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The Honourable Claude Richmond
Speaker of the Legislative Assembly
Province of British Columbia
Parliament Buildings
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Dear Sir:

I have the honour to transmit herewith to the Legislative Assembly of British Columbia my 2003/2004 Report 5: Monitoring the Government's Finances.

Wayne Strelioff, CA
Auditor General

Victoria, British Columbia
December 2003

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

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Wayne Strelioff, CA
Auditor General

In providing services to their citizens, provincial governments receive and spend tens of billions of dollars each year. If you were to compare spending by most provinces to that by publicly traded corporations, the provincial spending would be at least equal to that of most large corporations in Canada.

In the private sector, investors and boards of directors have long relied on a broad array of information to evaluate the overall performance and prospects of an organization. In the public sector, the availability of such information to oversight agencies, legislators and the public has been limited. The situation is changing, however. Large private sector companies and many Crown corporations now provide comprehensive commentary on their financial position and results in the "management discussion and analysis" section of their annual reports. The need for governments to clearly comment on their overall finances has also become a focus of Canada's financial standard setting institutions.

For several years, my Office has encouraged the government of British Columbia to take a lead role in providing this information annually—and in a recent report, I was pleased to acknowledge the government's continuing progress in adopting best practices in its financial reporting.

More remains to be done. While financial statements are an important component of reporting and necessary for anyone wanting to understand an organization's financial position, they are an insufficient means of measuring and explaining that organization's overall finances.

In the section titled "Provincial Financial Reporting Overview" in the Public Accounts, the government currently provides a written commentary on its Summary Financial Statements and the province's financial performance. In my opinion, this overview does little to make the government's finances more understandable to legislators and the public.

Auditor General's Comments

In this report, I present my own analysis of government's finances, using information from sources I was confident in—for example, audited financial statements, the annual Budgets and Estimates, and reports published by credible third-party agencies. I also adhered to key financial reporting principles including:

1. *Completeness* – I used a financial framework that provides the full view of all financial operations of government.
2. *Relevance* – I provide trends and indicators that complement as well as supplement financial statements.
3. *Significance* – I present information important to the legislators and interested public, covering the range of services provided by government from the perspective of the burden on taxpayers.
4. *Understandability* – I looked beyond internal accounting adjustments and related party transfers that, in my view, make explaining the government's finances difficult.

This report does not contain a discussion of future milestones and projections. It should do, however, if it were prepared by the government. Any such discussion should also be forward looking and include reasonable projections.

Using the seven-year financial information framework presented in this report, I describe a number of financial trends and indicators for British Columbia, and show how the province compares in some respects to other jurisdictions. This framework is different in content and form than the government's Summary Financial Statements.

The framework is based on the complete reporting entity that the government has stated it will provide in its Summary Financial Statements when it fully adheres to Canadian generally accepted accounting principles (GAAP) in fiscal 2004/05—that is, the framework includes the financial position and results of schools, universities, colleges and hospitals.

As well, the framework provides a breakdown that shows the financial burden to taxpayers. It distinguishes between general programs (such as health care) that depend on taxes and other general revenues to cover their operations, and self-supporting businesses (such as BC Hydro) that bring in revenue to cover the cost of the goods and services they provide. And, compared to the Summary Financial Statements, the framework provides a greater level of detail about revenues, expenses, assets and liabilities of government business enterprises. Additional detail concerning those enterprises provides useful insight into the government's finances and its public policies.

In Part 1 of this report, I use the financial information framework to present information about the revenues, expenses, assets and liabilities of the government. I initially wanted to prepare this information for a 10-year period, but some necessary data for years before 1997 is unavailable. I also wanted to compare the planned results to the actual results. Again, however, I found it difficult to put the necessary information together.

Also in Part 1, I examine trends in several important financial indicators.

In Part 2, I compare British Columbia with other Canadian jurisdictions by looking at the changing trends in three main indicators of the government's overall fiscal performance.

Overall Picture in 2003

In the year ended March 31, 2003, British Columbia incurred an annual deficit of $2.9 billion. This is the result of a $4.7 billion annual deficit in the general programs of government, offset by a $1.8 billion surplus in government business enterprises.

The government's financial trends in various areas over the last seven years are shown in Exhibit 1.

The overall accumulated deficit at the end of March 2003 totaled $4.7 billion (compared to $1.7 billion in 2002). This means that the current and future citizens of British Columbia carry $26.2 billion of net liabilities ($23.2 billion in 2002) against which they own infrastructure assets with a depreciated value of $21.5 billion ($21.5 billion in 2002).

Exhibit 1

Financial Information Framework, 1997 to 2003

This financial information framework is built around the activities of the government's general programs and enterprises

Revenue and Expense
For the Years Ended March 31
(Amounts in $ Millions)

	1997	1998	1999	2000	2001	2002	2003
General programs							
Revenue	22,630	23,048	22,940	24,677	27,243	27,608	25,276
Expense	23,942	25,009	25,405	25,818	27,488	29,753	29,968
	(1,312)	(1,961)	(2,465)	(1,141)	(245)	(2,145)	(4,692)
Enterprises							
Revenue	7,884	8,284	9,434	10,380	14,496	13,149	11,468
Expense	6,809	6,958	7,914	9,088	12,771	12,064	9,702
	1,075	1,326	1,520	1,292	1,725	1,085	1,766
Annual surplus/(deficit)	**(237)**	**(635)**	**(945)**	**151**	**1,480**	**(1,060)**	**(2,926)**

Assets and Liabilities
As At March 31
(Amounts in $ Millions)

	1997	1998	1999	2000	2001	2002	2003
General programs							
Financial assets	6,419	6,795	7,018	9,288	9,182	9,186	7,960
Liabilities	28,651	29,737	31,011	33,828	33,796	35,290	37,184
	(22,232)	(22,942)	(23,993)	(24,540)	(24,614)	(26,104)	(29,224)
Enterprises							
Assets	17,760	18,439	19,299	18,814	19,387	18,669	18,960
Liabilities	14,819	15,267	16,013	15,655	15,964	15,765	15,929
	2,941	3,172	3,286	3,159	3,423	2,904	3,031
Net liabilities	**(19,291)**	**(19,770)**	**(20,707)**	**(21,381)**	**(21,191)**	**(23,200)**	**(26,193)**
General infrastructure assets	18,572	18,416	18,408	19,233	20,523	21,472	21,539
Accumulated deficit	**(719)**	**(1,354)**	**(2,299)**	**(2,148)**	**(668)**	**(1,728)**	**(4,654)**

Source: Summary Financial Statements of the Government of the Province of British Columbia, including notes, schedules and supplementary information; Crown corporation financial statements

Auditor General's Comments

Credit rating agencies still regard British Columbia as the second lowest credit risk of all provinces in Canada, after Alberta. In the 1997/98 fiscal year, British Columbia's credit rating dropped from the highest in the country to parallel that of Alberta. During the 1999/2000 fiscal year, Alberta's position improved and has since remained stronger than British Columbia's. During 2002/03, Manitoba's and Ontario's credit ratings improved to equal that of British Columbia's.

In 2002/03, British Columbia's Gross Domestic Product (GDP) per capita continued to be below Canada's average. British Columbia ranked fifth amongst the provinces in that measure, behind Alberta, Ontario, Saskatchewan and Quebec. Just a year earlier, British Columbia's ranking was fourth.

The British Columbia government is committed to adopting fully, by April 1, 2004, GAAP for senior governments. This process of change presents the government with a good opportunity to revisit its financial reporting as a whole. My Office is eager to play a supportive role in this matter. I believe the recommendations in this report, aimed at helping the government provide better discussion and analysis of its finances, offer an important starting point.

I wish to thank officials of the Government of British Columbia and of my counterparts in other Canadian jurisdictions who assisted me by providing information and explanations I needed to produce this report. I also wish to acknowledge the hard work, professionalism and dedication of my staff who helped me with this work.

Wayne K. Strelioff, CA
Auditor General

Victoria, British Columbia
December 2003

Summary of Recommendations

Summary of recommendations in this report

We recommend that the government include the discussion and analysis of its finances in its Public Accounts. As a starting point, the information should be similar to that provided in this report, prepared in a manner consistent with best practices for the disclosure of such information.

We recommend that the government use the indicators of financial condition identified by the Canadian Institute of Chartered Accountants, and other important financial and economic measures, in its discussion and analysis to inform the legislators and citizens of British Columbia of the state of the government's finances.

Glossary

Glossary

Accumulated surplus/deficit	The total of all past annual surpluses and deficits to date.
Annual surplus/deficit	The difference between the government's annual revenues and expenses.
Business enterprises	Also known as commercial, self-supporting, or modified equity enterprises. These are self-sufficient Crown corporations that sell goods or services to parties outside the government reporting entity.
CICA	The Canadian Institute of Chartered Accountants.
Derivative contract	A "swap" or other financial instrument that is entered into with a third party, and is used to hedge interest rate, foreign currency or other risk exposures.
Federal transfers	Funds received by a province from the federal government, such as the Canada Health and Social Transfer (CHST) and equalization payments.
Financial assets	Assets of government (such as cash, investments, loans and accounts receivable) that can be converted to cash in order to pay government's liabilities or finance its future operations. Financial assets also include the government's investments in its business enterprises.
General infrastructure assets	Tangible physical assets used by the government to provide general program services to citizens.
Generally accepted accounting principles (GAAP)	This refers to the accounting principles that government should follow in order to be consistent in its accounting practices with similar organizations. The authority for GAAP is the CICA.
General programs	Those activities of government that are supported by taxpayers.
Government reporting entity	The group of organizations that are consolidated in the government's Summary Financial Statements.

Glossary

Gross domestic product (GDP)	The money value of goods and services produced within a geographical boundary. It can be reported without adjusting for inflation (known as market value, current, or nominal GDP) or it may be discounted for the effects of inflation (real GDP). In this report, GDP is not adjusted for inflation.
Hedging	Reducing potential exposure to foreign currency, interest rates or other risks. Often achieved by entering into derivative contracts with a third party.
Net liabilities	A government's total liabilities less its financial assets. This is the residual liability amount that will have to be paid or financed by future taxpayers.
PSAB	Public Sector Accounting Board of the CICA. This Board recommends accounting principles for Canadian governments.
Public debt	Borrowings of the government. Debt generally consists of debentures, notes payable, capital leases and mortgages.
Public debt charges	Also known as the cost of borrowing, or debt servicing costs, this is the interest incurred by the government on its borrowings.
SUCH sector	Refers to School districts, Universities, Colleges and Health authorities.
Summary Financial Statements	The financial statements through which the government reports its financial position and operating results.

Part 1: Financial Measures and Trends in British Columbia

Part 1: Financial Measures and Trends in British Columbia

Telling the Financial Story Clearly

The annual financial statements of an organization provide the most conventional explanation of that organization's finances. However, because these statements are often complex, many large organizations, including some governments, also use their annual reports to tell their financial stories in a more clear, concise and reader-friendly way. Currently, in British Columbia the equivalent to a government annual financial report is the Public Accounts.

The Comptroller General has often said that British Columbia is a leader amongst the provinces in its reporting practices in the Summary Financial Statements. We are pleased with that assessment and think that an earlier report of ours this year, *Adopting Best Practices in Government Financial Statements – 2002/2003,* reflects our supportive views in this area. At the same time, we know there is more to be done. While financial statements are an important means of understanding an organization's financial position and results, they are not sufficient to allow full evaluation and reporting on overall finances. A more comprehensive approach to reporting by governments is needed.

We therefore encourage the government to include, at a minimum, explanatory information in the annual Public Accounts, similar to that provided in this report.

The Public Sector Accounting Board (PSAB) of the Canadian Institute of Chartered Accountants (CICA) recently issued a draft statement of practices it recommends senior governments adhere to when preparing a discussion and analysis of their finances.

In Appendix A of this report, we have reproduced the "Overview" section of the Public Accounts. The overview contains a mixture of complicated reconciliations between the Consolidated Revenue Fund and the Summary Financial Statements, charts showing different breakdowns of revenues and expenses, a staff utilization table, and certain definitions. This information does not reflect much of the current thinking of the accounting profession on monitoring a government's finances.

We believe legislators and the public would greatly benefit from the inclusion in the Public Accounts of appropriate explanatory information, prepared according to disclosure principles including those outlined in the opening comments on page 2—completeness, relevance, significance, and understandability. Alternatively, the information could be prepared according to PSAB's draft recommended practices, outlined below. The results would be, to a large extent, similar. Adhering to either the principles or practices would help the government tell its financial story in a way that is easy for legislators and the public to understand.

PSAB's draft statement of recommended practices proposes that governments:

- Include financial statement discussion and analysis (FSD&A) in an annual report together with the Summary Financial Statements. The FSD&A should be referenced to the related Summary Financial Statements.
- Include an acknowledgment by government that it is responsible for the preparation and content of the information.
- Communicate information embodying the basic characteristics of financial statement information—understandability, relevance, reliability and validity, and comparability.
- Include a concise summary of the significant events affecting the financial statements.
- Include information on significant risks and uncertainties underlying the financial statements, and an outline of the strategies, policies and techniques adopted to manage them.
- Identify and explain significant annual variances. This could include year-to-year or budget-to-actual variances.
- Include an analysis of trends related to the elements of the financial statements. This could include a trend analysis of financial assets, liabilities, net liabilities, tangible capital assets, revenues, expenses, and cash flows.

