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Observations on Financial Reporting:

Audit Findings Report on the 2007/08 Summary Financial Statements

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The Honourable Bill Barisoff
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Dear Sir:

I have the honour to transmit herewith to the Legislative Assembly of British Columbia my 2008/2009 Report 9: Observations on Financial Reporting: *Audit Findings Report on the 2007/08 Summary Financial Statements*.

John Doyle, MBA, CA
Auditor General of British Columbia

Victoria, British Columbia
October 2008

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

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John Doyle
Auditor General

My audit opinion on the Summary Financial Statements is a major output of my Office. It is the culmination of a large body of audit work conducted by staff within my Office, as well as by many private sector auditors that carry out their work in support of my opinion on government's consolidated financial statements.

This audit work creates the material used to publish this report on the Summary Financial Statements, where I summarize key issues affecting the quality of government's financial reporting, as well as recommendations to further improve their utility.

The Province has a reputation in Canada as a leader in public sector financial reporting. Established over years of hard work, such leading reputations can be diluted, even overtaken as other jurisdictions catch up, as the reporting environment changes. Although the Summary Financial Statements largely meet Canadian standards in public sector financial reporting, there is still room for improvement if government wants to avoid eroding its position.

During the audit, I brought a number of concerns about the Summary Financial Statements to government's attention. Government declined to adjust its statements for some of these, which resulted in several qualifying statements to my audit opinion. I must note that these reservations were well-grounded in Canadian accounting guidance. In some cases, they represented long-standing points of discussion with the Ministry of Finance, where the magnitude and significance of the issues had now become material. I have included additional explanations about my audit reservations in this report.

Audit reservations are unusual and should not be taken lightly. They represent issues the auditor considers so significant that, if uncorrected, might mislead a financial statement user. I was therefore disappointed that government chose not to address these issues. In many cases the underlying accounting, or amendments to notes to the financial statements, would have been relatively easy to remedy. I am puzzled that government would choose to have these reservations in my audit opinion rather than correct the deficiencies.

Auditor General's Comments

Readers familiar with the contents of this annual report my Office issues on the Summary Financial Statements may note a few new items. For example, this year we have included a summary of the financial management and control issues that were encountered and discussed through management letters with audited entities during the conduct of the 2007/08 audit. While not conclusive about the quality of financial control and governance across the government reporting entity, it provides an overview of the types of issues encountered.

In future years I plan to expand the coverage of this report to include the results of a wider range of issues including financial management and control, governance and broader accountability reporting. To achieve this, I may ask for additional audit procedures in some or all entities not audited directly by my staff.

In the report I issued on last year's Summary Financial Statements, I indicated there were several focus areas related to the quality of financial reporting I intend to examine and report on. Governance processes and practices, as well as financial management and controls, are important to review to ensure appropriate structures are in place, and that they are operating as intended. My staff will conduct a number of reviews and publish reports in this area, including topics in information technology and public-private partnership arrangements.

Looking ahead, impacts on government's financial reporting processes from implementing upcoming International Financial Reporting Standards in Canada may be significant. Although Canadian standard setters have not yet finalized all the public sector entities that will be included, I urge government to start taking the lead and considering the accounting policy guidance it should provide, since much work will be needed before they fully come into effect during 2011.

There is also an increasing expectation for governments to provide their financial and non-financial performance information via the internet, and in a format that allows users to access information at levels appropriate to their needs. There are already good examples of e-reporting from the public and private sectors in Canada and further afield. This is an area where British Columbia can demonstrate leadership, as it has in financial reporting in the past.

Auditor General's Comments

In summary, government's Summary Financial Statements are acceptable, but could be better. Most of the reservation issues I raise in this report could be easily resolved. To assist this, I have made recommendations where appropriate—I hope government will act upon these in time for the current fiscal year's financial statements.

I wish to thank all staff in my Office and in private sector audit firms who assisted in the audit of British Columbia's 2007/08 Summary Financial Statements.

John Doyle, MBA, CA
Auditor General of British Columbia

Victoria, British Columbia
October 2008

Executive Summary

Executive Summary

Introduction

This report is written to inform legislators and the public about the Auditor General's opinion of government's 2007/08 Summary Financial Statements, and discuss significant findings relating to the audit. It is also intended to encourage improved practices in financial reporting and management.

This year, we expanded the focus of the report to include a broad range of issues, including governance, financial management and financial disclosure, and have highlighted issues and recommendations from the financial statement audits of all government organizations included in the Summary Financial Statements.

Audit reservations related to the 2007/08 Summary Financial Statements

During our audit of the Summary Financial Statements for the year ending March 31, 2008, we discussed a number of significant issues with government, many of which were resolved satisfactorily. More than 50 monetary adjustments to the Summary Financial Statements were made at our request, and a further 12 adjustments were made to what was disclosed in the notes and schedules in the financial statements.

However, government chose not to adjust a number of other items in the financial statements and notes. Therefore, in the Auditor General's opinion, six reservations were expressed for departures from Canadian generally accepted accounting principles.

For one material balance in the Summary Financial Statements, we were not able to obtain sufficient, appropriate audit evidence to determine the reasonableness of government's estimate, although government was satisfied with the amount. This resulted in the Auditor General making a seventh audit reservation—a scope limitation. We discuss these reservation items in some detail in the main body of this report:

1. Resource roads—limitation on the scope of our audit.
2. No separate disclosure of liabilities related to leased tangible capital assets.
3. Land used for highways not properly disclosed.

4. Oil and natural gas producers royalty credits inappropriately netted from revenues.
5. No provision for deep-well credits.
6. Inadequate disclosure of a First Nation loan guarantee amount.
7. Failure to recognize a portion of a First Nation settlement.

An unreserved, or "clean" audit opinion does not signify that a set of financial statements are free of all possible errors or have lesser quality disclosures of financial results or condition. However, while financial statements with audit reservations do not necessarily indicate serious problems, they should also not be taken lightly. While these reservations are of concern, the Summary Financial Statements are, in the Auditor General's opinion, otherwise fairly presented according to Canadian standards.

Other future significant accounting issues

There are two other important accounting matters that need to be addressed. We believe government needs to fully analyze its accounting policy for First Nation settlements, and inherited Crown land transactions.

In our audit of the 2007/08 Summary Financial Statements, we did not consider the impact of government's accounting treatment on First Nations settlements material enough to include a reservation in the Auditor General's opinion. However, given the level of effort and activity in trying to resolve First Nations issues, it is possible that the amounts involved in these settlements will be material in the future. We also believe that this is an area where government's commitment to transparency should be improved in its disclosure of these transactions.

Another accounting issue we discuss is government's accounting for, and recognition of, inherited Crown land when it is to be sold or given away. We disagree with how government accounts for these transactions and have made several recommendations in this area. We believe that these transactions, some of which are also related to First Nations issues, may be material in the future, and if not accounted for correctly, may result in future audit reservations.

Other audit findings reported to government organizations

The Summary Financial Statements brings together the financial performance of 148 separate government entities and the Consolidated Revenue Fund. Each of these is audited individually by either our Office or by private sector auditors. In planning and performing these audits, consideration is given to risks in internal controls over financial disclosure, financial management and the governance and accountability relationships in these organizations.

Risks and internal control weaknesses found during the audits are brought to management's attention by financial statement auditors in a "management letter". It is management's responsibility to weigh the costs of implementing recommended control improvements against the benefits that will be achieved. Each auditor is also required to include its management letter, including management's proposed actions, in a communication to the audit committee or governing board, where the issues are usually discussed. As part of the audit process, auditors generally follow-up all actions planned by management to ensure the control deficiencies are remedied. The results are included in the annual reporting process to the audit committees or governing boards.

Of the 141 entites, the 19 ministries and the Office of the Comptroller General expected to have received management letters, 88% were issued for the 2007/08 audit cycle by their auditors at the time of our review. Of these organizations with management letters, over 60% had findings, resulting in over 350 issues and recommendations, while the rest had letters noting no findings. Included in these findings were the following categories:

- Capital asset policies.
- Assurance for use of service providers.
- Account reconciliations.
- Inventory management procedures and the accuracy of data.
- System documentation and controls.
- Segregation of duties.

We have included these to highlight the potential risk areas, and in doing so, assist organizations improve their own controls.

Executive Summary

Some progress has been made on our prior year recommendations

The focus in the front section of this year's report is on the more significant issues, which includes some issues raised last year. For the remaining issues, this year's report only notes those recommendations made last year that government has implemented. The rest of the outstanding recommendations, which are of less significance, have been updated and included in a separate management letter to government. The status of all of last year's recommendations can be found in Appendix B.

The improvements we describe include disclosures in the use of estimates, updating estimates of long-term liabilities and consistent use of interest capitalization.

We also recommended last year that government complete its assessment of capitalization of resource roads. Some roads were capitalized in 2007/08 that were not previously capitalized. However, as noted in the Auditor General's audit opinion reservations, we could not obtain sufficient evidence to determine the reasonableness of some of the amounts.

New financial reporting standards bring fresh challenges and opportunities

As signaled in last year's report on the Summary Financial Statements, Canada has announced that Canadian private sector accounting standards will converge with international ones by 2011. Although no decision has been made yet on the future of all public sector accounting standards, there are many entities included in the Summary Financial Statements that, due to the nature of their operations, must use private sector standards (e.g., British Columbia Hydro and Power Authority and Insurance Corporation of British Columbia).

Some of these entities will have to use the new international standards. Regardless of whether or not public sector standards are also converged with international ones, there will be considerable additional work and complexity in the consolidation process at the summary level. We believe that government could reduce these impacts through being more proactive in setting a general reporting framework for International Financial Reporting Standards (IFRS) in the public sector, which could streamline the consolidation process for these entities.

Executive Summary

We have made recommendations designed to improve future financial statements

To assist government's ability to improve the quality of its financial statements in future years, we have made several recommendations in the report. In addition to recommendations relating to audit reservations, we also made recommendations in the following areas:

- review of accounting policy and guidance regarding measurement and recognition of First Nations settlement costs;
- treatment, disclosure and valuation of inherited Crown land;
- improved assessment and disclosure of contractual obligations; and
- improved segmented reporting disclosure.

Response from the Ministry of Finance

We appreciate the opportunity to respond to the Office of the Auditor General's comments. We remain committed to providing meaningful financial statements. To this end we continue to report our financial statements in accordance with public sector generally accepted accounting principles (GAAP), which are those accounting policies and applications that have been generally accepted by a majority of senior government jurisdictions in Canada. Our key objectives in preparing the Public Accounts are to:

- provide the right level of information to help users understand the current financial position of the Province and the government's annual operating results,
- report consistently so that users can easily compare results between years, and
- select accounting policies and apply accounting standards as consistently as possible with other jurisdictions in Canada.

In doing so, we are mindful that too much detail can obscure the informative value of the financial statements, that the cost of additional reporting should not be greater than the benefit received, and that to be useful financial statements must be presented on a timely basis so that users have the benefit of reliable information that is relevant to their current needs. It is difficult to balance these objectives but we, like all other jurisdictions in Canada, have made great improvements in past years and continue to improve the quality of public sector financial reporting each year.

In this report the Auditor General provides background information on the conversion of Canadian private sector accounting standards to International Financial Reporting Standards (IFRS). This is a significant issue in financial reporting for governments because some of the organizations included in the Government Reporting Entity prepare their own statements using private sector standards. There is much debate among Canadian jurisdictions and public sector standard setters about whether there is a benefit from having some public sector organizations report under IFRS. Although Canadian and international standards are conceptually consistent, there are numerous differences that will add complexity, time and cost to the reporting process. We also believe that the purpose and definition of government business type organizations needs to be reviewed to ensure we retain a conceptually consistent basis of reporting for the public sector and ensure the financial statements of these organizations remain useful in assessing the program delivery, service potential, and stewardship of assets. As the definition of government business type organization is currently not well defined, it is difficult to achieve agreement on which entities will currently be subject to reporting under IFRS. The province maintains its commitment to working with standard setting bodies and the Canadian financial community to address these uncertainties in a timely manner.

In his opinion on the 2007/08 Public Accounts, the Auditor General identified seven areas of reservation which are outlined in this report. While we disagreed with the Auditor General's recommended changes in the application of GAAP for these long standing policies or practices, we remain committed to further review of these suggestions with our colleagues in other jurisdictions, standard setting bodies, and the accounting profession. Our objective is to ensure that public sector accounting standards and practices continue to evolve to meet the needs of the users of financial statements and remain generally accepted by practitioners in a majority of jurisdictions in Canada. Accounting relies very heavily on the use of professional judgement to determine what standards should apply to specific transactions or how information is best disclosed to inform the users of financial statements. Even though we may not agree on the application of accounting standards in every situation, we remain collectively committed to the ongoing study and debate required to resolve differences in professional judgement. We thank the Auditor General for the suggestions provided.

In this report, the Auditor General outlines seven areas of reservation where we did not agree on the application of accounting standards.

