned for implementation in June/July 1997.

3. **Processing and Recording Benefit Payments and Recoveries.** The ministry has taken steps to significantly improve the accounts receivable system functionality within the Management Information System. The first stage of this new system was implemented in September 1996, which significantly enhanced the ministry's ability to ensure that repayment agreements were prepared for all repayable amounts and to provide effective management controls which ensure that all accounts receivable are properly processed and recorded in the ministry's accounting system. The second release of the accounts receivable system is scheduled for implementation in June 1997 and will introduce significant enhancements to improve the ministry's processes for managing and recovering assigned pension and other benefits. The ministry is continuing to work with Human Resources Development Canada on improvements to the system for monitoring and tracking assigned Unemployment Insurance Benefits and with the Residential Tenancy Branch of the Ministry of Attorney General to increase recoveries of assigned security deposits.

   Treasury Board has authorized the ministry to use collection agencies to recover amounts owing from former clients. Two such agencies are already in place and one more will be added by February 1997.

   The combination of these initiatives will significantly enhance the ability of the ministry to manage amounts owing to it.

4. **Maintaining Controls Over Data in the Computer System.** The ministry took immediate action to address the recommendations to establish stringent controls over passwords and to improve procedures for reviewing and monitoring program changes. The interim procedures established have been effective, however, some revisions

are required and will be incorporated into formal policies and procedures which will be implemented by the end of the fiscal year. The ministry has developed major disaster recovery plans, and successfully tested the migration of its key systems to a recovery site during the fall of 1996. The ministry remains committed to the continual re-evaluation testing and improvement of its disaster recovery plans.

We are pleased to say that the Ministry of Human Resources has made significant progress in addressing the recommendations you presented. Our new legislation, rejuvenated policies, enhanced systems and well-trained staff are the key resources we are using to ensure the issues raised in your report are appropriately resolved.

Ministry of Small Business, Tourism and Culture

BC 21 Community Projects Program

A review of controls over community project grants for one-time capital projects

Recommendation:

The Community Grants Branch redesign the application form so that it requests details of what outcomes the applicants expect to achieve with the project and describes the process open to applicants who wish to appeal a funding decision.

Status:

The Branch plans to redesign the application form to incorporate the recommendations. However, since the future of the program will be unknown until the review of the Build BC Special Account is complete, there has not been an opportunity to present and obtain approval for a new form.

The letter to unsuccessful applicants provides instructions to contact the Branch if they require further information or explanation.

Recommendation:

The Branch review the program guidelines with a view to ensuring that funding from other provincial government programs is not used to supplement the applicant's two-thirds share of the project.

Status:

No change in the Branch's position which is that even though some applicants use operational funds provided by the province to assist with capital project costs, the Branch does not consider this type of arrangement to violate guidelines.

Recommendation:

The Branch place greater emphasis on the evaluation of financial need in the appraisal process to ensure that grants are given only to those projects that would not proceed, in the manner or time intended, without assistance.

Status:

The analysts have been made aware of the need to assess the financial need of the applicants. This assessment is reflected in the summaries presented to the BC 21 Committee in order to assist the committee in making their funding decision.

Recommendation:

The Branch review the administrative arrangements of the appraisal process with a view to providing a shortlist of recommendations based on a ranking of competing projects for consideration by the committee.

Status:

No change. Since the issuance of the Auditor General's report, the Committee has not considered BC 21 Community Projects funding requests policy and therefore has not had an opportunity to respond to this recommendation. The Branch would only be in a position to rank eligible applications if it receives direction or guidelines on selection criteria used by the Committee.

Recommendation:

The BC 21 Committee document its rationale for approvals so as to provide guidance to the Branch on how it makes its decisions and to promote effective accountability to the public for decisions made.

Status:

No change. Again, since the issuance of the Auditor General's report, the Committee has not considered BC 21 Community Projects funding request policy and therefore has not had an opportunity to respond to this recommendation.

Recommendation:

The Branch require all organizations to submit an independent certification of project costs to ensure that public funds are used for the purpose granted.

Status:

No change. It is proposed that applications from municipalities or regional districts exceeding a minimum threshold level of (say) $25,000 would require independent certification and application forms would be clarified to include this requirement. However, until the BC 21 Committee is established and gives approval to these changes, there will be no change to the information requirements from municipalities and regional districts.

