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# Auditor General of British Columbia

# Monitoring the Government's Finances

## Province of British Columbia

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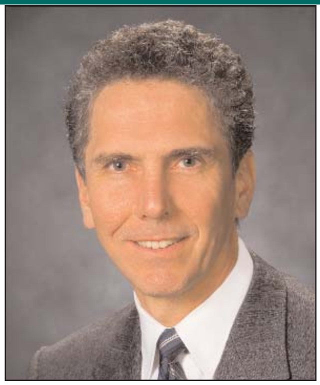


Wayne Strelioff, FCA
Auditor General

Describing the significant events that affect the financial health of government is a challenging thing to do. It's not easy to decide how much to summarize and how far to simplify it. The risk is leaving out important facts. Yet, providing the right information is critical: for allowing legislators and the public to make reasonable assessments of financial performance, for holding government accountable, and for ensuring transparency in the budgeting and financial reporting process overall.

In June 2005, I congratulated the government for leading other jurisdictions by adopting Generally Accepted Accounting Principles (GAAP) for the Summary Financial Statements. This milestone achievement gives the government a good foundation to build on as the standards underlying GAAP will continue to evolve and improve.

I believe that presenting the information as shown in Exhibit 2 would lead to a better discussion of how all government activities are accounted for. It would also clarify for decision-makers the tradeoffs they need to consider.

Last year I was pleased to note that the government had, for the first time, included in the Public Accounts a preliminary discussion and analysis of its financial statements. The form and content of a formal financial statement discussion and analysis originated from the private sector's "Management's Discussion and Analysis." This piece, expected to be written frankly and openly, has come to be a significant part of any company's financial reporting: the investing community typically rewards companies who are transparent in their disclosures, and punishes those who are not. This year I was surprised not to see further development of the financial statement discussion and analysis in the Public Accounts, but I understand that adopting GAAP was a complex and difficult task that took up most of the government's financial reporting energies. Still, I encourage the government to pick up where it left off last year and continue to develop a more thorough discussion and analysis of its financial performance.

Such analysis is necessary if readers are to understand the major trends, indicators and decisions that affect government's financial position.

The Public Sector Accounting Board (PSAB) of the Canadian Institute of Chartered Accountants (CICA) recommends that senior governments adopt the following practices in providing financial statement discussion and analysis:

- 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 include a discussion and analysis of performance indicators for government. In 1997, the CICA undertook an important research study, the results of which were released in a report titled *Indicators of Government Financial Condition.* A similar analysis is included this year in the government's *2005 Financial and Economic Review*. The indicators in our report include the results and financial positions of all government business enterprises whereas those in the *2005 Financial and Economic Review* do not. We have included the relevant indicators here in this report for the past nine years. Taken together, these indicators tell us much about the sustainability, flexibility and vulnerability of government finances. They also help to answer a question I am often asked: "How are we doing?"

I am also sometimes asked another question, the answer to which can only be addressed by more complete government financial reporting. That question is "How will government's current plans affect its future ability to provide key services?" In past reports I have noted that PSAB has, along with its other recommendations, called for government's financial reporting to include an assessment of future milestones and projections. My Office has been advocating such an approach for some years now.

Combining all of these elements—statements prepared in accordance with GAAP, financial statement discussion and analysis, indicators of government financial condition, and future milestones and projections—would form a well-rounded report regime that could be a valuable resource for legislators and the public. The better quality and usefulness of this financial information would not only help decision-makers directly, but would also encourage the development of broader, more meaningful discussions of government's finances.

## Overall Picture

In the year ended March 31, 2005, British Columbia incurred an annual surplus of $2.6 billion. This is the result of a $163 million surplus in the general programs of government, combined with a $2.4 billion surplus in government business enterprises. The annual surplus is higher than planned by approximately $2.5 billion and a significant change compared to the 2004 deficit of $1.3 billion.

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

## Exhibit 1

### Financial Information Framework, 1997 to 2005

*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 | 2004 | 2005 |
|---|---|---|---|---|---|---|---|---|---|
| **General programs** | | | | | | | | | |
| Revenue | 22,796 | 23,248 | 23,357 | 25,086 | 27,383 | 27,858 | 25,488 | 26,702 | 30,371 |
| Expense | 24,157 | 25,252 | 25,763 | 26,289 | 27,853 | 30,106 | 30,317 | 29,861 | 30,208 |
| | (1,361) | (2,004) | (2,406) | (1,203) | (470) | (2,248) | (4,829) | (3,159) | 163 |
| **Enterprises** | | | | | | | | | |
| Revenue | 7,995 | 8,361 | 9,502 | 10,439 | 14,560 | 13,217 | 11,527 | 12,081 | 12,914 |
| Expense | 6,920 | 7,035 | 7,982 | 9,147 | 12,835 | 12,132 | 9,761 | 10,197 | 10,502 |
| | 1,075 | 1,326 | 1,520 | 1,292 | 1,725 | 1,085 | 1,766 | 1,884 | 2,412 |
| **Annual surplus/(deficit)** | **(286)** | **(678)** | **(886)** | **89** | **1,255** | **(1,163)** | **(3,063)** | **(1,275)** | **2,575** |

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

| | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 |
|---|---|---|---|---|---|---|---|---|---|
| **General programs** | | | | | | | | | |
| Financial assets | 10,333 | 11,058 | 12,259 | 14,416 | 14,093 | 13,632 | 12,063 | 12,975 | 13,836 |
| Liabilities | 33,070 | 34,548 | 36,741 | 39,507 | 39,483 | 40,615 | 41,999 | 44,340 | 43,866 |
| | (22,737) | (23,490) | (24,482) | (25,091) | (25,390) | (26,983) | (29,936) | (31,365) | (30,030) |
| **Enterprises** | | | | | | | | | |
| Assets | 18,767 | 19,384 | 20,307 | 19,874 | 20,476 | 19,740 | 19,988 | 20,715 | 21,095 |
| Liabilities | 15,597 | 15,983 | 16,792 | 16,486 | 16,824 | 16,607 | 16,728 | 17,330 | 17,332 |
| | 3,170 | 3,401 | 3,515 | 3,388 | 3,652 | 3,133 | 3,260 | 3,385 | 3,763 |
| **Net liabilities** | **(19,567)** | **(20,089)** | **(20,967)** | **(21,703)** | **(21,738)** | **(23,850)** | **(26,676)** | **(27,980)** | **(26,267)** |
| General infrastructure | 19,563 | 19,407 | 19,399 | 20,224 | 21,514 | 22,463 | 22,226 | 22,255 | 23,117 |
| **Accumulated deficit** | **(4)** | **(682)** | **(1,568)** | **(1,479)** | **(224)** | **(1,387)** | **(4,450)** | **(5,725)** | **(3,150)** |

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

The overall accumulated deficit at the end of March 2005 totalled $3.2 billion (compared to $5.7 billion in 2004). This means that the current and future citizens of British Columbia carry $26 billion of net liabilities ($28 billion in 2004) against which they own infrastructure assets with a depreciated value of $23 billion ($22.3 billion in 2004).

In 2005, the government's ratio of net liabilities to Gross Domestic Product (GDP) decreased, dropping to 16.8%. This reversed a trend over the prior four years which saw the ratio increase from 16.6% to 19.2%. The result is that the overall burden on future taxpayers has decreased.

In our analysis of government financial condition (according to the CICA indicators of government financial condition), we found both positive developments and mixed signals:

- The sustainability measures this year indicate that the government has an increased ability to maintain existing programs and meet existing creditor requirements without increasing the debt burden.
- The flexibility measures indicate that there is growing financial flexibility, but a growing dependence on federal transfer payments.
- The vulnerability measures confirm the government's dependence on federal transfer payments, but highlight its low degree of vulnerability to foreign capital markets, specifically through its ability to service foreign debt.

How did we do compared with the rest of Canada? In 2004/05, British Columbia's economy, as measured by the percentage increase in GDP per capita, performed better than Canada's but not as well as Alberta, Saskatchewan, and Newfoundland and Labrador. In terms of total GDP, British Columbia's GDP per capita continued to be below Canada's average. British Columbia again ranked fifth amongst the provinces in that measure, behind Alberta, Ontario, Saskatchewan, and Newfoundland and Labrador.

According to Moody's Investors Services, all the provinces but two maintained their credit rating during the year ending

March 31, 2005. The exceptions are Nova Scotia and British Columbia whose ratings were raised. However, Moody's still regards British Columbia as the second lowest credit risk of all provinces in Canada, after Alberta.

I wish to thank officials of the Government of British Columbia and my colleagues 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 to produce this report.

*Wayne Strelioff, FCA*
*Auditor General*

*Victoria, British Columbia*
*November 2005*

# 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. |
| BCCPI | British Columbia Consumer Price Index |
| 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 rate 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. Also referred to as "net debt." |
| 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. |
| Revenue-generating assets | The assets of government business enterprises. These are termed revenue-generating as the assets are used in the operations of self-supporting business enterprises. |
| SUCH sector | Refers to School districts, Universities, Colleges and Health authorities. |
| Summary Financial Statements | The consolidated 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

## How are we doing?

Can a single financial report paint a clear picture of the financial performance of government?

Currently, the Public Accounts, Financial and Economic Review and Budget documents together provide over 500 pages of complex financial information. This serves some users well, but is a lot for most people to read and digest. Legislators and the public generally don't have the time, inclination or requisite experience to tease out the important trends and events that help explain the government's finances—or that answer the simple question of how we as a province are doing. It's therefore important that those who prepare such information (meaning staff within ministries and government's other organizations) receive clear guidance on what needs to be reported and how. Useful, meaningful financial reporting takes a conscious effort to address the needs of general readers.

In our recent report *Building Better Reports: Our Assessment of the 2003/04 Annual Service Plan Reports of Government,* we offered several suggestions for improving government financial reporting:

> *[The] report should provide basic financial information and explain planned and actual costs for each core business area, goal, objective, strategy or result achieved. The report should explain how current funding compares to past and forecast funding. Key financial variances and any changes in funding that affected the achievement of planned performance targets should also be explained. The report should provide financial trend information for expenditures and key revenue generating activities should also be described."*[1]

In further support of that advice, we add the following:

For the financial statement discussion and analysis in the Public Accounts to be useful, it needs to discuss the circumstances and trade-offs that influence financial decisions. A clear picture should allow us to see all the initiatives—those completed, accelerated and shelved. This requires frankness. It also requires a full discussion of what the alternatives were, how the risks

[1] Source: Appendix A of our assessment of the Annual Strategic Plan Report of the Government of BC, principle 5 recommendation, http://www.bcauditor.com

were managed, and why certain outcomes were delivered and others weren't. Important as well is including broader economic information. This sets the overall context for the government's finances and how decisions are affected by factors outside the government's control.

Financial plans and results should be reported in clear language that describes the events critical to answering, from the provincial government's perspective, "how are we doing?" Simple, straightforward explanations ensure that not only those with advanced technical expertise can understand the government's finances and make informed assessments of accountability: such clarity gives all citizens, legislators and other government decision-makers the opportunity to grasp the government's overall financial picture, too.

In our proposed reporting model detailed in Exhibit 2 (page 16), we show a simplified consolidation of Government Business Enterprises. This currently isn't done in the province's Public Accounts. Instead, the government follows the existing Canadian requirement of consolidating only the equity of these entities and not transferring each financial statement line item. Compared with this approach to financial reporting, we believe that our model helps to better highlight the effect these organizations have on the income and net debt of government.

International accounting standards advocate the full consolidation of Government Business Enterprises into government financial reporting. Although our model does not yet reflect the rigour expressed by this new international standard, we believe that it may someday be a requirement for Canadian GAAP.

## Monitoring government's finances

In this report we present a financial framework that we believe is necessary if we are to monitor government's finances in a meaningful way.

To create a credible framework, we have used information we are confident in. This includes, for example, audited financial statements, the annual Budgets and Estimates, and reports published by credible third-party agencies. We have also adhered to the following key financial reporting principles:

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

We organized the financial framework to present financial information of the general programs and commercial enterprises separately. We have taken care in preparing the multi-year financial information to ensure consistency in accounting treatment from year-to-year, so that a meaningful comparison of financial trends can be made. Where accounting policies have changed we have restated prior year amounts to maintain consistency.

To make trends meaningful, we have been building our database to prepare a 10-year history. We could not do this because certain important information has not been easily available, but we now have nine years of information.

Using the nine-year financial information framework, as shown in Exhibit 2, we describe a number of financial trends and indicators for British Columbia, and show how the province compares in some respects to other jurisdictions.

We provide here financial measures and trends for annual revenue, expense, surplus/deficit, assets and liabilities. These are the major financial components of government's financial condition.

We also provide nine-year (and, when possible, 10-year) trends of indicators of financial condition, based on the guidelines for governments published by the Canadian Institute of Chartered

## Exhibit 2

### Detailed Financial Information Framework, 1997 to 2005

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

| | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 |
|---|---|---|---|---|---|---|---|---|---|
| **General programs** | | | | | | | | | |
| Revenue | | | | | | | | | |
| Taxation | 13,463 | 13,551 | 13,620 | 13,796 | 14,329 | 14,136 | 12,331 | 13,830 | 14,917 |
| Natural resources | 2,622 | 2,638 | 2,074 | 2,759 | 3,956 | 3,160 | 3,222 | 3,309 | 3,973 |
| Federal transfers | 2,296 | 2,165 | 2,527 | 3,109 | 3,285 | 3,310 | 3,815 | 3,619 | 5,231 |
| Other | 4,415 | 4,894 | 5,136 | 5,422 | 5,813 | 5,788 | 6,120 | 5,944 | 6,250 |
| Unusual items | – | – | – | – | – | 1,464 | – | – | – |
| | 22,796 | 23,248 | 23,357 | 25,086 | 27,383 | 27,858 | 25,488 | 26,702 | 30,371 |
| Expense | | | | | | | | | |
| Health | 7,456 | 7,820 | 8,102 | 8,683 | 9,291 | 10,414 | 11,036 | 11,197 | 11,462 |
| Education | 6,447 | 6,526 | 6,533 | 6,709 | 7,269 | 7,811 | 7,907 | 8,238 | 8,511 |
| Social services | 3,099 | 3,181 | 3,146 | 3,115 | 3,263 | 3,442 | 3,145 | 2,819 | 2,665 |
| Interest | 1,712 | 1,636 | 2,127 | 2,347 | 2,336 | 2,161 | 1,982 | 1,951 | 1,844 |
| Other | 5,443 | 6,089 | 5,855 | 5,435 | 5,642 | 5,931 | 5,735 | 5,533 | 5,726 |
| Unusual items | – | – | – | – | 52 | 347 | 512 | 123 | – |
| | 24,157 | 25,252 | 25,763 | 26,289 | 27,853 | 30,106 | 30,317 | 29,861 | 30,208 |
| Surplus/(Deficit) | (1,361) | (2,004) | (2,406) | (1,203) | (470) | (2,248) | (4,829) | (3,159) | 163 |
| **Enterprises** | | | | | | | | | |
| Revenue | | | | | | | | | |
| BC Hydro | 2,514 | 2,610 | 3,085 | 3,516 | 7,952 | 6,378 | 4,464 | 4,477 | 4,875 |
| ICBC* | 2,624 | 2,690 | 2,822 | 2,966 | 2,872 | 2,971 | 3,023 | 3,300 | 3,448 |
| BC LDB* | 1,543 | 1,598 | 1,645 | 1,671 | 1,732 | 1,798 | 1,890 | 2,004 | 2,159 |
| BC Railway Company | 421 | 427 | 419 | 480 | 497 | 441 | 306 | 374 | 371 |
| BC Lottery Corp.* | 867 | 942 | 1,261 | 1,402 | 1,483 | 1,607 | 1,792 | 1,890 | 2,029 |
| Other | 26 | 94 | 207 | 404 | 24 | 22 | 52 | 36 | 32 |
| | 7,995 | 8,361 | 9,502 | 10,439 | 14,560 | 13,217 | 11,527 | 12,081 | 12,914 |
| Expense | | | | | | | | | |
| BC Hydro | 2,175 | 2,202 | 2,689 | 2,970 | 7,403 | 6,120 | 4,075 | 4,400 | 4,641 |
| ICBC | 2,779 | 2,676 | 2,761 | 2,776 | 2,886 | 3,213 | 2,943 | 2,998 | 3,049 |
| BC LDB | 956 | 992 | 1,029 | 1,054 | 1,090 | 1,161 | 1,236 | 1,280 | 1,380 |
| BC Railway Company | 385 | 387 | 392 | 1,063 | 503 | 607 | 302 | 323 | 193 |
| BC Lottery Corp. | 595 | 652 | 806 | 870 | 921 | 1,001 | 1,121 | 1,162 | 1,218 |
| Other | 30 | 126 | 305 | 414 | 32 | 30 | 84 | 34 | 21 |
| | 6,920 | 7,035 | 7,982 | 9,147 | 12,835 | 12,132 | 9,761 | 10,197 | 10,502 |
| Surplus/(Deficit) | 1,075 | 1,326 | 1,520 | 1,292 | 1,725 | 1,085 | 1,766 | 1,884 | 2,412 |
| **Total annual surplus/(deficit)** | **(286)** | **(678)** | **(886)** | **89** | **1,255** | **(1,163)** | **(3,063)** | **(1,275)** | **2,575** |

* The goal here is to cut down on the double lines taken up by the long company names.

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

| | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 |
|---|---|---|---|---|---|---|---|---|---|
| **General programs** | | | | | | | | | |
| Financial assets | 10,333 | 11,058 | 12,259 | 14,416 | 14,093 | 13,632 | 12,063 | 12,975 | 13,836 |
| Liabilities | 33,070 | 34,548 | 36,741 | 39,507 | 39,483 | 40,615 | 41,999 | 44,340 | 43,866 |
| | (22,737) | (23,490) | (24,482) | (25,091) | (25,390) | (26,983) | (29,936) | (31,365) | (30,030) |
| **Enterprises** | | | | | | | | | |
| Assets | | | | | | | | | |
| BC Hydro | 11,457 | 11,319 | 11,705 | 11,663 | 12,538 | 11,939 | 11,896 | 11,849 | 12,060 |
| ICBC* | 5,263 | 5,630 | 5,957 | 5,974 | 5,909 | 5,821 | 6,189 | 6,899 | 7,605 |
| BC LDB* | 89 | 84 | 91 | 92 | 111 | 125 | 153 | 134 | 154 |
| BC Lottery Corp. | 100 | 137 | 164 | 160 | 147 | 160 | 185 | 184 | 288 |
| BC Railway Company | 1,659 | 1,777 | 1,939 | 1,401 | 1,390 | 1,257 | 1,130 | 1,154 | 522 |
| Other | 199 | 437 | 451 | 584 | 381 | 438 | 435 | 496 | 466 |
| | 18,767 | 19,384 | 20,307 | 19,874 | 20,476 | 19,740 | 19,988 | 20,715 | 21,095 |
| Liabilities | | | | | | | | | |
| BC Hydro | 9,747 | 9,424 | 9,722 | 9,465 | 10,196 | 9,709 | 9,697 | 9,936 | 9,919 |
| ICBC | 5,053 | 5,406 | 5,672 | 5,499 | 5,428 | 5,582 | 5,870 | 6,281 | 6,588 |
| BC LDB | 89 | 84 | 91 | 92 | 111 | 125 | 153 | 134 | 154 |
| BC Lottery Corp. | 85 | 95 | 89 | 86 | 104 | 110 | 127 | 113 | 109 |
| BC Railway Company | 527 | 608 | 784 | 866 | 864 | 890 | 759 | 740 | 415 |
| Other | 96 | 366 | 434 | 478 | 121 | 191 | 122 | 126 | 147 |
| | 15,597 | 15,983 | 16,792 | 16,486 | 16,824 | 16,607 | 16,728 | 17,330 | 17,332 |
| | 3,170 | 3,401 | 3,515 | 3,388 | 3,652 | 3,133 | 3,260 | 3,385 | 3,763 |
| **Net liabilities** | **(19,567)** | **(20,089)** | **(20,967)** | **(21,703)** | **(21,738)** | **(23,850)** | **(26,676)** | **(27,980)** | **(26,267)** |
| General infrastructure | 19,563 | 19,407 | 19,399 | 20,224 | 21,514 | 22,463 | 22,226 | 22,255 | 23,117 |
| **Accumulated surplus/(deficit)** | **(4)** | **(682)** | **(1,568)** | **(1,479)** | **(224)** | **(1,387)** | **(4,450)** | **(5,725)** | **(3,150)** |

*ICBC: Insurance Corporation of BC, BC LDB: BC Liquor Distribution Branch

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

Accountants (CICA). As well, we have adhered to the guidance on financial statement discussion and analysis published by the Public Sector Accounting Board (PSAB) of the CICA.