1. Resource Roads—scope limitation

The BC Timber Sales Program adopted a policy of recording, as a non-financial asset, the costs of road building, timber development, and marketing. In his 1999/00 Report on the Public Accounts, the Auditor General concurred with this accounting treatment. During the 2007/08 year-end process, the Auditor General recommended that these investments in resource roads under the BC Timber Sales Program should be reported as tangible capital assets instead of prepaid program costs, another category of non-financial asset, and provided an estimate of the financial change required for past and future years. While we agreed that recording these amounts as tangible capital assets was consistent with our current stated accounting policies, Ministry experts disagreed with the analysis of the Office of the Auditor General in developing their estimate.

The total cost of investments in these roads was known for each year but because they had not been capitalized in the past, the information was not available to determine how much of that annual cost should be attributed to roads with an expected useful life of 5 years, 10 years, or longer. Using their assessment of resource roads at March 31, 2008, Ministry experts estimated the most likely impact of capitalizing road costs since the inception of the program and provided their estimates and supporting rationale to the Auditor General. The basis of estimation and measurement uncertainty associated with it was disclosed in the Public Accounts under Changes in Accounting Treatment as required by accounting standards. In the absence of reliable information, which was not required, anticipated, or collected at the time transactions were entered into, the Auditor General included a scope limitation in the audit opinion.

2. Separate disclosure of liabilities related to leased tangible capital assets

Recommendation 1 — We recommend that government include liabilities related to leased tangible capital assets as a separate line on the statement of financial position, and include the additional note disclosure as required by Canadian public sector accounting standards.

Liabilities related to leased tangible capital assets totalled $310 million in the 2007/08 Public Accounts, approximately 1% of Taxpayer Supported Debt totalling $28,537 million. We disclose this amount in a footnote to the table on Taxpayer Supported Debt and believe the amounts are appropriately disclosed considering their materiality (1%), given the highly aggregated nature of the Summary Financial Statements. Collecting the additional information for a large number of minor lease arrangements from across the reporting entity would result in additional cost and time in the reporting process, which we believe is not justified by the incidental nature of these lease arrangements.

Response from the Ministry of Finance

Under the heading of "Significance and Judgement", public sector accounting standards acknowledge that they are not intended to apply to immaterial or insignificant items, and that there is no substitute for professional judgement in determining what constitutes fair presentation or good practice in a particular case. We do agree that the obligations arising from lease arrangements are properly recorded as liabilities, and that the presentation and disclosure of lease liabilities should change if the amount becomes material or significant in the future.

3. Separate disclosure for land used for highways

Recommendation 2 — We recommend that land used for highways be included in the "land and land improvements" category as required by Canadian public sector accounting standards, instead of the "highway infrastructure" category.

The Office of the Auditor General recommended in its 1995/96 and 1996/97 Report on the Public Accounts that government should determine the costs of the Province's highway system, including any land acquired for highway construction. These amounts were capitalized as highway infrastructure in the 1999/00 Public Accounts and have been reported consistently on that basis in subsequent years. We agree that if the land component of highway infrastructure can be separately valued with a satisfactory degree of reliability, and if any other considerations that led to the initial combination of these amounts are no longer significant, it may be more appropriate to disclose the cost of highway rights of way in a different asset class. We were unable to address this recommendation in the 2007/08 Public Accounts because the issue was identified very late in the year end process.

4. Oil and natural gas producers' royalty credits

Recommendation 3 — We recommend that the government record royalty revenues on a gross basis as required by Canadian public sector accounting standards.

Royalty revenues have been reported net of allowable deductions in the calculation of royalties' payable since the inception of these programs. Allowable deductions are part of the pricing mechanism laid out in the legislation and regulations that determine how much royalty is payable. In cases where it is more expensive for producers to access the resource, the royalty rate must reflect that additional cost or it will be uneconomical for operators and no royalty revenue will be earned. In no situation would the amount of allowable deductions be received by the province.

All jurisdictions in Canada that have oil and gas exploration programs establish pricing mechanisms for royalties using allowable deductions to recognize the different costs related to specific situations. In every jurisdiction royalties are reported net of those allowable deductions. It is generally accepted that revenue should be recognized when it has been earned and it is either realized or realizable. Amounts such as, allowable deductions in the pricing of a royalty will never be realized, therefore, we believe they should not be recorded as revenue. Recording these amounts as revenue would imply that the revenue is available to service debt or for increased program spending and since the revenue will never be received, that is not the case.

The amount of allowable deductions to royalties is disclosed in footnote 2 of the Schedule of Net Revenue by Source, included in the 2007/08 Public Accounts.

5. Provision for deep well credits

Recommendation 4 — We recommend that the government accrue a liability for the deep well credits as they are earned by the oil and gas producers, as required by Canadian public sector accounting standards.

Regulation provides for an allowable deduction on the royalties payable if the well is deeper than 2500 meters. The deduction is calculated based on the depth of the well and can be calculated when the well is drilled, even though the royalties will be payable only when the well produces which could be in future accounting periods. Because the deduction is only relevant in the calculation of royalties attributable to a specific well when they occur, there is no amount payable to the producer at the financial statement date. Recording an amount payable related to the costs incurred by the producer would not be appropriate because the costs are not refundable; the only provision is for a deduction in the calculation of future royalty revenues.

Recording a liability for allowable deductions arising from deep wells would require an expense to be recorded in the current fiscal year and result in inflated revenues recorded in a subsequent fiscal year.

6. Disclosure of First Nation loan guarantee amounts

Recommendation 5 — We recommend that government disclose the amount of all loan guarantees as required by Canadian public sector accounting standards.

The Province entered into a cost sharing agreement with the federal government in 1993 respecting the sharing of pre-treaty costs, settlement costs, implementation costs and the costs of self-government. Under this agreement, Canada provides loans to First Nations for participation in negotiations which will be repaid out of settlement, the cost of which is shared equally between the province and Canada. To be equitable, the agreement requires that in the event of a default, the province must reimburse Canada for its equal share of the loan amount. It is unlikely that there will ever be a default because Canada has a number of mechanisms available to ensure the terms of the loan are satisfied.

We disclose the existence and nature of this commitment to Canada under the cost sharing agreement in the contingent liabilities note included in the public accounts and advise that the amount of any liability is not determinable at this time. We have not included this amount in guaranteed debt because, unlike other loan guarantees between the Province and third party borrowers, there is in this case no guarantee arrangement between the Province and First Nations. The agreement is a cost sharing arrangement between two participating governments in support of broader program objectives.

7. Failure to recognize a portion of a First Nations settlement

The province does not control the GVRD and did not acquire title to the land that was transferred from GVRD to the Musqueam First Nation. In 1989, the GVRD accepted title to these lands from the province, without charge, so that it could create the Pacific Spirit Park. To allow the transfer to take place, the GVRD filed an affidavit with the BC Court of Appeal acknowledging the existing rights and claim of the Musqueam First Nation. The transfer of land from the GVRD to the Musqueam First Nation was a culmination of that acknowledged responsibility.

Because the transaction was between the GVRD and Musqueam First Nation, we did not create a transaction for inclusion in the Province's financial statements.

In his report, the Auditor General also identifies other issues that did not form part of his audit opinion but are significant.

8. Government needs to review accounting for First Nations settlement costs

Recommendation 6 — We recommend that government review current accounting policy and guidance to ensure it adequately addresses how to measure, and when to recognize, the unique nature of First Nations settlement transactions in the Summary Financial Statements.

We agree with the Auditor General's recommendation and over the past year have worked with experts in government and other jurisdictions to define the appropriate accounting for First Nations settlement transactions. As noted by the Auditor General, this is a challenging area of accounting as there is no formal guidance in national or international accounting standards and the substance of transactions involving aboriginal rights and title is unique.

9. Accounting for, and recognition of, inherited Crown land revaluations

Recommendation 7 — We recommend that when inherited Crown land is valued, the change in value be credited directly to accumulated surplus/(deficit) and not to revenue.

Recommendation 8 — We recommend that Crown lands be recognized in government's financial statements once the lands have been identified and valued.

Recommendation 9 — We recommend that government review their policy to ensure a consistent and appropriate valuation method is used when recognizing inherited Crown lands.

We disagree with the Auditor General's recommendation. Current public sector accounting standards recommend that Crown land should not be given accounting recognition as assets.

PS1000.55 When natural resources and Crown lands have been inherited by the government in right of the Crown and have not been purchased, they are not given accounting recognition as assets in government financial statements. These items are not recognized as assets because the costs, benefits, and economic value of such items cannot be reasonably and verifiably quantified using existing methods.

When a parcel of land is identified for transfer to a third party, circumstances have changed, the land is surveyed, and an estimate of its value can be made. Accounting standards define this as a change in estimate and require the change to be recorded on the prospective basis, meaning that both the write up in value and the cost of the transfer be recorded in revenue and expense in the current year. All jurisdictions in Canada that transfer Crown land follow this practice.

When the status of Crown land changes through conversion to some other use, or through a transfer to a third party, the value of land should be recognized in the financial statements. We agree the best available method of estimating the value of land should be used when it is appropriate to do so.

10. Disclosure of contractual obligations

Recommendation 10 — We recommend that government disclose contractual obligations for operating expenditures and capital expenditures separately on a comparative basis, and include a summary description of the nature of the expenditures.

We currently fulfill the requirements of GAAP in disclosing contractual obligations in our financial statements.

Contractual obligations are estimates of future payments under agreements which may include capital or operating elements or in some cases, both. Because the disclosure is of future payment obligations rather than future expense recognition, we believe it would be inconsistent with the way all other information in the financial statements is presented to represent them as separate capital and operating obligations.

Also, given the highly aggregated nature of the Summary financial statements, it would not be possible to provide interested users with sufficient information on the broad range of obligations across the Government Reporting Entity. Interested parties would be better served by examining the detailed disclosure in the financial statements of the Crown agencies reporting the obligations.

Recommendation 11 — We recommend that the significance of contractual obligations be assessed only after information on all entities' contractual obligations have been collected.

We do not believe it is practical to collect data on every long term contract that each of the 175 organizations in the Government Reporting Entity enters into. We have established a materiality level to ensure that each organization with single contracts or groups of similar contracts, totalling $50 million or more over the life of the contract, are included in the Contractual Obligations note. We believe this is a practical and appropriate level of materiality for the disclosure of estimates of future obligations and will continue to use professional judgement to ensure material and significant future obligations are disclosed.

11. Segmented reporting disclosure

Recommendation 12 — We recommend that the method of significant allocations to segments and the basis of pricing inter-segment transfers be disclosed in the Summary Financial Statements.

We agree with the recommendation but note that we do not make significant allocations to sectors or inter sector transfers.

Recommendation 13 — We recommend that disclosure of the nature of the segments be generic enough to apply to all aspects of the segment reporting schedules.

We agree with the recommendation.

Recommendation 14 — We recommend that a description of the debt servicing function be included in the significant accounting policies note, and that the description of the Other function be amended to better reflect its nature.

We believe that "debt servicing" is self explanatory, and that the "other" function is clearly described.

Response from the Ministry of Finance

Recommendation 15 — We recommend that government, in continuing to adopt best disclosure practices, produce detailed sector schedules in the Summary Financial Statements.

We do not agree that additional schedules of segment information would be significantly beneficial to users of the financial statements or that the benefits would exceed the time and cost required to prepare these schedules.

In his report, the Auditor General has provided overall comments on issues identified in 142 separate management letters to government and other government organizations included in the Summary Financial Statements. The management letters prepared for non-CRF organizations are a formal communication, from the auditor to the audit committee or governing board, that identify areas where management and governance practices, including internal controls, can be improved. In the case of the CRF, each ministry receives a management letter with findings on ministry processes and controls, and the Comptroller General receives a management letter with findings related to the Summary Financial Statement reporting process, governments accounting and financial management policies. Although the management letter findings are not material to the financial statements, government organizations do follow-up on the recommendations as the advice provided supports the ongoing efforts of government organizations to maintain effective governance, financial management and financial reporting processes.

Although the specific management letter findings only relate to individual organizations, they identify issues that are important to all government organizations. Each organization is responsible for responding directly to their auditor on actions taken or planned in response to specific recommendations. The issues will also be reviewed from a government reporting entity perspective as part of our ongoing effort to improve financial management and governance practices.

We believe the 2007/08 Public Accounts once again demonstrates government's commitment to transparent and accountable financial reporting that meets the information needs of our users. We thank the Office of the Auditor General for its continuing support in meeting this objective.

Cheryl Wenezenki-Yolland
Comptroller General

Detailed Report

Introduction

Purpose of the report

The purpose of this report is to inform Members of the Legislative Assembly and the public about the Auditor General's opinion on the Summary Financial Statements and the more significant audit findings from the work of our Office and of the private sector firms that audited the organizations consolidated in the 2007/08 Summary Financial Statements. At the same time, we hope the report encourages government to improve practices in the areas we have highlighted.

The Public Accounts is the main publication used by government to report annually on its financial performance. The main focus of the document is the Summary Financial Statements on which the Auditor General provides an audit opinion. Providing this opinion constitutes the most significant portion of the work the Office does to meet its mandate.