In this report, we present an example of an easy-to-understand framework that the government could use in monitoring its finances. That said, we would still like to amend the framework further by including in it the government's current year financial plans, including milestones and projections. That information is not yet available, but we hope it will be when government implements generally accepted accounting principles (GAAP) fully in its 2004/05 Estimates as required by the Budget Transparency and Accountability Act, and applies them to its future financial publications.

Exhibit 2 shows the seven years of information we used as the basis of our comments on measures and trends in this report. It provides a detailed breakdown of revenues, expenses, assets and liabilities of the government related to its general programs and commercial enterprise activities. We have not tried to produce a financial statement discussion and analysis that meets all the qualitative characteristics of PSAB's statement of recommended practices. In our view, such a complete analysis is best left for the government.

Recommendation:

We recommend that the government include the discussion and analysis of its finances in its Public Accounts. As a starting point, the information should be similar to that provided in this report, prepared in a manner consistent with best practices for the disclosure of such information.

Unless otherwise noted, in this report a particular year refers to the fiscal year ending in that year. For example, 2003 refers to the fiscal year 2002/03 which runs from April 1, 2002 to March 31, 2003.

In this report we also make use of statistical and economic data supplied to us by Statistics Canada. Our convention in using this data is similar to the government in its reporting of the key indicators of provincial debt in its Public Accounts. Population data for a fiscal year is the population as at July 1 of the fiscal year. Gross domestic product and consumer price index data for a fiscal year are the amounts for the calendar year which ends in the fiscal year.

In addition, unless otherwise noted, all financial data used in this report is based on that presented in the framework in Exhibit 2.

Exhibit 2

Detailed Financial Information Framework, 1997 to 2003

Revenue and Expense
For the Years Ended March 31
(Amounts in $ Millions)

	1997	1998	1999	2000	2001	2002	2003
General programs							
Revenue							
Taxation	13,463	13,551	13,620	13,796	14,329	14,136	12,331
Natural resources	2,671	2,681	2,015	2,821	4,181	3,263	3,281
Federal transfers	2,296	2,165	2,527	3,109	3,285	3,310	3,815
Other	4,200	4,651	4,778	4,951	5,448	5,435	5,849
Unusual items	–	–	–	–	–	1,464	–
	22,630	23,048	22,940	24,677	27,243	27,608	25,276
Expense							
Health	7,456	7,820	8,102	8,683	9,291	10,414	10,937
Education	6,447	6,526	6,533	6,709	7,269	7,811	7,954
Social services	3,099	3,181	3,146	3,115	3,263	3,442	3,145
Interest	1,712	1,636	1,769	1,876	1,971	1,808	1,693
Other	5,228	5,846	5,855	5,435	5,642	5,931	5,727
Unusual items	–	–	–	–	52	347	512
	23,942	25,009	25,405	25,818	27,488	29,753	29,968
	(1,312)	(1,961)	(2,465)	(1,141)	(245)	(2,145)	(4,692)
Enterprises							
Revenue							
BC Hydro	2,403	2,533	3,018	3,458	7,889	6,311	4,407
Insurance Corporation of BC	2,624	2,690	2,822	2,966	2,872	2,971	3,023
BC Liquor Distribution Branch	1,543	1,598	1,645	1,671	1,732	1,798	1,890
BC Lottery Corporation	867	942	1,261	1,402	1,483	1,607	1,792
BC Railway Company	421	427	418	479	496	440	304
Other	26	94	270	404	24	22	52
	7,884	8,284	9,434	10,380	14,496	13,149	11,468
Expense							
BC Hydro	2,064	2,125	2,622	2,912	7,340	6,053	4,018
Insurance Corporation of BC	2,779	2,676	2,761	2,776	2,886	3,213	2,943
BC Liquor Distribution Branch	956	992	1,029	1,054	1,090	1,161	1,236
BC Lottery Corporation	595	652	806	870	921	1,001	1,121
BC Railway Company	385	387	391	1,062	502	606	300
Other	30	126	305	414	32	30	84
	6,809	6,958	7,914	9,088	12,771	12,064	9,702
	1,075	1,326	1,520	1,292	1,725	1,085	1,766
Total annual surplus/(deficit)	**(237)**	**(635)**	**(945)**	**151**	**1,480**	**(1,060)**	**(2,926)**

Assets and Liabilities
As At March 31
(Amounts in $ Millions)

	1997	1998	1999	2000	2001	2002	2003
General programs							
Financial assets	6,419	6,795	7,018	9,288	9,182	9,186	7,960
Liabilities	28,651	29,737	31,011	33,828	33,796	35,290	37,184
	(22,232)	(22,942)	(23,993)	(24,540)	(24,614)	(26,104)	(29,224)
Enterprises							
Assets							
BC Hydro	10,462	10,392	10,716	10,617	11,467	10,892	10,887
Insurance Corporation of BC	5,263	5,630	5,957	5,974	5,909	5,821	6,189
BC Liquor Distribution Branch	89	84	91	92	111	125	153
BC Lottery Corporation	100	137	164	160	147	160	185
BC Railway Company	1,647	1,759	1,920	1,387	1,372	1,233	1,111
Other	199	437	451	584	381	438	435
	17,760	18,439	19,299	18,814	19,387	18,669	18,960
Liabilities							
BC Hydro	8,981	8,726	8,962	8,648	9,354	8,891	8,917
Insurance Corporation of BC	5,053	5,406	5,672	5,499	5,428	5,582	5,870
BC Liquor Distribution Branch	89	84	91	92	111	125	153
BC Lottery Corporation	85	95	89	86	104	110	127
BC Railway Company	515	590	765	852	846	866	740
Other	96	366	434	478	121	191	122
	14,819	15,267	16,013	15,655	15,964	15,765	15,929
	2,941	3,172	3,286	3,159	3,423	2,904	3,031
Net liabilities	**(19,291)**	**(19,770)**	**(20,707)**	**(21,381)**	**(21,191)**	**(23,200)**	**(26,193)**
General infrastructure assets	18,572	18,416	18,408	19,233	20,523	21,472	21,539
Accumulated surplus/(deficit)	**(719)**	**(1,354)**	**(2,299)**	**(2,148)**	**(668)**	**(1,728)**	**(4,654)**

Source: Summary Financial Statements of the Government of the Province of British Columbia, including notes, schedules and supplementary information; Crown Corporation financial statements

Revenue Trends

Exhibit 3 shows the government's revenue sources from general programs and commercial enterprises. Between 2002 and 2003, total revenue decreased by $4.1 billion. This was the second consecutive year of decline. From 1997 to 2001, total revenue had shown a general increase. The government's total annual revenue has risen between 1997 and 2003, from $30.5 billion to $36.7 billion, an increase of 20%.

Exhibit 3 also shows the revenue from general programs broken down into its components of taxation, natural resources, federal transfers and other sources.

Taxes and revenue generated from businesses enterprises are the two most significant sources of revenue for the government of British Columbia. In 2003, each contributed about one-third to the total revenue.

Similar to the trend in total revenue between 1997 and 2001, that for taxation revenue also increased, but has since fallen over the last two years. Taxation revenue increased from $13.4 billion in 1997 to $14.3 billion in 2001, but dropped to $14.1 billion in 2002 and then $12.3 billion in 2003. Between 2002 and 2003 personal income tax and corporation income tax decreased by $1.2 and $0.9 billion, respectively. Provincial sales tax increased by $0.2 billion in the same time, and the remaining taxes increased by a net of $0.1 billion.

Revenue from commercial enterprises showed a similar change. Between 1997 and 2001, revenue increased, from $7.9 billion to $14.5 billion. Most of this was due to increases in energy sales by the BC Hydro and Power Authority. Between 2002 and 2003, however, revenues from commercial enterprises decreased by $1.7 billion. The main reason for this was a reduction in energy sales by the BC Hydro and Power Authority. Other government

Exhibit 3

Government Revenue, 1997 to 2003

Government revenue by main source ($ Billions)

	1997	1998	1999	2000	2001	2002	2003
General programs							
Taxation	13.4	13.5	13.6	13.8	14.3	14.1	12.3
Natural resources	2.7	2.7	2.0	2.8	4.2	3.3	3.3
Federal transfer	2.3	2.2	2.5	3.1	3.3	3.3	3.8
Other	4.2	4.6	4.8	5.0	5.4	6.9	5.8
	22.6	23.0	22.9	24.7	27.2	27.6	25.2
Enterprises	7.9	8.3	9.4	10.4	14.5	13.2	11.5
Total revenue	**30.5**	**31.3**	**32.3**	**35.1**	**41.7**	**40.8**	**36.7**

Source: Office of the Auditor General of British Columbia

commercial enterprises include the BC Liquor Distribution Branch, BC Lottery Corporation, BC Railway Company and Insurance Corporation of British Columbia.

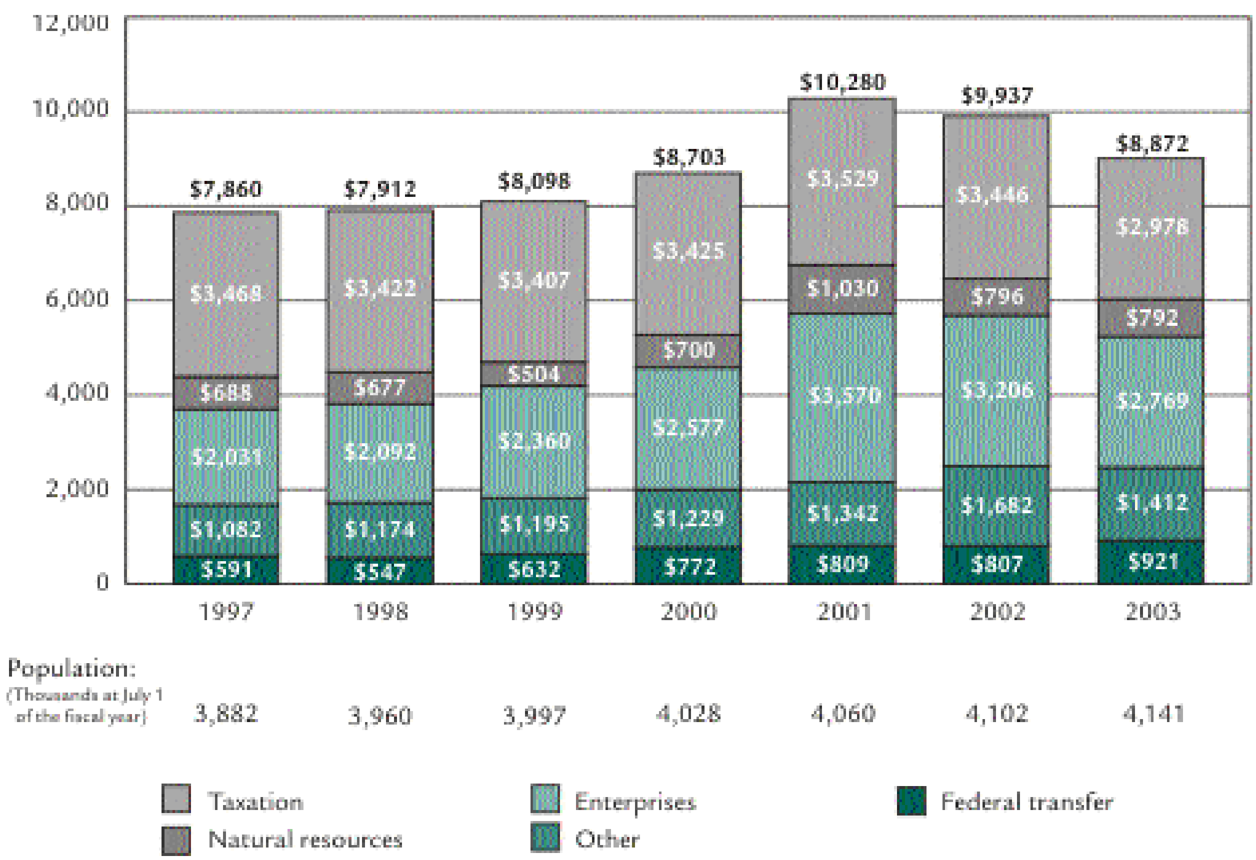
Included in federal transfer revenue for 2003 are federal equalization receipts of $543 million. This is a $385 million increase over the 2002 figure of $158 million.

Exhibit 4 shows the revenue per capita for each of the four general program revenue categories and for revenue from commercial enterprises. Overall, per capita government revenue increased 13%, from $7,860 in 1997 to $8,872 in 2003.

Exhibit 4

Per Capita Revenue, 1997 to 2003

Per capita revenue by main source over the past seven years ($)



Source: Office of the Auditor General of British Columbia; Statistics Canada

Exhibit 5 shows the rate of change in revenue over the last seven years by each of the revenue components, compared to the increase in the province's Gross Domestic Product. The base year in this exhibit is 1997. Revenue for each main source in the six years that follow has been shown as a percentage of that for 1997.

