1999/2000: Report 10

OFFICE OF THE

Auditor General of British Columbia

Report on Government Financial Accountability for the 1998/99 Fiscal Year Parts I and II

Province of British Columbia

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OFFICE OF THE
Auditor General
of British Columbia

LOCATION:
8 Bastion Square
Victoria, British Columbia
V8V 1X4

OFFICE HOURS:
Monday to Friday
8:30 a.m. – 4:30 p.m.

TELEPHONE:
(250) 387–6803
Toll free through Enquiry BC at: 1–800–663–7867
In Vancouver dial 660–2421

FAX: (250) 387–1230

E–MAIL: bcauditor@oag.bc.ca

INTERNET HOMEPAGE:
This report and others are available at our Internet Homepage which also contains further information about the Office: http://www.oag.bc.ca

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overview

overview

This, my Report on Government Financial Accountability for the 1998/99 Fiscal Year—Parts I and II, includes my comments on the Public Accounts of the Province and on the reporting by government of provincial debt for the 1998/99 fiscal year. The Public Accounts and Debt Statistics were both published in September 1999, a further improvement by government on the timeliness of the annual production and publication of both these important accountability documents. Parts III and IV of this report, dealing with my comments on Province's financial systems and control, and with progress on revision of the Estimates process, will be issued later this spring.

There are a number of significant issues that I refer to in this report.

Report on the 1998/99 Public Accounts

Reporting Entity

Once again this year, I have qualified my Auditor's Report on the Summary Financial Statements of the Province because, in my opinion, these statements do not present the complete operations, assets and liabilities of the government. Although I have expressed concern on this matter in my reports during the last three consecutive years, the government continued to leave the school districts, public advanced education institutions, and health authorities outside its financial reporting entity. The government argues that these organizations have an initial accountability to local boards, and for this reason excludes them from the ranks of those organizations that are accountable to a minister or directly to the Legislature. In my opinion, this argument is not valid because local accountability for providing essential services cannot satisfy the overall need for accountability for these services to all citizens of British Columbia.

I strongly urge the government to include operating and balance sheet information on school districts, colleges, universities, and health authorities in the Summary Financial Statements of the Province.

Tangible Capital Assets

The government is approaching the last stages of its program of recording its tangible capital assets. This program, which started in 1995, will be substantially complete by 2001. The result of this initiative—which I support—is that the Province's financial statements will henceforth be presented on the full accrual basis of accounting. I view this accounting treatment as appropriate because it better reflects the full cost of government services on a current and long-term basis. The government recognizes that some fine tuning is still necessary, and has incorporated that requirement into its plans.

A noticeable effect of the government's implementation of full accrual accounting was that, in the process, it resolved a long-standing concern I had with the treatment of over $5 billion of amounts given to various government-dependent organizations as loans.

Documenting Government Intentions

Accounting must reflect the true nature of the economic substance of transactions. The latter is determined partly from examining government intentions behind entering into a transaction. Accounting records may not reflect conclusively the nature of a transaction if underlying government intentions are not properly documented.

In this report I have explained how lack of proper documentation of government intentions in relation to the transfer of certain transportation service functions from the Province to the Greater Vancouver Transportation Authority causes me concern regarding the accounting treatment of the transactions.

According to the terms of a multi-million dollar multi-lateral agreement, the Province exchanged its responsibility for providing certain of its transportation services for certain of the Greater Vancouver municipal government's responsibilities, some of which were outside the field of transportation. In my view, the government's intentions for entering into this complex transaction are not clear. I found at least two equally plausible interpretations of the economic substance of the transaction, one of which would result in a much higher annual deficit than that reported by the government for the 1998/99 fiscal year.

I strongly encourage the government to document, in writing, what it wishes to achieve in terms of its public responsibilities, before it conducts negotiations to structure any significant "transaction" with entities outside its reporting entity.

Report on the Province's Financial Management

Debt Management Reporting

Again this year I have expressed an opinion on the Summary of Provincial Net Debt, Key Indicators of Provincial Debt and Summary of Key Benchmarks. These audited statements are part of the *Debt Statistics* report that was issued along with the Public Accounts in September 1999. I am pleased with the improved timeliness of the report.

The Province, through 552513 British Columbia Ltd., holds the majority interest in Skeena Cellulose Inc., a forest products company that the government decided to help out of financial difficulty. The government still views Skeena as a business with a strong likelihood of providing the Province with a reasonable future return on its investment. In the meantime, funding Skeena has increased total provincial debt by $220 million to the end of the 1998/99 fiscal year. Budget '99 estimated that this amount will be further increased by $100 million in 1999/2000 to $320 million, twice the initial investment during fiscal 1997/98.

Currently, debt of 552513 British Columbia Ltd. is classified as self-supporting debt. This means that the government is treating 552513 British Columbia Ltd. as a business enterprise for accounting purposes. The inability of Skeena to operate thus far at a profit, and the trend in increased provincial debt caused by financing Skeena's capital and operating needs, may bring the appropriateness of this accounting treatment into question in respect of future financial reporting.

Sinking Funds

The Province, based on a long-standing government policy, for each borrowing that is greater than $20 million, voluntarily sets aside sums annually to enable it to repay the borrowings at maturity. In past years, because of continuing deficits, the government had to borrow to make installment payments to the sinking funds. The government stated in its 1998/99 Debt Statistics report that, by discontinuing this policy of making sinking fund payments on its direct debt, the Province will decrease its borrowing requirements by approximately $400 million in fiscal 1999/2000. Clearly, this also means that $400 million less will have been accumulated to repay the debt at the maturity dates.

Since the government reports its debt net of sinking funds, there will be little effect on the Province's reported net debt position.

Debt Management Plan

I am concerned that the Budget '95 plan to manage provincial debt, with the objective to gradually repay direct debt over some 20 years, has gone through many significant changes, and is no longer clearly referred to in the provincial Budget '99. Instead, reference is made to a "Five-year Fiscal Planning Framework" that sets forth a framework within which the government is going to manage its revenue, expenditure and debt. The objective of the framework is to keep the debt affordable, a planning target that does not have clear measurable indicators.

I have made known to the Legislative Assembly that I will not be seeking reappointment as Auditor General when my second term in office comes to an end in March 2000. Therefore this is my last report on financial accountability of the government.

I would like to take this opportunity to bring to the attention of the Legislative Assembly that during the 12 years of my office I have witnessed much improvement in the financial accountability by the government to the public. Certainly, there is still more to be done. I am, however, particularly encouraged by recent progress. Here I present some of the more important achievements reached by the government regarding timeliness and completeness of its financial reports over the past 12 years.

In 1989 I reported that only once (in 1987) since the establishment of the Office of the Auditor General in 1977 had the Public Accounts been tabled by the government before the following year's spring sitting of the Assembly. Last year the 1998/99 Public Accounts were tabled on September 16, 1999.

The Summary Financial Statements, referred to in 1989 as the "Consolidated Financial Statements," were then considered a secondary set of financial statements that was produced but was not used by the government in its public references to the results of government operations. In 1998/99 the Annual Report of the Government included the Summary Financial Statements as the main financial statements of the Province, as well as extensive unaudited financial information about the government operations including those of school boards, public advanced education institutions and health authorities.

Until 1992, the government did not record its liability to any of the statutory pension plans for the unfunded portion of pension benefits earned by employees. The 1998/99 financial statements of the Province recorded this as being $2.7 billion owing by the Province to all statutory pension plans.

In 1989 the Province's financial statements were presented on a modified accrual basis of accounting. The government expensed in the year of acquisition every dollar spent on fixed assets. The 1998/99 financial statements of the Province are, in most respects, presented on a full accrual basis, with significantly all major classes of tangible capital assets being properly recorded and amortized.

Most improvements in financial reporting have been preceded by similar improvements in budgeting activities. Currently there are plans for enhancements to the annual budget process resulting from my review of the Estimates process and the report of the Budget Process Review Panel titled "Credibility, Transparency & Accountability," both issued in 1999. I understand the government is intending to produce its first summary reporting entity budget for the fiscal year 2000/01, to be tabled in the spring of this year.

The government, for the fourth consecutive year, in 1999 issued along with the public accounts a comprehensive report on provincial debt, including three debt related audited statements. In these statements the government included information about total debt of the Province.

All the changes referred to above have contributed significantly to better government financial accountability.

I have greatly appreciated the cooperation I have received from government officials and staff in ministries, Crown corporations and agencies throughout these years. Their helpful assistance enabled me to complete my audits of the Public accounts in an efficient manner.

I wish, also, to acknowledge the outstanding work of my staff over the last twelve years. Their tireless efforts assisted me in meeting my responsibilities relating to the audit of the Public Accounts, as well as in providing advice to government managers. Their efforts have contributed significantly to the enhanced financial accountability of the government, and I thank them for their hard work, professionalism and dedication.

George L. Morfitt, FCA
Auditor General

Victoria, British Columbia
January 2000

part 1: report on the 1998/99 public accounts

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 part of the 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, 1999. 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 is reported to 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 year-end.

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 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.

The Public Accounts for the 1998/99 fiscal year were published in two volumes and tabled in the House in September 1999, six months after the end of the fiscal year. This date is approximately one month earlier than in the previous year. We commend the government for continuing to improve the timeliness of publishing this important document. For the 1999/2000 fiscal year, the government is planning to issue the Public Accounts by August 31, 2000, five months following the end of the fiscal year. We continue to support the government in this regard.

Volume I (Section A) of the Public Accounts, titled *Annual Report*, provides a commentary by government on the financial data reported in the Summary Financial Statements, plus an overview of its financial reporting. 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 health and education organizations that are excluded from the Summary Financial Statements. These organizations form part of a province-wide program, are locally based and have an accountability to a local board.

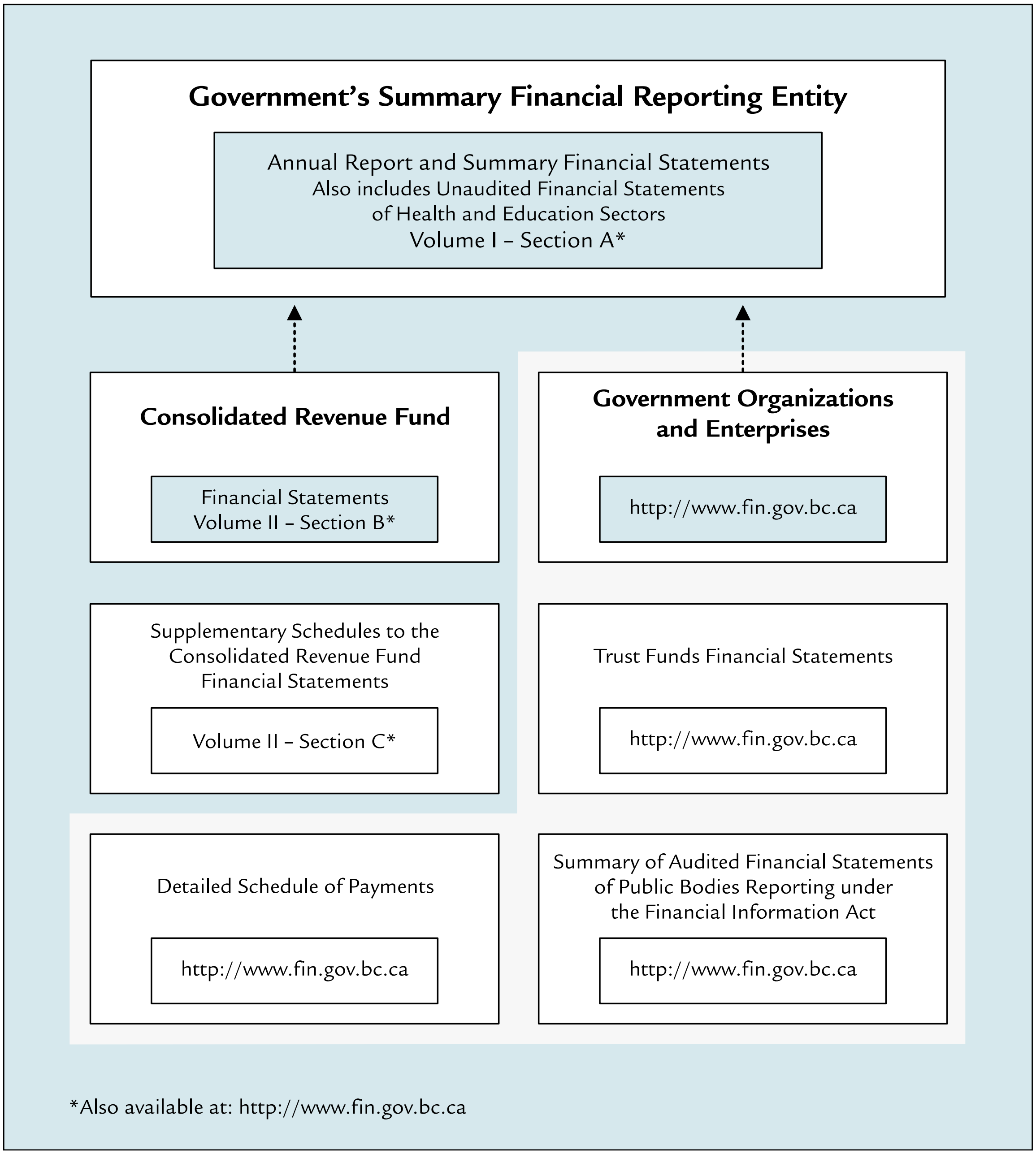
Volume II (Sections B and C), titled *Financial Statements and Schedules of the Consolidated Revenue Fund,* contains the audited financial statements of the Consolidated Revenue Fund, together with unaudited supplementary schedules to the financial statements. This volume is intended to serve as the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

The government has published the above two volumes in standard hardcopy form. Those publications, along with detailed schedules of payments and other supplementary data, are posted on the Ministry of Finance and Corporate Relations' web site at http://www.fin.gov.bc.ca.

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 1998/1999 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 the entities owned or controlled by the Province (most, but not all, are currently aggregated), 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 A52 and A53 of Appendix C 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 C 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 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 and partnerships that provide goods or services to the public. Government enterprises, on the other hand, earn or are expected to earn, in the normal course of their operations, sufficient revenue from goods or services they provide to the public to pay for their operations.

In preparing the Summary Financial Statements, the government uses different methods to consolidate the results of government organizations, enterprises and partnerships. 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 that are generally accepted for commercial operations. As for the provincial interests in government partnerships, they are consolidated on a proportionate basis according to the Province's share of the total provincial contributions to the partnerships.

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, since the 1996/97 fiscal year, the government has excluded the results of those organizations from the Summary Financial Statements. The effect of the exclusion is explained in the reservation 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 major tangible capital assets of the Province, whether purchased or acquired through exchange of assets, have been capitalized. Highways and bridges are the exception. The government expects to have substantially completed recording its capital assets by the end of the 2001/2002 fiscal year.

In the past, the Province loaned funds to various government entities for the acquisition of capital assets. It also provided grants to the entities for the repayment and servicing of those loans. During the 1998/99 fiscal year, the government legislatively restructured its capital funding mechanism with respect to some of the entities. This involved the government releasing those entities from having to repay certain debt obligations, and instead the funds advanced to them for the acquisition of capital assets were recorded as prepaid capital advances in the Province's financial statements.

"Net liabilities," the difference between the Province's liabilities and its financial assets, is an important indicator of the Province's financial condition. Because the Summary Financial Statements no longer differentiate between "financial" and "non-financial" assets, a reconciliation is provided in the notes (Note 27 of the 1998/99 Summary Financial Statements) to clearly show 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 be 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, 1999, 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 1998/99 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.

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, 1999, are shown in Exhibit 1.2.

Exhibit 1.2

Comparative Summary of Financial Results and Balances for the Year Ended March 31, 1999

($ Millions)

	Government Reporting Entity[1]	Consolidated Revenue Fund Reporting Entity
Assets, end of year	26,530	24,145
Liabilities, end of year:		
Public debt	31,303	31,100
Other	6,108	5,763
	37,411	36,863
Net deficiency, end of year	10,881	12,718
Net expense for the year	(1,219)	(466)
Guaranteed debt, end of year	469	538

[1] Not adjusted for the effects of reservations in the Auditor General's reports (pages 25 and 26).

Source: The Public Accounts

Special Fund

Natural Resource Community Fund

The Natural Resource Community Fund was established in April 1992 under the Natural Resource Community Fund Act. The purpose of this Special Fund is 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 statutes 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 $62 million in revenues from natural resources and $9 million in investment income. During that time, it has transferred $59 million back to the General Fund and paid out $1.8 million in assistance to eligible communities.

In 1998/99, the fund received $8 million from natural resource revenues and earned $2 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, 1999, stood at its $25 million limit, as it has for the past five 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, 1999. Also, as auditor of 79 government entities and trust funds, the Auditor General issued auditor's reports on those organizations' financial statements prepared for their accounting year-ends falling in the 1998/99 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 opinion on the financial statements of government entities are similarly appended to those statements in each entity's annual report.

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 auditor with respect to the statements.

The standard auditor's 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 the scope 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, or the opinion paragraph, contains the auditor's conclusion based on the audit conducted. 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.

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.

Summary Financial Statements

The Auditor General's report on the Summary Financial Statements for the fiscal year ended March 31, 1999, 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, 1999, would increase by $4,150 million ($4,327 million for 1998), total liabilities as at March 31, 1999, would increase by $1,896 million ($1,505 million for 1998), and the net deficiency as at March 31, 1999, would decrease by $2,254 million ($2,822 million for 1998). Similarly, there would be an increase in revenue for the year ended March 31, 1999, of $1,704 million ($1,313 million for 1998), and an increase in expense for the year then ended of $1,659 million ($1,163 million for 1998), resulting in a decrease in annual deficit for the year ended March 31, 1999, of $45 million ($150 million for 1998).

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 operations of the Province.

Further comments on the above-mentioned matter can be found on page 31 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.

For the three years preceding the 1998/99 fiscal year, the Auditor General's reports contained a reservation about the government accounting treatment of loans recoverable through future appropriations, and about certain debt obligations of government organizations that were guaranteed by the Province and expected to be repaid by future government funding. To address the Auditor General's concerns regarding the accounting for these loans, the government made some significant legislative and accounting policy changes during the 1998/99 fiscal year. With these changes, the Auditor General is satisfied that his concerns have been appropriately dealt with. An audit opinion without reservation was therefore issued on the Consolidated Revenue Fund financial statements for the fiscal year ended March 31, 1999.

Other Reports

While conducting our financial statement audits, we encounter numerous items that call for study and corrective action by ministries, central agencies and government entities. 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 to be 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 or are part of a government partnership.

A detailed schedule of organizations and enterprises included in the government reporting entity is shown on pages A52 and A53 of Appendix C of this report.

There were a number of changes to the composition of the government reporting entity during the 1998/99 fiscal year. These are summarized below:

- New organizations formed and added to the reporting entity during the year were 580440 B.C. Ltd., BC Society for the Distribution of Gaming Revenue to Charities, Canadian Blood Services, Homeowner Protection Office, Oil and Gas Commission, Rapid Transit Project 2000 Ltd., and Vancouver Trade and Convention Centre Authority. W.L.C. Developments Ltd., a government organization within the reporting entity, was renamed British Columbia Assets and Land Corporation.

  A brief description of these organizations and their operations is provided on pages 72 to 74 of this report, in the section titled "Audit of Financial Statements of Government Entities, Trust Funds, and Other Organizations."

- British Columbia Educational Institutions Capital Financing Authority and British Columbia School Districts Capital Financing Authority were wound up effective April 1, 1998, and British Columbia Regional Hospital Districts Financing Authority was dissolved on March 31, 1999. Also dissolved during the year was the Downtown Revitalization Program Society of British Columbia. All assets and liabilities of these entities have been transferred to the Consolidated Revenue Fund.

