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OFFICE OF THE

Auditor General of British Columbia

Report on Government Financial Accountability for the 1997/98 Fiscal Year

Part 1

Report on the 1997/98 Public Accounts

Province of British Columbia

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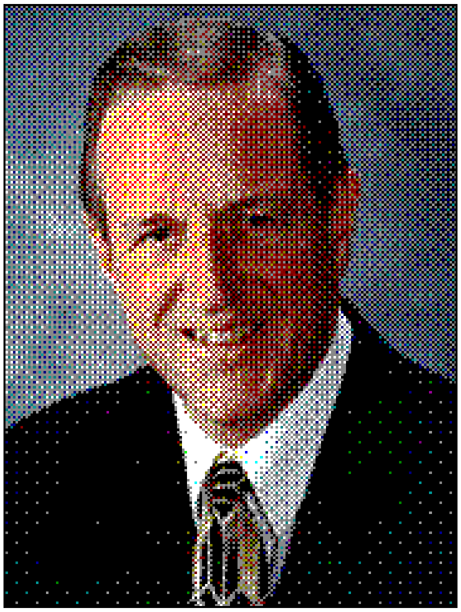
overview

overview



The Public Accounts are the primary annual accountability documents of government. They include the Province's financial statements — statements that show whether the Province's finances are improving or deteriorating, and how well the government performed financially compared with its fiscal plan.

By auditing the Province's financial statements, my Office helps contribute to an effective accountability relationship between the government and the Legislative Assembly. This is a primary responsibility of my Office and so is the focus of much of my staff's work throughout the year. In meeting this responsibility, I also rely on the work of many private sector auditors who audit public bodies not audited by my Office. The financial statements of these public bodies, as well as those I audit, are included in the Public Accounts.

Timeliness

Complete and timely accounting is essential to public trust and this year I am pleased to note the issuance of the Public Accounts on a far more timely basis — October 20, 1998, for the 1997/98 Public Accounts compared to December 18, 1997, for the 1996/97 Public Accounts. This is a significant achievement; however, further improvement is still necessary and I urge the government to strive for even earlier issuance of the Public Accounts. My Office will provide continuing support in this regard, as is demonstrated by the issuance of this report devoted solely to my comments on the Public Accounts of the Province.

Completeness

Although I am pleased with the more timely release of the Public Accounts, I remain concerned about the completeness of government's financial accountability. My Auditor's Report is qualified as to completeness because the government, again this year, excluded from its financial statements all regional hospital districts, public health care organizations, universities, colleges and institutes, and school districts. In this report I have discussed the matter at some length as, suffice to say, without their inclusion I do not believe the financial statements provide a full accounting of government.

I also remain concerned that when preparing, discussing and reporting on its operating plan, the government continues to reference the Consolidated Revenue Fund. The Consolidated Revenue Fund encompasses ministry operations only, and includes only those revenues it receives directly. This presents an incomplete accounting picture, as much of the business of government is conducted through government organizations whose activities are not included in the Consolidated Revenue Fund. However, these organizations' financial activities are included within the Summary Financial Statements, which I believe should be the basis for full accountability of the financial affairs of government.

Full Accrual Accounting

In addition to the improved timeliness of the issuance of the Public Accounts, I am also pleased to note the continuing progress made by the government in capitalizing tangible assets. I believe that the recording of such assets is essential to determining the full cost of government services and establishing better stewardship over assets.

Debt Management Reporting

As of the time of issuance of this report, I note that the Debt Statistics — a report for the year ended March 31, 1998, on the government's management of debt — has not yet been released. I believe this to be a most important public accountability document and urge its timely release in future along with the Public Accounts.

Other Matters

In this report, I make recommendations for improvements to the government's accounting and financial controls, and provide comments that will help readers understand the financial information provided by government. I have also included information about the Province's revenue, expense, deficit and debt. I hope my comments and suggestions help improve the completeness and clarity of government's financial accountability.

I have annually, since 1991, reported separately on the Public Accounts. Over the years my report has evolved to include my comments on many aspects of government's public financial accountability, such as on its reporting of the provincial debt, and on systems and processes that enable the government to account for its financial activities.

This year, to help the Legislative Assembly in its timely review of the Public Accounts, I have issued this report entitled, "Report on Government Financial Accountability for the 1997/98 Fiscal Year, Part I, Report on the Public Accounts". Other parts of my report on 1997/98 public financial accountability will be issued in early 1999.

I wish to acknowledge the full cooperation of the government officials and staff within ministries, Crown corporations and agencies who devoted time and effort to enabling me to complete my audit of the Public Accounts in an efficient manner.

I also 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

November 1998

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 accounting policies stated in them, on a basis consistent with that of the preceding year. 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 or ensure the proper collection of revenue and making of expenditures. He or she may also provide the Legislative Assembly with an assessment as to whether the Financial Statements of the Province have been prepared in accordance with the most appropriate basis of accounting for the purpose of fair presentation and disclosure.

The Auditor General also has the mandate to comment on whether government programs are being administered economically and efficiently, and on whether there has been compliance with laws and regulations. This the Auditor General does periodically, in other public 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, 1998. 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 Province's financial statements are an important component of the financial accountability discipline imposed on the government by the Legislative Assembly. They are the means by which audited financial information about government's stewardship of public funds are reported to all British Columbians. The Financial Administration Act requires that these statements be finalized annually no later than the end of September — six months after the fiscal yearend.

Public Accounts

The Public Accounts are prepared pursuant to the Financial Administration Act. They contain the Province's financial statements and other information that the government is either required by law, 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 Province's financial statements, are determined by Treasury Board. According to the Act, the Public Accounts must be sent to the Minister of Finance and Corporate Relations no later than December 31 following the end of the fiscal year. The Minister must then table them before the House shortly after the first sitting of the Assembly.

In recent years the government has been making the Public Accounts available to the Members of the Legislative Assembly and the public usually in late December, before they were officially tabled in the House. In October 1998, the Public Accounts for the 1997/98 fiscal year were published in two volumes. This date is approximately two months earlier than in the previous year. We commend the government for further improving the timeliness of publishing this important document, and we encourage it to continue publishing its financial statements soon after the end of the fiscal year.

Volume I (Section A), titled *Annual Report*, provides a commentary by government on the numbers reported in the Summary Financial Statements, plus additional information on the financial performance of the government. The audited Summary Financial Statements of the Province, which provide a more complete accounting for government organizations and enterprises, are also in this volume. The unaudited section of the volume provides additional information on the results of the health and education sectors.

Volume II (Sections B and C), 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. 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.

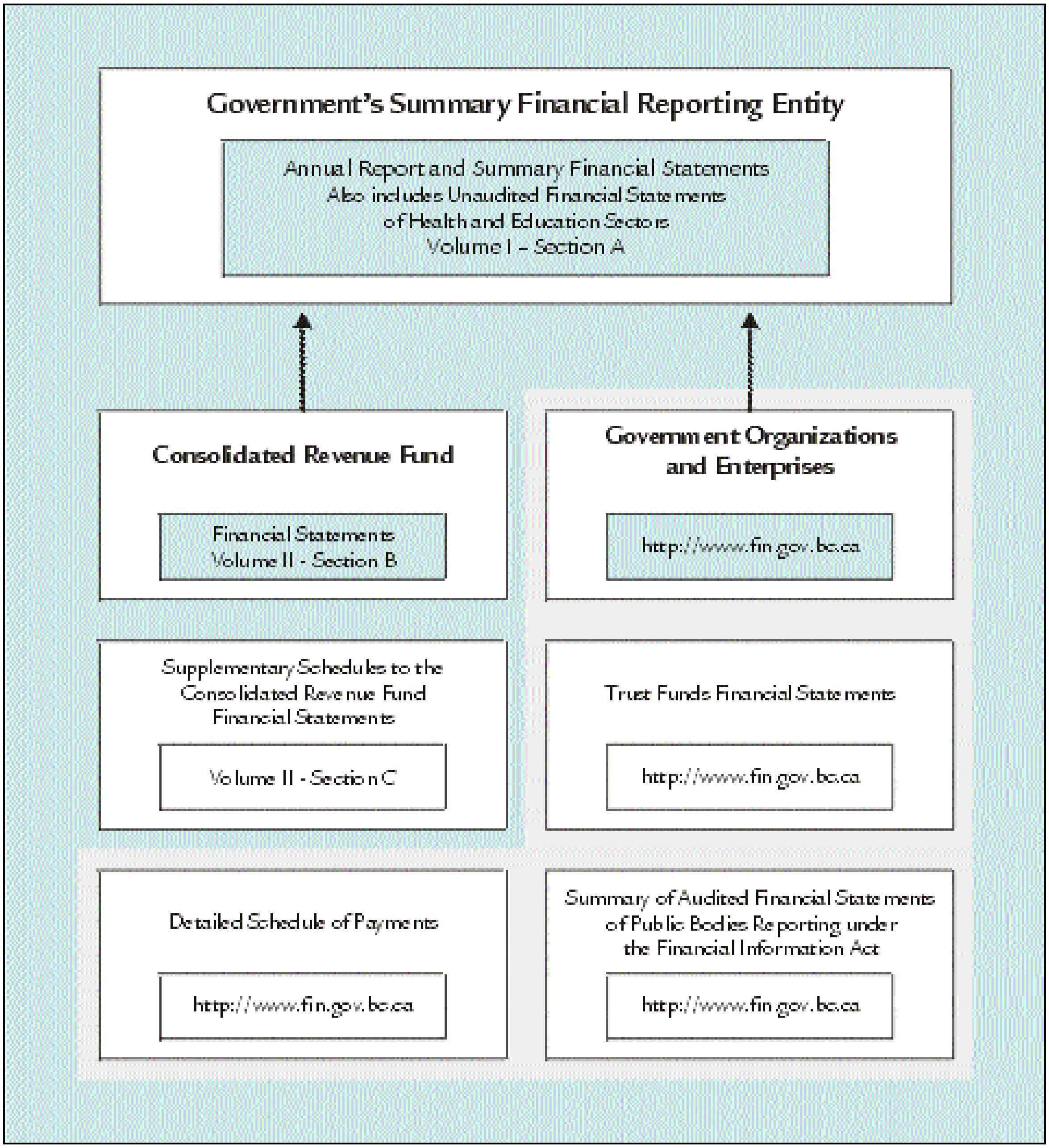
For the past four years, the Public Accounts have been published in three volumes: Volume I, *Annual Report*, including the Summary Financial Statements, Volume II, *Financial Statements and Schedules of the Consolidated Revenue Fund*, and Volume III, *Other Government Financial Statements and Information*. This year the government has published the first two volumes in standard hardcopy form. The detailed schedules of payments, however, along with the information previously included in Volume III, are published on the Ministry of Finance and Corporate Relations' web site at http://www.fin.gov.bc.ca.

Every few years, Treasury Board may set a new limit for payments by the government, and these must be disclosed in the Public Accounts — Detailed Schedules of Payments. The last time this limit was changed, it affected reporting of the Public Accounts for the 1991/92 fiscal year. At that time, the limit for disclosing salaries was raised from $35,000 to $50,000. For the 1997/98 Public Accounts, the reporting limits for employees' salaries has been raised from $50,000 to $75,000, and the limits for grants and contributions and for payments to suppliers of goods and services have been raised from $10,000 to $25,000. Unchanged, however, were the limits for the reporting of payments to the Members of the Legislative Assembly, indemnities and allowances, and salaries and travel expenses of ministers, deputy ministers, associate deputy ministers, and Order-in-Council and other appointees.

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

Exhibit 1.1

Financial Reporting in the 1997/1998 Public Accounts



Source: The Public Accounts

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. Aggregating most, but currently not all, entities owned or controlled by the Province, the statements consolidate the financial position and results of operation of the Province's general and special funds — collectively referred to as the Consolidated Revenue Fund — with the financial position and operating results of the government entities (see pages A51 and A52 of Appendix D of this report for a complete list).

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." Government organizations, in addition to the Consolidated Revenue Fund, include corporations, associations, boards, foundations, societies and similar entities that are separated from the operation of central government mainly for administrative reasons. They also include subsidized corporations that provide goods or services to the public. Government enterprises, on the other hand, are usually separate legal entities that, in the normal course of their operations, earn — or are expected to earn — sufficient revenue from goods or services they provide to the public, to pay for their operations.

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 the 1995/96 fiscal year, the composition of the government reporting entity was significantly expanded so that universities, colleges and institutes, school districts, regional hospital districts, and public health care organizations were included in the Summary Financial Statements of the Province. However, starting in the 1996/97 fiscal year, the government excluded those organizations from reporting in the Summary Financial Statements. The effect of the exclusion is explained in the qualification paragraph of the Auditor General's Report on the Summary Financial Statements of the Province.

Capitalization of tangible capital assets is continuing to proceed on a phased-in basis. Virtually all purchased or otherwise acquired-for-value, major tangible capital assets of the Province have been capitalized with the exception of highways and bridges. Capitalized assets of the Consolidated Revenue Fund (CRF), starting in the 1997/98 fiscal year, included parkland, which accounts for a major part of land acquired by the CRF. The government expects to have substantially completed recording its capital assets by the end of the 2001/02 fiscal year.

"Net liabilities," the difference between the Province's liabilities and its financial assets, is an important indicator of the Province's financial conditions. Because the Summary Financial Statements no longer differentiate between "financial" and "non-financial" assets, they do not embody this important indicator. Note 30 of the statements provides a reconciliation that clearly shows the Province's net liabilities at the end of the fiscal year.

Consolidated Revenue Fund Financial Statements

The Consolidated Revenue Fund is established by the Financial Administration Act. Its financial statements account for the financial activities of central government, which includes ministries, special offices and other appropriations.

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 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 operating fund statements of the government on which the Auditor General provides an auditor's report.

These fund statements could by used mistakenly for reviewing the Province's overall financial position and results of operations. To prevent any misunderstanding, the Auditor General's report for the year ended March 31, 1998, contains these two additional opening paragraphs:

These fund statements are prepared to compare the actual operating results of the Consolidated Revenue Fund with the estimates of revenue and expense as presented by the annual Estimates and Budget of the government for the 1997/98 fiscal year. As with the annual Estimates, these fund statements do not include many of the significant financial activities of the Province which occur outside the Consolidated Revenue Fund. These additional activities occur in organizations and enterprises for which the government is responsible and which are to be included, along with the Consolidated Revenue Fund, in the Province's Summary Financial Statements.

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.

Exhibit 1.2

Comparative Summary of Financial Results and Balances for the Year Ended March 31, 1998[1]

($ Millions)

	Government Reporting Entity	Consolidated Revenue Fund Reporting Entity
Assets, end of year	25,120	21,710
Liabilities, end of year:		
Public debt	29,096	28,191
Other	6,253	5,992
	35,349	34,183
Net deficiency, end of year	10,229	12,473
Net expense for the year	(432)	(152)
Guaranteed debt, end of year	862	1,622

[1] Not adjusted for the effects of reservations in the Auditor General's reports (pages 21 to 23)

Source: The Public Accounts

To clarify the significant differences in financial results between the government's summary financial reporting entity and the Consolidated Revenue Fund, relative financial results and balances for the fiscal year ended March 31, 1998, are shown in Exhibit 1.2.

Special Fund

Natural Resource Community Fund

Effective April 1, 1992, the Natural Resource Community Fund was established under the Natural Resource Community 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.

Since its creation in 1992/93, with a transfer of $15 million from the British Columbia Endowment Fund, the fund has earned $54 million in revenues from natural resources and $7 million in investment income. During that time, it has transferred $49 million back to the General Fund and paid out $1,750,329 in assistance to eligible communities.

In 1997/98, the fund received $9 million from natural resource revenues and earned $1 million in income from investments. No amounts were paid out in assistance and $10 million was transferred back to the General Fund. The balance of the Natural Resource Community Fund as at March 31, 1998, stood at its $25 million limit, as it has for the past four years.

The Auditor General's Reports Resulting from Financial Statement Audits

Auditor's Reports on Financial Statements

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, 1998, and on the financial statements of 78 entities whose fiscal yearends occurred during the 1997/98 fiscal year.