Recommendation:

The terms and conditions of the grant agreement require a full accounting of project revenues and costs from the applicant, before the final release of funds. Where project revenues exceed costs, procedures should be in place to recover the funds.

Status:

No change in the Branch's position. It would be difficult to monitor such a requirement if it were imposed. And, in general, recovering funds that have already been promised is not likely to be a high priority for the BC 21 Committee.

Recommendation:

The Branch enhance its public reporting by providing more complete information annually about the program's activities.

Status:

The Branch now prepares an Annual Financial Report (separate from the ministry's Annual Report) which contains information on the activities of the Branch, grants approved, sectors and categories, jobs created, etc.

Recommendation:

An evaluation of the program's performance be undertaken to allow for a meaningful assessment of how well the program's aims and objectives are being achieved.

Status:

No change. While the Branch collects and forwards a substantial amount of information to the Ministry of Employment and Investment, the ministry has not issued a report concluding on the overall performance of the program.

audit of financial statements of government entities, trust funds, and other organizations

audit of financial statements of government entities, trust funds, and other organizations

Changes in the 1995/96 Fiscal Year's Government Financial Reporting Entity

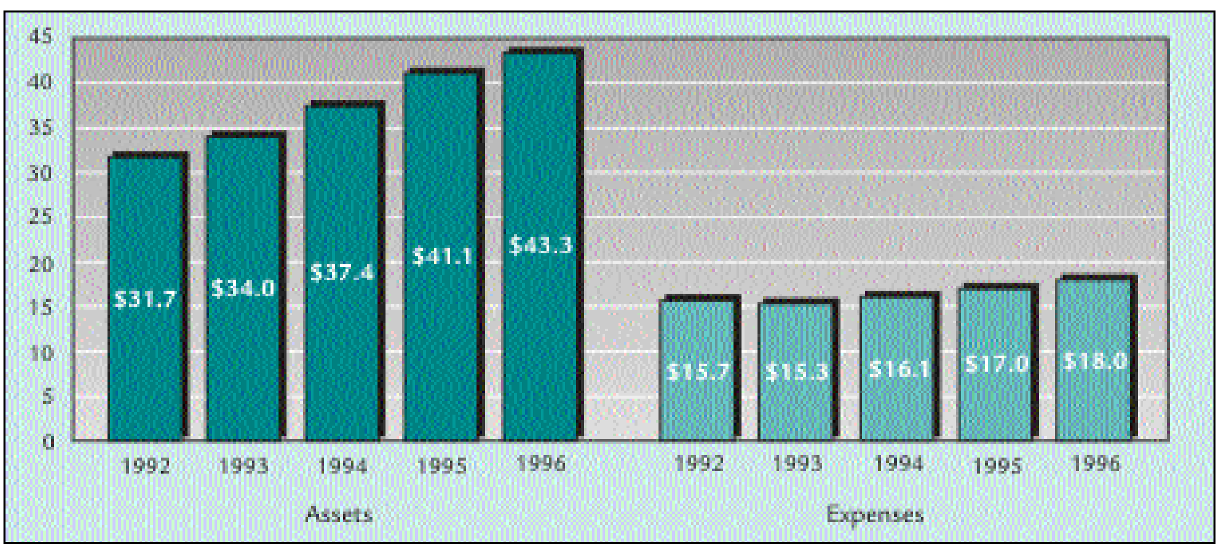
The Summary Financial Statements of the Province for the 1995/96 fiscal year include the results of many more government organizations than in previous years. In addition to the results of the financial activities and operations of the Consolidated Revenue Fund (including the Liquor Distribution Branch) and 43 other government organizations and enterprises, these statements include, for the first time, the results of the province's 29 regional hospital districts, 120 hospitals and hospital societies (heath care organizations), 75 school districts, 19 colleges, 5 universities, and the British Columbia Institute of Technology.

In the 1995/96 fiscal year, the assets and expenses of these entities, 292 in all, amounted to $43.3 billion and $18.0 billion, respectively. Exhibit 9.1 shows the assets and expenses of the

Exhibit 9.1

Changes in Assets and Expenses

Assets and expenses of government entities, 1992 to 1996 ($ Billions)



Source: Financial statements of government entities

entities reported in the Summary Financial Statements of the Province in 1996, with assets and expenses for 1992 to 1995 restated for comparison.