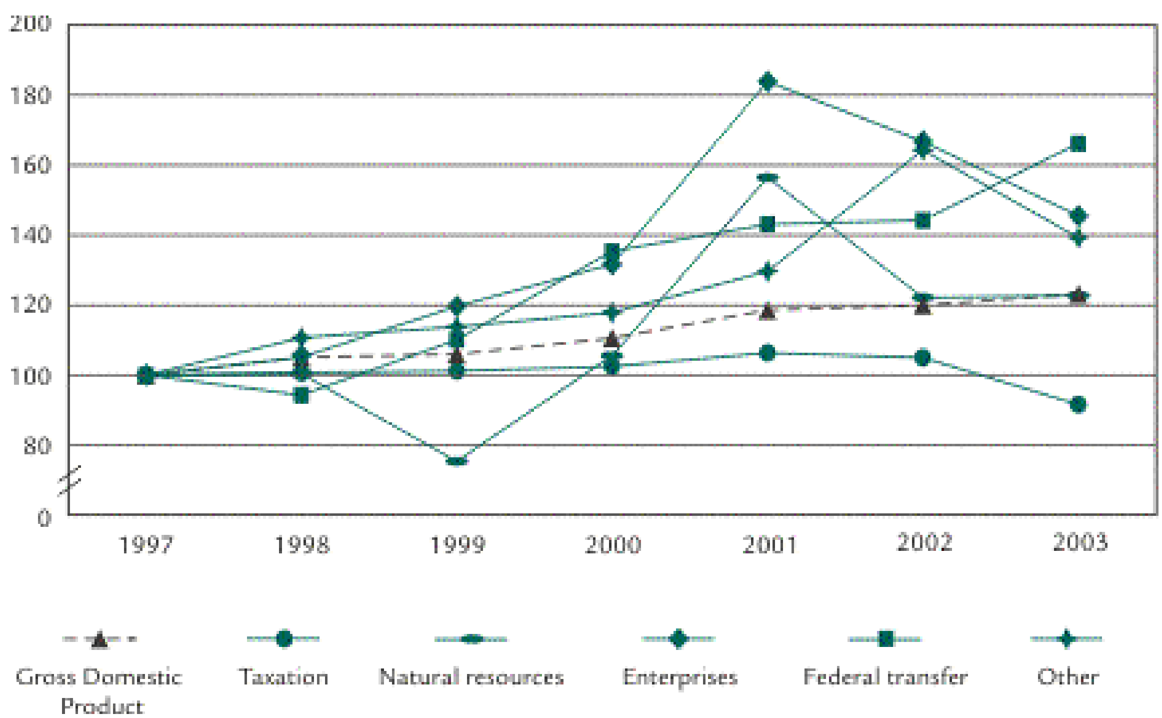
Taxation revenue shows a large decline in 2003, resulting from decreases in personal tax rates.

"Other" revenue shows a large one-time increase in 2002, resulting from gains made from the settlement of pension plans.

Exhibit 5

Change in Revenue, 1997 to 2003

Rate of change in revenue by main source, compared to the Gross Domestic Product (1997 = 100)



Source: Office of the Auditor General of British Columbia; Statistics Canada

Natural resources has been the most volatile of revenue sources. Revenue in this category declined sharply in 1999 mainly because of decreases in forest-related revenues. It then increased significantly in 2000 and 2001 because of higher oil and natural gas prices that spurred higher royalty sales of Crown land drilling rights, only to decline again in 2002 as natural gas prices and sales revenue of downstream hydro-electric benefits fell.

Revenue generated from commercial enterprises increased sharply in 2001 due to higher energy prices that increased BC Hydro's sales revenues significantly.

Expense Trends

Exhibit 6 shows the annual expenses incurred by government, for general programs and enterprises, from 1997 to 2003.

Total government expenses increased from $30.7 billion in 1997 to $39.7 billion in 2003, an increase of 29%. Health, education and social services combined account for just over 50% of the total expenses of the province.

Exhibit 6

Government Expense, 1997 to 2003

Government expense by main component ($ Billions)

	1997	1998	1999	2000	2001	2002	2003
General programs							
Health	7.5	7.8	8.1	8.7	9.3	10.4	10.9
Education	6.4	6.5	6.5	6.7	7.3	7.8	8.0
Social services	3.1	3.2	3.1	3.1	3.2	3.5	3.2
Interest	1.7	1.6	1.8	1.9	2.0	1.8	1.7
Other	5.2	5.9	5.9	5.4	5.7	6.3	6.2
	23.9	25.0	25.4	25.8	27.5	29.8	30.0
Enterprises	6.8	7.0	7.9	9.1	12.8	12.1	9.7
Total expense	**30.7**	**32.0**	**33.3**	**34.9**	**40.3**	**41.9**	**39.7**

Source: Office of the Auditor General of British Columbia

The interest costs reported in Exhibit 6 relate only to the interest cost of general programs, or taxpayer-supported, debt. To arrive at the total interest costs for government, we would need to add the interest expense of enterprises. For 2003, the general programs interest expense is $1.7 billion and the total interest expense is $2.2 billion.

Although general program debt has increased from $21.1 billion in 1997 to $29.2 billion in 2003 (an increase of 38%) the related interest expense has remained the same at $1.7 billion. The reason for this is the general decline in interest rates over the last seven years.

The “other” expense category includes $340 million as the cost of writing off assets of the regional hospital districts during 2003. These assets are still in use in the health field, but as of 2003 are no longer controlled by the provincial government. The “other” expense also includes the cost of restructuring the general programs of government, being $172 million in 2003 ($347 million in 2002). These are shown as unusual items in Exhibit 2.

Restructuring expenses of $80 million are also included in the expenses of enterprises in 2003 ($211 million in 2002).

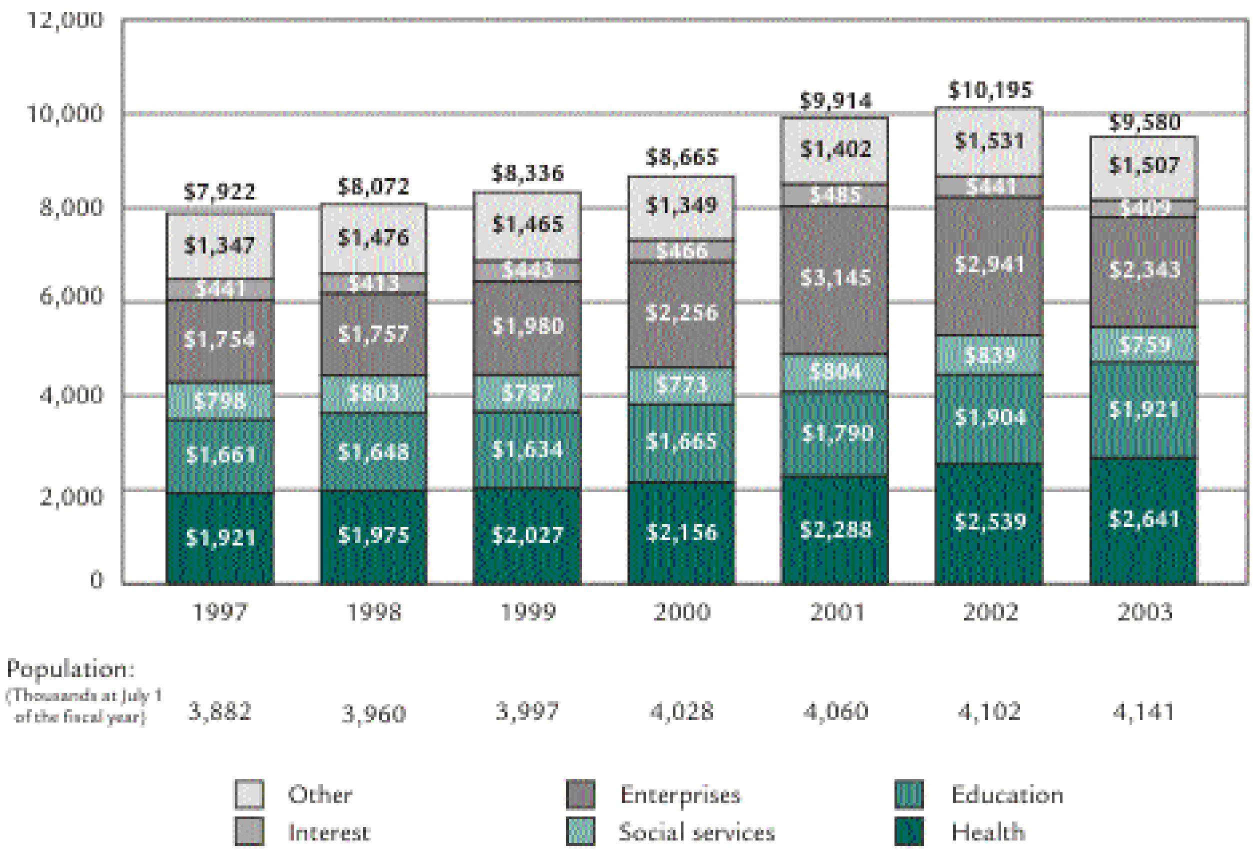
One of the largest increases in expense over the seven-year period has occurred in government enterprises, from $6.8 billion in 1997 to $9.7 billion in 2003, a $2.9 billion increase. The $3.7 billion increase between 2000 and 2001 was largely attributable to BC Hydro’s operations. The cost of electricity purchased by BC Hydro for resale made up a significant part of this increased expense in the government’s commercial enterprises. These higher costs are matched by the higher revenues reported by BC Hydro for energy sales. In 2002 and 2003, the commercial enterprises expenses decreased, largely because of a decrease in BC Hydro’s energy purchase costs during those years.

Exhibit 7 shows the government’s per capita expenses for the last seven years, by expense category. Overall, per capita government expense increased by 21%, from $7,922 in 1997 to $9,580 in 2003. The largest per capita increase was in health expenses, an increase of 37% over the last seven years. Per capita social services expenses have decreased 5% over the same period.

Exhibit 7

Per Capita Expense, 1997 to 2003

Per capita expense by main component over the past seven years ($)



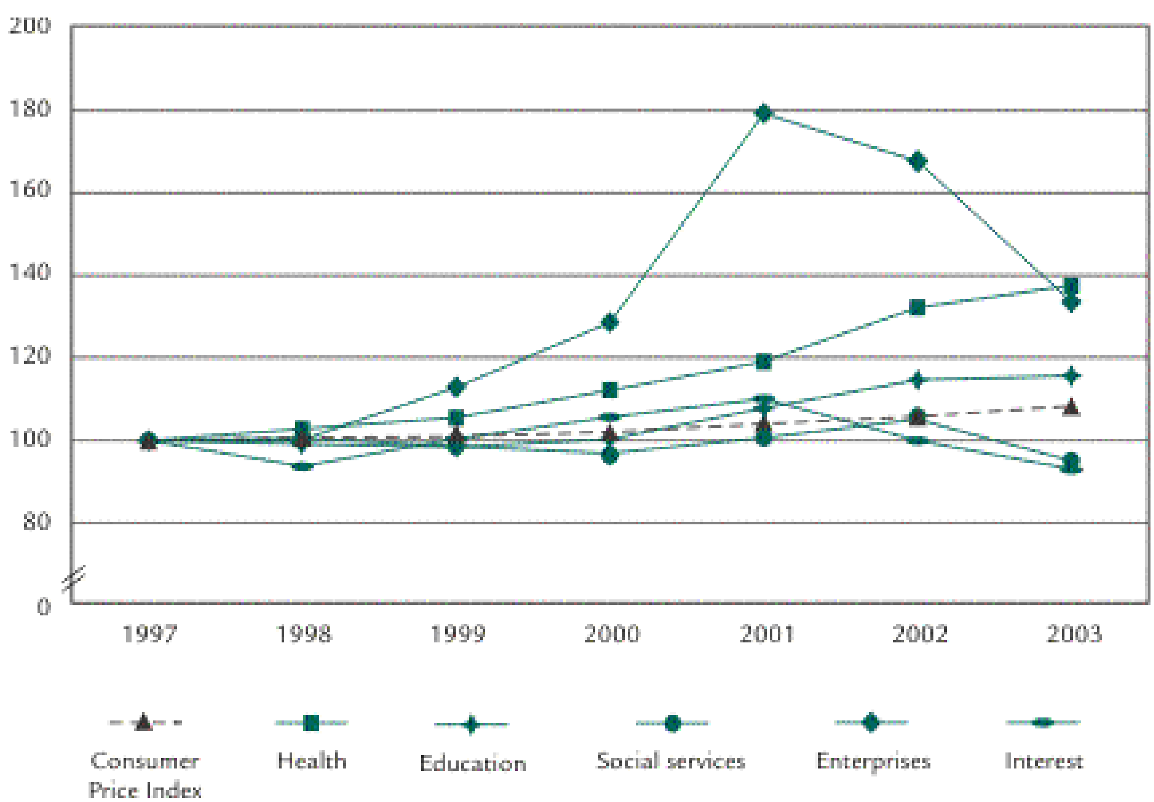
Source: Office of the Auditor General of British Columbia; Statistics Canada

Exhibit 8 shows the rate of change in per capita expenses over the last seven years for health, education, social services, interest and enterprises. To show the change over the past seven years, the per capita expense in each category has been indexed to that expense in the year 1997. The expense is in actual dollars and has not been adjusted for inflation. However, the British Columbia Consumer Price Index (CPI) is plotted to show the general increase in prices in the province (also indexed to 1997) for comparison.

Exhibit 8

Change in Per Capita Expense, 1997 to 2003

Rate of change in per capita expense for health, education, social services, enterprises and interest compared to the Consumer Price Index (1997 = 100)



Source: Office of the Auditor General of British Columbia; Statistics Canada

Relative to the Consumer Price Index, spending per capita for health has increased significantly over the last seven years. Per capita spending on education initially declined, but has increased in the last few years; and per capita spending on social services has decreased significantly between 2002 and 2003.