As discussed in the previous section of this report, the government has excluded from its summary reporting entity many education and health care organizations. This exclusion has had the following effects on the reporting of Province's financial position and operations for the fiscal year 1998/99:

- An amount of $6.3 billion is shown as prepaid capital advances, and tangible capital assets are reported at an amount that is lower by approximately $8.4 billion. These amounts relate to funds provided over the years to advanced education institutions, school districts and health care organizations for the acquisition of tangible capital assets, and their capital assets currently not aggregated in the Summary Financial Statements.
- "Other assets" and "other liabilities" decreased by approximately $2.1 billion and $1.5 billion, respectively. These amounts reflect, among other things, cash and bank balances, accounts receivable, accounts payable and accrued liabilities of advanced education institutions, school districts and health care organizations at March 31, 1999.
- The net deficiency (accumulated deficit) of the Province is reported at $10.9 billion, higher by approximately $2.3 billion.
- Both "revenue" and "expense" are reported at amounts that are lower by approximately $1.7 billion. The differences relate to revenue (such as tuition fees and patient charges) that is not funded through the Consolidated Revenue Fund but is necessary for the organizations to collect for delivering their programs, and associated expenses.
- There is practically no impact on the consolidated net expense, with the total remaining at $1.2 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, 1999

Balance Sheet

	Existing[1]	Pro Forma[2]
Assets		
Other assets	13.2	15.3
Equity in government enterprises	2.9	2.9
Prepaid capital advances	6.3	–
Tangible capital assets	4.1	12.5
	26.5	30.7
Liabilities		
Other liabilities	6.1	7.6
Debt	31.3	31.7
	37.4	39.3
Net deficiency	(10.9)	(8.6)
	26.5	30.7

Statement of Operations

	Existing[1]	Pro Forma[2]
Revenue	23.4	25.1
Expense	24.6	26.3
Consolidated net expense for the year	(1.2)	(1.2)

[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

Improved Presentation for Government Enterprises

In preparing the Province's 1998/99 financial statements, the government made some presentation changes to enhance the disclosure of financial activities conducted by government enterprises and the effect of these activities on the Province's accounts.

Government enterprises, as described in the preceding section, are public sector entities that earn or are expected to earn, in the normal course of operations, sufficient revenue from goods or services they provide to the public to pay for their operations. Their results are consolidated in the Summary Financial Statements on a modified equity basis. Accordingly, the original cost of the Province's investment in government enterprises is adjusted each year to include the enterprises' net earnings or losses and other equity changes.

The Province's equity interest in government enterprises is presented on the balance sheet as "equity in government enterprises." In fiscal years 1997/98 and prior, this line item included not only the original cost of investment and net earnings or losses of those enterprises, but also the contributions (or dividends) that are due from them to the Province. In the 1998/99 fiscal year, changes were made to the balance sheet to show those contributions on a separate line, "Due from government enterprises." With this new presentation, the "equity in government enterprises" line item in the Province's financial statements now provides more accurate information about the amount of equity interest that the government has in those enterprises.

Previously, in consolidating operating results of government enterprises in the Province's financial statements, the government made a distinction between "operating" and "non-operating" components of those results in the statement of operations. The amounts contributed by government enterprises to the Province for the year were disclosed as operating transactions, while "unremitted earnings" (or net earnings retained within those enterprises) were disclosed separately as non-operating transactions. The government changed its financial statement presentation in the 1998/99 fiscal year to eliminate this distinction. Under the new format, the government has combined "contributions from government enterprises" and "increase (decrease) in unremitted earnings of government enterprises" into "net earnings of government enterprises," a single line item, reflecting the total operating results of government enterprises.

In addition, the supplementary "statement of government enterprises, summary of results of operations and statement of equity" now combines information that was previously provided in two separate statements, "statement of equity in government enterprises" and "summary of results of operations." This change is consistent with the presentation changes in the Summary Financial Statements, as discussed above.

Disclosure of the Year 2000 Issue

The Year 2000 issue arises because many computer systems and programs made use of dates represented by only two digits for the year. Consequently, when processing dates, computers and other electronic devices may assume that "00" means the year 1900 rather than 2000. This "Year 2000 problem" could result in computer systems producing meaningless information or failing completely. The Auditor General recently issued a separate report titled "Report on the Preparedness of the Government of British Columbia in Dealing with the Year 2000 Problem."

In addition to preparations for the Year 2000 problem, there arose another issue about disclosing the problem and its potential impact. In 1998, the Canadian Institute of Chartered Accountants published an accounting guideline recommending that all organizations disclose in their financial statements the uncertainty that the Year 2000 issue imposed on their operations and systems. The disclosure was recommended because of the pervasive nature of this issue, its potential to cause significant system failures and the fact that it will affect all entities at the same time.

In the 1998/99 fiscal year, the government included a note in the Province's financial statements on the Year 2000 issue. Even though the government has taken steps to address the potential effects of the Year 2000 problem on its operations, it is not possible to be certain that all aspects of the problem will be fully resolved. The note cautioned about the possibility that some disruptions might affect the government's ability to conduct normal business operations.

Changes in Government Accounting Policies

Prepaid Capital Advances

In the 1998/99 fiscal year, the government adopted a new accounting policy on "prepaid capital advances." Under this policy, funds advanced by the government to specified government organizations for the purchase of tangible capital assets are recorded as an asset (and described as prepaid capital advances) of the Province. The policy also requires prepaid capital advances to be amortized over the estimated useful lives of the underlying tangible capital assets.

Prepaid capital advances are accounted for as an asset in the Province's financial statements because the Province has an ongoing claim to the use of tangible capital assets that are acquired by government organizations from the capital funds provided by the Province. The advances, representing the underlying tangible capital assets, are considered a future benefit to the general public in that the assets are dedicated to the delivery of government programs such as health care and education.

As at March 31, 1999, the government recorded prepaid capital advances of $6.3 billion in the Province financial statements. A significant portion of this amount—$6.0 billion—was previously recorded as loans repayable through future government funding.

The new accounting policy resolves a long-standing issue on which the Auditor General has commented extensively in the past, questioning the appropriateness of recording, as assets of the Province, loans made through the Fiscal Agency Loan Program to certain public sector organizations. Under this program, the government initially borrowed funds and then made loans, through capital financing authorities, to various public sector organizations for the purchase capital assets. However, some of these organizations, such as school districts, post-secondary education institutions and health organizations, depended on government funding to repay their debt.

Along with introducing the new accounting policy, the government passed legislation to: transfer the assets and liabilities of capital financing authorities to the Consolidated Revenue Fund; wind up the authorities; and release the organizations referred to above from certain of their debt obligations. Some of these transactions took effect on April 1, 1998, and others on March 31, 1999. The Capital Financing Authority Repeal and Debt Restructuring Act, effective

April 1, 1998, dealt with the debt of school districts and post-secondary education institutions, and wound up the British Columbia Educational Institutions Capital Financing Authority and the British Columbia School Districts Capital Financing. The Greater Vancouver Transportation Authority Act, effective March 31, 1999, dealt with the debt of regional hospital districts (discussed in more detail on pages 44 to 47).

On the Province's financial statements, "loans for purchase of assets, recoverable from future appropriation" has been eliminated and "prepaid capital advances" recorded. As indicated above, prepaid capital advances at March 31, 1999, amounted to $6.3 billion. The above events and their impact are further described in the notes to the Summary Financial Statements (see pages A30 and A31 of Appendix C of this report).

Government Transfers

Government transfers, most commonly referred to as grants and contributions, make up a significant portion of government expenses. For the 1998/99 fiscal year, the government changed its accounting policy for the recording of such transfers. The revised policy requires grants and contributions to be recorded in the period that best reflects the substance of the underlying events.

Previously, grant payments were recorded as expenses in the Province's financial statements when the disbursement of the funds was authorized. We had expressed concerns about this practice in several of our previous reports on the Public Accounts, suggesting that the government should record grants and contributions in the same period in which the events giving rise to the transfers occurred. Such practice is recommended by the Public Sector Accounting Board of the Institute of Chartered Accountants.

The government revised its policy on government transfers in May 1999, applied it to the 1998/99 fiscal year operations, and reported in the Public Accounts that there was no financial impact on the Province's financial statements as a result of the policy change.

We noted that, as of October 1999, the government's financial accounting policy manual had not been updated to reflect this recent change in accounting policy. However, we understand that the Office of the Comptroller General is currently working with senior staff of various ministries to assist them in the full and proper application of the new policy on all government transfers. The policy manual, we were told, will be updated when the consultation process is complete.

Government Partnerships

In the 1998/99 fiscal year, the government adopted a new accounting policy on "government partnerships." A government partnership is defined as a contractual arrangement between the government and a party (or parties) outside the government reporting entity that has all of the following characteristics:

- the partners cooperate in achieving common, significant and clearly defined goals;
- the partners make a financial investment in the government partnership;
- the partners share control of decisions related to the financial and operating policies of the government partnership on an ongoing basis; and
- the partners share, on an equitable basis, the significant risks and benefits associated with the operations of the government partnership.

Under the new accounting policy, the government aggregates the account balances and results of government partnerships in the Province's financial statements using the proportionate line-by-line consolidation method. The policy and the method adopted by the government are consistent with the accounting standards for government partnerships, as recommended by the Public Sector Accounting Board of the Canadian Institute of Chartered Accountants.

To illustrate, the new government partnership policy was applied this year to consolidate the accounts of the Canadian Blood Services (CBS) with those of the Province of British Columbia. The CBS was formed during 1998/99 to manage the blood supply system for Canadians. British Columbia, together with all other territorial and provincial governments other than Quebec, has equal representation as a member of this organization. All members of the organization share common goals, risks and benefits, and all have made financial contributions to the organization on an equal basis.

As the CBS met the definition of a government partnership, its financial results were consolidated in the Summary Financial Statements on the basis of the Province's proportionate share of the total member contributions to the partnership for the fiscal year ended March 31, 1999.

Application of Government Accounting Policies

Accounting for Capital Items

Capitalization of Tangible Capital Assets

Starting in the 1995/96 fiscal year, the government began to phase in the capitalization of tangible capital assets in the Province's financial statements. Initially, the process of identifying and valuing the numerous capital asset items used in the government's central activities was expected to take three years. However, because of the difficulty in identifying and valuing some capital assets, the planned target date of completing the capitalization process has now been delayed to fiscal year 2001/02. Exhibit 2.2 shows the assets that have already been capitalized and the proposed capitalization schedule for the remaining tangible capital assets.

Exhibit 2.2

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
1998/99 or earlier	Buildings
	Ferries and Landings
	Land*
	Mainframe and Minicomputers
	Microcomputers
	Parkland
	Vehicles
1999/2000	Heavy Equipment
	Highways
	Operating Equipment
2000/01	Tenant Improvements
	Office Furniture and Equipment
2001/02	Dams and Water Management Systems
	Forestry Roads
	Land Improvements
	Silviculture

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

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

Land

Land Database

The government must verify the ownership and historical cost of capital assets, 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 has so far been able to record only a portion of the land acquired by the Province over many decades.

In our report on the 1995/96 Public Accounts, we commented on the problems encountered by government in determining the ownership and cost of land. Because the databases maintained by the Land Titles Office and the British Columbia Assessment Authority are not designed specifically to keep track of the land acquired and owned by the Province, complete and accurate cost information needed for valuation purposes is often not readily available.

Given the difficulty in identifying and valuing all land held by the Province, the government decided to capitalize land cost with its associated asset class starting in the 1997/98 fiscal year. We commented in our report last year that the cost of land associated with buildings had not been capitalized. This matter was rectified in the 1998/99 fiscal year.

As we pointed out in our "Report on Government Financial Accountability for the 1997/98 Fiscal Year," the government has committed itself to developing a special 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 recorded and maintained centrally. The construction of such a database will require a lot of effort, but it is a necessary task. We understand that the government has started to work on this initiative.

We recommend that the government continue its effort to develop a central database of relevant information on all land owned by the Province and, once the database is completed, maintain and update the information on a timely basis.

Determination of Cost of Land Acquired

In accounting for the cost of land acquired by the Province, we commented last year that certain relevant costs (for example, legal, registration, appraisal, design, survey, and other overhead costs) were sometimes not included as part of the cost of acquired land. Generally accepted accounting principles require that the cost of tangible capital assets include the purchase price as well as other acquisition costs.

We believe inconsistencies in recording land costs occur because the government accounting policy on capitalization of land does not address this issue clearly. We had recommended in our report last year that the government provide ministries with guidance on the accounting for capitalization of land. The government has since provided ministries with such guidance.

Determination of Cost of Parkland Acquired

The Province's accounting policies state that the cost of tangible capital assets include all costs directly attributable to the acquisition, construction, development and 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. 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.

We commented last year that park-acquisition costs were determined inconsistently because there was no clear guidance on which costs were to be capitalized. This was the case especially where existing users of land were compensated with other assets, in addition to cash, in exchange for the land users meeting specific conditions set by the government for their relocation. In some instances, we believe that knowledge of the government's intentions at the time of the transaction might have been the only factor that could assist in determining whether or not the cost was directly associated with the park.

We recommended in our "Report on Government Financial Accountability for the 1997/98 Fiscal Year" that the government develop guidelines for determining which costs for creating a park should be capitalized and which costs should be charged to normal operations. These guidelines have yet to be developed by the government.

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

Highways

Before 1993, construction of provincial highways was under the mandate of the Ministry of Transportation and Highways. In 1993, this responsibility moved to the BC Transportation Financing Authority (BCTFA), a Crown corporation established to plan, acquire, construct, and improve the transportation infrastructure throughout the Province.

According to the 1998/99 schedule for the capitalization of tangible capital assets in the financial statements, the government was to capitalize highway infrastructure in the 1999/2000 fiscal year. During 1998/99, the government decided to transfer ownership of almost all the provincial highways held under the responsibility of the central government to the BCTFA so that all highway assets were recorded in one organization. The highway infrastructure and associated land, valued together at $4.1 billion, was transferred to BCTFA at $1, the nominal value at which it was recorded in the Consolidated Revenue Fund Financial Statements. The determination of the net book value of the highways was based on depreciated historical costs and estimates. We were satisfied that the government made a reasonable effort to determine the accuracy of the value of highways transferred.

While the transfer resulted in an increase in capital assets of a net book value of $4.1 billion being recorded in BCTFA's financial statements, it has had no financial impact on the Province's 1998/99 Public Accounts. The reason for this is that the government's accounting policy for the fiscal year 1998/99—in the transitional period of capitalization of assets—continues to require all highway acquisition costs to be expensed in the Province's financial statements in the year the cost incurred. According to the government's transitional plan, highway assets will be capitalized in the Province's financial statements starting in the fiscal year 1999/2000.

Computers

Last year, we commented that there were 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. To address our concern about the inconsistent accounting treatment of these costs, the government changed its policy to exclude the cost of employee salaries from capitalization even where those costs are directly attributable to the construction or development of the asset. This exception is inconsistent with standard accounting practices, which normally require the cost of a constructed asset to include direct construction or development costs, such as materials or labour.

Furthermore, the exclusion of the cost of employee salaries directly attributable to the construction or development of an asset from capitalization may result in inconsistent accounting treatment of capital costs. For example, the cost of contractor's fees directly attributable to the construction or development of computer software would be capitalized, while the cost of employee salaries performing similar development tasks would not.

We recommend that the government review its accounting policy for constructed assets to ensure all costs directly attributable to the construction or development of assets are capitalized.

We also commented in our last year's report on the Public Accounts that there were inconsistencies in how the ministries applied the capitalization guidelines provided to them by the Office of the Comptroller General, and that there was a need for training ministry staff to enable them to consistently apply guidelines on accounting for tangible capital assets. We noted that, during the fiscal year 1998/99, such training was provided to ministry staff by the Office of the Comptroller General.

Vehicle Sale and Leaseback

We commented last year that the Province, on March 31, 1998, 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 in the Province's accounts at the time of the sale was $9 million.

In accounting for the transaction last year, the government recorded as a capital lease only the portion of the lease payments that related to vehicles built before 1992. We recommended that the entire sale transaction be accounted for as a capital lease, because the risks and benefits of ownership of all the leased vehicles remained with the Province.

During our 1998/99 audit, we were not aware of any other significant lease arrangement that may give rise to similar concern.

Prepaid Capital Advances for Health Facilities

Background

In the fall of 1997, the Province and the Greater Vancouver Regional District (GVRD) reached an agreement to embark on a major transportation initiative in the Greater Vancouver region. The overall objectives of this agreement were to:

- reform governance and funding for transit and major roadways;
- promote better management of transportation demand in Greater Vancouver; and
- implement transportation plans that meet the purposes of the Province and the GVRD.

Key in this agreement was the creation of a new corporation, the Greater Vancouver Transportation Authority (GVTA). Now known as TransLink, GVTA was made responsible for providing an integrated transportation system in the Greater Vancouver region. The GVTA is governed by a board consisting mainly of elected officials of the GVRD. Many of the local transportation programs previously the responsibility of the government were transferred to the corporation. For example, it is now responsible for the service delivery of the Vancouver buses and SeaBus (formerly operated by British Columbia Transit), SkyTrain (formerly operated by British Columbia Rapid Transit Company Ltd.), and the Commuter Rail System (formerly operated by West Coast Express Ltd.). It is also responsible for the administration and control of certain roads transferred to it from both the Province and the BC Transportation Financing Authority.

The delegation of transportation responsibilities to GVTA also included certain funding arrangements and responsibility for future expansion of the transportation system in the Greater Vancouver area. The funding provisions also included some specifics such as:

- transferring ownership of certain assets and debt obligations associated with the transit operation in Greater Vancouver from the Province to GVTA;
- transferring the motor fuel and parking sales taxes that the Province collects in Greater Vancouver to GVTA; and
- granting GVTA the power to raise revenues through user fees, tolls, vehicle charges and taxes.

Financial Reporting

The same agreement between the Province and the GVRD also specified that the Province would assume responsibility for the Greater Vancouver Regional Hospital District’s

(GVRHD's) share of hospital cost, allowing the GVTA to replace the existing hospital levy with a regional transportation levy.

To formalize the agreement, the Greater Vancouver Transportation Authority Act was passed on July 30, 1998. The Act, among other things, provided for the transfer of assets and liabilities of the British Columbia Regional Hospital Districts Financing Authority to the Consolidated Revenue Fund. It also wound up the financing authority and released the regional hospital districts from certain debt obligations.

Unrelated to this agreement, but also occurring in the 1998/99 fiscal year, the government made a significant accounting change to the Province's financial statements (described under "Prepaid Capital Advances," page 36)—a change that later affected the financial reporting of transactions resulting from the agreement. This new accounting policy on prepaid capital advances was adopted to account for funds advanced by the Province to specified public sector organizations for the purchase of tangible capital assets.

On January 1, 1999, authorized by the Greater Vancouver Transportation Authority Act and the Hospital District Act, the government dissolved the GVRHD and assumed all of its debt obligations (including the portion expected to be paid off by taxpayers within the GVRD). Then, applying its new accounting policy, the government accounted for the debt released as a prepaid capital advance. This accounting decision was made on the basis that the funds originally advanced by the government to the GVRHD were used for the construction of health facilities in the district, facilities on which the Province holds an ongoing claim. Legal opinion sought by the Office of the Comptroller General has confirmed the Province's right over the assets.

Reporting Concerns

Financial reporting of the varied, and sometimes very complex, business activities of government is not an easy job at the best of times. It can be even more of an accounting challenge when the underlying intentions and parameters of the activities are not clear. Here, the question is how the accounting of the cost of delivering health care and transportation services in British Columbia, and the treatment of amounts previously owed the Province by GVRHD as prepaid capital advances should have been done. While, based on a plausible explanation, the Auditor General's Report on the Province's Financial Statements was not qualified on this matter, we discuss below another equally valid interpretation of this transaction.