All additions to and removals from the summary reporting entity are summarized in the *Audit of the Financial Statements of the Province* on page 23 of this report. Additions include three newly created organizations:

- Royal Roads University was incorporated on June 30, 1995, under the *Royal Roads University Act*. The university is a degree-granting institution dedicated to studies and research activities supporting the applied and professional fields.
- The Columbia Basin Trust was incorporated on July 6, 1995, under the *Columbia Basin Trust Act*. The Trust is to manage allocations made to the Trust of benefits derived from the Columbia River Treaty, for the ongoing economic, environmental, and social benefit of the people of the Columbia Basin. The Trust has entered into an agreement with the Province of British Columbia to participate in various joint ventures for the purpose of owning, constructing or operating power projects to provide sustainable funding for the Trust. The agent for the Province in operating these joint ventures is the Columbia Power Company.
- West Coast Express Limited was incorporated on August 3, 1995, for the purpose of operating, marketing, and providing customer services for the commuter rail system of B.C. Transit. Active operations started November 6, 1995, providing commuter service between the District of Mission in the Fraser Valley and downtown Vancouver. The company is reimbursed in full through B.C. Transit for net expenses incurred in providing this service.

Auditors of Government Entities

Exhibit 9.2 shows, for the government entities included in the 1995/96 Summary Financial Statements of the Province, the asset and expense amounts audited by private sector accounting firms and those audited by the Auditor General. The combined assets and expenses audited by the private sector totaled $34.1 billion and $15.6 billion, respectively. The private sector audited the hospital regional districts, health care organizations, and school districts, as well as 19 colleges and 29 other government organizations. The Auditor General audited all 5 universities, the British Columbia Institute of Technology, and 14 other government organizations, with combined assets and expenses of $9.2 billion and $2.4 billion, respectively.

In addition to the government entities included in the summary level financial statements, the Auditor General audited a further 38 organizations with assets of $59.0 billion and expenses (including financing transactions) of $30.2 billion. Among these were 30 trust funds, including pension and superannuation plans, and investment funds administered by the government. Five new funds were started during the year: the Short Term Bond Fund, the Pension Bond Fund, the Private Placement Fund, the Fixed Term Mortgage Fund, and the Construction Mortgage Fund.

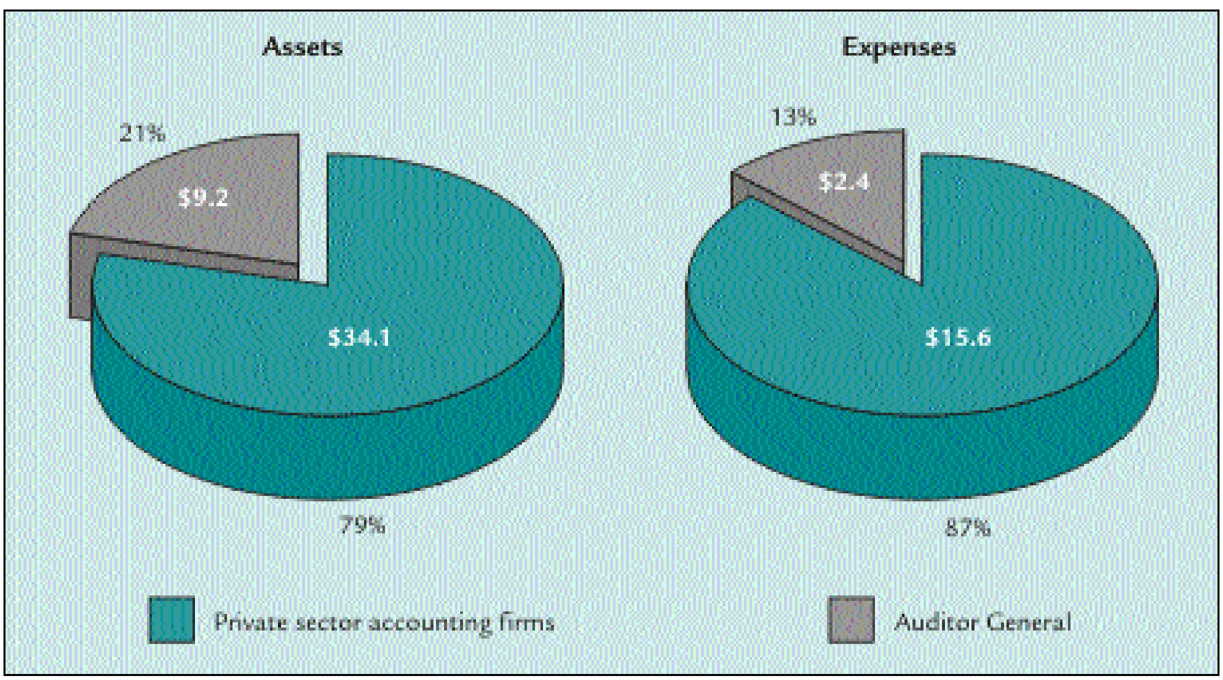
Appendix B of this report lists all government entities audited by the Auditor General, as well as other organizations and trust funds audited by the Auditor General which are not included in the Summary Financial Statements of the Province.