The Auditor General's reports on the Province's financial statements 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 those statements in each entity's annual report. The Auditor General's reports on the financial statements of trust funds held and administered by the government can be found on the Ministry of Finance and Corporate Relations' web site at http://www.fin.gov.bc.ca.

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 that defines an audit, and describes the nature and extent of the auditor's work and the degree of assurance that the auditor's report provides. This paragraph states that the auditor conducts the audit in accordance with generally accepted auditing standards (which require the auditor to obtain reasonable assurance that the financial statements are free of material misstatement). It also includes the Auditor General's confirmation that all information and explanations required for the audit have been received. The final paragraph contains the auditor's conclusion based on the audit conducted — the opinion. Where there is a cause for a reservation of opinion, the recommended report requires the auditor to give the reasons for such reservation, draw attention to the effects of the reservation on the financial statements, and place such explanation before the opinion paragraph.

Summary Financial Statements

The Auditor General's report on the Summary Financial Statements for the fiscal year ended March 31, 1998, was issued with one reservation, or qualification, as to the fair presentation of those statements. The following two paragraphs explain the reasons for, and the effect of, the reservation on the financial statements of the Province.

In preparing these statements the government did not include the regional hospital districts, public health care organizations, universities, colleges and institutes, and school districts. These organizations meet all requirements of the government's general accounting policy on the reporting entity which provides for the inclusion in the Summary Financial Statements of organizations that are accountable for the administration of their financial affairs and resources either to a minister of the government or directly to the Legislature, and that are owned or controlled by the government. Their exclusion is based on a decision by the government, stated in note 1(a) of these statements, that when an entity is part of a Province-wide program, is locally-based, and has initial accountability to a local board, it is excluded from consideration as being accountable to a minister of the government or directly to the Legislature for the purposes of the Summary Financial Statements. This decision selectively excludes the above-mentioned organizations which are, nevertheless, accountable to the government. Therefore the regional hospital districts, public health care organizations, universities, colleges and institutes, and school districts should be included in the summary reporting entity.

Had the regional hospital districts, public health care organizations, universities, colleges and institutes, and school districts been included in these statements, the total assets as at March 31, 1998 would increase by $4,307 million ($3,914 million for 1997), total liabilities as at March 31, 1998 would increase by $1,420 million ($1,338 million for 1997), and the net deficiency as at March 31, 1998 would decrease by $2,887 million ($2,576 million for 1997). Similarly, there would be an increase in revenue for the year ended March 31, 1998 of $1,331 million ($1,112 million for 1997), and an increase in expense for the year then ended of $1,181 million ($1,021 million for 1997), resulting in a decrease in annual deficit for the year ended March 31, 1998 of $150 million ($91 million for 1997). These changes include the effect of eliminating on consolidation amounts totaling

$5,018 million ($4,964 million for 1997) described in the balance sheet as "Loans for the purchase of assets, recoverable through future appropriations."

The Auditor General believes that the Summary Financial Statements — as presented by the government — together with information contained in his reservation paragraph, would provide the reader of the statements with adequate information to assess the financial position and results of operation of the Province.

Further comments on the above-mentioned matter can be found on page 27 of this report, in the section titled "Changes in the Composition of the Summary Financial Reporting Entity."

Consolidated Revenue Fund Financial Statements

The preamble to the Auditor General's Report on the Consolidated Revenue Fund Financial Statements explains the specific purpose of those statements and refers to other significant financial activities of the Province that occur outside the Consolidated Revenue Fund.

This year, the report contains a reservation regarding the government accounting treatment of loans recoverable through future appropriations, and of certain debts of government organizations that are guaranteed by the Province but expected to be repaid by future government funding. The two reservation paragraphs explain why the Auditor General has expressed a qualified opinion on these financial statements and quantifies the effect of the reservation on the Consolidated Revenue Fund Financial Statements:

The government has recorded as assets of the Consolidated Revenue Fund the amounts described in the balance sheet as "Loans for the purchase of assets, recoverable from future appropriations." These loans do not have the necessary characteristics of assets, and should be accounted for as an expenditure of the Consolidated Revenue Fund of the period in which each loan was incurred. Similarly, the debt of government organizations guaranteed by the Province, the repayment of which depends on future appropriations, 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, 1998 would increase by $6,309 million to $18,782 million (for 1997 by

$6,198 million to $18,519 million), liabilities as at March 31, 1998 would increase by $555 million to $32,038 million (for 1997 by $702 million to $33,695 million), and net operating expenses for the year ended March 31, 1998 would increase by $111 million to $263 million (for 1997 by $306 million to $643 million).

We have commented in greater detail about loans and guaranteed debts repayable through future government funding on page 44 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 entitled "Audit of the Financial Statements of the Province." Those relating to our audit of government entities are contained in a subsequent report section entitled, "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 Composition of the Summary Financial Reporting Entity

Government accounting policies define what should be included in the Summary Financial Statements of the Province. According to these policies, 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 A51 and A52.

Changes to the composition of the government reporting entity during the 1997/98 fiscal year are summarized below:

- BCIF Management Ltd., British Columbia Arts Council, Fisheries Renewal BC, Industry Training and Apprenticeship Commission, Tourism BC, and 552513 British Columbia Ltd. were created and added to the reporting entity.
- Legal Services Society was added to the reporting entity because of changes to its governing statute.

In the 1995/96 fiscal year, the composition of the government reporting entity was expanded to include health care organizations, regional hospital districts, universities, colleges and institutes, and school districts. However, starting in the 1996/97 fiscal year, the government decided to exclude these organizations from the summary reporting entity. In the 1997/98 Summary Financial Statements, the government therefore included the following caveat in its accounting policies:

Accountability to a minister or directly to the Legislature, for purposes of the reporting entity, does not include those entities that are part of a province-wide program yet are locally based and have an initial accountability to a local board.

Excluding these organizations has had the following effects on the reporting of government operations for the fiscal year 1997/98:

- The tangible capital assets have decreased by approximately $8.0 billion. This amount represents physical assets acquired by advanced education institutions, school districts and health care organizations that otherwise would not have been accounted for in the Summary Financial Statements of the Province. Including capital assets and their amortization will provide better information about the total costs of government programs and enhance the stewardship over tangible capital assets invested by the government.
- The amounts receivable has been decreased by $5.0 billion. This represents the outstanding balance of loans made over the years by various financing authorities to advanced education institutions, school districts, and health care organizations for the purchase of capital assets.
- Had the above organizations been included in the government reporting entity, their assets and liabilities would have been combined with other assets and liabilities of the Province, and any of their debt to the Province would have been eliminated against the corresponding loans receivable held by the Consolidated Revenue Fund. However, since they are not included, the government should write off these loans as an expense in the periods they were made. These loans, made under the Fiscal Agency Loan Program, have no value to the Province as assets, because their repayments depend on government's future payments to the borrowing organizations.
- "Other assets" and "other liabilities" have each decreased by approximately $1.3 billion. These amounts reflect the other assets and liabilities of advanced education institutions, school districts and health care organizations.
- The net deficiency (accumulated deficit) of the Province increased by approximately $2.9 billion, from $7.3 billion to $10.2 billion.
- Both "revenue" and "expense" decreased by approximately $1.4 billion and $1.2 billion, respectively. These amounts represent the revenue, such as tuition fees and patient charges, that are not funded through the Consolidated Revenue Fund but are necessary for the organizations to deliver their programs.
- The net operating expense increased by approximately $0.2 billion.

Exhibit 2.1 summarizes the above differences and shows the significance of the information currently being excluded from the Province's financial statements.

Exhibit 2.1

The Overall Effect of the Change in the Reporting Entity

Effect of expanding the government reporting entity to include health care organizations, regional hospital districts, universities, colleges and institutes, and school districts ($ Billions)

Condensed Summary Financial Statements
Province of British Columbia
March 31, 1998

Balance Sheet

	Existing[1]	Pro Forma[2]
Assets		
Other assets	12.5	13.8
Equity in government enterprises	3.2	3.2
Loans for purchase of assets, recoverable from future appropriations	5.0	-
Tangible capital assets	4.4	12.4
	25.1	29.4
Liabilities		
Other liabilities	6.2	7.5
Debt	29.1	29.2
	35.3	36.7
Net equity (deficiency)	(10.2)	(7.3)
	25.1	29.4

Statement of Operations

	Existing[1]	Pro Forma[2]
Revenue	23.5	24.9
Expense	24.0	25.2
Net operating expense for the year	0.5	0.3

[1] Existing summary reporting entity comprising government organizations (excluding health care organizations, regional hospital districts, universities, colleges and institutes, and school districts) and government enterprises.

[2] The summary reporting entity as in (1) above, and including health care organizations, regional hospital districts, universities, colleges and institutes, and school districts.

Source: The Public Accounts and financial statements of excluded organizations

Changes in the Presentation of the Financial Statements of the Province

New Balance Sheet Format

Up to and including the 1996/97 fiscal year, the focus of the Province's statement of financial position was on disclosing the Province's "net liabilities." In arriving at this important indicator of financial position for the past four years, the financial statements of the Province distinguished between "financial" and "non-financial" assets. Non-financial assets included loans repayable from future appropriations. By classifying these loans as non-financial assets, the government made it clear they were not assets on hand at the end of an accounting period that could discharge existing liabilities of the Province or finance future government operations.

In the 1997/98 fiscal year, the government changed its financial statement presentation, replacing the statement of financial position with a typical "balance sheet" that shows assets, liabilities, and net equity or net deficiency. This change in presentation reflects the government's commitment to full accrual accounting that requires capitalization of tangible capital assets. By doing so, the government is moving away from a net liabilities concept of financial reporting, to allow recording of the full costs of its programs (including the annual charges to programs of costs associated with the use of capital assets). However, in order not to lose sight of the net liabilities, that indicator is separately disclosed in a note to the financial statements.

The effects of changes made in the presentation of the Province's financial statements can be seen in Exhibit 2.2, which compares the new balance sheet of the Summary Financial Statements, as reported in the 1997/98 Public Accounts, to the statement of financial position, as it would have been reported if the 1996/97 style of presentation had been followed.

Exhibit 2.2

Presentation of the Financial Position of the Province

These two statements, extracted from the Summary Financial Statements of the Province, compare the way government used to report loans made through its Fiscal Agency Loan Program with how it reports them now ($ Millions)

Balance Sheet[1]

(as reported in the 1997/98 Public Accounts from Summary Financial Statements)

	March 31, 1998	March 31, 1997[2]
Assets		
Other assets	8,043	7,630
Fiscal Agency Loan Program	12,652	12,525
Tangible capital assets	4,425	4,356
	25,120	24,511
Liabilities and net deficiency		
Other liabilities	6,590	6,475
Public debt, used for government operating purposes	16,107	15,291
Public debt, used for Fiscal Agency Loan Program	12,652	12,525
	35,349	34,291
Net deficiency	**10,229**	**9,780**
	25,120	24,511

Statement of Financial Position[1]

(As would have been reported in the 1997/98 Public Accounts if there was no change in financial statement presentation)

	March 31, 1998[2]	March 31, 1997
Liabilities		
Other liabilities	6,590	6,475
Public debt, used for government operating purposes	16,107	15,291
Public debt, used for loans		
Recoverable through future appropriations	5,018	4,964
Recoverable from agencies	7,634	7,561
	35,349	34,291
Financial assets		
Other financial assets	8,043	7,630
Loans for the purchase of assets, recoverable from agencies	7,634	7,561
	15,677	15,191
Net liabilities	19,672	19,100
Non-financial assets		
Loans for the purchase of assets recoverable through future appropriations	5,018	4,964
Tangible capital assets	4,425	4,356
Net deficiency	**10,229**	**9,780**

(1) Condensed for comparison purposes.
(2) Re-arranged for comparison purposes.

Source: Office of the Auditor General

Changes in legislation that come into effect in 1998/99 allow the Province to forgive loans made to certain government-dependent organizations to purchase capital assets, and to assert a claim to use of those assets in delivering programs for which the Province is responsible (e.g., education, health care and transportation). Any amount representing the value of yet unused assets will be treated as “prepaid capital advances.” In the future, these advances will be recorded on the balance sheet when the related assets are acquired, and will be amortized over the life of those assets. In the Summary Financial Statements, if health and educational organizations are included in the reporting entity as we recommend, the “prepaid capital advances” would be eliminated on consolidation and only the tangible capital assets themselves would be reported. A more detailed discussion of prepaid capital advances is contained on page 44 of this report.

Extended Debt Note Disclosure

This year’s Consolidated Revenue Fund Financial Statements and Summary Financial Statements have provided additional disclosure on how the Province manages risk in its existing debt portfolio. A new explanation entitled “Risk Management and Derivative Financial Instruments” was added to note 21, “Public Debt, Used for Government Operating Purposes,” on how the Province manages the risks inherent in its borrowing programs.

Any contract that gives rise to a financial asset (in the books of one party to the contract) and a financial liability or equity (in the books of the other party) is referred to as a “financial instrument.” A simple example of a financial instrument is the debt of the Province. A “derivative financial instrument” is a term widely used for secondary contracts such as options, futures, forwards, interest rate and currency swaps of the underlying debt principal or interest payments.

Since the Province borrows in both domestic and foreign markets, it is exposed to fluctuations in currency values. Any upward changes in currency value relative to the Canadian dollar can cost the Province a higher amount in Canadian dollars when it is settling debt or paying interest on money borrowed in a foreign currency. Now, in note 21, the government explains how it uses derivative instruments to manage risks associated with its financial instruments.

Dealing with Measurement Uncertainty

Some level of "uncertainty" exists whenever amounts are estimated. Too much uncertainty, however, could have a significant effect on the government's financial statements. In 1995, the Canadian Institute of Chartered Accountants recommended that organizations disclose in their financial statements any amounts that are subject to significant "measurement uncertainty."

In the 1997/98 fiscal year, the Province, for the first time, included a note to both the Summary and the Consolidated Revenue Fund Financial Statements on measurement uncertainty. The note cautioned about the uncertainty related to determining personal income tax revenues, Canada Health and Social Transfer payments, the unfunded pension liability, and provisions for bad debts relating to Skeena Cellulose Inc.

Personal income tax revenue ($5.3 billion in 1997/98) makes up a substantial portion of the Province's total revenue of $21 billion. Because of delays in collecting taxes, the accurate revenue amount for the fiscal year is not available when financial statements are prepared. Knowledgeable staff at the Ministry of Finance and Corporate Relations must estimate much of the amount receivable from taxes. They know that a relatively small change in any of the deciding factors can have a material effect on total revenue. For example, a significant factor in estimating the personal income tax revenues yet to be received for a fiscal year is the expected personal income growth for both calendar years included in a fiscal year. This figure must be estimated using incomplete information. As a result, a range of reasonably possible assumptions are considered. A change of 1% in this factor (for example, from a growth rate of 3% to 4%) would result in a change in the estimates of approximately $50 million in personal income tax revenues.

Canada Health and Social Transfer payments ($1.6 billion in 1997/98) are also subject to measurement uncertainty (because they are directly related to the estimated amount of personal income tax revenue). So, too, is the pension liability. The estimation of this amount ($2.8 billion in 1997/98) is based on actuarial valuations. Again, given the magnitude of the amounts involved and the dependence of the actuarial valuations on assumptions about long-term future events, a relatively small variation in assumptions could have a very large impact on the Province's financial statements.

In the case of the Province's efforts to protect jobs and the local community during the financial difficulties of Skeena Cellulose Inc. (through direct cash payments and debt guarantees), the measurement uncertainty lies in the unclear future profitability of the corporation — which itself depends on future world pulp and paper prices. Currently these prices are volatile, and therefore accurately measuring the risk of losing all or some of the monies spent, or accurately determining the likelihood that the Province will have to pay out any of the corporation's guaranteed debt at the financial statement date, is difficult. Note 2 to the Summary and Consolidated Revenue Fund Financial Statements discloses this uncertainty clearly.