Unfortunately, the 2005 Public Accounts of provinces other than Alberta, Saskatchewan, Ontario and Nova Scotia have not been available in time for us to use their latest audited financial information in this report. Also, several provinces do not report on their complete reporting entity, or have a reporting entity that is different in nature than that of British Columbia. For these reasons we have been limited to only three widely used indicators to compare our province's overall financial performance to that of other provinces.

Admittedly, the reporting model we present has some shortcomings. For instance, it does not contain a discussion of future milestones and projections, or a year-to-year comparison of planned to actual results. These elements we would expect the government to include when it moves—as we encourage it to do—to preparing such a full report.

## Our Reporting Model

The Summary Financial Statements are a general-purpose financial reporting tool. They are prepared in a fixed format following strict accounting principles that allow only the net result of commercial enterprises to be included. A primary difference between the Summary Financial Statements and the reporting model we are using in this report is that we capture details

Unless otherwise noted, in this report a particular year refers to the fiscal year ending in that year. For example, 2004 refers to the fiscal year 2003/04 which runs from April 1, 2003 to March 31, 2004.

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.

of all economic activities of the government, irrespective of the organizational form in which they take place. We include the detailed revenues, expenses, assets and liabilities of all government, including commercial enterprises.

The financial framework we present is a specially designed database put together to facilitate complete financial analysis. As well as summarizing financial data we also include information about population and GDP. We have included a wide range of details so that trends can be developed on all measures consistently. The financial framework is therefore not meant to be a set of financial statements or to replace the Summary Financial Statements.

Exhibit 2 shows the nine years of information we used as the basis of our comments on measures and trends in this report.

We have not tried to produce a financial statement discussion and analysis that meets all the qualitative characteristics of PSAB's guidelines. In our view, such a complete analysis is best left to government to do. In Appendix A of this report, however, we have reproduced the "Financial Statement Discussion and Analysis Report" section of the 2005 Public Accounts.

In Part 1 of this report, we present British Columbia's trends in financial measures and indicators.

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

This year we have added a Questions and Answers section as Part 3 of the report. These are common questions often asked in public venues.

## Revenue Trends

Exhibit 3 shows the government's revenue sources from general programs and business enterprises. General programs are broken down into the separate components of taxation, natural resources, federal transfers and other sources.

## Exhibit 3

### Government Revenue, 1997 to 2005

*Government revenue by main source ($ Billions)*

| | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 |
|---|---|---|---|---|---|---|---|---|---|
| **General programs** | | | | | | | | | |
| Taxation | 13.5 | 13.6 | 13.6 | 13.8 | 14.3 | 14.1 | 12.3 | 13.8 | 14.9 |
| Natural Resources | 2.6 | 2.6 | 2.1 | 2.8 | 4.0 | 3.2 | 3.2 | 3.3 | 4.0 |
| Federal Transfer | 2.3 | 2.2 | 2.5 | 3.1 | 3.3 | 3.3 | 3.8 | 3.6 | 5.2 |
| Other | 4.4 | 4.9 | 5.1 | 5.4 | 5.8 | 7.3 | 6.1 | 5.9 | 6.3 |
| | 22.8 | 23.2 | 23.4 | 25.1 | 27.4 | 27.9 | 25.5 | 26.7 | 30.4 |
| **Enterprises** | **8.0** | **8.4** | **9.5** | **10.4** | **14.6** | **13.2** | **11.5** | **12.1** | **12.9** |
| **Total revenue** | **30.8** | **31.6** | **32.9** | **35.5** | **41.9** | **41.1** | **37.0** | **38.8** | **43.3** |

Source: Office of the Auditor General of British Columbia

Overall, between 1997 and 2005, the government's total annual revenue has risen from $30.8 billion to $43.3 billion, an increase of 41%. Between 2004 and 2005, total revenue increased by $4.5 billion or 11.6%. This is the second consecutive increase in revenue since the two consecutive years of decline in 2002 and 2003. From 1997 to 2002 there was a five-year trend of increases. During 2001 and 2002, government revenues were unusually high due in large part to large sales of hydro-electric power. Those sales returned to normal in 2003.

Taxes and business enterprises provide the two most significant sources of revenue for the government. Combined, these two sources represent almost two-thirds of the total revenue.

### What are government business enterprises?

Government business enterprises are Crown corporations that do not ordinarily need financial assistance from government general revenue to operate – that is, they are financially sustainable. Included in this revenue for 2005 is $1.0 billion (2004: $1.1 billion, 2003: $1.3 billion) related to hedging transactions. A similar amount is included in their expenses. These transactions are mainly forward contracts and derivative financial instruments related to the purchase and sale of energy. Because of a change in accounting policy beginning in 2003, BC Hydro is now off-setting the revenues against the expenses and recognizing only the net amount from its hedging transactions. To maintain consistency of the basis of ratios presented in this report, we have not netted them.

In 2005, tax revenue represented 34% of total revenue, having increased by $1.1 billion over the prior year. This is a significantly smaller portion than in 1997 when it represented 44% of total revenue.

Personal income tax, social services tax, property tax and corporate income tax are the main components, representing about 81% of total tax revenue. While all tax revenue sources increased over those in the prior year, personal income tax revenue increased by only 3.5%, while corporate income tax revenue rose by 62%. Similar to the upward trend in total revenue, taxation revenue increased from $13.5 billion in 1997 to $14.3 billion in 2001. It then dropped to $14.1 billion in 2002 and $12.3 billion in 2003, before rebounding in 2004 to $13.8 billion and up again in 2005 to $14.9 billion.

Revenue from business enterprises is collected from, among others, the following Crown corporations: BC Hydro, BC Liquor Distribution Branch, BC Lottery Corporation, and the Insurance Corporation of British Columbia. BC Ferry Corporation ceased to be a Crown corporation in 2004, and some of the assets of BC Railway Company (BC Rail) were sold during 2005.

In 2005, revenue from business enterprises represented about 30% of the total revenue, down slightly overall from a high of 35% in 2001. Between 1997 and 2001, revenue from business enterprises almost doubled, from $8.0 billion to $14.6 billion. Energy sales by BC Hydro increased significantly in 2001 and 2002. In 2002 and 2003, revenue declined, but has steadily increased since then to the current year's level.

Federal transfer payments in 2005 were up by 44% to $5.2 billion. This unusually large increase from the prior year occurred because the province was required in 2004 to repay a $0.9 billion equalization program transfer back to the federal government because the federal government transferred too much to the province in 2003. As a portion of total revenue, federal transfer payments remained fairly constant from 1997 to 2002, but have grown substantially in recent years to 12% of total revenue in 2005.

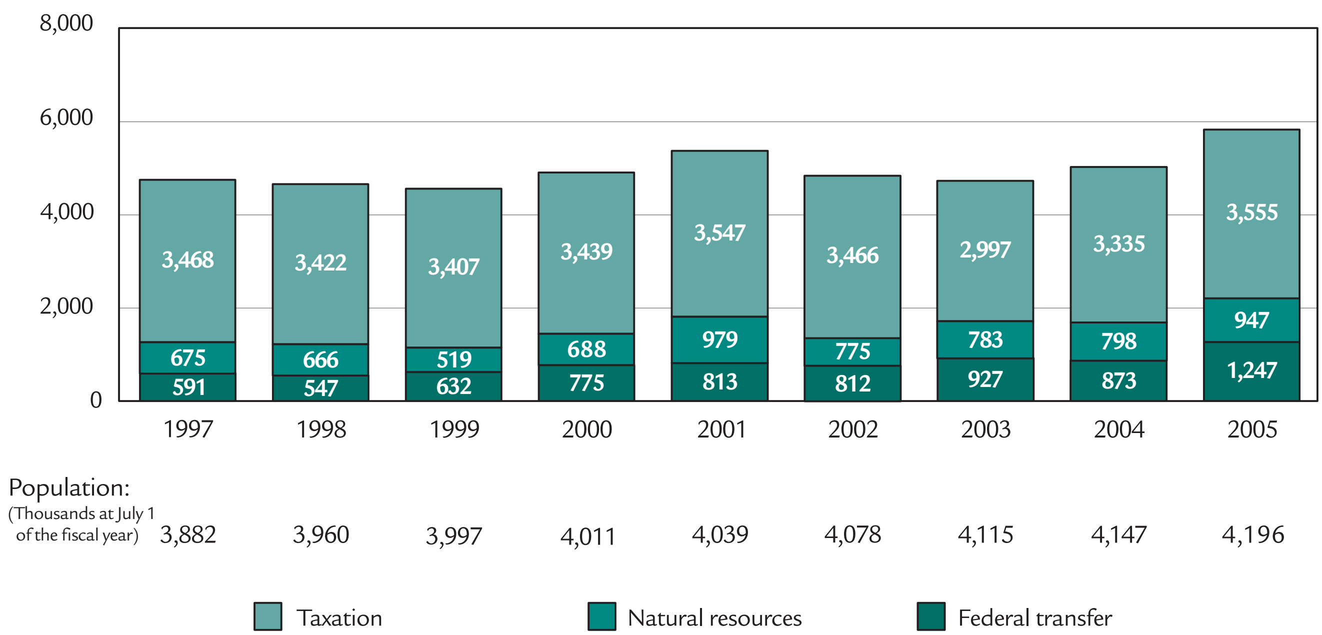
Natural resource revenue increased by $664 million in 2005, an increase of 20% from the prior year. Almost half of the increase, $311 million, was attributable to higher timber sales. A substantial increase in permit fee and royalty revenue for petroleum and natural gas represents most of the rest of the increase from the prior year. As a portion of total revenue, natural resource revenue has remained relatively constant since 1997.

Exhibit 4 shows the per capita revenue for the three general program revenue categories. Revenue from these three sources has increased by 21% from 1997 to 2005. When combined with other revenue and revenue from enterprises, the total revenue per capita increased in 2005 by 30% from $7,932 in 1997 to $10,315 in 2005.

## Exhibit 4

### Per Capita Revenue, 1997 to 2005

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



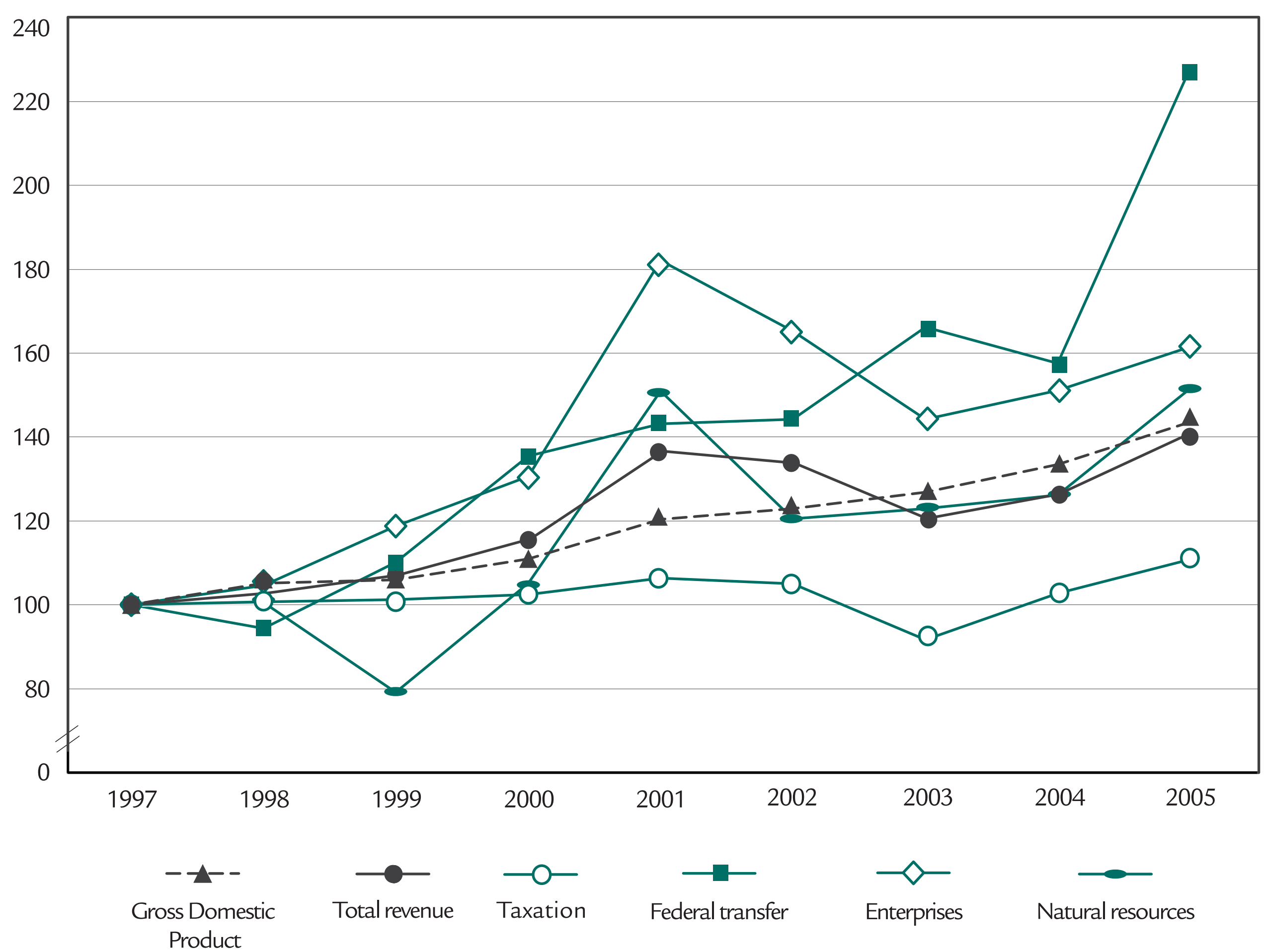

Source: Office of the Auditor General of British Columbia; Statistics Canada

Exhibit 5 shows the rate of change in revenue over the last nine years for each of the revenue components, compared with the increase in the province's Gross Domestic Product (without adjusting for the effects of inflation). The base year in this exhibit is 1997. For each year that follows, the revenue for each component is shown as a percentage of the 1997 revenue. For example, federal transfer payments in 2005 were more than double the amount received in 1997.

## Exhibit 5

### Change in Revenue, 1997 to 2005

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




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

There was a slight upward trend in taxation revenue between 1997 and 2001, a significant decline in 2003, and then substantial increases in 2004 and 2005. The 2003 decline was the result of lower estimates of personal income tax revenue, related mainly to decreases in personal income tax rates. The resurgence in 2004 and 2005, was the result of increases in personal and corporate income tax revenue.

Natural resource revenue has been among the most volatile of all revenue sources. It declined sharply between 1997 and 1999, mainly from decreases in forest-related revenues; increased significantly in 2000 and 2001 because of higher oil and natural gas prices,(which also spurred higher royalty sales of Crown land drilling rights); and then declined again in 2002 as natural gas prices and sales of downstream hydro-electric benefits fell. Following two consecutive years of small increases in 2003 and 2004, natural resource revenue increased sharply in 2005 as a result of large increases in timber harvest volumes and natural gas prices.

Revenue generated from business enterprises has also been volatile in the past nine years. It increased sharply in 2001 mainly because of higher energy prices, decreased in 2002 and 2003, and then increased again in 2004 and 2005. Revenue from all business enterprises except BC Hydro has been growing fairly consistently since 1997. The BC Lottery Corporation and BC Liquor Distribution Branch have shown the most consistent income growth.

Federal transfer revenue has continued to increase because of larger Canada Health and Social Transfer payments provided to all provinces. As noted above, the large increase in 2005 was a result of an overpayment in 2003 that was repaid in 2004. This lowered the 2004 amount below that which it would have normally been.

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

## Expense Trends

Exhibit 6 shows the annual expense incurred by government for general programs and enterprises from 1997 to 2005.

In 2005, total government expense remained fairly constant for the third consecutive year, after increasing by 36% from 1997 to 2002. Health, education and social services expense combined now account for 56% of the total expense of the province.

Health expense has increased every year since 1997, when it was $7.5 billion, to $11.5 billion in 2005—an increase of 54%. It continues to be the highest expense category, and now represents 28% of total government expense.

Education expense has also increased every year since 1997. Then it was $6.4 billion and in 2005 it rose to $8.5 billion, an increase of 32%. Education expense now represents 21% of total government expense.

Social services expense has declined for the third consecutive year from $3.4 billion in 2002, to $2.7 billion in 2005, a decrease of 20.6%. As a percentage of the total expense, social services expense has gradually declined from 10% in 1997 to 6.5% in 2005.

### Exhibit 6

### Government Expense, 1997 to 2005

*Government expense by main component ($ Billions)*

| | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 |
|---|---|---|---|---|---|---|---|---|---|
| **General programs** | | | | | | | | | |
| Health | 7.5 | 7.8 | 8.1 | 8.7 | 9.3 | 10.4 | 11.0 | 11.2 | 11.5 |
| Education | 6.4 | 6.5 | 6.5 | 6.7 | 7.3 | 7.8 | 7.9 | 8.2 | 8.5 |
| Social Services | 3.1 | 3.2 | 3.1 | 3.1 | 3.3 | 3.4 | 3.1 | 2.8 | 2.7 |
| Interest | 1.7 | 1.6 | 2.1 | 2.3 | 2.3 | 2.2 | 2.0 | 2.0 | 1.8 |
| Other | 5.4 | 6.1 | 5.9 | 5.4 | 5.7 | 6.3 | 6.2 | 5.7 | 5.7 |
| | 24.2 | 25.3 | 25.8 | 26.3 | 27.9 | 30.1 | 30.3 | 29.9 | 30.2 |
| **Enterprises** | **6.9** | **7.0** | **8.0** | **9.1** | **12.8** | **12.1** | **9.8** | **10.2** | **10.5** |
| **Total expense** | **31.1** | **32.3** | **33.7** | **35.4** | **40.7** | **42.2** | **40.1** | **40.1** | **40.7** |

Source: Office of the Auditor General of British Columbia

The interest expense reported in Exhibit 6 only relates to general programs, which is taxpayer-supported debt. To arrive at the total interest expense for government, the interest expense of enterprises also needs to be included. For 2005, the general programs interest expense was $1.8 billion and total interest expense, including enterprises, was 2.3 billion. In total, interest expense declined slightly in 1998, gradually increasing to a peak in 2000 and 2001. Since 2001, interest expense has been declining.

Although general programs debt has increased from $25 billion in 1997 to $32 billion in 2005 (an increase of 28%), the related interest expense in 2005 is only slightly higher than it was in 1997. The reason for this is the general decline in interest rates over the last nine years.