Annual Surplus/Deficit Trend

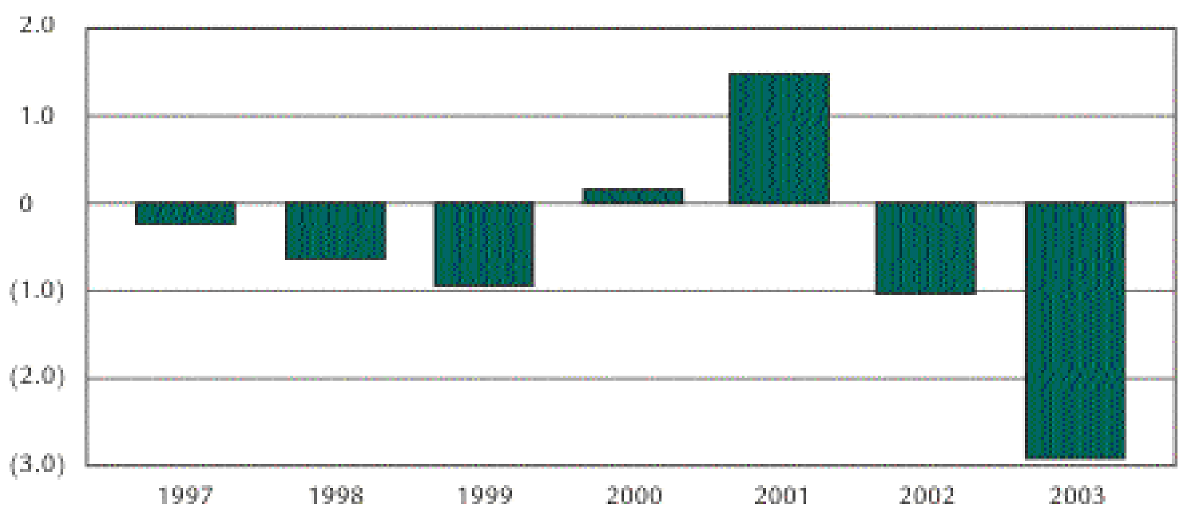
Exhibit 9 shows the trend in annual surplus/deficit for the province. A surplus occurs when annual revenues exceed expenses. A deficit occurs when expenses exceed revenues.

Between 1997 and 1999, the province recorded annual deficits ranging from $0.2 to $0.9 billion. In 2000 and 2001, there were surpluses of $0.2 and $1.5 billion, respectively. And in 2002, the province had a deficit of $1.1 billion, followed in 2003 by a deficit of $2.9 billion.

Exhibit 9

Annual Surplus/(Deficit), 1997 to 2003

The annual surplus/(deficit) ($ Billions)



Source: Office of the Auditor General of British Columbia

The 2002 deficit included two unusual items: revenue from the settlement of pension plans of $1.5 billion, and government restructuring expenses of $0.5 billion. Without these unusual adjustments, the deficit for 2002 would have been $2.1 billion rather than $1.1 billion.

Asset Trends

Government assets are grouped according to their use and can be considered either financial or non-financial in nature. Financial assets are cash, investments, inventories, loans and other types of receivables. They are generally converted to cash in the normal cycle of events, for example loans are converted to cash when collected. Financial assets also include the investments held by government in its enterprises.

Non-financial assets include physical (or “tangible”) capital assets that the government has paid for or acquired by trading for other assets. They are not normally converted to cash. Physical capital assets are recorded in the government’s financial statements at their net book value (cost less depreciation). They exclude Crown land, forests and other natural resources that belong to the Crown.

Assets are also characterized as being either “infrastructure” or “revenue-generating.” Physical capital assets used in the government’s general programs do not generate direct revenue. They are the infrastructure needed to serve the public. Those used in government enterprises (such as railways, trains, hydro-electric dams and transmission lines) do generate revenue.

The distinction between revenue-generating capital assets and infrastructure assets is important because, unless an alternative service delivery is secured, a government does not generally pay off its debt by selling the infrastructure needed to serve citizens.

Exhibit 10 presents an overview of the categories of government assets—financial, revenue-generating, and general infrastructure. It also shows the value of all physical capital assets owned by the government. This is the sum of the general infrastructure assets and the capital assets of business enterprises.

Exhibit 10

Assets, 1997 to 2003

Financial, revenue-generating, infrastructure and total capital assets of the government ($ Billions)

	1997	1998	1999	2000	2001	2002	2003
General programs							
Financial assets	6.4	6.8	7.0	9.3	9.2	9.2	7.9
Enterprises							
Revenue-generating assets	17.8	18.4	19.3	18.8	19.4	18.7	19.0
	24.2	25.2	26.3	28.1	28.6	27.9	26.9
General Infrastructure assets[1]	18.6	18.4	18.4	19.2	20.5	21.4	21.5
	42.8	**43.6**	**44.7**	**47.3**	**49.1**	**49.3**	**48.4**
Total physical capital assets	29.5	29.5	29.7	30.1	31.3	32.3	32.6

[1]See glossary on page 11.

Source: Office of the Auditor General of British Columbia

From 1997 to 2003, the government's total assets increased from $42.8 billion to $48.4 billion, a seven-year growth of $5.6 billion, or 13%. Increases in physical capital assets accounted for approximately 55% of this change.

Because of British Columbia's size and geography, the need for capital infrastructure within the province is substantial. In the last seven years, the net book value of infrastructure assets used within government programs (such as hospitals, other health care facilities, schools, post-secondary institutions, roads, ferries, buses and rapid transit) has increased from $18.6 billion to $21.5 billion, a 16% increase.

In the same seven-year period, the value of revenue-generating assets of the government enterprises (such as those used in power generation, transmission and distribution) has increased by 7% from $17.8 billion to $19.0 billion.

The total value of physical capital assets owned by the government, used in both its commercial activities and general programs, has increased by 11% from $29.5 billion to $32.6 billion.

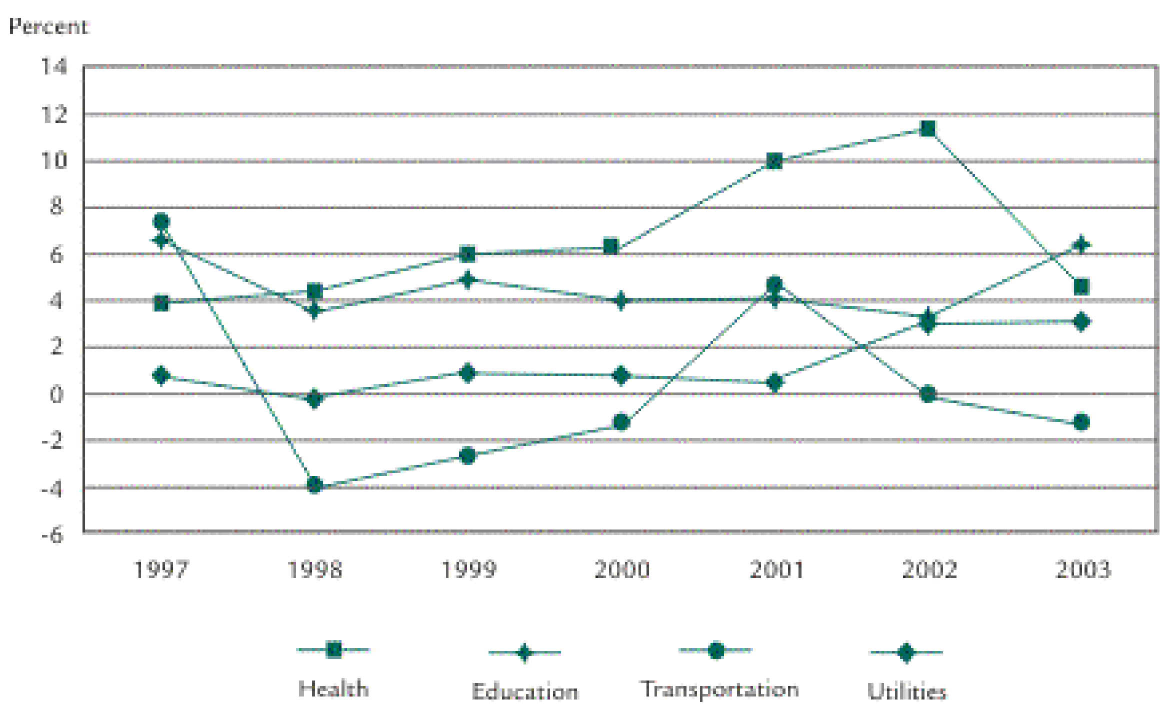
Exhibit 11 shows the percentage change in the net book value of total physical capital assets managed by government and used for health, education, transportation and utilities from 1997 to 2003. The net book value change is the final result after capital additions, disposals and depreciation of the assets are taken into account.

In total, except for a slight decrease in 1998, the net book value of physical capital assets has increased each year. In the transportation sector, however, the book value of assets decreased in 1998, 1999, 2000 and 2003. In 1998, the government slowed capital spending—in particular that on transportation—to examine its capital investment policy and look for alternative ways to meet the province's infrastructure needs.

Exhibit 11

Change in Physical Capital Assets, 1997 to 2003

Annual percentage change in the net book value of total physical capital assets for health, education, transportation and utilities



Source: Office of the Auditor General of British Columbia

Government borrows for different reasons: it may do so to finance its operating shortfalls, to build up its stock of capital assets, to finance investment or lending, or simply to ensure that funds are there when needed. Exhibit 12 shows the increase in net book value of the government's total physical capital assets for each of the years 1997 to 2003, compared to the change in total debt each year. This graph provides a picture of how much of the change in debt is being used to provide for capital assets versus other uses of the borrowed funds.

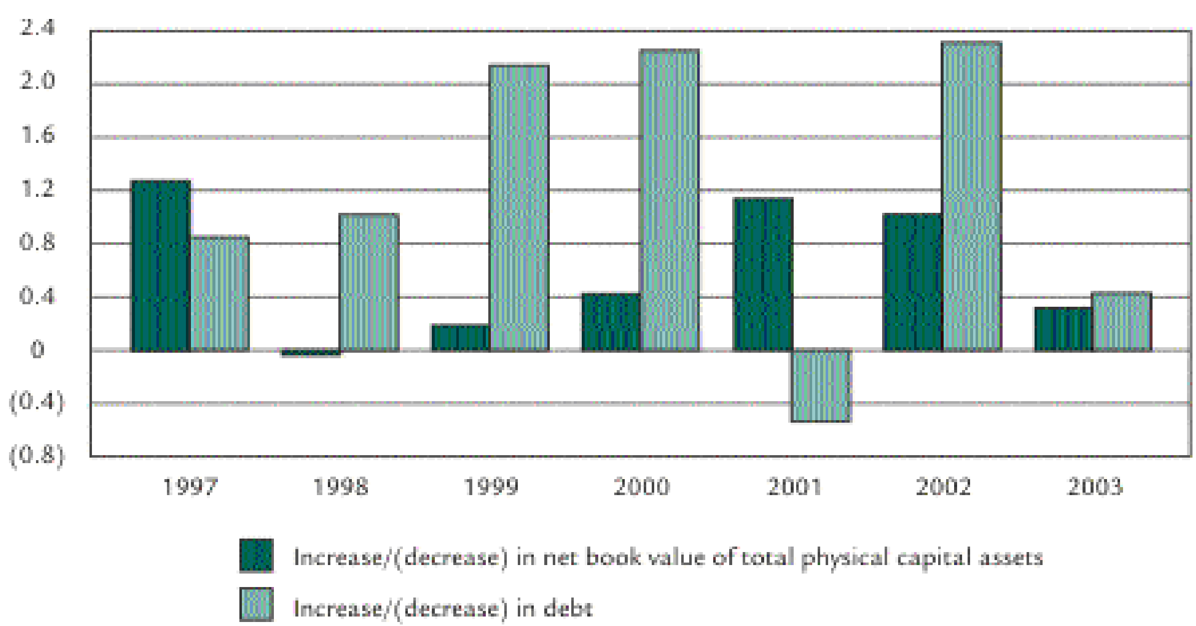
Liability Trends

Government is liable for its obligations to individuals, private firms and other governments. Public debt—amounts borrowed by the government—makes up a very large part of this obligation.

Exhibit 12

Comparing Changes in Capital Assets and Public Debt, 1997 to 2003

Increase in net book value of total physical capital assets compared to change in debt ($ Billions)



Source: Office of the Auditor General of British Columbia

Exhibit 13 shows the government's debt and other obligations for the last seven years, by general programs and enterprises. Total debt has increased by $7.6 billion, or 26%, between 1997 and 2003.

Total debt increased by only $0.4 billion during 2003, even though the annual deficit was much more, at $2.9 billion. The reason debt increased so little compared to the size of the annual deficit is that the government funded its operations by drawing down $1.1 billion in "warehoused" funds it had borrowed in previous years. The government also financed its deficit by decreasing its temporary investments and other working capital balances.

The liabilities of government enterprises presumably will be paid through their ongoing business activities. The general program obligations, however, have to be met by financial assets available to government general programs, which include the net assets of the enterprises. Any shortage in the equation—referred to as "net liabilities"—will have to be borne by future taxpayers.

Exhibit 13

Liabilities, 1997 to 2003

($ Billions)

	1997	1998	1999	2000	2001	2002	2003
General programs							
Debt	21.1	22.1	23.9	26.5	26.4	28.6	29.2
Other obligations	7.6	7.6	7.1	7.3	7.4	6.7	8.0
	28.7	29.7	31.0	33.8	33.8	35.3	37.2
Enterprises							
Debt	8.0	8.0	8.4	8.0	7.6	7.7	7.5
Other obligations	6.8	7.3	7.6	7.7	8.4	8.1	8.4
	14.8	15.3	16.0	15.7	16.0	15.8	15.9
Total liabilities	**43.5**	**45.0**	**47.0**	**49.5**	**49.8**	**51.1**	**53.1**

Source: Office of the Auditor General of British Columbia

Exhibit 14 shows the future taxpayers' net liabilities at the end of each of the years 1997 to 2003. Over the seven years, net liabilities increased from $19.3 billion to $26.2 billion, an overall increase of $6.9 billion, or 36%. The largest single increase was during 2003, when net liabilities increased by $3.0 billion.