We have produced this report annually for a number of years. Our aim is to comment on the quality of the provincial government's financial reporting and to assist it in meeting its stated commitment to improving that reporting. We do this by noting where changes would enhance the quality of its financial reporting. We also make note of future changes in significant accounting standards that will affect the Summary Financial Statements.

Changes from last year

For the first time this year, we expanded this report from its previous focus on financial disclosure to also include a broader range of areas, including governance and financial management. We plan to continue with this approach, broadening the range of issues we address in future reports.

We have gathered issues and recommendations from the audit of all government organizations, and have highlighted some of the themes in this report.

Introduction

Background of the report

As an independent Officer of the Legislature, the Auditor General reports on, and provides recommendations to improve government's financial management and accountability practices. Our annual audit of the Summary Financial Statements of the Province of British Columbia is a significant focus of our Office.

The audited Summary Financial Statements are included in government's Public Accounts (and are available online at: http://www.fin.gov.bc.ca/ocg/pa/07_08/pa07_08.htm). The Public Accounts also include unaudited information, such as government's discussion and analysis of its financial results, and information about the Consolidated Revenue Fund.

This report is based on the result of audit work done between August 2007 and July 2008 by about 70 staff and contractors of our Office on the audit of the Summary Financial Statements. It is also based on the result of the audit work done by the Office and many private sector accounting firms on the government organizations that are included in the government reporting entity.

How best practices are determined

Many government transactions involve significant amounts of money, and can be highly complex to properly account for. It is therefore essential that the accounting policies chosen to record and report those transactions be the best ones for making the financial information understandable and conveying the substance of what actually happened. Accounting and reporting standards exist specifically for the public sector, but deciding which standards are most appropriate for a given situation often requires significant analysis and professional judgement.

In Canada, accounting standards for governments are issued by the Public Sector Accounting Board (PSAB) of the Canadian Institute of Chartered Accountants (CICA). Further guidance exists in the accounting standards issued by the Accounting Standards Board of the CICA for publicly-traded and privately-owned companies. Together, these standards are referred to as Canadian generally accepted accounting principles (GAAP). In British Columbia, the Budget Transparency and Accountability Act requires government to follow GAAP in budgeting, accounting, and the preparation of its Summary Financial Statements.

In situations not specifically covered by Canadian GAAP, guidance on appropriate accounting policies can be obtained from standards issued by bodies empowered to do so in other jurisdictions.[1] However, when a Canadian jurisdiction looks to other sources of GAAP, it must be sure to choose policies that are consistent with this country's GAAP, including PSAB and its conceptual framework for accounting standards.

According to PSAB, the accounting policies chosen should result in financial statements that:

- provide an accounting of the full nature and extent of the financial affairs and resources that government controls, including those related to the activities of its agencies and enterprises;
- describe government's financial position in a way that is useful for evaluating government's ability to finance its activities, meet its liabilities and commitments and provide future services;
- describe the changes in government's financial position, showing the sources, allocation and consumption of government's resources, how government's activities affected its net debt and how government financed its activities; and
- demonstrate the accountability of government for the resources, obligations and financial affairs for which it is responsible.

Government is obligated to ensure that its financial statements properly present the operating results and financial position of the whole of government. Adopting best practices in financial accounting and reporting helps government fulfill this important responsibility effectively.

[1] Examples include the Government Accounting Standards Board and Financial Accounting Standards Board in the U.S., as well as the International Accounting Standards Board.

Introduction

Composition of and auditing the government reporting entity

The Summary Financial Statements as at March 31, 2008, are a consolidation of 148 government entities (Exhibit 1), plus the Consolidated Revenue Fund which is composed of 19 ministries and 8 Officers of the Legislature. All of these together make up the "government reporting entity"— and sets the scene for a very large and complicated accounting and audit process.

Exhibit 1

Government entities, by type, in the government reporting entity

Entity type	Number of entities
Colleges	21
School districts	60
Universities	6
Health authorities	6
Hospital societies	10
Regional authorities	3
Crown corporations	41
Other organizations	1
Total	148

Source: Derived from the reporting entity schedule in the 2007/08 Summary Financial Statements.

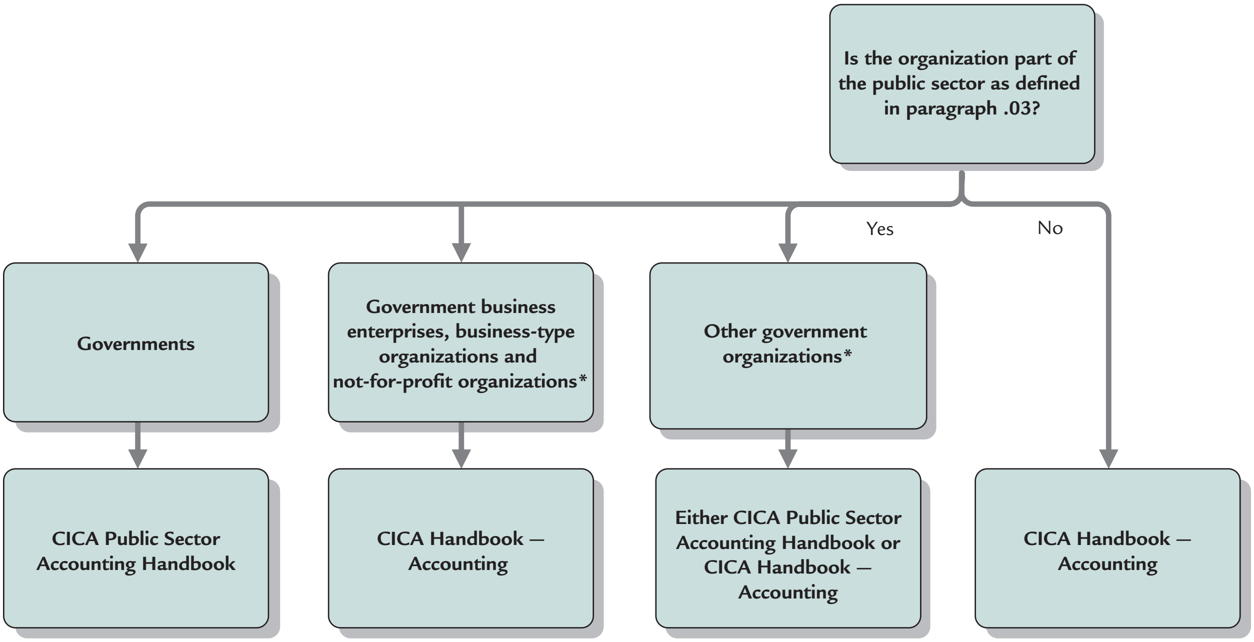
Government's financial reporting framework

Under British Columbia law, the Province's financial statements must be publicly reported in accordance with Canadian GAAP.

In the public sector, entities can report their financial results using either PSAB standards or those issued by the CICA for private sector entities. The PSAB standards require entities to use selection criteria to determine which GAAP basis of reporting they must follow in recording their financial activity and preparing their financial statements (Exhibit 2).

Exhibit 2

Canadian GAAP basis for preparing public sector financial statements



* PSAB reserves the right to recommend additional or different information to meet the special circumstances of government organizations.

Paragraph .03 states: "For purposes of applying these standards, "public sector" refers to federal, provincial, territorial and local governments, government organizations, government partnerships and school boards."

Source: Introduction to Public Sector Accounting Standards

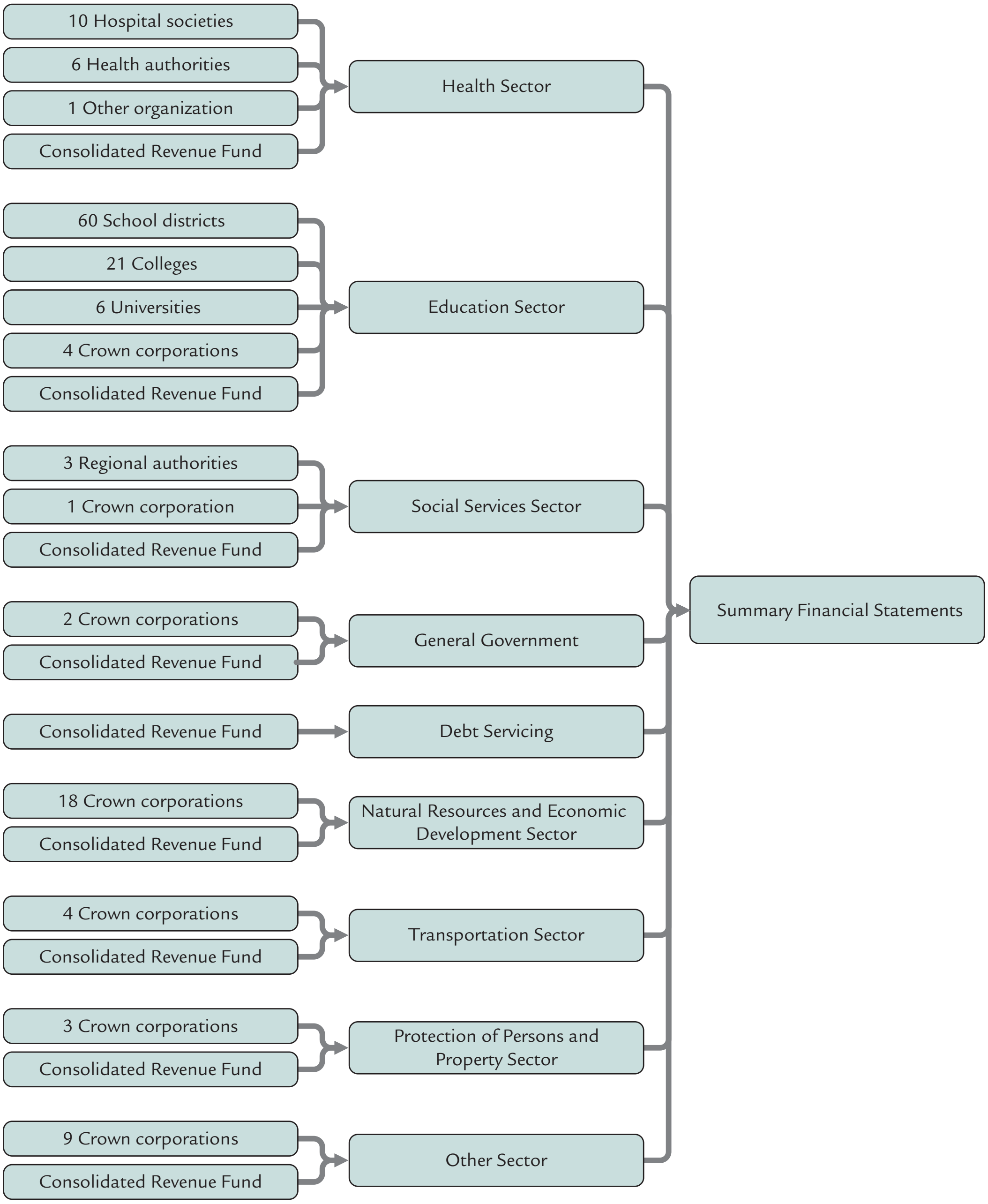
The audit process

Each government entity is required to prepare annual financial statements, which must then be audited by either the Auditor General or another audit firm (see Appendix C). The 148 audited financial statements are combined with the audited accounts of the Consolidated Revenue Fund to create the consolidated Summary Financial Statements which the Auditor General audits and provides an audit opinion on.

Exhibit 3 shows how all the 148 government entities are grouped into sectors of similar business activity and are consolidated into the Summary Financial Statements.

Exhibit 3

Consolidation of government organizations into the Summary Financial Statements



Note: See Appendix C for breakdown of sector by government organization.

Source: Derived from the reporting entity schedule in the 2007/08 Summary Financial Statements.

Introduction

How we audit the Summary Financial Statements

The Auditor General, in accordance with the Auditor General Act, must report each year in accordance with Canadian generally accepted auditing standards (GAAS) to the Legislative Assembly on the Summary Financial Statements.

To meet GAAS, the Auditor General prepares a financial statement audit coverage plan (this annual plan can be found on our website at: www.bcauditor.com). The plan is prepared for review and approval by the Select Standing Committee on the Public Accounts, and is designed to ensure the Auditor General maintains sufficient audit coverage related to the audit of the Summary Financial Statements.

A foundation of the plan is the GAAS requirement that auditors must have sufficient knowledge and understanding of the operations of the entities they audit, including any entities that are consolidated in the financial statements being audited. The auditors must also be able to determine whether the information contained in the consolidated financial statements is complete and has been fairly presented.

Knowledge can be obtained by directly auditing individual entities or by developing an audit plan that relies on the work of other auditors who have been appointed to audit the individual entities that will be consolidated. The degree of reliance will vary depending on the assessed business risks of each entity.