Appendix C lists the government entities that are included in the Summary Financial Statements and whose financial statements were audited by private sector accounting firms.

Exhibit 9.2

Distribution of Financial Statement Attest Audits

Asset and expenses amounts audited by private sector accounting firms and by the Auditor General (for government entities), 1995/96 ($ Billions)



Source: The Public Accounts

Auditor's Reports

Both management and auditors have responsibilities associated with an entity's financial statements. Management is responsible for preparing the 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 position and operating results of the entity and are in accordance with appropriate accounting principles.

Where the auditor finds that the financial statements are not in accordance with appropriate accounting principles and the exception is considered to be material, the auditor must include a reservation in his or her report. During this past year, the auditor's report on the financial statements of a publicly funded university included in the Summary Financial Statements of the Province contained such a reservation. In addition, the auditor's report for one small entity not included in the Summary Financial Statements contained a reference to revenue which, by its nature, could not be verified satisfactorily.

Accounting Standards for Government Organizations

Accounting standards continue to emerge for the public sector, largely under the guidance provided by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants (CICA). Developments affecting accounting policies for government are discussed in the *Audit of the Financial Statements of the Province* on page 23 of this report.

For government-owned entities included in the Summary Financial Statements and trust funds, PSAAB, in September 1996, issued an exposure draft entitled *Introduction to Public Sector Accounting and Auditing Recommendations.* In this, PSAAB states that government-owned business-type or not-for-profit organizations should generally follow the appropriate accounting recommendations in the CICA's Handbook. This would result in similar organizations in the private and public sectors reporting their activities in the same way, and make the financial statements in both sectors comparable and more understandable to the reader.

Accounting Standards for Not-for-Profit Entities

Accounting standards for business organizations are well established. Those for not-for-profit organizations, however, are still being implemented. In March 1996 the CICA added several new sections to its handbook, aimed at enhancing financial reporting by not-for-profit organizations. These recommendations are effective for fiscal years beginning on or after April 1, 1997. Some entities, nevertheless, are choosing to implement earlier.

The primary purpose of the new recommendations is to improve the measurement of resources used by not-for-profit organizations. In the past, the main purpose of not-for-profit financial statements has been to portray the “flow of funds”—that is, to show receipts and payments of cash in the periods they occur. The new standards place more importance on the reporting of costs within the periods when the resources are used. By providing the full cost of services, the financial statements will assist resource providers in allocating scarce resources in the most cost-effective manner. “Flow of funds” information is now presented through the statement of cash flows.

By providing the full cost of programs, the accountability of government not-for-profit entities will be enhanced. With accurate measures of the cost of programs, it is possible to determine whether the organization is achieving its financial objectives and whether the public is receiving value for money.

To arrive at full program costs, perhaps the most important change is the capitalization and amortization of physical assets. In the past, a variety of methods of accounting for physical assets was permissible. In the future, these assets will be recorded on the balance sheet and expensed over their useful lives in a manner similar to that in the private sector. This is consistent with the trend in accounting for physical assets by government.

Other new sections in the handbook address contributions received, financial statement presentations for not-for-profit organizations, and the reporting of controlled and related entities by not-for-profit organizations.

For many entities, implementing these changes is not an easy task. To apply these changes retroactively requires extensive restatement of past transactions making up the opening balances in the financial statements. Additional audit work is also required. As well as examining the current year’s figures, auditors of these entities must examine the restated comparative figures and ensure the revised presentation complies with the new handbook sections.

Financial Statement Comparability in the Public Sector

The absence of consistent accounting principles can lead to a lack of comparability between similar organizations within the public sector and between them and those in the private sector. The ability to make such comparison provides important information to users as to the performance of an organization.