Exhibit 15 shows the net liabilities on a per capita basis. This shows the amount that each citizen would need to pay in order to finance the government's past revenue-generating and spending practices. The net liabilities per capita have increased by 27% over the past seven years. The majority of that increase has come in the last two years.

Monitoring net liabilities—the difference between a government's total liabilities and its financial assets—in terms of Gross Domestic Product provides valuable information about the government's finances. In the next section we show the net liabilities as a percentage of the gross domestic product.

Exhibit 14

Net Liabilities, 1997 to 2003

($ Billions)

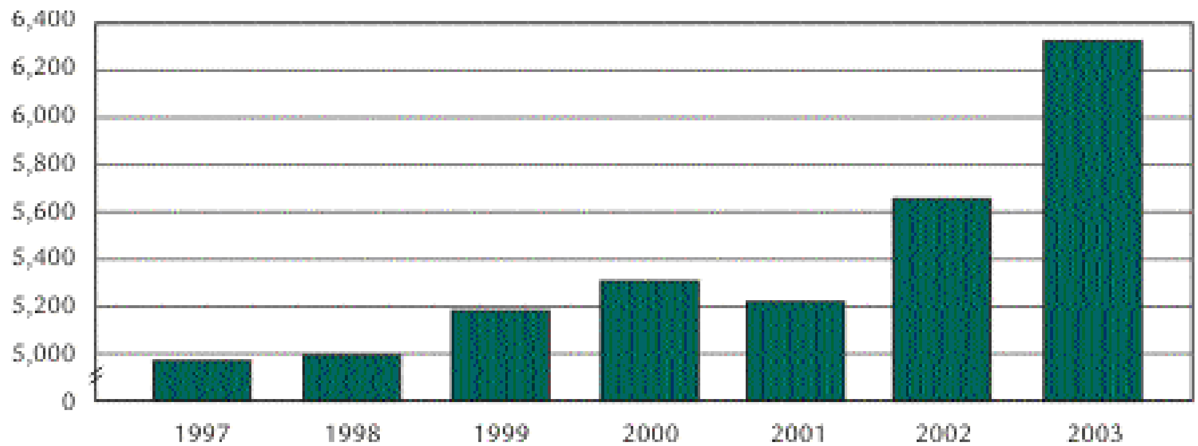
	1997	1998	1999	2000	2001	2002	2003
Total liabilities	43.5	45.0	47.0	49.5	49.8	51.1	53.1
Less: General program financial assets	6.4	6.8	7.0	9.3	9.2	9.2	7.9
Enterprise assets	17.8	18.4	19.3	18.8	19.4	18.7	19.0
Net liabilities	**19.3**	**19.8**	**20.7**	**21.4**	**21.2**	**23.2**	**26.2**

Source: Office of the Auditor General of British Columbia

Exhibit 15

Net Liabilities Per Capita, 1997 to 2003

Net liabilities per capita represents the average financial burden of each citizen of British Columbia ($)



Source: Office of the Auditor General of British Columbia

CICA Indicators of Financial Condition

In 1997, a research group of the Canadian Institute of Chartered Accountants (CICA) published a report titled *Indicators of Government Financial Condition*. Senior governments and market analysts in Canada have started to use the indicators to monitor the financial condition of the federal and provincial governments with respect to the following concepts:

Sustainability—the ability of a government to maintain existing programs and meet existing creditor requirements without increasing the debt burden on the economy.

In other words: Can the government continue to raise revenue in order to spend the way it does now?

Flexibility—the degree to which a government can increase financial resources to respond to rising commitments, by either expanding its revenues or by increasing its debt burden.

In other words: If the government were to increase its spending, how much "room" is there in the provincial economy for the government to pay for the spending by increasing either taxes or debt?

Vulnerability—the degree to which a government becomes dependent on, and therefore vulnerable to, sources of funding outside its control or influence.

In other words: Does the government rely too much on revenue from the federal government – revenue that it is unable to control from year to year? Generally, a province can control its taxation policies, but it cannot control the annual transfer of funds from the federal government.

The CICA recommends the reporting of 10 indicators of government financial condition, 7 of which are relevant to provincial governments. These are summarized in Exhibit 16.

Exhibit 16

Indicators of Financial Condition

This report presents a seven-year trend for each of the CICA's indicators of government financial condition

Sustainability indicators:

1. Net liabilities to gross domestic product
2. Change in net liabilities to gross domestic product

Flexibility indicators:

3. Public debt charges to revenue
4. Changes in physical capital stock
5. Own-source revenue to GDP

Vulnerability indicators:

6. Government-to-government transfers to own-source revenue
7. Foreign currency debt to total government debt

Source: Canadian Institute of Chartered Accountants

Sustainability Indicators

Two sustainability indicators compare the size of the net liabilities and the annual change in net liabilities, to the size of the provincial economy. A stable net liabilities to GDP ratio indicates that the rate of growth in the economy is similar to the rate of growth in the province's net liabilities. An increasing ratio indicates that the government's current fiscal policies are increasing the financial burden on the provincial economy and on future taxpayers. A declining ratio signals the opposite.

Exhibit 17 shows the seven-year trend of net liabilities to GDP for British Columbia. Up to 2002, the ratio had remained relatively stable, at between 16 and 18%. In 2003, it increased by almost 2%, to 19.5%. The increasing trend over the last three years means that the overall burden on future taxpayers is increasing.

Exhibit 18 shows the change in net liabilities to GDP ratio in British Columbia for each of the past seven years. There is no "correct" or "optimal" ratio of net liabilities to GDP that a government should aim to achieve. The trend should be examined in conjunction with other financial indicators of the government's finances. The fluctuation in this ratio over the past seven years has been approximately 2% or less.

Flexibility Indicators

The three indicators of government's financial flexibility are:

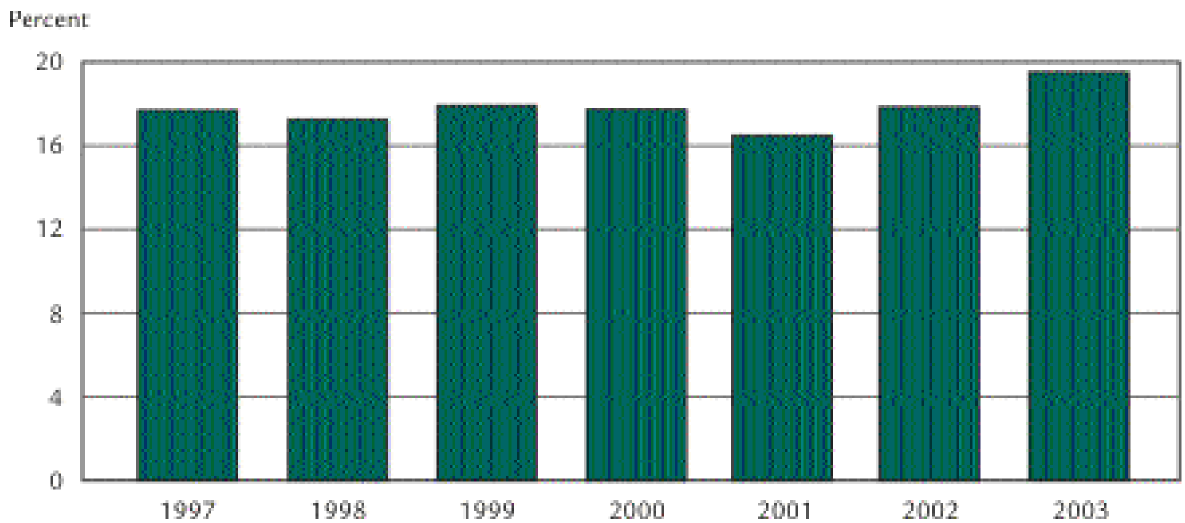
- public debt charges to revenue;
- changes in physical capital stock; and
- own-source revenue to GDP.

The public debt charges to revenue indicator is often referred to as the "interest bite." It shows how much of each dollar of the province's revenue is used to pay interest charges on debt, and it is normally measured in the form of cents per dollar of revenue. If an increasing portion of the revenue of the province is used to pay interest on government debt, then less money would be left to provide services to the citizens of British Columbia.

Exhibit 17

Net Liabilities to Gross Domestic Product (GDP), 1997 to 2003

Net liabilities as a percentage of GDP in British Columbia

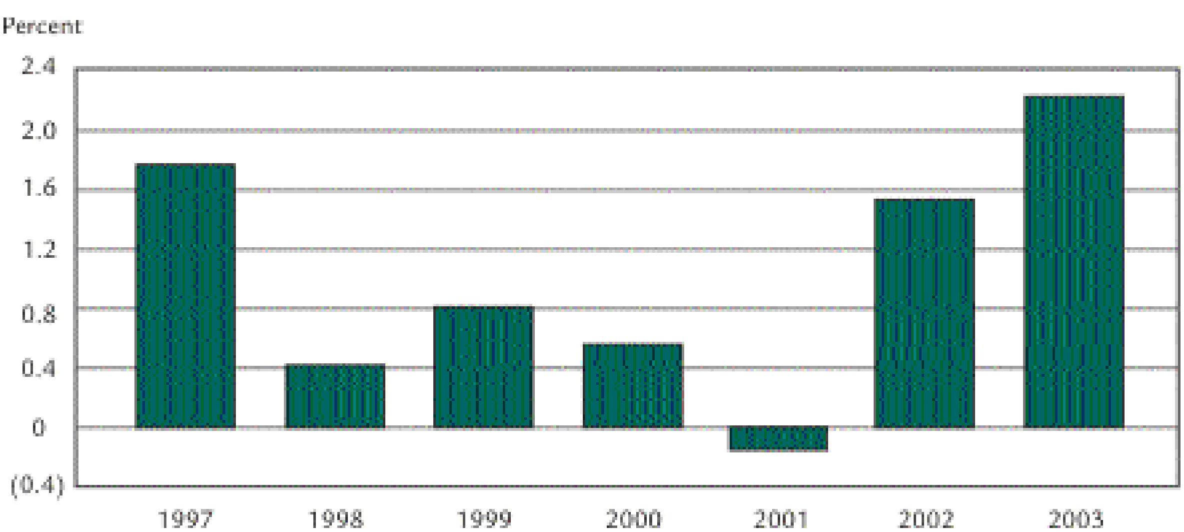


Source: Office of the Auditor General of British Columbia; Statistics Canada

Exhibit 18

Change in Net Liabilities to Gross Domestic Product (GDP), 1997 to 2003

Annual change in net liabilities expressed as a percentage of GDP in British Columbia



Source: Office of the Auditor General of British Columbia; Statistics Canada

Exhibit 19 shows the seven-year trend in public debt charges to revenue. The interest bite trend for British Columbia has improved between 1997 and 2003. The improvement over the last few years was due mainly to increases in revenue (including substantial increases in hydro-electricity revenues in 2001 and the pension plan settlement gain of $1.5 billion in 2002), concurrent with the relatively flat costs of borrowing as a result of lower interest rates. The debt charges used in this indicator include both the interest expense of government's general programs and the interest included in the expenses of enterprises.

We calculated the interest bite of the province to be approximately 6.0 cents for the 2002/03 fiscal year. The government reported its interest bite to be 6.4 cents. The difference is explained mainly by the fact that we included in our calculation, as required by GAAP, revenue from schools, universities, colleges and hospitals (the SUCH sector).

The trend of changes in physical capital stock indicates the net amount of spending on infrastructure and other capital items by government. It is measured as the percentage change in the net book value of total physical capital assets (cost less accumulated depreciation).

This indicator emphasizes the need for governments to put in place, and maintain, adequate infrastructure to serve its citizens. Any deferring of expenditures on maintenance can lead to a need for expensive corrections at a later date—and such a strain on future resources reduces the flexibility of government to provide other services.

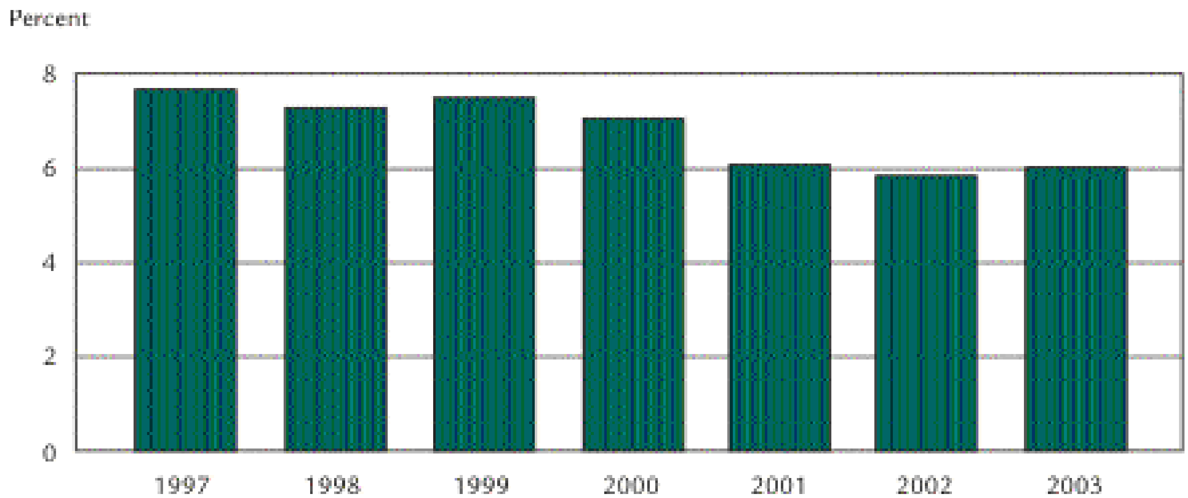
Exhibit 20 shows the annual percentage change in physical capital stock of the provincial government from 1997 to 2003. The graph indicates that the government's capital spending on total physical capital assets was constrained in 1998, but the percentage change has been larger since then.