As the Auditor General need not directly carry out the audits of all government entities in the Summary Financial Statements, the plan is developed to ensure that the Auditor General's direct audit coverage is broad enough to allow a sufficient depth of involvement in significant issues in government entities and across sectors. It also allows the Auditor General to provide, through varying levels of staff involvement with the audits, a government-wide perspective on significant accounting issues in government entities and across sectors.

Since many government entities are audited by private sector auditors, the Auditor General is able to express an opinion on the Summary Financial Statements, through his reliance on their work.

To meet GAAS and ensure that those auditors have carried out sufficient and appropriate work to enable placing reliance on them, the Auditor General's staff get involved in planning, conducting and reporting of the audits, and communicating with the appointed auditors on the Auditor General's intended reliance on their work.

Summary Financial Statements

Reservations in the Auditor General's audit opinion on the 2007/08 Summary Financial Statements

An auditor's role in informing users of departures from Canadian GAAP

"Scope limitation" describes the circumstances where the auditor has been able to conduct the audit examination in accordance with GAAS, but has not been able to apply all the tests and procedures considered necessary in the circumstances. The result is that the auditor does not have sufficient, appropriate audit evidence to form an opinion as to whether the financial statements are presented fairly in accordance with Canadian GAAP. This situation may occur even though management of the entity being audited is satisfied with a particular matter. Because the auditor, however, is unable to perform a necessary audit procedure, he or she is therefore unable to either support or refute management's assertions.

An auditor must express a reservation of opinion if the financial statements are affected by a departure from GAAP, or if he or she is unable to obtain sufficient appropriate audit evidence to determine whether there has been a GAAP departure (this is usually referred to as a "scope limitation"; see sidebar).

A departure from GAAP may occur when the financial statements are prepared using an inappropriate accounting treatment, when there is an inappropriate valuation of an item in the financial statements or when there is a failure to disclose essential information or to present information in an appropriate manner. In any of these cases, the auditor's reporting objective is to inform the reader about a departure from GAAP that materially affects the financial statements. A reservation of opinion is the method of achieving this objective.

In considering whether a reservation is necessary, the auditor considers the materiality of the misstated items individually and in aggregate, in relation to the financial statements as a whole. A reservation would not be made for an immaterial misstatement.

A misstatement (or the aggregate of all misstatements) in the financial statements is considered to be material if, in the light of surrounding circumstances, it is probable that the decision of a person who is relying on the financial statements and who has a reasonable knowledge of business and economic activities will be changed or influenced by the misstatement.

As a result, when expressing a reservation, the auditor needs to explain clearly the change that would be needed so that users of the financial statements can assess for themselves what the impact would be.

An auditor is required to determine materiality based on his or her perception of the needs of users—but it is difficult to predict with certainty who those users will be or, indeed, even what the specific needs of the known users are. Consequently, the materiality decision ultimately becomes a matter for the auditor's professional judgement. Materiality is not a fine line where one dollar less is not material or one dollar more is material. Rather, it is an area between what is very likely not material and what is very likely material.

Making that determination of what is, and what is not material, also involves qualitative as well as quantitative considerations. Disclosing complete and appropriate information — that is, being open and transparent about the balances and transactions in the financial statements — is just as important as ensuring the precision of the numbers. Hence, an auditor may express a reservation on a lack of disclosure, something which will have no impact on the reported surplus or deficit in the financial statements.

The auditor works with management with the aim of being able to form an unqualified opinion, and reports to management on the items found that, in the auditor's view, need to be corrected. If material items are not corrected, the auditor expresses a reservation in the audit opinion. For items that are not material but also not corrected, the auditor totals them and if, at the end of the audit, those items are collectively determined to be material, then the auditor asks management to make further adjustments to reduce the total dollar amount of unadjusted items. If management makes no adjustment, that also causes the auditor to express a reservation in the audit opinion.

Audit adjustments and reservations

In our audit of the Summary Financial Statements for the year ending March 31, 2008, we discussed a number of significant issues with government, many of which were resolved satisfactorily. More than 50 monetary adjustments to the Summary Financial Statements were made at our request, and a further 12 adjustments were made to what was disclosed in the notes and schedules in the financial statements.

However, government chose not to adjust a number of other items in the financial statements and notes. The Auditor General therefore expressed six reservations in his audit opinion for departures from Canadian GAAP.

For one material balance in the Summary Financial Statements, we were not able to obtain sufficient, appropriate audit evidence to determine the reasonableness of government's estimate, although government was satisfied with the amount. This resulted in the Auditor General making a seventh audit reservation — a "scope limitation" (see sidebar).

The audit reservations are explained in more detail in the following sections. Their effect on the statement of financial position and the results of operations is shown in Exhibit 4.

Exhibit 4

Impact of the Auditor General's audit reservations on the March 31, 2008, Summary Financial Statements

	As reported	Audit adjustment required ($ millions)	As corrected
Financial assets	$ 29,642	$ 175	$ 29,817
Liabilities	51,925	234	52,159
Net assets (liabilities)	(22,283)	(59)	(22,342)
Non-financial assets	29,734	Unknown[1]	29,734
Accumulated surplus (deficit)	$ 7,451	$ (59)	$ 7,392
Revenue	$ 39,831	$ 620	$ 40,451
Expense	36,945	679	37,624
Surplus (deficit) for the year	$ 2,886	$ (59)	$ 2,827

Note 1: As this was a limitation of scope, we were unable to determine whether an adjustment was required.

1. Resource roads — limitation on the scope of our audit

This year, government completed an assessment of its resource roads and valued and capitalized those roads that it considered appropriate. We agreed with the assessment of which roads should be capitalized.

However, information which we needed in order to audit some of the amounts reported was not available at year end. Because the amounts were material, we reported this fact in our audit opinion as a scope limitation.

Construction of these roads began in 1988 as part of government's Small Business Forest Enterprise Program (since re-organized as the BC Timber Sales program). The types of roads built vary by life expectancy: 5, 10 and 40 years.

Capitalizing these roads in the financial statements means recording the cost as an asset in the year the road is built, and then amortizing that cost over the expected life of the road. Both the original cost and the accumulated amortization should be disclosed in the financial statements. In the case of the Summary Financial Statements, these amounts are disclosed by major category in a schedule at the back. The total cost less the accumulated amortization of tangible capital assets — also known as the net book value — is shown on the statement of financial position. Thus, a road with an expected life of 10 years that was built 6 years ago would have its cost and 6 years of amortization included in the schedules of cost and accumulated amortization, and would be included in the total net book value of tangible capital assets on the statement of financial position at 40% of its original cost.

While $634 million has been spent on these roads since 1988, information detailing how much was spent each year was only available to us going back to 1993. As well, what is not known accurately is how that cost should be allocated between the 5-year, 10-year and 40-year roads. That information is available for the most recent year, but since the allocation between 5-year, 10-year and 40-year roads can vary significantly from one year to another, it is not a matter of simply applying the current data to earlier years.

Knowing this allocation is important for calculating the net book value of the roads at March 31, 2008. Management has made an estimate and recorded a net book value of $294 million. However, we were unable to obtain adequate audit evidence in the time available to satisfy ourselves that the amount was correct.

Our plan in the coming year is to work with the Ministry of Forests and Range and to visit BC Timber Sales offices to determine if their records will provide sufficient, appropriate information to adequately support an estimate of the net book value of the roads.

2. Separate disclosure of liabilities related to leased tangible capital assets

As required by PSAB, liabilities related to leased tangible capital assets must be disclosed separately on the statement of financial position. As well, the notes to the financial statements should disclose particulars of liabilities related to leased tangible capital assets (including interest rates and expiry dates) separately from other long-term liabilities. Significant conditions of the lease agreement must also be disclosed, including future contractual obligations, purchase options, terms of renewal and contingencies and circumstances that require or result in the government's continuing involvement in the contractual arrangement.

In the financial statements, we found that government does not disclose the liabilities related to leased tangible capital assets on a separate line on the statement of financial position, although it collects this information. Neither does it disclose any particulars of the liability (information which would be required to be collected). The only disclosure is given in footnote 3 to note 17, which states the amount only.

We believe that the amounts involved are material, and that this is useful information that should be disclosed for the users of the financial statements. Therefore, we asked government to show these liabilities separately on the statement of financial position and to include appropriate disclosure in the notes as required by PSAB. Government chose not to do so. We therefore included a reservation in our opinion concerning the lack of required disclosure.

The amount disclosed by the government in footnote 3 of note 17 is $310 million ($281 million for the prior year). This amount includes liabilities related to the Sierra Yoyo Desan Road, which we believe should be classified as public-private partnership (P3) obligations. Hence, our audit opinion refers to the lack of disclosure of $277 million ($246 million for the prior year) in lease liabilities.

Recommendation 1

We recommend that government include liabilities related to leased tangible capital assets as a separate line on the statement of financial position, and include the additional note disclosure as required by Canadian public sector accounting standards.

3. Separate disclosure for land used for highways

For tangible capital assets, PSAB requires that financial statements disclose particulars of: the cost at the beginning and end of the year; additions, disposals and write-downs during the year; the useful life of the asset; the amortization charged during the year; the accumulated amortization at the beginning and end of the year; and the net book value at the beginning and end of the year. Furthermore, PSAB requires that this detail be disclosed for each major category of tangible capital asset, and that major categories be determined by type of asset, such as land, buildings, equipment, roads, water and other utility systems and bridges.

The government discloses this information in the consolidated statement of tangible capital assets on page 90 of the Summary Financial Statements.

We noted that land used for highways, with a total cost of just over $1 billion, was included in the "highway infrastructure" category and had been in that category ever since highways were first capitalized in 2000. Although we asked for the amount to be moved into the "land and land improvements" category, government instead added a comment (in note 21) that highway infrastructure included right-of-ways.

In our view, this is not sufficient because it does not disclose the amount, over $1 billion of land, included in the highway infrastructure category. As well, the way the comment was inserted implied that the right-of-ways have a useful life of between 5 and 40 years, but land—which is what the right-of-ways are—has an indefinite useful life. As this is a material error, we included a reservation in our opinion about the land being included in highway infrastructure and about the implication of it having a useful life of 5-40 years.

Recommendation 2

We recommend that land used for highways be included in the "land and land improvements" category as required by Canadian public sector accounting standards, instead of the "highway infrastructure" category.

Findings for 2007/08

4. Oil and natural gas producers' royalty credits

The government provides incentives to oil and natural gas producers through programs that provide credits for road construction, summer drilling and deep drilling and that induce activity in marginal, ultra marginal and low production wells.

These incentives, $445 million in 2007/08, are being deducted from oil and gas royalty revenues in the Summary Financial Statements.

According to PSAB, financial statements should disclose the gross amounts of revenues, to ensure that the total magnitude is reflected in the financial statements. Such information is necessary for understanding and assessing the financial impact of a government's revenue-raising capability and for enhancing legislative control.

Similarly, financial statements should disclose the gross amounts of expenses so that the total magnitude of a government's consumption or reduction of economic resources in the period is reflected in the financial statements. Such information is helpful in understanding and assessing the cost of government services, programs and, in this case, incentives.

Although PSAB allows credits to be deducted from taxes, we think the royalties are in the nature of an exchange transaction revenue rather than a non-exchange transaction of taxes, given that the producers are paying for the extraction of the oil and gas public assets. It is, therefore, our view that the credits deducted from the royalties should be grossed up instead of being deducted from revenues.

We asked government to increase revenues and expenses by $445 million each, but it declined to do so. Instead it disclosed oil and gas royalty revenues net of deductions, and the amount of the deductions, in the unaudited Consolidated Revenue Fund Schedule of Net Revenue by Source (on page 107 of the Public Accounts). This approach was not acceptable because the disclosure was outside the audited Summary Financial Statements. Since government did not make the adjustment and the amount is material, we included a reservation in our opinion about the amounts being netted.

Recommendation 3

We recommend that government record royalty revenues on a gross basis as required by Canadian public sector accounting standards.

5. Provision for deep-well credits

Deep-well credits are earned by oil and gas producers when they drill a well that qualifies as a deep-well. The producers notify government of the depth of the well that has been drilled, and government calculates the credit earned as a result. Government also keeps a record of the amount of the credit for each well. When production starts, government calculates a monthly amount of royalty otherwise payable on the production from that well, and applies the credits earned to reduce the royalty. The remaining credits are carried forward to be applied against future production royalties (payable monthly) from that well. The total amount of earned and unclaimed credits at March 31, 2008, was $59 million.

PSAB requires that liabilities be recorded when they are incurred. In our opinion, a liability exists once the producer has drilled the well, although government will not know about it until a return notifying government of the deep-well drilling has been filed. At that point, government cannot avoid paying the credit (by allowing it to be deducted from the future royalty payments). Although there is some uncertainty about when government will have to act on the liability, its existence is clear.

On its own, this amount was not significant enough for us to include a qualification in our audit opinion. However, the total amount of unadjusted differences, including this amount, exceeded our materiality limit. We therefore asked government to record this $59 million liability to reduce the amount of unadjusted differences. Government chose not to do this and so we included the matter as a reservation in our audit opinion.