For there to be consistent and comparable information between similar organizations, the basis of accounting needs to be consistent. The CICA's standards provide alternative accounting treatments, but both the boards and the funding ministries of organizations need to be fully informed as to the choices that are available. The boards will want to choose the alternatives that best portray the activities of the entities, while the funding ministry will want to ensure consistency between entities in reporting those activities. As the chief accounting officer of the government, the Comptroller General's advice should be sought in this process.

The Auditor General, as the auditor of the government, works with both the funding ministries and the Office of the Comptroller General to encourage appropriate financial reporting throughout all government sectors.

Memorandum of Understanding

The Auditor General's 1996 Annual Report described the Memorandum of Understanding between the Minister of Finance and Corporate Relations and the Auditor General. The Memorandum is a temporary measure, pending needed changes to the *Auditor General Act*. The Memorandum requires the minister to seek the Auditor General's advice as to the appointment of auditors for all government organizations for which the minister appoints the auditor or influences the appointment. It goes some way to rationalize who should perform the financial statement audits of government organizations and gives the Auditor General the opportunity to provide guidance to private sector auditors as to the nature and extent of the audit work that should be conducted. These new arrangements should enable our Office to better carry out its mandate, and to provide advice to the Legislative Assembly and government as to the audit services purchased by the taxpayer.

The Memorandum is supported by a five-year implementation plan which provides for the Auditor General to become auditor to some organizations for which he is not currently the auditor, and for him to relinquish other audits to the private sector. New audits assumed by our Office will enable us to increase our knowledge of government organizations and audit issues relating to them. Audits taken on will be returned to the private sector on a rotational basis over a three– to five–year time period. In this first year of implementation, the Office has assumed the audit of the British Columbia Buildings Corporation and relinquished four audits: British Columbia Assessment Authority, Provincial Capital Commission, British Columbia Health Research Foundation, and Creston Valley Wildlife Management Authority Trust Fund. These changes will result in an overall reduction in the direct financial audit work carried out by our Office, and enable us to meet an increased oversight role, necessitated by both the requirements of the Memorandum and the expansion of the government's reporting entity.

As already mentioned, the number of government entities included in the 1995/96 financial statements has increased significantly. As the auditor appointed by the Legislative Assembly, the Auditor General must report on the government's financial statements, which include information from the financial statements of all the government entities. In forming the Auditor General's report on these statements, we rely on the reports and work of the auditors of these entities. We must take reasonable care to assure ourselves that our reliance on other auditors is justified. We do this by meeting with the private sector auditors and reviewing their working papers to the extent we consider necessary.

Statutory Pension Plans: Inflation Indexing

Four large public sector statutory pension plans—Municipal, Public Service, Teachers', and College—cover employees in the municipal, hospital, school, Crown corporation, college, and public service sectors.

Each pension paid from these plans is made up of two parts: the basic pension and a cost-of-living component. Of total pension benefits paid in fiscal 1996 for all four plans, we estimate that approximately 78% are related to the basic pension and 22% to cost-of-living increases (although this relationship would vary for each plan).

Contributions are made by both the employees and the employers into two separate accounts—the basic and the inflation (cost-of-living) account. The intention of the basic account is to accumulate sufficient assets to fully fund an employee's pension at retirement. When referring to the unfunded liability of the plan, the actuary is referring to the basic account only. The inflation account is not considered in the valuation. Annually an amount sufficient to fund the current year's cost-of-living increase for those on pension is transferred from the inflation account to the basic account. Legislation covering each plan provides for inflation indexing only if there is money available in the special account to do so. If there is a shortfall in these inflation accounts in a given year, only partial inflation benefits would be provided to pensioners.

All plan members receive an annual Member's Benefit Statement from the Superannuation Commission showing their service, total contributions, credits, and pension benefits. This statement includes the comment that cost-of-living adjustments are "subject to the availability of adequate funds in the Inflation Adjustment Account." Thus, although members are informed each year of the conditions for paying cost-of-living increases, they are given no information on the current status of this account or on whether sufficient funds will be available for cost-of-living increases when they retire.

We believe that many plan members currently contributing into the inflation accounts of these four pension plans expect to receive fully indexed benefits in retirement. However, there is no guarantee of this.