The ratio of own-source revenue to GDP represents the extent to which the government is taking income from its own economy in the form of taxation revenue and other fees. Typically, own-source revenue is all revenue other than federal transfers. This indicator measures the percentage of revenue that a government collects directly from the value of the provincial economy.

Exhibit 19

Public Debt Charges to Revenues (the "Interest Bite"), 1997 to 2003

Total debt interest expense as a percentage of total provincial revenue

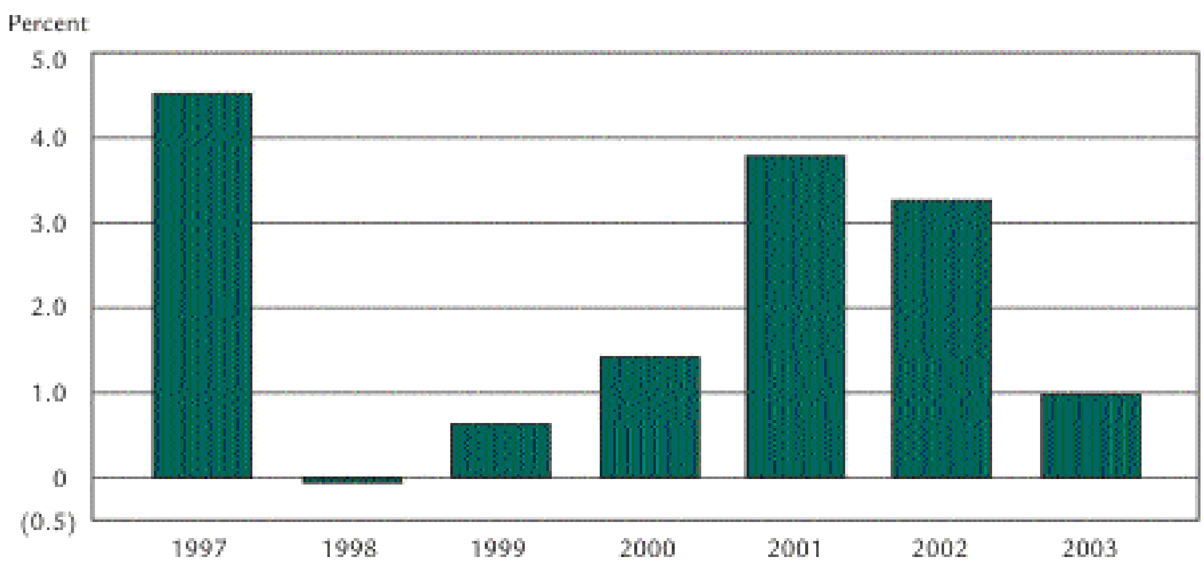


Source: Office of the Auditor General of British Columbia

Exhibit 20

Changes in Physical Capital Stock, 1997 to 2003

Annual percentage change in the net book value of total physical capital assets



Source: Office of the Auditor General of British Columbia

Exhibit 21 shows the ratio of own-source revenue to GDP for the seven years 1997 to 2003. The relatively stable trend in this indicator over that time shows that the government has generally obtained its own-source revenue at a similar pace to the growth of the province's economy. The unusually large increase in the own-source revenue to GDP indicator in 2001 and 2002 was due to a large increase in BC Hydro and pension settlement gain revenues in those years.

Vulnerability Indicators

The two relevant indicators of government's financial vulnerability are:

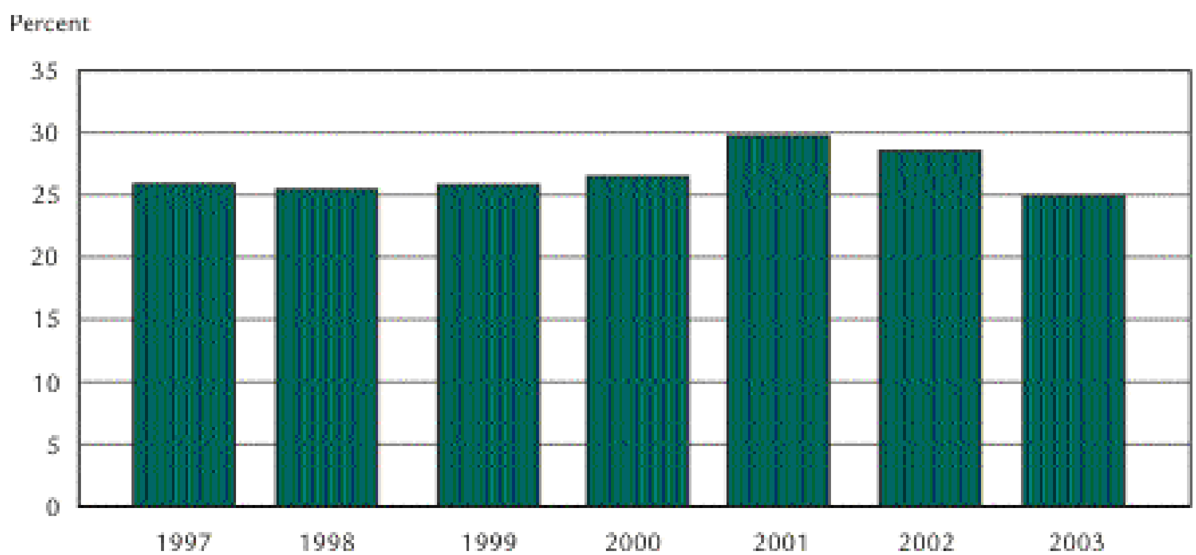
- government-to-government transfers to own-source revenue; and
- foreign currency debt to total government debt.

The idea behind this set of indicators is that funds obtained from federal or international sources (either from government transfers or borrowing) are not considered to be as controllable as revenue generated within a province. Own-source revenue is more

Exhibit 21

Own-source Revenue to Gross Domestic Product (GDP), 1997 to 2003

Provincial revenue, net of federal transfers, as a percentage of GDP in British Columbia



Source: Office of the Auditor General of British Columbia; Statistics Canada

controllable by the government through tax legislation or the charging of fees.

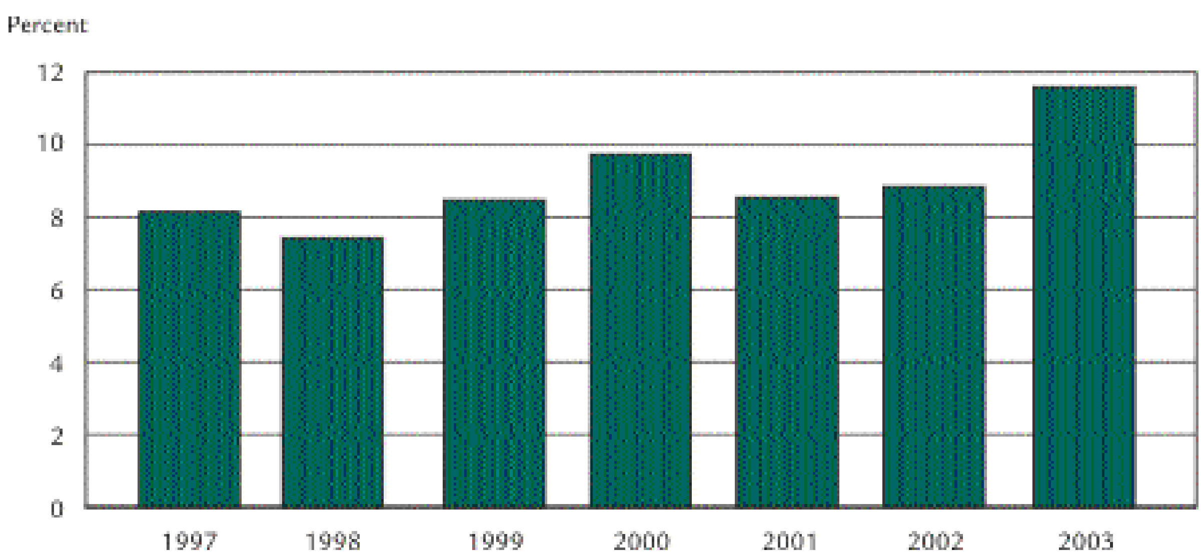
The province receives transfers from the federal government to support the delivery of health, education, social services and other programs. The government-to-government transfers to own-source revenue indicator compares federal government transfers to other provincial sources of revenue. Increases in the ratio may denote a higher dependence on the federal government as a funding source. Because the province does not generally control federal funding decisions, an increase in this ratio would add to the province's financial vulnerability.

Exhibit 22 shows the percentage of government-to-government transfers to own-source revenue for the seven years ending March 31, 2003. The province's dependence on the federal government for funding has remained relatively stable over the years. An increase occurred in 2000 and again in 2003 because of additional contributions received from the federal government

Exhibit 22

Government-to-Government Transfers to Own-Source Revenue, 1997 to 2003

Federal transfers as a percentage of all other government revenue



Source: Office of the Auditor General of British Columbia

through the Federal Equalization program. Federal Equalization revenue was $543 million during 2003.

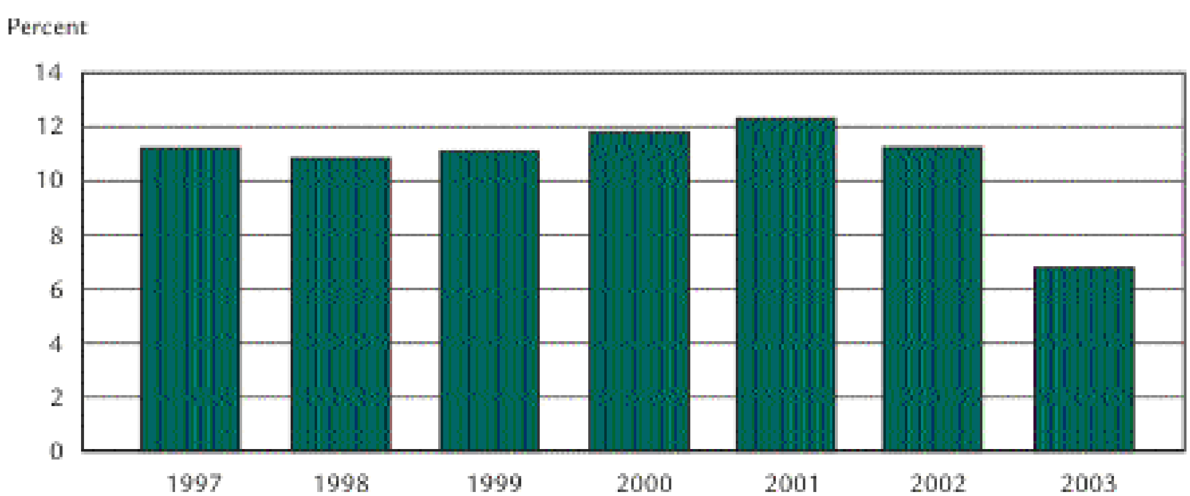
The government of British Columbia often borrows in foreign currencies. To minimize its exposure to swings in these currencies, the government enters into derivative contracts such as currency swaps and forward contracts for most foreign-denominated debt. These contracts ensure that debt repayments are fixed in Canadian dollars. For many years, information concerning public debt issued in foreign currencies has been included in a note to the government's financial statements. The note discloses any "hedging" through foreign currency derivative contracts.

The ratio of non-hedged foreign currency debt to total government debt shows the degree of vulnerability of a government's public debt position to swings in foreign currency. Tracking monies borrowed by the government in currencies other than the Canadian dollar is important because of the uncertainties associated with exchange rates when repayment comes due. Exhibit 23 shows that the non-hedged foreign currency debt as a percentage of total government debt has decreased during 2003. This was due to a repayment of non-hedged foreign currency debt during the year.

Exhibit 23

Foreign Currency Debt to Total Government Debt, 1997 to 2003

Non-hedged foreign currency debt as a percentage of total government debt



Source: Office of the Auditor General of British Columbia; Ministry of Finance

Part 2: Comparing British Columbia to Other Canadian Jurisdictions

Part 2: Comparing British Columbia to Other Canadian Jurisdictions

The big picture—where do we stand?

Population data for a fiscal year is the population as at July 1 of the fiscal year.

Gross domestic product data for a fiscal year are the amounts for a calendar year which ends in the fiscal year.

Government can both influence, and be influenced by, changes in the economy. On one hand, government policy can affect the financial and social climate of the province by determining how, and how much, it will collect from and spend on its citizens. On the other hand, taxation, resource and other government revenues are closely tied to the performance of British Columbia's economy. A vibrant economy will normally produce greater revenue for government. Spending that revenue can stimulate economic growth.

In the 2002/03 fiscal year, in comparison to other western Canadian provinces and Ontario, British Columbia experienced moderate inflation, higher unemployment and (with the exception of Manitoba) lower Gross Domestic Product per capita. Exhibit 24 compares inflation, unemployment and GDP per capita in all western Canadian provinces and Ontario for 2002/03.