Other expense items include: natural resources and economic development, transportation, protection of persons and property, and general government. The small increase in this expense category is a result of increases and decreases being balanced in a number of activities. Although forest fire and restructuring expense were lower in 2005, there were increases in regional and economic development, transportation, forestry and mining expense.

The expense of enterprises increased substantially from $6.9 billion in 1997 to a high of $12.8 billion in 2001. It fell to $12.1 billion in 2002, and $9.8 billion in 2003, where it has remained relatively stable for the past two years (see "What are government business enterprises?" —page 20).

Most of the increase in expense of enterprises over the prior year is attributable to BC Hydro, the Insurance Corporation of BC, BC Liquor Distribution Branch and BC Lottery Corporation. This was partially offset by small decreases in BC Rail and other expenses. The $3.7 billion increase between 2000 and 2001 was largely a result of BC Hydro's operations. The cost of electricity purchased by BC Hydro for resale made up a significant part of this increased expense. These higher costs are matched by the higher revenues reported by BC Hydro for energy sales. In 2002 and 2003, business enterprises expense decreased, largely because of a decrease in BC Hydro's energy purchase costs (and energy sales) during those years.

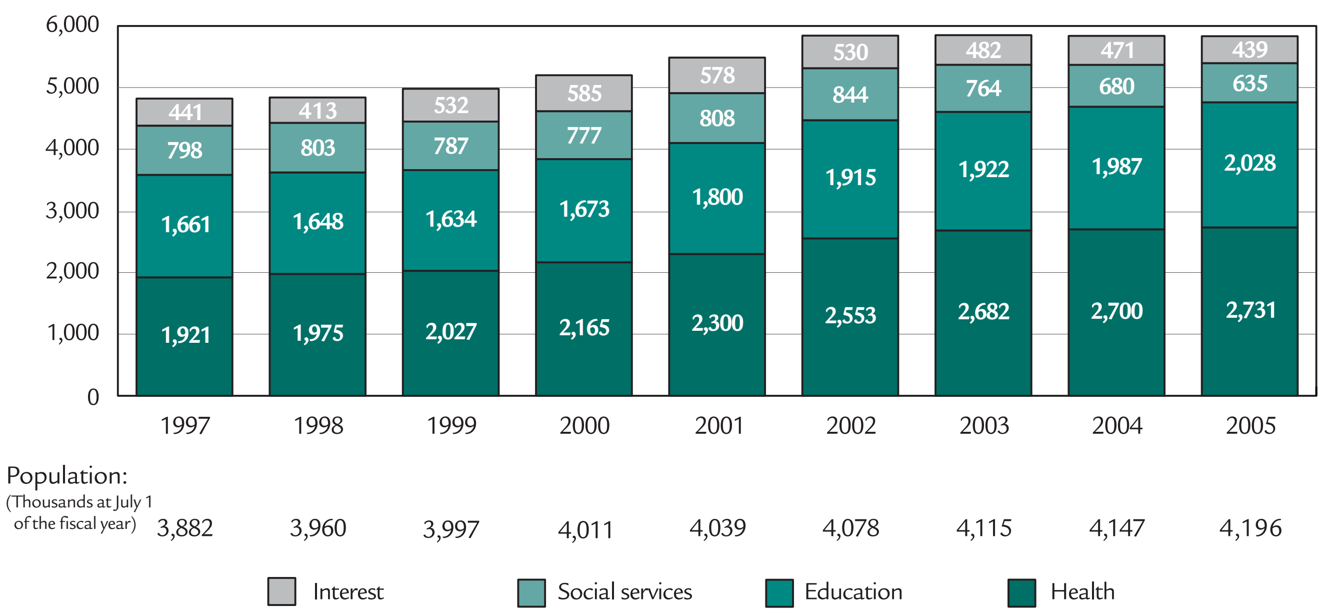
Exhibit 7 shows the government's per capita expense for the last nine years, for the four main program expense categories. Although the four main program expenses have grown by 21% from 1997 to 2002, it is interesting to note that they have remained fairly constant for the past four years. The largest per capita expense increases over the past nine years were health at 42%, enterprises at 40% and education at 22%. Per capita social services expense decreased by 20% over the same period.

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

## Exhibit 7

### Per Capita Expense, 1997 to 2005

*Per capita expense by main program over the past nine years ($)*

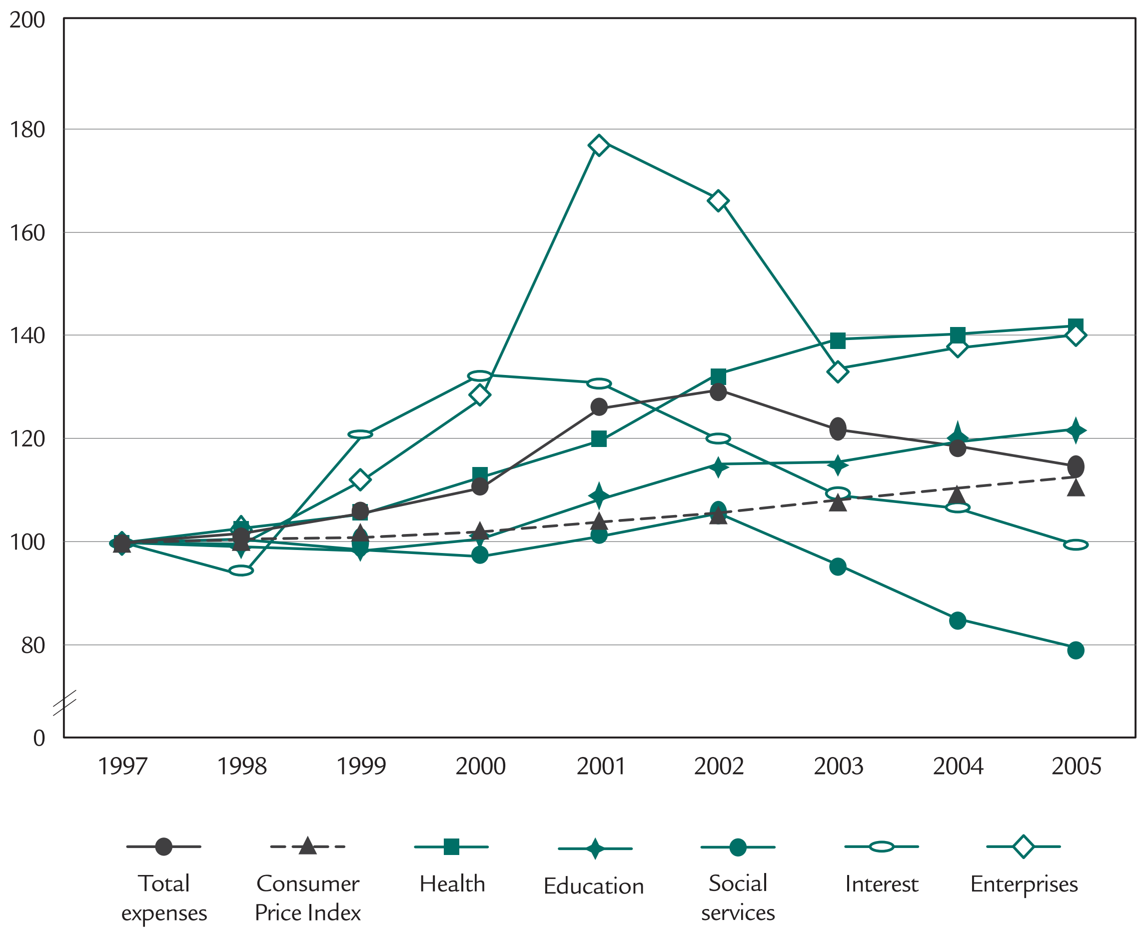



Source: Office of the Auditor General of British Columbia; Statistics Canada

## Exhibit 8

### Change in Per Capita Expense, 1997 to 2005

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




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

Relative to the BCCPI, spending per capita for health has increased significantly over the last nine years. Per capita spending on education initially declined, but has increased in the last several years; and per capita spending on social services has decreased significantly over the last three years.

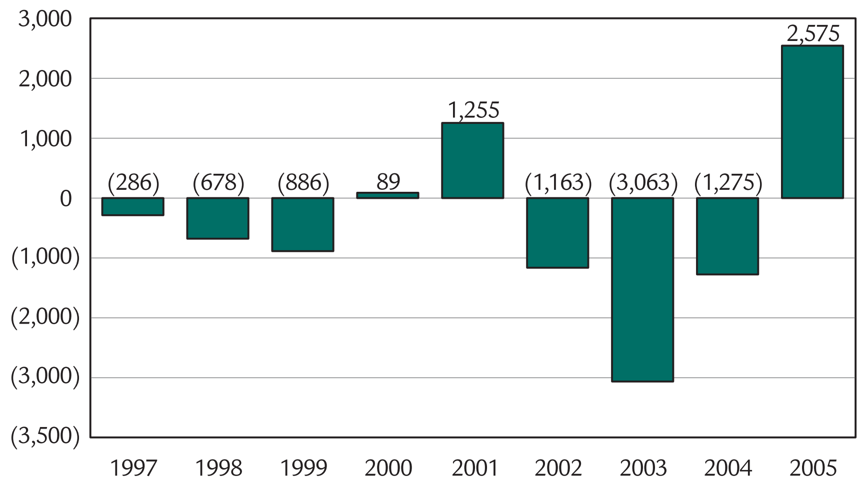
## Annual Surplus/Deficit Trend

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.

### Exhibit 9

Annual Surplus/(Deficit), 1997 to 2005

*The annual surplus/(deficit) ($ Millions)*




Source: Office of the Auditor General of British Columbia

Between 1997 and 1999, the province recorded annual deficits ranging from $0.3 to $0.9 billion. In 2000 and 2001, there were surpluses of $0.1 and $1.3 billion, respectively. And between 2002 and 2004, deficits occurred of $1.2 billion, $3.1 billion and $1.3 billion, respectively. In 2005, a significant $2.6 billion surplus was recorded.

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 transactions, the deficit for 2002 would have been $2.2 billion rather than $1.2 billion. The 2005 surplus is mainly the result of increases in federal transfer payments ($1.6 billion higher), taxes

($1.1 billion higher) natural resource revenue (.7 billion higher) and net earnings of business enterprises ($0.5 billion higher) than in the prior year. These were only partially offset by $0.3 billion more in general programs expense.

## 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 (original 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 are not considered to be revenue-generating, even though they may help generate some direct revenue. They are instead considered part of the infrastructure needed to serve the public. Assets used in government enterprises are expected to generate sufficient revenue to cover the cost of the operations of those enterprises.

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

Exhibit 10 presents an overview of the major categories of government assets: financial, infrastructure and revenue-generating.

It also shows the value of all physical capital assets owned by the government. This is the sum of the general programs infrastructure capital assets and the capital assets of business enterprises.

From 1997 to 2005, the government's total assets increased from $48.7 billion to $58.0 billion, a nine-year growth of $9.4 billion, or 19%. Increases in physical capital assets accounted for approximately 36% of this change.

Because of British Columbia's size and geography, the need for capital infrastructure is substantial. In the last nine years, the net book value of infrastructure assets used within government programs (such as hospitals, other health care facilities, schools, post-secondary institutions, roads, buses and rapid transit) has increased from $19.6 billion to $23.1 billion, an 18% increase.

In the same nine-year period, the total value of financial and physical revenue-generating assets of the government enterprises has increased by 12%, from $18.8 billion to $21.1 billion.

## Exhibit 10

### Assets, 1997 to 2005

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

| | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 |
|---|---|---|---|---|---|---|---|---|---|
| **General programs** | | | | | | | | | |
| Financial assets | 10.3 | 11.1 | 12.3 | 14.4 | 14.1 | 13.6 | 12.1 | 13.0 | 13.8 |
| Infrastructure capital assets(1) | 19.6 | 19.4 | 19.4 | 20.2 | 21.5 | 22.5 | 22.2 | 22.3 | 23.1 |
| | 29.9 | 30.5 | 31.7 | 34.6 | 35.6 | 36.1 | 34.3 | 35.2 | 37.0 |
| **Enterprises** | | | | | | | | | |
| Revenue generating financial assets | 7.8 | 8.3 | 9.0 | 9.0 | 9.7 | 8.9 | 8.9 | 9.5 | 10.3 |
| Revenue generating capital assets(1) | 11.0 | 11.1 | 11.3 | 10.9 | 10.8 | 10.8 | 11.1 | 11.2 | 10.8 |
| | 18.8 | 19.4 | 20.3 | 19.9 | 20.5 | 19.7 | 20.0 | 20.7 | 21.1 |
| **Total assets** | **48.7** | **49.8** | **52.0** | **54.5** | **56.1** | **55.8** | **54.3** | **55.9** | **58.0** |
| (1)Total physical capital assets | 30.5 | 30.5 | 30.7 | 31.1 | 32.3 | 33.3 | 33.3 | 33.5 | 33.9 |

Source: Office of the Auditor General of British Columbia

Since 1997, the total value of physical capital assets owned by the government, used in both its business activities and general programs, has increased by 11%, from $30.5 billion to $33.9 billion.

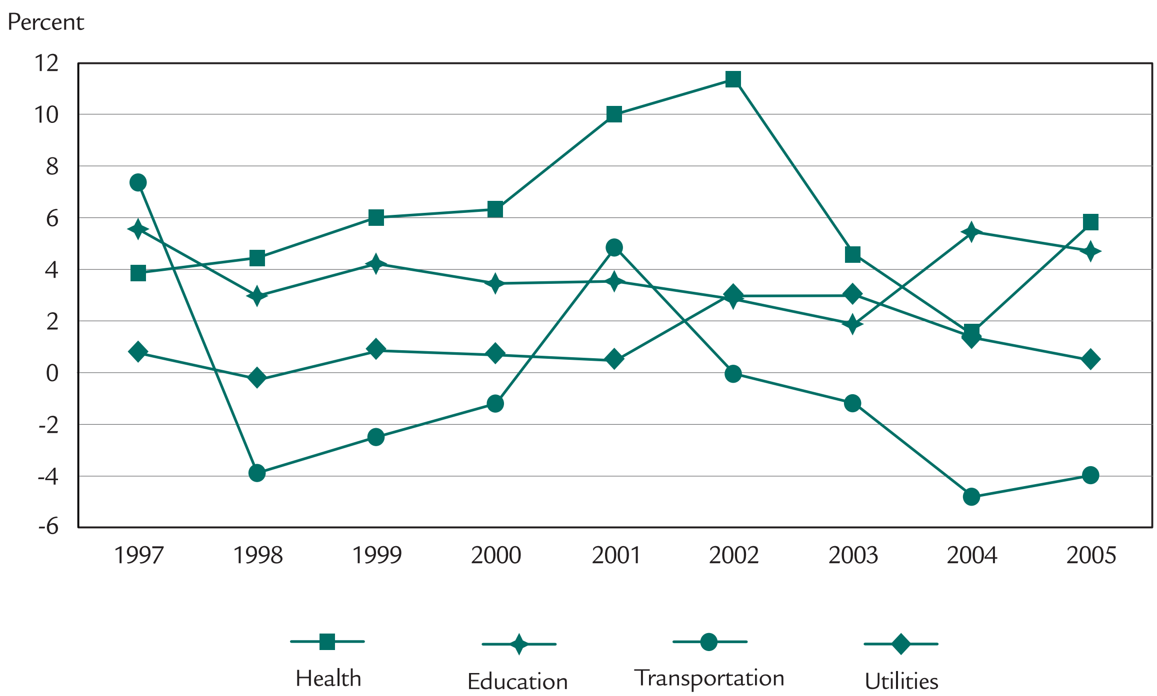
Exhibit 11 shows the percentage change in the net book value of total physical capital assets managed by government and used for health, education, transportation and utilities from 1997 to 2005. The net book value change is the final result after capital additions, disposals and depreciation of the assets are taken into account.

In total, except for a slight decrease in 1998, the net book value of total physical capital assets has increased each year since 1997. In the transportation sector, however, the book value of assets decreased in 1998, 1999, 2000, 2003, 2004 and 2005. In 1998, the government slowed capital spending—on transportation in

## Exhibit 11

### Change in Physical Capital Assets, 1997 to 2005

*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

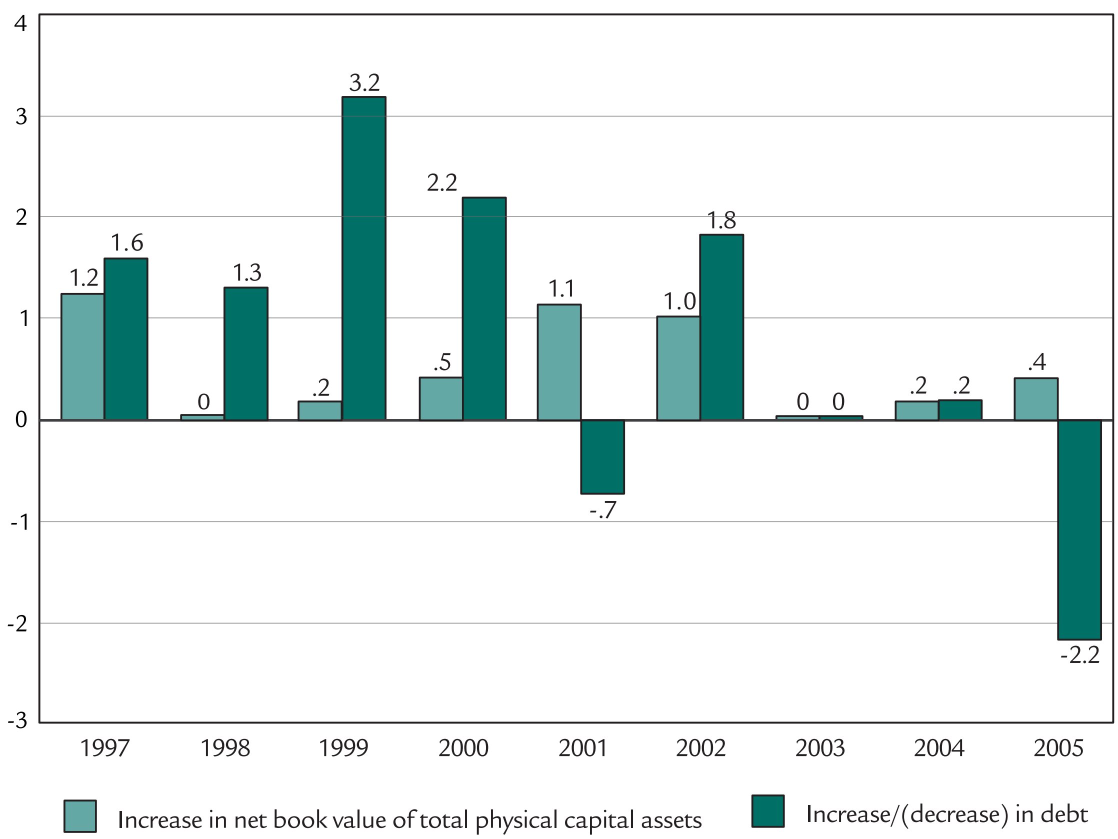
particular—to examine its capital investment policy and look for alternative ways to meet the province's infrastructure needs. The effects of BC Ferry Corporation and BC Rail transactions somewhat distort the transportation assets figures. The increase in transportation assets in 2004 would be significantly larger if we removed the effect of the transfer of BC Ferry Corporation assets to British Columbia Ferry Services Inc., and the same would hold true in 2005 if we consider the effect of the sale of the BC Rail Assets.

Exhibit 12 shows the increase in net book value of the government's total physical capital assets for each of the years 1997 to 2005, compared with the change in total debt each year.