Despite uncertainties, government management must try to make its best estimates in determining an amount that has a significant effect on the financial statements of the Province. These estimates are further subject to audit by the Auditor General to confirm that they are, in the circumstances, reasonable amounts and calculated on a consistent basis.

Government Accounting Policies

Expense Basis of Accounting

For the past few years, the basis of presentation for the Consolidated Revenue Fund (CRF) Financial Statements has changed each year.

Before the 1995/96 fiscal year, the Province's financial statements were presented on the "expenditure" basis of accounting. This meant that the full cost of tangible capital assets was charged to the expenditure of operations of the year in which the assets were acquired, regardless of their useful lives. As a result:

- capital assets were not recorded at their cost less depreciation in the balance sheet of the Province;
- the costs associated with the government programs or services for which capital assets were acquired did not reflect the use of those assets evenly over the life of assets; and
- as assets were expensed in full, keeping records for safeguarding and maintaining them were left outside the coverage of the government's corporate accounting function.

In 1995/96, the Province made the decision to capitalize tangible capital assets. As a result, its financial statements, both the Summary and the Consolidated Revenue Fund, were presented on the "expense" basis of accounting. The expense basis requires that the full costs of capital assets be accumulated as acquired, and presented as assets in the balance sheet. It also requires that the annual amortization of tangible capital assets be considered as an operating expense and shown in the Statement of Operations.

Recording all tangible capital assets that the government has acquired for value in the past is a significant task that may take a few years to complete. Because, in the transitional period, the financial statements of the government will include a mix of "capitalized" and "not capitalized" assets, they do not truly reflect a complete expense basis of accounting. Therefore, to overcome this unavoidable shortcoming, the government will provide a reconciliation to the expenditure basis of accounting for the next few years.

In 1996/97, the Summary Financial Statements of the Province continued to be presented on the expense basis. However, the Consolidated Revenue Fund Financial Statements for that year were presented on the expenditure basis, although expense-based figures were also provided to allow comparison. The reason given for this dual presentation was that the main purpose of the Consolidated Revenue Fund Financial Statements is to provide a comparison with the Budget as shown in the Estimates. Therefore, while the government wished to continue reporting its financial position and results of operations on the expense basis of accounting, it also had to provide expenditure amounts because the 1996/97 fiscal year Estimates were prepared on the expenditure basis. We commented that presentation on two different bases of accounting was potentially confusing for the user, particularly as the unaudited expense-based amounts were used in producing other government publications, such as the "British Columbia and Economic Review." We recommended that the Province use only the expense basis of accounting in its financial statements and other financial information.

The Auditor General Act requires that the Auditor General, in his or her opinion, attest to the consistency in the presentation of financial statements with the basis used in the prior year. Every time the government changed its basis of accounting in the past few years, it restated its prior year's financial statements, therefore presenting both its current and prior year's financial statements on the same basis. Also, in a note, it described the effects of any changes in accounting policies. In our opinion, this is an acceptable accounting practice, providing adequate disclosure in financial statements to ensure consistency from year to year.

We are pleased to note that the government has introduced the concept of capitalization and amortization of tangible capital assets in its Estimates for the year ended March 1998. Accordingly, starting in the 1997/98 fiscal year, both financial statements of the Province are presented only on the expense basis of accounting.

Tangible Capital Assets

In its 1995/96 financial statements, the government began the process of capitalizing its tangible capital assets. Initially, the process of identifying and valuing the numerous tangible capital assets used in the government's central activities was expected to take three years. Thus, in the first year, only the following types of tangible capital assets (asset classes) were recorded on the balance sheet:

- computer systems (hardware and software) with a combined cost of $100,000 or more;
- land, for which historical cost, or a reasonable estimate of it, 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 Province must verify ownership and historical cost, and determine an appropriate method and term of depreciation before any particular asset class can be recorded in the financial statements. The determination of historical cost has proven to be more difficult than was originally thought, particularly for land. The result is that the government was only able to record a portion of all land acquired by it over decades.

In the 1996/97 fiscal year, the government removed from the balance sheet the $710 million cost of land which it recorded in 1995/96. It also postponed additional capitalization planned for 1996/97, but lowered the thresholds set in 1995/96 for computer systems and buildings to $10,000 from $100,000 and $50,000, respectively. This resulted in an additional $14 million being recorded for computers and buildings.

In the 1997/98 fiscal year, the government proposed a new schedule for capitalizing the Province's remaining tangible capital assets, and confirmed it by exchanging a memorandum to that effect with the Auditor General. Exhibit 2.3 shows the assets that have already been capitalized, and the proposed capitalization schedule for the remaining tangible capital assets.

Exhibit 2.3

Tangible Capital Assets Capitalization Schedule

The government plans to capitalize all tangible assets acquired by the Consolidated Revenue Fund by the year 2002

Fiscal Year	Asset Class
1997/98 or earlier	Buildings
	Vehicles
	Mainframe and Minicomputers
	Microcomputers
	Parkland*
	Ferries and Landings
1998/99	None
1999/00	Heavy Equipment
	Operating Equipment
	Tenant Improvements
	Highways
2000/01	Office Furniture and Equipment
	Dams and Water Management Systems
	Forestry Roads
2001/02	Land Improvements
	Silviculture

*Land, other than parkland, is capitalized along with its associated asset. (e.g. buildings, highways)

Source: Memorandum of Understanding between Minister of Finance and Corporate Relations and the Auditor General

Specific Issues

Land

In our report on the 1995/96 Public Accounts, we commented on the problems encountered by the government in determining the ownership and cost of its land. Information from the different databases maintained by the Land Titles Office and the British Columbia Assessment Authority proved difficult to reconcile. The above-mentioned memorandum proposes a two-part solution to this problem.

First, instead of attempting to compile, in one year, information about all land held by the Province, the government now plans to capitalize land cost with its associated asset class. In the 1997/98 fiscal year, for example, the land cost associated with ferry landings was capitalized. Also capitalized was land cost associated with parks. Cost of land on which buildings are situated has not yet been capitalized. In 1999/2000, the cost of land acquired for building roads and bridges will be recorded as part of the cost of highways and the related infrastructure.

We recommend that the government expedite recording in its financial statements the cost of land used for provincial buildings.

As mentioned above, information on land owned by the Province exists in the Land Titles Office and the British Columbia Assessment Authority. However, because the databases in these agencies were not designed specifically to keep track of land acquired and owned by the Province, complete and accurate cost information needed for valuation purposes is often not readily available. In its memorandum on capitalization issues, the government has committed itself to developing a dedicated land database, to be used by ministries in the valuation of land as it is capitalized. This will ensure that sufficient accurate information about land owned by the Province is maintained centrally. We recognize that constructing such a database will require spending time and resources, but it is a necessary task.

We recommend that, on a timely basis, the government develop a central database of relevant information on all land owned by the Province.

In auditing the cost of land acquired for value by the Province, we noted that certain relevant costs (for example, legal, registration, appraisal, design, survey, and other overhead costs) are sometimes not accounted for as part of the cost of acquired land. Generally accepted accounting principles require that the cost of a tangible capital asset include the purchase price as well as other acquisition costs. We believe the inconsistency occurs because the government accounting policies on capitalizing cost of land do not address this issue clearly.

We recommend that the government provide ministries with clear and detailed guidance on accounting for the capitalization of land.

Highways

There are a number of complex issues related to the capitalization of roads and bridges. For example, should all highways be recorded in one asset class? What is the estimated useful life of each type of road or bridge? What is the best method to amortize each type of highway? How should the cost of reconditioning a road or reinforcing a bridge be dealt with? Although this class of assets is not scheduled to be included in the Province's financial statements until 1999/2000, we encourage the government to address these complex issues early so that the necessary information can be identified and obtained in time to meet the proposed implementation schedule.

Computers

In the 1997/98 fiscal year, the government recorded all microcomputers and peripheral devices, regardless of cost, as tangible capital assets. In that year alone, the government ministries spent about $64 million on new mainframe, mini- and micro-computers, and software.

In auditing the cost of computers, we noted inconsistencies between ministries in their treatment of certain ancillary costs. For example, some ministries expense software development costs, such as payroll and administration expenses, while others capitalize these costs and expense them over the life of the developed system.

Also in the 1997/98 fiscal year, the government reassessed the expected useful life of its mainframe and minicomputer systems, and reduced it from 10 years to five years. In 1997/98, their estimated useful life was re-evaluated and determined to be only five years. We found that this change was not applied in all cases consistently by all ministries, despite the guidance provided to them by the Office of the Comptroller General. We believe further training may be required to emphasize the application of capitalization guidelines periodically issued by the Comptroller General.

We recommend that the government provide ministries with adequate training to enable them to consistently apply guidelines on accounting for tangible capital assets.

Vehicle Sale and Leaseback

On March 31, 1998, the Province sold most of its vehicle fleet to PHH Vehicle Management Services Inc. for $38 million, and leased the vehicles back for a minimum term of one year. The book value of these vehicles at the time of the sale was $9 million. As the transaction occurred on the last day of the 1997/98 fiscal year, no portion of the $29 million gain was recognized in the fiscal year ending March 31, 1998.

For the purpose of financial statements, it is important to decide whether a lease is a capital or an operating lease. In accounting for a capital lease, the leased asset and the resulting obligation are recorded on the balance sheet as an asset and a liability. For an operating lease, no such asset or liability is recorded. The lessee (in this case the Province) only records, as expense, the annual cost of leasing the capital items.

The government, however, decided to record as a capital lease only the portion of the lease agreement that related to vehicles built before 1992. In making this decision it accepted the advice of a prominent consulting firm that interpreted the guidance provided by the Canadian Institute of Chartered Accountants (CICA).

The CICA's guidance is intended to help organizations determine the nature of a lease for accounting purposes. It is not intended to override the main test of who, in fact, carries the risks and benefits from the rewards. The CICA requires that a lease be recorded as a capital lease when the risks and benefits of ownership of the leased asset have been transferred to the lessee. In our opinion, the risks and benefits of ownership of all the leased vehicles remain with the Province. We believe this to be the case because, according to the PHH agreement, while the government maintains the leased vehicle fleet during the term of the lease, any subsequent gain or loss when the vehicles are sold by PHH will revert to the Province.

We recommend that, in keeping with the substance of the agreement with PHH Vehicle Management Services Inc., the sales transaction be accounted for as a capital lease, and be recorded as an asset and a liability in the Province's financial statements.

How Is the Cost of Parkland Determined?

In the 1997/98 fiscal year, the Province began capitalizing the cost of land acquired for parks. The Province's accounting policies state that tangible capital asset costs include all costs directly attributable to the acquisition, construction, development or installation of those assets. For some capital assets, the process of determining which costs are directly attributable to their acquisition is a relatively simple process. For example, there is normally little dispute over the cost of acquiring office furniture. However, for other assets, it may be difficult to determine which costs were directly associated with the asset purchase, and which costs may have been incurred had the purchase not occurred.

In many instances, determining the cost of a provincial park is as simple as determining the cost of any other asset. However, when a large provincial park is created, a series of transactions may be necessary before land becomes available for use. For example, under licence, large tracts of Crown land may be in use by one or more commercial users. While the Province may not be legally required to pay compensation in these situations, it may nevertheless choose to do so (e.g., by providing other land with similar resources or paying compensation). This compensation would normally be accounted for as the cost of creating the park. In other situations, the Province may engage in a series of transactions for the purpose of relocating the current user. These transactions may include the payment of additional amounts to the current user in order to encourage development of another part of the Province. Such payments could, but not necessarily, be directly related to the creation of the provincial park.

We examined the costs of several parks acquired in recent years, and concluded that park-acquisition costs are being determined inconsistently because there is no clear guidance on which costs are to be capitalized. This is particularly the case where existing users of the land are compensated with conditions for their relocation. In some instances, we believe, knowledge of the government's intentions at the time of the transaction may be the only factor that could be useful in determining whether or not the cost is directly associated with the park.

We recommend that the Province develop guidelines to help government negotiators and the Comptroller General determine which costs incurred when creating a park should be capitalized and which should be charged to normal operations.

Gross Basis of Accounting

A fundamental principle of financial statement presentation is the use of the gross basis of accounting. To properly reflect the operations of the government, the financial statements should show the total (or gross) amount of revenues received and expenses made. Although netting expenses against related revenues has no effect on the net surplus or deficit recorded by the government, netting transactions does not allow the full picture of the government's operations to be presented.

The note describing significant accounting policies of the government for the preparation of the Summary Financial Statements specifies that those statements are presented on the gross basis of accounting. However, the Consolidated Revenue Fund Financial Statements disclose no such requirement. In recent years, we have seen a growing trend to net some expenses against some revenues in these statements. This creates the appearance that expenses have been reduced and revenue did not occur.

Last year in our report on the 1996/97 Public Accounts, we commented on one such instance of netting expenses against revenues — the treatment of government assistance to Canadian Airlines International. In 1997/98, we noticed three additional instances: the netting of the bad-debts expense against the related revenue stream, and the netting of certain expenses against liquor licensing revenue and investment fund management fees.

Provision for Bad Debts — Sometimes revenues that have been earned cannot be collected. Bad debts are normally considered part of the cost of doing business. The appropriate accounting in these cases is to record separately all revenues earned and all amounts that are not expected to be collected (as a provision for bad debts). This is done in the financial statements of most organizations, including the Summary Financial Statements of the Province. However, in 1997/98, the government changed its accounting policy for the Consolidated Revenue Fund Financial Statements and started to set off the provision for the bad-debts expense against the related revenue stream. This had the effect of reducing the revenues and expenses of the Consolidated Revenue Fund by $33 million from what should have been reported. Meanwhile, the provision for bad debts arising from *loans* that cannot be repaid continues to be shown as an operating expense.

Costs Incurred by the Liquor Licensing Branch (LLB) — Another change in 1997/98 was the netting of the operating cost of the LLB against liquor licensing fee revenue. In prior years, the sale of licences enabling dining establishments to serve alcoholic beverages was recorded separately as a revenue of the Province. This year, the decision was made to treat the revenue as a recovery of the expenses incurred in operating the branch.

According to the government's accounting policies, recoveries may be recorded as a credit to expense if:

1. they can be specifically identified with the expense transactions and payment has actually been made from an appropriation;
2. provision has been approved through the Estimates; and
3. the expenses to which they related were incurred in the same fiscal year.

In this case, provision for the recovery had been approved through the Estimates and only the amount actually expensed was treated as a recovery. The fee-related income that exceeds the expenses of running the branch continues to be treated as revenue. However, there is no direct relationship between the administrative expenses incurred in running the branch and the fees collected. The branch performs other functions than merely selling liquor licences. Consequently, we believe that the operating costs of the LLB should not have been set off against licensing revenue. This change in accounting treatment reduced revenues and expenses of the Consolidated Revenue Fund by $5.5 million from what should have been reported.

Management Fees Revenue — In previous fiscal years, management fees for the Province's investment funds were considered to be revenue of the Investments Branch of the Provincial Treasury. In 1997/98, the branch was separated from Provincial Treasury and became the Office of the Chief Investment Officer. The status of the branch also changed from that of a special account, in which revenues and expenses were recorded on a gross basis, to that of a $1,000 vote in which expenses net of recoveries were recorded. This change resulted in revenues and expenses of the Consolidated Revenue Fund being shown as $3.7 million less than they should have been.

Canadian Airlines International — As we reported last year, the Province agreed to provide funding of $11.1 million to Canadian Airlines International for each of four years, beginning in 1996/97. The Province has chosen to record this amount as a reduction in fuel tax revenue rather than as a direct grant. Because the amount is set, and is a concession that has been made only to one airline, we believe it should be more appropriately recorded as an expense.

The total effect of these changes in accounting treatment is to reduce reported revenues and expenses in the Consolidated Revenue Fund by $53.3 million. Although there is no effect on the net deficiency reported by the Fund for the current year, there is a significant bias when only expense numbers are referred to or compared with prior years' amounts.

We recommend that the government use the gross basis of accounting for the Consolidated Revenue Fund Financial Statements.

Loans and Guaranteed Debts Repayable Through Future Government Funding

Under the Fiscal Agency Loan Program, the government initially borrows funds and then makes loans to various public sector organizations so they can purchase capital assets.