Pension boards for the four statutory pension plans were established in 1994. The Superannuation Commissioner is the Chair of each board. Along with the boards' responsibility to make recommendations to the government on such things as changes in benefits, funding policy, and contribution rates, the boards are responsible for reporting to plan members on issues relating to the plan. In the short time the boards have been constituted, they have been monitoring the inflation accounts. No information as yet, however, has been reported to plan members on the status of the inflation accounts.

We recommend that the pension boards consider when and how best to communicate to plan members the status of the inflation accounts.

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 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, using 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, exceeds 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 95% 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

Reports, Entities, and Trust Funds Audited by the Auditor General

In addition to auditing the Summary Financial Statements of the Province and the Consolidated Revenue Fund Financial Statements the Auditor General is the Auditor of:

Government Reports

Debt Management Report

- Summary of Provincial Net Debt
- Key Indicators of Provincial Debt
- Summary of Key Benchmarks

Internal Control Objectives for the Investment System of Provincial Treasury

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 Institute of Technology

British Columbia Liquor Distribution Branch[1]

British Columbia Regional Hospital Districts Financing Authority

British Columbia School Districts Capital Financing Authority

British Columbia Securities Commission

Columbia Power Corporation

Creston Valley Wildlife Management Authority Trust Fund

Duke Point Development Limited

Forest Renewal BC

Health Facilities Association of British Columbia

Provincial Capital Commission

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[1]Branch of Ministry of Attorney General

Royal Roads University

Simon Fraser University

University of British Columbia

University of Northern British Columbia

University of Victoria

W.L.C. Developments Ltd.

Other Entities

Legal Services Society

Provincial Employees' Community Services Fund

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

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 Pension Plan

Province of British Columbia Pooled Investment Portfolios:

- Active Canadian Equity Fund
- Active U.S. Equity Fund
- British Columbia Focus Fund
- Canadian Money Market Fund ST1
- Canadian Money Market Fund ST2
- U.S. Dollar Money Market Fund ST3
- Canadian Corporate Bond Fund
- Construction Mortgage Fund
- Customized U.S. Equity Fund

- Fixed Term Mortgage Fund
- Indexed Canadian Equity Fund
- Indexed Government Bond Fund
- Managed International Equity Fund
- Passive International Equity Fund
- Pension Bond Fund
- Private Placement Fund
- Realpool Investment Fund
- S & P 500 Index Equity Fund
- Short Term Bond Fund
- TSE 100 Index Equity Fund

Public Service Pension Plan

Teachers' Pension Plan

Workers' Compensation Board of British Columbia

Workers' Compensation Board Superannuation Plan

Westel Telecommunications Ltd. Pension Plan

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. Community Financial Services Corporation

B.C. Festival of the Arts Society

B.C. Games Society

B.C. Health Care Risk Management Society

B.C. Pavilion Corporation

BC Transportation Financing Authority

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 Railway Company

British Columbia Rapid Transit Company Ltd.

British Columbia Systems Corporation

British Columbia Trade Development Corporation

British Columbia Transit

Columbia Basin Trust

Discovery Enterprises Inc.

Downtown Revitalization Program Society of British Columbia

First Peoples' Heritage, Language and Cultural Council

Insurance Corporation of British Columbia

Okanagan Valley Tree Fruit Authority

Pacific National Exhibition

Provincial Rental Housing Corporation

Science Council of British Columbia

Victoria Line Ltd.

West Coast Express Limited

120 Health care organizations

29 Regional hospital districts

75 School districts

19 Colleges and advanced education institutes

Trust Fund

Credit Union Deposit Insurance Corporation of British Columbia

appendix d

Excerpts from the 1995/96 Public Accounts

The material that forms Appendix D is from the Public Accounts of British Columbia for the fiscal year ended March 31, 1996. It consists of the Summary Financial Statements of the province and the Auditor General's Report on them.

Contents

appendix e

Auditor General's Report on Statements Collectively Referred to as the 1995/96 "Debt Management Report"

The material that forms Appendix E is the government's annual report card on the Province's debt as at March 31, 1996, and the Auditor General's report on it. The report card which is included as "Section A, Debt Management Report" in a document published by the government in March 1997, titled "Debt Statistics 1995/96" consists of three statements. These are:

- Summary of Provincial Debt.
- Key Indicators of Provincial Debt.
- Summary of Key Benchmarks.

The government, in March 1995, requested that the Auditor General annually provide the Legislative Assembly with an opinion on the accuracy and completeness of its report card presented each year.

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