## Exhibit 12

### Comparing Changes in Public Debt and Capital Assets, 1997 to 2005

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




Source: Office of the Auditor General of British Columbia

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. It is important to note, however, that the government borrows for a number of different reasons: to finance its operating shortfalls, to build up its stock of capital assets, to finance investment or lending, or to ensure that funds are available when needed.

## 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 13 shows the government's debt and other obligations for the last nine years, for general programs and enterprises. Total debt has increased by $5.8 billion, or 17%, between 1997 and 2005. In three of the past nine years, debt decreased: by $724 million in 2001, $15 million in 2003 and $2.2 billion in 2005.

The liabilities of government enterprises will, presumably, be paid through their ongoing business activities. The general program obligations, however, have to be paid for by using financial assets available to government general programs. Those include the net assets of the enterprises. Any shortfall, or "net liabilities," will have to be borne by future taxpayers. Net liabilities provides an important measure of the affordability of government's spending and investment activities.

Exhibit 14 shows the net liabilities at the end of each year from 1997 to 2005. Over this time, net liabilities increased from $19.6 billion to $26.3 billion, an increase of $6.7 billion, or 34%. The largest single increase was in 2003, when net liabilities increased by $2.8 billion, or 12%. In 2005, net liabilities decreased for the first time in nine years, by $1.7 billion, or 6%.

## Exhibit 13

### Liabilities, 1997 to 2005

*($ Billions)*

| | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 |
|---|---|---|---|---|---|---|---|---|---|
| **General programs** | | | | | | | | | |
| Debt | 25.0 | 26.4 | 29.1 | 31.6 | 31.3 | 33.0 | 33.3 | 33.4 | 32.0 |
| Other obligations | 8.1 | 8.1 | 7.6 | 7.9 | 8.2 | 7.6 | 8.7 | 10.9 | 11.8 |
| | 33.1 | 34.5 | 36.7 | 39.5 | 39.5 | 40.6 | 42.0 | 44.3 | 43.9 |
| **Enterprises** | | | | | | | | | |
| Debt | 9.0 | 8.9 | 9.4 | 9.1 | 8.7 | 8.8 | 8.5 | 8.6 | 7.8 |
| Other obligations | 6.6 | 7.1 | 7.4 | 7.4 | 8.1 | 7.8 | 8.2 | 8.8 | 9.5 |
| | 15.6 | 16.0 | 16.8 | 16.5 | 16.8 | 16.6 | 16.7 | 17.3 | 17.3 |
| **Total liabilities** | **48.7** | **50.5** | **53.5** | **56.0** | **56.3** | **57.2** | **58.7** | **61.7** | **61.2** |

Source: Office of the Auditor General of British Columbia

## Exhibit 14

### Net Liabilities, 1997 to 2005

*($ Billions)*

| | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 |
|---|---|---|---|---|---|---|---|---|---|
| Total liabilities | 48.7 | 50.5 | 53.5 | 56.0 | 56.3 | 57.2 | 58.7 | 61.7 | 61.2 |
| Less: General program financial assets | 10.3 | 11.1 | 12.3 | 14.4 | 14.1 | 13.6 | 12.1 | 13.0 | 13.8 |
| Enterprise assets | 18.8 | 19.4 | 20.3 | 19.9 | 20.5 | 19.7 | 20.0 | 20.7 | 21.1 |
| **Net liabilities** | **19.6** | **20.1** | **21.0** | **21.7** | **21.7** | **23.9** | **26.7** | **28.0** | **26.3** |

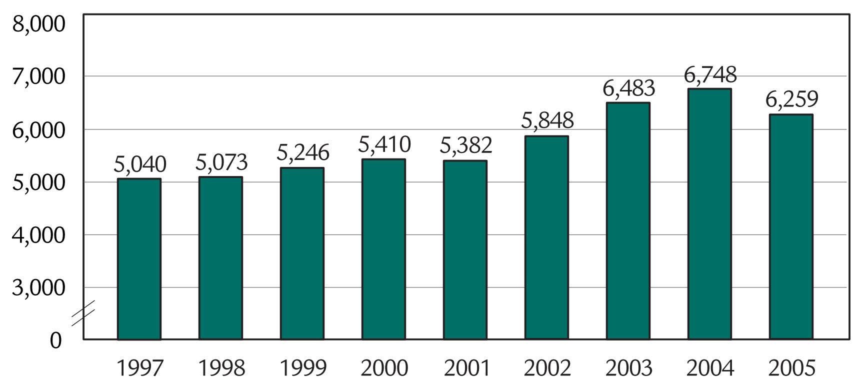
Source: Office of the Auditor General of British Columbia

Exhibit 15 lists the province's net liabilities on a per capita basis. The figures show the amount, in theory, that each citizen would need to pay in order to discharge government's past borrowing and spending practices. The net liabilities per capita have increased by 24% over the past nine years. The majority of that increase occurred in 2002, 2003 and 2004 which was primarily the result of a growing accumulated deficit. The amount decreased in 2005 by 7% over the previous year. The decrease is mainly the result of a decrease in debt by 5% and an increase in population by 1%.

## Exhibit 15

### Net Liabilities Per Capita, 1997 to 2005

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




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

Monitoring net liabilities—the difference between a government's total liabilities and its financial assets—provides valuable information about the government's financial position. In the next section, we discuss the government's financial condition.

## CICA Indicators of Financial Condition

In 1997 the Canadian Institute of Chartered Accountants (CICA) published a report entitled *Indicators of Government Financial Condition.* These indicators provide key relationships, ratios and trends that may assist legislators, key decision-makers and the public in evaluating the financial trade-offs related to policy decisions and better understanding the overall financial condition of government.

The indicators are gaining wider acceptance by senior governments and market analysts in Canada in assisting them in monitoring the financial condition of the federal and provincial governments with respect to the following key 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 directly 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 nine-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

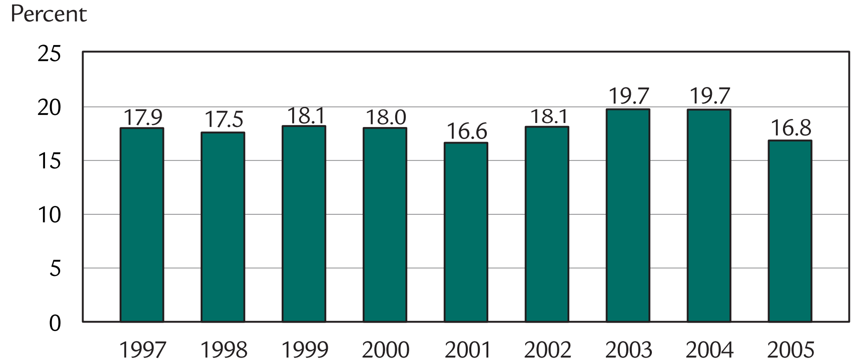
Two sustainability indicators compare the size of the net liabilities and the annual change in net liabilities with the size of the provincial economy.

The first of these two indicators is shown in Exhibit 17, which gives the nine-year trend of net liabilities to the Gross Domestic Product (GDP) for British Columbia. A government with a low net liabilities to GDP ratio has more room to manoeuvre in terms of revenue and spending choices than if it has a higher ratio. A stable net liabilities to GDP ratio indicates that the rate of growth in the economy is similar to the rate of growth in a province's net liabilities. An increasing ratio indicates that a 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

### Net Liabilities to Gross Domestic Product (GDP), 1997 to 2005

*Net liabilities as a percentage of GDP in British Columbia*




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

Prior to 2002, the ratio was relatively stable, between 16% and 18%. In 2003 and 2004, it rose to almost 20%, increasing the overall burden on future taxpayers. In 2005, the ratio fell significantly to 16.8%, the second lowest level in nine years.

The second sustainability measure is the change in net liabilities to GDP. This ratio helps to assess the degree to which a government is moving toward, or away from, sustainability. Each year a government must judge the effect that interest rates and the health of the overall economy will have on its plans. The optimal ratio of the change in net liabilities to GDP is adjusted annually. This activity allows a government to stabilize the net liabilities to GDP ratio at an amount that does not put an undue financial burden on the provincial economy and future taxpayers.

Exhibit 18 shows the change in net liabilities to GDP ratio in British Columbia for the past nine years. The ratio over the eight years prior to 2005 demonstrates annual increases in net liabilities for all years except 2001. The positive increases in net liabilities to GDP suggest a reduced sustainability. In 2005, the ratio was negative 1%. This was the result of the growth in the GDP and of the government paying down some of its public debt, a sign that the government moved towards a greater degree of sustainability.

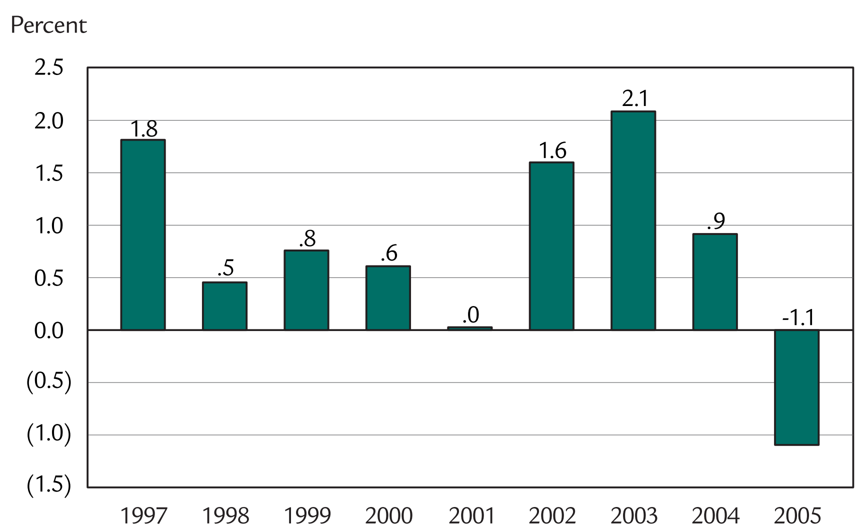
### *Summary*

These sustainability ratios are affected by economic growth, interest rates and government's debt burden. With interest rates at 40-year lows and a healthy growth in provincial GDP, the government is moving toward a more sustainable financial position. The challenges remaining are two-fold: to maintain

## Exhibit 18

### Change in Net Liabilities to Gross Domestic Product (GDP), 1997 to 2005

*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

a net liabilities to GDP ratio that will allow the government to provide public services in the future; and to accurately forecast and proactively manage the changes needed to stabilize the net liabilities to GDP ratio over the long term.

## 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 provincial revenue is used to pay interest on government debt, then less money would be left to provide citizens with services.

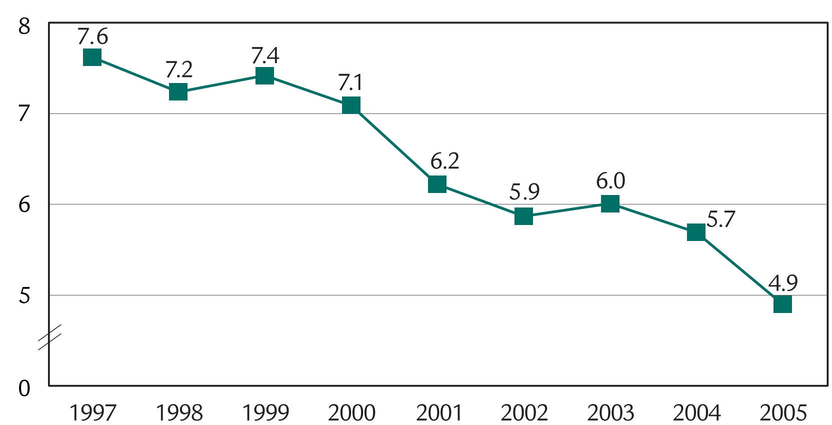
Exhibit 19 shows the nine-year trend in public debt charges to revenue. The interest bite trend for British Columbia improved between 1997 and 2005. The improvement over the last two years was due mainly to increases in revenue, concurrent with falling costs of borrowing as a result of low interest rates and reduced debt in 2005. We calculated the interest bite of the province to be about 5 cents for every dollar of revenue for the 2005 fiscal year. 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.

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 (original cost less accumulated depreciation).

## Exhibit 19

### Public Debt Charges to Revenue (the "Interest Bite"), 1997 to 2005

*Total debt interest expense as a percentage of total provincial revenue*




Source: Office of the Auditor General of British Columbia

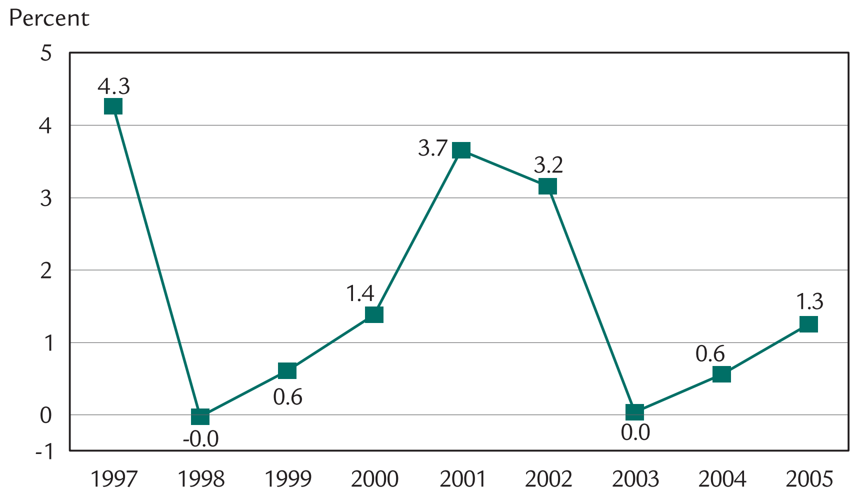
Exhibit 20 shows the annual percentage change in physical capital stock of the province from 1997 to 2005. The graph indicates that the government's capital spending on total physical capital assets was constrained in 1998, but the percentage changes have been higher since. The smaller increases in 2003 and 2004 reflect, respectively, the write-off of regional hospital district assets and the removal of BC Ferry Corporation from the government reporting entity. The increase in 2005 of 1.25% includes the removal of $0.6 billion of BC Rail assets from the accounts of the province. If we were to remove the effect of this on the ratio, we would see that capital asset spending would have increased by 3% in 2005.

This indicator emphasizes the need for governments to put in place, and maintain, adequate infrastructure to serve its citizens. Any deferral of expenditures on maintenance and replacement can

## Exhibit 20

### Changes in Physical Capital Stock, 1997 to 2005

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




Source: Office of the Auditor General of British Columbia

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.

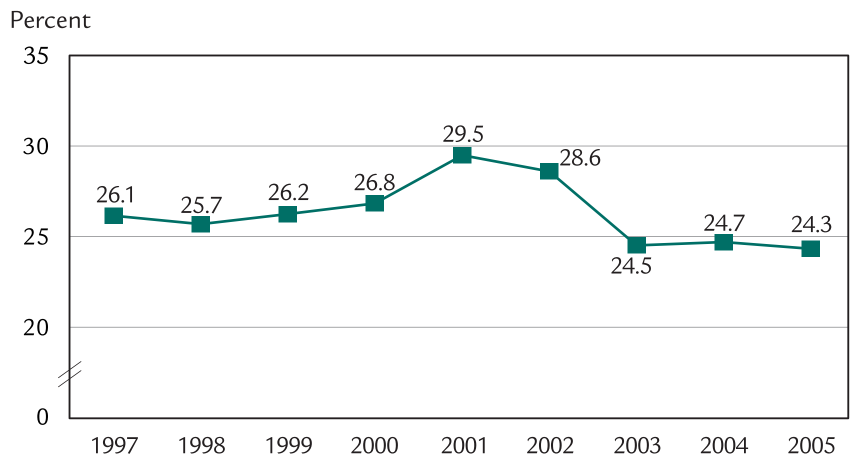
The ratio of own-source revenue to GDP represents the amount of income government is taking from the whole provincial economy in the form of taxation and user fees. Typically, own-source revenue is all revenue other than federal transfers. This indicator expresses government's own-source revenue as a percentage of total provincial GDP.

Exhibit 21 shows the ratio of own-source revenue to GDP for the nine years from 1997 to 2005. 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 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. The lower amount in 2003 reflects the decrease in tax revenue in that year. The lower amount in 2005 reflects a small increase in taxes and fees collected, offset by a larger increase in GDP over the prior year.

### Exhibit 21

**Own-source Revenue to Gross Domestic Product (GDP), 1997 to 2005**

*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

*Summary*

Effectively managing each of these indicators in the future may be challenging. How will the government manage the interest bite in the future? The common consensus among financial experts is that interest rates, currently at 40-year lows, will rise in the near future. Higher interest often precipitates overall weakening in an economy, which can reduce revenues and increase debt costs. Maintaining a manageable debt balance in the face of such demands will be a challenge.

Is the government replacing and maintaining the physical assets needed to deliver public services into the future? It is often difficult to judge whether infrastructure is deteriorating beyond the point when maintenance is not enough any more. Accounting for physical assets can be a difficult task, since it is hard to forecast when the assets need replacement and how much it will cost to replace them. It is important that the government have a way to obtain this information so it can make informed decisions.

The favourable trend in a decreasing ratio of own-source revenue to GDP needs to be viewed with some caution. Has the government's move to collect more taxes and user fees than in prior years really led to increasing financial flexibility? The large increase in federal transfers may have allowed the government to collect less in taxes and fees than it may have needed to for providing the same degree of service. This may signal an increase in vulnerability, which we discuss in the next section.

## 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 funds obtained within the province.

The province receives transfers from the federal government to support the delivery of health, education, social services and other programs. These transfers are not as controllable as tax legislation or the charging of fees. The government-to-government transfers to own-source revenue indicator compares federal government transfers with 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.

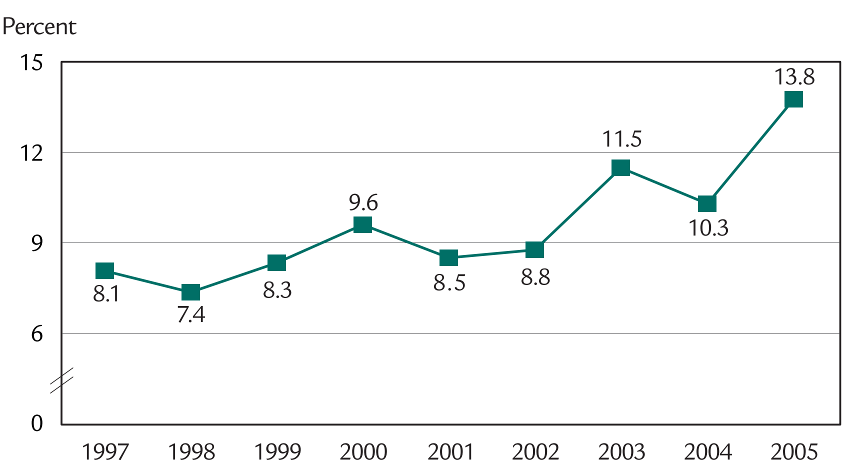
Exhibit 22 shows the percentage of government-to-government transfers to own-source revenue for the nine years ending March 31, 2005. The province's dependence on the federal government for funding remained relatively stable until 2002, but has increased substantially in the last three years. The large jump in 2003 and slight decrease the following year were the result of an overpayment of funds through the federal equalization program, which was repaid in 2004. In 2005, there was a significant increase in equalization payments of more than double the amount budgeted by the provincial government. In 2003, 2004 and 2005, the federal government increased payments to British Columbia under the Canada Health and Social Transfer program. The provincial government can use most of this funding for anything it wants. In 2005, the federal government almost doubled its payments to British Columbia under the Canada Health Accord. These payments must be used for designated health expenditures.