The substance of the series of transactions that took place between the Province, British Columbia Transit, and the GVRD was unclear to us. It seems that, in an overall program to transfer transportation governance in Greater Vancouver to the GVTA, the Province agreed to transfer certain assets of the British Columbia Transit and certain provincial highways to the authority in exchange for taking over certain responsibilities for health care from GVRD. The Province also assumed the GVRHD's share of the liability for constructing the district's health facilities. Furthermore, it appears that, in order to lessen the burden of the operating costs of the GVTA's new responsibilities, the Province allowed the GVTA to introduce a transportation levy. And, in turn, the Province agreed to drop the existing hospital levy that was used to finance the operating costs—including debt repayment—of the GVRHD's health facilities.

Had these exchanges been explicitly articulated and clearly documented between the various parties involved in the "package deal," the accounting treatment of the transactions would likely have been different from how they are currently disclosed in the accounts of the Province. What makes this supposition valid is that, although no change has occurred in health care or transportation services provided to the public, the health care cost to the Province has substantially increased and the transportation cost decreased.

Because of the way the said "package deal" is documented, we were unable to determine whether the release of the GVRHD's debt by the government has been a funding activity related to health care, or instead to the transfer of transportation responsibilities to GVTA. The Public Accounts have been prepared on the basis of the former supposition. However, if the latter was the case, then the amount currently recognized as a prepaid capital advance would have been accounted for as a contribution and expensed by the government. Had the government's release of the debt obligations of the GVRHD been expensed, the Province's annual deficit for the year ended March 31, 1999, would have increased by about $260 million.

Accounting is to reflect management intentions and the economic substance of the transactions. When governments enter into agreements or arrangements that involve extensive and intricate transactions, it is essential that the underlying intentions and economic substance of the activities be clear so that transactions can be properly accounted for.

We recommend that in all cases—but particularly when negotiating significant multi-lateral business transactions—the government clearly articulate its underlying intentions and the economic effects that it is expecting to realize, so that proper accounting of those transactions can be determined.

Accrual Accounting

Liability for Post-Retirement Benefits

Many retired members of the Public Service Superannuation Plan and other government-funded pension plans receive benefits paid for by their former employers. For example, these employers may pay all or a portion of the pensioners' premiums for public health care plans. As an employer, the Province is responsible, under existing pension agreements, for paying the Medical Services Plan and Extended Health Care premiums for its current and retired employees. This is disclosed in the notes to its financial statements.

For a number of years, we have commented on the way the government records the Province's obligation for post-retirement benefits in the financial statements. Currently, the cost of these benefits is recorded only when the benefits are actually paid. The liability for unpaid benefits earned by retired and current employees is not recorded in the Province's financial statements. We believe that all post-retirement benefits earned over an employee's service life should be accounted for in the financial statements as liabilities of the Province. The government agrees that a liability for employee post-retirement benefits exists, but has not recorded it in the Province's financial statements.

The government said in the past that it was waiting for a more definitive accounting policy pronouncement from the Canadian Institute of Chartered Accountants (CICA) on how to value employee future benefits. In March 1999, the CICA issued new accounting standards for recording employee future benefits. These standards require the accrual and recording, over the term of employees' service lives, of all benefits—not only pension income, but also other benefits such as life insurance, medical and dental plans—earned by the employees. We understand that the Office of the Comptroller General is in the process of obtaining an estimate of this liability and is considering its inclusion in the 1999/2000 Public Accounts.

We recommend that a reasonable estimate of post-retirement benefits be included as a liability in the Province's financial statements.

Contingent Liability for Environmental Clean-up Costs

Many sites around the province are contaminated and money will have to be spent to restore them. Some of the more common provincial sites where contamination exists, or may exist, include government highway work yards, gravel pits, and forestry work camps and yards. Potential contaminants include gas, oil and chemicals. The cost of cleaning up contaminated sites could be significant.

For a number of years, the government has included an accrual in the Province's books to provide for the cost of cleaning up certain sites known to be contaminated and for which the Province is responsible. As at March 31, 1999, the Province's financial statements included $44 million with respect to the provision account. We noted that few procedures were carried out at year end, by either the Comptroller General's staff or other ministries' staff, to determine whether the provision amount was adequate or reasonable for the specific sites that the provision was meant to cover.

In the Province's 1998/99 financial statements, the government has also disclosed that it is not possible to determine the amount of additional environmental clean-up liability for other contaminated sites because site evaluations have not been completed. We were advised that, as of March 31, 1999, the government (through British Columbia Buildings Corporation) is reviewing other provincial sites where contamination is suspected so that it can assess the extent of contamination and estimate the costs associated with the clean-up.

We recommend that the government establish formal procedures for reviewing annually the reasonableness of the the environmental clean-up liability recorded in the Public Accounts. The government should also ensure that all provincial sites for which the Province is responsible are evaluated for possible contamination so that the total liability for restoring contaminated sites can be determined.

Insurance Risk Management Account (IRMA)

Under its self-insurance program, the Province insures risks of various classes of persons working in the public sector, including many in the health and education fields. Transactions related to the self-insurance program (including insurance premiums collected, claims paid out, and the liability for claims received) are recorded in a special account of the Consolidated Revenue Fund.

In our "Report on Government Financial Accountability for the 1997/98 Fiscal Year," we had recommended that the Province account in its financial statements for all its liability relating to third-party insurance claims. The reason was that the government, for a number of years, had recognized a liability in preparing the Province's financial statements only when claims had been registered and accepted by the government's risk management office. No liability was recorded for incidents that may have occurred as of March 31 of a given year but for which no claim had been filed, or if filed, had not yet been accepted by the government.

For the fiscal year 1998/99, the government recorded in the Province's financial statements an additional liability for potential insurance claims according to the actuarial valuations. These valuations estimate the amount that the insurer expects to pay out for existing claims and for claims that have yet to be registered.

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 also does not allow the full picture of the government's operations to be presented.

The accounting policies stated in note 1 to the Summary Financial Statements of the Province specify that those statements must be 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 revenues in the Province's financial statements. This gives the appearance that expenses have been reduced when in fact that may not be true. Last year, in our report on the 1997/98 Public Accounts, we commented on a number of instances where expenses were netted against revenues in the Consolidated Revenue Fund Financial Statements. These included the netting of government assistance to Canadian Airlines International ($9 million) against fuel tax revenue, and the netting of the bad debts expense ($61 million) against the related revenue stream. This matter remained a concern for the fiscal year 1998/99.

Another area of concern to us is when revenues are reported as “recoveries” of expenses in the financial statements. Such practice also creates the appearance that government operating expenses have been reduced, since recoveries are netted against expenses in the financial statements. To illustrate this point, we discuss below the accounting treatment, in the 1998/99 Consolidated Revenue Fund Financial Statements, of contributions received from the British Columbia Lottery Corporation.

In 1998/99, a portion ($67 million) of the contributions received from the Lottery Corporation was recorded as a recovery against grants (totalling the same amount) paid out from the Consolidated Revenue Fund to a government organization, the BC Society for the Distribution of Gaming Revenue to Charities. The rest of the contributions from the Lottery Corporation, $369 million, was recorded as revenue.

Of note here is the fact that the government, in the above case, treated contributions received from the same source inconsistently, partly as revenue and partly as recoveries. The accounting treatment was also inconsistent with that used in prior years, when contributions from the Lottery Corporation were recorded—correctly—as revenue in the Consolidated Revenue Fund Financial Statements. And, as well, it was inconsistent with the way the government records contributions from other government enterprises. The ultimate effect of all this was that the total government expenses in the 1998/99 Consolidated Revenue Fund Financial Statements were reported at an amount lesser by $67 million.

We raised this matter with government officials. The Office of the Comptroller General and Treasury Board staff advised us that the $67 million was a recovery from the Consolidated Revenue Fund, after the contributions from the Lottery Corporation had been added to the fund, as provided in the 1998/99 Estimates. While we acknowledge that the recovery was provided for in the Estimates, its description there was unusual. It stated that the “recoveries are from revenues paid into the Consolidated Revenue Fund by the British Columbia Lottery Corporation." The wording used in this sub-vote description for recoveries was unlike any other description of recoveries included in the Estimates. Such descriptions in other votes refer to some external funding sources outside the central government (such as the federal government or the Crown corporations), whereas in this case, the source of recovery specifically referred to was from the Consolidated Revenue Fund.

We are concerned that the practice of recording revenue as a recovery of expenses in the Estimates and the Province's financial statements could potentially be misused to give the appearance that program expenses have been contained or lowered.

We again recommend that the government use the gross basis of accounting for the Consolidated Revenue Fund Financial Statements, and avoid the reporting of government revenues as recoveries of expenses.

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.

Normally, for stakeholder funding in a government entity to be appropriately recorded as an investment, there must be a reasonable expectation of financial return. However, where the government entity is not a business or commercial enterprise, an expectation of financial return is normally remote or absent. On this basis, it would be difficult to justify contributions to such entities as an investment.

Last year, in our "Report on Government Financial Accountability for the 1997/98 Fiscal Year," we commented about the appropriateness of recording as an investment the $45 million contribution the Province made to Columbia Basin Trust (Trust) on April 1, 1996.

The provincial contribution 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."

There does not seem to be any expectation of a financial return to the Consolidated Revenue Fund. Furthermore, the recipient corporation is not a business enterprise that could sustain its operations without ongoing subsidies from the government. Nevertheless, the government continued to record this contribution as an investment in the 1998/99 fiscal year. We believe that the investment should be written off and expensed as a grant in the Consolidated Revenue Fund.

We recommend that the initial contribution to the Columbia Basin Trust, currently recorded as an investment in the Consolidated Revenue Fund, be written off and expensed as a grant in the Province's accounts.

Improved Accountability Through Better Information

Accounting for Government Enterprises

Earlier, on page 20, we defined "government organizations" and "government enterprises" and explained how their results are consolidated in the Summary Financial Statements. Government organizations are fully consolidated in the Summary Financial Statements, which means that all their revenues, expenses, assets and liabilities are aggregated on a line-by-line basis after they are adjusted for compliance with the government's stated accounting policies. Government enterprises, on the other hand, are recorded on the modified equity basis, meaning that the Summary Financial Statements include only the original cost of the government's investment in these entities, adjusted annually for their net earnings, losses and other equity changes.

We believe that, as we commented in our previous reports on the Public Accounts, government enterprises should be accounted for on the line-by-line consolidation basis. One reason is that excluding these government enterprises from full consolidation in the Summary Financial Statements results in a significant amount of revenues, expenses, assets and liabilities that are under government stewardship not being aggregated. This hinders in the proper evaluation of the full extent of the government's financial activities.

Another reason is that, although government enterprises may carry out a self-sufficient commercial activity, they are invariably also given responsibility to implement major public policies. This makes them essentially equivalent to other government programs captured and reported in the Summary Financial Statements. For example, British Columbia Hydro and Power Authority, established in 1962 as a Crown corporation, has a corporate mission to provide integrated energy solutions to its customers in an environmentally and socially responsible manner. Similarly, the British Columbia Lottery Corporation, as an agent of the Crown, is the authority designated by the Province to conduct and manage lottery games.

Also, recording in the Summary Financial Statements only the adjusted value of the Province's investment in government enterprises is inconsistent with the gross basis of accounting, a policy that has been adopted by the government and stated in the Province's financial statements.

Over the last few years, however, we have noted that the government has changed the basis of consolidation for some entities that were previously accounted for on a modified equity basis. For example, in the fiscal year 1998/99, the government consolidated the financial activities of British Columbia Assets and Land Corporation and B.C. Community Financial Services Corporation on a line-by-line basis. However, the financial activities of other government enterprises continue to be recorded on a modified equity basis on the grounds they do not depend on the government to subsidize their operations. These enterprises include a number of large corporations such as British Columbia Hydro and Power Authority, British Columbia Railway Company, and the Insurance Corporation of British Columbia.

The accounting for government enterprises used in the Summary Financial statements is consistent with the current recommendations of the Public Sector Accounting Board of the Canadian Institute of Chartered Accountants. Nonetheless, we believe that consolidating government enterprises fully, on a line-by-line basis, in the Summary Financial Statements would provide better financial information to enhance public sector accountability.

Exhibit 2.3 shows the significance of the information currently excluded from disclosure in the Summary Financial Statements. It compares the main components of the Balance Sheet and Statement of Operations, as currently presented, to similar pro forma financial statements prepared on the assumption that all components of the government reporting entity are consolidated on a line-by-line basis.

Exhibit 2.3

Effect of Reporting the Government Enterprises on a Full Consolidation Basis

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

Condensed Summary Financial Statements
Province of British Columbia
March 31, 1999

Balance Sheet

	Existing[1]	Pro Forma[2]	Difference
Assets			
Other financial assets	13.2	12.9	(0.3)
Equity in government enterprises	2.9	—	(2.9)
Prepaid capital advances	6.3	6.3	—
Tangible capital assets	4.1	15.4	11.3
	26.5	34.6	8.1
Liabilities			
Other liabilities	6.1	14.0	7.9
Debt	31.3	31.5	0.2
	37.4	45.5	8.1
Net deficiency	(10.9)	(10.9)	—

Statement of Operations

	Existing[1]	Pro Forma[2]	Difference
Revenue	23.4	31.3	7.9
Expense	24.6	32.5	7.9
Consolidated net expense for the year	(1.2)	(1.2)	—

[1] Government organizations are currently recorded on a full consolidation basis, and government enterprises on a modified equity basis.

[2] Government organizations and enterprises are all accounted for on a line-by-line consolidation basis.

Source: The Public Accounts and financial statements of government's commercial enterprises

financial highlights

financial highlights

In this section of the report, we highlight financial information to provide an overview on the state of the Province's finances. Financial data presented here are taken from the summary level financial statements included in the Public Accounts of the relevant years, and are restated to reflect accounting changes during those years so as to provide a consistent basis for comparison between the last five years.

Since fiscal year 1996/97, the Auditor General's Report on the Summary Financial Statements of the Province has contained a reservation with respect to the appropriateness of the summary reporting entity. This means that, to understand the Province's financial results for those years, the reader needs to 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 results of published Summary Financial Statements for all fiscal years except 1995/96 to reflect the effects of this reservation. In the 1995/96 fiscal year, the adjustment was not necessary as the government had expanded the composition of the summary reporting entity to include health care organizations, regional hospital districts, universities, colleges and institutes, and school districts. Since then, however, the government has excluded those bodies referred to above from the summary reporting entity.

Also, in the 1995/96 fiscal year, the government changed its accounting policies to phase in capitalizing tangible capital assets and amortizing them over their useful lives. The financial data used for the purposes of this section reflects the effects of this policy change.

As a result of legislative changes in the 1998/99 fiscal year, certain debt obligations owed to the Province were released and prepaid capital advances were recorded. This change was applied prospectively and prior periods were not restated.

As in previous years, financial data have not been 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 1999 Budget, the government reported an overall economic contraction in 1998 of 0.5% (compared to an economic growth of 2.0% in 1997). This was attributed largely to sluggish growth in the Asian economies and softening of international commodity prices. The government expects that economic conditions will improve in 1999 but still remain restrained because of conditions in the Asian economies and global uncertainty. Real economic growth in 1999 is projected to increase by 0.5%, while employment is forecast to increase by 3.1%, resulting in some 58,000 new jobs in British Columbia. On the basis of these expectations and an anticipated increase in service demand, the government has set its 1999/00 budget target at a deficit of $890 million.

Revenue

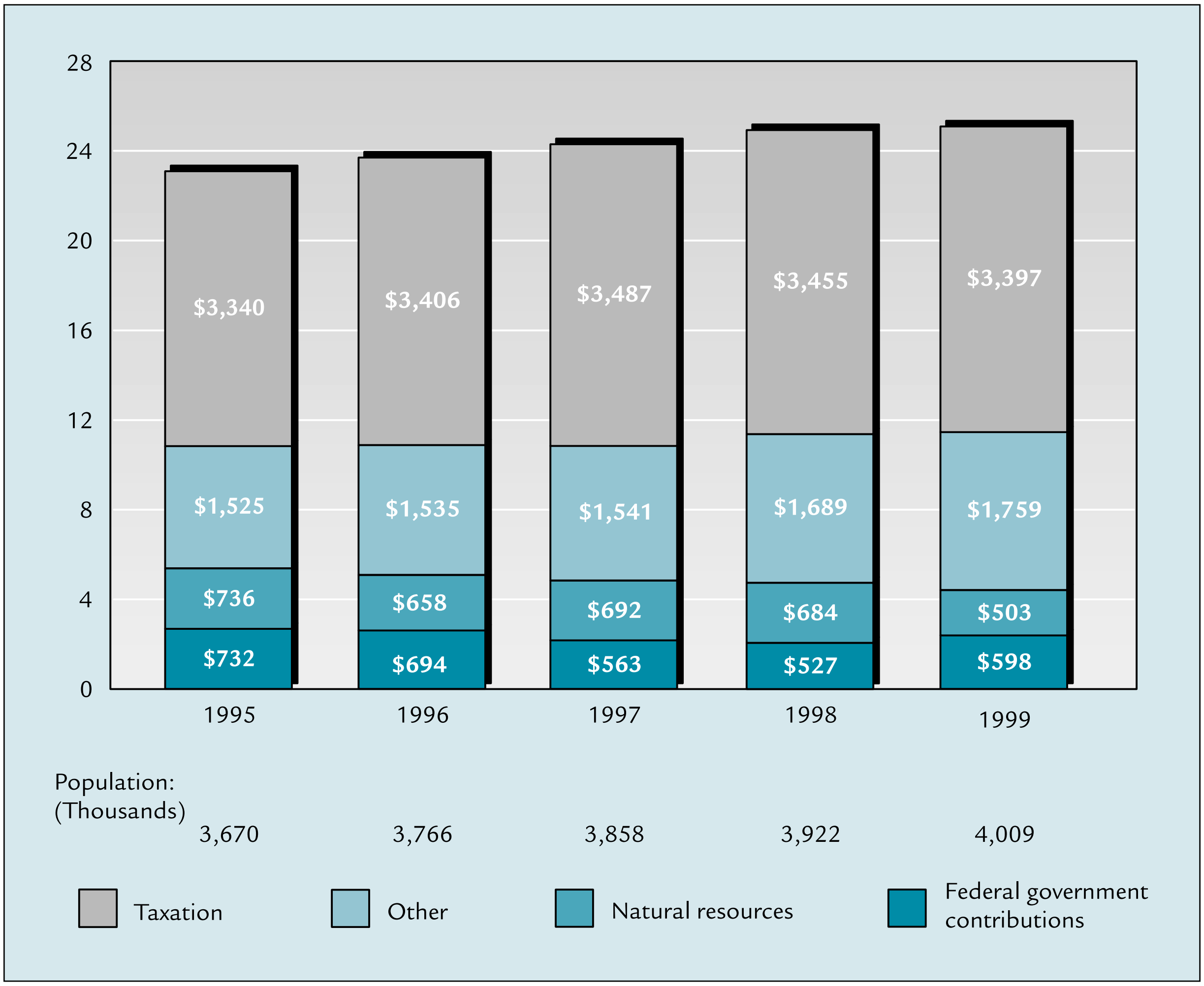
Exhibit 3.1 shows total revenue of the Province in each of the years 1995 to 1999. For the year 1999, revenue from all main sources except “natural resources” have increased. The largest percentage increase in revenue by main source was in “Federal government contributions.” It increased by 16.1%, from $2,065 million in 1998 to $2,398 million in 1999. This increase was offset by a significant decline in natural resources revenue—a decline of 24.8%, from $2,681 million in 1998 to $2,015 million in 1999.

Taxes remain the most significant source of revenue for the government of British Columbia. Over the last five years, they have accounted for 53 to 54 cents of every dollar of provincial revenue. Taxation revenue has increased by 11.1%, from $12,256 million in 1995 to $13,620 million in 1999. Expressed in other terms, this means that the average taxation revenue generated by each resident of British Columbia (per capita revenue) has increased from $3,340 in 1995 to $3,397 in 1999. Compared with all other taxes, personal taxes have had the highest dollar increase over the past five years, increasing by $717 million, or 15.2%.