Recommendation 4

We recommend that government accrue a liability for the deep-well credits as they are earned by the oil and gas producers, as required by Canadian public sector accounting standards.

Findings for 2007/08

6. Disclosure of First Nations loan guarantee amounts

The federal government has provided loans to First Nations to help them with the costs of treaty negotiations. It is intended that repayment of the loans will be made out of the treaty settlement amounts. In the event that the loans are not repaid, the Province has committed to paying the federal government 50% of the amount loaned.

The provincial government has disclosed (in note 25(b)) that it has committed to reimbursing the federal government for 50% of the outstanding loans should any of these First Nations default, but it has not disclosed the amount of the loans ($343 million), as required by PSAB.

Government discloses the amount of other loan guarantees. We asked government to disclose the amount of this one as well, but it chose not to. We therefore included a reservation in our audit opinion.

Recommendation 5

We recommend that government disclose the amount of all loan guarantees as required by Canadian public sector accounting standards.

7. Failure to recognize a portion of a First Nations settlement

On March 11, 2008, the Province of British Columbia and the Musqueam Indian Band signed a Reconciliation, Settlement and Benefits Agreement, to settle three court cases and further the Province's relationship with First Nations.

The agreement involved transfers of land and cash to the Musqueam Indian Band. Included in the land transfers were portions of the Pacific Spirit Regional Park which was held in fee-simple title by the Greater Vancouver Regional District (GVRD).

To meet the government's obligations under the agreement, the Legislative Assembly passed Bill 12, the 2008 Musqueam Reconciliation, Settlement and Benefits Agreement Implementation Act. This legislation received royal assent on March 31, 2008, and so the amount involved — except for the Pacific Spirit park land — was accrued as a liability at the year end in the Summary Financial Statements, as required by PSAB. The actual transfers were completed shortly after year end.

The government maintained that because the Pacific Spirit park land was being transferred directly from the GVRD to the Musqueam Indian Band, it was not a provincial transaction and did not need to be recorded in the provincial financial statements. We pointed out, however, that the transfer arrangement is between the Province and the Musqueam Indian Band. The GVRD is not a party to the agreement. Accordingly, we believe that although the legal form of the transaction is the direct transfer as described by the government, the substance of the transaction is that the Province was obtaining the land from the GVRD and then transferring it to the Musqueam Indian Band to settle its obligation.

PSAB requires that accounting policies be chosen that result in the fair disclosure of financial information, and that one of the considerations in the choice must be the concept of substance over form. This concept has been followed in developing accounting policies for recording transfers received from the federal government, following PSAB requirements that such transfers should be accounted for in a manner that best reflects the substance of the underlying events rather than the form or funding pattern. This approach is used by government for accounting for federal revenue transfers and we believe that the same approach—substance over form—should be used in accounting for the transfer of the land to the Musqueam Indian Band.

Because the substance of the transfer of the Pacific Spirit park land is a transfer from the GVRD to the Province, and then from the Province to the Musqueam Indian Band, we believed that the government should record this transaction in its financial statements, in accordance with PSAB requirements.

Government chose not to record the transaction. Because the amount, $175 million, is material, we therefore included a reservation in our audit opinion. If the transaction had been recorded, government would show revenue and an asset (land) of $175 million for the receipt of the land from the GVRD, and a grant expense and an amount payable of $175 million for the liability for the transfer of the land to the Musqueam Indian band.

Other significant issues

Two other matters related to the Summary Financial Statements also, in our view, should be addressed. We believe that government needs to fully analyze its accounting for First Nations settlements; and we disagree with the accounting treatment that government uses for recording inherited Crown land transactions.

For 2007/08, we did not consider the potential impact on Financial Statement users was sufficient enough to include a reservation in our opinion. However, it is possible that the amounts involved might be material in the future.

8. Government needs to review accounting for First Nations settlement costs

The Six-Stage Treaty Process of the British Columbia Treaty Commission Agreement

Stage 1 – Statement of intent to negotiate

Stage 2 – Readiness to negotiate

Stage 3 – Negotiation of a framework agreement

Stage 4 – Negotiation of an agreement in principle

Stage 5 – Negotiation to finalize a treaty

Stage 6 – Implementation of the treaty

Source: Ministry of Aboriginal Relations and Reconciliation website.

Treaty negotiations between the Province, Canada and First Nations have been ongoing since the BC Treaty Process was established in 1992. Treaty negotiations are a multi-stage process (see sidebar) that culminates with the implementation of a treaty that defines the unique rights of First Nations (as protected under the Canadian Constitution) and, effectively, settles outstanding aboriginal land claims.

Stage 5 of the BC Treaty Process includes reaching a final agreement that embodies what was outlined in the agreement in principle (arrived at in stage 4) and formalizes the new relationship among the parties. Significant progress was made in fiscal 2007/08 with two Final Agreements, Tsawwassen and Maa-nulth, that are now proceeding through the ratification process. Once signed and formally ratified, the final agreement becomes a treaty.

In our report on the 2006/07 Public Accounts, we discussed the need for government to review its accounting policies for settlements with First Nations. While there has been significant discussion about specific transactions with First Nations, the government has not yet developed comprehensive accounting policies or guidance to address the unique nature of transactions related to First Nations' rights.

The most significant provincial component of Final Agreements currently undergoing ratification is inherited Crown land (the unique elements of Crown land transactions involving First Nations is discussed in the next section). There are many unique elements included in the Final Agreements that require government to assess the recognition, timing and valuation for these settlement costs. Given the current-year progress with two Final Agreements, we see an urgent need for government to address the accounting treatment for these transactions to ensure they are appropriately and accurately recorded in the government's financial statements in accordance with Canadian public sector accounting standards.

Recommendation 6

We recommend that government review current accounting policy and guidance to ensure it adequately addresses how to measure, and when to recognize, the unique nature of First Nations settlement transactions in the Summary Financial Statements.

9. Accounting for, and recognition of, inherited Crown land revaluations

Lands inherited by the Province of British Columbia (inherited from the former British Columbia Crown colony in 1871) are not given accounting recognition as land assets in the Summary Financial Statements because the costs, benefits and economic value of these inherited Crown lands cannot be reasonably quantified. Government's accounting policy is to capitalize these lands at a nominal value of $1.

From time to time, some of this land may be sold or given away as free Crown grants. When government decides to do this, measuring its value becomes possible because the land is being used to meet the needs of government for some form of transaction with a third party. Using this method, government values the land and recognizes its existence and its disposal in its financial statements.

The way in which government recognizes the existence of the land is to record revenue equal to the value of the land. When the land is given away as a grant, the government writes off the land, recording an expense. (If the land is sold, the land is written off as a cost of sale and the sale proceeds are recorded as revenue.) This accounting results in no net impact on the government's statement of operations since the expense recorded when the land is given away is offset by the revenue recorded when the land is recognized. This accounting portrays the government to be in no better or no worse position after having disposed of the Crown land.

In our opinion, the value of the land should be recognized in the government's financial statements as a credit to the accumulated surplus/(deficit) balance, and not as a credit to revenue.

Revenues (including gains) are defined by PSAB as increases in economic resources, either by way of increases of assets or decreases of liabilities, resulting from the operations, transactions and events of the accounting period. The government has not gained an asset by recognizing the Crown land: the land is already owned by the Province because it was inherited through the right of the Crown. Therefore, we do not agree that the recognition of Crown land can result in revenue (a gain) to the Province when there is no net change in government's economic position.

Recommendation 7

We recommend that when inherited Crown land is valued, the change in value be credited directly to accumulated surplus/(deficit) and not to revenue.

Government's decision to use Crown lands in a transaction may not occur simultaneously with government's actual disposal of the land—and it may not even occur in the same fiscal year. For example, land related to First Nations final agreement negotiations is often valued at a significantly earlier date than when the final agreement is reached.

We believe that Crown lands should be recorded in the financial statements once the lands have been identified for use in the transaction and have been valued.

Recommendation 8

We recommend that Crown lands be recognized in government's financial statements once the lands have been identified and valued.

Inherited Crown lands can be valued in a number of different ways. Some lands are valued using appraisals. Provincial rural Crown lands are valued based on a cost-sharing formula. Depending on the type of land, a cost may be determined before any formal survey or arm's length valuation is conducted. Therefore, it is important that the appropriate values be used when land is being recognized in government's financial statements as inventory for resale.

Recommendation 9

We recommend that government review their policy to ensure a consistent and appropriate valuation method is used when recognizing inherited Crown lands.

Being accountable and transparent

In its opening comments to the 2007/08 Public Accounts entitled *Leading the Way*, government states that "British Columbia is committed to leading practices in public sector reporting"; and that "the province continues to improve the Public Accounts in terms of their usefulness to readers … [and] … British Columbia continues to be a leader." It also refers to "British Columbia's open and transparent financial reporting".

We consider that, while the British Columbia government has a reputation across Canada as a leader in public sector financial reporting, it should continue striving to be a leader in being open and transparent. In the two sections below, we recommend ways in which government could be more transparent and demonstrate greater accountability to the citizens of British Columbia both in disclosure of contractual obligations and in segmented reporting in its Summary Financial Statements.

10. Disclosure of contractual obligations

Beginning with the 2005/06 Summary Financial Statements, government has been increasing the disclosure of its contractual obligations. A contractual obligation is a legally binding commitment government enters into, requiring it to make payments in future years. Examples are leases of buildings and equipment, contracts for services such as payroll, and various P3 agreements that government has entered into. Under Canadian GAAP, disclosure of significant contractual obligations is required, with details such as a description of the obligation's nature and the extent and timing of the related expenditures.

Government is meeting the minimum Canadian GAAP disclosure requirements with respect to disclosing the nature of contractual obligations by disclosing in the Summary Financial Statements the amount and which sector obligations relate to.

We believe, however, that government could improve its disclosure on contractual obligations in the Summary Financial

Statements by providing a comparative amount for the total column, segregating the obligations related to capital expenditures from those for operating expenditures, and adding summary descriptions of the significant components of each line item in the note.

Adding these further details would help readers understand the types of obligations government is committed to. As well, separating capital from operating commitments makes it easier to assess their respective impacts in future years.

For disclosure purposes, the Province has assessed "significant contractual obligations" to mean those over $50 million. We believe this threshold should be removed or at least reduced when government is gathering contractual obligation information from organizations. We note, for example, that individual obligations below $50 million from the 60 school districts are significant when totalled. In our view, only after all contractual obligation information has been gathered from all organizations should an assessment of significance for disclosure be made. Taking this approach would eliminate the risk of sizeable contractual obligations going unreported in the Summary Financial Statements.

Recommendation 10

We recommend that government disclose contractual obligations for operating expenditures and capital expenditures separately on a comparative basis, and include a summary description of the nature of the expenditures.

Recommendation 11

We recommend that the significance of contractual obligations be assessed only after information on all organizations' contractual obligations have been collected.

11. Segmented reporting disclosure

The purpose of producing functional consolidated sector information is to provide financial statement users with more detail and to make it easier for them to understand both the composition of the Summary Financial Statements as a whole and the relative size and financial results of each major part. Providing segmented information also:

- enhances the transparency of financial reporting; and

- helps users:
  - identify the resources allocated to support the major activities of government;
  - make more informed judgements about the government reporting entity and its major activities; and
  - better understand the manner in which the organizations in government are organized.

This year, for the first time, government was required to follow a new PSAB handbook standard on segmented reporting. The standard covers how to define and disclose segments in government's Summary Financial Statements.

To its credit, government has been disclosing some segmented information for a number of years, even though there has been no requirement to do so until this new standard was introduced.

For the fiscal year ending March 31, 2008, government presented its segmented reporting statements by sector in the schedules following the notes. It also disclosed the basis for identifying its segment disclosure, under its significant accounting policies note.

We have identified additional changes we believe are also necessary for government to fully comply with the new standard.

- The method of making significant allocations to segments and the basis of pricing inter-segment transfers should be disclosed.
- The significant accounting policies segment disclosure focuses on expenses rather than segments as a whole. The disclosure should be generic enough to apply to all components (assets, liabilities, revenues and expenses) disclosed under the segment reporting schedules in the Summary Financial Statements.
- The debt servicing segment included in sector schedules should be included in the significant accounting policies note.
- The description of the "other function" in the significant accounting policies note should include further detail, such as amounts related to housing and support for the Olympics.

Last fiscal year government's segmented information is broken down by financial statement line item for sectors such as health, education, social services and so on, which meets PSAB standards. However, producing supporting schedules to these sectors would make it easier for financial statement users to understand the finances of the separate sectors of government. For example, a schedule for the health sector would include the consolidation of the health authorities, hospital societies, related health Crown corporations and the Ministry of Health. We believe government should provide above-minimum disclosure to make financial statements more understandable to readers, and therefore encourage government to lead by example by producing detailed statements for each segment.

Recommendation 12

We recommend that the method of significant allocations to segments and the basis of pricing inter-segment transfers be disclosed in the Summary Financial Statements.