The British Columbia government often borrows in foreign currencies. To minimize its financial exposure (that is, hedge its risk) to swings in these currencies, the government enters into derivative contracts such as currency swaps and forward contracts.

## Exhibit 22

### Government-to-Government Transfers to Own-source Revenue, 1997 to 2005

*Federal transfers as a percentage of all other government revenue*




Source: Office of the Auditor General of British Columbia

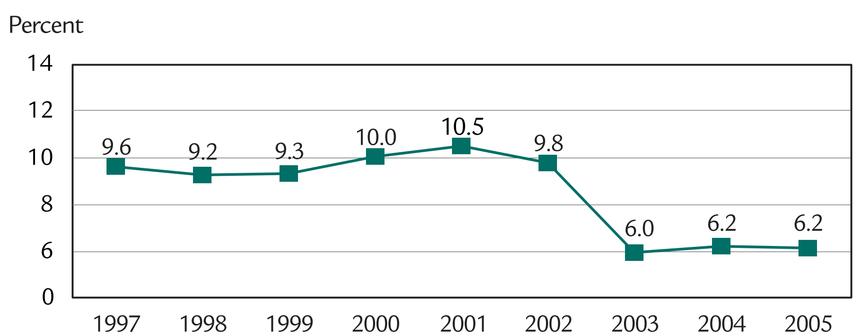
These contracts ensure that its foreign currency debt repayments are fixed in Canadian dollars. For many years, information concerning public debt issued in foreign currencies has been included in a note in the government's financial statements. The note discloses any "hedging" through foreign currency 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 exchange rates. 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 remained fairly stable for the past three years after falling to its lowest level in 2003. The decrease during that year 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 2005

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




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

*Summary*

These vulnerability indicators reveal the provincial government is becoming increasingly vulnerable to the fiscal decisions of another level of government, and decreasingly vulnerable to foreign currency exchange rate movements.

# 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?

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 2004/05 fiscal year, in comparison with other western Canadian provinces and Ontario, British Columbia experienced moderate inflation, higher unemployment and (with the exception of Manitoba) lower GDP per capita. These results are the same as for those in the previous fiscal year. Exhibit 24 compares inflation, unemployment and GDP per capita in all western Canadian provinces and Ontario for 2004/05.

### Exhibit 24

Economic Indicators for the Western Provinces and Ontario, 2004/05*

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

| | Inflation % | Unemployment % | GDP per capita $ |
|---|---|---|---|
| British Columbia | 2.0 | 7.2 | 37,289 |
| Alberta | 1.4 | 4.6 | 58,537 |
| Saskatchewan | 2.2 | 5.3 | 40,643 |
| Manitoba | 2.0 | 5.3 | 34,406 |
| Ontario | 1.9 | 6.8 | 41,768 |

*Inflation, Unemployment and GDP data are for the calendar year ending December 31, 2004. Population data is as at July 1, 2004.

Source: Statistics Canada

# Part 2: Comparing British Columbia to Other Canadian Jurisdictions

There are many financial and statistical indicators available today that allow jurisdictions to be compared with one another. However, comparing provincial statistical and economic information is problematic. 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 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 scope of financial 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 in three significant indicators over the last nine years. 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 year-to-year fluctuation of the province's shortage of financial assets to meet its liabilities, compared with changes in the economy. It is a 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 in other jurisdictions. It is calculated by dividing the nominal GDP for the year by the population. Since 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 a watching brief 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, with the second highest provincial credit rating in Canada, after Alberta. British Columbia's credit rating improved to Aa1 in 2005 from Aa2 which it had, had since 1998.

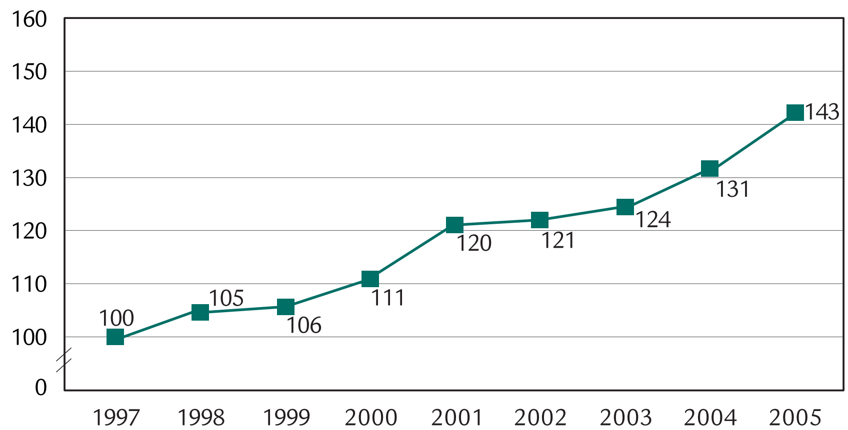
Exhibit 25 shows the GDP growth for British Columbia for the nine years ending in fiscal 2005. (In Part 1, we compare GDP growth with government revenue growth, with revenue as an indicator of vulnerability, and with net liabilities and change in net liabilities as an indicator of sustainability.) The graph shows fairly steady growth in the province's GDP over that time, though growth was somewhat flat in 1999 and 2002. Some of the growth in fiscal 2001 could be attributed to higher energy prices. In fiscal 2005, GDP was 9.9% higher than in the prior year.

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 other provinces. This information, showing the average output per person for each jurisdiction, is an indicator of the wealth of the province.

## Exhibit 25

### Rate of Change in British Columbia's Gross Domestic Product (GDP), 1997 to 2005*

*The GDP represents the size of the provincial economy (1997 = 100)*




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

Source: Statistics Canada

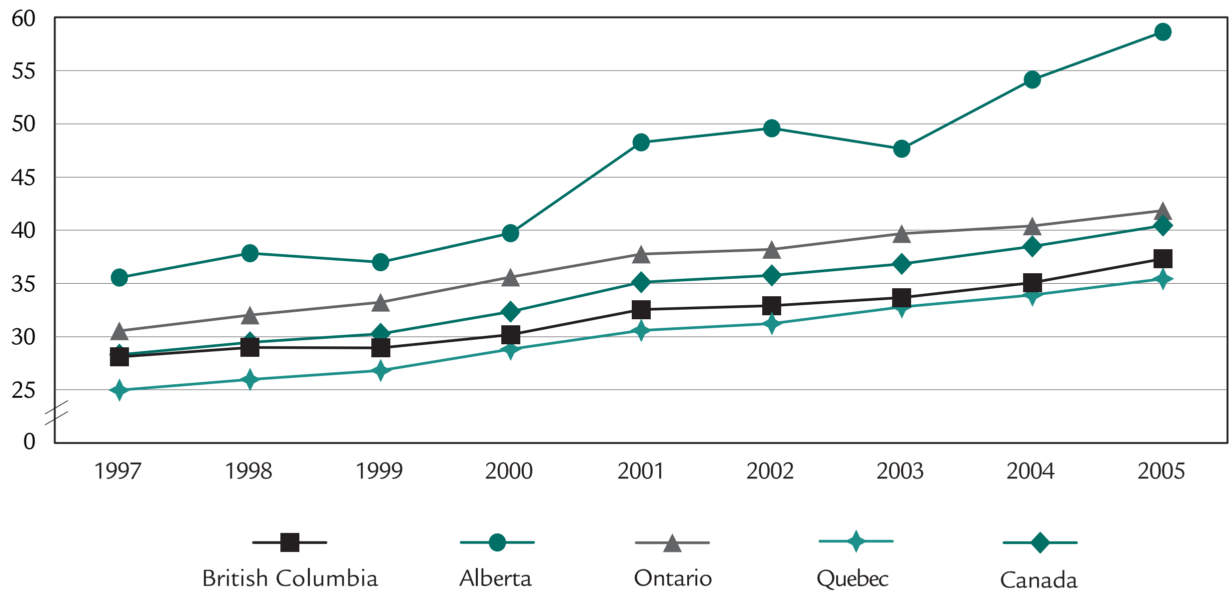
Alberta had the highest GDP per capita in fiscal 2005, followed by Ontario and then Saskatchewan. British Columbia's GDP per capita remained at fifth position amongst the provinces in 2005, behind Newfoundland & Labrador and the Canadian average. The figure for Canada approximates a weighted average of all provinces.

In Exhibit 17 (on page 39), we presented the net liabilities to GDP indicator for British Columbia for the nine years 1997 through 2005. 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 with GDP makes it easier to compare the net liabilities of one year with another, as well as across different jurisdictions.

## Exhibit 26

Gross Domestic Product (GDP) Per Capita, for Canada and four of the Provinces, 1997 to 2005*

*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

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 are based on information from their Public Accounts, corrected for any misstatements for which there were audit qualifications.

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.

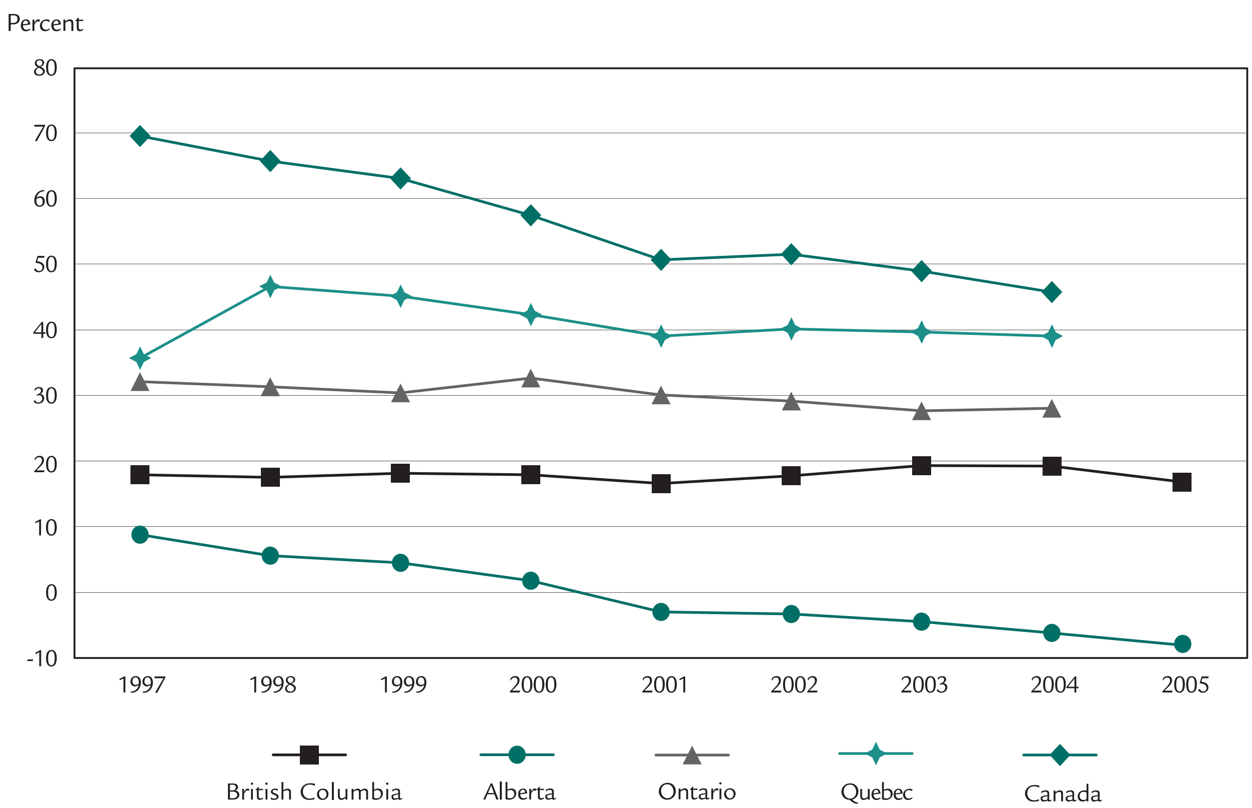
British Columbia ranks second among all jurisdictions with respect to the net liabilities to GDP indicator, behind Alberta, and has maintained this position for all years since fiscal 1997. British Columbia's ratio of net liabilities to GDP has remained fairly stable since 1997, while many other provinces have shown improvement in recent years.

Exhibit 28 compares British Columbia's credit rating by Moody's Investors Service with the ratings for Alberta, Ontario, Quebec and Canada for the nine years ending March 31, 2005. Appendix D provides the credit ratings for these jurisdictions and the six remaining provinces.

## Exhibit 27

### Net Liabilities to Gross Domestic Product (GDP), for Canada and four of the Provinces, 1997 to 2005*

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



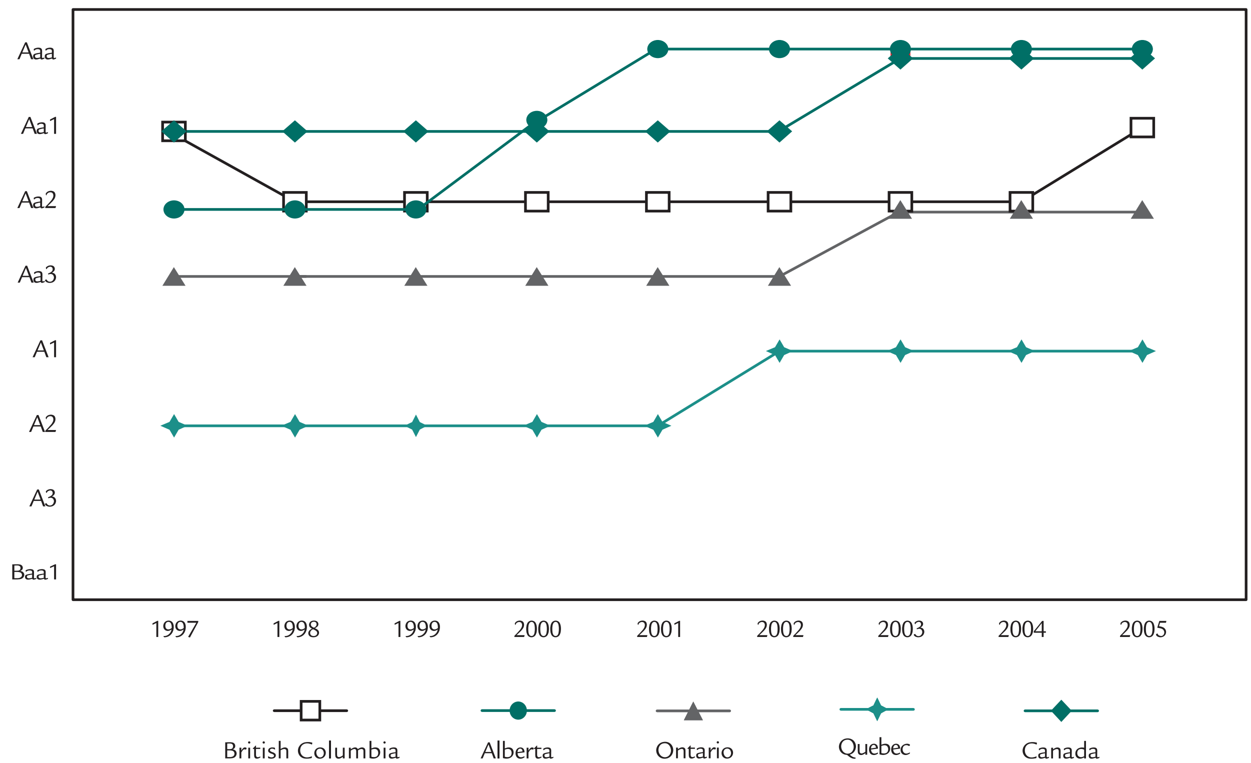

*GDP data is for the calendar year ending in the above fiscal years.

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

## Exhibit 28

### Credit Rating, for Canada and four of the Provinces, 1997 to 2005

*Credit ratings as at March 31 of each year*




Source: Moody's Investors Service

**Recommendation:**

**We recommend that the government expand its use of the financial statement discussion and analysis in its Public Accounts to better describe the year's activities so that legislators and the public can better understand the major trends, indicators and decisions that have affected the governments financial position and its financial performance.**

**We also encourage the government to use the indicators and other important financial and economic measures identified in Part 2 of this report in its financial statement discussion and analysis in order to provide a more complete context for the discussions contained in the Public Accounts and other public documents.**

# Part 3: Questions and Answers

# Part 3: Questions and Answers

Several common questions arise when the government finances are being discussed with legislators or in a public forum. The most common is: How are we doing? This straight forward question is usually answered with a qualified "Well, that depends…."

The questions below illustrate different ways the query can be asked and answered. I hope that these, when read together, will give a fairly complete picture of how we really are doing.

1. **Is the government making the best use of the public's resources?**

The answer to this question involves important policy issues that are best left to informed legislative and public debate. However, this report highlights how government can do more to inform that debate by publishing a robust financial discussion and analysis-based on using indicators of government performance for the entire government. This information gives legislators and the public much of the financial and statistical information they need to enter into such a debate.

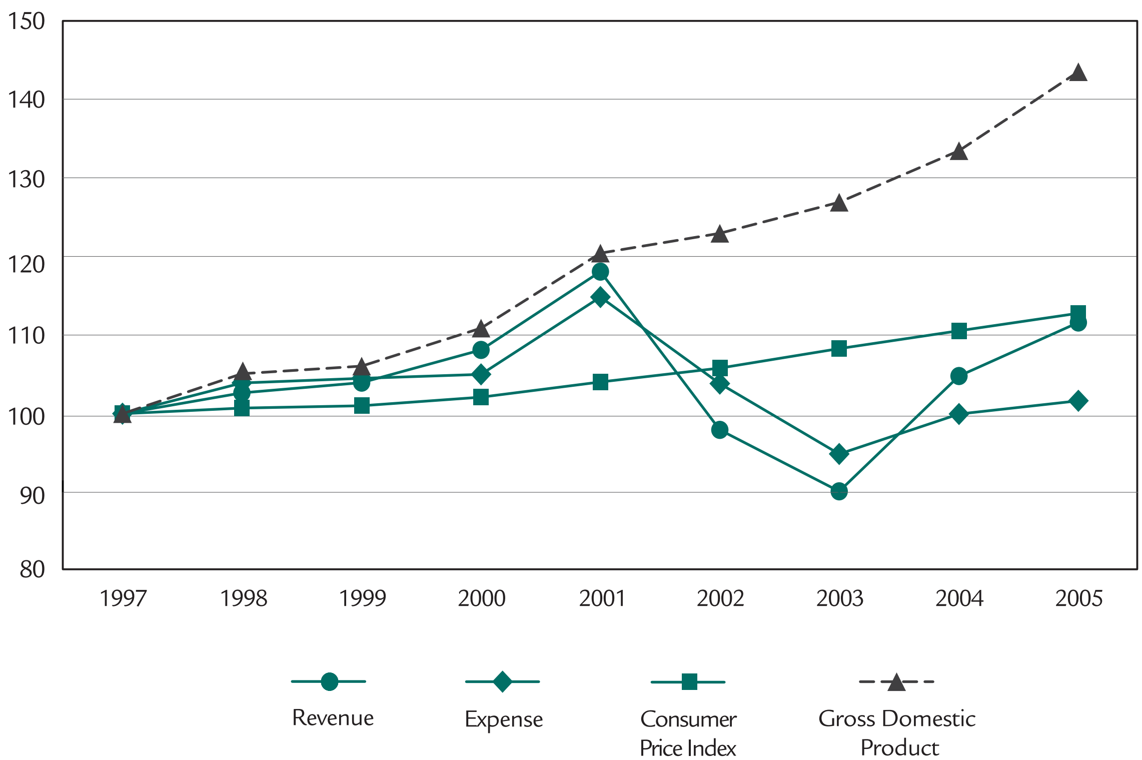
2. **Are the Government's revenue and spending increases or decreases sustainable?**

Until 2001, revenue and expense grew at a rate that outpaced inflation but was lower than the growth in the economy. In 2002 and 2003, both revenue and expense fell and appeared to be moving in a direction that would not be sustainable in the long term. The trend has reversed in the last two years, and revenue and expense are again tracking inflation and GDP in a more sustainable manner. The graph in Exhibit 29 compares the percentage changes in government revenue and expense with the changes in British Columbia's consumer price index (BCCPI) and its Gross Domestic Product (GDP). Exhibit 5 on page 23 shows the rate of change for each of the revenue components compared with the rate of exchange in GDP, and Exhibit 8 on page 28 shows the rate of change for each of the expense components compared with the change in CPI.