Exhibit 3.1

Revenues, 1995 to 1999

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



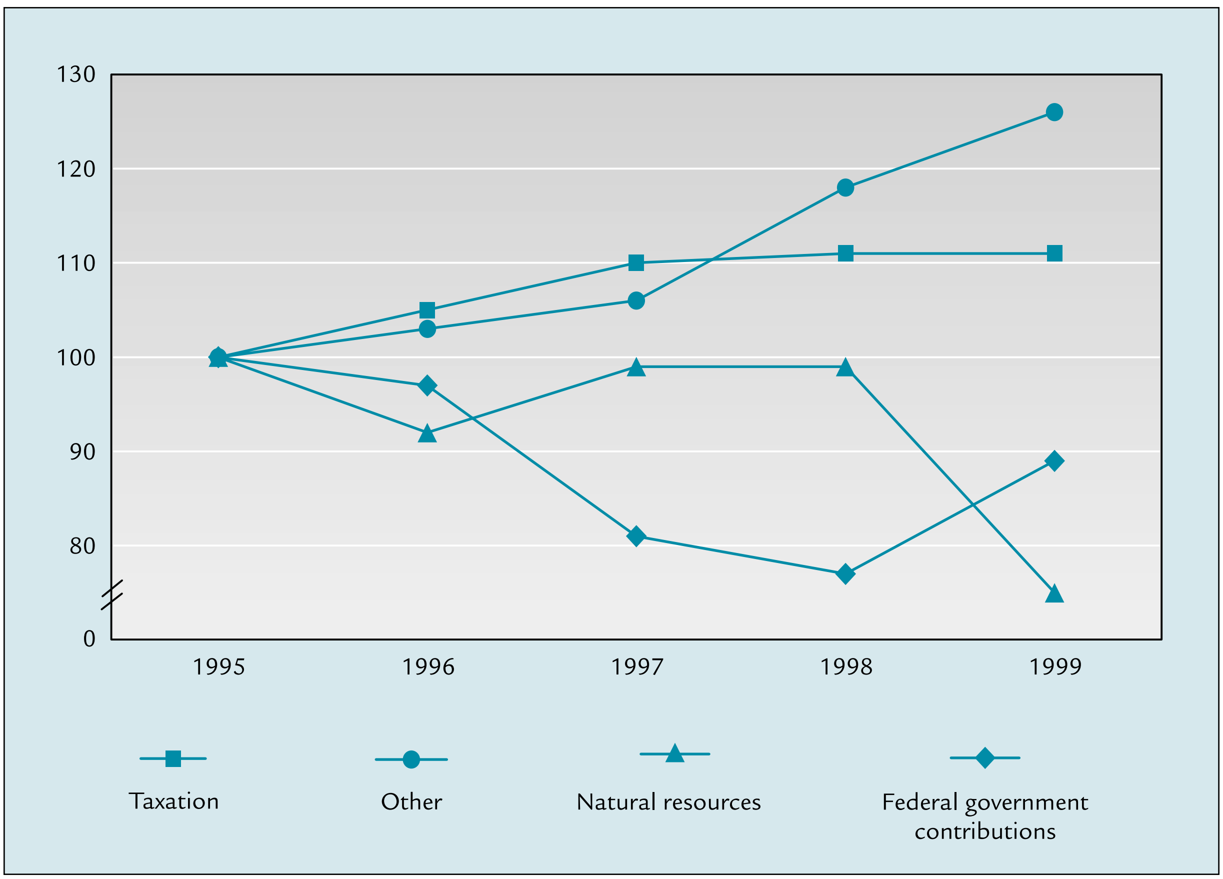
Source: The Public Accounts (restated) for financial figures; Statistics Canada for population statistics as at July 1

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 1995. Revenue for each main source in the four years that follow 1995 has been shown as a percentage of the base year. “Other” revenue has grown significantly over the last five years. 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 exhibit also shows that contributions from the federal government decreased over the years, then rose in 1999 largely because of the additional cash entitlements made to the Province as a result of revised population estimates. Natural resource revenue, on the other hand, gradually increased between 1996 and 1998, but declined sharply in 1999 because of stumpage rate reductions in the forest industry.

Exhibit 3.2

Change in Revenues, 1995 to 1999

Rate of change in revenue by main sources (1995 = 100)



Source: The Public Accounts (restated)

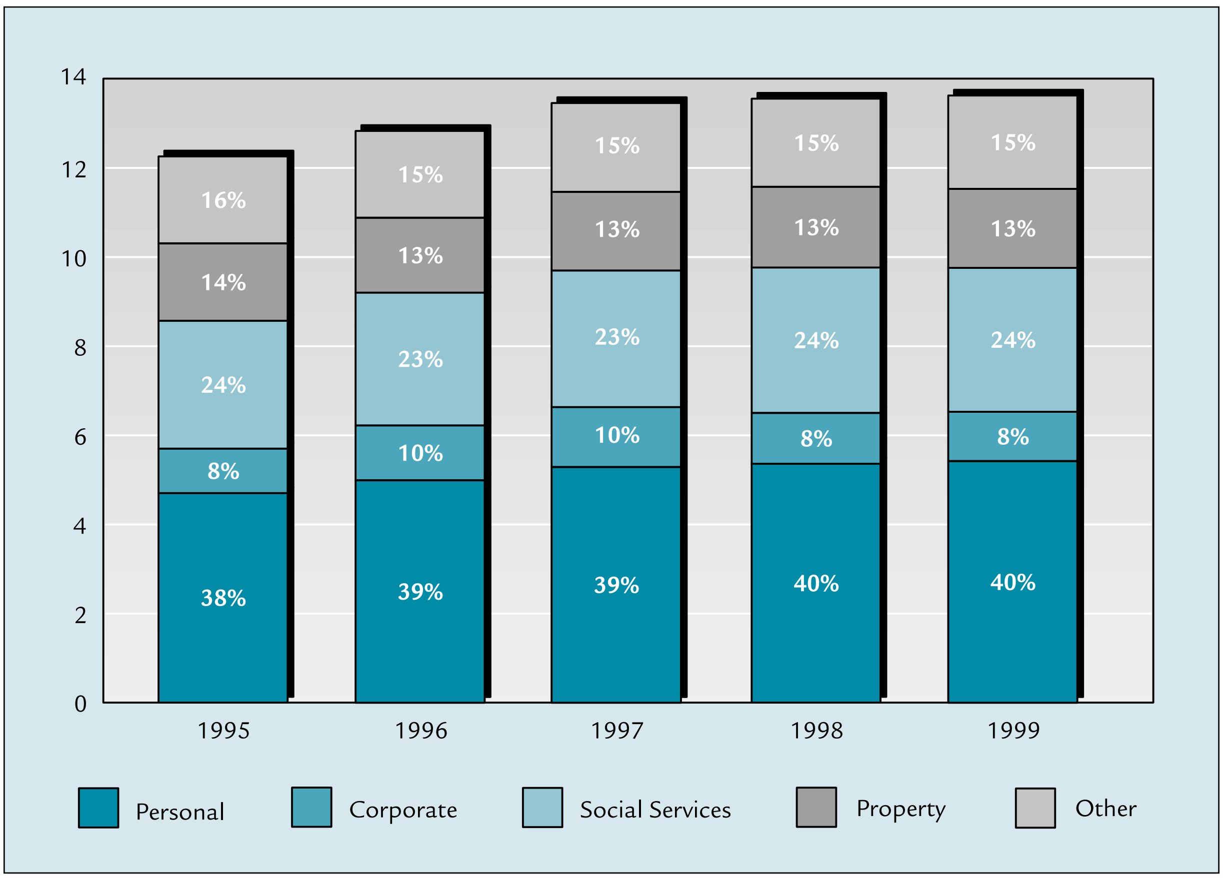
Exhibit 3.3 shows the taxation revenue by source over the five-year period from 1995 to 1999, and the ratio of revenue from each of the major taxation sources to the total taxation revenue of the Province.

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. The proportion of each of these major categories of taxes to the total taxation revenue has remained relatively stable over the last five years.

Exhibit 3.3

Taxation Revenue, 1995 to 1999

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 1995 to 1999. The GDP is used in this exhibit as an indicator of the Province's economy. As in Exhibit 3.2, 1995 is taken as the base year for the comparison.

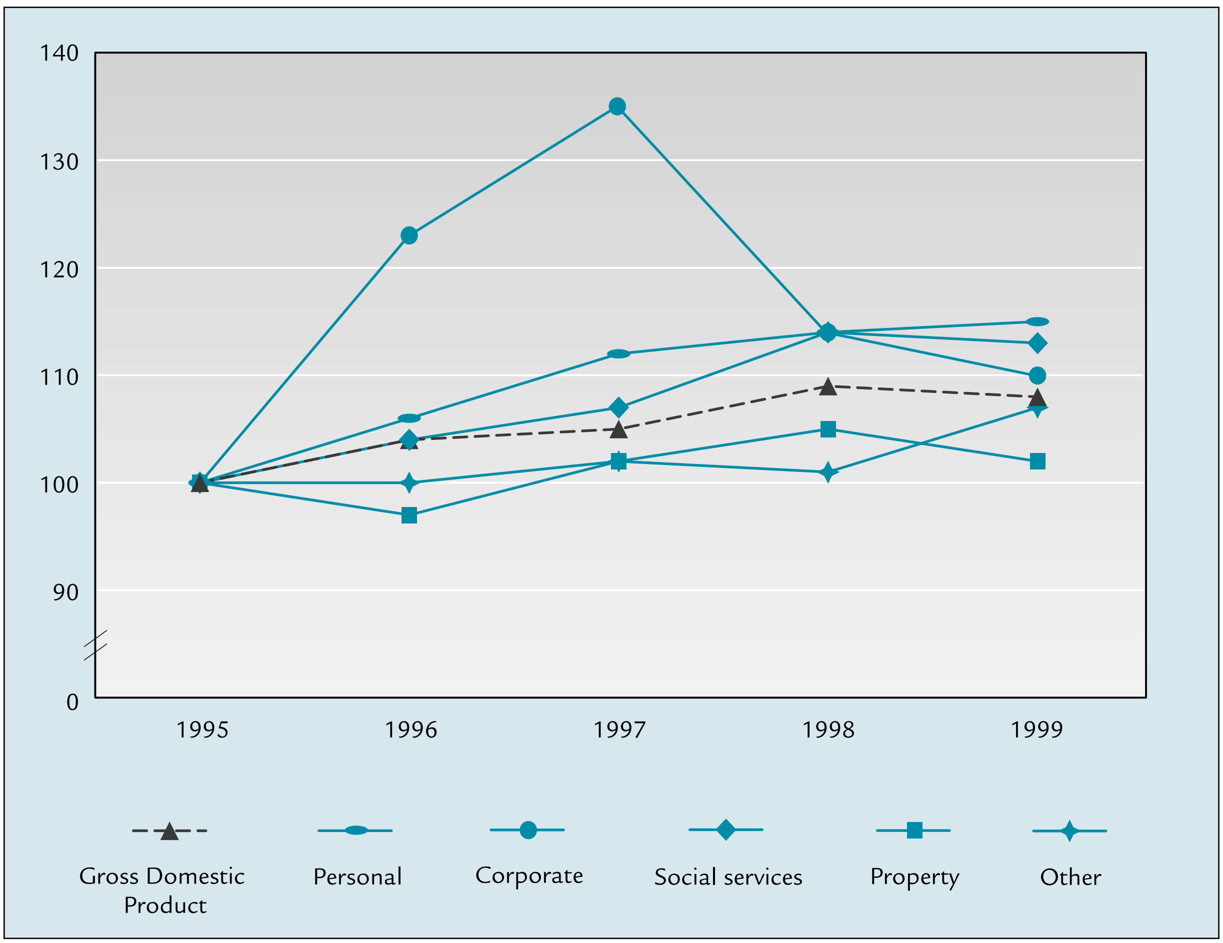
Expense

Exhibit 3.5 shows the Province's total expense from 1995 to 1999. 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 3.4

Change in Taxation Revenue, 1995 to 1999

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



Source: The Public Accounts (restated)

The exhibit also provides information on average expense per resident of British Columbia (per capita expense) in each function group. As well, the percentage of expense in each group to the total government expense is shown.

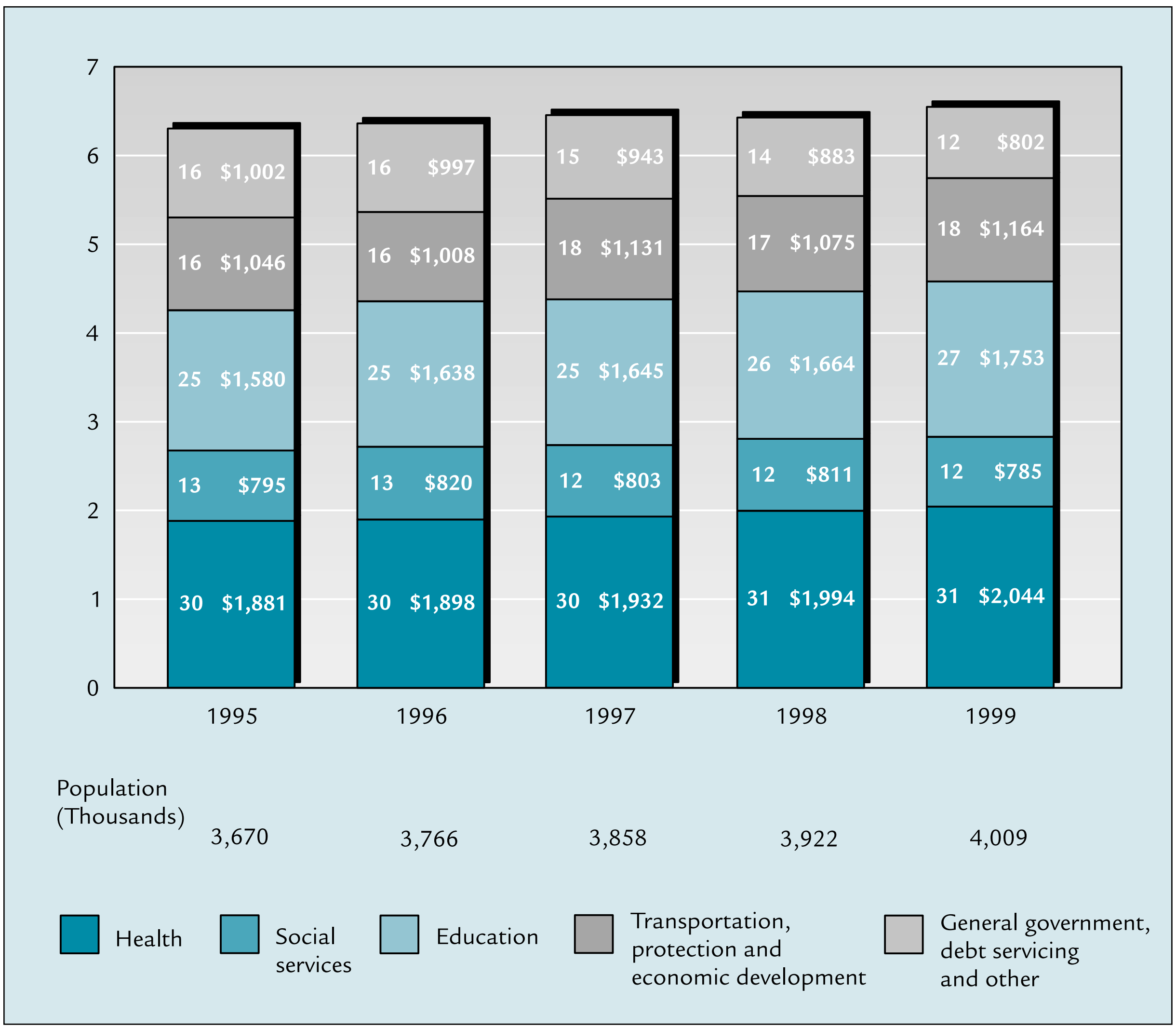
In the last five years, health, education and social services combined have accounted for an average of 68% of the total expenses of the Province:

- Health costs have increased from $6,901 million in 1995 to $8,194 million in 1999, an increase of 18.7%.

Exhibit 3.5

Expenses, 1995 to 1999

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



Source: The Public Accounts (restated)

- The cost of social services has increased from $2,919 million in 1995 to $3,149 million in 1999, an increase of 7.9%.
- The cost to the Province of educating our students has increased from $5,799 million in 1995 to $7,029 million in 1999, an increase of 21.2%.

In the same five-year period, the Province's population increased by 8.1%, from 3.7 million to 4.0 million, and its GDP grew by 7.6%, from $100,672 million to $108,300 million.

Exhibit 3.6 shows the rate of change in per capita expenses 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 1995. The expense is in actual dollars and has not been adjusted for inflation. However, the British Columbia CPI is plotted in the exhibit to show the general increase in prices in the province, indexed to 1995, for comparison.

Deficit

The consolidated net expense (known as the annual deficit) of the Province—the excess of expense (operating and capital) over revenue—is an important indicator of the Province's financial performance. The annual deficit for 1999 was $1,174 million, or 4.7% of the year's total revenue of $25,083 million. The accumulated deficit of the Province—the total of all government deficits and surpluses to date—amounted to $8,627 million at the end of the fiscal year 1998/99.

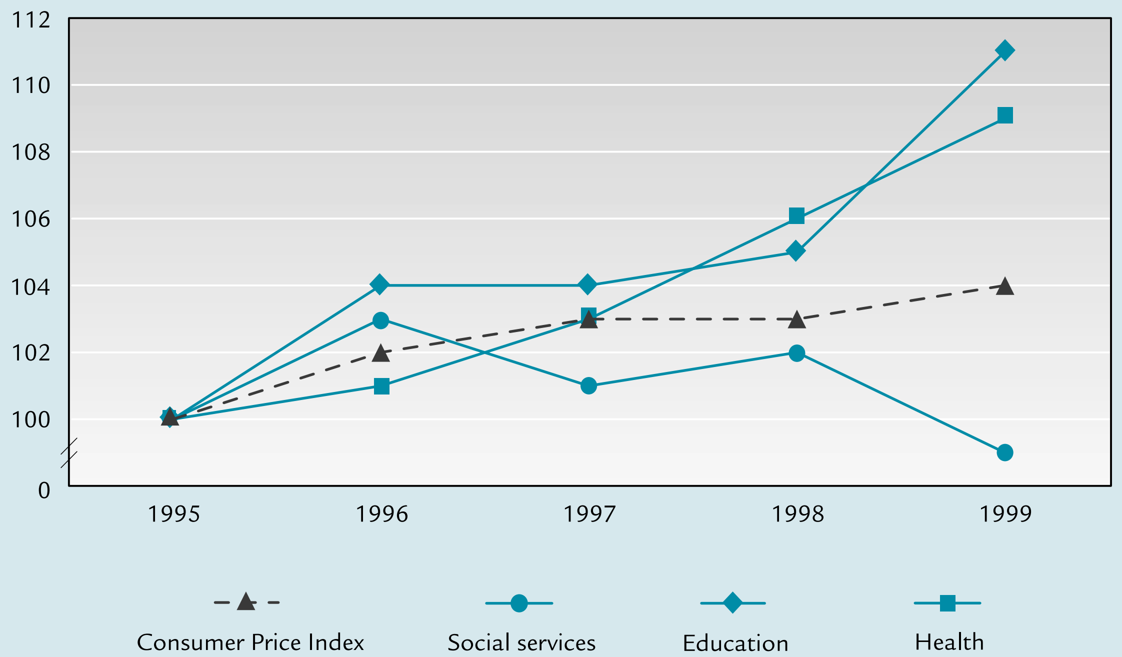
In addition to debt and accumulated deficit, a third financial indicator is also provided in the financial statements: net liabilities. The net liability amount is an indicator of the Province's financial indebtedness. This information is disclosed in the notes to the Summary Financial Statements. The 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), borrowing funds (i.e., assuming additional debt), selling off assets, or undertaking a combination of these.