In previous reports on the government's annual Public Accounts, we noted our concern with the government's accounting of loans made through this program to certain public sector organizations that depend on the government funding to repay their debt. We recommended that these loans, which were recorded in the Province's financial statements as "loans for purchase of assets, recoverable from future appropriations," be expensed in the period the loans were made.

The main reason for our recommendation was that, though these loans were used by the recipient organizations for purchasing tangible capital assets, the loans themselves provided no future benefits to the lender (that is, the government). For these loans to be repaid, the government first had to advance sufficient funds to the borrower. At the same time, the government had no control over tangible capital assets owned by organizations that by its own definition are residing outside its reporting entity. Nevertheless, the government decided to continue recognizing the loans as assets of the Province. And therefore, again, the Auditor General's Reports on both the Consolidated Revenue Fund Financial Statements and the Summary Financial Statements of the Province for the year ended March 31, 1998, were qualified.

In late 1997/98, the government examined the possibility of forgiving the loans referred to above, and providing the recipient organizations with "capital advances" equal to the book value of the existing tangible capital assets they hold. In exchange, the government would gain the right to use those assets in delivering its programs. Because the government has moved to a full cost, expense basis of accounting (see page 34), such an arrangement would have helped the government better account for inter-generation expenses. It would also ensure that lump-sum payments made by the government to organizations that help it provide health care, education, and transportation services were accounted for in the Province's financial statements, to the extent they provided utility for delivering those services.

In pursuing this idea, the government consulted with the Auditor General. We are pleased to report that, based on a memorandum exchanged between the Minister of Finance and Corporate Relations and the Auditor General in March 1998, the government agreed to introduce legislation to eliminate three capital financing authorities through which these loans were made. According to new legislation, it is expected that the debt held by the government organizations will be forgiven and the amounts paid out by the government to date for the purchase of tangible capital assets (less any sinking fund) will be recorded as a "prepaid capital advance" on the balance sheet of the Consolidated Revenue Fund. The prepaid capital advances will be amortized over the estimated useful lives of the underlying capital assets. The government is also committed to asserting, in due course, its claim to the use of the underlying assets represented by the prepaid capital advances.

We believe that these changes, when fully made, will resolve the long-standing issues related to the accounting for loans made by the government to dependent organizations.

To begin implementing these planned actions, the government passed the Capital Financing Authority Repeal and Debt Restructuring Act on May 13, 1998. This Act, which came to effect on April 1, 1998, dissolved both the British Columbia Educational Institutions Capital Financing Authority and the British Columbia School Districts Capital Financing Authority. The debt obligations owed to both authorities by school districts, colleges, institutes and universities were released as of that date, and the related sinking funds held by those educational institutions were deemed to be held by the government. At the same time, the assets and liabilities of the authorities were transferred to the Consolidated Revenue Fund.

These events resulted in a decrease of "loans for purchase of assets, recoverable from future appropriations" and an increase in "public debt used for government operating purposes" each of $4,045 million as at April 1, 1998.

Also, in our previous reports on the Public Accounts, we had recommended that guaranteed loans of entities which are dependent on government funding be accounted for as the liabilities of government. We are pleased to report that, in 1998/99, the government will include approximately $307 million of debt of the entities that had previously been guaranteed by the Province in public debt used for government operating purposes.

We understand the government is establishing a similar process for the British Columbia Regional Hospital Districts Financing Authority. The Greater Vancouver Transportation Authority Act, passed on July 30, 1998, dissolves the British Columbia Regional Hospital Districts Financing Authority (effective March 31, 1999) and transfers its assets and liabilities to the Consolidated Revenue Fund. This releases the regional hospital districts from the part of their debt obligations to the financing authority that corresponds to the government's percentage of that debt obligation (approximately 60%).

These forthcoming changes have been disclosed in note 32 of the Summary Financial Statements for the year ended March 31, 1998, under the heading "subsequent events."

Liability for Post-Retirement Benefits

For a number of years, we have commented on the way the Province records its obligation for post-retirement benefits. We believe that all post-retirement benefits earned over an employee's service life should be accounted for as liabilities of the Province in its financial statements. This view is supported by the standards proposed by the Canadian Institute of Chartered Accountants, which recommend that all future benefits be accounted for in the same way — not only pension income, but also other benefits, including health care and life insurance premiums. Currently, the cost of these benefits is recorded only when the benefits are actually paid, an amount of approximately $14 million each year. However, the liability for unpaid benefits earned by retired and active employees is not recorded in the financial statements.

Note 25 of the Summary Financial Statements of the Province states that, under existing pension agreements, the government is responsible for paying pensioners' Medical Services Plan and Extended Health Care premiums, which are recorded when due. Although this disclosure makes clear who is responsible for this liability, it does not quantify it.

In hearings held by the Select Standing Committee on Public Accounts, government representatives agreed that a liability exists, but stated that estimating the liability (by actuarial calculation or otherwise) would be expensive. At the conclusion of each of these hearings, the committee recommended that the government report this liability when it is practical.

We recommend that a reasonable estimate of post-retirement benefits be included as a liability in the Summary Financial Statements of the Province.

Insurance Risk Management Account (IRMA)

In our report on the 1995/96 Public Accounts, we reported that the Province did not adequately report its liability for potential insurance claims.

The Province 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 this self-insurance (including insurance premiums received, claims paid out, and the liability for claims received but not yet paid out) are recorded in a special account of the Consolidated Revenue Fund.

When a claim is registered with the government's risk management office and accepted by it, the government's liability is calculated and recorded. Any payment against these claims is entered as a reduction of the liability. The government considers the difference between these two amounts to represent its insurance liability for known claims. No liability is recorded, however, for incidents that may have occurred as of March 31 of a given year, but for which no claim has yet been filed, or if filed has yet not been accepted by the government.

Normally, insurance premiums are based on an actuarial valuation of the amount that the insurer expects to pay out for incidents arising in a given year. In other words, total premiums collected over time is an amount that allows payments of all claims — even if they are not yet registered. Therefore, we believe that, in the absence of an actuarial valuation of claims that have occurred but not yet been registered, the Province's total insurance liability would be more accurately estimated as the difference between the premium revenues received over time and the amounts paid out. This amount is represented by the balance, at any time, in IRMA special account. For 1997/98, the account balance is $27.2 million.

We again recommend that the Province account for all its liability for third-party insurance claims.

Contributions to Government Organizations

There are different circumstances under which the Province makes payments to government organizations. It may, for example, provide funding for operations or capital acquisitions, or it may make an investment in an organization with the expectation of financial return on that investment.

While the accounting treatment for contributions is understandably different in each case, we are concerned about the overall lack of consistency in how similar types of contributions to government organizations are accounted for.

Normally, for stakeholder funding in a business organization to be appropriately recorded as an investment, there must be a reasonable expectation of financial return. On this basis alone, there is no justification to consider a contribution as investment when government is funding its non-commercial businesses; however, the government does not always use this concept.

A case in point is the $45 million contribution the government made to Columbia Basin Trust on April 1, 1996. The Province recorded this payment as an investment rather than expensing it as a grant, even though the recipient corporation is not a business enterprise, and is fully consolidated in the Summary Financial Statements of the Province.

This payment is described in the Trust's financial statements as a "Regional Benefit Program Payment" made "for purposes consistent with Section 4 of the Columbia Basin Trust Act." According to Section 4 of the Act, the purpose of the Trust is to "invest, spend and otherwise manage the Regional Allocation and the Trust's other assets, including any assets that may be transferred to it, for the ongoing economic, environmental and social benefit of the region."

Although this contribution might bring some financial return to the Trust, there seems to be no expectation of a return to the Consolidated Revenue Fund, financial or otherwise.

We recommend that the government account for payments to its organizations in a manner that reflects the substance of the transactions.

financial highlights

financial highlights

Financial data presented here are taken from the summary level financial statements included in the Public Accounts of the relevant years. To provide consistent bases for comparison between the last five years, financial results of 1994 and 1995 have been restated to take into account changes in government accounting policies since April 1, 1995.

In the 1995/96 fiscal year, the government expanded the composition of the summary reporting entity to include health care organizations, regional hospital districts, universities, colleges and institutes, and school districts. However, starting in the 1996/97 fiscal year, the government excluded those bodies referred to above from the summary reporting entity.

Also, in the 1995/96 fiscal year, the government has changed its accounting policies to phase in capitalizing tangible capital assets and amortizing them over their useful lives.

As in previous years, financial data are not adjusted for changes in the Consumer Price Index (CPI). Population and Gross Domestic Product (GDP) figures are from statistics as at July 1 and December 31 of each year respectively. Otherwise, all “year” references in this section apply to the fiscal year ended March 31 of the year noted.

In its 1998 Budget, the government reported an overall economic growth in 1997 of 2.0% (up from 0.5% in 1996). For 1998, the government expects that the pace of provincial economic activity would slow largely because of the sluggish growth in the Asian economies, softening of international commodity prices and declining population growth. The overall economic growth in 1998 is projected to increase 0.9%, resulting in some 9,000 new jobs in British Columbia. On the basis of these expectations, the government is setting as its

The Auditor General’s Report on the 1997/98 Summary Financial Statements of the Province contains a reservation with respect to the appropriateness of the summary reporting entity. This means that, to understand the Province’s financial results for that year, the reader should consider information from the Summary Financial Statements together with matters referred to in the Auditor General’s report on those statements. For the purpose of this section we have adjusted the 1996/97 and 1997/98 Summary Financial Statements to reflect the effects of this reservation.

1998/99 target the goal of reducing its deficit by about half of what it was in 1997/98, and moving to a balanced budget by 1999/2000.

Revenue

Taxes remain the most significant source of revenue for the government of British Columbia. Last year, they accounted for 55 cents of every dollar of the provincial revenue. Compared with all other taxes, personal taxes have had the highest dollar increase over the past five years, increasing by $885 million, or 19.8%.

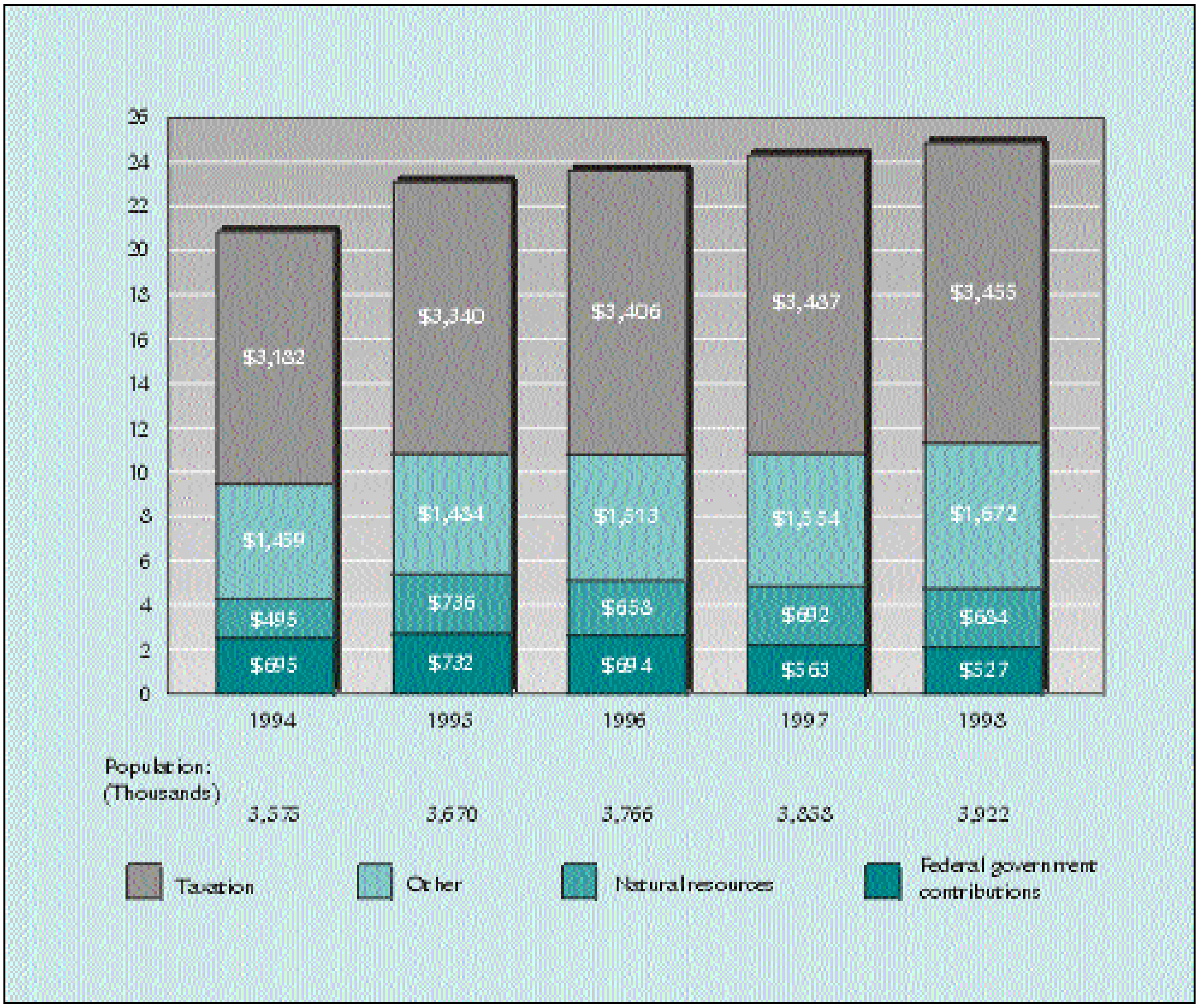
For the year 1998, the largest percentage increase in revenue by main source was in “Other” revenue. This category includes all fee and licence collections, earnings from investments, contributions from government enterprises, recovery of monies from sources outside government, and some miscellaneous revenue. This increased 9.4% from $5,997 million in 1997 to $6,559 million in 1998.

Exhibit 3.1 shows total revenue of the Province in each of the years 1994 to 1998. Taxation revenue has increased significantly from $11,375 million in 1994 to $13,551 million in 1998. Expressed in other terms, this means that the average taxation revenue generated by each resident of British Columbia (per capita revenue) has increased from $3,182 in 1994 to $3,455 in 1998.