Recommendation 13

We recommend that disclosure of the nature of the segments be generic enough to apply to all aspects of the segment reporting schedules.

Recommendation 14

We recommend that a description of the debt servicing function be included in the significant accounting policies note, and that the description of the other function be amended to better reflect its nature.

Recommendation 15

We recommend that government, in continuing to adopt best disclosure practices, produce detailed sector schedules in the Summary Financial Statements.

Other Audit Findings

Management letters—a wealth of information

From August 2007 to July 2008, staff and contractors from our Office and from the many private sector accounting firms audited the financial information of government organizations that are included in the government reporting entity. In planning and performing each audit, consideration is given to an organization's internal control over financial disclosure, financial management, governance and accountability. Findings related to the risks identified are then brought to management's attention with recommendations, referred to as a management letter (it is a CICA standard that significant findings be communicated to management by the auditor). It is management's responsibility to weigh the costs of implementing recommended control improvements against the benefits that will be achieved, and to implement those recommendations it considers beneficial.

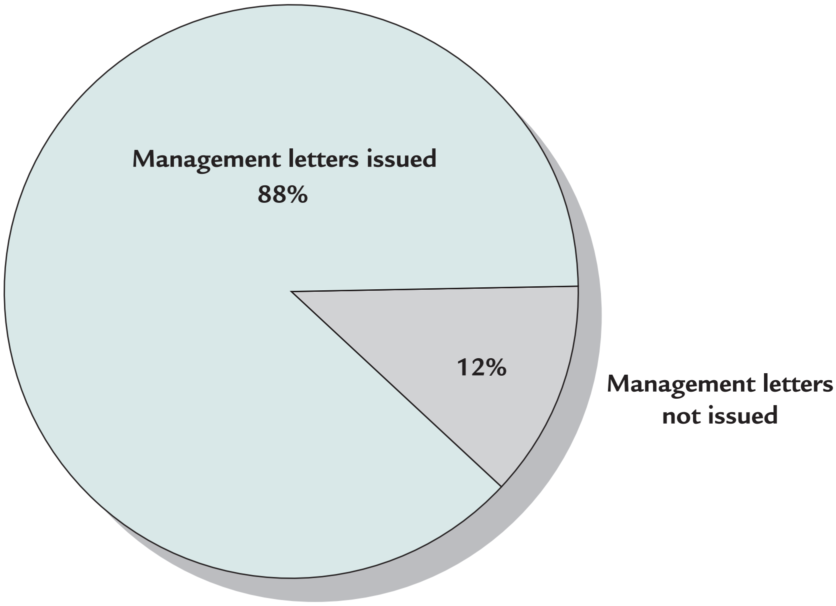
Government organizations

We expect management letters to be issued for all of the government entities (148 entities) in the government reporting entity, the 19 ministries, and the Office of the Comptroller General. However, the total number of management letters expected to be issued for 2007/08 is only 161 for a variety of reasons, including organization wind-up. Of those, 142 (88%) had been issued at the time of this report (Exhibit 5).

Findings for 2007/08

Exhibit 5

Management letters issued



Total number of management letters issued:	142
Total number of management letters not issued at the time of this report:	19
Total number of government organizations management letters expected:	161

Management letters not yet issued

Informing management about items identified during the financial statement audit is a by-product of the audit work. It is not part of the process of obtaining sufficient, appropriate audit evidence to support the content of the auditor's report on the financial statements. Consequently, management letters do not have to be released with the auditor's report on the financial statements.

It is a generally accepted practice for the auditor to present findings to the audit committee with management present. Only after this meeting will the auditor formally release the management letter. Delays may occur if this meeting takes place after the release of the financial statement audit opinion or if the audit committee does not meet during the summer. This explains why not all management letters of government reporting organizations had been released in time for us to review them for this report.

Findings for 2007/08

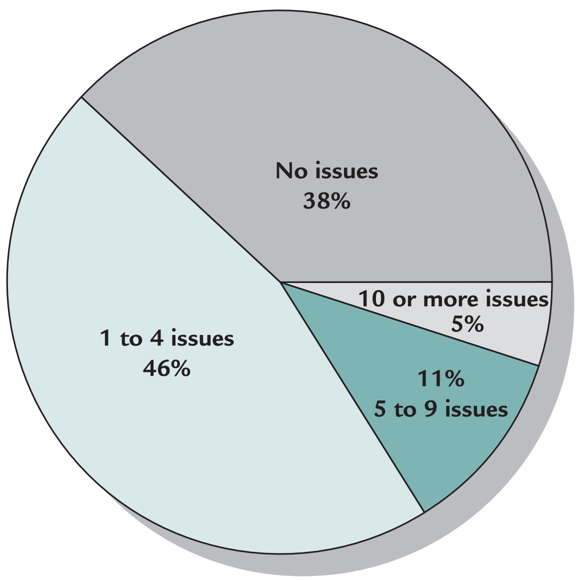
In 2008/09, we will continue to review all management letters issued. We expect all government organizations to have received their letters by early summer, in time to be included in this report. The findings presented in management letters are significant and we feel that they should be considered by management as soon as possible in the fiscal year to allow organizations to implement corrective measures where possible.

Management letter issues

Combined, the management letters so far issued include more than 350 issues and recommendations. These letters focus mainly on improving the areas of financial disclosure, governance and accountability, and financial management. We found that 84% of the 142 letters issued contained fewer than five issues. And of those, 54 (38%) contained no issues at all. Of the remaining 16% of letters, seven had 10 or more issues — and one had more than 25 (see Exhibit 6).

Exhibit 6

Number of management letter issues by organization



Government entities with:	
no management letter issues	54
1 to 4 management letter issues	65
5 to 9 management letter issues	16
10 or more management letter issues	7
Total number of management letters issued:	142

Findings for 2007/08

Because the audit process is not intended to disclose issues outside the financial statements process, although it may do so, each organization needs to be vigilant in conducting its own review of possible issues related to financial disclosure, governance and accountability and financial management. To help organizations identify potential risk areas, we summarize below major findings from the audits, highlighting those concerns that arose most often and have the greatest potential risk and impact. All government organizations should examine these findings with an eye to improving their own controls.

Financial disclosure findings

12. Capital asset policies

The management of each government entity is responsible for adopting reasonable accounting policies, in accordance with GAAP, and for applying them consistently, including those for capital assets. Capital assets include buildings, roads and other long-lived assets. Because of their significance in financial reporting, inappropriate capital asset accounting policies, or errors in the application of those policies, can lead to a considerable misstatement of an entity's financial condition.

There were instances in some government organizations where capital asset policies were inappropriate or insufficient. In other cases, policies were not applied consistently within the organization, or the values of capital assets were not being tracked appropriately. In some organizations, amortization policies were not in compliance with GAAP. And, on a number of occasions, accounting policies did not allow for the value of capital assets to be accurately reported in the financial statements, leading to a misstated cost of ownership of these assets.

Government organizations should ensure that additions and disposals of capital assets are adequately tracked and capital asset policies are in accordance with GAAP and consistently applied.

Findings for 2007/08

Governance and accountability findings

13. Governance practices

Governance refers to the structures and processes by which organizations are directed, controlled and held to account. These are supported by guiding core principles of accountability, leadership, integrity, stewardship and transparency. Good governance provides clear and ethical direction, anticipates risk, communicates effectively and gives and receives information on performance. Poor governance is at the heart of many public sector failures and may lead to the loss of public trust.

There are several issues that are limiting the ability of some government organizations to govern effectively. These include: policies that were not being reinforced or were missing; signed Conflict of Interest Statements that could not be found or understood; inappropriate quality assurance; inadequate internal audit functions; unclear roles and responsibilities; and incomplete financial controls.

To run effectively and efficiently, government organizations need to ensure that they have correct and complete policies, procedures and controls, and that they adhere to them. Clearly defined roles and responsibilities must also exist and be understood.

14. Assurance for use of service providers

Government sometimes uses third parties to provide some of its services. These arrangements give entities access to the expertise and experience of outside service providers. However, along with these advantages are risks, such as services not being performed well or not all revenue being collected or remitted.

Some organizations had not obtained adequate assurance from third parties they had service agreements with regarding the design, implementation and operating effectiveness of controls over the third party systems they rely on.

Government organizations need to regularly obtain assurance that third-party service providers have adequate controls and systems in place that would be expected when government itself is providing those services and using public resources.

Findings for 2007/08

Financial management findings

15. Documentation and communication of contracts

A government entity establishes contracts with outside parties in order to provide or receive specific services related to its day-to-day business activities. In the absence of complete and specific contract documentation, discrepancies can arise in the interpretation of terms of the agreement. These discrepancies can hinder business relationships, cause inefficiencies in the overall business operations of government and lead to legal disputes.

There were a number of issues related to inadequate contract documentation and communication within a number of government entities. Among these were the absence of contracts, as well as outdated, unclear and incomplete contract documentation.

Government organizations should ensure that adequate documentation and controls are in place when a contractual relationship exists between an entity and outside parties.

16. Understanding of management authorization levels

Government organizations implement policies and procedures to ensure that adequate control exists over the purchasing of goods and services. If proper authorization for expenditures is not followed within an organization, unauthorized purchasing and overspending, and possibly fraud, may occur.

There were deficient policies and procedures relating to the authorization of expenditures in a number of government organizations. In some cases, expenditure authorization levels were not being adhered to, updated signing authority levels were not being followed and payments were being made without appropriate authorization levels.

Government organizations need to review their signing authority matrices and ensure they are applied consistently.

17. Documentation for disaster recovery plans

In the event of a disaster occurring in any government organization, appropriate procedures and documentation should be in place to minimize the loss of data and the disruption to public services. A disaster recovery plan documents the step by step activities a business is to undertake in the event of a disaster, such as who will perform specific activities and the timeframe in which they will be performed. This formal document should be reviewed on a regular basis and updated whenever a significant change to the business or operating system takes place. A small number of government entities do not have a disaster recovery plan documented.

Government organizations should continue performing risk assessments with respect to business continuity and disaster recovery planning. Key processes, systems and required recovery times should be identified, and used to drive the development of comprehensive disaster recovery plans.

18. Use of cash basis of accounting

While there are generally two possible accounting methods for reporting financial transactions — the cash basis and the accrual basis — GAAP requires that financial statements be presented using the accrual basis.

Under the cash basis, transactions are not recorded until cash is received or paid. Under the accrual basis, financial transactions are recorded when an organization becomes liable to pay amounts or when amounts are due to it. A risk when reporting under the cash basis is that the financial accounts will not reflect significant non-cash transactions such as rights to receive benefits and obligations to settle debts in a future period. For this reason, the accrual method gives the reader a more accurate picture of the entity's entire financial performance.

There are occasions when items are not practicably measurable until cash is received (e.g., for self-assessed tax revenues and certain other transfer payments from other governments), at which time they would be accounted for. In such limited circumstances, government is allowed to use the cash basis of accounting, as it does for recording corporate income tax revenues. However, as reliable methods are developed to estimate the amounts of self-assessed tax revenues and transfer payments owing to the government, such amounts would be accounted for on an accrual basis (as all other transactions should be recorded).

We observed that two additional revenue transaction streams were being reported using the cash basis of accounting. Both revenue streams were being recorded only when cash was received from the payer, despite the fact that the amounts due at year end could be determined. Since these transaction streams were being reported using the cash basis of accounting, revenues were not correctly reported in the financial statements because unpaid amounts owing from payers at the end of the fiscal year were not recognized.

Government organizations should ensure that all measurable financial transactions are recorded using the accrual basis of accounting.

19. Account reconciliations

Account reconciliations are performed by organizations to ensure that transaction recording is complete, accurate and to prevent fraud. Performing account reconciliations should be a fundamental control over financial reporting. The absence of adequate reconciliation procedures opens up the opportunity for errors in an organization's financial accounts, which in turn can lead to improper representation (and understanding) of past operating performance, as well as erroneous future budgeting. And if reconciliations are left unchecked by management, there is an increased risk of misappropriation of public funds through fraud.

There were a number of instances in government organizations where reconciliation procedures were inadequate or non-existent. Some government organizations did not perform regular reconciliations of key financial accounts. In some cases, figures from payroll and accounts payable were reported without appropriate documentation. In many cases, account reconciliations were not performed in a timely manner.

Government organizations should ensure that reconciliations of all accounts are properly performed on a regular and timely basis.

20. System documentation and controls

Government organizations rely heavily on information technology systems to provide services. Well-developed and well-designed systems control data entry and manipulations through error checking, controls and security. These eliminate data errors and thus possible mistakes in service provision.

In some cases there was limited information technology services and function documentation, heavy reliance on intellectual knowledge and inadequate system controls, such as:

- payments being backdated to prior periods;
- transaction data transferred between systems via interfaces with inadequate controls (increasing the risk of inaccurate or incomplete transactions and account balances);
- duplicate transactions were processed creating risk of overpayment to suppliers; and
- event logs reviewed only for investigative purposes rather than randomly.

To reduce operational risk, government organizations need to maintain complete system documentation and ensure that adequate system controls are properly implemented and adhered to.