Exhibit 3.7 tabulates the Province's accumulated deficit and net liabilities over the past five years.

Exhibit 3.6

Change in Expenses, 1995 to 1999

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



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

Exhibit 3.7

Accumulated Deficit and Net Liabilities, 1995 to 1999

($ Millions)

Year ended March 31	1995	1996	1997	1998	1999
Accumulated deficit, beginning of year	(6,623)	(6,517)	(6,778)	(7,440)	(7,576)
Adjustments[1]				144	123
Surplus (deficit) for year	106	(261)	(662)	(280)	(1,174)
Accumulated deficit, end of year	(6,517)	(6,778)	(7,440)	(7,576)	(8,627)
Tangible capital assets, end of year	(10,465)	(10,384)	(12,069)	(12,435)	(12,544)
Net liabilities, end of year	(16,982)	(17,162)	(19,509)	(20,011)	(21,171)

[1] 1998 adjustments largely relating to the regionalization of the health sector
1999 adjustments largely relating to the adoption of prepaid capital advance policy

Source: The Public Accounts (restated)

Exhibit 3.8 shows the annual result of operations compared to the growth in the provincial economy as represented by the percentage change in GDP from the previous year.

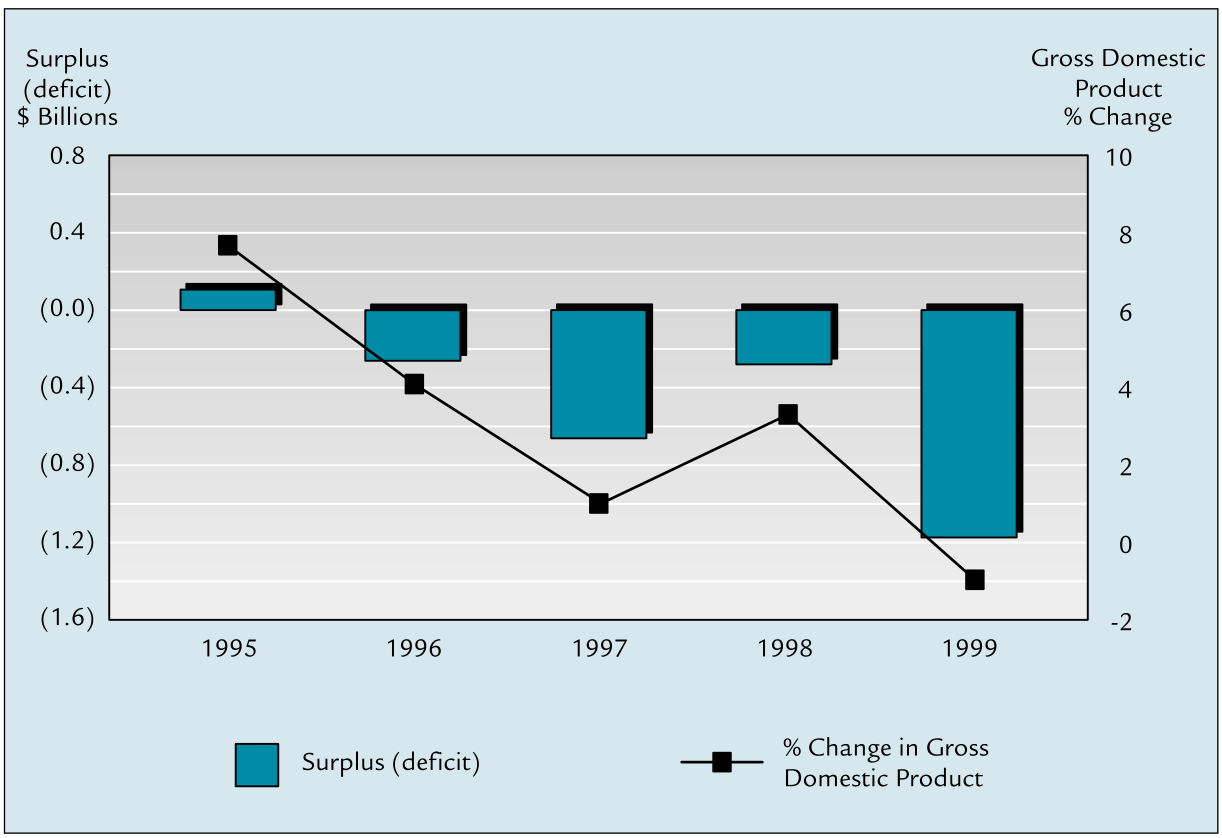
Public Debt

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 3.8

Annual Surplus (Deficit) and Gross Domestic Product (GDP), 1995 to 1999

Annual surplus (deficit) compared to percentage change in GDP



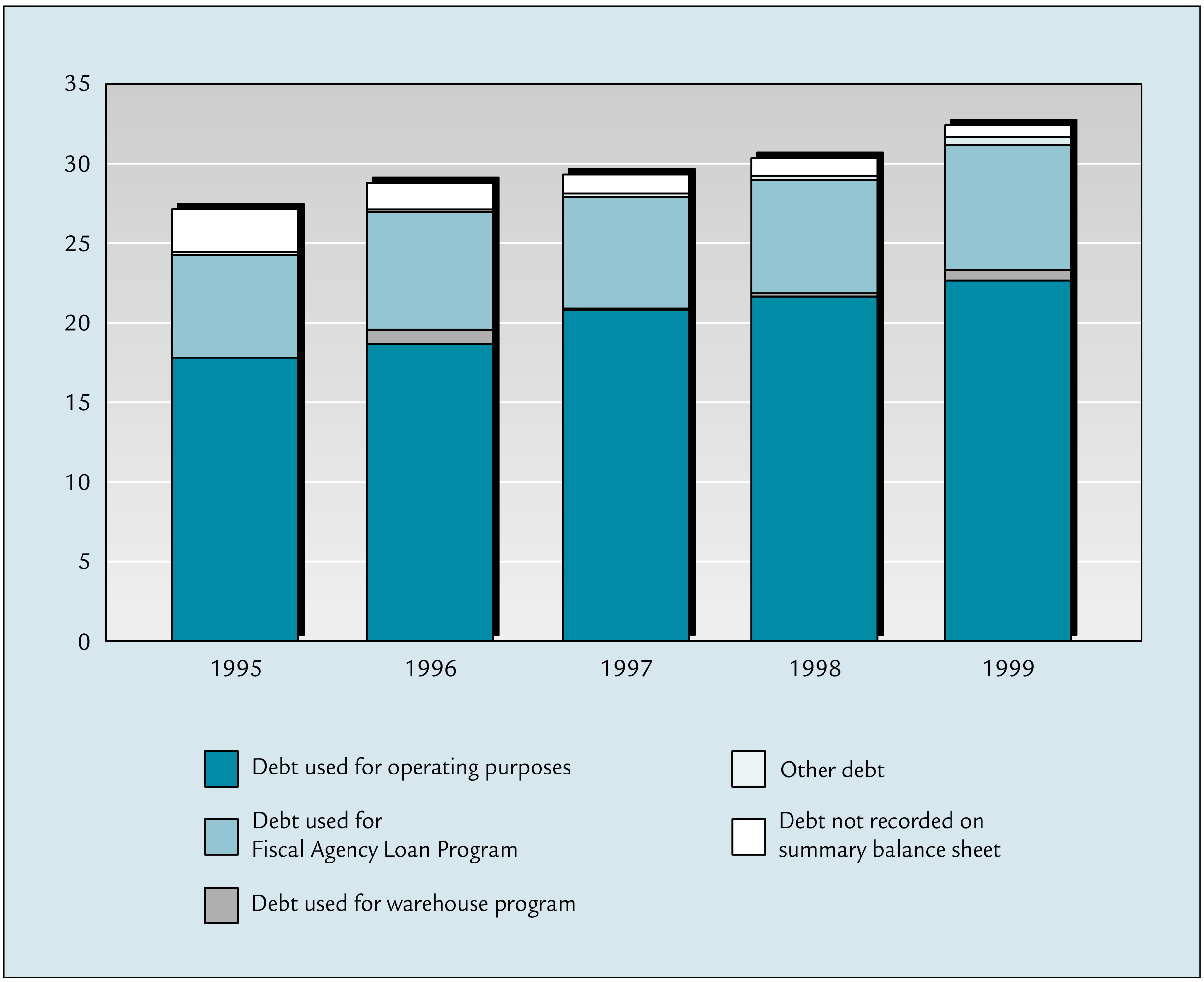
Source: The Public Accounts (restated)

Exhibit 3.9 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 1995 to 1999. During the last five years, the total funds borrowed by the Province increased from $27,122 million in 1995 to $32,401 million in 1999, an increase of 19.5%.

Exhibit 3.9

Total Public Debt, 1995 to 1999

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



Source: The Public Accounts (restated)

Exhibit 3.10 shows the monies borrowed for government "operating purposes" at the end of each of the last five years, compared with the accumulated deficit.

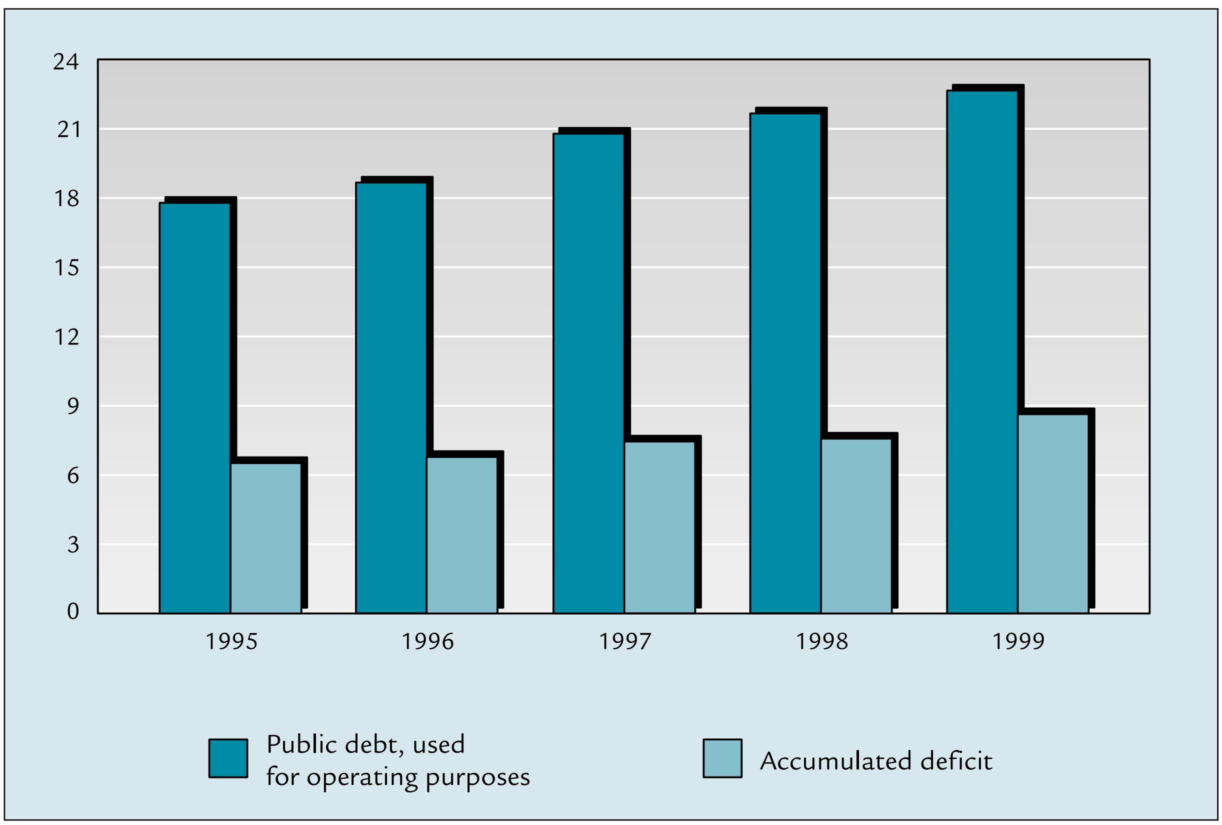
> In government financial reporting, debt used for "operating purposes" means monies borrowed for use in all aspects of operation of ministries and all fully consolidated government operations, including acquisition of assets.

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 3.10

Operating Debt and Accumulated Deficit, 1995 to 1999

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

Government Entities

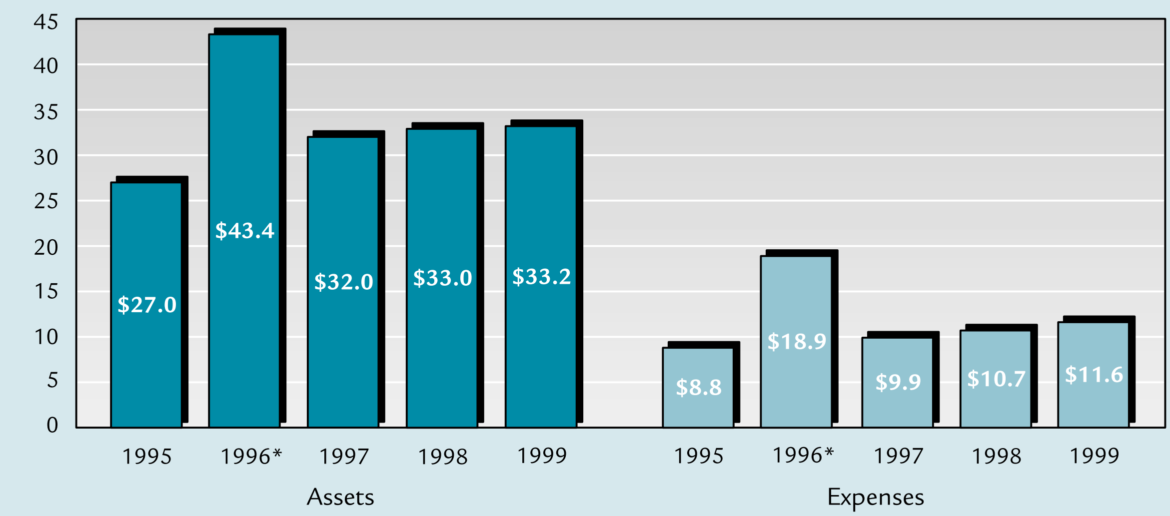
The Summary Financial Statements of the Province for the 1998/99 fiscal year include the results of the financial activities and operations of 55 government organizations and enterprises (collectively referred to in this section as government entities). These entities are listed in Appendix B.

The assets and expenses of the 55 government organizations and enterprises mentioned above amounted to $33.2 billion and $11.6 billion, respectively. Exhibit 4.1 shows the changes in total assets and expenses of these government entities from 1995 to 1999. Not all of the assets and expenses of these entities are aggregated in the Summary Financial Statements of the Province. The reason is that, for some entities, only the investment cost and net earnings or losses are included (as explained in this report on page 20).

Exhibit 4.1

Changes in Assets and Expenses

Assets and expenses of government entities, 1995 to 1999 ($ Billions)



*For 1996, entities in the education and health sectors were also included.

Source: Financial statements of government entities

Last year, the Province's financial statements included 50 such entities. The changes in the composition of the government reporting entity from last year are summarized in the Audit of the Financial Statements of the Province on page 31 of this report. Exhibit 4.2 provides a brief description of the organizations added to the entity, and their respective operations.

Exhibit 4.2

Organizations Added to the Government Reporting Entity in 1998/99

Brief description of organizations and their operations

580440 B.C. Ltd.

580440 B.C. Ltd. was incorporated on February 17, 1999, under the Company Act of British Columbia. Its objective is to provide financing to the Vancouver Trade and Convention Centre Authority, another government entity, for the expansion of the Vancouver trade and convention centre.

The corporation has two board members who are provincial government employees, and it is currently accountable to the Minister of Education. As the corporation does not have its own staff, the Ministry of Employment and Investments provides it with administrative and accounting services at no cost.

The corporation has entered into an agreement with the Province to borrow $114 million from the Province and lend that amount to the Vancouver Trade and Convention Centre Authority. For the year ended March 31, 1999, the corporation had borrowed $29 million and loaned that amount to the authority.

British Columbia Assets and Land Corporation

The British Columbia Assets and Land Corporation, renamed from W.L.C. Developments Ltd. (a name under which it was part of the government reporting entity in prior years), was incorporated under the Company Act of British Columbia. Originally responsible for the development and marketing of provincially owned lands in Whistler, the corporation signed an agreement with the Province in 1997 to develop, market and sell provincial Crown lands throughout British Columbia. In the 1998/99 fiscal year, the mandate of the corporation was further expanded to include the management of land tenures on provincial Crown lands and the selling of government assets.

The board of directors, appointed by a Minister of the government, is made up of eight Deputy Ministers and two senior executives of the corporation. The sole shareholder of the corporation is the Minister of Finance and Corporate Relations. With the mandate of the corporation expanded, 136 staff were transferred from government ministries to manage new responsibilities.

The corporation's primary revenue is from fees it has negotiated with the government on land sales and leases. For the year ended March 31, 1999, the fees were $15 million.

BC Society for the Distribution of Gaming Revenue to Charities

The BC Society for the Distribution of Gaming Revenue to Charities was established on July 10, 1998, under the Society Act of British Columbia. The purpose of the society is to distribute funds received from the Province of British Columbia to eligible charitable and religious organizations.

A seven-member board of trustees has been appointed by the Minister responsible for gaming. The eligibility of charities to receive gaming revenue and the grant amounts are determined by the British Columbia Gaming Commission, another government agency. The society has no staff, and receives administrative support from the commission and the Gaming Policy Secretariat. The cost of this support is paid by the government.

The society provides funds to eligible organizations to supplement those organizations' gaming revenue from licensed bingo events. For the year ended March 31, 1999, the society made payments totaling $67 million.

Canadian Blood Services

Canadian Blood Services was incorporated without share capital on February 16, 1998, under Part II of the Canada Corporation Act. It was incorporated following the results of the Krever Commission of Inquiry on the Blood System in Canada. The corporation owns and operates the national blood supply system for Canada (except Quebec), with responsibility for the collection, testing, processing and distribution of blood products, as well as the recruitment and management of blood donors.

The members of the corporation are the Ministers of Health of the Provinces and Territories of Canada, excluding Quebec. The members provided start-up contributions to the corporation, plus contributions to fund the operation of the blood supply system. Soon after its incorporation, Canadian Blood Services acquired blood system assets from the Canadian Red Cross Society.

The Province of British Columbia's portion of financial interest in the corporation, which is a government partnership, is aggregated in the Province's financial statements on the basis of its proportionate share of total member contributions to the corporation.

Homeowner Protection Office

The Homeowner Protection Office was created in 1998 under the Homeowner Protection Act. Its purposes are to establish a licensing and mandatory third-party home warranty system for residential builders, undertake a research and education function, and provide loans and financial assistance to eligible owners of leaky homes to pay for their building envelope repairs.

The board comprises three persons appointed by the government. The current board consists of a Deputy Minister, the Chief Executive Officer of the office and the Chair of the Board of Commissioners of the British Columbia Housing Management Commission. After the first six months of operations, the office employed 18 staff.

The operations of the office are funded by special fees levied on residential builders and contributions from the provincial government. In addition, the government has committed to making advances to the office of up to $75 million to establish a financial assistance program. The loan is to be repaid over the expected 10-year course of the program. As of March 31, 1999, the Province had loaned the office $8.1 million and the office had approved 344 loans totaling over $7 million.

Oil and Gas Commission

The Oil and Gas Commission was established under the Oil and Gas Commission Act on July 30, 1998, to administer industry activity on oil and gas lands, and to resolve industry land use and economic issues related to aboriginal lands on behalf of the Province of British Columbia. The commission has its headquarters in Fort St. John.