## Exhibit 29

### Revenue and Expense Trends, 1997 to 2005*

*Rate of change in Revenue and Expense compared to BCCPI and BCGDP*




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

3. **Is the government changing the level of activity carried out through its government business enterprises?**

Compared with that in the rest of government, the level of activity carried out through business enterprises increased substantially from 1997 to 2001, but decreased the year thereafter. From 1997 to 2005, general program revenues increased 33% overall and general program expenses increased 25%. In the same period, government business enterprise revenues increased 62% and their expenses increased 52%. (These amounts are not adjusted for inflation).

More detailed information is provided on revenue trends in Exhibit 5 on page 23 and on expense trends in Exhibit 8 on page 28.

4. **To what extent are the government's financial results affected by the sale of its investments?**

In 2005, the government recorded a net gain of $199 million from the BC Rail transaction. It also recognized a valuation adjustment for the loss of $46 million against other investments.

5. **How are the government's finances affected by transfers from the Federal Government for equalization and other program delivery?**

The province's dependence on the federal government for funding remained relatively stable until 2002, but has increased substantially in the last three years. The government receives transfers from the federal government every year under various program agreements. Exhibits 3, 4 and 5 compare the federal transfers with other sources of government revenue, and Exhibit 22 on page 46 shows government-to-government transfers as a percentage of total provincial government revenue. We concluded (see page 45) that in 2005 the magnitude of transfers from the federal government increased the provincial government's vulnerability to sources of revenue that are not under its control.

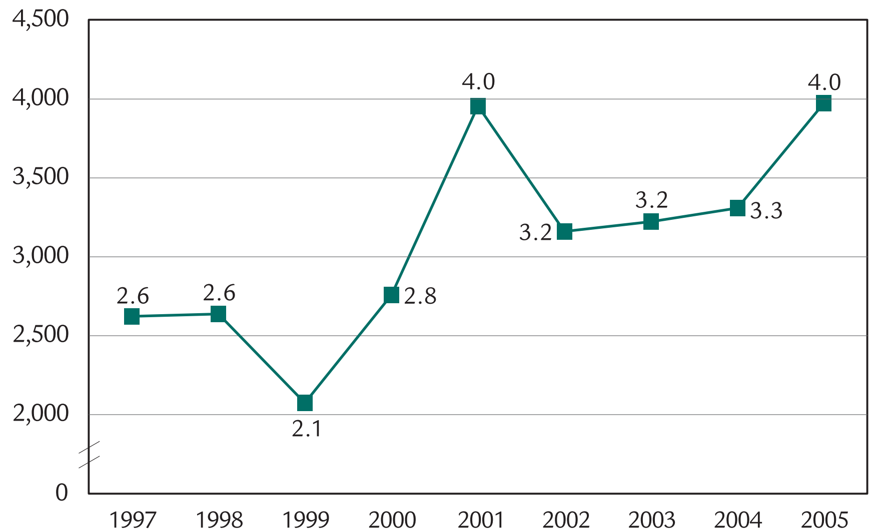
6. **What impact has natural resource revenue had on the government's finances?**

The impacts of changes in revenue from natural resources are significant to the government's finances. Revenue from natural resources is the most volatile source and difficult to budget for. Exhibit 30 shows that natural resource revenue was its lowest in 1999 at $2.1 billion, and highest in 2001 and 2005 at $4.0 billion. Exhibit 5 on page 23 shows that income from natural resources in 2005 grew by 20% over that in the prior year.

## Exhibit 30

Natural Resource Revenue, 1997 to 2005

*($ billions)*




Source: Office of the Auditor General of British Columbia

Oil, minerals and wood are actively traded on world markets and can be subject to significant price fluctuations due to world supply and demand. For example, in recent years, the price of oil experienced extreme price swings globally, causing similar swings in the British Columbia government's oil revenues. The softwood lumber dispute, the mountain pine beetle infestation and the North American housing boom have all significantly impacted the forestry sector. Recent increases in the world demand for raw materials and commodities have also affected the mining sector. Many of these factors are beyond the direct control of the provincial government.

7. **What impact have the government business enterprises had on the government's finances?**

Government business enterprise activity has a significant impact on the government's finances. Exhibit 1 on page 4 and Exhibit 2 on pages 16 and 17 show this impact on the annual operations and the accumulated net liabilities. Government business enterprises contribute substantial revenue to its financial results and net assets to its financial position.

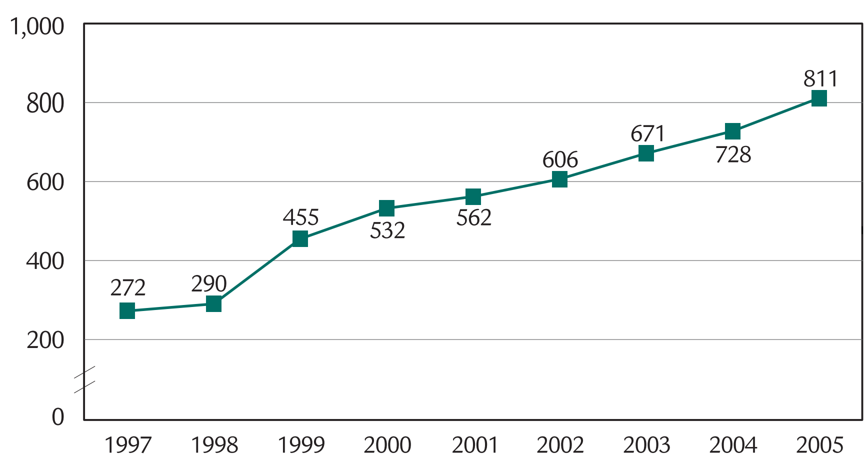
8. **What impact have gaming operations had on the government's finances?**

The net income from gaming operations has a significant impact on government revenues. In 2005, the government earned a net income from the BC Lottery Corporation of $811 million. Net income is the amount of gaming revenues received by the government after deducting expenditures for gaming operations. Exhibit 31 shows that the growth in net income from gaming has been fairly constant since 1999 when it jumped substantially over that in the prior year.

## Exhibit 31

Net Income from Gaming 1997 to 2005

*($ millions)*




Source: Office of the Auditor General of British Columbia

9. **How have the financial results for 2005 differed from the results that were expected for the year?**

The overall surplus for the year was $2.6 billion compared to the planned surplus of $100 million.

Revenue items with a significant effect:

- Contributions from the federal government were $5.2 billion, $0.9 billion higher than expected.
- Taxation revenue was $14.9 billion, $0.7 billion higher than expected.
- Natural resource revenue was $4 billion, $0.5 billion higher than expected.
- Net earnings of Crown corporations were $0.3 billion higher.

Expense items with a significant effect:

- Natural resource expense was $184 million higher than expected (it had been expected to decline by $165 million).
- Education expense was $258 million higher than the prior year and $234 million higher.
- Health expense was $268 million higher (but lower than the budgeted amount by $154 million).

Please see the detailed discussion in Part 1 of this report and the discussion on expense trends, starting on page 25.

10. **How much debt and interest per capita does the government have?**

The net liabilities per capita in 2005 were $6,259. Exhibit 15 on page 36 shows net liabilities on a per capita basis—that is, the amount that each citizen would need to pay in order to discharge government's past borrowing, revenue-generating and spending practices. Interest expense per capita for 2005 was $439. Exhibit 7 on page 27 shows the government's per capita expenses for the last nine years, for each expense category including interest.

11. **How much of the government's debt is payable in foreign currencies?**

Foreign currency denominated debt may be hedged or non-hedged. Hedged debt is debt whose interest payments and repayment terms are pegged to the Canadian dollar and are not vulnerable to changes in exchange rates. When debt is non-hedged, the interest and repayment terms are vulnerable because of changes in exchange rates. Total foreign currency hedged and non-hedged debt was $8.7 billion, or almost 22% of the total government debt in 2005. Exhibit 23 on page 47 gives the ratio of non-hedged foreign currency debt to total government debt, which was 6.2% at March 31, 2005.

12. **How much of the government's total liabilities include liabilities of government business enterprises?**

The government's total liabilities include debt as well as other liabilities. The government's total liabilities as at March 31, 2005, were $61 billion. Liabilities of the government business enterprises make up $17.3 billion of that total. Exhibit 13 on page 35 shows the government's total liabilities, including liabilities of government business enterprises from 1997 to 2005.

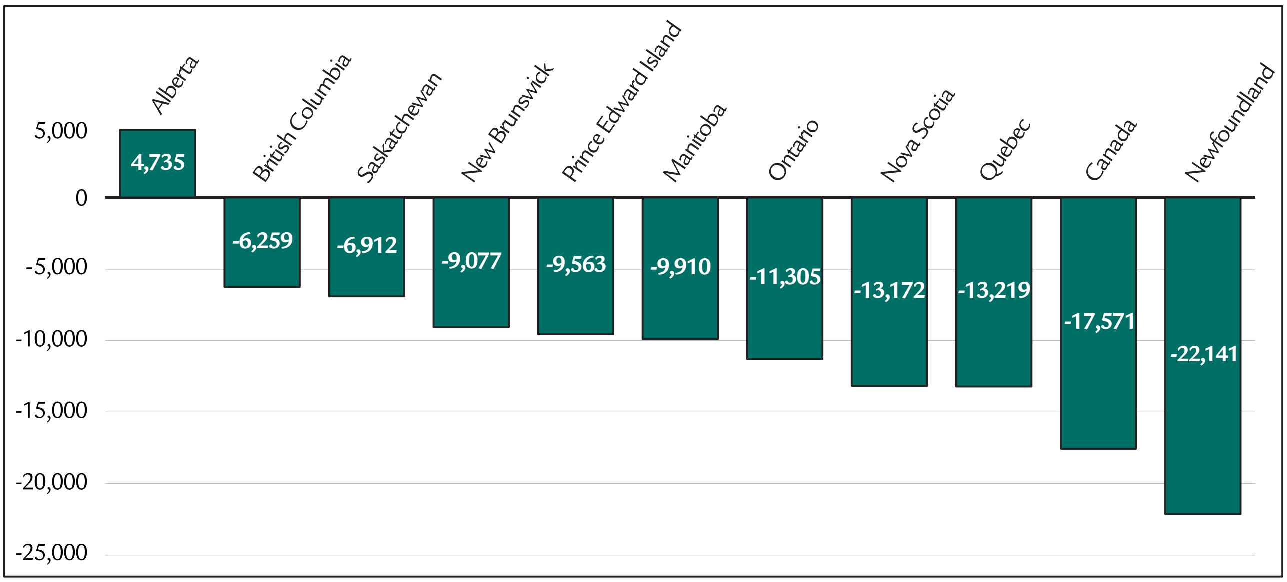
13. **How has the province's credit rating changed from 1997 to 2005?**

British Columbia's credit rating was raised in 2005 to Aa1 from Aa2 (Aa2 being the level to which it had fallen in 1998). Compared with that of other provinces, British Columbia's credit rating is second best, behind Alberta's. Exhibit 28 on page 57 compares British Columbia's credit rating with selected provinces and the Government of Canada. Appendix D shows how credit ratings compare for all provinces.

## Exhibit 32

### Net Debt Per Capita (Alberta: Net Assets)

*(Dollars)*




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

14. **How does the government's net liabilities per capita compare with that of other provinces?**

British Columbia's net liabilities are the second lowest among provinces. Exhibit 32 compares British Columbia's net liabilities per capita with that of the other provinces. British Columbia, Alberta and Saskatchewan figures are for 2005; all others are for 2004. We have included the older information for the other provinces because this was the only data available at the time.

15. **What is the annual percentage change in British Columbia's GDP?**

There is no single rate that would adequately describe the annual percentage change in British Columbia's GDP for the last nine years because GDP grew at an uneven rate during that time. In 1999, 2002 and 2003, GDP growth was fairly flat. In the other years the growth rate was moderate. Overall, GDP grew by 43.5% from 1997 to 2005. Exhibit 25 on page 54 shows the rate of change in GDP since 1997 (not adjusted for inflation).

16. **How does the British Columbia's GDP per capita compare with the other provinces?**

British Columbia has the fifth highest GDP per capita behind Alberta, Ontario, Saskatchewan and Newfoundland & Labrador. Appendix B compares the GDP per capita for British Columbia with that for all provinces and Canada.

# 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 acknowledgement of the government's continuing progress in adopting best practices in financial reporting.*

*The Province of British Columbia continues to be a leader in summary budgeting and financial reporting. The Budget documents are our financial plan; the Overview section and the Provincial Debt Summary within the Public Accounts comment upon and report the actual financial results against that plan. The province, via the Internet, also provides public access to the Financial and Economic Review with its significantly expanded budgetary variance analysis, economic commentary and historical reference information. As stated last year, these documents already provide much of the data the Auditor General included in his suggested framework.*

*This year, the province prepared its statements fully in accordance with generally accepted accounting principles (GAAP) with the inclusion of the school districts, universities, colleges, institutes and health authorities (SUCH) sectors. Previously, the SUCH sector results were only reported in supplemental information. With this change, the Public Accounts and the unqualified audit opinion have achieved consistency with the 2004/05 Budget, which already included the SUCH sector.*

*The Province of British Columbia now leads other jurisdictions by legislating that the province must produce its budget and financial reports each year in full compliance with GAAP for senior governments. Compliance began with the 2004/05 Budget. Achieving this goal has been one of government's top priorities. British Columbia is one of the first provinces to include all SUCH sector organizations in its Public Accounts.*

*The province also requires government 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. Individual ministries and Crown corporations and agencies are also required to produce similar information. Therefore, the province already provides a detailed accountability to the public from planning to reporting.*

*In terms of the timeliness of financial reporting, British Columbia was amongst the very first in the country to release its audited financial statements. This is the fourth year in a row for a June release of the Public Accounts. Although we are in the relatively early stages of* *performance reporting, and while there is room for improvement, it is clear the government has dramatically improved its financial and accountability information. The province's reporting is extensive, particularly when compared to most other provinces.*

*We generally agree with the expanded disclosure principles advocated by the Auditor General. However, the adjusted balance sheet and operating statement presentation suggested by the Auditor General in this report is one we do not agree with at this time. This approach includes an alternate disclosure for government business enterprises. This is not consistent with the Public Sector Accounting Board (PSAB) and GAAP, which currently recommend modified equity accounting for government business enterprises. PSAB has recently released a new exposure draft on segment reporting. In the future, this may result in expanded disclosure for government business enterprises; however, it is too early to make any assumptions on how our Public Accounts disclosure will be impacted until the final recommendation from PSAB.*

*The Auditor General has recommended additional financial trend and ratio analysis to accompany the Public Accounts, which go beyond GAAP requirements and our current reporting. British Columbia is already a leader in its disclosures and, as such, we agree it is important for governments to provide explanatory context for their financial reports. Much of the expanded information, as proposed by the Auditor General, is based on the recommendations included in the "*Statement of Recommended Practices on Financial Statement Discussion and Analysis*" issued by PSAB in June 2004, many of which British Columbia has already adopted. As the recommendations are only suggested practice, the province is not required to follow the practices in meeting its legislated GAAP commitment.*

*More specifically, 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, and other indicators, are being used by various jurisdictions, including British Columbia. We will monitor the reporting of other jurisdictions as well as review any new guidance to determine which of these indicators would be appropriate for the next Public Accounts.*

## Response from the Ministry of Finance

*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 inter-provincial 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 to ensure only information critical to understanding the province's financial position is included. Other considerations include the cost of gathering the information, its impacts on entities included in the government reporting entity, its impact on timeliness of reporting and the avoidance of duplication across reports.*

*Significant improvements have been made by the province as a result of concentrating our resources on meeting the legislated commitment of making the Budget documents, Estimates and Summary Financial Statements fully compliant with GAAP. We look forward to working with the Auditor General, to enhance the use of the Financial Statement Discussion and Analysis section of the Public Accounts, as we receive further definitive guidance from PSAB.*

# Appendices

# Appendix A: 2004/05 Public Accounts Overview

## 2004/05 Public Accounts Overview (unaudited)

### Financial Statement Discussion and Analysis Report

# Financial Statement Discussion and Analysis Report

The focus of the province's financial reporting is the Summary Financial Statements, which consolidate the operating and financial results of the province's Crown corporations, agencies, and school districts, universities, colleges, institutes and health authorities with the Consolidated Revenue Fund. These are general–purpose statements designed to meet, to the extent possible, the information needs of a variety of users.

The Public Accounts are prepared in accordance with the *Financial Administration Act* and the *Budget Transparency and Accountability Act* (BTAA).

The BTAA was amended in 2001 with the passing of Bill 5. Under section 20 of that Bill, the government has mandated that "all accounting policies and practices applicable to documents required to be made public under this Act for the government reporting entity must conform to generally accepted accounting principles." This move to fully comply with generally accepted accounting principles (GAAP) has been completed effective in the 2004/05 fiscal year.

For senior governments, GAAP is generally considered to be the recommendations and guidelines of the Public Sector Accounting Board of the Canadian Institute of Chartered Accountants.

An accounting policy advisory committee has been established as an independent body and is assisting the province in addressing this issue.

The Public Accounts are printed in one volume and include the Overview, the Summary Financial Statements, Supplementary Information, the Consolidated Revenue Fund Extracts and the Provincial Debt Summary. Additional information is available to the public on the Internet at: www.fin.gov.bc.ca.

# Financial Highlights

## Financial Highlights

The information contained within the Financial Highlights is taken from the Summary Financial Statements on pages 29–79. The budget figures are from pages 3–5 of the *Estimates—Fiscal Year Ending March 31, 2005*, with certain restatements as outlined in Note 30 on pages 62–64.

Reflecting robust economic performance in both domestic and export sectors, improved natural resources revenue, higher than anticipated federal transfers and sound financial management on the spending side, the province ended the year with a record surplus of $2,575 million, $2,475 million higher than budget. Compared to the previous year, the 2004/05 results were a $3,850 million improvement.

### Summary Accounts' Surplus (Deficit)

| | In Millions | | | Variance | |
|---|---|---|---|---|---|
| | 2004/05 Budget | 2004/05 Actual | 2003/04 [1] Actual | 2004/05 Actual to Budget | 2004/05 vs 2003/04 |
| **Taxpayer–supported Programs and Agencies** | $ | $ | $ | $ | $ |
| Revenue | 28,420 | 30,821 | 27,176 | 2,401 | 3,645 |
| Expense | (30,292) | (30,658) | (30,212) | (366) | (446) |
| **Taxpayer–supported net earnings** | (1,872) | 163 | (3,036) | 2,035 | 3,199 |
| Self–supported Crown corporation net earnings | 2,072 | 2,412 | 1,884 | 340 | 528 |
| **Surplus (deficit) before unusual items** | 200 | 2,575 | (1,152) | 2,375 | 3,727 |
| Restructuring exit expense | | | (123) | | 123 |
| Forecast allowance | (100) | | | 100 | |
| **Surplus (deficit) for the year** | 100 | 2,575 | (1,275) | 2,475 | 3,850 |

[1]The 2003/04 figures have been restated to include the school districts, universities, colleges, institutes and health authorities (SUCH) sector and other adjustments.