21. System security

Government organizations rely heavily on information technology systems to provide services. These services require that the information processed be correct, which in turn requires the data and the overall systems be secure. Without complete security the increased risk of incorrect or fraudulent transactions exists.

In some cases there was poor adherence to password procedures. In other cases, system access rights were authorized by people who did not have the appropriate authority, and employees had access to areas of the system that they should be restricted from.

Also found were inadequate controls over physical access to computers, some servers that were not regularly subjected to virus scans and desktop computers that were not configured to enforce automatic installation of operating system patches. As well, there were security risks stemming from poorly handled access to systems after the employee's tenure with that organization was terminated.

Government organizations should follow and enforce proper and complete information technology security policies and procedures.

22. Inventory management procedures and the accuracy of financial data

Appropriate procedures for managing inventory ensure that unauthorized movement of goods cannot occur. Strict policies and procedures must be in place relating to the ordering, safeguarding, counting and valuing of inventory to ensure that the year end balance presented in an organization's financial data is accurate.

There were inadequate inventory controls (in one case resulting in more than $70,000 worth of goods being written off), inadequate inventory count procedures, and inadequate inventory order methods found (which increase the risk that goods could be ordered for personal use).

Government organizations need to ensure that adequate safeguards are in place to protect inventory.

23. Review of reports

Internal reports are generated to inform staff and management of unusual activities and mitigate operational risks. Government has a large reporting infrastructure in place to ensure operations are efficient and effective. When problems exist with this infrastructure, the risk of inefficiencies arises, as does the potential for errors.

There were instances of inadequate and incomplete use of reports (including event logs, transaction reports, expenditure reports, financial records, payroll reports and timesheets) found. Also found were government organizations not implementing report recommendations related to improving business processes and internal controls.

Government organizations need to ensure that correct and timely report review practices are undertaken, and that report findings and recommendations are acted on.

24. Segregation of duties

The operation of government organizations is based on a great number of operational sequences. Given the large number of operational activities that are completed regularly, many operational controls are put in place to reduce the risk of fraud or error. A key operational control is the segregation of duties, which is accomplished by having all critical functions (such as initiation, authorization, recording, reporting and custody of assets) performed independently of one another.

There were instances where there was insufficient segregation of duties found, increasing operational risk. Duties not segregated included financial, payroll, purchasing, and system development and maintenance processes.

Government organizations should adopt appropriate segregation of duties, where applicable, to reduce the risk of fraud and error.

Update on Issues from 2006/07

The front section of this year's report focuses on what our Office views as the more significant issues related to the Summary Financial Statements which includes some issues raised last year.

Last year's report also included recommendations on a larger number of issues, many of which were of less significance. This year, we communicated those lesser issues in a separate management letter issued to government. However, because we have reported on them publicly in the past, we only note here those recommendations we made last year that government has implemented (to see a summary of the current status of all of last year's recommendations see Appendix B).

Disclosure around the use of estimates

Government provides disclosure in note 2, "measurement uncertainty", about the estimates it uses in the course of preparing the financial statements. Last year, we recommended that government indicate in this note which financial statement line items were affected by the use of estimates. This it has done. We also recommended that it disclose details of any significant changes in prior year estimates. Government indicated a willingness to do so this year. However, we also agreed that there was nothing to disclose for this year.

Assessment of long-term liabilities

We recommended last year that government assess its long-term liabilities each year to ensure they are accurate and based on the most recent information. Government did this for the significant ones that we looked at.

Accounting for resource roads

We recommended last year that government complete its assessment of accounting for resource roads in fiscal 2007/08 and record the applicable roads as tangible capital assets in the Summary Financial Statements. We also recommended that government include in its assessment the need to record asset retirement obligations.

Update on Issues from 2006/07

This year, government has recorded resource roads as tangible capital assets and has included the asset retirement obligations. However, as noted in our audit opinion, the amounts for the roads were based on estimates and we were not able to obtain satisfactory audit evidence to determine the reasonableness for some of them.

Policy on interest capitalization

We recommended last year that government revise its policy on capitalization of interest during construction so that the policy is applied more logically (in terms of calculating the amount) and consistently across the government reporting entity. Government has done this as described in the notes (note 1(e)) to the Summary Financial Statements.

Looking to the Future: International Financial Reporting Standards (IFRS)

IFRS in Canada

The Canadian Accounting Standards Board has announced that Canadian GAAP will cease to exist for all publicly accountable enterprises beginning January 1, 2011.

From that date onward, publicly traded and certain other publicly accountable enterprises will be required to report under IFRS.

For the public sector in British Columbia, all government business enterprises (e.g., British Columbia Hydro and Power Authority and BC Lottery Corporation) and business type organizations (e.g., BC Assessment Authority and BC Pavilion Corporation) are currently directed by PSAB to follow Canadian GAAP as it applies to publicly accountable enterprises. This would mean that these public sector entities will be required to report under IFRS. PSAB is now reviewing this directive to decide if it is still appropriate.

What is the move to IFRS all about?

Adopting IFRS is intended to make financial results more transparent and consistent for users globally. It will result in a single set of globally accepted, high quality accounting standards that are used in more than 100 countries. Canada’s decision to adopt IFRS is intended to benefit Canadian enterprises by providing better access to international capital, funding and investment opportunities.

The expected impact of this change

IFRS is generally similar to Canadian GAAP. They are based on a similar conceptual framework with similar style and form and, generally, they reach similar conclusions. This fundamental similarity should ensure a relatively smooth transition for government’s publicly accountable enterprises.

The change to IFRS will affect more than financial reporting. Many areas of an entity’s business will be affected, including lending agreements, debt covenants and bonus-based remuneration plans. The comprehensive technological systems that companies use to record and analyze financial transactions and related company-specific infrastructure may need to be modified.

Implementation of IFRS will provide an excellent opportunity for entities to undertake a “big picture” review of their financial reporting to make sure it is providing the right information needed for good decision-making.

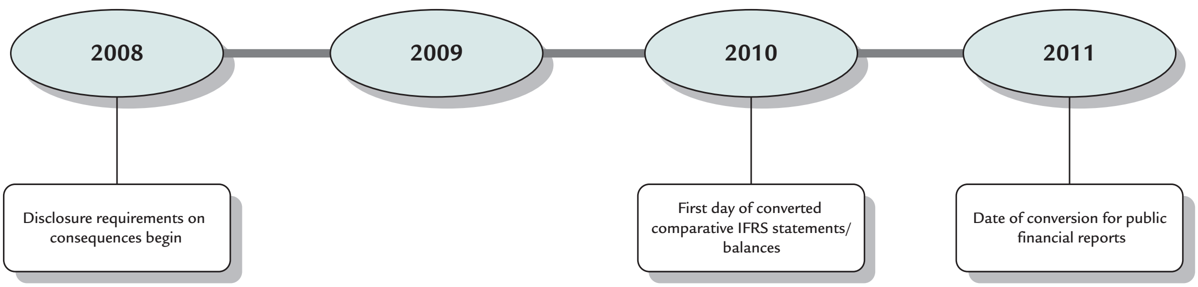
Looking to the Future:

The timelines for conversion

Disclosure requirements in the financial statements for IFRS conversions begin in 2008 for government entities. The likely effects of conversion must be disclosed every year after that until full conversion occurs in 2011 (Exhibit 7).

Exhibit 7

Conversion timelines for International Financial Reporting Standards



(Dates mark start of a government entity's fiscal year.)

How is government impacted?

Although government business enterprises and business-type organizations are required to adopt IFRS, the majority of the government reporting entities currently are not. These currently excluded entities include ministries, school districts, universities, colleges, health authorities and hospitals. They will continue to account for their financial results as they have in the past, or possibly adopt a totally different set of reporting standards, which are currently being considered by Canadian standard setters. As a result, significant adjustments and significant extra work in the consolidation process may be needed when preparing the Province's Summary Financial Statements to present the financial results on a consistent basis.

For those government entities that will have to adopt IFRS, accounting policy choices will have to be made in advance of the implementation date. Government could reduce the impacts at the summary level by being proactive and directing these IFRS entities to adopt certain accounting policies and required disclosures in their financial statements.

Appendices

Appendix A: Glossary

Accounting Standards Board

A board that is part of the CICA and has the authority to develop and establish standards and guidance governing financial accounting and reporting in Canada.

Canadian Institute of Chartered Accountants (CICA)

An independent body that conducts research into current business issues and supports the setting of accounting, auditing and assurance standards for business, not-for-profit entities and government. It issues guidance on control and governance, publishes professional literature, develops continuing education programs and represents the Chartered Accountant profession nationally and internationally.

CICA Accounting Handbook

A collection of accounting standards and guidance for profit-oriented enterprises and not-for-profit entities, issued by the CICA Accounting Standards Board.

exchange and non-exchange transactions

In an exchange transaction, one party pays another and receives something in return, as with the purchase of goods, services or the right to do something. In a non-exchange transaction, the payee does not receive anything in return, as with taxes.

Financial Accounting Standard (FAS)

Accounting standards issued in the United States by the Financial Accounting Standards Board (FASB). The standards govern the preparation of financial reports and are officially recognized as authoritative by the (U.S.) Securities and Exchange Commission.

generally accepted accounting principles (GAAP)

Accounting principles as laid down (in Canada) by the CICA and PSAB, to be followed in the preparation and presentation of financial statements.

generally accepted auditing standards (GAAS)

Auditing standards laid down (in Canada) by the CICA to be followed by every audit practitioner who issues an audit opinion on a set of financial statements.

government business enterprise

An entity that sells goods and services to individuals and organizations outside of the government reporting entity as its principal activity, and that can, in the normal course of operations, cover its expenses from those sales. It is a separate legal entity with the power to contract in its own name and to sue and be sued. It also has the financial and operational authority to carry on a business.

Appendix A

government business-type organization

A government entity that has been delegated the financial and operational authority to carry on a business. It is a separate legal entity with the power to contract in its own name and that can sue and be sued. It also sells goods and services to individuals and organizations as its principal activity. Government business-type organizations may sell goods and services within the government reporting entity, or they may rely on subsidies from the government or other organizations in the government reporting entity to maintain their operations or meet their liabilities. Sales of goods and services do not include imposed fees and penalties, such as licences and fines.

government not-for-profit organization

A government entity normally without transferable ownership interest, organized and operated exclusively for social, educational, professional, religious, health, charitable or any other not-for-profit purpose. A not-for-profit entity's members, contributors and other resource providers do not, in such capacity, receive any financial return directly from the entity.

government organizations

Organizations that are controlled by the government and included in the government reporting entity.

government partnership

A contractual arrangement between the government and a party or parties outside the government reporting entity where the partners cooperate toward achieving significant clearly defined common goals, make a financial investment in the government partnership, share control of the decisions related to the financial and operating policies on an ongoing basis and share on an equitable basis, the significant risks and benefits associated with the operations.

government reporting entity (GRE)

Is comprised of the organizations that are controlled by government.

materiality

The condition of being material. A misstatement (or the aggregate of all misstatements) in financial statements is considered to be material if, in the light of surrounding circumstances, it is probable that the decision of a person who is relying on the financial statements, and who has a reasonable knowledge of business and economic activities, will be changed or influenced by such misstatement.

An auditor is required to determine materiality based on his or her perception of the needs of users—but it is extremely difficult to predict with certainty who those users will be or, indeed, even what the specific needs of known users are. Consequently, the materiality decision ultimately becomes a matter for the auditor's professional judgement. Materiality is not a fine line where one dollar less is not material or one dollar more is material. Rather, it is a grey area between what is very likely not material and what is very likely material. Making that determination involves qualitative as well as quantitative considerations.

modified equity

A method of consolidation whereby only the investment and earnings from the investment are recorded in the financial statements. This method is used to consolidate government business enterprises.

non-exchange transaction

See "exchange and non-exchange transactions".

Public Sector Accounting Board (PSAB)

A board that is part of the CICA and issues standards and guidance with respect to matters of accounting and financial reporting in the public sector.

Public Sector Accounting Handbook

A collection of accounting standards and guidance for the public sector, issued by the PSAB.

reservation of (audit) opinion

When an auditor expresses a reservation in an audit opinion if the financial statements are materially affected by a departure from GAAP; or when the auditor is unable to obtain sufficient appropriate audit evidence to determine whether there has been a departure from GAAP concerning a material item (also referred to as a scope limitation). A reservation is also known as a "qualification".

tangible capital assets

Non-financial assets having physical substance that:

(i) are held for use in the production of supply of goods or services;

(ii) have useful economic lives extending beyond an accounting period; and

(iii) have been acquired to be used on a continuing basis.

Appendix B: Current Status on the Auditor General's Recommendations on the 2006/07 Public Accounts

In our report on the 2006/07 Public Accounts, we made 21 recommendations. Of these, nine have been completed or substantially completed, while 12 have not. Some of these outstanding ones are reported again in our 2007/08 findings, while others were reported to government in our annual management letter to the Comptroller General. There are also a number of outstanding ones where we have not made further recommendations, but which we believe should still be implemented. The status of each of these is summarized in the table below.