Exhibit 3.1

Revenues, 1994 to 1998

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



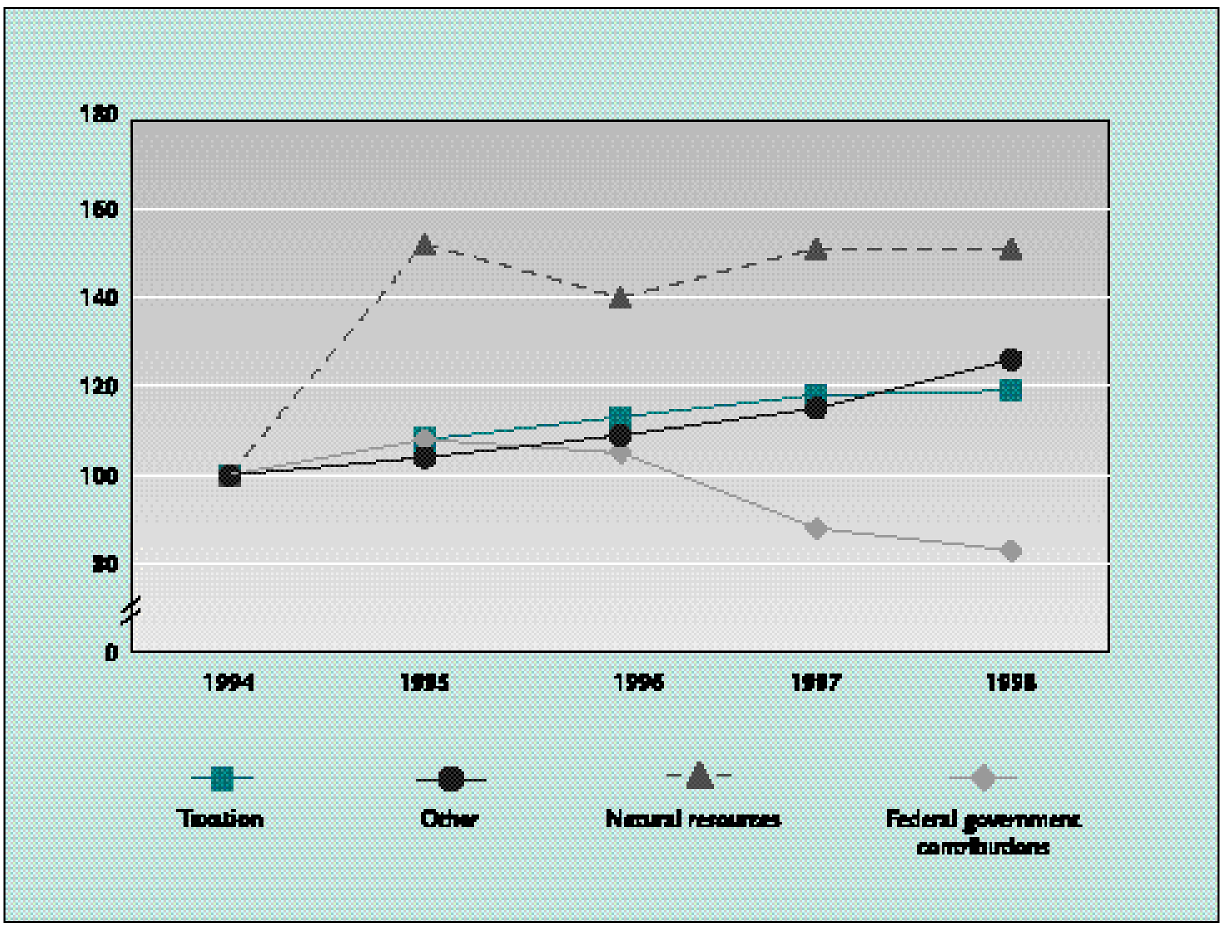
Source: The Public Accounts (restated) for financial figures; Statistics Canada for population statistics as at July 1

Exhibit 3.2 shows the rate of change in revenue over the last five years by main sources. The base year in this exhibit is 1994. Revenue for each main source in the four years that follow 1994 has been shown as a percentage of the base year. Natural resource revenue has grown significantly over the last five years. During the same period, contributions from the federal government show a gradual decline.

Exhibit 3.2

Change in Revenues, 1994 to 1998

Rate of change in revenue by main sources (1994 = 100)



Source: The Public Accounts (restated)

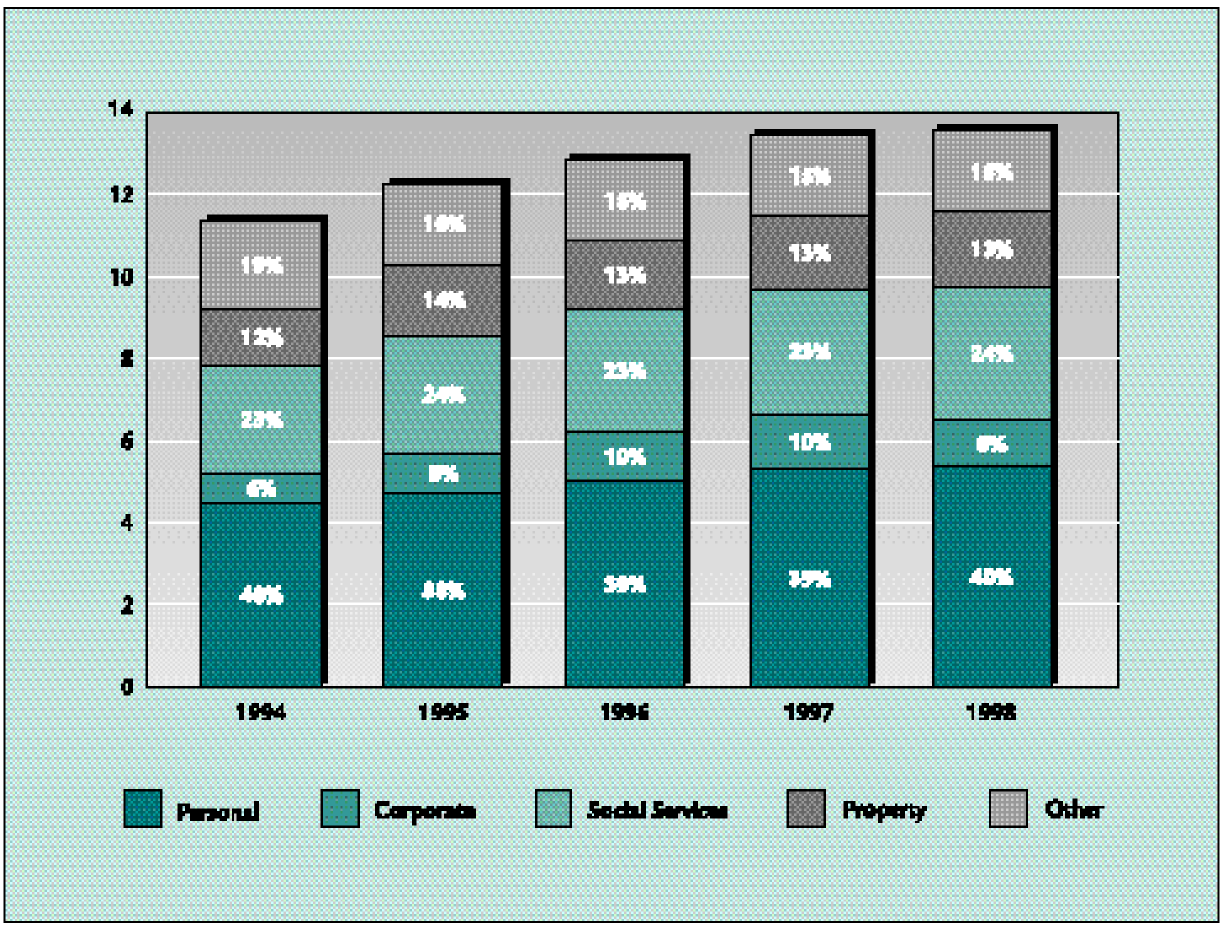
Exhibit 3.3 shows the taxation revenue by source over the five-year period from 1994 to 1998, and the ratio of revenue from each of the major taxation sources to the total taxation revenue of the Province.

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 presented in Exhibit 3.3, 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 3.3

Taxation Revenue, 1994 to 1998

Total, and percentage of total, taxation revenue by source ($ Billions)



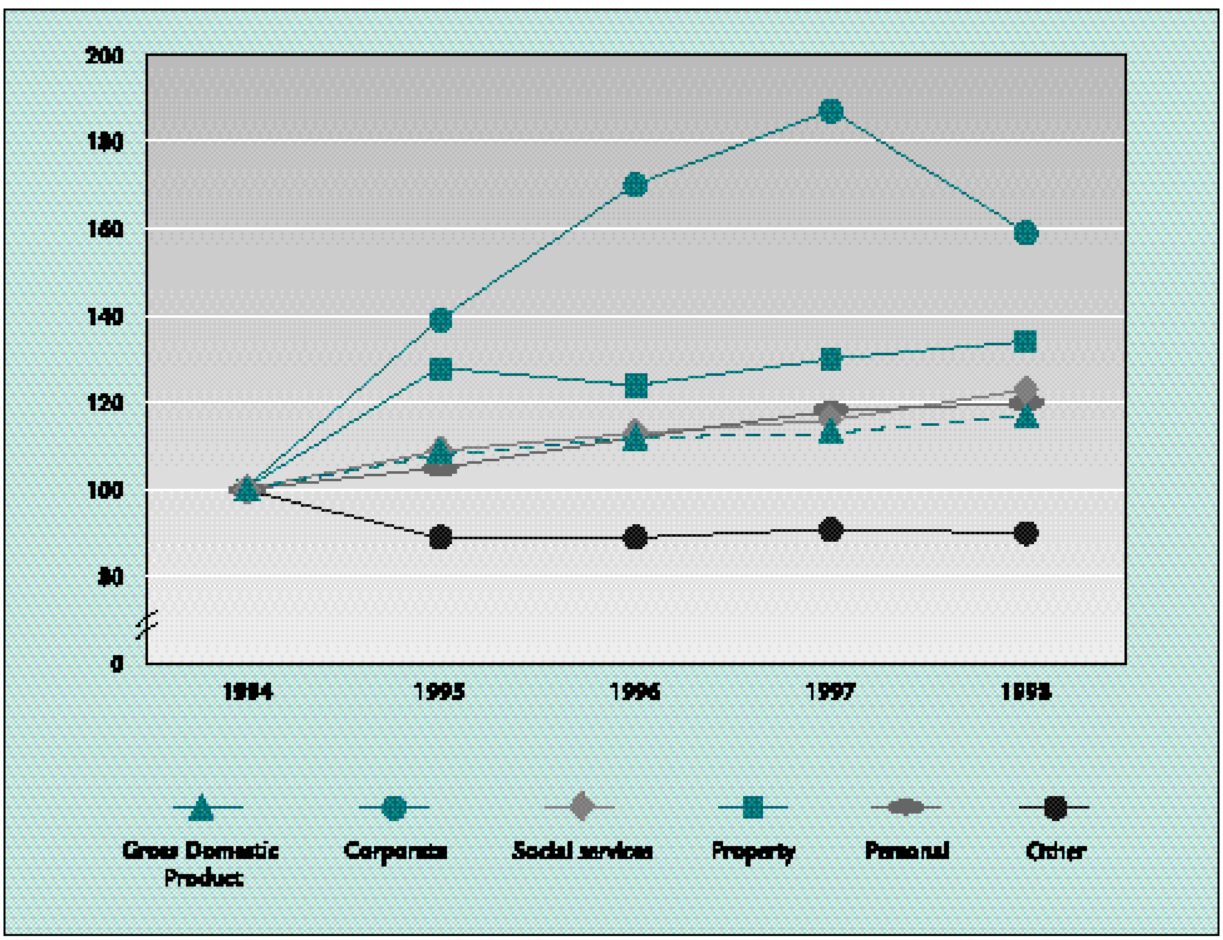
Source: The Public Accounts (restated)

Exhibit 3.4 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 1994 to 1998. The GDP is used in this exhibit as an indicator of the Province’s economy. As in Exhibit 3.2, 1994 is taken as the base year for the comparison.

Exhibit 3.4

Change in Taxation Revenue, 1994 to 1998

Rate of change in taxation revenue by major categories, compared to Gross Domestic Product (1994 = 100)



Source: The Public Accounts (restated)

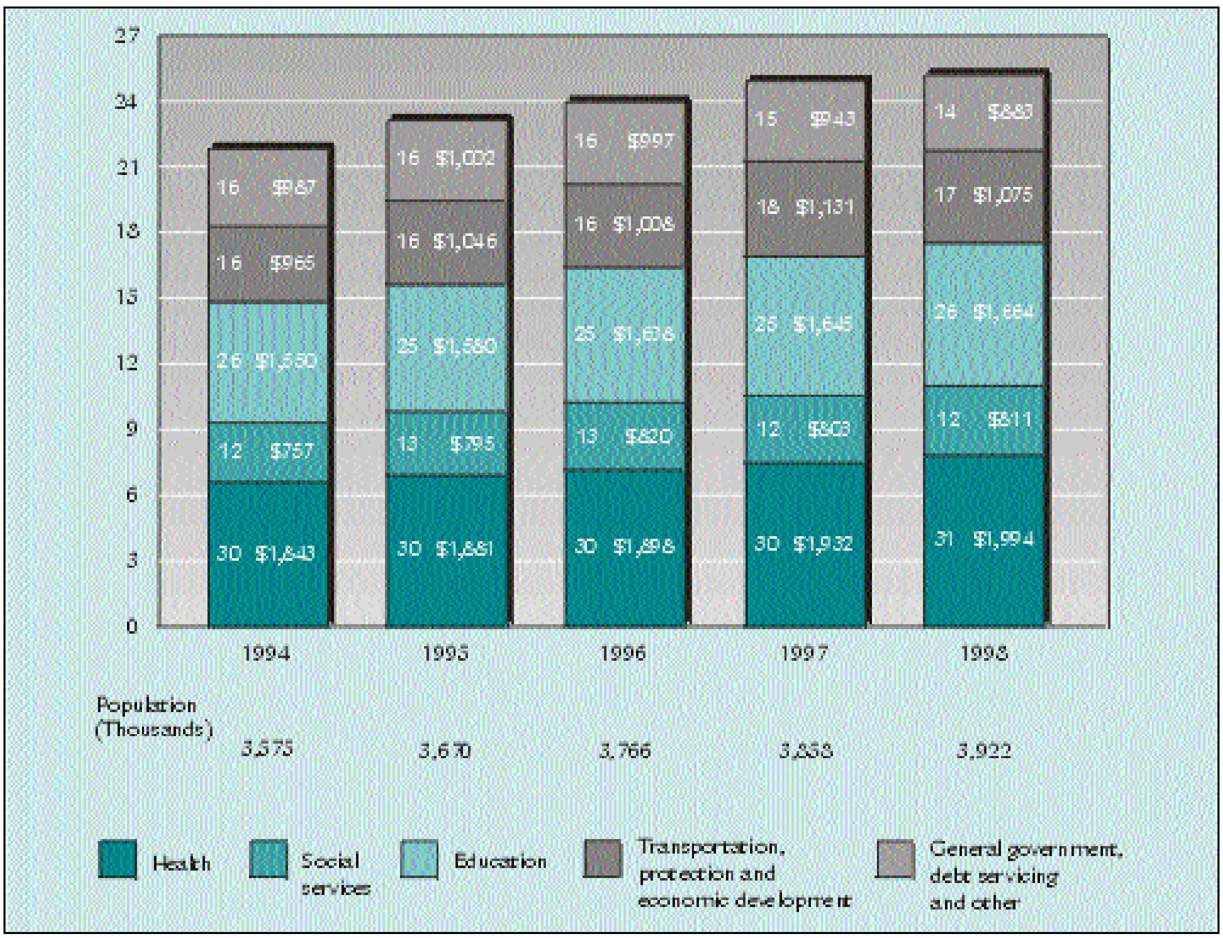
Expense

Exhibit 3.5 shows the Province's total expense from 1994 to 1998. 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 functions are grouped, as are the general government, debt servicing and all other functions. Exhibit 3.5 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.

Exhibit 3.5

Expenses, 1994 to 1998

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



Source: The Public Accounts (restated)

In the last five years, health, education and social services combined have accounted for an average of 68% of the total expenses of the Province:

- Health costs have increased from $6,589 million in 1994 to $7,820 million in 1998, an increase of 18.7%.
- The cost to the Province of educating our students has increased from $5,541 million in 1994 to $6,526 million in 1998, an increase of 17.8%.
- The cost of social services has increased from $2,705 million in 1994 to $3,181 million in 1998, an increase of 17.6%.