There are many financial and statistical indicators available today that allow jurisdictions to be compared to one another. Comparing provincial statistical and economic information is not without problem. Much work needs to be done to make such comparisons relevant. For instance, statistical and economic information is constantly being updated, and this can result in

Exhibit 24

Economic Indicators for the Western Provinces and Ontario, 2002/03*

British Columbia has higher unemployment, moderate inflation and lower gross domestic product (GDP) per capita

	Inflation %	Unemployment %	GDP per capita $
British Columbia	2.3	8.5	32,445
Alberta	3.4	5.3	48,326
Saskatchewan	2.8	5.7	34,123
Manitoba	1.6	5.2	31,741
Ontario	2.0	7.1	38,992

*Inflation, Unemployment and GDP data is for the calendar year ending December 31, 2002. Population data is as at July 1, 2002.

Source: Statistics Canada

significant changes. It is therefore important to ensure that the date of such information is the same when inter-provincial comparisons are being made.

In addition, the financial information that is produced within each jurisdiction may not be entirely comparable, depending on the accounting policies and reporting entity adopted by each jurisdiction. And, while the absolute dollar value of financial information also makes it difficult to compare provincial finances on a direct basis, the use of ratios and indicators (such as a comparison to GDP or the population) often removes these differences.

In this part of the report, we assess the changes over the last seven years of three significant indicators. These indicators, described below, can provide us with a better understanding of British Columbia's financial performance relative to that of other provinces and the federal government.

Net Liability to GDP

This ratio is used to monitor the fluctuation from year to year of the province's shortage of financial assets to meet its liabilities, compared to changes in the economy. It is a universal ratio used by all jurisdictions in Canada, and therefore is well established and understood by governments and investors alike. This ratio is also referred to as "net debt to GDP."

In British Columbia, the government publishes annually, in the Provincial Debt Summary section of the Public Accounts the ratio of its public debt to GDP. Monitoring that ratio is also appropriate.

GDP Per Capita

This ratio is used to monitor the year-to-year changes in the province's economy relative to those changes in the economies of other jurisdictions. It is calculated by dividing the nominal GDP for a year by the size of the population. Because many external factors tend to have a similar effect on Canadian jurisdictions, this ratio is also widely used as an indicator of success of a government's fiscal policies. Although GDP per capita is not a complete indicator of citizens' standard of living, it does provide some idea of the programs and services that a province can afford.

Credit Rating

As a service to lenders, credit rating agencies keep watch on changes in the provinces' financial condition and publicly report on them. In the opinion of these agencies, British Columbia has been able to keep its high standing in the international financial market. British Columbia, along with Manitoba and Ontario, is the second highest-rated province in Canada, after Alberta. British Columbia has maintained a credit rating of Aa2 since 1998.

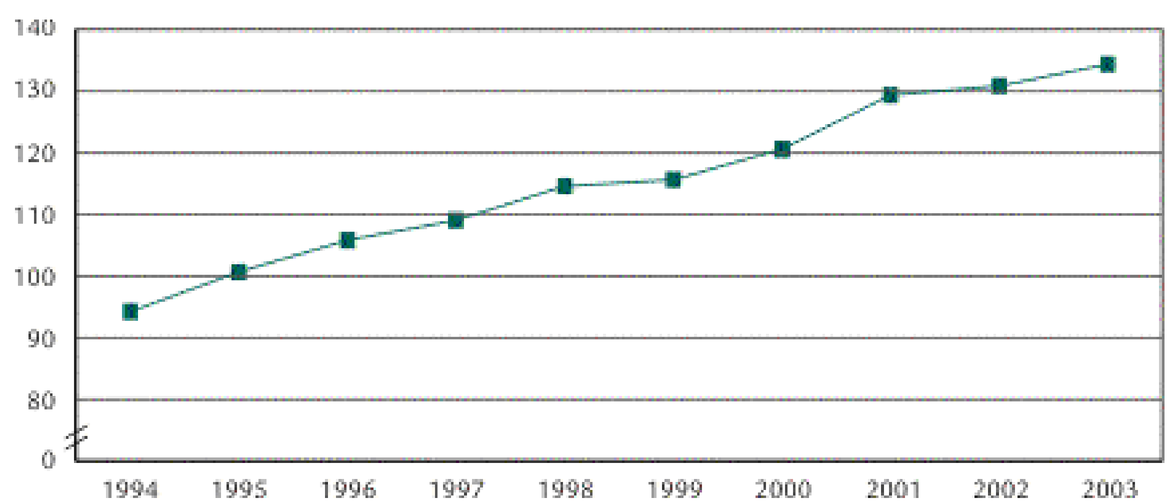
We encourage the government to use these indicators as performance measures of success of its overall fiscal policies.

Exhibit 25 shows the GDP for British Columbia for the 10 years ending in fiscal 2003. The graph shows fairly steady growth in the province's GDP over that time, though growth was a little flat in fiscal 1999 and 2002. Some of the growth in 2001 can be attributed to high energy prices. In 2003, GDP was 2.7% higher than in the previous fiscal year.

Exhibit 25

British Columbia's Gross Domestic Product (GDP), 1994 to 2003*

The GDP represents the size of the provincial economy ($ Billions)



*GDP data is for the calendar year ending in the above fiscal years.

Source: Statistics Canada

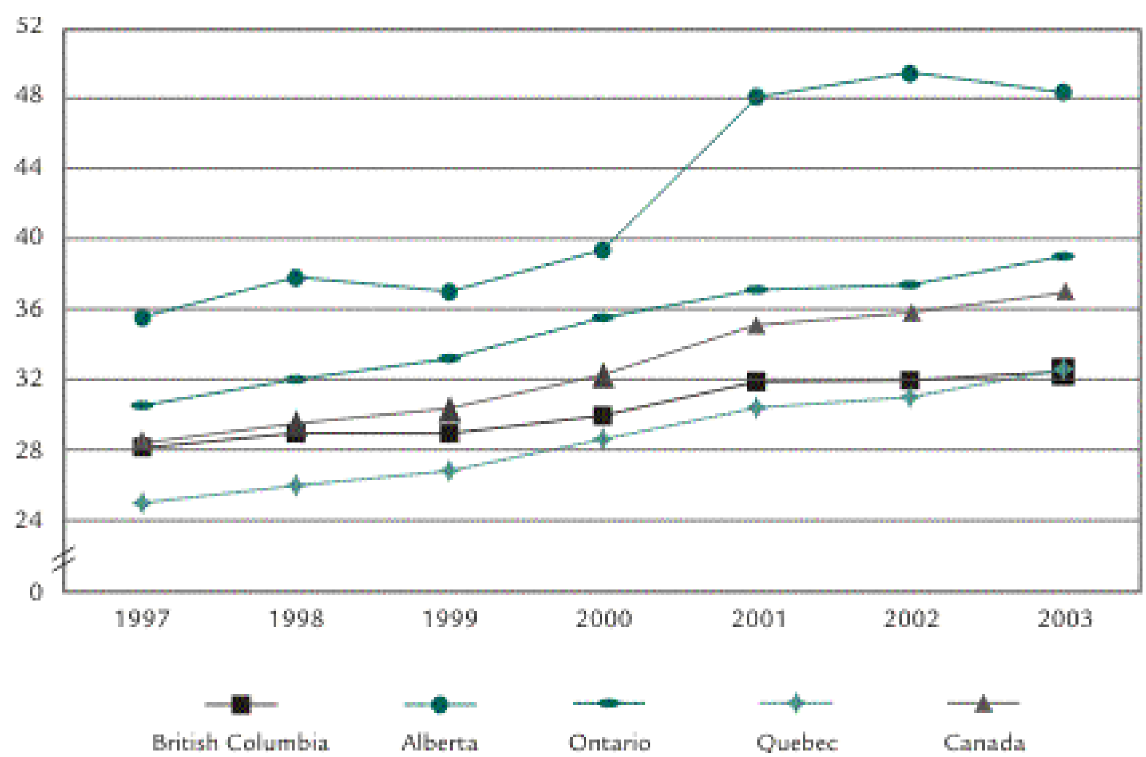
Exhibit 26 presents the GDP per capita for British Columbia, Alberta, Ontario, Quebec and Canada as a whole. Appendix B provides the data for these jurisdictions and the six remaining provinces. This information provides the average output per person for each jurisdiction, and is an indicator of the wealth of the province.

Alberta had the highest GDP per capita in fiscal 2003, followed by Ontario and then Canada (the figure for Canada approximates a weighted average of all provinces). British Columbia's GDP per capita has dropped from fourth to fifth place in fiscal 2003 among the provinces, behind Saskatchewan and Quebec.

Exhibit 26

Gross Domestic Product (GDP) Per Capita, for Canada and four of the Provinces, 1997 to 2003*

A measure of the financial wealth of a jurisdiction ($ Thousands)



*GDP data is for the calendar year ending in the above fiscal years. Population is as at July 1 of the fiscal year.

Source: Statistics Canada

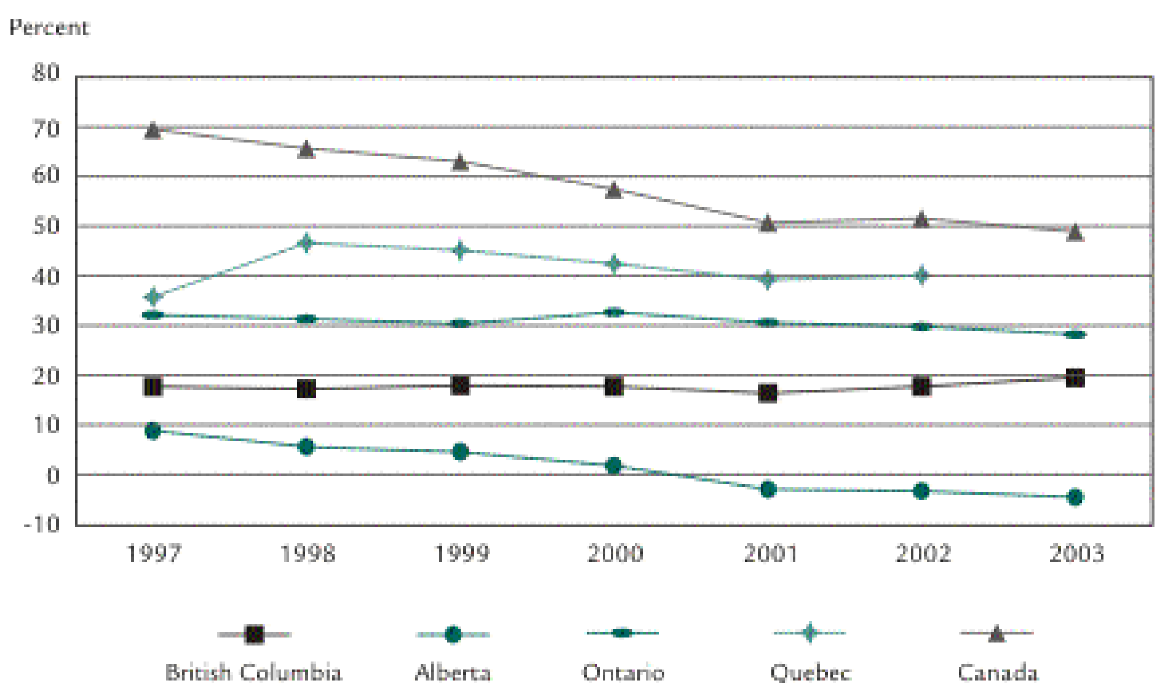
In Exhibit 17 on page 37, we presented the net liabilities to GDP indicator for British Columbia for the seven years 1997 through 2003. Net liabilities can also be thought of as the amount that current and past generations of British Columbians are leaving to future generations of citizens to pay or finance. Comparing the net liabilities to GDP makes it easier to compare the net liabilities of one year to another, as well as across different jurisdictions.

Exhibit 27 presents the net liabilities to GDP for British Columbia, Alberta, Ontario, Quebec and Canada as a whole, for fiscal years since 1997. Appendix C provides the data for these jurisdictions and the six other provinces. The net liabilities for the other jurisdictions is based on information from their Public Accounts, corrected for any audit qualifications.

Exhibit 27

Net Liabilities to Gross Domestic Product (GDP), for Canada and four of the Provinces, 1997 to 2003*

The extent to which the economy is able to sustain the demands placed on it by the government



*GDP data is for the calendar year ending in the above fiscal years.

Source: Office of the Auditor General of British Columbia; Statistics Canada

In the graphs in Exhibit 27 a lower liability ratio is better to have than a higher one. Alberta is the only jurisdiction with a "negative" net liability to GDP, and it has been in that position since 2001. This indicates that Alberta has more financial assets than liabilities.

British Columbia ranks second among all jurisdictions with respect to the net liabilities to GDP indicator, behind Alberta, and has maintained this position for all years since fiscal 1997.

Exhibit 28 compares British Columbia's credit rating by Moody's Investors Service to the rating for Alberta, Ontario, Quebec and Canada for the 10 years ending March 31, 2003. Appendix D provides the credit ratings for these jurisdictions and the six remaining provinces.