The board of the commission comprises two directors, the Commissioner and the Deputy Commissioner of the organization, each appointed for a five-year term. The commission is accountable to the Minister of Energy and Mines. It took over the oil and gas industry services formerly provided by several government ministries, a move that involved the transfer of 55 management and other staff from these ministries to the commission when it began active operations on October 23, 1998.

The commission is funded through revenue derived from levies on oil and gas production and fees under the Petroleum and Natural Gas Act and the Pipeline Act. During the first year of operations, the commission earned $5.8 million from levies and fees and incurred $6.1 million in expenses.

Rapid Transit Project 2000 Ltd.

Rapid Transit Project 2000 Ltd., formerly 560255 B.C. Ltd., was incorporated under the Company Act of British Columbia on February 25, 1998. The Company is responsible for the construction of two Skytrain extensions in the Greater Vancouver area on behalf of the Province of British Columbia.

The board of directors, appointed by the Province, consists of board members from British Columbia Transit and BC Transportation Financing Authority and a Member of the Legislative Assembly.

. . . continued

To March 31, 1999, the Province had provided funding of $190 million, $57 million of which has been used to make deposits on 20 new Mark II Skytrain vehicles for the existing system. The vehicles and the debt directly associated with the purchase, including interest, are to be transferred to the Greater Vancouver Transportation Authority, under an existing negotiated agreement. With respect to the costs associated with the construction of the two Skytrain extensions, they are being capitalized as a project asset. The Province is currently assessing alternative structures for a separate entity to operate the Skytrain extensions.

Vancouver Trade and Convention Centre Authority

The Vancouver Trade and Convention Centre Authority was incorporated on October 2, 1998, as a not-for-profit corporation, without share capital under the Canada Corporation Act. The purpose of the organization was to promote tourism and conventions in British Columbia and to finance, build and own the convention and exhibition facilities and necessary ancillary facilities at Canada Place in Vancouver.

The authority was to be governed by a board of directors made up of representatives from the federal and provincial governments and industry. At present, there are five directors, all of whom are appointed by the provincial government. Three of the directors are provincial government employees. The authority is currently accountable to the Minister of Education.

For the period ended March 31, 1999, the authority spent $43 million and held further commitments outstanding of $40 million. It received funding by way of borrowings from a provincial Crown corporation (580440 B.C. Ltd.), which in turn had borrowed the funds from the Province of British Columbia.

On October 5, 1999, the government announced that, because there was no financial commitment from the federal government, no commitment for the construction of the hotel and no agreement with the unions on labour rates, it was canceling the trade and convention centre project. At that time, it estimated the net cost of the project to the government to be about $73 million.

Auditors of Government Entities

Exhibit 4.3 shows, for the government entities included in the 1998/99 Summary Financial Statements of the Province, the asset and expense amounts audited by the Auditor General and those audited by private sector accounting firms. The Auditor General audited 25 such entities, which had total assets of $10.0 billion and expenses of $3.1 billion. Private sector accounting firms audited 29 government entities, which had combined assets and expenses of $23.2 billion and $8.5 billion, respectively. And there was one small entity that did not require an audit.

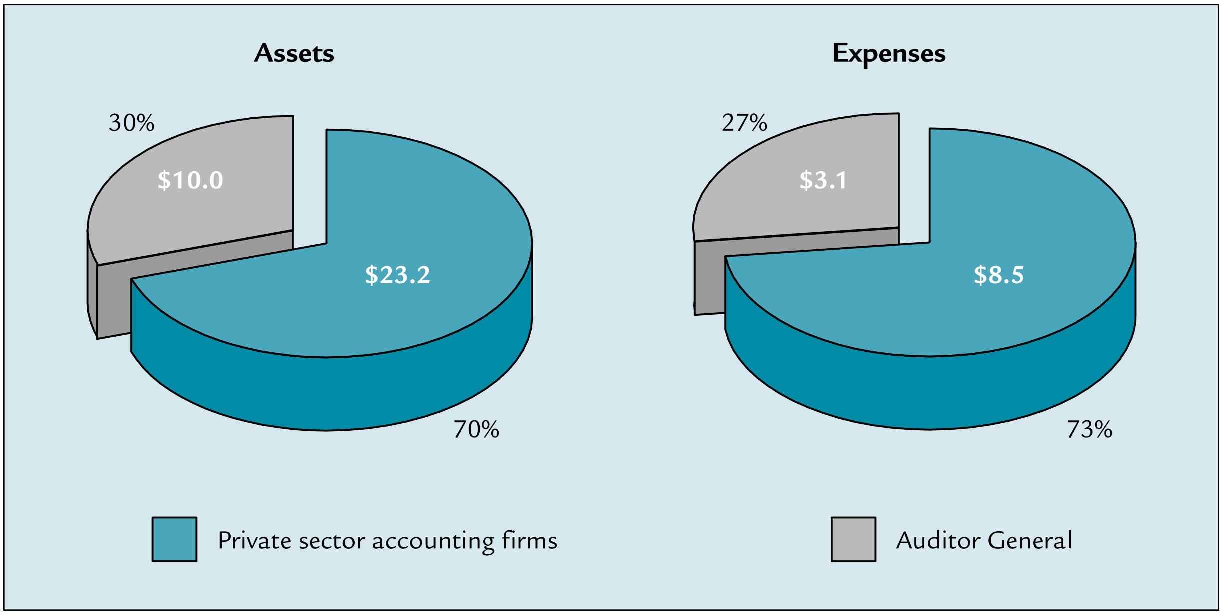
The Auditor General audited, in addition to the government entities included in the Summary Financial Statements of the Province, a further 54 government entities with assets of $84.5 billion and expenses (including financing transactions) of $48.5 billion. Among these were 38 trust and investment funds, including pension and superannuation plans, administered by the government.

Appendix B of this report lists all the government entities referred to above.

Exhibit 4.3

Distribution of Financial Statement Attest Audits

Asset and expense amounts audited by private sector accounting firms and by the Auditor General (for government entities), 1995 to 1999 ($ Billions)



Source: Financial statements of government entities

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 in accordance with generally accepted accounting principles.

Where the auditor finds that the financial statements are not in accordance with generally accepted accounting principles and the exception is considered to be material, the auditor must include a reservation in his or her report. With the exception of one entity, the auditor's reports on the financial statements of government entities included in the Summary Financial Statements were issued without reservations. The exception was a small entity, for which the auditor's report included references to the nature of revenue that did not lend itself to satisfactory audit verification.

Accounting Standards for Government Entities

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

The two main sources to which public sector entities usually refer for accounting guidance are the Canadian Institute of Chartered Accountants (CICA) and its Public Sector Accounting Board (PSAB). Most public sector entities look to the generally accepted accounting principles set by the CICA when selecting the basis for financial reporting by their organizations. On the other hand, the PSAB recommendations are aimed at governments. Certain public sector entities, however, may apply the PSAB recommendations when they are appropriate to their objectives and circumstances, or when the application of specific PSAB standards is directed by the CICA.

An organization will select the accounting standards that most fairly portray its activities. As the chief accounting officer for 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 government organizations and the Office of the Comptroller General to encourage appropriate financial reporting throughout all government sectors.

Below, we discuss some accounting issues that we have noted in relation to financial reporting for schools.

School Districts Need Better Accounting Standards

Under the School Act, every school district is required to prepare audited financial statements. The Act broadly specifies the format, content and timing of the financial statements. The Ministry of Education provides detailed instructions and guidelines for the school districts to follow in their preparation of financial statements.

Last year, we reported our concerns regarding the appropriateness of certain accounting policies adopted by school districts, and the consistency of accounting principles and financial statement reporting standards followed by them. Unless all districts record and present the results of their operations in an appropriate and consistent manner, the users of school district financial statements are hampered in making meaningful comparison of financial management and performance between the various school districts within the province. We recommended the government conduct a comprehensive review of accounting for school districts, with the purpose of improving their financial accountability.

This year, during our review of school district financial statements, we found the same concerns as noted above. However, we are pleased to report that the Ministry of Education has taken some steps to improve the accounting and reporting for school districts. For example, it is currently conducting a review to determine what principles and practices of accounting and financial reporting are appropriate for the school districts in the province. Comparability, wherever practical, with school districts in other provinces is also stated as an objective of this review. Other specific accounting issues that are to be addressed in this review include the full accrual of leave and other liabilities, the setting up of prepaid expenses and inventories, accounting for trust funds and surpluses, and depreciation of fixed assets.

The Ministry of Education hopes to have changes to school district accounting and financial reporting ready for implementation at the beginning of the next school year, July 1, 2000.

Memorandum of Understanding with the Minister of Finance and Corporate Relations

The provisions of the 1995 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 fulfill 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 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 of 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 usually returned to the private sector on a rotational basis over a five-year period.

For the 1998/99 fiscal year, as a result of four years of memorandum implementation, the Office employed agents for the following audits that it had performed directly in the past:

- British Columbia Assessment Authority
- British Columbia Institute of Technology
- Creston Valley Wildlife Management Authority Trust Fund
- Legal Services Society
- Provincial Capital Commission
- Simon Fraser University
- University of Northern British Columbia
- University of Victoria

We relinquished the audit of British Columbia Health Research Foundation and assumed the direct audits of British Columbia Buildings Corporation, BC Transportation Financing Authority, Kwantlen University College and Victoria Line Ltd.

In 1998/99, we released audits of five community health services societies to private sector auditors, and were appointed auditor for the following organizations:

- 580440 B.C. Ltd.
- Arrow Lakes Power Company
- BC Society for the Distribution of Gaming Revenue to Charities
- Campbell River/Nootka Community Health Council
- Canadian Blood Services
- Columbia Thermal Power Company
- Homeowner Protection Office
- New Forest Opportunities Ltd
- Office of the Jobs and Timber Accord Advocate Inc.

- Oil and Gas Commission
- Vancouver Trade and Convention Centre Authority

During this fifth year of the agreement, we will release Royal Roads University to a private sector accounting firm that will be engaged as our agent. In addition, we will release a sixth community health services society to private sector auditors.

In keeping with the terms of the memorandum, we provide not only the Minister but also management with advice on 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 helps us to provide further advice to the Minister and the Legislative Assembly about audit issues.

part II: report on province's financial management

provincial debt: comments on its reporting

provincial debt: comments on its reporting

At March 31, 1999, the total debt of the Province of British Columbia amounted to $32.4 billion—that is $8,082 for each person living in the province. The government's Budget '99 predicts that the provincial debt will increase during the 1999/2000 fiscal year to $34.7 billion. By comparison, 20 years ago the provincial debt was about $7 billion. Since then, the total provincial debt has increased every year except for the period of 1988 to 1990.

Each year, since the 1991/92 report on the Public Accounts, the Auditor General has commented on the government's reporting of public debt and made several recommendations as to how the reporting of debt information could be improved. And in response, the government has over the last several years improved its reporting of debt, both within the Public Accounts and in other publications. It has produced an annual report on debt since the 1994/95 fiscal year. That report, first titled "Debt Management Progress Report," is now named "Debt Statistics." Although some debt information is also contained in other government publications, the annual Debt Statistics report remains the main source for information on provincial debt. The latest "Debt Statistics 1998/99" was published along with the Public Accounts in September 1999.

Debt Measures and Indicators

In the annual Debt Statistics report, the government details a variety of matters related to provincial debt. These matters include, to some extent, key benchmarks to help the public better understand provincial debt and its fiscal impact. Exhibit 5.1 summarizes the 10 key measures and performance

Exhibit 5.1

Measures and Indicators Recommended for Disclosure in the Public Accounts

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

indicators that the Auditor General identified in 1991/92 as necessary for accountability on debt.

For the last few years, some of the measures and indicators presented by the government have been slightly different from those determined by the Auditor General. The reason the amounts are different is that the government's debt measures and indicators, similarly to the government's Summary Financial Statements, excludes all health care organizations, regional hospital districts, universities, colleges and institutes, and school districts (commonly referred to as the "S.U.C.H. sector"). It is our opinion that the Summary Financial Statements, and the Debt Statistics report, should include the S.U.C.H. sector. However, except for the "debt to revenue" ratio, the exclusion of the S.U.C.H. sector from the government reporting entity has not resulted in a significant difference in the reporting of debt measures and indicators.

In the final report of the Budget Process Review Panel (established by the Minister of Finance and Corporate Relations in April 1999 based on a recommendation made by the Auditor General in his February 1999 Report on the Estimate Process in British Columbia), entitled "Credibility, Transparency & Accountability—Improving the B.C. Budget Process," issued on September 27, 1999, the panel recommended that "Legislation require that the reporting and budgeting entity must be the Expanded Summary Entity, which includes the CRF, Crown corporations and other agencies, and those S.U.C.H. sector public bodies that meet the Generally Accepted Accounting Principles criteria for inclusion in the entity." When the government implements the advice of the panel, the measures and indicators in the Debt Statistics report will likely be on the same basis as that which the Auditor General currently provides.

We discuss here the 10 measures and indicators referred to earlier, under the following group headings:

- Total Provincial Debt
- Financial Well-being of the Province
- Cost of Debt Servicing
- Changes in Debt

For the purpose of this report, unless specifically referred to otherwise, debt measures and indicators are based on the reporting entity that includes the S.U.C.H. sector, and references to debt are to the debt net of sinking funds.

It is important to remember that one cannot look at each measure or indicator in isolation. It is only when various indicators are looked at together, including the year-to-year trend of that information, that a proper assessment of debt can be made. Also, graphs showing several years of data for the indicators of total debt may be helpful.

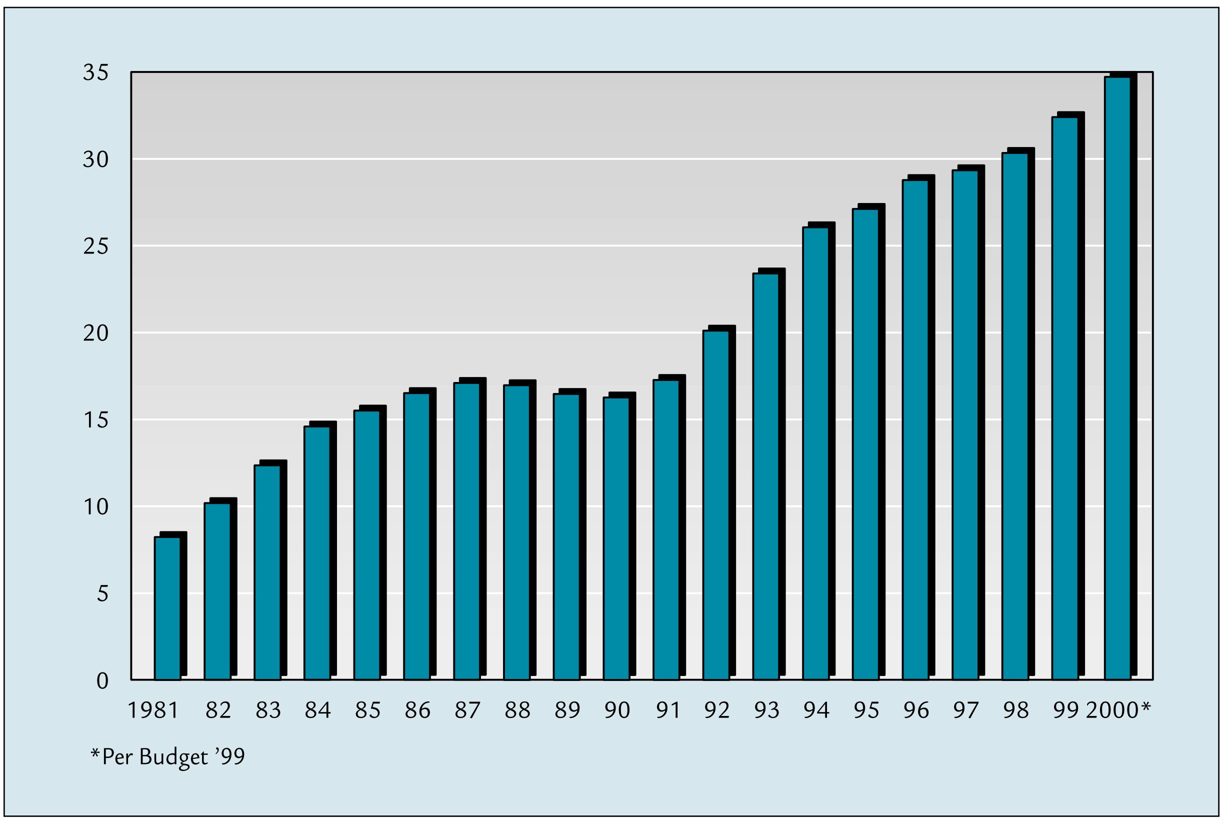
Total Provincial Debt

The first measure of provincial debt is the total provincial debt. The total debt of the Province of British Columbia increased from $30.3 billion in 1998 to $32.4 billion in 1999, an increase of $2.1 billion (6.8%) in one year. However, "Debt Statistics 1998/99" reports total debt to be $32.0 billion as at March 31, 1999. The difference between the two amounts is due to $0.4 billion of additional debt having been borrowed in the S.U.C.H. sector. Exhibit 5.2 shows the total provincial debt for the 20 years ending March 31, 2000 (figures for the year 2000 are from Budget '99 and are based on the government's reporting entity).

Exhibit 5.2

Total Provincial Debt

Total debt for the 20 years 1981 to 2000 ($ Billions)



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

The total debt of the Province is composed of amounts borrowed for the operation of the central government (for operating and capital purposes in the Consolidated Revenue Fund), for the warehouse borrowing program, for government agencies, and for third-party debt guaranteed by the government. Exhibit 5.3 shows the debt composition as at March 31, 1999. The total provincial debt at that date was $32.4 billion, and consisted of the $31.3 billion in debt reported in the Summary Financial Statements, together with $0.5 billion in additional debt of “government enterprises,” $0.2 billion in third-party guaranteed debt, and $0.4 billion in debt of the S.U.C.H. sector.

The Debt Statistics report provides a breakdown of total debt between taxpayer-supported debt and self-supporting debt. In addition, most of the key indicators of provincial debt presented by the government are shown on both a total and taxpayer-supported basis. We are pleased that the government is providing debt information on a total basis, because this is the amount that the government is ultimately responsible for repaying.

Two important indicators of trend in provincial debt are “debt to revenue” and “debt per capita.”

Debt to Revenue

The debt to revenue indicator is calculated as the ratio of debt outstanding at year end to revenue from all sources for that year. It indicates how many years of revenue it would take to repay the provincial debt. Comparing this ratio for the 1997/98 fiscal year (95.0%) to that for the 1998/99 fiscal year (98.2%) shows that, during 1998/99, the rate of increase in debt was higher than the rate of increase in revenue.

The total revenue figure used in calculating the above ratio for 1998/99 was approximately $1.7 billion larger than that used by the government to arrive at its 102.3% ratio. The $1.7 billion reflects additional revenue generated by the S.U.C.H. sector.