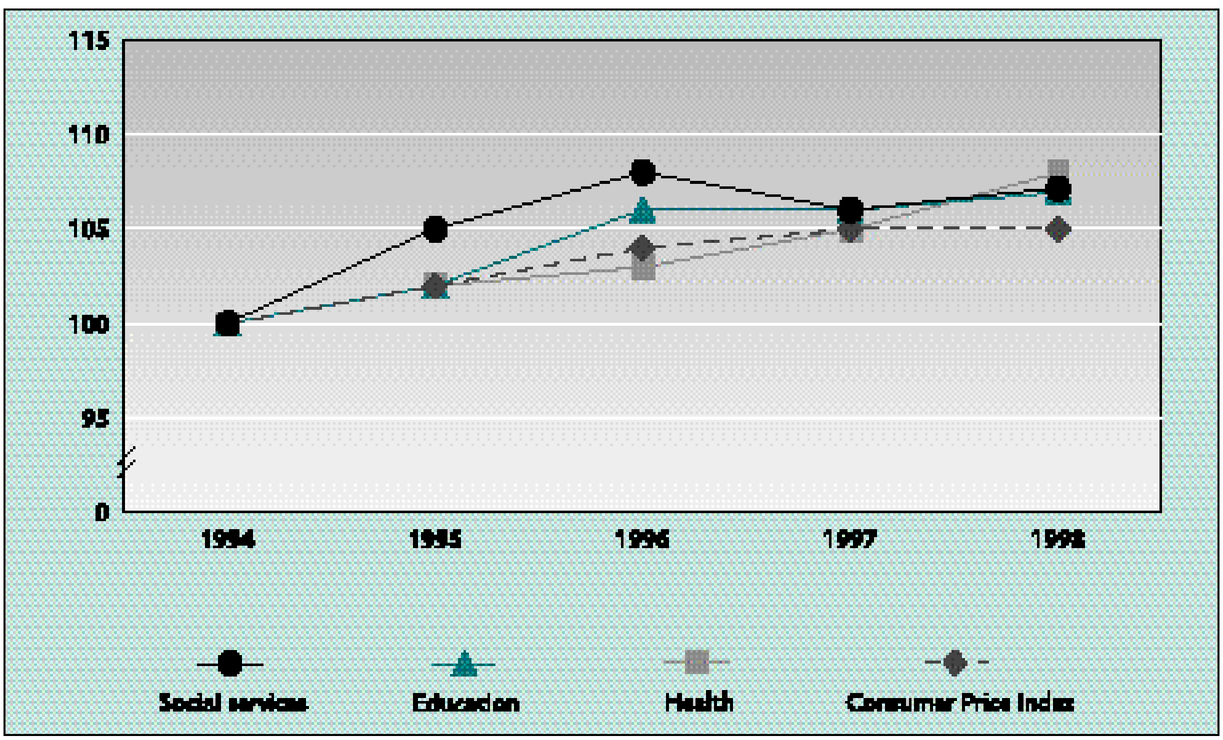
In the same five-year period, the Province's population increased by 8.3% from 3.6 million to 3.9 million, and its GDP grew by 17.0% from $93,490 million to $109,347 million.

Exhibit 3.6 shows the rate of change in per capita expense over the last five years for social services, education and health. To show the change over the five-year period, the per capita expense in each category has been indexed to the year 1994. The expense is in actual dollars and has not been adjusted for inflation. However, the British Columbia CPI is plotted in Exhibit 3.6 to show the general increase in prices in the Province, indexed to 1994, for comparison.

Exhibit 3.6

Change in Expenses, 1994 to 1998

Rate of change in per capita expenses for social services, education and health, and in the Consumer Price Index (1994 = 100)



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

Deficit

The consolidated net expense (known as the annual deficit) of the Province — the excess of expense (operating and capital) over revenue — is an important indicator of the Province's financial performance. The annual deficit for 1998 was $282 million, or 1.1% of the year's total revenue of $24,856 million. The accumulated deficit of the Province — the total of all government deficits and surpluses to date — amounted to $7,342 million at the end of the fiscal year 1997/98.

Exhibit 3.7 shows changes in British Columbia's accumulated deficit over the past five years.

In addition to debt and accumulated deficit, a third financial indicator is also provided in the financial statements: net liabilities. This is disclosed in the notes to the Summary Financial Statements.

The term "net liabilities" represents the difference between total liabilities and financial assets. In order to pay liabilities when they come due, the Province may have to finance this difference by ensuring that future operating revenues exceed expenses (i.e., there is a surplus), by borrowing funds (i.e., assuming additional debt), by selling off assets, or by undertaking a combination of these. The net liability amount is an indicator of the Province's financial indebtedness.

Exhibit 3.7

Accumulated Deficit, 1994 to 1998

($ Millions)

Year ended March 31	1994	1995	1996	1997	1998
Accumulated deficit, beginning of year	(5,523)	(6,387)	(6,281)	(6,542)	(7,204)
Adjustments[1]					144
Surplus (deficit) for year	(864)	106	(261)	(662)	(282)
Accumulated deficit, end of year	(6,387)	(6,281)	(6,542)	(7,204)	(7,342)

[1] 1998 Adjustments largely relating to the regionalization of the health sector.

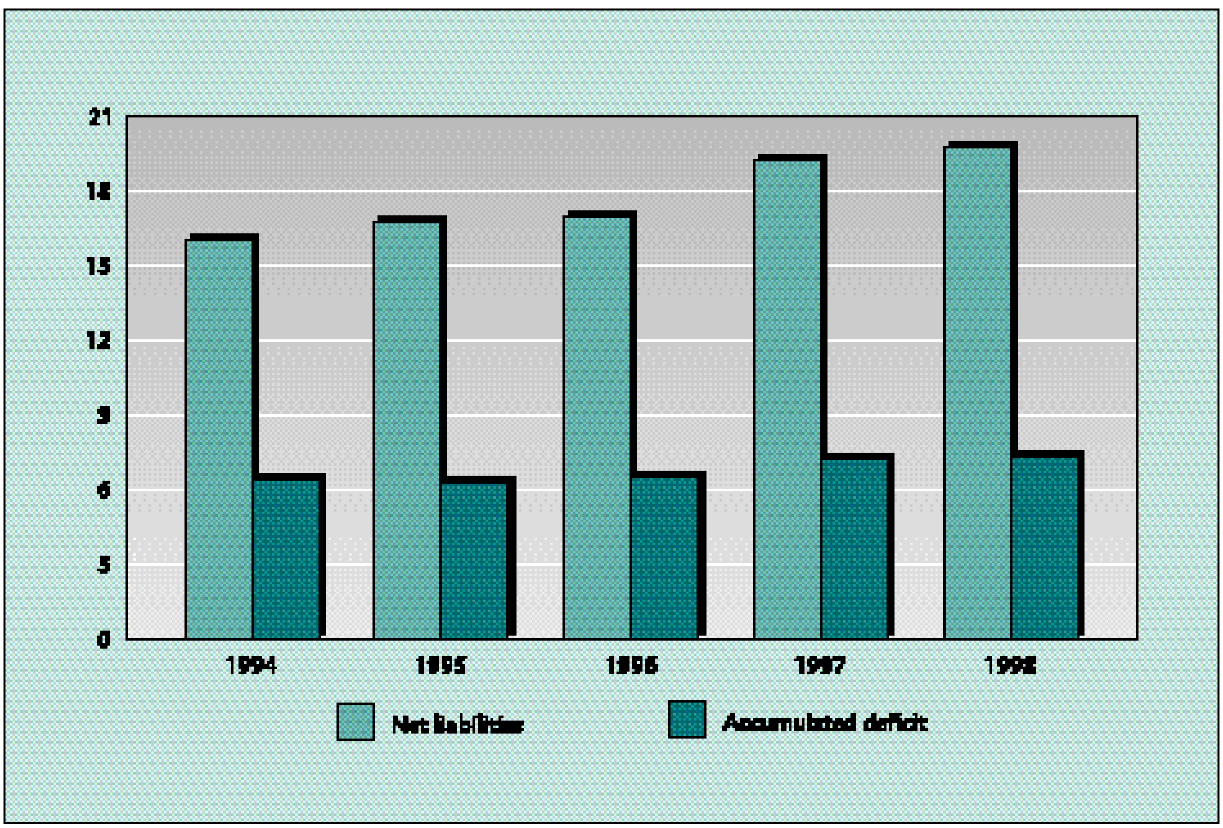
Source: The Public Accounts (restated)

Exhibit 3.8 provides information on the accumulated deficit and net liabilities over the past five years. During this period, the accumulated deficit increased by 15.0% from $6,387 million in 1994 to $7,342 million in 1998, and the net liabilities increased by 23.3% from $16,036 million in 1994 to $19,777 million in 1998.

Exhibit 3.8

Accumulated Deficit and Net Liabilities

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



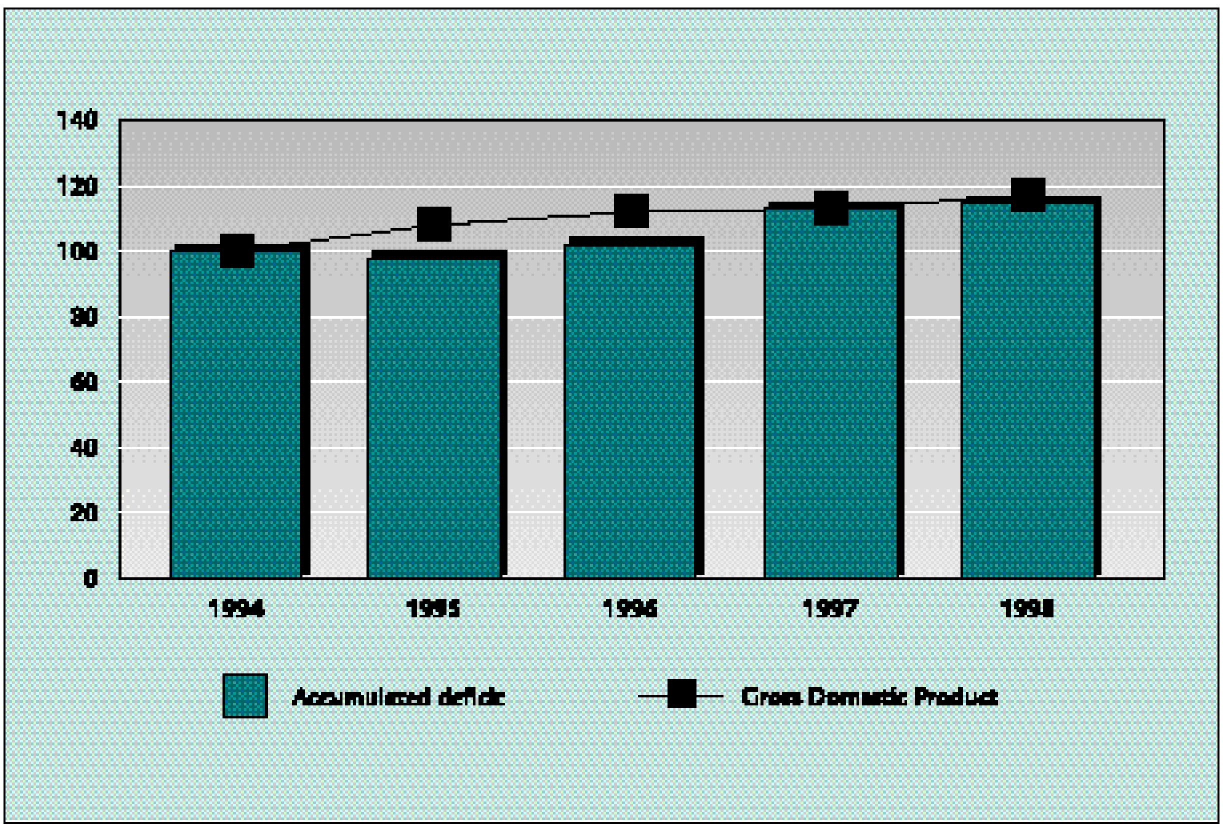
Source: The Public Accounts (restated)

Exhibit 3.9 shows the rate of change in the Province's GDP compared with the rate of change in accumulated deficit at each fiscal year end, 1994 to 1998, indexed to 1994. During the last five years, the accumulated deficit increased by 15.0%, compared to the GDP, which increased by 17.0% and the population by 8.3%.

Exhibit 3.9

Accumulated Deficit and Gross Domestic Product (GDP), 1994 to 1998

Rate of change in accumulated deficit and in GDP (1994 = 100)

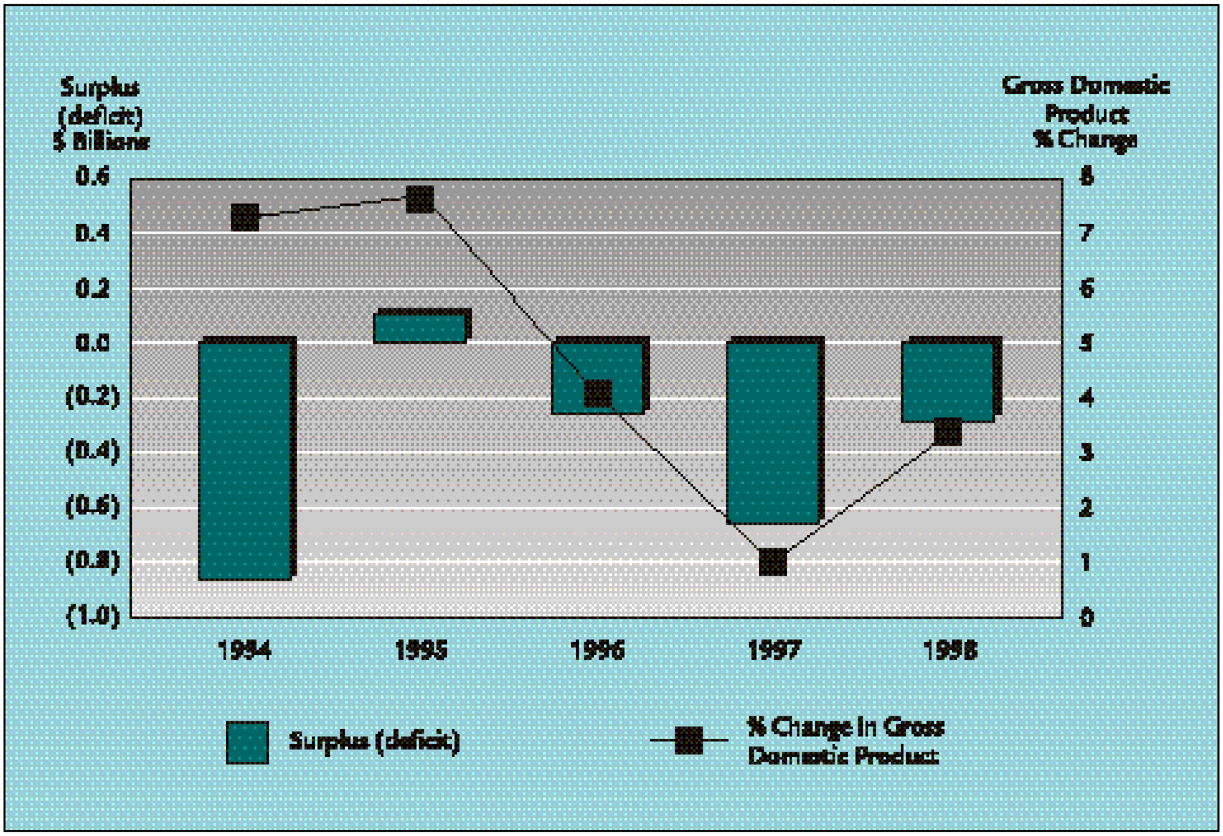


Source: The Public Accounts (restated)

Exhibit 3.10

Annual Surplus (Deficit) and Gross Domestic Product (GDP), 1994 to 1998

Annual deficit compared to percentage change in GDP



Source: The Public Accounts (restated)

Exhibit 3.10 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.