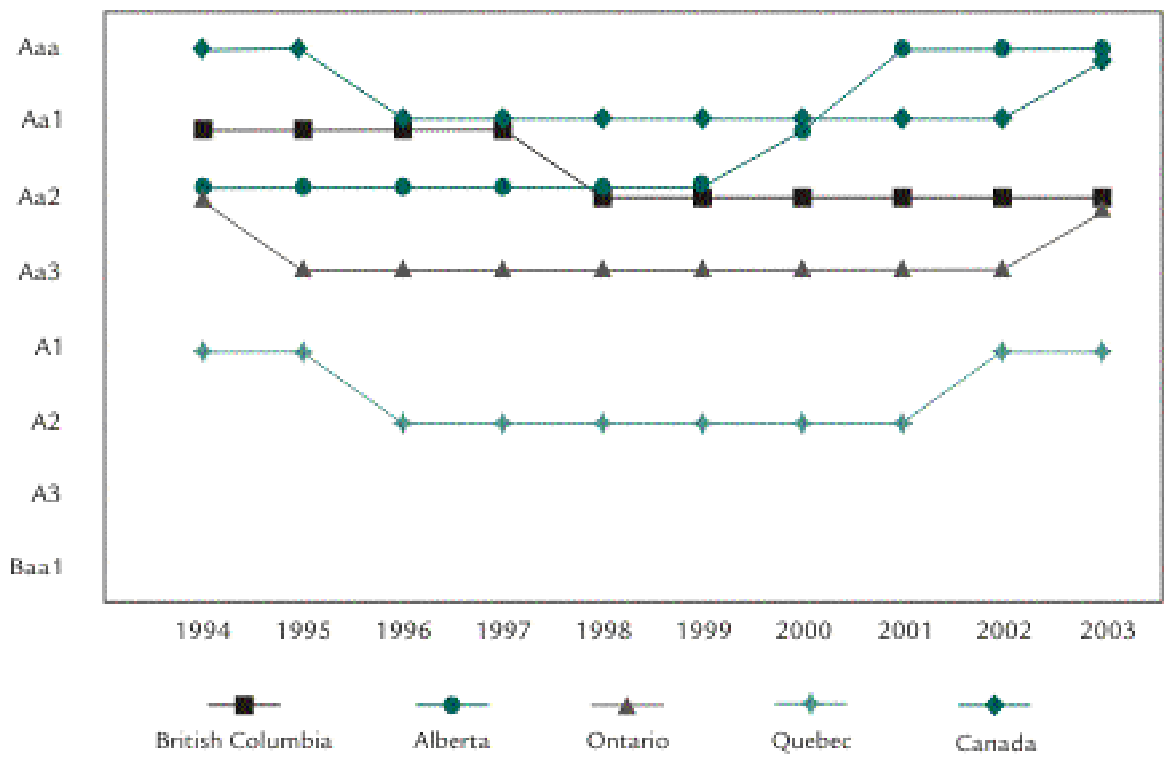
Recommendation:

We recommend that the government use the indicators of financial condition identified by the Canadian Institute of Chartered Accountants, and other important financial and economic measures, in its discussion and analysis to inform the legislators and citizens of British Columbia of the state of the government's finances.

Exhibit 28

Credit Rating, for Canada and four of the Provinces, 1994 to 2003

Credit ratings as at March 31 of each year



Source: Moody's Investors Service

Response from the Ministry of Finance

Response from the Ministry of Finance

We appreciate the opportunity to respond to the Auditor General's comments and his acknowledgement of the government's continuing progress in adopting best practices in its financial reporting.

The Province of British Columbia continues to be a leader in Summary budgeting and reporting where the operations of Crown corporations and agencies are fully reflected in our Budget documents and in our Public Accounts (PAs). The Budget documents are our financial plan, and the Overview and Provincial Debt Summary within the Public Accounts reports the actual results against that plan and includes additional graphs and commentary. As well, the province via the Internet provides public access to the Financial and Economic Review with its expanded budgetary variance analysis, economic commentary and historical reference information. As stated last year, much of the data the Auditor General included in his suggested framework is provided in those documents.

In particular, for the 2003/04 fiscal year, the government changed its budget and quarterly report presentation to conform to GAAP, and to create greater consistency between the budget and public accounts presentations. This format is consistent with the recommendation in last year's auditor general report on this issue. However, while revenues and expenses of taxpayer-supported organizations are detailed, revenues and expenses of government "Enterprises" are not broken out as the Auditor General recommended since the government wishes to be consistent with GAAP. In addition, beginning with the 2004/05 budget, the government will fully include the Schools, Universities, Colleges and Health Authority (SUCH) sector into its budget and reporting entity.

The province also requires government, as well as individual ministry and Crown corporations and agencies, to prepare three-year service plans and reports that disclose goals and objectives and related performance measures to be released with the Budget and Public Accounts. Therefore, the province already provides a detailed accountability loop from planning to reporting. In terms of the timeliness of financial reporting, British Columbia for the second year in a row was second in the country in the releasing of its audited financial statements and even improved the release date by two weeks compared to the previous year. Although we are in the relatively early stages of performance reporting, and there is room for improvement, it is clear that the government has dramatically improved its financial and accountability information. The province's reporting is extensive.

Also, as stated last year, the province of British Columbia lead other jurisdictions by legislating that the province must produce its budget and financial reports in full compliance with Generally Accepted Accounting Principles (GAAP) for senior governments. Compliance is required starting with the 2004/05 budget. Achieving this goal is clearly one of government's top priorities. There continue to be significant policy, technical and administrative issues to be resolved in making this very major change to the government reporting entity.

We generally agree with the disclosure principles advocated by the Auditor General. We are concerned; however, about the Auditor General recommended disclosure for segmented reporting. The Public Sector Accounting Board (PSAB) and Generally Accepted Accounting Principles (GAAP) currently recommend modified equity accounting for government business enterprises. The Auditor General format which advocates breaking out the financial statements into "General Programs" and "Enterprises" is not the format currently illustrated in the PSAB handbook. A new task force is being struck by PSAB to address segment reporting but it is too early to make any assumptions on how our Public Accounts disclosure will, if at all, be impacted as a result of the determinations of that task force.

The Auditor General has recommended additional disclosure to accompany the Public Accounts. We also agree that it is important for governments to provide explanatory context for their financial reports; however, when it comes to explanatory commentary provided by governments with their audited statements, there is no agreed upon guidance currently provided by the accounting profession. Much of the proposed expanded information as proposed by the Auditor General is based on the recommendations included in an exposure draft on Financial Statement Discussion and Analysis issued by the PSAB for comment in July 2003 with comments required by September. There is no information yet available on whether or not there is widespread acceptance of these recommendations by other jurisdictions. The recommendations are currently only draft and a final decision on recommended disclosure is not anticipated until March or June of 2004.

There is no general use of all the Canadian Institute of Chartered Accountants' Indicators of Government Financial Condition recommended by the Auditor General, in part, because of concerns over their reliability as measures. Some of these indicators, and other indicators, are being used by various jurisdictions, including British Columbia.

Since British Columbia is the first major Canadian jurisdiction to legislate GAAP and there is such a diversity of reporting across the country, comparing information across jurisdictions for anything more than indicative purposes would be misleading. Other provinces do not have the same organizations nor are they currently including the same entities in their Government Reporting Entity. Therefore, meaningful comparisons are difficult. Until greater consistency is achieved across Canada, at least in terms of the application of accounting guidance, any comparisons should be made cautiously.

As the government strives for continuous improvement of reporting, it must also take into account the value of any new information to report users, its cost, its impact on timeliness of reporting and the avoidance of duplication across reports. As stated earlier the province already does a significant amount of explanatory reporting through a variety of documents. The government on an on-going basis reviews and modifies reporting requirements to adapt to best practices and enhance meaningful analysis. There is always room for enhancement; however, keeping up with evolving GAAP/PSAB guidance is challenging in its own right—raising the bar will have to be done cautiously, in consultation with the office of the Auditor General and with general agreement across jurisdictions. We also require agreement on the reporting standard by the accounting profession.

Some of the difficulties the province faces if it were required to include the draft disclosure in the Public Accounts include but are not limited to:

- *Duplication of existing reporting.*
- *The full consolidation of Government Business Enterprises distorts government revenues and expenses and creates volatility which is, for example, based on commercial transactions, such as the purchase and sale of power as opposed to changes in government revenue or expense trends.*

- *Acquiring some of the additional recommended information would require extra resourcing and put even further stress on crowns and School University Colleges and Hospitals (SUCH) entities who currently have no GAAP requirement to produce the proposed information.*
- *Some of multi year trend analysis information, particularly that associated with the SUCH sector information, is not currently collected. This historical information may not be available even if cost was not an object. Lack of availability of historical information would make some of the trend analysis difficult, if not impossible.*
- *Different accounting policies impact reported amounts making it sometimes very difficult to follow numbers through the financial statements or to do meaningful comparatives over multiple years.*
- *Inclusion of the recommended disclosure and analysis will impact the timeliness of the release of the Public Accounts.*

Improvements will be made over time; however, in the immediate future we are concentrating our resources on meeting the legislated commitment of making the Budget documents, Estimates and Summary Financial Statements fully compliant with GAAP by 2004/05. We look forward to working with the Auditor General on this priority project following the introduction of GAAP and receipt of definitive guidance from the Public Sector Accounting Board.

December 2003

Appendices

Appendix A: 2002/03 Public Accounts Overview

2002/03 Public Accounts Overview

Appendix B: Gross Domestic Product (GDP) per Capita

The ratio of GDP per capita for all provinces and Canada, for the fiscal years 1997 to 2003*

(Dollars)

	1997	1998	1999	2000	2001	2002	2003
British Columbia	28,091	28,940	28,932	29,940	31,861	31,901	32,445
Alberta	35,504	37,776	36,959	39,347	48,064	49,467	48,326
Saskatchewan	28,513	28,589	28,829	29,724	32,982	32,748	34,123
Manitoba	25,125	26,218	27,216	27,947	29,220	30,206	31,741
Ontario	30,516	31,996	33,187	35,487	37,053	37,314	38,992
Quebec	24,960	25,952	26,797	28,590	30,366	30,954	32,583
Newfoundland and Labrador	18,627	19,088	20,506	22,525	25,595	25,770	30,064
New Brunswick	22,134	22,398	23,417	25,139	26,466	27,126	27,604
Nova Scotia	20,991	21,817	22,864	24,410	25,715	26,726	27,723
Prince Edward Island	20,801	20,496	21,759	22,993	24,594	25,036	26,926
Canada	28,278	29,437	30,249	32,202	34,931	35,597	36,765

*GDP data is for the calendar year ending in the above fiscal years. Population is as at July 1 of the fiscal year.

Source: Statistics Canada

Appendix C: Net Liabilities to Gross Domestic Product (GDP)

The ratio of net liabilities to GDP for all provinces and Canada, for the fiscal years 1997 to 2003*

(Percent)

	1997	1998	1999	2000	2001	2002	2003
British Columbia	17.69	17.25	17.91	17.73	16.38	17.73	19.49
Alberta	8.82	5.58	4.54	1.78	-2.97	-3.33	-4.57
Saskatchewan	32.14	30.71	29.93	27.63	24.40	26.15	26.89
Manitoba	29.31	28.36	27.86	30.42	28.08	28.27	n.a.
Ontario	32.11	31.32	30.36	32.63	30.57	29.77	28.19
Quebec	35.71	46.63	45.14	42.42	39.20	40.07	n.a.
Newfoundland and Labrador	69.42	69.04	70.25	66.36	61.27	64.91	60.14
New Brunswick	32.66	34.04	33.53	35.82	33.98	32.20	32.14
Nova Scotia	42.82	45.55	48.06	48.89	46.94	48.12	46.60
Prince Edward Island	35.91	36.40	33.34	31.83	30.79	31.09	n.a.
Canada	69.50	65.67	63.04	57.46	50.71	51.55	48.90

n.a.—not available

*GDP data is for the calendar year ending in the above fiscal years.

Source: Office of the Auditor General of British Columbia; Statistics Canada

Appendix D: Credit Ratings

Credit rating for all provinces and Canada, as at March 31 for the fiscal years 1994 to 2003

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
British Columbia	Aa1	Aa1	Aa1	Aa1	Aa2	Aa2	Aa2	Aa2	Aa2	Aa2
Alberta	Aa2	Aa2	Aa2	Aa2	Aa2	Aa2	Aa1	Aaa	Aaa	Aaa
Saskatchewan	A3	A3	A3	A3	A3	A2	A2	A1	A1	Aa3
Manitoba	A1	A1	A1	A1	A1	Aa3	Aa3	Aa3	Aa3	Aa2
Ontario	Aa2	Aa3	Aa3	Aa3	Aa3	Aa3	Aa3	Aa3	Aa3	Aa2
Quebec	A1	A1	A2	A2	A2	A2	A2	A2	A1	A1
Nova Scotia	A3	A3	A3	A3	A3	A3	A3	A3	A3	A3
New Brunswick	A1	A1	A1	A1	A1	A1	A1	A1	A1	A1
Newfoundland and Labrador	Baa1	Baa1	Baa1	Baa1	Baa1	Baa1	Baa1	Baa1	Baa1	A3
Prince Edward Island	A3	A3	A3	A3	A3	A3	A3	A3	A3	A2
Canada	Aaa	Aaa	Aa1	Aa1	Aa1	Aa1	Aa1	Aa1	Aa1	Aaa

Source: Moody's Investors Service

Appendix E: Office of the Auditor General: 2003/04 Reports Issued to Date

Report 1

A Review of Performance Agreements Between
the Ministry of Health Services and the Health Authorities

Report 2

Follow-up of Performance Reports, August 2003

Report 3

Adopting Best Practices in Government Financial Statements –2002/2003

Report 4

Alternative Payments to Physicians: A Program in Need of Change

Report 5

Monitoring the Government’s Finances

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