Debt Per Capita

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

Each British Columbian’s share of the provincial debt increased from $7,657 to $8,082 between 1998 and 1999

Exhibit 5.3

Total Provincial Debt

Details of gross and net debt as at March 31, 1999 ($ Millions)

	Gross Debt	Sinking Funds & Unamortized Discounts	Net Debt	
Direct debt of Consolidated Revenue Fund				
Operating purposes	13,442	1,252	12,190	
Capital financing purposes	9,307	2,308	6,999	
				19,189
Debt of Warehouse Borrowing Program	661	3	658	
				658
Debt of government agencies[1]				
552513 British Columbia Ltd.[3]	221	–	221	
580440 British Columbia Ltd.[4]	29	–	29	
BC Transportation Financing Authority	1,467	34	1,433	
British Columbia Assessment Authority	4	–	4	
British Columbia Buildings Corporation	907	192	715	
British Columbia Ferry Corporation	1,035	63	972	
British Columbia Housing Management Commission	44	–	44	
British Columbia Hydro and Power Authority	8,510	1,036	7,474	
British Columbia Liquor Distribution Branch	3	–	3	
British Columbia Railway Company	628	21	607	
British Columbia Transit	70	11	59	
Columbia Basin Trust	47	–	47	
Columbia Power Corporation	47	–	47	
Educational Institutions	209	34	175	
Homeowner Protection Office	8	–	8	
Improvement Districts	5	1	4	
Pacific Racing Association	7	2	5	
Provincial Rental Housing Corporation	139	–	139	
Rapid Transit Project 2000 Ltd.	57	–	57	
Regional Hospital Districts	318	–	318	
School Districts	27	–	27	
Victoria Line Ltd.	3	–	3	
				12,391
Third-party guaranteed debt[1]				**163**
Total provincial debt[2]				**32,401**

[1] Debt of government agencies and third-party guaranteed debt is extracted from the audited accounting records of the Ministry of Finance and Corporate Relations as at March 31, 1999, where possible, or from the most recent financial statements of the agency.

[2] Debt includes regular borrowings, notes payable, capital leases, mortgages and minority interests.

[3] This company owns shares in Skeena Cellulose Inc.

[4] This company provides funding to the Vancouver Trade and Convention Centre Authority.

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

(a change of 5.6%). The explanation for this is that the rate of increase in debt was higher than the rate of increase in population. Exhibit 5.4 shows the debt per capita for the five years ending March 31, 1999.

Financial Well-being of the Province

The fourth and fifth indicators shown in Exhibit 5.1 measure the financial well-being of the province. The following "crowding out" effects can seriously hamper fiscal decision-making and become an obstacle to government meeting its program objectives.

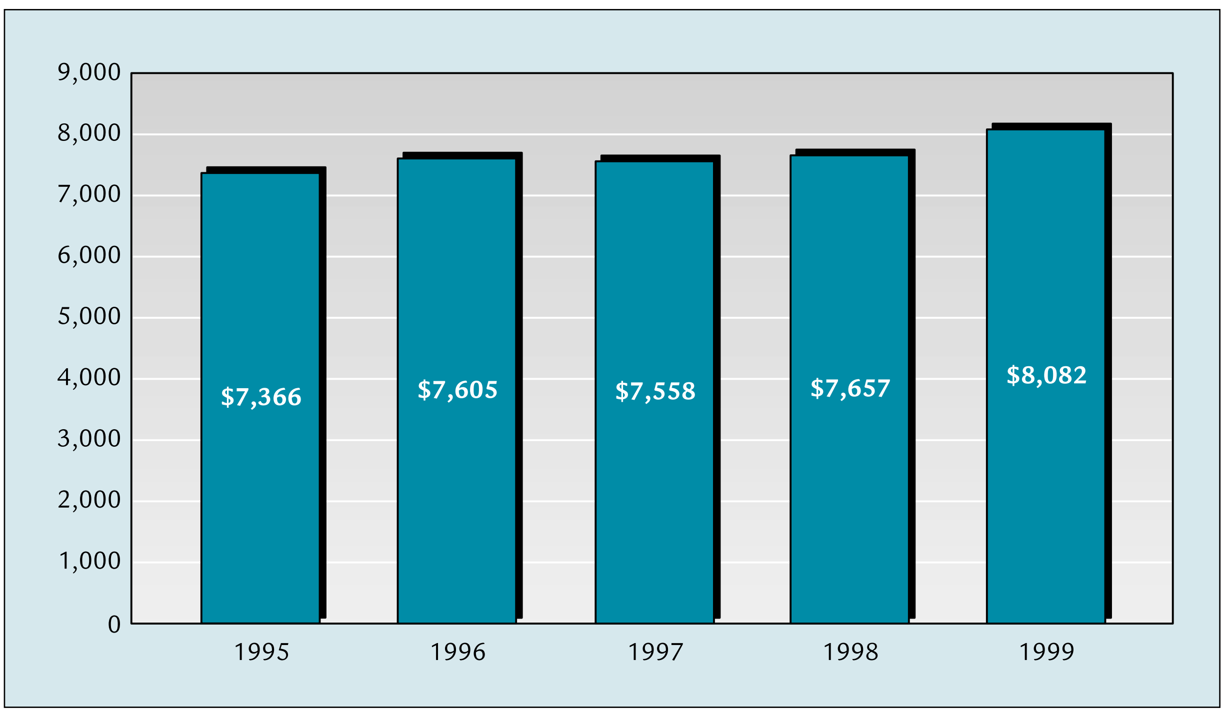
Debt to Gross Domestic Product

The Province's ability to service its debt relates primarily to both its economy and the magnitude of its debt. Gross Domestic Product (GDP) is a calculation of economic production. The debt to GDP indicator compares total debt outstanding at year end to the annual GDP of the Province. As debt increases as a percentage of the GDP, the proportionate cost of interest and

Exhibit 5.4

Debt Per Capita

Average share of provincial debt of a person living in British Columbia, 1995 to 1999



Source: The Public Accounts and Ministry of Finance and Corporate Relations for debt; B.C. Statistics for population debt repayment increases, and the capacity of the government to pay for programs or obtain additional revenue through taxation decreases. Exhibit 5.5 shows the total debt of the Province as a percentage of GDP for the 20 years ending March 31, 2000.

The debt to GDP ratio increased from 27.7% as at March 31, 1998, to 29.9% as at March 31, 1999. This shows that debt increased at a higher rate than the provincial economy grew during the 1998/99 fiscal year. Budget '99 predicts the ratio of debt to GDP will increase again during the fiscal year ending March 31, 2000, to 31.7%.

Interest Bite

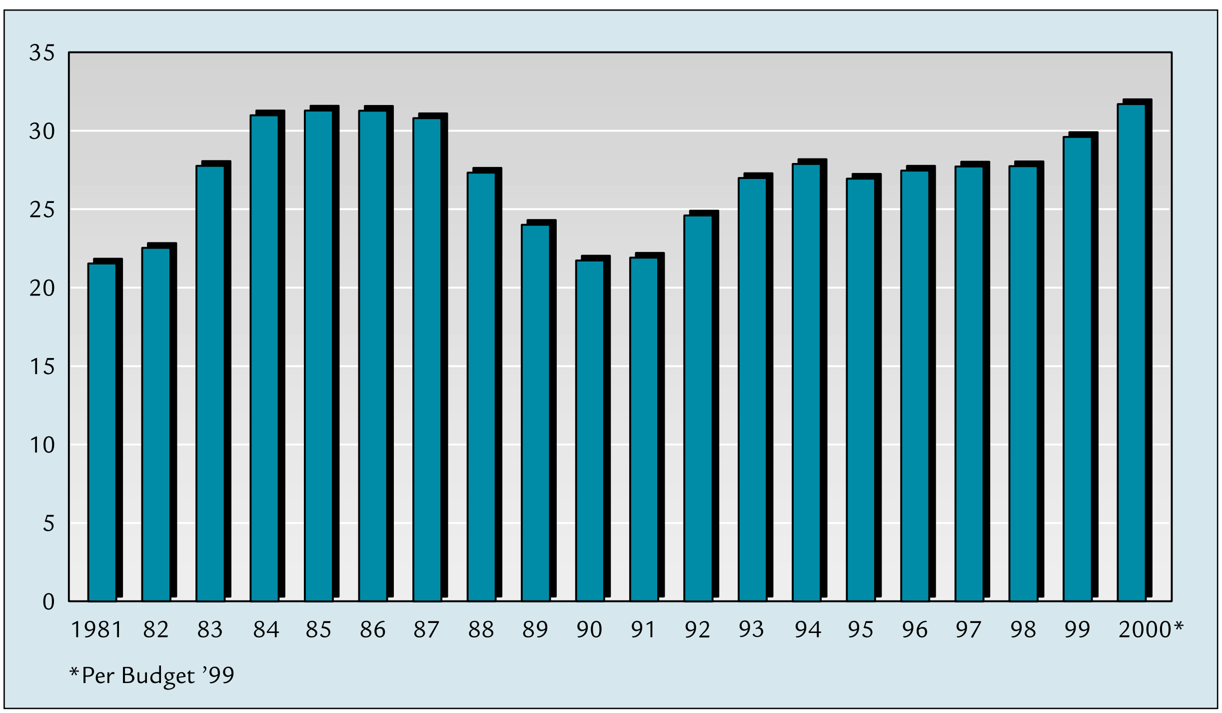
As more money goes to pay the interest on debt, less money is left over to pay for government programs such as health care, education and social services.

The interest bite shows how much of each dollar of the Province's total revenue is used to pay for debt servicing costs.

Exhibit 5.5

Debt to Gross Domestic Product (GDP) Ratio

Provincial debt as a percentage of GDP in British Columbia, 1981 to 2000



Source: The Public Accounts and Ministry of Finance and Corporate Relations for debt; B.C. Statistics for B.C. GDP

It is a ratio, calculated by dividing the total cost of borrowing into total revenue. Were an increasing portion of the revenue of the Province used each year to pay interest on debt, less money would be left to provide services to taxpayers. Thus, the interest bite gives an indication of the fiscal flexibility of the Province.

We calculated the interest bite of the Province to be approximately 7.5 cents for the fiscal year 1998/99 (compared to 7.2 cents in 1997/98). This means that the rate of increase in revenue has been lower than the rate of increase in debt servicing costs. The government has reported the interest bite for 1998/99 as 7.8 cents per dollar. The difference is due to accounting for the increased revenue of the S.U.C.H. sector.

Cost of Debt Servicing

The sixth and seventh measures listed in Exhibit 5.1 relate to the interest cost of debt.

Total Cost of Debt Servicing

The cost of debt servicing, or the Province's cost of borrowing money, represents the interest paid on debt plus incidental costs associated with the administration of debt, less investment income from sinking funds. It does not include the cost of contributing to sinking funds or other repayments of principal.

The Summary Financial Statements for the 1998/99 fiscal year reported the annual debt servicing expense as $2,358 million (compared to $2,198 million in 1997/98). This is not, however, the Province's total cost of debt servicing because it does not include government enterprises and the S.U.C.H. sector. By adding these costs to those reported in the Summary Financial Statements, the total cost of debt servicing would be $2,477 million in 1998/99 (compared to $2,305 million in 1997/98).

Rate of Interest

The rate of interest can be calculated by dividing the total cost of debt servicing into the average debt outstanding during the year. This ratio provides a measure of average interest cost during the year, which can then be compared to market rates, to prior years, and to other jurisdictions.

"Debt Statistics 1998/99" reported the taxpayer-supported interest rate to be 7.6% for the fiscal year ending March 31, 1999 (compared to 7.7% for fiscal 1997/98).

Changes in Debt

Total debt of the Province increased by $2.1 billion during the 1998/99 fiscal year. Understanding changes in debt most commonly requires an analysis of the sources of borrowing, how debt changed and why debt (and the operating deficit) changed. These are the last three indicators shown in Exhibit 5.1. They are interrelated, in that to understand why debt has been incurred, it is useful to know both the uses and sources of borrowing. A statement of changes in debt should therefore explain why and from whom the Province has been borrowing.

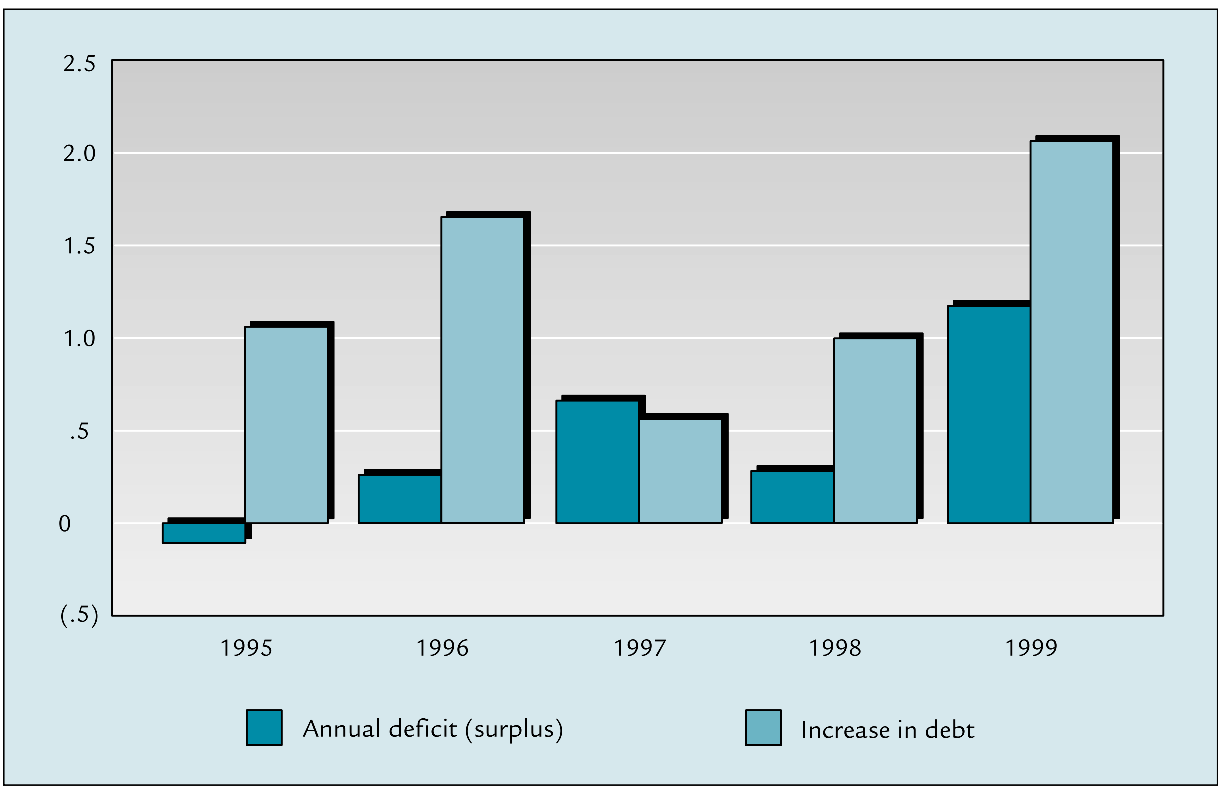
One reason for an increase in debt could be the financing of the annual deficit of the government. In addition, a government may borrow to finance capital asset acquisitions, new investment and lending, or simply to have funds available for future needs.

Exhibit 5.6 shows the annual change in total provincial debt compared to the annual deficit. As noted in last year's report, during 1997 the government, in addition to borrowing

Exhibit 5.6

Deficit Compared to Debt

Annual deficit (surplus) compared to the annual increase in total provincial debt, 1995 to 1999 ($ Billions)



Source: The Public Accounts. Deficit (surplus) figures have been restated to conform to the entity basis used in this report.

approximately $555 million, drew down $795 million of funds it had previously borrowed and kept unused ("warehouse borrowing"). Warehouse borrowing increased the total debt during 1996, but was not put to use until 1997. For 1998, the increase in government debt included $112 million that the government had borrowed and warehoused for future use. In 1999, there was an additional $446 million in warehoused debt that the government borrowed for use at a later date.

Exhibit 5.7 shows the increase in provincial debt, providing a breakdown of the changes in the Consolidated Revenue Fund operating and capital debt, warehouse debt, government agency debt and third-party guaranteed debt during the 1998/99 fiscal year. A complete statement of changes in debt would include a listing of the sources and uses of current borrowings, such as debt repayment, financing of annual operating deficit, lending, warehousing and capital spending.

The government has started annually providing some information about changes in debt. "Debt Statistics 1998/99" provides good information on the sources of borrowing during the year, and there is also some information on how debt changed during the year. We encourage the government to continue the reporting of those changes, but to improve the information it provides, particularly with respect to the uses of debt.

Debt Related to Skeena Cellulose Inc.

During the 1997/98 fiscal year, the government became involved with Skeena Cellulose Inc. (Skeena), a forest products company located in northern British Columbia. Skeena, a privately held company, was in financial difficulty and in danger of shutting down. The government decided that it would help to keep the company operating by providing loans and other guarantees. One result of the government's involvement was that the Province acquired, through its subsidiary 552513 British Columbia Ltd. (552513 BC Ltd.), a majority ownership interest in Skeena.

This section of our report focuses on what effect supporting Skeena has had on the total provincial debt. Last year, in our "Report on Government Financial Accountability for the 1997/98 Fiscal Year," we described how the company's debt was restructured and the Province became the majority shareholder. This position was unchanged as at March 31, 1999. As at that date, the government owned, through 552513 BC Ltd., 65.6% of the outstanding shares of Skeena. Funding the takeover of Skeena increased total provincial debt, as reported in "Debt Statistics 1998/99," by $220.8 million at the

Exhibit 5.7

Changes in Total Provincial Debt

Detailed list of change in total provincial debt in the 1998/99 fiscal year ($ Millions)

	Debt as at March 31, 1999	Debt as at March 31, 1998	Increase/ (Decrease) in Debt
Direct debt of Consolidated Revenue Fund			
Operating purposes	12,190	11,488	702
Capital financing purposes	6,999	5,769	1,230
	19,189	**17,257**	**1,932**
Debt of Warehouse Borrowing Program	**658**	**212**	**446**
Debt of government agencies			
552513 British Columbia Ltd.[1]	221	158	63
580440 British Columbia Ltd.[2]	29	–	29
BC Transportation Financing Authority	1,433	1,090	343
British Columbia Assessment Authority	4	5	(1)
British Columbia Buildings Corporation	715	735	(20)
British Columbia Ferry Corporation	972	795	177
British Columbia Housing Management Commission	44	52	(8)
British Columbia Hydro and Power Authority	7,474	7,234	240
British Columbia Liquor Distribution Branch	3	3	–
British Columbia Railway Company	607	504	103
British Columbia Transit	59	1,578	(1,519)
Columbia Basin Trust	47	47	–
Columbia Power Corporation	47	48	(1)
Educational Institutions	175	185	(10)
Homeowner Protection Office	8	–	8
Improvement Districts	4	4	–
Pacific National Exhibition	–	3	(3)
Pacific Racing Association	5	5	–
Provincial Rental Housing Corporation	139	122	17
Rapid Transit Project 2000 Ltd.	57	–	57
Regional Hospital Districts	318	102	216
School Districts	27	11	16
Victoria Line Ltd.	3	2	1
	12,391	**12,683**	**(292)**
Third-party guaranteed debt	**163**	**185**	**(22)**
Total provincial debt	**32,401**	**30,337**	**2,064**

[1]This company owns shares in Skeena Cellulose Inc.

[2]This company provides funding to the Vancouver Trade and Convention Centre Authority.

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

fiscal year end (compared to $157.1 million at March 31, 1998). Budget ’99 estimates that the debt of 552513 BC Ltd. will increase to $319.3 million by March 31, 2000, which is more than double the amount outstanding as at March 31, 1998.

As 552513 BC Ltd. has a majority interest in Skeena, and 552513 BC Ltd. is fully owned by the Province of British Columbia, all of the debt of 552513 BC Ltd. is included in the total debt reported in “Debt Statistics 1998/99.” This includes $4.0 million of fiscal agency loans, $124.5 million in guaranteed debt, and $92.3 million in non-guaranteed debt, for a total of $220.8 million.

However, because 552513 BC Ltd. is classified by government as a government commercial enterprise, its results are aggregated in the Summary Financial Statements on a modified equity basis. This means that the Summary Financial Statements of the government correctly include $4.0 million of debt on the balance sheet, while $124.5 million is disclosed in the contingencies and commitments note to the financial statements. It also means that the debt of 552513 BC Ltd. is recorded in “Debt Statistics 1998/99” as a self-supporting debt. A footnote to the Summary of Provincial Net Debt alerts the reader to the fact that future profitability is uncertain due to the volatility of world pulp prices and their potential impact on Skeena Cellulose Inc. Therefore, we have been monitoring the profitability of the company to determine whether it should be reclassified as taxpayer-supported debt.