Public Debt

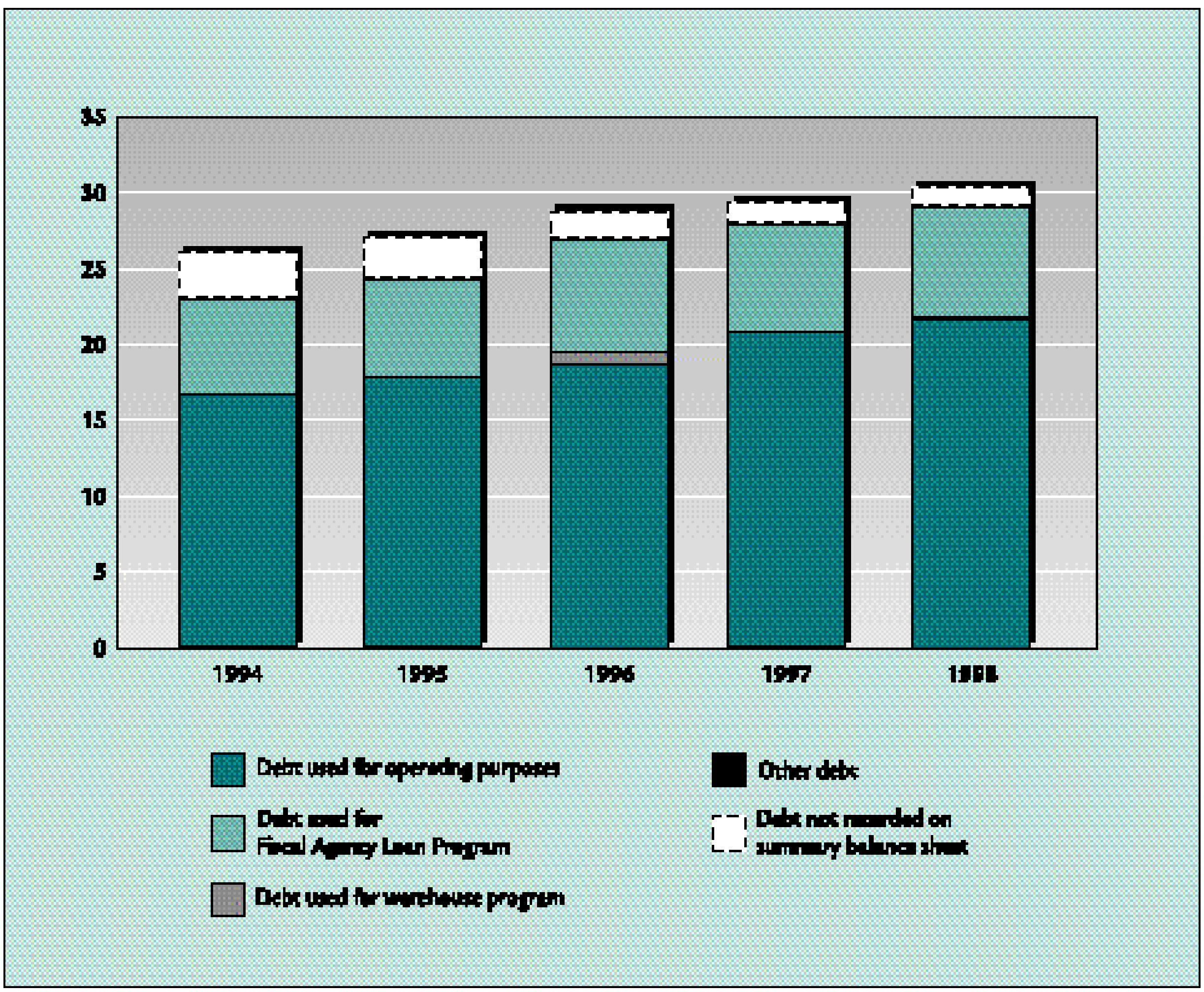
The Province has been borrowing in the capital market for three purposes: first, for its own current needs; second, for its own anticipated needs in the future; and third, to lend funds through its Fiscal Agency Loan Program to various government and other public sector entities. Entities receiving funds through this loan program, and which will repay these funds through their operations, include British Columbia Railway Company, and British Columbia Hydro and Power Authority.

Exhibit 3.11 shows the amount of public debt, including amounts borrowed by the Crown enterprises included in the government reporting entity from sources outside the government (not recorded in the Summary Financial Statements), at March 31 for each of the years 1994 to 1998. During the last five years, the total funds borrowed by the Province increased from $26,061 million in 1994 to $30,337 in 1998, an increase of 16.4%.

Exhibit 3.11

Total Public Debt, 1994 to 1998

Debt by category, including debt not recorded on the summary balance sheet ($ Billions)



Source: The Public Accounts (restated)

Exhibit 3.12 shows the balance of monies borrowed for government "operating purposes" at the end of each of the last five years, compared with the accumulated deficit balances at the same dates.

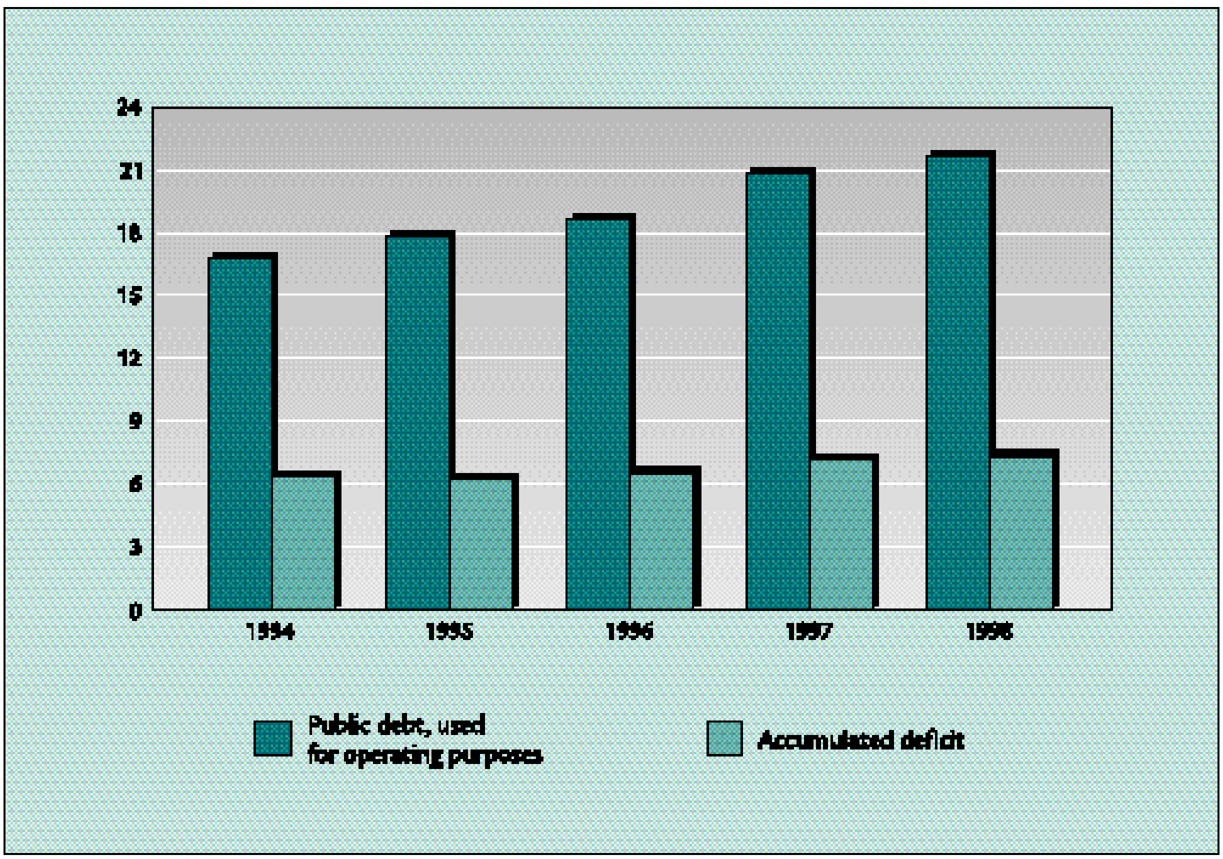
In government financial reporting, debt used for "operating purposes" means monies borrowed for use in all aspects of operation of ministries and all fully consolidated government operations, including acquisition of assets.

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

Exhibit 3.12

Operating Debt and Accumulated Deficit

Comparison of public debt used for operating purposes[1] and the accumulated deficit at the end of each of the past five fiscal years ($ Billions)



[1]See highlighted explanation above.

Source: The Public Accounts (restated)

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

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

Auditors of Government Entities

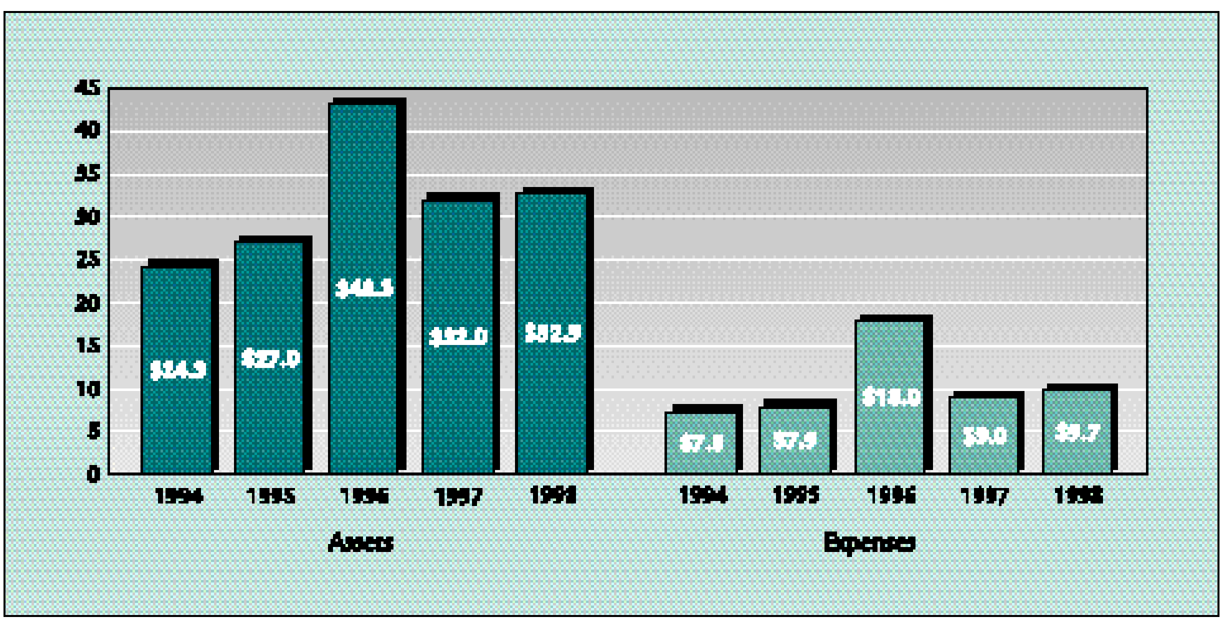
The Summary Financial Statements of the Province for the 1997/98 fiscal year include the results of the financial activities and operations of the Consolidated Revenue Fund (including the British Columbia Liquor Distribution Branch) and 49 other government organizations and enterprises.

In the 1997/98 fiscal year, the assets and expenses of these 49 government organizations and enterprises (collectively referred to in this section as government entities) amounted to $32.9 billion and $9.7 billion, respectively. Exhibit 4.1 shows the assets and expenses of these government entities reported in the Summary Financial Statements of the Province from 1994 to 1998.

Exhibit 4.1

Changes in Assets and Expenses

Assets and expenses of government entities, 1994 to 1998 ($ Billions)



Source: Financial statements of government entities

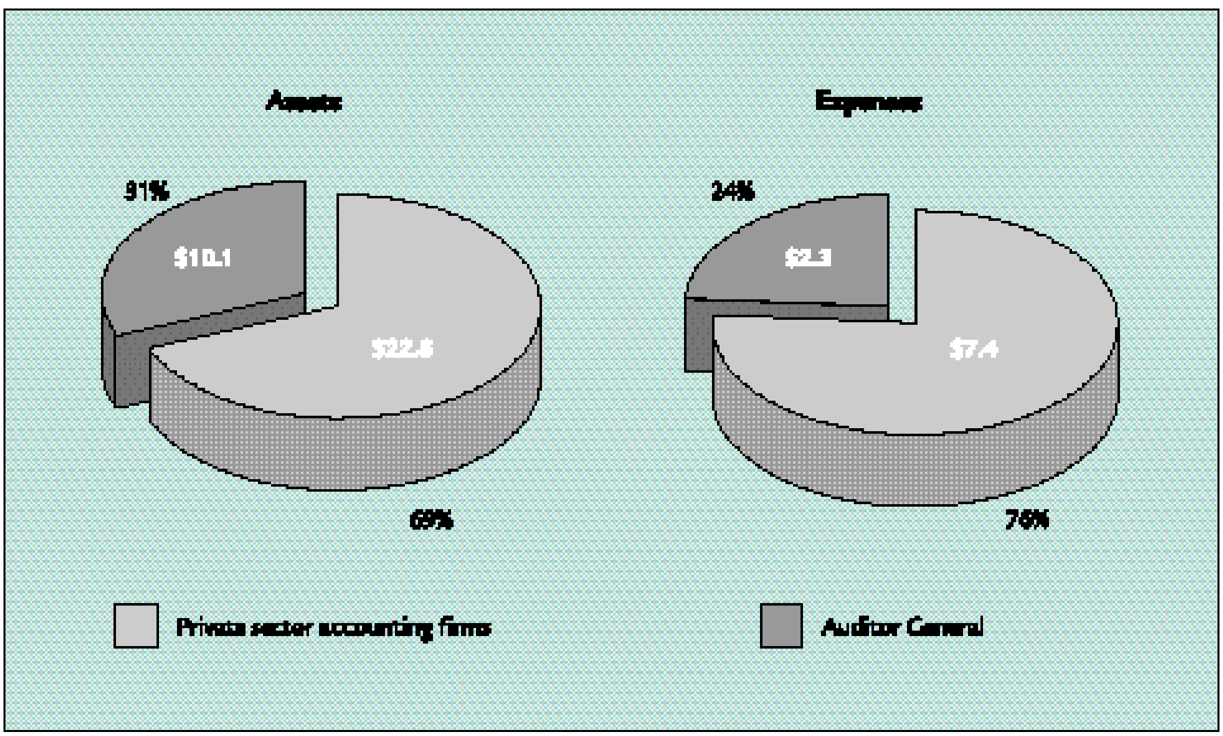
All changes to the summary reporting entity are summarized in the *Audit of the Financial Statements of the Province* on page 25 of this report.

Exhibit 4.2 shows, for the government entities included in the 1997/98 Summary Financial Statements of the Province, the asset and expense amounts audited by private sector accounting firms and those audited by the Auditor General. Private sector accounting firms audited 27 government entities, which had combined assets and expenses of $22.8 billion and $7.4 billion, respectively. The Auditor General audited 21 such entities, with total assets of $10.1 billion and expenses of $2.3 billion. And there was one small entity that does not require an audit to be performed.

Exhibit 4.2

Distribution of Financial Statement Attest Audits

Assets and expenses amounts audited by private sector accounting firms and by the Auditor General (for government entities), 1994 to 1998 ($ Billions)



Source: The Public Accounts

In addition to the government entities included in the Summary Financial Statements of the Province, the Auditor General audited a further 57 organizations with assets of $83.0 billion and expenses (including financing transactions) of $47.8 billion. Among these were 33 trust funds, including pension and superannuation plans, and investment funds administered by the government.

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 the private sector accounting firms.

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, with the exception of one entity, the auditor's report on the financial statements of those government entities included in the Summary Financial Statements was issued without reservation. The exception was relating to one small entity, of which its auditor's report includes references to the nature of revenue that was not susceptible to satisfactory audit verification.

Accounting Standards for Government Entities, Financial Statement Comparability in the Public Sector

When, in similar organizations within the public sector, appropriate accounting principles are applied consistently, it enhances comparability between them and between these and similar organizations in the private sector. Such comparisons may also provide important information to users about the performance of a public sector organization.

The two main sources that public sector organizations usually refer to for accounting guidance are the Canadian Institute of Chartered Accountants (CICA) and its Public Sector Accounting and Auditing Board (PSAAB). They offer alternative accounting treatments for different accounting needs. Normally, the governing boards of funded organizations, as well as the central agencies and ministries that fund them, are fully informed about the available choices. Of course, most governing boards will select an accounting standard that best portrays the activities of the entity. Funding ministries, on the other hand, will be more interested in ensuring reasonable consistency between entities in the financial information they report about their activities.

As the chief accounting officer of the government, the Comptroller General's advice is often 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.

In this report we discuss some of the accounting issues that we have noted in relation to the reorganization of health care, and to the financial reporting of entities included in the education sector.