	Auditor General's Recommendation for the 2006/07 Public Accounts	Current Status

Recommendations Related to Improved Presentation and Other Accounting Changes

Government's financial statement discussion and analysis

1	We continue to recommend that government present a long-term trend analysis in the financial statement discussion and analysis (FSD&A) so that it can provide more context for discussing government's financial performance. In addition, we recommend that government cross-reference the FSD&A and the Financial and Economic Review.	**Not completed.** Government added another year to the trend analysis; however, it did not cross reference between Financial and Economic Review and its FSD&A in the Public Accounts.
2	We recommend that government continue to expand its FSD&A to better cover material financial risks and uncertainties and the challenges involved in their ongoing management.	**Not completed.** No significant improvements noted in the 2007/08 financial statement discussion and analysis.
3	We recommend that government adopt the use of the CICA-recommended measure of "government-to-government transfers to own-source revenue" for use in the financial statement discussion and analysis.	**Not completed.** Government continues to use total revenue in its calculation of this vulnerability measure.

Disclosure of contractual obligations

4	We recommend that government disclose contractual obligations for operating expenditures and capital expenditures separately on a comparative basis, and include a summary description of the nature of the expenditures.	**Not completed.** See discussion in this year's report.

Disclosure around the use of estimates

5	We recommend that government disclose the financial statement lines where the items subject to measurement uncertainty are recorded.	**Completed.** See update on issues in this year's report.
6	We recommend that government disclose details of significant changes in prior year accounting estimates.	**Completed.** See update on issues in this year's report.

Disclosure of university-controlled organizations (and any other organizations) that meet the definition of a government business enterprise

7	We recommend that, as required by PSAB standards, the university controlled organizations (and any other organizations) that meet the definition of a government business enterprise and are accounted for on the modified equity basis be disclosed in the government's financial statements — in the Statement of Financial Position for Self-supported Crown Corporations and Agencies and the Summary of Results of Operations and Statement of Equity for Self-supported Crown corporations and Agencies.	**Not completed.** No change made and, since it is immaterial, is not repeated in this year's report.

Appendix B

Recommendations Related to New Issues

Disclosure of tangible capital assets under lease

8	We recommend that government create a table for tangible capital assets under lease, similar to the table presentation used for the current statement of tangible capital assets.	**No change.** Not repeated in this year's report since government does disclose the details in the footnotes to the Tangible Capital Assets table in the Summary Financial Statements; however, it is not in a table format.
9	We recommend that capital lease related liabilities be disclosed separately to meet PSAB standards on leased tangible capital assets.	**Not completed.** See discussion in this year's report.

Assessment of long-term liabilities and disclosure of material errors

10	We recommend that government regularly assess long-term liabilities to ensure they are a true and fair reflection based on the most recent information available.	**Completed.** See update on issues in this year's report.
11	We recommend that when government corrects material errors in its financial statements, it also provide a description of the error and the effect of the correction, and that it head the prior period columns on the face of the financial statements "as restated".	**Not completed.** Government said it does not follow this practice. We believe that it should be done for material prior year errors.

Recommendations Related to Prior Year Issues

Accounting for resource roads

12	We recommend that government complete its assessment of accounting for resource roads in fiscal 2007/08 and record the applicable roads as tangible capital assets in the Summary Financial Statements.	**Completed.** See update on issues in this year's report.
13	We recommend that government assess where asset retirement obligations should be recorded for applicable resource roads and recognize those obligations in their financial statements.	**Completed.** See update on issues in this year's report.

Appendix B

Retirement and post-employment benefits disclosure

14	We recommend that government fully implement the remaining PSAB standards on retirement benefits to meet the minimum required disclosure.	**Not completed.** This issue has been included in this year's management letter to the Comptroller General.
15	We recommend that government fully implement the PSAB standard on post-employment benefits to meet the minimum required disclosure.	**Not completed.** This issue has been included in this year's management letter to the Comptroller General.

Interest expense disclosure

16	We recommend that government include all interest in a single line item on the financial statements.	**Substantially completed.**

Disclosure of Olympic Games commitments

17	We recommend that government disclose its complete Games-related commitments in its Olympics commitment note.	**Not completed.** Not repeated in this year's report since government meets minimum GAAP disclosure; however, it still does not disclose all its Games-related commitments in the Olympics commitment note.

Policy on interest capitalization

18	We recommend that government revise its policy on capitalization of interest during construction so that the policy is applied more logically (in terms of calculating the amount).	**Completed.** See update on issues in this year's report.
19	We also recommend that government apply its policy on capitalization of interest during construction consistently across the government reporting entity.	**Completed.** See update on issues in this year's report.

Appendix B

Recommendations Related to Changing Standards and Emerging Issues

Segment disclosures

20	We recommend that, in addition to implementing the required segmented reporting standards, government continue its leading practise in this area of disclosure by producing detailed sector schedules in the Summary Financial Statements.	**Not completed.** This issue has been included in this year's management letter to the Comptroller General. See discussion in this year's report.

Accounting for treaty accommodation costs

21	We recommend that the Province review accounting for treaty accommodation and settlement costs to ensure transactions are recorded and disclosed in a true, fair and consistent manner.	**Not completed.** See discussion in this year's report.

Appendix C: Government Organizations Included in the 2007/08 Summary Financial Statements, and Their Auditors

Sector and Organization	Audited by: Auditor General	Audited by: Private Sector Auditors[1]
Government ministries (all) (Consolidated Revenue Fund)	✓	
Health Sector		
Bella Coola General Hospital		✓
Canadian Blood Services (government partnership)		✓
Fraser Health Authority		✓
Interior Health Authority		✓
Louis Brier Home and Hospital		✓
Menno Hospital		✓
Mount St. Mary Hospital		✓
Nisga'a Valley Health Authority		✓
Northern Health Authority		✓
Providence Health Care		✓
Provincial Health Services Authority		✓
R.W. Large Memorial Hospital		✓
St. Joseph's General Hospital		✓
St. Michael's Centre		✓
Vancouver Coastal Health Authority		✓
Vancouver Island Health Authority	✓	
Wrinch Memorial Hospital		✓
Education Sector		
British Columbia Institute of Technology		✓
Camosun College		✓
Capilano College		✓
College of New Caledonia		✓
College of the Rockies		✓
Douglas College		✓
Emily Carr Institute of Art and Design		✓
Industry Training Authority	✓	
Institute of Indigenous Government		✓

Appendix C

Sector and Organization	Audited by: Auditor General	Private Sector Auditors[1]
Justice Institute of British Columbia		✓
Kwantlen University College		✓
Langara College	✓	
Leading Edge Endowment Fund		✓
Malaspina University-College		✓
Nicola Valley Institute of Technology		✓
North Island College		✓
Northern Lights College		✓
Northwest Community College		✓
Okanagan College		✓
Okanagan University College		✓
Open Learning Agency		✓
Private Career Training Institutions Agency		✓
Royal Roads University		✓
School District No. 5 (South East Kootenay)		✓
School District No. 6 (Rocky Mountain)		✓
School District No. 8 (Kootenay Lake)		✓
School District No. 10 (Arrow Lakes)		✓
School District No. 19 (Revelstoke)		✓
School District No. 20 (Kootenay-Columbia)		✓
School District No. 22 (Vernon)		✓
School District No. 23 (Central Okanagan)		✓
School District No. 27 (Cariboo-Chilcotin)		✓
School District No. 28 (Quesnel)		✓
School District No. 33 (Chilliwack)		✓
School District No. 34 (Abbotsford)		✓
School District No. 35 (Langley)		✓
School District No. 36 (Surrey)		✓
School District No. 37 (Delta)		✓
School District No. 38 (Richmond)	✓	
School District No. 39 (Vancouver)		✓
School District No. 40 (New Westminster)		✓
School District No. 41 (Burnaby)		✓

Appendix C

Sector and Organization	Audited by: Auditor General	Private Sector Auditors[1]
School District No. 42 (Maple Ridge-Pitt Meadows)		✓
School District No. 43 (Coquitlam)		✓
School District No. 44 (North Vancouver)		✓
School District No. 45 (West Vancouver)		✓
School District No. 46 (Sunshine Coast)		✓
School District No. 47 (Powell River)		✓
School District No. 48 (Howe Sound)		✓
School District No. 49 (Central Coast)		✓
School District No. 50 (Haida Gwaii-Queen Charlotte)		✓
School District No. 51 (Boundary)		✓
School District No. 52 (Prince Rupert)		✓
School District No. 53 (Okanagan-Similkameen)		✓
School District No. 54 (Bulkley Valley)		✓
School District No. 57 (Prince George)		✓
School District No. 58 (Nicola-Similkameen)		✓
School District No. 59 (Peace River South)		✓
School District No. 60 (Peace River North)		✓
School District No. 61 (Greater Victoria)		✓
School District No. 62 (Sooke)		✓
School District No. 63 (Saanich)		✓
School District No. 64 (Gulf Islands)		✓
School District No. 67 (Okanagan-Skaha)		✓
School District No. 68 (Nanaimo-Ladysmith)	✓	
School District No. 69 (Qualicum)		✓
School District No. 70 (Alberni)		✓
School District No. 71 (Comox Valley)		✓
School District No. 72 (Campbell River)		✓
School District No. 73 (Kamloops-Thompson)		✓
School District No. 74 (Gold Trail)		✓
School District No. 75 (Mission)		✓
School District No. 78 (Fraser-Cascade)		✓
School District No. 79 (Cowichan Valley)		✓
School District No. 81 (Fort Nelson)		✓

Appendix C

Sector and Organization	Audited by: Auditor General	Audited by: Private Sector Auditors[1]
School District No. 82 (Coast Mountains)		✓
School District No. 83 (North Okanagan-Shuswap)		✓
School District No. 84 (Vancouver Island West)		✓
School District No. 85 (Vancouver Island North)		✓
School District No. 87 (Stikine)		✓
School District No. 91 (Nechako Lakes)		✓
School District No. 92 (Nisga'a)		✓
School District No. 93 (Francophone Education Authority)		✓
School District consolidation[2]	✓	
Selkirk College		✓
Simon Fraser University	✓	
Thompson Rivers University		✓
The University of British Columbia		✓
University College of the Fraser Valley		✓
University of Northern British Columbia		✓
University of Victoria		✓
Vancouver Community College		✓
Natural Resources and Economic Development Sector		
552513 BC Ltd	✓	
BCIF Management Ltd[3]		✓
BC Immigrant Investment Fund Ltd	✓	
B.C. Pavilion Corporation	✓	
British Columbia Enterprise Corporation	✓	
British Columbia Hydro and Power Authority[3]		✓
British Columbia Innovation Council		✓
British Columbia Transmission Corporation[3]	✓	
Columbia Basin Trust		✓
Columbia Power Corporation[3]	✓	
Creston Valley Wildlife Management Authority Trust Fund		✓
Forestry Innovation Investment Ltd	✓	
Nechako-Kitamaat Development Fund Society		✓
Oil and Gas Commission	✓	

Appendix C

Sector and Organization	Audited by: Auditor General	Audited by: Private Sector Auditors[1]
Pacific Carbon Trust[4]		
Partnerships British Columbia Inc		✓
Tourism British Columbia	✓	
Vancouver Convention Centre Expansion Project	✓	
Transportation Sector		
BC Transportation Financing Authority	✓	
British Columbia Railway Company[3]		✓
British Columbia Transit		✓
Rapid Transit Project 2000 Ltd		✓
Social Services Sector		
Community Living British Columbia	✓	
Fraser Region Interim Aboriginal Authority	✓	
Legal Services Society		✓
Vancouver Island Aboriginal Transition Authority	✓	
Other Sector		
BC Games Society		✓
British Columbia Arts Council[5]		
British Columbia Assessment Authority	✓	
British Columbia Housing Management Commission		✓
First Peoples' Heritage, Language and Culture Council		✓
Homeowner Protection Office		✓
Provincial Capital Commission[3]		✓
Provincial Rental Housing Corporation		✓
The Royal British Columbia Museum Corporation		✓
Protection of Persons and Property		
British Columbia Securities Commission	✓	
Insurance Corporation of British Columbia[3]		✓
Organized Crime Agency of British Columbia Society		✓

Appendix C

Sector and Organization	Audited by: Auditor General	Private Sector Auditors[1]
General Government Sector		
British Columbia Liquor Distribution Branch[3]	✓	
British Columbia Lottery Corporation[3]		✓

1 The Auditor General attends the Audit Committee meetings of a number of government entities that are audited by private sector auditors.

2 The consolidation of school districts is prepared by the Ministry of Education to report the results as at March 31. (Individual school districts have a June 30 year-end.)

3 These entities are self–supported Crown corporations and agencies (government business enterprises) and are recorded on a modified equity basis in the sector in which they are listed.

4 Pacific Carbon Trust was set up just before the year-end and was not audited this year. It will be audited in future years.

5 This entity is not audited.