If 552513 BC Ltd.’s debt were to be reclassified as taxpayer-supported debt, this would raise the question as to whether Skeena should become a fully consolidated organization in the Summary Financial Statements rather than a modified equity enterprise. Making such a change would increase the debt reported in the balance sheet of the Summary Financial Statements by an amount equal to 552513 BC Ltd.’s guaranteed and non-guaranteed debt. Other assets and liabilities of 552513 BC Ltd. would also be included in the Summary Financial Statements, instead of only the net equity that is currently consolidated.

As noted earlier, this section deals only with how supporting Skeena affects total provincial debt. It does not measure the total cost and benefit of that support to the taxpayers of British Columbia. For example, the increase in debt does not measure any grants or contributions paid to Skeena, nor does it measure any concessions made in the company’s payment of provincial stumpage fees or municipal property taxes. It also does not measure any benefits derived from that support, such as continued employment. It should also be noted that if Skeena were to cease operations, the non-guaranteed debt could be borne by the minority shareholder.

Sinking Funds

Previously, in our comments on debt measures and indicators, we stated that the term "debt" referred to debt net of sinking funds. In this section, we discuss sinking funds—what they are, how the government reports them, and how it accumulates them. This topic is of importance because on June 1, 1999, the government changed its sinking fund policy. The government stopped making sinking fund contributions on existing and new Consolidated Revenue Fund debt issued for direct operating and capital financing purposes. This change in policy affects approximately $19.2 billion of the $32.4 billion total debt outstanding as at March 31, 1999. Most of the remaining debt continues to accumulate sinking funds.

The issue of whether or not the government should continue to make voluntary sinking fund instalments is not addressed in this report because making sinking fund contributions constitutes only one aspect of proper debt management. The purpose of this section of the report is to discuss the effects of the government's decision to discontinue with both making voluntary payments to the existing sinking funds and establishing new sinking funds for future debt.

In general, sinking funds are investments set aside to repay debt. When long-term debt is issued, the lender may require the borrower to open an investment account, in trust, to accumulate annual sinking fund instalments. Alternatively, the borrower may voluntarily establish one. For example, if a company borrows $100 million for 20 years, it may be required (or voluntarily choose) to annually place approximately 2% of the debt amount in a sinking fund account. At the end of the 20 years, the annual instalments of $2 million, together with the interest earned on the investments purchased with those instalments, would be used to help the borrower repay the debt. There also exist other types of sinking fund arrangements.

Sinking Fund Reporting

In the Summary Financial Statements of the Province, the government reports its net debt as a liability on the balance sheet. The gross amount of the debt (the amount repayable at maturity) is disclosed in the notes to the financial statements. To arrive at the net debt amount, gross debt is reduced by sinking funds and also adjusted by unamortized discount and premium balances. The latter balances arise from accounting adjustments related to the differences between the actual amounts that the government receives at the time of the debt transactions and the debt maturity amounts.

For example, in the Summary Financial Statements for the year ending March 31, 1999, note 23 discloses the gross debt for government operating purposes to be $26,375 million. After deducting sinking funds of $3,703 million and discount and premium balances of $157 million (plus $2 million for debt held by the Consolidated Revenue Fund itself), the net debt in note 23 and on the statement of financial position is $22,513 million.

The total of all sinking funds disclosed in the Summary Financial Statements is $4,604 million. In contrast, according to "Debt Statistics 1998/99" (see Appendix D), sinking funds related to total provincial debt were $4,746 million. The sinking fund figure in the Debt Statistics report is $142 million higher because it includes sinking funds related to additional guaranteed and non-guaranteed debt. The debt of the warehouse program does not have any sinking funds related to it. The reason for this is that the assets related to the debt warehouse program are correctly reported separately, as assets, in the Summary Financial Statements, not as sinking fund investments that reduce the related debt liability.

In some instances the government may "certify" or "defease" a debt. This could occur if the sinking fund assets have grown such that all future interest payments and the final debt repayment can be made by the government from the sinking fund account. When there are sufficient sinking fund assets relating to a specific debt, the Minister of Finance and Corporate Relations may "certify" the corresponding sinking fund account. When this is done, there is no further requirement for the government to make sinking fund instalments on that debt. In addition, the debt is "defeased," that is, the debt and its related sinking fund are removed from the balance sheet of the Province's financial statements. The defeased, non-matured debt is disclosed in a note to the financial statements. Notes 23 and 24 of the Summary Financial Statements as at March 31, 1999, report that a total of $1,486 million in par value of debt has been defeased for financial statement reporting purposes.

Maintaining Sinking Funds to Repay Debt

The Province is not normally required by lenders to maintain a sinking fund investment account. However, it has been a government policy for many years to establish sinking fund accounts for borrowings greater than $20 million and with a term greater than five years. The authority to create sinking funds comes from section 63 of the Financial Administration Act. This section states that the Lieutenant Governor in Council (or, if so delegated, the Minister of Finance) may provide "for the creation, management and application of sinking funds, including the setting of terms and conditions that will apply to those sinking funds." Thus, whether or not sinking funds are created is at the discretion of the government.

Most provinces across Canada have established sinking funds for the repayment or retirement of their debt. Based on our brief enquiries, it appears that Canada, Alberta and Ontario do not maintain sinking funds for their direct government debt.

There are several good reasons why governments might have in the past created, or choose in the future to create, sinking funds.

One, by making annual sinking fund instalments, the government is effectively making small repayments of debt each year. This helps smooth out the effects of market timing, particularly if the government has to re-borrow the funds at the end of the debt term. Sinking funds also reduce the effect of having to refinance debt at a time when interest rates are high.

Sinking funds also help reduce the shifting of inter-generational debt burden. Providing for the repayment of debt with current tax dollars (and presumably as expenditures are incurred and assets for which the funds were borrowed are being consumed) means that future generations will not have to pay for the consumption of current taxpayers. However, considering that the government currently borrows to make sinking fund payments, there may still be an intergenerational transfer of the debt burden.

Sinking funds created at the discretion of government could also serve as a potential source of lower cost financing should there ever be a financial borrowing crisis. However, the use of sinking funds for current operating needs would not normally be regarded as prudent, and should be subject to strict financial discipline. The government has a pre-arranged line of credit of $1 billion with a syndicate of banks in the event emergency funding is needed. This credit facility would, to a great extent, reduce the need for the government to draw upon its sinking fund investments during a borrowing crisis.

There are also several reasons why governments might choose to dispense with the long-standing practice of maintaining sinking funds. For example, borrowing money each year simply to invest in sinking funds held by the

Province might not represent sound financial management if the Province could not earn more on its sinking fund assets than it costs the government to make interest payments. The Ministry of Finance and Corporate Relations estimates the annual cost of maintaining sinking funds at approximately $10 million, of which about $2 million is due to the interest rate differential between borrowing and investing.

The government states in its 1998/99 Debt Statistics report that, by discontinuing sinking fund instalments on the Province’s direct debt, the Province will decrease its borrowing requirements by approximately $400 million in fiscal 1999/2000. Since the government reports its debt net of sinking funds, there will be no effect on the Province’s reported net debt position because of the discontinuance of sinking fund contributions. Lower sinking fund payments are offset by lower borrowing.

Credit rating agencies have stated that the discontinuance of sinking fund contributions will have little effect on the Province’s credit rating, since those agencies focus on the Province’s net debt rather than its gross debt. What could affect the financial standing of the Province, however, would be if the Province were to liquidate its sinking funds in the future and, instead of using the proceeds to repay debt, used them to pay for program expenditures. Such an action, which may or may not affect the deficit, would in effect increase the Province’s net debt. The net debt amount would also be affected by the difference between the accounting value and the market value of sinking fund investments sold. A gain or loss on the sale of sinking fund investments would arise if the market value of those investments was higher or lower, respectively, than their accounting value at the time of liquidation.

Plans for Managing Debt

Budgets ’95 to ’98

The government introduced its first debt management plan in Budget ’95. At that time, the government committed to publishing annually an audited debt management progress report. This report was to provide information on debt measures and performance indicators, and to match the provincial debt to benchmarks set in the debt plan. The government publishes this debt information in its annual Debt Statistics reports.

In Budget ’97 the government changed the name of its debt plan to the “financial management plan,” and provided new goals and benchmarks for the provincial debt.

Exhibit 5.8

Comparison of Goals in the Various Debt Management Plans

A comparison of goals that were to be achieved by the government's debt management plan from Budget '95 and financial management plans from Budgets '97 and '98

Published Goals and Other Information	Debt Management Plan (Budget '95)	Financial Management Plan (Budget '97)	Financial Management Plan (Budget '98)
Stated length of plan	20 years	3 years	3 years
Credit rating relative to other provinces	Highest	N/A	N/A
Direct (operating) debt of the Consolidated Revenue Fund	Eliminate over 20 years	Reduce over 20 years	N/A
Taxpayer-supported debt as a percent of provincial GDP	Reduce to 10.2% by 2015	Cap at 20% Reduce to 20% by 2000 Reduce to 15% by 2015	Target range of 19–22% until 2001 Limit to 21.2% as at March 31, 1999
Taxpayer-supported interest expense (in cents) per dollar of revenue (interest bite)	Cap at 8.5 until 2015	Cap at 9.0	Cap at 9.0
Operating results—surplus or deficit	Surplus	Balanced	Balanced in fiscal 1999/2000

The Auditor General has commented extensively on the above debt management plans in a number of his prior reports. We have not repeated those comments here: rather Exhibit 5.8 provides a summarized comparison of goals in the debt plans from Budgets '95, '97 and '98. In general, we have noted that the plans have become less specific, shorter in duration, and less demanding.

Each of the government's debt plans so far has included a goal with respect to the ratio of taxpayer-supported debt to GDP. In Budget '98, the government stated that the unpredictability of the rate of economic growth made it prudent for government to retain some flexibility when establishing targets based on GDP. The government felt it would then be able, during periods of economic slowdown, to accelerate capital investments to stimulate the economy. Accordingly, the government added a three-year target range to guide the management of its taxpayer-supported debt to GDP ratio.

The goals of the Budget ‘98 financial management plan were as follows:

- Limit the taxpayer-supported debt to GDP ratio to a target range of 19–22% over the next three years. (The target range was to be reviewed annually to ensure that the limits remained appropriate and would be lowered as the level of taxpayer-supported debt to GDP declined);
- Limit the taxpayer-supported debt to GDP ratio at March 31, 1999, to 21.2%;
- Balance the operating budget in 1999/2000; and
- Maintain the 9.0% cap on the cost of debt relative to provincial revenue.

The audited 1998/99 Debt Statistics report states that the taxpayer-supported debt to GDP ratio at March 31, 1999, was 21.2% and the taxpayer-supported interest bite was 7.4 cents.

Budget ’99

Budget ’99 does not discuss the financial management plan. This is unusual because the provincial Budget has discussed the debt management plan or the financial management plan each year since its inception in 1995.

One area where debt is discussed in Budget ’99 is in a topic box on page 44 of that report. The topic box, titled “Five-Year Fiscal Planning Framework,” states that it “provides a five-year framework within which government will manage revenues, expenditures and debt levels.” The topic box states that the business community has recommended the adoption of new debt targets. It also notes that one of the government’s fiscal planning principles is that debt levels remain affordable. The topic box then goes on to say that, over the next five years of the fiscal planning framework, the taxpayer-supported debt to GDP range has been set at between 22% and 27%.

It appears to us that the government has abandoned its financial management plan in favour of a five-year fiscal planning framework. We make several comments regarding this change.

Two reasons for having a debt plan are (1) to achieve certain goals and (2) to be able to measure performance against those goals. Excessive modification, or abandonment, defeats the purpose of having a plan in the first place. As well, it may erode public confidence in the reliability of the planning information government presents to the Legislative Assembly and the public.

Ideally, a debt plan should be long term in nature. Short term estimates and decisions related to debt, such as we find in the annual Estimates or Budget, should support the long-term plan's goals. The government's three-year financial management plan forecast has been changed to a five-year fiscal planning framework.

In the government's five-year planning framework, the only specific goal remaining with respect to debt is that the taxpayer-supported debt to GDP must remain within a range of 22–27% over the next five years. Debt to GDP is only one goal of many that could be chosen as a benchmark by the government. While it is a useful long-term trend ratio, in the short-term the level of GDP can be somewhat unpredictable. If the government is able to provide target ranges for its surplus or deficit over the next five years, it should also be able to publish estimated ranges for its debt during this time. The government could then provide targets with respect to how much total debt will change during each fiscal period, and report the longer-term trend of taxpayer-supported debt to GDP as a measure of its performance.

There are also other measures that could be estimated and reported by the government, such as those shown in Exhibit 5.1. In addition, the credit rating of the Province is an important measure of debt management. We think a useful goal would be the maintenance of a certain credit rating.

The ratio of taxpayer-supported debt to GDP ranged from 19 to 22% in the Budget '98 financial management plan. By comparison, the new range of 22 to 27% in Budget '99 is quite large. However, it is difficult to judge whether this ratio is reasonable or not, as the framework does not provide enough information to determine how this figure was chosen or if this ratio can even be sustained. Ultimately, more information is needed to judge whether or not this debt goal is reasonable or not.

Also important to note is that the five-year fiscal planning framework only discusses taxpayer-supported debt. Over the past several years, the Auditor General has encouraged the government to disclose the relevant debt ratios and benchmarks on a total debt basis. In effect, commercial enterprises may borrow to help government reduce its taxpayer-supported debt. For example, commercial enterprises may borrow funds to pay a dividend to the Province. The Province could then use these funds to pay down taxpayer-supported debt. We are pleased that the government continues to provide, in the Debt Statistics report, its debt measures and indicators on both a total basis and taxpayer-supported basis.

In the past, the Minister of Finance and Corporate Relations has asked the Auditor General to provide an audit opinion on the benchmarks and other measures contained in the debt management and financial management plans. The Auditor General's most recent opinion appears in "Debt Statistics 1998/99," that was published by the government in September 1999.

Conclusion

We are pleased that the government reports on the public debt, disclosing key measures and indicators of debt. We encourage it to continue this reporting, and to make improvements by disclosing longer trend information for the debt measures and indicators.

We also believe that there is still room for improvement in the reporting of changes in debt, particularly regarding the use of borrowed funds.

As well, we think that the government should formally adopt some form of debt management plan. The plan should publish goals that are measurable and achievable, in both the short and the long term. There should not be excessive modification to the plan, as this defeats the purpose of having set a plan in the first place. The government should also provide a complete and clear explanation of the assumptions that support its debt plan, and discuss contingencies should significant assumptions fail to be realized.

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 that 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 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 that are audited by other auditors and that 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 expense, 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

Government Entities and Trust Funds—Their Inclusion in, or Exclusion from, the Province's 1998/99 Financial Statements, and Their Auditors

Entities Included in the Summary Financial Statements

	Audited by: Auditor General	Audited by: Private Sector Auditors
552513 British Columbia Ltd.	✓	
580440 B.C. Ltd.	✓	
B.C. Community Financial Services Corporation		✓
B.C. Festival of the Arts Society		✓
B.C. Games Society		✓
B.C. Health Care Risk Management Society		✓
B.C. Pavilion Corporation		✓
BC Society for the Distribution of Gaming Revenue to Charities	✓	
BC Transportation Financing Authority	✓	
BCIF Management Ltd.		✓
British Columbia Arts Council[1]		✓
British Columbia Assessment Authority	✓	
British Columbia Assets and Land Corporation	✓	
British Columbia Buildings Corporation	✓	
British Columbia Enterprise Corporation	✓	
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 Liquor Distribution Branch[2]	✓	
British Columbia Lottery Corporation		✓
British Columbia Railway Company		✓
British Columbia Rapid Transit Company Ltd.		✓

	Audited by	
	Auditor General	Private Sector Auditors
British Columbia Regional Hospital Districts Financing Authority	✓	
British Columbia Securities Commission	✓	
British Columbia Systems Corporation		✓
British Columbia Trade Development Corporation		✓
British Columbia Transit		✓
Canadian Blood Services		✓
Columbia Basin Trust		✓
Columbia Power Corporation	✓	
Creston Valley Wildlife Management Authority Trust Fund	✓	
Discovery Enterprises Inc.		✓
Downtown Revitalization Program Society of British Columbia		✓
Duke Point Development Limited	✓	
First Peoples' Heritage, Language and Cultural Council		✓
Fisheries Renewal BC	✓	
Forest Renewal BC	✓	
Health Facilities Association of British Columbia	✓	
Homeowner Protection Office	✓	
Industry Training and Apprenticeship Commission	✓	
Insurance Corporation of British Columbia		✓
Legal Services Society	✓	
Oil and Gas Commission	✓	
Okanagan Valley Tree Fruit Authority		✓
Pacific National Exhibition		✓
Provincial Capital Commission	✓	
Provincial Rental Housing Corporation		✓
Rapid Transit Project 2000 Ltd.		✓
Science Council of British Columbia		✓
Tourism British Columbia	✓	
Vancouver Trade and Convention Centre Authority	✓	
Victoria Line Ltd.	✓	
West Coast Express Limited		✓

Entities Not Included in the Summary Financial Statements

	Audited by: Auditor General	Audited by: Private Sector Auditors
British Columbia Institute of Technology	✓	
Campbell River / Nootka Community Health Council	✓	
Coast Garibaldi Community Health Services Society	✓	
East Kootenay Community Health Services Society	✓	
Kwantlen University College	✓	
Royal Roads University	✓	
SF Univentures Corporation	✓	
Simon Fraser University	✓	
Technical University of British Columbia	✓	
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	✓	
Other Education and Health Sector Entities:		
Colleges and Advanced Education Institutes (20 entities)		✓
Community Health Councils (33 entities)		✓
Community Health Services Societies (5 entities)		✓
Health Care Organizations (13 entities)		✓
Health Regions / Regional Health Boards (11 entities)		✓
Regional Hospital Districts (39 entities)		✓
School Districts (60 entities)		✓

[1] The entity's financial statements were unaudited.
[2] Branch of Ministry of Small Business, Tourism and Culture.

Trust Funds Disclosed in the Summary Financial Statements

	Audited by: Auditor General	Audited by: Private Sector Auditors
BC Rail Ltd. Pension Plan	✓	
British Columbia Hydro and Power Authority Pension Plan		✓
British Columbia Investment Fund Ltd.		✓
British Columbia Public Service Long Term Disability Plan	✓	
College Pension Plan	✓	
Credit Union Deposit Insurance Corporation of British Columbia		✓
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	✓	
Asian 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 Equity Fund	✓	
European Indexed Equity Fund	✓	
Fixed Term Mortgage Fund	✓	
Indexed Canadian Equity Fund	✓	
Indexed Government Bond Fund	✓	
International Equity Fund	✓	
Long Term Bond Fund	✓	
Managed International Equity Fund	✓	
Passive International Equity Fund	✓	
Pension Bond Fund	✓	
Private Placement Fund 1995	✓	
Private Placement Fund 1996	✓	

	Audited by	
	Auditor General	Private Sector Auditors
Private Placement Fund 1997	✓	
Private Placement Fund 1998	✓	
Realpool Investment Fund	✓	
S & P 500 Index Equity Fund	✓	
Short Term Bond Fund	✓	
TSE 100 Index Equity Fund	✓	
U.S. Enhanced 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

Excerpts from the 1998/99 Public Accounts

The material that forms Appendix C is from the Public Accounts of British Columbia for the fiscal year ended March 31, 1999. It consists of the Summary Financial Statements of the Province and the Auditor General's Report on them.

Contents

appendix d

Excerpts from Debt Statistics 1998/99

Section I of Debt Statistics 1998/99 titled *Province of British Columbia Debt Report* contains the Auditor General's Report on Summary of Provincial Net Debt, Key Indicators of Provincial Debt and Summary of Key Benchmarks.

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