Reorganization of Health Sector

In response to the 1991 report by the Royal Commission on Health Care and Costs, the Province began restructuring the health care service delivery system. The process was complex and the new direction proposed by the government created some concern. In June 1996, the Minister of Health halted the process and assembled a Regionalization Assessment Team, consisting of Members of the Legislative Assembly, to conduct a review. The Regionalization Assessment Team submitted its report and recommendations to the Minister of Health in the fall of 1996. One of the key recommendations was the transfer of responsibility for health care services to local health authorities. The idea was accepted and the regionalization of the health sector began on April 1, 1997.

The local health authorities are made up of regional health boards (RHBs), community health councils (CHCs) and community health services societies (CHSSs). The Health Authorities Act of 1993, with its subsequent amendments, sets out the overall responsibilities of all three bodies, including the health services societies which were created under the Society Act. When these authorities assumed responsibility for health care, the Ministry of Health entered into a Funding and Transfer Agreement with them. This agreement sets out the obligations of the health authorities, as well as the funding and compliance requirements the authorities must meet in managing and delivering health services. Under this arrangement, these health authorities stay accountable to the Minister of Health, though they are also locally accountable to their respective communities.

As a result of all this reorganization, the activities of certain health care organizations operated by religious groups and societies were brought under the “umbrella” of the health care authorities. Together these groups and societies have formed the Denominational Health Care Facilities Association. Its members receive operating funds and direction from a designated health board or health council, to carry out acute care and continuing care services. During the process of regionalization of health care, the association also entered into an agreement with the Minister of Health, which stated that the ministry would recognize the right of association members to own, manage, operate and conduct affairs of their respective facilities and to carry out their respective religious missions. However, some of the association’s members have since expressed concern to the Comptroller General and the Auditor General that the inclusion of their assets in the Province’s financial statements would take away their individual status and suggests the government has legal title to their assets.

In our opinion, the Summary Financial Statements of the Province should 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 that are owned or controlled by the government. Our review of the matter confirms that these denominational health care organizations are accountable to the Minister of Health. The strategic direction of these organizations, to the extent they provide health care services, is controlled — through the designated health authorities — by the government. Accordingly, we believe that they should be included in financial information provided by the government publicly on health care services it controls. In this way the government would be able to state publicly how much in assets is employed in providing health care services and at what annual cost. Nevertheless, to respect the fact that some of the assets employed in providing health care services to the public are privately owned, we also believe that the government should use appropriate disclosure in its reporting.

We recommend that the government include an appropriate note in the Province's financial statements and financial information it provides on health care to reflect the ownership of certain privately owned assets employed in providing health care services to British Columbians.

New Financial Reporting for Colleges and Institutes

The British Columbia Institute of Technology and all but one public college in British Columbia used "fund accounting" principles in its financial statement presentation for the fiscal year ended March 31, 1997. According to this approach, the colleges recognized as revenue amounts they received as contributions, even if they purchased assets with them that would benefit the institutions for a long time. Also, they fully charged to the expenditure in a capital fund those amounts they used to purchase tangible capital assets, and generally recorded no depreciation. Each organization's statement of financial position and statement of operations described the activities of the major "funds." The result of this treatment is that the cost of acquiring capital assets, less any outstanding debt related to those assets, was usually credited to equity in capital assets. As we reported in our previous Report on the Public Accounts, we believe that colleges should follow accounting standards that rectify the shortcomings of fund accounting, such as those explained above.

We are please to report that, for the fiscal year ended March 31, 1998, most colleges and institutes in British Columbia implemented the new not-for-profit organization accounting standards of the Canadian Institute of Chartered Accountants (CICA). These standards address capitalization and depreciation of tangible capital assets, and allow deferral of contributions specified for purchasing them. Contributions that are not for a specific purpose are recognized as revenue as they are received. Implementing these new standards has been a major task for colleges and institutions, and for it they must be commended.

Applying these standards retroactively resulted in significant changes to the colleges' financial statement presentation for 1996/97. These changes are summarized in Exhibit 4.3 for all colleges and institutes.

The most significant results of these changes are a $448 million provision for accumulated depreciation of tangible capital assets and a $218 million recognition of deferred capital and non-capital contributions. Other changes include the classification of net assets as either unrestricted or externally restricted assets, a decrease of $630 million in the investment in capital assets, the elimination of $6 million in inter-fund balances, and the netting of sinking funds with long-term debt.

For the statement of operations, the new standards resulted in revenue recognition of $39 million in amortization of deferred capital and non-capital contributions for 1996/97, and $49 million in depreciation expense for tangible capital assets. Adjustments were made to the grants from the provincial government and other revenue sources to recognize amounts deferred. Items affecting equity in capital assets — such as $68 million in capital funding, $93 million in capital expenditures, and $22 million in debt principal repayments — are no longer recognized in the statement of operations. Inter-fund transfers have also been eliminated.

Exhibit 4.3

Summary of Changes in Financial Statement Presentation - Colleges and Institutes

($ Millions)

Balance Sheet

	96/97 restated	96/97	Increase (Decrease)
Assets			
Short-term assets	232	232	0
Interfund receivable	11	17	(6)
Sinking funds	139	202	(64)
Capital assets	1,167	1,616	(448)
Total assets	**1,549**	**2,067**	**(518)**
Liabilities			
Other liabilities	170	173	(3)
Inter-fund payable	11	17	(6)
Debt	936	1,000	(64)
Deferred contributions	278	60	218
Net assets			
Investment in capital assets	150	780	(630)
Other balances	4	37	(33)
Total liabilities and net assets	**1,549**	**2,067**	**(518)**

Income Statement

	96/97 restated	96/97	Increase (Decrease)
Revenue			
Grants from Province	670	706	(36)
Amortization of deferred contributions	42	3	39
Inter-fund transfers	5	9	(4)
Capital funding	18	86	(68)
Other revenue	331	349	(18)
Total revenue	1,066	1,153	(87)
Expenses			
Amortization	52	3	49
Capital expenditures	5	98	(93)
Debt servicing	100	122	(22)
Inter-fund transfers	6	10	(4)
Other expenses	890	907	(17)
Total expenses	1,053	1,140	(87)
Surplus	**13**	**13**	**0**

Source: Data compiled by the Office of the Auditor General

Schools: Need for Better Accounting Standards

Annually, the Ministry of Education in British Columbia spends approximately $4 billion to fund some 60 school districts. Last year this accounted for about 17% of the Consolidated Revenue Fund expenses.

Under the School Act, every school district is required to prepare audited financial statements and an annual report each year. The Act deals broadly with the format, content and timeliness of the financial statements. The Ministry of Education makes instructions and provides guidelines for the school districts to follow in their financial statement preparation. School districts also make employee and supplier payment schedules publicly available, and other accountability information required by the Financial Information Act.

The only way that users of the school district financial statements can draw meaningful comparisons between educational programs in various school districts within the Province is if all districts record and present the results of their transactions in a unified and consistent manner. This is not happening. The accounting principles and standards of financial statement reporting currently being used by school districts are interpreted and applied quite differently from district to district. This not only makes financial comparison between school districts difficult, it also calls into question the usefulness of information provided in government summary financial statements and the education sector's financial accounts.

For example, different school districts account for employee's leave liabilities, vacation pay and sick leave in very different ways. Some recognize them as they are paid, others as they are earned, and others not at all. Inconsistencies also exist in reporting retirement allowances and severance pay. Furthermore, some school districts record certain revenue and expenditure items on a cash basis rather than an accrual basis, some do not recognize prepaid expenditures, and use a variety of methods to record inventories.

Accounting for tangible capital assets we also found to be inappropriate. For instance, school districts capitalize the original purchase of capital assets, but expense the replacement cost of other assets, making no provision for depreciation. Consequently, the costs of assets replaced remain on the books indefinitely, while school expenses vary from year to year based on the type of capital outgoing. The result is that amounts reported may not represent the actual cost of assets that the school districts currently hold.

We also noted that school district financial statement presentation needs improvement. Currently, school districts compare the current year balances with their budget; they do not compare the current year amounts with those of the prior year's. We think such a comparison would provide valuable information.

We recommend that the government conduct a comprehensive review of accounting for school districts, with the purpose of improving their financial accountability.

Memorandum of Understanding with the Minister of Finance and Corporate Relations

The provisions of the Memorandum of Understanding between the Minister of Finance and Corporate Relations and the Auditor General are designed to provide a rational audit process that allows the Auditor General to fulfil the duties imposed by the Auditor General Act.

The memorandum 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. In the memorandum, the Minister has agreed that the auditor selection process will reflect the judgements of the Auditor General with respect to:

- the persons appointed as auditor;
- the nature and extent of the audit work undertaken; and
- the standards adhered to in conducting the audit.

The memorandum applies to audit appointments requiring the approval of the Minister, and also to appointments made by an Order-in-Council. These include almost all Crown corporations, the colleges, 11 regional health boards and 34 community health councils. It is supported by an implementation plan that provides for the Auditor General to become auditor to some organizations, and for him to relinquish other audits to the private sector. New audits assumed by the Office enable us to increase our knowledge of government organizations and audit issues relating to them. Audits taken on are returned to the private sector on a rotational basis over a five-year period.

For the 1997/98 fiscal year, after three years of implementation, the Office employed agents for the audits of the British Columbia Buildings Corporation (BCBC), the British Columbia Authority Assessment, Provincial Capital Commission, Creston Valley Wildlife Management Authority Trust Fund, and British Columbia Institute of Technology. All, except for BCBC, were previously audited directly by our Office. We relinquished the audit of the British Columbia Health Research Foundation and assumed the direct audits of the BC Transportation Financing Authority, Kwantlen College and Victoria Line Ltd.

We have also been appointed auditor for the following new organizations:

- Technology University of British Columbia
- Fisheries Renewal BC
- Tourism British Columbia
- 552513 British Columbia Ltd.
- Industry Training and Apprenticeship Commission
- Seven Community Health Services Societies (1 year)

During this third year, we will be releasing the following audits to the private sector accounting firms, who may be engaged as our agents:

- Legal Services Society
- Simon Fraser University
- University of Victoria
- University of Northern British Columbia
- Five Community Health Services Societies

As well, we will assume the audit of a Community Health Council, and retain the audit of two Community Health Services Societies.

In keeping with the terms of the memorandum, we provide not only the Minister but also management with advice as to the appointment of auditors. At the start of the auditor appointment process, we advise management about the various factors to be included in the Request for Proposal that goes to audit firms and we review the draft request and offer suggestions for improvement. We then review the process undertaken by the government organization, analyze the short list of suggested auditors, and provide our advice on the audit appointment to the Minister.

The Auditor General must also report on the government's financial statements and examine other financial information included in the Public Accounts. This information is drawn from the financial statements of all the government entities. In this work, 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 annually with some of the private sector auditors and reviewing their working papers to the extent we consider necessary.

The result is that this process is providing us with a good understanding of the nature of the audit work being undertaken in the public sector, which in turn will help us provide further advice to the Minister and the Legislative Assembly about audit issues.

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

- *We recommend that the government expedite recording in its financial statements the cost of land used for provincial buildings.*
- *We recommend that, on a timely basis, the government develop a central database of relevant information on all land owned by the Province.*
- *We recommend that the government provide ministries with clear and detailed guidance on accounting for the capitalization of land.*
- *We recommend that the government provide ministries with adequate training to enable them to consistently apply guidelines on accounting for tangible capital assets.*
- *We recommend that, in keeping with the substance of the agreement with PHH Vehicle Management Services Inc., the sales transaction be accounted for as a capital lease, and be recorded as an asset and a liability in the Province's financial statements.*

How Is the Cost of Parkland Determined?

- *We recommend that the Province develop guidelines to help government negotiators and the Comptroller General determine which costs incurred when creating a park should be capitalized and which should be charged to normal operations.*

Gross Basis of Accounting

- *We recommend that the government use the gross basis of accounting for the Consolidated Revenue Fund Financial Statements.*

Liability for Post-Retirement Benefits

- *We recommend that a reasonable estimate of post-retirement benefits be included as a liability in the Summary Financial Statements of the Province.*

Insurance Risk Management Account (IRMA)

- *We again recommend that the Province account for all its liability for third-party insurance claims.*

Contributions to Government Organizations

- *We recommend that the government account for payments to its organizations in a manner that reflects the substance of the transactions.*

Accounting Standards for Government Entities, Financial Statement Comparability in the Public Sector

- *We recommend that the government include an appropriate note in the Province's financial statements and financial information it provides on health care to reflect the ownership of certain privately owned assets employed in providing health care services to British Columbians.*
- *We recommend that the government conduct a comprehensive review of accounting for school districts, with the purpose of improving their financial accountability.*

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 Province'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 judgement, based on the information contained in the statements, would be influenced.

In our audit of the Province's financial statements we have assumed that an error in the current year's deficit in excess of one-half of 1% of the gross expense 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 Province's 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 judgement in determining the application of these two key factors. Professional judgement 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 for the 1997/98 Fiscal Year

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

Annual Debt Statistics

Summary of Provincial Net Debt

Key Indicators of Provincial Debt

Summary of Key Benchmarks

Other Audit Reports

Internal Control Objectives for the Investment System of the Office of the Chief Investment Officer

Health Assurance Audits:

Stated Internal Control Objectives for the Payroll and Employee Benefits System and the Continuing Care, Adult Mental Health and Public and Preventive Health Expenditures System of the Ministry of Health and Ministry Responsible for Seniors, and the Control Procedures Designed to Achieve those Objectives

Summary and Schedules of Capital Assets Transferred from the Ministry of Health and Ministry Responsible for Seniors to Regional Health Boards

Summary and Schedules of Accrued Payroll Leave Liability of the Ministry of Health and Ministry Responsible for Seniors to Regional Health Boards

Entities Included in the Summary Financial Statements

552513 British Columbia Ltd.

BC Transportation Financing Authority

British Columbia Assessment Authority

British Columbia Buildings Corporation

British Columbia Educational Institutions Capital Financing Authority

British Columbia Enterprise Corporation

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

Fisheries Renewal BC

Forest Renewal BC

Health Facilities Association of British Columbia

Industry Training and Apprenticeship Commission

Legal Services Society

Tourism British Columbia

Provincial Capital Commission

Victoria Line Ltd.

W.L.C. Developments Ltd.

Other Entities Not Included in the Summary Financial Statements

British Columbia Institute of Technology

Canadian HIV Trials Network

Community Health Services Societies

- Cariboo Community Health Services Society
- Kootenay Boundary Community Health Services Society
- Coast Garibaldi Community Health Services Society
- East Kootenay Community Health Services Society
- North West Community Health Services Society
- Peace Liard Community Health Services Society
- Upper Island / Central Coast Community Health Services Society

Kwantlen University College

Provincial Employees Community Services Fund

[1] Branch of Ministry of Small Business, Tourism and Culture

Royal Roads University

SF Univentures Corporation

Simon Fraser University

Technical University of British Columbia

The Cedar Lodge Society

The University of British Columbia

University of Northern British Columbia

University of Victoria

University Foundations:

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

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
- European Indexed 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 1995
- Private Placement Fund 1996
- Private Placement Fund 1997
- 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

Westel Telecommunications Ltd. Pension Plan

Workers' Compensation Board of British Columbia

Workers' Compensation Board Superannuation Plan

appendix c

Government Entities and Trust Funds Audited by Private Sector Auditors, or Unaudited, and Whose Financial Statements Are Included in the 1997/98 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

BCIF Management Ltd.

British Columbia Arts Council

British Columbia Ferry Corporation

British Columbia Health Research Foundation

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

West Coast Express Limited

Other Entities Not Included in the Summary Financial Statements

20 Colleges and advanced education institutes

28 Community health councils

22 Health care organizations

11 Health regions/regional health boards

60 School districts

39 Regional hospital districts

Trust Fund

Credit Union Deposit Insurance Corporation of British Columbia

appendix d

Excerpts from the 1997/98 Public Accounts

The material that forms Appendix D is from the Public Accounts of British Columbia for the fiscal year ended March 31, 1998. It consists of the Summary Financial Statements of the Province and the Auditor General's report on them.

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