Improvements in taxation revenue, federal transfers and natural resources revenue helped offset tax measures implemented during the year.

Expenses included the additional costs related to forest fires and floods. Spending related to the gain on completion of the BC Rail/CN Transaction (*see* Note 33) and additional federal health funding was offset by related revenue increases. The remaining expense was lower than budget, as priority initiatives were funded from lower debt service costs and program savings.

# Financial Highlights

## Changes from 2004/05 Budget

| | In Millions | | | |
|---|---|---|---|---|
| | Revenue | Expense | Forecast Allowance | Surplus (Deficit) |
| | $ | $ | $ | $ |
| **Surplus (Deficit) per Budget** | **30,492** | **30,292** | **(100)** | **100** |
| Increase in taxation revenue (before tax reductions) | 882 | | | 882 |
| Impact of tax reductions | (150) | | | (150) |
| Increase in federal transfers | 737 | | | 737 |
| Additional federal health care funding and related spending | 148 | 148 | | |
| Increase in natural resource revenue | 541 | | | 541 |
| Gain and distribution of gain on BC Rail/CN Transaction[1] | 199 | 169 | | 30 |
| Other net increases in self–supported Crown corporations net earnings | 141 | | | 141 |
| Increase in other revenue | 243 | | | 243 |
| Increase in debt interest expense | | | | |
| Program savings (including interest expense savings of $189 million) | | (519) | | 519 |
| Priority spending initiatives | | 452 | | (452) |
| Increase in forest fires and floods costs | | 116 | | (116) |
| Unused forecast allowance | | | 100 | 100 |
| Subtotal of changes in actual results compared to budget | 2,741 | 366 | 100 | 2,475 |
| **Actual Results** | **33,233** | **30,658** | | **2,575** |

[1]*See* Note 33.

## Changes in Actual Results from 2003/04 to 2004/05

| | In Millions | | |
|---|---|---|---|
| | Revenue | Expense | Surplus (Deficit) |
| | $ | $ | $ |
| **2003/04[1] Surplus (Deficit)** | **29,060** | **30,335** | **(1,275)** |
| Increase in taxation revenue (*see* page 14) | 1,087 | | 1,087 |
| Increase in federal contributions (*see* page 14) | 1,612 | | 1,612 |
| Increase in fees and licences revenue (*see* page 14) | 90 | | 90 |
| Increase in natural resources revenue (*see* page 14) | 664 | | 664 |
| Net increase in other revenue (*see* page 14) | 192 | | 192 |
| Increase in self–supported Crown corporation net earnings (*see* page 14) | 528 | | 528 |
| Increase in health expense (*see* page 16) | | 268 | (268) |
| Increase in education expense (*see* page 16) | | 258 | (258) |
| Decrease in other expenses (*see* page 16) | | (203) | 203 |
| Subtotal of changes in actual results | 4,173 | 323 | 3,850 |
| **2004/05 Surplus (Deficit)** | **33,233** | **30,658** | 2,575 |
| **2003/04[1] Accumulated Surplus (Deficit)** | | | (5,725) |
| **2004/05 Accumulated Surplus (Deficit)** | | | **(3,150)** |

[1]The 2003/04 figures have been restated to include the school districts, universities, colleges, institutes and health authorities (SUCH) sector and other adjustments.

# Financial Highlights

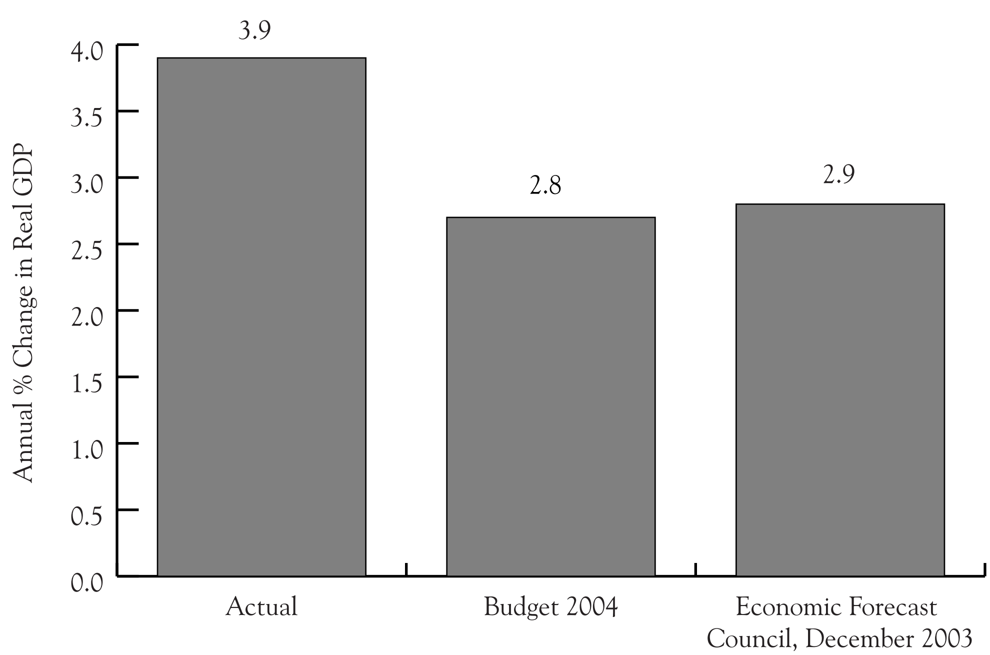
In fiscal 2004/05, the province included the impacts of school districts, universities, colleges, institutes and health authorities (SUCH) directly in its financial statements. This added $395 million to the province's surplus and reduced the accumulated deficit by $4,983 million (*see* Note 1).

Gross debt reported on the financial statements at the end of 2004/05 was $39,921 million, $2,066 million lower than in 2003/04. For budget, planning and reporting purposes, and when reporting to rating agencies, the province subtracts from the financial statement debt sinking fund assets used to repay debt at maturity and adds all debt guarantees and the debt directly incurred by the self–supported Crown corporations to determine the total provincial debt. At the end of 2004/05, the total provincial debt was $35,826 million, a reduction of $1,941 million from the previous year.

## Economic Highlights

British Columbia's economy grew by 3.9% in 2004, the strongest growth among the provinces, according to preliminary results from Statistics Canada. The estimated 3.9% growth was significantly higher than the budget forecast of 2.8% and the pre–budget forecast of 2.9% of the Economic Forecast Council. Domestic activity continued to be the main driver of economic growth last year. Real business investment grew by 11.7% in 2004. Growth in housing starts of 25.8% in 2004 led to residential construction investment growth of 14.8%. Additionally, machinery and equipment investment, supported by a stronger Canadian dollar, saw growth of 20.0% in 2004. Consumer spending, which accounts for about two–thirds of all economic activity in the province, grew by 4.1% in 2004, supported by low interest rates and strong employment growth of 2.3%. Despite the continued rise of the Canadian dollar against the US dollar in 2004, total exports of goods and services grew by 4.9%. Imports of goods and services grew by 6.4% in 2004.

**British Columbia Real Gross Domestic Product Growth 2004**



# Financial Highlights

## Strong and Stable Credit

British Columbia now maintains a stronger credit rating, as confirmed by the recent upgrades by all three credit rating agencies. In 2004/05, Moody's Investors Service Inc. upgraded the province to Aa1 (2004: Aa2), Standard and Poor's upgraded the province to AA (2004: AA–) and Dominion Bond Rating Service's upgraded the province to AA (2004: AA (low)).

### Credit Ratings May 2005

| Province | Rating Agency[1] Moody's Investors Service Inc. | Standard and Poor's | Dominion Bond Rating Service |
|---|---|---|---|
| British Columbia | Aa1 | AA | AA |
| Alberta | Aaa | AAA | AAA |
| Saskatchewan | Aa3 | AA– | A(high) |
| Manitoba | Aa2 | AA– | A(high) |
| Ontario | Aa2 | AA | AA(negative) |
| Quebec | A1 (positive) | A+ | A(positive) |
| New Brunswick | Aa3 | AA– | A(high) |
| Nova Scotia | A2 | A | A(low) |
| Prince Edward Island | A2 | A | A(low) |
| Newfoundland | A3 | A– | BBB (high) |
| Canada | Aaa | AAA | AAA |

[1]The rating agencies assign letter ratings to borrowers. The major categories, in descending order of credit quality, are: AAA/Aaa; AA/Aa; A; BBB/Baa; BB/Ba; and B. The "1", "2", "3", "high", "low", and "–" modifiers show relative standing within the major categories. For example, AA+ exceeds AA.

## Financial Performance

### Revenue

For the 2004/05 fiscal year, revenue totalled $33,233 million, $2,741 million higher than budget and $4,173 million higher than in 2003/04.

### Revenue by Source

| | In Millions | | | Variance | |
|---|---|---|---|---|---|
| | 2004/05 Budget | 2004/05 Actual | 2003/04 [1] Actual | 2004/05 Actual to Budget | 2004/05 vs 2003/04 |
| | $ | $ | $ | $ | $ |
| Taxation | 14,185 | 14,917 | 13,830 | 732 | 1,087 |
| Contributions from federal government | 4,346 | 5,231 | 3,619 | 885 | 1,612 |
| Fees and licences | 3,578 | 3,621 | 3,531 | 43 | 90 |
| Natural resources | 3,432 | 3,973 | 3,309 | 541 | 664 |
| Net earnings of self–supported Crown corporations | 2,072 | 2,412 | 1,884 | 340 | 528 |
| Miscellaneous | 1,990 | 2,246 | 1,937 | 256 | 309 |
| Investment earnings | 889 | 833 | 950 | (56) | (117) |
| **Total revenue** | **30,492** | **33,233** | **29,060** | **2,741** | **4,173** |

[1]The 2003/04 figures have been restated to include the school districts, universities, colleges, institutes and health authorities (SUCH) sector and other adjustments.

Revenue was $2,741 million higher than budget mainly due to the effects of robust economic and income growth, strong commodity prices, new federal/provincial agreements for health and Equalization transfers.

# Financial Highlights

Taxation revenue, which comprises 45% of all revenue, was $732 million higher than budget and $1,087 million higher than in 2003/04, primarily due to increased corporate income tax instalments from the federal government and higher 2003 personal and corporate income tax assessments. Revenue from other tax sources was up as increased migration, income and economic growth resulted in higher than anticipated personal and business expenditures. Excluding the October 2004 provincial sales tax reduction to 7.0% from 7.5% and further measures announced in February 2005, which together total $150 million, taxation revenue would have been $882 million higher than budget.

Including the additional $148 million health care funding announced after budget, contributions from the federal government were $885 million higher than budget and $1,612 million higher than in 2003/04 mainly due to improved federal Equalization program and health and social transfer revenue. Increased Equalization revenue was due to the revised methodology used to calculate entitlements established at the First Ministers' meeting on October 26, 2004. Improved health and social transfers reflect the additional $148 million Health Accord funding and British Columbia's share of the Public Health and Immunization Trust announced in the federal budget, and the annual increase from 2003/04 includes British Columbia's share of an increased national base.

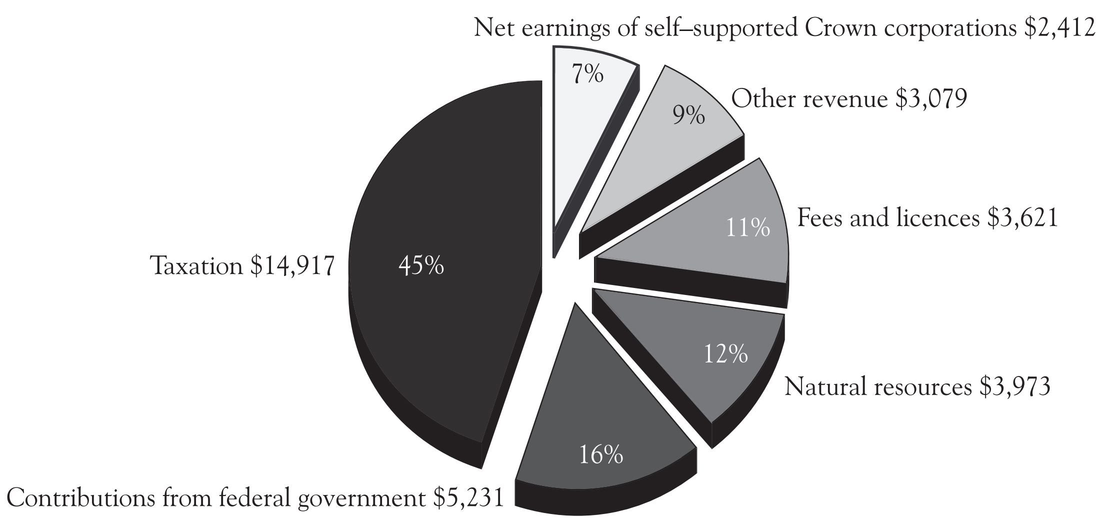
Natural resources revenue was $541 million higher than budget and $664 million higher than in 2003/04, reflecting strong global demand for energy and mineral products, and a robust US housing market, resulting in higher commodity prices and increased Crown forest harvest volumes.

Net earnings of self–supported Crown corporations were $340 million higher than budget and $528 million higher than in 2003/04. The change from budget reflects a $347 million increase over budget of ICBC financial results, the $199 million gain on completion of the BC Rail/CN Transaction (*see* Note 33) offset by a $148 million reduction in British Columbia Hydro and Power Authority's net earnings and $58 million in other net decreases in self–supported Crowns. The increase from the prior year reflects the gain on completion of the BC Rail/CN Transaction and the British Columbia Hydro and Power Authority's $137 million receipt of an arbitration award from Alcan Inc. to Powerex for indemnities Alcan issued as part of a power sales arrangement with Enron Power Marketing, Inc.

Revenue from fees and licenses, investment earnings, and miscellaneous sources was $243 million higher than budget and $282 million higher than in 2003/04. The change from budget reflects $110 million in school–generated funds now being reported on the school districts' financial statements and higher recoveries of program costs. The increase from 2003/04 reflects increases in deferred operating income from prior years being recognized into income in 2004/05 made up of: $95 million from universities, $54 million from school districts and $28 million from health authorities. There was also an increase in licencing revenues of $18 million relating to more high weight vehicles registered and a $16 million increase in fines and penalty revenue due to fewer people taking the early discount payment option.

Primary sources of provincial revenue are outlined in the chart below.

### Revenue by Source



# Financial Highlights

## Expense

In 2004/05, provincial expense totalled $30,658 million, $366 million higher than budget and $323 million higher than in 2003/04.

### Expense by Function

| | In Millions | | | Variance | |
|---|---|---|---|---|---|
| | 2004/05 Budget | 2004/05 Actual | 2003/04 [1] Actual | 2004/05 Actual to Budget | 2004/05 vs 2003/04 |
| | $ | $ | $ | $ | $ |
| Health[2,3] | 11,787 | 11,633 | 11,365 | (154) | 268 |
| Education[3] | 8,788 | 9,022 | 8,764 | 234 | 258 |
| Social services | 2,678 | 2,665 | 2,819 | (13) | (154) |
| Interest[3] | 1,661 | 1,472 | 1,572 | (189) | (100) |
| Natural resources and economic development | 1,321 | 1,670 | 1,486 | 349 | 184 |
| Transportation[3] | 1,265 | 1,448 | 1,278 | 183 | 170 |
| Protection of persons and property | 1,166 | 1,215 | 1,365 | 49 | (150) |
| Other | 1,148 | 1,028 | 1,074 | (120) | (46) |
| General government | 478 | 505 | 489 | 27 | 16 |
| **Total operating expense** | **30,292** | **30,658** | **30,212** | **366** | **446** |
| Restructuring exit expense | | | 123 | | (123) |
| **Total expense** | **30,292** | **30,658** | **30,335** | **366** | **323** |

[1]The 2003/04 figures have been restated to include the school districts, universities, colleges, institutes and health authorities (SUCH) sector and other adjustments.

[2]The 2004/05 budget for health excluded $148 million in additional health funding from the federal government that was not known at the time of the budget, but was included in the *Supply Act* passed on May 29, 2004.

[3] Interest expense does not include interest relating to prepaid capital advances. These interest costs are recorded in the related health, education and transportation functions. *See* Note 28 on page 61 for more details.

Health spending was $154 million lower than budget but $268 million higher than in 2003/04. The change from budget, in part, reflects a $60 million adjustment of prior years' expense accruals which were credited to revenue and therefore, not available for the ministry to spend and $40 million in program underspending, resulting from lower than expected demand in the Medical Services Plan and PharmaCare.

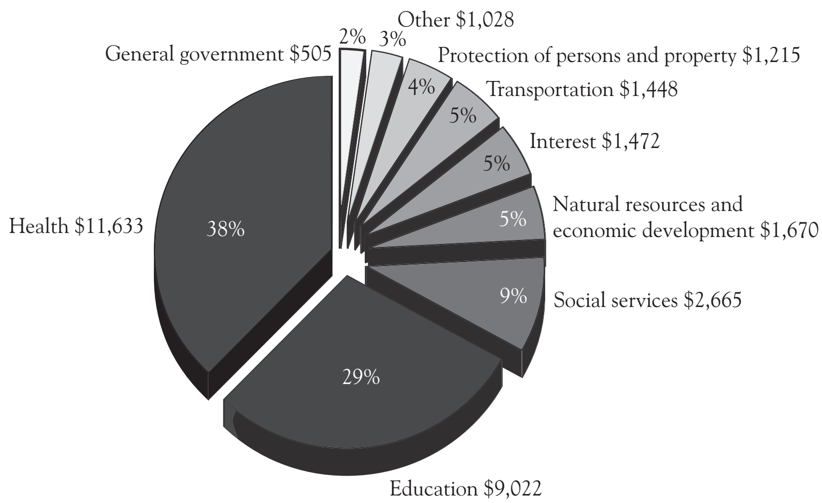
Education spending was $234 million higher than budget and $258 million higher than in 2003/04. The increase from budget reflects the inclusion of $108 million in expense relating to school–generated funds. The main reason for the actual to actual increase is the Ministry of Advanced Education's Strategic Investment Plan, the additional funding provided to school districts and the inclusion of actual costs for local institution and school–based programs.

Natural resources and economic development spending was $349 million higher than budget and $184 million higher than in 2003/04. The increase from budget was primarily due to unanticipated forest fire suppression costs and priority initiatives including forestry revitalization and reforestation as outlined in Note 30.

In accordance with Canadian generally accepted accounting principles for senior governments, provincial expenses are reported on a functional basis in the Public Accounts. Under functional reporting, expenses are grouped and classified according to their principal purpose using a modified version of the Statistics Canada account classification system. Primary expense functions are outlined in the chart below:

# Financial Highlights

### Expense by Function




## Ministry, Program and Agency Reporting

While functional reporting allows for greater comparability across jurisdictions, it is not considered the primary tool for managing results, as the level of aggregation does not provide specific information about the operational objectives and major activities of the reporting entity. Reporting by entity provides management and the public additional information regarding the allocation of resources and related costs of the different operational activities of government. For example, Health Services (below) only includes ministry amounts, which total $10,606 million, while the health function in the above table shows an expense of $11,633 million. The difference is due to the health function including the health services ministry, health authorities, hospital societies, health–related spending of taxpayer–supported Crown corporations and agencies, and other ministries' programs that are related to health function spending.

### Expense by Major Accountability

| | In Millions | | | Variance | |
|---|---|---|---|---|---|
| | 2004/05 Budget | 2004/05 Actual | 2003/04 Actual [1] | 2004/05 Actual to Budget | 2004/05 vs 2003/04 |
| | $ | $ | $ | $ | $ |
| Health Services | 10,558 | 10,606 | 10,466 | 48 | 140 |
| Education | 4,943 | 4,887 | 4,787 | (56) | 100 |
| Advanced Education | 1,899 | 1,908 | 1,897 | 9 | 11 |
| Management of Public Funds and Debt | 800 | 677 | 708 | (123) | (31) |
| Other ministries and programs | 6,809 | 7,965 | 7,210 | 1,156 | 755 |
| Government restructuring (all ministries) | | | 167 | | (167) |
| **Consolidated Revenue Fund expense** | **25,009** | **26,043** | **25,235** | **1,034** | **808** |
| Less: grants/internal transfers | (13,562) | (14,954) | (14,168) | (1,392) | (786) |
| Recoveries | 1,632 | 1,705 | 1,738 | 73 | (33) |
| Other taxpayer–supported entities including the SUCH sector (net of accounting adjustments) | 17,213 | 17,864 | 17,530 | 651 | 334 |
| **Total expense** | **30,292** | **30,658** | **30,335** | **366** | **323** |

[1]The 2003/04 figures have been restated to include the school districts, universities, colleges, institutes and health authorities (SUCH) sector and other adjustments.

# Financial Highlights

During the 2004/05 fiscal year, the Legislative Assembly approved eleven Supplementary Estimates totalling $1,152 million. Further information on the Supplementary Estimates information is reported in Note 30.

Major variances in Expense by Major Accountability are:

- Consolidated revenue fund spending was $1,034 million higher than budget, primarily due to the additional spending authorized through supplementary estimates outlined in Note 30. These include the transfer of additional federal healthcare funding to health authorities, a capital assistance grant to the BC Transportation Financing Authority, and additional funding for forest revitalization, community infrastructure projects and other initiatives.
- Consolidated revenue fund spending in 2004/05 was $808 million higher than in 2003/04 results primarily due to the spending authority through supplementary estimates, partially offset by lower disaster–related costs resulting from forest fires and floods.
- Grants and internal transfers were $1,392 million higher than budget mainly due to increased transfers to health authorities, additional capital funding provided to the BC Transportation Financing Authority and the inclusion of the Industry Training Authority as part of the government reporting entity.
- Grants and internal transfers in 2004/05 were $786 million higher than in 2003/04 results due to the capital funding transfers.
- The $651 million increase in spending over budget by other taxpayer–supported entities mainly reflects the inclusion of spending related to school–generated funds, the additional healthcare dollars provided to health authorities, the inclusion of the Industry Training Authority as part of the government reporting entity, and an additional contribution by the BC Transportation Financing Authority for the Richmond–Airport–Vancouver (RAV) rapid transit project.
- Spending by other taxpayer–supported entities in 2004/05 was $334 million higher than in 2003/04 due to the impact of increased funding for school districts and higher costs in post–secondary institutions.

Further details on ministry, program, agency and SUCH sector spending can be found in the 2005 British Columbia Financial and Economic Review available in July 2005 at: www.fin.gov.bc.ca/pubs.htm

## Financial Assets

Financial assets as at March 31, 2005, totalled $24,880 million, $1,525 million higher than budget and $499 million higher than as at March 31, 2004. The increase compared to budget is primarily due to a $1,110 million increase in cash and temporary investments due in part to receipt of additional federal funding that had been deferred, to the effects of $347 million increase over budget of ICBC financial results and restoring the Columbia River power projects to commercial status ($303 million). Accounts receivable are $434 lower than budget due to lower than anticipated actual receivables. The increase from the previous year mainly reflects a $878 million increase in cash and temporary investments, partially offset by the British Columbia Railway Company's repayment of its $467 million loan from the province.

### Financial Assets

| | In Millions | | | Variance | |
|---|---|---|---|---|---|
| | 2004/05 [1] Budget | 2004/05 Actual | 2003/04 [2] Actual | 2004/05 Actual to Budget | 2004/05 vs 2003/04 |
| | $ | $ | $ | $ | $ |
| Accounts receivable | 3,067 | 2,633 | 2,838 | (434) | (205) |
| Equity in self–supported Crown corporations and agencies | 2,433 | 3,219 | 3,221 | 786 | (2) |
| Loans for purchases of assets recoverable from agencies | 7,179 | 6,901 | 7,512 | (278) | (611) |
| Other financial assets | 10,676 | 12,127 | 10,810 | 1,451 | 1,317 |
| **Total financial assets** | **23,355** | **24,880** | **24,381** | **1,525** | **499** |

[1]Certain budget numbers have been restated to be consistent with the reporting of actuals on the gross basis.
[2]The 2003/04 figures have been restated to include the school districts, universities, colleges, institutes and health authorities (SUCH) sector and other adjustments.

# Financial Highlights

As at March 31, 2005, the province's equity investment in self–supported Crown corporations was $3,219 million. In 2004/05, these organizations provided government with $2,412 million in net income.

Other financial assets include cash and cash equivalents, temporary investments, inventory, loans receivable, and amounts due from other governments. The increase of other financial assets relates to: a $645 million increase in general investment due to federal health and Equalization payments included in temporary investments; $187 million funding deposited into temporary investments for future infrastructure costs for BC Transportation Financing Authority; a $40 million increase in temporary investments relating to school–generated funds; and, $256 million in amounts due from the federal government.

## Liabilities

Total liabilities were $523 million lower than budget and $1,140 million lower than in 2003/04.

**Liabilities**

| | In Millions | | | Variance | |
|---|---|---|---|---|---|
| | 2004/05 [1] Budget | 2004/05 Actual | 2003/04 [2] Actual | 2004/05 Actual to Budget | 2004/05 vs 2003/04 |
| | $ | $ | $ | $ | $ |
| Taxpayer–supported debt | 35,073 | 32,032 | 33,432 | (3,041) | (1,400) |
| Self–supported debt | 8,160 | 7,889 | 8,555 | (271) | (666) |
| Forecast allowance | 100 | | | (100) | |
| **Total financial statement debt** | **43,333** | **39,921** | **41,987** | **(3,412)** | **(2,066)** |
| Accounts payable and other liabilities | 6,234 | 6,583 | 6,826 | 349 | (243) |
| Deferred revenue | 2,716 | 5,256 | 4,087 | 2,540 | 1,169 |
| **Total liabilities** | **52,283** | **51,760** | **52,900** | **(523)** | **(1,140)** |

[1]Certain budget numbers have been restated to be consistent with the reporting of actuals on the gross basis.
[2]The 2003/04 figures have been restated to include the school districts, universities, colleges, institutes and health authorities (SUCH) sector and other adjustments.

## Financial Statement Debt

Total financial statement debt was $3,412 million lower than budget and $2,066 million lower than in 2003/04. The changes are due to debt retirement from the increased surplus, cash from deferred federal health funding and cash from the repayment of the British Columbia Ferry Services Inc. debenture.

## Accounts Payable and Other Liabilities

Accounts payable and other liabilities were $349 million higher than budget but $243 million lower than in 2003/04. The increase compared to budget results is consistent with the increase in overall expense. The reduction from the prior year in part reflects a reduction in the amounts due to other governments.

## Deferred Revenue

Deferred revenue was $2,540 million higher than budget and $1,169 million higher than in 2003/04. The increase from budget also reflects the change in accounting treatment for recognition of bid revenues, which increased deferred revenue by $1,262 million. The remaining increase between the 2004/05 results compared to both budget and 2003/04 results related to $691 million in additional federal healthcare funding for reduction in wait times and other priorities; $196 million in deferred funding for future capital projects in the SUCH sector; and to deferred federal operating grants of $131 million for the 2004 Canada Health and Social Transfer Supplement, $35 million for the Public Health and Immunization program and $66 million in funding for purchasing medical equipment.

# Financial Highlights

## Total Provincial Debt

As noted in the table below, total provincial debt was $4,095 million lower than the amount reported in the province's financial statements due to the impact of sinking funds and the inclusion of debt guarantees and non–guaranteed debt. Total provincial debt at March 31, 2005 was $35,826 million, which is $3,569 million lower than budget and $1,941 million lower than in 2003/04.

### Total Provincial Debt

| | In Millions | | | Variance | |
|---|---|---|---|---|---|
| | 2004/05 Budget | 2004/05 Actual | 2003/04 [1] Actual | 2004/05 Actual to Budget | 2004/05 vs 2003/04 |
| | $ | $ | $ | $ | $ |
| Gross financial statement debt | 43,333 | 39,921 | 41,987 | (3,412) | (2,066) |
| Less: sinking funds assets | (4,331) | (4,516) | (4,619) | (185) | 103 |
| Third party guarantees and non–guaranteed debt | 393 | 421 | 399 | 28 | 22 |
| **Total provincial debt** | **39,395** | **35,826** | **37,767** | **(3,569)** | **(1,941)** |

[1]The 2003/04 figures have been restated to include the school districts, universities, colleges, institutes and health authorities (SUCH) sector and other adjustments.

A more comprehensive overview of provincial debt, including key debt indicators is located on pages 101–114.

## Non–financial Assets

At March 31, 2005, non–financial assets totalled $23,730 million, which was $84 million lower than budget and $936 million higher than in 2003/04. The increase in non–financial assets from the previous year reflects infrastructure spending for the post–secondary system, health facilities (including equipment purchases) and transportation.

### Non–financial Assets

| | In Millions | | | Variance | |
|---|---|---|---|---|---|
| | 2004/05 [1] Budget | 2004/05 Actual | 2003/04 [2] Actual | 2004/05 Actual to Budget | 2004/05 vs 2003/04 |
| | $ | $ | $ | $ | $ |
| Tangible capital assets | 23,437 | 23,117 | 22,255 | (320) | 862 |
| Other assets | 377 | 613 | 539 | 236 | 74 |
| **Total non–financial assets** | **23,814** | **23,730** | **22,794** | **(84)** | **936** |

[1]Certain budget numbers have been restated to be consistent with the reporting of actuals on the gross basis.
[2]The 2003/04 figures have been restated to include the school districts, universities, colleges, institutes and health authorities (SUCH) sector and other adjustments.

Non–financial assets typically represent resources that government can use in the future to provide services. The majority of the province's non–financial assets reflects capital asset expenditures and takes the form of tangible capital assets.

## Net Liabilities and Accumulated Deficit

In accordance with Canadian generally accepted accounting principles, the government's statement of financial position is presented on a net debt or net liabilities basis. Net liabilities represent the difference between a government's financial assets and its liabilities and is often used as a measure of the future revenue required to pay for past transactions and events.

The accumulated deficit represents the sum of the current and all prior years' operating results. At March 31, 2005, accumulated deficit totalled $3,150 million, which was $1,964 million lower than budget and a $2,575 million improvement over the previous year. The improvement over budget includes the difference between forecast results for 2003/04 at the time the budget was prepared and the actual results for the year.

### Net Liabilities and Accumulated Deficit

| | In Millions | | | Variance | |
|---|---|---|---|---|---|
| | 2004/05 [1] Budget | 2004/05 Actual | 2003/04 [2] Actual | 2004/05 Actual to Budget | 2004/05 vs 2003/04 |
| | $ | $ | $ | $ | $ |
| Financial assets | 23,355 | 24,880 | 24,381 | 1,525 | 499 |
| Less: liabilities | (52,283) | (51,760) | (52,900) | 523 | 1,140 |
| Net liabilities | (28,928) | (26,880) | (28,519) | 2,048 | 1,639 |
| Less: non–financial assets | 23,814 | 23,730 | 22,794 | (84) | 936 |
| **Accumulated deficit** | **(5,114)** | **(3,150)** | **(5,725)** | **1,964** | **2,575** |

[1]Certain budget numbers have been restated to be consistent with the reporting of actuals on the gross basis.
[2]The 2003/04 figures have been restated to include the school districts, universities, colleges, institutes and health authorities (SUCH) sector and other adjustments.

### Summary Accounts' Staff Utilization for the Fiscal Year Ended March 31, 2005[1]

| | | | | Variance | |
|---|---|---|---|---|---|
| | 2004/05 Budget | 2004/05 Actual | 2003/04 Actual | 2004/05 Actual to Budget | 2004/05 vs 2003/04 |
| Consolidated Revenue Fund[2] | 27,160 | 26,859 | 28,684 | (301) | (1,825) |
| Taxpayer–supported Crown corporations and agencies[3] | 3,940 | 3,822 | 5,076 | (118) | (1,254) |
| **Total staff utilization** | **31,100** | **30,681** | **33,760** | **(419)** | **(3,079)** |

The table above provides a summary of full–time equivalent (FTE) employment.

[1]Staff utilization is the full–time equivalent of the number of persons employed in the fiscal year whose salaries are paid by taxpayer–supported entities within the Summary Financial Statements.
[2]*See* the Consolidated Revenue Fund schedules at www.fin.gov.bc.ca/pubs.htm for details.
[3]*See* Financial Statements of Government Organizations and Enterprises at www.fin.gov.bc.ca/pubs.htm for details.

# Financial Highlights

The FTE reductions for the Consolidated Revenue Fund against 2004/05 budget reflects lower than anticipated staffing levels in a number of ministries. The decrease from 2003/04 reflects reduced requirements for forest fire fighting and the completion of the final stages of the government's restructuring initiative at the end of the 2003/04 fiscal year.

The difference between budgeted utilization for taxpayer–supported Crown corporations and actual utilization was 118 FTEs. This primary difference included 46 fewer FTEs than budgeted for the Oil and Gas Commission and 35 fewer FTEs than budgeted for the Canadian Blood Services. The decrease between 2004/05 and 2003/04 reflects three major changes: the transfer of Forensic Psychiatric Services Commission to Providence Health Care (448 FTE decrease); British Columbia Building Corporation restructuring their property management department (454 FTE decrease); and, the transfer of the Pacific National Exhibition outside the reporting entity (398 FTE decrease).

# 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 2005*

*(Dollars)*

| | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 |
|---|---|---|---|---|---|---|---|---|---|
| British Columbia | 28,091 | 28,940 | 28,932 | 30,147 | 32,516 | 32,871 | 33,622 | 35,041 | 37,289 |
| Alberta | 35,504 | 37,776 | 36,959 | 39,648 | 48,184 | 49,500 | 48,346 | 54,076 | 58,537 |
| Saskatchewan | 28,513 | 28,589 | 28,829 | 30,323 | 33,566 | 33,264 | 34,561 | 36,750 | 40,643 |
| Manitoba | 25,125 | 26,218 | 27,216 | 27,967 | 29,682 | 30,537 | 31,873 | 32,707 | 34,406 |
| Ontario | 30,516 | 31,996 | 33,187 | 35,548 | 37,719 | 38,153 | 39,626 | 40,346 | 41,768 |
| Quebec | 24,960 | 25,952 | 26,797 | 28,787 | 30,573 | 31,193 | 32,739 | 33,856 | 35,402 |
| Newfoundland | 18,627 | 19,088 | 20,506 | 22,859 | 26,367 | 27,243 | 31,989 | 35,239 | 37,839 |
| New Brunswick | 22,134 | 22,398 | 23,417 | 25,354 | 26,762 | 27,589 | 28,213 | 29,900 | 31,101 |
| Nova Scotia | 20,991 | 21,817 | 22,864 | 24,688 | 26,403 | 27,823 | 29,157 | 30,882 | 32,055 |
| Prince Edward Island | 20,801 | 20,496 | 21,759 | 23,228 | 24,659 | 25,157 | 27,370 | 28,099 | 29,007 |
| Canada | 28,278 | 29,437 | 30,249 | 32,313 | 35,080 | 35,719 | 36,790 | 38,414 | 40,386 |

*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 2005*

*(Percent)*

| | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 |
|---|---|---|---|---|---|---|---|---|---|
| British Columbia | 17.94 | 17.53 | 18.13 | 17.95 | 16.55 | 17.79 | 19.28 | 19.23 | 16.79 |
| Alberta | 8.82 | 5.58 | 4.54 | 1.77 | -2.97 | -3.33 | -4.49 | -6.18 | -8.09 |
| Saskatchewan | 32.14 | 30.71 | 29.93 | 27.37 | 24.31 | 26.18 | 26.97 | 25.44 | 21.00 |
| Manitoba | 29.31 | 28.36 | 27.86 | 30.40 | 27.61 | 27.91 | 27.88 | 30.30 | na |
| Ontario | 32.11 | 31.32 | 30.36 | 32.64 | 30.06 | 29.11 | 27.66 | 28.02 | na |
| Quebec | 35.71 | 46.63 | 45.14 | 42.30 | 39.06 | 40.13 | 39.65 | 39.04 | na |
| Newfoundland | 69.42 | 69.04 | 70.25 | 66.37 | 60.60 | 62.81 | 63.89 | 62.83 | na |
| New Brunswick | 32.66 | 34.04 | 33.53 | 35.75 | 33.85 | 31.92 | 31.71 | 30.36 | na |
| Nova Scotia | 42.82 | 45.55 | 48.06 | 48.71 | 46.11 | 46.75 | 44.87 | 42.65 | na |
| Prince Edward Island | 35.91 | 36.40 | 33.34 | 31.97 | 31.05 | 31.46 | 31.44 | 34.03 | na |
| Canada | 69.50 | 65.67 | 63.04 | 57.46 | 50.66 | 51.52 | 48.94 | 45.74 | na |

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 1997 to 2005

| | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 |
|---|---|---|---|---|---|---|---|---|---|
| British Columbia | Aa1 | Aa2 | Aa2 | Aa2 | Aa2 | Aa2 | Aa2 | Aa2 | Aa1 |
| Alberta | Aa2 | Aa2 | Aa2 | Aa1 | Aaa | Aaa | Aaa | Aaa | Aaa |
| Saskatchewan | A3 | A3 | A2 | A2 | A1 | A1 | Aa3 | Aa3 | Aa3 |
| Manitoba | A1 | A1 | Aa3 | Aa3 | Aa3 | Aa3 | Aa2 | Aa2 | Aa2 |
| Ontario | Aa3 | Aa3 | Aa3 | Aa3 | Aa3 | Aa3 | Aa2 | Aa2 | Aa2 |
| Quebec | A2 | A2 | A2 | A2 | A2 | A1 | A1 | A1 | A1 |
| Nova Scotia | A3 | A3 | A3 | A3 | A3 | A3 | A3 | A3 | A2 |
| New Brunswick | A1 | A1 | A1 | A1 | A1 | A1 | A1 | A1 | A1 |
| Newfoundland | Baa1 | Baa1 | Baa1 | Baa1 | Baa1 | Baa1 | A3 | A3 | A3 |
| Prince Edward Island | A3 | A3 | A3 | A3 | A3 | A3 | A2 | A2 | A2 |
| Canada | Aa1 | Aa1 | Aa1 | Aa1 | Aa1 | Aa1 | Aaa | Aaa | Aaa |

Source: Moody's Investors Service

# Appendix E: Office of the Auditor General: 2005/2006 reports issued to date

## Office of the Auditor General: 2005/06 reports issued to date

Report 1 – April 2005

Follow-up of the Recommendations of the Select Standing Committee on Public Accounts contained in its Fourth Report of the 3rd Session of the 36th Parliament: Earthquake; Performance Audit

Report 2 – May 2005

Joint Follow-up of 2001/2002: Report 1 Managing Interface Fire Risks and Firestorm 2003 Provincial Review

Report 3 – June 2005

Audit of the Government's Corporate Accounting System: Part 1

Report 4 – July 2005

Building Better Reports: Our Assessment of the 2003/04 Annual Service Plan Reports of Government

Report 5 – July 2005

Keeping the Decks Clean:
Managing Gaming Integrity Risks in Casinos

Report 6 – November 2005

Monitoring the Government's Finances
Province of British Columbia

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